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The Economic Relations of the United States and China over the Years 2005–2015

The author concentrates in the paper on the trade and financial relations between the United States of America and People's Republic of China over the period 2005–2015. The growing interdependence of the two leading economies on the Western (the US) and Eastern (China) hemispheres undoubtedly is a salient factor in global economy that needs to be scrupulously studied. The geoeconomic competition between the two states overlaps the concomitant geopolitical rivalry. It is one of the most germane phenomenon in the global economic and political relations of the contemporary world.

Keywords: *US, China, US–China trade relations, US–China financial relations, US–China economic relations, trade, finances, US economy, Chinese economy*

1. Introduction

Over the last decade extraordinarily important and substantial changes took place in the global economy. Many of them were related to occurrences, developments and processes happening within the Peoples' Republic of China (PRC), the United States (US) and between these two biggest world economies. According to the experts of the International Monetary Fund, China in 2014 overtook the US as the world's largest economy measured in overall GDP adjusted for power purchase parity. This is an occurrence of giant economic and political significance. It would not be an exaggeration to state that the economic relations of China and the United States are nowadays the most important for economic prosperity of the whole globe. In the paper the author is going to focus on the US and China's economic relations in the last 10 years with particular attention to trade and financial matters.

The author tries to answer briefly for the following research questions in the paper: what are the main tendencies in the bilateral US–China economic relations; what are the most disputable issues in economic relations of these two powers as well as in what direction are both countries' economic relations evolving. The main thesis of the article is that the US leaders are increasingly worried about the augmenting financial weight of China in the world that, from their perspective, might constitute a serious threat for the primacy of the US dollar and, more broadly, the US economy in the world.

The article, except for introduction and conclusion, consists of three parts dedicated in sequence to: the US–China trade relations, the US–China disputations over the yuan's currency rate, and the US–China rivalry for global financial dominance in the world.

2. The US–China Trade Relations

The US routinely has huge trade imbalances in its trade with the PRC. Even worse for the US government, these trade imbalances present a clear tendency to grow over time. As Table 1 evidently displays, the US's exports to China increases year by year, nonetheless China's exports to the US grows every year in even higher numbers. Only in 2009 – the year of global economic depression did the trade between two powers temporarily drop. In the remaining years of the last decade it always grew.

Table 1. US trade in goods with China 2005–2015

Year	Export	**Import**	**Balance**
2005	41,192.0	243,470.1	–202,278.1
2006	53,673.0	287,774.4	–234,101.3
2007	62,936.9	321,442.9	–258,506.0
2008	69,732.8	337,772.6	–268,039.8
2009	69,496.7	296,373.9	–226,877.2
2010	91,911.1	364,952.6	–273,041.6
2011	104,121.5	399,371.2	–295,249.7
2012	110,515.6	425,619.1	–315,102.5
2013	121,746.2	440,430.0	–318,683.8
2014	123,620.7	468,483.9	–344,863.2
2015	116,071.8	483,244.7	–367,172.9

Source: U.S. Census Bureau, viewed September 20, 2016, https://www.census.gov/foreign–trade/balance/c5700.html.

As Tables 2 and 3 unequivocally show, excluding Hong Kong, the US is the main destination of exports from China and China is the main source of the US imports. It should be underlined that a large part of China's exports to the US is the so–called processing trade. That means that China's economy imports many goods from other, mostly Asian, states, processes them and then exports new, processed goods to the US. As a consequence a relatively large portion of the Chinese exports to the US has a low value added or, in other words, is not very profitable (Kastner 2015, p. 117).

Table 2. Main destinations of China and the US's merchandise exports in 2014

Main destinations of China's merchandise exports	Percentage of total China's merchandise exports	Main destinations of US merchandise exports	Percentage of total US merchandise exports
1. United States	17.0	1. Canada	19.3
2. European Union (28)	15.9	2. European Union	17.1
3. Hong Kong	15.5	3. Mexico	14.8
4. Japan	6.4	4. China	7.7
5. Republic of Korea	4.3	5. Japan	4.1

Source: World Trade Organization, viewed September 20, 2016, http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN%2cUS.

