Some Ideas for Enhancing the Economic Relationship between China and the United States

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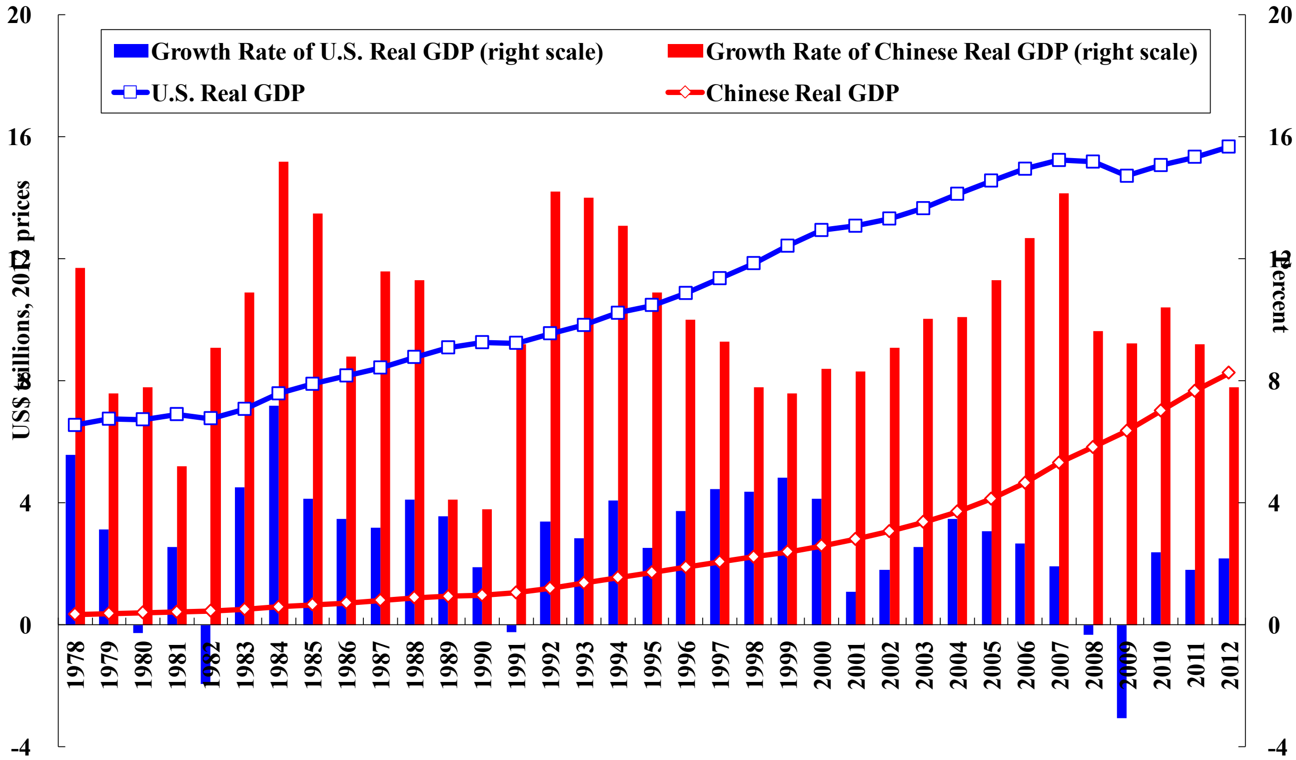
Introduction

After 35 years of economic reform and opening to the World, China has grown into a major economic power in aggregate terms. It has overtaken Japan to become the second largest economy in the World, with a GDP of US$8.26 trillion in 2012 (in 2012 prices), after the United States, which remains securely as the largest economy in the World, with a GDP of US$15.68 trillion in 2012 (see Figure 1)[2].

