Conflicts in the U.S.-China Economic Relationship: Opposite Sides of the Same Coin?

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Objectives

• Rebalancing of Chinese economy
  – Shift of emphasis from export-based growth to development of domestic economy
  – Export driven growth cannot be sustained in future.
  – External changes – trade balance
  – Domestic changes – saving investment

• United States Economic Relationship With China

• Rebalancing of U.S. economy
  – External changes – trade balance
  – Domestic changes – saving investment
China’s Trade

• Distinguish between processing trade and normal trade
  – Processing trade dominated by foreign invested firms
    • Terminal for Asian supply network
    • Relatively low Chinese value added
    • Large trade surplus
  – Normal trade dominated by Chinese firms
    • High Chinese Value added
    • Large trade deficit – sensitive to exchange rate
All China Merchandise Trade, 1990-2011
(as percent of GDP)

Source: International Monetary Fund, Direction of Trade Statistics (DOTS), World Bank, World Development Indicators (WDI).
A. All China Processing Trade, 1993-2011
(as percent of GDP)

Source: China Customs
B. All China Normal Trade, 1993-2011
(as percent of GDP)

Source: China Customs
Domestic and Foreign Value Added: Normal versus Processing Exports

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<tr>
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<tbody>
<tr>
<td><strong>Normal Exports</strong></td>
<td></td>
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<tr>
<td>Total foreign value-added</td>
<td>5.2</td>
<td>10.4</td>
<td>16.0</td>
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<tr>
<td>Total domestic value-added</td>
<td>94.8</td>
<td>89.6</td>
<td>84.0</td>
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<td><strong>Processing Exports</strong></td>
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<tr>
<td>Total foreign value-added</td>
<td>79.0</td>
<td>74.6</td>
<td>62.7</td>
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<tr>
<td>Total domestic value-added</td>
<td>21.0</td>
<td>25.4</td>
<td>37.3</td>
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China’s Exchange Rate

• Importance of a focus on multilateral real rate exchange rate
  – Large appreciation in recent years
  – Major change in competitive balance with the United States
  – But, offset by fall in exchange rates of other major players in Asian supply network.
    • Korea and Taiwan have had major declines in exchange rates
Trade-Weighted Real Exchange Rate, China and the United States, 1990 – 2012

Source: JP Morgan
Domestic Rebalancing

• Difficult to see evidence of rebalancing on domestic side
  – Narrowing of S-I gap due to continued rise in investment, not consumption
  – Surge of saving in 2000s was widespread: government, corporate, and households
  – Some improvement in household income share in 2009

• Future rise in consumption may be most likely in public sector.
Gross Saving and Investment, China, 1990 – 2011 (percent of gross national income)

Gross Saving by Institutional Sector, 1992 – 2009 (percent of national disposable income)


Percent of national disposable income.
United States in China

• Surprisingly low level of U.S. involvement
  – Steady decline in U.S. share of China’s imports
    • 2001 – 11.4 percent
    • 2011 – 7.7 percent
  – U.S. FDI in China
    • 3 percent of U.S. global total
    • 15% rate of return over past 10 years
    • 5-10% of FDI in China
  – U.S. uses Asian production network rather than its own production facilities
US – China Economic Relations

- China has reduced its share of exports going to the United States from 29 percent in 2001 to 20 percent in 2001.
- Diversifying toward intra-Asia trade, other developing economies.
- However, China has become a far more dominant source of U.S. current account imbalance
  - 2000-20%; 2005-30%; 2011-67%
Distribution of U.S. Current Account Balance, 2000-11
(percent of national disposable income)

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<td>Current Account Total</td>
<td>-416</td>
<td>-746</td>
<td>-466</td>
<td>280</td>
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<tr>
<td>Asia</td>
<td>-247</td>
<td>-378</td>
<td>-395</td>
<td>-18</td>
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<tr>
<td>China</td>
<td>-88</td>
<td>-219</td>
<td>-315</td>
<td>-96</td>
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<tr>
<td>Hong Kong</td>
<td>3</td>
<td>9</td>
<td>35</td>
<td>26</td>
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<tr>
<td>Other Asia</td>
<td>-163</td>
<td>-162</td>
<td>-84</td>
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<td>Canada</td>
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<td>Europe</td>
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<td>Africa</td>
<td>-18</td>
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<tr>
<td>Other</td>
<td>11</td>
<td>10</td>
<td>8</td>
<td>-2</td>
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Rebalancing the U.S. Economy

• Opposite of China’s situation
  – Large external imbalance
  – Excessive reliance on domestic consumption
  – Low saving and investment
  – Rapid growth of domestic and external debt

• External evidence of rebalancing
  – Substantial decline in current account deficit
  – Sustained fall in exchange rate
  – Continued loss of market share – goods and service
(percent of GDP)

Source: Bureau of Economic Analysis, Balance of Payments and International Investment Position.
U.S. Net Foreign Investment, Stock, 1980-2011
(percent of GDP)

Source: Bureau of Economic Analysis, Balance of Payments and International Investment Position.
U.S. Exports, Merchandise and Commercial Services, 1980-2011 (percent of global total)

Source: World Trade Organisation, Statistical Database
Rebalancing the U.S. Economy (2)

• Domestic economy
  – Continued surge in consumption share of GDP
  – Household saving rate back to pre-crisis level
  – Negative net national saving rate
  – Very depressed levels of investment
    • Early 2000: 7%  2012: 3%
    • Most of the decline in residential
  – Domestic imbalance → external imbalance?
  – Ongoing GDP gap ≈ 5-6%
Personal Consumption as Share of GDP, 1951 – 2012
(percent of GDP)

Source: table 1.1.5 of the national accounts and author calculations
### Components of National Saving, 1960-2012

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<td>Net Saving</td>
<td>10.9</td>
<td>6.3</td>
<td>5.7</td>
<td>3.2</td>
<td>-1.4</td>
<td>-0.2</td>
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<td>Government</td>
<td>0.0</td>
<td>-3.5</td>
<td>-2.0</td>
<td>-2.3</td>
<td>-10.7</td>
<td>-8.8</td>
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<tr>
<td>Private</td>
<td>10.9</td>
<td>9.8</td>
<td>7.7</td>
<td>5.5</td>
<td>9.3</td>
<td>8.6</td>
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<td>Corporate</td>
<td>3.9</td>
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<td>Households</td>
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<td>Net Domestic Investment</td>
<td>11.2</td>
<td>9.4</td>
<td>8.1</td>
<td>8.1</td>
<td>2.5</td>
<td>3.7</td>
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<tr>
<td>Government</td>
<td>2.1</td>
<td>1.6</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Private</td>
<td>9.2</td>
<td>7.8</td>
<td>6.9</td>
<td>6.7</td>
<td>1.2</td>
<td>2.9</td>
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<tr>
<td>Current Account</td>
<td>0.4</td>
<td>-2.1</td>
<td>-1.8</td>
<td>-5.5</td>
<td>-3.4</td>
<td>-3.8</td>
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</table>
Actual and Potential GDP 2004 – 2013
(trillions of dollars)

Source: Congressional Budget Office, Bureau of Economic Analysis, and author’s estimates
Economic Recovery

• Fiscal stimulus versus consolidation
• Problems are structural and not just cyclical imbalances
• Cannot sustain spending in excess of income.
• Recovery will require elimination of current account deficit.
• Improve U.S. as location for economic activity and jobs
  – Lower real exchange rate
  – Increase saving
  – Corporate tax reform
  – Improve labor skills
  – Rebuild physical infrastructure
  – Resolve international standards for intellectual property rights