



Institute of Strategic and International Studies (ISIS) Malaysia

**NEWSCLIPPINGS AND ARTICLES
ON
CURRENT ECONOMIC SITUATION**

July 16 - 31, 2009

**INFORMATION SERVICES DIVISION
ISIS MALAYSIA**

THE WALL STREET JOURNAL.

THURSDAY, JULY 16, 2009

Business Needs to Speak Up on Trade

By Scott Davis

Global trade is a complex creature that requires cooperation across national borders and between governments and businesses. But what it delivers is simple: jobs and higher living standards.

Growth in trade since World War II has added an average of about \$1 trillion a year to America's income (in 2003 dollars), according to economists at the Peter G. Peterson Institute for International Economics. And if the world's remaining barriers to trade and investment were to fall, global trade would add another \$500 billion to domestic wealth creation each year.

That's the good news. The bad news is that the importance of trade and its value to our economy is being lost amid the current global economic crisis. There is an increasing number of voices calling for protectionist policies. For the first time in decades, trade is declining across the world. That should worry every American.

There is a mistaken belief that America can go it alone—that by closing its borders to trade it can retain jobs and grow independent of the world. But that isn't true. The economy will not grow in isolation, and enacting laws that require governments to "Buy American" or protecting specific industries—such as agriculture—from

trade competition will only hurt economic growth. Trade barriers force us to pay more than we need to for goods and services and make it harder for our companies to compete.

Forty packages can create a job at UPS.

Unfortunately, tough economic times encourage protectionism. In November, G-20 leaders pledged to reject protectionism. But as the World Bank

noted recently, since November, 78 trade measures have been proposed or implemented by G-20 nations; 66 of them aim to restrict trade.

We are at a tipping point. If national leaders turn to protectionism for domestic political reasons, we'll likely see policies that do lasting damage to global trade flows.

If that happens, I and other free-trade proponents will have ourselves to blame for not standing up for free trade. The facts are on our side, but popular perception is not. Those who support free trade must stand up to be counted. Businesses have to be vocal and determined to knock down short-term political reactions that will have long-term consequences.

We also have to acknowledge that the benefits of global trade are not equally distributed. There are some who are displaced as economies compete in a global marketplace. We need to pay more attention to those who lose their jobs and help them find new professions with new skills.

Congress has recently reauthorized the Trade Adjustment Assistance Act, which provides funding for retraining displaced workers. This helps address the reality that global progress can carry a personal cost. By facing up to that cost, we can counter a potent and false argument against trade: That trade reduces the number of good-paying jobs in America.

Trade actually generates jobs. The United States is the world's largest exporter of goods and services. Its total exports last year reached \$1.8 trillion. The Treasury Department estimates that as many as 57 million Americans work for companies engaged in global commerce.

In my company, we can see how trade creates jobs. We create the equivalent of one new U.S. job for every 40 imported or exported packages we add to our total volume. Last year, we grew this portion of our business by more than 10%, creating thousands of quality jobs. Facts like these are what proponents of free trade must use to counter arguments against globalization.

I have confidence that reason will prevail, and we will get past the politics to create a trade system that is both workable and fair.

The current economic crisis is no reason for us to surrender to protectionist impulses. Recessions end. Economies heal. And for those who are prepared for the upturn, success will follow.

Mr. Davis is chairman and CEO of United Parcel Service.

China Takes the Brakes Off

By Victor Shih

The official Chinese press recently issued a series of stories celebrating an apparent recovery of the country's growth rate, to 8%. By all appearances, China has once again deployed its enormous state capacity, including state control of the banking system, to ward off a recession. However, unlike the last major stimulus program in the late 1990s, this stimulus relies on an unconstrained credit expansion and is generating much fewer marginal benefits to the economy. Quite the opposite: Out-of-control credit expansion contains the seeds of future financial problems.

A decade ago, as now, China faced a serious economic downturn. At the beginning of 1998, growth had sunk briefly below 7% from the robust growth of nearly 9% in 1997. The trigger was the Asian financial crisis. In response, the central government first launched a 200 billion yuan (roughly \$24 billion at that time's exchange rate) rescue package for ailing state-owned enterprises in 1998, followed by investment of nearly one trillion yuan in western China from 2000 to 2003 to help maintain growth rates at 7%.

Although these programs appear similar to the current package, there are some significant differences. Most importantly, the previous stimulus was not accompanied by a spectacular increase in bank loans. Increases in lending between 1998 and 2001 never went above 20% per quarter compared to the same quarter in the previous year. For most quarters, lending increased by less than 15%.

In sharp contrast, the first and second quarters of 2009 saw credit expansion well above 30% compared to the same quarters in 2008. The reason for this disparity is that the late '90s stimulus was

under much stricter guidance from the central government. First, although the state-owned enterprise rescue plan and the Go West campaign were large for the time and in some respects not very efficient, the stimulus investment boom was kept under the relatively firm grasp of the central authorities.

In contrast, the current central stimulus package of four trillion yuan (\$586 billion) is a side show compared to the 20-plus trillion yuan in investment planned by local governments. For some reason, Beijing has shown little willingness to constrain fantastical local investment plans. The National Development and Reform Commission (NDRC), previously a

bastion against uncontrolled local investment, has shown nothing but great enthusiasm for approving local construction projects. The NDRC even has devised ways to allow local governments to borrow more by using long-term loans from policy banks or bond issuance as the 30% required initial capital. Local governments then can borrow the rest from commercial banks, effectively financing some projects entirely with debt.

As a result, banks are asked to finance projects with dubious commercial viability. This despite the fact that the local authorities guaranteeing construction-related loans in many cases will have a hard time repaying the debt with their own fiscal income. Unlike in the late '90s, the central government this time has done little to shield banks from local political pressure. Instead, regulators are only asking banks to bolster their bad-debt provisions in anticipation of the inevitable rise in nonperforming loans.

Another difference between the previous package and the current one is the net benefits to the economy. In 2000, there were only 96,000 miles of expressway and well-built Class 1 and 2 highways. In 2008,

after eight years of intensive building, China had 248,000 miles of higher-grade highway, an increase of more than 200%. Construction of other infrastructure has seen similar pace in the past few years. The marginal benefit of additional trillions of yuan in infrastructure investment is likely limited. Although lower-level technocrats and some government think-tanks have pointed this out, the higher authorities seem to pay little heed to the economic benefits of such a torrential pace of investment. The central government simply has approved the construction of more highways, bridges, airports and dams.

But not all the money may end up going toward infrastructure anyway. State Council researcher Wei Jianing estimates that at least 20% of the new credit has gone into the stock and real-estate markets instead of generating real benefits to the economy. This is leading to a revival of speculative investment in these markets. The Shanghai composite stock index has increased by well over 50% from the beginning of the year, while real estate prices in several major markets have climbed back near previous highs. This robust recovery took place in the face of still-declining exports and a relatively modest recovery in the growth rate. Given that result, the 20% figure may be a conservative estimate.

Should this pace of credit expansion continue for the remainder of the year, China may well face a difficult trade-off down the road. The economy is unlikely to

face a financial crisis because most of the debt is owed to domestic investors and depositors and China can still prevent large-scale capital flight. However, if inflation spikes next year, the central government will have to choose between shutting off credit, which will reveal a massive nonperforming loan problem currently obscured by a torrent of new loans, or an unprecedented level of inflation. High inflation is destabilizing, as it has caused major runs on the banks before. If additional credit expansion in the face of rising inflation is not an option, the greater the extent to which lending is uncontrolled at the moment, the bigger a nonperforming loan problem the central government will face in the future.

An often overlooked ingredient to China's success story is that generations of top-level central technocrats like Chen Yun, Yao Yilin and Zhu Rongji time and again used their political influence to constrain local investment bubbles, thus forestalling high inflation and major financial crises. Past retrenchment campaigns were unpopular and controversial, but senior technocrats nonetheless maneuvered to stop uncontrolled local investment. As credit continues

to rocket toward the stratosphere, China is in increasing need of such leadership again.

Mr. Shih, an assistant professor of political science at Northwestern University, is author of "Factions and Finance in China:" (Cambridge University Press, 2008).



THE WALL STREET JOURNAL.
FRIDAY - SUNDAY, JULY 24 - 26, 2009

ADB warns of risks in East Asia

By LEIGH MURRAY

BANGKOK—Economies in emerging East Asia face continuing risks in their efforts to return to growth, the Asian Development Bank said, warning they can't rely on China alone to stimulate a regional recovery.

The Manila-based development bank said prospects of a return to growth levels seen in recent years also won't materialize until industrialized economies recover enough "to rekindle demand for the region's exports."

"The risks to emerging East Asia's transition to recovery, while having dissipated somewhat over the past few months, remain firmly tilted on the downside," the bank said in its semiannual Asia Economic Monitor, released in Bangkok.

While the report didn't provide new forecasts for gross domestic product, the ADB said projections it made in March could be revised for several economies in emerging East Asia—defined as the 10 members of the Association of Southeast Asian Nations plus China, Hong Kong, Taiwan and South Korea.

In March, the ADB said that GDP growth for emerging East Asia would likely reach 3% this year, but it now expects to revise that upward. It is also likely to raise its GDP growth outlook for China from 7%, and Indonesia from 3.6%.

On the downside, the ADB said it is likely to lower the 2009 GDP projections it made in March for Malaysia (minus 0.2%), Philippines (plus 2.5%), Thailand (minus 2%), Hong Kong (minus 2%), Singapore (minus 5%) and Taipei (minus 4%).

"As external demand will remain sluggish in the near future, emerging East Asia's recovery is expected to be gradual, with 2010 growth rising to about 6%," it said, adding it will take time before the region's economies return to their "full potential."

The bank said domestic stimulus measures, not a strong pickup in demand for exports, are likely to drive GDP growth in the region.

The report said GDP in Japan, meanwhile, is also forecast to shrink

5.8% this year, the largest contraction since 1955, due to a collapse in exports and weak domestic demand. It expects the U.S. economy to shrink 3% this year, and the euro zone to contract 4.3%.

The report also said China's ability to increase imports from emerging East Asia is dependent on its ability to export, and without a rebound in global demand China "cannot be expected to be the major driver for the region's recovery."

Beijing should let yuan rise, IMF says

BY BOB DAVIS

The International Monetary Fund's governing board urged China to continue to use fiscal stimulus to boost growth and to let its currency appreciate even if that contributes to short-term unemployment.

The recommendation came as China's top Communist Party leaders Thursday vowed to continue an active fiscal policy and a moderately loose monetary policy for the rest of the year.

The completion of the IMF review of China's economic policies was as significant as the message. For the past several years, China has blocked the IMF from finishing reviews of its economy—which are supposed to be done annually for every member country—because it objected to public criticism of its tightly controlled exchange rate. During the George W. Bush administration, the U.S. tried to use IMF reviews as another tool to press China to revalue the renminbi, also known as the yuan.

In the past year, the IMF has looked to end the exchange-rate fight, especially after the global recession made China—one of the few large fast-growing economies—more significant internationally. According to an IMF summary of the 24-member

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IMF, in delayed China report, praises Beijing's stimulus efforts

Continued from first page
ber board discussion on July 8, "many directors" urged further strengthening of the yuan.

The term used by some directors to describe the currency was "substantially undervalued." In the past, the IMF sought to label China's exchange rate as "fundamentally misaligned," a designation that Beijing found so unpalatable that it blocked the reports.

The current review praised "China's stability-oriented economic policies as a bedrock of regional stability," and urged additional fiscal stimulus, through 2010, aimed at boosting private consumption. That is largely Beijing's intention. China's four trillion yuan (\$585 billion) plan, announced in the fall, was designed to be spent through the end of next year.

On Thursday, the Political Bureau of the Chinese Communist Party said it will continue the policies that have helped restart China's economic growth. "The direction of macroeconomic policies can't change," state television cited the Politburo as saying.

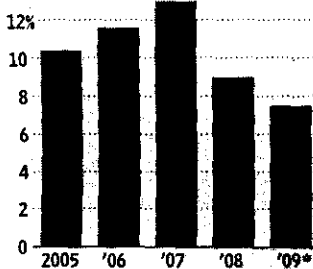
Its vow to maintain Beijing's expansionary policies is likely to damp growing calls by economists—and the head of the central bank's research bureau—for the government to fine-tune policy to avoid future inflation or asset-price bubbles.

Such calls have strengthened as economic growth in the second quarter quickened to 7.9% from a year earlier, compared with 6.1% in the first from the year before, amid a huge wave of lending and investment projects, driven by the government. China's stock markets have been among the world's best-performing, while its property market has rebounded.

On the currency question, IMF

Asian engine

China's real gross domestic product, percentage change from previous year



*projected
Source: International Monetary Fund

directors argued that strengthening the yuan would increase the purchasing power of households and shift investment away from the export sector, a longtime goal of the U.S. and Europe, some of whose manufacturing industries have withered under Chinese competition.

However, there was disagreement within the board about how rapidly China should revalue. Some directors said revaluation "should be pursued in a gradual manner, as and when conditions permit." The IMF didn't identify which countries urged what policies. The U.S. and Europe have generally hammered at Beijing to revalue, while China and other countries that tie their currency to the U.S. dollar have argued for a go-slow approach.

The IMF said directors recognized that in the near term, shifting the Chinese economy away from exports could boost unemployment. They urged retraining and other programs for laid-off workers. But "over a longer horizon," directors said, there would be "employment gains" from making the transition.

Chinese consumption would become "a key factor in driving global growth," the IMF directors said, as imports and investment increased in China.

Earlier this month, the IMF raised its forecasts for China's economic growth by one percentage point in each of the next two years, predicting an expansion of 7.5% in 2009 and 8.5% in 2010.

The U.S. and China also are weighing how eventually to unwind stimulus programs.

China said Wednesday it will discuss the matter in Washington at next week's Sino-U.S. Strategic and Economic Dialogue, as both sides seek to manage inflation concerns while the crisis abates.

—Jason Dean, Aaron Back
and Terence Poon
contributed to this article.

Asia revisits safety nets

Moves to bolster aid will take time to trigger more consumer spending

BY PATRICK BARTA

BANGKOK—Asian countries are beginning to build extensive social-welfare programs like those that long

have existed in the West, a move they hope will encourage

their people to save less, spend more and help put the region—and the world—on a stronger economic footing in the years ahead.

But creating a reliable social safety net is hard work, and it may be a long time, perhaps decades, before Asia sees results.

Analysts have long worried that Asians lack sufficient health, unemployment and other benefits to tide them over when downturns or emergencies occur, or to prepare for old age. Only about 30% of Asia's elderly receive a pension, according to the United Nations. Just 20% of its unemployed have access to unemployment benefits or other work-related social programs.

Partly as a result, Asians tend to save more and spend less of their income than their counterparts in the West. That contributed to the global imbalances that are one cause of the current world recession: U.S. consumers went deep into debt to finance consumption while Asians socked away money and relied on exports to Western consumers.

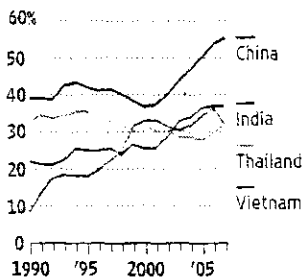
Social-welfare programs are one way of addressing those imbalances. The idea is that if Asian consumers have more confidence in their gov-

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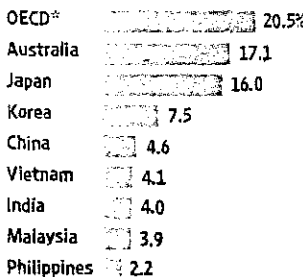
Save or spend?

Asians save more than people in other parts of the world, in part because their governments spend relatively little on social welfare.

Saving rates of selected economies, as a percentage of gross domestic product

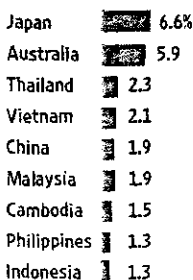


Social expenditure as a percentage of GDP, 2004-05



*30 developed countries

Public-health expenditure as a percentage of GDP, 2006



Sources: Asian Development Bank; OECD; World Bank

Asia bolsters safety nets

Continued from first page

ernments to take care of them in times of trouble, they will be more willing to spend today, igniting new demand for consumer goods and leaving the world economy less dependent on Western shoppers.

China recently said it will invest \$120 billion to improve health care by building clinics and extending basic medical coverage to 90% of its 1.3 billion people within three years. Vietnam is implementing a national unemployment-benefits system. India has unveiled a voluntary pension system for up to several hundred million people who work at small companies, and is developing a nationwide identification database to better provide health care and other benefits.

Those programs build on efforts undertaken in recent years. Thailand launched a national health-care program in 2001 that offers basic medical care for just 30 Thai baht, about \$1, to most citizens. India's latest national budget expands a program begun in 2005 that guarantees 100 days of work per year for rural laborers.

But many governments, including India, suffer from large budget deficits or lax tax collection, and may find it hard to finance expanded welfare programs.

In addition, a stronger safety net is no guarantee Asians will consume more. Europeans enjoy one of the world's most robust safety nets, and they tend to save more than Americans.

And it can take years, maybe decades, before consumers build up enough trust in welfare programs to modify spending behavior. In many Asian countries, such as Indonesia, services provided by social programs are dismal, with many residents avoiding government medical clinics altogether.

"The credibility of the systems has to be tested, and people have to be comfortable" that they still will be around after changes in government or economic crises, says Joseph Zveglic, an Asian Development Bank economist. Although he supports efforts to expand social safety nets, he says, "it's going to take time for people's activities to change."

Some analysts say a better way to wean Asia off exports and encourage domestic consumer spending would be to let Asian currencies appreciate. That would make Asian exports less attractive to foreign consumers, give local consumers more spending power to buy imported goods, and force Asian business to diversify beyond exports. But Asian authorities may be un-

likely to risk putting exporters in jeopardy by allowing their currencies to rise.

Those countries that have expanded their safety nets over the past decade have seen mixed results. In Thailand, residents were quick to take advantage of the country's new national health-care program. More than 45 million people registered to participate by mid-2003. Consumer spending shot up soon after the program was introduced, but economists believe the surge was driven more by an expansion of consumer credit and a sharp uptick in growth that occurred as Thailand's economy rebounded from the 1997-98 Asian financial crisis.

Growth in consumer spending later slowed, and in recent years Thailand's savings rate has begun climbing again after several years of declines, according to the Asian Development Bank. Most other major Asian countries have

likewise seen their savings rates increase or stay about the same since the late 1990s, including Vietnam, where savings climbed to about 32% of gross domestic product in recent years from roughly 18% in 1995. Those trends could intensify in the future as the region struggles to

fully recover from the current recession.

