Im Fokus

Hu Goes to Washington: Comments on the Development of U.S.-China Economic Relations

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Abstract

The article gives a short overview of the major policy issues in U.S.-China economic relations. It starts with some comments about Hu Jintao's visit to the U.S. in April 2006 and then looks in more detail at bilateral trade relations. In the third part of the paper the discussion on IPR protection as one of the major conflicting topics in U.S.-China relations is picked up. The last part deals with the future of bilateral economic relations.

Keywords: U.S.-China economic relations, Hu Jintao, U.S.-China trade, U.S. direct investment in China

Introduction

Chinese President Hu Jintao's visit to the USA in April this year has triggered a discussion about the nature of U.S.-China relations, especially economic relations. The assessment of China's growing international competitiveness in the U.S. is mixed. There is much concern about the negative impact of Chinese imports on U.S. industry and employment and the question as to what extent the alleged exchange rate manipulation has contributed to the vast current bilateral trade imbalance. In addition to the tension about trade issues, a number of other problems have overshadowed the economic relationship. The lack of protection of intellectual property Rights (IPR) has been one of the much debated topics, with the U.S. accusing Chinese companies of being software pirates.

This contribution aims at giving a short overview of the major policy issues in U.S.-China economic relations. We start with some comments about Hu Jintao's visit to the U.S. and look then in more detail at bilateral trade relations. Data are presented on the development of imports and exports in the period 1995 to 2005, and on the structure of U.S. trade with China in 2005. We show that the growth of U.S.-China trade has been strongly supported by U.S. companies' investment in China. In the third part of this paper we pick up the discussion on some of the major conflicting topics in U.S.-China relations, especially IPR protection. The last part deals with the discussion about the future of bilateral economic relations.

Some peculiarities of Hu's visit to the U.S.

The fact that the Chinese President Hu Jintao's first visit to the U.S. has not been given the status of a 'state visit' by the U.S. government indicates the ambivalent attitude towards a rising China. Although Hu was received with full military honours at his arrival ceremony in Washington, there was no formal dinner or state banquet, which demonstrates the difference between a mere "visit" and a "state visit". The U.S. administration downplayed the decision to offer a "social lunch" instead of a "state dinner". But it seems to be that it did not wish to appear to be courting high level Chinese officials while facing strong anti-Chinese sentiment at home (Jiang 2006). The China-expert Elizabeth Economy makes it even more clear that the U.S. administration's decision not to categorise Hu's visit as a "state visit" was a signal to the domestic audience: "There are a number of contentious issues, and the downside of raising the profile of this visit in terms of domestic politics clearly outweighs the upside in terms of pleasing the Chinese" (Economy 2006).

President Hu's visit to the U.S. took place at a time of strong debate about the impact of China's emergence on the U.S. economy. One of the major concerns is the shutting-down of factories as the reaction to more competitive products from China, and the fact that a growing number of U.S. companies relocate production sides to China. In order to ease the tension on conflicting issues and to prepare the ground for Hu's visit, the Chinese side promised to expand market access for U.S. companies in China and to strengthen efforts to protect IPRs. Hu's trip was, therefore, an attempt to "[...] clear US minds of doubts and suspicion about China" (*China Daily*, 18.4.06).

A signal that China is serious about a more balanced trade and a better protection of IPRs was the fact that Hu started his tour in Seattle. Here, a Chinese purchasing mission headed by Wu Yi had signed a deal to procure 80 Boeing jets on April 11. The delegation, consisting of 111 Chinese businesses, concluded contracts worth US$ 16.2 billion (*China Daily*, 18.4.06). In Seattle, Hu was invited by Bill Gates to a dinner with about 100 dinner guests. He informed the founder of Microsoft that the Chinese government intends to spend more than US$ 400 million on Windows software over the next three years.