Figure 1: The Real GDP and Its Annual Rates of Growth of China and the U.S. (trillion 2012 US$)



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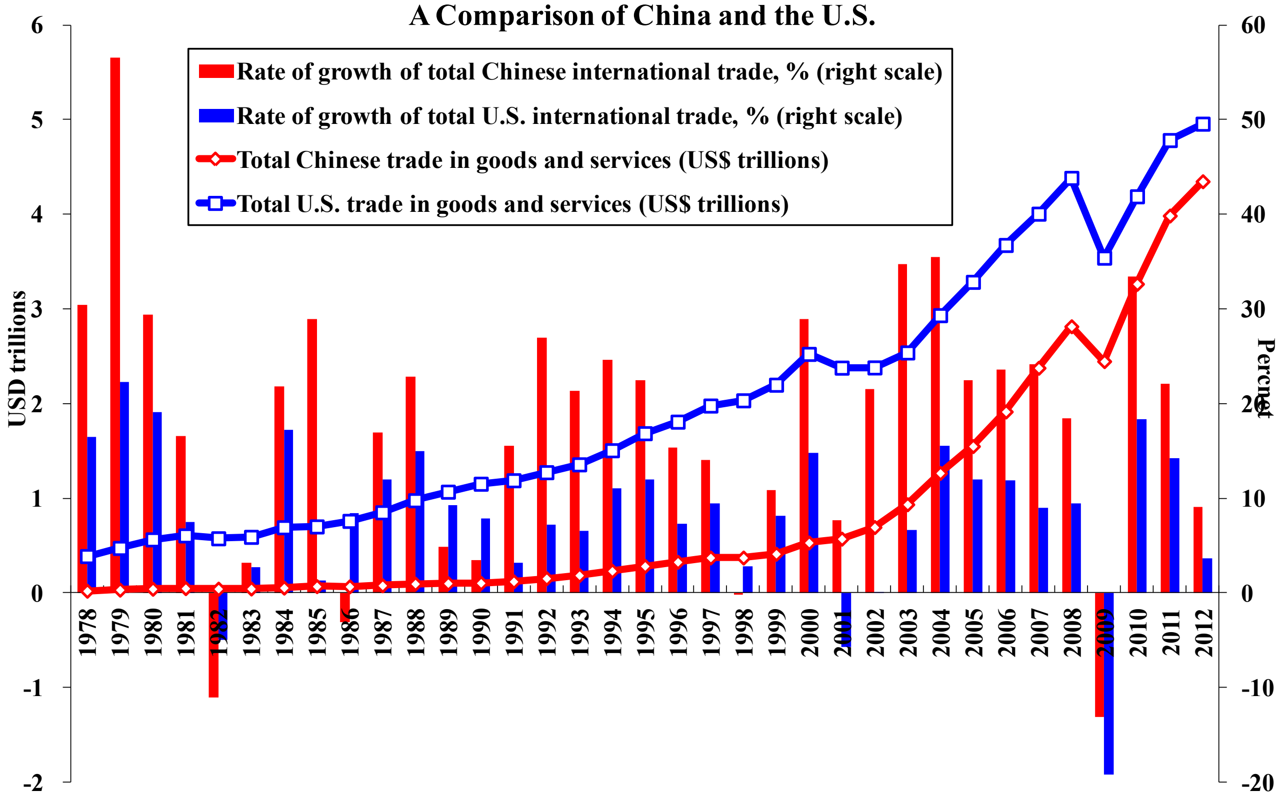
[2] *US-China Economic Relations in The Next Ten Years: Towards Deeper Engagement and Mutual Benefit*, Part I, p.22.

China has also grown into the second largest trading nation in the World in terms of the total value of international trade in goods and services, after the U.S. (see Figure 2). While China is the largest exporting nation in terms of goods and services, followed by the U.S., the U.S. is the largest importing nation in terms of goods and services, followed by China. China is also the largest exporting nation in terms of goods alone, followed by the U.S[3]. The U.S. is the largest exporting as well as importing nation in terms of services, followed by respectively the United Kingdom and Germany.

Figure 2: The Value of International Trade and Its Rate of Growth: A Comparison of China and the U.S.



Both the U.S. and China have the ability to affect global markets through changes in either their demands or their supplies or both—they can affect the prices in the global markets for agricultural commodities, energy (including coal, oil and gas), gold, other minerals and natural resources, and even rare earths.

[3] *US-China Economic Relations in The Next Ten Years,* Part I, p.24.

Both China and the U.S. have the ability to guide the World on global economic initiatives—the U.S. as the leading developed economy and China as the leading developing economy and both as the two largest trading nations in the World. They can provide leadership to the World economy on issues that affect every country and region, such as the extension of the Doha Round of World trade negotiations and the reduction of the risks of global warming, especially if they work together for common purposes.

