Understanding the US-China Trade Relationship

Prepared for the
US-China Business Council
by Oxford Economics

January 2017

THE US-CHINA BUSINESS COUNCIL
美中贸易全国委员会

Foreword

The US-China Business Council (USCBC) is pleased to have commissioned this study by Oxford Economics on the overall impact of China on the US economy.

During this year's election campaign, the negative impact of trade with China, such as estimates of jobs lost, received considerable attention. In most cases, the presented data fails to provide a balanced assessment that incorporates the positive effect of the commercial relationship with China. Presenting only the negative impact and ignoring the jobs created, lower inflation, and other benefits of trade with China can lead to policies based on incomplete or misleading information.

At the same time, the benefits projected in this study will only be fully realized if China moves forward with economic reforms that address the very real market access and level playing field barriers faced by American companies, farmers, and workers. The stagnation of reforms is creating policy uncertainty and undermining confidence at a time of political transitions in both countries.

We must address unfair trade practices by China (or any other trading partner) when they occur. We also need to be clear about other factors that affect jobs in the United States, such as technological changes and productivity, and put in place effective domestic programs that will maintain our international competitiveness and support workers and communities affected by trade.

Oxford Economics' study, through its analysis of the economic relationship with China, provides a sound basis for such a policy discussion.

John Frisbie
President
The US-China Business Council

The US-China Business Council (USCBC) is a private, nonpartisan, nonprofit organization of roughly 200 American companies that do business with China. For more than four decades, USCBC has provided unmatched information, advisory, advocacy, and program services to its membership. Through its offices in Washington, DC; Beijing; and Shanghai, USCBC is uniquely positioned to serve its members' interests in the United States and China.

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Executive summary

As the recent presidential campaign focused renewed attention on the condition of the US economy, many Americans have been told that international trade—and more specifically, China's trade relationship with the United States—is bad for workers and hurts US growth.

The US-China trade relationship is far more nuanced than the headlines suggest, however, and the trade deficit doesn't tell the whole story.

Across a range of indicators, China has contributed more economic benefits to the United States than recent headlines suggest.

Today, **the US-China trade relationship actually supports roughly 2.6 million jobs in the United States** across a range of industries, including jobs that Chinese companies have created in America. And as the Chinese middle class continues its rapid expansion over the next decade (the number of Chinese middle-class consumers will exceed the entire population of the United States by 2026), US companies face significant opportunities to tap into a new and lucrative customer base that can further boost employment and economic growth. Economic data show that nations trading closely with China outperform nations with less integrated trade ties, and we expect this trend to continue.

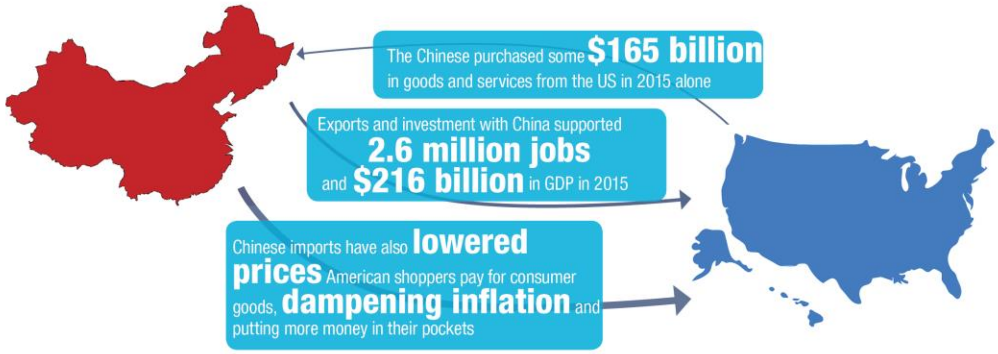
Examples of the benefits to the US economy from trade with China include:

- China purchased $165 billion in goods and services from the United States in 2015,[1] representing 7.3 percent of all US exports and about 1 percent of total US economic output.
- Although some US manufacturing jobs have been lost because of the trade deficit, US firms sell high-value products to China, including cars and trucks, construction equipment, and semiconductors, which support jobs. US firms also export business and financial services, totaling $6.7 billion in 2014 and $7.1 billion in 2015. **By 2030, we expect US exports to China to rise to more than $520 billion.**
- As China has become an integral part of the global manufacturing supply chain, much of its exports are comprised of foreign-produced components delivered for final assembly in China. **If the value of these imported components is subtracted from China's exports, the US trade deficit with China is reduced by half, to about 1 percent of GDP—about the same as the US trade deficit with the European Union.**
- America's 11th-largest export market in 2000, China has grown to become the third-largest destination for American goods and services. **US exports to China directly and indirectly supported 1.8 million new jobs and $165 billion in GDP in 2015.** When the economic benefits generated from US investment in China and Chinese investment in the US are combined, the total amounts to 2.6 million US jobs and about $216 billion of GDP.
- China is expected to continue to be one of the fastest growing major economies, creating growth opportunities for American companies— **provided China proceeds**

[1] US Census Bureau/Bureau of Economic Analysis US international trade in goods and services release, FT–900

with economic reforms that will remove lingering market access barriers in many sectors.

- China is a leading purchaser of US agricultural products. In 2015, China purchased an estimated $15 billion in agricultural goods; Illinois and Texas each accounted for $1 billion of this total.



- Chinese manufacturing also lowered prices in the United States for consumer goods, dampening inflation and putting more money in American wallets. At an aggregate level, US consumer prices are 1 percent - 1.5 percent lower because of cheaper Chinese imports. **The typical US household earned about $56,500 in 2015; trade with China therefore saved these families up to $850 that year.**
- Since 2003, productivity growth in US manufacturing outpaced most advanced economies. Oxford Economics calculates that US manufacturing productivity increased by 40 percent from 2003 to 2016, or 2.5 percent annually, compared with 23 percent in Germany.[2] Meanwhile, rapidly rising factory wages and a rising currency make Chinese workers relatively less cost-competitive than their American counterparts. **US factories are still 90 percent more productive than Chinese manufacturers.** These trends may lead to some "reshoring" or retention of manufacturing jobs in the United States.

[2] Oxford Economics, "United States: Still 'Numero uno' in a competitive market." Research brief, March 14, 2016.

Introduction

The pace and scope of China's growth over the past three decades is unprecedented. In less than one generation, a population larger than that of the United States rose from poverty, creating a middle class of more than 300 million people who devour Hollywood movies, enthusiastically shop online, and lead the world in the use of mobile web and e-commerce applications. China is now crisscrossed by bullet trains connecting massive industrial complexes that produce cars, TVs, chemicals, and electronics sold to consumers in the world's second-largest economy and buyers around the world.

Americans don't always see China's growth as positive, particularly those in the manufacturing sector. It is easy to tally the dislocation that foreign competitors, including many from China, have caused among US manufacturers. And indeed, the US trade deficit with China is still significant at $334 billion, or 1.9 percent of GDP.

But this obscures the fact that US exporters have been increasing what they sell to China, proving it to be a strong market for a wide range of sectors such as agriculture, chemicals, and transport equipment. China has become the third-largest purchaser of US-made products and services (after Mexico and Canada, our closest neighbors with which the US has a free trade agreement), buying $165 billion in goods and services in 2015 alone. These sales will increase as China's economy matures and Chinese wages continue to rise. By 2026, we expect the United States to be exporting $369 billion in goods and services to China and by 2030 this figure will reach $525 billion, or 10 percent of total US exports, reflecting the enormous size of China's market and the faster pace in the projected growth in its cohort of middle class consumers.

