The U.S.-China Trade Friction: Causes and Proposed Solutions

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The U.S.–China trade relationship has undergone tremendous growth since 1979, when the United States and China established their diplomatic relationship. The trade volumes have increased dramatically after China joined the World Trade Organization in 2001. However, the trade relationship between the two countries has recently experienced some setbacks—specifically in terms of the huge U.S. trade deficit with China, currency manipulation by the Chinese government, and China's failure to enforce laws to protect the intellectual property rights of U.S. companies. This article discusses the three major issues of the US-China trade relations: burdens, causes, and solutions.

INTRODUCTION

The government-directed capitalism of China for the past three decades has lifted over 400 million people out of poverty, made China the second-largest economy in the world, and caused China to become the third-largest trading nation in the world.[1] China is the second-largest U.S. trading partner, its third-largest export market, and its biggest source of imports.[2] However, some of the policies of China's tightly managed capitalism, such as its currency manipulation, have created considerable friction with its trading partners, raising serious international concerns about growing current account imbalances, most notably with the United States (U.S.). In 2006, the Bank for International Settlements said that such huge imbalances could pose a serious problem in the long run for the world economy.[3] In recent years, international organizations such as the International Monetary Fund and some countries, such as the U.S., have proposed numerous measures to correct them.

With the world's largest population and the world's second-largest economy, China is a huge market for U.S. exports and investors. However, bilateral economic relations have become strained over a number of issues, such as large U.S. trade deficits with China, its currency manipulation, its poor record on enforcing intellectual property rights (IPR), its mixed record on implementing the World Trade Organization (WTO) commitments, and its extensive use of industrial policies.[4] Another complication of the U.S.–China bilateral relationship has to do with the growing level of economic integration and mutual interdependence between the two economies. This article provides an overview of U.S.–China economic

relations (trade and investment), surveys the trade disputes, and discusses measures to reduce the trade imbalances.

U.S.–China Economic Relations

This section deals with the two types of closely related international transactions, foreign trade and investments.

Tables 1 and 2 underscore a new reality in bilateral trade relations between the U.S. and China. As shown in Table 1, the U.S. trade deficit with China increased from $83 billion in 2001 to $273 billion in 2010. Table 2 shows that the U.S. current account deficit declined somewhat in dollar amounts in 2009 over 2008, but China's account-balance surplus as a share of the U.S. account-balance deficit has consistently surged over time, even throughout the U.S.-originated global credit crisis of 2007–2009.

TABLE 1
U.S. TRADE IN GOODS WITH CHINA (U.S.$ BILLIONS)

Year	***Exports***	Imports	Balance
2011	103.94	399.36	-295.42
2010	91.88	364.94	–273.06
2009	69.50	296.37	–226.87
2008	69.73	337.77	–268.04
2007	62.94	321.44	–258.51
2006	53.67	287.77	–234.10
2005	41.19	243.47	–202.28
2004	34.43	196.68	–162.25
2003	28.37	152.44	–124.07
2002	22.13	125.19	–103.06
2001	19.18	102.28	–83.10
2000	16.18	100.01	–83.83
1999	13.11	81.789	–68.68
1998	14.24	71.17	–56.93
1997	12.86	62.56	–49.69
1996	11.99	51.51	–39.52
1995	11.75	45.54	–33.79
1994	9.28	38.79	–29.51
1993	8.76	31.54	–22.78
1992	7.42	25.73	–18.31
1991	6.28	18.97	–12.69
1990	4.81	15.24	–10.43
1989	5.75	11.99	–6.23
1988	5.02	8.51	–3.45
1987	3.50	6.29	–2.80
1986	3.11	4.77	–1.66
1985	3.86	3.86	0.00

Source: U.S. Census Bureau (http://www.census.gov/foreign-trade/balance/c5700.html), February 2012.

