



CHAPTER 1

THE DEVELOPMENT OF U.S.-CHINA ECONOMIC RELATIONS, 1978 TO THE PRESENT

HUO Jianguo

President, Chinese Academy of International Trade and Economic Cooperation (CAITEC)

With contributions from LI Wei, Carol MA (The Fung Business Intelligence Centre),
HUANG Zhilong (Associate Research Fellow, Department of Strategic Research at CCIEE)

Executive Summary

The rapid growth of China since its reform and opening up in 1978 is one of the most significant economic events of the world economy in the past few decades. The U.S. played an important role in China's development during this period, not least because the U.S. has been one of the most important markets for China's exports. Direct investments from the U.S. to China brought with them not only financing, but also technology, management knowhow and global market access. Economic cooperation with the U.S. helped generate a lot of job opportunities for China's abundant labor force. The U.S. has also benefited from China's development. The increase in imports of value-for-money consumer goods from China helped to raise the living standard of most Americans and keep consumer price inflation low in the U.S., and the latter in turn led to lower interest rates that underpinned faster U.S. economic growth. Meanwhile, many U.S. multinational corporations (MNCs) and small and medium enterprises (SMEs) have built up large production and trading businesses in China, selling goods not only back to the U.S., but also in the Chinese domestic market and to third markets. China has become a profit center of many U.S. businesses. Services trade is also a key aspect of the U.S.-China trade relationship. U.S. service providers are competing globally in sectors from financial services to education, and to energy and environmental services, etc. Advancing bilateral services trade will provide multiple benefits for the U.S. and China. Not only will it support high-paid American jobs, but it will also help China develop its services sector which is a key component in China's next stage of economic transformation. An input-output analysis shows that exports of goods and services by

the U.S. and China to each other created 0.73m jobs in the U.S. and 11.4m jobs in China in 2010¹.

More than half of China's exports are products produced by foreign companies based in China. Many of the components used to produce China's exports are imported from other economies, notably East Asia, often from foreign companies that produce in these economies. This pattern of production and trade is a reason why China runs trade deficits with most East Asian economies while it has trade surpluses with the U.S. The rapid growth of China's exports therefore has occurred together with a rapid rise in intra-Asian trade and an increasing sophistication in the global supply chain of many industries and products. U.S. import statistics also show that in many products, the rise in the proportion of U.S. imports from China was matched by a fall in the share of imports from other East Asian economies. These facts reflect the increased use of China by foreign companies as an assembly base to enhance their global competitiveness and the pivotal role China plays in the development of global supply chains. A lot of these foreign companies are American. U.S.-China economic cooperation is therefore not only a matter for the two countries concerned. In a broader context, it is an integral part of a globalization process that flourished during the past few decades. Both the U.S. and China are major beneficiaries of this globalization process.

Although growing U.S.-China trade ties are obviously mutually beneficial, trade tensions between the two countries arise from time to time. The two countries are concerned about 'unfair' trade. There

¹ See Chapter 8 in Part II for details.



are also accusations by both sides of various trade protectionist measures adopted by the other party.

Specific trade disputes between the two countries could be resolved through the appropriate World Trade Organization (WTO) resolution procedures. More importantly, both countries should understand the long-term complementarities that underpin their trade relations and the enormous potentials for bilateral trade growth in the coming years, which will positively impact on jobs and economic development. Promotion of imports and domestic consumption is a key part of China's 12th Five-Year Plan and it is aiming to increase its aggregate imports to US\$10tr or more in five years². Meanwhile, the U.S. National Export Initiative aims to double exports to US\$3tr by the end of 2014. These will not only help to promote bilateral trade but also redress the trade imbalance between the two countries. Since 2006, U.S. exports to China have grown faster than Chinese exports to the U.S. every year. From 2001 to 2011, U.S. exports of goods and services to China increased by about four times, meaning that exports double every five years, or have an average annual growth rate of close to 15%.

Given the large size of China, after the rapid growth over a period of over three decades, it today has become an important market in itself. China's middle class is expanding fast and urbanization is continuing at a rapid rate. China's surge in demand for resources such as iron ore, coal and oil, and of food, have become a major factor influencing commodity markets. More and more Chinese savings are looking for investment opportunities around the world, not only as portfolio investments, but also increasingly in the form of direct investments. As China keeps expanding to integrate itself into the global economy, the outside world also wants to tap into the many opportunities that arise from China's development.

To realize the potentials of further trade growth, China and the U.S. should act in a collaborative manner to achieve their respective goals and targets for trade. Building on the results of the fourth round of the U.S.-China Strategic and Economic Dialogue (SED) in May 2012, the two nations should continue to strive for a more open global trade system and jointly resist trade protectionism so as to drive economic growth in both countries and achieve a more balanced trading relationship.

One specific suggestion made by this study is for both the U.S. and China to organize trade fairs to help U.S. SMEs to export to China. The China Import and Export Fair – known as the Canton Fair – played an important role in promoting Chinese exports. There is room for a similar trade fair to take place in the U.S. – perhaps in San Francisco – to help boost SME exports to China. More efforts to foster state-to-province and city-to-city partnerships by both countries would also be helpful.

U.S. high-tech export controls have constrained U.S. exports to China. Since 2002, U.S. high-tech products trade with China has been in deficit. From 2002 to 2010, the deficit increased from US\$11.8bn to US\$94.2bn³. Relaxation of high-tech export controls to China could alleviate some of the current U.S.-China trade imbalance. Both sides should promote bilateral trade in high-tech products, while the U.S. should reform and streamline its export control processes.

The U.S. and China are the two largest economies and trading nations in the world, accounting for 18.5% of world merchandise exports and 21.8% of world merchandise imports in 2011⁴. Trade relations between the two countries will therefore have a significant impact on the multilateral trade system. Having a constructive relationship between the two countries is important, not only for the future of these two countries, but also for the world as a whole.

2 "Bashing China isn't going to solve the world's debt crisis", Chen Deming, *The Telegraph*, 3 November 2011, <http://www.telegraph.co.uk/news/worldnews/asia/china/8867884/Bashing-China-isnt-going-to-solve-the-worlds-debt-crisis.html>

3 Data sourced from US Census Bureau.

4 World Trade Organization (2012), *International Trade Statistics 2012*.

The Development of U.S.-China Economic Relations, 1978 to the Present

The Development of U.S.-China Economic Relations

History of the economic exchange between the U.S. and China

In 2012, China was the second largest trade partner of the U.S. and the U.S. is China's largest export market. According to Chinese statistics, the total trade in goods between China and the U.S. amounted to US\$484.7bn in 2012⁵, 198 times of that in 1979. The U.S. statistics showed an even bigger figure at US\$536.2bn, 226 times of that in 1979⁶ (Figure 1). Bilateral trade in services totaled US\$38.03bn in 2011⁷(Figure 2).

Direct investment flows between the U.S. and China also witnessed a significant increase. U.S. direct investments in China rose from around US\$326m in the early-1980s to around US\$5.42bn in the early-2000s⁸. By the end of 2011, the U.S. had set up accumulatively 66,500 companies in China and made over US\$70bn worth of investment in China, representing 5.9% of China's total foreign direct investment (FDI) utilization. The U.S. was the third largest source of foreign investment after Hong Kong and Japan⁹.

Chinese direct investment in the U.S. increased almost 28-fold between 2003 and 2011 – from US\$65m to US\$1.8bn in 2011¹⁰. According to statistics compiled by the Rhodium Group¹¹, the amount

Figure 1: U.S.-China Trade in Goods, 1979-2012

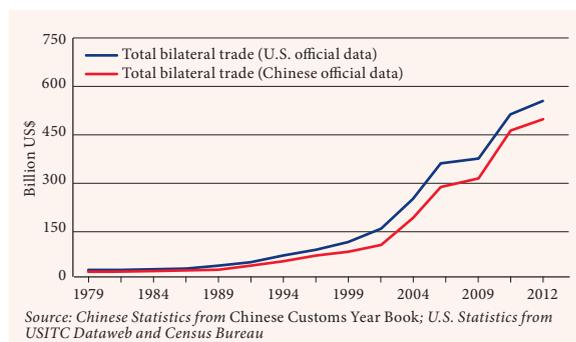
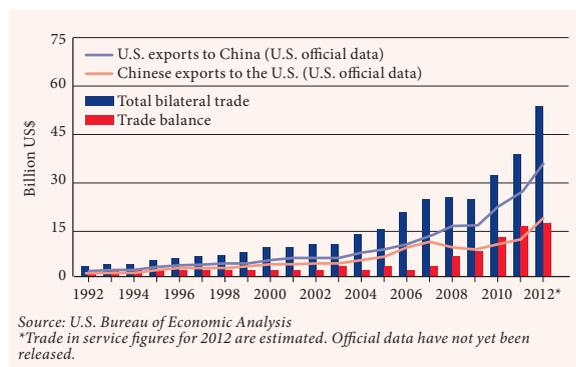


Figure 2: China-U.S. Trade in Services, 1992-2012



of Chinese investment in the U.S. reached a record US\$6.5bn in 2012. Chinese companies operated in at least 35 of the 50 U.S. states in 2010¹².

The developments of U.S.-China economic relations since 1979 can be roughly divided into the following four phases:

Phase 1: Bilateral trade increased rapidly after China's economic reforms and opening up, 1979-1992
China began its process of economic reform and opening up in the late 1970s and established diplo-

5 Data sourced from China Customs.

6 Data sourced from U.S. Census Bureau.

7 Data sourced from U.S. BEA.

8 Data sourced from Chinese Ministry of Commerce (MOFCOM).

9 See Chapter 13 for more details.

10 Data sourced from MOFCOM. See Chapter 13 for more details.

11 "Foreign Investment in China: A Tale of Two Statistics", Thilo Hanemann, Rhodium Group, 4 January 2013.

