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Trade Surplus Grows Abnormally Amid insufficient Domestic Demand — China's Economic Rebalancing Will Help Counter the Tariff War

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Abstract:

This paper takes the recent intensification of Trump 2.0 trade policies and the changes in the external economic and trade environment as the background. It systematically observes the characteristics of China's surging trade surplus and structural external imbalances during her 14th Five-Year Plan period. It also analyzes the rooting causes of these characteristics from both international and domestic perspectives, especially focusing on the domestic economic pattern of strong supply verses relatively weak demand. It further explores the policy options for countering the US tariff war and promoting domestic economic rebalancing. In response to the current situation where Trump is increasingly provoking a tariff war, China should adopt a dual approach of countering bullying and opposing decoupling. This includes joining hands with BRICS members, developing countries, and non-US Western countries (i.e., the traditional US allies) to resist the US tariff war policies. Meanwhile, China should enhance its economic and industrial technological levels and consolidate the momentum of productivity catch-up. Especially it should confront the internal and external imbalances caused by insufficient domestic demand and weak consumption, and vigorously implement a rebalancing strategy through increasing household income, promoting consumption and expanding domestic demand. This will solidify the foundation for China's sustained economic development and thereby more effectively counter the US unilateral trade policies and better cope with external environmental changes.

Keywords: Trump 2.0 Policies; Trade Surplus; Insufficient Domestic Demand; Tariff War

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Main Points

1. In the past two months, the Trump administration's domestic and foreign policy actions reflect a significant adjustment—and even a directional shift—from some core principles of longstanding U.S. policy. This marks a period of rapid adjustment and reconstruction of the Western-led global economic order established since World War II. These developments suggest that the "great changes unseen in a century" are accelerating. China now stands at a critical juncture, with historical initiative in hand and facing both unprecedented opportunities and challenges.

2. The U.S.'s aggressive tariff policy carries a dual aim: to dismantle and then reconstruct the global economic and trade system. At present, the U.S. is willing to pursue a global tariff war as an extreme means of tearing down the open trade framework gradually built after the World War II. The next stage appears to be the creation of a new, group-based discriminatory trade regime—one that better serves U.S. interests, is more easily controlled by the U.S., and is underpinned by emerging geopolitical alignments through integration of the "security umbrella" and "tariff umbrella."

3. Riding the momentum from its electoral victory last November, the Trump administration views the current confrontation as a possible last chance to reverse the strategic impasse in U.S. economic policy. It appears willing to accept severe costs—including global market volatility, a moderate domestic recession, and even disruption to the international role of the U.S. dollar—if doing so serves its broader objectives. The administration is prepared to endure welfare losses and systemic instability in pursuit of strategic gains.

5. In recent years, China's industrial and manufacturing capabilities have advanced in leaps and bounds. These gains have markedly improved supply-side production capacity and international competitiveness. This progress reflects the effective synergy between market mechanisms and national policy in advancing toward the global technological frontier. However, persistent weaknesses in domestic demand and consumption together with surging external surplus have emerged as structural shortcomings that need to be addressed to enhance resilience. During the 14th Five-Year Plan, China's trade surplus has grown to unprecedented levels, with external demand contributing more to GDP growth than ever before. Last year, the number of WTO trade investigations targeting China exceeded historical highs. Although the central government adopted the "dual circulation" strategy in 2020—emphasizing greater reliance on the domestic market—implementation remains incomplete. The current imbalance, marked by a large trade surplus alongside weak domestic demand, carries significant risks and adjustment pressures.

6. Historical experience offers a warning: in the early 2000s, China's trade surplus also expanded rapidly, only to be sharply curtailed by the 2008 U.S. financial crisis. The resulting collapse in external demand between 2009 and 2010 reduced China's economic output by the equivalent of 5.1 percentage points. Today, with rising reliance on external demand and ongoing global uncertainty, China must prepare for potential shocks of comparable magnitude.

7. China's comprehensive countermeasures on April 3 sent a clear message of opposition to U.S. coercion. At the same time, China should actively engage in bilateral, plurilateral, and multilateral platforms—especially with non-U.S. Western nations and BRICS members—to collectively resist the tariff war and anti-globalization tendencies. Meanwhile, pragmatic negotiations with the U.S. on relatively neutral issues can help reduce the costs of confrontation.

8. The top priority in facing external risks is to "manage our own affairs well": resolving the real challenges facing economic growth, reinforcing the foundations for long-term development, and turning crisis into opportunity. This calls for comprehensive macroeconomic, structural, and institutional reforms from both the supply and demand sides. In particular, the gap between insufficient domestic demand and weak consumption must be closed. Expanding domestic demand, increasing incomes, boosting consumption, and accelerating rebalancing through the dual circulation strategy will create the conditions needed to achieve modernization and weather external shocks.

With Trump re-elected as U.S. president and launching a series of radical domestic and foreign policies, the international economic and political landscape is undergoing rapid transformation—so fast that it could be described as "one day equals twenty years." The traditional post–World War II order, which the United States participated in and led in constructing, is shifting quickly. This reflects the accelerating momentum of the "great changes unseen in a century." As the most important emerging power of our time, China holds a pivotal position in this global transition and possesses the historical initiative. Carefully studying and accurately understanding the underlying dynamics of these changes, and scientifically formulating strategies to respond to both internal and external challenges, carry special significance not only for China's economy but also for global development.

Compared with his first term eight years ago, Trump's second term has been markedly more impulsive and unconventional, both domestically and internationally. In the realm of foreign economic policy—the focus of this article—the use of unilateral tariff measures has reached extreme levels. The announcement on April 2 of reciprocal tariffs targeting more than 80 trading partners[1] is, in effect, a declaration of a tariff war against the entire world. According to the design laid out by Dr. Miran, Chairman of Trump's Council of Economic Advisers, the U.S. aims not only to dismantle the current international trade order, but also to integrate its so-called "tariff umbrella" with a "security umbrella," in order to construct a bloc-based discriminatory trade system. This system would prioritize U.S. interests, allow for greater U.S. control, and be aligned with new geopolitical realities, thereby strengthening strategic checks on its rivals. How other countries respond to the U.S.'s sweeping tariff policies, what retaliatory effects will follow, how the U.S. economy will be impacted, what new risks these actions pose to global growth, and how the U.S. will proceed with integrating trade and geopolitical objectives—all of these remain critical questions requiring close observation and analysis.

In response to the large-scale trade war launched by the Trump administration during his first term, China adhered to its principles while responding pragmatically and achieved meaningful outcomes. Confronted with a deteriorating global political and economic climate, intensified anti-globalization sentiment, and a clearly weakening of traditional international circulation, Chinese policymakers in 2020 proposed a long-term development strategy of "Dual Circulation": "taking domestic circulation as the mainstay while promoting mutual reinforcement of domestic and international circulations."[2] Reflecting on the past five years, China has made substantial strides in addressing technological bottlenecks by leveraging the advantages of its new national system, especially in high-tech sectors. While the supply-side dimension of dual circulation has alleviated some pressure, the issue of insufficient domestic demand persists. The trade surplus has expanded abnormally, and reliance on external demand for economic growth has increased. The demand-side goal of "relying more on the domestic market" has yet to be fully achieved. In today's turbulent external environment, China enjoys several advantages in weathering external shocks. At the same time, it must remain vigilant to serious risks stemming from internal and external imbalances.

This article uses the recent rollout of Trump's 2.0 policy and the shifting external trade landscape as its backdrop. It examines the characteristics and structural imbalances of China's trade surplus growth during the 14th Five-Year Plan period. It then analyzes the root causes of these patterns from both international and domestic perspectives, with particular attention to domestic oversupply. The article concludes by exploring policy options for responding to the U.S. tariff war and promoting domestic economic rebalancing. Given the escalation of the tariff war under Trump's second term, China should adopt a dual-track strategy: confronting U.S. coercion while opposing decoupling. This includes working with BRICS members, developing countries, and even non-U.S. Western nations (i.e., traditional U.S. allies) to jointly resist U.S. tariff aggression. Domestically, China must continue advancing technological

[1] The data comes from Annex I of the White House executive order issued on April 2, 2025. If the 27 EU member states are counted separately, the tariffs would cover 83 countries. The list released by Trump on his social media Truth Social includes 185 economies, which are the 185 trading partners of the United States. Except for the 57 economies in Annex 1, a 10% tariff is imposed on the other 128 economies. Annex 1 only lists the 57 economies for which the reciprocal tariffs are calculated separately.

[2] Xi Jinping, "Explanation on the 'Proposal of the CPC Central Committee on Formulating the 14th Five-Year Plan for National Economic and Social Development and the Long-Term Goals for 2035,'" *Xinhuanet*, November 3, 2020.

upgrading, strengthening its industrial base, and consolidating its productivity gains. At the same time, it must address imbalances arising from weak domestic demand and subdued consumption by implementing a rebalancing strategy that expands domestic demand, raises incomes, and stimulates consumption. These efforts are vital to reinforce China's economic foundations, effectively counter U.S. suppression tactics, and respond more capably to a shifting global environment.

This article is organized into five parts. First, it briefly examines key elements of Trump's 2.0 policy agenda. Second, it analyzes the underlying logic and structural flaws of the U.S. tariff war through the lens of the Milan Report. Third, it summarizes nine empirical features characterizing the recent sharp increase in China's trade surplus and its consequences. Fourth, it presents six explanatory factors behind the surplus growth, combining international and domestic perspectives, especially the role of insufficient domestic demand. Finally, it outlines China's policy choices—both in terms of external responses to the tariff war and internal steps toward rebalancing—and argues that proactive economic rebalancing is also the superior strategy for countering the U.S. tariff offensive.

1. Trump 2.0 Policy and the Tariff War

In his second term, Trump's policies during the first two months have been more radical, hasty, idealistic, and confrontational, breaking decisively with the traditional political establishment. In domestic affairs, the newly established Department of Government Efficiency (DOGE), led by Elon Musk, has aggressively pursued public-sector layoffs and pushed to dismantle federal agencies such as the U.S. Agency for International Development and the Department of Education. On immigration, the administration has introduced the most stringent border controls to date, conducted large-scale deportations of undocumented immigrants, and replaced the traditional EB-5 visa program with a new "Golden Card Program." In foreign policy, the sudden shift in Russia's position on the war in Ukraine has shaken the longstanding U.S.-Europe alliance, prompting immediate adjustments in Germany's fiscal and defense policies as well as the European Union's broader security posture. Additionally, territorial claims made over Greenland and Panama through different channels have drawn global attention and astonishment. Collectively, these early moves in Trump 2.0 mark not only significant adjustments but also potential directional changes in foundational U.S. policy principles, signaling a period of rapid recalibration and restructuring of the Western and global political order that the United States once helped shape and lead after World War II.

