U.S.-China dialogue faces retooling after election

By David Lawder
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WASHINGTON -- U.S. Treasury Secretary Henry Paulson's high-level economic dialogue with Beijing will likely be replaced with a new or modified forum next year despite some progress on thorny bilateral issues.

The so-called "strategic economic dialogue" ended its fourth session this week with China and the United States agreeing to launch talks for an investment treaty and setting goals for a previously agreed 10-year cooperation "framework" on energy and the environment.

But it wasn't enough to satisfy critics who say the process has failed to resolve the most important issue, an undervalued Chinese currency that undercuts U.S. producers in global markets.

"The SED is built on a flawed premise, namely that regularly scheduled dialogue alone can achieve meaningful progress on critical and complex issues," said Scott Paul, executive director for the Alliance of American Manufacturing.

"We need a more robust approach from Washington, one that includes clear objectives, mechanisms to assess progress, incentives for achievements, and punitive measures for backsliding," Paul said.

Paulson, who made over 70 trips to China as the former head of Wall Street investment bank Goldman Sachs, has made the dialogue the centerpiece of his term, which will end in January. He will preside over one more round of talks, expected in December after a new U.S. president is elected.

With job losses an increasingly big issue in the November elections, the next president -- particularly if it turns out to be Democratic candidate Barack Obama -- is more likely to take a tougher line on China trade and currency issues.

"An Obama administration would be under tremendous pressure to change direction on China. I think you would see fewer of these types of constructive meetings," said Daniel Griswold, director of trade policy studies at the Cato Institute, a libertarian think tank in Washington.

"You'd have more confrontation, and more (World Trade Organization) cases filed against China."

Paulson’s Centerpiece

The semi-annual talks were launched in December 2006 to tackle long-term issues, including massive trade and financial imbalances between the two countries and the difficulties of U.S. companies trying to enter China's fast-growing markets.

Thorniest among these has been China's yuan currency, which many U.S. manufacturers and lawmakers still say is deliberately undervalued by as much as 40 percent, giving Chinese exporters a massive pricing advantage.

But the first two sessions of the SED produced little direct progress in this area and drew sharp criticism from Democrats in Congress. The focus then shifted to energy and environmental issues and incremental steps to allow more foreign participation in China's financial markets.

Outside the glare of the talks, China has allowed the yuan to rise about 20 percent against the dollar since officially abandoning a fixed exchange rate three years ago.

And a day after this week's talks ended, Beijing increased retail gasoline and diesel prices by up to 18 percent, after Paulson urged China let market forces determine fuel prices.

"For a grade, I'd give the SED a solid B," said Charles Freeman, a fellow at the Center for Strategic and International Studies and a former U.S. trade negotiator.

The talks have helped to lay groundwork for China's integration into the world economy and have brought into focus its energy and environmental challenges, he said.

But there will be a "compulsion to institute something new" to fix perceived problems in the U.S.-China relationship as America grows more anxious about job losses, he added.

"There's no way you can avoid some sort of senior-to-senior economic dialogue. You can't litigate your problems with China, and you can't ignore China," Freeman said.

Indeed, on Friday, the International Monetary Fund said U.S. growth, traditionally the engine of the global economy, will depend "to an unusual degree" on the strength of domestic demand in its trading partners in the next five to 10 years. China is now the fastest-growing market for U.S. exports.

Chinese Confidence

At this week's dialogue talks in Annapolis, Maryland, Chinese officials struck a more confident tone.

After years of being lectured by the United States on how to run their economy and regulate their financial system, the Chinese officials chided lax U.S. oversight of the mortgage sector as the root cause of global financial turmoil.

"Now, apart from wanting to learn from the U.S.'s experience in macroeconomic policy, we also want to learn some of the lessons they have learned as a result of the turmoil," said Zhou Xiaochuan, the head of China's central bank.

Niu Jun, a professor of international relations at Peking University, said the talks also may have helped drive home to Beijing its "growing role in the global economy."

Washington should consider elevating its relationship with Beijing to a summit-level "G2" partnership that would explicitly recognize China's as one of the world's two most important economic powers, said Fred Bergsten, director of the Peterson Institute for International Economics.

"The United States would have to give true priority to China as its main partner in managing the world economy, to some extent displacing Europe," Bergsten wrote in a recent article. "Nothing less is likely to attract China or engage the United States sufficiently to create the effective leadership that the world so desperately needs."

(Reporting by David Lawder, Editing by Chizu Nomiyama)