

President Hu Jintao's Visit to the U.S.

Key issues to watch

Currency Policy

The Chinese government has long faced sharp criticism from the U.S. over its exchange rate policy, which American government and business claim keeps the yuan undervalued and gives China an unfair trade advantage. Persuading China's leadership to show greater flexibility on the reform of its tight currency controls and allow the yuan to strengthen at a faster pace will likely rank as one of the key objectives for the U.S. government during President Hu Jintao's upcoming visit. However, the amount of pressure President Obama's administration can bring to bear on the currency issue is fairly limited. First, China enjoys considerable leverage given its unique status as the largest creditor nation to the U.S., with Beijing holding more than \$900 billion worth of U.S. Treasury bonds. Chinese officials are justifiably concerned about the security of their investments as the American economic recovery remains weak and high rates of government spending and loose monetary policy persist. Second, China is reluctant to allow a rapid appreciation of the yuan and risk hurting its export manufacturing sector, which has been the key driver of the country's economic growth over the past two decades. Third, the Chinese government has demonstrated a greater willingness to accommodate U.S. concerns regarding its currency policy by allowing the yuan to begin gradually strengthening six months ago, albeit at a very slow rate (5-6% annually).

Last week, U.S. Commerce Secretary Gary Locke reiterated the need for a faster revaluation of the yuan to occur, citing the harmful effect on U.S. competitiveness caused by an artificially weak Chinese currency. However, the Obama administration will find it difficult to achieve any major gains on the currency issue during President Hu's visit given China's role as America's primary financier, the importance of maintaining gradual currency reform to the health of the Chinese economy and the recent gesture of goodwill by the Chinese government in allowing a small degree of appreciation over the past six months.

North Korea

Both China and the U.S. have a mutual interest in maintaining peace and stability on the Korean peninsula, especially given the region's status as a potential flashpoint for the eruption of hostilities between the two powers. Unfortunately, the rising aggression of Kim Jong-il's pariah regime in 2010 has significantly escalated tensions in the region. The sinking of the South Korean naval ship, the *Cheonan*, by a North Korean torpedo in March last year and the more recent shelling of South Korea's Yeonpyeong Island in November brought relations between the two Koreas to one of their lowest ebbs since the cessation of major hostilities during the Korean War in the 1950s. Significant

advancements recently revealed in North Korea's nuclear programme have also helped fuel a rising view in the American defense establishment of the country as a direct threat to the national security of the U.S.

As North Korea's most important ally, China has faced increasing international pressure to rein in its northern neighbour, particularly from the U.S. Deescalating tensions on the peninsula is almost surely ranked high on the list of priorities for the Obama administration during President Hu's visit. Washington will very likely continue to urge Beijing to more vigorously exercise its considerable leverage over North Korea, which is highly dependent on China for aid and energy supplies. However, Beijing is understandably worried that an abrupt severing of its support for North Korea would trigger the collapse of the isolated regime and destabilise the entire region. In addition, the Chinese leadership has repeatedly expressed concerns about what it sees as an excessive level of American interference in a regional security issue. For example, the U.S.-South Korea joint military exercises conducted in the Yellow Sea near China last year in the wake of the attack on Yeonpyeong Island were viewed by China as unnecessarily provocative.

Despite such tensions, a top Chinese diplomat recently reiterated the mutual interest held by both China and the U.S. in preserving peace and stability on the peninsula and also reemphasised China's desire to see a resumption of the six-party talks, which were suspended in May 2009 following North Korea's second nuclear test. The six-party talks are a multilateral forum to conduct negotiations aimed at achieving the denuclearisation of the peninsula. China has been keen to see the U.S. give greater concessions to North Korea, but the Obama administration has so far hesitated to agree to a resumption of the talks due to concerns about rewarding North Korea for its aggressive behaviour and violations of past agreements. The top priority attached to deescalating tensions on the peninsula by a top Chinese diplomat in the buildup to President Hu's visit underscore China's recognition of deepening U.S. concerns. However, whether or not the two sides will come to a significant agreement, such as a resumption of the six-party talks, remains to be seen.

U.S. Diplomatic Cables

The release of U.S. diplomatic cables exchanged between the State Department and American embassies around the world by WikiLeaks has generated considerable tensions between the U.S. and other countries, including China. Released memos related to China have thus far covered sensitive topics such as American perceptions of China's economic push into Africa and an alleged hacking campaign against Google. The failure of the U.S. government to properly safeguard its diplomatic communications will likely not result in a serious rupture in bilateral ties but will almost certainly undermine trust between the two countries. Particularly worrisome is the continued release of new memos by WikiLeaks, which creates uncertainty about what new revelations will come out in the months ahead.

