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Congress Fumes As China Talks Show Few Gains

Lawmakers Will Grill Officials on Trade, Yuan; Threats, Not Theatrics

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WASHINGTON -- It looks like the bad cops will do it their way.

The good cop/bad cop routine the U.S. has been playing with China -- with the Treasury secretary preaching dialogue while Congress threatens to penalize Beijing for its trade policies -- may end with angry lawmakers stepping in to retaliate, after two days of talks produced no major breakthrough.

A second round of sweeping economic discussions ended yesterday with only a short list of accomplishments: new air routes between the U.S. and China, slightly more access to Chinese markets for U.S. financial-services firms and the possibility of greater exports of U.S. clean-coal technology.

But Treasury Secretary Henry Paulson failed to secure an agreement to combat copyright piracy or win concessions in the area that raises the most hackles in Congress: Beijing's practice of keeping the yuan weak against the dollar.

Henry M. Paulson

Nonetheless, the Treasury secretary claimed victory, if in subdued terms. "I happen to think that dialogue is good," he said in an interview after the negotiations. "I have never postulated that by doing the dialogue we would avoid trade legislation."

Indeed, even as the Chinese delegation went to Capitol Hill for face-to-face talks with congressional leaders, lawmakers signaled that they intend to move ahead with legislation punishing Beijing for its currency policies. "We're not happy with China's actions to date regarding currency," said Democratic Rep. Sander Levin of Michigan, chairman of the House trade subcommittee.

Many economists question whether forcing the yuan upward would do much to narrow the gaping U.S. trade deficit, almost a third of it with China. But several pending bills address China's currency policies, which U.S. manufacturers, unions and their congressional allies say give Chinese firms an unfair price advantage, swell the trade gap and cost Americans their jobs.

Since 2003, Sens. Charles Schumer (D., N.Y.) and Lindsey Graham (R., S.C.) have repeatedly offered legislation that would impose a 27.5% tariff on all Chinese imports in retaliation. But the senators admitted it wasn't intended as much to become law as it was to force the Bush administration to increase pressure on Beijing and to give President Bush a big stick with which to do it.

SLOW AND STEADY

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See a chart [2] tracking the yuan's slow rise against the dollar.

With the Democrats now in charge of both the House and the Senate, the threat is no longer just theatrics. The Chinese must "understand that China faces the real prospect of veto-proof trade legislation if we don't start seeing measurable progress on currency and other issues," Mr. Schumer said.

Nicholas Lardy, an Asia expert at the Institute for International Economics in Washington, predicted Congress will gravitate this year toward legislation that would authorize the president to impose duties on Chinese goods to counter the perceived subsidy effect of a weak currency.

"If you're concerned about downward pressure on U.S. wages, the big current-account deficit we have, the massive undervaluation of the Chinese currency -- there's little to nothing here on that," Mr. Lardy said of the results of this week's talks.

Mr. Bush handed the China economic portfolio to Mr. Paulson based on the former Goldman Sachs chief executive's fat China Rolodex, and his experience cutting deals there during more than 70 trips to the country.

Mr. Paulson and his counterpart, Vice Premier Wu Yi, last year launched the semiannual "Strategic Economic Dialogue" as a way to look beyond the horizon to the economic issues that will mark U.S.-China relations for decades to come. Among these are the immaturity of China's financial markets, its huge environmental threats and the country's weak social-security system that leads Chinese to save a huge portion of their income instead of spending it on American and other products.

Public and congressional pressure, however, has forced Mr. Paulson to focus on securing quick results, something that has been hard to come by. "I'd always like to see more progress," Mr. Paulson said. "But I'm quite clear that progress is accelerating, and I think you'll continue to see more."

Particularly sticky has been the currency issue. China fixed the value of the yuan to the dollar in 1994 and kept it frozen for more than a decade. In July 2005, however, Beijing finally began to allow the currency to creep upward, amid intense U.S. and European pressure. Since then, the yuan has appreciated by about 8.1% against the dollar.

Chinese officials have said they plan to release their grip on the currency eventually, but they worry that sudden shifts could rattle their financial system. Last week, in advance of the Washington talks, authorities slightly widened the trading band within which the yuan is allowed to move.


Wu Yi

Stepping out of a meeting with House members yesterday, People's Bank of China Governor Zhou Xiaochuan told reporters, "They may think that we can accelerate the speed of reform, but we think that we have already tried our best and domestically we have pressure to slow down a little bit."

Mr. Paulson repeated his view that his differences with China regarding currency policy aren't whether the yuan will be allowed to move, but rather how soon it will be allowed to move. "The real test will be how much flexibility there is in the [yuan] on a daily basis and over time," he told reporters.