Hu's visit to Yale University was surely a highlight for the Chinese self-image. In his speech at Yale University, Hu stressed the similarities between China and the U.S. and their role as equal partners:

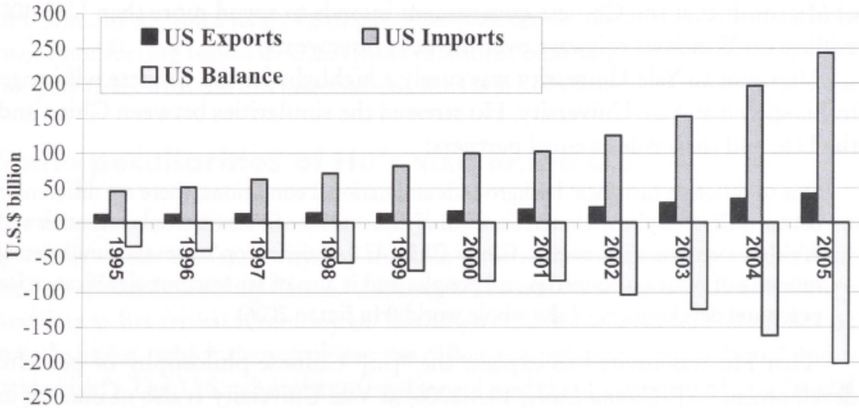
> Due to different historical backgrounds and national conditions, there are differences between China and the United States. But this enables us to learn from each other and draw on each other's strengths. Closer China-U.S. cooperation serves the fundamental interests of our two countries and peoples and is also of far-reaching significance for peace and development of the whole world (Hu Jintao 2006).

That Hu was invited to explain the "[...] Chinese philosophy of peaceful development [...]" (*China Daily*, 18.4.2006) at Yale University is also of interest, as this university is the US President Bush's alma mater.

Bilateral trade relations

Bilateral trade has surged very rapidly since the mid-1990s, and so did the U.S. trade deficit. During the period 2000 to 2004 China has had the world's largest bilateral trade surplus with the U.S.; it represents about one quarter of the U.S.'s total trade deficit. Measurement problems of bilateral trade, however, have long been existing, with official figures vary strongly among both countries. According to the US Department of Commerce (USDOC) statistics that are generally applied in the U.S. to measure bilateral trade, trade between the U.S. and China is greatly unbalanced. In 2005, the U.S. had a trade deficit with China which amounted to US$ 201.7 billion (US$ 41.8 billion in U.S. exports to and US$ 243.5 billion imports from China) (see graph 1). Meanwhile, Chinese statistics indicate a trade surplus with the U.S. in 2005 of US$ 114.2 billion (US$ 162.9 billion in exports and US$ 48.7 billion in imports). This large gap in the statistics of both countries is due to different calculating methods applied in the U.S. and China. Since a huge part of China's foreign trade is conducted through the Hong Kong Special Administrative Region, the gap can be partly explained because of the entrepot trade through Hong Kong.

Figure 1: China's Trade with the U.S.



Source: U.S. International Trade Commission, US Department of Commerce, 2005.

The reasons for China's vast trade surplus with the U.S. are manifold. Generally speaking, trade and economic relations between China, as the largest developing country, and the U.S., as the biggest developed country in the world, have maintained a fast growing momentum in recent years and have provided economic benefits for both countries. China has become the fourth largest export country and the third largest trade partner of the U.S., while the U.S. is the second largest trade partner to China (XNA, 4.11.2006). Vice Premier Wu Yi argued at the press conference of the US-China Joint Commission on Commerce and Trade (JCCT)[1] in Washington D.C. on April 11, that China and the U.S. are "very much complementary with each other". Chinese exports to the U.S. have increased very rapidly, but this is not the case for Chinese imports from the U.S.; the U.S. has been losing market share in China. According to a report published by the

[1] The JCCT was found in 1983 and is the only forum that exists at present for China and the U.S. to address commercial disputes. It therefore represents a government-to-government consultative mechanism.

USCBC/China Business Forum (2006: 7-8), one reason for this trend is China's huge demand for commodities and raw materials. In these sectors, the U.S. and other developed countries do not have a comparative advantage. Another reason is that U.S. exporters are losing market share everywhere, not just in China. Yet U.S. congressmen have increased their pressure on the Chinese government to address the ever-growing U.S. trade deficit. Some U.S. senators see the U.S.-China trade relationship at a critical point, and a number of legislative proposals to impose trade penalties on Chinese imports have been suggested to the U.S. Congress. The question is as to how this trade friction between both countries could be solved.

