“A Tale of Two Deficits: US Trade Deficit and US Trade Deficit with China”

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ARTICLE INFO	Yusen Liu and Stacy Vollmers (2005). A Tale of Two Deficits: US Trade Deficit and US Trade Deficit with China. *Innovative Marketing* , *1*(2)
RELEASED ON	Tuesday, 01 November 2005
JOURNAL	"Innovative Marketing "
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”

NUMBER OF REFERENCES
0

NUMBER OF FIGURES
0

NUMBER OF TABLES
0

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BUSINESS PERSPECTIVES

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A Tale of Two Deficits: US Trade Deficit and US Trade Deficit with China

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Abstract

The United States is the largest trading nation in the world. Before 1971, the US had always enjoyed a trade surplus. However, since 1971, (excluding 1973 and 1975) the US has experienced a trade deficit. As the US trade deficit persists and grows, concern and debate over the effects of the trade deficit have grown. Some arguments suggest that the US trade deficit benefits US consumers and businesses, adds to US investment, and contributes to US economic growth while other arguments claim that the US trade deficit causes loss of US jobs, depreciates the US dollar, raises US interests rates, and slows down the US economy.

Among the 10 largest trading nations in the world, the US is the nation with the largest trade deficit. The United States has a trade deficit with each of the ten largest trading nations from which it imports goods and services, the largest deficit being with China. Is China the major cause of the US overall trade deficit? What are the effects of US China trade?

This paper analyzes both the overall US trade deficit and the US trade deficit with China. Two different views on the two different trade deficits are presented. The conclusion is that the US trade deficit is a complicated issue which requires multiple means to solve. The appreciation of China's currency alone will not solve this problem.

Key words: International trade, trade deficit and surplus, China, United States, currency.

Introduction

Globalization is the general trend of today's world. It has made possible the integration of business and other activities for more efficient, effective, and productive purposes on a global scale (Liu, 2005). In the process of globalization, international trade has played an important role. Adam Smith, the well-known Classic economist and earliest advocate of globalization, was a proponent of Laissez faire economy and a supporter of free trade (Hirsch, 1976). In his celebrated book, "The Wealth of Nations", Smith stated that nations should specialize in producing the kind of products with which they have a higher productivity and exchange these products with other nations (Smith, 1937). Then all the nations participating in the exchange process would be benefited (Ball, 1993). Smith's theory had tremendous impact on the expansion of international trade, the development of the industrial revolution and the spread of capitalism all over the world in the 18th and 19th centuries.

Nevertheless, the prevailing view in the early days of commerce and trade was that of mercantilism, which states that the wealth of nations depends on the accumulation of gold and silver. In order to accumulate wealth, governments should encourage exports and limit imports. This spurred the expansion of trade, especially exports (Heckscher, 1934). However the export efforts of many nations often met with trade barriers, such as quotas, permits, licenses, tariffs, and other obstacles. The colonization of the American continents and many nations in Africa and Asia from the 17th to 19th century is directly or indirectly related to the mercantilist ambition to seek gold and silver. In this century, mercantilism still has its influence. A lot of nations emphasize the importance of export trade and the accumulation of hard currency, which are part of the reasons for imbalanced trade among nations (Heckscher, 1934).

Since the 1950s, international trade has grown rapidly. By 1997, total world trade volume had reached $15.8 trillion, and US trade had surpassed $1.5 trillion. By 2003, total world trade volume had reached to $60 trillion, and the trade volume of 10 largest trading nations in the world had amounted to $7.4 trillion (U.S. Census, 2005). The US was the largest trading nation with total trade volume of $2.5 trillion. However, the US imported $496 billion more goods and services

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than she exported, making the US the trading nation with the largest trade deficit in the world as seen in Table 1.

