The US Response to a Growing Trade Deficit with China

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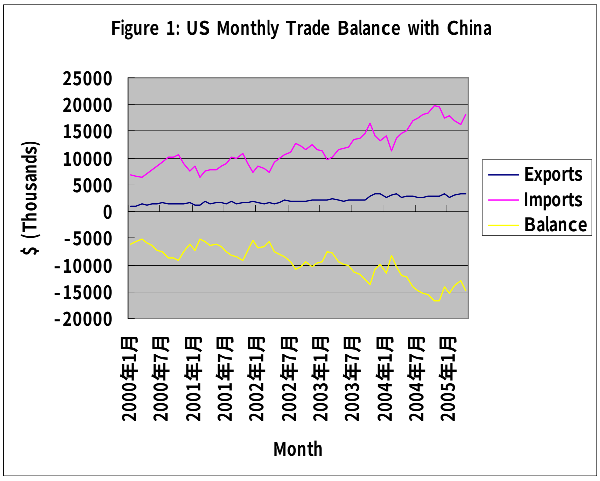
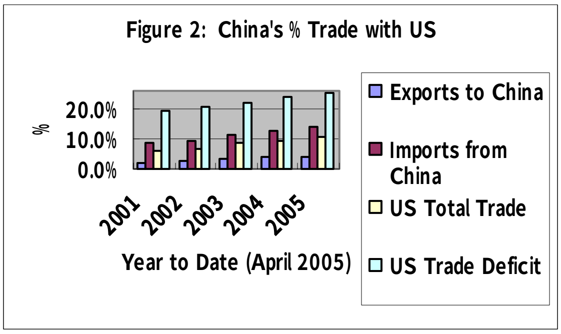
I. Trade with China and the Fall of the US Manufacturing Sector

The rise of China is an ever growing topic among US policy makers. Probably the largest point of contention in US-China relations today is the US trade deficit. Measured from April 2005 on a year to date basis, the US imported $212 billion from China and only exported $35 billion, a trade deficit of $177 billion. This deficit grew from the previous yearly period by 33% and shows signs of increasing even faster. Figure 1 shows that since 2002, imports from China have been rapidly increasing, while exports, although increasing themselves, pale in comparison. This has lead to a massive, growing trade deficit. Figure 2 shows that China now accounts for over 25% of the US trade deficit, and over 10% of its total trade. It may soon outpace Mexico to become the US's second largest trading partner after Canada. While China's share of the US import market is rapidly increasing, the proportion of US exports to China has remained steady at around 4%.





Source: US Census Bureau

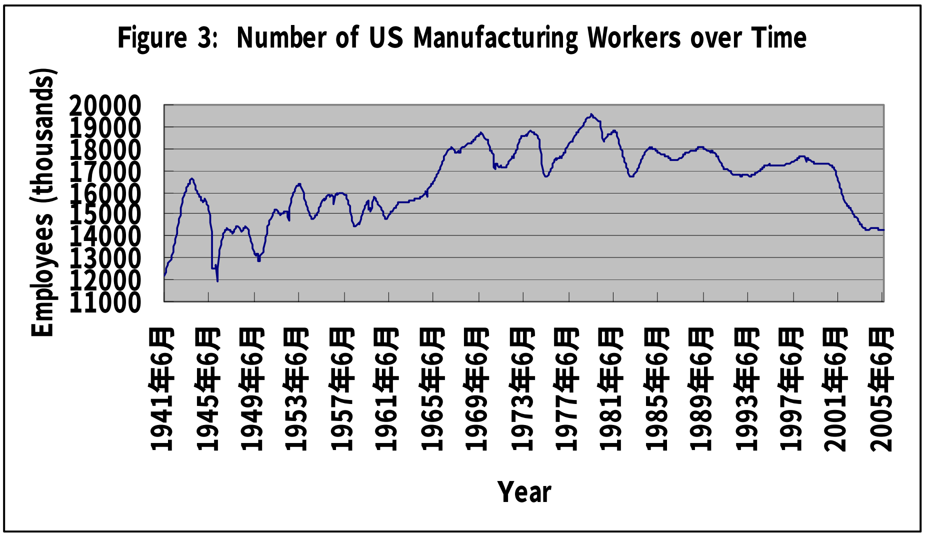
Table 1 shows the US's top 10 imports to and exports from China. As can be seen, since 2000 China has seen rapid increases in exports of computer and electronic equipment, textiles, and furniture. The top US exports to China are an order of magnitude less when compared to China. The some of the rapidly growing exports are agricultural – soybeans and cotton, while certain manufacturing sectors have seen more moderate increases or even declines.

Table 1: US Top Imports to and Exports from China

Imports from China			Exports to China		
Type	2004 Value ($, thousands)	Growth Since 2000	Type	2004 Value ($, thousands)	Growth Since 2000
Computer Parts	23794210	161%	Semiconductors	2938303	237%
Toys and Bicycles	17844052	42%	Soybeans	2328833	131%
Household Gadgets	17336897	89%	Industrial machines	1911342	186%
Textiles	10601204	100%	Aircraft	1617532	11%
Computers	10052085	590%	Organic Chemicals	1442375	218%
Furniture	9709247	140%	Cotton	1431259	2429%
Footwear	8421936	27%	Plastic	1381725	157%
Video Equipment	7905474	305%	Computer parts	1070259	-5%
Kitchen Appliances	5902998	135%	Telecomm equipment	1020814	20%
Telecom equipment	5672818	135%	Measuring instruments	996202	196%
Radios/Stereos	5480107	27%	Steelmaking materials	984441	295%

