

Chapter 2

What Promotes China's Trade Surplus?

China's export share in the total world export increased year by year, and the quality of export products is rising, which means that China's exports have greatly improved in quantity and quality. China seizes the opportunity of economic globalization, and fully participates in global economic and industrial division of labor. Huge FDI, processing and assembling trade, labor advantage, scale advantage, technology advantage and industry advantage promote China's exports in goods, and China's competitive advantage in services trade will be stronger. The exchange rate of RMB is not the all-important reason for China's trade surplus.

2.1 FDI and Processing and Assembling Trade

Huge FDI and processing and assembling trade, which have close relationship with each other, are very important reasons for high growth rate of China's exports.

2.1.1 *FDI's Contribution to China's Exports*

Since China's reform and opening-up, more and more multinational companies came to China as China's FDI (foreign direct investment), starting business for production and sale. In the twenty-first century, encouraged by the Chinese government, many large multinational companies established R&D centers in China.

High growth rate of China's exports is accompanied by more and more FDI, which can be seen from Table 2.1. A large proportion of China's export growth is the growth in exports of foreign-investment enterprises (or foreign-owned enterprises). In 2005, foreign-investment enterprises contributed 62.6 % of China's export growth, and in 2006, the proportion was 57.8 %. Even in 2011 when the proportion of foreign-investment enterprises in China's export growth was the lowest during 2005–2011, the proportion was 41.5 %. We can have the conclusion

Table 2.1 The share of foreign-investment and domestic enterprises in China's export growth (2005–2011)

Years	Share of foreign-investment enterprises (%)	Share of domestic enterprises (%)
2005	62.6	37.4
2006	57.8	42.2
2007	52.9	47.1
2008	45.2	54.8
2009	52.2	47.8
2010	50.5	49.5
2011	41.5	58.5

Note Share of foreign-investment enterprises = export growth of foreign-investment enterprises/China's export growth. Share of domestic enterprises = export growth of domestic enterprises/China's export growth

Source Calculated based on the data from General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/tabid/44604/Default.aspx>

that about half of China's export growth is contributed by foreign-investment enterprises, which reflects the characteristics of the global division of labor.

The huge FDI not only brings more China's exports to other countries, but also brings more China's imports of semifinished products from home countries. China has huge quantity of exports, but transnational corporations have huge profit, who pay taxes to home countries.

State-owned enterprises, collective enterprises and foreign-owned enterprises¹ have different shares in China's exports and imports, and foreign-owned enterprises always were the biggest during 2006–2011, and they have significant impact on China's trade surplus (Table 2.2). China's state-owned enterprises had deficit in foreign trade during 2006–2011, and Foreign-owned enterprises in China had surplus in foreign trade during 2006–2011, and as we know that foreign-owned enterprises in China account for the biggest proportion of exports and imports of China.

Foreign-owned enterprises in China have the biggest impact on China's huge exports and China's trade surplus, and China's huge exports and trade surplus are the important reasons for frequent trade remedy measures² to China and the pressure on RMB's exchange rate. Since big transnational corporations have impact on the governments of home countries, which are generally developed countries and the countries with trade deficit like the U.S. and the EU, trade remedy measures to China are against state-owned enterprises, collective enterprises, and private enterprises generally.

¹ Non-state-owned enterprises include collective, private, and foreign-owned firms.

² As trade remedy measures, anti-dumping measures and anti-subsidies and Countervailing Measures aim at price discrimination, and safeguard measures aim at substantially increase in imports.

Table 2.2 Exports and imports of state-owned enterprises and foreign-owned enterprises in China (2006–2011, billion U.S. dollars)

	2006		2007		2008		2009		2010		2011	
	Export	Import	Export	Import	Export	Import	Export	Import	Export	Import	Export	Import
Total	969.08	791.61	1218.02	955.82	1428.55	1133.09	1201.66	1005.56	1577.93	1394.83	1898.60	1743.47
State-owned enterprise	191.35	225.24	224.81	269.72	257.23	353.81	190.99	288.47	234.36	387.56	267.22	493.40
Foreign-owned enterprise	563.84	472.62	695.52	559.41	790.62	619.96	672.23	545.21	862.31	738.00	995.33	864.83
Others	213.90	93.76	297.68	126.69	380.70	159.32	338.44	171.88	481.27	269.28	636.05	385.23

Source: General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/tabid/44604/Default.aspx>

2.1.2 Processing and Assembling Trade and China's Exports

Processing and assembling trade accounts for a large proportion of China's foreign trade (Table 2.3). After 1990 the export of processing and assembling trade accounts for about 50 % of China's total exports, and in 1999 this proportion reached a peak of 56.88 %. After China's entry into WTO, this ratio is maintained at about 50 %. However, in 2007 the imports of processing and assembling trade accounted for 38.5 % of China's total imports.³ Processing and assembling trade is characterized by "both sides outside, large-volume import and export", which means that raw materials and intermediate goods import from overseas while manufactured goods export to overseas markets.

A large part of processing and assembling trade in China is conducted by the multinational companies, and China's processing and assembling trade is the reflection of the outsourcing strategy of multinational companies. Judging from the statistics, a lot of China's exports are high-tech products, but there is a big proportion of processing and assembling trade in China's exports of high-tech products. Core components and parts of high-tech products are transported from the home countries of multinational companies to China, coupled with non-core components and parts produced in China, so high-tech products are assembled by Chinese workers, and then export to other countries like the U.S. and EU. This reminds us that although China's foreign trade achieved leapfrog development with huge trade surplus, a big proportion of China's foreign trade competitiveness is based on multinational companies and international division of labor.