Table 3. Main destinations of China and the US's merchandise imports in 2014

Main destinations of China's merchandise imports	Percentage of total China's merchandise imports	Main destinations of US merchandise imports	Percentage of total US merchandise imports
1. European Union	12,4	1. China	19.9
2. Republic of Korea	9.7	2. European Union (28)	17.8
3. Japan	8.3	3. Canada	14.8
4. United States	8.2	4. Mexico	12.5
5. Taiwan	7.8	5. Japan	5.7

Source: World Trade Organization, viewed September 20, 2016, http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN%2cUS.

Over the last decade many trade disputes have emerged between the US and China. As of March 2015 China and the US were engaged in 16 trade disputations in the World Trade Organization (WTO) (Morrison 2015, p. 46). During the period 2005–2014 the US government sued China 13 times for not complying with the WTO's regulations. These disputations concerned the following issues: auto–industry (World Trade Organization 2015a, 2015d), export of broilers (World Trade Organization 2015b), wind power equipment (World Trade Organization 2015l), flat–rolled electrical steel (World Trade Organization 2015f), electronic payment services (World Trade Organization 2015c), restriction on exports of different raw materials (World Trade Organization 2015n), grants and loans given to Chinese firms on privileged conditions (World Trade Organization 2015g), financial information services and foreign financial information suppliers (World Trade Organization 2015h), audiovisual entertainment products (World Trade Organization 2015k), inadequate protection and enforcement of intellectual property rights in general (World Trade Organization 2015j), unfair granting of refunds, reductions and exemptions from taxes for Chinese companies (World Trade Organization 2015e), automobile parts (World Trade Organization 2015i) and the ban of exports of rare earth minerals implemented by Beijing (World Trade Organization 2015m).

In particular, the last case is worth a closer look due to the publicity it attracted and its importance for the global economy. Rare earth minerals is a group of 17 elements that can be found in the Earth's crust in relatively small amounts. Concurrently, these elements are crucial to a number of salient high–tech industries. China in its latest decades gained an overwhelming monopoly on the exploitation and processing of these minerals to the point where it accounts for 97% of global production. Chinese authorities at the breakthrough of the first and the second decade of the 21st century began gradually restricting the exports of rare earth minerals. The principal objective of this policy was to stimulate the development of the high–tech industry within China. China's moves on that subject were very unfavorable to major rare earth minerals importers, including the US (Morrison & Tang 2012, p. 2). As a response the US government together with Japan and the European Union initiated a dispute settlement case against the PRC within the frameworks of the WTO. In 2015 China lost the case in the WTO and had to lift most of its export restrictions to rare minerals, molybdenum and tungsten (World Trade Organization 2015m).

On its part China also took the US to WTO's tribunals for illegal trade practices six times. China initiated dispute settlements against the US as to the following matters: some questionable anti–dumping proceedings involving China (World Trade Organization 2015q), unduly duties on some products from China (World Trade Organization 2015r, 2015s), anti–dumping measures on shrimp and diamond sawblades from China (World Trade Organization 2015o), certain passenger vehicles and light truck tires (World Trade Organization 2015t), poultry (World Trade Organization 2015p) as well as coated free–sheet paper (World Trade Organization 2015u). As we can see from these examples, the range of bilateral trade arguments between two major economies is quite wide.

