Push Xi Jinping to Open China's Market

By Eswar Prasad

Donald Trump and Xi Jinping are set to meet this week in an informal setting, rightly lowering expectations of any major meeting of minds or concrete outcomes. Yet there's a lot riding on prospects of the U.S. and Chinese presidents smoothing over a war of words that, if it escalated, could hurt both countries' economic interests. The stakes for the global economy are high, as a rocky relationship between the two leading economic powers could prove disruptive to international trade and add to volatility in financial markets.

The key challenge for Mr. Trump will be to pick the right fights with Mr. Xi, rather than revert to talking points from the campaign trail. His continued attacks on China since taking office are not healthy portents.

Mr. Trump seems determined to put China on the back foot, ostensibly giving the U.S. a better negotiating position for the many economic and geopolitical tussles that lie ahead. In itself, this strategy may have some merit.

However, Mr. Trump is focusing on high-profile but weak lines of attack, such as his misguided charge of Chinese currency manipulation and the size of the bilateral trade deficit. These issues resonate with Mr. Trump's political base, adding to the temptation to claim a win by getting tough on China, particularly to ease the sting of the recent health-reform debacle. Mr. Trump has repeated the currency-manipulation charge even as his Treasury Department attempts a more deliberate and calibrated approach.

The accusation that China is manipulating its currency to gain an unfair advantage for its exports isn't supported by economic facts. For nearly three years, China's central bank has been intervening in currency markets to prevent the yuan from falling too sharply in value against the dollar. Thus, if anything, China has been doing the U.S. a favor by not letting the yuan depreciate as much and as fast as the markets seem to want.

China currently meets only one of the three criteria identified by the U.S. Treasury in 2016 as necessary conditions to formally accuse a U.S. trading partner of currency manipulation: It has a bilateral trade surplus with the U.S. of more than $20 billion.

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Among America's trading partners, China has the biggest bilateral merchandise trade surplus with the U.S., nearly $350 billion. This is certainly a big imbalance, but the battle should be fought with the right weapons, rather than with unsupported allegations and protectionist measures. A formal charge of currency manipulation or the imposition of tariffs on imports from China would likely elicit an immediate and aggressive counterstrike.

The risk is that such actions could spiral into a tit-for-tat series of restrictions on bilateral trade and investment that would hurt both economies. China is likely to take overt as well as covert retaliatory actions that could include restricting American companies' access to markets and investment opportunities, as well as disrupting the supply chains of American businesses that rely on Chinese intermediaries. The U.S. economy, especially multinational corporations that operate in China in one form or another, could suffer significant collateral damage if a trade war were to break out.

U.S. economic and business interests would be better served by Mr. Trump's greater attention to issues of real economic significance in the bilateral economic relationship. China could be prodded to provide U.S. exporters greater access to its large and growing markets.

Liberalization of foreign investment in key sectors, including financial services, could help American firms that want to set up or expand operations in China. Soothing other irritants in the bilateral relationship, such as theft of intellectual property, would also benefit U.S. businesses.

Focusing on these issues would garner broader international support for Mr. Trump in wresting from China the narrative about how to structure the global trading system in a way that spreads the benefits more evenly across countries. Taking the high road by pushing for freer trade rather than engaging in a protectionist street fight would better help Mr. Trump expand American jobs and promote a more vibrant and dynamic economy.

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