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The Research of Reasons Behind the US-China Trade Imbalance

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ABSTRACT
The US-China trade deficit has directly brought about the ongoing trade war and is a major factor contributing to the growing tensions between the two global superpowers. Only by thoroughly analyzing the factors behind the massive imbalance and understanding the connection between them can effective measures be proposed and enacted upon, bringing about a healthy, sustainable trade relation and making space for further economic growth. In light of this fact, this paper goes through the history of US-China trade and focuses on the underlying reasons behind the ongoing imbalance, finally putting forward methods to address it. It concludes that Chinese, as well as American and international factors have all contributed to the imbalance, and that the numbers may be further exaggerated due to imperfections in the measuring system. Finally, this paper proposes solutions to resolve the issue.

***Keywords*：** *US–China relations, trade imbalance, US-China trade deficit*

1. INTRODUCTION

The world holds its breath as tensions rise between the two largest economies in the world: China and the US. The two countries have long treated each other with vigilance but hostility has risen to an almost unprecedented level since the beginning of the US-China trade war in 2017. No country stands to benefit from their confrontation as it slows global economy and destabilizes global finance. Therefore, it is of increasing significance to address the main reason behind the it: the US-China trade imbalance. Since the beginning of China's trade surplus in 1993, the scope of the imbalance has increased at lightning speed and up till 2018, has reached the incredible value of 323.7 billion US dollars (UN Comtrade).

Understanding of the reasons contributing to this massive, ongoing imbalance is the first step towards implementing effective policies and obtaining a healthy trade relationship. Therefore, it is crucial to have a comprehensive view upon the causes of this abnormal trade pattern. This has compelled a rising number of scholars to conduct research upon the underlying reasons of the US-China trade deficit. Most of them focus their research on a specific area, and conduct in-depth analysis of the role of certain factors. This type of work, though elaborate, lacks comprehensiveness. It is impossible to obtain an all-round understanding of the many factors that contribute to the trade imbalance based on such research.

This paper seeks to address the stated problem by presenting an overview of the reasons proposed by scholars, as well as additional reasons concluded after thorough analysis of data. It also analyzes the mechanism behind each factor and their ultimate impact upon the imbalance, offering an compendious view upon the US-China trade imbalance. By summarizing the history and development of trade between China and the US, and by analyzing various factors from both countries, this paper offers an inclusive view upon their overall state of trade.

2. THE EVOLUTION OF TRADE

The history of trade between the two countries is the foundation of understanding the present imbalance. The trade relationship between China and the US can be divided into six stages, starting from the founding of the People's Republic of China in 1949 and extending to today.

(1) 1949-1970 Segregation

The US imposed strict sanctions upon China from 1949 to 1970, mostly due to growing hostility between capitalist and socialist countries during the cold war. During this period, little to no trade took place, and

China was all but cut off, trade-wise, from the capitalist world.

(2) 1971-1978 Breaking the ice

Tension began to ease later on as the relationship between China and the Soviet Union too a turn for the worse, and the US began to see China as a potential ally. During his visit to China in 1971, Richard Nixon eased sanctions and other economic restrictions imposed upon China, which officially marked the end of the 21-year trade isolation between the two nations. From 1971 to 1978, trade skyrocketed, multiplying by 235 times within a mere 8 years.

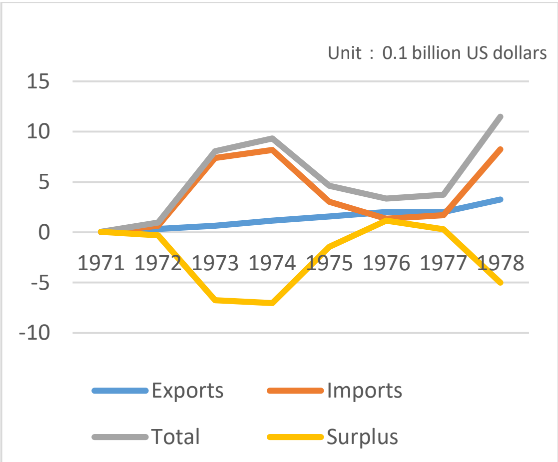

Figure 1. China-US Bilateral Trade volume 1971-1978

(3) 1979-1988 Rapid progression

Even faster growth was achieved during the ten years following China's economic reform in 1979. The reform prompted bilateral trade agreements to be made, and US-China trade growth reached an incredible speed within the next nine years, with total volume rising from 2.5 billion to 10 billion dollars.