China gets trade surplus from processing and assembling trade. The process of processing and assembling trade is that China imports components and parts, which assembled in China by Chinese workers, and manufactured goods are re-exported to other countries. We can see that in the process of processing and assembling trade China's exports must be greater than imports. If the majority of China's foreign trade is processing and assembling trade, the possibility of China's foreign trade surplus will be very big. According to China customs statistics, China's trade surplus in Ministry of Commerce of the People's Republic of China 2010 was \$183.1 billion, of which the processing and assembling trade surplus was \$322.9 billion,⁴ which means, if there is no processing and assembling trade in China, China will have foreign trade deficit (\$139.8 billion). In the first quarter of 2011 China's trade deficit was \$1.02 billion and China's processing and assembling trade surplus was 77.11 billion U.S. dollars.⁵ In other words, if there is no processing and assembling trade in China, in the first quarter of 2011 China's trade deficit will reach \$78.13 billion.

³ Comprehensive Department of the Ministry of Commerce of the People's Republic of China: <http://zhhs.mofcom.gov.cn/tongji.shtml>.

⁴ Calculated based on the data from General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/publish/portal0/tab44604/module109000/info286988.htm>.

⁵ Calculated based on the data from General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/publish/portal0/tab44604/module109000/info302778.htm>.

Table 2.3 China's processing and assembling trade and its proportion in China's foreign trade (1986–2011)

Years	Processing and assembling trade (billion U.S. dollars)	Proportion in China's foreign trade (%)	Years	Processing and assembling trade (billion U.S. dollars)	Proportion in China's foreign trade (%)
1986	5.62	18.16	1999	110.88	56.88
1987	8.99	22.80	2000	137.65	55.24
1988	14.06	29.59	2001	147.43	55.41
1989	19.79	37.66	2002	179.93	55.26
1990	25.42	40.94	2003	241.85	55.19
1991	32.43	45.10	2004	327.97	55.28
1992	39.62	46.64	2005	416.47	54.66
1993	44.25	48.23	2006	510.36	52.67
1994	56.98	47.09	2007	617.56	50.71
1995	73.70	49.54	2008	675.11	47.19
1996	84.33	55.83	2009	587.00	
1997	99.60	54.49	2010	740.30	46.92
1998	104.45	56.86	2011	835.40	44.00

Source The data of 1986–2008: *China Statistical Yearbook 2009*, National Bureau of Statistics of China: <http://www.stats.gov.cn/tjsj/ndsj/2011/indexch.htm> the data of 2009–2011: calculated based on the data from: <http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/index.htm>

Multinational companies and processing and assembling trade are important factors to China's foreign trade, which are affected by each other. Multinational companies get big profits through their FDI in China and the home countries of multinational companies export a lot of components and parts to China. China's trade surplus is likely to continue as the trend of FDI in China and processing and assembling trade of China are all stable.

2.2 China's Comparative Advantage and Competitive Advantage are Strong

China's comparative advantage is based on labor, which is the abundant factor of China. Most of China's workers are skilled workers, with certain technical skills, and they are comparative cheaper than the workers of industrialized countries like the U.S., EU, and Japan. Large scale, technology advantage and industry advantage are China's competitive advantages, which become stronger.

2.2.1 Labor Advantage

China is the largest developing country with the largest population in the world. Chinese workers with skills are comparative cheaper than the workers of industrialized countries, and Chinese workers are more skilled than the workers of other

Table 2.4 The average monthly wage of manufacturing employees

	2006		2007		2008	
	Local currency	U.S. dollar	Local currency	U.S. dollar	Local currency	U.S. dollar
China ^a	1497.2	191.7	1740.3	238.4	2016.0	295.2
Japan	299,600	2518.7	296,800	2603.5	293,400	3233.1
Korea, Rep. ^b	2,594,800	2790.7	2,772,000	2961.2	2,757,800	2189.6
Singapore	3618.0	2364.7	3764.0	2613.9	3955.0	2746.5

Note The average monthly wages in U.S. dollar are calculated from the average monthly wages in local currency with the foreign exchange rates at the end of the years

^a State-owned units, urban collective-owned units and other ownership units

^b Including family allowances and other allowances in kind

Source National Bureau of Statistics of China: <http://www.stats.gov.cn/tjsj/qtsj/gjsj/index.htm>

low income countries, and this is one of the bases of China's comparative advantage. In 2008, the average monthly wage of manufacturing workers in China was \$295.2, only 9 % of Japanese workers, 13 % of South Korean workers, as well as 11 % of Singapore's workers (Table 2.4). Although average wage of manufacturing workers in China rises rapidly in recent years, the average wage of employees in China, compared with circumjacent more developed countries, is quite low.

China's labor advantage can continue since China is in the process of industrialization and dual economy of China is still obvious. Dual economy is the characteristic of developing countries, which means that within one country there exist two separate economic sectors and there are both a huge number of skilled workers and a huge number of rural people who will become workers if the industry sectors of this country need more labors. In China there are more than 600 million rural people, a big proportion of whom can become skilled workers after they get necessary education, and they are the base of China's labor advantage in the future.

2.2.2 Scale Advantage, Technology Advantage and Industry Advantage

Scale advantage, technology advantage and industry advantage are competitive advantages of China.