However, despite the rapid growth of the Chinese economy, China is still a developing economy in terms of its real GDP per capita. Between 1978 and 2012, Chinese real GDP per capita grew 16 times, from US$354 to US$6,102 (in 2012 prices), which was still below the World mean real GDP per capita. By comparison, the U.S. GDP per capita was US$49,879 in 2012, more than eight times the Chinese GDP per capita[4].

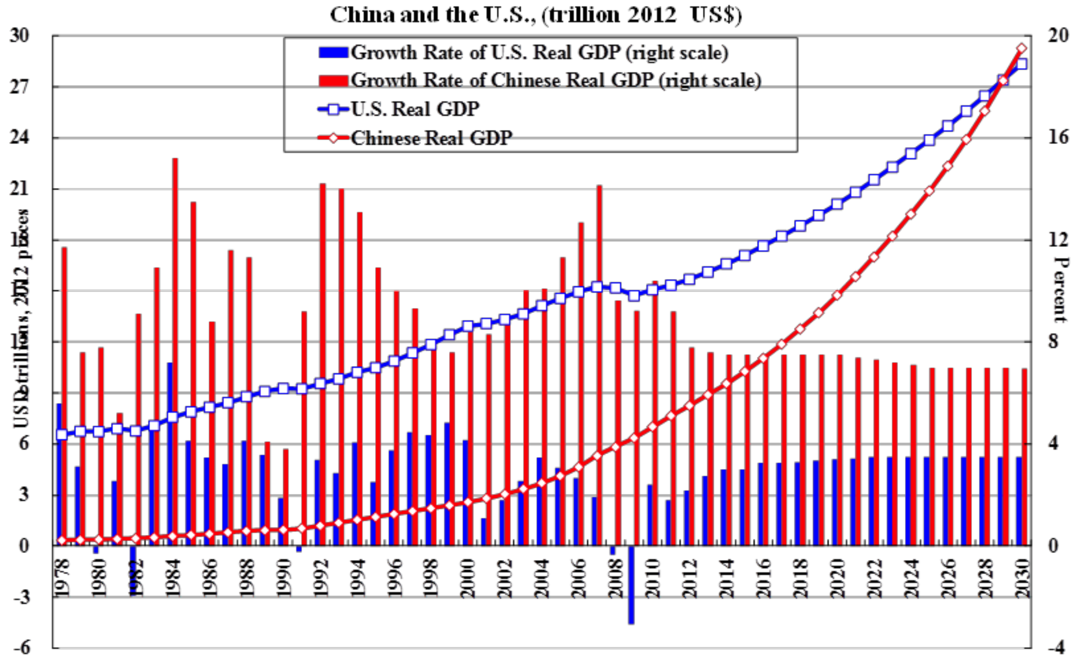
Projections of GDP and Trade

GDP

It is projected that the U.S. and Chinese economies will grow at average annual real rates of approximately 3.3% and 7.3% respectively between 2012 and 2030 (see Figure 3). Under these assumptions, Chinese real GDP will catch up to U.S. real GDP in approximately 15 years--around 2029, at which time both Chinese and U.S. real GDP will exceed US$27 trillion (in 2012 prices), more than three times the Chinese GDP and not quite two times the U.S. GDP in 2012. By then, China and the U.S. will each account for approximately 15% of World GDP.