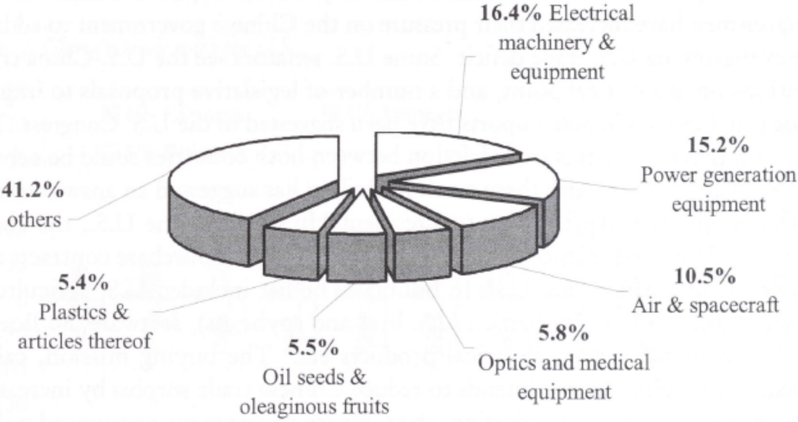
In an effort to smooth these tensions Beijing has suggested an answer to this problem: In early April, prior to President Hu's visit to the U.S., the above mentioned business mission went to the U.S. and signed purchase contracts and agreements worth around US$ 16 billion. The list included U.S. agricultural products (lifting Chinese ban on U.S. beef and soybeans), software, 80 Boeing passenger aircrafts, cars, electrical products etc. The buying mission, called "cheque book diplomacy", intends to reduce Chinese trade surplus by increasing U.S. exports to China. In addition, the Chinese government announced policy measures to stimulate the growth of domestic consumption and demand. The government has already started to abolish the tax on agriculture, will increase spending on infrastructure and expand state investment in the country's health and education system. A three-year plan to balance its global surplus has also been formulated. In order to achieve this aim, changes in the export policy have been announced, including the encouragement of less export-driven manufacturing, and more services aimed at the domestic market (U.S. Department of Commerce, April 2006; McCartney and Baldwin 2006; SCMP, May 5, 2006).

Looking at the structure of U.S. exports to China in 2005, better market access for U.S. products to the Chinese market would mainly benefit high value-added products such as machinery and equipment (16.4% export share), power generation equipment (15.2%) and air and spacecraft (10.5%) (see graph 2).

The structure of imports from China shows that there is a high share of industrial products, especially high tech products, such as electrical machinery and equipment and power generation (together 43.5%). The major consumer goods are toys and games (7.9%), furniture (7%), apparel (6.9%) and footware (5.2%) (see graph 3).

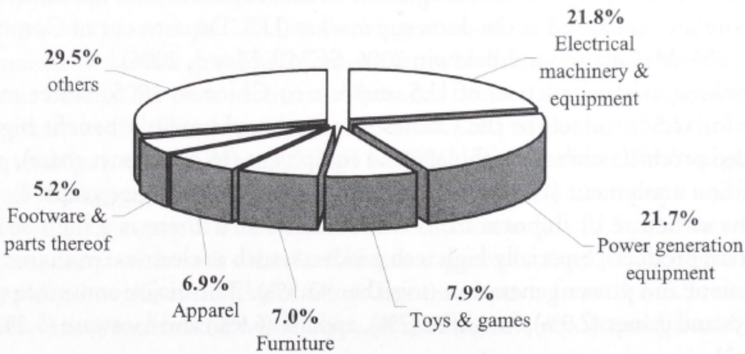
U.S. investment in China has contributed to the increase of Chinese export competitiveness as a large share went into high tech sectors such as computers

Figure 2: 2005 Top U.S. Exports to China



Source: The US-China Business Council (USCBC) (2006).