> China has become the third-largest purchaser of US-made products and services, spending $165 billion in 2015 alone. In just 10 years, that figure is expected to increase to $370 billion.

US multinational companies and entrepreneurs have been major contributors to the development of China's economy. Jeep and General Motors were among the first to set up automobile manufacturing centers in China, for example, gaining an early foothold in what is now the world's largest automobile market.

In the wake of these first movers, the global supply chain, with its hub in Asia, developed rapidly in the 2000s. Companies such as Apple used US know-how to develop products to be assembled in China using components manufactured around the world and then sold in markets around the globe, including the United States. Doing so improved the competitiveness and profitability of US businesses, which are today among the world's largest in dynamic sectors, such as automotive and technology. US businesses' income from direct investments around the world has tripled since 2000 to 2.4 percent of GDP, with income from China making an important contribution. Naturally, as large businesses earn more overseas income, they can spend more with smaller suppliers and subcontractors here at home.

As the Chinese economy transitions into the modern age, there is ample reason to believe US exports can grow even more rapidly, and US firms can harvest significant revenues from their investments.

How China supports US—and global—growth

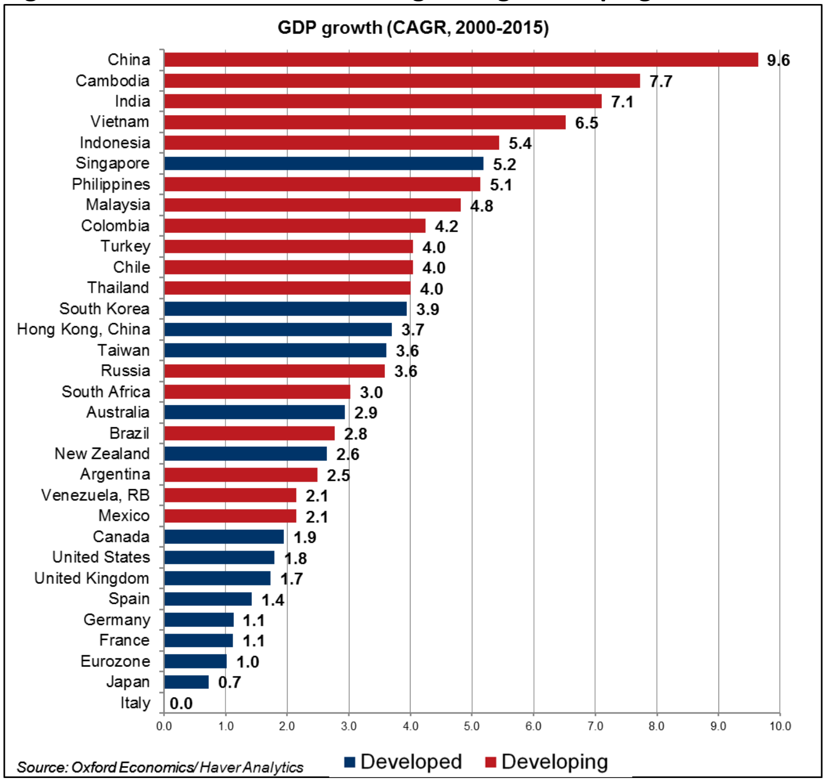
Once dominated by state-owned enterprises and collective farms, China has transformed into a vibrant economy where millions of entrepreneurs and independent companies operate. Moreover, a nation once unsympathetic to capitalism received billions in foreign direct investment from companies looking to sell to Chinese consumers and is now looking to invest in markets around the globe, including the United States.

This transition hastened China's rise—and benefited its closest trading partners. Indeed, the United States has seen demonstrable returns since China entered the World Trade Organization (WTO) in 2001.

Both China and the US have outperformed their peers since 2001

China's economic performance is perhaps without precedent for an emerging economy. Since 2000, its GDP growth averaged almost 10 percent annually, even when accounting for the recent slowdown, which reflects the rapid maturation of its economy. While the US economy has added 15.4 percent to world GDP growth over the past 15 years, China has added 26.6 percent to world economic output. China has contributed more to global expansion over the past 15 years than the Eurozone and the United States combined. This rapid growth transformed China into the world's second-largest economy, even if overall living standards hardly compare with those of the most industrialized economies. China's increase in size after 2000 is equivalent to adding another Germany and France to the world economy.

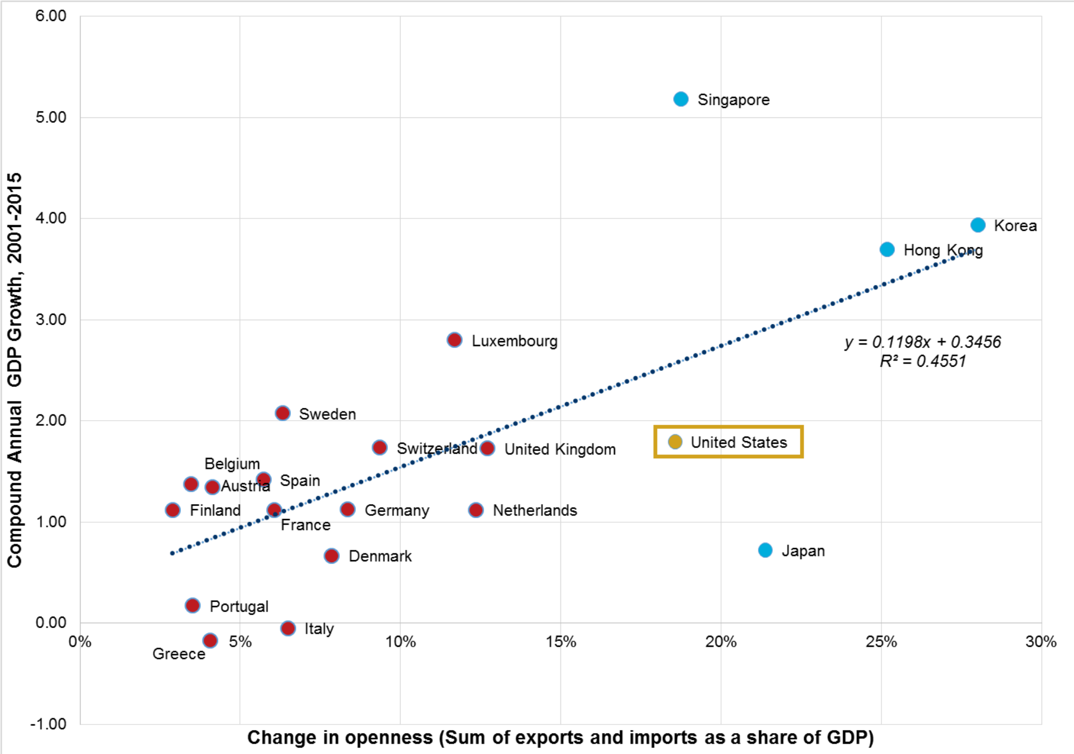
Fig. 1: China has been the fastest-growing developing market since 2000



Source: Oxford Economics/Haver Analytics

China's growth has benefitted other economies. Many factors determine a country's economic performance, ranging from population and education to investment and R&D, but Fig. 2 shows that countries with the biggest increase in openness (the sum of exports and imports as a share of GDP) with China—particularly neighboring Hong Kong and South Korea—had the highest growth since 2001.

