



Obama in China: Limited Expectations

Nicholas R. Lardy, coauthor of China's Rise: Challenges and Opportunities, credits the President with moves to stabilize the relationship with China but expects few breakthroughs when he travels there later in the month.

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Nicholas Lardy, senior fellow at the Institute, is here to talk about President Obama's trip to Asia and, in particular, his visit to China. Thanks for joining us, Nick.

Nicholas Lardy: Thank you, Steve.

Steve Weisman: What sort of reaction do you think the Chinese will have for President Obama's policy so far when he visits Shanghai and Beijing?

Nicholas Lardy: I think they're trying to maintain, as the phrase goes, "a positive, cooperative and comprehensive relationship." That's the phrase that each side has put on the relationship. And I think the Chinese government wants to keep the relationship moving forward. They're looking for areas to seek common ground. Of course, they're standing up for their own interests, as you would expect.

But I think we'll have a good atmosphere coming out of the trip. There are no major disputes looming, no major disappointments coming. Of course, that's in part because expectations have been brought down a bit. But within that framework, I think it will be a successful trip.

Steve Weisman: What has been the aftermath of something we've discussed, which is the action by the United States to raise tariffs on tires from China? That was a month or two ago and [it] suggested to some observers that it was the opening wedge of a kind of trade conflict with China. Has that been brought under control?

Nicholas Lardy: I think it's moving through WTO channels in a very systematic, orderly way. And thus, you could say it's not likely to spin out of control with unilateral actions by either side. I think the WTO in this case is proving its value and tempering the perhaps immediate reaction of governments to take some strong step to defend their interests.

Steve Weisman: Still, Obama is an undefined figure for many in Asia. Is that true in China?

Nicholas Lardy: I don't think it's true for the leadership because President Hu Jintao and President Obama have met now on several occasions—in the G-20 meetings and various locations, on the sidelines of UN General Assembly in New York a few weeks ago, and they've had several very substantive exchanges.

So this is not a maiden kind of summit. It is a state visit. It, of course, will be President Obama's first trip to China, but I think the Chinese have gotten comfortable with him and that is part of the reason I think the trip will have no surprises and will be relatively successful.

Steve Weisman: What was the Strategic Economic Dialogue, or SED, which has now become the Strategic and Economic Dialogue, or S&ED? Are there any changes that you see this administration has brought about in some of these basic, especially economic, issues?

Nicholas Lardy: There's a great deal of continuity but there are some differences of emphasis. And I think [Treasury] Secretary Geithner's emphasis is slightly different from [former Treasury] Secretary Paulson's, and maybe has put things on a more productive track.

Part of it is the change in the environment. It's easy for us to admit now that our financial system is not perfect and they shouldn't just be taking lessons from us. And they also are more self-confident. They're pushing back. They're giving us advice, how to defend the value of our dollar and get our fiscal deficit under control and other things.

So as I've said before, it's a somewhat more symmetrical relationship. But in part, that's a function of the time and the fact that we've come through a financial crisis that has revealed the weaknesses in our system and some of the strengths of the Chinese system.

Steve Weisman: You've discussed here and in other forums your analysis of the Chinese stimulus program and their efforts, which I believe you think have been significant to rebalance their economy, as Washington policymakers have long asked China to do. What's the perception inside the administration of how much progress China has made on that score?

Nicholas Lardy: Quite frankly, I'm not sure they've focused on it very much. The evidence is partial and very, very new. China's trade deficit, for example, on the third quarter of this year is less than half it was in the same period of a year ago. So this is a situation that's evolving very rapidly.

A lot of the documents addressing the rebalancing question that came out of the G-20 meeting in Pittsburgh a few weeks ago were talking about the rebalancing challenge as if it were a prospective one. I think in fact, substantial progress has been made not only in China but in the United States, where our external deficit is coming down quite dramatically—it will probably be just a little bit more than 2 percent this year compared to 6 percent two or three years ago.

So I think the policy dialogue needs to shift slightly and focus more on the question of how to consolidate the gains that have already been made, how to build on them and preserve them, sustain them going forward, rather than describing them as a brand new challenge we're not quite sure how to deal with.

Steve Weisman: What role will climate issues play in the discussions in China?

Nicholas Lardy: I think it will be very near the top of the list. I think geopolitical issues will probably be at the top of the list, Korea, Iran, and other major global issues for the United States and China. But I think climate change will be right up there, after the geopolitical issues.

