A Looming US-China Trade War

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Introduction

China exports more to the United States than US exports to China. The resulting trade deficit against China has been a major issue during the presidential campaign and now is a real issue facing the Trump administration. President Trump has claimed repeatedly that China is "stealing our jobs" and China is a "currency manipulator." The currency manipulation designation can easily escalate to a trade war with China. Several questions arise:

(1) Is China a currency manipulator?
(2) Is a looming trade war with China inevitable?
(3) Who are the losers and winners in a trade war?

These are not easy questions. The answers lie not only in sound economic analyses, but also in wise political judgements.

U.S. Trade Deficit with China

To put the issue into perspectives, let's look at Table 1. In 2015, the United States had an overall trade deficit of $763 billion. The trade deficit with China alone, at $367 billion, accounted for 48.1%. In fact, both the size of the trade deficit with China and China's share in US's total trade deficit have increased after China joined in the World Trade Organization (WTO) in 2001.

Table 1
U.S. Trade Balance with China and World: 1999-2015

Year	Balance on Goods with China ($ billions)	Total Balance on Goods ($ billions)	Ratio (%)
1999	-69	-337	20.5
2000	-84	-447	18.8
2001	-83	-422	19.7
2002	-103	-475	21.7
2003	-124	-542	22.9
2004	-163	-665	24.5
2005	-203	-783	25.9
2006	-234	-837	28.0
2007	-259	-821	31.5
2008	-268	-832	32.2
2009	-227	-510	44.5
2010	-273	-649	42.1
2011	-295	-741	39.8
2012	-315	-741	42.5
2013	-319	-702	45.4
2014	-345	-752	45.9
2015	-367	-763	48.1

Arguments for and against Free Trade

The benefit from free trade and globalization has long been accepted in economics and the international community. To be sure, China has benefited enormously from reform, opening-up, and globalization, lifting 700 million people out of poverty in the past three decades. The benefit has extended to US consumers who enjoy inexpensive Chinese imports.

A recent research paper by MIT economist Autor and his co-authors, however, casts some doubt on the benefit and highlights the cost of free trade. They show that alongside the heralded consumer benefits of expanded trade are substantial adjustment costs and distributional consequences. These impacts are most visible in the local labor markets in which the industries exposed to foreign competition are concentrated. Adjustment in local labor markets is remarkably slow, with wages and labor-force participation rates remaining depressed and unemployment rates remaining elevated for at least a full decade after the China trade shock commences.

Is China a Currency Manipulator?

In general, a week currency makes a country's goods less expensive and thus boosts the country's exports while discouraging imports. Many countries have either directly or indirectly influenced the foreign exchange market to weaken their currencies. These countries include not only emerging economies such as China, but also developed economies such as Japan, Switzerland, and the Eurozone nations. In fact, in 2010 Brazilian Finance Minister denounced the U.S. for staging a currency war, after lower U.S. rates and easing monetary policies sent capital flowing into emerging markets, making Brazil's commodity exports more expensive.

The Treasury Department's Evaluation

The Treasury Department seeks to identify any major trading partner of the United States that has:

(1) A significant bilateral trade surplus with the US (at least $20 billion)
(2) A material current account surplus (in excess of 3 percent of GDP)
(3) Engaged in persistent one-sided intervention in the foreign exchange market

In its most recent report (see Table 2 for major results) submitted to Congress, the department concludes that China is not a currency manipulator. In fact, China stands out only in one criterion.

Table 2
Major Foreign Trading Partners Evaluation Criteria

	Bilateral Goods Deficit (USD Bil., Trailing 4Q) (1)	Current Account			FX Intervention		
		Balance (% of GDP, Trailing 4Q) (2a)	3 Year Change in Balance (% of GDP) (2b)	Balance (USD, Billion; Trailing 4Q) (2c)	Net FX Purchases (% of GDP) (3a)	Net FX Purchases ($ Bil.) (3b)	Persistent Net FX Purchases? (3c)
China	356.1	2.4	0.0	260.9	-5.1%	-566	No
Germany	71.1	9.1	2.3	312.3	-	-	No
Japan	67.6	3.7	2.6	158.3	0.0%	0	No
Mexico	62.6	-2.9	-0.8	-31.7	-2.2%	-24	No
Korea	30.2	7.9	2.0	107.1	-1.8%	-24	No
Italy	28.3	2.3	1.9	42.5	-	-	No
India	24.0	-0.8	4.2	-16.0	0.3%	5	No
France	18.0	-0.5	0.4	-12.8	-	-	No
Taiwan	13.6	14.8	5.2	75.8	2.5%	13	Yes
Switzerland	12.9	10.0	-1.6	66.2	9.1%	60	Yes
Canada	11.2	-3.4	0.1	-51.1	0.0%	0	No
United Kingdom	-0.3	-5.7	-2.0	-161.2	0.0%	0	No
Memo: Euro Area	130.5	3.2	1.3	380.4	0.0%	0	No

Sources: Haver Analytics; National Authorities; U.S. Bureau of Economic Analysis; and U.S. Department of the Treasury Staff Estimates

Winners and Losers of a Trade War

So China is not a currency manipulator, according to the Treasury Department. Will President Trump launch a full-scale trade war with China by imposing substantial tariffs on Chinese imports? It's his decision to make, but we can analyze the consequences of such a war. If America targets Chinese trade, China will hit back. Who are the winners and losers? In the short run the US government might get more tax revenue; some American manufacturers will benefit from repressed foreign competition. But the biggest losers are U.S. consumers. Studies have shown that tariffs likely impose a heavier burden on poor and middle-class Americans, as these households generally spend more on traded goods as a share of expenditure/income.

Is a US-China Trade War Inevitable?

A trade war with China is not inevitable. Such a war will have more losers than winners. Cooperation and negotiation are the best way to resolve any trade issues. A US seeking to reduce trade deficits with China should try to enforce the rules of global trade within the framework established by the World Trade Organization.