"In this economy, I'm trying to save as much as I can," says Banyen Sriwongrak, a 43-year-old vendor in central Bangkok who makes about \$12 a day selling jasmine garlands near a religious shrine. She says she used Thailand's 30-baht health-care program to have a lump removed two years ago in a surgery that normally would have cost 16,000 Thai baht, or about \$475. Having that protection was helpful, she says, but it hasn't fundamentally changed her spending, which includes squirreling away two or more days' worth of income each month and sending an additional \$60 or so to support her mother in rural Thailand. "We don't know what the future will bring," she says.

None of that means Asian governments should stop investing in welfare programs. Such programs can greatly improve residents' lives even if they don't ultimately affect spending patterns. And the benefits in terms of changed consumer behavior may show up later.

Upgrading safety nets "isn't something that's going to get us out of the [current financial] crisis," says Mr. Zveglic, the Asian Development Bank economist. But if investments in the social safety net are made now, it may help the next time.



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A New Strategic and Economic Dialogue with China

By Hillary Clinton
And Timothy Geithner

When the United States and China established diplomatic relations 30 years ago, it was far from clear what the future would hold. In 1979, China was still emerging from the ruins of the Cultural Revolution and its gross domestic product stood at a mere \$176 billion, a fraction of the U.S. total of \$2.5 trillion. Even travel and communication between our two great nations presented a challenge: a few unreliable telephone lines and no direct flights connected us. Today China's GDP tops four trillion dollars, thousands of emails and cellphone calls cross the Pacific Ocean daily, and by next year there will be 249 direct flights per week between the U.S. and China.

To keep up with these changes that affect our citizens and our planet, we need to update our official ties with Beijing. During their first meeting in April, President Barack Obama and President Hu Jintao announced a new dialogue as part of the administration's efforts to build a positive, cooperative and comprehensive relationship with Beijing. So this week we will meet together in Washington with two of the highest-ranking officials in the Chinese government, Vice Premier Wang Qishan and State Councilor Dai Bingguo, to develop a new framework for U.S.-China relations. Many of our cabinet colleagues will join us in this "Strategic and Economic Dialogue," along with an equally large number of the most senior leaders of the Chinese government. Why are we doing this with China, and what does it mean for Americans?

Simply put, few global problems can be solved by the U.S. or China alone. And few can be solved without the U.S. and China together. The strength of the global economy, the health of the global environment,

the stability of fragile states and the solution to nonproliferation challenges turn in large measure on cooperation between the U.S. and China. While our two-day dialogue will break new ground in combining discussions of both economic and foreign policies, we will be building on the efforts of the past seven U.S. administrations and on the existing tapestry of government-to-

government exchanges and cooperation in several dozen different areas.

At the top of the list will be assuring recovery from the most serious global economic crisis in generations and assuring balanced and sustained global growth once recovery has taken

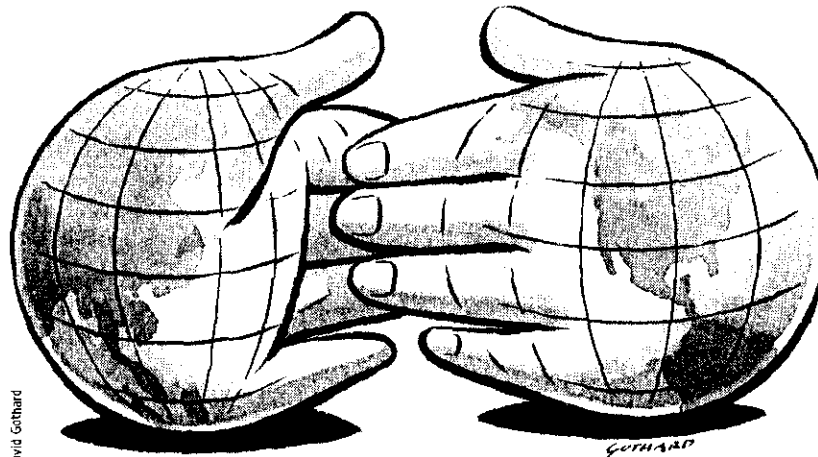
hold. When the current crisis struck, the U.S. and China acted quickly and aggressively to support economic activity and to create and save jobs. The success of the world's major economies in blunting the force of the global recession and setting the stage for recovery is due in substantial measure to the bold steps our two nations have taken.

As we move toward recovery, we must take additional steps to lay the foundation for balanced and sustainable growth in the years to come. That will involve Americans rebuilding our savings, strengthening our financial system and investing in energy, education and health care to make our nation more productive and prosperous. For China it involves continuing financial sector reform and development. It also involves spurring domestic demand growth and making the Chinese economy less reliant on exports. Raising personal incomes and strengthening the social safety net to address the reasons why Chinese feel compelled to save so

much would provide a powerful boost to Chinese domestic demand and global growth.

Both nations must avoid the temptation to close off our respective markets to trade and investment. Both must work hard to create new opportunities for our workers and our firms to compete equally, so that the people of each country see the benefit from the rapidly expanding U.S.-China economic relationship.

A second priority is to make progress on the interconnected issues of climate change, energy and the environment. Our



David Guthard

two nations need to establish a true partnership to put both countries on a low-carbon pathway, simultaneously reducing greenhouse gas emissions while promoting economic recovery and sustainable development. The cross-cutting nature of our meetings offers a unique opportunity for key American officials to meet with their Chinese counterparts to work on the global issue of climate change. In the run-up to the international climate change conference in Copenhagen in December, it is clear that any agreement must include meaningful participation by large economies like China.

The third broad area for discussion is finding complementary approaches to security and development challenges in the region and across the globe. From the provocative actions of North Korea, to stability in Afghanistan and Pakistan, to the economic possibilities in Africa, the U.S. and China must work together to reach solutions to these urgent challenges confronting not only our two nations, but many others across the globe.

While this first round of the U.S.-China Strategic and Economic Dialogue offers a unique opportunity to work with Chinese

officials, we will not always agree on solutions and we must be frank about our differences, including establishing the right venues to have those discussions. And while we are working to make China an important partner, we will continue to work closely with our long-standing allies and friends in Asia and around the world and rely on the

appropriate international groups and organizations.

But having these strategic-level discussions with our Chinese counterparts will help build the trust and relationships to tackle the most vexing global challenges of today—and of the coming generation. The Chinese have a wise aphorism: "When you are in a common boat, you need to cross the river peacefully together." Today, we will join our Chinese counterparts in grabbing an oar and starting to row.

*Mrs. Clinton is the U.S. Secretary of State.
Mr. Geithner is Secretary of the Treasury.*

THE WALL STREET JOURNAL.

MONDAY, JULY 27, 2009

Chinese Meet and Greet

The Obama Administration has been at pains to sell today's kickoff meeting of the U.S.-China Strategic and Economic Dialogue as a revamped, bigger and better version of the Bush-era Strategic Economic Dialogue. But a tweaked name and a few new agenda items won't resolve a basic problem: Until Washington frankly addresses tough issues facing the relationship, Beijing won't budge on much of anything.

That was the main lesson of former Treasury Secretary Hank Paulson's semi-annual meetings with his Chinese counterparts. For two years, Mr. Paulson focused on the twin phantoms of exchange-rate targets and trade imbalances. Congress embarked on a spree of protectionist rhetoric and China bashing. In return Beijing did little to further liberalize its markets to foreign trade or address its corruption-ridden banking system.

This year's meeting isn't shaping up to be much different, aside from the fact that Secretary of State Hillary Clinton seems to have wrested some of the

China portfolio from Treasury, which is now co-hosting the two-day meeting with State. Their mission is to "focus on addressing the challenges and opportunities that both countries face on a wide range of bilateral, regional and global areas of immediate and long-term strategic and economic interests." In other words, nobody in Washington is quite sure what exactly will be accomplished, or when.

The main agenda item, as during the Bush years, is to push for "balanced and sustainable" economic growth—diplomatic code for more wrangling over meaningless trade statistics. A more productive discussion would focus on trade protectionism and the fiscal profligacy of the Obama administration and its effect on the value of the world's global currency, the U.S. dollar.

China seems keen to put both issues on the table, given its top officials have been publicly fretting about them for months. For good reason: Beijing is one of the world's largest holders of U.S. dollar-denominated assets and one of America's largest trading partners. The two countries are already involved in

trade disputes over tires and chicken. However, Mr. Geithner is more likely to talk about economic issues that play better to his Democratic audience at home: health care, exports and U.S. jobs.

Mrs. Clinton, who's nominally in charge of the "strategic" part of the dialogue, also has sticky issues to confront. President Hu Jintao's administration has led severe crackdowns on Uighur and Tibetan minorities, jailed human-rights activists and tightened the Communist Party's grip over the judiciary and the Internet. Abroad, China has done little to help resolve the Iranian nuclear crisis, is ramping up assistance to Burma and has proved the main enabler of Kim Jong Il's regime in Pyongyang.

Mrs. Clinton seems more eager to talk about climate change than any of these other, more pressing, issues—some of which directly threaten



Hillary Clinton

American security. The softly, softly approach is par for the course for this White House, however: On a trip through China earlier this year, Mrs. Clinton asserted that things like human rights "can't interfere" with cooperation between Washington and Beijing on other issues like the economic crisis or climate change.

These backward priorities will play well on Capitol Hill, where Congress is talking about exchange-rate "adjustments" again and the newest form of protectionism: global warming legislation. The House of Representatives is already proposing protectionist tariffs on nations that don't limit emissions.

But soft-peddling around Beijing for the sake of scoring a few political points back home isn't the way to build an honest relationship with an authoritarian state increasingly intertwined with U.S. strategic and economic interests around the world. It's good to encourage more communication between the U.S. and China, but not if both sides are going to ignore the most difficult issues.

THE WALL STREET JOURNAL.

TUESDAY, JULY 28, 2009

The Currency of Trade Balances

By Michael Pettis

Chinese and American officials will discuss trade balances at this week's Strategic and Economic Dialogue in Washington. This discussion must involve more than just exchange rates.

Many analysts have long pointed to exchange-rate manipulation as a quick fix for trade imbalances, or the gap between what a country produces and what it consumes. When the Japanese and German currencies soared in value against the dollar after the Plaza Accords of September 1985, many analysts thought that these countries' trade surpluses with the U.S. would decline. They were partly right. The German trade surplus with the U.S. declined. But even though the value of the yen doubled, Japan's trade surplus surged.

This should not have been surprising. In response to the Plaza Accords, Tokyo directed a flood of low-interest credit into the manufacturing sector while informally guaranteeing corporate borrowers. Manufacturers increased production for export markets even as household consumption declined. The trade surplus with the U.S. rose.

China is trying to do the same thing, despite a rising yuan. Policies include low lending rates enforced by the central bank, energy and commodity subsidies and most importantly, a flood of implicitly guaranteed credit aimed at investment in infrastructure and the manufacturing

sector. Yet consumption is still repressed thanks in part to very low deposit rates, constraints on consumer financing and low wages.

China's trade surplus with the U.S. won't necessarily soar. In the short run, American consumers are hamstrung by wage stagnation and rising unemployment. For the next few years, U.S. con-

The U.S. shouldn't focus solely on the value of the yuan.

sumption will grow more slowly than its production, and the trade deficit will narrow.

Still, the U.S. should care what China does even if a rising U.S. savings rate forces the necessary rebalancing. The best-case scenario for the U.S. would see healthy GDP growth buttressed by decent consumption. The worst-case scenario would see a contraction in GDP driven by even faster contraction in consumption. For China, the best-case scenario would be explosive consumption growth driving slightly lower GDP growth. China's worst-case scenario would be slower consumption growth that drags down GDP growth sharply.

Both countries face balancing acts between short-term employment needs and long-term adjustments. As the U.S. government races to replace debt-f-

ueled household consumption, it helps create jobs and gives more time to China to adjust, but at the expense of lowering the savings rate. As China pours new loans into the system at a rate of more than a quarter of last year's GDP in just six months, it creates short-term employment but increases additional excess capacity and degrades the government's balance sheet.

Both countries need time to adjust. If this week's summit in Washington fails to address the timing of the trade adjustment and coordination among the two countries' fiscal and monetary policies, both countries will see the inevitable rebalancing—but with slower GDP growth. If rising savings in the U.S. clash with government-induced production hikes in China, both countries could be forced into mutually destructive policies. The consequences, especially for China, could be brutal.

The next few years are going to be difficult in the best of cases. Conflicting adjustment policies, especially if they lead to protectionist trade clashes, could make it much worse. The Strategic and Economic Dialogue should aim to resolve what seem like domestic policy conflicts but which are ultimately trade rebalancing issues.

Mr. Pettis is a senior associate at the Carnegie Endowment for International Peace and a finance professor at Peking University.

Now China Has a Credit Boom

By Paul Cavey

After second-quarter GDP numbers revealed a rebound in China's growth rate to near the politically significant 8% level, it is easy to think nothing has changed. When the world grows, China grows, and when the world collapses, China still seems to grow. But don't be fooled: China's impressive headline GDP rate masks an important fundamental shift. Its growth is now fuelled by cheap debt rather than corporate profits and retained earnings, and this shift in the medium term threatens to undermine China's economic decoupling from the global slump.

This logic might seem surprising given the conventional wisdom that China's growth has always been fuelled by cheap credit. Interest rates sometimes have been below inflation, making them negative in real terms, which is a common definition of cheap money. More striking still, the official cost of capital has consistently trailed the return. The implication is that companies can re-invest borrowed money for a higher return than they have to pay back to the banks. In this sense, bank credit is more than free.

If this weren't enough, overseas money has been piling into China, inflating foreign exchange reserves and domestic liquidity. So perhaps it is not surprising that outstanding bank loans have doubled in the last few years, or that there is much talk of a shadow banking system. Then there is China's reputation for building overcapacity in its industrial sector, a notoriety it won even before the crash in global demand. This showed a disregard for returns that is always a tell tale sign of cheap money.

But the reality was more complicated. The government kept interest rates low for the past few years to reduce the attractiveness of the yuan in the eyes of foreign investors, in an attempt to discourage speculative inflows. But the government has

used huge financial repression to offset this potential monetary inflation, sterilizing inflows and telling the banks not to lend. The supply of money was thus rationed, logically meaning that the real price of money was higher than the rate officially set by the central bank.

**Companies used
to rely on
retained
earnings.
Not anymore.**

As for China's loan growth, it was accompanied by equally strong growth in the economy. So China didn't exhibit the usual surge in the credit-to-GDP ratio that is generally associated with monetary bubbles. As for the shadow banking system, it certainly exists. But the formal banking system was restricted by regulation. Informal lending channels were important but seemed to be used most often for short-term cash needs rather than the financing of long-term fixed investment projects.

The net result was that instead of China having an economy swimming in money, the norm was financial repression that prevented the intermediation of undoubtedly excess liquidity into the domestic economy. What about the perception of overcapacity? This should show up in a mix of two phenomena. First, margins would fall, as companies cut prices to boost sales. Second, asset turnover would deteriorate. Measured as the ratio of revenue over assets, this would show sales volumes weren't high enough to require using all the productive machines that the company had invested in.

On this basis it was possible to find cases of overcapacity in sectors of the economy in recent years, but not that many. Moreover, the industries that seem to have had too much investment tended to be those dominated by state-owned firms. These companies benefited from the limited supply of loans from government-controlled banks be-

cause they were able to offer the collateral that China's banks demanded—land holdings or a government connection that acted like an implicit guarantee.

China's private sector, by contrast, was short of collateral and thus starved of cash. This pushed them toward labor-intensive industries that didn't require as much capital investment, which fortuitously were just the ones that were growing most strongly on the back of overconsumption in the United States. The



resulting high top-line revenue growth helped offset weak margins, producing a flow of retained earnings that allowed the private sector to finance itself even without access to bank capital.

But that's all changing now. The slowdown in U.S. consumption amid a credit crunch has exposed the weaknesses in this export-led financing model. So now China is turning instead to cheap debt for fund-

ing, a shift suggested by this year's 35% or so rise in bank loans.

This change is yielding results, with GDP already jumping back towards the magic 8% level. But this isn't business as usual. While the previous credit rationing implied higher real interest rates, today's turbo-charged credit figures show the cost of capital is now very low. The longer this persists, the more likely China in the medium term will face just the overcapacity and bad debt that many observers feared already existed.

Policy makers in Beijing are well aware of these risks, having seen so many credit cycles, both at home and abroad. Indeed, fear of end-game problems when a credit bubble inevitably collapses is exactly what made the government so worried about credit growth and asset prices in recent years. Compounding the problem is the lack of any palatable solutions. Strong global growth between 2003 and 2007 provided a safety net, allowing Beijing to tighten domestic credit without worrying that China's own growth would collapse. This safety net is gone now.

It's not impossible for Beijing to take away the punch bowl of credit. There is plenty of room to defy the skeptics and in the next few months and push through structural reforms. For instance, some of the privileges state-owned enterprises continue to enjoy in terms of the ability to provide domestic services like banking and telecoms could be dismantled, allowing the country's

more productive private sector to thrive in local markets rather than just overseas. But without such changes China will be relying on growth financed by cheap domestic debt. This means China will be decoupling itself from the U.S. consumer, but at the cost of a credit bubble.

Mr. Cavey is head of China economics at Macquarie Bank.

End of Singapore recession bolsters Asia hopes

By John Burton in Singapore

Singapore raised its annual economic forecast yesterday as it announced unexpectedly sharp growth for the second quarter, putting an end to the city-state's worst recession in 45 years and bolstering hopes that the financial crisis in Asia may have reached its low point.

The export-dependent economy is closely watched as it is seen as a bellwether for Asia and an important indicator of global demand.

South Korea, which will release its second-quarter figures next week, indicated last week that it had probably recorded its fastest quarter-on-quarter growth for 5½ years.

A Philippine official said his country expected to report higher growth for the second quarter, Reuters reported. China will report second-quarter gross domestic product tomorrow.

Singapore's GDP grew 20.4 per cent last quarter from the January-March period on a seasonally adjusted, annualised rate, following four consecutive quarters of contraction, according to a preliminary estimate by the ministry of trade and industry. The economy contracted by 3.7 per cent from a year ago against a 9.6 per cent fall in the first quarter. The government said it now expected the economy to contract by 4.6 per cent for the full year against a previous estimate of 6.9 per cent.

Robert Prior-Wandesforde, regional economist for HSBC in Singapore, said: "It's typically the most open economies, like Singapore and Malaysia that crashed the most, which we think will see the greatest trade recovery kicking in."