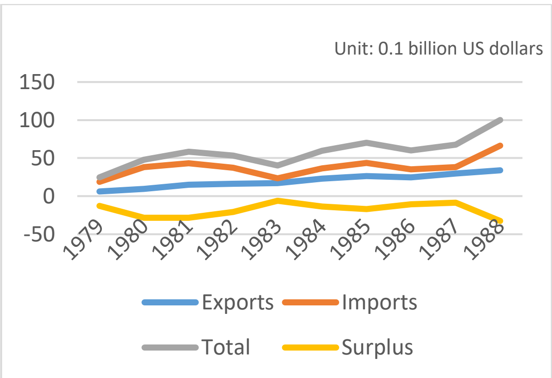

Figure 2. China-US bilateral trade volume 1989-1988

(4) 1989-2000 The tug-of war

As the Soviet Union began to collapse and drastic changes took place in Eastern Europe during the 1980's, China's political value to the US decreased and new sanctions were imposed, resulting in frequent arguments, negotiations and compromises from 1989 to 2000. But despite growing political tension and constant disputes during this period of time, total trade between the two nations steadily rose while the US surplus decreased, and it was during this period, specifically, in 1993, when trade deficit took place. The US-China trade deficit grew only larger within the coming years, rising from 6.2 billion dollars in 1993 to 29.7 billion dollars in 2000.

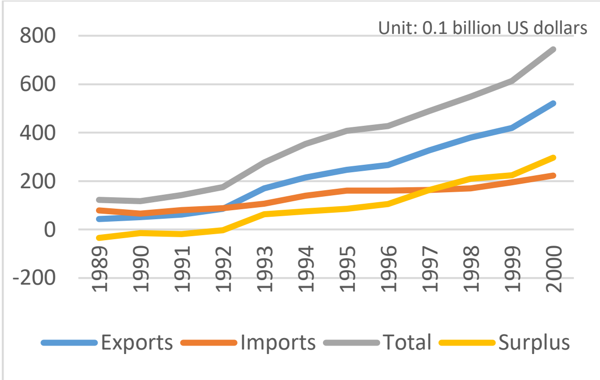

Figure 3. China-US bilateral trade volume 1989-2000

(5) 2001-2016 The golden era

The relationship between the US and China finally normalized in 2001, and from 2001 to 2016, economic relations between the two nations reached a golden era in which existed both competition and cooperation. Both the trade volume and imbalance grew at a great speed. With trade deficit increasing tenfold within 16 years, the imbalance between the US and China had reached an unprecedented state.

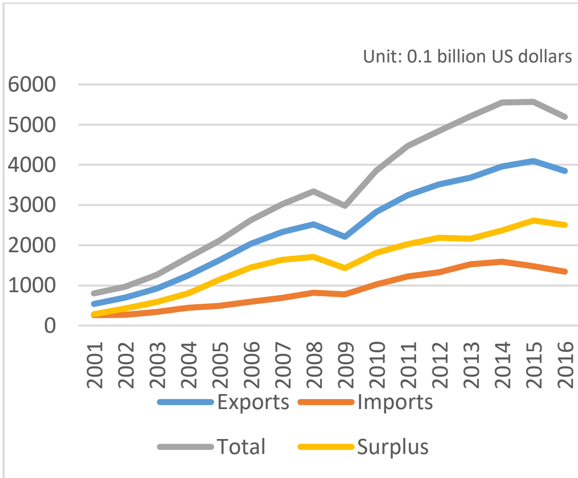

Figure 4. China-US bilateral trade volume 2001-2016

(6) 2017-Today Full confrontation

When Trump took office in 2017 he implemented his "America first" policy by addressing the increasingly severe imbalance with a series unilateral and protective trade policies and starting a trade war with China. This signaled the beginning of a new era between China and the US. As tensions between the two countries rose to unprecedented levels, trade fell and for the first time since 1971, seems to be fluctuating at a steady level instead of growing upwards.