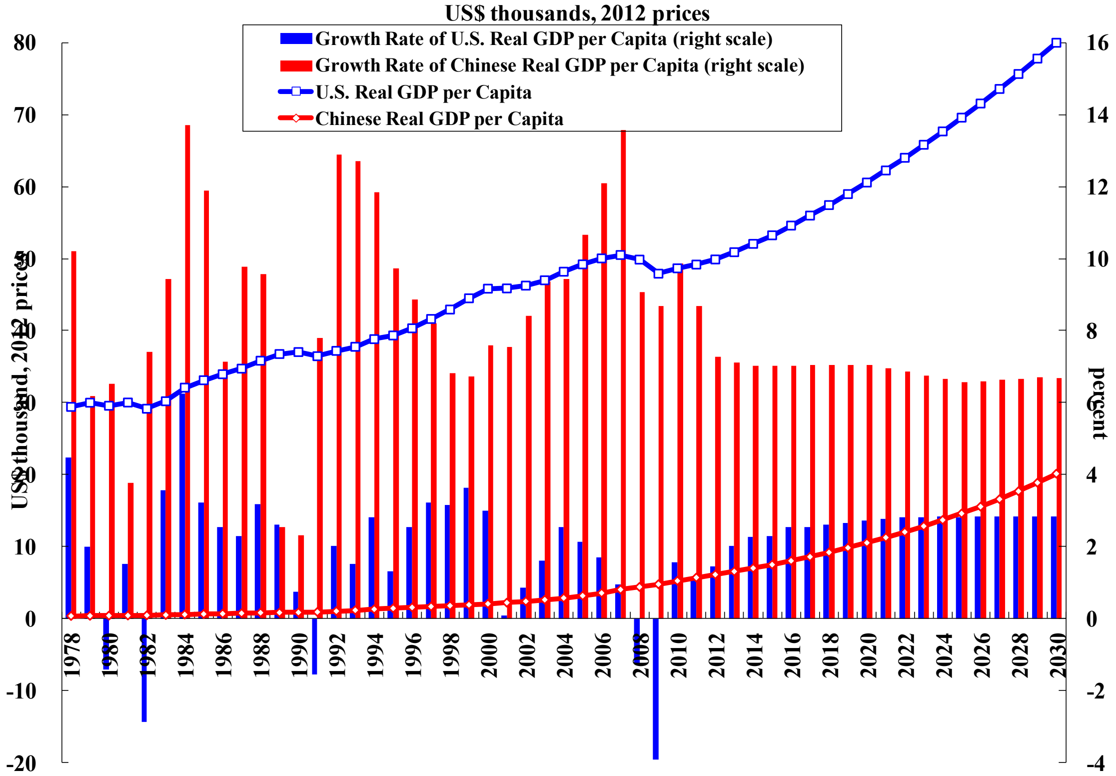
[4] *US-China Economic Relations in The Next Ten Years,* Part I, p.23.

Figure 3: Actual and Projected Real GDPs and their Annual Rates of Growth of China and the U.S., (trillion 2012 US$)



By 2030, the Chinese real GDP per capita is projected to exceed US$20,100 (in 2012 prices), which would still be just a quarter of the projected then U.S. per capita real GDP of US$80,000 (see Figure 4). It will take around 45 years, almost till 2060, for China to catch up to the United States in terms of real GDP per capita.

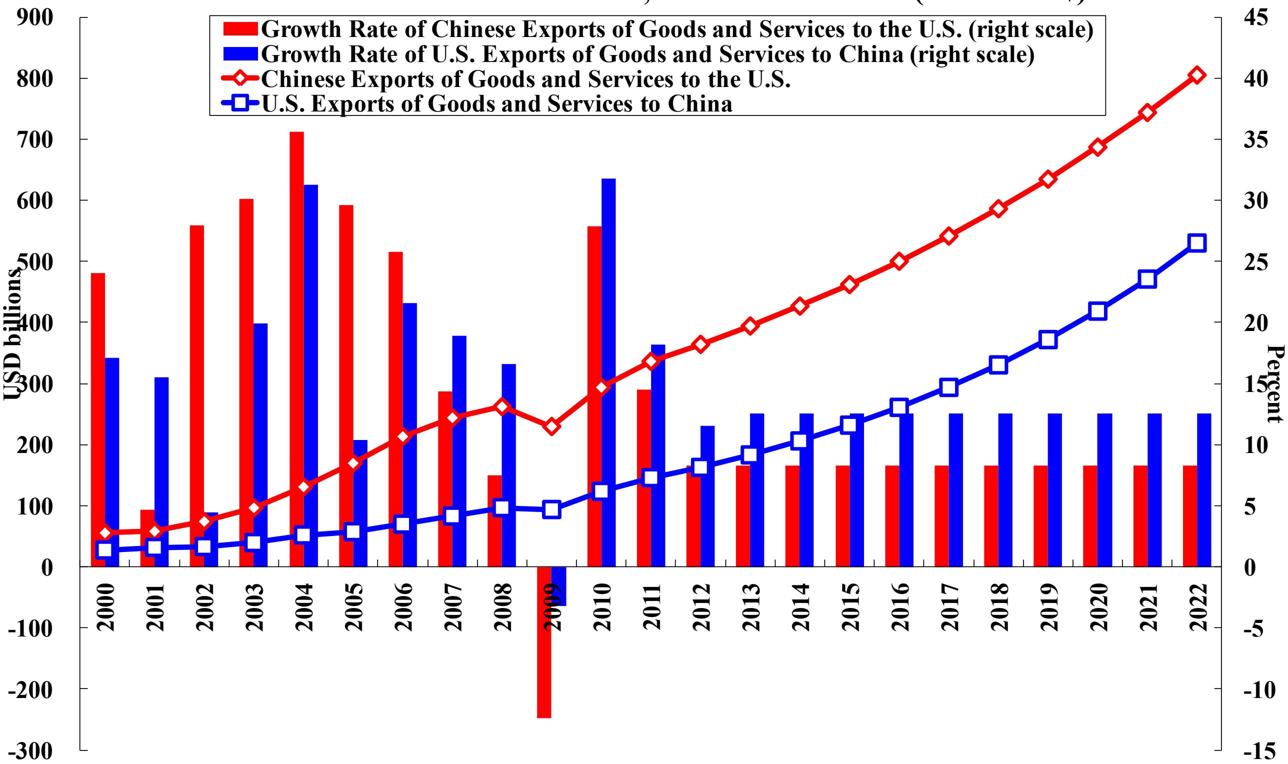
Figure 4: Actual and Projected Real GDP per Capita of China and the U.S., US$ thousands, 2012 prices