The trade ministry added a note of caution, saying a "sizeable part" of Singapore's manufacturing uptick came from areas such as biomedical business that may not be sustained.

Swingapore

Singapore's is a weeble economy: knock it all you like, but, like the children's toy, it won't stay down for long. The city state has sprung out of recession, months after posting some of the world's most horrendous drops in output. The resilience of Asia's 11th largest economy – the second, after Vietnam, to report second-quarter gross domestic product data – spread cheer across regional equities. The ratio of risers to fallers on Asian stock markets yesterday was more than three to one.

This is an over-reaction, of course. On advance estimates, first half output is tracking at about minus 7 per cent, year-on-year – miles away from the average 8.2 per cent yearly growth of 2004 to 2007. Output is merely back to where it was two years ago. Yet the second quarter's gain in GDP of more than 20 per cent, quarter on quarter, was the strongest since the end of the last slump, in the autumn of 2003. Manufacturing was the surprise driver, moderating from a drop of 24 per cent in the first quarter, year-on-year, to a fall of just 1.5 per cent. This is a recovery, however you look at it.

Still, after four consecutive quarters of contraction, the road ahead will not be smooth. With exports accounting for almost two-thirds of GDP, Singapore is inextricably leveraged to developed economy demand. The government itself is warning that re-stocking in volatile exports sectors such as pharmaceuticals may not last: year-on-year growth in pharma output ricocheted from minus 54 per cent in March to 139 per cent in May. Consumers are cowed; real salaries have been dropping for two years. Unemployment is still well below the peak of six years ago. And bigger macro threats persist. Google search data shows that Singaporeans, the second-biggest economic rent collectors on global trade after Hong Kongers, are the most bothered by rising protectionism.

Survival lessons for developing nations

The importance of family ties in a financial crisis

As a recent World Bank report makes clear, hard times accentuate the importance of kith and kin. Nowhere is this more true than in developing countries, where automatic stabilisers are weak and vulnerability is high. Support from friends and family abroad is more constant than fragile states and footloose businesses.

In the boom years, development finance was chiefly about foreign investment and foreign aid. In 2007 capital flows to developing countries amounted to \$1,200bn. That source of money is now drying up. Over the next year capital flows to developing countries are expected to collapse, from \$707bn to \$363bn.

While foreign investment is in free-fall, remittances – money sent from developed world migrants to relatives in the developing world – are expected to remain relatively stable. The World Bank predicts a 7 per cent fall in 2009, followed by a modest 3 per cent rise the year after. By 2010 remittances will broadly equal net private capital flows to developing countries.

In the short term, the main risks to remittance flows are a significant worsening of the global economy and exchange rate depreciation in countries with sizeable remitting populations. Any further collapse of the Russian rouble, for example, would have big

knock-on effects in central Asia.

Stability of remittance flows is important. While the biggest aggregate recipients are India, China and Mexico, the countries most reliant on remittances tend to be poorer and more unstable: Honduras, Lebanon, Tajikistan.

In the longer term, the outlook for remittances is mixed. A simple continuation of past growth is unlikely. Economic uncertainty in the developed world has already provoked ugly populist demands for a severe tightening of immigration policy. Meanwhile, ties between older migrants and their relatives in the developing world may weaken over time.

The role of remittances, both in stabilising consumption in the developing world and in preventing recession from widening global instability, has begun to be recognised. While earlier Group of Eight gatherings underlined the risk of remittances being used as cover for terrorist financing, the L'Aquila summit reiterated the aim of making them easier and cheaper. Leaders set the objective of halving administrative costs from 10 to 5 per cent in five years.

Wiring money home may not rank with fiscal stimulus for drama but, taken together, remittances are a crucial link in the global economy.

After the storm comes a hard climb



Martin Wolf

Is the world economy on its way out of the crisis? Has the world been learning the right lessons? The answer to both questions is: up to a point. We have done some of the right things and learnt some of the right lessons. But we have neither done enough nor learnt enough. Recovery will be slow and painful, with substantial danger of relapses.

Start, however, with the good news. The financial crisis, narrowly defined, is over: stock markets have rallied; liquidity is returning to markets; banks have been able to raise equity; and the extreme risk spreads in financial markets of last year have disappeared. When addressed powerfully, panics end. In this case, the commitment of the authorities to the rescue of a failing financial system was unprecedented. It has had the desired results.

The worst of the economic crisis is also passing. As the Organisation for Economic Co-operation and Development noted in its latest Economic Outlook, "for the first time since June 2007, the projections... have been revised up for the OECD area as a whole compared with the previous issue". Similarly, the International Monetary Fund states in its latest World Economic Outlook update that "economic growth during 2009-10 is now projected to be about half a percentage point higher than forecast by the IMF in April, reaching 2.5 per cent in 2010".

Such a turning point in forecasts is an indicator of pending recovery. It emerges clearly in the successive monthly consensus of forecasts for 2010. Improvements in these forecasts can be seen for the US, Japan and the UK, though, worryingly, not for the eurozone (see chart). China's forecasts show great resilience. Confidence in India is also rising.

Yet we must put this news, welcome though it is, in context. The worst of the financial crisis may be behind us, but the financial system

remains undercapitalised and weighed down with an as yet unknown burden of doubtful assets. It is also far from a truly "private" financial system. On the contrary, it is underpinned by massive explicit and implicit taxpayer support. The probability of mischief down the road is close to 100 per cent. But the current hope is that the road to any such mischief goes via a recovery.

Equally, the expected economic "recovery" is not going to feel like much of one. The latest consensus forecasts for growth in the high-income countries for 2010 are well below potential. Yet this is also at a time when the admittedly uncertain estimates of "output gaps" (or excess capacity) are at extreme levels. For 2009 the OECD estimates these at 4.9 per cent of potential gross domestic product in the US, 5.4 per cent in the UK, 5.5 per cent in the eurozone and 6.1 per cent in Japan. Given the forecasts for modest growth, excess capacity will be greater at the end of 2010 than at the end of 2009. The risks to inflation – or rather risks of deflation – are self-evident. So are the chances of further jumps in unemployment. In keeping with this, the "breakeven rate" of inflation implied by inflation-indexed and conventional US treasury bonds has fallen again, to close to 1.5 per cent. June's hysteria over rising yields on conventional bonds looks absurd.

Behind the excess capacity and the massive increases in fiscal deficits is the disappearance of the high-spending consumer, above all from the US. This is suggested by the huge shifts in the balance between private sector incomes and spending implied by OECD forecasts for current account and fiscal balances. In 2007, the US private sector spent 2.4 per cent of GDP more than income. In 2009, suggests the OECD, it will be spending 7.9 per cent of GDP less than income. This massive shift into prudence – long called for by critics and so little appreciated now it has come – largely explains the shift into fiscal deficits: between 2007 and 2009, a 10.3 per cent of GDP shift in the private sector's balance between income and

spending was offset by a 7.3 per cent of GDP fiscal worsening and a 1 per cent of GDP improvement in the current account deficit (see chart). Even as it is, this fiscal offset has not prevented a deep recession.

Private sector prudence is likely to endure in a post-bubble world characterised by mountains of debt. In the last quarter of 2008 and the first quarter of 2009, US household borrowing was modestly negative. But at the end of the first quarter of 2009 the ratio of gross household debt to GDP was a mere 2 per cent of GDP lower than at the end of 2007. De-leveraging is a painful process: it has barely begun.

If, as is likely, the private sector remains prudent, the public sector will remain profligate. Moreover, so long as this period of retrenchment lasts, the risk will not be inflation, but rather deflation. The lesson from Japan is that fiscal profligacy and deflationary pressure can last longer than anybody imagines. The longer they last, the trickier and more inflationary the exit may prove.

Those who expect a swift return to the business-as-usual of 2006 are fantasists. A slow and difficult recovery, dominated by de-leveraging and deflationary risks, is the most likely prospect. Fiscal deficits will remain huge for years. The alternatives – liquidation of excess debt via either a burst of inflation or mass bankruptcy – will not be permitted. The persistently high unemployment and low growth may even threaten globalisation itself.

Depending heavily on massive monetary expansion and fiscal deficits in erstwhile high-spending countries will ultimately be unsustainable. As I have argued, the stronger is the growth in demand in erstwhile surplus countries, relative to potential GDP, and so the more powerful is global rebalancing, the healthier will be the global recovery. Is this going to happen? I doubt it.

If the exit into vigorous recovery seems still so uncertain, has the world at least been learning the right lessons for future management of the world economy? I believe not. The financial sector that is emerging from the crisis is even more riddled with moral hazard than the one that went into it. Its fundamental weaknesses are not yet redressed. Questions also remain about the working of the dollar-based international monetary system, the right targets for monetary policy, the management of global capital flows, the vulnerability of emerging economies, demonstrated in central and eastern Europe, and, not least, the financial fragility demonstrated so often and so painfully over the past three decades. However difficult the recovery may be, we must not ignore these questions. After my summer break, I look forward to addressing them in September.

martin.wolf@ft.com

FINANCIAL TIMES July 18/19 - 2009

Dealing with Delhi is a serious matter

India needs to temper its belligerent self-righteousness

After decades of ill-considered mutual indifference, the US and India are finally taking each other seriously. Perhaps that will come to be seen as one of the most significant achievements of the late and unlamented Bush administration. But the first official visit by Hillary Clinton as US secretary of state to Mumbai and Delhi will not be plain sailing. Building trust between the world's two greatest democracies will call for concessions from both sides.

The bilateral relationship has certainly been transformed. Two-way trade boomed during the Bush years, up from \$30bn to almost \$60bn between 2004 and 2007. The biggest stumbling block - India's nuclear programme - has become a source of co-operation on civil nuclear energy. Defence is a growth area for collaboration, as is counter-terrorism. Mrs Clinton's symbolic gesture of staying at the Taj Palace hotel in Mumbai, the most prominent target of November's terror attack, will be much appreciated by ordinary Indians.

But both sides have hard bargaining to do on global and regional challenges: reaching agreement on a post-Kyoto pact to curb global warming; clearing obstacles to trade liberalisation in the Doha round; and engaging India in stabilising the conflicts in

neighbouring Pakistan and Afghanistan, including Kashmir.

On global issues, Delhi is concerned that the US pays too much attention to China. But like it or not, Beijing has a more consistent world view, making it an easier partner to deal with. India's perspective on global challenges can be surprisingly narrow. Its bouts of belligerent self-righteousness - even when it has much to be self-righteous about - do not help.

Delhi is right that the rich nations must do far more to reduce carbon emissions than the poor. The rich created the problem. But India is irresponsible in flatly rejecting any global targets. In the Doha round, India was blamed for being particularly intransigent. But the US also has to go further in scrapping farm subsidies, and opening its market to Indian exports - including of IT services.

On Pakistan and Afghanistan, India needs to engage more positively. Getting its dialogue with Pakistan back on track after the Mumbai bombings is an essential first move.

India's much-improved relationship with America is good news. Mrs Clinton must show she is ready to respond to genuine Indian concerns. In exchange, India needs to be more coherent and responsible in its own global engagement.

Asia keeps the west's betrayed faith

**Kishore Mahbubani
and William Weld**

Before the current economic crisis exploded, most Asian policymakers and intellectuals believed that when it came to the theory and practice of economic development, the west knew best. This conviction was justified. For two centuries or more, western economies had far outperformed their own. Asian economies only began to perform well when they accepted and implemented Adam Smith's theories of free-market economics.

However, when the crisis led to a global recession, with severe downturns in several major western economies, many Asians began to question their belief in western competence. An important distinction needs to be stressed here: while Asians have retained their faith in western theories on economics, they have progressively lost faith in western practices of economic management.

For example, many Asians are genuinely bewildered that a great mind such as Alan Greenspan could believe that derivative traders did not need any regulation. In 2003, the then chairman of the US Federal Reserve said: "The vast increase in the size of the over-the-counter derivatives markets is the result of the market finding them a very useful vehicle. And the question is, should these be regulated?" His answer was that the state should not go beyond regular banking

regulation because "these derivative transactions are transactions among professionals".

In contrast to this ideological conviction that markets knew best, the Asian mix of ideas on economic development would include a combination of the old-fashioned values of hard work, prudent savings and a dynamic private sector balanced by judicious government intervention when markets fail.

It is vital to stress the diversity of Asia. India is as different from China as Singapore is from Vietnam. Yet virtually all Asian societies believe that government has an important role in managing the economy. All Asian governments would agree with Amartya Sen, the Nobel prize-winning economist, that the invisible hand of the marketplace has to be balanced by an emphasis on the visible hand of good governance, a statement he made at the Lee Kuan Yew School of Public Policy.

Another striking difference that has emerged in Asian and western attitudes is that while the western mind remains ideologically committed to free markets, many western populations have in practice become wary of free trade. By contrast, the faith of Asian populations in free trade is growing stronger.

The "buy American" provisions recently enacted by the US Congress, for example, are entirely wrong-headed. They will make American industries less, not more, competitive. A stark new political reality in America is that it is virtually impossible to get the US Congress to ratify new

free-trade agreements, even when they are overwhelmingly in the American interest. The US-Colombia FTA will benefit Americans more than Colombians if it kills the drug industry in Colombia. But this deal seems dead in the water.

By contrast, the Asia-Pacific region is exploding with new FTAs. The largest in the world will be the one between the 1.2bn people of China and the 500m of the Association of Southeast Asian Nations. This has already been signed and ratified, and comes into force in 2010. Japan, Australia,

**While many western
populations are becoming
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this in Asian societies**

New Zealand and India are following suit with similar agreements with Asean. A recent study by the Asian Development Bank notes that there are about 20 cross-regional FTAs at different stages of implementation, which have significantly improved economic welfare. Asia is becoming awash with competitive liberalisation, while populist protectionist sentiment prevails in the west.

Recent analyses of the impact of the current crisis on Asian economies have correctly stated that the collapse of Asian exports to the US will also mean a decline in intra-Asian trade, since much of this is lower down the

global value chain and involves products ultimately destined for the US. If this accounted for all the growth in intra-Asian trade, then one should be pessimistic about the future. The ADB notes, however, that the value of total merchandise trade between east Asia and south Asia increased eightfold between 1990 and 2007, with each region exporting according to its comparative advantage. Not all of it was due to American demand.

This decoupling of the Asian-western consensus could lead to major changes. It is entirely conceivable, for example, that the Asian economies will perform better than their western counterparts for a good while, by adhering to western ideas on economic development as western societies effectively backtrack from them, openly or surreptitiously.

Similarly, while many western populations are becoming increasingly wary of globalisation, there is virtually no evidence of this in Asian societies. Indeed, most Asians want more, not less, globalisation. The current phase of globalisation was generated by the west, to be sure, but now we may witness the Asianisation of globalisation. This seeming paradox, too, will be a result of the decoupling of the Asian-western consensus.

History does take interesting turns.

*Kishore Mahbubani is dean of the Lee Kuan Yew School of Public Policy in Singapore and has just published *The New Asian Hemisphere: the Irresistible Shift of Global Power to the East*. William Weld is a former governor of Massachusetts*

Warring economists are carried along by the crowd

Paul De Grauwe

There can be little doubt. The science of macroeconomics is in deep trouble. The best and the brightest in the field fight over the most basic problems. Take government budget deficits, which now exceed 10 per cent of gross domestic product in countries such as the US and the UK. One camp of macroeconomists claims that, if not quickly reversed, such deficits will lead to rising interest rates and a crowding out of private investment. Instead of stimulating the economy, the deficits will lead to a new recession coupled with a surge in inflation. Wrong, says the other camp. There is no danger of inflation. These large deficits are necessary to avoid deflation. A clampdown on deficits would intensify the deflationary forces in the economy and would lead to a new and more intense recession.

Or take monetary policy. One camp warns that the build-up of massive amounts of liquidity is the surest road to hyperinflation and advises central banks to prepare an "exit strategy". Nonsense, the other camp retorts. The build-up of liquidity just reflects the fact that banks are hoarding funds to improve their balance sheets. They sit on this pile of cash but do not use it to increase credit. Once the economy picks up, central banks can withdraw the liquidity as fast as they injected it. The risk of inflation is zero.

Both camps line up an impressive list of Nobel prize-winners to buttress their arguments. Economists have often disagreed in the past, but this time the tone is different. The protagonists do not hesitate to accuse the other camp of ignorance or bad faith. I have never seen anything like this.

So what? Does it matter that economists disagree so much? It does. Take the issue of government deficits. If you want to forecast the long-term

interest rate, it matters a great deal which of the two camps you believe. If you believe the first one, you will fear future inflation and you will sell long-term government bonds. As a result, bond prices will drop and rates will rise. You will have made a reality of the fears of the first camp. But if you believe the story told by the second camp, you will happily buy long-term government bonds, allowing the government to spend without a surge in rates, thereby contributing to a recovery that the second camp predicts will follow from high budget deficits.

Most people are not sure which camp is right. They hesitate. One day, when green shoots are popping up here and there, they believe the story warning about inflation; the next day, when the shoots turn brownish, they believe the other story. Disagreements among economists take away the intellectual anchors around which market participants interpret events and forecast the future. Ultimately, all our forecasts use a particular economic model to interpret data and to forecast their future course. The existence of wildly different models takes away this intellectual anchor and this translates into more market volatility.

This conflict matters not only for market participants, but also for policymakers. The two camps of economists have wildly different estimates of the effect of a 1 per cent permanent increase in government spending on real US GDP over the next four years. According to the first camp, the Ricardians, the multiplier is closer to zero than to one, ie 1 per cent extra spending generates much less than 1 per cent of extra GDP, producing little extra tax revenue. Thus budget deficits surge and become unsustainable.

By contrast, the second camp, the Keynesians, predict that the same 1 per cent of extra government spending multiplies into significantly more than 1 per cent of extra GDP each year until the end of 2012. This is the stuff of dreams for governments,

because such multiplier effects are likely to generate additional tax income so that budget deficits decline.

With so much disagreement it is no surprise that policymakers are unsure and vacillate. Some countries, such as the US and France, go all out for the Keynesian story; others, such as Germany, put more faith in the Ricardians. Personally I think the Keynesians are right, but my opinion is irrelevant. The point is that the cacophony of analysis helps to explain why policymakers react in different ways to the same crisis and why it is so difficult for them to come up with co-ordinated action.

How to resolve this crisis in macroeconomics? The field must be revamped fundamentally. Some of its shortcomings are obvious. Before the

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financial crisis, most macroeconomists were blinded by the idea that efficient markets would take care of themselves. They did not bother to put financial markets and the banking sector into their models. This is a major flaw.