As a big country, China has the competitive advantage of scale economy. On the one hand, in China, a large-scale domestic market supports Chinese corporations to enlarge production, so the average cost of Chinese products can be lower than that of products made in other countries. On the other hand, China has done the best to participate in economic globalization, and with better infrastructure,

better market environment and better legal environment of China, more and more transnational corporations come to China, so international division of labor accelerates the development of scale economy in many industries and reduces the average cost of Chinese products farther.

Although China is a developing country, technology advantage and industry advantage in China's foreign trade becomes more obvious. From 2001 to 2011, China had trade deficit in primary products and trade surplus in manufactured goods, which means that China has competitive advantage in manufactured goods. From 2001 to 2011, most of China's exports were manufactured goods, which means that technology advantage and industry advantage of China are the bases of China's exports, instead of resource advantage (Table 2.5).

China's technology advantage and industry advantage also can be seen in China's foreign trade of high-tech products. The proportion of China's exports of high-tech products in China's total exports increased from 17.5 % in 2001 to 29.0 % in 2011, and the peak is 31.4 % in 2009. The proportion of China's imports of high-tech products in China's total imports also increased from 26.3 % in 2001 to 26.6 % in 2011, and the peak is 31.2 % in 2006. It can be seen that the proportion of China's exports of high-tech products in China's total exports increased much faster than the proportion of China's imports of high-tech products in China's total imports. In 2004, China's trade deficit of high-tech products turned into trade surplus, and China's trade surplus of high-tech products expanded over time. In 2009, due to financial crisis, China's imports and exports of high-tech products declined slightly, but the proportion of China's exports of high-tech products in China's total exports was 31.4 % and the proportion of China's imports of high-tech products in China's total imports was 30.8 % (Table 2.6).

China attaches importance to technical progress and education. The proportion of high-tech goods in exporting goods made by Chinese companies becomes higher and higher. Chinese workers are skilled workers, and they not only have competitive advantage in processing and assembling trade, but also have competitive advantage in general trade.

Technology spill-over effect of foreign direct investment is another reason for China's technology advantage and industry advantage. The proportion of high-tech products such as IT products in China's exports becomes higher and higher since many top high-tech transnational corporations had invested in China and taken China as production base and R&D center. China has trade deficit mainly with South Korea, Japan and Taiwan of China, and China has trade surplus mainly with the United States and EU. This reflects the global strategy of transnational corporations, which means that China imports key intermediate goods from South Korea, Japan and Taiwan of China and exports manufactured goods to the U.S. and EU, since China's abundant labor resources are China's comparative advantage and high-tech products such as mechanical and electrical products are assembled in China. With enlargement of FDI, China exports more high-tech products and there are more skilled workers in China.

Table 2.5 Classification of China’s imports and exports in goods, 2001–2011, (billion U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Primary products	Export	26.34	28.54	34.81	40.55	49.04	52.92	61.51	79.96	81.69	400.55
	Import	45.74	49.27	72.76	117.27	147.71	187.13	243.09	362.39	433.85	604.38
Manufactured goods	Export	239.76	297.06	403.42	552.78	712.92	916.02	1156.27	1352.74	1496.07	1798.05
	Import	197.81	245.90	340.00	443.96	512.24	604.33	712.86	770.17	962.39	1139.08

Source The data of 2001–2010: National Bureau of Statistics of China: <http://www.stats.gov.cn/tjsj/qttj/gjsj/index.htm>
The data of 2011: DRCNET Statistical Database System: <http://www.drcnet.com.cn/eDRCnet.common.web/docview.aspx?docId=2810271&leafId=16354&chId=4289>

Table 2.6 China’s foreign trade of high-tech products (2002–2011)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Export (billion U.S. dollars)	46.5	67.9	110.3	165.5	218.2	281.5	347.8	415.6	376.9	492.4	548.8
Growth rate (%)	25.5	46.02	62.44	50.05	31.84	29.01	23.55	19.49	−9.3	30.7	11.5
The proportion in total exports (%)	17.5	20.8	25.2	27.9	28.6	29.1	28.6	29.1	31.4	31.2	29.0
Import (billion U.S. dollars)	64.1	82.8	119.3	161.4	197.7	247.3	287.0	341.9	309.8	412.7	462.9
Growth rate (%)	22.1	29.2	44.08	35.29	22.49	25.09	16.05	19.13	−9.4	33.2	12.2
The proportion in total imports (%)	26.3	28.1	28.9	28.8	30	31.2	30	30.2	30.8	29.6	26.6
Net export (billion U.S. dollars)	−17.6	−14.9	−9.0	4.1	20.5	34.2	60.8	73.7	67.1	79.7	85.9

Source General Administration of Customs of the People’s Republic of China: <http://www.customs.gov.cn/tabid/44604/Default.aspx>

China's scale advantage, technology advantage and industry advantage are the important reasons for China's huge exports, but in international division of labor China's position is not very high. China's processing and assembling trade brings trade surplus for China, but the value-added brought by China's processing and assembling trade is just a small proportion in the whole value of goods, and this reflects that in the vertical division of labor of intra-product specialization China's advantage is still labor although China's exports are high-tech products. It is necessary for China to continue to increase technology advantage and industry advantage.

2.3 Small Proportion of China's Services Trade Deficit

Services trade is an important part of foreign trade. With development of economic globalization and global division of labor, the proportion of trade in services is on the rise, and services trade increasingly becomes one of the engines of open economy. The development of China's services trade has lagged behind the development of China's trade in goods, but developing services trade is one of the objectives for development of China's foreign trade. Although China has had trade deficit in services trade for many years, China's trade in services developed quickly and China's trade deficit in services trade was a small proportion in China's total foreign trade.