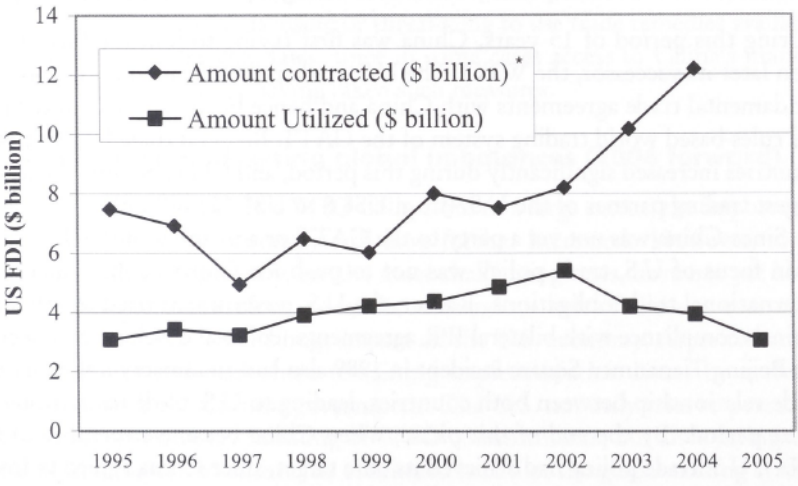
Figure 3: 2005 Top U.S. Imports from China



Source: The US-China Business Council (USCBC) (2006).

and electronic products (U.S. Statistics: US$ 1.34 billion between 2000 and 2004, annual growth rate 25%). The largest shares of U.S. investment were directed towards transportation equipment (US$ 1.83 billion, annual growth rate 31%) and towards chemicals (US$ 1.64 billion, annual growth rate 11%). The cumulative U.S. investment up until 2004 reached US$ 15 billion. Between 2000 and 2004 the total amount of U.S. direct investment amounted to US$ 8.22 billion, making the U.S. the fifth-largest source of foreign direct investment (US-China Business Council, January 2006a).

Figure 4: U.S. Direct Investment in China from 1995-2005



*Note: * In Dec. 2005 MOFCOM stopped reporting contracted FI figures. Since then the contracted value refers to actual investment levels (i.e. utilized investment).*

Source: Ministry of Commerce (MOFCOM), in The US-China Business Council (USCBC) (2006).

According to Chinese statistics, the annual value of contracted direct investment from the U.S. increased very rapidly after China's accession to the WTO in 2001. In contrast, the annual amount of utilised direct investment showed a continuous decline since 2001 (see graph 4).

In a recent study on the development of bilateral trade relations from a long-term perspective, the United States Trade Representative (USTR)[2] divides the U.S. trade policy towards China into three distinct phases, beginning in the year of 1986. According to the report, U.S. trade policy as a whole has always had two core principles - firstly to enhance an increasingly open, rules-based international system and, secondly, to capture the economic benefits of more open global markets for the American people. Against the backdrop of these two core principles of U.S. trade policy, the three phases have been characterised by the USTR as follows:

Phase 1 – Pre-GATT (WTO) accession stage (1986–2001)

During this period of 15 years, China was first trying to join the GATT and then later its successor, the WTO. The U.S. trade policy focused on negotiating fundamental trade agreements with China and hence bringing the country into the rules-based world trading system of the GATT. Bilateral trade between both countries increased significantly during this period, and China became the fourth largest trading partner of the U.S. (from US$ 8 to US$ 121 billion).

Since China was not yet a party to the GATT or a member of the WTO, the main focus of U.S. trade policy was not to push for China's compliance with international trade obligations. Rather, the U.S. government tried to influence China's compliance with bilateral IPR agreements. Political developments such as the Beijing Tiananmen Square incident in 1989 also had an impact on the bilateral trade relationship between both countries, leading to U.S. trade restrictions for some period. By the end of this phase, when China became a member of the WTO, U.S. trade policy had achieved its core target, since China agreed to lower trade barriers in practically every sector of its economy.