Climate Change

The recently concluded 2010 UN Climate Change Summit in Cancun (28 November—10 December) achieved modest gains and happily managed to avoid a repeat of 2009's disastrous Copenhagen Summit. Participating governments agreed upon a deal which includes a Green Climate Fund that will provide developing countries with \$100 billion in aid per year by 2020, new mechanisms to share low-carbon technologies, measures to protect forests, etc. Unfortunately, as expected, the summit failed to yield a binding global accord to succeed the Kyoto Protocol. As the world's largest polluters, both China and the U.S. are essential to achieving any international framework for lowering global emissions. Yet both countries again found themselves at loggerheads over issues such as binding emissions cuts for developing countries, bigger emissions reductions commitments by developed countries, international verification systems, etc. However, in the wake of the dismal 2009 summit, which saw a sharp deterioration in the Sino-U.S. bilateral relationship, Cancun marked a step forward. In addition, earlier this month, a senior Chinese diplomat underscored the rising level of cooperation achieved between the U.S. and China at Cancun, which bodes well for the prospects of future collaboration.

Protectionism

Both China and the U.S. hold legitimate concerns about the other side engaging in trade protectionism and profess a desire to see greater economic openness. Achieving heightened access to the other's domestic market will be a top priority for both countries during the visit. Beijing has accused the U.S. of exacerbating commercial ties through contentious actions such as anti-dumping measures, high-tech export restrictions and investigations into Chinese government subsidies for the country's burgeoning clean energy industries. For example, a Chinese Foreign Ministry spokesman emphasised last week that U.S. restrictions on high-tech exports are partly responsible for the skewed trade balance between the two countries. In November 2010, the U.S. trade deficit with China stood at \$25.6 billion, and it continues to grow. The U.S. is understandably wary about allowing a dramatic relaxation of its export restrictions on high-tech products due to risks such as intellectual property theft and national security concerns. However, the loosening of restrictions on products where such risks are minimal could help narrow the widening trade imbalance. U.S. Treasury Secretary Timothy Geithner recently expressed the willingness of the U.S. government to give Chinese companies greater access to the American market and high-tech goods in return for greater flexibility from Beijing on currency reform.

Several key grievances commonly voiced by the U.S. include accusations of currency manipulation to bolster Chinese manufacturers, unfair government subsidies supporting clean energy companies in China, a lack of transparency in the Chinese market and weak protection of intellectual property. For example, the Office of the U.S. Trade Representative announced plans in October to launch an investigation into allegedly illegal Chinese subsidies that violate WTO trade rules and favour domestic manufacturers in China's booming clean energy industries. In December, the U.S. administration

requested the WTO investigate government subsidies supporting the Chinese wind power sector, which Beijing has vigorously defended as compliant with WTO trade rules.

Despite such trade frictions, both countries are keen for the visit to underpin a positive commercial relationship. U.S. companies, in particular, are increasingly anxious to enjoy greater access to the Chinese market given continued weakness in the American economy. The Chinese economy's impressive rebound from the global recession and status as one of the leading engines of world growth have created opportunities in the Chinese market that simply do not exist for many U.S. companies at home.

Fortunately, positive business outcomes anticipated for the visit have already begun to materialise. For example, according to the Chicago Council on Global Affairs, U.S. and Chinese companies are expected to sign roughly 40 deals during President Hu's planned visit to Chicago. Such agreements will play an important role in strengthening bilateral economic ties.

Rare Earths

China's global monopoly over the supply of rare earth minerals has generated rising alarm in the U.S., especially since last summer when the Chinese government reduced its rare earth exports by over 70% for the 2nd half of 2010. The 17 elements comprising the rare earths family are often critical components in the development and manufacture of some of the world's most advanced and cutting-edge technologies, used in the production of everything from iPads to wind turbines to weapons systems. Open access to rare earths is essential for foreign governments and business to continue playing any meaningful role in the burgeoning industries which stand at the technological frontier.

Beijing's sustained policy to tighten its supply of rare earths to world markets since 2005 has prompted American government and industry to seek to reestablish the domestic rare earths supply chain in the U.S., which moved overseas to China beginning in the 1990s. However, the extraction of rare earths is very difficult and requires heavy investments in both time and money. Rare earth mines in the U.S. face stringent environmental regulations, a lack of financing exacerbated by the global economic recession and the prospect of years of development before being able to launch full operations.

China does have legitimate concerns justifying the need for the imposition of limitations on its rare earth exports such as over-exploitation of its reserves which has resulted in severe environmental degradation. In addition, projections that China's demand for rare earths will equal the country's entire supply by 2012 make the government's desire to safeguard a vital national resource understandable. The Chinese government has offered reassurances to the U.S. and other countries that it will never block the export of rare earths and only wants to export the metals at a reasonable price and volume. Such pledges are certainly encouraging, but the Obama administration will likely try to persuade China to loosen its current restrictions during the visit.