12 See Chapter 13 for more details.



matic relations with the U.S. in 1979. The most obvious feature of this first phase of bilateral economic exchange is its primary focus on trade in goods.

Starting from a low base, total bilateral trade of goods increased rapidly from US\$2.45bn in 1979 to US\$17.49bn in 1992, according to Chinese statistics¹³. The U.S. statistics show a similar trend with the bilateral trade increasing from US\$2.37bn to US\$33.15bn¹⁴.

Much of the trade took the form of the so-called “processing and assembly” trade, under which most inputs and components would be imported into China and all outputs would be exported, thus minimizing any impact on the domestic market which was then highly regulated.

Phase 2: U.S.-China economic ties strengthened after Deng Xiaoping’s southern tour, 1993-2001

The starting point of phase 2 was marked by the late Chinese senior leader Deng Xiaoping’s inspection tour of South China in mid-1992. Late in that year the Chinese government announced plans to build a socialist market economy and to renew its efforts at economic reform and opening to the world.

U.S.-China trade grew steadily with Chinese exports aided by a significant devaluation of the renminbi (RMB) on 1 January 1994 and the granting of (non-permanent) most-favored-nation status by the U.S.¹⁵. In 1999, China and the U.S. entered into a bilateral agreement for China’s accession into the WTO. This agreement expedited the process of China’s WTO accession, and created favorable conditions for the stable, healthy, long-term development of U.S.-China economic relations.

According to Chinese official statistics, bilateral trade of goods increased from US\$27.65bn in 1993 to US\$80.49bn in 2001¹⁶. (The U.S. official statistics recorded a bilateral trade increase from US\$40.30bn

to US\$121.52bn¹⁷.) Other areas of economic cooperation such as services trade and technological cooperation also grew in depth and breadth.

Besides, FDI flow from the U.S. to China had a quantum jump, from only US\$511m in 1992 to US\$2.06bn in 1993 and US\$4.43bn in 2001¹⁸.

Phase 3: Further expansion of bilateral trade and investment after China’s accession to the WTO, 2002-2010

China became an official WTO member in late 2001. This was a milestone in China’s opening to the world, and gave further impetus to the growth in U.S.-China economic relations. China began to evolve into an important part of an East Asian and global consumer market production and supply chain network.

The Multi Fiber Agreement (MFA), an agreement that imposed quotas on the amount of textile and garments developing countries could export to developed countries, came to an end on 1 January 2005. This was another important event in the development of China’s trade. As China was very competitive in the textiles and garments industries at that time, the end of the quota system led to a very rapid increase in Chinese exports.

In this phase, China continued to be the fastest growing market for U.S. exports. According to U.S. statistics, U.S. exports to China grew by 317% and U.S. imports from China grew by 192%¹⁹.

At the same time, U.S.-China trade in services grew 219% to US\$31.43bn, compared to an overall growth in U.S. trade in services of 84%. China’s share of U.S. services exports rose from 2.1% to 4%²⁰.

In the beginning of the early 2000s, Chinese enterprises began to make direct investments in the U.S. and elsewhere, but the cumulative total of Chinese direct investment in the U.S. as of 2010 was less

13 Data sourced from China Customs.

14 Data sourced from US Census Bureau.

15 In 2000, the U.S. Congress granted China permanent most-favored-nation status (MFNS) for trade. This opened the door for China to become an even bigger player in the world economy.

16 Data sourced from China Customs.

17 Data sourced from U.S. Census Bureau.

18 Data sourced from MOFCOM.

19 Data sourced from U.S. Census Bureau.

20 Data sourced from U.S. BEA.

than US\$5bn²¹, a small fraction of the cumulative U.S. direct investment in China of approximately US\$70bn by around 65,000 U.S. firms. Cumulatively, U.S. direct investment accounts for 6.7% of the total stock of FDI in China.

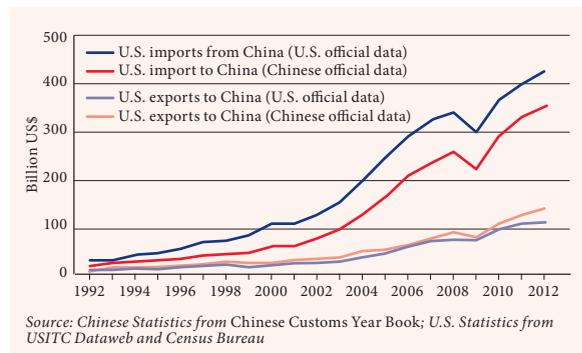
Phase 4: Stronger commitment to strengthen cooperation, 2011 onwards

The U.S. and China are entering a new phase of mature and comprehensive economic exchange. In May 2011, the U.S. and China signed the “U.S.-China Comprehensive Framework for Promoting Strong, Sustainable, and Balanced Growth and Economic Cooperation”. The two countries affirm that both will, based on common interests, and from a strategic, long-term, and overarching perspective, promote more extensive economic cooperation in joint efforts to build a comprehensive and mutually beneficial economic partnership, to boost prosperity and welfare in the two countries, and to achieve strong, sustainable and balanced growth of the world economy. Within the next 10 years, the U.S. and China will enter into a new phase of a comprehensive and mutually beneficial economic partnership; the two countries will be able to conduct broad cooperation on trade, investment, finance, technology, clean technology, infrastructure and global economic governance.

Developments in U.S.-China trade since China’s WTO accession

One of the significant economic events during the past three decades has been China’s entry into the WTO. China and the U.S. have clearly benefited from China’s WTO entry. As a result of market openings mandated by the WTO agreement, U.S.-China trade has advanced at breakneck pace. This trade has helped create jobs, raise incomes and contribute to economic growth in both countries.

Figure 3: U.S. Merchandise Trade with China, 1992- 2012



Trade in goods

U.S. merchandise exports to China increased from US\$19.2bn, or 2.53% of total exports, in 2001 to US\$110.6bn, or 7.1% of total exports, in 2012 (see Figure 3)²². China is now the largest market for US agricultural exports such as soybean and cotton. The U.S. also has a comparative advantage in automobiles and airplanes. For instance, the Boeing Company has predicted that over the next 20 years, China will buy 5,000 new commercial airplanes valued at US\$600bn and will be Boeing’s largest commercial airplane customer outside the U.S.²³.

Chinese merchandise exports to the U.S. also grew at a rapid pace, with an annual average growth of about 19% between 2001 and 2012, reaching US\$425.64bn in 2012²⁴. As the U.S.’s major supplier of goods imports, China has comparative advantage in machinery, toys and sports equipment, furniture and bedding, and footwear.

Trade in services

From 2001 to 2011, U.S. service exports to China expanded from US\$5.41bn to US\$26.7bn. Over the same period, the U.S. service trade surplus with China rose from US\$1.88bn to US\$15.37bn²⁵. The U.S. has distinctive competitive advantages in the

21 Data sourced from MOFCOM.

22 Data sourced from U.S. Census Bureau.

23 The Boeing Company, statement on Chinese approval of 200 Boeing Aircrafts, 19 January 2011.

24 Data sourced from U.S. Census Bureau.

25 Data sourced from U.S. BEA.

areas of tourism, education, financial services and transfer of patent rights (see Figure 2).

China plans to increase the contribution of the service sector to total GDP from 43% in 2010 to 47% in 2015, which means tremendous opportunities for U.S. service providers²⁶. Instead of continuing to develop low-cost, low-value-added industries, China is vigorously developing services and advanced manufacturing industries. U.S. companies engaging in professional service industries such as design, brand building, IT, research and development (R&D), and legal and financial services could give full play to their strengths to assist in the upgrading and restructuring of Chinese enterprises and factories. Advancing services trade with China could support American jobs.

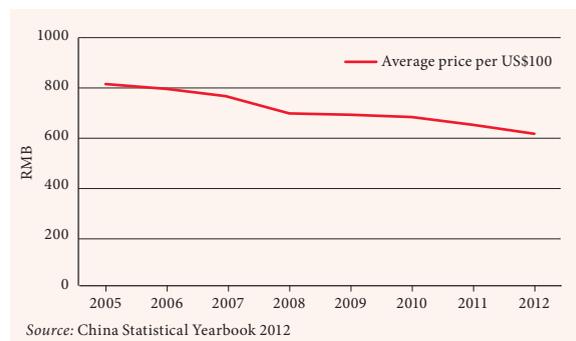
Future competitive advantages hinge on companies' ability to provide value-added services. Indeed, a number of companies are putting increasing focuses on building their services strengths. For example, the world's largest automaker General Motors (GM) established its own lending operation GM Financial in 2010. This captive lending arm can be an important profit contributor and help generate more vehicle sales for GM by providing attractive loan and lease terms to consumers.

In response to the growing demand for commercial airline pilots and maintenance technicians in the Asia Pacific region²⁷, Boeing has also expanded its Flight Services business in China, greatly enhancing training capacity for airlines in the region. With the introduction of an advanced 787 Dreamliner training suite for pilot and maintenance training, and a newly-installed 747-400 full-flight simulator, the company is tripling its offerings at the Boeing Flight Services Shanghai training campus.

26 The service industries account for about 68% of U.S. GDP. This information was sourced from the Office of the United States Trade Representative, 25 October 2012, <http://www.ustr.gov/trade-topics/services-investment/services>

27 The "Boeing Pilot & Technician Outlook" projects the largest demand for global pilots and maintenance technicians will be in the Asia Pacific region. China's expected requirement leads the region's demand with a need for 72,000 new commercial airline pilots and more than 108,000 maintenance technicians over the next 20 years.

