Czech University of Life Sciences Prague

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Diploma Thesis

China-US Trade Relations

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Summary of aims and objectives:

This thesis deals with the trade relations of the two largest trading economies the US and China. It aims to provide a detailed picture of the two studied countries, in terms of their economic developments, differences in their starting points, and political systems. The thesis aims to shed light on the complexity of China-US trade relations and evaluate their past developments from rivals to strategic partners, their trade issues that arise during trading, and the future prospects of relations.

The theoretical background presents an overview of modern trade theory and will acquaint us with the two studied countries by giving a summary of their export and imports by countries and the commodity structure. The differing political and economic background of the US and China are analyzed with special importance given to the sources and consequences of China´s economic rise. The aim of the quantitative section of the thesis is to identify the main its determinants that influence US-Chinese trade balance in merchandise products, which is done by constructing a linear regression econometric model.

Keywords: the US, China, trade, China-US trade relations, the WTO, exports, imports, Renminbi, IPR, economic growth, trade deficit, FDI

Methodology:

This thesis aims to evaluate China-US trade relations by providing a review of relevant available literature and its subsequent analysis, which will constitute a foundation of the methodology of the study. Economic and political comparison will be used, as well as data interpretation, economic and statistical analysis.

The theoretical part of the thesis provides an overview of modern trade theorist thinking based on a literature review of modern trade theory, starting with David Richardo to Michael Porter. The next part of the theoretical section shall acquaint us with the two studied countries by giving a picture of their export and imports by countries, which shall be carried out by data evaluation of especially trade balance figures, and also the commodity structure of export and imports will be given. The differing background of the US and China will be presented by using economic and political comparison. The sources and consequences of Chinese growth will be discussed and the stages of development of both countries will be identified using the framework of the World Economic Forum´s Global Competitiveness Report.

The overview of trade issues is based upon publications by both American and Chinese authors, from a range of institutions including the Congressional Research Service, National Bureau of Economic Research, United States Institute of Peace, World Bank, US-China Business Council, university reports, and media coverage such as the Wall Street Journal. In order to provide additional impartial perspective, reports and discussion papers from Bank of Finland and the Finnish Ministry of Employment and Economy were used.

Moreover, this thesis will give a picture of the developments of the US-Chinese trade balance, by constructing a linear regression econometric model comprised of 20 observations between the years 1994 and 2013. It models the total bilateral trade balance between the USA and China in merchandise goods with respect to other variables. Parameters will be estimated using the OLSM in SW Gretl. The most significant determinants of the US-Chinese trade balance will be chosen to form the final model based on economical and statistical and analysis. Data analysis and description will be used to carry out the economic verification, statistical verification, econometric verification and model application. In model application the most explanatory determinant of the US-Chinese trade balance will be selected as well as modelling the possible effects of variable increases on the trade balance. These scenarios reflect the forecasted predictions of American GDP by the World Economic Outlook report “Uneven Growth: Short- and Long-Term Factors” and the Chinese inflation forecast by the People’s Bank of China.

Key Findings and Conclusions:

Studying the US-Chinese trade relationship is extremely valuable. Both the US and China are countries with growing power and influence on international affairs, each with a different starting point, what makes the study of the nation’s trade relations so interesting. The US is has been the dominant and leading economic and political power ever since we can remember. On the contrary, China is an emerging power whose potential has only been uncovered in the last decades. The US still remains the largest economy in the world, China ranks second, however China is the world´s largest trading economy and premier creditor.

China grew exceptionally after implementing domestic reforms and opening itself to trade and heavy investment. International trade has played a key role in China´s process of reform and a large factor that has contributed to its success has been a substantial increase in its economic ties with the United States during the last three decades.

China’s rapid economic growth can be attributable to two basic factors: Investment growth paid by huge domestic savings and Export-driven growth. However, the financial crisis highlighted its export dependency, which is the highest in the world. Being reliant on external demand is very unstable indeed and China will not be able to sustain its investment-driven and export-led growth, unless it becomes a major center for new technology and innovation and implements comprehensive economic reforms.

The US, to put it simply, has created and continually creates global order. It created a rules-based international and economic order as part of the post-war reconstruction, the US Dollar became the world reserve currency and the US acts as a lender of last resort, thus establishing American dominance in the global economic system financial sector. In the new world order we have witnessed the gradual decline of the share of US GDP in the global GDP figure. Nevertheless, the core strength of America remains its powerful economy with advanced technology, military reserves, educated and technologically skilled population in a liberal democratic political system capable of making sustainable decisions.

As the world is increasingly economically interdependent it would be unwise for the two countries with the greatest contribution to world GDP (over 33%) to not have friendly relations. We can witness an undeniable complementarity of the Chinese and American economy, which is precisely the reason why their economies are so deeply connected. The greatest benefits from exchanges occur when cooperation happens between economies that are the most different, i.e. when their comparative advantages practically do not overlap.

It is vital that the relationship of genuine partnership continues between the China and the United States. A pre-requisite for this to happen is that both countries have to respect the other’s legitimate core interests, even though differences arising between them are inevitable. Some issues that have caused trade friction are measures the Chinese government seeks to promote its economic development: barriers to entry exist, subsidies to domestic firms are given, all of which is linked to the lack of enforcement of WTO obligations, moreover the Chinese currency was for many years considered to be undervalued, which acted as a "subsidy" making their products cheaper, and also US firms incur great losses due to the unacceptably high levels of IPR piracy in China:.

Despite the fact that we can observe both benefits and drawbacks in the US-Chinese relationship, it is still considered by most analysts to be "mutually beneficial overall". It is essential that Beijing and Washington continue to uphold an open and transparent dialogue to fully comprehend each other's intentions on important issues. Taking steps to increasing trust is essential to reducing the risk of conflict between the dominant and rising power.

In the quantitative section of the thesis it was found that out of twelve chosen variables, the three that are most explanatory of the US-Chinese trade balance were the GDP of the US, the Interest rate of China and the Inflation rate of China.

Selected Literature:

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