

Eye on China and United States

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Abstract

United States strives to force the Chinese into agreement of increasing the value of their exchange rate to help the USA avoid inflation

As China did not come into an agreement with the USA, Tariffs are being put on Chinese products entering USA. However China as began to add tariff on poultry received from the US as well. China was previously not named in the legislation permitting US to add tariff on their goods. But recently a bill was passed giving the commerce department the ability to place important tariffs on all countries to undervalue their currency. The bill passed in legislation had the support of 99 republicans. China has been managing their currency in a manner that makes their goods cheaper to sell and American goods more expensive. The Chinese manipulation of their currency has been quite expensive for the USA, as it has cost them \$1.5 billion jobs increasing the percentage of unemployment greatly and significantly. This imposition of tariffs on Chinese goods could result in effecting \$300 billion dollars worth of their products. It is obvious that the Americans are attempting to improve and acknowledge their growth and power.

As predictions have developed over this conflict, arguing the fact that China will not negotiate with the USA at this point rather fight back and also approach in adding tariffs on US imports. However, this reaction by the Chinese will only worsen the scenario and result in the possible inflation of the US economy or worldwide trade war. This is a very sensitive time for the United States as their biggest hopes are dependent on the Chinese. But it doesn't look like they will be too satisfied with the outcome.

1. Introduction

In this article I will discuss the possibility of the United States passing legislation that would enable the government to place tariffs on all imports from China. Tariffs have been subscribed on specific products such as steel and tires because of proof of export being unfair; however, placing tariffs on all products coming from a country is unusual. The tariffs put on Chinese products by the US will be retaliating for the Chinese, because in a sense they are devaluing their currency. For example, dumping their products in the United States to bypass the fact that they are selling their products for a much lower price As the article goes on I will share my predictions and thoughts as to the possible outcome and the relationship that might occur between American and Chinese government if the bill is passed and accepted by the WTO. The House of Commons in America are also behind this matter as they believe it will help pull up their economy. They believe it's so significant that the vote to pass the tariff bill was 348 to 79 and they also had the vote of 99 republicans.¹ This means that all of United States is backing up the tariff put on Chinese products, meaning that they may be lacking knowledge of the other side

¹ David E. Sanger, *Eye on China, House Votes for Greater Tariffs Power*, September.29.2010, web Octobe.28.2010

of the story, other side of the story being China. As a closure of the article I will take my side on one of the competing countries, U.S or China and share with you my opinion and predictions. In my predictions you will find what I presume may happen in the relationship between China and USA and whether this conflict will reach a closure anytime soon and if not what the next move could be.

2. Background

Over the last thirty years the economies of both China and the United States have extremely expanded. However, three decades have passed; China is known to be one of the largest trading partners with the US, providing them with the largest source of imports.² For the United States, China is an ideal place for investment because of their growing population and their rapid rise of economy. U.S. and China economic relationship benefits certain business interest, consumers, and groups. However, some domestic groups and consumers disagree with U.S. economic interests because they find investment in China unreasonable. Research has proven that many trading conflicts may occur but the outcome of economic relationship between China and U.S. could benefit the both sides. Also researches argue that China and the United States could be a large factor behind the cause of global imbalances and global financial problems.

As the conflict began back in 2005, The US government began to pressure the Chinese to revalue their currency. At that time the Chinese had been able to maintain a fixed exchange rate of 8.28 since 1995, which threatened the US and gave them the mentality that this fixed rate convey' risk to global economic growth. In 2005, one reason the US put extreme pressure on China to revalue their currency was due to the Schulmer- Graham bill that introduced the idea of tariff's put on Chinese products. United States proposed a 27.5% tariff on all Chinese exports to the United States if the Chinese did not accept to change their currency policies. If Chinese were not to accept this agreement at that time, a U.S. tariff on Chinese exports could have led China to a very sensitive situation. U.S.A's idea of a 27.5% on Chinese products could have resulted in China's fall of economy and a possible recession. However, retaliation by China would have some effects on China itself, but make U.S. worst off than China. But as it appears, although this issue could have had a negative effect on both China and U.S., the Chinese would be more at risk and it would be to their benefit to come into agreement with the US and revalue their currency to prevent global imbalances.³

