

ECONOMIC NEWS UPDATE

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29 May 2007

Dialogue Not Enough to Satisfy Congress

Dialogue. To Europeans dialogue has always been preferred to what they see as the grim alternative: confrontation. Until now that has been one of many differences between us and our European allies. We set great store by results, Europeans by process. That's one reason for our differences over the proper way of handling Iran's march towards the acquisition of nuclear weapons. One key British member of the team negotiating with the Iranians told me he considers those negotiations a success -- they prove that Europeans can remain united. Americans are more inclined to dub a process that has not deterred the Iranians from pursuing their nuclear ambitions a failure.

But that difference might be narrowing, at least when it comes to trade. Last week a large team under the leadership of Secretary of Treasury Hank Paulson met with an

even larger Chinese team headed by vice premier Wu Yi, and including fifteen ministers, for a continuation of the Strategic Economic Dialogue that was set in motion in Beijing last December. The move of the dialoguers to Washington put them within easy reach of members of congress, many of them angry with China for, as they see it, undervaluing its currency, stealing American intellectual property, closing its markets to US financial institutions, banning imports of US beef (a particular concern of President Bush), and deploying a host of "unfair trade practices" to sustain its massive \$232 billion-and-growing trade surplus. Add to those nascent protectionist congressmen who are hearing from constituents about job losses due to imports, others offended by China's suppression of human rights and persecution of religious minorities, its

refusal to vote for sanctions against Sudan over the slaughter in Darfur, and still others worried by China's decision to increase its ability to hit the US with long-range missiles and increase its submarine fleet, and you have a potent anti-China lobby.

Paulson, of course, is well aware of the complicated and hostile political atmosphere. Indeed, he has of late been commenting on the difference between the private sector from which he came after 32 years at Goldman Sachs, and the public sector. In his old job he could get things done, quickly: everyone in the room wanted to make a deal. The public sector is different, he says: not all of the multiple constituencies want to see a deal done, and some that do are unprepared to make any concessions to make agreement possible.

So Paulson's broad strategy is to replace what he calls Americans' "impatience" for results with acquiescence in dialogue. "I happen to think that dialogue is good," he announced at the conclusion of last week's talkfest. His faith in talk is a good thing, since Paulson had precious little to report by way of results, and probably regretted his promise "to show that words are precursors of results."

He could announce only two positive, albeit minor, results of the dialogue. The first is an aviation deal that will allow US carriers to double the number of daily flights between the US and China, from 10 to 23. But not immediately. The long march to the 23 daily flights will not be concluded until 2012. That's one year after China agreed to an open

skies deal granting US cargo carriers "unfettered access."

The Chinese also agreed to ease their restrictions on the activities of foreign financial firms, but only a little. Wu Yi flatly refused to raise the ownership ceilings imposed on joint ventures with American firms. This was a particular disappointment to the Treasury Secretary, who has been pressing hard for major liberalization of financial markets -- so much so that many accuse him of doing Goldman Sachs' bidding, rather than setting priorities that give greater weight to agricultural and manufacturing interests.

In fairness to the Secretary, it should be pointed out that the Chinese are giving some ground on other issues. They have allowed their currency to appreciate 8% against the dollar, raised export duties on certain low-value steel products, reduced import duties on a few items, and did precede the "Dialogue" with a \$32.6 billion buying spree in 24 states, most of which are represented by influential congressmen. They also invested \$3 billion in private equity firm Blackstone in an attempt to diversify China's huge, \$1 trillion holding of dollars from Treasury IOUs to higher-yielding assets, and at the same time win plaudits for increasing inbound investment.

This, however, is a lot less than congress is demanding. No progress was made on the question of China's theft of US intellectual property, the subject of a US complaint to the World Trade Organization. DVDs of American films are hitting the streets of Beijing

at \$1 each before the films open in American theaters. And an 8% revaluation doesn't come close to the 25%-to-40% upward move that congressmen have set their hearts on.

So Paulson tried to explain to the Chinese that although he and the administration oppose retaliatory measures, "Congress legislates and there will be trade legislation in Congress ... reflecting the views of the American people who don't believe that the benefits of trade are shared evenly or fairly." Wu Yi heard the same message during her visit with Congress, but indicated she has no intention of stepping up the pace of currency revaluation or trade liberalization to appease Congress.

Which could have serious consequences. New York senator Chuck Schumer, now that his Democrats are in control of both Houses of Congress, is passing the word that he has a veto-proof majority for a bill that would penalize Chinese goods unless the yuan is revalued. He has the support of both Republicans and Democrats on the House Ways and Means Committee. Its chairman, Charlie Rangel of New York, has a good working relationship with Paulson, I am told, but nevertheless indicates that he is prepared to support legislation to impose sanctions on Chinese imports this year.

Bad news for China, which needs export-creating jobs, and bad news for America, which needs Chinese investment in Treasury securities to hold down interest rates, and cheap Chinese goods to restrain inflation.



THE SUNDAY TIMES

A version of this Update appeared in
The Sunday Times (London)