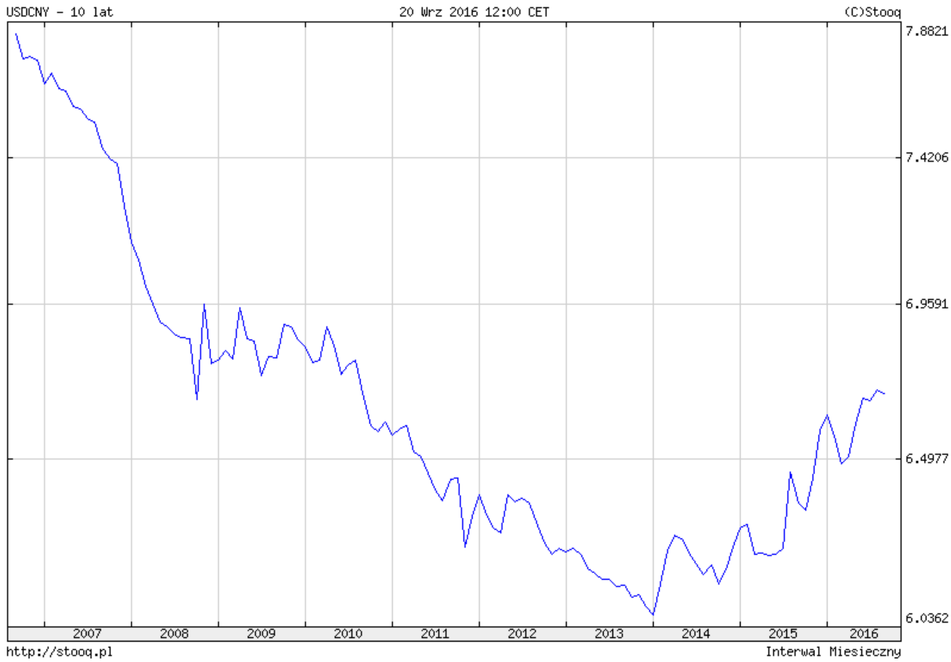
The analysis of bilateral trade disputes between the US and the PRC in the WTO shows that the US twice more often sued China for violation of the WTO' rules than China sued the US. It is characteristic that a great deal of the trade disputes between the PRC and the US resulted either from the protectionist policies of China or the industrial espionage (especially cyberespionage) widely practiced by Chinese entrepreneurships. As well, a very liberal, to say the least, approach to the protection of intellectual property rights of foreign companies, is a constant motive in the US–China trade arguments (Dumbaugh 2009, pp. 1–2). Though sometimes the US experts opine that a growing concern among American consumers about the safety of the Chinese products is one of the main reasons for the bilateral trade disputations, a closer examination of the matter leads to the conclusion that it is more often a pretext to restrict China's quite competitive imports than a real threat for American consumers. In spite of setting up special bodies like the US–China Joint Commission on Commerce and Trade (JCCT) aimed, among other things, at alleviating trade disputes, it seems unlikely that in the nearest future the frequency of trade disputes between the US and China will diminish more than symbolically.

3. The US–China Disputations over the Yuan's Currency Rate

Over the period subjected to the studies the US government almost constantly pressed China to let its currency revalue against the dollar. A good deal of rhetorical and verbal battles between China and the US on the "appropriate," "normal," "correct" and "fair" exchange rate between the yuan and dollar took place in the last decennary, particularly in the US Congress – US politicians tried to show their voters how much they care for jobs in their states. The main reason for that pressure was the giant and still increasing deficits that the US economy had in bilateral trade with China. Overall, China was quite resistant to this pressure, despite the fact that from time to time the People's Bank of China (PBoC) made decisions to correct the yuan's peg to the dollar up. There were two rounds of the yuan's revaluation since 2005. The first round occurred in July 2005 when the PBoC raised the exchange rate of the renminbi to dollar from 8.28 to 8.11. This revaluation was widely unexpected and surprised the markets. From that moment on, over the course of the next three years the yuan gradually was revalued against the dollar to reach the level of 6.82 in July 2008, just before the financial crisis erupted. The second stage of revaluation occurred between June 2010 and August 2011. The yuan peg to the dollar was set at the higher level of 6.40 (Rickards 2012, p. 98). In the summer of 2015 it is salient to note that these revaluations were always conducted after scrupulous analysis of its effects. It ought to be emphasized that the Chinese central bank did not hesitate to depreciate the yuan in relation to the dollar, whenever it considered such a step to be right. For example, in the summer 2015 the PBoC unexpectedly appreciated the yuan to the consternation of US's authorities (Jackson 2015, pp. 1–2). With this move the PRC proved that it could refute the US's pressure when vital economic interests of China go into force. Diagram 1 presents how the yuan fluctuated against the dollar in the period subjected to analysis.