² Wayne M. Morrison, *China's economic conditions*, July.29.2010, web October.30.2010

³ HKTD, *Schumer, Graham Withdraw China Tariff Bill as Bush Administration Pushes Long-Term Approach*, October.20.2006, web, October.30.2010

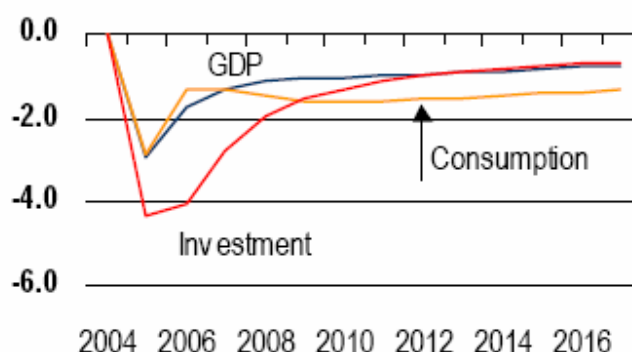


Figure 1. Example of consumption and investment of China with a 27.5 % tariff on imports into the United⁴

As a result and as stated by the Bank of China, the dollar-yuan exchange rate went from 8.26 to 6.83 yuan per dollar from July 2005 to July 2009 which was an appreciation of 21%.(Calculated from back of China data using the official middle rate)

However, once the effect of the Global financial crisis became obvious the government of China managed to maintain the yuan/dollar exchange rate similarly stable since 5 to 6 months into 2010.⁵

As US had just pulled up their economy between 2005-2008 and created the “ American” life as it was to be referred to, their sudden economy downfall and strive towards recession sort of forced them to approach China the way they began to do so as of 2009.⁶ Due to their high percentage of unemployment and economic downfall, they wanted to force China into increasing their currency rate. However, the way the conflict had began to grow; China had taken in the stubborn request from the US and did not want to give in that quick, so they decided to be stubborn back. Although it was a rough time for the economy of US, China was having lots of economic success and had been able to maintain it just as successfully. They felt that this selfish request from the US was not to be tolerated even though they were being threatened with tariffs. But China was not one to stand and take the threats, instead they stood up tall and strong behind their Economy and created tariff’s amongst the poultry they were receiving from the US. This Action taken by the Chinese was a clear act of defense and it resembled the beginning of a Global trade Conflict.

3. Trade Barriers

In 2009- China was the largest source of US imports at \$296 billion compared to the \$338 billion of imports they had in 2008, which was 19% of US imports. Compared to 2008, US imports were down 12.3%. But in total, import from US had declined by 25.8%. Also in 2009, China was reported to be the third largest source of US imports containing, agriculture, fish, and forest products at 7.2 billion. Other product categories included forest products, seafood, and

⁴ Economic Scenarios.com, “What if China Revalues its Currency?”, Issue7

⁵ HKTDC, Schumber, Graham Withdraw China Tariff Bill as Bush Administration Pushes Long-Term Approach, October.20.2006,web

⁶ Professor Warwick McKibbin, Dr Andrew Stoeckel, What if The US Imposes a Tariff on China’s Export to Force a Revaluation?,web November.1.2010

processed fruit and vegetable. However, during the first 5-6 months of 2010, up until July ,imports from China increased by 16.7% over the same period in 2009, which was slower than the total increase in US imports by 25.2 % .⁷

Investment plays a huge role between the relationship of China and US. China has invested in the US assets that can be referred to in two categories. One being Holdings of US securities, and second being FDI (Foreign direct investment). A significant and large amount of Chinese investment has gone into US securities, while FDI stores the bulk of investment in China from the US. However, US must not forget that its Treasury securities are still beheld in China. Treasury Department in April 2010 reported an estimate that US securities held in China is standing at 1,464 billion and has increased 21.5% since 2008.