Such Chinese trade surpluses have enabled the country to accumulate a huge amount of foreign exchange and gold quickly, so that as the world's largest holder of reserves, China now accounts for almost 30 percent of the world total, which equates to about 50 percent of the nation's gross domestic product (see Table 3). This Chinese economic success has been highlighted in news reports and academic papers about the country's trade surplus and its vast foreign holdings: "No wonder why the global financial crisis has brought the bilateral trade relationship between the U.S. and China the spotlight of international attention. Indeed, China and the U.S. together epitomize the sources and dangers of global macroeconomic imbalances."[5]

TABLE 2
CURRENT ACCOUNT BALANCES FOR THE U.S. AND CHINA (U.S.$ BILLIONS)

Year	United States (A)	China (B)	(B)/(–A) (%)
2000	–416.3	20.5	4.9
2001	–396.6	17.4	4.4
2002	–457.3	35.4	7.7
2003	–519.1	43.1	8.3
2004	–628.5	68.9	11.0
2005	–745.8	132.4	17.8
2006	–800.6	231.8	29.0
2007	–710.3	353.2	49.7
2008	–677.1	420.6	62.1
2009	–376.6	243.3	64.6
2010	-470.9	237.8	50.5
2011	-473.4	201.7	42.6

Sources: The World Bank (http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?page=2)

TABLE 3
CHINESE FOREIGN EXCHANGE RESERVES: 2001-2011

Year	U.S.$ (billions)	GDP (U.S.$ billions)	As a percentage of Chinese GDP
2001	212.2	1,325	16.02
2002	286.4	1,454	19.70
2003	403.3	1,641	24.58
2004	609.9	1,932	31.57
2005	818.9	2,257	36.28
2006	1,066.3	2,713	39.30
2007	1,528.2	3,494	43.74
2008	1,946.0	4,522	43.03
2009	2,399.2	4,991	48.07
2010	2,847.3	5,931	48.00
2011	3,181.1	7,319	43.46

Sources: for reserves, China's State Administration of Foreign Exchange (http://www.safe.gov.cn/); for China's GDP, the World Bank (http://data.worldbank.org/indicator/NY.GDP.MKTP.CD)

Bilateral trade between the U.S. and China has steadily increased since these two countries established their diplomatic relationship back in 1979. Their bilateral trade volume increased from $5

billion in 1980 to $457 billion in 2010: "In 1978 (before China's reform began) total U.S.–China trade (exports plus imports) was $1 billion; China ranked as the 32nd largest U.S. export market and its 57th largest source of U.S. imports. In 2010, China was the second-largest trading partner (after Canada), the third-largest U.S. export market (after Canada and Mexico), and the largest source of U.S. imports."[6] Table 1 shows that, under the prosperous growth of trade between the two countries, the U.S. trade deficit with China has also surged sharply in the past few decades, as U.S. imports from China have grown much faster than U.S. exports to China. That deficit increased from $0 in 1985 to $273 billion in 2010; in recent years, China has accounted for about 29 percent of the total U.S. trade deficit.

U.S.–China Investment Ties

International investment flows consist of foreign portfolio investments (financial flows) and foreign direct investments. Foreign portfolio investments are purchases of foreign bonds, stocks, financial derivatives, or other financial assets without a significant degree of management control. Foreign direct investments (FDIs) are equity investments such as purchases of stocks, the acquisition of entire firms, or the establishment of new subsidiaries. The U.S. Department of Commerce defines FDIs as investments in either real capital assets or financial assets with a minimum of 10 percent ownership in a foreign firm.[7]

Financial flows between the two economies have increased, but have become more lopsided over time in favor of Chinese holdings of U.S. securities. Table 4 shows that portfolio investments from China to the U.S. have surged in recent years. This largely reflects Chinese Central Bank purchases of U.S. securities, which include short-term and long-term U.S. Treasury and corporate securities. As shown in Table 4, from 2003 to 2010, China's holdings of U.S. securities grew by almost $1.35 trillion, or 527 percent; China's holdings of U.S. securities as a share of China's total foreign holdings also rose from 3.9 percent in 2002 to 15.2 percent in 2009, increasing its ranking of major foreign holders of U.S. securities from fifth to first.[8] However, not only have U.S. holdings of Chinese securities been small fractions of Chinese holdings of U.S. securities, but also China has been a small source of U.S. holdings of foreign securities, with only 1 or 2 percent of total U.S. holdings of foreign securities. The largest types of U.S. securities held by China are short-term and long-term U.S. Treasury securities, which are used to finance U.S. federal deficits. Furthermore, Table 5 shows that China's holdings of U.S. Treasury securities as a share of total foreign holdings increased from 6 percent in 2000 to 26 percent in 2010.