There is a deeper problem, though, that will be more difficult to resolve. This is the underlying paradigm of macroeconomic models. Mainstream models take the view that economic agents are superbly informed and understand the deep complexities of the world. In the jargon, they have "rational expectations". Not only that. Since they all understand the same "truth", they all act in the same way. Thus modelling the behaviour of just one agent (the "representative" consumer and the "representative" producer) is all one has to do to fully

describe the intricacies of the world. Rarely has such a ludicrous idea been taken so seriously by so many academics. (Other fields of economics have not been deluded by this implausible idea and therefore do not face the same criticism.)

We need a new science of macroeconomics. A science that starts from the assumption that individuals have severe cognitive limitations; that they do not understand much about the complexities of the world in which they live. This lack of understanding creates biased beliefs and collective movements of euphoria when agents underestimate risk, followed by collective depression in which perceptions of risk are dramatically increased. These collective movements turn uncorrelated risks into highly correlated ones. What Keynes called "animal spirits" are fundamental forces driving macroeconomic fluctuations.

The basic error of modern macroeconomics is the belief that the economy is simply the sum of microeconomic decisions of rational agents. But the economy is more than that. The interactions of these decisions create collective movements that are not visible at the micro level.

It will remain difficult to model these collective movements. There is much resistance. Too many macroeconomists are attached to their models because they want to live in the comfort of what they understand – the behaviour of rational and superbly informed individuals.

To paraphrase Isaac Newton, macroeconomists can calculate the motions of a lonely rational agent but not the madness of the crowds. Yet if macroeconomics wants to become relevant again, its practitioners will have to start calculating this madness. It is going to be difficult, but that is no excuse not to try.

The writer is professor of economics at the university of Leuven and the Centre for European Policy Studies

US seeks closer China ties

Obama sets out vision in Washington talks

Economic and climate co-operation sought

By Daniel Dombey and Sarah O'Connor in Washington

Barack Obama yesterday sought to recast the US's relationship with China, urging Asia's rising superpower to forge deeper ties with Washington on the economy, climate change and nuclear proliferation.

Speaking at the start of two days of top-level talks between the countries on the diplomatic and economic challenges confronting them, the US president predicted that Washington's relationship with Beijing would "shape the 21st century".

Mr Obama depicted China as a force for progress that needed to co-operate with Washington, address global issues and respect human rights within its own borders.

But, acknowledging China's growing influence and in a sign of shifting US priorities, the president and senior US officials did not reiterate the public calls Washington has made in the past for Beijing to allow its currency to strengthen.

"Some in China think that America will try to contain China's ambitions; some in America think that there is something to fear in a rising China," said Mr Obama. "I take a different view."

The president set out a vision of the future in which the two countries would be "partners out of necessity, but also out of opportunity".

The nature of the strategic and economic talks in Washington is the result of a push to give political focus to what had been a Treasury-dominated dialogue under Mr Obama's predecessor, George W. Bush.

Hillary Clinton, secretary of state, and Tim Geithner, Treasury secretary, together with China's vice-premier Wang Qishan and state councillor Dai Bingguo are participating in the talks.

'Some in China think we will try to contain China's ambitions; some in America think there is something to fear in a rising China'

Mr Dai said that the two countries were "in the same big boat that has been hit by fierce wind and huge waves, with our interests interconnected, sharing weal and woe".

He concluded his speech by quoting Mr Obama's campaign cry of "Yes we can".

In spite of the rhetoric, the relationship between the US and China remains in large part defined by China's status as the world's biggest holder of US Treasury bonds. This status heightens Beijing's influence over Washington and increases its exposure to the battered US economy.

Mr Obama said the countries' top priorities should be co-operation on the economy and climate change, and combating the threat of nuclear proliferation in Iran and North Korea.

He praised China for "lifting

hundreds of millions of people out of poverty" and emphasised US calls for "the religion and culture of all peoples [to] be respected and protected".

Washington responded cautiously to recent clashes involving China's Uighur minority in Xinjiang province. US diplomats are trying to balance a likely visit by Mr Obama to China later this year with a possible meeting between Mr Obama and the Dalai Lama, the exiled Tibetan leader.

Mr Geithner urged China to shift its economy towards domestic consumption, which he said would be a "huge contribution to more rapid, balanced and sustained global growth."

He also said that the US would help China win greater representation at international organisations such as the International Monetary Fund.

Stress behind the US-China dialogue

Protectionist pressures could unsettle strategic engagement

When the US and China use the word "strategic" to denote their relationship of adversarial symbiosis, it can mean they are trying too hard. President Bill Clinton worked hard towards a "constructive strategic partnership" a decade ago, only to see his progress evaporate amid acrimony over Nato's war in Kosovo and the accidental bombing of the Chinese embassy in Belgrade.

Barack Obama appears similarly determined to relegate mistrust as the two sides engage in their inaugural "Strategic and Economic Dialogue" in Washington. He has invested considerable effort to change the bilateral relationship's perennial default setting from rivalry to co-operation.

His dispatch of energy secretary Steven Chu and commerce secretary Gary Locke - both Chinese-Americans - to Beijing as part of a series of confidence-building overtures this year was a smart move. So was the visit to Beijing of Nancy Pelosi, the House speaker and arch human rights critic, who unveiled a gentler message, emphasizing environmental co-operation.

President Obama says the US-China relationship "will shape the 21st century". Like Mr Clinton before him, he seems genuinely intent on more harmonious ties.

So far the Chinese, though less effusive, have echoed American enthusiasm for the strategic dialogue, not least by sending a huge delegation. On some big issues there is emerging common ground. Following exhaustive negotiations, the two sides are working towards a joint agreement on climate change. Taiwan, a longstanding source of bilateral hostility, has become less incendiary following the process of conciliation between President Hu Jintao and Ma Ying-jeou, Taiwan's president. The two sides also identify a common interest in stalling North Korea's progress towards developing nuclear weapons.

But beyond these, challenges loom. While both sides profess a desire to deepen commercial relations, protectionist pressures are rising. In the case of China, such pressures often stem from a flurry of provincial directives to "buy local". If inflation takes hold in China later this year, as many predict, the country's role as a beacon of hope in the global economy could be impaired.

Similarly, if the US policy of quantitative easing drives down the value of the US dollar, the patience of Chinese policymakers could be severely tested, as they watch the value of their \$802bn in US Treasury holdings plummet.

Rising India labours in the shadow of Asia's real giant

Shankar Acharya

In recent years, the rise of China and India has become a salient feature of the global economic landscape. Conferences and books have proliferated with titles such as "China and India Rising" and "Dancing with Giants". Although individual contributions have often delineated carefully the differing paths taken by these two populous Asian nations, there has been a general tendency to lump the two countries together in discussions of global economic issues ranging from international trade to climate change.

At one level, this is quite natural. China and India are the only two countries with more than a billion people. Both are in Asia. Both have opened up to international trade and capital flows in the past three decades. Both have demonstrated sustained and enviable economic growth since 1980. It is true that if current growth rates are maintained, both countries could join the US in the trio of the world's largest economies by around 2025, measured in purchasing power parity (PPP) prices.

Yet for all its apparent sense, the pervasive bracketing of China and India too often masks critical differences between them and impedes a better understanding of the challenges posed to the world economic order by their economic expansion.

First, China and India today are at different stages of development. The two countries may have had similar average incomes in the late 1970s. But their subsequent growth trajectories have changed the situation materially. India's 4 per cent average annual growth in per capita gross domestic product since 1980 is commendable and has brought enormous benefits to her population. However, it pales in comparison with China's spectacular growth in per capita income of over 8

per cent a year, which has transformed the living standards of her people and made the country a major economic power. By 2007 average incomes in China were about two and a half times higher than in India, at official exchange rates, and about twice as high in internationally comparable PPP prices.

More importantly, the World Bank estimates that the proportion of people in extreme poverty – defined as those living on \$1.25 a day – had fallen to 16 per cent in China by 2005, while it still remained above 40 per cent in India. With a higher poverty line of \$2 a day, the Bank reports three-quarters of India's population to be poor as compared with 36 per cent in China. Other correlates of poverty show similar divergence. For example, over 40 per cent of India's children under five remain malnourished, compared with 7 per cent in China. In short, China is no longer a poor country, whereas India still fits that description.

The second major difference between the two nations is the far greater impact of China on the global economy, especially in the present decade. This is due mainly to two reasons: first, China's much more aggressive strategy of export-and-foreign-investment-led industrialisation; and second, the extraordinary pace of China's growth. Thus, between 2000 and 2007, China's merchandise exports almost quintupled in value to account for nearly 9 per cent of world exports, while India's export share increased sedately from 0.7 to 1 per cent. The increase in the value of China's exports over the seven years was nearly seven times India's total exports in 2007.

Despite the rapid growth of India's information technology-based service exports since 1995, in 2007 China's total service exports exceeded India's by 40 per cent. By 2007 China's \$1,500bn of foreign exchange reserves were about six times India's and her current account surplus of \$370bn was

of a different order from India's modest deficits. In most years of this decade foreign direct investment inflows into China have been eight to 12 times higher than to India, though the multiple dropped after 2005.

Similarly, China's primary energy consumption of commercial fuels has doubled since 2000 to about 1.9bn tonnes of oil equivalent. The increase over the seven years is more than double India's total primary energy consumption of 410m tonnes of oil equivalent in 2007. Unsurprisingly, China's carbon dioxide emissions had soared to 5.6bn tonnes by 2006, compared with 1.3bn tonnes from India. In per capita terms China's emissions were almost four times higher than India's. With China's economy three times as large as India's today and

rent account surpluses.

Both countries have an important stake in bringing the Doha round to a successful conclusion: China because she is one of the biggest trading nations; and India because her economic interests are better served by a liberal, international trading order than a system of regional blocs. Or the contentious issue of greenhouse gases, China's actions will obviously have much more significant consequences, given that her emissions are four times greater in both absolute and per capita terms.

What of the future? Many believe that on current trends India will achieve China's present economic scale in about 15 years. Perhaps. But by then, it is not unreasonable to expect that the Chinese economy may also have expanded threefold. The main point is that China's explosive growth has not only dominated the global economic scene over the past decade; there is a strong likelihood that it will do so for the decade ahead as well. Put differently, there is really only one new economic giant in town. The other potential giant, India, is still a relative strapping. Thus far her growth in trade, capital flows, energy consumption and emissions has been at a steady, moderate pace. Ten or 15 years on, the story may be different.

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given her disproportionately larger footprint in international trade, capital flows, energy consumption and carbon emissions. China's potential role in helping solve the major global economic issues of the day is correspondingly greater. For example, in the global recession, China's massive fiscal stimulus over the past year has already helped revive China's growth and imparted a significant stimulus to other Asian economies.

Similarly, on the enduring issue of global imbalances, India, with her modest current account deficits and high share of private consumption, can do little to ameliorate this problem. China, in contrast, can play a much bigger part by stimulating greater consumption and undertaking significant currency appreciation to contain and reduce her massive cur-

rent account surpluses. In an important sense, the sequential rise of China and India has made things easier for the global economic community. The strains of accommodating one giant at a time have been substantial but broadly manageable. Had both the populous Asian countries embarked on growth of 8-10 per cent a year roughly the same time, it could have been far more challenging for the international economic order – and perhaps more dangerous.

The writer is former chief economic adviser to the government of India. His most recent book is India at Global Crisis

America should not take China too seriously



David Pilling

What a difference an "and" makes. The US-China Strategic Economic Dialogue (SED), a twice-yearly bilateral encounter centred on economic issues, has morphed under President Barack Obama into the broader Strategic and Economic Dialogue (S&ED). For those with a grammatical bent, the addition of a conjunction transforms the word "strategic" from an adjective describing the economic dialogue into a portmanteau adjective describing anything Hillary Clinton damn well wants.

The upshot of US inter-agency rivalry is that Mrs Clinton's state department joins Tim Geithner's Treasury at the heart of the conversation with Beijing. That is no bad thing. It has broadened the agenda from what Hank Paulson, Mr Geithner's predecessor, originally conceived in 2006 as a narrowly economic forum. Now that the state department has muscled in, climate

change, North Korea and any other issue of global or bilateral import have joined US deficits, financial sector reform and the renminbi as potential subjects for discussion.

Widening the agenda of talks, the latest round of which wrapped up in Washington on Tuesday, makes sense. The Sino-US relationship is evolving fast. Mr Obama's China policy builds on foundations laid by his predecessor. For a president who promised change, one area of constancy with George W. Bush's White House has been the posture towards Beijing. That was one of the few things his predecessor was judged to have got about right. Unlike Mr Bush, or Bill Clinton before him, President Obama has not had to backpedal from initial hostility towards China towards a more accommodating stance.

In part this is because of his conviction that it is good to reach out. If he can talk to Tehran or Pyongyang, he can certainly entertain friendly dialogue with Beijing. It is also because he had little choice. The economic crisis has tilted the balance of power towards China. The US is feeling less confident about its economic underpinnings and less able than before to lecture Beijing on revaluation or the delights of

liberalisation, particularly since so many of its own banks, insurers and carmakers have fallen under state control.

If anything, it is Beijing – some of whose officials now privately boast they have nothing at all to learn from the Great Spendthrift – that has the upper hand. China's seeming financial hold over the US has been brought into sharp relief. Beijing has become prone to lecture Washington

Far from being a sign of strength, Beijing's vast foreign reserves are the side-effect of an over-reliance on exports

on the need to safeguard its \$2,000bn reserves, the bulk of which are parked in US dollars.

It is wholly appropriate that Washington accords due attention to China, the most important emerging power since America itself. But there is also a danger of taking China too seriously. In compensating for past neglect, things could swing too far the other way. For all the euphoria about the G2 – the Sino-US axis that, according to some breathless

reckoning, is the only meaningful global forum – it is worth pausing to survey the facts.

For a start, China's financial grip over the US is not as tight as many suggest. Far from a sign of strength, Beijing's accumulation of vast foreign reserves is the side-effect of an economic model too reliant on exports. The enormous trade surplus is the product of an undervalued renminbi that has allowed others to consume Chinese goods at the expense of Chinese people themselves.

Beijing cannot dream of selling down its Treasury holdings without triggering the very dollar collapse it purports to dread. Nor are its shrill calls for the US to close its twin deficits – which would inevitably involve buying fewer Chinese goods – entirely convincing. Rather than exposing the superiority of China's state-led model, the global financial crisis has laid bare the compromising embrace in which the US and China find themselves.

Commentators also sometimes confuse China's rapid progress and likely emergence as a superpower with present-day reality. China is still a relatively poor country. For all its military ambitions, it is decades away from being a match for the US. In 2005, according to the Stockholm

International Peace Research Institute, China accounted for just 4 per cent of global military spending, a tad short of the UK and France, and an aircraft-carrier-length away from the US, at 46 per cent. True. US might has been humbled in Iraq and Afghanistan. But China has not even tried to project its power on nations such as North Korea, which has tiptoed towards nuclear status under its very nose.

China is more fragile than its increasingly strident tone suggests. Its economy has been kept churning by enforced bank lending that could yet rebound in asset price bubbles or a crop of bad loans. Communist party control is strong but brittle. Given the choice between projecting China's authority on the world stage at this month's G8 summit in Italy or tackling brewing ethnic conflict in Xinjiang, Hu Jintao, China's president, chose to rush home.

None of this suggests that the US is wrong to engage China at the highest and deepest of levels. China's emergence as a great power demands no less. Yet the US, quiet on human rights and muted on the renminbi, may be underselling itself. China will be a huge force to be reckoned with. But it is not quite there yet.

david.pilling@ft.com

Fool's gold



**Paul
Krugman**

The American economy remains in dire straits, with one worker in six unemployed or underemployed. Yet Goldman Sachs just reported record quarterly profits — and it's preparing to hand out huge bonuses, comparable to what it was paying before the crisis. What does this contrast tell us?

First, it tells us that Goldman is very good at what it does. Unfortunately, what it does is bad for America.

Second, it shows that Wall Street's bad habits — above all, the system of compensation that helped cause the financial crisis — have not gone away.

Third, it shows that by rescuing the financial system without reforming it, Washington has done nothing to protect us from a new crisis, and, in fact, has made another crisis more likely.

Let's start by talking about how Goldman makes money.

Over the past generation — ever since the banking deregulation of the Reagan years — the U.S. economy has been "financialized." The business of moving money around, of slicing, dicing and repackaging financial claims, has soared in importance compared with the actual production of useful stuff. The sector officially labeled "securities, commodity contracts and investments" has grown especially fast, from only 0.3 percent of G.D.P. in the late 1970s to 1.7 percent of G.D.P. in 2007.

Such growth would be fine if financialization really delivered on its prom-

ises — if financial firms made money by directing capital to its most productive uses, by developing innovative ways to spread and reduce risk. But can anyone, at this point, make those claims with a straight face? Financial firms, we now know, directed vast quantities of capital into the construction of unsellable houses and empty shopping malls. They increased risk rather than reducing it, and concentrated risk rather than spreading it. In effect, the industry was selling dangerous patent medicine to gullible consumers.

Goldman's role in the financialization of America was similar to that of other players, except for one thing: Goldman didn't believe its own hype. Other banks invested heavily in the same toxic waste they were selling to the public at large. Goldman, famously, made a lot of money selling securities backed by subprime mortgages — then made a lot more money by selling mortgage-backed securities short, just before their value crashed. All of this was perfectly legal, but the net effect was that Goldman made profits by playing the rest of us for suckers.

And Wall Streeters have every incentive to keep playing that kind of game.

The huge bonuses Goldman will soon hand out show that financial-industry highfliers are still operating under a system of heads they win, tails other people lose. If you're a banker, and you generate big short-term profits, you get lavishly rewarded — and you don't have to give the money back if and when those profits turn out to have been a mirage. You have every reason, then, to steer investors into taking risks they don't understand.

And the events of the past year have skewed those incentives even more, by putting taxpayers as well as investors on the hook if things go wrong.

I won't try to parse the competing claims about how much direct benefit Goldman received from recent financial

bailouts, especially the government's assumption of A.I.G.'s liabilities. What's clear is that Wall Street in general, Goldman very much included, benefited hugely from the government's provision of a financial backstop — an assurance that it will rescue major financial players whenever things go wrong.

You can argue that such rescues are necessary if we're to avoid a replay of

the Great Depression. In fact, I agree. But the result is that the financial system's liabilities are now backed by an implicit government guarantee. Now the last time there was a comparable expansion of the financial safety net, the creation of federal deposit insurance in the 1930s, it was accompanied by much tighter regulation, to ensure that banks didn't abuse their privileges. This time, new regulations are still in the drawing-board stage — and the finance lobby is already fighting against even the most basic protections for consumers.