The graph on the Table 1 shows China's Holdings of U.S. Treasury Securities: 2003-2009 and May 2010; the numbers are in \$ billion and as a percent of total foreign holdings.⁸

Table 1. China's Holdings of U.S. Treasury Securities 2003-2009 and May 2010

	2003	2004	2005	2006	2007	2008	2009	May 2010
China's Holdings(\$billions)	159.0	222.9	310.0	396.9	477.6	727.4	894.8	867.7
China's Holdings As a percent of Total Foreign Holdings	10.4%	12.1%	15.2%	18.9%	20.3%	23.6%	24.2%	21.9%

Sources: U.S. Treasury Department⁹

As a result of this Global Conflict between China and US, US businesses are having a difficult time working in China because of important trade barriers that are clear acts of force by Beijing in respect of the WTO (World Trade Organization). Any progress actions taken by China in market access barriers could be more significant to the US than their request for the increase in the Yuan. This proves that US's biggest concern may be to increase the Yuan by force, but basically to have more control over China in general. But due to the conflicts China had with US in the beginning months of 2010 over US criticism of internet censorship, Washington's arms sales to Taiwan, and president Obama's meeting with Dalai Lama (Tibet's exiled leader), China keeps reconsidering their agreement to increase the Yuan, they don't see a reason in the rush of doing so when the US is not making any efforts to grasp their attention positively, rather than doing things to make them more angry. This proves to us that China is willing to negotiate and compromise the issues the US is having with their economy , they do understand that the US may be facing inflation and that the increase in the yuan may somewhat help their economy, But China would like to see something in return that would also be of their benefit.¹⁰

⁷ Boeing Corporation, *Current Market Outlook, 2009-2028*, September 2009
November.1.2010

⁸ Internet World Stats, at <http://www.internetworldstats.com/top20.htm>, web
November.1.2010

⁹ Sources: U.S. Treasury Department

¹⁰ Dabiel Nasaw, *China retaliates over US arms sales to Taiwan*, January.30.2010, web

4. Current Issues

The drama that started back in 2005 is still an on-going world threat in 2010, as the conflict is not only resolved but heated up. All of this on-going back and forth conflict between the two countries let the US to the decision of attaching tariffs to export products coming from China, such as tire and steel. This decision was made by Barak Obama on September. 17. 2010.

From my point of view, the reason behind all of this drama is the decrease of employment in America, Raising the idea that placing a tariff on Chinese products could increase economy and open job availabilities since the presence of tariffs Chinese tire imports have fallen 30%. However, In the US, tire- making jobs are down 10% according to the Bureau of Labor Statistics data.¹¹

China makes its goods cheaper on world trade markets, encouraging consumers to buy their stuff under pricing competitors from other countries .The US needs to come to the realization that China is not the only country with low cost workforce and productions. There are other countries such as Taiwan, Vietnam, Indonesia, and Thailand that are much lower in cost. Why doesn't U.S. turn its ballpoint on them?

We must keep in mind that as much as China needs U.S. the U.S. needs China more especially if they want to avoid and prevent recession. China is the largest foreign holder of U.S. debt as they are holding 847 billion dollars in Treasury securities. China's export industry would subside without the U.S. encounters. China has a net trading deficit with its other partners which make it even more dependent on U.S. exports. On October 3, 2010 China announced their decision on adding tariffs on poultry imports that they receive from the United States. Because of the realization that the U.S. suppliers are guilty of dumping products into the Chinese market China was encouraged to act upon their decision for tariffs. It would be beneficial to the U.S. economy if they do not pick closer attention to the tensions growing between them and the world's third largest economy being China.¹²

China has a goal, and their goal is to keep the yuan (their currency) at a low value. By doing so they think that they will increase their rates of import and export. The economic theory is that China should let its currency value make it easier for Chinese consumers to buy imported goods from America and Europe.¹³ However, US the world's biggest defaulter should invest and spend more and reduce their amount of borrowing. As stated by representative Sander M. Levin, democrat of Michigan and chairman of the ways and means committee, "the best way to avoid a trade war is for there to action, and I think we hope to stimulate that."¹⁴ This statement made by Levin is significant as it confirms the idea of taking action and not allowing China to act upon any ideas that they may have regarding this situation. The US had not manipulated the Yuan (Chinese currency) 1994. This currency dispute between China and US has reintroduced speculation that the US agreed to weaken the dollar's exchange rate as agreed in the 1985 deal of

November.2.2010

¹¹ Doug Palmer, *Obama slaps duties on tire imports from China*, September.11.2009, web
November.2.2010

