



## A Growing US-China Rift

*Nicholas R. Lardy says relations with China are deteriorating over climate change, Iran, and the possible return of global current account imbalances.*

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Steve Weisman: It's early 2010 and China is increasingly the focus of news on several fronts including climate change, the possibility of sanctions in Iran, and the future of the global economy.

This is Steve Weisman at the Peterson Institute for International Economics with Nicholas Lardy, senior fellow at the Institute, to sort through some of these developments. Thanks for joining us, Nick.

Nicholas Lardy: Thank you, Steve.

Steve Weisman: China is not only in the news but it seems to be increasingly the focus of criticism in Europe and the United States for its policies in these areas. Let's start with climate change. After Copenhagen, criticism in Europe has been especially fierce that China allegedly prevented an agreement, or something like an agreement, from taking place there. What's your sense of the justice or injustice of that criticism?

Nicholas Lardy: I think it's easy to criticize China's policy but I think the reality is that it was known months and months in advance that China had certain goals that were not compatible with reaching a binding agreement. And I think those who were most closely involved in negotiating in a run-up to Copenhagen with the Chinese recognized the unwillingness of the Chinese to move forward on a number of really critical issues.

Steve Weisman: Is there any hope that in coming months they can achieve a consensus, if not in terms of a treaty or binding set of obligations?

Nicholas Lardy: Well, I think it would probably require substantial compromises. I don't think China is going to agree to binding commitments. I don't think they're going to agree to an absolute reduction in greenhouse gas emissions. And I think they're unlikely to agree to kind of an iron-clad system of verification of whatever it is they do promise to do. So, I think on all three of those issues, China's position will make it difficult to have a favorable outcome unless a favorable outcome is redefined.

Steve Weisman: The Chinese envoy to Copenhagen was removed according to some news reports. Is this a sign of internal disagreement about how to approach Copenhagen?

Nicholas Lardy: There is bound to be a range of opinions in China on this, as there is on most issues. But I think the direction from the top is pretty clear that they feel they have made a very substantial commitment by setting forth the goal of reducing the carbon intensity of their

growth. And I think it is—I mean my assessment is it is a very substantial contribution. But it's not what most countries have been looking for, and that is absolute reductions. And China is, as I said, unwilling to move in that direction.

Steve Weisman: And it shares that position on absolute reductions with the other major countries in its tier, which are now called the BASIC countries.

Nicholas Lardy: Yes, I think their view is [that] most of the problem stems from the emissions of the now-developed countries and they should not be asked to undertake absolute reductions when they're at relatively low levels of per capita income. Someone made the statement that this is like the rich man having a fabulous dinner and inviting someone in for coffee and then inviting them to split the check. I think the Chinese feel, as [do] the Indians and a number of others, that—

Steve Weisman: And the Brazilians and the South Africans.

Nicholas Lardy: Right. That their contribution to this problem cumulatively is so small compared to the current advanced industrial economies that they should not be required at this stage to make absolute reductions.

Steve Weisman: Let me turn to another sensitive issue where there seems to be a lot of focus on China, and that's Iran. Again, the West—the United States and the Europeans—is talking about sanctions going through the United Nations Security Council, but again China seems to be balking. What's the state of play there?

Nicholas Lardy: China has supported the modest sanctions that are already in place. I think the question you raise really is will they support a tougher set of UN-sponsored sanctions. And I think here, it's very difficult to know in advance of an actual vote on a very specific concrete proposal. But I think in general, China has signaled that it is not very enthusiastic about a much stronger set of sanctions.

Steve Weisman: And on the global economy, China of course has recovered more robustly than any other country in the world. Its growth, as you had projected, is going to be very strong this year. So, you're hearing some concerns again about the return of the global imbalances issue, of China building up big surpluses. Is there any sign of that and what do you make of the concerns being expressed in the United States and Europe?

Nicholas Lardy: I think the concerns are real. China has been the first globally significant economy to recover strongly. It is now allowing its currency to depreciate very dramatically on a trade weighted basis that is looking against all the currencies of its major trading partners. And so, I think one can now make a stronger case that its recovery has been based at least in part, on imposing cost on others through allowing its exchange rate to depreciate.

And so I think China is more vulnerable to criticism on its exchange rate policy now than it has been in the recent past. And it's compounded by the fact that the Premier of China has taken a very tough public stance on this saying, quite frankly, things that don't necessarily make complete economic sense, but basically saying that China is not going to allow its currency to appreciate and the world should be applauding this.

So there is a huge opening gulf, I would say, between what many countries in the West—the rest of the world, not just the United States and Europe but others: you know the Brazils and Indias and so forth, what they think should be done and what the Chinese are saying they'll do, now. So that expanding gulf does create problems.

In the short run, of course, China's surplus has declined dramatically in 2009, but the IMF forecasts that it will widen again going forward. Of course forecasts of current accounts are notoriously unreliable but I don't think there's any doubt the currency of China remains significantly undervalued. They're still building up massive foreign exchange reserves. That means they're intervening in the market to prevent an increase in the value of their currency, which is really the opposite of what they had pledged to do when they changed their currency policy four and a half years ago.

Steve Weisman: Okay, Nick, huge gulf between the United States and China on currency and something of a gulf on Iran, something of a gulf on global warming, on climate change. What happened to the idea of a G-2 US-China cooperative enterprise in the 21st century?

Nicholas Lardy: I think at the beginning of the Obama administration, I had the view—and I think many others did—that the Sino-US economic relationship was in pretty good shape. Indeed, perhaps the best shape it had been in for some time and not just on economics but on a range of other issues. But what we've seen over the first year of the Obama administration is some real deterioration and I think a growing sense of frustration, within the high levels of the administration about how China is fulfilling its role. Of course the G-2 concept was never officially embraced as US policy.

Steve Weisman: Right.

Nicholas Lardy: But I think within the administration, more and more people at and near the top are really wondering what the potential for close cooperation with China on major global issues is, and whether or not it still might turn into more of an adversarial relationship. I think we're at a potential tipping point where those who have thought China could be integrated into the system and play a positive role are having a harder and harder case to make based on what the Chinese are actually doing.

Steve Weisman: Well, on that less-than-optimistic note, thanks, Nick, for joining us.

Nicholas Lardy: Thank you.