TABLE 4
CHINESE AND U.S. HOLDINGS OF EACH OTHER'S SECURITIES (U.S.$ BILLIONS)

Year	China's holdings of U.S. securities	U.S. holdings of Chinese securities	Chinese balance
2003	255.497	13.738	241.759
2004	340.972	12.723	328.249
2005	527.275	28.443	498.832
2006	698.929	75.314	623.615
2007	922.046	97.284	824.762
2008	1,205.080	54.903	1,150.177
2009	1,464.027	102.303	1,361.724
2010	1,610.737	102.226	1,508.511
2011	1,726.621	76.798	1,649.823

Sources: for Chinese holdings, the U.S. Department of the Treasury (http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/shlhistdat.csv); for U.S. holdings, the U.S. Department of the Treasury (http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/fpis.aspx)
Note that the table excludes Hong Kong, Macau, and Taiwan, which are reported separately.

Table 6 shows that FDI flows between the two economies have increased. In sharp contrast to financial flows, however, the U.S. has directly invested in China many times (somewhere between 40 to 40 times from 2000 to 2010) more than China has directly invested in the U.S. Nevertheless, the U.S. FDI in China is relatively small relative to China's holdings of U.S. securities. In fact, the U.S. is one of the largest foreign direct investors in China.

TABLE 5
THE CHINESE MAINLAND HOLDINGS OF U.S. TREASURY SECURITIES: JUNE 2002- JUNE 2011

Year	China (U.S.$ billions)	Grand total (U.S.$ billions)	China's holdings in terms of total foreign holdings (%)
2000	60.3	1,015.2	5.94
2001	78.6	1,040.1	7.56
2002	118.4	1,235.6	9.58
2003	159.0	1,523.1	10.44
2004	222.9	1,849.3	12.05
2005	310.0	2,033.9	15.24
2006	396.9	2,103.1	18.87
2007	477.6	2,353.2	20.30
2008	727.4	3,077.2	23.64
2009	894.8	3,685.1	24.28
2010	1,160.1	4,435.6	26.15
2011	1,151.9	5,004.2	23.02

Sources: U.S. Department of the Treasury (http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfhhis01.txt), February 20, 2012.

TABLE 6
U.S. AND CHINESE BILATERAL FDI FLOWS, 2000-2011 (U.S.$ MILLIONS)

Year	U.S. FDI in China	Chinese FDI in the U.S.	U.S. balance
2000	11,140	277	10,863
2001	12,081	535	11,546
2002	10,570	385	10,185
2003	11,261	284	10,977
2004	17,616	435	17,181
2005	19,016	574	18,442
2006	26,459	785	25,674
2007	29,710	584	29,126
2008	53,927	1,105	52,822
2009	50,048	1,624	48,424
2010	58,509	3,245	55,264
2011	54,509	3,815	50,694

Source: the U.S. Bureau of Economic Analysis (http://www.bea.gov/international/), February 20, 2012.

