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THE CHINA-US TRADE IMBALANCE: AN INTERNATIONAL MACROECONOMIC PERSPECTIVE

Abstract:

While the United States is presently the world's largest economy, China is the world's largest exporter, replacing the US as the largest manufacturing nation a decade ago. Since then, the China-US trade imbalance has been the key source of economic tension between the two superpowers, stretching back to concerns raised by the Bush and Obama administrations. Members of the European Union have had similar concerns about their trade imbalances with China.

In the US, since the turn of the century the demise of manufacturing firms unable to compete against low priced Chinese imports has repeatedly sparked calls for retaliatory action by the US government against China. Given the impact exchange rates have on international competitiveness and trade flows, the value of the exchange rate has also been central to the ongoing China-US dialogue on the trade imbalance. The US government has repeatedly pressed China to revalue its currency from the mid-2000s on the grounds that its undervalued currency boosted the competitiveness of China's manufacturing sector and contributed to the bilateral trade imbalance.

While the CNY/$US exchange rate has strengthened significantly over the past decade, somewhat paradoxically, China's trade deficit with the United States has continued to widen from a deficit of near $80 billion in 2000 to close to $400 billion in 2018. Under the Trump administration, direct action has been taken to reduce this trade imbalance by imposing tariffs on Chinese imports to the US, beginning with tariffs on steel and aluminium and extended to solar panels and household appliances. China has retaliated by imposing tariffs on chemicals, coal, medical equipment and soybeans.

This paper presents a two-country international macroeconomic framework for examining the determinants of the China-US trade imbalance. Inspired by Alexander's (1952) much neglected absorption approach, it emphasises that the bilateral trade imbalance reflects discrepancies between levels of their respective output, or aggregate supply, and expenditure, or aggregate demand.

The paper is structured as follows. Section 2 summarises recent Chinese and US growth, bilateral balance of payments trends and protectionist measures, before Section 3 proposes a simple international macroeconomic framework based on the distinction between output and expenditure to examine the key issues. Section 4 then adapts the framework to examine the influence of discrepant economic growth, exchange rate management, protectionist measures and foreign direct investment on the trade imbalance, before Section 5 draws policy implications.

Keywords:

China; United States; Trade Imbalance; Exchange Rate; Protection; Foreign Investment

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