Figure 4: US\$/RMB Exchange Rate (average price per 100 US\$), 2005-2012



Frictions in U.S.-China economic and trade relations

Although growing U.S.-China economic ties are widely considered to be mutually beneficial, tensions between the two countries have risen over a number of issues.

China's currency policy

Many U.S. policymakers, labor groups and representatives of import-sensitive industries have charged that, despite gradual reforms, the Chinese government continues to manipulate its currency to keep its value artificially low against the dollar. The critics claim that this policy constitutes a de facto subsidy of Chinese exports to the U.S. and acts as a tariff on U.S. imports to China. They believe China keeps the value of the RMB artificially low to gain a competitive trade advantage.

China's response is that it intends to "proceed further with reform of the RMB exchange rate regime and to enhance the RMB exchange rate flexibility", but it rules out any large one-time revaluation, stating "it is important to avoid any sharp and massive fluctuation of the RMB exchange rate"²⁸. Since China began exchange rate reforms in 2005,

28 "Statement on Promoting the Reform of the RMB Exchange Rate Regime and Enhancing the RMB Exchange Rate Flexibility", 19 June 2012, http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2010/20100621164121167284376/20100621164121167284376_.html

the RMB has appreciated in nominal terms by about 23% against the U.S. dollar²⁹(see Figure 4).

Trade restrictive measures

A number of trade restrictive measures such as tariff-rate quotas (TRQ), import duties and trade remedies have been imposed by the U.S. and China. History shows that trade restrictive measures introduced in times of crisis might meet the short-term domestic political needs but can also hamper long-term economic development.

Both China and the U.S. resort to trade remedy measures including countervailing and anti-dumping duties to protect domestic industries and employment. These have led to an increasing number of cases brought to the WTO trade dispute settlement process.

Since 2010, China has launched a number of anti-dumping and countervailing cases against U.S. imports including dispersion unshifted single-mode optical fiber, caprolactam, distillers dried grains, coated bleached folding, solid bleached sulphate (SBS), folding boxboard (FBB), coated ivory board or white card paper, ethylene glycol monobutyl ether, diethylene glycol monobutyl, and resorcinol (resorcin)³⁰. On the other hand, the U.S. has also initiated a series of anti-dumping investigations of Chinese imports, including steel wheels, steel cylinders, crystalline silicon photovoltaic cells and modules, wind towers and drawn stainless steel sinks³¹.

In March 2012, U.S. President Barack Obama signed into law a bill that authorizes the U.S. Commerce Department to impose punitive countervailing duties on non-market economies including China, providing subsidies to manufacturers and importers.

Intellectual property rights protection

Although China has improved significantly its intellectual property rights (IPR) protection regime over the past decades by beefing up its laws and conducting periodic focused campaigns against major infringers, protection of IPR is still inadequate. The U.S. International Trade Commission (USITC) estimated that in 2009, U.S. intellectual property-intensive companies that conducted business in China lost US\$48.2bn in sales, royalties and license fees because of IPR violations³². U.S. Customs and Border Protection reported that China accounted for 66% of pirated goods seized by the agency in 2010. There is also a growing trend for counterfeit goods from China to be shipped by mail or courier.

Government procurement

Foreign firms are disadvantaged in their access to China's government procurement market. In June 2009, the Chinese government issued a circular with a "Buy China" provision, requiring that projects funded by the US\$586bn stimulus package gave preference to domestic firms. U.S. businesses are concerned that final implementing regulations for the forthcoming Chinese government procurement law will promote the use of domestic content to the disadvantage of products and services from foreign-owned companies.

China committed to the Government Procurement Agreement (GPA) as part of its WTO accession. But its inclusion in the GPA is still under negotiation. Since 2007, China has submitted three offers, but each time economies already part of the GPA have asked it to make improvements so that the terms are comparable to the concessions they made when they acceded to the agreement.

29 Data sourced from the *China Statistical Yearbook*, various years.

30 World Trade Organization (2012), "Director-General's report on trade-related developments (Mid-October 2011 to mid-May 2012)", World Trade Organization.

31 "Director-General's report on trade-related developments (Mid-October 2011 to mid-May 2012)", World Trade Organization, 2012.

32 See Chapter 14 for more details.

Figure 5: Share of Processing Trade in China's Total Exports, 1981-2011



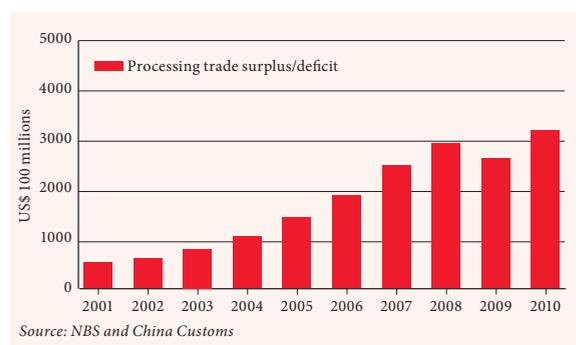
Figure 7: Share of Foreign-invested Enterprises in China's Total Export Value, 1986-2011



Figure 6: Share of Foreign-invested Enterprises in Total Value of China's Processing Trade Exports, 1995-2011



Figure 8: China's Balance of Processing Trade, 2001-2010



Reasons and perspectives on the U.S.-China trade imbalance

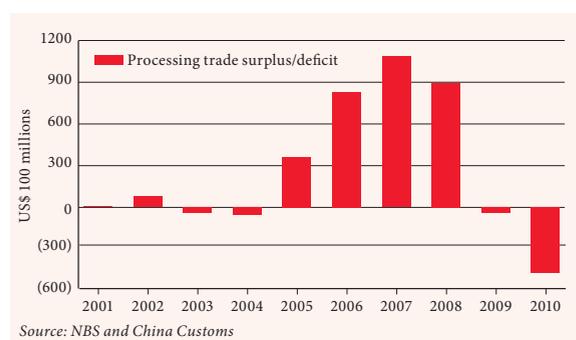
Since China's exports to the U.S. exceed by a wide margin U.S. exports to China, the U.S. trade deficit with China is likely to continue for a long time, even though U.S. exports to China have been increasing faster than Chinese exports to the U.S. in recent years.

From a macroeconomic perspective, the low savings rate and high consumption rate in the U.S. are the fundamental reasons for the growing trade deficit the U.S. has with the rest of the world.

However, to understand better the bilateral U.S.-China trade imbalance, one should take a closer look into China's trading pattern.

Although the relative importance of processing trade has been decreasing over the past decade, it still accounted for 44% in total exports in 2011 (see Figure 5).

Figure 9: China's Balance of General Trade, 2001-2010



Foreign-invested enterprises have dominated the export sector, with 52.4% of total export value and 83.7% of the processing trade in 2011 (see Figures 6 and 7).

Processing trade accounts for most of China's trade surplus (see Figure 8).

In the two years since 2009, China has recorded a trade deficit in the general trade sector (see Figure 9).

These facts show that a substantial proportion of China's trade surplus comes from the processing trade surplus that is created by foreign-invested enterprises using China as a base for the assembly of final products.

The growth of China as part of this East Asian and global supply chain has also resulted in a 'transfer' of trade surpluses with the U.S. from other Asian economies to China. Standard gross trade statistics therefore need to be examined in more detail before valid conclusions could be drawn.

The imposition by the U.S. of controls on high-tech exports to China also helps to explain part of the U.S. trade deficit with China, as indicated by a fall in the U.S.' market share of China's import of high-tech products and a rapidly growing trade deficit the U.S. has with China in high-tech products trade.

China as the final assembler in Asia-wide production networks

The sizable bilateral goods trade deficit that the U.S. has with China has a lot to do with the growing internationalization of production with China as the final assembly point for many products. As companies in Japan, South Korea, Singapore, Taiwan and other neighboring economies and regions have moved production plants to China or expanded their operations in China, products previously made in these countries and exported to the U.S. would be exported from China to the U.S. and classified as made in China. Therefore, a side effect of these developments is the 'transfer' of the trade surpluses these economies have with the U.S. to China.

As shown in Figure 10, the trade deficits of the U.S. with South Korea, Japan and Taiwan edged down in recent years. From 2004 to 2010, South Korea's trade surplus with the U.S. decreased from US\$19.9bn to US\$10.1bn; Japan's dropped from US\$75.2bn to US\$59.8bn; and Taiwan's went from US\$12.9bn to US\$9.9bn. These falls occurred as China's trade surplus with the U.S. built up and

Figure 10: Changes in Trade Surplus of Major U.S. Trade Deficit Sources, 2004 and 2010

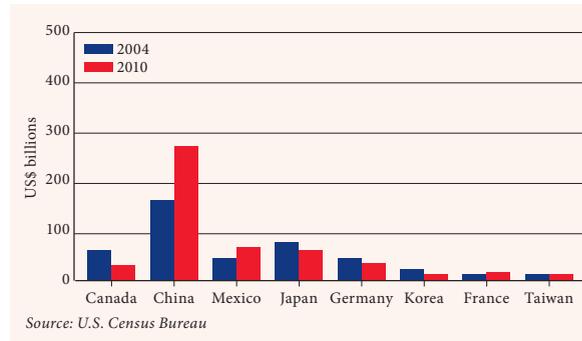
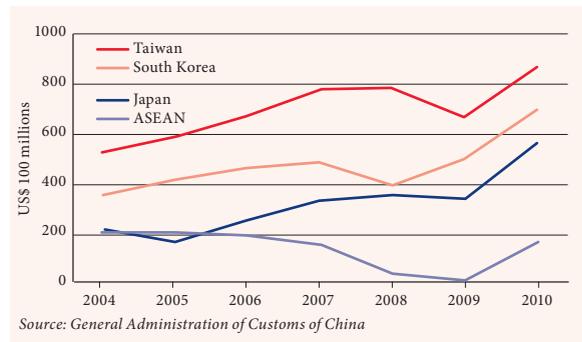


Figure 11: China's Trade Deficit with Neighboring Economies, 2004-2010



China's trade deficits with its neighboring economies and regions grew. For example, China's trade deficit with Japan rose from US\$20.8bn in 2004 to US\$55.7bn in 2010; the deficit with South Korea increased from US\$34.4bn to US\$69.6bn; and the deficit with Taiwan expanded from the US\$51.1bn to US\$86.0bn (see Figure 11).