Hostility has only risen since Trump launched the Section 301 Investigation against China in 2017. Since then, the US government has increased tariffs and imposed additional taxes upon more than 2000 types of Chinese products. Incredibly high taxes in certain areas (such as the 48.64%-106.95% anti-dumping tax and 17.14%-80.97% countervailing duties imposed upon Chinese aluminum foil producers) severely lower the competitiveness of Chinese products. China responded by imposing retaliatory tariffs against a number of major US products such as soy beans, cars, and cosmetics, further obstructing trade between the two countries.

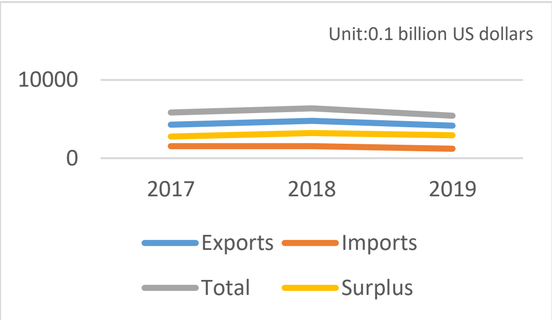

Figure 5. China-US bilateral trade volume 2017-2019

3. CAUSE OF IMBALANCE

The cause of the gigantic trade imbalance between China and the US can be attributed to many reasons. We can divide these reasons into three categories: Chinese factors, American factors and international factors

3.1 Chinese factors

Many scholars have focused on China while analyzing the reasons behind the trade imbalance. Their research mainly attributes the causes to Chinese government interference in the exchange market, excess Chinese saving, and China's export-oriented policy propel, as described in detail below.

(1) Government interference in the exchange market

Experts have long accused China of deliberately undervaluing its local currency in order to increase exports. Under rising international pressure, the Chinese government made a compromise in 2005 and implemented a new " basket of currencies" exchange policy. However, the government takes strong measures in the foreign exchange market with the goal of keeping the RMB-USD exchange rate within a limited range. This interference gives Chinese products the advantage of low prices in the international market and hence promotes China's exports, which further contributes to its trade imbalance with the US.

(2) Excess Chinese saving

The Chinese general public has a high tendency to save. China, consequently, has the highest saving rate in the world: 45%. This played a a major role regarding the trade imbalance between the two nations. Excess supply of funds contributed directly to the rapid increase in the U.S. current account deficit between 1996 and 2000(Bernanke，B.S.,2005). Excess savings caused capital to flow rapidly into the US, which fueled large appreciations in stock prices, real estate prices, and the value of the dollar. Higher stock market wealth caused an increase in consumption, which encouraged imports,the rapid increase in household wealth and expectations of future gains reduced U.S. residents' perceived need to save, and the strong dollar made U.S. imports relatively cheaper exports more expensive. All these reasons further accelerated the US's rising trade deficit.

(3) China's export-oriented policy

Like many Asian countries, China implements an export-oriented policy. This plays a key role when it comes to its massive trade surplus with the US. The Chinese government encourages exports through various measures such as export subsidies, export credits and tax deductions. The imbalance with the US does not reflect any irrational affinity, however, for China is willing to export anywhere. The fact that the US is by far more open to international trade and capable of absorbing China's flood of goods (compared with other regions with high consumption levels and developed financial markets such as Europe)(Dooley et al.,2003), has led the US to become a major importer of Chinese goods, resulting in the prominent trade imbalance between these two countries.

3.2 American factors

Other scholars have placed their attention upon America while conducting research of the factors behind the trade imbalance. Their studies indicate that the US dollar's dominant international currency status and US export control contribute to the imbalance.

(1) The US dollar's dominant international currency status

The US dollar is by far the most widely used currency in the world, taking up more than 60% of total foreign exchange reserves since 1996. People are willing to hold onto US dollars and use them in transactions because they believe that the Federal Reserve is able to realize its value. If the US reaches a trade balance, this indicates that people are no longer willing to hold on to excess US dollars, and that the dollar has lost it's prominent role in the international monetary system. This has determined that the US must remain in a trade deficit, and hence the question at hand is not whether or not there should be a deficit, but rather how large that deficit should be.