Causes of U.S.–China Trade Imbalances

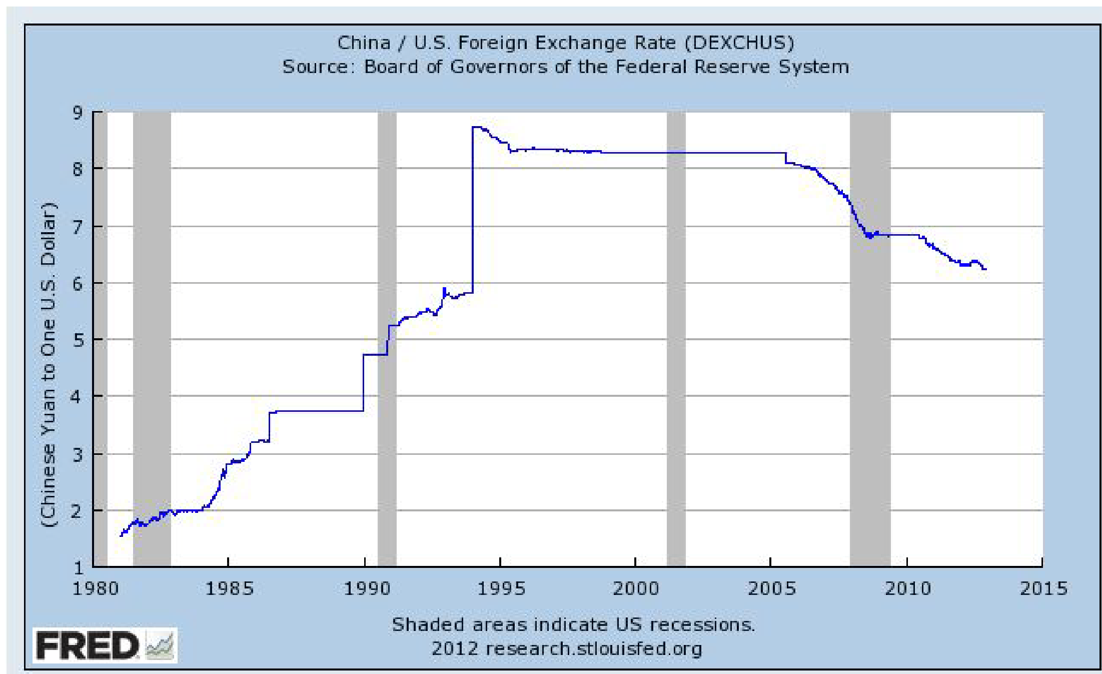
Although U.S.–China economic relations have substantially increased in recent years, tensions have arisen over a variety of issues, as the U.S. trade deficit with China has surged sharply since China joined the WTO. Four major U.S. concerns have been China's currency manipulation, its intellectual-property theft, its WTO implementation issues, and its extensive use of industrial policies.

China's Currency Policy

Many observers believe that China's heavily managed exchange rate has contributed to its huge trade surplus with its trading partners, most notably the U.S. Figure 1 shows that China pegged its renminbi (RMB), or yuan, to the U.S. dollar at about 8.28 yuan to the dollar between 1994 and 2005. On July 21, 2005, China appreciated the RMB to the dollar by 2.1 percent and moved to a managed float based on a basket of major foreign currencies. The dollar–yuan exchange rates moved from 8.27 in July 2005 to 6.83 in July 2009, or by 21.1 percent. However, once the effects of the global financial crisis began to become apparent around July 2009, China stopped its gradual appreciation of the RMB, and had kept the dollar–yuan rates relatively constant at 6.83 from July 2009 to mid-2010. With little fanfare, however, China's currency has appreciated by 12 percent since June 2010 and 40 percent since 2005, leading many economists to question whether the exchange rate was still the most important economic issue for the U.S. to press with China's leaders. Nevertheless U.S. policy-makers, politicians, labor unions, and business executives have charged that China continues to manipulate the RMB in order to keep its value artificially low. Estimates of undervaluation for the yuan against the dollar had ranged from 5 percent to 20 percent.[9]

However, on April 16, 20012, China moved to widen the daily trading range from ± 0.5 percent to ±1 percent from the par value. China does not eliminate its tight grip on the yuan because China's central bank still sets a daily reference rate (par value) for its currency. Nevertheless, the change is seen as an important step toward foreign complains about China's currency polity.

FIGURE 1
THE CHINESE YUAN VERSUS THE U.S. DOLLAR



Direct source: The Federal Reserve Bank of St. Louis
(http://research.stlouisfed.org/fred2/series/DEXCHUS), December 3, 2012.

Some researchers used to argue that a large appreciation of the RMB against the dollar, such as a 40 percent appreciation, could eliminate the bilateral U.S.–China deficit.[10] However, they also say that such a policy would only hurt China and not reduce the overall U.S. trade deficit, because the U.S. would start to import the same goods from other countries instead. Some other researchers argue that depreciation of the dollar against the yuan may cause the U.S. trade deficit with China to deteriorate, at least in the short run, because the higher costs of U.S. imports will more than offset the reduced volume of U.S. imports.[11] Many business executives and economists say that other issues, such as intellectual property theft and barriers to entering Chinese markets are now a bigger drag on the U.S. economy.

