





# It's time for a 'grand bargain' between China and the U.S.

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SHANGHAI — With her visit to Asia this week, Hillary Clinton becomes the first U.S. secretary of state since Dean Rusk in the 1960s to cross the Pacific instead of the Atlantic on her first overseas trip. Her most important stop, it almost goes without saying, will be in Beijing. China and the United States are the yin and yang of the global financial crisis, the opposite poles of an imbalanced financial system that has helped throw the world economy into chaos.

Tensions are inevitable between the two Pacific powers, one with the world's biggest economy, the other with the third biggest. Beijing reasonably fears that Washington will try to get out of its rut by choking off the flood of imports from China that has given the U.S. an enormous trade deficit with China. The U.S. rightly worries that China will try to export its way out of trouble by letting its currency depreciate and making the price of the goods it sells to Americans even cheaper, killing U.S. jobs and draining away the benefits of Washington's stimulus package.

Ms. Clinton will try to smooth over these tensions. She will say reassuring things about trade, trying to wipe out the memory of her China-bashing during last year's presidential nomination campaign ("we play by the rules and they manipulate their currency"). She will insist that "buy American" need not mean "don't buy Chinese." She will soft-pedal human rights, even though she considers herself a rights champion. The Chinese, meanwhile, will make similarly calming noises about their currency ("Depreciate? Us?") and insist they are doing their bit to lick the crisis by spending hundreds of billions to stimulate their own economy.

It is not enough. Yes, it is good that Ms. Clinton recognizes the centrality of the relationship with China. And, yes, it is good that the Chinese have seen the need to be reassuring and not to beat up on the Americans, even though they believe Washington and Wall Street are entirely to blame for the whole mess.

But what is required is a truly co-ordinated approach in which the two economic powers work hand in hand to overcome it. (Japan, the world's second biggest economy, is so tied up in political knots that it is almost a non-entity.)

A U.S. China watcher, Eswar Prasad of Cornell University, calls for a "grand bargain" between the two. The Chinese would agree to allow their currency to seek its natural value on the market and reform their economy so it relies more on domestic consumption than on exports. The Americans would agree to accept the Chinese as partners in global economic management and also to control their own consumption and debt.

All this makes great sense. The Chinese have been seeking improved voting rights on the International Monetary Fund and a seat at the Financial Stability Forum, a club of finance ministers, central bankers and the like. Bringing them on board would encourage responsible behaviour.

Letting the Chinese currency float would cause it to rise over time, making Chinese exports more expensive for Americans and thus lowering the U.S. trade deficit. Encouraging Chinese domestic consumption would help normalize an economy that relies to an abnormal degree on savings and investment. Curbing American consumption and debt would help correct the profligacy that helped get us in this fix in the first place.

Making a grand bargain happen is another matter. The Chinese are in a tight spot. Collapsing exports mean that millions of migrant workers have been thrown out of work, their frustration a potential time bomb for an unelected regime such as China's. Letting the yuan rise would increase the pain at a time when Chinese authorities have been trying to lessen it (by easing taxes on exporters, for instance). The Americans, for their part, are in the process of adding to their debt, not taming it. Doing so will entail great pain and a long political struggle.

But it must be done. China and the U.S. need each other as never before. China needs Americans to go on buying Chinese goods and keep Chinese workers employed. The U.S. needs China to bankroll Washington's debt and provide a manufacturing platform for U.S. multinationals. The rest of the world needs them both to work together on the imbalances that have distorted the global financial system.

"Some believe that China on the rise is by definition an adversary," Ms. Clinton said before she left for Asia. "To the contrary, we believe the United States and China benefit from, and contribute to, each other's successes." Quite so. Now let's see them prove they know it.