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Philip Bowring

Shortchanging the IMF

HONG KONG

A trillion or two trillion dollars here, a few hundred billion there, the stimulus numbers coming out of the United States, Europe, China and (maybe) Japan have the capacity to shock and awe, or to be too big to be meaningful.

All of these countries are in a position to print more money without having to worry much about the short-term consequences of sky's-the-limit bailouts and pump-priming.

But the one truly shocking figure for those concerned about the global dimensions of the crisis is that the International Monetary Fund is having to plead for a paltry $150 billion.

The IMF's managing director, Dominique Strauss-Kahn, recently said that this amount would probably be needed to help counter the impact of the worsening global outlook on emerging markets and poorer countries. He was right to be chiding the developed world and the major holders of very large foreign reserves, all advocates of globalization, for failing to take a global view of the crisis.

The international lender of last resort has to beg for funds to help the world's poorest nations.

That the head of what is supposed to be the international lender of last resort has to beg for what is, by current standards, such a tiny amount sums up just how broken the international system has become. Unless some mammoth efforts are made very soon to fill the void being left by the sudden collapse of exports, particularly of commodities, which have plunged in price, much of the developing world will soon find itself having to cut spending rather than stimulate demand, thereby deepening global recession and adding to the miseries of the global financial sector.

An additional consequence, especially damaging for the West in general and the IMF in particular, is that the Asian drift toward setting up a regional alternative to the IMF will be given a big boost. As much for political as economic reasons, China, Japan, Taiwan and Singapore — which all have huge foreign-exchange surpluses, will focus on ways of lending to Asia's deficit countries rather than helping emerging markets as a whole through the global institutions.

The IMF's $150 billion is paltry by any standard. It is just 8 percent of China's reserves and 4 percent of the combined reserves of the six other leading East Asian economies. It is also puny when measured against the needs of countries with open foreign-exchange markets needing safeguards against sudden, possibly irrational, outflows.

Even South Korea recently found that $200 billion in reserves was barely enough to stem a crisis. The problems looming for those many developing countries with modest reserves and rapidly deteriorating trade balances are alarming. The collapse in prices for commodity producers will help most of the developed world and China, which do not need help because their currencies are accepted as reserves, or, in China's case, because its reserves are so large.

Clearly the IMF really needs a lot more than an additional $150 billion, or some new or revived mechanisms for providing both liquidity support to emerging markets and ensuring a flow of longer-term capital at a time when lending by the banking systems of most advanced countries is constrained by their need to rebuild capital destroyed by the U.S. meltdown.

One such mechanism could be a revival of issuance of Special Drawing Rights, a device created in the late 1960s to supplement global reserves and by extension act to increase capital flows to developing countries. After years of rapid liquidity growth caused by U.S. deficits there may not seem need for yet more.

But those global foreign-exchange reserves are very unevenly distributed, and, with the U.S. current account deficit likely to plunge and neither the Euro area nor Japan likely to go into significant external deficit, new money is needed internationally.

Another route could be for the IMF to act as an intermediary in enabling developing countries with sound fiscal records to sell local currency bond funds to central banks or even pension funds and private investors in countries with big surpluses. The Asian Development bank has already started doing this in a minor way with its listed Asian Bond Index Fund.

Indeed, Asia may already be quietly quite advanced in regional cooperation, ignoring the IMF. In addition to the Asian Development Bank, and the activities and numerous currency swap arrangements between Asian central banks, there is evidence that Asian institutions have been active in supporting dollar bond issues by countries in the region, like the Philippines, at a time when emerging markets instruments generally have been shunned.

Such regional cooperation is in many ways admirable. But unless matched by efforts elsewhere, it could lead to a divide that strengthens existing tendencies towards regional trading blocs. That would be to no one's long-term benefit. But it will happen if Western countries continue to fail to grasp the global ramifications of what is occurring to their own economies — and to fail to recognize that they still hold most of the keys to the international financial and trading system.

THE JAPAN TIMES TUESDAY, JANUARY 20, 2009

Coordinate a global stimulus for this crisis

Kemal Dervis and Juan Somavia
Geneva

As recession spreads around the world, the global production networks that arose with the globalization of the world economy have become sources of cutbacks and job losses. Postponing purchases of new winter coats in the United States means job losses in Poland or China. These losses then translate into reduced demand for American or German machine tools.

