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Open Markets?: India, China and America Trade Issues

Summary of ICA Institute Study Group
held on September 24, 2005

Discussion leader:
Dr. Penelope Prime, Director
China Research Center, Kennesaw State University
Kennesaw, GA USA

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The Current Situation

After the Cold War, private capital flow replaced official development assistance as the main form of capital transfer around the world. There is increasing demand for primary products: China and India have made normally inelastic price commodities like farm produce attractive again because of their huge populations and rapidly growing economies. There is also high mobility of labor and capital. There is wage pressure on the U.S. middle class because China and India present cheap labor options that are attractive to U.S. companies, who would rather outsource than pay higher wages at home.

U.S.- Trade Deficit

The panel agreed that trade deficit is not always a bad thing. However, if the U.S. trade balance continues to increase as a percentage of GDP, it may not be sustainable.

The panel discussed timing as an interesting insight into U.S. trade deficits. Something significant could have happened in the mid-1990s because that is when the deficit started growing exponentially. The panel discussed factors possibly causing this:

- The 1997 Asia crisis - The meltdown of 1997 decreased Asian demand for goods and services.
- Dotcom crash - could have added cost pressures for US manufacturers.

- Decreased value creation – agriculture and manufacturing declined while capital-intensive production increased which indicates that the U.S. economy is now services-based, pointing to increased consumption.

Concerns for U.S.

- Asia is financing U.S. debt, which makes the U.S. vulnerable and could give Asia a stronger influence on U.S. policies.
- Cost of maintaining global dominance - there are political considerations that may be contributing to deficit e.g. to ensure cooperation in the U.S. dominated global system, significant financial costs have to be incurred.

India and China – Their Issues and Policies

China's economic expansion is structurally flawed because it is exclusively export-oriented. There is no liberalization to spur domestic economic activity, which could be problematic for China if there is decreased demand for its goods abroad. India understands this and is trying to encourage domestic, demand-driven growth. Foreign companies are usually in India to serve the domestic market.

Another problem that belies China's success story is that over half of exports from China are from foreign companies and most of the rest is from state-owned companies. It means that very few private entities are being encouraged to compete in the economy, which is bad for innovation and not a sign of a healthy economy. The conclusion was that China's democratic reforms (which open up private enterprise) must go hand-in-hand with its economic liberalization.

Evidence shows that consumption as a fraction of GDP is declining instead of growing. On the other hand, savings are increasing. This is further evidence to support the panel's conclusion that China has a lot of liquidity but has not invested it much in ways to fuel consumer demand.

Final Points

The U.S. can use China's over-reliance on exports as leverage to influence change in trade policies that could improve the U.S. trade balance. Any changes will be slow and difficult given several factors:

- Tension between bureaucrats and technocrats
- Effect on local businesses (e.g., revaluation could force thousands out of business)
- President Hu Jintao is not necessarily a reformer (more interested in preserving communist power structure, etc.)

There is growing backlash in China over the government's policies. Many average Chinese citizens are not seeing the benefits of FDI in China so foreign companies are feeling some pressure. The government is concerned that uneven growth is contributing to social tensions.