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The Upshot

IMPERFECT PARTNERS

How Trump Can Improve the Messy U.S.-Chinese Economic Relationship

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Neil Irwin @Neil_Irwin APRIL 6, 2017

The United States and China are locked in a mutually dependent, frequently dysfunctional economic partnership. The world's biggest and second-biggest economies are like a married couple that complain about each other constantly yet can't even contemplate a divorce.

The marriage enters a new phase Thursday, as President Xi Jinping of China visits for two days of meetings at the Florida estate of a president who made China a punching bag on the campaign trail.

The question is whether President Trump can turn his bellicose language into concrete gains for American companies and workers. A look at the economics of the relationship between the nations, and conversations with former officials with battle scars from past negotiations, show a path for getting a better deal.

That path to success may not include the kind of flashy, headline-generating announcements that the Trump administration has tended to celebrate.

It's not about the currency (for now)

In February, Mr. Trump called China the “grand champions at manipulation of currency.” During the campaign, too, he frequently assailed China for artificially reducing the value of the renminbi to favor its companies versus American and other competitors.

It is a view that is outdated. For years, China did intervene in financial markets to depress the value of its currency. But now it is intervening to keep the yuan from falling — actually doing the opposite of what Mr. Trump alleged. Economists generally think that the Chinese currency is close to the levels that would be set by purely market forces.

That doesn’t mean currencies shouldn’t come up at Mar-a-Lago. This moment of relative peace between the countries on currency policy could be the ideal time to develop an understanding for the future.

“I think currency is still an issue, but it doesn’t make sense to discuss it under the rubric of manipulation,” said Brad Setser, a senior fellow at the Council on Foreign Relations. “China is managing its currency; it’s just that it’s managing it right now in a way that is relatively advantageous to the United States. That understanding of how China intends to manage its currency in the future remains a top-order issue.”

In other words, Mr. Trump could use this moment not to beat China over the head about what happened in the past, or where things stand today, but to develop an agreement on what it will do in the future, if a day comes when market forces start pushing the yuan upward.

Focus on the causes of the trade deficit, not the number

Mr. Trump has similarly assailed the United States trade deficit with China and other countries, often characterizing it as a scorecard, evidence that China is winning at trade and the United States losing, to the tune of $310 billion a year.

The reality is more nuanced. The persistent trade deficit is indeed problematic, but that’s because of the factors that drive it and the imbalances they cause to build.

Simply targeting a lower trade deficit could well leave both American and Chinese workers worse off, if carried out the wrong way. For example, a trade war that significantly reduces American imports from China while also reducing American exports to China would reduce the trade deficit but would mean lower incomes and fewer jobs in both countries.

The U.S.-China trade imbalance is indeed driven in part by trade barriers that China enacts against American companies, including a 25 percent tariff on imported automobiles and various quotas and restrictions that reduce agricultural imports. If Mr. Trump can persuade China to loosen those restrictions, it might close the trade deficit by increasing American exports — the healthy kind of trade rebalancing.

But the trade gap isn't driven just by the details of trade arrangements. It is also driven by the flow of capital between countries. To oversimplify, when a company sells more abroad than it buys, it has to do something with that money.

The flip side of a current account deficit, as an economist might put it, is a capital account surplus. China's trade imbalances are a function not only of its trade practices, but also of its very high levels of savings, which are in turn invested around the world.

For China to change that, it would have to change the very structure of its economy: away from savings and big-ticket infrastructure investments, and toward consumer demand — including for products made both domestically and abroad.

If the Trump administration really wants the trade deficit with China to come down over time, it's not enough to look at only one side of the international economic ledger — flows of goods — while ignoring the flow of capital.

In practice, this would mean making demands on some issues that might seem like purely domestic concerns only tangentially related to trade. That might include pushing China to allow more troubled state-owned enterprises to fail, so that their accumulated profits might be spread through the Chinese economy instead of funneled toward the purchase of foreign assets. A more generous pension system might spur demand among older Chinese citizens.

If China allowed global financial companies more access to its market, it could both encourage more domestic spending and give a major American industry an opportunity it has long sought.

Use leverage carefully

President Trump prides himself on being a dealmaker, and his negotiating style is to lay out extreme requests in order to work back to agreement. But resetting economic relations with China will prove trickier than any real estate deal.

One of the fundamental realities of the relationship is that while neither side is wholly comfortable with how it works, these are big, powerful countries that can't be easily swayed by what a country on the other side of the Pacific Ocean wants to happen. The leverage that each side has to deploy is limited — at least so long as neither country is willing to shoot itself in the foot.

So, for example, in trying to get more favorable Chinese treatment of American goods and services, the standard menu of carrots Mr. Trump has to offer for compliance is relatively modest. China wants things like United States membership in the Asian Infrastructure Investment Bank that it started, and support for its "One Belt, One Road" program to build better transportation infrastructure stretching from Southeast Asia to Europe.

Bigger Chinese goals, like achieving "market economy" status in the World Trade Organization, are likely to be nonstarters unless the country makes major progress on allowing international companies better access to its market.

The United States could conceivably have more negotiating leverage by threatening punitive tariffs or other aggressive measures, as Mr. Trump did during his campaign, but those actions are just as likely to produce a painful blowback from China that damages the United States.

Then there are noneconomic issues, which invariably could shape the contours of economic relationships.

“In the Obama administration, China was a good citizen cooperating with us on Iran sanctions and on climate change, which I think made it hard for the U.S. to contemplate anything that harsh in the trade arena,” said David Dollar, a former Treasury Department official in Beijing and now a senior fellow at the Brookings Institution. “You could have something similar if the Trump administration wants China to cooperate more on North Korea. That could be hard to turn around and be harsh on them in the economic realm.”

Be patient, and don’t get distracted by baubles

Mr. Trump likes to announce big splashy deals, and given that the Chinese are looking for places to invest their capital in the United States, it would be easy enough to find something along those lines to announce.

But in the context of the two giant economies, that kind of thing is small bore. This flawed economic relationship has been building for a long time, and the fixes are unlikely to come overnight.

“Mr. Trump ought to pick the right fights rather than focus on issues that resonate with his political base but which are unlikely to help U.S. economic interest in either the short term or long run,” said Eswar Prasad, an economist at Cornell and author of “Gaining Currency,” a book about China’s role in global finance.

It’s unlikely that the first meeting between the new president and the Chinese leader will resolve issues that have been building for years or even decades. Rather, those who have worked in diplomacy advise looking beyond the current headlines to make progress on lowering Chinese trade barriers, increasing its domestic savings and committing not to return to the days of manipulating its currency lower.

When you’re talking about commerce between two superpowers, things don’t change overnight.

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