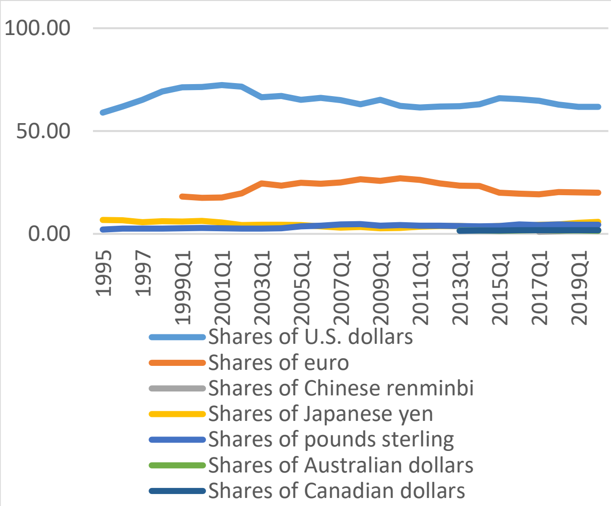

Figure 6. World currency composition: Shares of total allocated reserves

(2) US export control

Export control exercised by the US also poses as a problem when it comes to its massive deficit with China (Zhu J. and Shao J.,2020). With rapid advance of technological skill on China's side and further development of international trade, the US has imposed a series of measures restricting the exports of high-tech products to China. Further restrictions and sanctions regarding high-technology exports have also been implemented upon many Chinese enterprises and individuals by the US government(Lu W. et al.,2020). This has given China no choice but to export certain products from other countries, making it even more difficult to reduce the trade imbalance at hand.

3.3 International factors

International factors have also played a prominent role in the current trade imbalance. Globalization and direct investment from transnational corporations have accelerated the US-China trade deficit, and the numbers may be further exaggerated due to imperfections in current measuring systems.

(1) Globalization and comparative advantages

Globalization plays a crucial role regarding the trade imbalance between China and the US.

Developed countries such as the US are home to the latest technical innovations. They provide high-tech products and service to the international market, while developing nations such as China lack cutting-edge technology but are abundant in cheap labor, and hence mostly engages in processing and manufacturing primary commodities, as well as performing basic services. China's large share of total global manufacture results largely from the comparative advantage made possible by proficient and cheap labor, therefore their products are favored by countries with high purchasing power such as the US. This, along with the fact that the US has moved a considerable amount of its manufacturing industry abroad to save costs, has led to the phenomenon of the US turning to imported products in order to bridge the gap between domestic demand and domestic output, resulting in its ever-growing trade deficit with China.

(2) Direct investment from transnational corporations

Since the economic reform that took place in 1979, China has become an increasingly attractive place for foreign direct investment. Due to low costs and cheap labor, China is viewed as an ideal location for manufacturing by transnational corporations, and hence the substantial amount of factories set by foreign transnational companies. This type of foreign direct investment causes not only the transition from trade surplus to trade deficit between the investing country to the receiving country, but also the transfer of trade, from being between the investing country and the purchasing country, to between the receiving country to the purchasing country. These two effects both tend to increase the US-China trade deficit because many large American corporations have established plants in China, and American consumers are also purchasers of foreign goods supplied by foreign corporations that have chosen to locate now plants in China.

(3) Imperfections in current measuring systems and principles

Another (often ignored) factor impacting the trade imbalance between the US and China is the different statistical methods used when measuring international trade. The US attributes the added value of re-export in Hong Kong to China's exports. In addition, the US adopts FOB terms when measuring its exports to China yet uses CIF terms when measuring imports. This indicates that added values such as freight and insurance are incorporated in the deficit value (Chen J. and Yang G., 2019). Another issue is that although the advanced service industry in the US runs a massive surplus with China, the value of services is not counted in trade between the two countries. All these factors have exaggerated the statistics regarding the trade imbalance.