Fig. 2: Countries with closer economic links with China grow faster

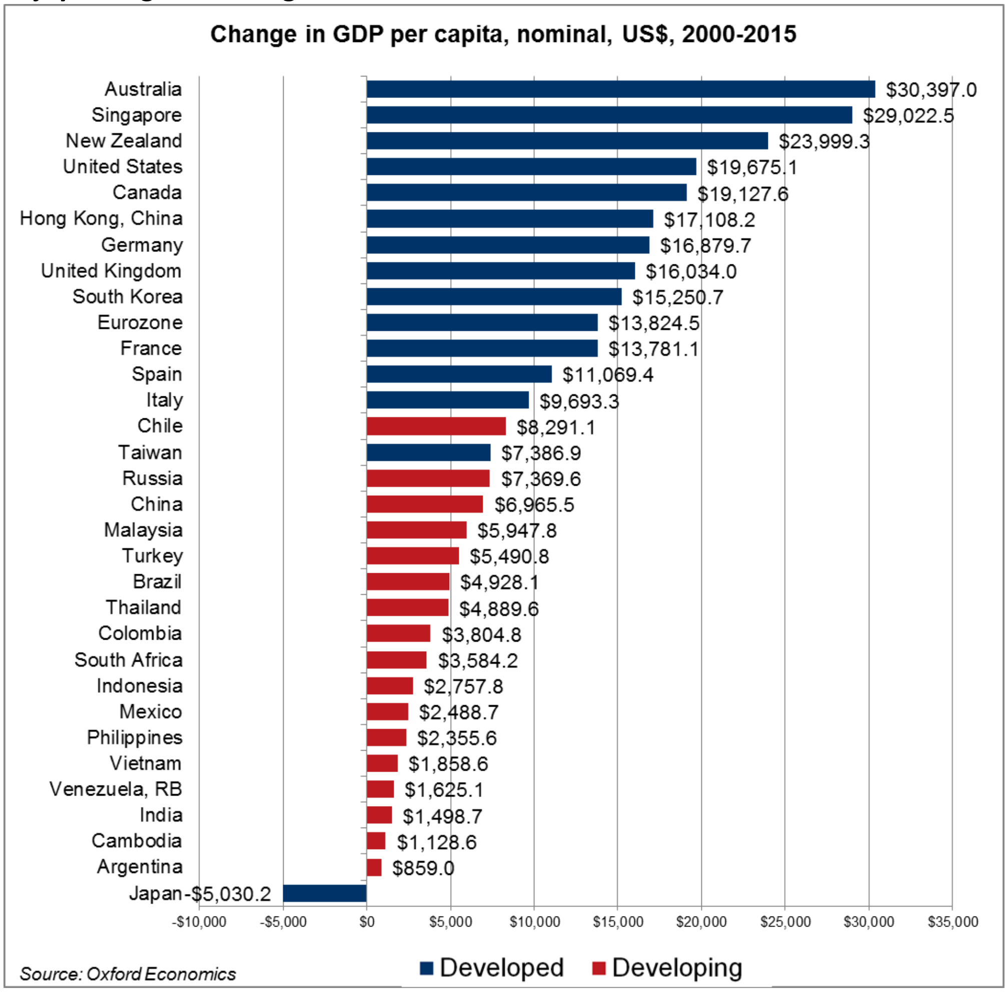


Source: Oxford Economics/Haver Analytics

Despite the Great Recession of 2008, the United States has experienced stronger growth than most other developed economies outside of Asia. Since 2000, US compound annual growth rate (CAGR) in GDP has been 1.8 percent, ahead of most large industrialized nations. In fact, among developed countries, it is only those economies that are closer in proximity to China (Singapore, Korea, Hong Kong, and Taiwan) or are major exporters of mineral products, coal, and agricultural commodities like dairy products (Australia, New Zealand, and Canada) have benefited more from China's rapid growth.

If we look at the absolute increase in GDP per capita since 2000 to see how incomes of households on average have improved (Fig. 3), only Australia, New Zealand, and Singapore have outperformed the United States. All three economies benefitted from relatively strong performance through the financial crisis and its aftermath, and Australia and New Zealand enjoy significant natural resource endowments.

Fig. 3: Among developed nations, only Australia, Singapore, and New Zealand have enjoyed larger income gains than the United States



Closer integration with China demonstrates economic benefits

US businesses benefit in four key areas from the trade relationship with China:

- **Exports to China support jobs at home**. US goods and services to China were worth $165 billion in 2015, accounting for 7.3 percent of all US exports and about 1 percent of total US GDP. Agricultural commodities such as soybeans and pork products represent major exports, but US firms also sell a significant amount of manufactured goods, including transport equipment (passenger cars, planes), construction equipment, and high value-added electronics, such as semiconductors. The United States also exports a range of business and financial services, representing $6.7 billion in 2014 and $7.1 billion in 2015. Tourism plays another important role: Oxford Economics estimates there were 2.6 million passenger arrivals from China in the United States in 2015, up from 230,000 in 2000. These visitors support hotels, restaurants, and the retail sector. Total exports to China directly supported 1.5 million jobs and $128 billion in GDP in 2015 according to estimates by Oxford Economics.

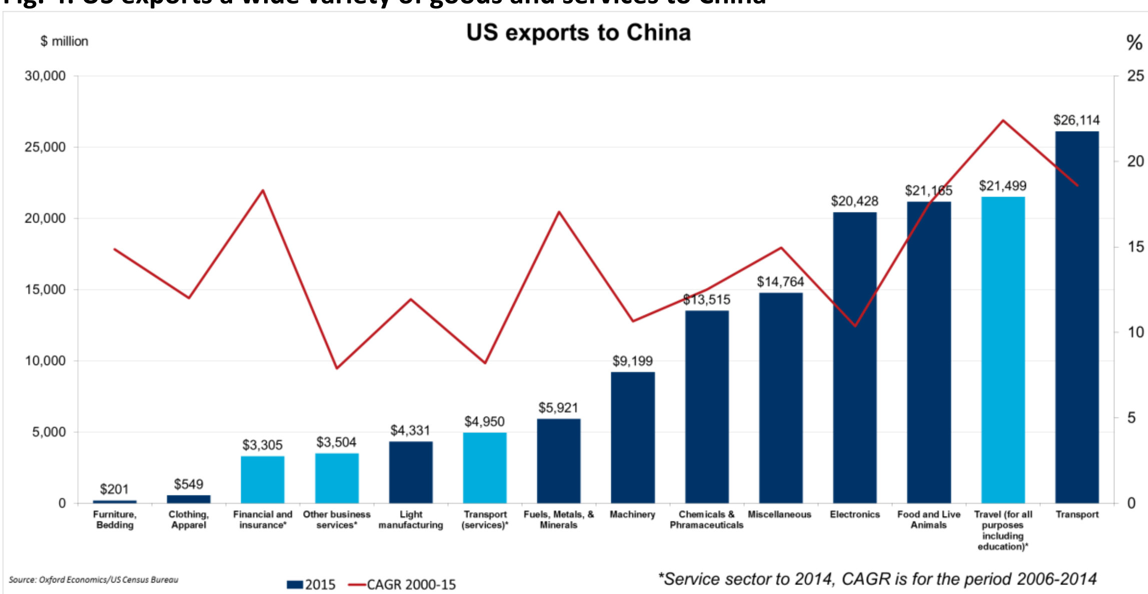
  It is also important to note that China is deeply connected in the global supply chain, so a significant number of products indirectly find their way to China,

