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China's Rise to No. 2 May Stoke Trade Fires

The Asian tiger's stride past Japan will focus attention on its trade imbalance.

by Joel Schectman

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Now that China is the world's second-largest economy, Europe and the U.S. are bound to turn up the heat on the gaping trade imbalance. The country and Japan have long been neck and neck, but China's stride past its heavily industrialized neighbor sends a powerful message. "China can no longer be called an emerging economy," said **Bernard Baumohl**, executive director of The Economic Outlook Group. "It has to come to terms with a greater international responsibility. China has to play fair."

The latest numbers from Tokyo on Monday show that Japan's economy is worth about \$1.28 trillion. China's GDP came in at \$1.33 trillion, surpassing its longtime nemesis for the first time, in the second quarter.

While the difference is slight, the symbolic value of the milestone could have real effects on America's push for China to reduce its trade imbalance. In July, China exported \$28.7 billion more in goods and services than it imported. Compare that with the U.S.'s own \$49.9 billion trade deficit. The U.S. and Europe complain that China keeps its trade gap high by manipulating its currency and shielding its own companies from competition. "China is now the second-largest economy. It becomes increasingly hard to defend all these protectionist policies," said **Baumohl.**

Western nations say that the trade deficit, which makes them reliant on foreign debt, is bad for the world economy—China included. “You can’t keep running up the debt forever,” said David Wyss, chief economist for Standard & Poor's. “Eventually international markets are going to decide that the U.S. has too much debt, then the dollar dives—but that means the yuan dives too.”

The policies may also ultimately hurt the Chinese consumer, whose demand for pricier goods is surging. Keeping the yuan low makes Chinese products cheaper for American consumers, but it also makes imports more expensive for Chinese customers.

With China’s rise to the No. 2 economy, politicians in the U.S. may get additional firepower to seek retaliatory measures, which could be bad for everyone. With the U.S. trade deficit at its largest in more than two years, Sen. Charles Schumer of New York has been pushing for a bill that could hit Chinese companies with a new round of tariffs.

“Politicians don’t like deficits. But a new round of protectionism in the U.S. could be destabilizing to both economies,” said Wyss.