4. SOLUTIONS TO THE TRADE IMBALANCE

Since 1993, the US-China trade deficit has grown at an alarming rate, and is a main cause of the rising tension between these two nations. Hostility between the global superpowers directly influence international relations and economic situations, therefore it is of great significance to take active measures against the growing imbalance. Solutions that scholars have presented so far focus largely on the part of China by proposing both internal and external reforms.

4.1 Chinese internal reforms

The Chinese government can implement internal policies to address its ongoing trade surplus, and aim to upgrade its industrial structure as well as adjust consumption preferences.

(1) Industrial upgrade

China's current industrial structure fits its somewhat unbalanced export structure. The majority of China's exports consist of labor-intensive products with low added value, while technology-intensive products take up but a meager portion. China's imports, however, consist mostly of high tech, capital-intensive products. China's secondary industry has taken up the lion's share of Chinese production since 1970, earning China the title of "World Factory".

The comparative advantage of Chinese products relies heavily on cheap labor, which has led to a dependency upon labor-intense, low technology goods that leave little room for added value. Improvement trade also takes up more than 50% of China's exports, further indicating severe dependency upon foreign technology and innovations. An industrial reform shifting China's production towards a more technology-based structure can not only increase potential profitability and competitive power in the innovation-oriented global market, but also limit the capacity of production of labor-intensive products, and hence decrease the trade imbalance.

(2) Adjusting consumption preferences

Further studies have suggested that inducing a behavioral shift towards greater Chinese household consumption and lower private saving is an option for reducing China's massive trade surplus (Makin A.J.,2020).

This view is consistent with many of China's objectives: both China's 12th 5-Year Plan and latest politburo meeting sets goals of boosting domestic demand while stabilizing trade. Greater consumption leads to an increased demand of US goods as well as local production, which not only boosts imports but also reorients the economy towards consumption and away from exports. Not only does increased consumption raise living standards without affecting China's output, more US exports also raises US output without changing expenditure, which leads to an increase in US saving.

4.2 Chinese external reforms

Furthermore, China can also adjust it's external policies. Upon evaluation, it can be concluded that measures such as exploring foreign markets, expanding its sphere of trade, increasing imports and reevaluating the RMB exchange rate would prove effective in reducing the trade imbalance.

(1) Exploring foreign markets and expanding foreign trade

Not only is the the composition of Chinese exports unbalanced, the same uneven distribution stands for its export market. As the number 1 export partner of China, the US has taken up 16-22% of all China's exports for the past 30 years, almost three times of the number 2 export partner (Japan) for the past five years(UN Comtrade).

It's also worth noticing that while the part of significant trading partners (such as Japan and Korea) in the overall volume of Chinese trade have been decreasing, the part of the US has been,in fact, increasing (or at least has remained approximately constant). The fact that China is differentiating its trade relations while remaining somewhat dependant on the US for exports further indicates the imbalance of its export market. Therefore, it is crucial for China to implement a strong trade diversification policy, to tap into foreign markets and strengthen trade relations with them in order to promote healthy growth, lower risk, counterbalance its export reliance on the US, and reduce the growing surplus between the two nations.

(2) Expanding imports

Expanding imports has benefits beyond decreasing the China-US trade imbalance. With the current global economic slowdown and rise of trade protectionism, it will be difficult for China to further increase its substantial 13% proportion of global exports. In order to promote economic growth, China should place further attention upon the economic benefits of imports while seeking measures to expand and optimize its import structure (Li Q.,2020).

By replacing certain areas of production with imports, China can more swiftly engage in its industrial transition from low-end manufacturing towards technology based production. Increasing imports can also encourage consumption, and hence facilitate China's goal of pivoting toward a consumption-oriented economy. The additional market competition brought by foreign products also creates incentives for Chinese businesses to increase productivity and improve product quality so as to raise competitive power, resulting in talent introduction and accelerated technological progress. More importantly, an increase of imports can directly address China's massive trade surplus with the US.

China can accomplish import expansion through various measures such as reducing tariffs, loosening import quotas and import licenses, lowering price floors, and easing its rigorous restrictions regarding technical securities and commodity packaging.