Trade

By 2022, the U.S. and China are likely to become each other's largest trading partner in the World. U.S. exports to China are projected to rise to US$530 billion, more than three times the value in 2012. By 2022, Chinese exports to the U.S. are projected to reach US$805 billion. Despite the higher growth rates of U.S. exports of goods and services to China from 2007 onwards, China's trade surplus with the U.S. will likely remain high, at a projected US$275 billion in 2022, but constituting only 1.5% of the projected Chinese GDP (see Figure 5)[5]. It is expected that China will run a trade deficit with the rest of the world excluding the U.S. and an approximately balanced international trade with the World as a whole.

Figure 5: Actual & Projected Chinese Exports to the U.S. and U.S. Exports to China and Their Rates of Growth, Goods and Services (billions US$)



It is possible for U.S. exports to China to be much higher and the bilateral China-U.S. trade to be much closer to balance if one or more of the following conditions are realized:

(1) The U.S. approves the export of liquefied natural gas (LNG) to China (The U.S. has the potential of becoming a major exporter within the next decade);

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[5] *US-China Economic Relations in The Next Ten Years,* Part I, p.30-31.

(2) The U.S. and Chinese enterprises enter into long-term contracts for large-scale exports of agricultural commodities—for example, corn, soybean, beef, chicken and pork—from the U.S. to China; and

(3) The U.S. relaxes its control on high-technology exports to China.

Some Principles for Economic Relations between Major Powers

A traditional norm of international relations among countries is equality and mutual respect. Between major powers, an important principle is that of mutual reciprocity: both countries should treat each other insofar as possible in a similar and symmetric way. For example, if one country's direct investors are accorded national treatment in the other country, the expectation is that the direct investors of the other country will also be accorded national treatment in the former. The average effective tariff rates on each other's imports should normally be approximately equal even though their exports and imports may differ. And the visa application processes for one country's citizens to visit the other country should also be comparable in terms of time and other requirements.

Going one step further, each country should treat the other in the same way as it would like to be treated. For example, there should be mutual recognition of each other's core interests. It is difficult, if not impossible, for two major powers to see eye-to-eye on every issue, as their national preferences and interests may differ. However, they can agree to disagree and acknowledge the existence of differences in a non-hostile manner. They should, to the extent possible, take into account the effects of their policies and actions on each other, regardless of whether the policies and actions themselves are directed at each other or not. For example, it is possible to envisage joint efforts to mitigate the employment displacement effects of one country's exports to the other.

An important aspect of relations between major powers is that of effective and timely communication, coordination and information sharing. There should be no surprises between China and the U.S. There should, at all times, be full information on both sides: both countries should understand each other's domestic as well as foreign constraints and be aware of the contingency plans of each other—so that there will be no miscalculations on either side.