Intellectual Property Rights (IPR)[12]

China has failed to combat widespread IPR piracy in the country, despite its repeated promises to the U.S. and other countries. The U.S. has pressed China to improve its IPR protection efforts since the late 1980s, especially after the country became a member of the WTO in 2001. Although China has introduced many new laws and regulations designed to combat IPR violations, it has not enforced those new laws and regulations to a sufficient degree to halt the widespread of piracy of U.S. companies' intellectual property in China. Such failures have led to new threats from the U.S. concerning trade sanctions against China.

The Chinese enforcement agencies and judicial system often lack the resources and/or the will needed to vigorously enforce the IPR laws, and convicted IPR offenders generally face minor penalties. Many U.S. firms are dissatisfied with the lax and ineffective enforcement of the IPR laws in China, since such practices usually result in billions of dollars of loss in their annual sales revenues. Industry analysts claim that many U.S. products—such as motion pictures, business software, and sound recordings—are pirated in China, which is causing U.S. companies to lose billions of dollars every year. China also accounts for a significant share of the imported counterfeit products seized by the U.S. Customs and Border Protection. As a result, the U.S. has recently brought a series of IPR cases against China in the WTO, and in most cases obtained favorable rulings.

Even though the Chinese government has repeatedly pledged, through agreements, promises, and new regulations, to take immediate action to crack down on the large-scale production, distribution, and exports of pirated materials, many business groups assert that there is an urgent need to establish effective mechanisms to ensure long-term enforcement of the IPR laws and to provide greater market access to U.S. IPR-related products. In fact, they contend that China's poor IPR protection is one of the most significant obstacles to doing business in China.

China's Obligations in the World Trade Organization

China applied for WTO membership over a period of 13 years, but this effort was unsuccessful, mainly due to U.S. opposition. The opposition was based on a laundry list of economic and political issues, including concerns with human rights, tension between Taiwan and China, China's nuclear arsenal, objections from labor unions in the U.S., and the use of protectionist policies by China: "As bad as our trade deficit with China is today, it will grow even worse if we approve a permanent trade deal," said House Minority Whip David Bonior (D., Mich.) back in October 1999. Even with this opposition, on November 15, 1999, an historic agreement was reached between the Chinese and American trade negotiators, which set the stage for China's formal entry into the WTO.[13]

One of the major worries of opponents of the normalization of trade relations with China was concern about the growing trade imbalance between the two countries. Many believed that the growing U.S. trade deficit was due to China's high tariffs and numerous restrictions on American exports. In joining the WTO on December 11, 2001, China agreed to lower its average tariff from 16.7 percent in 2000 to 10 percent in 2005, and to reduce the number of items under import license and quota from approximately 300 to zero in the next five years. In addition, China agreed to liberalize foreign investment in banking, insurance, financial services, the wholesale/retail trade, and telecommunications. All of these industries had been under tight government control until China joined the WTO. In return, the U.S. granted China permanent normalized trade relations status. Without this legislation, China's trade status would be open

to yearly debate, as it had been in the past. Additionally, as a member of the WTO, China began to enjoy open markets with all WTO members, including the U.S.

However, the U.S. identified many areas of concern in its eighth annual China WTO compliance, issued in December 2009. They include: (1) China's failure to maintain effective IPR enforcement; (2) industrial policies and national standards designed to promote Chinese firms; (3) restrictions and distribution rights; (4) discriminatory and unpredictable health and safety rules on imports; (5) burdensome regulations and restrictions on services; and (6) the failure to provide adequate transparency of trade laws and regulations. In recent years, the U.S. has stated that China's failure to comply with key areas of its WTO commitment largely stemmed from its incomplete transition to a market-based economy.