In economic and trade policy, the administration's macroeconomic agenda generally aligns with the goals of boosting growth and controlling fiscal deficits as outlined in Treasury Secretary Bessant's "3-3 Plan." Over the past two months, key supply-side measures—primarily tax cuts and deregulation—have been rolled out. The administration has pledged to extend the 2017 Tax Cuts and Jobs Act (TCJA), which is set to expire at the end of this year, and is considering further reducing the corporate income tax rate from 21% to 15%. On the deregulation front, the Biden-era policies addressing climate change have been swiftly reversed. On the first day in office, the new administration withdrew from the Paris Agreement, rescinded multiple environmental regulations, restarted offshore drilling, accelerated fossil fuel extraction, and announced plans to eliminate electric vehicle subsidies included in the Inflation Reduction Act. Additional moves—such as easing bank compliance requirements, weakening climate risk disclosure obligations, and relaxing cryptocurrency oversight—further illustrate the administration's deregulatory orientation. Notably, much of this agenda is centered on the sweeping DOGE reform, which has focused on "deregulating the regulators" as a central mechanism. As such, DOGE has become the flagship initiative of the administration's macroeconomic growth strategy.[3]

In addition, a recent public statement by Finance Minister Bessant regarding recession risks in the U.S. economy offers insight into the new administration's macroeconomic policy thinking. With cost-push inflation pressures stemming from radical tariff and immigration policies, alongside weakening consumer

[3] The author pointed this out in "How to Deal with the Sino-US Trade War? Three New Trends in the Trump Cabinet Are Worth Paying Attention to," *Observer*, December 16, 2024. The current policy trend is generally consistent with the above observations and speculations.

sentiment due to a correction in tech stocks, market analysts have increasingly raised concerns about a possible recession. In this context, Bessant's remarks during a March 17 media interview stand out: "I cannot guarantee that there will be no recession, nor am I worried about a stock market crash." This seemingly neutral and candid position departs from the conventional tone typically adopted by financial officials, who tend to offer reassuring assessments and align with the bipartisan tradition of using stimulus to sustain growth. Whether this reflects a strategic preference within the Trump administration for a short-term recession—believing "sooner is better than later"—or confidence in a new growth model that would make long-term stimulus unnecessary remains unclear. It also raises the question of whether such a stance might inadvertently contribute to the very downturn it dismisses. If a recession does materialize under these unique policy and geopolitical conditions, it could have consequences far more severe than those of a typical cyclical contraction. For China—whose growth has become increasingly reliant on external demand in recent years—these risks demand careful monitoring and contingency planning.

The underlying mindset of the current U.S. policy team is also noteworthy. They appear driven by the conviction that the rest of the world has long taken advantage of the United States, which they view as the root cause of the country's economic decline. In their logic, foreign trade policy becomes the key instrument to overhaul the global economic order in service of the "Make America Great Again" agenda. However, given the continuing erosion of U.S. international competitiveness, the administration lacks the conditions to implement constructive, multilateral economic strategies. As a result, it has turned to tariffs as the primary—and arguably overused—policy tool. This approach is clearly laid out in the two official memorandum documents that define the core logic of Trump 2.0's trade strategy.

The *America First Trade Policy* (AFTP), released on January 20—the first day of Trump's second term—outlines the overarching direction of the new administration's trade agenda. Unusually, the document bears the signatures of nine federal agencies, with the first three being the State Department, the Treasury Department, and the Department of Defense, followed by the Department of Commerce and, in the seventh position, the Office of the U.S. Trade Representative. This broad institutional endorsement signals that the document is not merely a departmental trade directive, but rather a statement of core economic philosophy for the entire administration. The AFTP declares that trade policy must adhere to the "America First" principle and serve five key objectives: promoting economic growth, controlling inflation, raising wages, increasing national wealth, and reducing the fiscal and trade deficits. Among the major policy tasks outlined are: reducing the trade deficit to support domestic manufacturing; establishing a new "External Revenue Service" (ERS) to coordinate tariff implementation; evaluating foreign unfair trade practices and developing countermeasures; reviewing the United States-Mexico-Canada Agreement (USMCA); reassessing all existing trade agreements under a strict reciprocity framework; identifying bilateral and sectoral opportunities to expand U.S. exports; revisiting "double-reverse" trade remedy rules (anti-dumping and anti-subsidy); and strengthening measures against counterfeit goods, contraband, fentanyl, and de minimis imports valued under US$800.

The second key policy document, *Reciprocal Trade and Tariffs* (RTT), was released on February 13 and sets out a concrete action plan centered on "reciprocity" as the foundational principle, with tariffs as the principal enforcement mechanism. Based on the premise—widely regarded as flawed—that foreign governments' unequal policies have caused the U.S. trade deficit and hollowed out its manufacturing base, the RTT proposes to systematically evaluate tariffs and non-tariff barriers imposed by other countries on U.S. exports. These barriers are to be quantified and translated into "equivalent" reciprocal tariffs, which will form the basis for new U.S. tariff schedules. These tariffs are intended to apply universally, encompassing both strategic rivals and longstanding allies. After weeks of preparation, the administration officially launched the reciprocal tariff plan on April 2 under the authority of the International Emergency Economic Powers Act of 1977 (IEEPA). At a 4:00 p.m. press conference that day, President Trump proclaimed it "the long-awaited American Liberation Day."

However, the method used by the U.S. Trade Representative (USTR) to calculate "equivalent tariffs" is striking in its simplicity and lack of rigor.[4] Rather than directly assessing the actual tariff and non-tariff

[4] USTR: "Reciprocal Tariff Calculations" https://ustr.gov/issue-areas/reciprocal-tariff-calculations

barriers imposed by each trading partner, the USTR employs a four-step estimation procedure to derive the equivalent tariff rates. First, it arbitrarily treats the share of the U.S. trade deficit with each partner relative to total U.S. imports as a proxy for that country's overall tariff and non-tariff restrictions on U.S. goods.[5] Second, it subjectively selects a tariff pass-through elasticity (denoted φ) and a demand elasticity for imports, assuming these values yield an import elasticity with respect to tariffs equal to one—that is, it presumes a one-to-one inverse relationship between the trade deficit ratio and the tariff rate. Third, using the ratio of the U.S. trade deficit to imports for each country, it calculates the theoretical tariff rate required to reduce that deficit to zero. Fourth, it applies a discount factor—typically around 0.5—to this theoretical rate to arrive at the final reciprocal tariff rate to be levied.[6] To prevent trade circumvention via rerouting, a floor of 10% is imposed on all reciprocal tariffs, regardless of the calculated outcome.[7]

Based on this approach, countries such as the United Kingdom, Singapore, and Brazil received the minimum 10% reciprocal tariff. At the high end, Vietnam and Cambodia were assigned tariffs of 46% and 49%, respectively. Other economies fall in between: the European Union at 20%, Japan 24%, India 26%, South Korea 25%, Thailand 36%, Switzerland 31%, Indonesia 32%, Malaysia 24%, and Taiwan Province of China 32%. Canada and Mexico, currently engaged in negotiations with the United States, were not subject to reciprocal tariffs in this round, and product exemptions under the United States-Mexico-Canada Agreement (USMCA) remain in effect. China received a new reciprocal tariff rate of 34%, which, when combined with the two earlier rounds of 10% tariffs and the Section 301 tariffs imposed in 2018–2019, raises the cumulative tariff burden on Chinese exports to an exceptionally high level. According to USTR estimates, the implementation of this reciprocal tariff policy would lift the simple average U.S. tariff rate to approximately 20%, while the weighted average tariff rate on imports would rise to 41%.

Before fully rolling out the reciprocal tariff regime, the Trump administration also advanced two unilateral tariff rounds. First, citing fentanyl supply and trafficking concerns, it imposed a 25% tariff on Mexico and Canada and two separate 10% tariffs on China. Second, it revoked the Section 232 tariff exemptions on steel and aluminum that had been granted in 2018, reinstating a blanket 25% tariff, and introduced new tariffs on downstream products (e.g., auto parts and household appliances) covering an additional US$151 billion in goods. While the stated aim of the tariff war is to overhaul the global trade order, rather than merely adjust bilateral relations, China remains its principal strategic target. This focus is underscored in the *America First Trade Policy* document, where China is the only country given a dedicated section (Section 3) with five priority items: (1) evaluation of the Phase One trade agreement, (2) re-evaluation of the "Four-Year Review of the Section 301 Report on China" in May 2024, (3) consideration of launching a new Section 301 investigation, (4) review of China's permanent normal trade relations (PNTR) status, and (5) assessment of ongoing intellectual property rights violations.

2. The Logic and Challenges of Tariff Wars: Insights from the Miran Manual[8]

Over the past two months, the sweeping and often dramatic domestic and foreign policy initiatives of the Trump 2.0 administration have disrupted the political economy of both the United States and the wider world, leaving many observers perplexed. Why would the United States, as the world's only superpower, adopt such an apparently self-destructive course of action? Is this the result of President Trump's own impulsive decision-making, a distorted manifestation of the U.S.'s strategic anxieties as interpreted by a particular political faction, or a reflection of deeper structural forces grounded in a specific logic and worldview?

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[5] Tariffs charged to the U.S.A., including currency manipulation and trade barriers.

[6] The USTR did not explain the origin of this coefficient of approximately 0.5, which appears to be based on considerations such as retaining leverage for continued pressure in subsequent negotiations.

[7] A related joke is that Australia's overseas territories, the Heard and McDonald Islands, were also included in the U.S. list of 10% tariffs. Reportedly "packed with seals, penguins, and other birds," this archipelago near Antarctica has no permanent residents.

[8] His report title is "A User's Guide to Restructuring the Global Trading System", I am not sure it should be Milan's Guide or Manual?

To explore these questions, the *User's Manual for Reshaping the Global Trade System* (hereinafter referred to as the *Miran Manual*), authored by Stephen Miran, Chairman of the U.S. President's Council of Economic Advisers (CEA), offers a rare and revealing reference. Though nominally written for market participants, the report provides a systematic account of the Trump administration's evolving approach to trade and monetary policy—particularly the logic and risks associated with its aggressive tariff strategy, and the potential for an ensuing currency war.

Officially released in November of last year, the *Miran Manual* aims to alert investors to the shifting landscape of global trade and finance. Using an economic framework, it analyzes the strategic background, policy rationale, objectives, and constraints underlying the administration's choice of trade confrontation as a central tool of foreign economic policy. While the report's tone is clearly partisan, and its assumptions sometimes questionable, it nonetheless sheds empirical light on the challenges, contradictions, and potential pitfalls of the U.S. approach—especially from the standpoint of emerging economies navigating an increasingly hostile external environment. In this context, studying the *Miran Manual* is useful not only for understanding others, but also for better assessing one's own vulnerabilities and strategic options.

Many of the analytical arguments in the *Manual* are not original to the author but draw on a long-standing body of U.S. academic and market commentary[9] concerning the structural dilemmas facing the American economy. The goal of the report is to offer a cohesive framework that reflects the political priorities and market dynamics currently shaping U.S. policy. Though somewhat long and dense—at over 40 pages—it organizes its analysis around three core themes, each of which will be briefly outlined below.

