

TO: David Cameron, UK Foreign Secretary  
FROM: Jasmine Evans-Mudie, British diplomat  
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RE: China-UK Trade Imbalance

### **Summary**

Recognising China as a pivotal trading partner, it is essential to address the persistent trade imbalance between the UK and China. This memo, therefore, advocates three policy recommendations to increase British exports - devaluing the British pound, pursuing a Free Trade Agreement (FTA), and increasing research into Chinese business operations. With geopolitical differences and high domestic inflation, we recommend that the government initially focuses on fostering a deeper understanding of Chinese business practices. The belief is that increased research will improve UK businesses' successes in overseas markets, rebalancing the UK-China trade relations cooperatively and sustainably.

### **Background**

The trade imbalance between the UK and China has become an increasingly pressing concern in recent years, worsening since the Covid-19 pandemic, from £18.3 billion in 2019 (Ward, 2020) to £35.8 billion (ONS UK Trade, 2023). This highlights potential issues around economic instability, reduced economic growth, and further concern about the UK's national security. So, with China ranking as our third-highest source of imports in Q1 2023, but the UK's presence in the Chinese market limited to only 1.5% (Department for Business & Trade, 2023), corrective measures must be undertaken.

The significance of this trade imbalance also extends beyond the bilateral context. In an interconnected global economy, the economic health of major players like the UK, the sixth largest economy, and China, the second largest economy, has far-reaching effects globally, with both countries hosting substantial trading partners. Therefore, this skewed trade balance is highly significant, considering both countries host juxtaposing political and economic ideologies. With increasing fears of conflicts, there are also worries that the UK is overly dependent on China (Barns-Graham, 2022), meaning the presently poor trade balance needs to be addressed imminently.

We are confident that improving our trade balance is achievable. Considering China's annual growth rate still exceeds most of our trading partners, implementing these policies should ensure long-term success, especially if we focus our efforts on increasing exports to China, as opposed to minimising imports. This is especially important in development industries. So, by effectively implementing our recommendation to invest in research on Chinese consumer behaviour and market trends, the UK will position itself to strengthen diplomatic ties with China, all while addressing the trade imbalance.

### **Policy Options**

The government has three broad strategies to choose from; whether they are implemented depends on the timeframe and geopolitical relations.

## **1. Devaluing the British pound**

This policy has several advantages and can be achieved through intervention in the foreign exchange market. Devaluing the British pound should make British goods more competitive in international markets, including China since a weaker currency makes British goods and services cheaper for foreign buyers. This strategy will lead to a short-term improvement in the trade balance as it should increase exports as British products have a competitive advantage.

Moreover, devaluing the pound will attract foreign investment as assets become more affordable for international investors. Given London's renminbi clearing centre and position as the world's second-largest offshore centre for RMB payments (City of London, 2023), this would enable a further influx of foreign capital, ultimately causing a substantial positive effect on the UK-China trade balance.

However, these benefits of improved financial performance are predominantly short-term, and devaluing the British pound could leave the UK vulnerable. Devaluing the pound risks Chinese retaliation through currency manipulation, a characteristic of China's trade from 2003 to 2013 (Swanson, 2019). So, despite gaining a competitive advantage in the short term, this devaluation may strain diplomatic relations and instead result in harmful trading countermeasures. Moreover, the UK is currently experiencing a period of high inflation. So, at present, the risk of further weakening the currency may actually outweigh the benefits since it could lead to higher import costs and spiral inflationary pressures in the domestic economy.

Considering high domestic inflation, there are currently better policies. However, this policy recommendation should be reconsidered at regular intervals, as it may prove effective during periods of deflation.

## **2. Pursuing a Free Trade Agreement (FTA)**

A second recommendation is to reduce or eliminate tariffs and other trade barriers, as this will foster increased economic cooperation between the UK and China. By facilitating smoother trade between the two nations, an FTA seeks to promote exports, creating a more open and favourable environment for bilateral trade.

On the global stage, an FTA could set a precedent, influencing the future of international trade agreements and fostering cooperation. Chinese businesses' confidence in investing and expanding their presence in the UK remains predominantly high, so by opening an FTA, there will likely be an influx in foreign investment. This would have bountiful positive effects, increasing the volume of trade between the UK and China, benefitting businesses in both nations, and improving the trade balance.

However, due to the significant political, economic, and cultural differences between the UK and China, negotiating a successful and mutually beneficial FTA will take time. This is a drawback to proposing an FTA at present, as a general election is anticipated within the next 12 months. An FTA would also surface issues around market access and intellectual property rights. So, while it aims to boost economic activity, it could increase competition due to China's comparative labour advantage.

If the current government wins the next election, this is an excellent policy to implement since, over the approximate four years - as opposed to twelve months - there is scope to agree on a mutually positive and effective trade agreement with China.

### **3. Increased research into Chinese business operations to facilitate the success of UK ventures in the Chinese markets.**

By investing in comprehensive research initiatives and encouraging cross-continental communication, the UK can gain a competitive edge by deciphering the intricacies of the Chinese business landscape. This would help British businesses tackle challenges in the Chinese marketplace while also helping Chinese businesses engage in the UK economy with less uncertainty, benefitting our trade position and diplomatic relations.

Furthermore, focusing on research is a strategic move that aligns with the UK's increasing goals of innovation-driven growth. By understanding the Chinese market at a granular level, the UK can identify untapped opportunities and stimulate innovation with evidence-led guidance assisting businesses in uniquely positioning their strategies, products, and services in alignment with Chinese market trends.

This approach transcends the limitations of traditional trade policies, offering a pathway to sustainable economic growth and resilience. With better knowledge, including consumer spending patterns, marketing and business regulations, exports should increase, bettering our trade balance with China.

#### **Policy Recommendation**

Therefore, the primary recommendation is to increase research into Chinese business ventures. This is grounded in recognising that a profound understanding of the Chinese market dynamics is essential for fostering a sustainable and mutually beneficial trade relationship between the UK and China. Intended outcomes include recognising the complexity of the global economy and the need for a nuanced, long-term strategy to address the trade imbalance. It has no negative implications for the international community and should instead be viewed as a positive performance of international cooperation and bilateral growth. After all, this policy will allow the British government and domestic business owners to understand the world's 2nd largest economy far better than competitors whilst simultaneously, and sustainably, improving the trade balance.

#### **Sources**

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