



## Issue Brief: How Much Does China's Exchange Rate Impact the Trade Deficit?

Answer: Probably less than you think.

Yes, an exchange rate that better reflects and responds to trade flows is important. Yes, a multilateral, comprehensive look at global economic imbalances is necessary. But China's exchange rate is probably not the significant factor in the US trade deficit that some make it out to be.

First, many of the goods the United States used to import from Japan, Taiwan, and other Asian economies now come from China because Asian companies have shifted their export manufacturing base there. As China's share of the US trade deficit has risen with this shift, the share of the US deficit from the rest of East Asia has declined (see Figure 1).

Think of it this way: Ten or fifteen years ago when you bought a TV, the label probably read "Made in Japan" and was an import. Today, that TV now says "Made in China" – and is still an import.

To suggest, as some have, that if an item were not imported from China, it would be made in the United States is misleading, at best.

Further, the RMB appreciated nearly 20 percent between 2005 and the start of the global recession in 2008 as a result of steady engagement and negotiation. During this period of significant RMB appreciation, the US trade deficit continued to grow, underscoring our point about the limited relationship between the exchange rate and the trade deficit (see Figure 2).

China halted exchange rate movement in July 2008 due to the developing uncertainties in the financial markets. Now that financial markets have stabilized and China is seeing export growth again, its central bank has announced a return to exchange rate flexibility. We think that means that China will resume gradual appreciation, as long as politics don't intervene -- especially given the country's rising inflation and its oft-stated desire for rebalancing its domestic economy.

It also is important to note that US companies selling to China never cite the exchange rate as a competitive barrier – and our 300+ percent growth in exports to China since the beginning of the decade underscores that. Every year, USCBC surveys its members on the barriers that impact their business with China. The

exchange rate never comes up as an issue harming their sales. In fact, China is the only major US export market that has averaged 15 percent annual growth over the past decade – the annual growth rate required to meet the Obama administration's goal of doubling US exports in five years.

Clearly, there are factors that make China's exports to the United States cheaper than those produced in other countries or, in some cases, domestic products. If those factors are due to unfair trade advantages, we should go after them with the appropriate trade tools. But focusing on the exchange rate to solve the trade deficit is the wrong approach.

Legislation that imposes a tariff on imports from China to offset currency undervaluation will violate WTO rules and will tax US consumers without getting us any closer to the objective of moving China toward a market-driven exchange rate. It's hard to find a winner in this type of action, but the clear loser would be American households.

So, what should be done?

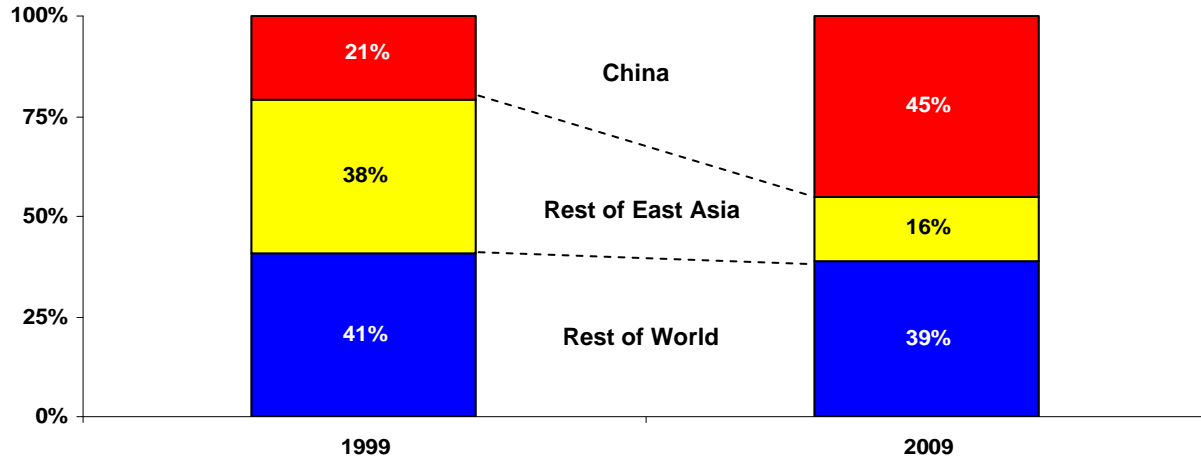
USCBC supports an exchange rate that better responds to China's global trade flows. The Obama Administration had it exactly right last year when it said it would pursue a multilateral approach to global imbalances, including exchange rate issues. China needs to be at the table for the all-important discussions on addressing the current global financial imbalances and regulatory challenges.

