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US-China trade ties: A heated exchange

Renewed economic weakness raises fears of an all-out trade war

By Alan Beattie



Europe's economic conflagration is generating more than just horrified fascination from the world's policymakers. The weakness radiating from the eurozone has the potential to inflame existing tensions elsewhere. In the US, though the administration and Congress are casting an increasingly worried eye on the region, the continued irritation of China's actions on currency and trade remains one of their main preoccupations.

If the American economy stalls and unemployment remains high as the US heads into an election year, Capitol Hill's patience is likely to wear thin, and fears of an all-out international trade war will rise.

Several potential flashpoints remain. Although Beijing unpegged the renminbi from the dollar in June 2010, it has allowed only a small appreciation this year. And despite some reform of its "indigenous innovation" policy, aimed at creating high value-added industries, China retains an array of domestic interventions including subsidies, procurement controls and the compulsory transfer of technology by foreign companies.

Yet US officials argue they are making some progress with a nuanced and flexible approach, taking opportunities as they arise and trying to work with Chinese reformers rather than endlessly seeking confrontation.

"We are following a **dual approach** – trying to bring China into the international system and get it to take responsibility for being one of a small group of countries responsible for making the international system work well," says one senior administration official. "And, at the same time, push them hard when they take actions that contravene the rules."

Although the US administration has been trying to widen the front of its engagement with Beijing, it is still the currency that most exercises Capitol Hill. China's current account surplus, which American lawmakers say largely reflects undervaluation of the renminbi, has fallen from more than 10 per cent relative to Chinese gross domestic product in 2007 to a likely level of about 4 per cent this year. Nonetheless, many on Capitol Hill claim that currency manipulation to support China's exporters has maintained global imbalances.

This year China is likely to permit appreciation of less than 5 per cent, which would still leave the renminbi substantially undervalued by most estimates, though such calculations are rejected by Beijing. The Peterson Institute for International Economics, a Washington-based think-tank, says the renminbi remains 24 per cent below fair value against the dollar. Easing inflationary pressures and signs of slowing growth have reduced the incentive for China to allow faster appreciation to cool the domestic economy.

The US has used a mixture of bilateral and plurilateral diplomacy to try to persuade Beijing that its interests lie in allowing appreciation; Washington has sought to corral a supporting posse among the Group of 20 leading economies.

Politicking in Washington has handed the administration a further, though potentially dangerous, negotiating tool: the threat of currency tariffs. In October, the Senate passed a

bill that would compel the US to use calculations of currency undervaluations when assessing to what extent imports are deemed to be unfairly priced, for the purposes of imposing emergency so-called “antidumping” and “countervailing duty” tariffs. Almost all the plausible Republican candidates for the presidential nomination say they support the bill.

The White House appears to be trying to use the bill as a threat, saying it shares its aims while expressing vague concerns about its legality under World Trade Organisation rules. This nuanced position irritates the Republican leadership in the House of Representatives; it says the proposal threatens an out-and-out trade war, and is resisting Democrats’ pressure to bring similar legislation to a vote in the House.

Some experts agree that such threats can be counterproductive. Nick Lardy of the Peterson Institute says direct confrontation merely weakens the position of those in the Chinese system – such as the central bank – arguing privately for greater currency flexibility. “Other departments and agencies can say to the [central bank]: you are just kowtowing to western interests,” he says.

He reckons the administration’s other tactic – organising a coalition of sympathetic countries – is probably more fruitful, playing on China’s unwillingness to appear isolated. Washington has many natural allies in the G20. Brazil, in particular, has also been exercised about the renminbi.

But events elsewhere in the global economy are conspiring to weaken the campaign. Rising risk aversion among investors has recently reversed capital flows into China and weakened the renminbi. And in Europe, some officials still hope that China will help a eurozone rescue effort and so have little incentive for confrontation.

