Insight: Ten years on, American business rethinks China dreams

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WASHINGTON (Reuters) - Few in the United States would recognize Charlene Barshefsky or remember what she did. Not so in China where the former Trade Representative says she is stopped in the streets by ordinary people and thanked.

Paul Eckert and Stella Dawson

Her gift to the Chinese people was leading the U.S. delegation that negotiated China's entry to the World Trade Organization in December 2001. The removal of trade barriers heralded unprecedented economic growth for China, vaulting it in a decade to the second largest economy in the world and helping slash its rural poverty rate from

10.2 percent in 2000 to 2.8 percent in 2010.

"The Chinese consider WTO entry the most historic achievement in U.S.-China relations since (U.S. President Richard) Nixon's visit to China," in 1972, Barshefsky said.

It is a different story in the United States where, 10 years on, China's entry into the club of world trading nations is having equally huge ramifications.

The flood of cheap manufactured goods gives an extra $600 a year for the average American family to spend on clothing, shoes, household goods and electronics. But Made in China has hastened the decline of U.S. manufacturing. Factory jobs have shrunk in number by 25 percent the past decade to 11.5 million today, and average factory wages adjusted for inflation have virtually stagnated.

Chinese imports meanwhile have ballooned the U.S.-Sino trade deficit to $273 billion, four times that with any other country. It has stirred anti-China sentiment, a labor union backlash and legislation in Congress to try and force China to let its currency strengthen more rapidly to lower its export advantage.

Now American business, lured a decade ago by the promise of a fast-growing Chinese middle class, is starting to shift gears and rethink what the China dream can deliver. Some chief executives are questioning whether the United States is pressing China hard enough to hold up its side of the bargain in joining the elite trade club.

"I think by any definition -- if you look at the raw numbers -- we've made a lot of progress. But by the same definition, we'd be fooling ourselves if there isn't a lot of frustration," said the man who now holds Barshefky's old job, U.S. Trade Representative Ron Kirk.

The reconsideration of China is taking place while the United States struggles with an economic slump that has brought high unemployment and doubts about the country's long-term fiscal health. It is also taking place in an election year, and while China is a regular target in presidential campaigns, even Mitt Romney, with the strongest corporate credentials of all the Republican candidates, has made a point of criticizing China.

Almost 10 years to the day that China joined the WTO on December 11, 2001, Washington is growing concerned that China has lost its commitment to freer trade and that as new leaders prepare to take over next year, China is abandoning its march toward market capitalism in favor of state mercantilism.

"There's competition between the American economic model and the more state-centered economic model of China and other countries," said Robert Hormats, U.S. Undersecretary of State for economic affairs in an interview last month.

For the United States, toughening its economic stance toward the world's emerging superpower is a delicate balancing act and carries with it geopolitical risks as China flexes its muscle across Northern Asia, Africa and Latin America.

"We have a challenge in dealing with China," said Hormats, one of the Obama administration's top economic diplomats. "On one hand, the global system won't work well if we and China can't cooperate and productively resolve our differences. On the other hand, we have real differences, many of which are awfully difficult to resolve."

TENSIONS MOUNT

The U.S. complaints about China are well known -- widespread theft of intellectual property, a lack of transparency about its regulations, missed WTO deadlines for opening markets, foot-dragging in allowing its currency to rise in value and subsidies such as low-interest state loans that favor domestic industries.

China argues that as a developing economy, it needs to protect its nascent industries and help them grow. It also retorts that the United States blocks its companies in key sectors.

Huawei Technologies, for instance, withdrew its $2 million bid this year for 3 Leaf Technologies when the U.S. government raised national security concerns, and oil giant CNOOC canceled an $18.5 billion bid for American oil company Unocal Corp in 2005 after a political backlash in the United States.

As trade frictions grow, corporate America for the first time is publicly voicing concern that the trade deal with China is lopsided, and pressure is building on President Barack Obama to toughen his stance.

Jim McNerney, Boeing Co's chief executive, touched upon the issue in November, speaking of a "dilemma" in China relations when he asked Obama at the APEC business summit how he would assess the U.S.-China relationship when both the left and the right are calling for a harder line.

Obama gave his administration's standard response of pursuing constructive engagement and a strong policy with a key partner, but the subtle criticism appeared to have hit home. Later, after a private meeting with Chinese President Hu Jintao, he called for China to stop "gaming" the world trade system.

Business can be a far more powerful lobby than trade unions, the traditional voices that have complained of China's trade practices.

Its influence, particularly in a presidential election year, could lead to increasingly adversarial relations.

"The level of business support for stable U.S.-China relations is beginning to fracture," said Nick Consonery, China expert at the EurAsia Group, a political risk institute that works closely with corporations.

"It is definitely happening because the business perspective is changing and they are less willing to get out in front of (and

support) the administration's 'strong and stable' relationship."

In October, the U.S. Senate passed for the first time a bill designed to punish Chinese imports with levies, unless China allows its currency to rise more rapidly in value. Many U.S. economists and lawmakers believe China's yuan is kept artificially cheap by as much as 10-25 percent -- another subsidy to Chinese exporters that helps them undercut foreign competition.