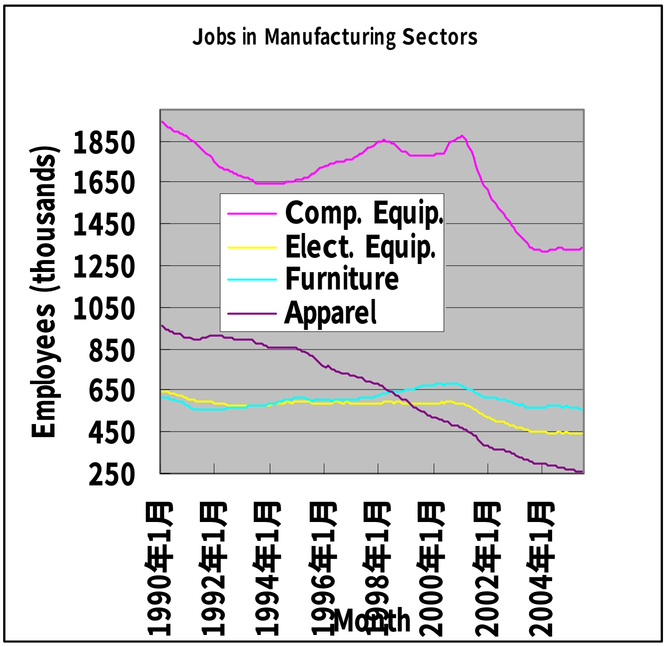
Source: US Census Bureau

This rapid rise in imports from China since it joined the World Trade Organization (WTO) has been accompanied by a rapid drop in manufacturing jobs in the US. Figure 3 shows the manufacturer labor market in the US over time. Disregarding economic recessions, the number of manufacturing jobs remained relatively steady in America from 1980-2000. But note the rapid decline in manufacturing jobs around 2001, the same time that China joined the WTO. Manufacturing employment slipped from 17.2 million to 14.2 million. Many of these lost jobs can be blamed on the recession after the burst of the internet bubble. However, unlike in previous times, the economic recovery has not led to a return in manufacturing jobs. Even in 2005, there were fewer manufacturing jobs in the US than there were since 1950.



Source: US Department of Labor

If we examine particular areas of manufacturing the trend becomes even more apparent. Figure 4 shows employment in the areas of US manufacturing where China has seen big increases in exports to the US. As can been seen, computers, electronics, and furniture sectors all began to decline in 2001 and have yet to recover. Apparel, part of the textile industry, is actually an exception. Apparel jobs have been in decline since the early 1990s and have continued to decline almost linearly ever since. The year 2001 seems to mark no change in this pattern for apparel.



Source: US Department of Labor

Americans have many explanations for the rise in imports from China and the loss of manufacturing jobs in the US. Free trade advocates contend that this is just a restructuring process. The US textile industry was long protected by the Multi-fiber agreement that ended in 2004. It is failing now because China has a comparative advantage in textile production. They say that America must shift into and create new industries in the face of global competition. Some thinkers have a fairly pessimistic view of the situation. Clyde Prestowitz, who was counselor to the Secretary of Commerce during the 1980s Japan-US trade disputes, has now shifted his focus to China. In his new book Three Billion New Capitalists, he argues that unless the US invests heavily in education and undertakes an industrial policy strategy similar to Japan, China, and other Asian countries, America will decline economically in the face of China and India.[1] This view that American is beginning to lag behind the world in terms of education is often expressed by groups ranging from congressmen to Bill Gates. Even moderate "pro-China" thinkers like the Nixon Center's David Lampton worry that "by 2010 China could well be turning out about four times the number of engineering doctorates as the United States."[2]

Another way that some US experts, particularly economists, look at the situation is through patterns of consumption. The US is consuming nearly all of its wealth. Americans propensity to save is less than 1%, and the US budget deficit is at all time highs. China and Asia in general, save a lot. The propensity to save in China is around 40% and has risen since the 1980s. Essentially poor China is making toys for rich America to buy (and loaning them money to buy the toys through the purchase of US government bonds.) In this scenario Japan and Europe are often blamed for not playing "more of a role" in the system by raising their GDP growth rates. Who is most to blame, whether it be the spenders, savers, or "no-growers" depends on who you talk to. Some place the blame on the US overly consumer culture and the associated government incentives for destroying the potential for future growth. Others blame

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[1] Clyde Prestowitz, Testimony before the U.S.-China Economic and Security Review Commission, May 19th 2005, <http://www.uscc.gov/hearings/2005hearings/written_testimonies /05_05_19_20wrts/prestowitz_clyde_wrts.htm>.

[2] David Lampton, Testimony before Senate Foreign Relations Committee Subcommittee on East Asian and Pacific Affairs, "Hearing: Effects and Consequences of an Emerging China," (find real source, incorrect)

“mercantilist” China for “forcing” its people to save in order to flood America with cheap products. Last, there are those who lament that if Japan had only maintained a 3% growth rate, rather than slipping into its “lost decade,” the US would not now be in such a bind with “communist” China. It seems the US has already forgotten the trade friction with Japan in previous years as it copes with the rise of China.

Perhaps not surprisingly, the most common way to explain the United States’ recently poor performance in the face of China is through one-sided criticism or outright China-bashing. There has been an outcry in America that jobs are being lost to China and that American businesses cannot compete because of China’s “unfair” advantages. For instance, using RMB undervaluation discussed in Part A as an excuse, the president of a small manufacturing firm at a recent congressional hearing said,

“if the Chinese currency was correctly valued, I wonder how many would actively be pursuing services there? With that correct exchange rate, it is my belief that China could no longer be competitive in the world market. I do not believe the average Chinese shop operates nearly as efficiently or accurately as shops in the U.S.”

