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NEWS ANALYSIS
By Pete Engardio

"Substantial Benefits" from China Trade?

A new economic study says the U.S. gains plenty from its commerce with China, while admitting that disruptions are also significant

America's rocketing trade deficit with China has spelled misery for many U.S. factory workers and owners. And it raises alarms for economists and politicians worried about America's deteriorating balance of payments. But take an eagle-eye view, and the trade relationship with China has been a huge blessing for the U.S. economy. That's the conclusion of a study by Oxford Economic Forecasting (OEF), an independent economic advisory firm, that was released Feb. 2 by China Business Forum, a pro-trade business lobby.

OEF estimates that trade and investment with China will add 0.7% to U.S. gross domestic product by 2010 by stimulating productivity growth and U.S. exports, among other things. It calculates that annual average household income has risen by \$500 since 2000, and will be \$1,000 higher by 2010. U.S. consumer prices would have been 0.5% higher in 2005 had China not embarked on the sweeping economic reforms that made its export explosion possible, OEF estimates, and that gap will reach 0.8% by 2010. The bottom line is that "the long-term benefits to the United States of trade with China are substantial," the report states.

The study concedes that the disruption to specific U.S. industries also is substantial. It estimates that 205,000 manufacturing jobs were lost since 2000, when Chinese exports began to really explode as China prepared to enter the World Trade Organization, and that number will reach 500,000 by 2010. But add in the new services jobs created due to the China trade, and the actual net loss in U.S. jobs is marginal. OEF also acknowledges that America's swelling current-account balance poses big potential risks, but it says China isn't to blame. U.S. exporters have lost market share in most of the world, it notes.

"STANDARD TRADE THEORY." China's trade surplus with the U.S. looks less formidable when put into context, OEF contends. The \$165 billion reported by the U.S. drops to \$132 billion when U.S. goods shipped to China via Hong Kong are included. Furthermore, while China's share of U.S. imports has risen dramatically -- from 8.2% in 2000 to 14.8% in 2005 -- that's largely because Japanese, South Korean, Taiwanese, and Singaporean companies began shifting production en masse to the mainland in 2000, as they anticipated China's WTO entry. As a result, the U.S. imbalance with all of East Asia has remained basically the same -- around 29% -- for five years.

What to make of these findings? It shouldn't come as a surprise that greater trade leads to higher macroeconomic growth. "Our methodology isn't rocket science," says economist Erik Britton, the study's lead author. "This is just standard trade theory." But the report isn't likely to quell critics who argue that China's runaway trade surplus with the U.S. is harmful to most Americans.

The basic problem with focusing on growth in U.S. GDP, argues economist Mark Weisbrot of the liberal-leaning Center for Economic Policy & Research in Washington, is that it ignores how that income is distributed. While the richest and best-educated Americans have benefited enormously in recent years, the income of average U.S. workers has grown slowly. "We have had a 30-year period in which the real median wage has grown 9%, while productivity is up 80%," Weisbrot says. "Almost none of that improvement has gone to the majority of the labor force." Indeed, inflation-adjusted median U.S. household income dropped from 2000 to 2004.

WIDENING GAP. Weisbrot agrees that Chinese imports have lowered U.S. consumer prices. "It's pretty easy to see that if you have competition with people who are paid very low wages and have no right to organize unions, you will have downward pressure on prices," he says. But that doesn't necessarily translate into greater overall purchasing power for most Americans. "The downward pressure on wages is really hurting most employees in this country more than the cheaper consumer goods are helping them," he adds.

China trade hawk Thomas Palley, former chief economist for the congressionally appointed U.S.-China Economic & Security Review Commission, is harsher in criticizing the study. He says it's "misleading" to suggest that Chinese exports have contributed little to America's overall deficit. In 1994 the U.S. trade gap with China was equal to 24.4% of the U.S.

deficit with the rest of the world. In 2004 that percentage had reached 33.1%.

Trade data through November, 2005, show the gap between China and America's other trading partners widened much further. True, other East Asian nations transferred substantial manufacturing to the mainland, Palley notes. But that doesn't mean Japan, Taiwan, and South Korea, all of whose costs have risen sharply, would've been able to maintain those surpluses. "Absent those lower costs [from China], they would have exported less," he contends.

QUACK REMEDIES? OEF's Britton says he doesn't disagree with many of the criticisms of U.S.-China trade. "We don't want to downplay that there have been significant job losses in specific sectors. That's a serious effect indeed," he says. "And if somebody feels China is not playing fair, that's an issue that needs to be dealt with. We certainly wouldn't want to resist moves for China to open up further, or move to a market-determined exchange rate." The purpose of the study, however, was to look at the whole economy. "If you look at losses in one place, you also have to look at the job creation elsewhere."

That means U.S. policymakers should think long and hard before imposing some of the remedies advocated by China hawks. If Beijing were to simply strengthen its currency by 25%, as many in the U.S. argue, that would provide a small boost to U.S. exporters to China, but cause America's overall trade deficit to shrink by just \$10 billion to \$15 billion. That's because Chinese factories would absorb lower profits or lose orders to other low-cost Asian producers.

Limiting inflows of Chinese manufactured goods would only ease pressure on U.S. industry to boost productivity -- and protect America's least-efficient sectors. Says Britton, who is British: "In the U.K., we did that for many decades, and the result was significant economic decline."

AMERICAN ISSUES. Britton does agree that America's ballooning balance-of-payments deficit -- now a record 6% of GDP -- is "undeniably large, deteriorating, and in the long range not sustainable." OEF believes that demand abroad for U.S. dollar assets is strong enough for the U.S. to get away with running a current-account deficit for another three to five years, in the range of 7% of GDP, before running into serious financial problems. Weisbrot believes the risk of a painful readjustment to global financial flows is higher.

At the end of the day, the argument about China trade comes down to the basic debate over whether or not gains for the U.S. macroeconomy benefit all Americans in the long run -- and whether the U.S. is consuming beyond its means. These are issues that America, rather than China, must resolve itself.

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