¹² Chris Maxey, *Is Inflation Gone Today and Here Tomorrow?*, October.18.2010, web
November.2.2010

¹³ David E. Sanger, *Eye on China, House Votes for Greater Tariffs Power*, September.29.2010, web
November.2.2010

¹⁴ Sewell Chan, *I.M.F. Chief Steps Into Dispute Over China's Currency Policy*, October.7.2010,web
November.2.2010

Plaza accord.¹⁵ But, Mr. Strauss- Kahn and his principal duty, John P. Limpsky attempted to avoid that speculation by reintroducing the group of 20 (the committee beholding the largest economies) whose leaders are to meet next month for discussion. Their discussion could involved many topics, but currency being it's most significant.

Earlier this year, The Chinese had promised flexibility in their currency, but since their promise that Yuan has increased slightly, barely noticeable or attractive to the US. Mr. Yao the president of China stated that the rise of the yuan is significantly based on China's domestic and economic situation. The Yuan is known to be almost 20% undervalued. At the G20 meeting, Geither presented a letter to countries with relentless deficits (mostly referring to the US and other industrialized countries) and encouraged them to greater savings and export, and proposed to those countries with constant surpluses such as China and Germany that they should alter their exchange rates to allow domestic spending. This proposal was mostly targeted at China, distributing the idea of promoting competition to either weaken their exchange rate or prevent approval of an undervalued currency. China is damaging the trade deficit of US in many different ways. In US, the house of represantives have already passed a bill that will be giving Obama administration the power to distribute a penalty to countries that manipulate their currency in hopes of gaining power in world trade. After the November elections are over, the senate will most likely back up The Obama administration as well.

The following graph (see Fig. 2) shows the recent increase and decrease of yuan VS dollar (2010).¹⁶

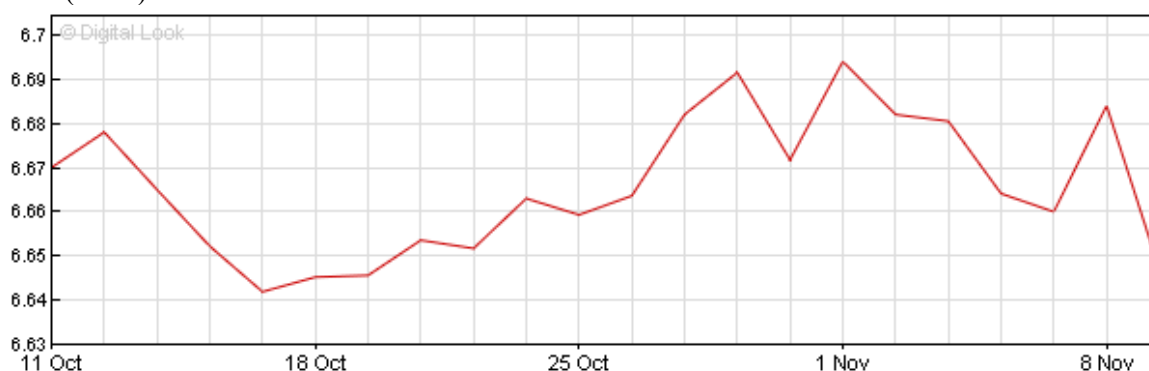


Figure 2. United States Dollar – Chinese Renminbi as of November 9/2010 ¹⁷

5. Predictions

After much research and analysis of this Global know conflict between China and The United States of America over the yuan (Chinese currency) I have grown to create some predictions as to what might happen next. As we know the US has already put tariffs on products such as steel and tire coming from China, But its seems to me that the US is obviously bluffing right now ; meaning that US is trying to put tariffs on major industrial products coming from China to exert the message that they are serious.

