

China's Stimulus Will Work

By Calla Wiemer

Global markets have cheered the stimulus plan Beijing announced Sunday, and with good reason. At \$586 billion, it's ambitious. And although it might take some time to take effect, it could help usher in important changes in China's economy. If China is going to "rescue the world" from economic crisis, this kind of stimulus package is the way to do it.

Some have advocated a rescue of a different sort, calling for China to use its foreign reserves to bail out the U.S. financial system. But that is not the ticket to global recovery. The bulk of China's official reserves are held in low-risk U.S. dollar assets and that is where prudence dictates they should remain.

Rather than buying more assets, China could better pump up the world economy by buying more goods. The reason China's reserves are so large in the first place is that the country exports a lot more than it imports. In 2007, China's trade surplus accounted for nearly 2% of world GDP. China's industrial development has been driven by U.S. consumer demand while U.S. consumption has in turn been fueled by Chinese lending that kept interest rates low and asset values rising. But this symbiosis has fallen apart as the U.S. economy has softened and Chinese consumers are failing to fill the gap.

To reinvigorate its economy, China must rely on homegrown consumption. China's national saving rate in 2007 reached a phenomenal 51.2% of GDP, up 13.5 percentage points from the 37.7% rate of 2000. In counterpoint to this rising saving rate, the investment rate flattened out at around 43% of GDP from 2004 onward. The resulting excess of saving over investment finds

its counterpart in a trade surplus as export revenues not spent on imports are absorbed as a savings outflow.

The main driver of the increase in the saving rate has been a very high rate of GDP growth. A rapid increase in saving rates is common among developing countries in their growth take-offs. But growth is not the only factor influencing saving, and even with growth sustained at a goodly pace there are many avenues for government policy to alter the saving versus

consumption choice. The stimulus plan just announced by Beijing contains a mix of consumption- and investment-boosting elements. With investment spending already extremely high by any standard, elevating this source of demand does not hold much promise for sustaining growth. More railroad construction will not help to rebalance the Chinese economy. But other elements of the plan appear well conceived to stimulate consumption either directly or indirectly. Even where the immediate fiscal outlays are of an investment nature, if the spending feeds quickly into income growth or productivity gains, consumption can be promoted. This is true, for example, for such elements of the package as rural water conservancy and electrification and reconstruction in earthquake devastated areas.

The real potential for fiscal spending to have an impact on consumption, though, is through social spending. One element of the policy package focuses on health and education spending; another captures social security, pensions and income support. Spending in these areas not only supports public consumption directly, it stimulates private consumption as well by relieving households of the need to save to fi-

nance retirement or self-insure against mishap.

Strengthening the social welfare system has been an avowed goal of the current administration since it came to power six years ago. Yet budgetary allocations to social welfare purposes remain woefully low. Understandably, health and education are not as easy to throw money at as a railroad, especially in a country that is largely rural and poor. Funds have to be disbursed at the local level, and much capacity development must take place before this can be done effectively. The last six years have seen important progress in the way social spending is administered. Responsibility for service delivery has been shifted

from the village and township levels upward to the counties where personnel are better trained and monitoring systems are more readily implemented.

Across the country, experiments in fashioning health-care delivery systems have gone forward. As of 2007, Rural Cooperative Medical Schemes were established in 86% of rural counties. While these have not been ambitious in terms of the dollar amounts—the level of coverage is typically under \$10 per person per year—they've contributed importantly to administrative capacity building. The upshot is that with an institutional framework in place but

with funding as yet only nominal, there is both need and opportunity to ramp up fiscal flows. Similar situations exist with regard to education and social insurance programs.

The Chinese government has the fiscal space to undertake a massive stimulus program. Last year the fiscal budget was in surplus, and the cumulative level of

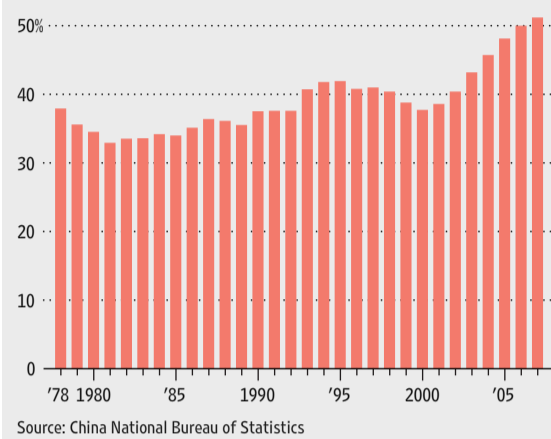
debt-to-GDP is modest. Avenues for productive spending are readily available. A redirecting of the economy toward consumption-based growth will ensure the tax base continues to expand and a healthy fiscal position is maintained.

China's stimulus package is good news for the world at large. More Chinese consumption means more demand for foreign goods and less export competition for producers abroad. As China's growth is driven more by absorbing domestic resources into the provision of social services not only are incomes generated, but human capital formation takes place contributing to productivity gains and income growth into the future. That means a growing consumer market to be tapped in the years ahead.