If these lobbying efforts succeed, we'll have set the stage for an even bigger financial disaster a few years down the road. The next crisis could look something like the savings-and-loan mess of the 1980s, in which deregulated banks gambled with, or in some cases stole, taxpayers' money — except that it would involve the financial industry as a whole.

The bottom line is that Goldman's blowout quarter is good news for Goldman and the people who work there. It's good news for financial superstars in general, whose paychecks are rapidly climbing back to pre-crisis levels. But it's bad news for almost everyone else.

The bottom line is that Goldman's blowout quarter is good news for Goldman and the people who work there. It's good news for financial superstars in general, whose paychecks are rapidly climbing back to pre-crisis levels. But it's bad news for almost everyone else.

TRADE AND CLIMATE

Failure to agree on how to address global warming could undermine half a century of opening world trade.

When leaders of the world's richest nations and the big developing countries agreed at the Group of 8 summit this month to restart global trade negotiations, they sent a powerful signal about the need for concerted action to deal with the world's economic emergency.

It was disturbing, however, that they could not agree on a common strategy for reducing the greenhouse emissions causing global warming. Trade and climate policy have become increasingly entangled. Failure to agree on how to address global warming could undermine half a century of opening world trade.

The U.S. House of Representatives proved the point last month when it passed a climate bill that would impose trade penalties on countries that do not accept limits on carbon emissions. Last year, the European Commission approved the idea of an "equalization" levy on imports from countries that have not agreed to cut emissions.

President Obama rightly opposed the penalties in the House bill. Unilateral sanctions are unlikely to work and more than likely to provoke a dangerous protectionist tit-for-tat trade war. Yet if the world's biggest emitters of CO₂ — including the United States, China and India — fail to reach an agreement at a meeting in Copenhagen in December, the temptation for countries that accept limits on emissions to impose unilateral sanctions on countries that do not could well become irresistible.

The main reason trade and climate change are linked is that the damage inflicted by greenhouse gases is not mainly local or regional. If big emitters

do not cut back, atmospheric concentrations of greenhouse gases will continue to rise dangerously no matter what the rest of the world does.

Congress is concerned that domestic limits on carbon emissions would put American companies at a competitive disadvantage with rivals in countries with no such caps. But that is not the only problem. In the absence of a system of import duties related to carbon, industries with high emissions might relocate to nonsignatory countries to save money. Or they might fail, unable to compete with dirtier and cheaper foreign rivals.

There are precedents for using trade measures for environmental goals. The Montreal Agreement to curb the use of ozone-depleting gases included trade controls on such substances. And the World Trade Organization has suggested that levying taxes at the border on the carbon content of imports would be acceptable if they are devised properly.

Such tariffs must be part of an international agreement on climate change. An international accord that includes trade-related enforcement measures must also include commitments on emission reductions all around, as well as financial aid for poorer countries to meet the caps without sacrificing economic growth.

Further, any deal must set clear guidelines on how to identify and quantify transgressions and establish appropriate countermeasures. It also must not open a backdoor for protectionism. Without such a deal, trade is going to have problems. Failing to conclude the current negotiations will be the least of them.

Signs seen of V-shaped recovery in East Asia

BANGKOK

Asian Development Bank
urges officials to continue
with monetary expansion

REUTERS

Emerging East Asia has entered the transition from recession to what looks like the start of a V-shaped recovery, but policy makers must maintain expansionary monetary policies, as risks remain, the Asian Development Bank said Thursday.

"Emerging East Asia could see a V-shaped recovery, with growth dipping sharply in 2009 before regaining last year's pace in 2010," Jong-wha Lee, the bank's chief economist, said at a news conference in Bangkok. "But it is only a small V shape," he said, adding that it would be driven more by domestic stimuli than a rebound in external demand.

In its semiannual review of East Asian economies and policy, the bank said that for the region's emerging economies, prospects for 2009 remained the worst since the 1997-1998 financial crisis. The bank expects these economies' gross domestic products to grow 3 percent this year, after a 6.1 percent gain in 2008.

The bank's emerging East Asia category includes Brunei, Cambodia, China, Hong Kong, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, South Korea, Taiwan, Thailand and Vietnam.

"As external demand will remain sluggish in the near future, emerging East Asia's recovery is expected to be gradual, with 2010 growth rising to about 6 percent," the review said.

It said that China looked set for a quick recovery, with growth expected at 7 percent this year and 8 percent next year, providing a much-needed lift to the region's economies, but that Europe, the United States and Japan were important sources of demand.

"China alone cannot be the sole engine for the region's recovery, as external demand is very weak. We need two engines," Mr. Lee said. He added that China's demand for imports from emerging East Asia depended on China's own ability to export.

The bank said monetary policy in Asia needed to remain expansionary until the expected recovery gained substantial traction or big inflationary pressures emerged.

Asian governments have increased spending and cut interest rates to help the economy. But many have paused to monitor the impact of monetary easing, and the debate is turning to when rates may have to rise, especially if heavy government spending fuels inflation.

"The authorities should plan rather than implement credible and coherent exit strategies to unwind the policy stimulus to prevent inflationary expectations from rising, which could later impede recovery and sustainable growth," the bank's statement said.

The bank said that, despite aggressive rate cuts, monetary conditions in the region had not been overly expansionary, considering the sharp contractions in the real economy, the benign inflation environment and moderating growth in bank lending.

Asian shares climb higher on optimism over growth

Market Roundup

BY KEVIN PLUMBERG

REUTERS

HONG KONG Asian stocks climbed to a 10-month high, led by energy shares, though some investors wondered whether upward momentum from corporate earnings reports justified increasingly pricey valuations.

The dollar hovered close to a seven-week low and the yen was being sold off, with traders basically tracking equity markets as a gauge of investor penchant for risk taking. The four-month rally in global stock markets has put pressure on both currencies, which acted as havens throughout the financial crisis.

The latest batch of U.S. corporate results has been mixed, with solid earnings from Apple and Starbucks enough to bump up the Nasdaq for an 11th straight session, while results from Morgan Stanley were disappointing.

Still, the pace of positive revisions to earnings estimates as well as bullish economic signals have made investors increasingly optimistic about growth prospects in developing Asia.

"Emerging East Asia could see a V-shaped recovery, with growth dipping sharply in 2009 before regaining last year's pace in 2010," said Jong-Wha Lee, chief economist with the Asian Development Bank, in a report. The report said, however, that policy makers should plan exit strategies to unwind policy stimulus to avert inflation expectations, but not yet implement them.

The Hang Seng index in Hong Kong was the top gainer in the region. After its 1.3 percent dip Wednesday, the index rose 3 percent with property stocks and resource-related names among the highfliers. The top oil refiner in Asia, Sinopec, jumped 5.3 percent.

Shanghai shares rose a percent to a fresh 13-month closing high.

Some investors were beginning to question whether equity prices reflected fundamentals, especially in hot industries. For example, valuations of real estate stocks in Hong Kong on the basis of 12-month forward price-to-earnings have been above the five-year average since May, according to I/B/E/S estimates.

The Nikkei 225 share average in Japan ended 0.7 percent higher as strength in high-technology companies like Kyocera offset weakness in domestically oriented companies like KDDI. Since hitting a two-month low on July 13, the index has rallied 8.2 percent.

The MSCI index of Asia Pacific shares outside Japan rose 1.2 percent, with gains in the energy sector leading the broader market. Since July 13, the MSCI index has climbed more than 13 percent and it reached its highest level Thursday since last September.

"The market has had a good run. And a number of people have been suggesting things are getting a little bit expensive," said Martin Angel, dealer at Patersons Securities in Australia.

Indian shares rose 2.6 percent, while Singapore rose 1.4 percent followed by South Korea's 0.2 percent rise. Shares in Australia and Taiwan fell marginally.

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The retreat from global financing



Floyd Norris

HIGH & LOW FINANCE

NEW YORK The era of financial globalization may be coming to an end.

Virtually universal revulsion at the errors and excesses of the financial giants and the global recession that resulted have not led to any real consensus on what to do about it, either at national or international levels.

Instead, countries are looking out for themselves or simply quarreling. Recriminations are in fashion, whether against regulators who allowed bailed-out bankers to get big pay packages or against financial institutions that were unpopular in some countries long before the financial crisis.

Samuel Johnson once said, "When a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully." He might have added that a reprieve from the death penalty can cause the mind to wander.

That wandering can be seen in Britain, where the Labour government has put together a package of regulatory reforms that the Conservative opposition vows to repeal if it wins the next election, as is widely expected.

The same wandering can be seen in Washington, where the Federal Reserve and the Treasury are being pilloried in Congress for actions that were — or at least appeared to be — necessary to avert collapse after the global economy went into free fall last autumn.

The Institute of International Finance, a group of the world's largest financial institutions, put out a report Thursday pleading for international cooperation and voicing fears in particular about national efforts to apply different standards to local affiliates of

international banks. "We are operating in a globally interconnected world where we need to strengthen the system's capacity to minimize the risks and to maximize the benefits of the interconnected global marketplace," said Josef Ackermann, the chief executive of Deutsche Bank and chairman of the institute.

The big banks are particularly concerned about a proposal by the Financial Services Agency in Britain to "ring-fence" assets of British subsidiaries of foreign financial firms. Other countries have indicated they may follow suit, noting the way Lehman Brothers brought assets home before it failed.

For any one country, the group said, that might appear prudent. "But this can only put the brakes on global recovery, global finance capacity and ability to respond to global liquidity problems."

But what was global before the crisis quickly turned local. The countries that suffered the most were those that had no locally owned banking systems — think of Eastern Europe — and those that had banking systems far larger than they could afford to rescue — think of Iceland.

To many, the crisis showed the dangers to so-called host countries of relying on foreign banks supervised by

Countries are looking out for themselves or simply quarreling. Recriminations are in fashion.

"home country" regulators. When bailouts were necessary, the home countries were reluctant to let the money be used overseas.

Charles Dallara, the director of the institute, quoted a central banker as saying, privately and sadly, "We are going back to a world of national banking." Mr. Dallara thinks that would be disastrous for global efficiency and global growth.

There could be a healthy debate on that issue. Over the past 30 years, financial globalization appeared to be crucial to increasing global growth and prosperity. Is that record unworthy of respect in the aftermath of the collapse, or are there ways to keep the benefits while avoiding a new financial crisis?

But that debate is not taking place. Among the leaders of the major countries, there is universal agreement that a coordinated global regulatory system is needed — and little resolve to get such a system. They talk global when

the Group of 20 meets and act local after they return home.

In Europe, there is much more hostility both to credit rating agencies and to hedge funds than there is in the United States, albeit for reasons that have little to do with the crisis. So tougher rules may be applied there.

The first duty of banking regulators is to protect the banking system. That usually means keeping the banks healthy, which is in everyone's interest. But if the banks are weak, it can seem like a good idea to hide that weakness from the public, to buy time for the banks to regain health. That tendency to secrecy needs to be resisted, particularly since secrecy can also help to obscure the original regulatory failures that created the problem.

It is amazing that these days the Fed is being raked over the coals not for its pre-crisis failures — of inadequate regulation of the banks, no regulation of mortgage brokers and too-easy monetary policy as the housing bubble grew — but for the successful steps it took to contain the crisis last autumn and winter.

Even after several congressional hearings, I am still not sure whether the Fed and the Treasury really forced Bank of America to complete its purchase of Merrill Lynch at the end of last year or whether such an action would have been improper. But having lived through the aftermath of the Lehman collapse, I am glad I did not get to see how the markets and the economy would have responded to a New Year's Eve crisis at Merrill.

One measure of the post-Lehman panic is that the government ended up offering to guarantee all kinds of things that in any other environment would have seemed safe. When Neil Barofsky, the inspector general for the Troubled Asset Relief Program, totaled up possible federal guarantees at \$23.7 trillion, he included the guarantee of assets — like Treasury bills — in money market funds and the aggregate of mortgages guaranteed by Fannie Mae and Freddie Mac.

That memory now is being used to criticize those who fashioned the bailouts as having been overly generous to undeserving bankers. It should be used to remind everyone of just how close to disaster the financial world appeared to be — and of the need for comprehensive international cooperation to create a regulatory system that actually works.

ONLINE: HIGH AND LOW FINANCE

Join the conversation with Floyd Norris, the chief financial correspondent of *The New York Times*. norris.blogs.nytimes.com

A last gasp for the G-8?

The rationale for the Group of Eight, composed of leading industrialized nations, has been thinning for years. Not only has the group produced little of substance at its annual leaders' summit, but its members are unable to deliver on whatever pledges are produced. Moreover, the political heft of the eight has diminished as other countries have developed and demanded commensurate influence in global political deliberations. Their demand for more input into key institutions has meant that most G-8 meetings include almost twice as many participants, as other key nations join the deliberations. But the size of the group, the ad hoc nature of the agenda and the lack of any real follow-through means the meeting is increasingly derided as a photo op, devoid of real substance.

The gap between the group's ambitions and its reality was on full display last week at the annual summit that convened in L'Aquila, Italy. The meeting backdrop may have been more revealing than intended: The summit host, Italian Prime Minister Silvio Berlusconi, decided to hold the get-together in a town devastated by an earthquake only weeks earlier to draw attention to the plight of the residents. So, world leaders occupied the remaining standing buildings while 25,000 people remained in the tents they call home. Mr. Berlusconi may have succeeded in getting the world's media to display the hardships borne by the people of L'Aquila, but it is unlikely that the attention will make their lives any easier.

Sadly, that is likely to be the assessment for the entire summit. One of the key agenda items at the summit was forging consensus on a formula to cut the greenhouse gas emissions that contribute to climate change. As always, real progress proved elusive. The G-8 did make a long-term commitment to reduce carbon emissions by 80 percent by 2050, but they set no more immediate targets. But the developed countries continue to demand that their developing counterparts participate in any global regime to fight global warming, a position that is anathema to the developing world, whose leaders argue, not without some justification, that they should not have to pay to fix a problem they did not create. All participants agreed that global average temperatures should not rise over 2 degrees Celsius. But absent a truly global regime, there is little prospect for a genuine solution to the global warming problem.

Or take food security. Coming on the heels of reports that more than 1 billion people worldwide suffer chronic hunger, the

need for sustained and systematic efforts to provide aid has never been higher. The G-8 governments pledged \$20 billion over three years for agricultural assistance to poorer countries. That was \$5 billion more than was in the original draft communique, but it is not clear if that is new money or is part of the doubling of aid that was originally promised at the 2005 G-8 meeting. Moreover, since the G-8 provided \$13 billion in assistance since January 2008, then this amount seems a bit small.

The best way for the G-8 countries to aid poor and developing nations is to open markets to their goods. As expected, the leaders reconfirmed their "commitment to keep their markets open and free, and to reject protectionism of any kind." That is nice language, but close scrutiny shows that virtually every G-8 member has implemented some measures that are trade restricting. Even more important is the need for all governments to push for the completion of the Doha Round of trade negotiations. Those talks were supposed to have been wrapped up in 2004. Instead, they have been stalled for years, despite repeated acknowledgments — by the G-8 and other groups — that they are essential to sustaining the momentum for trade and spreading prosperity. Once again, rhetoric outpaces reality and the continued empty promises make the G-8 look ineffectual.

If the G-8's moment has passed, what will replace it? The obvious contender is the Group of 20, which includes all the G-8 members and other economic powers, such as China, Brazil, India, and Saudi Arabia to name but four. Altogether, the group is responsible for 85 percent of global wealth, 80 percent of world trade, and two thirds of the world's population. The inclusion of the remaining 12 countries provides more than just heft, however: Their participation means that G-20 decisions enjoy more international legitimacy than do those of the G-8.

But if the size of the G-20 makes it a more credible global leader, then it also makes consensus more difficult, especially given the diversity of its membership. G-20 members cover the range of political and economic models, include both producers and consumers, debtors and creditors, developed and developing nations alike. Finding common ground has been difficult. In fact, the G-20's record of delivering on its pledges is little better than that of the G-8. That may provide some solace for G-8 supporters, but it is not a compelling reason to keep the group going.

THE JAPAN TIMES FRIDAY, JULY 17, 2009

Economic growth may fall to 1%: IMF

Washington

JULI

Japan's potential economic growth rate could fall from about 1.75 percent in 2007 to close to 1 percent over the medium term despite its projection of a recovery in 2010, the International Monetary Fund said Wednesday.

In a statement at the conclusion of its annual discussions with Japanese officials, the IMF pointed to the nation's slow shift to a domestic demand-led economy.

On current policies, Japan's potential growth could fall to that level "as investment rates

decline due to tighter corporate financing and structural rigidities slow rebalancing of growth toward domestic sources," it said.

The IMF urged Japan to "press ahead with structural reforms, including deregulating the agricultural and service sectors, enhancing product market flexibility, further developing financial markets and encouraging inward foreign direct investment."

The international lending institution expects gross domestic product to fall by 6 percent in 2009 before expanding by 1.75 percent in 2010.

But "the outlook is excep-

tionally uncertain" and "risks are tilted to the downside due to a deteriorating labor market, still-tight financial conditions and lingering uncertainties about global growth," it said.

"A sustained recovery will likely emerge during the course of 2010 but will hinge critically on improvement in overseas lending conditions and trade," the IMF said.

While supporting Japan's stimulus measures taken so far, it said "a longer or more severe recession could call for additional targeted and reversible measures next year."

The IMF showed under-

standing of Japan's goal of generating a primary budget surplus within 10 years, giving up its initial goal of achieving a surplus by fiscal 2011, under its fiscal and economic policy guidelines for 2009.

But once an economic recovery takes hold, Japan should strive toward achieving its new targets of placing the debt ratio firmly on a downward path. It also said the nation's new fiscal consolidation strategy "will likely require expenditure cuts as well as comprehensive tax reform, including an increase in the consumption tax" from the present 5 percent.

Protectionist trend on the rise



DAVID
HOWELL

London

In the English language the word "Protection" sounds warm and friendly. Everyone needs protection against the storms of life and it is nice to give protection and be protected. But lift this innocent word into the international sphere and it becomes a sinister and ominous concept, a harbinger of narrow selfishness, conflict and impoverishment.

At present it is a word being heard increasingly on the world stage. The virus of protectionism, like the virus of swine fever, is spreading fast through the global economy, and taking new and more dangerous forms.

