

U.S.-China Relations: Great Powers, Great Issues

A Preview of the Obama-Hu Summit • 13 November 2009

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Dear Ogilvy clients and friends,

When President Obama arrives in China this for his first visit as President, he will bring high expectations and an agenda that touches on many more issues than previous summits. China's rapid transformation into a global financial power means that climate change, clean energy and specific bilateral trade issues now take priority over traditional summit agenda items like nuclear proliferation and human rights. Chinese media report that this summit is very important for the future of China-U.S. relations, while U.S. experts indicate that the meeting will allow the two countries to strengthen their strategic partnership but may not lead to any tangible results.

FINANCIAL CRISIS

Analysts debate what role China might play in responding to the global financial crisis, given its huge foreign exchange reserves but its relative reluctance to become a major player in global economic affairs and its tendency to be cautious with its reserves. Some have speculated that China may, in order to help stabilize its most important trading partner (the United States), boost purchases of U.S. securities (especially Treasury securities) in order to help fund the hundreds of billions of dollars that are expected to be spent by the U.S. government to purchase troubled assets and stimulate the economy. Additionally, China might try to shore up the U.S. economy by buying U.S. stocks.

During her first visit to China in February, Secretary of State Clinton urged China to continue to buy U.S. Treasury securities. Some contend that taking an active role to help the United States (and other troubled economies) would boost China's image as a positive contributor to world economic stability, similar to what occurred during the 1997-1998 Asian financial crisis when it offered financial aid to Thailand and pledged not to devalue its currency.

On the other hand, there are a number of reasons why China might be reluctant to significantly increase its investments of U.S. assets. One concern could be whether increased Chinese investments in the U.S. economy would produce long-term economic benefits for China. Some Chinese investments in U.S. financial companies have fared poorly, and Chinese officials could be reluctant to put additional money into investments that were deemed to be too risky. Secondly, a sharp economic downturn of the Chinese economy would likely increase pressure to invest money at home, rather than overseas. Many analysts (including some in China) have questioned the wisdom of China's policy of investing a large

volume of foreign exchange reserves in U.S. government securities (which offer a relatively low rate of return) when China has such huge development needs at home.

While attending the G-20 summit in London on the global financial crisis in April, President Obama and President Hu agreed “to work together to resolutely support global trade and investment flows” and to “resist protectionism.”

TRADE

In October, the U.S.-China Joint Commission on Commerce and Trade met in Zhejiang Province and signed 11 agreements relating to trade in clean energy, tourism and aviation. In addition, China agreed to strengthen oversight of the pharmaceutical sector and to take appropriate action to investigate copyright infringement of US medical and scientific journals. China also announced its intention to re-open the pork market and to simplify the procedure for procuring wind-power equipment.

In the corporate world, this year has seen numerous cross-border operations and mergers & acquisitions. Just last month, Sichuan TengZhong Heavy Industrial Machinery acquired General Motors’ Hummer. Still awaiting approval from the Chinese government, James Taylor of GM is confident in the transaction. According to the terms of this acquisition, Tengzhong will own the Hummer brand, trademark and trade names, and the rights to manufacture Hummer vehicles.

Under the stimulus package implemented at the close of last year, the Chinese government pledged to inject 4 trillion Yuan over the next two years in to the Chinese economy – specifically to help domestic businesses. Specifically, the government aims to boost 10 main industries, which include automobiles, steel, shipbuilding, textiles, machinery, electronics and information, light industry, petrochemicals, non-ferrous metals, and logistics. This package is to include tax cuts and incentives, industry subsidies and subsidies to consumers, funding to help firms invest abroad.

Both nations have spoken out against using protectionist measures to protect domestic industries, however earlier this month, the U.S. announced a decision to levy tariffs on imported oil and gas pipe from China. Along that same line, the European Union recently imposed 5-year tariffs of up to 39 percent on imports of Chinese steel pipes, alleging Chinese exporters were selling these pipes below cost. An even bigger trade issue is the 35 percent tax on imported Chinese tires imposed by the U.S. due to the belief that the increasing number of imports were hurting domestic manufacturers. These measures have raised concerns for the Chinese government, which is concerned that Chinese products will have no place in US or EU markets. China’s government will continue its market diversification to avoid focusing solely on the U.S., E.U. and Japan and will expand trade with Russia, Africa, Southeast Asia and South America.

In reaction to the US tariffs, the Chinese government has announced a tax on poultry imports and auto parts from the US. Additionally, China has proposed a tax on imports from the US of a chemical used to make nylon – adipic acid – alleging these products coming in from the US, Europe, and South Korea have been sold at below market price for years.

CLIMATE CHANGE

Currently, China and the United States are responsible for 40 percent of global carbon emissions. To address this issue, President Obama has expressed support for climate change legislation, asserting that the United States should serve as an example for countries around the world and start the reducing carbon emissions which cause global warming. Under this legislation, the government will implement a cap and trade system for carbon emissions and strive to cut carbon emissions in the US 17 percent by 2020. However, in order to prevent other countries around the world from picking up the slack, e.g. producing increasing levels of carbon emissions, other nations would need to commit to this initiative as well.

For China, cutting emissions would likely result in slowed development. At the UN General Assembly on September 22, 2009, Chinese President Hu stated all countries must fulfill their individual, respective duties to cut overall global emissions. As developing countries need to maintain momentum and continue their current pace of development, richer countries must pass regulations to heavily cut carbon emissions. Additionally, countries with access to clean technology must make it a priority to share with poorer nations.

China has made addressing the issue of climate change a priority. Pledging to increase the efficiency of the Chinese economy, President Hu expressed plans to boost renewable energy at a Shandong wind project last month. The country is investing in alternative forms of energy, including wind and solar.

Furthermore, China's 11th Five Year Plan outlines goals for reduced pollution levels, and teams have been developed to ensure these goals are met.

CHANGING GEOPOLITICAL ENVIRONMENT

Human rights has been a principal area of U.S. concern in its relations with China. Some policy makers contend that the U.S. policy of engagement with China, especially since granting the PRC permanent normal trade relations status in 2000, has failed to produce meaningful political reform. Others argue that U.S. engagement has helped to accelerate economic and social change and build social and legal foundations for democracy and human rights in the PRC. While human rights is not likely to be a major

issue at the upcoming summit, President Obama may bring up the issue of freedom of expression, religion, access to information and perhaps Tibet.

A number of policy makers have accused the Obama Administration of de-emphasizing human rights in its early overtures to China. In February, Secretary of State Clinton stated in Beijing that disagreements on human rights “cannot block the possibility of significant cooperation” on bilateral issues such as the global economic crisis, climate change, and international security threats. In May 2009, House Speaker Nancy Pelosi, a staunch critic of China’s human rights policies since 1989, and a bi-partisan congressional delegation traveled to the PRC and met with governmental and non-governmental groups in a visit primarily focused on forging bilateral cooperation on climate change.

While there is obviously a full agenda on tap for the summit, we should expect public proclamations of energetic and ongoing dialogue. While the thorny issues around trade and the specifics of climate change will certainly be addressed, it is unlikely either leader will be willing to let disagreements overshadow the ongoing need for cooperation between the world’s two superpowers.