The first level of content seeks to define the fundamental problems facing the U.S. economy and explain why the United States has adopted economic and trade policies that diverge from its traditional post–World War II stance. The author circles around the issue: he begins by citing existing literature to restate the familiar argument that globalization and the "China shock" have contributed to the U.S. trade deficit and industrial hollowing-out, then raises the question of why the U.S. dollar exchange rate fails to correct these imbalances and prevent excessive loss of manufacturing. He turns to a widely accepted view in international economics to answer this: given the U.S. dollar's role as the dominant international reserve currency, global demand for dollar-denominated assets has effectively severed the link between the exchange rate and the trade balance. This, the author argues, has led to the sustained contraction of U.S. tradable sectors such as manufacturing. The *Miran Manual* thus frames the core challenge in U.S. external economic relations as a serious misalignment between the financial equilibrium exchange rate and the trade equilibrium exchange rate—essentially a modern version of the "Triffin Dilemma."

This framing, however, is highly debatable. Empirical evidence from the past half-century shows that the decline in manufacturing's share of value-added and employment is not unique to the United States. Other major advanced economies—such as Germany, the United Kingdom, and Japan—have experienced similar trends, despite their currencies lacking the dollar's international status. While reserve currency status may influence a country's industrial structure to some degree, it is far from a decisive or sole factor. Much like the decline in agriculture's share of GDP during economic development, the relative decline of manufacturing is primarily driven by more complex forces—including evolving patterns of factor endowment and rising per capita income. Although there are clear weaknesses in the *Manual*'s problem definition, its subsequent analysis proceeds on the basis of this framework.

Even accepting this empirical foundation, a country grappling with the modern Triffin Paradox should, as a matter of logic, consider two broad responses. First, if the international currency status of the dollar is the root cause, then the logical solution would be for the United States to gradually step back from its

[9] For example, Joseph E. Gagnon and Fred Bergsten's systematic research on competitive dollar policies, Michael Pettis's analysis of the U.S. trade deficit driven by global demand for dollar reserve assets, and Brad Setser's related work; recent views by Zoltan Pozsar on new version of Bretton Woods system; studies by others such as Robert Lighthizer that question the foundations of free trade; and the two "China shock" papers cited in the Milan Manual and other literature used in specific analytical sections.

role as issuer of the world's primary reserve currency. Second, if relinquishing dollar hegemony is politically or practically infeasible, then the U.S. must look to alternative policy instruments to mitigate the consequences. At this conceptual crossroads—from defining the problem, to diagnosing its causes, to outlining a response—the author refrains from stating his own normative view. Instead, he takes as given the Trump administration's refusal to abandon the dollar's privileged status and shifts the focus to analyzing two preferred policy tools under that constraint: the redesign of trade tariffs and adjustments to the U.S. dollar's currency arrangements.

The second level of content analyzes the role of tariffs as the preferred policy tool in the U.S. government's economic and trade strategy. The *Miran Manual* argues that tariffs can reduce imports, ease trade deficits, and revive the domestic tradable manufacturing sector—core motivations behind the Trump administration's heavy reliance on tariff policy. Additionally, tariffs are expected to generate fiscal revenue. The AFTP document mentioned earlier even proposes the creation of a Foreign Revenue Service (ERS) to channel tariff proceeds toward easing fiscal deficits and debt pressure. The *Manual* offers a detailed discussion on why tariff wars might be effective, the factors that could limit their effectiveness, and how tariffs may impact inflation through price transmission mechanisms. While the discussion appears empirical and analytical, the author clearly supports tariff escalation, going so far as to cite approvingly research that estimates an "optimal" tariff rate of 20%—roughly the level the U.S. is expected to reach after announcing the new round of reciprocal tariffs.

Also notable is the report's forward-looking perspective on the structure of the global trade system. The central theme of the *Miran Manual* is "reconstructing the global trade system," and this reconstruction consists of two phases: destruction and creation. The post–World War II free trade order is to be dismantled via tariff wars—a process already underway under Trump 2.0. As for the reconstruction phase, the report proposes a framework inspired by Zoltan Poszar's classification of international security dimensions. It suggests that the U.S. integrate geopolitical security guarantees with national tariff levels—combining the "security umbrella" with the "tariff umbrella." Under this logic, countries would be categorized into three groups—friends, adversaries, and neutrals—based on multiple criteria. Each category would be assigned different tariff and security arrangements: allies would receive stronger security commitments and lower tariffs, competitors would face weaker security cooperation and higher tariffs, and neutral countries would fall somewhere in between. In essence, the report promotes a shift from globalization to bloc-based economic segmentation, with tariffs as a core instrument of geopolitical strategy. The targeting of emerging powers under this model is unmistakable.

The tariff war blueprint outlined in the *Miran Manual* runs counter to established economic principles and is unlikely to succeed. The goal of substantially reducing the trade deficit is difficult to achieve for several reasons, as illustrated by flaws in the USTR's equivalent tariff methodology. The assumption of a unitary elasticity of import demand is overly optimistic. For instance, the USTR assumes a tariff elasticity of 1, based on an import demand elasticity of 4, but other studies estimate this elasticity at 2 to 3. A lower elasticity means that the trade balance responds less to tariff hikes. Moreover, because the current U.S. tariff policy targets nearly all trading partners simultaneously, there is little scope to substitute across import sources, further reducing elasticity and blunting the adjustment effect. The USTR's assumption that other variables remain unchanged is also unrealistic.[10] In practice, tariffs are likely to cause the dollar to appreciate and trigger retaliatory actions from trade partners, both of which would weaken the intended effects. While tariff revenue may rise, the resulting increase in import prices will feed through to domestic inflation, eroding U.S. competitiveness and hurting consumers.

High tariffs may yield localized benefits in a few protected industries, but they cannot restore manufacturing to its historic share of the economy. The long-term shift toward global production networks have led to the offshoring of manufacturing tasks that involve lower value-added processes. These segments generally cannot support the high wage and input costs associated with a high-income economy like the United States. Even with a 20% tariff, it would be difficult to offset the wage and

[10] Assuming that offsetting exchange rate and general equilibrium effects are small enough to be ignored... (USTR: "Reciprocal Tariff Calculations").

productivity gap between the U.S. and emerging-market producers. Historical experience reinforces this view: in Trump's first term, a 25% protective tariff was imposed on steel and aluminum. Yet U.S. steel production fell by 9% and North American aluminum output rose by just 0.83%. At the same time, the U.S. aluminum surplus with Mexico declined while the deficit with Canada widened. These outcomes show that tariffs did not solve the competitiveness and trade imbalance issues in these sectors.

It follows that if reshoring were achieved on a larger scale, it would likely come at the cost of lowering overall economic productivity by expanding the share of low-efficiency activity—thereby reducing national income and living standards. In such a scenario, voters themselves may become the first to reject the logic of a protracted tariff war.

The third level of content concerns the conception of U.S. dollar monetary policy. This refers not to the conventional macroeconomic stabilization policies administered by the Federal Reserve, but to the broader set of tools aimed at reshaping the international monetary architecture surrounding the U.S. dollar and its derivative functions. Based on its diagnosis of the strategic challenges facing the U.S. economy, the Miran Manual outlines three proposed monetary strategies.

The first is a multilateral initiative in which major trading partners would jointly promote depreciation of the U.S. dollar. Drawing inspiration from the 1985 Plaza Accord—signed by the United States, Japan, West Germany, France, and the United Kingdom—the proposal envisions coordinated foreign exchange interventions and policy signaling to lower the dollar's value and ease the U.S. trade deficit. The Miran Manual refers to this hypothetical arrangement as the "Mar-a-Lago Accord." While the author is in favor of such an agreement in principle, he also acknowledges that the current economic and geopolitical environment is fundamentally different from the 1980s. Today, the largest holders of dollar-denominated reserve assets are no longer U.S. allies in Western Europe and Japan, but rather China, other East Asian economies, and oil-producing countries in the Middle East. This reality casts serious doubt on the feasibility of replicating a Plaza-style agreement.

The other two strategies are unilateral measures designed to change the terms under which foreign entities hold U.S. dollar assets, with the twin goals of easing U.S. fiscal and debt burdens and weakening the dollar by reducing demand for its reserve assets. One proposal is the introduction of "century bonds" that would require foreign investors—particularly allies—to exchange their current holdings of U.S. debt for 100-year, non-tradable, zero-interest bonds. Liquidity support would be provided via Federal Reserve swap lines, allowing foreign holders to meet cash needs without selling their assets. This plan amounts to a disguised default on existing debt obligations. Another proposal is to impose fees on foreign holders of U.S. Treasury securities, especially official holders such as foreign governments and central banks. These charges could be introduced through legislation or executive orders, for example by withholding a portion of interest payments.

Both proposals are coercive and unilateral, aiming to rewrite the rules of the current international monetary order in ways that favor U.S. interests. Naturally, such measures would likely provoke widespread resistance from international investors and could even trigger the collapse of the U.S. dollar's status as the world's primary reserve currency. To soften opposition, the Miran Manual outlines a carrot-and-stick mechanism: countries that accept these arrangements would receive security guarantees and tariff relief, while those that resist could face reduced military protection or punitive tariff increases. This approach reveals the explicitly transactional and hegemonic logic behind the proposals. That said, the report also includes a more neutral suggestion under the "Mar-a-Lago Accord" framework: encouraging foreign manufacturing firms to invest in the United States, with China identified as having the greatest potential for cooperation.

Despite their differences in implementation, the two unilateral options share three common goals. First, both aim to impose implicit costs on foreign investors—either through direct fees or the loss of interest income and real principal value under long-term, zero-yield bonds. Second, both seek to reduce U.S. fiscal pressures. With U.S. federal debt now exceeding US$36 trillion and interest payments projected to reach US$892 billion in 2024, reducing payments to foreign creditors would offer short-term fiscal relief. Third, both aim to reduce the dollar's exchange rate by lowering foreign demand for U.S. assets, thereby

boosting U.S. export competitiveness and supporting domestic manufacturing—consistent with the underlying logic that a weaker dollar benefits the tradable sector.

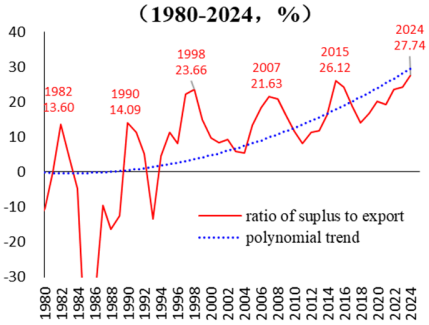
The “Mar-a-Lago Accord” remains a conceptual proposal and has not yet been adopted as formal policy. The Miran Manual concedes that these currency measures would have immediate impacts on global financial markets and could undermine confidence in the dollar. Given the Trump administration’s stated priority of preserving dollar hegemony, such policies are not currently under active consideration. Still, the *Manual* does not rule them out in the future and advocates sequencing—tariffs first, currency later—as the appropriate policy order. With the new round of unilateral tariffs now fully launched, it remains to be seen whether the U.S. will also pursue a monetary dimension to its strategic adjustment.

