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
- Revaluation of yuan will benefit China more than US
China’s Economic Growth

- China has grown at 10% a year in real terms since 1978
- Currently world’s 4\textsuperscript{th} largest economy, and 3\textsuperscript{rd} 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

True export ratio*

1980 85 90 95 2000 06

0 10 20 30 40

Breakdown of China’s GDP growth
Percentage points

- Net exports
- Government spending
- Investment
- Consumption

1999 01 03 05 07†

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!

Private consumption as % of GDP
2006
United States
Britain
Australia
Italy
Germany
India
Japan
France
South Korea
Singapore
China

China’s private consumption and wages as % of GDP

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

- Low productivity of investment
- Depressed wages
- Rural-urban income inequality
- Regional inequality
- Environmental damage
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
  - better able to set interest rates and control inflation
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 selling low-yielding government bonds/reserve requirements/financial repression
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

- **US Trade Deficit (%)**
  - **China**
    - 1985: 0
    - 2004: 24
  - **Japan/Hong Kong**
    - 1985: 52
    - 2004: 16

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

- To rebalance growth, has to address external imbalance
- Independent monetary policy
- To get resources out of export sector
- Other Asian currencies will also appreciate – “orderly correction” of US external imbalance
For Further Information:


Available at:

http://agecon.ag.ohio-state.edu/programs/Anderson/trade/