For the short period of time after the global financial crisis of 2008 it even seemed that the world was entering into a period of a real currency war between major economies, with China and the US as the major players. Fortunately, this did not happen, to a certain degree thanks to China's mild, responsible, and prudent conduct after a series of American unconventional steps in monetary policy that were to some extent oriented towards the devaluation of the US dollar. For China this Federal Reserve System's ultraloose monetary policy was unfavorable for two principal reasons. First of all, it made China's huge dollar–denominated holdings worth less. Even worse was importing the inflation from the US to China's economy. Due to the fact that China's currency was pegged to the dollar, any depreciation of the US dollar resulted in a quite proportional depreciation of the yuan. To maintain this peg between the renminbi and the dollar the PBoC had to buy dollars for newly printed currency. The more yuans it printed, the higher the inflation emerged in China.

Diagram 1. USD/CNY over the last decade



Source: Stooq, viewed September 20, 2016, http://stooq.pl/q/?s=usdcny&c=10y&t=l&a=lg&b=1.

The American politicians (particularly the Republicans) and some economists argue that the undervalued yuan had a considerable negative effect for the US economy, especially for the manufacturing sector. These people claim that if China's currency had not been undervalued, the US industrial firms would not move their manufacturing activities abroad. Despite these arguments, it must be stressed that the decline of job positions in the manufacturing sector of the US economy is a result of many various factors – the yuan's undervaluation is merely one of a multitude of them and, on top of that, it is definitely not the most important factor (Morrison & Labonte 2008, pp. 30–31).

As well, it must be highlighted that at least after 2008 not only China manipulated its currency. The US did it even more. Many economists believe that one of the main, although undeclared publically, reasons of quantitative easing policy carried out by the Federal Reserve was to weaken the dollar against other currencies (Rubin 2010). In this light it would be hypocrisy on the side of the US political and financial leaders to reproach China for notorious currency manipulation.

Table 4. Basic economic indicators of the US and the PRC (2015)

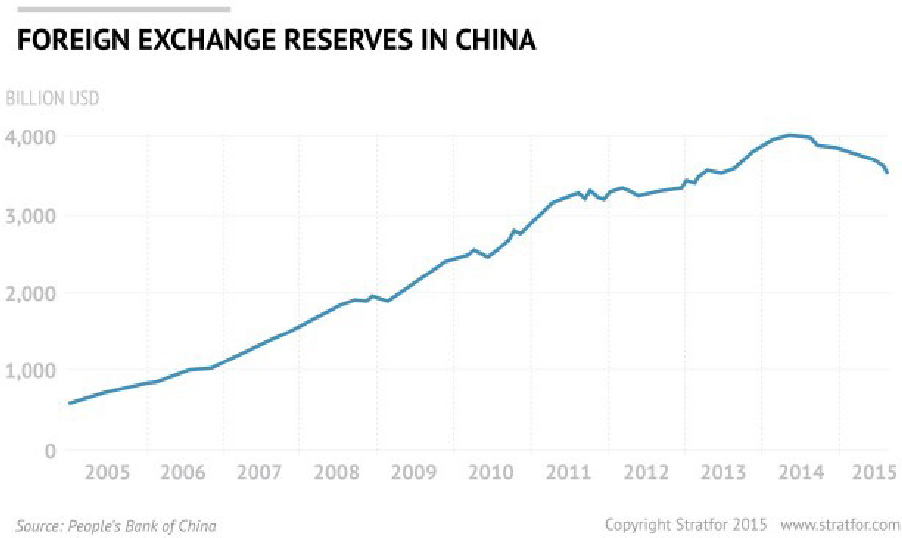
Economic indicator	US	China
GDP (PPP) [trillions of $]	17.95	19.39
GDP (official exchange rate) [trillions of $]	17.95	10.98
GDP per capita (PPP) [$]	55,800	14,100
Gross national saving [% of GDP]	18.7	46.0
Labor force [millions]	156	804
Unemployment rate [%]	5.2	4.2
Inflation rate [%]	0.1	1.4
Gini index	45	47
Public debt [% of GDP]	73.6	16.7
Taxes [% of GDP]	18.1	21.3
Reserves of foreign exchange and gold [trillions of $]	0.130	3.217
Exports [billions of $]	1.598	2.270
Imports [billions of $]	2.347	1.596
Current account balance [billions of $]	–484.1	293.2
External debt [trillions of $]	1.726	0.950
Stock of direct foreign investment at home [trillions of $]	3.116	1.723
Stock of direct foreign investment abroad [trillions of $]	5.191	1.111
Share in world total merchandise exports in 2014 [%]	8.53	12.33
Share in world total merachndise imports in 2014 [%]	12.64	10.26

Source: CIA – The World Factbook, viewed September 20, 2016, https://www.cia.gov/library/publications/the–world–factbook/geos/us.html and https://www.cia.gov/library/publications/the–world–factbook/geos/ch.html.

