

US-China Trade Disputes: Rising Tide, Rising Stakes

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The renminbi-dollar exchange rate is the largest and most important of the economic disputes between the United States and China. It affects all US imports from China (valued at \$243 billion in 2005) and all US exports to China (valued at \$42 billion in 2005) and has repercussions throughout Asia. A revaluation of the renminbi and other Asian currencies by 20 percent, together with a sharp reduction in the US savings deficit, might reduce the US global current account deficit (\$760 billion in 2005) by as much as \$120 billion per year.

China continues to refuse to substantially appreciate its currency, and US administration and congressional efforts have induced only slight changes in the Chinese exchange rate regime. To force a substantial revaluation, interested US groups are looking to advance a case against China in the World Trade Organization (WTO). The core of the case is that China's exchange rate policy allows Chinese firms to export goods to the United States at artificially low prices, resulting in US job losses. The protagonists contend that the undervalued renminbi violates Article XV(4) of the General Agreement on Tariffs and Trade (GATT) and the WTO Agreement on Subsidies and Countervailing Measures. But the chances of a US legal victory in the WTO are modest, and the WTO Dispute Settlement Body would most likely reject the claims. Similarly, while a policy case against the renminbi value can be made in the International Monetary Fund (IMF), a legal case has no supporting precedent and faces an uphill battle.

Even if China revalues its currency, however, other conflicts threaten to worsen US-China economic relations. When import quotas imposed under the Multi-Fiber Arrangement ended in January 2005, Chinese textile and clothing exports expanded rapidly. Both the United States and the European Union then negotiated a fresh set of bilateral quotas with China. While the new quotas are set to expire in 2008, textile and clothing trade disputes are virtually certain to continue for a decade or longer. Disagreements over Chinese tax and tariff discrimination against imported semiconductors, automobile parts, and other products are also front and center on the trade agenda. Chinese violation of intellectual property rights (IPRs); US antidumping duties on bedroom furniture, color television sets, and other products; and China's nonmarket economy status add to the litany of commercial disputes. The recent US decision to block China National Offshore Oil Corporation's bid to acquire US oil company Unocal may be a harbinger that investment issues will compound bilateral trade frictions.

As Chinese firms compete in new industries and expand their world market share in established lines of trade, and as the US economy slows from earlier brisk growth and US unemployment creeps above 5 percent, existing disputes in individual sectors will likely intensify and new disputes erupt. Geopolitical disagreements—punctuated by China's rapidly expanding military arsenal—have every prospect of sharpening economic tensions. In short, however difficult 2006 may seem in US-China commercial relations, looking back from the vantage of 2008, the current era may seem placid. For the foreseeable future, trade and investment disputes cannot be avoided—but they can be managed.

In its best long-term interests, China should take several measures to foster an open world trading system. It should

- revalue the renminbi substantially and eventually adopt a floating exchange rate.
- liberalize access to its own markets unilaterally rather than waiting for global trade talks to conclude. Such a move would challenge other WTO members and invigorate the Doha Development Round.
- announce the progressive phaseout of domestic subsidies and incentives for infant industries, such as semiconductors, and eliminate them immediately in industries that have demonstrated their prowess in export markets, starting with textiles and clothing.
- strengthen and streamline its system for protection of IPRs. Among other measures, China should devise incentives that encourage private citizens and public officials to report IPR violations and enforce IPRs.

For their part, US leaders should publicly declare that expanding trade relations between the United States and China serves US economic interests, even when China has a huge bilateral trade surplus (about \$201 billion in 2005). Criticism leveled at Chinese economic policies should focus on China's trade surplus with the world, exchange rate equilibrium, market access barriers, and unwarranted subsidies—not China's bilateral surplus with the United States. The United States should

- apply time-limited safeguards in industries where Chinese imports are rising rapidly and genuinely injure domestic US firms. WTO paragraph 241 safeguards are preferable to paragraph 238 safeguards. Both safeguards violate the WTO nondiscrimination principle in that they can be imposed solely against Chinese exports. However, unlike the automatic process of paragraph 238, paragraph 241 safeguards require an initial investigation to determine whether Chinese exports inflict injury on domestic firms.
- shift to normal safeguards ahead of the expiration in 2013 of WTO paragraph 241 safeguard actions. Unlike paragraph 241 safeguards, normal safeguards apply to all imports except those of free trade agreement partners; they cannot single out China for discriminatory trade restrictions.
- phase out the application of the discriminatory nonmarket economy status against Chinese exports ahead of its expiration (under the WTO) in 2016.
- reshape its trade adjustment assistance (TAA) program, focusing on wage insurance and health benefit initiatives, to effectively address the impact of Chinese imports on US manufacturing jobs. Safeguard measures, including antidumping duties that are imposed against Chinese and other imports, should be accompanied by TAA relief. The emphasis of US measures should shift from product markets to job markets.

Whatever their geopolitical differences, both countries share an enormous stake in fostering open trade and investment. Both countries risk huge losses if their commercial relations are engulfed by a wave of protection and recrimination. However, both can share enormous gains if their joint policies ensure the continued expansion of world trade and investment.

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