There are many Americans who share his beliefs. The situation has led to more and more calls for the Bush Administration to take action. The US has been quick to impose quotas on textiles under the “safeguards” rules it worked out with China as a condition for it joining the WTO. China itself has imposed quotas on its textile exports to calm US sentiment. But as Figure 4 demonstrates, China’s position as a manufacturing giant seems to be having an even greater impact on other manufacturing areas.

The remainder of this paper will examine various criticisms brought against China with regard to trade issues by US policy makers and opinion leaders. I have grouped them into three categories: A. Should the RMB be revalued? debate, B. the unfair labor practices arguments, and C. the failure to comply with WTO commitments. By examining these criticisms we can better understand American thinking towards China and how this is shaping the US is response to globalization.

II. Blaming China

A. Should the RMB be revalued?

During the first half of 2005, the most vocal criticism of China revolved around its currency, the RMB. It has been pegged to the dollar for the past ten years at a rate of 8.2 RMB/$. Many vocal groups in the media and Congress maintain that the RMB is grossly undervalued and that Chinese authorities are manipulating the currency to keep it that way. They claim that this has allowed Chinese products to be more competitive in the international market, thus precipitating the US trade deficit and job loss. The RMB should be revalued or China must face the consequences of a US economic retaliation. Many US thinkers and policy makers do not hold this position, however. There are several general arguments on the issue that I have divided into five categories.

1. Those that believe the RMB is intentionally undervalued and want to punish China with a tariff if it does not revalue soon:

These are the most radical of the "RMB is undervalued" group. They believe that Chinese authorities are intentionally "manipulating" its currency in keeping it pegged to the dollar. They claim that Chinese manufacturers are enjoying an up to 40% price advantage when compared to American manufacturers. The US government should therefore impose tariffs on Chinese goods as long as they continue this currency manipulation. This position was made famous by New York Democratic Senator Charles Schumer and his Republic co-sponsor Lindsey Graham. In April 2005 they proposed a bill that would impose a 27.5% tariff, a percentage half way between the "high" and "low" estimates of undervaluation, on all Chinese exports if the government did not revalue within sixth months. "Given that Chinese policies are unfair to American businesses and workers - and that they jeopardize the increasingly important but fragile regime of global free trade - we believe our strategy is the best way to insure that China finally plays by the rules."[3] A vote on the bill was postponed until the year due to outside pressure. Although such a bill has support from some Senators who represent small manufacturing businesses, it is criticized by most groups as too protectionist.

2. Those that believe the RMB is intentionally undervalued, but imposing tariffs is the wrong way to go about it.

This is a popular position in Congress because it tends to appease both sides of the fence. This group believes that one of the main reasons for the trade deficit is China's undervalued currency. Revaluing will prevent the loss of many America jobs. But

[3] Charles E. Schumer and Lindsey Graham, "Will it take a tariff to free the yuan?" *New York Times*, July 8 2005.

criticism is also leveled against "unfair advantages" China has due to claims of suppressed wages, poor working conditions, lack of worker benefits, and prison labor. Therefore, the focus should not only be only on currency revaluation but also on these larger problems. A tariff is not the right way to influence China because it damages the international system of free trade. Instead, the US should use the WTO framework and other international organizations to pressure China into adopting better labor standards and to crack down on intellectual property rights (IPR) violations. The National Association of Manufacturers (NAM) and similar organizations favor this view, which is summed up in this statement before Congress: "Would a considerably stronger Chinese Yuan have beneficial effects? Many NAM member companies have indicated that a 20 percent or more price shift would change the competitive situation dramatically. Others say their problems go beyond that. Some commentators state that Chinese wages are so low that no amount of appreciation would make a difference."[4]

3. Those that believe the RMB should be revalued, but more for China's own good than the US.

This is a fairly widespread, balanced position held by the Treasury Department, Alan Greenspan, and several prominent organizations and economists such as China expert Nick Lardy of the Institute for International Economics. These thinkers, who are often free-traders, are strongly opposed to a tariff, which they typically label as protectionist. It would drive up US domestic prices and violate the spirit of the WTO. Generally, this group does not believe that China is manipulating its currency for its own advantage, but rather maintaining the peg for stability reasons. The Bush administration's Treasury Department under John Snow has so far refused to label China a currency manipulator, despite pressure from Congress. Lardy points out that China has steadfastly maintained the current peg since 1994, both through periods of undervaluation and overvaluation. But he also argues that the idea of stabilizing the nominal exchange rate is faulty reasoning by the Chinese authorities, because it follows that the real exchange rate has fluctuated over this period.[5]

These thinkers believe that revaluing or floating the RMB will have positive benefits for the Chinese economy for several reasons. As Beijing continually tries to

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[4] Al Lubrano, statement before the Senate Finance Committee, "US-China Economic Relationship," June 23, 2005, <http://finance.senate.gov/hearings/testimony/2005test/altest062305.pdf>.