In 2004-10, Asia accounted for about 55% of the total U.S. trade deficit, with this figure relatively stable over the period. But as the production base of many consumer products, China became the major source of the U.S. trade deficit with Asia, with its contribution increasing from 24.85% to 43%. These figures show that the trade surpluses of some Asian economies with the U.S. have been 'transferred' to China.

Another set of data also illustrate the transfer of trade surpluses to China from other East Asian

economies. Figure 12 shows that East Asia's share of U.S. manufacturing imports stood at about 40% between 1990 and 2009, during which the share of imports from China increased from 3.51% to 23.72%, while that of the rest of East Asia decreased from 39.18% to 18.72%.

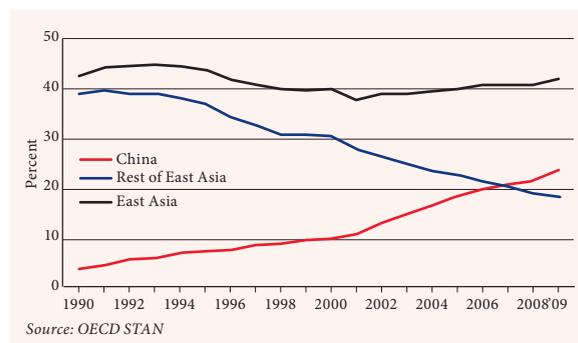
From 1990 to 2009, China's share of total U.S. high-tech imports increased from 1.81% to 28.33%, while its share of medium-high tech imports grew from 1.06% to 13.53%, medium-low tech imports from 1.87% to 15.54%, low-tech imports from 9.37% to 36.86%, and ICT imports from 1.97% to 40.31%. Over the same period, the share of imports by the U.S. from other East Asian economies gradually decreased – from 60.64% to 24.64% for high-tech products, from 37.97% to 22.74% for medium-high tech products, from 21.63% to 11.81% for medium-low tech products, from 33.57% to 10.25% for low tech products, and from 72.34% to 30.59% for ICT products (see the Appendix to this chapter for more details).

Global sourcing trends have been changing in recent years. Due to rising labor and other costs in China, a growing number of manufacturers in China, particularly those low-value-added, assembly-type manufacturers, have been relocating production plants to lower-cost emerging markets such as Vietnam, Indonesia, Cambodia, Bangladesh and Mexico. Some companies have pursued a “China plus” strategy by setting up factories outside China to test the waters in new markets and diversify their supply chains. These developments suggest that part of China's bilateral trade surplus with the U.S. would likely be shifted to these emerging countries in the coming years.

Gross data may not show China's real gain from its trade with the U.S.

Processing trade, characterized by a relatively small share of domestic added value and high import content, accounts for about half of China's foreign trade. The trade picture would be different if the

Figure 12: Contribution of East Asian Economies to U.S. Imports of Manufactured Products



actual value-added in each country is taken into account, rather than the total imports and exports of goods and services.

A Study by Professor Chen Xikang³³ of the Academy of Mathematics and Systems Science at the Chinese Academy of Sciences found that in 2010 every US\$1,000 of U.S. exports to China (including re-exports from Hong Kong) generated an added value of US\$880 for the American economy. In comparison, for every US\$1,000 of Chinese exports to the U.S. – including re-exports from Hong Kong – the added value was only US\$573. The domestic value-added contribution to the U.S. economy of U.S. exports to China was thus about 54% more than that of the added value contribution to the Chinese economy of Chinese exports to the U.S. Moreover, China's trade surplus with the U.S. in 2010 as measured by the value-added approach was US\$91.7bn, about 58% less than the US\$ 217.9bn based on the gross value of trade.

³³ See Chapter 8 for more details.

Who captures the value?

There is little value in high-volume product assembly. The following cases demonstrate the real gain that China realizes from engaging in processing trade.

Mattel Barbie dolls

The U.S. bought 45% of China's total toy exports from 2000 to 2009. For every Barbie doll selling at US\$9.90 on the U.S. market, Chinese manufacturers pocketed only US\$0.35, while brand owner Mattel took in US\$8.0 (information sourced from "Interview with Sheng Guangzu on issues of China's trade surplus and trade balance", China: Xinhua News Agency, 2010).

HP notebook computers

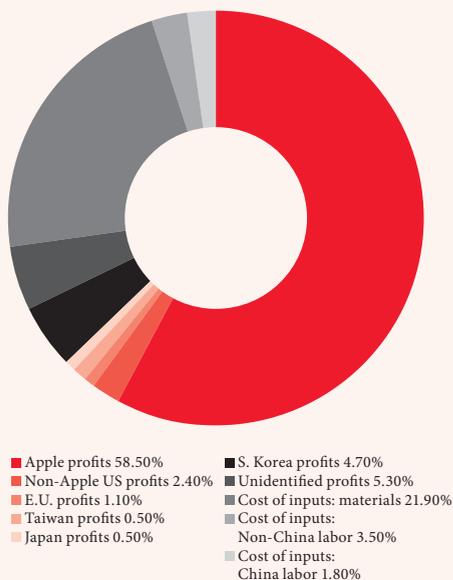
China exported a total of 620 million computer units from 2000 to 2009, of which nearly 30% went to the U.S. In that period, China imported Intel chips and other components from the U.S. valued at US\$5.6bn (information sourced from, "Interview with Sheng Guangzu on Issues of China's trade surplus and trade balance", China: Xinhua News Agency, 2010.)

According to Shanghai Customs, HP notebook computers exported to the US from China sold for about US\$1,000 each to end users, of which U.S. companies shared US\$169.60, while the processing fees of Chinese enterprises were only US\$30.30, or 3% of the retail price.

Apple iPhones

The iPhone is one of Apple's big money makers. U.S. academics Kenneth L. Kraemer, Greg Linden and Jason Detrick determined that Apple kept about 58% of the retail price of the iPhone 4 – a far bigger share than other firms in the supply chain received (information sourced from, "Capturing Value in Global Networks: Apple's iPad and iPhone", Kenneth L. Kraemer, Greg Linden and Jason Detrick, University of California, Irvine; University of California, Berkeley; and Syracuse University, July 2011). A 2010 study by the Asian Development Bank Institute showed of the US\$2.02bn worth of iPhones exports to the U.S. from China, 96.4% was transferred added value from other economies – Japan (US\$670m), Germany (US\$326m), South Korea (US\$259m), the U.S. (US\$108m) and other countries (US\$542m). The value added in China was only US\$73.45m, or 3.6% of the value of iPhone exports to the U.S. (information sourced from, "How the iPhone Widens the United States Trade Deficit with the People's Republic of China", Xing, Yuqing, and Neal Detert, ADBI Working Paper 257, Tokyo: Asian Development Bank Institute, December 2010)(see Figure 13).

Figure 13: Value Distribution of the iPhone, 2010



Source: Kenneth L. Kraemer, Greg Linden, and Jason Detrick, *Capturing Value in Global Networks: Apple's iPad and iPhone*, University of California, Irvine, University of California, Berkeley and Syracuse University, July 2011.



Figure 14: U.S. High-Tech Products Trade with China, 2002-2010

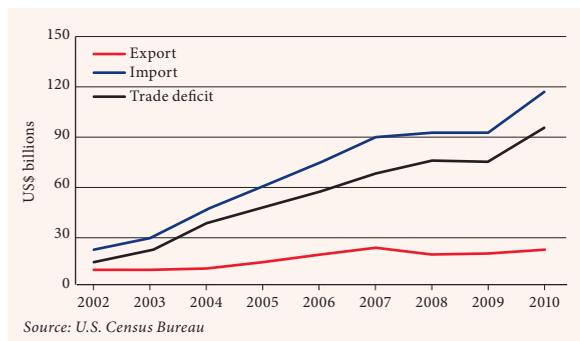
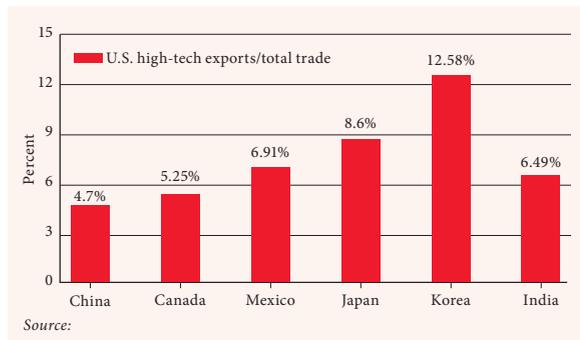


Figure 15: Proportion of U.S. high-tech exports in total bilateral trade volume between the U.S. and the respective countries



U.S. controls have severely limited its high-tech exports to China. U.S. high-tech products trade with China has been in deficit since 2002, when the shortfall was US\$11.8bn. By 2010, the deficit had risen to US\$94.2bn (see Figure 14). In 2003, the U.S. tightened controls on high-tech exports to China, especially software and equipment, and stepped up monitoring of China’s nuclear and missile technology development. Four years later, the U.S. Department of Commerce announced fresh limits on the export to China of dual-use products and technologies³⁴. These entailed 31 provisions, regulating 20 categories of products that could not be exported to China.