According to Oxford Economics, total exports to China directly supported 1.5 million jobs and $128 billion in GDP in 2015.

either as part of the Asia supply chain or to feed Chinese demand. Not only are exports from the United States to Hong Kong and Singapore re-exported to China, but US products are embedded in the exports of other countries. According to OECD data, 3 percent to 4 percent of the value of exports from other Asian countries—a significant number of which are destined for China—can be attributed to the United States. If we add the indirect exports to the goods the United States directly ships to China, the value of US exports to China increases by more than 25 percent. Taking this into account, China supported about 1.8 million US jobs and $165 billion in GDP in 2015.

China's rapid growth and rising consumer demand does not only have an impact on growing US exports. It also influences how much China's neighbors purchase from the United States, as their increased trade with China assists their expansion as well. As highlighted in Fig. 2, South Korea, Hong Kong, Singapore, and Taiwan all benefited from China's rise, and these economies all sit in the top 15 export markets for the United States. For example, South Korea purchases nearly 3 percent of US exports, while Hong Kong, Singapore, and Taiwan combined purchase another 6.1 percent of US exports.

Fig. 4: US exports a wide variety of goods and services to China



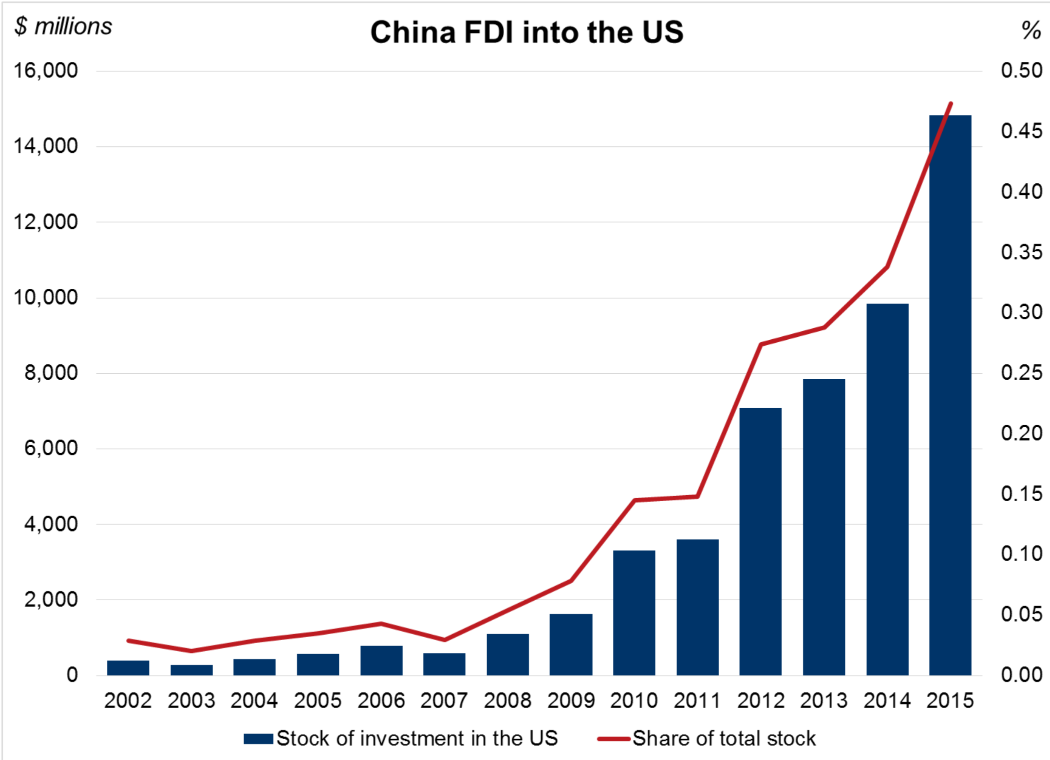
- **US investment in China and Asia generates income for US businesses**. Americans don't just benefit from direct sales to China; the investments US firms made in China also generate returns. The income from US investments in China totaled about $9.8 billion in 2015, equivalent to 0.5 percent of corporate profits in the United States, according to the Commerce Department's Bureau of Economic Analysis (BEA).[3] In addition, BEA data found that less that 6 percent of products made in China by US-owned companies were sent to the United States, while 80 percent of those sales were sold to customers in China. If profits from these operations were redistributed to US-based shareholders and spent

[3] http://www.bea.gov/international/factsheet/factsheet.cfm?Area=650

domestically, they would support 103,000 jobs and $11.9 billion in GDP.[4] However, this only captures part of the return from US investment in the Asian supply chain. If we include those returns on US investment in the Sino-Asian supply chain,[5] then as many as 688,000 jobs could be supported.

- **Chinese firms are beginning to invest in the United States**. China invested $14.8 billion in the United States in 2015, up from $277 million in 2000. Based on data from the BEA, more than 38,000 people are employed at US affiliates of Chinese firms. Taking into account how these affiliates interact with the rest of the US economy through the supply chain, we estimate this Chinese investment in the United States supports a total of 104,000 jobs and $10.8 billion in GDP. For example, Haier, a Chinese appliance manufacturer, employs 12,000 US workers who produce appliances out of facilities in Kentucky, Indiana, Alabama, Georgia, and Tennessee, and is expanding its operations in South Carolina to add 400 new workers. Automotive parts manufacturer Wanxiang has major US operations employing more than 12,500 American workers.

Fig. 5: Chinese FDI into the US is accelerating



- **Trade with China increased US productivity, which lies at the heart of wealth creation.** Studies show that greater openness to trade stimulates competition and entrepreneurship, which leads to productivity gains.[6] Based on typical trade

[4] This is likely an upper limit of the impact because US businesses do not redistribute all profits as dividend, and not all shareholders are based in the United States.
[5] The United States earned $65.7 billion on its Foreign Direct Investments in the Asia Pacific region in 2015.
[6] Dessus, Fukasaku, and Safadi (1999) found a 10 percent rise in the openness ratio resulted in GDP rising by 0.8–0.9 percent. Frankel and Romer (1999) found that an increase in trade exposure of 1 percent increases income by 0.5 percent. Dollar and Kraay (2004) found a 100 percent increase in trade share should induce a 25 percent increase in per capita GDP in a decade.

impacts, Oxford Economics estimates that trade with China has boosted US productivity by 0.17 percent, boosting overall economic growth. Development of the global supply chain enabled many US firms—Apple, GM, and Ford, to name a few—to be internationally competitive, enhancing the productivity of these firms and the US economy as a whole.

In short, China's development benefits the US economy. When combined, the export and investment channels of the activities above supported $216 billion, or 1.2 percent of GDP in 2015, as well as 2.6 million jobs.