[5] Nicholas R. Lardy, "Exchange Rate and Monetary Policy in China," *Cato Journal,* Vol. 25, No. 1 (Winter 2005).<http://www.cato.org/pubs/journal/cj25n1/cj25n1-6.pdf>.

keep its currency fixed at the current rate, the amount of RMB circulating in the economy is increasing as more outsiders buy RMB due to the expected appreciation. This is leading to a rise in inflation and overinvestment. Foreigners and Chinese alike are pouring money into the real estate sector, one of the few avenues of investment in China, while they wait for the RMB to appreciate. Releasing the peg will ease inflationary pressure and help curb overinvestment in areas like the housing sector. Additionally, authorities are using much of this accumulated foreign currency to buy (US and other foreign) government bonds. These bonds have low yields compared to other forms of investment and such purchases are essentially financing the spending habits of richer nations. These experts believe that the RMB could be used for more useful practices such as stimulating Chinese consumption or further investment in Chinese infrastructure. Additionally, since only 10% of China's trade is with the US, tying the RMB to the dollar represents an unnecessary risk.[6]

On the other hand, revaluing will not affect US jobs or its current account deficit. First of all, they believe that China has a very effective workforce that would be competitive even without the currency boost. Secondly, studies show that although exports from China have been increasing in recent years, the percent of exports coming from Asia as a whole remain stable at 30%.[7] This is because many traditional Asian exporting countries such as Japan and Korea have simply moved their factories and operations to China. Additionally, China has become a hub for re-exporting, which is importing parts manufactured in other countries, assembling them, and then re-exporting to foreign markets such as the US. Manufacturers hurt by the revaluation will switch their output to other, cheaper Asian countries, and continue exporting to the US. Some go far as to say that a revaluation will actually hurt the US in the short run, since Americans will have less access to cheaper goods. Phil Swagel of the American Enterprise Institute points out that "at the current exchange rate, this means that China is paying too much for the U.S. Treasury bonds it buys to prevent an appreciation of the yuan, while U.S. consumers and businesses are getting a discount on everything they buy from China."[8]

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6 Nicolas R. Lardy, "China's Role in the revised Bretton Woods system, a case of mistaken identity," *Institute forInternational Economics*, Working Paper No. WP05-2, March 2005. <http://www.iie.com/publications/wp/wp05-2.pdf>.

7 Jason Dean, "China reports continued surge in trade surplus," *The Wall Street Journal*, June 12, 2005, <http://online.wsj.com/article/0,,SB112102580848081551,00.html?mod=home_whats_news_asia>.

8 Phillip L. Swagel, "China should revalue the RMB," *Beijing Review*, Jun 22, 2005.

Despite the lack of short term benefits to the US, this group believes a more flexible Chinese currency will help alleviate some of the current imbalances in the international system. Many other Asian countries also have undervalued currency and are "afraid to revalue" because of competition from China. If the RMB is allowed to appreciate, it may encourage other Asian countries to follow. They propose that an overall appreciation of Asian currencies, coupled with increased savings in the US and more growth in Europe and Japan, is the correct path to correcting global currency imbalances.

4. Those that believe the Chinese currency is undervalued, but the Chinese should not revalue at this time.

According to these thinkers, China maintains a fixed peg with the dollar for economic stability. While it will be good for China to switch to a more flexible currency in the future because of the arguments presented above in 3, now is not the time due to various factors. Many poorer countries maintain a fixed exchange rate because their weaker economies are more susceptible to fluctuations in the currency. While China's coastal regions are becoming highly developed, the poorer regions to the west still benefit from this fixed exchange rate. Additionally, the poorer farmers will suffer more from an appreciation than their richer, city dwelling cousins. Farmer productivity is relatively low and the undervalued exchange rate gives them an advantage over competing imports. This has allowed them to gradually increase their incomes in recent years. A revaluation would further exacerbate the growing gap between rich and poor, a problem that is a top priority for Beijing to solve.[9]

Another reason why China should not revalue now is China's weak financial sector. Chinese banks are still struggling to dispose of non-performing loans (NPLs) that have built up over the years in the state owned exporting sector. Most companies with NPLs are dependent on cash flows denominated in dollars, but most of their loans are denominated in RMB. If the RMB appreciates substantially relative to the dollar it will be even more difficult for these companies to pay off their debt. This could potentially lead to a crisis that could collapse the Chinese financial sector. Before China can revalue, it should focus on restructuring its banking sector so that loans are

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<http://www.aei.org/publications/pubID.22749,filter.all/pub_detail.asp>.

[9] Morris Goldstein, Interview with Radio Free Asia, April 5, 2005. <http://www.rfa.org/english/news/business/lelyveld/2005/05/18/china_currency/

more market based and NPLs are disposed of. There are signs that China is moving in this direction by trying to list its banks on foreign stock markets, and by seeking foreign bank investments, such as the recent 10% stake that Bank of America bought in Construction Bank of China. These arguments are shared by many China experts. Some of the experts in the category 3 also favor a gradual, rather than sudden, revaluation for the reasons presented here. The Bush administration, however, has stated that “the time is right” for revaluation.

This group is opposed to a tariff for the standard reasons already mentioned above. Stiglitz has proposed a different solution. China should levy an extra tax on its own manufacturing (in particular textile) industry equivalent to the economic effect a revaluation would have on stemming exports. In this way, the Chinese government could increase its revenues and reduce exports, without releasing the peg and inviting all of the problems described above. The tax could be easily adjusted, could be targeting only at certain industries, and would not be in violation of WTO agreements.[10] The Chinese actually adopted this strategy in early 2005, but it was later rescinded for unspecified reasons and is being replaced by self-imposed quotas.

5. Those that believe the RMB is not undervalued.

This argument is laid out well by Albert Keidel, former Deputy Director of East Asian Nations at the Treasury Department. According to this line of thinking, the trade surplus as a percentage of GDP is the best measure of whether or not a currency is overvalued. But China’s trade surplus compared to GDP in 2003 and 2004 was a relatively modest 3%. By comparison, Germany had a 4% rate, Indonesia’s was 7%, and Singapore’s was 33%![11] As mentioned above, the large trade surplus with America exists only because other Asian countries (not to mention US multinationals such as Wal-mart) have channeled their exporting through China. Additionally, there is upward pressure on the RMB not because it is truly undervalued, but because of speculation by investors seeking to cash in on revaluation.

