THE WALL STREET JOURNAL.
WSJ.com

ECONOMY | SEPTEMBER 30, 2010

For Both Nations, Depending on a Rival

By DAVID WESSEL

The leaders of the U.S. and China know that each country's economy depends enormously on the other. China is hugely dependent on selling goods to the U.S. to keep its vast army of workers employed. The U.S. is hugely dependent on China continuing to lend the U.S. government billions of dollars a day.

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An employee handles stacks of yuan at a Bank of China branch in Hefei, China. The U.S. House passed a bill penalizing China over foreign-exchange practices.

But recent ratcheting-up of tensions between the two is a reminder that leaders in both countries face mounting internal political pressure—largely around jobs at home. While politicians on both sides seek to use popular outrage and local business interests as levers to pressure the other side, there's a risk that the simmering squabble will boil over, scalding both economies and innocent-bystander economies as well.

Though the temperature is clearly rising, tensions have been mainly rhetorical and low-intensity trade spats despite the devastating recession in the U.S. About two-thirds of antidumping complaints filed in the U.S.—which allege some country is selling goods below cost—are aimed at China.

On Wednesday, a World Trade Organization panel ruled that congressionally mandated U.S. restrictions on imports of cooked chicken from China were unscientific and discriminatory. The restrictions, which have since expired, led China to impose duties of more than 100% on certain U.S. exports of chickens to China.

Yet while free traders wince at the escalating rhetoric and raise the specter of a tit-for-tat series of trade measures that will yield the 21st-century equivalent of the Smoot-Hawley tariffs of the Great Depression, some Obama administration officials note that—despite the deep recession—the U.S. on their watch has adopted fewer protectionist measures than Ronald Reagan did.

For China, the U.S. is a market it can't afford to lose. It accounts for about a fifth of all Chinese exports, some of those goods that the U.S. no longer makes and has to buy from somewhere. In the first seven months of this year, according to U.S. data, the U.S. imported $193.9 billion worth of goods from China, more than from the European Union ($178.9 billion) or Canada ($159.9 billion) or Mexico ($128.8 billion) or Japan ($66 billion).

China's reluctance to bow to U.S. pressure to let its currency, the yuan, appreciate against the U.S. dollar is driven in large part by the interest of its politically powerful exporters. A higher currency would make their wares more costly in the U.S.

In New York recently, Chinese Premier Wen Jiabao said that if China were to allow the yuan to appreciate by as much as some U.S. politicians demand, a wave of job losses and business bankruptcies would engulf China. "Only the Chinese premier has such pressure on his shoulders," Mr. Wen said. "And that is the reality."

Despite apparent support among some Chinese economists and central bankers for letting the currency rise gradually, Eswar Prasad, a professor of trade policy at Cornell University, sees "a shift in the narrative in Chinese political circles."

In the aftermath of the global financial crisis that the U.S. triggered, he says, "there is a sense that China has the upper hand and the U.S. is beholden to China." That's makes the leadership more determined not be pushed around by the U.S.

For the U.S., borrowing more than $1 billion a day from abroad, China is a lender it can't do without as well as an obvious target for Americans worried about jobs and wages. It's also a significant and potentially huge market for U.S. companies—both as a destination for U.S.-made goods and as place to produce goods cheaply.

The U.S. exported $48.6 billion worth of goods to China in the first seven months of the year, more than to Japan ($34.4 billion), but far less than to the EU ($135.1 billion) or Mexico ($90.4 billion).

But some big U.S. companies doing business in China are increasingly irritated by the obstacles to selling there—particularly financial and other services—and at what they complain is a Chinese propensity to steal intellectual property.

"That group has become disillusioned and is no longer a counterweight to those who see China as a threat," says Mr. Prasad. Indeed, the National Association of Manufacturers, its members divided, didn't join three dozen other business groups in opposing the House bill.

There is widespread, though not unanimous, consensus among economists that China's refusal to let the exchange rate rise is an impediment to the much-discussed "rebalancing" of the world economy —where the U.S. consumes less and China and Germany consume more.

There is a growing sense that existing global institutions aren't well equipped to prod a big country (China) with a large trade surplus to reduce it even amid global pressure on another big country (the U.S.) to reduce a large trade deficit. The International Monetary Fund lacks the muscle; the better-armed World Trade Organization lacks jurisdiction.

Yet some businesses and economists say the fixation on the exchange rate is misplaced. John Frisbie, the head of the U.S.-China Business Council, composed of companies doing business in China, said he feared that passage of the House bill would crowd out U.S.-China talks on market-access and other important trade issues.

Matthew Slaughter of Dartmouth's Tuck School of Business said, "Many U.S.-based companies would say we care much more about intellectual property protection than the exchange rate."

In the U.S., China is, of course, an easily identifiable villain for when voters want someone to blame for 9.6% unemployment. Incumbent Rep John Boccieri (D., Ohio), for instance, is blasting his Republican opponent as a "self-described free-trader" who says Ohio voters are more exercised about big government than about free-trade pacts. "He must be talking to people visiting from China," Mr. Boccieri says. "Because that's about the only place free-trade deals have created jobs."

A new Wall Street Journal/NBC News poll found that Americans overwhelmingly believe free-trade agreements have hurt the U.S. and cost jobs.

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