Letter

# Two opposing forces can be reconciled by Beijing

From Daniel Aronoff, Cambridge, MA, US

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Sir, F Scott Fitzgerald wrote “the test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time”. This insight applies to our thinking on US-China trade deficits.

Proponents of President Trump’s imposition of tariffs on Chinese goods, like Peter Navarro, correctly point to the drain on domestic demand and consequent displacement of jobs caused by large deficits (“Trump is standing up for American interests”, Opinion, April 9). There are many potential causes of a trade deficit and, as an accounting identity, trade deficits are always accompanied by domestic consumption above saving. But China’s management of the dollar-renminbi exchange rate and the massive accumulation of dollar reserves by the People’s Bank of China since China’s entry into the World Trade Organization in 2001, indicate the US-China imbalance is the intended outcome of China’s mercantilist policies. Moreover, the PBoC’s investment in US government debt has compressed US yields and risk spreads, which has triggered a dangerous “reach for yield” by US financial institutions.

On the other hand, critics of Mr Trump’s trade stance correctly point out that the large increase in the volume of US-China trade has increased the real incomes of US households by lowering their cost of goods and they express a valid concern that a trade war could reverse those income gains and exacerbate tension between the US and China.

Ultimately, the two opposing forces should be reconciled by China. Adam Smith’s argument that the mercantilist’s accumulation of financial assets reflects a transfer of wealth to its trading partners well applies to contemporary China. The PBoC is earning a near-zero return on its dollar assets and Chinese household consumption as a percentage of gross domestic product is the smallest on the planet. China would become wealthier under balanced trade.

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