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Transcript

CHINA IN THE WORLD PODCAST

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Guest: **Yukon Huang**

Episode 91: Breaking Down the U.S. Trade Deficit with China
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Haenle: Recently, I had the opportunity to speak with Yukon Huang, my colleague at the Carnegie Endowment and a senior fellow in the Carnegie Endowment's Asia Program. We discussed U.S.-China economic relations. Yukon's research at Carnegie focuses on China's economy and its regional and global impact. Prior to joining Carnegie, Yukon served as the World Bank's country director for China. Previous to that, he was country director for the Soviet Union. Yukon is still an advisor to the World Bank as well as the Asian Development Bank and the Asian Infrastructure Investment Bank, along with various governments and corporations. Yukon is also an A-list commentator for the Financial Times on China. During our discussion, Yukon shared his thoughts on major areas of friction in the U.S.-China trade and economic relationship. His latest book, *Cracking the China Conundrum: Why Conventional Economic Wisdom is Wrong*, explores why some of the usual arguments made about why China's economy, political system, and foreign policy is wrong. I would encourage you to check out his book, especially if you find our conversation in this podcast of interest.

Thank you for listening to the China in the World podcast. I hope you enjoy my conversation with Yukon. Please be sure to leave us a rating and comment on iTunes, as well as heading to the Carnegie-Tsinghua website to see more of the work from all of our scholars at the Carnegie-Tsinghua Center.

Yukon Huang, thank you very much for joining the China in the World podcast and thank you for coming to China this week to participate here at the Carnegie-Tsinghua Center in the 7th Annual U.S.-China Strategic Dialogue between leading American thinkers and Chinese thinkers. [I] really want to talk to you today about your area of expertise, which is of course economics and trade, something you focus on very closely at the Carnegie Endowment. Coming in to office—and certainly in the presidential campaign—we heard a lot of concerns about trade. Peter Navarro was a name that came up, and there was great focus on the trade deficit between the United States and China and a lot of talk about this being sort of at the root of our problems with China in the economics and trade area. We talked [about] looming trade wars, there was a lot of talk about defensive trade enforcement measures, countervailing duties, tariffs, border adjustment tax[es]. I first want to get a sense from you [of] where you think this concern comes from. Why are so many in the U.S. concerned by this? Why has there been so much tension on this particular topic?

Huang: It's a very common public perception that America faces an economic problem because it has the world's largest trade deficit. And of that deficit, sixty to seventy percent of it is represented by a bilateral trade deficit with China. So for the ordinary person, even policymakers, common sense would suggest that if I could somehow moderate America's trade deficit with China that the U.S. would benefit. Growth would be higher, [and] U.S. employment would benefit from the fact that more could be produced domestically. This is also next to an observation, a feeling, that American companies are investing too much abroad, and this is leading to a reduction in manufacturing jobs at home. It increases competitive advantages of America's competitors overseas, who then produce exports to the United States. And again, the feeling was that this is a China problem.

Haenle: In terms of looking at approaches to recalibrate the U.S.-China economic trade relationship, is this really where we should be focusing? Or is that misguided? I mean, if you look at what [is] coming out of Mar-a-Lago, this 100 Day Plan and what was just recently announced by the U.S., it was more about trade liberalization.

Huang: I think that's a good thing. Because at Mar-a-Lago I think, [they] put the dialogue on a better keel. Trade deficits are not really the issue. Bilateral deficits are not really the issue. Trade is inherently a multilateral issue, because companies produce parts and components that are produced here, they're shipped there. What you think is a trade deficit with China may actually be products that are largely produced in Japan or Korea or Taiwan or elsewhere. So that's not the issue. The overall trade balance is an issue. And that's determined actually by a country's savings rates. If they save more than they invest, they have a surplus. If, as happens in the United States, investment needs exceed savings availability, you have a trade deficit. And that deficit in the United States is largely because of budget deficits and households borrowing a lot. It's not really a China issue. But China contributes to this because the reverse is true in China. China is a very strong savings nation, more so than their investment needs would require. The consequence is that they run a trade surplus. And that surplus is money that flows [from] outside. A large amount of that comes from the United States.

