Why China matters in Trump's economic policy

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(Photo: General Motors.)

President-elect Donald Trump's threats to impose big tariffs on China have put that country in the global spotlight. Trump says he wants to bring back American factory jobs but economists say his tactics could result in a trade war that ultimately hurts the United States. Economics reporters Roger Yu and Paul Davidson try to sort it all out.

Q: How did China become the second-largest economy in the world and so intertwined with the U.S.?

With a population of nearly 1.4 billion, China is the world's largest country. It has taken advantage of its bountiful labor force to fuel an export-oriented economy. In short, it became richer by transforming itself into the world's factory. American companies fully exploited the opportunities, rushing to outsource manufacturing there.

The result was a burgeoning middle class in China that formed a new export market for American products. More Chinese students can now afford to study in the U.S., often forming the largest international student group at prestigious universities. Chinese tourists pack American hotels in major cities. And the Chinese government began investing heavily in U.S. Treasuries. China is now America's largest creditor.

Q: What is a trade deficit and why has our trade deficit with China widened?

A trade deficit occurs when a country's imports of goods and services exceed its exports, or goods and services shipped "abroad." The U.S. trade deficit across the globe totaled $531.5 billion in 2015, up from $508.3 billion a year earlier. In other words, Americans consume more foreign goods and services than the country ships overseas.

The vast majority of the U.S. deficit derives from trade with China. The gap with China rose to $365.7 billion in 2015 from $343.1 billion a year earlier. That's because more U.S. companies continue to outsource to China to take advantage of cheap labor, and those goods are then shipped to the U.S. Meanwhile, U.S. exports to China are growing as wages in that country increase and residents consume more, but not nearly as quickly as imports. The standard of living in China is still relatively low.

Also, China puts high tariffs on many American products while U.S. tariffs on Chinese products are low. And the dollar is strong, particularly in relation to the Chinese yuan. That makes U.S. goods more expensive for Chinese customers, and Chinese goods cheaper for Americans.

Q: What U.S. goods are exported to China and which Chinese goods are imported to the U.S.?

Some of the goods exported by the U.S. include industrial supplies, foods, airplanes and car parts and machinery. Goods imported to the U.S. from China include consumer electronics and clothing.

Q: Why has Trump made China such a big issue?

Politics plays a huge role. The Rust Belt states were very much in play for Trump, and he knew that the message of bringing jobs back from China would resonate with voters. It worked. "There's certainly a sense in heartland America that trade has not worked well for average workers, especially in the manufacturing sector," says Eswar Prasad, an economics professor at Cornell University. "It's a lot easier to blame the external boogeyman as the main culprit for the job losses. It presented a fat and juicy target."

Q: What does Trump want from China?

As seen in his recent negotiations with Carrier to keep operations in the U.S.,Trump has shown that the appearance of victory matters to him. So he's looking for concessions, says Mauro Guillen, an economics professor at the University of Pennsylvania. "What he wants is to score some kind of victory, at least symbolic," he says.

He may also have more substantive goals in mind, says Matthew Kahn, an economics professor at the University of Southern California. Trump could negotiate to broaden local market access for American companies, restrict its theft of U.S. intellectual property and continue Chinese investment in U.S. real estate and universities. "I think he wants China to consume more of our exports," Kahn says. "He wants more American success there."

Q: China has been accused of currency manipulation. Does this continue? How does it affect our trade policy and American companies' operations?

China pegs the yuan to the dollar, giving the government much control over its value. Most advanced economies let their currencies “float,” allowing market forces to dictate their currency value.

For years, China has deliberately devalued its currency, which made its exports cheaper. But the practice has faded in the past two years, Prasad says. With the Chinese economy cooling, market forces have driven the yuan to an eight-year low against the dollar in November. And China’s central bank and other state-owned banks have been intervening to ensure it’s not depreciating too far,” Prasad says. “Right now, it’s doing the reverse of currency manipulating,” he says. “It’s helping the U.S.”

Q: How does the trade deficit with China affect the U.S. economy?

For most Americans, the trade deficit is manifested on the shelves of stores like Walmart. Consumer goods have gotten cheaper because companies can make them at low cost in China. “The U.S. is a stronger nation because of trades with China,” Khan says. “I don’t think it’s a bad thing that we have a deficit with China.”

But don’t tell that to factory workers in Michigan and Ohio. Many factors have contributed to the exodus of jobs in those regions, including automation. But there’s no denying that American manufacturing jobs have been lost due to offshoring. Free trade “may come at the expense of some jobs in the U.S. But Americans have developed a taste for cheap consumer goods,” Guillen says.

Q: Trump has threatened to slap Chinese imports to the U.S. with 45% tariffs. Would that be effective in narrowing the trade deficit and bringing jobs back to the U.S.?

Unlikely, economists say. Any measures to lower imports of Chinese products — say, a tariff on a specific industry — will likely result in a tit-for-tat response from China, resulting in higher prices for U.S. exports.

Many U.S. manufacturers then will simply move operations to other countries with low costs, such as Vietnam. Raising tariffs is not a guaranteed remedy for regenerating U.S. manufacturing jobs, Prasad says.

China could seek to make accessing the Chinese market difficult for American companies. That could mean unforeseen licensing requirements and administrative procedures. Chinese students could be held back from attending American universities. Airbus’ planes could be favored over Boeing. Intellectual property laws may not be enforced as aggressively. China “can start to restrict its market even more," Prasad says. "There’s a lot they can do.”

Meanwhile, higher prices on Chinese imports to the U.S. will affect working-class Americans disproportionately, possibly leading to concerns about inflation.

Q: What is Trump’s endgame?

Despite Trump’s tweets that were antagonistic toward China, few economists expect him to risk a full trade war. But if he followed through on some campaign promises — such as tariffs or formally declaring China a currency manipulator — “that’d signal an opening salvo,” Prasad says.

Economists say Trump may be approaching the issue as a business dealer, bluffing and stretching boundaries to extract better deals. But the United States' need for access to the Chinese market isn’t waning, and Trump must tread carefully in his dealings, they say.

Q: China’s economy is slowing down. Why is this worrisome to Americans?

The Chinese economy continues to grow, just not at the rate it once did a few years ago. A slowing Chinese economy would mean less global demand for oil, steel, food and other commodities as well as fewer purchases of American real estate and luxury goods, and perhaps even a slowdown in China’s purchase of U.S. Treasuries.

Q: How is China trying to spark faster economic growth?

Facing more competition from countries with low-cost labor, such as Vietnam and Bangladesh, the Chinese government has started to shift from an export-driven economy to one fueled by domestic consumption. But the initiative has been slow to take effect as the Chinese are known to be aggressive savers. “They don’t have Medicare or Social Security,” Guillen says. “China has 400 million people still living in poverty in rural areas. They’re not ready to move toward a consumer-oriented economy.”

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