2.3.1 *Growth of China's Trade in Services*

Since China's accession to the WTO, China took steady steps to open more service sectors to foreign investors, including financial, education, healthcare and travel sector etc. The growth rate of China's services trade⁶ was very high. From 2000 to 2010, the total amount of China's foreign trade of services substantially grew from \$66 billion to \$362.4 billion, with an increase of 4.5 times.⁷ From Table 2.7 we can see that the growth rates of China's imports and exports of services were significantly higher than the growth rates of the world's imports and exports of services, and this reflects that China's opening in services sectors was more and

⁶ Here China's services trade refers to China's commercial services (non-government services), which exclude government services.

⁷ The data of 2001–2009: Ministry of Commerce of the People's Republic of China, *Statistics on China's Trade in Services* 2010; The data of 2010: State Administration of Foreign Exchange of the People's Republic of China, *China's international balance of payments* 2010;

Table 2.7 Commercial services trade: China and the world (2001–2010)

China				The world				
Export		Import		Export		Import		
Amount (Billion U.S. dollars)	Growth rate (%)	Amount (Billion U.S. dollars)	Growth rate (%)	Amount (Billion U.S. dollars)	Growth rate (%)	Amount (Billion U.S. dollars)	Growth rate (%)	
2001	32.9	9.3	39.0	8.6	1484.9	0.2	1472.9	1.2
2002	39.4	19.8	46.1	18.2	1596.4	7.5	1559.2	5.8
2003	46.4	17.8	54.9	19.1	1832.5	14.8	1780.0	14.2
2004	62.1	33.8	71.6	30.4	2220.4	21.0	2120.5	18.9
2005	73.9	19.0	83.2	16.2	2483.2	12.0	2358.7	11.3
2006	91.4	23.7	100.3	20.6	2818.3	13.5	2637.0	11.9
2007	121.6	33.0	129.3	28.9	3381.2	20.0	3126.5	18.4
2008	146.5	20.5	158.0	22.2	3803.6	12.9	3535.4	13.5
2009	129.5	−12.2	158.9	0.1	3311.6	−12.5	3114.5	−11.6
2010	170.2	31.4	192.2	21.0	3695.0	11.5	3510.0	12.7

Note According to the definition of trade in services by WTO, China's trade in services data do not include government services

Source The data of China (2001–2009): Ministry of Commerce of the People's Republic of China, Statistics on China's Trade in Services 2010: <http://tradeinservices.mofcom.gov.cn/c/2011-06-20/90562.shtml>; the data of China (2010): State Administration of Foreign Exchange of the People's Republic of China, *China's international balance of payments 2010*: http://www.safe.gov.cn/model_safe/tjsj/tjsj_detail.jsp?ID=110500000000000000,44&id=5 and the data of the world: WTO: http://www.wto.org/english/res_e/statis_e/its2011_e/its11_trade_category_e.htm

more adequate. Although the growth rates of China's imports and exports of services were somewhat alike, China's foreign trade of services has been in deficit for many years.

The total amount of China's services trade continues to expand, but compared with the total amount of the global services trade, the overall level of China's services trade is still relatively low. From the point of view of the structure of services trade, China's exports of services still mainly focus on travel, transportation and other traditional services trade,⁸ and the emerging services industries, such as communication services, insurance services, financial services, royalties & license fees, film & audiovisual, have a smaller proportion in China's exports of services.

⁸ China had trade deficit in transportation during 1997–2011, and China had trade deficit in travel during 2009–2011, although China had trade surplus in travel before 2008 (Appendix Table A.2).

2.3.2 *The Trade Competitiveness Index of China's Services Trade*

The competitivenesses of the different sectors of China's services are different. Based on trade competitiveness (TC) index, we analyze the competitivenesses of the different sectors of China's services. Trade competitiveness index eliminates the influence of macro economic fluctuations like inflation, and it can reflect whether certain sectors of a country have competitive advantage in international market competition. The range of TC_{ij} is $[-1, 1]$, and when its value is close to 0, it indicates a competitive advantage close to the global average. If $TC_{ij} > 0$, the industrial sector of the country has competitive advantage, and the closer to 1, the competitiveness stronger; when TC_{ij} equals to 1 it indicates that all the foreign trade of this industry is exporting without importing. If $TC_{ij} < 0$, the industrial sector of the country is lack of competitive advantage, and the closer to -1 , the competitiveness weaker; when TC_{ij} equals to -1 it indicates that all the foreign trade of this industry is importing without exporting (Table 2.8).

As a whole the TC index of China's services trade was negative, indicating that competitive advantage of China's services trade was lacking and competitiveness was lower than the global average.

In 2011, the TC index of China's transportation, travel, insurance services, royalties & license fees, film & audiovisual, government services were less than 0, and China's trade deficit in transportation, travel, insurance services, royalties & license fees was the main source of China's services trade deficit. The TC index of China's travel was 0.20 in 1997, but -0.20 in 2011. This change reflects both lacking competitiveness of China's travel industry and more overseas travel of richer Chinese people. China's trade deficit in transportation, insurance services, royalties & license fees reminds us that China needs to develop emerging service industries.