From the standpoint of economic logic and prevailing conditions, the tariff and currency policy alternatives laid out in the Miran Manual are unlikely to produce net benefits. They are improbable to meaningfully reduce the twin deficits or substantially revive the manufacturing sector. Yet they have already undermined the postwar international economic and trade order, intensified the global drift toward protectionism, and increased downside risks to global growth. From a strategic competition perspective, China’s strengthening economic fundamentals—particularly on the supply side—have provided crucial resilience against external shocks and a strong base for countering unilateral U.S. pressure. However, given persistent domestic demand weakness and a rising trade surplus, it is imperative to boost consumption and promote internal rebalancing in order to effectively respond to the dual strategy of security and tariffs embodied in the U.S. “two umbrellas in one” approach. The following section examines the structural features and drivers of China’s surplus expansion in recent years and explores potential domestic policy responses in light of evolving external conditions.

3. Characteristics of China’s Trade Surplus Expansion During the 14th Five-Year Plan

Observing the changes in the proportion of China’s goods trade surplus to exports over the reform period reveals six distinct peaks, reflecting the cyclical nature of trade balance shifts throughout the country's process of open economic development and growth. The first peak occurred in the early reform years, when efforts to adjust and consolidate the macro-economy led to short-term demand tightening. This coincided with supply-side expansion in basic goods like food and clothing, driven by institutional reform, which together contributed to surplus growth. The second and third peaks appeared around 1990 and at the end of the 1990s. In both cases, domestic demand weakened for various reasons—including the impact of the Southeast Asian financial crisis—resulting in a significant slowdown in growth and a temporary domestic oversupply that fueled the trade surplus. The situation during the early 2000s was unique: at that time, rapid productivity gains in the tradable sector and improved export competitiveness coincided with lagging structural and policy adjustments on the domestic front. As a result, domestic demand failed to keep pace with supply-side advances, leading to a sharp surge in the external surplus. The fifth peak occurred around 2013–2015, when overlapping cyclical, structural, and policy factors—including supply-side structural reform and efforts to reduce overcapacity—contributed to slower domestic demand and renewed surplus growth. The most recent episode has taken place in the current 14th Five-Year Plan period. Under the influence of complex internal and external conditions, and especially persistent domestic oversupply, China’s trade surplus has expanded again, with the surplus-to-export ratio reaching a record high. The following section outlines nine key features and implications of this latest round of surplus expansion.

Figure 1, China's surplus as a ratio to export for goods trade (1980-2024，%)



Sources： Wind, China's Customs, National Bureau of Statistics of China

Feature 1: The total amount of the current account has reached a new high, but the surplus as a percentage of GDP is still within the roughly normal range. When assessing a country's external balance from a macroeconomic perspective, one of the core indicators is the current account balance. In the first four years of the 14th Five-Year Plan, China's average annual current account surplus was US$367.8 billion, 2.43 times the annual average of US$151.2 billion during the 13th Five-Year Plan, and over 20% higher than the peak annual surplus of US$297.3 billion recorded in the 11th Five-Year Plan. On the other hand, due to the substantial expansion in the size of China's overall economy, the simple average of the current account surplus as a share of GDP during this period was 2.02%. While this marks a notable increase from 1.16% in the 13th Five-Year Plan, it remains well below the 7.24% peak reached during the 11th Five-Year Plan and is broadly within a balanced range. The International Monetary Fund (IMF), in its regularly published External Sector Reports (ESR), has in recent years assessed China's external balance as "broadly in line" with medium-term fundamentals. [11]

Figure 2, China's current account balance and its ratio to GDP（2001-2024，$100 million, %）

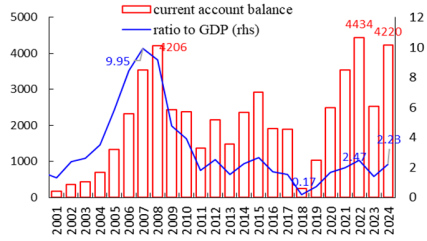
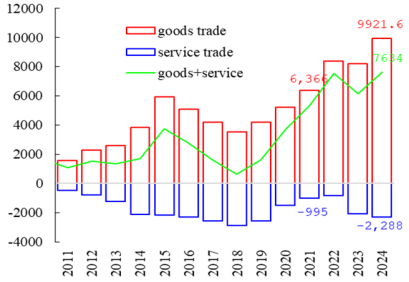


Figure 3, China's trade balances（2001-2024，$100 million）



Sources for fig.2: State Administration of Foreign Exchange, China. Sources for fig.3: National Bureau of Statistics of China.

Feature 2: Both the trade surplus and the proportion of GDP have increased significantly. In recent years, China's trade surplus in goods has soared, reaching US$992.1 billion in 2024, and averaging US$822.2 billion per year in the first four years of the 14th Five-Year Plan, which is 84.7% higher than the average surplus of US$445.1 billion during the 13th Five-Year Plan. China's trade in services continues to be in deficit, with an average annual deficit of US$155 billion in the first four years of the 14th Five-Year Plan, a decrease of 34.8% from the average of US$237.7 billion in the 13th Five-Year Plan. As a result, the total trade surplus rose from US$207.4 billion in the 13th Five-Year Plan period to an average of US$667.2 billion in the first four years of the 14th Plan, more than tripling; the total trade surplus accounted for 3.67% of GDP, far exceeding the 1.34% recorded during the 13th Five-Year Plan.

Feature 3: Within the goods trade, the expansion rate of the surplus of manufactured goods far exceeds the growth rate of the deficit of primary goods. The surplus of manufactured goods will reach

[11] IMF: *External Sector Report*, 2024, *"Imbalances Receding"*.

US$1.99 trillion in 2024, and the average annual value over the first four years of the 14th Five-Year Plan will be US$1.74 trillion, an increase of US$775 billion compared to the average annual surplus of US$965 billion in the 13th Five-Year Plan period, representing a rise of 80.3%. At the same time, China's trade deficit in primary goods also increased significantly to US$898.9 billion in 2024, with a four-year average of US$889.7 billion, up by US$388.5 billion from the average of US$501.2 billion during the 13th Five-Year Plan period, an increase of 77.5%. The absolute increase in the primary goods deficit is roughly half the increase in the manufactured goods surplus, and its growth is also slightly smaller in relative terms, highlighting the dominant role of manufacturing in driving the recent expansion of China's trade surplus.

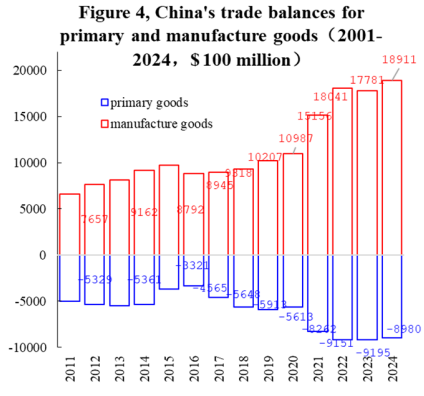


Figure 4, China's trade balances for primary and manufacture goods（2001-2024，$100 million）

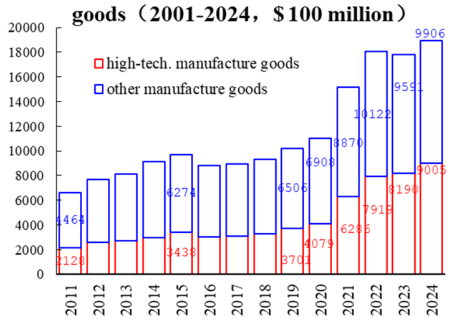


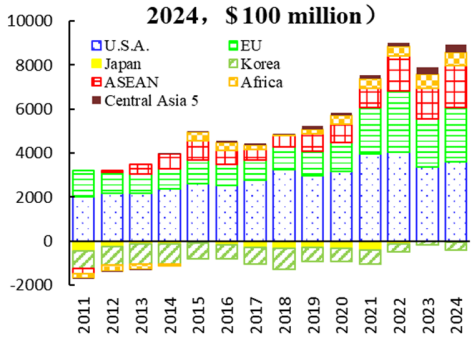
Figure 5, China's trade surplus for high-tech. and other manufacture goods（2001-2024，$100 million）

Sources for fig.4: China's Customs. Sources and notes for fig.5: China's Customs. The classification of the two types of manufactured goods is estimated by the author based on relevant conceptual definitions and data collation.

Feature 4: Within manufactured goods, the surplus of high-tech manufactured goods has accelerated and soared, while the surplus of traditional industries, including low-end and medium-end sectors, has also grown rapidly. In the first four years of the 14th Five-Year Plan, the average annual surplus of high-tech manufactured goods was US$785 billion, an increase of US$442.7 billion from the annual average of US$342.3 billion in the 13th Five-Year Plan period, more than doubling the increase. For example, the "new three" sectors of electric vehicles, lithium batteries, and solar cells had a total export of less than US$15 billion in 2018, and exports reached US$131 billion in 2024, creating an incremental surplus of more than US$100 billion. Another example is the chemical basic raw materials industry, which has changed from an average annual deficit of about US$50 billion in the 13th Five-Year Plan period to an average annual surplus of US$25.8 billion in the first four years of the 14th Five-Year Plan. However, the surplus of traditional manufactured products in China, including low-end and medium-end manufactured products, has also grown rapidly: the average in the first four years of the 14th Five-Year Plan was US$962.2 billion, an increase of US$339.5 billion from the average of US$622.7 billion in the 13th Five-Year Plan period, an increase of 54.5%. The trade surplus in manufactured goods shows the characteristics of "surging in the middle and high-end and rapid growth in the middle and low-end", which may be related to the fact that governments at various levels in China implement their own industrial policies in various ways and objectively hinder the exit of certain traditional industries.

Feature 5: The regional distribution of surpluses shows a trend of diversification and dispersion, but the major economies of the United States and Europe still account for the vast majority. As far as China's trade with the seven countries and economies that account for 86% of global GDP is concerned, the specific situation of China's goods surplus during the 14th Five-Year Plan is as follows: the surplus with ASEAN increased by 1.2 times, more than tripled with the five Central Asian countries, increased 1.3 times with the EU, and rose only 30% with the United States. The combined share of China's trade surplus with the United States and Europe fell from about 90% during the 13th Five-Year Plan to an average of 76% in the first four years of the 14th Five-Year Plan, indicating a significant decline in dependence on major developed economies. However, the U.S. and European markets remain the primary destinations for realizing China's trade surpluses. In addition, data suggest that China has achieved a certain degree of surplus diversion from the United States through outward foreign direct investment (OFDI) via several third countries.

Figure 6, China's trade balances for major trade partners（2001-2024，$100 million）



Sources and notes for fig.6: China's Customs. Central Asia 5 are Kazakhstan, Uzbekistan, Tajikistan, Kyrgyzstan, Turkmenistan.

Feature 6: China's global share of trade in goods and trade surpluses in manufactured goods has increased significantly. First, China's share of the global goods trade surplus rose from 17.5% in 2018 to 36.6% in 2024. Second, its share of the global manufactured goods surplus increased from 47.8% in 2020 to 64.8% in 2024. This elevated global share reflects the strong external competitiveness of China's open economy. However, under the current conditions of heightened volatility in the global trade environment, any broad-based contraction in external demand would expose China to greater risks.