Table 1

The 10 Largest Trading Nations in the World, 2003(US $ billion)

Country	Total Trade	Export	Import	Balance
USA*	2,537.5	1,020.5	1,517.0	-496.5
Germany	1,088.0	601.0	487.0	114.0
Japan	696.0	394.8	301.2	93.6
Britain	608.9	278.6	330.3	-51.7
France	601.0	306.2	294.8	11.4
China	509.8	266.2	243.6	22.4
Italy	490.5	253.6	236.9	16.7
Canada	488.5	261.5	227.0	34.5
Spain	266.7	117.6	149.1	-31.5
Brazil	113.8	58.2	55.6	2.6
Total	**7,400.2**	**3,557.7**	**3,842.5**	**-284.5**

Source: http://www.census.gov/foreign-trade/balance

The ten largest markets for US exports (top export destinations) are Canada, Mexico, Japan, the U.K., Germany, China, S. Korea, Netherlands, Taiwan, and France (U.S. Census, 2005). The major US exports to these countries are aircrafts, computers, automobiles, precision instruments, films, computer software, weaponry, chemicals, wheat, fruits, etc. The total amount of US exports to these countries reached $489 billion in 2003 as shown in Table 2.

Table 2

The 10 Largest Markets for US Exports, 2003 (US$ million)

Country	US Exports	US Imports	Total Trade	US Balance
Canada	169,923	221,594	391,517	-51,671
Mexico	97,411	138,060	235,471	-40,648
Japan	52,044	118,036	170,080	-66,032
U.K.	33,827	42,795	76,622	-8,967
Germany	28,831	68,112	96,943	-39,680
China	28,367	152,436	180,803	-124,066
S. Korea	24,072	37,229	61,301	-13,156
Netherlands	20,095	10,952	31,047	9,742
Taiwan	17,447	31,599	49,046	-14,151
France	17,053	29,219	46,272	-12,166
Total	**489,070**	**850,032**	**1,339,102**	**-360,795**

Source: http://www.census.gov/foreign-trade/balance

The ten largest markets for US imports (top import suppliers) are Canada, China, Mexico, Japan, Germany, U.K., S. Korea, Taiwan, France and Ireland (U.S. Census, 2005). The major US imports from these countries are automobiles, oil, electronics, steel, computers, textiles, apparels, shoes, toys, tools, etc. The total amount of US imports from these countries reached $864 billion in 2003 as shown in Table 3.

Table 3

The 10 Largest Markets for US Imports, 2003 (US$ million)

Country	US Exports	US Imports	Total Trade	US Balance
Canada	169,923	221,594	391,517	-51,671
China	28,367	152,436	180,803	-124,066
Mexico	97,411	138,060	235,471	-40,648
Japan	52,044	118,036	170,080	-66,032
Germany	28,831	68,112	96,943	-39,680
U.K.	33,827	42,795	76,622	-8,967
S. Korea	24,072	37,229	61,301	-13,156
Taiwan	17,447	31,599	49,046	-14,151
France	17,053	29,219	46,272	-12,166
Ireland	7,695	25,746	33,441	-25,746
Total	**476,670**	**864,826**	**1,341,496**	**-396,283**

Source: http://www.census.gov/foreign-trade/balance

The US Trade Deficit

For more than a century prior to 1971, the US experienced a trade surplus in goods trade. The amount of the surplus ranged from $4.9 billion in 1960 to $2.9 billion in 1970. However, this trend ceased in the early 1970's. Since 1971 (except for 1973 and 1975), the US has had a trade deficit in goods trade. This deficit had grown from -$2.3 billion in 1971 to -$547.5 billion in 2003 (U.S. Census, 2005). Table 4 presents the US Trade Balance in Goods, 1994-2003.

Table 4

US Trade Balance in Goods: 1994-2003 ($ billion)

Year	Exports	Imports	Total	US Balance
1994	502.8	668.7	1171.5	-165.8
1995	575.2	749.4	1324.6	-174.2
1996	612.1	803.1	1415.2	-191.0
1997	678.4	876.5	1554.9	-198.1
1998	670.4	917.1	1587.5	-246.7
1999	683.9	1,029.9	1,713.8	-346.0
2000	771.9	1,224.4	1,996.3	-452.4
2001	718.7	1145.9	1864.6	-427.1
2002	681.8	1164.7	1846.5	-482.9
2003	713.1	1260.6	1973.7	-547.5
Total	**6608.3**	**9,840.3**	**16,448.6**	**-3231.7**

Source: http://www.census.gov/foreign-trade/balance

The US trade balance in services presents a different situation. Before 1971, the US usually had an unfavorable trade balance in this area. The service trade deficit ranged from -$1.4 billion in 1960 to -$0.3 billion in 1970. This changed in the early 1970's, with the US balance of trade in service shifting from negative to positive. This surplus in service trade ranges from $1.0 billion in 1971 to $51.1 billion in 2003 (U.S. Census, 2005). Table 5 shows the US trade balance in service from 1994-2003.

