

Deja Vu All Over Again

China is an aspiring superpower, with economic and military ambitions; it is even less likely to cave [to U.S. demands] than Japan.

BY Jeffrey E. Garten
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Oct. 24, 2005 issue - During this past week, secretary of the Treasury John Snow, Federal Reserve chairman Alan Greenspan and Securities and Exchange Commission chairman Christopher Cox all descended on China. Their mission: to pressure Beijing to further open its economy and to allow its currency to float further upward.

Observing this full-court press, I couldn't help recalling my

experience as an investment banker living in Tokyo in the 1980s, watching the procession of American cabinet members demanding that Japan change its policies, or my later involvement as a senior trade official in the Clinton administration trying to pressure Japan on a number of economic fronts. Unfortunately, the United States does not seem to be applying the lessons of Japan to its dealings with China.

Japan between 1985 and 1995 was America's economic bete noire. The country ran trade surpluses while the United States ran deficits. Its currency was considered undervalued by Washington and the IMF. Japan Inc. was accused of predatory trade policies and of using its mountains of cash in a plot to "buy America"—all echoes of American fears about China today.

Washington and many of America's leading companies, such as Motorola and Intel, put many demands on Japan: spend more, save less, strengthen your currency and intellectual-property protections, lower your trade barriers. The Japanese were told to deregulate their economy in general and to take very specific measures in the construction, telecommunications, retail and automobile sectors. The pressure peaked in the summer of 1995 when Washington came close to imposing \$5 billion in trade sanctions on Japanese cars. A trade war was averted only at the last minute with a fig-leaf compromise.

The shame was that so little was accomplished. True, a few American companies, especially in the semiconductor industry, made inroads into the Japanese market. Eventually Japan started to open up, but that was due more to a 10-year recession than to anything Washington did. Even today Japan's deregulatory agenda remains enormous, the trade surplus is twice the size of China's and the yen is often manipulated for competitive purposes.

We are seeing a rerun of this movie. As the U.S. trade deficit with China tops \$107 billion so far this year—an increase of 27 percent from 2004—Congress is threatening to impose a heavy new tariff on all Chinese imports. The U.S. Treasury is under pressure to label China a "currency manipulator," a highly unusual charge and one that would precipitate emergency negotiations with Beijing.

If all Washington does is unilaterally butt heads with Beijing, it is likely to be even more disappointed this time around. China is an aspiring superpower, with economic and military ambitions; it is even less likely to cave than Japan was. Japan was a

more understandable target because it was a rich nation, whereas China still has a very low per capita income. It also has allies: unlike Japan, China is wide open to foreign investors, so most big American companies have no appetite for publicly criticizing Beijing. While Japan didn't have many friends in its own backyard, China is skillfully using its booming market to draw Asian neighbors into a web of dependencies, dominated by trade.

What should the United States have learned from its experience with Japan? First, in an increasingly global economy gunboat economic diplomacy rarely works. Multilateral pressure is a much better bet. (The one U.S. success with Japan was in managing a large revaluation of the yen in the multilateral Plaza Accord of 1985.) Today the United States should be joining forces with the European Union—and making more use of the IMF, the Bank for International Settlements and other global organizations—to pressure China.

Second, in a negotiation both sides have to be willing to give something. Tokyo deeply resented that America continued to run such high deficits while criticizing Japan for its surpluses. Surely Beijing has the right to feel the same way as it watches the U.S. administration lose all control of its fiscal policy.

Third: preach with caution. Some believe that Japan's meltdown in the early 1990s was due in part to American pressure for stimulative monetary policy at just the wrong time. And there is now a general consensus that Washington helped cause the Asian financial crisis of 1997-98 by pressing the developing countries of the region into overzealous deregulation.

Fourth: fight fear with action, not complaints. America overcame its apprehension about Japan not by lobbying Tokyo but by making itself more competitive. It balanced budgets in the late 1990s, invested in innovation, adopted an enlightened immigration policy and so on.

I'm all for more reforms in Beijing, but I'd feel better if John Snow were home working on the administration's domestic competitive strategy. Dispatching senior officials to hector the Middle Kingdom seems like *deja vu* all over again.

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