4. The US–China Financial Relations

Both the US and the PRC are heavily financially interdependent. Their financial relations is similar to the relation of a creditor (China) and debtor (the US). It is estimated that currently approximately one–third of the PRC's total foreign currency reserves is allocated in US Treasury securities alone, not including other dollar–denominated assets (Stratfor 2015a). The PRC, without a shadow of a doubt, is the biggest foreign holder of US Treasury securities. The constant huge Chinese trade surpluses enabled the PRC to gather gigantic foreign exchange reserves. Nowadays, China undoubtedly could boast the biggest foreign exchange reserves in world. Diagram 2 shows how the reserves mentioned above increased over the last decade.

Diagram 2. Foreign Exchange reserves in China 2005–2015



Source: Stratfor, viewed September 20, 2016, https://www.stratfor.com/sites/default/files/styles/stratfor_large__s_/public/main/images/foreign–exchange–reserves–in–china.jpg?itok=omOnskKQ.

Theoretically, the PRC at any moment could dump all the US Treasury securities on the global market bringing about a crisis of the US economy and giant turbulences in the global economy. If China ever did that, by that it would deal a very dire blow to the American economy. Nevertheless, such a highly hypothetical action would also be very harmful for China's economy. Beijing is not interested in the serious depreciation of the US dollar, because such a depreciation would entail the significant and undesirable real drop of value of China's foreign currency holdings. Even worse is the fact that such a move would certainly decrease the demand for China's goods in the US as well as other important markets and in consequence slow down the dynamics of China's GDP, concurrently raising unemployment in the Middle Kingdom (Morrison 2015, p. 30).

For the US, China is increasingly important as the largest holder of US Treasury securities. Its percentage of total US treasury securities holdings raised clearly since 2005 from the level of 11.5% to 19.5% as can be seen in Table 5. It means that the US augmented its financial dependence on China in this period of time. Paradoxically, China has been financing and supporting the ailing economy of its main global adversary. This situation of mutual interdependence and interaction restrains both global powers. The US leaders are well aware of it. Perhaps the best proof for such a claim was revealed in an confidential US diplomatic cable. Namely, the former Secretary of State Hillary Clinton during her talk with the then Australian Prime Minister Kevin Rudd asked him rhetorically: *How do you deal toughly with your banker?* (Guardian 2009). By the "banker" she meant China.

Table 5. China as a holder of US treasury securities

Month and year	**Grand total of US treasury securities [billions of $]**	**Treasury securities held by Mainland China [billions of $]**	**Percentage of total US treasury securities held by Mainland China**
March 2005	1952.2	223.7	11.5
March 2008	2505.8	490.6	19.6
March 2015	6175.9	1261.0	20.4
July 2016	6247.9	1218.8	19,5

Source: U.S. Treasury Department, viewed September 20, 2016, http://ticdata.treasury.gov/Publish/mfh.txt and http://ticdata.treasury.gov/Publish/mfhhis01.txt.