China's Industrial Policies

China has implemented numerous industrial policies to promote the development of industries deemed critical for future economic growth. China's industrial policies consist of the two related criteria: (1) acquisition of technology and development of innovative capacity and (2) development of competitive domestic firms. [14] These policies are designed to change China from a major manufacturing center to a major global source of innovation and to make its industries more competitive in the global market place. As a result, China has focused a large share of its research and development (R&D) on its space program, aerospace development and manufacturing, renewable energy, computer science, and life sciences.

The U.S. Department of Commerce believes that Chinese government procurement contracts for R&D and infrastructure projects are $85 billion per year. [15] Some U.S. companies have complained that China has given preferential treatment to locally developed technologies in government procurement. In addition, China has also established a number of restrictive practices and policies in its infrastructure projects against foreign companies. Critics charge that China has extensively used industrial policies and discriminatory government procurement policies to subsidize and protect Chinese firms at the expense of foreign companies. Of course, China has denied all of these charges.

Solutions

A seemingly obvious solution to the bilateral trade imbalance between the U.S. and China would be to eliminate the four major causes of the problem discussed in the previous section: (1) the U.S. and China should negotiate a reasonable floating exchange system; (2) China should be urged to enforce its IPR laws more effectively; (3) China should be required to comply more effectively with the WTO commitments; and (4) China should also remove its discriminatory government procurement policies against foreign companies. . Although the two countries have reached a number of agreements on these goals, they have had virtually no impact on the size of their bilateral trade imbalance. Thus, these two countries should look at other measures to solve their trade disputes, in addition to their continuous negotiations on these three issues.

Balance Saving and Investment Account

The U.S. trade deficits with other countries, especially with China, are rooted in its macroeconomic conditions. Well-balanced saving and investment is key to resolving the huge U.S. trade deficits. The past two decades have witnessed a declining household saving rate in the U.S. A negative government saving rate, as a result of the budget deficits, set the U.S. economy on course for the great recession of 2007–2009. The U.S. trade deficit is a two-way affair, reflecting the behavior of borrower and lender alike. As long as Americans save relatively little, foreigners will use their savings to finance profitable investment opportunities in the U.S.—the trade deficit is the result.

The U.S. should increase its savings to reduce its overall deficit with China in the long run. In order for the appreciation of the yuan against the dollar to reduce the bilateral trade imbalance, the U.S. must also boost the level of its savings in the long run. If China's surplus with the U.S. falls through appreciation of the yuan against the dollar, it will have less capital to invest in the U.S. Thus, if the U.S. did not reduce its dependence on foreign savings for its investment needs, the U.S. would need to obtain

investment funds from other countries, thereby making the overall U.S. current account balance remain relatively unchanged.

The yuan has appreciated by about 40 percent in nominal terms against the dollar since 2005, but its trade surplus with the U.S. has widened. A similar story holds true in the case of Japan, where the yen rose dramatically throughout the 1990s, only to see Japan's trade surplus continuing to grow. Thus, the real cause of the imbalance may not be the yuan, but may have to do with a lack of U.S. savings rather than a glut of China's excess savings, savings over investment.[16]

Managed Trade

Managed trade is government-sponsored trade designed to eliminate the trade imbalance between countries. An extreme example of managed trade would be China's agreement to reduce its trade surplus with the U.S. by 20 percent per year, so that the two countries' bilateral trade imbalance would be eliminated completely within five years. The main goal of U.S. trade policy with China in the past has been to open China's market to U.S. investors and products through a variety of agreements, pressures, and other measures, such as China's adoption of a market-based exchange system, its compliance with the WTO commitment, the enforcement of U.S. IPRs, and the elimination of other unfair Chinese trade policies. Although good progress has been made on these goals over the past two decades, the bilateral trade imbalance has surged rather than fallen back over time. Thus, China has recently faced U.S. pressures for it to reduce its trade surplus with the U.S. to a manageable level, through some type of managed trade.

Perhaps the best approach to getting rid of the U.S. trade deficits with China is through mutual policy actions by both the U.S. and the Chinese governments. The U.S. should try to bring domestic spending down, closer to its domestic output, while China should try to bring its domestic spending up, closer to its domestic output. This mutual cooperation would make the U.S. market less dependent on Chinese products while China, on the other hand, would become less dependent on its exports to the U.S. However, U.S. efforts designed to eliminate its trade deficit with China appear to be extremely difficult, if not impossible, to achieve. Any drastic adjustments of U.S. macroeconomic policies designed to reduce the U.S. trade deficits may not be possible under current economic conditions, such as high oil prices, the housing crisis, the growing budget deficits, and weak foreign markets for U.S. exports.