Many economists argue that even a sharp climb in the yuan's value will make only a limited dent in a U.S. trade deficit that measured $763.6 billion last year. But it is an issue that resonates on factory floors and Capitol Hill.

"There have been some positive outcomes that show China appreciates the many benefits derived from our economic relationship, but with those benefits comes responsibility," said Iowa Sen. Chuck Grassley, the ranking Republican on the Senate Finance Committee. Senators were expected to meet Ms. Wu and other Chinese officials today. "We'll impress upon them the importance of China meeting its responsibilities," Mr. Grassley said.

The Chinese put the best possible face on this week's talks. "Through the dialogue we have reached much consensus and realized positive results," Ms. Wu told reporters.

At the same time, she warned that trade retaliation would damage Sino-American relations. "Attempts to politicize economic and trade issues should be resisted," she told Mr. Paulson and a lineup of cabinet-level U.S. officials who participated in the discussions.

The Chinese came to Washington already cross about two recent U.S. moves: a Commerce Department decision to slap duties on Chinese glossy paper to counter alleged export subsidies, and the filing of a complaint with the World Trade Organization over, among other things, what the U.S. called Beijing's failure to stop copyright piracy.

Mixed Results

The U.S. and China wrapped up two days of economic talks

What they agreed on:

- More passenger and cargo flights between the U.S. and China
- Raising to $30 billion from $10 billion the cap on foreign ownership of Chinese stocks
- U.S. banks in China can offer yuan-denominated credit and debit cards
- Foreign securities firms will be allowed to offer brokerage, proprietary trading and fund-management services

What they didn't:

- Speeding appreciation of the yuan
- U.S. proposals to raise foreigners' percentage ownership cap for financial-services firms
- U.S. demands for a crackdown on copyright piracy

Adding to China's leverage, however, are foreign-currency reserves that top $1 trillion. Much of that is invested in U.S. Treasury bills and other dollar securities; the U.S. needs a constant infusion of such foreign capital to pay for its huge import bill. Should China's interest in U.S. assets wane -- either out of financial self-interest or retaliation -- it could push up U.S. interest rates and slow U.S. growth. Such a move would cut both ways, however; dumping dollar assets would likely make China's remaining stock less valuable.

Perhaps the most tangible achievement to come from the talks was an agreement that will more than double the number of nonstop U.S.-based passenger flights between the U.S. and China by 2012. Chinese airlines have resisted faster liberalization out of concern they would fare poorly in direct competition with American carriers. But the countries agreed to begin negotiations in 2010 on a full open-skies deal.

In the meantime, yesterday's accord, which will boost the number of daily U.S. airline flights between the U.S. and China to 23 in five years from 10 today, promises to bring something to nearly every major U.S.

aviation player -- especially after the near-elimination of all barriers for air-cargo traffic in 2011. At that time, routes currently assigned to cargo airlines such as **FedEx** Corp. and **United Parcel Service** Inc. will be made available for passenger carriers. China already has separately agreed to grant unlimited flights to UPS and FedEx when each of them opens new hubs in Shanghai and Guangzhou, respectively, in 2008.

But the phase-in of the deal starts slowly, with one airline in line to gain an additional daily service this year, one more getting authority to serve only Guangzhou in 2009 and one new passenger airline and one new cargo airline getting daily routes in 2010.

Currently, **UAL** Corp.'s United Airlines, Continental Airlines, Northwest Airlines and American Airlines offer some service to China. "Interest in the new routes will again outstrip supply," Northwest said. The Eagan, Minn., carrier, which has some China rights but serves that country from its hub in Tokyo, said it "urgently" wants to fly nonstop to Shanghai from its hubs in Detroit and Minneapolis, among other routes.

Delta Air Lines Inc. and **U.S. Airways Group** Inc., which currently are frozen out of the market by the lack of route rights, will have more chances to win coveted access to China.

Mr. Paulson was frustrated, however, in his efforts to persuade Beijing to allow U.S. investment firms, commercial banks and other financial-services companies to own greater shares in their China operations. He even invited Ms. Wu to his Washington home for two hours Monday evening to press the case for greater access on this front.

Instead, he walked away from the talks with what he conceded were "incremental measures."

Among other things, China agreed to allow foreigners, in total, to own as much as $30 billion in Chinese stocks, up from the current $10 billion ceiling, and to lift a moratorium on new joint ventures in the securities industry. Foreign brokerage firms will be allowed to offer a wider range of services, and foreign banks will be allowed to offer their own brand of yuan-denominated credit and debit cards.

--Robert Guy Matthews and Rick Carew in Washington and Susan Carey in Chicago contributed to this article.

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