Although Greenspan and others predict rising inflation as a cost of maintaining the current peg, inflation has actually been in a downward trend since mid-2004. Its yearly rate was 3.9% in 2004 but predicted to be only 2.2% in 2005. It is proposed

[10] Laurence Law and Joseph Stiglitz, “China’s alternative to revaluation,” *Financial Times*, April 24, 2005. <http://news.ft.com/cms/s/91c0f604-b4eb-11d9-8df4-00000e2511c8.html>

[11] Group 3 could counter that there is a lag in the affects of an undervalued currency, and as such these effects are only being experienced recently. Early 2005 has seen a growing trade surplus. Additionally, while imports to China are high, this is may only be because they are a developing country that is in vast need of foreign resources to build infrastructure.

that the Chinese government does not have to worry so much about inflation through correct management of the economy. This is because China has capital controls that restrict speculative "hot money" from flowing out of the economy. In this way, China has the freedom to raise interest rates or target certain specific sectors of the economy without inducing capital flight, thus cooling sections of the economy that it fears to be overheating (such as the real estate market).

Blame for the US current account deficit lies squarely with the US because of its low savings rate and lack of investment. "Instead of decrying China's exchange rate, Washington policy makers should turn their attention to the fundamental task of permanently raising U.S. worker productivity, the only solid basis for long-lasting increases in worker incomes and benefits".[12]

B. Unfair Labor Practices

The more traditional complaint that is leveled against China is that it has an unfair advantage because of its lack of regulations and poor working conditions.

1. China has an unfair advantage because it denies basic workers rights, resulting in extremely low wages and terrible working conditions.

Claims that China has extremely low wages that have "stagnated" are often sited as reasons for the Chinese competitive advantage. This argument came to a head in early 2004, when the AFL-CIO claimed that if worker's rights were not suppressed, the average wage would rise in China by 90% to 595%.[13] These claims are flatly rejected by many China experts. According to Lardy, such large wage increases are "not plausible for the simple reason that labor productivity in China is too low to support the postulated wage increase. The estimated wage increase would lead to the bankruptcy of most firms since the resulting wage bill would exceed the entire value added for the

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[12] Albert Keidel, "China's currency, not the problem," Policy Brief, Carnegie Endowment for International Peace, June 2005, <http://www.carnegieendowment.org/files/PB39.Keidel.FINAL.pdf>.

[13] *AFL-CIO Section 301 Petition Against China*, 2004, <http://www.aflcio.org/issuespolitics/globaleconomy/ExecSummary301.cfm>.

average firm."[14] Additionally, many sources show that Chinese wages have been increasing over time, rather than stagnating, nominally, in real terms, and in purchasing power parity terms. Figure 5 shows one researcher's estimates. As can be seen, both real wages and PPP adjusted real wages nearly doubled in the twelve year period between 1990 and 2002. This can be compared to the US, which in the same period saw real household incomes rise only 12.5% by 2000 to $45,000, only to fall 4.4% by 2003 to $43,000.[15]

Arguments that China does not comply with world labor standards are more convincing. China has signed many international agreements on workers rights, but their record is mixed. China passed a trade union law in 1993 that provides for workers freedom of association. In 2001 China updated this law, allowing for unions in private companies to seek legal protection to resolve disputes. Despite these developments, all unions must be registered under the government-run All China Federation of Trade Unions. This severely limits the freedom of such organizations, since all unions are ultimately state controlled. Additionally, political actions that could be construed as criticisms of the government are strictly prohibited. Wage negotiation is usually only carried out by administrative processes rather than collective bargaining, and the right to strike is denied. Overall, China has signed 3 of the 8 fundamental conventions of the International Labor Organization (ILO). They are the "Equal Remuneration Convention (No. 100), Minimum Age Convention (No. 138), and the Worst forms of Child Labor Convention (No. 182). China has not, however, ratified either of the two fundamental ILO conventions concerning freedom of association, the Freedom of Association and Protection of the Right to Organize Convention (No. 87) and the Right to Organize Convention (No. 98)."[16] Even with these rights on paper, enforcement remains a problem, and there are many NGOs that frequently report on labor violations.

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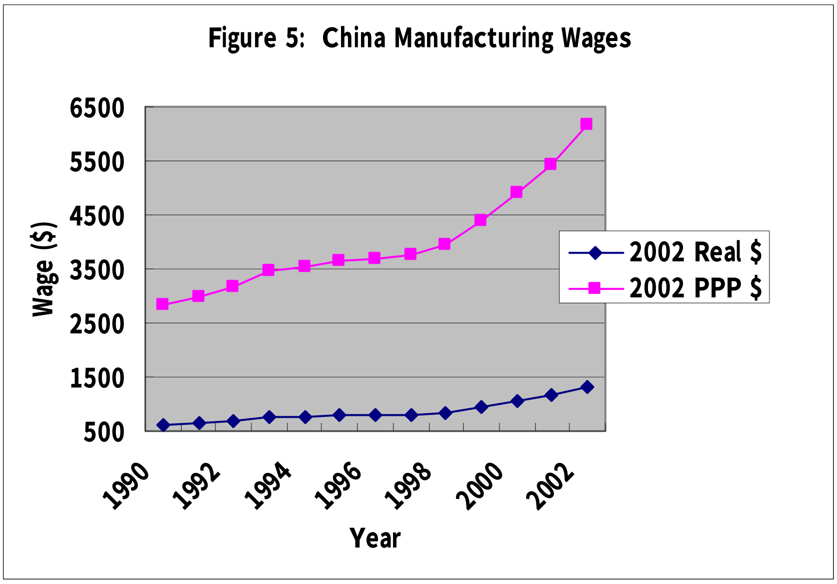
[14] Nicolas R. Lardy, "Do Chinese abusive labor practices encourage outsourcing and drive down American wages," Testimony before the Senate Democratic Policy Committee Hearing, March 29, 2004, <http://www.iie.com/publications/papers/paper.cfm?ResearchID=201>.