And, when China is found to be flouting international trade rules, we should seek direct dialogue to resolve the issue. If good faith dialogue fails, we should use rules-based trade tools, such as World Trade Organization (WTO) cases, when well-defined and winnable, to seek redress. The US government has done this with WTO cases on China's export subsidies, auto parts import barriers, financial news services market access barriers, and intellectual property rights enforcement shortcomings.

But we are deceiving ourselves if we think that "fixing" China's exchange rate will significantly impact the trade deficit, or the decades-long decline in manufacturing jobs due to productivity increases.

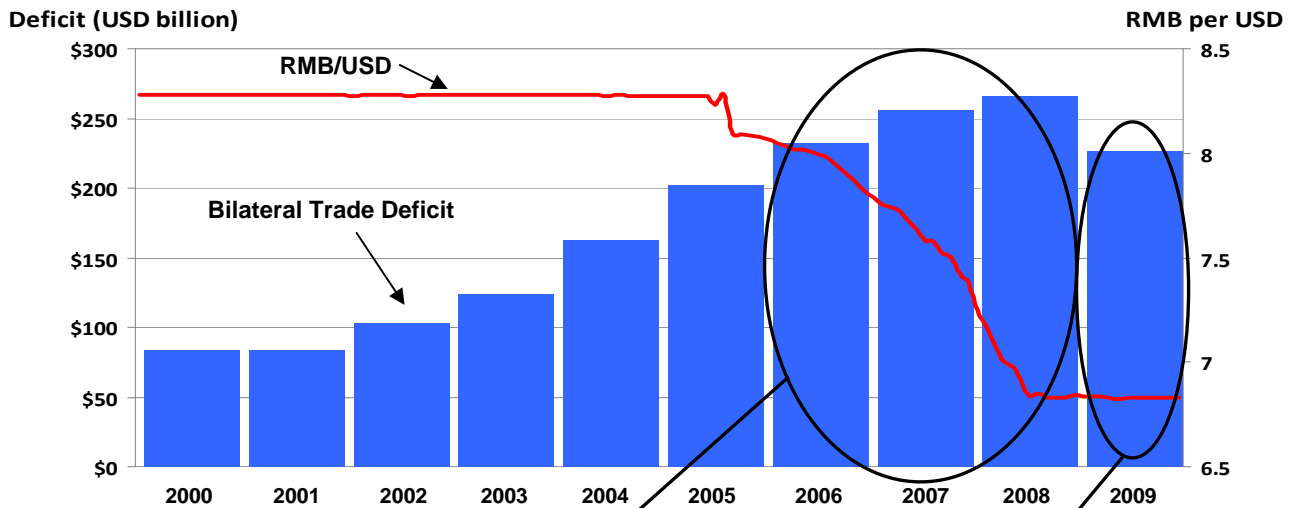
## China's Share of the US Trade Deficit Reflects a Shift from the Rest of East Asia

Figure 1: Composition of US Global Trade Deficit



## The RMB-USD Exchange Rate Shows Little Correlation with the Bilateral Trade Deficit

Figure 2: Exchange Rate Impact on US Trade Deficit with China



### 2005–2008

#### RMB strengthens dramatically, trade deficit grows

Despite a nearly 20 percent appreciation between July 2005 and July 2008, the US trade deficit with China continued to increase.

### 2008–2009

#### RMB exchange rate steady, trade deficit drops

The US trade deficit with China shrank 15 percent from 2008 to 2009 while the exchange rate remained steady, because of the recession and curtailed US consumer spending.