According to Chinese statistics, during 2001 to 2010, China’s high-tech imports rose from US\$64bn

to US\$412.7bn, representing an increase of 5.4 times with an average annual growth of 23%. Meanwhile, U.S. high-tech exports to China increased by 150.7%, far below the growth rates of exports from the E.U. (219.6%) and Japan (332.8%). If the U.S. had not imposed controls, its exports to China could have increased significantly more.

The Benefits of Economic Cooperation to the U.S. and China

Over the past 30 years, closer U.S.-China economic ties have not only brought more goods and services, but have created job opportunities and raised living standards for both countries. It has also encouraged exchange of ideas, personnel and technology. These economic benefits are largely attributable to candid dialogue and constructive cooperation between China and the U.S.

Benefits to the U.S.

China has become an important overseas market for many U.S. products

According to the U.S. Department of Commerce (USDOC), China was the 23rd largest market for U.S. exports in 1979. But China has become the third largest goods market since 2007. In 2012, the export of goods from the U.S. to China amounted to US\$110.6bn, 64 times that in 1979; China’s share of U.S. exports also increased from less than 1% in 1979 to 7.1% in 2012³⁵.

It is noteworthy that China was on the list of top five export markets of 42 U.S. states and was the biggest export market for Louisiana, Oregon and Washington in 2010³⁶.

The U.S. exports a wide range of high-tech products such as mechanical and electrical prod-

³⁴ ‘Dual use’ refers to items or technologies that have civilian, commercial and military applications.

³⁵ Data sourced from U.S. Census Bureau.

³⁶ ‘U.S. Exports to China by State: 2000-2010’, The U.S.-China Business Council, 30 March 2011, https://www.uschina.org/public/documents/2011/03/full_state_report.pdf.

Figure 16: Contribution of Chinese market to Total Sales of Majority-owned Foreign Affiliates of U.S. Companies, 1994 -2008

| | Sales in China - US\$ millions | Share |
|------|--------------------------------|--------|
| 1994 | 2,520 | 78.14% |
| 1995 | 4,377 | 81.06% |
| 1996 | 5,825 | 67.12% |
| 1997 | 8,213 | 67.67% |
| 1998 | 9,292 | 63.60% |
| 1999 | 14,306 | 70.19% |
| 2000 | 18,524 | 70.28% |
| 2001 | 23,036 | 70.54% |
| 2002 | 30,205 | 73.02% |
| 2003 | 36,824 | 75.53% |
| 2004 | 46,207 | 74.43% |
| 2005 | 52,665 | 67.88% |
| 2006 | 65,107 | 67.76% |
| 2007 | 79,349 | 70.99% |
| 2008 | 98,952 | 75.32% |

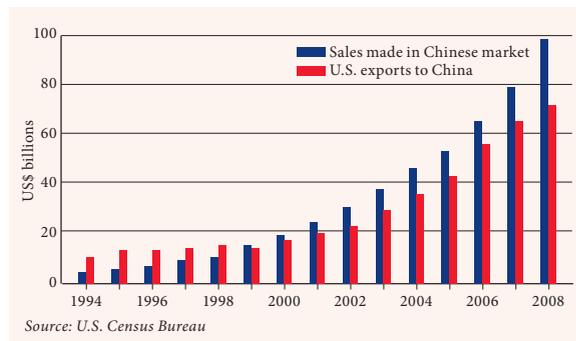
Source: U.S. Bureau of Economic Analysis, U.S. Direct Investment Abroad, 1994-2008

ucts, medical appliances, airplanes and automobiles to China. In 2010, the U.S. exported US\$4.5bn worth of automobiles to China, a 134.34% growth over the previous year. (In the same year, total U.S. automobile exports grew by 34.4%.) According to Boeing Company statistics, Boeing airplanes are the mainstream passenger and cargo airplanes in China. By June 2009, among the 1,383 operating civil airplanes, 736 (or 53%) are Boeing planes³⁷. In 2010, U.S. airplane exports to China grew by 7.9% from the previous year, reaching US\$5.76bn. (In the same year, the total U.S. airplane exports increased by 3.9%.)

U.S. companies yield significant investment returns in China

The U.S. is the third largest foreign investor in China: By the end of 2011, FDI stock from the U.S. to China totaled US\$54.2bn, 49.25% of which had been invested in manufacturing, followed by whole-

Figure 17: Sales Revenues Made by Majority-owned Affiliates of U.S. Companies in Chinese Market and Total U.S. Exports to China, 1994 -2008



sale trade (8.89%), holding companies (non-bank) (8.94%), information (5.56%), depository institutions (5.49%), mining (5.25%), and finance (except depository institutions) and insurance (4.58%)³⁸.

U.S. companies generate revenues from the Chinese market through direct investments: According to MOFCOM statistics from the annual joint inspection on foreign investment enterprises (FIEs) in China, U.S.-invested companies in China generated US\$310.4bn in sales revenues in 2011, of which US\$228.1bn and US\$82.3bn came from sales in China and global markets including the U.S., respectively. Since 1994, of the total sales made by foreign affiliates of U.S. companies, 70% are derived from China. And the sales volume in the Chinese market grew from US\$2.52bn in 1994 to US\$98.95bn in 2008 (see Figure 16). It is also noteworthy that since 1999, sales made by majority-owned Chinese affiliates of U.S. companies have been larger than the volume of U.S. exports to China (Figure 17).

China has also been the profit center for many U.S. businesses: According to MOFCOM statistics from the annual joint inspection on FIEs in China, U.S.-invested companies in China made US\$21.1bn in profits in 2011. Despite the global financial crisis, the majority of U.S.-invested companies in China still performed above par, and contributed significantly to profit growth of their parent companies.

³⁷ Information sourced from on 8 September 2011, <http://www.boeingchina.com>

³⁸ Data sourced from U.S. BEA.



In 2005, repatriated profits of all U.S. affiliates in China amounted to US\$3.3bn³⁹. According to an estimate, between 1999 and 2009, the operational net profit margin of U.S. direct investment in China was 15%, and if asset appreciation and Chinese currency appreciation factors are considered, the actual profit margin might have been 18%⁴⁰.

U.S. companies are actively participating in China's services sectors

The U.S. ran a trade surplus with China in its export of services. The figure grew from US\$515m in 1992 to US\$15.37bn in 2011⁴¹, representing a 29-fold increase. Statistics from U.S. Bureau of Economic Analysis (BEA) suggest that the value of U.S.-China trade in services was US\$38.03bn in 2011; of which, 70% was the U.S.' exports to China.

By the end of 2010, U.S. businesses had set up footholds in most of the 100 services sectors which are marked for liberalization in China. In accounting, banking, insurance, securities and commerce sectors, U.S. service providers are proven to have distinct comparative advantages. According to the statistics of the Chinese Ministry of Justice, as of March 2011, U.S. law firms had set up 101 representative offices in China, accounting for 42.98% of all the representative offices established by foreign law firms. According to the annual joint inspection statistics by MOFCOM, 1,343 U.S. consulting companies made sales revenue of US\$2.3bn in China in 2011.

Imports of consumer goods from China have greatly improved the standard of living for Americans

Chinese exports to the U.S. have been of adequate quality and low cost, which have helped to keep the rate of inflation low in the U.S.

Imports of 'Made-in-China' products have also improved the living standard for Americans. Among the Chinese exports to the U.S. market, about 75% are consumer products like garments and footwear, toys, bags and cases, and electronic and electrical products.

To take footwear as an example, according to the U.S. customs, the U.S. imported US\$15.07bn worth of footwear products from China in 2010, accounting for 76% of the total U.S. footwear imports (or equivalent to 87% of the total 2.07 billion pairs of footwear). The average price of a pair of imported shoes from China was US\$7.57 which was lower than the imported price from other regions by US\$7.99. It is estimated that the U.S. consumers saved US\$16.55bn in 2010 by importing footwear products from China⁴².

Division of labor between China and the U.S. benefits workers on both sides

The article "China makes, the world takes" by James Fallow illustrated that Chinese workers making US\$1,000 a year have been helping American designers, marketers, engineers and retailers make US\$1,000 a week (and up) to earn even more. Plus, they have helped shareholders of U.S.-based companies⁴³.

Another article⁴⁴ published by the Federal Reserve Bank of San Francisco found that goods and services from China accounted for only 2.7% of U.S. personal consumption expenditures in 2010; of which, less than half reflected the actual costs of Chinese imports. The rest went to U.S. businesses and workers transporting, selling and marketing goods carrying the 'Made in China' label.

Trade with China has also brought significant job opportunities in the U.S. In April 2010, the International Trade Administration and the

39 "The China Effect: Assessing the Impact on the US Economy of Trade and Investment with China", Erik Britton, Christopher T. Mark, Sr. a report by Oxford Economics and the Signal Group, January 2006.

40 "Why the financial restructuring is needed", Pan Yingli, *Jie Fang Daily*, 14 November 2010, Column 8 (潘英丽, 《为何需要加快金融转型》, 《解放日报》2010年11月14日第八版).

41 Data sourced from U.S. BEA.

42 Data sourced from USITC.

43 "China makes, the world takes", James Fallow, *The Atlantic*, July-August 2007, pp.19.