We are the two biggest polluters. There isn't going to be a successful outcome to climate talks, not just in Copenhagen but in subsequent discussions, unless there is a closer agreement or closer meeting of the minds between the two sides. A lot of effort has gone into trying to explore areas of common ground and in the run-up to President Obama's trip.

So I hope we hear some announcement. I don't think they're going to put forth a blueprint for the world. But I think if we can show some momentum, it will be very positive.

Steve Weisman: Speaking of Iran and North Korea, what do you expect in that front?

Nicholas Lardy: Quite frankly, I'm not very optimistic. I think China's leverage with the North Koreans has always been quite limited. They're very intransigent and extremely difficult to deal with.

So it's a problem we've got to work on together. It's not something that we can rely on the Chinese to come up with a solution or bring the Koreans back to the table. I just think it's a very tough problem that requires ongoing cooperation of all the Six Party participants in the talks but obviously focusing on the United States and China.

Steve Weisman: And Iran?

Nicholas Lardy: China has gone along with some modest sanctions in the past on Iran, but they have a very strong oil interest there, they're making investments there. I think it's an open question whether or not the Chinese would go along with much tougher sanctions if the negotiations with Iran don't lead to significant progress on the nuclear issue.

Steve Weisman: Our colleague, Fred Bergsten, the director of the Peterson Institute, has spoken of a G-2 relationship between the United States and China, defining the most important bilateral relationship in the world. And yet, talk of the G-2 has raised eyebrows in other parts of the world, especially Europe and Japan. Do you think there'll be much talk along those lines, of that kind of primacy of that bilateral relationship?

Nicholas Lardy: I think there'll be no mention of it whatsoever on this trip. Neither side, neither the US government nor the Chinese government, wants to promote this idea.

The Chinese don't like it because they fear that anything like this would subject them to much higher expectations for their role in the global system. They're trying to play a positive role but I think they feel their capacity is limited. Their per capita income is about \$3,000 to 3,500 and they worry that demands will be placed on them that they can't meet.

And certainly, the US administration has not been promoting the idea of a G-2. They are highly sensitive to our allies, both in Asia and in Europe, who would be offended, to say the least, if we try to formalize a G-2. I think the administration thinks it would be entirely counterproductive. That doesn't mean they don't want this cooperative, comprehensive relationship with China, and they want China to play a positive role. But I don't think anyone dreams of trying to promote a formal G-2.

Steve Weisman: Finally, when Secretary Geithner visited China earlier this year, he was asked a lot about the federal deficit and what the United States is going to do to bring it down over the coming years. And you and I heard questions like that at the conference we attended recently with Chinese economic thinkers and policymakers. What do you think is the level of Chinese concern right now about the US deficit at the height of stimulus programs and the depth of the recession?

Nicholas Lardy: I think they're quite concerned. I think they are in what has been called the dollar trap. Their reserves are so large. The prospects for diversifying into other currencies are quite limited. Those markets simply aren't big and deep enough for them to operate in, without having a substantial effect on the prices. So they're stuck with the massive holdings of dollars, and they're still growing quite significantly because their currency is undervalued. They still have some trade surplus and they have other capital inflows.

So their second best strategy is to jawbone the United States and try to ensure that the United States gets on a more sustainable fiscal path so that we don't have high inflation, we don't have an erosion of the value of the dollar; the value of the dollar does not fall in real terms in international markets, which would impose a very substantial cost on them. They now have \$2.3 trillion worth of foreign exchange reserves.

Steve Weisman: Of which how much do you think is dollars?

Nicholas Lardy: Probably at least 65 percent and maybe as much as 70 percent is denominated in dollars. So they have a very, very large exposure to dollar assets. If the dollar weakens, they take very large losses on those reserves.

Steve Weisman: And are they impressed by the assurances that they've received so far?

Nicholas Lardy: If they are, they're not saying so. I think their attitude is more "show me" and they're interested to see what the budget will be, coming from President Obama early next year. When he has to present a budget, how fast is he going to project to bring the deficit down, what steps is he going to take to do that, and more importantly, what's the congressional reaction going to be—can he get the kind of program he wants through the Congress? So the Congress is not usually too keen on raising taxes or cutting expenditures, so I think they'll be watching that very closely.

Steve Weisman: So President Obama may be hearing some of the same complaints about deficits in China that he does in Washington.

Nicholas Lardy: I'm certain the Chinese may be too polite to make it the kind of the centerpiece of their formal talking points. But I'm sure in the private discussions that will be an element that will be quite noticeable.

Steve Weisman: I'm sure he'll enjoy that very much. Nick, thanks very much.

Nicholas Lardy: Thank you, Steve.

