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Key Points of Contention in US-China Economic Relations

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The “superpowers” of the United States and China are at odds over a number of grave national security issues, including those of cybersecurity and the South China Sea and there is serious economic friction between these two major world economies.

At the root of the US-China economic friction is the issue of the bilateral trade imbalance. According to the customs statistics of each country, in 2014 the United States had a trade deficit of 342.6 billion US dollars with China, whereas China had a surplus of 237.0 billion dollars with the United States. Although a large US import surplus and a large Chinese export surplus are the norm, these figures indicate a significant difference of more than 100 billion dollars. The discrepancy between the customs statistics of both countries, which provide the standards by which to define their economic relations, is further compounding the bilateral trade friction.

In light of the significance of the statistical discrepancy, the US-China Joint Commission on Commerce and Trade has conducted two joint studies to date, first in 2009 and again in 2012; the participants in the studies came from the Department of Commerce and the Office of the US Trade Representative on the US side and the Ministry of Commerce and the General Administration of Customs on the Chinese side. As far as can be discerned from the US and Chinese customs statistics published since then, however, the discrepancies are not decreasing, either technically or in terms of real economic conditions.

Underlying the discrepancies are a host of technical issues, including differences between US and Chinese statistics in the commercial terms applied for valuation (such as free on board,

free alongside ship, and cost, insurance, and freight), statistical territory (whether or not to include Puerto Rico and the US Virgin Islands), timing of recording, country of origin, and exchange rates. In addition to these, there is the problem of the existence of intermediary trade via Hong Kong, a characteristic unique to Chinese foreign trade. In the past, even when goods of Chinese origin passing through Hong Kong were ultimately bound for the United States, Chinese statistics treated them as exports destined for Hong Kong; exports of this nature were later reclassified on the basis of final destination. However, the treatment of intermediary trade via Hong Kong has only grown more complex as more Chinese products are shipped to their final destination without passing through customs during their stop in Hong Kong, which is increasingly used solely for its port facilities and clearing functions.

Major changes are also taking place in US business with China. In 2012, local sales by Chinese subsidiaries of US companies totaled more than three times the value of US exports to China. Meanwhile, the proportion of intra-firm trade is increasing year by year, with nearly 30 percent of US imports from China coming from China-based subsidiaries and affiliated companies. As these trends indicate, borderless business development is growing more and more common in US-China economic relations, and the asymmetry in the US-Chinese trade balance is becoming structural in nature.

In fact, when trade in value-added (TiVA) between the United States and China is viewed from the perspective of the global value chain, we see a trade structure that differs from the picture of bilateral trade painted by customs statistics. Today, against the backdrop of revolutionary changes in the telecommunications and distribution sectors, industrial goods are often manufactured under a dispersed production system in which different stages of production are distributed across borders. Known as fragmentation, this international division of labor is especially prevalent in the production of IT and electronic devices, the majority of which are manufactured in China. China, as the “factory of the world,” is also responsible for the final stage of their production. Whereas conventional customs statistics are only concerned with the transaction values of final goods, the TiVA approach focuses on the value added per stage (country or region) of production.

A well-known case study using this approach is that of the iPhone. Apple's iPhones are shipped to the US market from factories in China, where the final goods are produced. In customs statistics, this appears as a US trade deficit with China. The TiVA method, by contrast, takes note of the fact that many of the parts and components of the iPhone are supplied to Chinese assembly plants from manufacturers in Japan, South Korea, the United States, and European countries. China, where the final product is assembled, merely contributes labor to the production of the iPhone, so that the added value generated in China accounts for no more than a few percent of the shipment value. In terms of trade in value-added, then, China cannot be seen to have a large trade surplus with the United States arising from its iPhone exports to the latter, leading us to conclude that the US-China trade imbalance based on customs statistics is in fact a poor reflection of real economic conditions.

As the case of the iPhone makes clear, the customs statistics that provide the yardstick for gauging the US-China trade imbalance are not necessarily an accurate measure of economic conditions. Nonetheless, it is also true that international division of labor of this sort between the United States and China significantly affects employment and income within the United States. For this reason, the United States has been taking measures to curb imports from China by, for instance, stepping up antidumping investigations on Chinese imports (of course, the current account balance of an economy reflects the difference between that economy's savings and investment, and border measures like the above are of temporary and symbolic significance at best). Another conspicuous trend in recent years is the high number of countervailing duties specifically targeting Chinese governmental subsidies on Chinese products.

This brings to light a new controversy in the US-China economic friction. From the surge in investments in the United States by Chinese state-owned enterprises, to the acquisition of US firms by Chinese firms, and down to exchange rate control and trading in US government bonds, questions are increasingly being raised in the United States about the ties between the Chinese government and Chinese companies and about Chinese government intervention and

involvement in the economic field. Are Chinese companies pursuing commercial interests, or are they exhibiting corporate behavior in line with government objectives? It is impossible, moreover, for US enterprises to compete on an equal footing with government-backed Chinese counterparts. New yet familiar criticisms like these are beginning to gather momentum in the US government, Congress, and business community. In short, China's state capitalism—which has certain repercussions on US national security—is reemerging as a key point of contention in US-China economic relations.

Since China's admission to the World Trade Organization, specific disputes regarding the US-China economic friction have been quietly resolved by WTO panels. When economic issues such as the above become linked with issues of national security, though, tensions in US-China relations tend to increase. The mechanism of "separation of politics and economics" needs to be restructured in US-China relations as well.