Table 5

US Trade Balance in Service: 1994-2003 ($ billion)

Year	Exports	Imports	Total	US Balance
1994	200.4	132.9	333.3	67.5
1996	219.2	141.3	360.5	77.9
1996	239.5	152.4	391.9	87.1
1997	256.3	166.3	422.6	89.9
1998	263.1	181.3	444.4	81.8
1999	282.5	199.7	482.2	82.8
2000	297.0	224.9	521.9	74.1
2001	287.9	223.4	511.3	64.5
2002	294.1	232.9	527.0	61.2
2003	307.4	256.3	563.7	51.1
Total	**2647.4**	**1911.4**	**4558.8**	**737.9**

Source: http://www.census.gov/foreign-trade/balance

A country may have negative trade balance in goods, positive balance in service, and because the negative imbalance in goods is greater than positive imbalance in service the overall trade balance is still in negative. Such is the case with the US's trade balance. When adding the US trade balances of goods and service after 1971, the positive balance in service, improves the picture of the overall US trade balance by somewhat offsetting the negative balance in goods. Table 6 presents the US trade balance in goods and services for 1994-2003.

Table 6

US Trade Balance in Goods and Service: 1994-2003 ($ billion)

Year	Exports	Imports	Total	US Balance
1994	703.3	801.6	1504.9	-98.4
1995	794.3	890.6	1684.9	-96.2
1996	851.6	955.5	1807.1	-103.9
1997	934.6	1,042.8	1,977.4	-108.1
1998	933.5	1,098.3	2,031.8	-164.9
1999	966.4	1,229.7	2,196.1	-263.2
2000	1,070.9	1,449.3	2,520.2	-378.3
2001	1,006.6	1,369.3	2,375.9	-362.7
2002	975.9	1,397.6	2,373.5	-421.7
2003	1,020.5	1,517.0	2,537.5	-496.5
Total	**9,257.6**	**11,751.7**	**21,009.3**	**-2493.9**

Source: http://www.census.gov/foreign-trade/balance

The above analysis highlights a serious issue in US international trade, the fast growing trade deficit. This situation was aggravated and the US trade deficit became worse when Asian countries tried to export more of their products to the US after the Asian financial crisis in 1997. In addition, the US trade deficit quickly increased recently as a result of oil price hikes. Consequently, the US trade deficit hit a record high of $496.5 billion in 2003.

This raises several questions: Is the huge US trade deficit a good thing or bad thing? What are the effects of the US trade deficit on US consumers, workers, and businesses? Does the US trade deficit have positive or negative effects on the US economy? What is China's role in this situation?

Two Views On Us Trade Deficit

There are two different points of view regarding the possible effects of the US trade deficit: possible negative effects of the US trade deficit, and possible positive effects of the US trade deficit. The possible negative effects of the US trade deficit will be examined first.

First, the US trade deficit results in loss of US jobs: According to Commerce Department estimates, the $1 billion trade deficit may result in loss of 20,000 jobs. If we use the money, instead of paying for foreign imports, make direct investment to produce import substitutes, we may create 20,000 jobs if each job pays $50,000 for compensation. In addition, the $1 billion trade deficit may also lower the US's GDP by $2 billion, and reduce US tax revenue by $0.4 billion (Department of Commerce, 1995). A $496.5 billion trade deficit in 2003 may result in loss of 9.93 million US jobs, lowering US GDP by $993 billion, and deduction of US tax revenue by $198.6 billion. By April 2005, the US Labor force was 148 million, unemployment was 5.2%, with 7.7 million unemployed. According to this theoretical view, eliminating the US trade deficit would more than solve the unemployment problem in the US.