Unemployment and reduced sales then feed back into new losses in banks' loan portfolios, further weakening the battered financial sector. As a result, anxiety, hopelessness and anger are spreading, as what was a financial crisis becomes an economic and human crisis. Unchecked, it could become a security crisis.

Trying to rescue the financial sector without supporting a recovery in terms of businesses, jobs and family purchasing power will not work. What is needed is a large worldwide fiscal stimulus to counteract falling private demand.

Different countries' capacity to act depends on their indebtedness, foreign exchange reserves and current-account deficits. Germany and China can do more than others. The United States can do a lot, in part because of the dollar's status as the main international reserve currency. Low interest rates mean that the additional debt burdens from public borrowing can remain manageable.

Moreover, if the stimulus succeeds and leads to an early recovery, the additional income gained may more than offset the increase in debt. Given the collapse of commodity prices and excess production capacities, there is no short-term inflation danger, even if part of the stimulus is financed directly by central banks.

Several countries have already announced measures, but what do they all amount to? Some constitute "new" money, while others represent existing commitments brought forward. We need to assess the quality of these packages.

The argument is strong for providing stimulus through increased government expenditures rather than relying on tax cuts, because panicked consumers might save the money instead of spending it. Debt and inflation will reappear as medium-term problems, so it is crucial that the fiscal ammunition helps long-term productivity, growth and sustainability.

Of course, fiscal stimulus does not mean just throwing money at the problem. We should remember that what growth there is in the world economy in 2009-2010 will come mostly from developing economies.

Each country may hope that others will stimulate their demand while it preserves its fiscal headroom, thereby relying on exports as the engine of recovery. Each country may also be tempted by protectionist measures, trying to preserve domestic jobs at the expense of imports. Such beggar-thy-neighbor policies in the 1930s aggravated and deepened the Great Depression.

The auto industry is a good example. Measures to keep the industry afloat in one country look like unfair competition to others. A collapse in the world's car industry must not fuel a deeper recession. The answer is to coordinate a global recovery package, which creates the opportunity to point recovery in the direction of a new generation of fuel-efficient and low-carbon-emission vehicles and green jobs.

Global coordination will increase the effectiveness of everyone's actions. Moreover, fairness and security considerations demand that the most vulnerable, who had no role in the making of this crisis, receive support.

Extending social safety nets helps the most vulnerable and is likely to have high multiplier effects, as the need to spend is most urgent for the poorest people. Training programs, including for green jobs, should be significantly increased. Public expenditures must be focused on programs with strong employment content, such as in small- and medium-scale infrastructure projects and support to local governments.

Credit lines should be kept open to smaller businesses, which employ the bulk of the world's workers but have the least access to credit. The use of social dialogue for crisis management should be increased, to rebuild trust. Donors must maintain the promised (and modest) levels of development aid to poorer countries. The availability and affordability of trade finance should be improved.

The International Monetary Fund and central banks should increase liquidity in a coordinated fashion in the form of short-term credit to emerging-market economies suffering from cuts in capital inflows and export earnings. The World Bank should increase lending to help finance growth-supporting expenditures in developing countries. Tangible progress is needed in global trade negotiations in order to signal that the world economy will remain open.

Meanwhile, the world must build new economic institutions. The International Labor Organization's Decent Work Agenda of employment and enterprise, social protection, sound labor relations and fundamental rights at work creates a solid platform for fair globalization.

This crisis is also an opportunity, as it has shown that the destinies of countries worldwide are linked. Policy coordination and a global strategy that instills confidence and creates hope will bring a quicker and stronger recovery to us all.

Kemal Dervis is the executive head of the United Nations Development Program; Juan Somavia is the director general of the International Labor Organization.

FINANCIAL TIMES WEDNESDAY JANUARY 21 2009

Japanese economy 'worsening rapidly'

Downbeat report from Cabinet Office

Consumer index falls to record low

By Mure Dickie in Tokyo

Japan's economy is "worsening rapidly" amid plunging industrial production, falling exports and worries about looming large-scale layoffs, the government declared yesterday in the latest in a series of increasingly gloomy assessments.

The downbeat assessment in the Cabinet Office's monthly economic report came as its separate index of consumer sentiment fell to a record low, underscoring the way in which fears about the prospects for the world's second largest economy have spread throughout the population.