[15] US Census Bureau

[16] *Fair Labor Association Year Two Public Report*, Aug 18 2004. <http://www.fairlabor.org/2004report/pdf/CompleteReport-part4.pdf>



Source: Judith Banister, "Manufacturing Employment and Compensation in China." Dec 2004, written under contract with US Dept. of Labor, <http://www.bls.gov/fls/chinareport.pdf>

Despite the apparent deficiencies in labor rights, some China experts argue that this is not so much a factor affecting competition and the trade balance. Foreign affiliates constitute 55% of all exporting firms in China. The average wage of a Chinese government owned exporting firm in 2002 was $1396, while the average wage of a foreign funded exporting firm was 29% higher at $1693. These foreign-backed firms are often monitored by outside international watchdogs, offer better benefits, cleaner working conditions, and environmental regulations.[17] Chinese wages are low, but not unusually low. Take the apparel industry as an example. As can be seen in Figure 5, wages are actually higher in China than many competing developing countries. According to a US government report on the global textile industry, China has "highly skilled sewers" and is "considered by industry among the best in making most garments and made-up textile articles at any quality or price level." Additionally, Chinese textile companies have invested heavily in new technology and have "efficient management and the technical know-how to produce virtually any textile or apparel article."[18] With such glowing reports about the industry and its productivity, it is hard to imagine that its workers are being grossly mistreated.

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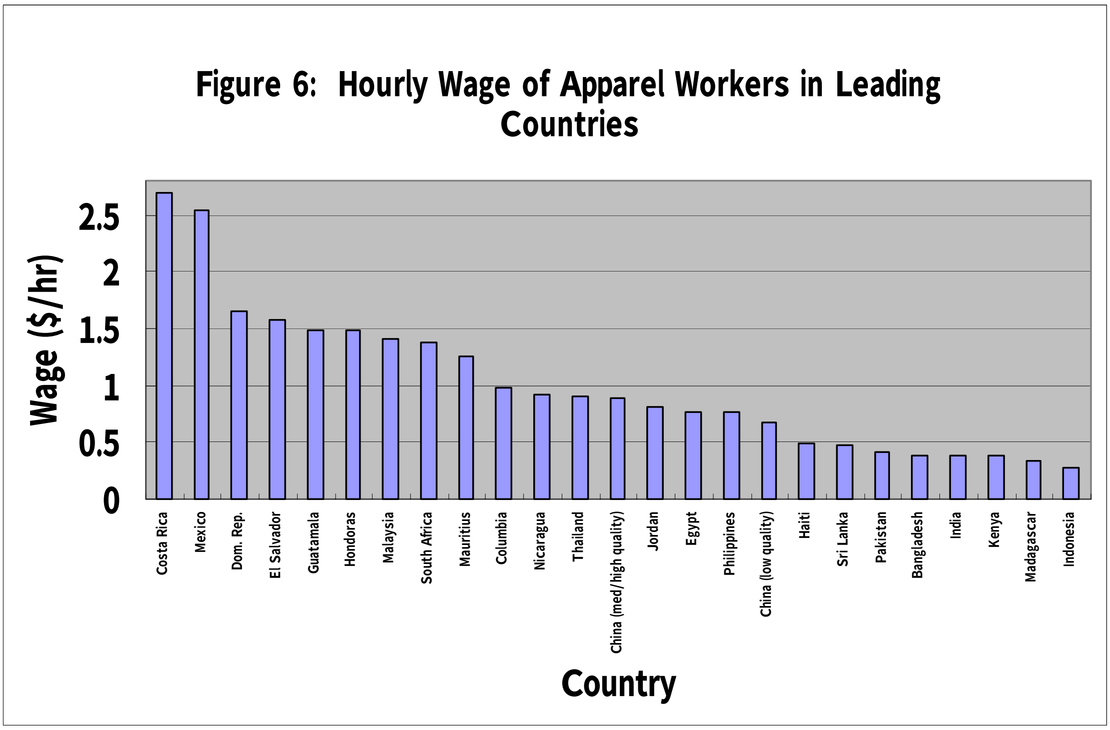
[17] Lardy, "Do Chinese abusive…"
[18] United States International Trade Commission, "Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market," June 2003, <http://hotdocs.usitc.gov/pub3671/main.html>.



Source: US International Trade Commission, "Textiles and apparel…"

2. China exports goods produced by forced prison labor

China has used system of prison labor, known as "Laogai," since the 1950s. Its original purpose was to change the minds of political activists who had "counter-revolutionary" ideas through "re-education classes" that often involved torture and painful physical labor. In recent years the Laogai population has shifted away from political prisoners to people who have committed more "normal" crimes. However, it is claimed that these labor camps are involved in producing goods for the exporting industry, under terrible conditions and little or no compensation. The prison labor issue was brought to the attention of the US government by Harry Wu, who runs the Laogai Research Foundation. He was imprisoned in the labor camps for much of his adult life, before moving to America. When he went back in 1995 to investigate the issue he was imprisoned again. His experiences have given him a first hand account of conditions in the labor camps, which he compares to Russian Gulags.

