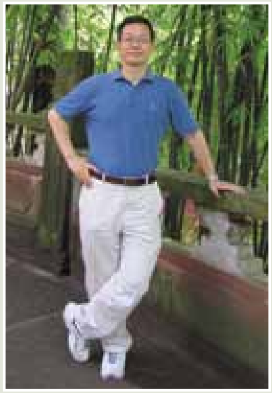
ASK AN ECONOMIST



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Yi Wen in Leshan, China.

Q. Why does the U.S. have such a large trade deficit with China?

Prices of consumer goods in the United States have been remarkably low and stable for decades. One of the most important reasons for this, besides sound monetary policies conducted by the Fed, is international trade with developing countries, such as China.

Each year, China sells goods to us at very low prices. For example, Chinese workers need to use 16 million T-shirts to exchange for one Boeing 737-800 airplane from us (at about $5 per T-shirt). More than that, they even lend goods to us by keeping our paper money for a long time.

The result is a huge trade deficit with China: For every dollar Americans spend on Chinese goods, Chinese spend 30 or fewer cents on American goods. China currently holds a total of $3 trillion in foreign reserves, mostly in U.S. dollars or U.S. government bonds. This means that U.S. consumers have been enjoying huge quantities of low-cost goods by borrowing cheaply from China at negative real interest rates.

The question is why Chinese people are willing to lend goods to us when they are still struggling with very low per capita income and consumption levels. One answer from economic theory is that they have a strong need to save for a rainy day. At their current stage of economic development, Chinese workers do not have a well-developed financial market and social safety net, both of which would reduce their need to save and would allow them to borrow when needed. Hence, even though their general economy is growing very fast, the rising uncertainty for each individual in both spending needs (such as the rising costs in health care, education and housing) and income prospects (such as unemployment risk) induces them to save excessively to provide the self-insurance that is not available to them from the market. Therefore, for every dollar a Chinese worker makes in trading with the U.S., he or she feels the need to save at least a quarter. The remaining part of the dollar is not even spent entirely on U.S. goods because Chinese workers (firms) also need dollars to buy raw materials from other countries to produce consumption goods, as China is a resource-poor country. This implies that the total imports of China from us will be *substantially less than its total exports to us, leading to the U.S.-China trade imbalance.*

Submit your question in a letter to the editor. (See Page 2.) One question will be answered by the appropriate economist in each issue.

LETTERS TO THE EDITOR

This is in response to "A Closer Look: Assistance Programs in the Wake of the Crisis" in the January 2011 issue of *The Regional Economist.*

Dear Editor:

Thank you for this excellent article on the "great recession." It cuts through quite a bit of mythology and lays out the facts in a clear and coherent way. The graphics and use of the Blinder and Zandi simulations provide a reasonable picture of the but-for world without intervention. Personally, I think that without U.S. assistance programs in place, the off-shore reverberations would have been far more reaching than the simulations suggest. Additionally, aggressive assistance in Europe and Asia was probably as valuable as the U.S. programs in helping to stave off global disasters that go beyond what the simulation can predict. Somehow in some way, the global political machinery gave way to common sense at a time that it absolutely had to.

Kyle Stiegert, professor of agricultural economics at the University of Wisconsin in Madison

This is in response to "Are Small Businesses the Biggest Producers of Jobs?" in the April 2011 issue. This letter has been edited for space reasons. To read it in its entirety, see www.stlouisfed.org/publications/re/letters/index.cfm

Dear Editor:

The article is directed at making the very salient point that we should look at net job creation, not gross, when assessing the dynamics of labor demand by small businesses. Unfortunately, the article presents an incomplete picture of the U.S. labor market that leaves the reader with the impression that firms with 500+ employees are the main drivers of employment.

Using 1992 as a baseline, it is clear why the authors can say that nearly 40 percent of jobs created have been at the largest firms. I would argue, however, that the heady years of the 1990s (a period that included an expansion of technology and free-trade agreements that we have not seen since) do not provide a reasonable baseline from which to derive long-term labor market expectations.

Indeed, the more recent decade provides a marked contrast. When we begin this analysis using the year 2000 as our baseline, a different picture emerges—one where small firms not only create more jobs, but where they create jobs that are more robust to economic downturns. It is intriguing to note the trend in the early 2000s (and today), when smaller firms are *increasing* employment, while the largest firms continue to hemorrhage jobs.

It should not be assumed that the distribution of employment in an advanced economy will naturally be biased toward employment at large firms. This is a consequence of *policy,* and I fear that the article by Mr. Kliesen and Ms. Maués could be interpreted as a reason to continue the same policies that have resulted in this labor force distortion. Last year, the German minister of finance, Wolfgang Schäuble, noted that, "The United States lived on borrowed money for too long, inflating its financial sector unnecessarily and *neglecting its small and mid-sized industrial companies*" (emphasis added).

Andrew Smale, master's student in applied economics, University of Minnesota in Minneapolis-St. Paul

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