Figure 7, China's goods trade surplus and its share of the global total（2001-2024*，$100 million, %）

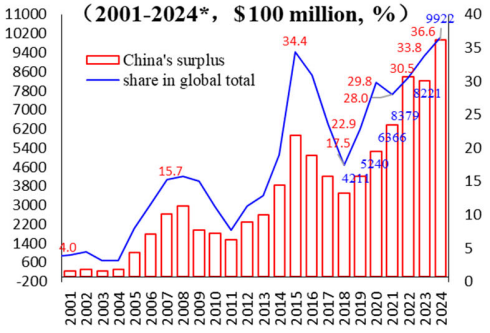
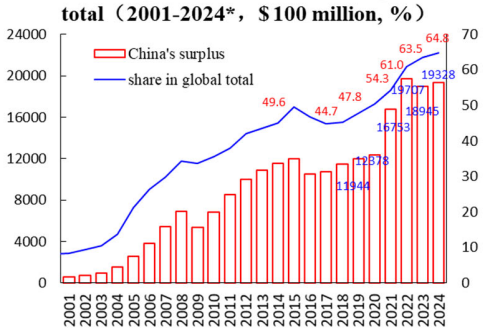


Figure 8, China's manufacture goods trade surplus and its share of the global total（2001-2024*，$100 million, %）



Sources and notes: World Bank "(World Integrated Trade Solution: WITS"; The global surplus data for 2024 is not yet available. It is estimated based on the relationship between the growth rate of China's surplus and the change in the proportion of the surplus from 2010 to 2023, combined with the data of China's surplus growth rate in 2024.

Feature 7: China's economic growth has become significantly more dependent on external demand. Affected by the pandemic and other factors, China's average economic growth rate has fallen slightly below 5% since 2020, while its reliance on external demand has increased significantly. In the first four years of the 14th Five-Year Plan, the share of GDP growth driven by external demand[12] averaged 0.77 percentage points—substantially higher than the 0.08 percentage point average during the 13th Five-Year Plan. From a historical perspective since the start of the new century, this figure is only below 1.07 percentage points, the level recorded during the period of pronounced imbalances from 2005 to 2008. In terms of the contribution rate of external demand to GDP growth, the annual average reached 13.17% during the first four years of the 14th Plan, far exceeding the 5.24% of the previous Plan period and even

[12] This indicator measures the GDP growth rate under the assumption that the contributions of the other two components of the growth troika—investment and consumption—are zero.

surpassing the previous historical peak of 8.56% from 2005 to 2008.[13] Notably, after the trade surplus surged in the early 2000s, the contribution of external demand to growth dropped sharply in the wake of the global financial crisis, falling to -42.2% and -10.6% in 2009 and 2010, respectively, with corresponding negative contributions to GDP growth of -3.97 and -1.12 percentage points. This historical experience warrants close attention. In the current context of a sharp reversal in the external environment and an escalating tariff war launched by the United States, preparing for potential negative feedback from a trade-surplus-driven growth model has become an urgent task.

Figure 9. Contribution for GDP growth in percentage point by external demand (2000-2024)

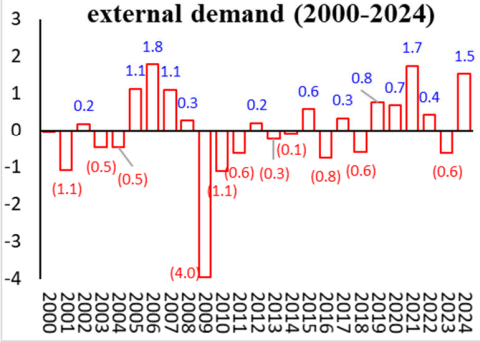
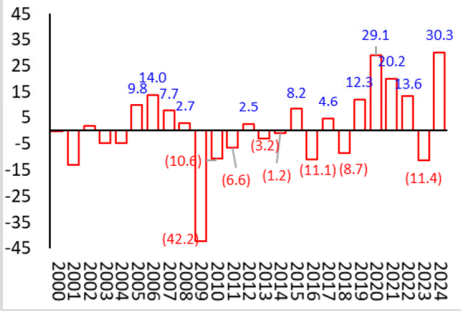


Figure 10. Contribution ratio for GDP growth by external demand (2000-2024, %)



Sources: National Bureau of Statistics of China

Feature 8: In 2023, trade protectionist policies in the United States and other Western developed countries intensified, with the Trump administration pushing the use of tariff tools to an extreme. During the 2021–22 pandemic period, the U.S. and the West were relatively tolerant toward trade imbalances, but beginning in the second half of 2023, they shifted to unilateral tariff measures aimed at suppressing China's "new three" exports.[14] In May 2024, the United States announced an additional 100% tariff on Chinese electric vehicles. On July 4 of the same year, the European Union imposed temporary tariffs on what it called subsidized Chinese EVs, and on August 26, Canada followed by announcing a 100% tariff on all Chinese electric vehicle imports. As noted earlier, the Trump administration has repeatedly wielded tariffs as a political and economic weapon, culminating in the recently introduced "reciprocal tariff" policy, which represents a particularly extreme implementation of tariff protectionism.

Feature 9: China faces a record number of trade investigations in the WTO, indicating that the external economic and trade environment is tightening across the board. In 2021–2022, the number of WTO trade investigations involving China was relatively low, but over the past two years, cases have surged, especially in 2024, when they reached an all-time high of 198—representing a 59.7% increase over the previous peak of 124 in 2009. While WTO trade disputes excluding China also rose in 2024 to 237 cases, this figure ranks only as the fifth highest year historically and remains 30.4% below the peak of 309. Notably, China alone accounted for 111 of the 206 additional global disputes in 2024, or 53.4% of the global increase. These figures suggest that the unprecedented level of trade investigations against China last year was not merely the result of heightened global trade tensions, but also reflects a degree of China-specific pressure in the international trade system.

[13] This indicator measures the contribution of external demand to GDP growth at a given growth rate. For example, if GDP grows by 5% in a given year and the contribution rate of external demand is 10%, it means that 10% of the 5% GDP growth is driven by external demand—equivalent to an external demand contribution of 0.5 percentage points.
[14] Lu Feng, Li Xin, Pan Song, and Li Jiang: "Will Trade Imbalance Return to the Spotlight of International Dialogue? —An Interpretation of the Rebound in China's Trade Surplus in Recent Years," *NetEase Finance Intelligence*, September 4, 2023.

Figure 11. Trade remedy cases against China and its share in the total cases in WTO （1995-2024，%）

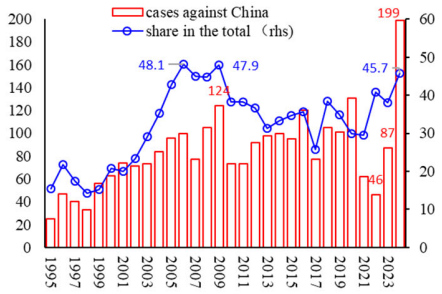
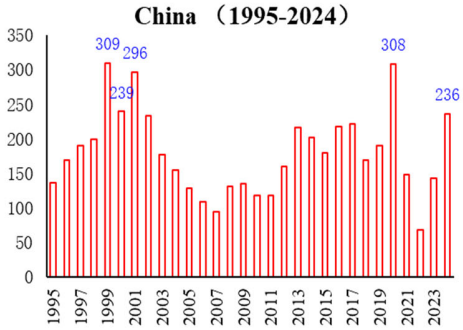


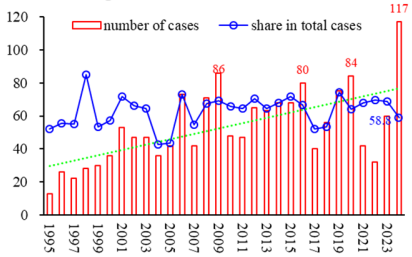
Figure 12. Total trade remedy cases in WTO excluding those against China （1995-2024）



Sources: China Trade Remedy Information Network of the Ministry of Commerce of China. https://cacs.mofcom.gov.cn/cacscms/view/statistics/ckajtj，Date of access: March 8, 2025.

In addition to developed economies such as the United States and the European Union, a growing number of developing countries—including some with relatively low income levels that have traditionally benefited from China's foreign assistance—have begun launching trade investigations against China. According to data referenced above, 117 WTO trade investigations against China in 2024 originated from developing countries, accounting for nearly 60% of all cases that year. Even Pakistan, a low-income neighbor with longstanding ties to China, initiated five separate trade cases in 2024. The factual evidences diverge from the conventional view that trade frictions involving China are primarily driven by advanced economies. It suggests that China's export surplus is expanding not only in mid- to high-end and emerging industries, but also in more traditional and even relatively lower-end sectors—exerting pressure on trading partners across a wide income spectrum and contributing to a general tightening of China's external economic relations.

Figure 13. Trade remedy against China in WTO initiated by developing country and its share in total cases against China （1995-2024）



Sources: China Trade Remedy Information Network of the Ministry of Commerce of China. https://cacs.mofcom.gov.cn/cacscms/view/statistics/ckajtj，Date of access: March 8, 2025.

This development raises an important question: Given Pakistan's much lower level of economic development, in which sectors does it perceive China's exports as directly threatening its domestic producers—enough to warrant multiple WTO trade actions? Several complex factors may be at play. On one hand, Pakistan may be overprotecting certain domestic industries. On the other hand, from China's perspective, the phenomenon may reflect deep-rooted structural issues in the multi-level industrial policy environment.

At the national level, China's industrial policy emphasizes cutting-edge innovation and technological upgrading. In coastal provinces and large cities, industrial strategies also tend to prioritize high-end sectors. However, in prefecture-level cities and counties in economically lagging regions, local governments often support relatively lower-end segments of the industrial structure, which may directly compete with industries in low- and middle-income countries. Thus, the growing frictions with

developing countries may partly stem from distorted factor prices and income distribution within China itself, which reinforce the persistence of traditionally production models in lower-tier regions.

To illustrate this point, the author examined a manufacturing enterprise located in a development zone in a relatively underdeveloped county in eastern China, producing goods similar to that involved in one of the Pakistani investigations.[15] The company began production in 2006, and while it was considered locally advanced at the time, its technology and processes have remained largely unchanged for nearly two decades. In a context of structural transformation and gradually rising factor costs, such operations probably ideally have either upgraded or exited the market. Yet the firm continues to operate at partial capacity, selling both domestically and abroad. Importantly, the blame for this inefficient resource allocation does not lie with the firm or its workers—market participants naturally act based on prevailing opportunity costs. The real issue is the absence of viable alternatives for industrial transformation, and a lack of pressure from appropriately priced factors of production. This case reflects the deep level of contradictions between the elements of internal and external imbalances in China's open economy.