Phase 2 – Integration into the global trading system (2001–2005)

The U.S.-China relationship deepened both on the economic and political level. Due to the WTO obligations that had come into effect, China's market had been substantially opened for U.S. goods and services. Bilateral trade grew from US$

[2] The Office of the United States Trade Representative was founded in 1962 and is part of the Executive Office of the President. The USTR plays a leading role in the development of policy on trade and trade-related investment.

121 billion to US$ 285 billion, and China became the third largest trading partner of the U.S.

In the meantime U.S. trade policy shifted its main focus upon monitoring China's integration into the global trading system, and thereby ensuring compliance with the accession obligations. The U.S. assessed China's performance based upon how well China implemented WTO obligations, regarding commitments such as protection of IPR, improvements in transparency, expansions in market access for services, scheduled reductions in tariff rates and the removing of non-tariff barriers. At that stage the success of U.S trade policy and its positive implications on the U.S. economy could be attributed to the usage of consistent dialogue between both countries and international institutions. However, the U.S. did not yet entirely renounce using or threatening to use trade remedies available in the WTO or under U.S. laws, since in some cases access to China's market must only be granted after having taken such measures.

Phase 3 – China addressing global imbalances (2006 forward)

By the time China has fulfilled WTO obligations to a large extent, the importance of China in the global economy will have further increased. However, some obligations which, apparently, are the most challenging ones, have not yet been fully implemented. Therefore, given the tremendous heft of Chinese economy on international trade and its huge impact on the U.S. economy, American trade policy currently addresses these remaining implementation issues by actively cooperating with the Chinese government. The U.S. not only tries to persuade China to go beyond only fulfilling of WTO commitments, but also, acting as a global trading power, to ensure the continued health of the global trading system and pursue balanced growth.

Conflicting issues in bilateral economic relations: the case of IPR protection

That President Hu started his first visit to the U.S. with a meeting at the Microsoft headquarter in Seattle was planned as a sign of a radical change in Beijing's policy towards IPR protection. Earlier in April, at the annual meeting of the JCCT, the two countries had signed procurement contracts, including those relating to software products. Purchasing Microsoft Windows operating systems and other

US-made software was to be regarded as part of China's efforts to crack down on the widespread use of pirated computer software. This practise costs U.S. software companies billions of dollars in lost revenue each year. Vice Premier Wu Yi, co-chairing the annual meeting and head of the Chinese delegation this year, indicated that China's national copyright administration and the Ministry of Information Industry have issued rules requiring all manufacturers to preload legal software on computers sold in China.

IPR protection represents a very sensitive issue in U.S.-China economic relations and is not restricted to software piracy, but has rather gone beyond software, movies, music and clothes to products such as car parts and pharmaceuticals. U.S. officials state that Chinese copies of music, movies, software and other products cost legitimate suppliers worldwide up to US$ 50 billion in lost potential sales every year (WSJ, April 11, 2006). China argued that it has already established laws and regulations that are consistent with international practice and that therefore adequate IPR legislation exists. Since China is a country of huge dimensions and IP crimes are more sophisticated, international and organised, the enforcement of IPR protection remains difficult. Despite these explanations on the Chinese side, the U.S. has pushed for stronger efforts to crack down on product piracy. During the JCCT meeting, United States Secretary of Commerce, Carlos Gutierrez, highlighted the importance of a credible course of action that must be taken by the Chinese government in order to enforce the rules of China's IPR regime. Gutierrez also pointed out that in the following months, results regarding the issue of controlling the infringements of IPR will be most crucial, otherwise protectionist voices would grow in the U.S. (U.S. Department of Commerce, April 2006).

China's Minister of Commerce Bo Xilai defends China's progress in protecting IPR, pointing to increased enforcement campaigns (WSJ, April 12, 2006). Bo Xilai announced that the Chinese government has devoted about 300,000 agents to anti-product piracy action. He also pointed out that the government has made it easier to apply criminal penalties instead of civil penalties to violators, has raised fines and has established special IPR enforcement offices in 50 major cities that will deal with IP complaints. During the JCCT meeting, Vice Premier Wu Yi also referred to these policy measures and mentioned the new action plan for the year of 2006, which will "cover the major IPR concern of the U.S. side" (U.S. Department of Commerce, April 2006). The U.S. assesses these efforts as rather modest, but also as a step in the right direction.