The index of consumer confidence among households of two or more people fell to 26.2 points in December, down from 28.4 points the previous month and the worst result since the index was created in 1982.

By adding the word "rapidly" to its assessment of the downturn, the cabinet highlighted the difficulty of finding any reason to hope for a near-term recovery in the economy, which contracted in the second and third quarters of last year and is clearly still mired in recession.

Industrial output, exports, individual consumption and housing starts were all even weaker than they had been in December, the cabinet said. "There is a need to be aware of the risk of further downward pressure on the economy" as the global financial crisis deepens and stock and currency markets experience extreme volatility, it said.

"It is feared that the rapid decline in industrial output will cause large-scale adjustments in employment," it added.

The government of Taro Aso, the prime minister, is struggling to push a package of stimulus measures and an economy-boosting budget for the year beginning in April through the Diet in the face of opposition from a resurgent Democratic party.

However, few economists expect the measures to be enough to restore the economy to health, with more attention focused on the likely impact of government stimulus policies in the vital export markets of the US and China.

"Any economic recovery [is set] to be driven by external factors rather than domestic ones," said Kiichi Murashima, economist at Nikko Citigroup in Tokyo.

After cutting its target interest rate to just 0.1 per cent last month, the Bank of Japan also has little room for further conventional action to support growth, while its efforts to ease access to credit for local companies appears to have had only limited effect.

The central bank, which holds a monetary policy board meeting this week, is coming under increasing pressure to ease the credit crunch by directly buying corporate debt on its own account.

The BoJ is also expected to sharply revise down its economic forecasts for the year beginning in April.

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Five lessons in global diplomacy

Javier Solana

The US is not just another country and its president is not just another politician. Who he is, the choices he makes, matter to billions of people around the globe.

There is no need to tell President Barack Obama that the world is messy and complicated or to list the many things that need to be done. We hope that Mr Obama and his team have also noted the places that have seen steady, sometimes dramatic, progress in recent years — China, Indonesia, Brazil and central Europe to name a few.

Successes can look after themselves. It is the problems and failures that he and others will have to focus on. In many cases, we understand the nature of the problem and even know what the solution looks like. Sometimes — in the Middle East, for example — we have known for years. The real question is how to implement it.

Of course, every country is different, every problem particular. But experience over the years (including my own) suggests some key ingredients for tackling international problems.

First, the solution is always political. Civil wars, inter-state conflicts, problems with energy, climate change or nuclear non-proliferation — all of these require political settlements that take account of the interests of all involved.

Power is about more than just military or financial muscle; legitimacy is important too. Sometimes, it is the most important element. There will be no solution in Palestine that does not take account of the rights of the Palestinians, weak as they may appear.

Second, intervention must always serve a political strategy and take account of the fact that foreign policy is all about the domestic politics of others. Domestic politics matter because they limit what is achievable in negotiations (for example, over how much carbon dioxide emissions can be reduced or tariffs cut in trade). This is never more the case than when the problem is a dispute over the control and legitimacy of the state — take the Democratic Republic of Congo or Iraq.

In the Balkans and elsewhere, the aim of crisis management has been to create a space for politics to work. But functioning politics is one thing that foreigners cannot provide; only the locals can do that.

Third, personalities and trust are essential. In a crisis, when institutions and order break down, a handful of leaders become key. For them to risk their future on a settlement requires courage. The reason dealing with Iran is so difficult is the lack of trust — on both sides. To establish at least enough trust to do business together has been my first objective. Diplomatic breakthroughs only become possible when negotiators are willing to take risks because of the trust they have built with each other.

Trust needs to be backed by tangible things: troops to police a ceasefire, trainers to build a police force, monitors for elections or at the border, military guarantees and development assistance. The European Union has ceasefire monitors in Georgia and is helping to build police or armed forces from the DRC to Afghanistan, from Kosovo to Palestine. It has also monitored many elections.

Sending monitors may seem unimpressive. But the mere presence of outside observers changes behaviour. As in physics, the act of observation modifies the behaviour of particles; though instead of producing uncertainty, political observers re-establish confidence.

Fourth, no single country, even the US, can solve problems on its own. The North Korean nuclear issue is inching forward in six-party talks that include China, Japan, South Korea and Russia.