4. The internal and external causes of the growth of trade surplus in recent years

In recent years, the global economy has undergone a series of shocks and rare fluctuations. During this period, China has experienced a large increase in trade surpluses and pattern of structural external imbalances, driven by a combination of domestic and international forces. Preliminary analysis suggests that at least six key factors—both external and internal—have shaped the recent trajectory of China's external trade balance. Among these, domestic imbalance or the phenomenon of strong supply and weak demand appears to be particularly influential in explaining the surplus dynamics. The following section examines each of these six factors in turn, followed by a broader discussion of their combined effects on the external balance.

Reason 1: The impact of differing anti-crisis policies adopted by China and major developed economies during the pandemic. In response to the sudden shock of COVID-19, China and advanced economies implemented distinct crisis management policies based on their respective national circumstances. China's stimulus efforts were primarily directed at subsidizing supply-side enterprises to support the resumption and expansion of production, while providing relatively limited direct transfers to households. This led to a rapid rebound in production capacity but muted growth in household consumption. In contrast, the United States and Europe implemented large-scale income support programs targeting households, which spurred strong consumption growth but left corporate production recovery comparatively weaker. This mirror-image policy configuration between supply-driven China and demand-driven Western economies was transmitted through trade linkages and became a key driver of China's widening trade surplus during the pandemic. The effects of this divergence were especially pronounced between 2020 and 2022, during which time China's surplus with the United States reached record highs, and its surplus with the European Union doubled. This pattern has been widely analyzed in academic research, including a 2022 article by the author.[16]

Reason 2: Closely linked to the first reason, during the pandemic, major developed economies in the United States and Europe implemented excessive stimulus policies that triggered severe inflation. To rein in inflation, these countries were forced to raise interest rates, which in turn drove up their exchange rates, eroding foreign trade competitiveness and indirectly boosting China's trade surplus as a key trading partner. Even before the pandemic, advanced economies were already experiencing slower productivity growth in tradable sectors such as manufacturing compared to emerging markets, weakening their competitive position. During the pandemic, under the influence of a policy mindset that

[15] Because the Pakistan WTO trade investigation case did not disclose specific information about the Chinese companies involved, it is not possible to determine whether the enterprise examined by the author is among those targeted in the investigation.

[16] Lu Feng: *Mirror Image of the Sino-U.S. Economy During the Pandemic*, published on the official website of the National School of Development at Peking University, 2022-03-23.
Lu Feng: *Characteristics and Causes of Economic Growth During the Pandemic*, published on the official website of the National School of Development at Peking University, 2022-12-21.

favored prolonged stimulus, they introduced massive support packages—unprecedented in scale and directly targeted at households—which led to the worst inflation in the U.S. and Western countries in four decades, peaking in 2021. The subsequent monetary tightening and rapid interest rate hikes drove up real exchange rates in these economies, contributing to widening trade deficits. This loss of competitiveness among developed countries became a significant external driver of China's expanding trade surplus.

Figure 14. Policy interest rates for U.S.A., Euro Area, UK and China (2020M1-2024M12，%)

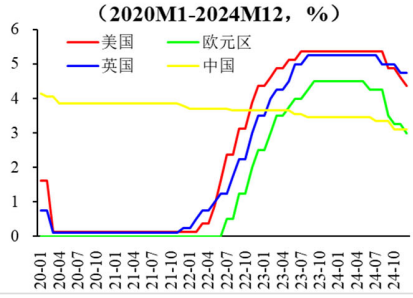
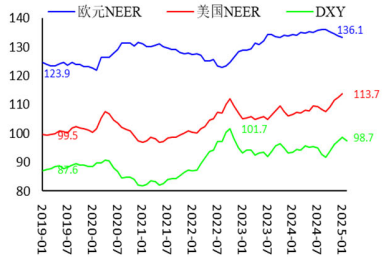


Figure 15. USD index (DXY) and nominal effective exchange rate for USD and Euro (2001.01-2005.01, 2001.1=100)

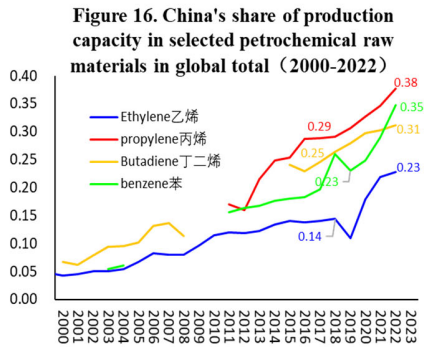


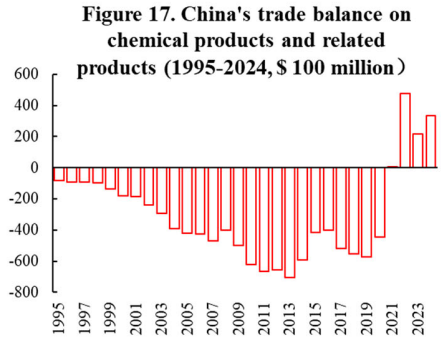
Sources: BIS

Reason 3: In recent years, significant breakthroughs in the upgrading of China's manufacturing sector have created new comparative advantages in mid-to-high-end and emerging industries, driving export growth and import substitution, thereby contributing to the expansion of the trade surplus. While external shocks and exceptional global conditions have played a role, a full understanding of China's extraordinary trade surplus growth and structural external imbalances must focus on domestic supply and demand dynamics. Two key developments warrant attention. First, China's tradable sectors have achieved clear, phased advances in industrial technology, substantially boosting supply-side capacity and external competitiveness. This is a positive achievement that aligns with the supply-side objectives of the "dual circulation" strategy. Second, domestic demand—particularly household consumption—has remained relatively weak and, for various reasons, has continued to lag behind. This growing divergence between supply-side progress and demand-side insufficiency has contributed to the sharp expansion in the trade surplus and the deepening of structural imbalances.

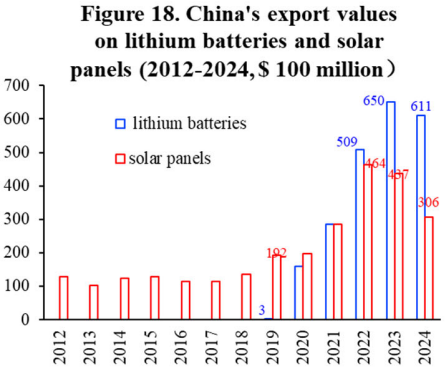
China's industrial transformation and upgrading since the beginning of reform and opening-up has unfolded in three broad stages. The first, from the 1980s to the early 1990s, was driven by institutional reforms that reshaped the state-owned industrial base, leading to the rapid development of light industry, consumer goods, and processing industries in an open market setting. The second, from the early 1990s through around 2010, was characterized by accelerated industrialization and urbanization. This phase saw the rise of heavy industry, expansion of full industrial chains, and a dramatic increase in the capital and technological intensity of manufacturing, with many sectors growing to world-leading scale. The third and current stage, unfolding in recent years, features an upgrade to mid-to-high-end capabilities across the manufacturing system, with some sectors advancing to the global frontier. Notable progress has been made in areas such as advanced shipbuilding, rail transit, basic petrochemical materials, large aircraft, medical equipment, semiconductor fabrication, and industrial robotics.

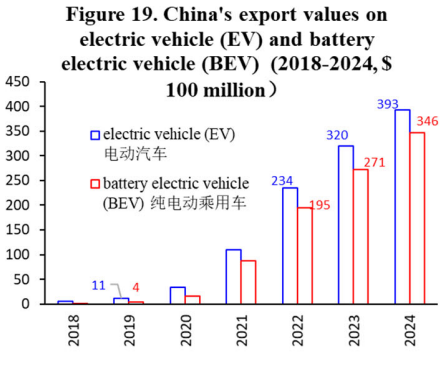
Two sectors in particular illustrate these trends. First, the rapid increase in capacity for producing basic chemical raw materials has shifted China's trade position in this area from deficit to surplus. Second, the emergence and rapid growth of the "new three" green industries—electric vehicles, lithium batteries, and solar cells—have exceeded expectations, with strong gains in domestic production and consumption as well as a marked rise in export surpluses.





Sources for Fig. 16: Estimated according to the information provided by China Petroleum and Chemical Network, China Industrial Economy Information Network, as well as domestic and foreign industry analysis institutions. Sources for Fig. 17: China's Customs





Sources: China's Customs

Reason 4: The adjustment of the real estate market has a temporary suppressive effect on domestic demand. Since the implementation of the "three red lines" policy in 2020, the domestic real estate sector has undergone a deep adjustment. The data below show that indicators such as real estate sales, financing, investment, and prices have all experienced the largest adjustments since the marketization of the real estate industry at the end of the last century. Real estate is one of the industrial sectors with significant macroeconomic impact. While the new policy has achieved positive results in releasing the contradictions accumulated by the industry over the years of excessive expansion, it has also had an objective restraining effect on fixed investment and residents' consumption through different channels. In addition, under China's special land fiscal system, the deep adjustment of real estate has been accompanied by a sharp contraction in the income of local government land operating funds, which has further dragged down domestic investment and consumption through the reduction of local expenditures. Insufficient domestic demand, especially weak consumption, increases dependence on external demand and translates into growth in export surplus.

Figure 20. Values of sales, investment and finance for China's real estate sector (2010M01-2024M12, ￥100 million）

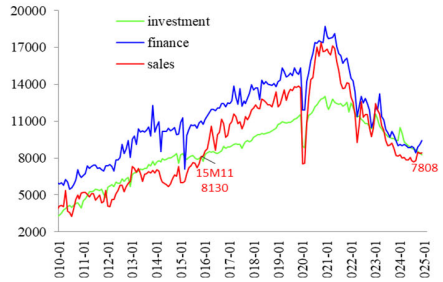


Figure 21. Growth rates of sales, investment and finance for China's real estate sector (2019M01-2024M12, %）

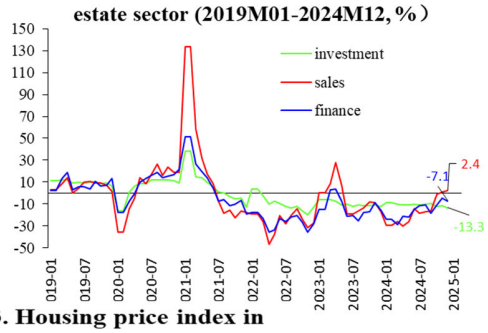


Figure 22. Price of residential building and its yoy growth rate (2010M1-2024M12, ￥/m2, %)

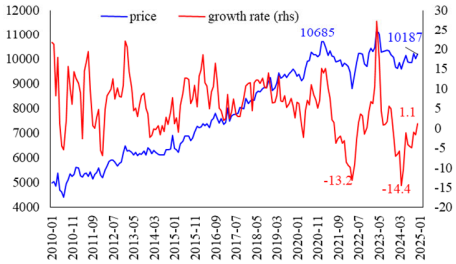
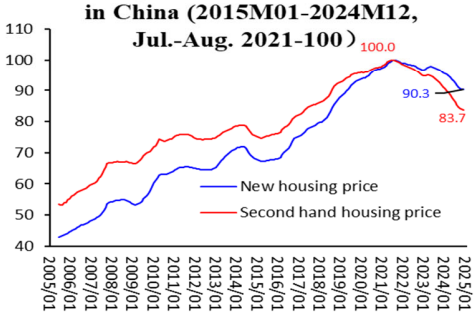


Figure 23. Housing price index in 70 large and medium-sized cities in China (2015M01-2024M12, Jul.-Aug. 2021-100）



Sources：National Bureau of Statistics of China

Reason 5: Weak final consumption is one of the underlying reasons that boosted the trade surplus. Relatively low consumption has been a persistent issue in China's macroeconomic analysis since the end of the last century. Although the share of household consumption in GDP rebounded significantly during the second decade of the new century, it has declined again in recent years, making the issue more difficult to address. While both consumption and investment are fundamental components of domestic demand in macroeconomic terms, they serve different functions when it comes to maintaining a dynamic balance between supply and demand. Fixed investment, though classified as demand during its implementation, becomes new productive capacity once completed, thereby shifting to the supply side and requiring additional demand to absorb the output it enables. In contrast, consumption represents the final form of demand and thus plays a unique role in sustaining aggregate supply-demand equilibrium. If consumer demand remains weak, investment can act as a temporary demand substitute to absorb excess supply, but it cannot resolve the root problem. In an open economy, this imbalance is ultimately channeled into a larger-scale expansion of the external surplus.