Fig. 6: Positive impact of relationship with China

Value of Sino-US relationship to the US, 2015		
	Gains to employment (thousands)	**Boost to GDP (percent)**
Direct exports to China	1,467	0.7
Indirect exports to China*	296	0.2
Income from outward FDI	688	0.3
Inward FDI from China	104	0.1
Total	**2,555**	**1.2**
Productivity boost from increased integration	0.2 percent gain in productivity	

*Indirect exports are defined as exports from the United States to other Asian countries that are re-exported to China.

Source: Oxford Economics calculations

Adjusting the trade balance to account for the value-added content of exports cuts the US trade deficit with China in half, to about 1 percent of GDP—broadly equal to the US deficit with the European Union.

Breaking down the impact of Chinese imports

Do these benefits offset the trade gap, and the loss of American manufacturing jobs? Indeed, the trade gap in goods with China has grown from 0.8 percent of GDP in 2000 to 2.0 percent of GDP in 2015, equivalent to almost half the overall trade deficit for the United States and most of the current account deficit.

From these numbers, some observers conclude that China is the main cause of the decline in manufacturing employment in the United States. One study[7] estimates that imports from China have cost as many as 3.2 million manufacturing jobs in the United States since 2001.

Unquestionably, an abundant supply of low-wage workers in China allowed Chinese-based factories to displace manufacturers from other countries, including in the United States. Without adequate policies to retrain laid-off workers for opportunities in emerging industries, China's impact can have long-lasting consequences.

Freund and Bolaky (2007) found a 1 percent increase in trade leads to a per capita income increase of more than 0.5 percent. Also, Brückner and Lederman (2012) found a 1 percent increase in openness leads to a short-run improvement in GDP per capita of 0.5 percent and a long-run improvement of 0.8 percent after 10 years. Chang et al (2009) also find positive growth effects, particularly for countries with a complementary reforms.

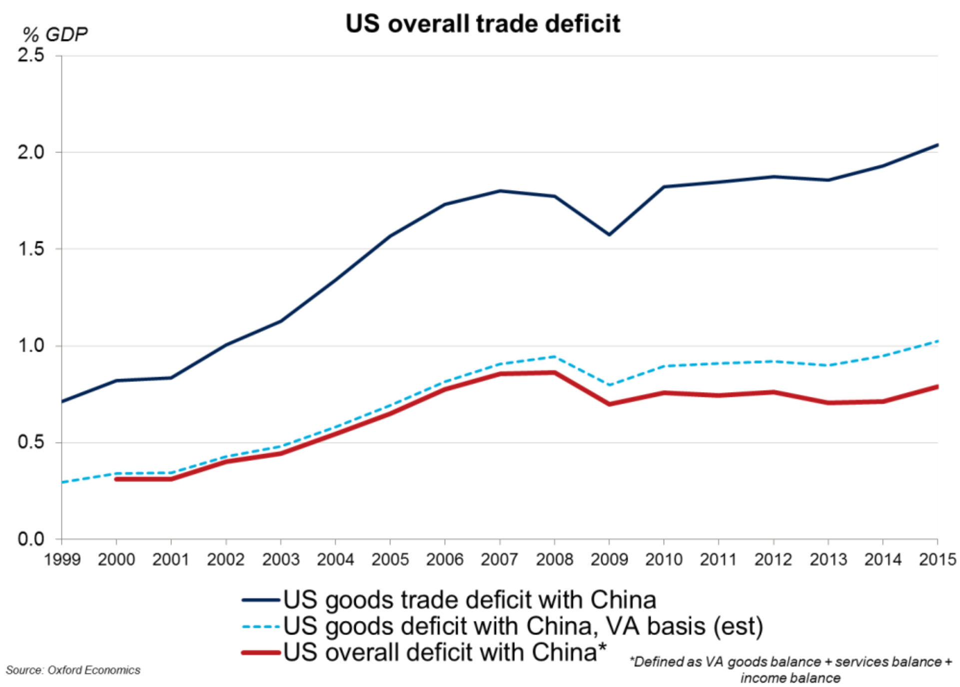
[7] See Autor, Dorn and Hanson (2016), "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade."

US trade deficit with China is overstated
However, the bilateral trade number fails to fully explain the impact of trade with China on the US economy. As it plugs into the global industrial supply chain, China is the "Great Assembler." The OECD estimates that about one-third of the content of Chinese exports is foreign, compared with just 15 percent of US exports. Although China has been trying to increase its domestic consumption and move up the value-added chain, the latest data suggests that even in key growth markets—computer equipment, electronics, and electrical machinery—the foreign content of goods assembled and re-exported from China is still roughly 50 percent.

Adjusting the trade balance to account for the value-added content of exports cuts the US trade deficit with China in half, to about 1 percent of GDP. This is broadly equivalent to the US trade deficit with the European Union.

And focusing solely on the trade deficit in goods ignores some of the key—and growing—strengths of the US economy, namely the service sector. The United States has a surplus with China of 0.2 percent of GDP on trade in services, up from 0.02 percent in 2000. Once the surplus from trade in services with China and the balance of income from investment are factored in, the US deficit with China falls to just 0.8 percent of GDP. As a share of GDP, the overall US trade balance with China has remained relatively stable since 2009.

Fig. 7: The US trade deficit with China has stabilized in recent years



Almost 75 percent of the total US trade deficit with China emanates from the electronics and textile manufacturing sectors. In both of these industries, China's growing market share in the United States actually represents China's displacement of imports from other countries: China has been squeezing out traditional apparel manufacturers such as Mexico, Hong Kong, and Taiwan. In electronics, Oxford Economics' calculations show

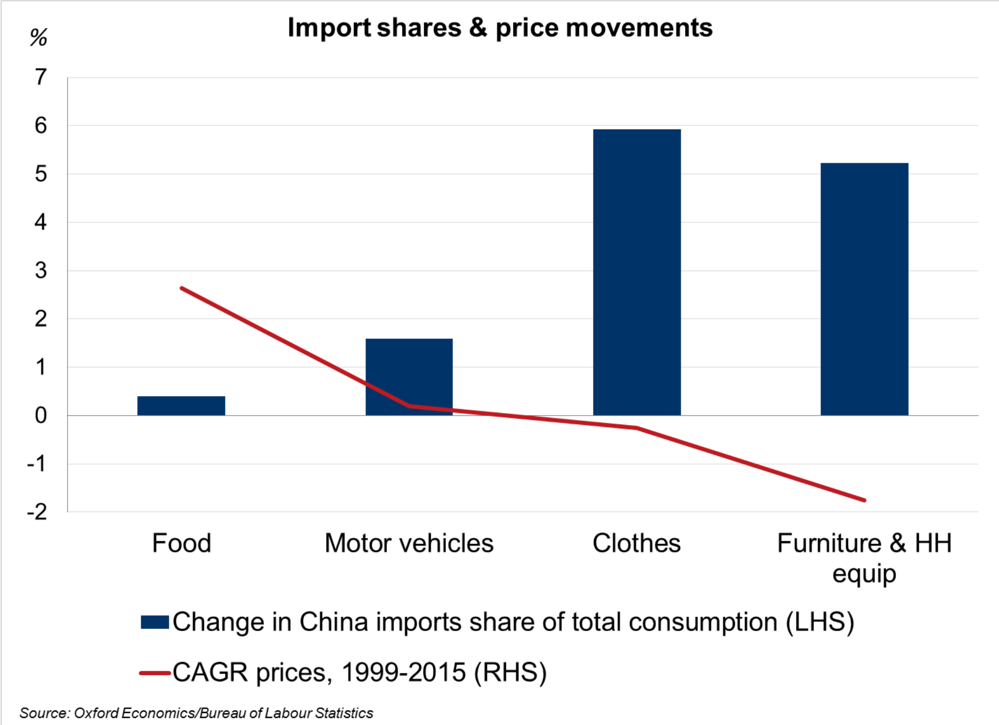
the volume of imports of computers and electronic products from Japan have barely grown since 2000, while South Korean exporters have lost market share.