44 "The U.S. Content of 'Made in China'", Galina Hale and Bart Hobijn, *FRBSF Economic Letter*, 8 August 2011, <http://www.frbsf.org/publications/economics/letter/2011/el2011-25.html>

Figure 18: Jobs in the U.S. Supported by Exports of Goods and Services to China, 1993-2008

| | Jobs generated by goods exports to China (thousand jobs/person) | Jobs generated by services exports (thousand jobs/person) | Total (thousand jobs/person) |
|------|--|--|---------------------------------|
| 1993 | 112.2 | 16.1 | 128.4 |
| 1994 | 114.0 | 17.0 | 131.0 |
| 1995 | 139.3 | 20.4 | 159.7 |
| 1996 | 135.4 | 24.6 | 160.1 |
| 1997 | 138.3 | 27.6 | 165.9 |
| 1998 | 149.0 | 30.1 | 179.1 |
| 1999 | 130.3 | 28.7 | 159.0 |
| 2000 | 150.5 | 34.9 | 185.4 |
| 2001 | 173.8 | 38.4 | 212.2 |
| 2002 | 187.4 | 40.2 | 227.6 |
| 2003 | 222.7 | 37.8 | 260.5 |
| 2004 | 250.2 | 45.6 | 295.8 |
| 2005 | 280.0 | 51.4 | 331.4 |
| 2006 | 350.1 | 62.1 | 412.2 |
| 2007 | 388.3 | 72.4 | 460.7 |
| 2008 | 413.6 | 80.4 | 494.0 |

Source: Calculations based on International Trade Administration, Economic and Statistics Administration of the USDOC, Exports Support American Jobs, 2010

Economic and Statistics Administration of the USDOC released the report “Exports Support American Jobs”, which examines the relationship between U.S. exports and the jobs they support for the period 1993 to 2008. Based on the number of export-driven employment and the percentage of export to China in the overall trade volume, U.S. exports to China supported 128,400 jobs in the U.S. in 1993, 112,200 and 16,100 of which are generated by goods trade and service trade, respectively. In 2008, exports to China helped create 494,000 jobs in the U.S., and goods trade and services trade generated 413,600 and 80,400 jobs respectively (see Figure 18).

An analysis by Professor Chen Xikang and his team found that for every US\$1bn of U.S. exports of goods and services to China in 2010, 6,400 person-years in non-farm employment were generated in the U.S. Since U.S. exports to China amounted to US\$114.5bn in 2010, this implies that an estimated 732,800 jobs were generated.

Many bemoaned the loss of American jobs to China. Indeed, statistics from the Bureau of Labor Statistics (BLS) show that since 2004, there have been 5,000 to 16,000 job losses in the U.S. per annum, accounting for 0.4-1.6% of the total layoffs. Of the total number of losses, within-company relocations account for 66%-93%⁴⁵ (see Figure 19). Even if all these relocations had gone to China, the impact is so small that it should not be a key factor affecting the big picture of the U.S.-China economic relations.

Benefits to China

The U.S. plays an important role in China’s GDP and export growth

During the past few decades, China has gained significant benefits through access to the U.S. market, investment and technology. Helped by the continu-

⁴⁵ Movement of work actions by type of separation where number of separations is known by employers, 2004 through 2008, 2009 and 2010. <http://www.bls.gov/mls/>



Figure 19: Job Losses in the U.S. due to Work Transferred Overseas, 2004-2010

| | Number of out-of-country relocations | | | | Total losses from the U.S. | Percentage of out-of-country relocations in the overall employment |
|---------------|--------------------------------------|----------------------------|---------------------------|--|----------------------------|--|
| | Total number of losses | Within company relocations | Losses to other companies | Percentage of within-company relocations in the total number of losses | | |
| 2004 | 16,197 | 12,905 | 3,292 | 79.68% | 993,909 | 1.63% |
| 2005 | 12,030 | 9,438 | 2,592 | 78.45% | 884,661 | 1.36% |
| 2006 | 13,367 | 11,776 | 1,591 | 88.10% | 935,969 | 1.43% |
| 2007 | 11,856 | 9,887 | 1,969 | 83.39% | 965,935 | 1.23% |
| 2008 | 11,431 | 10,392 | 1,039 | 90.91% | 1,516,978 | 0.75% |
| 2009 | 10,378 | 9,630 | 748 | 92.79% | 2,108,202 | 0.49% |
| 2010 | 5,336 | 3,548 | 1,788 | 66.49% | 1,257,134 | 0.42% |
| 1st Half 2011 | 3,325 | 3,042 | 283 | 91.49% | 486,482 | 0.68% |

Source: Movement of work actions by type of separation where number of separations is known by employers, 2004 through 2008, 2009 and 2010; Extended mass layoff events and separations, selected measures, 2004-2011.

ously expanding economic and trade cooperation with the U.S., China has been able to overcome the bottlenecks of market, resources and technology, and improve its economy in terms of size, structure and quality, and begin the process of its modernization.

Since the early 1990s, China has maintained an average annual economic rate of growth of nearly 10%, mainly due to its adherence to an open trade and investment regime. As an export-oriented economy, exports has played an important role in China's economic growth, accounting for over 40% of China's GDP, and contributed over 20% to its growth. As China's largest export market, the U.S. accounted for about 20% of China's total export for many years. The U.S. is also the biggest source of China's trade surplus.

Exports to the U.S. support employment at home

In the past 30 years, the composition of China's exports has witnessed a continuous process of upgrading. In the earlier years, primary products and low-technology, labor-intensive, light-manufactured products accounted for a dominant share of Chinese exports to the U.S. In recent years, mechanical and electrical products have gradually dominated China's exports to the U.S.

Exports to the U.S. have helped create employment. It has been estimated by Chen Xikang and

his team that every US\$1bn of Chinese exports of goods and services to the U.S. in 2010, created employment of 38,930 person-years in non-agricultural employment in China. Since Chinese exports to the U.S. amounted to US\$293.2bn in 2010, this means that an estimated 11.4 million person-years of employment was generated, equivalent to 2.4% of total Chinese non-agricultural employment. Besides, the contribution to Chinese GDP (value-added) from majority-owned Chinese affiliates of U.S. companies has increased from US\$678m in 1994 to US\$27.3bn in 2008.

In 2011, U.S.-funded enterprises paid a total tax of US\$21.7bn, employed 2.19 million workers including 26,100 expatriates, with 290,000 of them newly added that year⁴⁶.

U.S.-China economic cooperation contributes to China's industrial upgrading and modernization

By the end of 2010, U.S. companies have cumulatively set up over 250 R&D centers in China. The R&D expenditures by majority-owned Chinese affiliates of U.S. companies have grown from US\$7m in 1994 to US\$1,517m in 2008. (see Figure 20) U.S. direct investments in China have helped China to accelerate its industrial restructuring and upgrading process, and

⁴⁶ Sourced from MOFCOM statistics from the annual joint inspection on FIEs in China.

Figure 20: Contribution of the Majority-owned China Affiliates of U.S. Companies to China's GDP and Employment, 1994-2008

| | Added value in GDP US\$ millions | R&D expenditure US\$ millions | Number of newly employed Thousand persons |
|------|-------------------------------------|----------------------------------|--|
| 1994 | 678 | 7 | 62.4 |
| 1995 | 1,092 | 13 | 80.9 |
| 1996 | 2,073 | 25 | 101.4 |
| 1997 | 3,194 | 35 | 138.4 |
| 1998 | 3,004 | 52 | 175.5 |
| 1999 | 3,945 | 319 | 252.4 |
| 2000 | 5,495 | 506 | 252.0 |
| 2001 | 5,995 | (D) | 273.0 |
| 2002 | 7,631 | 645 | 316.7 |
| 2003 | 8,747 | 565 | 338.9 |
| 2004 | 12,529 | 575 | 459.9 |
| 2005 | 16,221 | 668 | 521.8 |
| 2006 | 18,489 | 759 | 591.5 |
| 2007 | 21,438 | 1,173 | 676.2 |
| 2008 | 27,296 | 1,517 | 774.2 |

Source: U.S. Bureau of Economic Analysis; U.S. Direct Investment Abroad, 1994-2008

have contributed to China's technological advancement. They have also helped Chinese enterprises to enhance management skills, learn from the international markets and broaden the global scope⁴⁷.

Prospects for Cooperation in the Next Decade: Further Trade Growth Opportunities and a Gradual Fall in the Trade Imbalance

Given the momentum built up in China's modernization process, China's economy is expected to continue growing at a rapid rate in the next decade and beyond, with urbanization, industrial upgrading, and consumer demand growth continuing to be major growth drivers. Meanwhile, while the U.S. economy is going through a difficult process of adjustment to the after effects of the financial crisis of 2007-2008 and the need to manage public sector

deficits, prospects for the U.S. economy continue to be promising, given the strong innovative and technological capabilities of the American economy. Looking forward into the next decade, the further growth of the U.S. and Chinese economies will create a lot of opportunities for the two countries to develop further their economic cooperation, to deepen engagement, and to benefit from this mutually interdependent relationship.

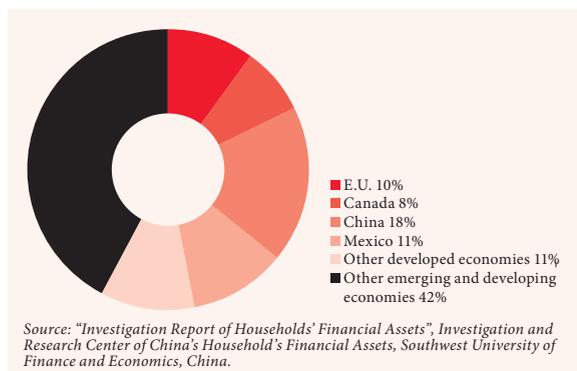
Promotion of imports and domestic consumption under China's 12th Five-Year Plan, and the U.S. National Export Initiative to double exports by the end of 2014 will both help promote bilateral trade and improve the trade imbalance. Both countries should seek common ground for trade cooperation to achieve a more balanced trade in the next decade.

