Closing Case ***THE CHINA TRADE DEBATE*** → ETHICAL DILEMMA → EMERGING MARKETS

Since 2011, China has dethroned Germany to become the world's champion merchandise (goods) exporter (see Opening Case). Why does the rest of the world buy so many "Made in China" products? From a resource-based view, Chinese exports win markets because they deliver value, are rare, and possess hard-to-imitate attributes. From an institution-based view, China's accession to the World Trade Organization (WTO) in 2001 has certainly provided a booster to its rise as a trading nation.

Substantiating free trade theories' claim that international trade is a *win-win* game, active trading has not only made China richer, but also made its trading partners richer. Since China's accession to the WTO in 2001, neighboring economies that actively trade with China (such as Hong Kong, Singapore, South Korea, and Taiwan) and distant economies that export to China large quantities of minerals and agricultural commodities (such as Australia, Canada, and New Zealand) have benefitted more. So has the United States. During the period of 2000–2015, among developed economies, only Australia, New Zealand, and Singapore enjoyed higher GDP per capita gains than the United States. Since 2001, US exports to China soared by 500%, doubling the growth of US exports to the rest of the world. Cheaper Chinese imports shave off US consumer prices by 1–1.5%. In other words, every American family enjoys an extra $850 every year. Overall, US–China trade supports approximately 2.6 million US jobs and adds 1.2% to US GDP (Exhibit 5.13).

EXHIBIT 5.13 POSITIVE IMPACT OF US-CHINA ECONOMIC RELATIONSHIP

	Gains to US employment	Boost to US GDP
Direct exports to China	1,467,000	0.7%
Indirect exports to China *	296,000	0.1%
Income from US foreign direct investment (FDI) in China	688,000	0.3%
Inward FDI from China	104,000	0.1%
TOTAL	**2,555,000**	**1.2%**

* Indirect exports are US exports to other Asian countries that are re-exported to China
Source US-China Business Council, *Understanding the US-China Trade Relationship* (Washington: USCBC, January 2017) 12.

However, not all is rosy. The US trade deficit with China has provoked an enormous debate (Exhibit 5.14). Despite enviable export success (see Opening Case), the United States, due to its extraordinary appetite for imports, runs the world's largest merchandise trade deficit. In 2015, it reached a $760 billion (5% of GDP). The lion's share, $334 billion (1.9% of GDP), was contributed by merchandise trade deficit with China. Should this level of trade deficit be of concern?

Armed with classical theories, free traders argue that this is not a grave concern. They argue that the United States and China mutually benefit by developing a deeper division of labor based on comparative advantage. They point out that in addition to China, the United States runs trade deficits with all of its major trading partners—Canada, the EU, Japan, and Mexico. The real US trade deficit with China is often overstated, because substantial value of Chinese exports is imported. If the value of such imported components is subtracted from China's exports, then the US trade deficit with China would be reduced in half, to less than 1% of US GDP—about the same as the US trade deficit with the EU. Quantitatively, such a level is manageable. Conceptually, former Treasury Secretary Paul O'Neill went so far as to say that trade deficit was "an antiquated theoretical construct." Paul Krugman, the 2008 Nobel laureate in economics, argued:

> "International trade is not about competition, it is about mutually beneficial exchange. . . . Imports, not exports, are the purpose of trade. That is, what a country gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves: the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment."

EXHIBIT 5.14 DEBATE ON THE US TRADE DEFICIT WITH CHINA

US trade deficit with China is a huge problem	US trade deficit with China is not a huge problem
Greedy exporters • Unscrupulous Chinese exporters are eager to gut US manufacturing jobs and drive US rivals out of business, resulting in massive unemployment.	*Eager foreign investors* • Two-thirds of Chinese exports are generated by foreign-invested firms in China, and numerous US firms have invested in and benefited from such operations in China.
The demon who has caused deflation • Cheap imports sold at "the China price" push down prices and cause deflation.	*Thank China (and Wal-Mart) for low prices* • Consumers benefit from cheap prices brought from China by US firms such as Wal-Mart. Trade with China pushes consumer prices down by 1–1.5%, and gives every American family $850 every year.
Intellectual property (IP) violator • China is a major violator of IP rights, and US firms lose billions of dollars every year.	*Inevitable step in development* • True, but the US did that in the 19th century (to Britain). IP protection has been improving in China—US films' box office revenues there grew from $2.1 billion in 2011 to $6.8 billion in 2015.
Currency manipulator • The yuan is severely undervalued, giving Chinese exports an "unfair" advantage in being priced at an artificially low level.	*Currency issue is not relevant* • The yuan is somewhat undervalued, but (1) US and other foreign firms producing in China benefit, and (2) the US also manipulates its own currency via quantitative easing.
Trade deficit will make the United States poorer • Since imports have to be paid, the United States borrows against its future with disastrous outcomes.	*Trade deficit does not cause a fall in the standard of living* • As long as the Chinese are willing to invest in the US economy (such as Treasury bills and foreign direct investment [FDI]), what's the worry?
Something has to be done • If the Chinese don't do it "our way," the United States should introduce drastic measures (such as slapping a 45% tariff on all Chinese imports).	*Remember the gains from trade argued by classic theories?* • Tariffs will not necessarily bring back US jobs, and will lead to retaliation from China, the third largest *importer* of US goods (behind Canada and Mexico). China will sue the US at the WTO, which the US will lose. Trade wars are lose-lose.

Critics strongly disagree. They argue that trade is about competition—about markets, jobs, and incomes. Fingering China as the primary contributor to the reduction of US manufacturing jobs from 17 million in 2000 to 12 million in 2016, Donald Trump as a candidate frequently threatened China with a trade war. A serious academic study published in the *American Economic Review* attributed one quarter of such decline to the "China syndrome." Economic Armageddon between the top two economies in the world with a 45% tariff on all Chinese imports could shave off 13% from China's exports and 1.4% of its GDP. But the United States could hardly hope to do better, and the poorest Americans would be the hardest hit. The *Economist* opined:

> "Were Americans unable to buy cheap imports, they would be poorer, with less to spend on other things. They would also be less specialized, and hence less productive at work . . . If China exploits its workers and pollutes its rivers so that poor Americans can enjoy cheap goods, it is not obvious that America is getting a raw deal."

Case Discussion Questions:

1. How do the US economy, US firms, and US consumers like you *benefit* from trade with China?
2. How are the US economy, US firms, and US consumers like you *hurt* by trade with China?
3. ***ON ETHICS:*** If you were appointed to be head of the new National Trade Council, how would you advise the president regarding the China trade policy?

Sources *American Economic Review, Economist*, *Journal of International Business Studies, Understanding the US-China Trade Relationship*, *USTR 2016 Report to Congress on China's WTO Compliance, World Trade Statistical Review 2016*. [Detailed references are omitted due to space constraints, and will be published in the two textbooks *GLOBAL 4E* and *GLOBAL BUSINESS 5E*]