China's competitiveness of construction services and computer & information services raised a lot, and they contributed largely to China's exports in services trade in 2011. The TC index of China's construction services and computer and information services were -0.34 and -0.47 respectively in 1997, but 0.60 and 0.53 respectively in 2011. The advantage of China's construction services is mainly from labor advantage, but the advantage of China's computer & information services is mainly from technology, and this reflects China's upgrading of the services trade structure.

There is no obvious rise of China's competitive advantage in services trade, but some structure change is positive. If China's trade deficit in services trade can be less, the possibility of China's foreign trade deficit will be even much lower.

Table 2.8 TC index of China's services trade (1997–2011)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Transportation	-0.54	-0.49	-0.53	-0.48	-0.42	-0.41	-0.40	-0.34	-0.30	-0.24	-0.16	-0.13	-0.33	-0.30	-0.39
Travel	0.20	0.16	0.13	0.11	0.12	0.14	0.07	0.15	0.15	0.16	0.11	0.06	-0.05	-0.09	-0.20
Communication services	-0.03	0.60	0.51	0.70	-0.09	0.08	0.20	-0.03	-0.09	-0.07	0.04	0.03	0.00	0.04	0.17
Construction services	-0.34	-0.31	-0.22	-0.25	-0.01	0.13	0.04	0.05	0.24	0.17	0.30	0.40	0.23	0.48	0.60
Insurance services	-0.71	-0.64	-0.81	-0.92	-0.85	-0.88	-0.87	-0.88	-0.87	-0.89	-0.84	-0.80	-0.75	-0.81	-0.74
Financial services	-0.84	-0.72	-0.20	-0.11	0.12	-0.28	-0.21	-0.19	-0.33	-0.80	-0.50	-0.33	-0.27	-0.04	0.07
Computer & information services	-0.47	-0.43	0.09	0.15	0.14	-0.28	0.03	0.13	0.06	0.28	0.32	0.33	0.34	0.51	0.53
Royalties & license fees	-0.82	-0.74	-0.83	-0.88	-0.89	-0.92	-0.94	-0.90	-0.93	-0.94	-0.93	-0.89	-0.93	-0.88	-0.91
Consulting	-0.15	-0.19	-0.30	-0.29	-0.26	-0.34	-0.29	-0.20	-0.08	-0.04	0.03	0.15	0.16	0.20	0.21
Advertising, media	-0.01	-0.11	0.00	0.05	0.04	-0.03	0.03	0.10	0.22	0.17	0.19	0.07	0.07	0.18	0.18
Film, audiovisual	-0.63	-0.44	-0.67	-0.54	-0.29	-0.53	-0.35	-0.62	-0.33	0.00	0.20	0.14	-0.50	-0.60	-0.60
Other business services	0.19	0.07	0.02	0.07	0.12	0.28	0.40	0.31	0.29	0.27	0.19	0.06	0.14	0.35	0.28
Government services	-0.58	-0.85	-0.76	0.24	0.30	-0.10	-0.12	-0.17	-0.09	0.09	-0.20	-0.13	0.06	-0.05	-0.16

Note 1 According to the definition of trade in services by WTO, China's trade in services data do not include government services

Note 2 Trade Competitiveness index (TC index) is the ratio of one product's net export value to the total trade value of this product. Its formulation is

$$TC_{ij} = \frac{X_{ij} - M_{ij}}{X_{ij} + M_{ij}} \quad (-1 \leq TC_{ij} \leq 1)$$

TC_{ij} is the trade competitiveness index of product j in country i . X_{ij} is the export value of product j in country i , and M_{ij} is the import value of product j in country i

Source The data of 1997–2010: State Administration of Foreign Exchange of the People's Republic of China, *China's international balance of payments 1997–2010*: http://www.safe.gov.cn/model_safe/tjsj_list.jsp?id=5&ID=11050000000000000000; and the data of 2011: State Administration of Foreign Exchange of the People's Republic of China, *Report on China's international balance of payments 2011*: http://www.safe.gov.cn/model_safe/tjsj/tjsj_detail.jsp?ID=11070000000000000000,14&id=5

2.4 RMB's Exchange Rate is Not the Key for China's Trade Surplus

From 1989 to 1994, China was identified as a currency manipulator by the U.S. government. Today, currency manipulator has become one of the weapons of the United States to force RMB (Yuan) to appreciate. RMB's appreciation will not remove China's trade surplus with the U.S. since the base of China's competitive advantage of foreign trade is from labor advantage, scale advantage, technology advantage and industry advantage, but RMB's acute appreciation can damage China's economy.

2.4.1 The Pressure of Appreciating RMB

The U.S. concentrates on the exchange rate of RMB since the U.S. disseminates that the reason of huge quantum of China's exports is that RMB is undervalued. Since China's entry into WTO in 2001, China's exports and trade surplus enlarged rapidly, and the pressure of appreciating RMB from the U.S., Japan and EU became very big.