The Laogai center estimates that in 1996, prison camps produced $800 million in exports from a sample of 100 labor camps. They say that there were over 1000 of such camps, and as many as 4 to 6 million forced laborers. This monetary figure was arrived at by compiling the value of goods produced in prison labor camps listed in Dun

& Bradstreet's Directory of Key Manufacturing Companies in P.R. China 1995/96. They also estimated that in the mid 1990s such camps exported 100% of the countries exportable graphite, as well as many other goods. Unfortunately, the group's numbers have not been updated.[19]

In June 2005 there was a congressional hearing on slave labor that featured Harry Wu and newer accounts of exported items produced by Falungong members working in such labor camps. These reports said that there were over 400,000 people imprisoned in labor camps, of which 60,000 were Falungong members.[20] Many of these workers were forced to work 12 hour days with little or no pay. They were fed only vegetables and suffered from exhaustion and physical damage. The reports implicated three large Chinese exporting companies that were allegedly contracting labor camps to produce some of their goods. They included Henan Rebecca Hair Products, the world's leading wig manufacturer, Shandong Leader Handicraft Articles Company, and Shanghai Three-Gun Group, a textile company. It was also said that workers were forced to produce everything from Christmas lights to Mickey Mouse dolls.[21]

Importing items produced by forced labor is illegal in the United States. In 1991 China passed a high profile law explicitly prohibiting such exports. In 1992 it signed a Memorandum of Understanding with the US promising that it would not export products produced by forced labor to the US. In 1994 another document of cooperation was signed on the subject. The US Customs Office maintains a list of banned companies that use prison labor. Since 1992, customs has prosecuted only three cases of export violations.[22] However, Customs says that Chinese officials are sometimes uncooperative, often denying access to suspected facilities, so it is difficult to determine the extent of the problem.

Obtaining an accurate estimation of the number of forced laborers is difficult. The Chinese government claims that there are around 250,000. The State Department's Country Report on Human Rights for China says there are reports of up to 300,000. The Laogai Research Foundation recently reports 400,000. We can compare these numbers to the total number of Chinese employed in manufacturing, around 140 million. This means that prison workers might constitute as much as 0.3% of the export

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19 Email correspondence and information found on <laogai.org>

20 *Pure Awakening.net*, "Japanese media pays attention to the persecution of Falungong members in China," June 28, 2004. <http://www.pureawakening.net/pa/article/2005/6/28/45652.html>

21 Gregory Xu, testimony at the Congress Executive Committee on China's "Forced Labor in China," June 24, 2004 <http://www.cecc.gov/pages/roundtables/062305/Xu.php>.

22 Charles Winwood, testimony before US-China Security Review Commission, Aug 2, 2001. <http://usinfo.org/USIA/usinfo.state.gov/regional/ea/uschina/customs.htm>. No cases were found reported after this statement.

manufacturer population (if we assume all the laborers are involved in exporting.) Although this figure is significant from a humanitarian standpoint, its magnitude seems to play little role in determining trade balance. More data is needed to determine whether or not this is truly a problem.

C. China is not complying with its WTO commitments

A third general criticism of China is that it is not upholding its WTO obligations. China joined the WTO in 2001 during the Clinton administration despite significant protest by certain members of Congress. Tariffs reductions, the abolishment of import quotas and export subsidies, and deregulation through China's accession have brought about significant increases in US-China trade. It has resulted in significantly lower commodity prices in American and higher standards of living in China. However, there are many vocal American thinkers who complain that China is not following through with many of the items it agreed to. China critic John Tcacik wrote in late 2003 that, "If it were a smaller economy, some of China's transgressions could be tolerated, but when the world's fourth largest trading nation ignores its obligations, China's trading partners ought to act."[23]

Although there were early fears such as these, the overall opinion of China's WTO accession has been positive, both from China experts and the US government. The 2004 Report to Congress on China's WTO Compliance states that "China deserves due recognition for the tremendous efforts made to reform its economy to comply with the requirements of the WTO." Additionally, this compliance has been improving over time. "U.S. stakeholders were significantly more satisfied with China's WTO performance in 2004 than in the previous two years." However, it also states that "serious problems remain, and new problems emerge."[24] The problems that remained were divided into categories of intellectual property rights, trading rights and distribution services, services, agriculture, industrial policy, and transparency.

The largest area of concern by far for US authorities and businesses has been intellectual property rights (IPR) issues. This is the area where US companies have a greatest comparative advantage. When China joined the WTO it also accepted the

[23] John J. Tkacik, Jr. "The US must face up to China's trade challenges," *The Heritage Foundation*, Backgrounder #1698, <http://www.heritage.org/Research/TradeandForeignAid/BG1698.cfm>.

[24] 2004 Report to Congress on China's WTO Compliance, United States Trade Representative, Dec 2004.
<http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/asset_upload_file281_6986.pdf>.

TRIPS agreement, which provides basic protections for patents, copyrights, trade marks, etc. China has made significant progress in revising its patent laws, increasing the penalties of those convicted of IPR violations, and raising awareness of the IPO concept through educational and informational secessions. On paper, some areas of China's IPO code are actually stricter than the US. Nevertheless, the problem of enforcement remains, and IPO violations continue to be rampant. Estimates of the market value of counterfeit goods produced in China range from $19 billion to $25 billion annually. China pirates everything from music and film to pharmaceuticals and electronics. Some say that 90% of all copyrighted materials in China are pirated, resulting in loses to US companies of between $2.5 billion to $3.8 billion annually.[25],[26] The US government continues to work with China to stop such piracy. It also encourages US companies to report violations to the appropriate authorities. Recent activity of increased fines and crack downs since late 2004 seems to indicate that China is taking IPO violations more serious. One other consideration is that China is trying to develop its own brand names, and cannot do so in the current environment.