Trade protection used to mean just raising tariffs, or imposing quotas on imports on certain goods from certain sources. The lessons of the great slump of the 1930s were thought to have taught people that raising protectionist barriers of this type ruined everybody. In the postwar period, international institutions and procedures were set up to maintain free trade, of which today's World Trade Organization is the heir and successor.

Meanwhile, protectionism has mutated into a whole variety of new guises and, in the current global recession, is beginning to rage virulently. Antidumping duties, "buy local" conditions in contracts, excessive health and safety rules, barriers to investment flows and "foreign" ownership, child-labor or forced-labor accusations — these are just some of the new instruments to which country after country is resorting as the virus spreads.

Now, a still newer form of protectionism has arrived in the form of carbon tariffs — which are imposed to protect one country's industries whose carbon emissions may be fined and heavily taxed from competition from another country's producers with no such burdens. This idea, which can of course be used to strike especially hard at imports from poorer countries and from lower-wage economies such as China and India, is gaining ground in the European Union and has now been fully approved by the U.S. Congress.

In turn, various Chinese and Indian leaders, and others, have protested that this amounts to outright trade war — just the sort of thing that the WTO exists to prevent. And of course they are right.

Slapping higher taxes and tariffs on the imports of their countries leads directly to poverty and unemployment. It delays the day when poorer economies might develop and become richer markets for imports, and it links one particular cause or campaign, carbon reduction, with the overall trade process — with potentially disastrous effects.

It is a classic example of good intentions leading to bad outcomes. The problem is too much zeal. Once a cause of this sort turns into a crusade, people become blind to the harmful, and even cruel, consequences their zealotry may produce.

Turning the fight against climate change into a trade war is particularly dangerous. It brings together as allies not only the well-intentioned green campaigners but also the most narrow nationalists, trade unions bent on guarding members' jobs against foreign labor, monopolists, inefficient producers trying to hide weaknesses, populist demagogues, and a bunch of other undesirables.

All of these phenomena can now be seen springing up like weeds on the world trade scene, while the WTO wrings its

hands and free traders find themselves pushed aside. According to the latest WTO report, new trade-distorting restrictions are being enacted twice as fast as acts of liberalization.

The vast availability of information and the passion for transparency now give every lobby, good or bad, new power to push their demands for more protection and to cow governments and politicians into panic protectionist measures and condoning the erection of new trade barriers. President Barack Obama has tried to warn against this cause-and-effect behavior in the U.S. Congress — probably in vain. He should remind them of how crippling American tariff hikes on imports in the 1930s helped lead directly to a world war.

It takes a very brave politician these days to speak out against these enormous pressures, which somehow must be resisted if the world is not to slide into another dark age of trade retaliation and nationalist protection. This is not just because the whole human race will end up poorer as a result; destroying trade and investment flows destroys dialogue and sows the seeds of bitter and violent conflict. Japan's 20th century is a grim reminder of how this can happen all too easily.

It would be a high irony if all the activity and lobbying and politicking of the campaigners against global warming and their scientific backers led not to a greener and more peaceful world, which everyone wants, but back to a domino process of trade isolation, with conflict and destruction to follow.

As always, moderating and calming voices are needed at the world leadership level. But as always they are proving very hard to find.

David Howell is a former British Cabinet minister and former chairman of the Commons Foreign Affairs Committee. He is now a member of the House of Lords.

Economic stimulus has been squandered



ROBERT J. SAMUELSON

Washington

It's not surprising that the much-ballyhooed "economic stimulus" hasn't done much stimulating. U.S. President Barack Obama and his aides argue that it's too early to expect startling results. They have a point. A \$14 trillion economy won't revive in a nanosecond. But the defects of the \$787 billion package go deeper and won't be cured by time. The program crafted by Obama and the Democratic Congress wasn't engineered to maximize its economic impact. It was mostly a political exercise, designed to claim credit for any recovery, shower benefits on favored constituencies and signal support for fashionable causes.

As a result, much of the stimulus' potential benefit has been squandered. Spending increases and tax cuts are sprinkled in too many places and, all too often, are too delayed to do much good now. Nor do they concentrate on reviving the economy's most depressed sectors: state and local governments; the housing and auto industries. None of this means the stimulus won't help or precludes a recovery, but the help will be weaker than necessary.

How much is hard to determine. By yearend 2010, the package will result in 2.5 million jobs, predicts Mark Zandi of Moody's Economy.com. But as Zandi notes, all estimates are crude. They involve comparing economic simulations with and without the provisions of the stimulus. The economic models must make assumptions about how fast consumers spend tax cuts, how quickly construction projects begin and much more. Depending on the assumptions, the results vary. When the Congressional Budget Office made job estimates, it presented a range of 1.2 million to 3.6 million by yearend 2010. Whatever the actual figures, they won't soon mean an increase in overall employment. They will just limit job losses. Since late 2007, those have totaled 6.5 million, and there are likely more to come.

On humanitarian grounds, hardly anyone should object to parts of the stimulus package: longer and higher unemployment benefits; subsidies for job losers to extend their health insurance; expanded food



stamps. Obama was politically obligated to enact a campaign proposal providing tax cuts to most workers — up to \$400 for individuals and \$800 for married couples. But beyond these basics, the stimulus plan became an orgy of politically appealing spending increases and tax breaks.

More than 50 million retirees and veterans got \$250 checks (cost: \$14 billion). Businesses received liberalized depreciation allowances (\$5 billion). Health care information technology was promoted (\$19 billion). High-speed rail was encouraged (\$8 billion). Whatever the virtues of these programs, many spend out slowly. The CBO estimated that nearly 30 percent of the economic effects would occur after 2010. Ignored was any concerted effort to improve consumer and business confidence by resuscitating the most distressed economic sectors.

Vehicle sales are running 35 percent behind year-earlier levels; frightened consumers recoil from big-ticket purchases. Falling house prices deter homebuying. Why buy today if the price will be lower tomorrow? States suffer from steep drops in tax revenues and face legal requirements to balance their budgets. This means raising taxes or cutting spending — precisely the wrong steps in a severe slump. Yet, the stimulus package barely addressed these problems.

To promote car sales and homebuying, Congress could have provided temporary but generous tax breaks. It didn't. The housing tax credit applied to a fraction of first-time buyers; the car tax break permitted federal tax deductions for state

sales and excise taxes on vehicle purchases. The effects are trivial. The recently signed "cash for clunkers" tax credit is similarly stunted; Macroeconomic Advisers estimates it might advance a mere 130,000 vehicle sales. States fared better. They received \$135 billion in largely unfettered funds. But even with this money, Goldman Sachs economists estimate that states face up to a \$100 billion budget gap in the next year. Already, 28 states have increased taxes and 40 have reduced spending, reports the Office of Management and Budget.

There are growing demands for another Obama "stimulus" on the grounds that the first was too small. Wrong. The problem with the first stimulus was more its composition than its size. With budget deficits for 2009 and 2010 estimated by CBO at \$1.8 trillion and \$1.4 trillion, it's hard to argue they're too tiny. Obama and congressional Democrats sacrificed real economic stimulus to promote parochial political interests. Any new "stimulus" should be financed by culling the old.

Here, as elsewhere, there's a gap between Obama's high-minded rhetoric and his performance. In February, Obama denounced "politics as usual" in constructing the stimulus. But that's what we got, and Obama likes the result. Interviewed recently on ABC, he was asked whether he would change anything. Obama seemed to invoke a doctrine of presidential infallibility. "There's nothing that we would have done differently," he said.

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Will Asia's economic recovery lead the way?

Jong-Wha Lee
Manila

The latest economic indicators from the world's advanced economies remain mixed. There are some signs of stabilization — industrial output and consumer spending are, for example, falling much more slowly than they were, but stabilization does not mean imminent recovery. A decline is still a decline.

Unemployment is still on the rise. Consumer and business confidence has not recovered. It is clear that the recession has yet to bottom out in the United States and Europe.

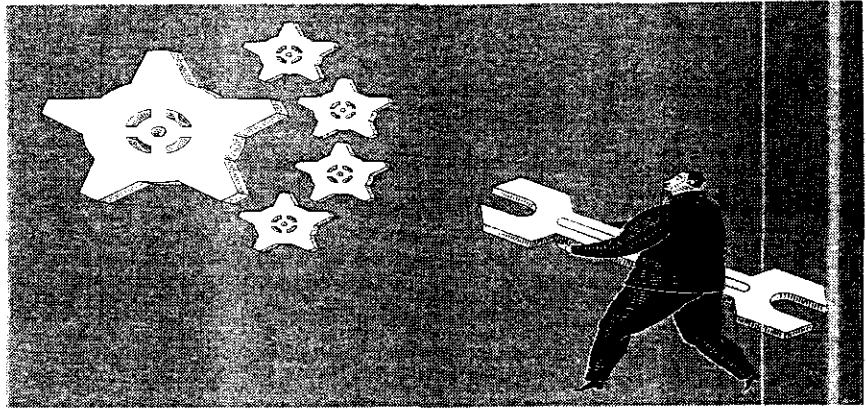
By contrast, signs are much more favorable in Asia. Markets, which are typically the first indicators of recovery, are rebounding much more sharply here. While the Dow Jones Industrial Average rose 11 percent in the second quarter, Japan's Nikkei 225 jumped 23 percent. Equity markets in China rose 25 percent, India 53 percent and Vietnam 60 percent.

Asia's real economy is doing much better too. Industrial production in South Korea, Singapore and Thailand has been rising in recent months. And while most economies in Asia have suffered their worst performance since the 1997-98 Asian financial crisis, we believe they have hit bottom.

The Asian Development Bank forecasts that gross domestic product (GDP) growth for emerging East Asia will still be 3.0 percent this year. While that's a significant reduction from the 6.1 percent growth in 2008, it is growth nonetheless — and much better than other regions of the world.

Will Asia lead the global recovery? Quite possibly. We expect a V-shaped recovery; growth in the region is likely to rise to around 6.0 percent next year, still two percentage points below the 8 percent average growth between 2003 and 2007. The reason is that while we expect government stimulus to boost domestic demand, we doubt the external demand that drove exports during the years before the latest crisis will return anytime soon. We now see the U.S. economy contracting 3.0 percent this year while the economies in Europe and Japan will likely shrink 4.3 percent and 5.8 percent, respectively.

China is leading the recovery in Asia. Aggressive government spending there — more than 7 percent of GDP this year, and 8 percent in 2010 — will fuel domestic growth. And that, in turn, should help other Asian economies recover as they fill



THE STRAITS TIMES

Chinese demand for their goods. China is the biggest offshore buyer of Korean products and the second-largest for Japan, snapping up about a quarter of Korean exports and one-sixth of Japan's. About 12 percent of total exports from the five largest Southeast Asian economies — Indonesia, Malaysia, the Philippines, Thailand and Vietnam — go to China.

But that won't be enough to restore developing Asia to the growth levels seen in recent years. For that to begin to happen, consumers in the world's major economies also need to start buying Asia's goods again. The U.S., Japan and Europe remain major markets for Asian exporters. Intra-Asian trade has grown rapidly in recent years, but remains largely based on parts and components rather than final goods. Asians still don't buy finished products made in their own backyard.

In fact, economic growth in the U.S., Japan and Europe influences East Asia's regional output at least as much as China's does. Plus, China's ability to sustain economic growth over 8 percent is also reliant on a global recovery to provide external demand for its exports. Economic growth that relies on stimulus is not sustainable. Clearly, China or Asia alone cannot be the region's sole engine of growth. Developing Asia needs two engines — China and, just as important, the major advanced economies.

The implications are clear. First, a rebalancing of the sources of growth is needed. Even if demand in advanced economies recovers to pre-crisis levels, that won't be enough to meet Asia's expanding exports. The key for sustaining long-term economic growth in Asia is how to strengthen Asia's own domestic and regional demand.

Governments can no longer rely on export-oriented development strategies.

Strengthening social safety nets, broadening and deepening financial markets, supporting small and medium enterprises (especially in services), and increasing exchange rate flexibility will all help strengthen domestic demand.

But effective rebalancing requires both demand-side and supply-side policies. Developing more competitive and efficient domestic industries to serve domestic markets will take time.

Second, to avoid any repeat of the global financial crisis, the region's policymakers should improve and streamline their regulatory and supervisory regimes, while reinforcing regional and global cooperation. By and large, emerging East Asia's financial systems and institutions were shielded from the direct impact of the global financial crisis.

The resilience of Asia's banking systems has been attributed to reforms taken following the 1997-98 Asian financial crisis. Nevertheless, current risk-management and prudential oversight are clearly insufficient. Both banks and regulators must upgrade their systems to prepare for future risks and challenges.

The underlying causes of the current global turmoil — emanating from financial innovation and globalization — stress the need to better supervise financial institutions and protect financial stability.

While Asia may already be on the path to recovery, a return to sustained and rapid long-term economic growth will require rebalancing the sources of that growth and safeguarding financial market stability.

Jong-Wha Lee is chief economist of the Asian Development Bank.

THE JAPAN TIMES TUESDAY, JULY 28, 2009

China, U.S. to begin key economic talks

Washington
Clinton role: Page 4
AFP-JJI

The United States and China on Monday were to open their most in-depth talks since the election of President Barack Obama, with the U.S. side seeking far-reaching cooperation on the global economic crisis and beyond.

Obama was set to inaugurate the two-day dialogue, part of the U.S. leader's push to build a broader relationship between the biggest developed and developing economies.

With China increasingly uneasy about its massive exposure to the U.S. economy, Secretary of State Hillary Rodham Clinton and Treasury Secretary Tim-

othy Geithner made a joint appeal to Beijing to work together to spur global growth.

"Simply put, few global problems can be solved by the U.S. or China alone. And few can be solved without the U.S. and China together," Geithner and Clinton wrote in an article published Monday in The Wall Street Journal.

The duo, who will lead the U.S. side in the talks, argued that measures by Washington and Beijing to create and save jobs helped the world at large weather its worst economic turmoil since the Great Depression.

"The success of the world's major economies in blunting the force of the global recession and setting the stage for recovery is

due in substantial measure to the bold steps our two nations have taken," they said.

"As we move toward recovery, we must take additional steps to lay the foundation for balanced and sustainable growth in the years to come."

No major announcements are expected in the Washington talks but a flurry of press briefings could shed some light on the sometimes fraught relationship of the two intertwined Goliaths.

State Councilor Dai Bingguo and Vice Premier Wang Qishan are heading the Chinese delegation to the "Strategic and Economic Dialogue," which broadens talks with China on the economy set up under former President George W. Bush.

Charles Freeman, a China expert at the Center for Strategic and International Studies, a Washington think tank, said the dialogue's main purpose is to build confidence between Washington and Beijing.

"While the United States and China have developed an increasingly close relationship over the years, there still remains a fundamental sense of mutual strategic mistrust," Freeman said.

China is the largest creditor to the United States and has voiced growing concern about the fragility of the dollar and the safety of its more than \$750 billion invested in U.S. Treasury bonds.

Assistant Finance Minister Zhu Guangyao told reporters

in Beijing that China will press the United States to ensure the safety of its investments.

"As an important investor, China is deeply concerned about the U.S. economic situation and hopes the U.S. stimulus policy could make effective progress," Zhu said.

He Zhicheng, a senior economist at the Agricultural Bank of China, expects the two sides to talk less about economics than about strategic issues, including Xinjiang.

But He said that the economic crisis has weakened U.S. leverage over China.

"The U.S. are more dependent on China than during the Bush period," He said. "In the financial crisis, China was in a better position than the U.S."

THE JAPAN TIMES TUESDAY, JULY 28, 2009

Clinton eyes more than economy in China talks

ANALYSIS

Washington
REUTERS

Secretary of State Hillary Rodham Clinton has hired envoys to tackle most tough foreign policy issues, but one priority she kept is China as Washington seeks Beijing's help on challenges from North Korea to Iran.

Clinton and Treasury Secretary Timothy Geithner cohost two days of "strategic and economic" talks with top Chinese officials this week — meetings traditionally handled by the Treasury under the former Bush administration.

Sidelined recently by an elbow injury, Clinton also wants to reassert herself as a key player amid reports she is playing a lesser role in crafting foreign policy for President Barack Obama, her rival in last year's Democratic presidential race.

Officials say Clinton — whose first foreign trip as secretary of state was to China — wants improved relations with Beijing to be a signature issue, with plans to broaden the previous focus from largely economic ties to a more "comprehensive" relationship.

"Over the past few years, the dialogue tended to shift significantly toward the economic

and financial side," said Clinton's spokesman, P.J. Crowley.

"I think it (Clinton's new role) reflects a return to a really broad range of issues, rather than a fairly narrow set that might have been the focus of the agenda over the past couple of years."

The goal of the talks on Monday and Tuesday in Washington is to set a framework for the Obama administration's agenda with the Chinese government — which is sending nearly all of its key officials for sessions.

"When you look at the U.S.-China relationship, it is kind of overweight on economics and light on security and foreign

policy cooperation," said Drew Thompson, director of China Studies at the Nixon Center.

Aside from stabilizing the shaky global economy, another focus of this week's talks will be climate change and clean energy, an area Clinton earmarked as a diplomatic priority with Beijing and where some experts expect the most movement.

As a permanent, veto-wielding member of the U.N. Security Council, China also has major sway on foreign policy issues the United States is most concerned about, with Iran and North Korea's nuclear ambitions at the top of the list.

"For the first time in frankly the history of U.S.-China relations, we have major global issues that have moved to the center of the U.S. bilateral relationship," said Ken Lieberthal of the Brookings Institution.

China has reluctantly agreed to three rounds of sanctions against Iran to curb its nuclear program and Washington and other Western powers want to squeeze Tehran further before yearend if it still refuses to give up sensitive atomic work the West suspects is aimed at building a bomb.

Beijing has often sided with Russia when it comes to increasing financial pressure on

Iran, which says its nuclear program is to generate more power. The Obama administration wants to break that pattern.

"When push comes to shove, if the Iranians are not forthcoming, I think China will come along and agree to more sanctions," said Douglas Paal of the Carnegie Endowment for International Peace.

Clinton also needs to sustain Chinese resolve over North Korea, where tensions are escalating after several missile launches and the testing of a nuclear device in May.

In addition, China could be helpful in putting pressure on Pyongyang to release two U.S.

journalists jailed since March after being picked up near the China-North Korea border.

Experts say one of Clinton's biggest challenges will be to break decades of mistrust, with both sides suspicious of the other's long-term intentions, said Lieberthal.

"I think both sides have to think strategically about how to build confidence in the relationship," added Lieberthal, a former China hand in the Clinton administration.