But when it comes from the United States, it lowers interest rates. It sort of puts a gentle encouragement to governments, corporations, [and] households to borrow more. So there are people who would say, indirectly, China's excessive savings or trade surplus may actually be causing America to have a little bit more of a trade deficit than might normally be the case. But this is not actually really the issue. The U.S. has been running a trade deficit for forty years straight, and [running] deficits even when China's trade surplus was insignificant. So clearly there's no direct relationship. So what is the real issue? The real issue happens to be investment flows. Money is flowing all over the world, seeking higher returns. So U.S. companies invest at home, they invest abroad. There's a lot of feeling that a lot of it is going to China—and that's a myth. Only 1.5% of America's foreign investment actually goes to China. Very little. One of the major reasons is, the U.S. is largely a services sector-oriented economy. It's media, it's health, it's education, it's financial services, it's IT, it's wholesale retail distribution systems…These are largely services activities. These are America's strengths. And this is where I think America does have a legitimate concern. Because China has one of the most restrictive foreign investment regimes, and the greatest bias is in services.

Haenle: So U.S. investment into China is quite low. You made a point in our discussions through the dialogue that European investment into China is actually growing much quicker and it's much greater than the United States. Why is that?

Huang: Well, if you go to stores in China, the malls, [or if] you look on the streets, the first thing you notice is that 90 percent of the products are European. There are manufactured goods, there are retail goods, there are high-end consumer goods, there is transport equipment, trucks, cars… Airbus manufactures in China. That means there is a lot of foreign investment being done by Europeans. Boeing does not, until recently. So it was all manufactured in the West. So the consequence is, there is relatively little U.S. direct investment here compared to European companies. Because European companies are heavily involved in manufacturing, more so than Americans. The American export mix here is agricultural commodities, and then there are a lot of services. So they are in fact suffering more from what I call a "restrictive" investment climate.

Haenle: And this is important to the United States because as you say, this is where our strength really lies.

Huang: Right. And this is an area where I think both sides need to work at it.

Haenle: And can we expect China, in the area of services, to liberalize foreign investment going forward? Is this in the realm of possibility?

Huang: I think this is potentially easier to do, and the government is more likely to consider this seriously in the coming years than [it] did before. Because five to ten years ago, when you looked at the Chinese economy, they were very weak in the services sector: financial services, IT, entertainment, whatever. [The sector was] dominated by a few state enterprises, which were actually not very competitive. Today, China actually has some major players.

Haenle: More competitive?

Huang: More competitive. And what we know from experience elsewhere is that if you want these Chinese companies to become more innovative, more competitive, [and] more creative, you need competition. And that's foreign competition. Or even more competition from more private Chinese companies. So here it is, China is the most restrictive of any major economy in the world toward services, and opening it up is actually good for China, and obviously clearly good for the United States.

Haenle: And do you see signs within the Chinese government that this is an area where they are willing to open?

Huang: Two or three months ago, they signaled an intention to open up certain sectors in financial areas, in some of the media and other areas, IT, whatever. The question is: Will they follow through? Because in the past, these kinds of commitments took a long time before they became a reality. And people questioned whether or not it would actually happen in the middle of a political transition or change in China. So I don't expect dramatic changes over the next several months.

Haenle: Right.

Huang: But I would actually expect that this time next year, there will be some very tangible actions. They'll say yes, we actually are serious. And some of this showed up in the Mar-a-Lago agreement. Because, for example, the credit card companies…

Haenle: MasterCard, Visa…

Huang: Yeah. They now should be able to operate fully. In principal, a couple years ago, people thought this would already happen. [But] it didn't happen. But now it looks like it is reality [and is] going to happen.

Haenle: And in addition to the investment, increased market access, [and] greater reciprocity, where as China can invest in our economy, we want to invest in their economy in similar sectors—what are the other issues that should be front and center in recalibrating the U.S.-China economic and trade relationship?