On July 21, 2005, with a view to establish and improve the socialist market economic system in China, enable the market to fully play its role in resource allocation as well as to put in place and further strengthen the managed floating exchange rate regime based on market supply and demand, the People's Bank of China, with authorization of the State Council, released *Public Announcement of the People's Bank of China on Reforming the RMB Exchange Rate Regime*,⁹ which announced: 1. Starting from July 21, 2005, China would reform the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies, and RMB would no longer be pegged to the U.S. dollar and the RMB exchange rate regime would be improved with greater flexibility. 2. The People's Bank of China would announce the closing price of a foreign currency such as the U.S. dollar traded against the RMB in the inter-bank foreign exchange market after the closing of the market on each working day, and would make it the central parity for the trading against the RMB on the following working day. 3. The exchange rate of the U.S. dollar against the RMB was adjusted to 8.11 Yuan per U.S. dollar at the time of 19:00 h of July 21, 2005. The foreign exchange designated banks might since adjust quotations of foreign currencies to their customers. 4. The daily trading price of the U.S. dollar against the RMB in the inter-bank foreign exchange market would continue to be allowed to float within a band of ± 0.3 percent around the central parity published by the People's Bank of China, while the trading prices

⁹ The People's Bank of China, http://www.pbc.gov.cn/publish/english/955/2001/20014/20014_.html.

of the non-U.S. dollar currencies against the RMB would be allowed to move within a certain band announced by the People's Bank of China. 5. The People's Bank of China would make adjustment of the RMB exchange rate band when necessary according to market development as well as the economic and financial situation. The RMB exchange rate would be more flexible based on market condition with reference to a basket of currencies. The People's Bank of China is responsible for maintaining the RMB exchange rate basically stable at an adaptive and equilibrium level, so as to promote the basic equilibrium of the balance of payments and safeguard macroeconomic and financial stability.

The China hawks in the Senate of the U.S. set their minds on appreciating RMB, and the U.S. government took measures to force China to appreciate RMB, although the U.S. government did not name China as currency manipulator until 2011. On December 27, 2011, *Report to Congress on International Economic and Exchange Rate Policies* (2011) was released, which announced: "Based on the ongoing appreciation of the renminbi against the dollar since June 2010, the decline in China's current account surplus, and China's commitments at the G-20 and the U.S.-China Strategic and Economic Dialogue (S&ED) asserting that it will continue to promote faster RMB exchange rate flexibility, Treasury has concluded that the standards identified in Section 3004 of the Act during the period covered in this Report have not been met with respect to China. Nonetheless, in light of the persistent misalignment of the RMB at a substantially undervalued level, Treasury assesses that movement of the RMB to date is insufficient and more progress is needed. Treasury will continue to closely monitor the pace of RMB appreciation and press for policy changes that yield greater exchange rate flexibility, level the playing field, and support a pronounced and sustained shift to domestic-demand led growth."

Under the pressure of the U.S. and EU, the Executive Board of the International Monetary Fund (IMF) adopted on 15 June the *Decision on Bilateral Surveillance over Members' Policies* to replace the *Decision on Surveillance over Exchange Rate policies* adopted in 1977. The new Decision clarifies the concept of exchange rate manipulation in order to gain an unfair competitive advantage over other members. In particular, the new Decision relates such behavior to the concept of fundamental exchange rate misalignment. The new Decision introduces a concept of external stability as an organizing principle for bilateral surveillance. (External stability encompasses both the current account of the balance of payments—and thereby also issues of exchange rate misalignment—and the capital account of the balance of payments.) The new Decision adds a principle recommending that members avoid exchange rate policies that result in external instability, regardless of their purpose, thereby capturing exchange rate policies. Directors noted that this principle should guide members in avoiding external instability arising from their exchange rate policies (IMF 2007). It is clear that this new principle is not good for China since China's trade surplus has been labeled as one of the reasons of global economic imbalances. China has expressed reservations about the adoption of this Decision as it does not fully reflect the developing countries' opinions.

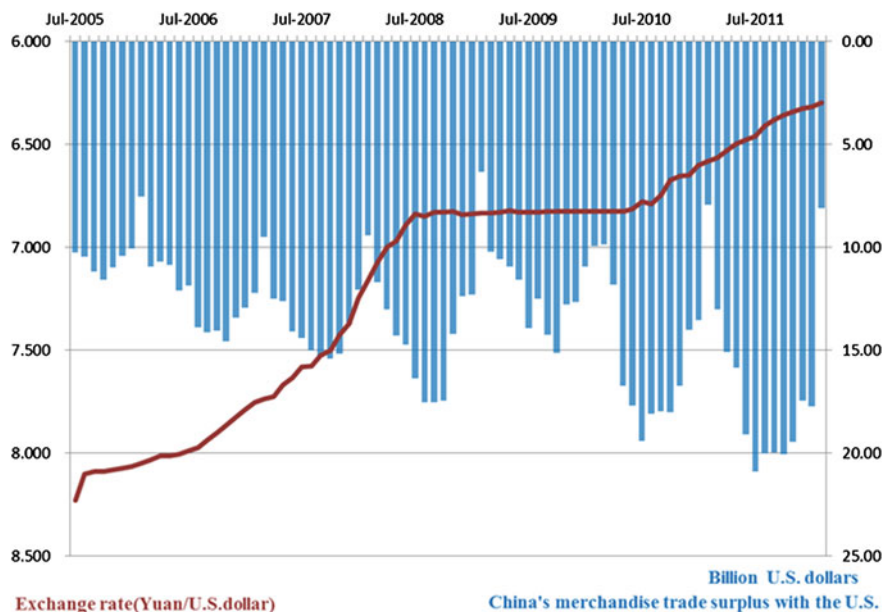


Fig. 2.1 China's merchandise trade surplus with the U.S. and exchange rate *Source* The data of exchange rate: State Administration of Foreign Exchange of the People's Republic of China: http://www.safe.gov.cn/model_safe/tjsj/tjsj_detail.jsp?ID=11110000000000000000,6&id=5 And the data of trade surplus: General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/tabid/44604/Default.aspx>

2.4.2 RMB's Appreciation Cannot Solve the Problem of Trade Imbalance

The reasons of China's trade surplus with the U.S. and EU are China's comparative advantage, competitive advantage and international division of labor. The reasons of the U.S. and EU's trade deficit are shortage of competitive advantage, improper economic policies, and the U.S. and EU's export controls of high-tech products against China.