(3) Reevaluating the RMB exchange rate

As stated previously, undervaluation of the RMB gives Chinese products a competitive advantage in global markets and boosts China's exports, aggravating its trade imbalance with other countries. Despite gradual appreciation, the RMB exchange rate has been kept at a relatively low level due to strong government interference in the exchange market. Observations such as the fact that China's export growth continue to grow faster than the global average indicate that the RMB may still remains undervalued and studies suggest that the fundamental cause of this persistent undervaluation is the lack of flexibility in China's exchange rate regime (Kinkyo, 2014).

Government interference confines the RMB's appreciation to an extent that it cannot keep up with the changes in underlying fundamentals, such as the rise in productivity. Scholars suggest that China should implement a more flexible exchange rate regime under which supply and demand play the key role in determination of currency value, therefore preventing the persistent misalignment in relative prices and decreasing the price advantage Chinese products hold in the global market. Such measures will facilitate the RMB's appreciation, which promotes Chinese consumption and discourages exports, and hence helping China achieve sustainable growth.

4.3 Policy evaluation

The analysis of potential policies presented by scholars are incisive yet still have space for improvement.

Existing studies are based on solid foundations of historical data and sound logic, and scholars have further strengthened their arguments by constructing innovative economic models. The measures proposed are feasible and constructive, many of which are already being implemented. However, the majority of suggested methods focus solely on China's part and ignore the equally responsible US. What's more, most existing analysis view many important factors as completely segregated, when the truth is that they are tied tightly together.

Taking measures against one factor may likely result in undesired changes in the others. For example, under the background of globalization, China's cheap, labor-intense products have a comparative advantage in the international market and have become favored by consumers in high-consumption countries such as the US. Theoretically, because an industrial transition towards high-end products would decrease the massive amount of China's exported low-end products, such a policy would be encouraged by the US.

The reality, however, is that China's transition poses as a threat to the global status and competitiveness of American high-tech products. Due to this fact, the US has consistently sought to repress growing Chinese high tech industries, through measures such as imposing sanctions on technological enterprises and relative individuals, banning certain Chinese applications and more. From this we can see that coming up with an effective policy is harder than it seems due to the great deal of elements that may come into play.

With both sides endeavoring to maximize its own interest, it may be difficult for either country itself to establish a policy addressing the trade imbalance without a counter-productive response of some sort from the other. Cooperation is key, yet with the growing hostility and conflict of interest, is becoming increasingly difficult. Therefore, it may be a wise approach to establish a bilateral facility between these two countries with the purpose of achieving and maintaining a healthy trade relationship.

Based on mutual respect, equality, and common interest, this facility would serve as a settlement center when it comes to trade-related matters the two countries cannot reach an agreement upon. This creates an orderly way in which trade can be regulated and re-balanced without the interference of political factors, and avoids the inefficiency of fruitless negotiations. By bringing about a healthy, sustainable trade relationship between two global superpowers, such a facility not only makes space for further economic growth in the two countries (and hence improving living standards of their citizens), but also strengthens the economic and financial stability of the world.

5. CONCLUSION

This paper focuses upon the underlying reasons behind the ongoing US-China trade deficit and proposes methods to address it. It concludes that Chinese, as well as American and International factors all play their role in the imbalance and that measures on part of the Chinese government can be taken to prevent further aggravation.

This paper takes a focused view upon US-China trade and gives a comprehensive analysis. However, it ignores the role of many other countries and their impact upon US-China trade, as well as the impact of non-trade-related issues such as political and military affairs. In light of growing globalization and the increasing interplay between all countries, further research should take into consideration the role of other trade partners and their influence upon US-China trade, while considering the impact of important non-trade factors.

It should also be noted that this paper takes each contributing factor as independent and ignores the complex connections between them. Further research can be oriented towards the correlations between various factors and their aggregated impact upon international trade, in order to be able to propose more effective methods. Qualitative research based on existing statistics may also lack the creativity needed in order to uncover underlying information, and hence further studies should expand their analytical methods, such as making use of data-modeling and other innovative methods to conduct a muti-dimensional analysis.

By basing future studies upon these principles, scholars can discover the correlations between data, as well as their internal and external effects, and hopefully uncover further information related to the US-China trade imbalance.

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