Change of Composition of U.S. Products for Export to China

Traditional U.S. exports to China include oilseeds and grains, waste and scrap, semi-conductors and other electronic components, and aerospace products and parts. Typical U.S. imports include computer equipment, miscellaneous manufactured commodities, communication equipment, and audio and visual equipment. These ranges of U.S. export items to China and import items from China indicate that the U.S. imports more advanced technology and manufactured products from China than the U.S. exports to China. This is at least partly the case because the majority of China's exports to the world are produced by foreign-invested firms in China, many of which have shifted their production lines to China in the past few years, to gain access to low-cost labor and the state-of-the-art manufacturing facilities in the country. To balance the exports from China, the U.S. needs to change its strategies in order to promote exports to the Chinese market. If the U.S. intends to expand its exports to China, it should pay attention to the changes of demand in the Chinese market.

China needs to import advanced technology and equipment worth tens of billions of U.S. dollars each year. Those advanced-technology products include high-performance computers, machine tools, and telecommunication equipment with an encryption capability, and the mobile phone technology known as CDMA (code division multiple access). For political reasons, export licenses for crime control and detection equipment are prohibited, and other high-tech products or programs with China are banned by the U.S. government. For example, the space program is a great opportunity for Sino–U.S. trade and cooperation, and such cooperation in this area could bring about tremendous benefits for American business entities. However, it looks quite unlikely that such cooperation with China will occur in the years to come.

Although the U.S. is the most advanced country in the world in terms of science and technology, it accounts for only a relatively small share of China's technology imports. At American expense, Japan and the European Union have steadily increased their market share in the Chinese technology market. China has huge reserves of foreign exchange and it is a potential market to which U.S. companies can export their products. Both the U.S. and China should explore new approaches, to maintain a well-balanced trade of goods and services between the two countries now and in the future.

CONCLUSION

Some U.S. politicians argue that the huge U.S. trade deficit with China arose solely because of unfair Chinese trade practices. In their view, Chinese practices directly threaten the world trading system. Chinese officials, on the other hand, point to the low U.S. saving rate, the U.S. budget deficit, and problems with U.S. export products, such as poor quality, high prices, poor after-sales services, and inadequate finance terms. The truth, of course, lies somewhere between these two positions. Economic and other relations between these two superpowers have become increasingly important. In spite of that notion, their relations have become severely strained. As China's role in the world economy has grown, so the U.S. has become concerned about its international economic position.

China has felt U.S. pressures on its unfair trade practices for the past two decades. Nevertheless, it has taken the full advantage of the open U.S. market, but without reciprocity. U.S. measures against Chinese exports have surged, and China's reaction to the U.S. pressure has recently strained the relationship between these two countries. The U.S. has demanded that China appreciates its yuan against the dollar, complies with its obligations in the WTO, improves its IPR regime, restrains its export growth in the U.S., and invests in the U.S. Although the two countries have reached a number of agreements on these goals, they have had practically no impact on the size of their bilateral trade imbalance.

Thus, these two countries should look at other measures to solve their trade disputes, in addition to their continuous negotiations on these issues. Perhaps the best approach to getting rid of the U.S. trade deficits with China is through mutual policy actions by both the U.S. and the Chinese governments. The U.S. should try to bring domestic spending down, closer to its domestic output, while China should to bring its domestic spending up, closer to its domestic output. This mutual cooperation would make the U.S. market less dependent on Chinese products, while China would become less dependent on its exports to the U.S. However, U.S. efforts designed to eliminate its trade deficits with China appear to be extremely difficult, if not impossible, to achieve. Any drastic adjustments of U.S. macroeconomic policies designed to reduce the U.S. trade deficits may not be possible under current economic conditions, such as high oil prices, the housing crisis, the growing budget deficits, and weak foreign markets for U.S. exports.

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