Finally, both countries should try to seek win-win solutions. For example, China currently saves and invests too much domestically and the U.S. does not invest enough. If the excess Chinese savings can be invested in the U.S., where the real rate of return is higher, both China and the U.S. will benefit.

Potential Areas of Cooperation between China and the United States

There are many potential areas of closer economic cooperation between the two major powers, the U.S. and China, that will benefit both countries: trade, investment, agriculture, tourism, energy, intellectual property protection and exchange rate coordination. These are discussed below in turn.

Trade

Given the significant economic complementarities between China and the U.S., the two countries should conduct feasibility studies and begin early-stage discussions of the opportunities and challenges of an eventual bilateral Free Trade Agreement between them, taking into account not only the benefits but also the costs. These activities can proceed in parallel with the discussions and negotiations with regard to the participation of China in the Trans-Pacific Partnership. The U.S. and China should also develop mechanisms for speedily resolving their trade disputes and avoiding bundling of unrelated disputes so that each dispute can be settled based on its own merits.

The bilateral China-U.S. trade has significant impacts on the GDP and employment of both countries. For every US$1 billion of U.S. exports to China, an estimated value-added of US$0.86 billion and employment of 4,800 person-years are created in the U.S. In 2022, the projected U.S. exports to China of US$530 billion is expected to generate US$456 billion (in 2012 prices) worth of value-added (up from US$100.8 billion in 2010), or 2.2% of the then U.S. GDP, and more than 2.54 million jobs (up from 732,800 in 2010) in the U.S[6].

For every US$1 billion of Chinese exports of goods and services to the U.S., an estimated value-added (GDP) of US$0.641 billion in 2012 prices (up from 0.573 billion) and employment of 15,000 (down from 38,930 in 2012) person-years are created in China. In 2022, a value-added of US$516 billion, or 3% of the then Chinese GDP, and total employment of 12.08 million person-years are projected to be generated by Chinese exports to the U.S[7].

2.2% and 3% of GDP and 2.5 and 12 million jobs for the U.S. and China respectively are economically very significant numbers for both countries. They indicate a high degree of potential economic interdependence between the two major powers.

Investment

An important aspect of the economic complementarities between China and the U.S. is the huge difference in their saving rates. The U.S. gross saving rate is about 12%, whereas the Chinese saving rate approaches 50%. China both saves too much and invests too much and the U.S. saves too little[8]. Both economies can benefit if Chinese nationals (individuals and firms) can increase their direct and portfolio investments in the U.S. The U.S. and China should conclude a bilateral investment treaty as soon as possible so as to facilitate two-way direct and portfolio investment flows between the two countries[9]. They can start by taking a negative-list approach to direct investment originating from each other, that is: both countries will issue a list of industries and sectors for which direct investment from the other will require governmental approval. Industries and sectors not explicitly included on the negative list will be completely open to direct investment from the other country without any requirement of government approval. (The negative lists of the two countries do not necessarily have to be the same.) This negative-list approach should greatly facilitate direct

[6] *US-China Economic Relations in The Next Ten Years,* Part I, p.30.
[7] Ibid.
[8] *US-China Economic Relations in The Next Ten Years,* Part I, p.33.
[9] Ibid, p.43.

investment flows between China and the U.S. as it reduces the uncertainty significantly for potential direct investors in both countries.

The stock of U.S. direct investment in China in 2011 was US$54 billion according to the U.S. and US$70 billion according to China, compared to the stock of Chinese direct investment in the U.S. of not quite US$10 billion. U.S. direct investment in China has been quite successful, generating almost US$40 billion of annual profits and also creating 1.8 million jobs in China[10]. For example, General Motors is already the market leader in the Chinese automobile market; Wal-Mart is China's largest retailer; and McDonald's and KFC are already household names in the Chinese fast-food sector[11]. China's service sector is relatively under-developed, while the U.S. has the most sophisticated service sector in the World. The Chinese economy needs to expand its service sector to provide more employment opportunities for its people. U.S. firms can help China develop its service sector through exports to and direct investments in China, creating value-added and employment in the U.S. in the process[12]. The potential for these and other U.S. businesses yet to invest directly in China is enormous.