Second, the US trade deficit causes depreciation of the US dollar: Since the US has incurred a huge and ever-growing trade deficit; the outflow of US dollars has resulted in a "glut" of US dollar supply in the global market. Thus, the supply of US dollars on the global market has greatly exceeded the demand. Therefore the value of US dollar has continuously declined in the global market. According to statistics, the US dollar has continuously depreciated against the Japanese yen and the Euro. In 1950, the exchange rate between the US dollar and the Japanese yen was USD 1=JPY 360, but in June 2005, the exchange rate became USD 1=JPY109. The US dollar has depreciated against the Japanese yen by about 70%. A second example is the Euro. In 2000 when the Euro was first introduced, USD 1 could exchange for Euro 1.20, but by June 2005, USD 1 could only exchange for Euro 0.82. The US dollar has depreciated against Euro by almost 40%. Part of the reason for the depreciation of the US dollar is the US trade deficit.

Third, the US trade deficit leads to higher interests rates in the US. Because a large amount of US dollars needed for the domestic market are paid for imports to foreign exporters, there is a shortage of US dollars left for borrower and investment in the domestic market. Therefore, the value of the dollar has been bid up, and interest rates have risen. If the US trade deficit had not been so large, US interests rates would have been lower.

Fourth, the US trade deficit slows down US economic growth: When much needed money is paid for the trade deficit, there is less funding left for investment in the domestic market. The lack of investment funding plus other negative effects of the trade deficit as mentioned above tend to slow down US economic growth. The possible positive effects of the US trade deficit will be examine next.

First, the US trade deficit benefits US consumers and US businesses. The huge US trade deficit results from the US importing large quantities of consumer goods and raw materials. This effectively increases product varieties and drives down prices for consumers. It also enables businesses to have access to cheap materials and resources. In addition, competition from foreign imports compels US businesses to improve quality and lower prices for their products. As a result, US productivity has been raised, and US products have become more competitive in the market place.

Second, much of the money paid for the US trade deficit returns to the US market and adds to US investment: A large portion of money paid for the US trade deficit to foreign exporters has come back to the US market as investment in US stocks, mutual funds and bonds. In addition, it has paid for acquisitions and purchases of US businesses and real estate. According to statistics, foreign acquisitions of assets in the United States in 2003 were $829.2 billion, up 13% from $768.2 billion in 2002. Foreign official acquisitions of US assets more than doubled in 2003 from 2002, to the highest level on record. This is because the depreciation of US dollar has made US products and assets cheaper for foreign investors (Bureau of Economic Analysis, 2004).

Third, the US trade deficit accelerates the trend toward high-tech industries: Large amount of foreign imports, especially those such as apparels, shoes, tools, toys, and light industrial goods, have helped the US structurally change from low-tech, labor-intensive industries toward high-teach capital-intensive industries. The US may loose jobs in low-tech, labor-intensive industries, but gains jobs in high-tech, capital-intensive industries such as computers, communication, aviation, precision instruments, biotechnology, etc. Most of the jobs added require high skills and good education, and therefore result in high pay.

Fourth, the US trade deficit contributes to US economic growth: As of 1996, the amount of US currency in circulation in the US was $1.5 trillion. However, the amount of US currency in circulation outside the US was $3.0 trillion (Wright, 1998). A large portion of US currency in circulation outside the US without exchanges for US products and assets is equivalent to no interest loan financing to US economy. From 1994 to 2003, the cumulative US trade deficit reached $2493.9 billion. The US trade deficit has helped supply much needed US dollars in the world market, and enabled the US dollar to become a true world currency. It has not only helped with the development of world trade, but has also promoted US economic growth.

US Trade Deficit With China

After Communists took over China in 1949, US-China trade was interrupted. Since President Nixon visited China in 1972, US-China trade has resumed and grown at a fast pace. By 1994, bilateral trade had reached $60.7 billion. From 1994 to 2004, US-China trade has picked up and grown much faster than before—it quadrupled from $60.7 billion in 1994 to $245.2 billion in 2004 (US-China Business Council. 2005). As the US is the largest developed country that is highly industrialized, and China is the largest developing country that is in the process of industrialization, US-China trade is highly complementary. Top US exports to China are machinery and equipment, aircraft, chemicals, iron and steel, paper, etc. Top US imports from China are equipment and machinery, toys, furniture, footwear, apparel, iron & steel, etc.

