



By: TA | AP Insight

# US-China trade talks: How to transform China into a more consumer-driven economy?



From the upcoming round of trade talks with China in Sweden, the US expects progress in two directions—to reduce excess production capacity in many sectors, as well as to increase spending by Chinese consumers. Both the US and Europe are trying to curb China's huge exports.

China's high dependence on **exports** will likely be a key focus of a new **round** of U.S.-China trade talks this coming week in Stockholm, but a trade deal would not necessarily help Beijing to rebalance its economy.

U.S. Treasury Secretary Scott Bessent has said he hopes the negotiations can take up this issue, along with China's purchases of oil from Russia and Iran, which undercut American sanctions on those two countries.

Hopes rose for a breakthrough in talks after U.S. President Donald Trump **announced** deals with Japan, Indonesia and the Philippines this week.

The U.S. wants China to do two things: Reduce what both the U.S. and the European Union see as excess production capacity in many industries, including steel and electric vehicles. And secondly, to take steps to increase **spending** by Chinese consumers so the economy relies more on domestic demand and less on exports.

"We could also discuss the elephant in the room, which is this great rebalancing that the Chinese need to do," Bessent **told** financial news network CNBC. He said China's share of global manufacturing exports at nearly 30%, "can't get any bigger, and it should probably shrink."

## China is tackling the same issues — for domestic reasons

The issues are not new, and China has been working to address them for years, more for domestic reasons than to reduce its trade surpluses with the U.S. and other countries.

Bessent's predecessor as treasury secretary, Janet Yellen, made industrial policy a **focus** of a trip to China last year. She blamed government subsidies for flooding the global market with "artificially cheap Chinese products."

The European Union, whose top leaders **met** their Chinese counterparts in Beijing on Thursday, has cited subsidies to justify EU tariffs on electric vehicles made in China.

## Economists have long argued that China likewise needs to transform into a more consumer-driven economy

In the 1980s, the U.S. pressured Japan to boost consumer spending when American manufacturing was overwhelmed by exports from the likes of Toyota and Sony.

Economists have long argued that China likewise needs to transform into a more consumer-driven economy. Consumer spending accounts for less than 40% of China's economy, versus close to 70% in the United States and about 54% in Japan.

Chinese leaders have **spoken** about both factory overcapacity and weak consumer spending as long-term problems and have sought over the past 20 years to find ways to rebalance the economy away from export manufacturing and massive investments in dams, roads, railways and other infrastructure.

Fierce price wars have prompted critical reports in official media saying that companies are "racing to the bottom," skimping on quality and even safety to reduce costs.

With strong government support, they've also expanded overseas, where they can charge higher prices but still undercut local competitors, creating a political backlash.

## Economists say China needs a consumer-driven economy

All that competition and price cutting has left China battling deflation, or falling prices. When companies receive less for their products, they tend to invest less.

That can lead to job cuts and lower wages, sapping business activity and spending power – contrary to the long-term goal of increasing the share of consumer spending in driving overall growth.

To counter that, the government is spending billions on rebates and subsidies for people who trade in their cars or appliances for new ones.

But acknowledging a problem and solving it are two different things.

**More fundamental changes are needed to boost consumption and rein in overcapacity**

Economists say more fundamental changes are needed to boost consumption and rein in overcapacity. Such changes can only come incrementally over time.

Private Chinese companies and foreign-invested companies create the most jobs, but they've suffered from swings in policy and pressures from the trade war, especially since the pandemic.

Demographic **changes** are another challenge as China's population shrinks and ages.

Many experts advocate expanding China's social safety net, health insurance, pensions and other support systems, so that people would feel freer to spend rather than save for a medical emergency or retirement.

Yan Se, an economist at Peking University's Guanghua School of Management, warned at a recent forum that deflation will become a long-term issue if China doesn't step up its welfare benefits.

"Chinese people deserve a better life," he said.

## Facing external threats, China wants to be more self-reliant

One possibility, put forward at the same forum by Liu Qiao, the dean of the business school, would be to change incentives for local government officials, rewarding them for raising consumption or household incomes instead of meeting an economic growth target.

He doesn't see that happening nationwide but said it could be tested in a province.

"That would send out a message that China needs a different approach," he said.



*A sustained improvement in household consumption will require greater reform ambition – The World Bank*

Chinese leader Xi Jinping has made transforming the country into a technology superpower a top priority. It's a goal that has gained urgency as the U.S. has tightened restrictions on China's access to high-end semiconductors and other advanced knowhow.

Output in high-tech manufacturing is growing quickly, adding to potential overcapacity, just as what happened with the government's encouragement of "green" technologies such as solar panels and wind turbines.

Various industries, including EV makers, have pledged to address the issue, but some local governments are striving to keep money-losing enterprises afloat, reluctant to lose tax revenues and jobs, or to fail to meet economic growth targets.

Going forward, the government is calling for more coordination of economic development

polices in fields such as artificial intelligence so that not every province champions the same industry.

But government moves to counter the impact of higher tariffs tend to support sectors already in overcapacity, and the share of consumption in the economy has fallen in recent years.

“A sustained improvement in household consumption will require greater reform ambition,” the World Bank **said** in its most recent update on China's economy.”