Figure 24. Per capita GDP for China, world average and selected groups of countries (2000-2023, USD)

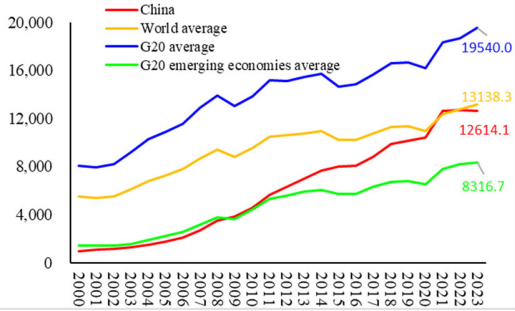
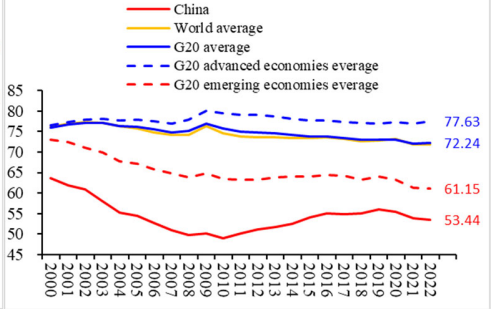
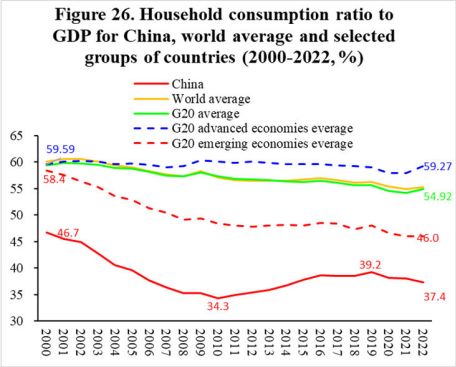
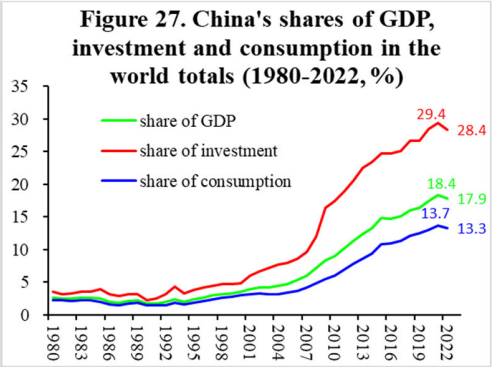


Figure 25. Consumption ratio to GDP for China, world average and selected groups of countries (2000-2022, %)



Sources: The World Development Indicators (WDI)





Sources: IMF WEO and The World Development Indicators (WDI)

There have been numerous studies in academic and policy circles examining the reasons behind China's persistently weak consumption in recent years, addressing factors such as the scarring effects of the COVID-19 pandemic, the delayed response of countercyclical macroeconomic policies, and the constraining impact of stringent real estate regulations. The author argues that, in the longer term, a fundamental issue lies in the allocation of public resources: a disproportionately large share has been directed toward enhancing supply-side capacity, while relatively small share has been used to support household income and consumption. Based on China's broad fiscal framework—the so-called "four accounts"—along with state-owned enterprise profits and public-sector depreciation, it can be estimated that roughly 45% of GDP is controlled by the public sector. A longstanding feature of China's resource allocation pattern is that most public resources is channeled into various forms of investment that have in large part boost supply-side capacity. This approach has made critical contributions to advancing national productivity and industrial upgrading. However, the share of public investment used to directly support household income and consumption remains limited. As a result, while supply capacity has continued to expand substantially, the lack of matching growth in domestic demand—especially consumption—has reinforced the imbalance between strong supply and weak demand, which in turn has shaped the structure of China's external trade surplus.

Reason 6: The weak general price trend in recent years and the significant depreciation of the real exchange rate of the RMB have contributed to the expansion of the trade surplus. According to the logic of open-economy growth, a country undergoing rapid productivity catch-up should experience a gradual appreciation of its real exchange rate, which facilitates structural upgrading, maintain external balance, and underpins sustained growth in per capita income—a dynamic known as the Balassa-Samuelson effect, well-documented in international experience. In the early 2000s, China's sustained real appreciation of the RMB accompanied a period of strong economic expansion, consistent with this effect.[17] In recent years, despite multiple economic shocks, the RMB's nominal effective exchange rate has remained relatively stable, indicating continued underlying competitiveness and resilience. However, due to persistent oversupply and subdued domestic prices—combined with high inflation abroad—the real effective exchange rate of the RMB has fallen sharply. Over the past year, the index has reverted to 2013 levels, marking a 12.5% depreciation from its 2016 peak. Under conditions of rapid industrial upgrading and productivity gains, real depreciation contradicts the Balassa-Samuelson logic. This

[17] Many years ago, I with my collaborators published several papers analyzing this issue. See: Lu Feng (2006), "The Puzzle of the RMB Real Exchange Rate (1979–2005): Challenging Issues Raised by China's Economic Catch-Up Practice," *Quarterly Journal of Economics*, Vol. 5, No. 3, April 2006; Lu Feng and Han Xiaoya (2006), "Long-Term Economic Growth and the Evolution of the Real Exchange Rate: The Balassa-Samuelson Effect Hypothesis and Its Empirical Evidence," *Economic Research*, No. 7, 2006; Lu Feng (2006), "The Deep Roots and Cognitive Enlightenment of Foreign Exchange Reserves Exceeding One Trillion US Dollars: Opportunities and Challenges in the New Stage of China's Economic Growth," *World Economy*, No. 11, 2006; Lu Feng and Liu Liu (2007), "China's Two-Sector Labor Productivity Growth and International Comparison (1978–2005): A Reexamination of the Relationship Between the Balassa-Samuelson Effect and the RMB Real Exchange Rate," *Quarterly Journal of Economics*, Vol. 6, No. 2, January 2007.

"reverse Balassa-Samuelson effect," driven by special circumstances, has artificially enhanced China's external price competitiveness and further expanded the trade surplus.

Figure 28. China's monthly yoy growth rates of CPI and GDP deflator (2000M01-2025M03, %)

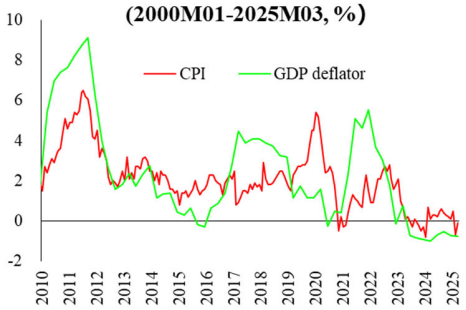
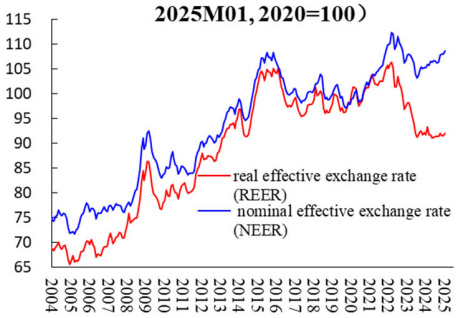


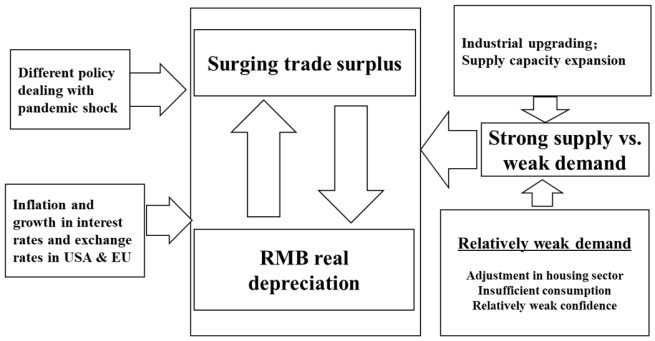
Figure 29. RMB's nominal and real effective exchange rates (2004M01-2025M01, 2020=100)



Sources: BIS

It should be emphasized that the six international and domestic drivers of China's recent trade surplus growth are not mutually independent, but rather interrelated and mutually reinforcing. For instance, the pandemic and the adjustment in the real estate sector have suppressed household consumption through different channels, while movements in the real exchange rate reflect a broad interplay of domestic and global macroeconomic conditions and policy responses. Overall, the surge in China's trade surplus and associated structural imbalance during the 14th Five-Year Plan period should not be viewed as a short-term outcome of currency depreciation in real terms alone. Instead, it reflects a deeper projection of temporary oversupply—or the broader contradiction of "strong supply and weak demand"—onto the external sector under the combined effects of the pandemic and external inflation. This highlights the urgent need for coordinated internal and external policy responses, particularly through comprehensive efforts to expand domestic demand, raise incomes, and enhance consumption.

Figure 30. Schematic diagram of the causes of trade surplus surge in China in recent years



5. Counter the tariff war externally and promote rebalancing domestically.

To summarize the above discussion, the current domestic and international economic landscape exhibits several key characteristics. First, externally, "great changes unseen in a century" are accelerating, marked by rising geopolitical tensions, a resurgence of unilateralism and protectionism, and intensifying economic pressure from the United States, which has increasingly identified China as its principal strategic competitor and escalated the tariff war accordingly. Second, domestically, the economy has sustained medium-to-high growth, particularly with significant advances in the industrial manufacturing sector, where the tradable sectors of the national economy have seen rapid improvement in technological capability and overall supply-side strength—evidence of the phased success of China's long-standing emphasis on productivity enhancement. Third, in terms of aggregate supply and demand dynamics, although demand has continued to grow—with emerging areas of consumption showing renewed

momentum—domestic demand, and household consumption in particular, remains insufficient. This has led to a persistent imbalance characterized by strong supply and weak demand, resulting in a large and growing trade surplus that now faces elevated external risks amid a shifting external global environment.