There are some signs that within its broader aim of replacing the dollar with the yuan as the world main reserve and trade currency the PRC is covertly hoarding huge amounts of gold. In July 2015 the PBoC announced that it had amassed 1,658 tons of gold – 604 tons of gold more than the last time it released an announcement or update on that matter (Saefong 2015). Yet, most pundits do not believe that this data correspond to the truth. They claim that in reality China possesses much more gold in its reserves than it officially declares. The bulk of estimations waver between 2,700 and 5,000 tons of gold (Saefong 2015; Nielson 2015; Holland 2014), however sometimes much higher assessments are also given. There is much evidence and indirect proofs supporting this assertion. For example, the Middle Kingdom is the biggest producer of gold all over the world, yet it does not export the gold abroad at all. The demand from Chinese individual and institutional investors does not explain the gap. Furthermore, it is not in China's interest to publicly admit that it is discreetly purchasing substantial amounts of gold because such a step would result in the rise in the price of this metal. Therefore, it is better to inconspicuously buy the gold at lower prices. Interestingly, it is probable that the PRC is doing this because in the future huge gold reserves in its possession would make the yuan much more attractive and credible as a reserve currency. It cannot be even excluded that in the long term the PRC will try to make the renminbi a currency backed by gold as was the dollar in 1971. Such a move would be an enormous challenge to the dollar's dominance as the leading world reserve currency.

One of the most important features of China's economic policy in the last decennium is its direction toward the gradual internationalization of the renminbi. This, in fact, directly binds China with the US, because the dominant standing of the American currency in the global trade and financial system is a direct obstacle in the realization of this ambitious Chinese objective. At the moment about 81% of global trade settlements is carried out in the US dollar, whereas merely 9% is conducted in Chinese currency (Nye 2015, p. 51). The long–term Chinese goal is to substitute the dollar as the dominant global currency. To attain this purpose China needs to essentially do three things:

- vastly increase the use of the yuan in global trade transactions (and at the same time decrease the use of the dollar);
- make the yuan fully and freely convertible in both domestic and international markets;
- make China's capital market very deep, favorable and attractive for investors from all over the globe.

Neither of these aims can be achieved in the short term. But as an ancient Chinese saying goes: "a journey of a thousand miles begins with a single step." Over the last 10 years China undoubtedly made the first relevant steps to reach this overarching distant purpose. Chinese authorities are by certain degrees letting more and more domestic companies settle their international transactions with the yuan instead of the dollar, yen or euro. In recent years Beijing struck several deals with many, mostly developing, states that determined to settle their mutual transactions in the yuan or through barter trade (Shambaugh 2013, p. 127).

Right now, at least by Western standards, capital control in China is very restrictive. For instance, Chinese citizens are not allowed to transfer more that 50,000 USD a year out of their motherland (Rickards 2015, chapter 4). The yuan bond market is very small in comparison to the dollar bond market. Although it is quite likely that over time the dollar's weight in the Special Drawing Rights (SDR) basket will be diminished in favor of China's currency, the US seems to be hell-bent on inhibiting and extending this inescapable process for as long as it can.

The US on its part intends to keep the privileged position of the US dollar in the world and to preclude China from undermining its dominance by the yuan. The US has been blocking for years reforms of voting rights in key financial institutions like the World Bank and the International Monetary Fund that would increase the standing of China at its cost. the US government inhibits efforts toward the yuan's entrance into the SDR basket. Currently, this basket is not composed of the yuan at all. Moreover, the structure of China's economy is also disadvantageous for the substitution of the US as the main pivot of the global economy supplying the rest of the world with primary reserve currency. In order to do that, China should have a much bigger domestic consumption and imports than it has today. Bearing this in mind, one need to accentuate that Xi Jinping lately has made meaningful efforts to transform the PRC's economy toward that direction.

The Obama Administration overtly criticized China for its foundation of the Asian Infrastructure Investment Bank (AIIB). This bank was created from scratch from China's initiative. The prevalent opinion in financial circles is that the AIIB is a competition for both the Japan–dominated Asia Development Bank and the US–dominated World Bank. China's government seeing how the US (especially the US Congress) obstructed and hampered the voting right reforms in the International Monetary Fund and the World Bank Group, which would enhance China's influence and significance in global economic governance, decided to create the AIIB. Nonetheless, recently the US suffered a considerable defeat in its efforts. American diplomacy put a considerable pressure on its allies, particularly on Japan, the United Kingdom and Australia not to join the Chinese initiative. But to the US government's dissatisfaction only Japan decided not to accede the AIIB. The White House was especially angry after the British prime minister made the decision to join the AIIB. This move initiated a kind of a domino effect in Europe, because in the wake of the United Kingdom's government other European governments took the same decision. Of course, every government silently counted on gaining some big contracts for their firms from the AIIB and China. To put it simply, Europe preferred its own economic interests over the interests of the US and Japan. This case proves the thesis that though the US can slow down and prolong China's rise in global finance it cannot impede it entirely. This trend seems to be inevitable.