Huang: Well, generally speaking, what America is asking for—and it sounds very common sensical and fair—they want equal treatment. They want it [so that] when an American company comes into China, it should be treated the same as Chinese companies. And in principal, China agrees. But you have lots of local regulations that often don't work very smoothly to this effect. What does China want? China wants to be able to invest in a greater range of activities in the U.S., including companies that have technological advantages that China does not have. And then you get into a security issue. And I would define this technological issue as complicated in the sense that there are technologically sophisticated companies which don't really relate to what I call "security concerns." And the U.S. has a very good system, CFIUS [the Committee on Foreign Investment in the United States], to review these. And it should be reviewed. And those kinds of investments should proceed. And there are areas where there are obviously security concerns. I think it is legitimate for any country to worry about security aspects for any foreign investment. But you could certainly open it up and make it easier for Chinese companies to go into the United States. And in fact it would make a lot of sense to the United States for more investment to come in.

Haenle: On trade, you mentioned earlier in this discussion that it's really at the end of the day a multilateral issue. The United States led the efforts to put together the Trans-Pacific Partnership (TPP). A lot of us wanted to see that concluded. But the Trump administration—unfortunately in my view—pulled out of that on day one. Was this a mistake?

Huang: I personally think it was a mistake. It's what most analysts or trade theorists would say is a mistake. I'm still kind of hopeful that maybe a year or two down the line, that the TPP might still be resurrected.

Haenle: As the Trump Pacific Trade Agreement? Or the TPP: Trump Pacific Partnership?

Huang: Maybe they'll package some things differently, and now it is a good thing. I think that countries like Japan or Canada or Australia are still talking about, how can we keep this alive? So I don't think it's a dead issue. It may come back. The question then is, is it in China's interests? Because initially TPP was seen as something that could be used to contain China. It wasn't a member.

Haenle: Right. A tool, actually, in the Pivot to Asia, seen as an effort to kind of keep China down, to contain it.

Huang: And this got caught up in the political rhetoric.

Haenle: Yeah.

Huang: Because in the U.S. political system, some people were actually citing this as a reason to approve the TPP. Now the reality is, if you have some sort of desire to influence China's economic and trade policies, that is best achieved by having China as *part* of the agreement. So the logic really would have been, let's move forward with the TPP. Set these high standards. And then at some point in time, when China has evolved a bit, it will be in its own interests to join. And in fact, that's probably the best of all worlds.

Haenle: And in fact, we were hearing voices coming out of China in the last couple [of] years saying exactly that. That it would be good for China to aim to achieve it, because it could put pressure domestically and push through some domestic reforms that are difficult here in China.

Huang: Right. And actually, what you also hear today is somewhat interesting in that people are saying that RCEP [the Regional Comprehensive Economic Partnership] should actually take some of the policies that are in the TPP. It doesn't have the United States in there. It has the ASEAN group: India, Australia, Korea, [and] Japan. And the issue is, should RCEP now think about some of the so-called good policy initiatives that are in the existing TPP and try to actually incorporate them? I think that would be a good thing.

Haenle: How would you describe the differences between TPP and RCEP? I've heard that the TPP goes behind the border, whereas RCEP is more about tariffs and issues at the border.

Huang: Yes. Tariffs, quotas, product-specific merchandise trade… TPP gets into intellectual property rights protection. It gets more into rules of origin, labor rights, environmental standards, [and] legal recourse to dispute resolutions. Many of these are good things. And the issue of course is that Asia is very diverse. So whether it is TPP or RCEP, the stickiest issue was, how do you apply these high standards to a very diverse range of countries? Some which could easily meet the high standards, and some which need time. And I said whether it is RCEP or TPP, this kind of gradual, phasing-in requirements, and how would it apply to countries like Malaysia or even like Vietnam, or China also. I think both of those are useful devices to try to solve a problem. And we need that of course because the world is so diverse.

Haenle: When TPP was still around for the United States, some had been talking about over time, RCEP and TPP quote "merging" into one broader trade agreement. Is that something that would have been possible?

Huang: For economists and trade theorists, this was the ideal. The idea was that you had a TPP process set very high standards. You had RCEP which reached out to a broader range of countries which in some ways, some of them could meet those standards. But they were giving a push in the same direction. And then you had this umbrella, what people called a free trade agreement for the Asia-Pacific. This was actually initiated by the U.S.—

Haenle: The United States [in] 2007, in Australia.

Huang: That's right. And at that time, China was not interested. Two years ago, when TPP was rolling along, China resurrected the idea, why don't we go for a FTAAP. Because it felt like it was actually being left out of the TPP. So I think—

Haenle: The U.S. didn't like that at the time, right? Because it sort of took away the spotlight from TPP.