But Paal cautioned Clinton against hanging her reputation too much on improved relations with China.

"We are not in a position to control them," he said.

Balance sheets key to an economic recovery

Michael J. Boskin
Palo Alto Calif.

Early signs of a manufacturing rebound, already strong in Asia, lend hope for some modest recovery from today's deep global recession. But a strong and durable economic expansion is unlikely until progress is made in dealing with the toxic assets poisoning the balance sheets of financial institutions and bedeviling policymakers almost everywhere.

The financial system is a complex interaction of lenders and borrowers, buyers and sellers, and savers and investors. When it functions well, it balances risk and reward, and innovation and safety.

Banks and other financial firms borrow short — increasingly in recent years from the commercial securities market, not deposits — and lend long at higher interest rates, taking on both credit risk (of default) and interest-rate risk. Increasing leverage boosts returns on the upside but is very risky on the downside. No surprise, then, that the large financial firms that failed — Bear Stearns, Fannie Mae and Freddie Mac, AIG and Lehman Brothers — had the highest leverage, in the range of 30 or 40 times their capital.

From 2002-2007, trillions of dollars were loaned for subprime and prime mortgages, autos, credit cards, commercial real estate, private equity and more, on the assumption by most borrowers and lenders that strong global growth, rising home prices and cheap, readily available short-term credit would continue for the foreseeable future. Once the music stopped, the assets plunged in value. The complexity of securitized pools of loans that were sold worldwide — bilaterally over the counter — as pieces of various tranches, meant that nobody was certain about who owned what or what it was worth.

This difficulty in valuing the now so-called toxic assets remains at the core of today's credit difficulties. The immense response by central banks and finance ministries has eased the strain. The United States Federal Reserve's commercial paper facility was helpful in reopening the commercial paper market (although other of its facilities have been less successful).

The barometer of stress watched most closely by experts, the LIBOR-OIS

(Overnight Indexed Swap) spread is down substantially from its stratospheric crisis levels. Some government programs are shrinking from lack of demand. But there remain little new securitization and bank debt offerings without government backup.

The original idea for the U.S. government to buy up some of the toxic assets with the \$700 billion Troubled Asset Relief Program (TARP) gave way to capital infusions and auto bailouts. Treasury Secretary Timothy Geithner's new public-private investment program to buy toxic assets has few takers, despite subsidized nonrecourse financing. So the toxic assets remain on bank and other balance sheets.

Can banks generate enough profits for long enough to buy time to write down smaller losses and raise private capital later in a stronger economy? Or are the losses so large and in danger of mounting further as others (such as commercial real estate) are added — that a gradual workout is unlikely, if not impossible?

Estimates of the losses on U.S. loans and securities range from under \$1 trillion to almost \$4 trillion. The IMF puts them at \$2.7 trillion, but the range of uncertainty is enormous. More than half is held by banks and broker-dealers. And analogous problems exist in Western Europe (e.g., for loans to Eastern Europe) and Asia.

Gradualism and profitability, and eventually U.S. Brady bonds, worked in the Latin American debt crisis in the 1980s. But a difficult economy will drive down the value of toxic assets and make more assets toxic. For example, falling home prices put more families in negative equity — mortgages worth more than the home. This creates an incentive to default, which increases foreclosures and lowers the value of the mortgage-backed securities on financial firms' books.

Policymakers need a Plan B in the event that one proves necessary, modeled on America's rapid resolution of insolvent savings and loans in the early 1990s, together with sales of toxic assets in large blocks to prevent so-called adverse selection from unraveling any bidding process. History is instructive.

Of the \$500 billion that America required for the Resolution Trust Corporation (equivalent to \$1 trillion today), \$400 billion was returned from asset sales, for a net cost of \$100 billion, one-tenth the worst-case

private forecasts of \$1 trillion. The final tab on the toxic mortgage bailout and other assets is likely to be a larger percentage of a larger amount, but still far less than the face value of the loans, because the underlying assets will in many cases retain considerable value.

In addition to bailouts and toxic asset plans, governments worldwide want central banks to monitor macroeconomic and overall financial-sector risk as opposed to focusing on individual firms. U.S. President Barack Obama's administration would anoint the Fed, whose history has been to recognize crises late. The Bank of England seeks similar powers. The European Union wants to establish a European Systemic Risk Board composed of the national central bank governors, chaired by the European Central Bank.

What will these central bankers do to advise on macro-prudential risk? Demand adjustments in large current-account imbalances? Call for reductions in taxes, spending, and government debt, which are the primary systemic risks? To do that could jeopardize monetary policy independence and heighten the threat of future inflation.

Dealing with financial institutions deemed too big to fail won't be easy. The current system, which allows privatized gains from highly leveraged risk-taking but socializes losses in the event of failure, must be changed to avoid episodic financial meltdowns.

To balance the benefits of scale and scope with the socialized losses to taxpayers, firms deemed too big to fail should be required to have more capital, and the amount should rise disproportionately with size. Converting some portion of debt to equity under predetermined solvency-threatening conditions would provide an extra layer of protection. Add a higher bar for government bailouts, and these stronger incentives would induce private financial institutions and investors to take responsibility before disaster strikes.

Michael J. Boskin is T.M. Friedman professor of economics and Hoover Institution senior fellow at Stanford University.
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Calls for 'new world order' at NAM summit

Writer: AFP

Published: 15/07/2009 at 02:59 PM

More than 50 heads of state from the developing world met Wednesday in Egypt to tackle the fallout from the global economic meltdown, with calls for a "new world order" to prevent a repeat of the crisis. Cuban President Raul Castro said in a speech at the opening session of the Non-Aligned Movement summit that the financial crisis had hit developing nations the hardest. "Every country in the world must seek just solutions to the global economic crisis," Castro told the 118-member body at the gathering in the Red Sea resort of Sharm el-Sheikh. "We call for a new monetary and economic world order... we must restructure the world financial system to take into consideration the needs of developing countries."

Global power dynamics also need to be addressed, Libyan leader Moamer Kadhafi said, demanding a restructuring of the UN Security Council which he branded a form of terrorism "monopolised by a few countries that are permanent members." "This represents a danger toward international peace. We have suffered all sorts of harm from the Security Council, it has become a sword over our necks," he said. "The Security Council is terrorism." Kadhafi said he wanted to correct the imbalance at the Security Council, demanding a permanent seat for the 53-member African Union, which he chairs.

India said members should play a bigger role on the world stage. "Decision-making processes, whether in the United Nations or the international financial institutions continue to be based on charters written more than 60 years ago, though the world has changed greatly since then," Prime Minister Manmohan Singh said. "Developing countries must be fully represented in the decision-making levels of international institutions," Singh said. But the developing world's military ambitions looked set to steal the summit limelight, with nuclear-armed South Asian foes India and Pakistan to hold talks on Thursday aimed at relaunching stalled peace talks.

Pakistani Prime Minister Yousuf Raza Gilani expressed optimism that relations with India were headed on the right track. "There has recently been some forward movement in our relations with India," Gilani said. "We hope to sustain this momentum and move towards comprehensive engagement. We believe durable peace in South Asia is achievable," he said. New Delhi and Islamabad's fraught relations deteriorated after terror attacks in the Indian commercial capital Mumbai in November last year which killed 166 people. The attacks were blamed by India on the banned Pakistani militant group Lashkar-e-Taiba, and Pakistan has acknowledged they were partially planned on its soil.

Indian foreign secretary Shiv Shankar Menon has been holding talks with his Pakistani counterpart Salim Bashir since Tuesday in preparation for the meeting between Singh and Gilani. Menon told a press conference Wednesday night that the talks were continuing. "We have had good detailed discussions. We are still in the process of talking to each other," he said. Singh has voiced hope that Pakistan will promise action against those behind the attacks when he meets Gilani for only the second high-level contact between the two sides since the Mumbai bombings.

Pakistan has said that it would "probably" put the five accused of involvement in the attacks on trial next week. The attacks left in tatters a fragile peace process launched in 2004 to resolve all outstanding issues of conflict, including a territorial dispute over the divided Himalayan territory of Kashmir. India, along with host Egypt, is one of the founding members of the NAM, the largest grouping of countries outside of the United Nations, aimed at giving a voice to the developing world.

Founded in 1955, NAM's 118 member states represent around 56 percent of the global population. NAM states consider themselves not formally aligned with or against any major power bloc.

Government again tries to boost SME liquidity

By: CHATRUDEE THEPARAT

Published: 16/07/2009 at 12:00 AM

Newspaper section: Business

A working panel will be established to map out measures to ease liquidity problems faced by exporters. It will focus on increasing financing for firms desperate for working capital to fulfil international purchase orders. The Finance Ministry would chair the working group endorsed yesterday by a meeting of the Joint Public-Private Consultative Committee. Other members include the Bank of Thailand, the Thai Bankers Association, the Export-Import Bank of Thailand, the Federation of Thai Industries and the Thai Chamber of Commerce (TCC).

"Liquidity is the urgent issue we have to address as soon as possible, as purchase orders have now resumed and delivery is likely by late third or fourth quarter this year," said Dusit Nontanakorn, the chairman of the TCC. The chamber also urged the government to manage the baht to make it more competitive to help exports.

Putthipong Punnakan, vice-minister to the Prime Minister's Office, said Prime Minister Abhisit Vejjajiva himself had directed the Finance Ministry and the SME Bank to accelerate the easing of their lending conditions, particularly for small and medium-sized enterprises, which have suffered operating losses over the past one to two years due to the economic crisis. Local SMEs are still finding it tough to secure lending from banks even with the government's initiatives to help small businesses overcome liquidity shortages. Most participating banks still have rigid conditions such as loan collateral and borrowers' operating performance records.

The SME Bank, for instance, has approved only 4.8 billion baht from its target of 26 billion, while the Government Savings Bank has endorsed only 2.69 billion from its target of 11 billion. The Bank for Agriculture and Agricultural Co-operatives has approved 13.87 billion from its target of 20 billion. The Small Business Credit Guarantee Corporation, meanwhile, has approved only 413.9 million baht in guarantees, less than 2% of its 30-billion-baht target. The committee also agreed to extend for another year the soft loan programme to tourism SMEs that was due to expire this month, said Mr Putthipong. In a related development, the committee directed the Interior Ministry to beef up law enforcement on the renting of apartments and condominiums, as about 4,000 of them now illegally offer similar services to hotels.

US envoy calls for two-track approach on N.Korea

Writer: AFP

Published: 18/07/2009 at 07:59 PM

The United States is willing to talk with North Korea "under the right circumstances" but will enforce sanctions aimed at shutting down its nuclear and missile programmes, a US envoy said Saturday. "What we are trying to do is follow a two-track strategy," Kurt Campbell, assistant secretary of state for East Asia and Pacific affairs, told reporters on arrival in South Korea from Japan. "Under the right circumstances, we'd be prepared to sit down with North Korea if they would abandon their nuclear ambitions," Yonhap news agency quoted him as saying.

"We're in the process of discussions with our partners about what are the next steps associated with diplomacy." After the United Nations Security Council censured its April 5 long-range rocket launch, the North announced it was quitting six-party nuclear disarmament talks with the United States, South Korea, China, Russia, and Japan. It staged its second nuclear test on May 25, prompting the Council to adopt a resolution imposing tougher sanctions. On Thursday the Council imposed a travel ban on five North Korean officials and asset freezes on five more entities involved in missile or nuclear programmes.

Campbell, who is making his first trip to the region since taking over from Christopher Hill last month, travels on to Thailand next week for the Asean Regional Forum on security issues. Following a meeting with Deputy South Korean Foreign Minister Lee Yong-Joon, Campbell urged the North to return to the six-party talks, warning that the impoverished communist state would face more isolation and hardship. "Truth of the matter is, down this path North Korea has chosen lie greater tensions, greater hardships for its people, more isolation and lack of engagement in international economy," he told journalists.

"I think it's unsustainable, and we believe that over time, North Korea will ultimately choose to re-engage," he said. During an hour-long meeting with Lee, the two talked about the need for the two allies to stand together as they confront "very difficult challenges" on the Korean peninsula and put together a "game plan" to work together over the coming months. The North has remained publicly defiant about the intensified sanctions. It says the US inspired the UN to condemn its April rocket launch, which it described as a peaceful attempt to put an experimental satellite in orbit.

The US and other nations saw it as a disguised test of a Taepodong missile, which is theoretically capable of reaching Alaska. On Saturday its official news agency reported comments by its ceremonial head of state Kim Yong-Nam at the Non-Aligned Movement summit in Egypt earlier this week. Kim "asserted that if such acts of the US are allowed to go on, the DPRK (North Korea) would be totally deprived of the legitimate right to use space," the official agency said.

"The DPRK can never accept dialogue or negotiations minus the principle of respect for sovereignty and equal sovereignty," Kim Yong-Nam was quoted as saying. "The prevailing situation compelled the DPRK government to take decisive steps to bolster up its nuclear deterrence."

ECONOMY

Hopes for rapid recovery misplaced, says economist

Writer: DARANA CHUDASRI

Published: 20/07/2009 at 12:00 AM

Newspaper section: Business

Has the worst of the global economic crisis passed? Financial markets have rebounded strongly from lows set in March, while economic indicators across the globe show that massive fiscal spending and low interest rates have begun to show results. But hopes of a rapid recovery may be misplaced, according to Sethaput Suthiwart-narueput, chief economist at Siam Commercial Bank. Thai gross domestic product is unlikely to recover to pre-crisis levels before the fourth quarter of 2010, he said.

How one defines recovery is the question, Dr Sethaput told business leaders at a British Chamber of Commerce luncheon on Friday. Thai economic growth could return to a positive, quarter-on-quarter growth in the third quarter of this year, and positive year-on-year growth in the fourth quarter. "But if you mean a return to pre-crisis levels, it might be the fourth quarter of 2010 at the earliest. And this would require growth of at least 4% for next year," Dr Sethaput said. While much of the Thai economy hinges on export performance, in terms of jobs, the impact of the sharp decline in global trade on the local labour market has been much less.

Dr Sethaput noted that Thailand's top three export industries - autos, electrical machinery and non-electrical machinery - accounted for around 41% of export value but just 1.4% of employment. On the other hand, tourism, a major employer in the country, is likely to lag behind the overall economy due to not only the economic crisis, but also the political chaos earlier this year as well as the impact of the H1N1 flu pandemic. Dr Sethaput noted that hotels, restaurants and domestic trade employ as much as one-fifth of the 37-million labour force.

"The tourism slowdown remains the largest downside for the Thai economy in light of the linkages to the overall economy and the large employment footprint. Growth in 2010 is unlikely to grow by enough to take us back to pre-downturn levels," he said. Tourism arrivals in 2010 are expected to grow 6%, lagging the 8.4% average annual growth posted from 2006 to 2008. While tourism across the region has fallen, arrivals to Thailand have dipped more than in other countries, reflecting factors specific to the kingdom, such as political confidence.

"The real problem with the Thai tourism sector is not on the demand side but the supply side. The current level of promotions and roadshows is not enough. We need to develop new destinations and improve on issues important to the quality of life and experiences of tourists, such as transport and water management," Dr Sethaput said.

Government spending, meanwhile, will have only a minor impact on economic growth, considering that the fiscal budget deficit of 3.8% of GDP or 350 billion baht actually reflects a primary deficit of just 134 billion, or 1.5% of GDP.

SCB forecasts an economic contraction of 4-4.5% for 2009. Second-quarter GDP is projected to fall 4.5% year-on-year, but should improve in the third quarter with a rebound in exports.

Thailand to benefit from \$1bn Asia fund

Writer: SUCHIT LEESA-NGUANSUK

Published: 22/07/2009 at 12:00 AM

Newspaper section: Database

IBM has invested \$1 billion (34 billion baht) in Asia, offering to finance economic stimulus IT initiatives on Smart Grid, Health Information Technology, Energy Efficiency and Smart Transportation. Thailand is one of 10 Asian countries with government funding committed to help stimulate the economy and which have the right to take part in the new IBM Global Financing program, according to Prachyanee Phumsuwan, Global Financing Manager, IBM Thailand. Apart from the \$1 billion invested in the Asia-Pacific region, the company has also allocated a US budget of \$3 billion (102 billion baht), with \$2 billion (68 billion baht) aimed at supporting key infrastructure projects in Europe.

The financing will help enterprise and municipals move ahead with IT projects related to Smart Grid, Health Information Technology, Energy Efficiency and Smart Transportation while awaiting government funding. "Due to the impact of the current economic downturn and tight credit market, many key IT infrastructure initiatives face difficulties in moving ahead and this may affect other projects in which a significant set of opportunities will be lost and key projects will be substantially delayed," said Prachyanee. "The company would like to extend our stimulus financing program to enable our country's infrastructure improvements and sustain our country's economic growth in the long term."

There is no specific set minimum requirement of IBM usage for enterprises to take part in the project, so long as IBM products make up the majority of the hardware, software and service components. Financing also can be applied to non-IBM technology as part of a larger IBM solution. The project has to start with a minimum of at least 1 million baht. The financing could be in the form of low rates and flexible financing options, enterprise financing facilities that offer structured lines of credit and specialised project financing packages that allow clients to align payment streams to anticipated benefits throughout the project.

"The outstanding point is IBM will offer deferred payment plans over 1-6 six months," Prachyanee explained. She also expects that this year one healthcare project in Thailand may be eligible to apply for this program. However when comparing with other Asean nations, Thailand's potential project portfolio would still be inferior to Singapore and Malaysia. Currently, there are several projects underway in Denmark and China. In Denmark, IBM is teaming with DONG Energy to implement an Intelligent Utility Network, installing remote monitoring and control devices that give the company information about the current state of the grid.

In China, IBM is working towards creating intelligent rail networks to improve the speed, safety and efficiency of both passenger and freight trains. In health care, the Government of China announced a plan to invest 850 billion yuan (4.24 trillion baht) over the next three years to provide every village with a medical clinic and at least one hospital for every county by 2011.

The plan includes funding for electronic patient records systems that can be shared by different hospitals around the country. With normal IBM Global Financing, the average growth of customers using financing in Thailand is around 10 percent over the past 2-3 years, with 200 existing customers providing loan and lease value, while this business unit still contributes less than 10 percent of a company's overall revenue. However for this year, the company financing growth may be stagnant because last year many big projects had already applied, especially in telecom, banking and industrial sectors.

Obama to address China-US economic talks

Writer: AFP

Published: 22/07/2009 at 03:59 AM

US President Barack Obama will address the opening of top level strategic and economic talks between Chinese and US leaders here next week, a White House official said Tuesday. "President Obama will address the opening session of the first US-China strategic and economic dialogue on Monday July, 27," White House spokesman Robert Gibbs said.