Promotion of China's imports and domestic consumption

China's 12th Five-Year Plan states that domestic consumption will be a key driver of growth in the

⁴⁷ See Chapter 13 for more details.

Figure 21: Projected Share of U.S. Nominal Export Growth, 2009-2014



future. This will be achieved by promoting urbanization, steadily reforming the income distribution system, improving the social security system and creating a favorable consumption environment. By 2015, China plans to increase the total retail sales of consumer goods to RMB32tr with an annual average growth of 15%.

China will also gradually change the focus of its trade policy from export orientation of the past 10 years to consolidating exports and promoting imports to achieve a more balanced trade. China aims to increase the size of its imports, with aggregate imports reaching US\$10tr or more in five years. China also plans to double its merchandise imports from the U.S. by 2015, increasing the value to US\$200bn, up from US\$122.1bn in 2011. Boosting imports will entail developing a more open market for a range of consumer goods. Based on current trends, China will overtake the U.S. to be the world's largest importer by 2020.

Doubling U.S. exports and re-industrialization

In January 2010, President Obama set out the National Export Initiative, a plan to double U.S. exports to US\$3tr by 2014, which implies an average annual growth rate of 15%. Besides setting up an 'export promotion cabinet' to involve all important economic sectors in the campaign, the U.S. government devised an action plan to achieve the goal.

According to the "2011 Economic Report of the President", from 2010 to 2014, Canada, the E.U. and other key U.S. trading partners would play significant roles in the initiative. While about 10% of export growth would come from the E.U. and 8% from Canada, more than 70% would be generated by trade with China, Mexico, Brazil and other emerging and developing countries and regions. China's share of export growth would reach 18%, far higher than that of any other economy (see Figure 21).

Implementation of the National Export Initiative and the 're-industrialization plan' to revitalize U.S. manufacturing, together with other moves such as the gradual relaxation of high-tech export controls, will not only help reduce the U.S. trade deficit but will also create jobs for Americans.

Return of manufacturing to the U.S.

A report by the Boston Consulting Group (BCG) published in 2012 finds that the U.S. could gain two to three million jobs and an estimated US\$100bn in output as seven industry clusters, i.e. transportation goods, electrical equipment/appliances, furniture, plastics and rubber products, machinery, fabricated metal products and computers/electronics shift production back from China to the U.S. in the next five years. The seven sectors account for about US\$2tr in U.S. consumption per year and about 70% of U.S. imports from China, valued at nearly US\$200bn in 2009. The job gains would come directly through added factory work and indirectly through supporting services, such as construction, transportation and retail⁴⁸.

This BCG report also predicts that, within five years, the total cost of production for many products will be only about 10% to 15% less in Chinese coastal cities than in some parts of the U.S. where factories are likely to be built. Factor in shipping, inventory costs and other considerations, and the

⁴⁸ "US Manufacturing Nears the Tipping Point: Which Industries, Why, and How Much?", Harold L. Sirkin, Michael Zinser, Douglas Hohner, Justin Rose, The Boston Consulting Group, 2012.

Figure 22: Export Control Reform Initiative

| Phase | Control list | Licensing | Enforcement | IT |
|---|---|--|--|--|
| I | Refine, understand, harmonize definitions to end jurisdictional confusion between two lists; establish new control criteria. | Implement regulatory-based improvements to streamline licensing. | Synchronize and de-conflict enforcement; create Enforcement Fusion Center. | Determine enterprise-wise needs. |
| II (Requires congressional notification; requires additional funding.) | Restructure two lists into identical tiered structures; apply criteria; remove unilateral control while appropriate; submit proposal multilaterally to add/remove controls. | Complete transition to mirrored control list; fully implement licensing harmonization. | Expand outreach and compliance. | Transition toward a single electronic licensing system. |
| III (Requires legislation) | Merge two lists into a single list; implement process for updating list. | Implement single licensing agency. | Consolidate enforcement activities under one agency. | Implement a single system for licensing and enforcement. |

Source: Ian F. Fergusson, Paul K.Kerr, “The US Export Control System and the President’s Reform Initiative”, Washington D.C.: Congressional Research Service, 2012.

cost gap between sourcing from China and manufacturing in the U.S. will be minimal. Certain U.S. states, such as South Carolina, Alabama and Tennessee, will turn out to be among the least expensive production sites in the industrialized world. As a result, the BCG report expects companies to begin building more capacity in the U.S. The early evidence of such a shift is mounting⁴⁹:

- The Coleman Company is moving production of its 16 quart wheeled plastic cooler from China to Wichita, Kansas, owing to rising Chinese manufacturing and shipping costs.
- Ford Motor Company is bringing up to 2,000 jobs back to the U.S. in the wake of a favorable agreement with the United Auto Workers that allows the company to hire new workers at US\$14 per hour.
- Sleek Audio has moved production of its high-end headphones from Chinese suppliers to its plant in Manatee County, Florida.

U.S. export control reform

After President Obama called for a broad review of the U.S. export control system in August 2009, the U.S. launched the Export Control Reform (ECR) Initiative

(see Figure 22), which is to change fundamentally the export control system in three phases. The goal is to achieve four ‘singularities’ – a single licensing agency, a single control list, a single enforcement structure and a single information technology system. The changes should reduce significantly restrictions on technology transfers, limiting them only to technologies that have a clear impact on national security and are not readily available elsewhere.

In the fourth round of the U.S.-China SED in May 2012, the U.S. agreed to “facilitate the export of civilian high-tech exports for civilian end-users and civilian end-uses” and to “process, in a timely manner, specific requests for items for civilian end-users and civilian end-uses that China wishes to procure that may be subject to export controls, once the United States receives all necessary information required under the Export Administration Regulations⁵⁰ (see Figure 23).

China’s tariff cuts

According to the “2011 Report to Congress on China’s WTO Compliance” published by the U.S. Trade Representative, China has implemented its tariff commitments for industrial goods on time each year. During its bilateral negotiations with in-

49 “Made in America, Again- Why Manufacturing Will Return to the US”, Harold L. Sirkin, Michael Zinser, Douglas Hohner, The Boston Consulting Group, 2011.

50 U.S. Department of the Treasury, Fourth Meeting of the U.S.-China Strategic and Economic Dialogue, Joint U.S.-China Economic Track Fact Sheet, <http://www.treasury.gov/press-center/press-releases/Pages/tg1567.aspx> (5 April 2012).

Figure 23: Results of the Fourth Meeting of the U.S.-China Strategic and Economic Dialogue

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|---|---|
| Enhancing macroeconomic cooperation | <p>Foster a durable global recovery, and establish a strong, sustainable and balanced future global growth.</p> <p>The U.S. plans to move toward a pattern of growth that features increased levels of investment, exports, and gross saving rate. China plans to transform its economic development pattern, improving the livelihood of its people and expanding domestic demand primarily by increasing consumption. Import tariffs will be reduced.</p> <p>Both plan to move towards more market-determined exchange rate systems and enhance exchange rate flexibility</p> |
| Promoting open trade and investment | <p>Foster open, fair and transparent investment environments to their domestic economies and to the global economy. Building a more open global trade system and jointly resisting trade protectionism.</p> <p>Strengthen law enforcement against IPR infringement.</p> |
| International rules and global economic governance | <p>To establish an international working group of major providers of export financing to create a set of guidelines on the official export financing that are consistent with international best practices.</p> <p>Strengthen information exchange of regional free trade agreements.</p> <p>Deepen the study of bilateral trade methodology.</p> |

Source: U.S. Department of the Treasury, Fourth Meeting of the U.S.-China Strategic and Economic Dialogue, Joint U.S.-China Economic Track Fact Sheet, 5 April 2012.

terested WTO members leading up to its accession, China agreed to increase market access for U.S. and other foreign companies by reducing tariff rates on industrial goods from 2002 through 2010. On the first day of each year, China implemented its scheduled tariff reductions as required. Indeed, since its WTO accession, China has reduced tariffs on goods of the greatest importance to U.S. industry from a base average of 25% to approximately 7%, significantly increasing market access for U.S. exporters in a range of industries⁵¹.

China has implemented several rounds of tariff cuts in 2012. In January, it reduced the interim import tariff rates on some 730 products, including energy and raw materials, high-tech manufacturing equipment, inputs for agricultural production, food and public health products. In April, China further reduced tariffs on such products as slitting blades for paper cutting machines (from 8% to 3%) and objective lenses (from 15% to 10%). In the Fourth Meeting of the U.S.-China SED, China committed to another round of import tariff cuts on a series of consumer goods before the end of 2012.