Huang: Right. They just wanted, practically speaking, to go forward with the TPP. Now we had the [unintelligible] position. The TPP is not out there. So in some ways, those in the United States who are still committed to a broader multilateral trade approach need to think of a way of saying, how do we get back on the table?

Haenle: Yeah.

Huang: And maybe a broad discussion of a free trade agreement for the whole region and some of the things that could be done, could be initiated. Now, the ideal thing would be that the U.S. and China have to realize that in this particular area, it is in the interests of both sides. And how do you get them actually back on the table that doesn't conflict with the political pressures they face at home. And so I think this is the agenda for the coming years.

Haenle: I can't let you get away without talking about the Belt and Road Initiative. You can't walk five feet in China without seeing something that is related to the Belt and Road. But in the United States, I talk to friends back home, [and] people don't really know anything about it. Why is this? How should the United States deal with the Belt and Road Initiative?

Huang: Well, you're right. You don't hear anybody talking about the Belt and Road Initiative. If you think about it, because of the fact that the word is so unusual—One Belt, One Road? What does that mean! It sounds like a slogan with no content.

Haenle: It's also changed names several times. It used to be the One Belt, One Road.

Huang: That's right. Now they want to talk about it as the "BRI," the Belt and Road Initiative. I don't like that. It sounds like a company! It no longer has this nice, Chinese theme. But initially, the idea is that One Belt, One Road is a unifying principle of integrating half the world—65 countries, accounting for a huge share of global GDP, ranging from Asia, South Asia, Central Asia, the Middle East, all the way to Europe. So it's basically a link between China and the other direction. Because they already have very strong trade links across the Pacific, going to Canada, the United States, and Latin America. So that's not the issue. The issue is broadening the direction. Is this in the U.S.'s interests? Yes, it is. Because any initiative which increases global trade incomes increases the market for everyone else. And in fact, the U.S. has had several initiatives in the past focusing on Central Asia and other countries to encourage greater integration. So the connectivity and infrastructure is in the interest of everyone. So what is the view that people should have of the One Belt, One Road initiative? Because a lot of people have the concern that this might be a so-called strategic endeavor of China.

Haenle: China's Marshall Plan.

Huang: Marshall Plan but in a negative way. That this will allow them to dominate these countries. It just gives them greater markets, [whereas] these countries won't benefit in some way. And my answer to this question is that the onus is on the countries themselves. They don't have to participate and take on a loan. They don't have to move forward with an infrastructure project. But there is money potentially available and the burden then is, does this make sense for me as a country? Whether in Sri Lanka, Burma, Pakistan, or even India. Does that road, that power project, that logistics initiative, that container system… will that basically improve my link with global markets? If it does, if the cost is reasonable, if my people generate jobs in this, and the terms are attractive, why not? But if you are irresponsible, and if you think that it's going to be a free deal, or there's corruption involved, then you may end up incurring more debt and not getting much out of this. So my input would be that here is an opportunity. The Chinese way of looking at these things has always been: We don't intend to interfere.

Haenle: In politics, right? Stay above the politics.

Huang: In politics. It's up to you to decide. Because that's the way China has always operated. They basically went to donors, or people, or whatever, and said, "If you want to lend us money, we will make a decision as to whether it serves our needs. If it doesn't, we don't want it. If we think we can get high returns on it, we'll go forward with this." This is the same philosophy here. So I think it's really a question of, here's a chance, an opportunity. Those who are ready for it, I think, can benefit a lot. And the others need to be fairly careful about this. And if it is so—and remember, this is not something that is going to be finished in one year or five years. It's twenty or thirty or forty years. And I think in that context, it clearly is a need to unify the rest of Asia to Europe. And everyone would benefit if that actually worked out pretty well.

Haenle: Well, Yukon Huang, thank you very much for joining us today for the China and the World podcast, and for joining us this week in Beijing for the 7th Annual U.S.-China Strategic Dialogue.

Huang: Pleasure to be here. Thank you very much.

Haenle: That's it for this edition of the Carnegie-Tsinghua China in the World podcast. I encourage you to explore our site and see the work of all our scholars at the Carnegie-Tsinghua Center. Thank you for listening. Be sure to tune in next time.