A paramount element of the US–China financial relations in regards to China's sovereign wealth fund's investments in the US. In 2007 China set up the enormous state–owned China Investment Corporation (CIC). At the outset Beijing granted the CIC 200 billion USD of initial capital. Since its foundation the fund invested much of its capital in the US financial sector. In 2007 the CIC bought a 9.9% share in Morgan Stanley – one of the biggest and most famous American investment banks (Martin 2008, p. 2). Some American policymakers did not welcome this and similar purchases. They argued that the CIC's investments were often politically–motivated and the fund was fully controlled by China's authorities which could be potentially dangerous for US national security. Some influential American politicians appealed for a painstaking revision of the US law in such a way as to obstruct or even entirely forbid China's sovereign wealth fund's investments in crucial US companies, especially financial ones. Others opted for enaction of the special limits on Chinese firms and funds as for the ownership of American entrepreneurships. In spite of such voices, the Bush Administration did not express its discontent with the CIC's purchases (Martin 2008, p. 21). The US did not push through very restrictive limits on China's sovereign wealth fund partly due to an apprehension that Beijing could respond with implementation of similar protectionist regulations that would largely impede the access of US financial corporations to the lucrative China's market.

5. Conclusion

China undeniably in the last decade has become a global economic center. Today its significance for the world economy almost equals the US position. The US in many respects is losing to China in economic competition. The role of the yuan in the global financial system is slowly but gradually rising. This process is inescapable. Chinese companies are becoming the biggest investors in foreign markets and a very relevant source of capital inflows for many states. The US corporations feel increasingly the competition of their China's equivalents. The Middle Kingdom's financial might is rarely disputed. The American policymakers are increasingly worried that China sooner or later may successfully undermine the US dominant position in the world financial system. The PRC appears to be determined to expand the role of yuan in global trade and finances as well as to enhance its economic influence in major financial institutions. Some specialists claim that the Trans–Pacific Partnership (TPP) trade agreement that had been finally agreed upon is nothing else but a try on the side of the US to preserve the American hegemonic position in the face of a vividly rising Chinese economic power in the world (Stratfor 2015b). Even though the TPP was not originally an American idea, it was furthered and supported by the White House as a response to China's economic expansion in the Pacific basin. Many commentators assert that, as a matter of fact, the TPP is to a certain degree an anti–China trade bloc. US President Barack Obama aptly expressed purpose of the US foreign economic policy with the following words: "If we don't write the rules for trade around the world, guess what? China will" (Schuman 2015). One may only add to these words that not only the trade rules but also financial rules come into play. A contest between two world powers for control of global trade, finances and economy is not by any means a pure fabrication, but an obvious fact.

These hard facts, beyond any doubt, point out that China's government pursues more influence and power in running the global trade and financial systems. In contrast to Beijing's expectations, the US authorities attempt to diminish and maximally slow down the shift of financial power from the US to China. The US political and financial leadership with undisguised unease and concern looks at these Chinese ambitions and aspirations to more actively participate in shaping the world economic system in its favor and to its advantage. Notwithstanding this rivalry, one should bear in mind that both powers are restricted in their actions by the plain truth that they are economically interdependent to a considerable extent. That is why they cannot push through their economic interests and desires too aggressively without taking into account the interests and wishes of the second partner as well as the third parties. Integrated and independent global markets are an additional factor that restrains China and the US in their moves.

It seems that the US will have no other option but to eventually recognize the augmenting Chinese financial might and allow it to have a more serious say in leading world financial institutions. The US someday will have to come to terms with strengthening the Chinese position in the global economy. Any desperate steps aimed at either reversing or suppressing this unavoidable trend are simply doomed to failure, even if some American policymakers may still delude themselves that they will be able to do it. China intends to be more active in managing the world economic system and no power, regardless how determined it is, will be able to obstruct it in the long run.

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