Never before has a currency measure, brought forward multiple times in the past, won U.S. Senate support. No action has yet been taken in the U.S. House, where it is expected to founder.

BUSINESS COMPLAINS

The policy that perhaps most frustrates American business stems from a

2008 announcement by China's State-Owned Assets Supervision and Administration Commission. It identified "economic lifeline" sectors that China says it must dominate.

The list is long -- aviation, air freight, coal, oil and petrochemicals, power generation, telecommunications and weapons.

Industries such as chemicals, equipment and auto manufacturing, electronic communications, steel and nonferrous metals are set as state controlled to varying degrees. These state-owned enterprises enjoy a monopoly or oligopoly in the Chinese market; subsidies for land, water and power; and below-market cost of capital.

Until recently, American business leaders had been loath to speak of China's practices for fear it would lose them lucrative contracts or result in regulatory scrutiny that harms their China operations.

Several have gone public in the past few months.

"The Chinese government is not going to allow a non-Chinese Internet company to succeed... It is a weapon in the 21st century national security games," eBay Inc chief executive John Donahue said in October at a Web 2.0 summit.

EBay has abandoned its efforts to build a Chinese marketplace where people bid for goods online after it ran into stiff competition from a free Chinese site. Its new strategy is to sell goods from Chinese companies to international buyers. "It was about finding a business model that works in China," said Daniel Feiler, spokesman for its China operations.

Google Inc. last year pulled back to Hong Kong on concerns Chinese were hacking the Internet search giant and a row with China over censorship.

Jeffrey Immelt, chief executive of General Electric Co which has multibillion dollar contracts in turbines, railroad engines and aircraft parts with China, also faced choices in how to compete. "The notion was, if we're part of the Chinese economy, we should be allowed to win."

But finding ways to win means that companies have to avoid confrontations with Chinese authorities, he said. "We're not naive or stupid about these things. We really do think a lot about it," said the CEO, who advises Obama on business competitive issues. "There is a multitude of ways to succeed in China."

China's policies have helped vault its industries to global prominence. It has 61 companies today among the global Fortune 500 list, almost quadruple the number in 2005. The U.S. tally over the same period has fallen to 133 from 176. What American business finds disturbing is that most of the Chinese companies are state-owned, including the three in Fortune's Top Ten -- China Petroleum and Chemical Corp, China National Petroleum and State Grid.

The U.S. Chamber of Commerce said in a joint report with the Coalition of Services Industries that China and other countries lavish regulatory favors and generous subsidies on their state-owned firms, making it very difficult to compete.

"No adequate and effective international disciplines now exist to deal with this problem," it said.

FIGHTING BACK

In the past three years, the United States has brought five cases against China at the WTO, more aggressive than the seven cases during the eight years of former President George W. Bush's administration.

By March 2010, the United States had won three WTO cases against China, four were resolved before WTO action, and four were pending.

Apart from negotiations at WTO complaints, the United States also is working to draw other big Asian trading nations into regional or bilateral trade pacts, which are designed to open markets and serve as a hedge or counterweight against Chinese trade policies. It ratified a free trade agreement with South Korea recently and has breathed new life into the Trans-Pacific Partnership (TPP), a 9-nation free-trade group that gained new heft in November when Japan, Canada and Mexico announced plans to join negotiations. U.S. officials want TPP to set new standards on free trade and become a template for future international trade deals.

What remains unclear in Washington is whether China's new leadership in 2012 will resume market opening or turn further inward.

The country took a huge leap in the 1990s as it prepared for WTO entry, slashing red tape, removing layers of protection for domestic factories and farms and opening its markets. That work is widely credited inside and outside China with turning the country into the industrial dynamo of today.

The U.S. ambassador to the WTO Michael Punke said China made "impressive steps" to bring its laws and regulations into line with global rules in the five years after WTO entry.

Some trade experts say reform fatigue then set in and they expect opening measures to resume. Other U.S. experts say China turned away from market liberalization as early as 2003, when the reform-minded team of President Jiang Zemin and Premier Zhu Rongji retired and handed power to the more cautious current leadership of Hu Jintao and Wen Jiabao, respectively.

"Nobody who was watching China enter the WTO back then saw this change coming," said China trade analyst Derek Scissors of the Heritage Foundation. "It was as if a different government with different priorities came in," he said.

Hu and Wen are due to retire from their state posts in March 2013 and hand over power to successors, most likely led by current Vice President Xi Jinping. The next generation of leaders has not expressed economic or trade policy views that depart from current statist orthodoxy, and are expected to proceed cautiously once in power.

The cost could be high, said Long Yongtu, who negotiated China's WTO entry in the late 1990s. He told a recent symposium he was extremely worried that "essentially, after 10 years, it seems China is drifting away from the WTO."

A statist model that denies fair competition for all enterprises, domestic and foreign, could stifle China's economic growth, Long said.

"We cannot only have large-scale and state-owned enterprises. That is only the skeleton of the economy. We need thousands upon thousands of small and medium-sized private enterprises. They are the flesh and blood of the Chinese economy."