A dialectical view of the current situation must begin by acknowledging China's robust supply-side performance: the manufacturing sector is thriving, high-tech industries are catching up rapidly, and the domestic market offers immense potential and resilience. The tariff war launched by the United States is fundamentally unpopular and, given its internal contradictions and growing international opposition, is unlikely to succeed. This provides an objective basis for maintaining strategic composure and confidence. At the same time, China must remain clear-eyed about specific transitional features of its development—namely, the coexistence of insufficient domestic demand and excessive external surpluses—and recognize the adjustment pressures these bring under the new external constraints imposed by the tariff war. In this evolving environment of compounded crises, it is imperative to respond externally by confronting and pushing back against economic coercion, while domestically accelerating structural rebalancing. This requires a dual-track strategy: on the one hand, firmly resisting decoupling and external pressure; on the other, using the external shock as a catalyst to address long-standing domestic imbalances, especially the persistent shortfall in household consumption. By turning external challenges into drivers of internal reform, China can lay a firmer foundation for achieving its long-term modernization goals.

5-1. The top priority is to deal with the US tariff war with both hands

In the face of Trump 2.0's long-term strategy of intensified suppression and containment of China—especially the frequent tariff offensives since his return to office and the recent escalation with so-called "reciprocal tariffs"—China must adhere to a dual-track response strategy.

As emerging economies continue to catch up and the global landscape evolves, the relative decline of U.S. economic hegemony from it peak in the period immediately following the second world war is a structural trend. However, the United States is unlikely to accept this calmly and will likely continue to resist by deploying tools it deems favorable—tariff wars included—and will inevitably focus its energy on targeting the largest emerging economy. These frictions are not easily resolved through dialogue alone. Recognizing this historical dynamic, China must respond with firm principles and strategic resolve to safeguard its core interests.

On April 2, 2025, the U.S. announced the imposition of "reciprocal tariffs" on all trading partners. The following day, China's Ministry of Commerce stated that "China firmly opposes this and will resolutely take countermeasures to safeguard its own rights and interests." By April 4, relevant Chinese authorities had announced a broad suite of countermeasures: a 34% tariff on all U.S.-origin imports in addition to current rates; filing a WTO dispute case against the U.S. over these reciprocal tariffs; export controls on seven categories of medium and heavy rare earth products; blacklisting 16 U.S. entities from dual-use item exports; sanctions against 11 U.S. firms under the unreliable entity list; anti-dumping investigations on U.S. and Indian CT tube imports; suspension of poultry product imports from two U.S. companies; and halting imports of poultry bone meal from three U.S. firms. These coordinated countermeasures make clear China's stance and confidence in resisting economic coercion.

Given the unique nature of the current U.S. tariff war—targeting not just China but most trading partners—China should actively pursue bilateral and plurilateral economic diplomacy with developing countries, BRICS members, and non-U.S. Western developed economies (i.e., traditional U.S. allies). Simultaneously, China should take advantage of multilateral platforms such as the G20, IMF, and World Bank Spring and Annual Meetings to speak out for fairness, mobilize international support against U.S. protectionism, and jointly resist anti-globalization impulses. China should also deepen cooperation with other countries in exploring reforms to multilateral economic and financial governance, especially as the U.S. hesitates or withdraws from global cooperation, thereby checking the negative spillovers of its unilateral policies.

At the same time, China has made clear through official channels that it does not rule out negotiation, stating that the U.S. should "immediately cancel its unilateral tariff measures and resolve disputes with trading partners through equal dialogue." Should the U.S. change course, China may respond

constructively, including on issues such as implementation of the Phase One trade deal or encouraging Chinese firms to invest in the U.S. Although such proposals are not actionable under the current standoff, they remain relevant should the external environment shift.

Moreover, with the global economy facing overlapping crises—climate change, sovereign debt risks, low growth, widening inequality—the U.S., if not fully committed to isolationism, must ultimately engage in multilateral governance. Continued cooperation among China, the U.S., and others within forums such as the G20, World Bank, and IMF could serve as a counterbalance to further escalation. Lastly, vigilance is needed: China must prepare for heightened global economic and financial instability, including the risk of a new recession triggered by U.S. tariff policy.

5-2. Implement the dominant strategy of expanding domestic demand and rebalancing

General Secretary Xi Jinping once noted: "Since reform and opening up, we have encountered many external risks and shocks, but have always been able to overcome them. This is because we have done our own things well and placed development on a domestic footing."[18] At its core, major power diplomacy hinges on domestic governance. In the face of significant changes in the external environment, the fundamental task is to adopt a problem-oriented approach to resolve key obstacles to high-quality development, thereby laying the groundwork for sustainable domestic growth, transforming crises into opportunities, and gaining strategic initiative.

As discussed earlier regarding the cyclical link between China's external balance and domestic economic growth, the sharp increase in trade surpluses in the early 2000s was followed by the U.S. financial crisis, which exerted significant adjustment pressure on China. Although the crisis was managed through G20-led cooperation and coordinated stimulus by major economies, it still led to a contraction in China's external demand equivalent to 4.0 and 1.1 percentage points of GDP in 2009 and 2010, respectively. This required a compensatory increase in domestic demand of 5.1 percentage points just to maintain pre-crisis growth. In the current context, with the U.S. tariff war undermining the foundations of international economic policy coordination, a potential recession may trigger even more unpredictable consequences. Therefore, while China must respond forcefully to U.S. tariff aggression, it must also strengthen domestic foundations on both the supply and demand sides—particularly by addressing the shortfall in domestic demand and relatively weak consumption—and accelerate the rebalancing of its growth model.

Economic rebalancing is not only necessary for mitigating external shocks but also for fostering more sustainable, high-quality development. It requires first ensuring a robust trajectory of supply-side improvement. To that end, China should continue to allow the market to play a decisive role while also leveraging the supportive functions of government. By drawing lessons from past successes in productivity and supply capacity growth, and further advancing supply-side structural reforms that emphasize institutional endpoints, China can consolidate gains in emerging industries and innovation, improve efficiency, and tackle persistent challenges such as overextended industrial systems, insufficient specialization, and dependence on foreign core technologies.[19]

On the demand side, in light of the persistent imbalance between strong supply and insufficient demand, as well as the expansion of external surpluses, it is essential to enact comprehensive policy responses. These include macroeconomic stabilization, structural reforms, and institutional adjustments aimed at expanding domestic demand and boosting consumption. Since late September of last year, a series of monetary, financial, and risk-focused fiscal policies have already begun to yield positive results for rebalancing efforts. Looking ahead, greater emphasis could be placed on income distribution reforms. For example, the share of household income in GDP could be raised through public finance reform and improved access to equalized public services across urban and rural areas. In the short term, centrally

[18] Xi Jinping: "Explanation on the CPC Central Committee's Proposal on Formulating the 14th Five-Year Plan for National Economic and Social Development and the Long-Term Goals for 2035," Xinhua News Agency, 2020-11-03.
[19] Xi Jinping: "Explanation on the 'Decision of the CPC Central Committee on Further Comprehensively Deepening Reform and Promoting Chinese-Style Modernization'," Xinhua News Agency, 2024-07-21.

financed policies might prioritize raising pensions for the most vulnerable and reducing or exempting healthcare premium obligations for low-income groups.

In parallel, institutional reforms that do not require large fiscal outlays can also be impactful. These include reforms to land property rights, household registration, and the legal framework. Such changes are essential for restoring demand and confidence. For instance, the needs of reforms in rural land rights and urban residency systems are widely recognized in the academic community as key to unlocking household consumption. While pilot programs and localized trials have progressed in recent years, deeper reforms now require political resolve.

Finally, although it is historically reasonable that China's public sector has long prioritized supply-side investments, current conditions call for a gradual and carefully designed shift in resource allocation. This means moderately increasing investments in people's livelihoods, especially for low-income groups, to raise actual and expected household income levels. Doing so will directly address the structural problem of weak consumption and its knock-on effects, and place China's economy on a more balanced and resilient footing.

It should be pointed out that intensifying the rebalancing policy efforts to target unbalanced growth factors is an inherent requirement for achieving high-quality development and ensuring that the benefits of growth are more broadly shared by the people in all. It is also a necessary step to preemptively mitigate the risks posed by a potential contraction in external demand triggered by a U.S.-provoked recessionary tariff war. In the longer term, economic rebalancing will better equip China to respond to external shocks and enhance its strategic leverage in global power competition. From the perspective of coordinated domestic and external policymaking in a major economy, rebalancing is therefore not only necessary, but represents a choice of dominant strategy.

First, domestic economic rebalancing will help ease external trade tensions and counteract U.S. efforts at economic containment. Although the Trump administration has aggressively wielded tariffs even against traditional allies, divergent economic interests and cognitive differences on China's institution render obstacles for China more closely collaborate with the U.S. allies against the U.S. unilateral tariff policy. At the same time, economic and trade frictions between China and developing economies have also increased recently. China's proactive efforts to advance rebalancing will improve its trade relations with non-U.S. Western economies such as the EU, while also enhancing the scope and quality of trade and investment cooperation with developing countries, thereby helping to blunt U.S.-led containment efforts.

Second, rebalancing is a necessary step toward advancing the internationalization of the renminbi (RMB) and reducing the leverage conferred by the dollar's global dominance in favor of Trump administration's unilateral trade policy. Structural change in the international monetary system tends to follow a path where "the old doesn't exit unless the new emerges." The problem is less about the shortcomings of existing reserve currencies and more about whether emerging alternatives offer credible substitutes. To become internationally viable, an emerging currency must be backed not only by robust supply-side capabilities, but also by sustained domestic demand and widespread prosperity underpinned by strong household consumption supported by relatively high per capita income. Raising household income and consumption is the natural end goal of economic development and, while not pursued for geopolitical reasons, it will in practice serve to erode the United States' ability to exploit the privileges of the dollar's global role.

Third, economic rebalancing will facilitate industrial upgrading and reduce the risk of technological decoupling or "strangulation" by the United States in high-tech sectors. By strengthening domestic demand and transitioning toward consumption-led growth, China can accelerate the shift of its industrial base toward innovation, high value-added production, and technology leadership. This process will be reinforced by deepening market-oriented reforms and converging growth with potential output, thereby enhancing resilience to future external shocks in trade and technology.

Finally, reducing overreliance of exports and trade surplus on the U.S. market through domestic rebalancing will help diminish the asymmetry that gives the United States tactical leverage in tariff wars. While the U.S. launches tariff actions based on domestic political and economic calculations, its large

trade deficit also exposes its declining competitiveness. Nonetheless, the imbalance in bilateral trade—where Chinese exports to the U.S. account for a larger share of China's GDP than vice versa—grants the U.S. an asymmetric advantage in the short-term impact of tariffs. Expanding the domestic market and diversifying trade partners will structurally rebalance this asymmetry and shift the playing field in China's favor.