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A Frugal Nation

Savings as a percentage of GDP, 1978-2007



Source: China National Bureau of Statistics

'Change' Is Coming to Asia

By Ying Ma

The U.S. and most Asian nations have enjoyed eight years of stable and warm relations under Republican President George W. Bush. Now, the region stands at the dawn of a new, Democratic era in Washington—led by a young and charismatic President-elect, Barack Obama. But just because Mr. Obama won an overwhelming victory in the polls doesn't mean his presidency will bode well for Asia.

Recall that the last time a charismatic, young Democratic President entered the White House with little foreign policy experience, U.S. relations with China—and other Asian nations—suffered for eight years. The year was 1992 and that president was Bill Clinton.

Under the Clinton administration, Sino-American relations deteriorated to depths unseen since President Richard Nixon's visit to China. In 1993, he threatened to revoke China's annual most-favored nation status—then a prerequisite for Sino-American trade—unless China demonstrated substantive progress in human rights. He reversed his position a year later when China refused to budge. In May 1995, he promised the Chinese government that the U.S. would not allow then-President Lee Teng-hui of Taiwan—which China considers a renegade province—to visit Mr. Lee's alma mater, Cornell University, for a reunion. A week later he reversed himself under congressional pressure.

Mr. Clinton's indecision and inexperience had serious consequences for the rest of the region. In March 1996, he had to dispatch two aircraft carriers to protect Taiwan, after China conducted massive missile exercises to register its dismay over what it perceived as Taiwan's quest for national independence and America's encouragement thereof. (The Clinton ad-

ministration's denunciation of similar missile games the previous summer failed to deter Beijing from a second show of force.) In June 1998, President Clinton caused great consternation in South Korea and Japan when he visited China but left these two U.S. allies out of his Asia itinerary, the first snub of this kind by any sitting U.S. President in the post-World War II era. To top it all off, U.S.-led NATO forces accidentally bombed the Chinese embassy in Belgrade in 1999, killing and injuring Chinese diplomats and civilians and sparking spontaneous multi-day, multi-city anti-American riots in China.

To be fair, President-elect Obama is not President Clinton. He is worse. He is even more inexperienced in the foreign policy arena than Mr. Clinton, and unlike Messrs. Clinton or Bush, Mr. Obama has adopted all the wrong positions on free trade and free markets, issues crucial to Asia's past success and future prosperity.

President Clinton, remember, was an eager and effective advocate of globalization, the lowering of trade barriers and the promotion of foreign investment as necessary ingredients of economic growth. After his early flip-flop on China's most favored nation trading status, he consistently pushed for the mainland's integration in the global trading system and even offended many in his own party by supporting China's accession to the World Trade Organization. Closer to home, he lobbied for and signed the North American Free Trade Act, promoting trade with America's neighbors, Canada and Mexico.

Mr. Obama, on the other hand, publicly disdains free trade and free markets in a way that no modern American president

ever has. On the campaign trail, he denounced corporations for doing what they must in today's competitive global marketplace: search for lower cost labor alternatives overseas, such as in Asia. Complaining about the U.S. job losses created by Nafta while ignoring its benefits, he

pledged to unilaterally renegotiate the free trade pact. He voted against the Central American Free Trade Agreement in 2006. As a presidential candidate, he opposed congressional approval of free trade agreements with Colombia and South Korea.

As President, Mr. Obama will be aided by powerful protectionist forces in the Democrat controlled Congress, including Speaker Nancy Pelosi in the House of Representatives who, in a much less significant position in the 1990s, ardently opposed U.S. trade with China. The President will also enjoy the support of the Senate's Chuck Schumer, who just a few years ago proposed a 27.5% tariff on Chinese imports. Mr. Obama himself has called repeatedly for China to stop its "currency manipulation"—a clear signal that trade fights are on the horizon.

A self-proclaimed "citizen of the world," Mr. Obama has refused to recognize that while numerous challenges remain, the success of Asia in the past half a century tells a story far more favorable for the free market than the one he has offered. Since 1978, China has implemented market liberalization policies that have led to three decades of explosive economic growth. Other Asian countries in the post-World War II era adopted market-oriented policies and gave the world the modernization of the Four East Asian Tigers—Taiwan, Singapore, South Korea and Hong

Barack Obama's win doesn't bode well for the region.

Kong. Vietnam has recently followed suit, and achieved an impressive transformation of its economy.

Asian capitals could look on the bright side and hope that Mr. Obama's hostility toward free trade and free markets is, as supporters have hinted, just campaign rhetoric. Or Asia's policy makers could hope that Mr. Obama, in his youthful inexperience, simply did not understand the issues. Much like the last young Democratic President, Mr. Obama could learn in office and change his stance when confronted with strategic realities. Perhaps the Communist regimes in Hanoi and Beijing can teach the U.S. President-elect a thing or two about the power of the market. Until then, America and Asia will simply have to wait and see what price his inexperience will exact.

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