However, an obvious issue resulting from this relationship is the US trade deficit with China. In each year from 1994 to 2004, the US had incurred a trade deficit with China, and the US trade deficit with China hit a record high of 175.8 billion in 2004. The total US trade deficit with China has amounted to $917.9 billion from 1994 to 2004 (US-China Business Council, 2005). Table 7 presents the US trade balance with China, 1994-2004.

Table 7

US Trade Balance with China: 1994-2004 ($ billion)

Year	US Exports	US Imports	Total	US Balance
1994	9.3	41.4	60.7	-36.7
1995	11.8	48.5	60.3	-36.7
1996	12.0	54.4	66.4	-42.4
1997	12.8	65.8	78.6	-63.0
1998	14.3	75.1	89.4	-60.8
1999	13.1	87.8	100.9	-74.7
2000	16.3	107.6	123.9	-91.3
2001	19.2	109.4	128.6	-90.2
2002	22.1	133.5	155.6	-111.4
2003	28.4	163.3	191.7	-134.9
2004	34.7	210.5	245.2	-175.8
Total	**194**	**1097.3**	**1301.3**	**-917.9**

Source: The US-China Business Council

Two Views On Us Trade Deficit With China

As we mentioned above, China is the trade partner with which the US has the largest trade deficit. The US-China trade deficit hit a record high of $175.8 billion in 2004, and the US trade deficit with China amounts to 917.9 billion from 1994 to 2004 (U.S. Census, 2005). This raises the questions: Is China the major cause for the US overall trade deficit? And what are the effects of the US China trade deficit? There are two different views on this issue, negative and positive. The negative view will be examined first.

First, China imports contributed to the huge US overall trade deficit. China is the US trade partner with largest trade imbalance. In 2003, the US overall trade deficit was $496.5 billion, and the US trade deficit with China was $124.0 billion. If we eliminated the US trade deficit with China, we would wipe out one quarter of the US overall trade deficit.

Second, China imports cause the loss of US jobs. According to a working paper by Dr. Robert Scott of the Economic Policy Institute, the US's growing trade deficit with China eliminated production supporting about 70,000 jobs per year from 1987 to 1997, 105,000 jobs per year from 1997 to 2001, with job displacement soaring to 234,000 from 2001 to 2003 per year (Scott, 2005). Therefore, cheap Chinese imports are the key factor for the overall US trade deficit and displacement of US workers. If we made China's imports expensive by forcing China to un-peg her currency from the US dollar, the Chinese yuan would appreciate and China imports to the US would be more expensive. As a result, there would be less Chinese imports, and the US China trade deficit would be reduced. Eventually the US overall trade deficit would be minimized and the related problems be solved. Now let's examine the positive view:

First, Chinese imports benefit US consumers and businesses in term of cheap prices and product variety. Most of China's imports are low-end market products that have competed and replaced similar products imported from other developing countries, especially countries in Asia. Therefore, the impact of China's imports to displace US workers is limited.

Second, according to an article by China Daily "RMB is not cause of US trade deficit", 60% of China imports to US are from foreign funded enterprises in China and much of the profits and benefits made in China imports go to the investors and traders from the US, Japan, Taiwan, and Hong Kong (Secretary General, Guangzhou Government, 2005).

Conclusion

The US is now facing two deficit problems — the US overall trade deficit, and the trade deficit with China. After the above analysis, we may make the following initial conclusions:

- The US trade deficit has both positive and negative effects on US consumers, businesses, and economy. Its overall benefits outweigh its negative effects.
- If the US trade deficit is reduced or kept at an appropriate level, it would benefit US consumers, businesses, and help the economy. However, if US trade deficit continues its free fall, some serious problems may occur. The scenario may include sharp depreciation of US dollars in the global market, the flow of foreign capital away from the US, and a setback for US economic recovery. These issues might cause serious problems for US trade and slow down US economic growth. The ever growing US trade deficit and the ensuing scenario may also include a trade war and financial crises on a global scale.
- The US-China trade deficit is a complex issue that requires concerted efforts and multiplied measures to deal with. Forcing China to appreciate her currency, thus making China imports expensive in the US alone would not solve the problem. The important thing is to increase US exports to other countries, and specifically increase US exports to China.
- The US trade deficit may have near term benefits, but for long term, it will have harmful effects. Therefore, it is important for the US to reduce her trade deficit and keep her trade deficit at an optimum level.

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