Recommendations for promoting bilateral trade

The U.S. and China recognize that achieving a more balanced trade relationship can advance economic

growth in both countries, positively impact global economic stability and promote international security. Listed below are the recommendations to promote bilateral trade in the next decade:

- 1 With the participation of chambers of commerce in the U.S. and China, both countries should establish information-sharing and early-warning mechanisms in areas of anti-dumping, countervailing and other trade issues to prevent decision-making errors.
- 2 The U.S. and Chinese governments should agree to an expedited process for the adjudication of their disputes at the WTO. A speedy resolution of these disputes can prevent a problem from festering and spreading over to other unrelated areas and also reduce the risks of either country engaging in purely ‘tit-for-tat’ type retaliatory behavior.
- 3 The increasing complementarity between FDI and trade has resulted from the growing fragmentation of production and the globalization of distribution networks. Both sides should establish a bilateral investment committee to promote investments in manufacturing and service sectors, and regularly exchange views on U.S.-China investment laws and policies.
- 4 The expansion of high-tech exports to China is a key initiative to ease part of the U.S.-China trade imbalance. Both sides should promote bilateral trade in high-tech products, and the U.S. should consider streamlining further its export control processes.

51 “2011 Report to Congress on China’s WTO Compliance”, USTR, December 2011, p. 28.

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- 5 Both sides should organize trade fairs particularly for SMEs to promote U.S. exports to China and foster the establishment of state-to-province and city-to-city partnerships. The China Import and Export Fair – the Canton Trade Fair, the world’s largest manufacturing goods fair – plays an important role in promoting exports from China. There is room for a similar trade fair to take place in the U.S. – in a city such as San Francisco – with the aim of helping SMEs to sell products to China.
 - 6 Both sides should jointly prevent the politicization of trade issues. Disputes should be addressed in a timely manner through communication to avoid escalation, thus leading to unnecessary and harmful consequences. Think tank scholars should establish a specialized research group to carry out collaborative studies and other projects so that both sides have a holistic picture of trade issues of common concern.
 - 7 Nearly 150 countries have recognized China’s market economy status (MES). But major developed economies such as the U.S., E.U. and Japan have not done so due to political, diplomatic and even ideological reasons. China should also play its part in expediting its market-oriented reforms to gain MES recognition from these economies⁵².
 - 8 The Doha Round of multilateral trade negotiations under the WTO has been going on since 2001, but there is still no sign that a conclusion is near. The impasse is due to the fundamental differences in the positions of key members including the U.S., E.U., China, Brazil and other major trading economies. The U.S. and China should work together to achieve a breakthrough so that a conclusion to the Doha Round could be achieved. This would promote multilateralism in

global trade negotiations and reinforce the free trade momentum globally.

In the absence of progress on the multilateral Doha Round of trade negotiations, countries have turned to smaller and more focused deals. For example, the bilateral free-trade agreement (FTA) between the U.S. and South Korea took effect in March 2012. The U.S. is in negotiations of a regional, Asia-Pacific trade agreement, known as the Trans-Pacific Partnership (TPP) Agreement with the objective of shaping a broad-based regional pact⁵³. Japan, China and South Korea also plan to open negotiations for a trilateral FTA by 2012.

The U.S. and China could study the feasibility of establishing an FTA. The China Center for International Economic Exchanges estimated that if China and the U.S. had already established an FTA and hence reduced their tariffs by 10%, China’s economy would have increased by 3.93% in 2011 while the U.S. economy would have risen by 0.45%⁵⁴. U.S.-China FTA will further facilitate and liberalize trade and investment between the two countries and more importantly, send a strong message of confidence to the world market.

Conclusion

While some economic indicators show that the global economy is stabilizing, the debt problem in the euro zone alluded to the risks still remaining in the global financial system. The austerity policies of many governments have resulted in high unemployment in many developed economies. The ‘quantitative easing’ policies of more and more central banks around the world have raised concerns about the uncertainties these policies may have on exchange rates with some countries expressing concerns about their export competitiveness. The

52 According to WTO rules, China will acquire MES 15 years after entering the organization. China joined the WTO in 2001, which means it should receive this recognition by 2016 at the latest. Due to China’s failure to achieve MES, Chinese products are calculated based on the market prices of a substitute country – often with much higher production costs than China – as the benchmark instead of its real costs, making Chinese companies vulnerable to anti-dumping and anti-subsidy investigations.

53 “Bilateral trade deals are moving ahead”, EIU Global Forecasting Service, *The Economist*, 2012.

54 “FTA process will take time”, Wei Jianguo, China Center for International Economic Exchanges, 2012.



impact of such unconventional monetary policies has also aroused concerns from many emerging economies about the impact of global capital flows on asset bubbles and inflation. Trade protectionism, capital flow control restrictions and other administrative measures to deal with the uncertainties of such a new economic and policy environment remain global threats. In addition, the implementation of Basel III could have an adverse impact on both the pricing and supply of trade finance. The road to full global economic recovery is replete with challenges.

Thanks to the collaboration of the American and Chinese governments, business communities, and other stakeholders in both countries, the bilateral trade relationship has made positive strides over the past three decades. On a bumpy road to recovery, more work needs to be done to develop fully commercial ties and tackle unresolved issues in order to bring greater mutual benefit to companies, employees and consumers.

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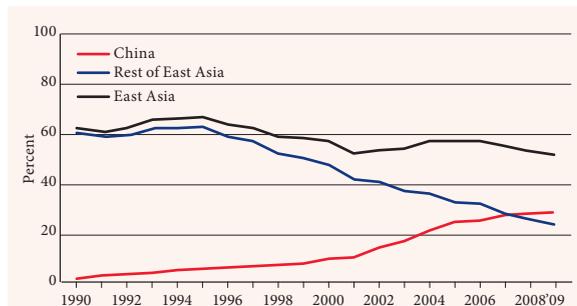
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Appendix

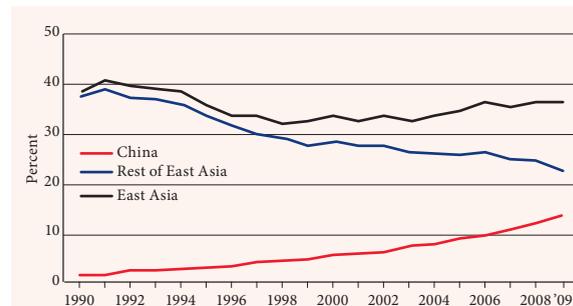
Figure 1A: Contribution of East Asian Economies to U.S. Imports of High-Technology Manufactured Products, 1990-2009



Notes:
East Asia refers to China, Japan, South Korea, Singapore, Taiwan, Hong Kong, Malaysia, Thailand, Philippines and Indonesia. Rest of East Asia is defined as East Asia less China.
According to the International Standard Industrial Classification (ISIC) of All Economic Activities, Revision 3, high-technology manufactured products comprise pharmaceuticals, office, accounting and computing machinery, radio, television and communication equipment, medical, precision and optical instruments, and aircraft and spacecraft.

Source: OECD STAN

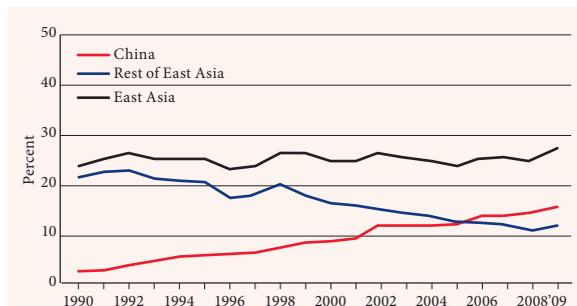
Figure 2A: Contribution of East Asian Economies to U.S. Imports of Medium-High Technology Manufactured Products, 1990-2008



Notes:
East Asia refers to China, Japan, South Korea, Singapore, Taiwan, Hong Kong, Malaysia, Thailand, Philippines and Indonesia. Rest of East Asia is defined as East Asia less China.
According to the International Standard Industrial Classification (ISIC) of All Economic Activities, Revision 3, medium-high technology manufactured products comprise chemicals and chemical products less pharmaceuticals, machinery and equipment, electrical machinery and apparatus, motor vehicles, trailers and semi-trailers, railroad equipment and transport equipment N.E.C.

Source: OECD STAN

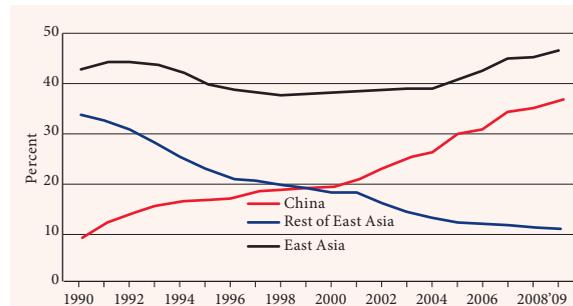
Figure 3A: Contribution of East Asian Economies to U.S. Imports of Medium-Low Technology Manufactured Products



Notes:
East Asia refers to China, Japan, South Korea, Singapore, Taiwan, Hong Kong, Malaysia, Thailand, Philippines and Indonesia. Rest of East Asia is defined as East Asia less China.
According to the International Standard Industrial Classification (ISIC) of All Economic Activities, Revision 3, medium-low technology manufactured products comprise coke, refined petroleum products and nuclear fuel, rubber and plastics products, other non-metallic mineral products, basic metals and fabricated metal products, building and repairing of ships and boats.

Source: OECD STAN

Figure 4A: Contribution of East Asian Economies to U.S. Imports of Low-Technology Manufactured Products



Notes:
East Asia refers to China, Japan, South Korea, Singapore, Taiwan, Hong Kong, Malaysia, Thailand, Philippines and Indonesia. Rest of East Asia is defined as East Asia less China.
According to the International Standard Industrial Classification (ISIC) of All Economic Activities, Revision 3, low technology manufactured products comprise food products, beverages and tobacco, textiles, textile products, leather and footwear, wood and products of wood and cork, pulp, paper, paper products, printing and publishing, manufacturing N.E.C. and recycling.

Source: OECD STAN

Figure 5A: Contribution of East Asian Economies to U.S. Imports of ICT Products