Gibbs added Obama and Chinese President Hu Jintao "launched this dialogue during their meeting in London in April as a way of strengthening relationships between the two countries." The new high-level discussions, set for Monday and Tuesday, are an extension of economic talks begun under the previous administration of George W. Bush, but with a broader focus.

The dialogue "will focus on addressing the challenges and opportunities that both countries face on a wide range of bilateral, regional and global areas of immediate and long-term strategic and economic interests," according to a joint statement from the US Treasury and State Departments last week.

Secretary of State Hillary Clinton and Treasury Secretary Timothy Geithner will chair the American side of the dialogue. Hu and Obama agreed when they met in April that Clinton and Chinese State Councilor Dai Bingguo will chair the "strategic track" and Geithner and Chinese Vice Premier Wang Qishan will chair the "economic track" of the talks. The US leader also accepted an invitation to visit China later in the year.

Obama to address China-US economic talks

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The Jakarta Post

Published on The Jakarta Post (<http://www.thejakartapost.com>)

China's economic growth accelerates amid stimulus

Joe McDonald , The Associated Press , Beijing | Thu, 07/16/2009 2:52 PM | Business

China's economic growth accelerated in the second quarter amid a stimulus-fueled surge in consumer spending and factory output, putting the government's 8 percent full-year growth target within reach.

The world's third-largest economy expanded by 7.9 percent in the April-June period from a year earlier, up from 6.1 percent growth in gross domestic product the previous quarter, the National Bureau of Statistics reported Thursday.

"The data showed the economic recovery is stronger than expected," said Zhu Jianfang, chief economist for Citic Securities Ltd. "There will be no suspense about achieving the government's goal of 8 percent GDP growth this year."

Many analysts expect China to be the first major country to emerge from the worst global economic slump since the 1930s.

The International Monetary Fund earlier this month raised its forecast of China's 2009 growth by one percentage point to 7.5 percent. The World Bank boosted its forecast last month from 6.5 percent to 7.2 percent.

Goldman Sachs said that compared with the previous quarter - the way other major economies measure growth - China's second-quarter growth accelerated to 16.5 percent on an annualized basis.

The government warned, however, that a full-fledged recovery is not firmly established.

"The difficulties and challenges in the current economic development are still numerous," a statistics bureau spokesman, Li Xiaochao, said at a news conference. "The base of the rebound of the people's economy is not stable."

The faster growth came despite a plunge in China's trade and foreign investment since late 2008, reflecting China's continued dependence on its 4 trillion yuan (\$586 billion) stimulus to keep the economy expanding.

Consumer prices in June fell .7 percent from a year earlier, the statistics agency said, giving Beijing a freer hand to keep spending on its stimulus without a danger of adding to pressure for prices to rise.

Chinese leaders are believed to have picked the 8 percent growth target partly because it is the

fastest rate at which the economy can expand without igniting pressure for prices to rise.

Beijing's stimulus aims to reduce reliance on exports by boosting domestic consumption through higher spending on construction of highways and other public works. Most of the money has gone to state-owned construction and steel companies, but it is starting to flow to the private sector as builders hire workers and buy other materials.

Industrial output rose 10.7 percent in June from a year earlier, faster than May's 8.9 percent growth, the statistics agency said. It said retail sales rose 15 percent in the first half from a year earlier, while first-half spending on factories and other fixed assets was up 33.5 percent.

The wave of positive data in recent weeks has encouraged investors, driving a stock market boom that has boosted China's benchmark Shanghai Composite Index by 75 percent since the start of the year.

The latest rise in quarterly growth "indicates that the country is on course to achieve its growth target for the year," said Jing Ulrich, JP Morgan & Co.'s chairwoman for China equities, in a report to clients.

Li, the government spokesman, said Beijing is closely watching prices to make sure its stimulus and rapid growth in bank lending and investment do not ignite inflation.

"There are still quite a lot of uncertainties," the spokesman said. "We should remain watchful about changes in prices."

Associated Press researcher Bonnie Cao in Beijing contributed to this report.

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The Jakarta Post

Published on The Jakarta Post (<http://www.thejakartapost.com>)

Indonesia needs to do more to protect financial sector

Aditya Suharmoko , The Jakarta Post , JAKARTA | Fri, 07/17/2009 10:44 AM | Business

In a world vulnerable to shocks, Indonesia needs a definitive authority to warn against impending crisis and prevent it spreading to the real sector, analysts say.

A discussion Thursday agreed that whether it was the Financial Services Authority (OJK) or the Financial System Stability Committee (KSSK), such an authority would have to detect and deal with a potential systemic threat of a financial crisis impact on the real sector, as happened during the 1997-1998 financial crisis.

The establishment of the OJK is still being discussed by the government and the central bank, while the founding of the KSSK is in the bill on the financial system safety net (JPSK), still being deliberated by the House of Representatives.

Sentot A. Sentausa, director of risk management at state-owned Bank Mandiri, said the JPSK was urgently needed to avoid a systemic threat to the financial sector that would affect the whole economy.

“There will be a clear mechanism on who will do what,” he said.

There should be a stress test of banks’ non-performing loans (NPL) and capital adequacy ratio (CAR) to determine how well the JPSK could deal with the worst-case scenario that could present itself to the financial sector, he added.

Economist A. Tony Prasetyantono, from state-owned Bank Negara Indonesia (BNI) said such protection would be effective only if there was effective supervision of the financial sector.

“A safety net will be effective if the supervision is effective,” he said.

“Guarantee and supervision are two sides of the same coin.”

Indonesia’s financial sector is now jointly supervised by Bank Indonesia and the Deposit Insurance Corporation (LPS) for banks, and the Finance Ministry for non-banking financial institutions.

The OJK is designed to put together the supervision of all financial institutions, banks and non-banking, under one roof.

“In preparing the OJK, bank supervision is expected to be more effective,” Tony said.

Finance Minister Sri Mulyani Indrawati stressed the need for a sturdy financial sector to support the whole economy.

“A financial sector that is sturdy and liquid will support the real sector,” she said.

She added the JPSK would be important because BI and the LPS could only handle individual issues of failed banks, not systemic issues.

“Once the issue becomes systemic, they won’t be able to handle it,” Mulyani warned.

The House has yet to approve the JPSK bill, pending agreement on several contentious issues, including the accountability, transparency, integrity and pace of the decision-making process, and legal certainty.

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The Jakarta Post

Published on The Jakarta Post (<http://www.thejakartapost.com>)

Strategic RI-US partnership

David Merril , Jakarta | Thu, 07/30/2009 12:41 PM | Opinion

The Indonesia-US relationship is on the most positive track ever in its long history. Though we are used to ups and downs in the relationship, we are now into new upside territory.

We wouldn't have dared to imagine we would ever see a US President who lived in Indonesia, in the same year as a comprehensive US-Indonesia bilateral partnership, proposed by a President of Indonesia. This rare moment reflects historic changes in both countries. We must seize it.

The two governments are moving at a rapid pace. President Yudhoyono's proposal of a comprehensive partnership was publicly accepted by Secretary Clinton right after she took office, followed by early her trip to Indonesia to agree on concrete areas of cooperation.

President Obama has several times expressed his commitment to the partnership - most recently in a call to President SBY in which he emphasized the importance of education, democracy, and climate change as areas of concentration for the partnership.

But the two governments cannot do it all. As originally proposed by Indonesia last November, the partnership "has to be for the long-term, and have strong people-to-people content." It requires the oxygen of public involvement in both countries - particularly over this summer, while the partnership content is still under discussion, and the scope for public input is greatest.

USINDO held a landmark April conference in Washington that strengthened the public input aspects of the partnership, particularly from American audiences. Now the scene shifts to Indonesia.

The focus of the upcoming week in Indonesia -- July 26-31 -- is how to expand US- Indonesia educational exchanges under the partnership and make sure it produces results. Of all the sectors in the partnership, education is the one that most depends on non-government actions --- it's hard even to imagine governments directing the formation of university-to-university linkages.

As recommended by the April conference, USINDO has organized and is co-chairing, along with the Institute for International Education, the Association of Public and Land-Grant Universities, and the East-West Center, a mission to Indonesia of 20 senior US university presidents and leaders. This mission is welcomed by both governments, and will feature opportunities for interaction and input from Indonesian universities, students, and the public

To put the task into perspective, the number of Indonesians engaging in long-term study in the US has fallen from 13,000 in 1997 to about 7,700. Only 130 Americans currently study in Indonesia compared to over 200 a decade ago. The reasons for these trends are a complex mix of factors,

including insufficient marketing by US and Indonesian universities and travel restrictions, but they do not reflect a lack of interest by Indonesians in study in the US, historically a key source of education for Indonesians, as for other countries.

The new partnership offers the perfect opportunity to restore US-Indonesia educational exchanges to levels that better reflect the potential for the exchange of knowledge between the countries. Such exchanges have also proved to strengthen the foundations of our bilateral relationship, making them especially appropriate for a partnership.

Our Educational Leaders' Mission wants to find ways to double the number of Indonesians studying in the US and Americans studying in Indonesia; expand university-to-university partnerships; strengthen academic centers in each country that promote study about the other, and promote understanding of fruitful areas for academic exchanges. We want Indonesians to hear about US universities seeking Indonesian students, and for Americans to look at Indonesia not just for traditional fields of research such as political science and anthropology, but for such subjects as climate change, food production, and coastal zone management.

The team will meet both government educational institutions and private universities. There will be a special USINDO Open Forum this week to provide an opportunity for public dissemination of the draft findings of the educators' visit, and for comments and questions from the Indonesian public. USINDO also plans a major conference in Jakarta in early October to provide for Indonesian input to other sectors of the partnership.

It is a signal of commitment that this week's senior education mission has proceeded despite the horrific events of last week. But those events remind us how important it is to rededicate ourselves to the role of education. Education leads to jobs and broad based economic growth opportunities, which extinguish the breeding grounds for whatever appeal terrorist acts may have for a few. Let's re-invigorate our educational partnership, and may it develop deep roots.

The writer, the president of the US-Indonesia Society, was Ambassador to Bangladesh and Director of USAID in Indonesia.

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Source URL: <http://www.thejakartapost.com/news/2009/07/30/strategic-rius-partnership.html>

Opinion

EDITORIAL

US stimulus package is not working

Published on July 16, 2009

Spending more to cure an overspending habit is not the solution to the economic crisis

A debate has just begun over whether it is necessary for the administration of US President Barack Obama to introduce a second stimulus package to prop up the US economy. The first stimulus package of US\$787 billion (Bt26.8 trillion), passed in February, is disbursing money to public projects designed to create jobs and win back confidence. But so far many people remain afraid that the first stimulus is not only too little and too late but also is missing the target. Most of the money from the first stimulus does not go to projects that create jobs but to programmes that promote consumption.

The root causes of the economic crisis in the United States are over-consumption and indebtedness.

US policy-makers simply cannot expect Americans to spend their way out of the economic recession when over-consumption is the problem in the first place. Over-consumption and indebtedness are weighing down the US economy. The mindset has to be transformed toward restructuring the indebtedness and reducing consumption before creating jobs via the support of small- and medium-scale enterprises.

Still, President Obama said on Saturday that Americans should give the \$787 billion stimulus package a chance to work before anybody may consider a second stimulus for the still-ailing economy. Obama acknowledged in his weekly radio and Internet address that people are getting nervous about continuing high joblessness. The unemployment rate hit 9.5 per cent in June. But the president said that reversing payroll losses will take time, and he asked Americans to be as patient as possible.

Republicans have already come out to label the stimulus package - earmarked for spending over the next two years - a failure. Both Obama and Vice President Joe Biden have argued that the bulk of the money from the programme is still being disbursed and that it has already saved many jobs.

But Time magazine, on July 13, reported that the White House is afraid that money from the stimulus might be wasted. It quoted a study that found that more jobs are created when

cities and states repair existing roads than when they build new ones. Highway maintenance projects not only put more people to work more quickly than building new roads, but also keep costs down in the future. At present the US is losing about 500,000 jobs a month.

Senator Sherod Brown, an Ohio Democrat, said: "Of course, it is not creating enough jobs. We're not going to have enough jobs because we lost so many."

Politically, Obama does not want to admit that the US might need a second stimulus package, although this idea has been discussed widely among the Democrats and even by Warren Buffett, the legendary investor.

"We must let it work the way it's supposed to, with the understanding that in any recession, unemployment tends to recover more slowly than other measures of economic activity," Obama said.

For Obama to admit that a second stimulus is necessary would amount to accepting that the first is not working. That would trigger a loss of confidence in the financial markets, as well as consumer confidence, both of which are already badly hurt. There is little liquidity left, so the second stimulus looks inevitable.

Since Obama signed the first stimulus package into law, the US economy has shed more than 2 million jobs and the unemployment rate has climbed higher than the White House predicted it would have ever reached without the stimulus. Then, Obama had a strong mandate to push out the stimulus. Now, the Republicans are expected to give him a harder time if he decides to go for a second stimulus.

"The reality is that it hasn't helped yet," said Republican senator Jon Kyl of Arizona. "Only about 6.8 per cent of the money has actually been spent. What I proposed is, after you complete the contracts that are already committed, the things that are in the pipeline, stop it."


Republican Eric Cantor of Virginia said: "I do think it is fair to say that the stimulus is a flop. The goal that was set when we passed it was unemployment wouldn't rise past 8.5 per cent, and what we see now is businesses just aren't hiring. Even the best projections have us losing 750,000 more jobs this year."

"A lot of it has been spent on ridiculous projects," said Senator John McCain, the Arizona Republican who was his party's presidential nominee last year.

Obama's allies defended the spending they helped usher into law. "It's a two-year plan and we're four months into it," said Senator Dick Durbin of Illinois.

However, the economic weakness is spreading around the US economy. The auto industry, airline industry, consumers, as well as banks, are in bad shape. Without support ahead, the US economy is likely to slip further. But first, policy-makers have to address the hard question of restructuring the excesses in the economy. Without this painful action, the

economy won't reach bottom and a recovery will never come to pass. For all the derivatives involved, the financial black hole, particularly in the banking sector, might be too big to mend.

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July 20, 2009 10:37 am (Thai local time)

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Breakingnews

Thailand's exports, imports down in June

Published on July 20, 2009

Thailand's trade picture showed no signs of recovery in June, when exports fell 25.9 per cent while imports were down 29.3 per cent year-on-year, government officials said Monday.

Thai exports in June amounted to 12.3 billion dollars with imports at 11.4 billion dollars, according to the Commerce Ministry's Permanent Secretary Siripol Yodmuangcharoen.

"This resulted in a trade surplus of 937 million dollars in June," he said.

Thailand's exports have been on a downward trend since January, as the global recession affected demand in the kingdom's main markets such as the United States and Europe.

During the first six months of 2009, Thailand's total exports amounted to 68.2 billion dollars, down 23.5 per cent compared with the same period last year, while imports were 57.2 billion, a 35.4-per-cent decline.

Many of Thailand's imports are parts and components used for assembly and manufacturing for its exports industries.

By mid-year Thailand's trade surplus amounted to 11 billion dollars, allowing it to maintain strong foreign exchange reserves. //DPA

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July 28, 2009 03:42 pm (Thai local time)

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Business

Guru Speak

Published on July 23, 2009

When will the Thai economy recover? The short answer is "not soon", as the global recovery is likely to be slow. The long answer is that it depends on one's definition of recovery: positive quarter-on-quarter growth (Q3 of 2009); positive year-on-year growth (Q4 of 2009 at the earliest); or return to the predownturn level of gross domestic product (Q4 of 2010 at the earliest).

The good news is that the economy probably hit bottom during the second quarter of this year. Based on the latest available data, our read is that GDP in the second quarter probably contracted by about 4.5 per cent year-on-year, less than the 7.1-percent contraction recorded during the first quarter.

While year-on-year growth could turn positive during the fourth quarter at the earliest, this does not mean that the economy has "recovered" in any meaningful sense given the unusually low base of GDP in the fourth quarter of 2008.

Under our baseline forecast of a contraction of over 4 per cent in 2009, recovery to 2007 GDP levels would require 2010 GDP growth of about 4 per cent, which seems too high in light of our expectation for a lacklustre global economic recovery.

Which sectors will recover first? Our baseline scenario that the recovery will be led by improving exports, with an additional but limited impetus provided by domestic fiscal stimulus, suggests sectors such as machinery and electronics and basic materials should recover and benefit most from the rebound in Chinese imports.

China is one of the few countries where the purchasing manager index - a muchwatched, forwardlooking indicator - is above 50, indicating expansion.

Data show that China's imports from Thailand have rebounded faster than those from elsewhere, with machinery and electronics accounting for nearly 60 per cent of total Thai exports to China and Hong Kong.

As of May, total Thai exports of machinery and electronics had picked up from their trough in January by 27 per cent.

The basic-materials sector - notably iron, steel and cement - will benefit most from fiscal stimulus. The bulk of the Bt1.4trillion second stimulus package is for transportation and logistics (40 per cent) and irrigation (17 per cent).

While the fiscal stimulus will provide a welcome boost to the economy, the long lead time associated with this kind of spending, coupled with the usual implementation delays, suggests that the magnitude of the actual stimulus in 2009 and 2010 could be less than commonly expected.

The tourism sector is likely to lag the recovery and remains the largest downside risk for the economy in light of its linkage to the overall economy and its large employment footprint.

While we expect tourist arrivals and revenue to drop by as much as about 15 and 20 per cent this, respectively, growth in 2010 is unlikely to grow by enough to take us back to pre-downturn levels.


We expect tourism arrivals and revenue to grow by 6 per cent and 12 per cent in 2010, respectively, due largely to the slow economic recovery in many of Thailand's major tourist markets.

Sectors that cater to lowerincome workers will lag. While hardasset prices have generally held up well in Thailand, this downturn has hit lowerincome workers harder. Sectors hit by the export and tourism slowdown tend to pay lower wages on average, and workers in these sectors have also suffered declines in their wages.

Thailand's economy will recover, but it is likely to recover to a new and lower growth path than before. Why? Thailand has relied substantially and increasingly on exports. But going forward, exports will no longer be as effective an engine of growth as before.

The US household will no longer be able to play its longstarring role as the world's consumer of last resort, and the global economy has yet to find an effective replacement. China alone will not be able to do it.

Without significant structural change to build up domestic demand on a sustainable basis by improving wage and productivity growth, Thailand will end up relying on export demand by default yet again.

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August 3, 2009 03:07 pm (Thai local time)
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