Chinese direct investment in the U.S. has been rising rapidly. China recently announced that outbound direct investments of less than US$1 billion would not require approval by the Chinese Government. Chinese direct investment in the U.S. can create both GDP and new jobs in the U.S., especially if the investment is in greenfield projects.

Agriculture

Among the major concerns of China and its people are food security and food safety. Is there enough food to feed everyone? Is the food safe and hygienic? The U.S. has the most sophisticated agricultural technology as well as systems to ensure food safety. The abundance of arable land and irrigation water in the U.S. and the high productivity and efficiency of U.S. agriculture mean that the

[10] Ibid, p.27-28.
[11] *US-China Economic Relations in The Next Ten Years,* Part I, p.15.
[12] Ibid, 16.

U.S. has the capability to further increase its agricultural production and exports to China significantly and thus help China ensure its food security as well as food safety at the same time[13]. China does not have sufficient land or water to meet its own agricultural needs. Both countries can therefore benefit greatly through such cooperation. Quantum increases in value-added and employment can be created in the agricultural and related sectors in the U.S. if agricultural exports, including food, can be significantly increased from their present levels. The key to significantly increased U.S. agricultural exports to China is a credible assurance of long-term supply by the U.S. and long-term demand by China. The recent acquisition of Smithfield Foods in the U.S. by China's Shuanghui International is indicative of the potential for China-U.S. cooperation in agriculture.

Tourism

Tourism creates jobs that, unlike manufacturing jobs and some service jobs, cannot be moved abroad. In 2012, approximately 1.5 million Chinese tourists visited the U.S. This number is projected to exceed five million a year by 2022 if visa administration is further streamlined and to reach 10 million if the visa requirement can be waived altogether[14]. Each million of Chinese tourists a year is estimated to generate a value-added of US$3.5 billion and 61,352 jobs in the United States, so that potentially up to US$35 billion of GDP and 600,000 jobs can be created through tourism by 2022[15].

It is possible to facilitate visits in both directions by introducing the option of online visa applications by the citizens of both countries. The visa applications can either be approved directly or the applicants can be asked to submit hard-copy applications for further consideration. Increases of mutual visits by the citizens of both countries to each other can only enhance understanding and improve relations between the two peoples.

[13] Ibid.
[14] *US-China Economic Relations in The Next Ten Years,* Part I, p.15.
[15] Ibid, 40.

Energy

China and the U.S. are the two largest coal producers and have the two largest proven coal reserves in the World. Today, China relies overwhelmingly on coal as a source of primary energy (approximately 70%), which pollutes the atmosphere as well as emits excessive greenhouse gases. This heavy Chinese reliance on coal is unlikely to change significantly any time soon. In contrast, the recent shale oil and gas boom in the U.S. is likely to reduce further the production and the use of coal in the U.S. There are thus opportunities for Chinese and U.S. firms to collaborate on developing and utilizing clean coal technologies, and in particular, to apply U.S. technologies and standards to the use of coal in China. Such collaboration should help to improve the air quality and reduce carbon emission in China[16].

Even though China also has large deposits of shale oil and gas, they cannot be easily exploited. However, the investment and technological cooperation of U.S. firms in China's nascent shale oil and gas industry can be very helpful to China in the medium to long run. In addition, there is still a great deal of room for the improvement of energy efficiency in China at the leval of individual industries. This also presents significant opportunities for U.S. technologies and U.S. firms.

Such cooperative efforts in the energy area will not only benefit China and the U.S. but also reduce significantly Chinese carbon emissions and hence the risks of global climate change.

Intellectual Property Protection

Intellectual property protection is a critical issue not only for the U.S. but also for China. China is in the process of trying to transform its economy from an input-driven one to an innovation-driven one. It will therefore have a strong interest in promoting innovation within China itself. Protection of intellectual property rights is essential to the promotion of innovation[17]. An outstanding example of such a transformation is what happened in the economy of Taiwan, which

[16] Ibid, 42.
[17] *US-China Economic Relations in The Next Ten Years: Towards Deeper Engagement and Mutual Benefit*, Part II Chapter 14 *"Intellectual Property Rights and Information Security"* by Edward Shao, p.3.

changed from being the piracy capital of the World at one time into a thriving center of innovation (with more than 10,000 U.S. patents granted to inventors in Taiwan in 2012).

