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Time running out for U.S.-China rebalancing act

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By [Emily Kaiser](#) - Analysis

WASHINGTON (Reuters) - When President Barack Obama talks about building a more export-driven U.S. economy, China might want to listen closely.

Beijing has been getting unsolicited advice for years, both from the United States and a host of private economists, urging China to shift its focus away from churning out exports and toward building domestic demand.

The global recession has effectively accomplished what cajoling did not. China's exports fell 21.4 percent in June from a year earlier, and its \$585 billion in stimulus spending has been widely credited with helping to revive domestic growth and stabilize the world economy.

While China was quick to act to counter the recession, it may be underestimating the deeper issue of U.S. consumers' changing attitudes toward borrowing and spending.

If Americans don't quickly return to their free-spending ways -- and many economists suspect they won't -- that will have big implications for global trade and economic growth, and perhaps also the U.S. dollar and Chinese yuan.

"They (China) recognize that the economy needs to be rebalanced, but they're still wed to this belief that they have plenty of time to do it," said Steven Dunaway, an adjunct senior fellow at the Council on Foreign Relations and a former International Monetary Fund official. "I believe the clock's run out."

Beginning on Monday in Washington, the United States and China hold the first of what are supposed to be twice-yearly strategic and economic talks. Rebalancing economic growth in both countries is certain to be a topic of discussion.

Obama has been pushing for a U.S. economy that relies on exports more than imports, and saving and investment ahead of borrowing and spending. It is a vision that resonates with U.S. consumers since the financial crisis has wiped out some \$12 trillion in U.S. household wealth, forcing Americans to curb spending and rebuild savings.

"Under the force of circumstances, we have been undergoing a cold-turkey cure for our addiction" to over-consumption, said Edward Gresser, a senior fellow at the Democratic Leadership Council and former policy adviser to the United States Trade Representative.

"Our imbalances have gone down pretty sharply and quickly. The Chinese (imbalances) have not," he added.

EXPORT PARADOX

The U.S.-China relationship has never been simple, but from an economic perspective it essentially boiled down to this: China produced hundreds of billions of dollars worth of goods each year that it shipped to voracious U.S. consumers, who increasingly paid for purchases with borrowed money.

China got jobs for its growing population, reserves that now stand at more than \$2 trillion, and some leverage over Washington, which desperately needs foreign investors to sustain purchases of U.S. government debt.

Americans got cheap and plentiful goods along with low inflation and interest rates, but also a mounting debt burden that is now a big reason why households are curbing spending.

That in turns helps explain why Obama is focused on exports. With U.S. consumer demand likely to be tepid for some time, the United States will have to look to the rest of the world to help build domestic growth.

Boosting exports is a tried and true way of escaping recession. Unfortunately, it is difficult to do when the entire world is mired in a simultaneous slump.

"The paradox is that we are returning to the old stage where everyone is hoping to ride the coattails of the U.S.," said Eshwar Prasad, a senior fellow at the Brookings Institution in Washington who has written extensively on Asian economic rebalancing.

The United States could gain a considerable export advantage by allowing the dollar to weaken, something that would be anathema to the Chinese, whose reserves are heavily weighted toward dollar-denominated assets.

To be sure, intentionally devaluing the dollar would be fraught with political peril at home and abroad. The most likely approach may be benign neglect, where officials say little about the dollar and do nothing if markets push it down. (For a yuan-dollar chart, see [here](#) ar/

But there is a risk that won't be enough.

David Rosenberg, chief economist at Gluskin Sheff in Toronto, said the dollar is the one remaining policy tool that U.S. officials have not used to fight the recession -- and if things get bad enough next year they just might be tempted.

"As the unemployment rate makes new highs and increasingly poses a political hurdle in a mid-term election year, (it) would make perfect sense, for a country that always operates in its best interest -- even if it may not be in everyone's best interest -- to sanction a U.S. dollar devaluation as a means to stimulate the domestic economy," he recently wrote to clients.

Rosenberg himself said his comment was purely conjecture. Still, the dollar has weakened recently against a basket of currencies, and U.S. officials clearly do see a shift in the U.S.-China trade balance as a means of boosting growth.

David Loevinger, the U.S. Treasury's coordinator for this week's U.S.-China talks, put it bluntly in a telephone conference with reporters last week.

"All this ultimately gets back to jobs in the U.S.," he said. "If the Chinese can increase their consumption, reduce their trade surplus, that's going to mean more U.S. exports, more U.S. jobs."

Indeed, the U.S. benefit is obvious. What is less clear is what's in it for China and the rest of the world.

(Additional reporting by Paul Eckert)

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