Currency has always been a hard point to press. There are few laws governing global exchange rates. By contrast, the trade in goods and services – and the associated issues of procurement, foreign investment, intellectual property rights and domestic regulation – has a variety of avenues that can be explored without touching off a diplomatic explosion. **True, the tapestry of trade law has large holes but the rules of the WTO, which China joined nearly 10 years ago, do have some constraining effect.**

The US administration cites a string of actions it has taken. These include WTO litigation against China’s own use of antidumping and countervailing duty import taxes on US exports, and the initiation of a wide-ranging investigation by the administration of

Beijing's support for its renewable energy industry. In this case, China pre-emptively abolished a programme subsidising its wind power industry.

“Once the potential for litigation is raised, to date there has been about a 50 per cent record of China taking an action to comply with its obligations before it actually goes through the dispute settlement process,” says Tim Reif, general counsel at the US trade representative's office.

Washington has also initiated cases with an eye to establishing useful precedents. Recently, it brought an action against Chinese antidumping and countervailing duties on US chicken exports. Poultry may not be the most glamorous or the highest value-added of exports but, since the case has broader connotations, it could prove a useful one. “China has been using antidumping and countervailing duties as a retaliatory measure,” says Mr Reif. “Part of the reason for bringing this action is to prevent their use as retaliation.”

Legal process is not without its problems. One is the limited coverage of WTO rules. China, for example, has placed much of its giant public procurement market off-limits to foreign companies. It also has yet to fulfil a promise to join the WTO's government procurement agreement, a standalone pact separate from the body's normal rules. Beijing has promised by the end of the year to make a fresh bid to join the agreement, but US businesses doubt its commitment.

Furthermore, the low-hanging fruit has already been harvested. The relatively easy cases have already been brought; bringing future actions is likely to be harder – not least because of the lack of information on Chinese subsidies and regulatory practices. Washington recently complained to the WTO that Beijing was failing to provide required information on its subsidies, but it has limited recourse in this area.

Business groups say American companies are also often reluctant to provide the US government with the information needed to bring cases, concerned about official retribution against their operations in China. The request for the renewables probe came from the US United Steelworkers' Union rather than a business. In a recent antidumping and countervailing duty action brought against imports of Chinese solar cells by US renewable energy businesses, six of the seven complainants exercised their rights to keep their identities secret.

Washington is coming under pressure to adopt a more confrontational stance on this issue. “Providing information to [the US trade representative] is a costly exercise both in terms of

the resources involved and the potential for tit-for-tat retaliation,” says Bill Reinsch, who chairs the US-China Economic and Security Review Commission, which reports annually to Congress. He believes US administrations, which have traditionally brought cases only when they consider themselves very likely to win, should file more long-shot actions to keep up the pressure on Beijing. The US could, he says, bring “nullification or impairment” actions, which argue broadly that China’s trading partners have not received the benefits they might have reasonably expected from its entry into the WTO.

America’s final tactic for dealing with China is to set up trade deals with groups of countries, and hope China will feel compelled to join. Recently the US agreed an outline pact in the Trans-Pacific Partnership, a grouping of nine countries – including Vietnam, which has extensive Chinese-style state intervention – with the aim of concluding a deal by the end of next year. Washington is also exploring the idea of creating more plurilateral agreements in the WTO on the lines of the government procurement agreement.

“China needs to understand that they are welcome to join future developments, such as plurilateral agreements in the WTO, or the [TPP], says Dan Price of Rock Creek Global Advisors and a former senior White House international economics official. “But those will go ahead whether it decides to participate or not.” However, the countries involved in the TPP collectively account for only about 6 per cent of US trade, so China is unlikely to feel compelled to join or lose all its export markets to American companies any time soon.

No one ever said persuading the world’s largest goods exporter to change its strategy would be easy. The US administration says China will move when it accepts that international commerce is not a zero-sum game, and that its maturing economy will benefit from a wider set of trade rules. Bringing this about will take time but, with America’s negotiating leverage limited, it looks like the most realistic strategy.

“We have to be able to show China that it is in its own interest to take a particular action,” a US official says. “We need to find lines to push for that seize the moment.”