RMB's exchange rate is not the key for China's trade surplus, and RMB's appreciation can not solve the problem of trade imbalance. Rather than cheap RMB leading to a flood of imports from China, RMB has actually strengthened as the U.S. trade deficit with China has widened (Fig. 2.1). From Aug 2005, RMB appreciated continuously against the U.S. dollar, and it has risen by more than 20 %. In Aug 2005, the exchange rate was 8.10 Yuan/1 U.S. dollar, and in Sep 2008, the exchange rate was 6.83 Yuan/1 U.S. dollar, and in Feb 2012, the exchange rate was 6.30 Yuan/1 U.S. dollar. But the U.S. trade deficit with China

Table 2.9 Trade between China and the U.S. (2001–2010)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
U.S. exports (billion U.S. dollars)	19.2	22.1	28.4	34.7	41.8	55.2	65.2	71.5	69.6	91.9
% change	18.3	15.1	28.5	22.2	20.6	32.1	18.1	9.5	−2.6	32.1
U.S. imports (billion U.S. dollars)	102.3	125.2	152.4	196.7	243.5	287.8	321.5	337.8	296.4	364.9
% change	2.2	22.4	21.7	29.1	23.8	18.2	11.7	5.1	−12.3	23.1
Total (billion U.S. dollars)	121.5	147.3	180.8	231.4	285.3	343	386.7	409.2	366.0	456.8
% change	21.4	21.2	22.8	28	23.3	20.2	12.7	5.8	−10.6	24.8
U.S. balance (billion U.S. dollars)	−83.0	−103.1	−124.0	−162.0	−201.6	−232.5	−256.3	−266.3	−226.8	−273.1

Note Calculated by USCBC. US exports reported on a free-alongside-ship basis; imports on a general customs-value basis

Source US Department of Commerce; US International Trade Commission (ITC); THE US-CHINA BUSINESS COUNCIL: <http://www.uschina.org/statistics/tradetable.html>

was 201.6 billion U.S. dollars, 266.3 billion U.S. dollars, and 273.1 billion U.S. dollars in 2005, 2008, and 2010 separately (Table 2.9).

It is noteworthy that Japanese Yen has appreciated a lot against the U.S. dollar since the 1980s, but up to the present the Japan's trade surplus with the United States is still large, and Japan experienced two lost decades after the Japanese asset price bubble's collapse, which was brought mainly by Japanese Yen's acute appreciation.

Appendix

Table A.1 Export of foreign-investment and domestic enterprises of China (Billion U.S. dollars)

	2004	2005	2006	2007	2008	2009	2010	2011
Total export	593.37	762.00	969.08	1218.02	1428.55	1201.66	1577.93	1898.60
Foreign-investment	338.61	444.21	563.84	695.52	790.62	672.23	862.31	995.33
Domestic	153.59	168.81	191.35	224.81	257.23	190.99	234.36	267.22
Others	101.17	148.98	213.90	297.68	380.70	338.44	481.27	636.05

Source General Administration of Customs of the People's Republic of China: <http://www.customs.gov.cn/tabid/44604/Default.aspx>

Table A.2 China’s services trade (1997-2011), (Billion U.S. dollars)

