

Trouble Waits For Paulson

WHATEVER POLITICAL SPIN IS PUT ON THE meeting of cabinet members and ministers from the United States and China this week in Washington, the event has already failed. Indeed, despite the exhaustive efforts of U.S. Treasury Secretary Hank Paulson, it is difficult to see how the world's two most important countries can avoid rising

tensions in the months and years ahead.

The meeting, officially called the U.S.-China Strategic Dialogue, was the first and highest-profile initiative announced by Paulson when he took office last summer. The Treasury secretary wanted to elevate the U.S.-China relationship from constant trade skirmishes to discussions of long-term strategic cooperation, and to show Congress that it need not impose punitive tariffs it has been considering. In doing so, the former Goldman Sachs CEO, who had extensive dealmaking experience in China and an unprecedented range of personal relationships with Beijing's leaders, raised expectations in Washington that he could put the U.S.-China relationship on a stronger footing.

But even as the first meeting of the Dialogue was concluding last December in Beijing, Congress started to beat on Paulson for evidence of tangible results. Unfortunately, he has had nothing to point to. The gigantic U.S. trade deficit with China has been climbing at twice the rate of last year, even as gaps with most other trading partners were narrowing because of the weakening dollar. The yuan has been inching up against the greenback a few points, but Washington is looking for a revaluation on the order of 30 percent. The Treasury's quest for deeper Chinese financial reforms has produced minimal results.

Meanwhile, over the past two months the U.S. trade representative has filed two major trade actions against China in the WTO regarding intellectual-property rights, and another under U.S. law charging Chinese subsidization of certain exports. Now Capitol Hill is winding up to

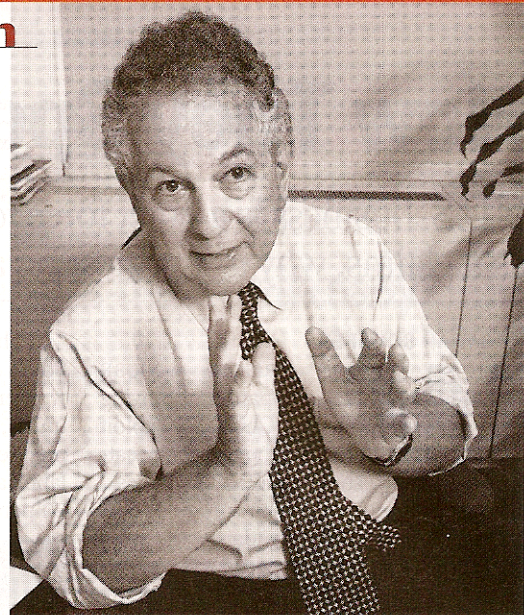
enact high tariffs in retaliation for Beijing's undervalued currency, the same legislation that Paulson was trying to divert in the first place.

Unless America's exports increase five times faster than its imports from China, the bilateral trade imbalance will continue to worsen. Last year China used part of its trillion-dollar foreign-exchange reserves to buy up nearly half of all the debt issued by the U.S. Treasury, enhancing its future leverage as a massive creditor. Beijing's aggressive effort to sew up energy sources in Africa, the Middle East and Latin Amer-

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ica could be on a collision course with the growing U.S. need for oil. From Seoul to Sydney, China is also becoming the central focus of other nations in Asia, pushing the United States out of the position it has occupied since General MacArthur entered Japan.

For the remainder of the Bush administration, the Strategic Dialogue will probably limp along. But the forces governing U.S.-China ties go well beyond this forum and the Treasury secretary's valiant efforts. I have known Paulson for nearly four decades and worked intensely with Chinese Vice Premier Wu Yi in the mid-1990s. I have not spoken to either about this week's summit, but



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here is what I suspect is on their minds.

Paulson is certain that China will become a superpower much sooner than most people realize. He is unwavering in his conviction that America must engage completely with China in good times and bad. He is ready to wage the fight of his political life to avoid U.S. protectionism, something that could put him on a collision course with Congress before this year is out.

Madame Wu has been a trade negotiator with Washington since the early 1990s. She has seen the United States link human rights to trade and place sanctions on American high-tech exports to her country. She is a veteran of bruising battles with Washington over China's entrance into the WTO. All the while, however, she has seen the increasing integration of the two economies. Wu is unlikely to make any meaningful concessions if it appears that she is responding to U.S. pressure, and she is no doubt assuming that things will eventually return to an even keel as they have in the past.

The truth is that Paulson and Wu are being overwhelmed by forces neither can control, from deeply emotional domestic politics in both countries to powerful and decentralized global financial markets. They come together at a time when the world's only superpower is struggling to hold on to its position and when a new contender is arising with a force and speed that no one could have predicted. This week's negotiations are much better than nothing, but the sad fact is that a political tsunami is gathering force.

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