US TRADE POLICY VIS-À-VIS CHINA: TIME TO PUSH THE "RESET BUTTON".

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Over the past decade the United States trade policy in regards to China has prioritized diplomatic dialogue aimed at maintaining good relations while persuading China to gradually address US economic concerns. I judge this approach a failure. It is time for a change in strategy.

During the most recent meetings of the US-China Strategic and Economic Dialogue (S&ED) the leader of one of the parties called for the establishment of "a clear timetable and road map"[1] for the other party to make requested changes in its economic policies. That leader was not US Treasury Secretary Geithner, but Chinese Vice Premier Wang Qishan, and the requested changes were in US not Chinese policy.

Washington should take advantage of this echo of its own repeated calls for a timeline for policy changes in China to adopt a firmer, less accommodating approach towards China.
The US should present a list of its concerns and insist on concrete action on a specified time schedule as the price for the US refraining from filing complaints in the WTO and imposing protectionist legislation. In exchange the US should agree to grant China its two major requests: market economy status and the negotiation of a bilateral investment agreement.
Such an approach, as more fully discussed below, will require difficult negotiations with both the US business community and the Congress. However, the potential benefits to the US

[1] Jay Solomon, "US presses China on human rights", *Wall Street Journal*, 10 May 2011.

economy, the international trading system and the Obama administration are significant. Moreover, Obama is currently uniquely well positioned to undertake the endeavor.

The Clinton and Bush Administrations, despite public discontent, adopted a patient approach towards China, arguing that China was a "necessary partner" and that the most productive means of achieving desired economic changes was "constructive engagement". The US worked assiduously to ensure China's admission into the WTO and subsequently chose to tackle disagreements through dialogue and persuasion. Harsh rhetoric and punitive legislation were avoided on the grounds that they risked triggering a backlash against US commercial interests. What are the results of this strategy of accommodation? A bag full of promises from China but little if any change in the issues of most concern to the United States. China continues to pursue policies that discriminate against foreign firms, its currency, the value of their currency, the RMB, remains artificially low, violations of intellectual property rights continue, its trade surplus with the US continues to grow and China's human rights record has gotten worse.

During the first years of his administration Obama has been disturbingly inattentive to trade policy, prompting many to wonder if he even has one. In regards to China Obama's policy seems to be Bush redux. He reestablished the Bush era Strategic Economic Dialogue (SED) as the Strategic and Economic Dialogue (S&ED), revived the Joint Committee on Commerce and Trade (JCCT) and, as in the past, promised that these "dialogues among equals" would result in mutually beneficial solutions to a broad range of economic issues. His Treasury Secretary replaced Bush's Treasury Secretary as the lead voice on China. Geithner, like Paulson, has called on China to let its currency rise but has refused to take the action-triggering step of officially naming China "a currency manipulator". Like Paulson, Geithner has defended China's go-slow approach to improving intellectual property protection, touted every promise Beijing makes to meet its WTO obligations and repeatedly pleaded with Congress not to enact legislation limiting Chinese imports. Not surprisingly the same policies have had the same dismal results.

The latest, just-completed, round of S&ED talks resulted in a new "US-China Comprehensive Framework for Promoting Strong, Sustainable, and Balanced Growth & Economic Cooperation". A US participant (speaking on background because of the sensitivity of the issue) is reported to have described the agreement as little more than a "procedural framework" replete with promises but lacking any timelines for action, let alone enforceable commitments, from either side. Indeed, US Commerce Deputy Assistant Secretary for Asia said the US "would have preferred much more explicit detail in terms of timeline, in terms of coverage, and in terms of implementation" for the Chinese "commitments" to ensure non-discriminatory application of its industrial and innovation policies, bolster intellectual property protection, and facilitate input from foreign business in the development of Chinese business-related regulations". And the US Chamber of Commerce for whom each of these areas is of major concern hailed the Chinese promises but cautioned that evidence of concrete actions would be necessary to sustain confidence in the S&ED process. Similarly, the US Council for International Business said "if implemented" the Chinese commitments would be significant but noted that past promises on these same issues have gone unfulfilled. The Engage China Coalition, made up of seven US financial services trade associations, applauded the inclusion of financial service reform and liberalization in the agreement but underscored that "meaningful progress" would require that China take more "concrete steps" to open its banking, securities, and insurance sectors. In sum the corporate sector wants to see concrete changes in China's policies and practices and they want to see them soon[2].

Obama's recent success in Pakistan won him renewed respect and popularity both at home and abroad as a strong results-oriented leader. As such he is well positioned to push the reset button in relations with China, a move that will inure to his benefit in 2012. As a follow-on to the S&ED talks Obama should meet with leaders of the multinational business to develop a list of priority concerns. Such a list doubtlessly would include the exchange rate, intellectual property protection, the "indigenous innovation policies", which promote Chinese innovators over those from the US particularly in the area of government procurement, subsidization of green industries, export controls on rare earth minerals, bid rigging on government procurement contracts, barriers to foreign investment in telecommunications and financial services, and frequent harassment of China-based US companies. The lists should then be presented to Beijing making it clear that the US is willing to adopt a roadmap for US policy changes as demanded by Chinese authorities but that its configuration will be determined by policy changes in China. No policy changes will be made in the US in advance of concrete actions by China on the listed priority items. If China wants the US to designate it as a "market economy" it must act like one, letting its currency appreciate and limiting government policies favoring domestic over foreign industries. If China wants the US to ease export controls on high-technology products it must offer verifiable assurances regarding their ultimate civilian use. If China wants a bilateral investment treaty with the US ensuring increased access for Chinese investors in the US it must liberalize its own investment regime and provide adequate investor protections. It must also improve

[2] *Inside US Trade*, 13 May 2011.

governance within its companies and institute regulatory changes to ensure a clear separation between government regulators and the firms they oversee. And if China wants a halt in US criticism of its human rights record it must change that record.

