How the *U.S. Congress* Views China

Sen. Lindsey Graham (R-SC)

The Senate's rising star on Chinese trade and finance issues sits down for a chat.

A TIE *exclusive interview.*

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TIE: A lot of people are worried about China—they see inventory starting to stockpile, and they worry that by next year Chinese exporters will have begun heavy discounting. The United States already has a current account imbalance approaching 7 percent of GDP. Is there any concern in Congress that at some point, China will try to export its way out of its overcapacity problem?

Graham: China and the United States have negotiated a textile agreement that's a good start on better relations. China is overbuilt in many ways. It's overbuilt in office space capacity. Its banks have a bunch of loans outstanding that are probably no good. The Chinese economy is too dependent on exporting. There is not enough consumerism in China.

Here is what I'm suggesting we worry about. We need to worry about Chinese business practices. The economies of scale in China are never going to change. That country has a lot of bright people who can do many terrific things. I've tried to get the Chinese to buy into an international business model that will allow us to have productive relationships, and move away from this confrontational model. As long as China manipulates the value of its currency to create a discount against all other currencies, it will be seen by manufacturing competitors as unfair. Without a system for protecting intellectual property rights, China will lose a lot of business investment and we're going to have a ton of friction between the Congress and China. As long as China engages in rampant transshipment and piracy, we're going to have problems. When they want to, the Chinese have the ability control piracy. Chinese-made movies don't get pirated. But American-made videos and movies get pirated to death. The transshipment issue, where goods assembled in China are sent to other countries to get the benefit of a trade agreement China is not party to, would stop if the government intervened.

The currency issue is the key to better relationships, or it could be the trigger that worsens relationships.

So my goal, working with Senator Charles Schumer (D-NY), is to tell the Chinese we want trade between our countries to be a win-win situation. When China signed up with the WTO, it was expected that they were signing on to a new way of doing business. But their business practices still follow the old way, which is the China-first model, which won't work.

TIE: **There is a sense in the markets that you and Senator Schumer were moving at eighty miles an hour and now you've deliberately slowed down to say twenty miles an hour. Is it because Alan Greenspan, the U.S. Treasury Department, and others have tried to negotiate a solution before you guys in Congress get tough?**

Graham: Great question. Our legislation came about after almost two years of trying to negotiate. We started with a Senate resolution that the Chinese were manipulating their currency—hurting market values and hurting manufacturing—and they needed to change their system. We scheduled a vote last year, then put it off, thinking something would happen.

The legislation [the China Free Trade Act, co-sponsored by Sens. Schumer and Graham] came about as a result of trying everything under the sun. We don't want tariffs. But we're not going to sit on the sidelines and watch China cheat us out of market share. The 67 votes we got to not table our amendment were a wake-up call to the Administration and hopefully to the Chinese. And our position is being reinforced by the European Union. Congress and the Senate aren't the only ones having problems with China's practices. It's almost every international business group.

We were encouraged when China revalued its currency. It was not much size-wise, but it was encouraging. I know the Chinese can't float their currency tomorrow, but as long as they are taking steps to follow international business norms with their currency and other business-related items, I can be patient because I know wholesale change is hard in an emerging economy. So we've slowed down for a purpose, to try to make this situation a win-win. Federal Reserve Chairman Alan Greenspan has convinced me that China is as much

Chinese Piracy

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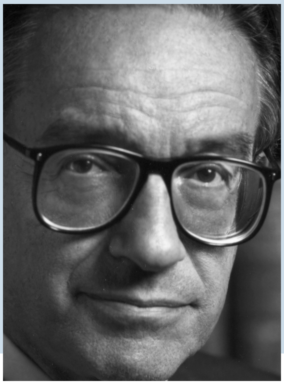

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TIE: **Do you feel like you understand who is making the decisions in China?**

Graham: I have a hard enough time understanding American politics. But I know China's central bank understands that revaluing and floating their currency helps the Chinese economy, because to buy enough dollars to keep the yuan's value below that of the dollar creates inflationary pressure. I believe, sincerely, that the economic side of the Chinese government understands that reform is in their best interest. The political side of the government has expressed the same sentiment. If a country is in the WTO and other international trade organizations, it should expect its trading partners to insist it plays fair, and we see the situation as China not playing fair. The currency reform movement is alive and well in China, but who is going to decide how much and when, I don't know.

