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Shaping the New Consensus
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Having ceded the global rebalancing effort to an ineffectual Congress and lost the Group of 20 to concerns over "quantitative easing" (QE2), the Obama administration must now find other methods to influence the China-US economic relationship. The administration should seek to shape the domestic debate, collaboratively formalize an international solution within the G20, and overtly demonstrate the option of increasing either economic incentives or pressure on China.

First, developing and future industries should be at the center of the yuan debate, not, as Congressional campaigners have made it, the immediate return of long-lost US manufacturing jobs from China. From the stump, radio, or television, President Obama should focus on the undervalued yuan's affect on potential future industries, like solar wafer and wind-turbine manufacturing, and current US-led industries to which China is seeking market-share, such as Silicon-Valley-type software and information technologies.

In new and developing industries, intellectual property theft, protectionist indigenous innovation, and domestic procurement policies can – and have – aided the development of domestic Chinese firms. Land and loan favors from provincial governments and state-owned banks help companies (like solar panel manufacturer Hunan Sunzone Optoelectronics) succeed by reducing their factory and input costs. Later, if selling its products abroad, such firms enjoy a competitive advantage in export markets on behalf of the yuan's unnatural weakness. Chinese solar panels in particular account for a very large and growing share of those delivered to US and German markets, roughly one-third and one-half, respectively. Conversely, no foreign solar industry can claim such a presence in China.

Direct government subsidization of immature technological industries is not uncommon or necessarily problematic – indeed, were it illegal the United States would be equally guilty – but restricting domestic market access for foreign companies while seeking entry to markets abroad will prove untenable. Accordingly, the US Trade Representative recently agreed to investigate claims by the United Steelworkers union that China was unfairly supporting its wind and solar products, advanced batteries, and energy efficient vehicles, and in doing so, effecting a distortion of the trade balance, which is illegal under WTO conventions.

Unless China's domestic and international economic policies change, this developmental process – "copy-subsidize-protect-export" – will be remembered as equally central to China's rise as the opening of its special economic zones in the early 1990s. Without reform, China's success will continue to be met with greater suspicion and remonstration from abroad. Avoiding such is in China's interest and the interest of its trade partners.

Therefore, President Obama must strongly emphasize the effect the undervalued yuan will have on potential future industries and international competition. If he makes this argument publicly and fairly, US expectations and political rhetoric will begin to reflect reality, paving the way for the US government to address the concerns that will become central to the US economy and worker.

Second, at the G20 finance ministers' meeting in South Korea, Treasury Secretary Timothy Geithner's proposal (described by IMF Chief Dominique Strauss-Kahn as not sophisticated or appropriate enough), sought to limit nations' current account surpluses and deficits as a percentage of their GDP and met with predictable resistance from developing countries and major exporters. In effect, as a proportion of GDP, Geithner sought to cap the amount of growth as a function of exports a nation can achieve, and, likewise, limit the amount of goods and services a debtor nation can import and consume. It is very difficult to envision a scenario in which developing nations running a current account surplus would actively restructure their trade balances to assuage international concerns.

Greece's sovereign debt crisis serves as a both an example of that which Geithner's proposal is intended to protect against and why his proposal will not work. The Greek debt crisis neatly illustrates the challenge of enforcing, on a national level, an unpopular policy formed by a supranational body. Manipulating numbers and circumventing regulations, Greece was able to spend its way into insolvency despite the constraints of being an EU member state and the requisite mandate to refrain from fiscal deficits greater than 3 percent of GDP.

It is no wonder the US proposal met with a cool response. The primary US goal – leveling multilateral pressure on China to balance its trade accounts and hasten currency reform – was obfuscated by the timing of the Federal Reserve's decision to undertake a second round of quantitative easing. This rightly sparked fears in many emerging G20 economies of capital inflows and knock-on inflationary effects. The Chinese CPI for October was 4.4 percent, a two year high, and though interest rates were raised at the end of last month, many experts are expecting another increase in the near term.

The tenor of the next G20 summit in Cannes, France will depend on QE2's effect on the strength of the US economic recovery, the US trade balance with China, and the level of inflation in developing countries. Under either best or worst case scenarios, the United States should seek to collaboratively

finalize trade targets (perhaps within narrow bands) or monitoring mechanisms, while continuing to build consensus among G20 members. A multilateral approach allows the US to demonstrate its benignity and consensus-building in juxtaposition to Chinese intransigence. Additionally, the IMF's plans for reorganization will grant the Fund greater freedom to criticize and monitor its members but leave US veto power intact. This is a net-win for the US. If there is a time for the United States to lead from the rear, the G20 in Cannes may be it.

It is certainly not the time for US withdrawal. Rather, when President Obama hosts Chinese President Hu Jintao in January, he should both pressure and invite Chinese cooperation by reminding Hu of the upcoming iteration of the Treasury's report on currency manipulators and the US need for infrastructure development, and rail development in particular – a need that the Chinese have a demonstrated capacity to fulfill. Additionally, Obama should remind Hu of the reservation with which Congress and the Committee on Foreign Investment (CFIUS) considers investments by China's state-affiliated firms and funds into the United States and his ability to influence – to relax or increase – such constraints. In short, Obama should make clear that Chinese failure to act fairly in its domestic economic policies and in international currency markets will result in a loss of face and influence abroad and Chinese economic opportunities in the US.

There are various ways for China and the US to meet in the middle. One of the first steps is for US politicians to correct their rhetoric to reflect reality and effect realistic expectations among their constituents. Second, the US should continue to pursue multilateral solutions vis-à-vis China, especially when offered favorable terms, as in the case of the IMF reorganization. Lastly, the US needs to rediscover the opportunities it can confer and the discomfiture it can exert in realizing its interests. In these ways, the US can shape a new consensus, domestically, internationally, and with China.