In the China-U.S. Exchange Foundation report, the establishment of a national intellectual property court in China with jurisdiction over all intellectual property disputes in all of China was proposed[18]. A similar proposal was included in the resolutions of the Third Plenum of the Central Committee of the Chinese Communist Party in November 2013. It is hoped that such a national court will greatly improve intellectual property protection for both domestic and foreign inventors in China.

Exchange Rate Coordination

A relatively stable US$-Renminbi exchange rate is not only good for both trade and investment flows between the two countries but also provides the foundation for stability of the exchange rates of other currencies in East Asia and the World.

Prof. Robert Mundell, Nobel Laureate in Economic Sciences, has proposed an ingenious way to reduce the volatility of the Euro-U.S. Dollar exchange rate through coordinated intervention by the central banks of both the U.S. and the Euro Zone. For example, if the U.S. and Euro Zone countries can agree on a range for the Euro-US$ exchange rate, say, between 0.7 and 0.8 Euro per US$, then the U.S. side will be assigned the responsibility of making sure that the exchange rate will not exceed 0.8 Euro per US$ and the European side will be assigned the responsibility of making sure that the exchange rate will not fall below 0.7 Euro per US$. When the U.S. Dollar threatens to rise above 0.8 Euro per US$, the U.S. central bank will purchase Euros with U.S. Dollars to drive up the value of the Euro. When the U.S. Dollar threatens to fall below 0.7 Euro per US$, the Euro Zone central bank will purchase U.S. Dollars with Euros to drive down the value of the Euro. In both instances, the respective central banks are acting in the interests of their respective country and region to

[18] *US-China Economic Relations in The Next Ten Years,* Part I, p.17.

prevent their respective exports from becoming too expensive. Thus, such an arrangement should be completely incentive-compatible for both sides.

If China and the U.S. can agree on a range for their exchange rate, say, between 5.5 and 6.5 Yuan per US$, they can also implement the Mundell plan. The responsibility for intervention will be divided between the two sides in an incentive-compatible way: If the U.S. side finds the Renminbi too weak, say, near the 6.5 Yuan mark, the U.S. can buy Renminbi in the foreign exchange market with US$ to drive it up; if the Chinese side finds the US$ too weak, say at the 5.5 Yuan mark, it can buy US$ with Renminbi in the foreign exchange market to prevent it from becoming too weak. Over time, if this arrangement proves to work, the agreed range can be gradually narrowed further. If the US$-Renminbi exchange rate can remain relatively stable, trade and investment flows in both directions will be able grow even faster, and the U.S. Dollar and the Renminbi together can in time form the core of an effective global currency.

Cooperation in the Provision of Global Public Goods

The U.S. and China, as the two largest energy producing as well as consuming countries in the World, can cooperate to improve energy efficiency, assure energy security and promote research on clean and renewable energy. The U.S. and China, as the two largest emitters of greenhouse gases, can also take common responsibility for the reduction of the risks of climate change and cooperate to forge a global consensus in the negotiations relating to the control of global emissions[19]. There is a window of opportunity as the recently increased supply of gas in the U.S. (from, for example, shale) reduces the cost of reduction of carbon emission in the U.S.

The U.S. and China, as the two largest trading countries in the World, can also take the lead in re-invigorating the Doha Round of world trade negotiations and enhancing the multilateral trading system, benefiting not only themselves but also the entire World economy[20].

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[19] *US-China Economic Relations in The Next Ten Years,* Part I, p.34.
[20] Ibid, 42.

Finally, the U.S. and China, working together, can also overhaul the international monetary order to make it much more stable, secure and sustainable.

Concluding Remarks

Closer economic cooperation between China and the U.S. can bring significant benefits in terms of GDP and employment to themselves. In addition, it can enhance mutual economic interdependence which can in turn reduce the mutual distrust and strengthen and sustain the overall relationship between the two countries, and hence further facilitate their cooperation and coordination. Given their respective economic powers--the U.S. as the leader of the developed world and China as the leader of the developing world--both countries, acting together, have the capabilities to lead the World on various global economic initiatives, benefiting not only themselves but also the entire World.