Perspectives

U.S.-China economic relations are overshadowed by a number of conflicting issues, such as vast trade imbalances, a lack of IPR protection, China's WTO compliance and the debate on the country's exchange rate system. In this paper we have concentrated on bilateral trade and IPR. Although the discussion on whether the Chinese government can be classified as a "currency manipulator" has been very heated in the U.S., this topic was not placed at the centre of bilateral discussion during Hu's visit. This was quite a reasonable decision, because as it is rather difficult to prove that China has pursued any currency manipulation strategy. In a recent report on the international economic and exchange rate policies published May 10, U.S. Treasury Secretary John W. Snow had to admit: "In the final analysis, though, the Treasury Department is unable to conclude that China's intent has been to manage its exchange rate regime for the purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantages in international trade. Thus, we have not designated China pursuant to the 1988 Trade Act" (Statement of Treasury Secretary). Snow referred in his report to the willingness of the Chinese government into allowing more flexibility and to reduce the trade surplus. During the final press conference at the end of Hu's visit to Washington, President Bush was asked if he "was able to persuade China to more quickly revalue its currency." Bush answered that the Chinese government made a major decision on its currency last year and that he hopeds that there would be more revaluation of the currency. There was no new commitment to this issue on the side of President Hu: "We have already launched the reform of the RMB Chinese currency exchange regime, which has paid off initially. And in the future, we'll continue to make efforts to improve the RMB exchange rate regime" (The White House, April 20 2006).

Even among academics, the question of whether China is manipulating its currency to gain an unfair advantage for its exports in the world market has been answered very differently. In a recent commentary to the *Wall Street Journal*, Ronald McKinnon warns that the possibility of a Japanese-style deflationary slump cannot be ruled out if China wereas forced to appreciate its currency, suggesting that this policy would eventually reduce its trade and saving surplus (McKinnon April 20, 2006). Therefore it is understandable that the Chinese government is rather reluctant to change its current policy. However, Hu's visit has shown that China is prepared to make conciliatory gestures, in order to avoid a trade war with the U.S., its biggest overseas market.

Table 1: Impact on the US economy of increased trade and investment with China

Year	GDP (%)	Net jobs (persons)	Consumer price level (%)	Current account (% GDP)
2001	-0.20	-66	0.0	-0.18
2002	-0.15	-64	-0.1	-0.15
2003	+0.05	30	-0.2	-0.12
2006	+0.50	24	-0.6	-0.05
2007	+0.60	10	-0.7	-0.03
2008	+0.60	5	-0.7	-0.01
2009	+0.60	5	-0.8	0
2010	+0.70	5	-0.8	0

Source: Oxford Economic Forcasting (OEF), in: The US-China Business Council (USCBC) (January 2006, 17).

Looking at the future development of bilateral economic relations, a report by the Oxford Economics and the Signal Group seems to offer some relief for the U.S. economy. Based on a detailed assessment of U.S.-China trade and investment since 2000, as well as projections for 2010, the report comes to rather optimistic conclusions regarding the impact of closer economic cooperation with China on the U.S. economy (see table 1). According to the report, U.S. GDP will be 0.7% higher, due to an increase in trade and investment since 2001. Another positive effect is a lower inflation rate; U.S. prices will be 0.8% lower by 2010 compared to 2001. This development has a positive impact on the income of U.S. households. By 2010, the real disposable income per U.S. household per year would increase by around US$ 1,000. Productivity of works across the U.S. will be 0.7% higher by 2010. There will be a negative impact on employment in the first years, but job lossess will be offset by an increase in U.S. service jobs. The report concludes that despite significant costs to certain import-sensitive industrial sectors, the long-term benefit to the United States in terms of trade and investment with China are substantial (The US-China Business Council January 2006).

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