Lower cost imports benefit US households

In addition, these imports also generate significant—and often overlooked—positives for US consumers. If you have ever wondered why prices for apparel and furniture, as well as most household appliances, have decreased over the past 15 years, the Sino-American trade relationship offers some of the explanation.

These generalized gains spread widely across the US economy and therefore are less visible than the concentrated job losses that result from the shuttering of a single factory.

Fig. 8: China-produced content lowers consumer prices



According to the Werner International Labor Cost Comparison, hourly labor costs in the textile industry were $2.65 in China in 2014 compared with $17.71 in the United States. In a sector where unskilled labor is a vital piece of the economic equation, replacing Chinese imports of textiles and clothing with US manufactured products would significantly raise US consumer prices.

Similarly, while technological advances like cheaper and more powerful microprocessors explain part of the decline in the price of computers and electronic goods, growing trade with China is another key factor. China plays an important role in lowering the prices US consumers pay for next-generation gadgetry—and helping US manufacturers afford their latest production innovations. It has been estimated[8] that assembling iPhones in

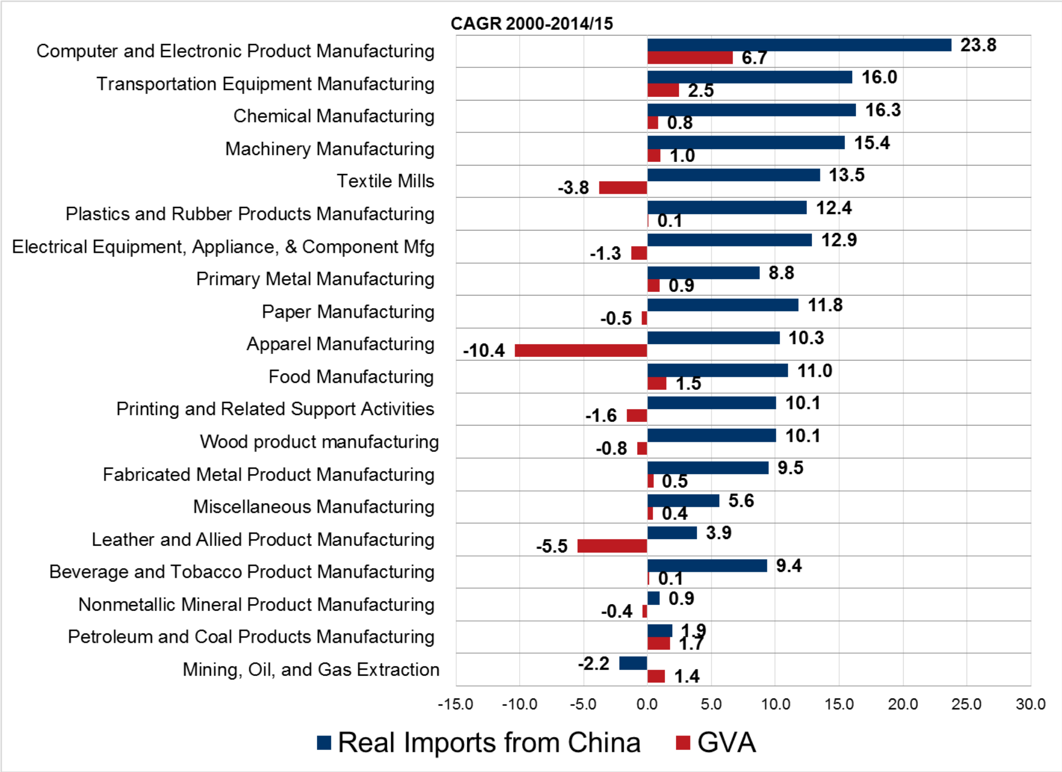
[8] Kraemer, Kenneth, Greg Linden, and Jason Dedrick, "Capturing value in Global Networks: Apple’s iPad and iPhone." University of California, Irvine, University of California, Berkeley.

the United States instead of China would add $30–$40 to their end price—an increase of about 5 percent. And if the various foreign-made components of the iPhone were also assembled in the United States, then the iPhone would be $100 more expensive than today.

Although Apple's iPhone may be an extreme case of leveraging global supply chains, it does illustrate the impact China has on household budgets—and the amount of money available to spend on goods and services not produced by China. Studies such as Kamin, Marazzi, and Schindler (2006) and Pain, Koske, and Sollie (2006) show that greater import penetration from China reduced US inflation by about 0.1 percent annually in the late 1990s and early 2000s. Extrapolating this as US imports of goods from China continued rise suggests average prices are 1–1.5 percent lower as a result of imports from China. Oxford Economics estimates the influence of such low prices boosted US GDP by up to 0.8 percent in 2015, supporting 1.8 million jobs.

US businesses performing strongly in many sectors with Chinese imports
The iPhone example also illustrates how China helps the United States meet the needs of its population and enables sectors where the United States has comparative advantage to grow faster. The product areas that experienced the most rapid growth in Chinese imports since 2000 are also the sectors where US businesses have seen the strongest growth. It is no accident that the United States is home to some of the largest and most successful companies in sectors such as computer and electronic equipment, transportation equipment, and chemicals. These industries have embraced global supply chains, cementing their competitive position in the global market place.

Fig. 9: Growth in US Gross Value-Added has come in areas where Chinese imports have grown



This is particularly true in the technology industry, where businesses in both China and the United States continue to adapt and expand to meet the demands of a rapidly evolving marketplace. Since 2000, the volume of household spending in the United States on computers and electronics has grown 15 percent each year, while business investment on computers has risen 6.3 percent annually. Although China's market share is growing, the market itself is growing so rapidly that US industry is also prospering.

In sum, by lowering the prices US consumers pay, and improving the competitiveness of key sectors of the US economy, goods and services imported from China provide a boost to US economic activity. Some studies have noted that greater imports from China can lead to factory closures and job losses. After totaling up the benefits of exports to and US investments in China, as well as cheaper imports and supply chain improvements, we calculate that on balance the US gains overall from its economic relationship with China.

Growth in China creates new opportunities for the United States

For many years, US farmers have been major beneficiaries of the expanding demand for foodstuffs in China, supplying soybeans, pork products, and wheat. Recently, China has also become an important market for highly sophisticated and relatively expensive products like airplanes and pharmaceuticals—sectors where American know-how leads the world.