Will such an approach trigger the long-feared backlash to the detriment of US companies and the US economy more broadly? I think not. For too long US policy has been based on the view of China as a necessary partner with the emphasis on the US needing China needing its large market for US exports, needing access to its cheap labor for US multinationals' global supply chains, needing its credit to support the US deficit. All this is true. Equally true, and seemingly forgotten however, is that the US is a necessary partner for China and that China knows it. There is no doubt that Beijing recognizes the importance to China of an open US market for its exports and investors. It is also clear that Beijing understands that it is in China's own, long-term best interest to meet US requests regarding enhanced intellectual property protection and RMB appreciation.

Adopting a hard line in economic negotiations with China is not only good policy, it is great politics. Historically when it comes to China policy, there have been two camps in the US. On one side are the "dragon slayers" who see China as an unfair, nefarious adversary and favor the use of economic sanctions to force Beijing to adopt US-advocated policies. In opposition are the "panda huggers" who consider China a necessary, useful and sensitive economic partner and advocate a diplomatic, accommodating approach. Although US policy has been dominated by the "Panda huggers" for decades, in recent years the "dragon slayers" have seen their numbers swell. This trend can be expected to escalate as the 2012 election nears. It is a well-known fact that opponents of trade liberalization in the US shift into high gear at election time. Advocating trade liberalization is almost as lethal for an office-seeker as advocating a tax hike. Support for protectionist policies in contrast is certain to win votes.

The political advantages are particularly significant this year and for this president. Barak Obama was elected with the backing of many anti-trade, pro-human rights advocates and he will need their active support again in 2012. These groups are squarely in the "dragon slayer" camp and have been disappointed with the Administration's failure to make good on its promise of "change" in this as in other areas. A reset of US policy towards one demanding results would go a long way towards ensuring their support, as well as that of the business community, in 2012. It is possible that a few members of the business community with thriving Chinese operations will continue to oppose such a change for fear of being the targets of a Chinese backlash. All indications are that they are outnumbered by those who have become frustrated and angry at Chinese intransigence.

Admittedly, the proposed quid pro quo in the form of enacting certain changes in US laws as requested by the Chinese will meet with resistance. “Dragon slayers” oppose “pandering to pandas”. Nevertheless my discussions with numerous members from this group leads me to believe that ultimately they will see the package as a positive evolution in US policy and reward the Administration on election day.

More serious is the reaction of the Congress whose approval is essential if US laws are to be altered. While a majority of the Congress, themselves up for election in 2012, can be expected to embrace a tough line towards China some likely will oppose the proposed quid pro quo. Most controversial will be granting China market economy status. US domestic import-competing companies consider the law denying this status and enabling them to easily secure limits on imports of competitive Chinese products essential to their survival. It will be difficult for members of Congress, particularly in an election year, to vote against these constituents. To win their support the Administration will have to do what all Administrations do: bargain. The Executive branch has many favors it can exchange for votes. Federal funds for members' favored infrastructure projects, the president's endorsement of unrelated legislation of importance to members, the president's attendance at a campaign rally are just a few of the possibilities.

At the close of the latest S&ED talks Chinese Vice Premier Wang Qishan said that the most important thing the Obama Administration can do for the US-China relationship is to “depoliticize economic issues with China”[3]. One year before a presidential election this is not going to happen and the Obama Administration should make this crystal clear. In fact, this political reality provides the President with additional leverage. Surely Beijing understands the political climate in the United States. By now it has sufficient international negotiating experience to know that the number one rule is to understand the politics and policy formation process of the other side.

A new hard-line US approach to China also has the potential to benefit the multilateral trading regime. The latest round of multilateral trade negotiations under the aegis of the WTO - the Doha Development Round - has ground to a halt largely due to disagreements between

[3] Op. cit.

developing and developed nations in the areas of agriculture and services trade. The divide has come to seem insurmountable as good will has been replaced by anger and frustration on both sides. However, if the major developing and the major developed country - China and the US - focused on working together to find a solution, it is likely one could be found. At least that is the thinking of involved negotiators. Representatives of the US and the EU as well as the WTO's Director General have all urged China to become actively involved, to become, in the words of a former US Trade Representative "a responsible stakeholder". However, as long as bilateral disagreements dominate the US-China economic relationship the two countries will not be able to focus on working together in this way. If the new US approach advocated in this paper is successful in bringing about concrete changes in Chinese policies and subsequently in US policies bilateral tensions would ease and the two parties could focus on the more important task of rescuing the multilateral trading system of which both are major beneficiaries. There has been considerable talk over the past half decade of a G2 [4] - made up of the US and China - becoming a leading force on a host of global issues. Trade and the WTO would not be a bad place to start.

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[4] Ramon Pacheco Pardo, "The EU and the G2: Is a G3 Possible", paper presented at the conference "The EU, the US and China: Towards the New International Order", Bruges, April 2011.