The second biggest problem has been with import restrictions, particularly in the agricultural industry, where the US is highly competitive. Although China has reduced its tariffs on agricultural imports, non-tariff barriers remain a significant problem. In particular, sanitary regulations have often been used to block US imports. From 2002 to 2003 China held up soybean and other crop shipments because of excessively stringent biotechnology regulations. These and many other non-tariff barriers were lifted throughout 2004 and there have been fewer and fewer complaints during the first half of 2005.

Despite complaints by the manufacturing industry, China's entry into the WTO seems to be working out for areas in which the US has a comparative advantage. In a protest against the Schumer tariff bill, Neil Bredehoeft, president of the US Soybean Association stated that while previously there have been "problems," "it is impossible to overstate the importance of China as a market for U.S. soybeans." It is estimated that in 2005 China will account for 40% of all US soybean exports, and "prospects for continued rapid growth in Chinese soybean imports are excellent."[27] The same can be said, ironically, for the cotton industry, whose exports to China almost doubled from

[25] USTR Report to Congress…
[26] Tkacik, "The US must…"
[27] Neal Bredehoeft, testimony at Senate Finance Committee's US-China Economic Relations, June 23, 2005. <http://finance.senate.gov/hearings/testimony/2005test/nbtest062305.pdf>.

2003 to 2004 as the Chinese textile industry moved into high gear.[28] Outside of the agricultural sector, multinational corporations such as Wal-mart and Intel are certainly happy about China's WTO accession.

III. Conclusion

US opinion leaders are quick to blame China for the trade deficit, but much of this blame is wrongly placed. While the majority may believe that the RMB is overvalued, there is no consensus as to whether or not this is intentional, or whether or not revaluing will even benefit the US. Certain US manufacturers complain about Chinese low skilled, low paid workers, yet US researchers present strong evidence that Chinese are actually highly skilled workers, and their wages are average but rising, leading to high productivity. Others activists complain that China has a poor record on workers rights, with poor working conditions that perhaps even involve forced, prison labor in exporting. But the data shows that over half of all exporting comes from frequently monitored foreign companies, and forced labor, despite being humanitarianly questionable, seems to make up an insignificant fraction of exports. The best criticisms of China with regard to trade revolve around violations of IPR. The US government should do its best to focus on this problem. The administration seems to be working hard, with new Chinese commitments worked out in a July 2005 economic conference. If the Chinese realize that it is in their best interest to enforce their new laws, this issue can be resolved without resorting to protectionism.

Since human rights and labor issues do not seem to be greatly affecting the trade deficit, they should not be dealt with on the trade level. Punitive, protectionist policies have a negative effect both on the US and Chinese economies. China is struggling to create 10 million new jobs a year to keep up with rising unemployment. Protectionist measures by the US hamper these efforts by forcing Chinese factories to lay off thousands of workers, potentially leading to popular discontent and social instability. At the same time, such measures lower the standard of living for poorer Americans as well by raising commodity prices. Instead, these issues should be tackled from below grassroots level. The US should share with China information on its legal system and offer training. Non profit organizations and other civil society groups should continue to work in China to promote better human rights standards. As wages rise and a larger

[28] Mr. Thomas Stallings, Testimony before House Subcommittee on Rural Enterprises, Agriculture, and Technology and Subcommittee on Tax, Finance and Exports, May 26, 2005, <http://wwwc.house.gov/smbiz/hearings/databaseDrivenHearingsSystem/displayTestimony.asp?hearingIdDateFormat=050526&testimonyId=333>.

middle class forms, the Chinese will be in a better position to solve these problems on their own. One of the best actions the US can take is to maintain open trade with China. In this way the growth of the Chinese middle class will be accelerated, creating better lives for both Americans and Chinese.

The United States has finally achieved what has been its fundamental principle in East Asian policy since it conquered its West Coast – an open door to Chinese markets, the “far West.” It fought and won a bloody war with Japan over this principle only to lose out during the cold war as communism nailed the door shut. Now, on its own, China has finally opened its markets to the world. This has led to a rising standard of living in both China and the United States. Yet through the achievement of this principle the US may be getting more than it asked for. Instead of becoming a vast marketplace for US goods, as earlier generations had hoped, the exact opposite is taking place. China’s rapid rise may one day pose a challenge for US hegemonic supremacy. In previous historical confrontations, the challenger objected to the hegemon’s rules. Communist Russia’s challenge to capitalist America through the Cold War was the last example. But as China rises, it seems to be playing more and more by the hegemon’s rules, accepting the capitalist system as the way to bring about its own prosperity. Will this embrace of the current system ultimately bring about peace or conflict with the US? Globalization may lead to massive dislocation of the US labor market. Local laborers may revolt against multinational companies with high stakes in China, leading to protest and instability. These events may in turn cause America to look inward, abandon its long preached free trade policies, and move towards isolationism – in effect, it may try to change the rules more to its own (questionable) advantage. On the other hand, with all its current lead and numerous advantages, it may learn to plan ahead and devise a way to compete with China and other growing powers through education and innovation. Many hope that the US and China will choose the path of healthy competition, rather than that of isolation or mercantilism that so often leads to war. The question remains, however, whether or not the path towards all-out free trade and globalization will ultimately also lead us to conflict.