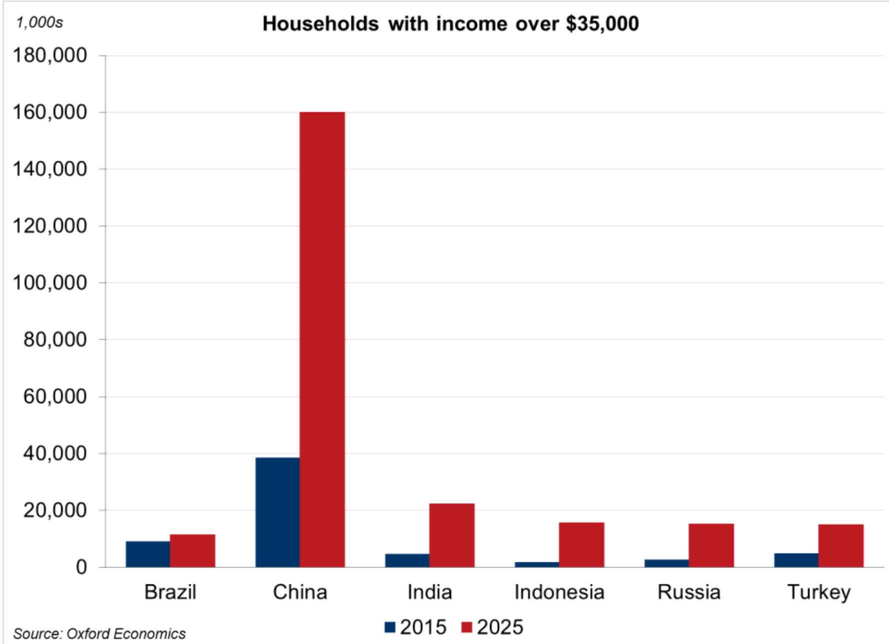
As underlying wage rates rise, land prices become more costly, and the supply of Chinese labor is no longer limitless, a transformation is taking place that is likely to boost the fortunes of US exporters. Rising costs in China and falling domestic energy prices resulting from the US shale oil and natural gas revolution are helping American manufacturers become increasingly competitive with their Chinese counterparts.

Burgeoning Chinese middle class an important growth opportunity

As the size and purchasing power of the Chinese middle class grows, these consumers will demand more of the services and higher-end products that American companies export. While some 40 million Chinese households now boast annual income in excess of $35,000, that population is projected to rise four-fold, to 160 million, by 2025.

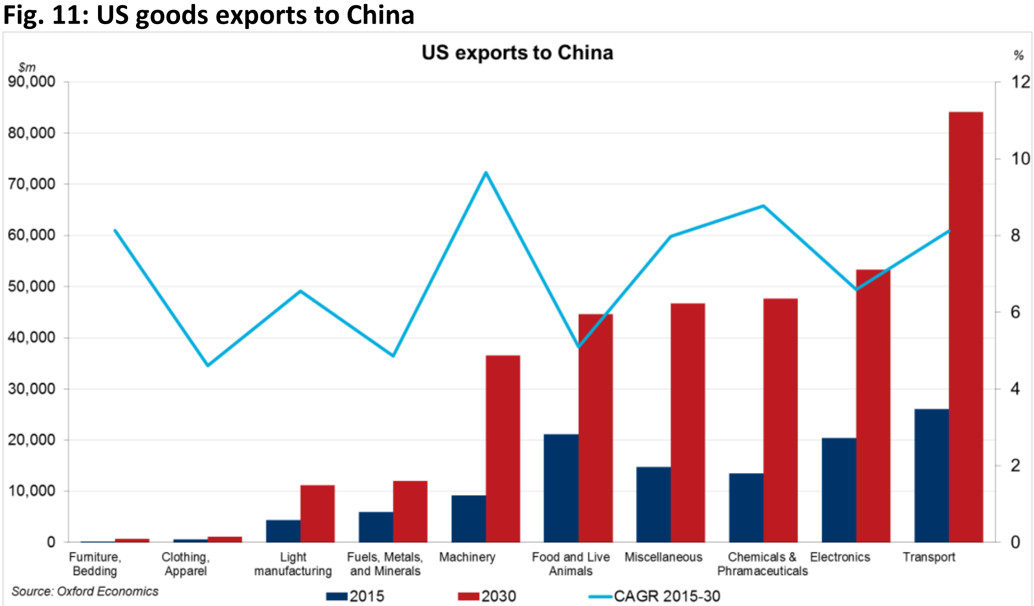
The growing Chinese middle class represents a substantial opportunity for US businesses—by 2025, 160 million consumers in China will have incomes greater than $35,000, up from 40 million today.

Fig. 10: China's growing middle class is a growth market for US businesses



As China's middle class expands, we expect demand for American-made goods and services to rise as well. Ford and General Motors have already established major footprints in China, now the world's largest automobile market. In the first half of 2016, GM sold 1.8 million vehicles in China—400,000 more than it sold in the United States—while Ford sold 580,000 vehicles in the same time period. A good number of these vehicles were American made. In 2014, for example, some 300,000 US- manufactured cars, trucks, and SUVs were exported to China, according to the US Commerce Department.[9]

Fig. 11: US goods exports to China



[9] http://www.trade.gov/td/otm/assets/auto/ExportPaper2015.pdf

The growth of US-produced services for China is even more rapid. The rise in Chinese tourism to the United States, for example, is already boosting sales among US retailers, hotels, casinos, and leisure resorts. US firms are also eager to gain greater access to China's financial services market, a potential boost for accounting firms, insurers, and other financial services. China accounts for 6.5 percent of total service exports from the United States, and this is projected to rise to 10 percent over the next decade or so.

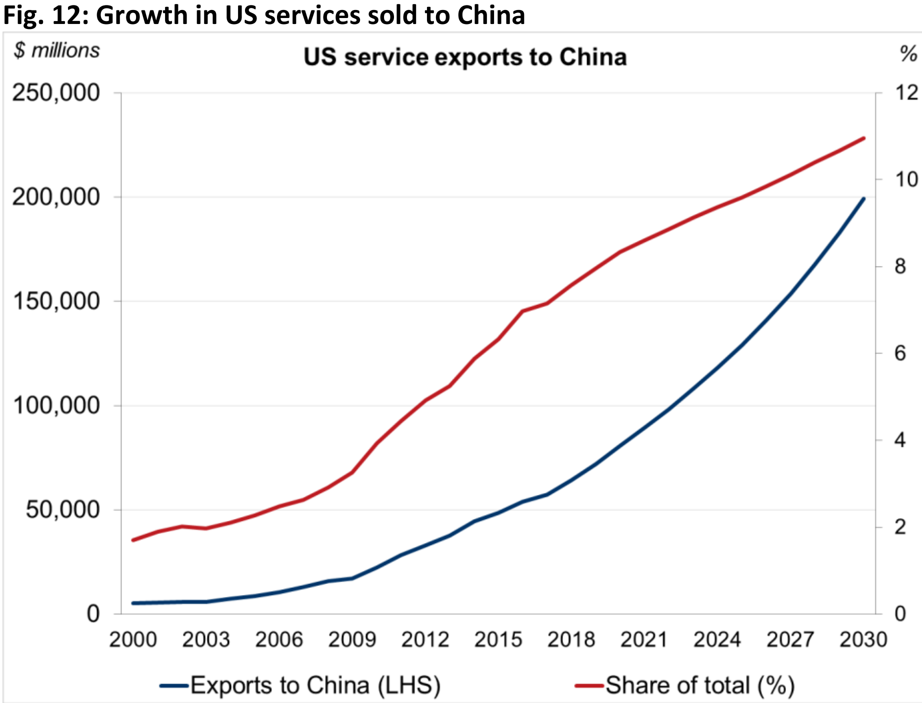
Sidebar: Reforms in China are necessary to realize potential gains

China's changing spending patterns – moving from investment-led outlays for factories and infrastructure, to growth in consumer spending and services – offers enormous opportunity for US firms to sell more of their expertise to a rising class of Chinese consumers. From insurance companies and banks to fashion designers and entertainment and sports franchises, US firms are beginning to find more places to sell American know-how and services.