	Transportation		Travel	Communication		Construction	Insurance	Financial	Computer	Royalties	Consulting	Advertising,	Film,	Other	Government
				services		services	services	services	and	and	media	audiovisual	business	services	
									information	license					
									services	fees					
1997	EX 2.95	12.07	0.27		0.59	0.17	0.03	0.08	0.05	0.35	0.24	0.01	7.68	0.07	
	IM 9.94	8.13	0.29		1.21	1.05	0.32	0.23	0.54	0.47	0.24	0.04	5.25	0.24	
1998	EX 2.30	12.60	0.82		0.59	0.38	0.03	0.13	0.06	0.52	0.21	0.02	6.21	0.02	
	IM 6.76	9.21	0.21		1.12	1.76	0.16	0.33	0.42	0.76	0.27	0.04	5.44	0.21	
1999	EX 2.42	14.10	0.59		0.99	0.20	0.11	0.27	0.07	0.28	0.22	0.01	6.91	0.08	
	IM 7.90	10.86	0.19		1.54	1.92	0.17	0.22	0.79	0.52	0.22	0.03	6.59	0.62	
2000	EX 3.67	16.23	1.35		0.60	0.11	0.08	0.36	0.08	0.36	0.22	0.01	7.08	0.28	
	IM 10.40	13.11	0.24		0.99	2.47	0.10	0.27	1.28	0.64	0.20	0.04	6.12	0.17	
2001	EX 4.64	17.79	0.27		0.83	0.23	0.10	0.46	0.11	0.89	0.28	0.03	7.28	0.43	
	IM 11.32	13.91	0.33		0.85	2.71	0.08	0.34	1.94	1.50	0.26	0.05	5.74	0.24	
2002	EX 5.72	20.39	0.55		1.25	0.21	0.05	0.64	0.13	1.28	0.37	0.03	8.76	0.36	
	IM 13.61	15.40	0.47		0.96	3.25	0.09	1.13	3.11	2.63	0.39	0.10	4.93	0.45	
2003	EX 7.91	17.41	0.64		1.29	0.31	0.15	1.10	0.11	1.88	0.49	0.03	15.06	0.36	
	IM 18.23	15.19	0.43		1.18	4.56	0.23	1.04	3.55	3.45	0.46	0.07	6.46	0.45	
2004	EX 12.07	25.74	0.44		1.47	0.38	0.09	1.64	0.24	3.15	0.85	0.04	15.95	0.38	
	IM 24.54	19.15	0.47		1.34	6.12	0.14	1.25	4.50	4.73	0.70	0.18	8.48	0.53	
2005	EX 15.40	29.30	0.50		2.60	0.50	0.10	1.80	0.20	5.30	1.10	0.10	16.90	0.50	
	IM 28.40	21.80	0.60		1.60	7.20	0.20	1.60	5.30	6.20	0.70	0.20	9.40	0.60	
2006	EX 21.00	33.90	0.70		2.80	0.50	0.10	3.00	0.20	7.80	1.40	0.10	19.70	0.60	
	IM 34.40	24.30	0.80		2.00	8.80	0.90	1.70	6.60	8.40	1.00	0.10	11.30	0.50	
2007	EX 31.30	37.20	1.20		5.40	0.90	0.20	4.30	0.20	11.60	1.90	0.30	26.90	0.60	
	IM 43.30	29.80	1.10		2.90	10.70	0.60	2.20	8.20	10.90	1.30	0.20	18.20	0.90	
2008	EX 38.40	40.80	1.60		10.30	1.40	0.30	6.30	0.60	18.10	2.20	0.40	26.00	0.70	
	IM 50.30	36.20	1.50		4.40	12.70	0.60	3.20	10.30	13.50	1.90	0.30	23.10	0.90	
2009	EX 23.60	39.70	1.20		9.50	1.60	0.40	6.50	0.40	18.60	2.30	0.10	24.70	0.90	
	IM 46.60	43.70	1.20		5.90	11.30	0.70	3.20	11.10	13.40	2.00	0.30	18.80	0.80	

(continued)

Table A.2 (continued)

	Transportation	Travel	Communication	Construction	Insurance	Financial	Computer	Royalties	Consulting	Advertising,	Film,	Other	Government
			services	services	services	services	and	and	media	audiovisual	business	services	
							information	license					
							services	fees					
2010	EX	34.20	45.80	1.20	14.50	1.30	9.30	0.80	22.80	2.90	0.10	35.60	1.00
	IM	63.30	54.90	1.10	5.10	1.40	3.00	13.00	15.10	2.00	0.40	17.20	1.10
2011	EX	35.60	48.50	1.70	14.70	0.80	12.20	0.70	28.40	4.00	0.10	32.30	0.80
	IM	80.40	72.60	1.20	3.70	0.70	3.80	14.70	18.60	2.80	0.40	18.30	1.10

Note According to the definition of trade in services by WTO, China's trade in services data do not include government services
Source The data of 1997–2010: State Administration of Foreign Exchange of the People's Republic of China, *China's international balance of payments 1997–2010*: http://www.safe.gov.cn/model_safe/tjsj/tjsj_list.jsp?d=5&ID=11050000000000000000; and the data of 2011: State Administration of Foreign Exchange of the People's Republic of China, *Report on China's international balance of payments 2011*: http://www.safe.gov.cn/model_safe/tjsj/tjsj_detail.jsp?ID=11070000000000000000,14&id=5

Table A.3 Exchange rate and China's trade surplus with the U.S

Month	Exchange rate (RMB/dollar)	Trade surplus (billion U.S. dollars)	Month	Exchange rate (RMB/dollar)	Trade surplus (billion U.S. dollars)
Jul-2005	8.229	10.26	Nov-2008	6.829	14.19
Aug-2005	8.102	10.47	Dec-2008	6.842	12.42
Sep-2005	8.092	11.20	Jan-2009	6.838	12.34
Oct-2005	8.089	11.59	Feb-2009	6.836	6.37
Nov-2005	8.084	11.00	Mar-2009	6.834	10.25
Dec-2005	8.076	10.44	Apr-2009	6.831	10.60
Jan-2006	8.067	10.07	May-2009	6.824	10.97
Feb-2006	8.049	7.54	Jun-2009	6.833	11.60
Mar-2006	8.035	10.98	Jul-2009	6.832	13.94
Apr-2006	8.016	10.73	Aug-2009	6.832	12.53
May-2006	8.015	10.90	Sep-2009	6.829	14.24
Jun-2006	8.007	12.11	Oct-2009	6.828	15.12
Jul-2006	7.991	11.88	Nov-2009	6.827	12.81
Aug-2006	7.973	13.89	Dec-2009	6.828	12.68
Sep-2006	7.937	14.13	Jan-2010	6.827	10.97
Oct-2006	7.903	14.04	Feb-2010	6.827	9.96
Nov-2006	7.865	14.57	Mar-2010	6.826	9.87
Dec-2006	7.824	13.45	Apr-2010	6.826	11.86
Jan-2007	7.790	12.97	May-2010	6.827	16.74
Feb-2007	7.755	12.25	Jun-2010	6.817	17.70
Mar-2007	7.739	9.51	Jul-2010	6.777	19.43
Apr-2007	7.725	12.51	Aug-2010	6.790	18.09
May-2007	7.670	12.64	Sep-2010	6.746	17.99

(continued)

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