We have a potentially explosive situation in America: We're borrowing equity in our homes to buy Chinese products. One day that will stop.

TIE: **What is the date at which you decide that you are not getting results?**

Graham: I think it would prudent to wait and see what happens in the aftermath of the President's visit. I remain cautiously optimistic that these Chinese see the need to revalue as a win-win.

TIE: **Some have observed that the adjustment in the yuan of 2 percent this summer was microscopic. In your view, what do you see as a credible move?**

Graham: Well, the experts say the yuan is undervalued 15 to 40 percent. Our manufacturers who compete with China believe the yuan's current valuation

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against the dollar is a real impediment to them staying in business. We want substantial reform, and substantial reform means eventually a floating currency. I'm patient as to how China gets there, but I do believe it is in China's long-term, best interest to float their currency. A revaluation process would signal to the world that China understood its obligations in terms of being part of the world community. The recent 2.3 percent was a start—that was well received, but we all understand that becomes just a fig leaf if nothing else is done.

TIE: **Are you worried that China is essentially this uncontrollable beast the leadership is trying desperately to ride and control? Regional strife is increasing, the expectations of the average Chinese person are growing, and the leadership isn't going to be able to fulfill its promises.**

Graham: I worry about that in my own country. Globalization is real, and we have to deal with it. The

Chinese have a different set of problems. They are an energy-starved nation. They must come up with new energy sources. They've got a lot of unemployed people still. I want to give some credit to the Chinese leadership. This 2.3 revaluation percent move is a good signal to the world community. China could be tremendous trading partner—they could be a great source of consumerism—but the problems in China are enormous.

The solution is partnerships—not an inward-looking solution where market share is held by manipulating trade policy, but a solution where China reaches out to the world community. The best brains would come and help with a new banking system, for example. For China to make the transition, they are going to need the help of the rest of the world. We need China for good consumer goods right now, and they need us for technological business advancements. If they will look outward there will be a welcome mat, and their problems will become easier to handle, not harder. If they are fighting us, if they are having to control their own economy, and are seen by their trading partners as people who cut corners and cheat, then their problems get exponentially worse.

TIE: **You made a good point earlier about overcapacity of production in China. A lot of U.S. analysts worry that the Fed will find itself overshooting on monetary policy, and when the U.S. economy slows down, our domestic demand will weaken and there will be large ripple affects in China. Since they are already carrying a lot of excess inventory, what does that mean for potential Chinese dumping into the international market?**

Graham: It means they've got a huge problem on their hands and we'll be the recipients of their huge problem. We have a potentially explosive situation in America: We're borrowing equity in our homes to buy Chinese products. One day that will stop. One day, our economy is not going to grow at 3–4 percent, and Americans will start cutting their purchasing. We're a cash cow for Chinese products. One day, they will not be able to float our own debt. It's in our mutual interest for us to be less dependent on Chinese capital to float our debt, and it is in their long-term interest to expand their economy beyond exporting to us.

We're not going to sit on the sidelines and watch China cheat us out of market share. Our position is being reinforced by the European Union.

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TIE: **We asked similar questions to officials at the European Central Bank and they said China faces a huge challenge. It must incorporate a group of people almost the size of the Canadian population into their workforce every year for the next twenty years, and such a feat requires 9.5 percent growth rates and 40 percent investment rates for as far as the eye can see. It's not impossible that they will hit that difficult target every year, but is it likely? On a scale of one to ten, with ten hyper-optimism and one avoiding a Chinese train wreck with the rest of the world, where do you see things going?**

Graham: Five. It could go either way. And the issue that will determine attitudes has become the currency issue. The currency issue is the key to better relationships, or it could be the trigger that worsens relationships.

TIE: **Thank you very much.** ◆