However, as economic reforms in China have slowed in recent years, questions are growing about the extent to which the Chinese government will give foreign companies equal treatment and greater access to the Chinese market. For example, foreign insurance firms continue to await further liberalization that would allow them to offer insurance as well as saving and retirement plans to newly affluent Chinese families who are now living outside the old economy, where state jobs and pensions were guaranteed.

China's economic liberalization and opening up is a critical factor in the ability of US companies to realize the potential gains in the relationship.

Fig. 12: Growth in US services sold to China

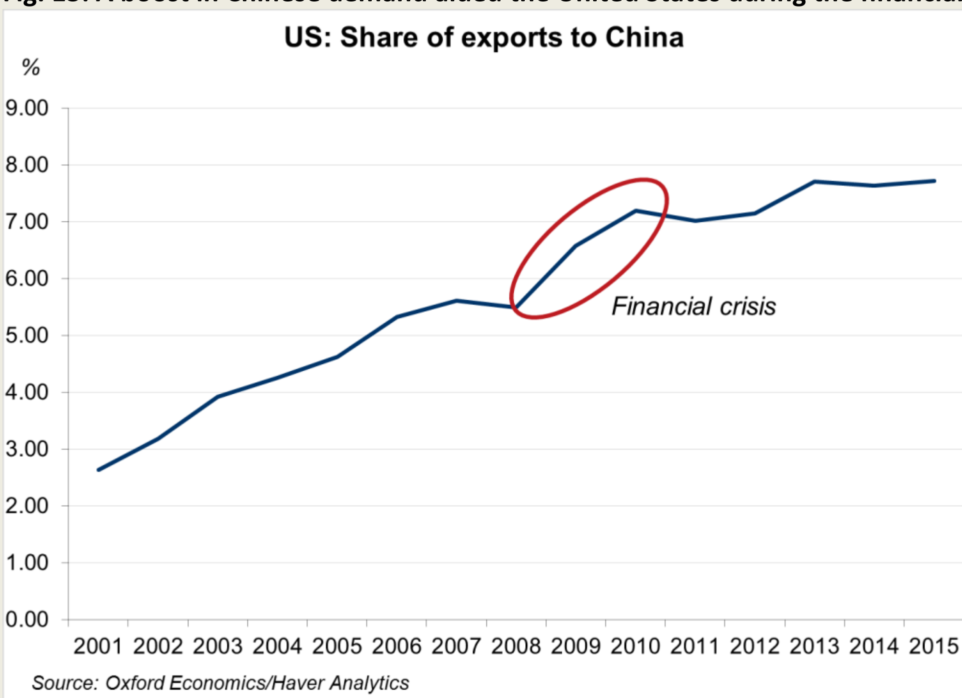


Sidebar: China's role in global macroeconomic affairs

China's growth and increasing financial maturity directly benefits US consumers and industry, and China has also helped the US economy in more indirect ways. Now that it has emerged as the world's second-largest economy, China has become a stabilizing factor when the global macro economy confronts crisis.

This was especially true during the 2008–09 financial crisis, when global demand was under siege and consumers in the United States and Europe suddenly felt unable to spend. To counteract a rapid deterioration in consumer demand and confidence, the Chinese initiated an enormous domestic infrastructure program to help boost spending and absorb more industrial equipment and raw materials from the United States and Europe to help stabilize the global economy. China's decision to "turn on the taps" and spend more increased its importance to the United States as a trading partner, and its demand for foreign goods helped re-stimulate the US economy. This boost in domestic Chinese consumption helped the United States expand net exports in ways that helped offset very weak domestic demand.

Fig. 13: A boost in Chinese demand aided the United States during the financial crisis



China also helps keep US interest rates low. As a major purchaser of US government debt, its demand for US bonds has helped keep borrowing costs down for the US government and the private sector. China now owns about 8 percent of the total stock of US debt, or about $1.2 trillion in US Treasuries. Despite concerns about China reducing its investments in US Treasury securities, it maintains a strong appetite for these assets. And as a large holder of Treasuries, it is in China's best interest to continue to be buyers and holders of US debt. From the US perspective, despite any unease with the Chinese being large funders of US debt, the net benefit of lower rates and the virtues of unfettered capital flows dominates.

Conclusion: China is important for growth

Our analysis shows that the assumptions regularly cited in the media about impact of the US trade deficit with China are frequently overstated. This is partly because the contribution of US services exports to China is often overlooked when tallying the balance of trade, but also because of the foreign-made content in Chinese exports. When these points are factored in, the US deficit with China falls from 2 percent to just 0.8 percent of US GDP—less than the US trade deficit with the European Union.

While it's true that moving manufacturing labor to China has led to fewer such jobs in the United States, the US-China trade relationship also supports roughly 2.6 million jobs in the United States across a range of industries.

In fact, the commercial relationship with China benefits the US economy in several ways:

- **China is now one of the United States' major export markets**, supporting millions of jobs—and its importance will only continue to grow.
- **Chinese investment in the United States supports US jobs and overall economic growth**. Chinese investments also keep US interest rates low, providing further stimulus for businesses and consumers.
- **China's role in the global supply chain improves the competitiveness of US business and lowers US inflation.** Imports from China (and other countries) can displace jobs in the United States. It is also true that imports can lower costs for US manufacturers and keep them competitive in international markets, as well as benefit American households by reducing the cost of living and making more money available to meet other spending needs.

While job losses in some sectors can be associated with rising global trade, American workers remain the most competitive in the world. The challenge for policymakers is to create an effective mechanism for retraining, so workers in industries that are disappearing can gain new skills suitable for rising sectors.

Princeton economist Alan Blinder, a former vice-chair of the Federal Reserve and an expert on global trade, argues that the cost of trade is outweighed by its value—and that an increasingly intertwined world economy is not just beneficial, but inevitable. No policy, he says, can make "the changes brought about by changing international trade patterns painless to everybody. But that's an impossible goal. Change hurts people always, but it also helps people. And holding back the tide of trade is analogous to holding back the tide of technology." [10] The challenge for policymakers is to develop programs to effectively support displaced workers, while ensuring the United States remains globally competitive and positioned to realize the net gains from trade with China and the rest of the world. Better communication of the role of trade in America's economic health, household incomes, and employment is also a necessity.

[10] http://wws.princeton.edu/news-and-events/news/item/qa-alan-blinder-trade-offshoring-and-economic-stimulus-package