Their economy is deeply in risk of inflation and by this huge bluff, they felt that they

¹⁵ RMB (Chinese yuan) effective exchange rate 1994-2010,web
November.4.2010

¹⁶ Jason Subler and Lu Jianxin, *China loosens Currency grip as G20 summit looms*, June.21.2010,web
November.4.2010

¹⁷ United States Dollar – Chinese Renminbi, November.2010,web
November.8.2010

would scare the Chinese and get what they want by creating this fear. And if the Chinese don't come in to agreement with US and increase their yuan, than the US is left no choice but to continue adding tariffs on other products coming into the USA via China. The US needs to be making money right now as the rate of unemployment is extremely high, what they are probably thinking is that either they will make this money a) By adding tariffs on Chinese products, or B) Chinese agree to increase the yuan, so Chinese exports would only be found in US as other countries won't be interested in business with China, leaving US the only country in the world carrying Chinese goods. But the way it seems there is a big possibility that both of these game plans won't work out positively for the US, as the Chinese are being defensive right now and have also added tariffs on US products such as poultry. I think that it is not to the USA's benefit at this time of sensitivity amongst its economy to start this sort of tariff trade war with China, as China is a wealthy and stable economy busy doing business all over the world. They need to come up with better negotiations, because US should not risk creating more conflicts with China, they certainly cannot afford to lose China's support at this time. And the way I look at this conflict is that there is no reason the Chinese should come into agreement with the US at this time, when they are so successful in what they have developed for themselves worldwide. The US is asking the Chinese to risk the inflation of their economy just so that the US can pull their economy back up, this is an incredible selfish demand on behalf of the Americans.

Let's just pretend that the Chinese do increase their Yuan for a moment so I can share with you my thoughts on the possible outcomes. So China decides to increase the exchange rate for their yuan and USA is suddenly extremely happy and on great terms with the Chinese as the Americans are no longer suffering from recession and unemployment, rather they are making more money than ever. But let's turn the view on to the Chinese economy for a moment, what is going to happen to them? Well, many things. One, they are going to lose a lot of business supports worldwide, as their yuan exchange rate is no longer cheap for countries to be interested in trade and investment. Two, the people living in China are going to start facing unemployment and poverty with the sudden rise of the yuan. Many may not even afford to maintain their life like they did before. What does this mean, the fall of the Chinese economy? But with all this being said I don't think that even if the yuan does appreciate The US deficit will not be reduced and employment rates may not rise so rapidly.

However, I would like you to also consider this aspect of my mentality. If the Chinese decide not negotiate with the US at this time, and both of these rival countries continue on adding tariffs on each other's products, than this conflict might leave the zone of verbal consultation and enter in the "war" zone. Meaning that China could be angered to a point that they may encourage war with the USA, as they make feel that US is taking advantage of them. The reason that I presume China would take this sort of action, is because USA cannot afford to take war actions right now as they do not have the extra money to do so and many of their troops of soldiers are still occupied in Iraq.¹⁸ But this is not the ideal plan for the Chinese either. Going into war or attempting war is not a cheap process and no one can really determine or predict the outcome. It could be negative for both countries and be extended into an even bigger conflict adding other subsidizing countries in the conflict as well. Creating a worldwide issue.

However let's not forget, that the Chinese are also angry at the fact that the US traded Arms with their competitor, Taiwan.¹⁹ The Chinese do not favor this action of sales between

¹⁸ C.Todd Lopez,*Fort Hood report outlines ways for Army to improve security response*, November.10.2010, web November.10.2010

¹⁹ Dabiel Nasaw, *China retaliates over US arms sales to Taiwan*, January.30.2010, web, November.6.2010

Taiwan and US, and may feel let down and disrespected on USA's behalf. IF USA continues trade with Chinese competitors and also the addition of tariff on Chinese products; I predict that the Chinese may just decide to end trade barriers with the USA. And this would be the beginning of war.

Furthermore, with all my predictions that I have stated above, I strongly believe that the chances of a tariff war is the most possible to develop between China and US. Meaning that I think that China and US are going to keep adding tariffs on goods they trade with each other, creating a sort of competition. But, what is going to be the resolution? Well, obviously USA is deeply angered because they did not easily get what they wanted as they predicted they would, so they may begin approaching competing countries of China, such as Taiwan, Indonesia, and Japan in hopes of better trading negotiations. And this act with deeply anger the Chinese; Striving them towards the decision of ending all trade barriers with USA. However, if they conclude trade barriers with USA, it is not the end of this conflict either, yet the beginning of War; and from the looks of it, this war could extend beyond just the participation of China and US on their own but the participation of other competing countries.

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