The accumulation of rules and institutions is what civilisation is built on. Agreed rules make states secure and people free

The EU has been most successful when it has worked with others: with the UN in Lebanon; with the Association of South East Asian Nations in Aceh/Indonesia; with the US everywhere.

The weakness of regional co-operation in the Middle East is both symptom and cause of the region's crisis-ridden politics. It is significant that the Arab states have written collectively to Mr Obama on the Middle East peace process. As the EU, we echo their call to push for a settlement.

In the Balkans, the EU and the US have worked consistently in partnership. So have Nato and the EU. One of my first experiences as EU high representative was working with the Nato secretary-general in Skopje on a constitutional settlement between Slav and Albanian communities. This is a reminder that almost all problems are regional and the involvement of neighbours is essential.

But increasingly, diplomacy is about more than mobilising states. We need to find ways to harness the expertise and resources of non-governmental organisations and companies and energise individuals towards shared goals.

Fifth, the best time to deal with a problem is the moment it arises, before positions become entrenched — ideally, before anyone has noticed there is a problem at all. But if that fails, you need to be ready to stick at it for a long time. The EU can be slow but it is quite good at engaging for the long term.

Ultimately, the objective of diplomacy is to create agreed rules. Rules on political participation, demarcation of borders or movements of military equipment. Rules to end conflicts within or between states. Rules to help us address the big issues of our time: climate change, non-proliferation and a sustainable and open global economy.

The accumulation of rules, procedures and institutions sounds like dreary work but it is what global civilisation is built on. Agreed rules make states secure and people free.

The start of a US administration is a special moment. The US and Europe should use it to recommit themselves to the task of building rules, trust and partnerships for our global world.

The writer is EU high representative for common foreign and security policy

Why President Obama must mend a sick world economy

Martin Wolf

Pity President Barack Obama. He won power partly because of the global economic crisis. He himself, most of his fellow citizens and much of the rest of the world agree that the US broke the world economy and now has the duty to fix it. Unhappily, this consensus is false. The crisis is a product of the global economy. It cannot be cured by the US alone.

Happily, Mr Obama has the authority needed to lead the world towards a resolution: his hands are clean, and his lack of desire to exculpate his country is evident. It is also in the interest of his country and the world that the world economy be put on a sounder footing. Should this effort fail, I fear a resurgence of protectionism will be the outcome.

What then is the global failure? It is the malign interaction between some countries' propensity towards chronic excess supply and other countries' opposite propensity towards excess demand. This is the theme of my book *Fixing Global Finance*. But the biggest point about the world economy today is that the credit-fuelled household borrowing that supported the excess demand in deficit countries has come to a sudden stop. Unless this is reversed, excess supply of surplus countries must also collapse. This statement follows as a matter of logic: at world level, supply must equal demand. The question is only how the adjustment occurs.

Michael Pettis of Peking University laid out the argument in the Financial Times on December 14 2008. Professor Pettis sees the world as divided into two economic camps: in one are countries with elastic systems of consumer finance and high consumption; in the other are countries with high savings and investment. The US is the most important example of the former. China is the most significant example of the latter. Spain, the UK and Australia were mini versions of the US; Germany and Japan are mature versions of contemporary China.

I have argued that the driving force behind these "imbalances" has been the policies of surplus countries and particularly of China, whose surpluses have grown particularly quickly (see chart). A managed exchange rate, huge accumulations of foreign currency reserves and sterilisation of their monetary consequences, tight fiscal discipline and high retained earnings of companies have generated national savings rates of well over 50 per cent of gross domestic product and current account surpluses of more than 10 per cent. Household savings appear to generate less than a third of total savings. In turn, investment has poured into expanding supply, including of exports: the ratio of China's exports to GDP rose from 38 per cent of GDP at the beginning of 2002 to 67 per cent in 2007 (see chart).

The view that the excesses of deficit countries were partly a response to the behaviour of surplus countries is shared by a number of policymakers, including Hank Paulson, outgoing US Treasury secretary. Zhang Jianhua of the People's Bank of China is reported to have declared that "this view is extremely ridiculous and irresponsible and it's 'gangster logic'". In this perspective, the pattern of global deficits and surpluses was solely caused by western policymakers, particularly the Federal Reserve's lax monetary policies and unregulated expansion of credit.

Yet, whoever was most responsible, one point is certain: huge asset price bubbles made possible the excess supply of some countries, particularly China. Since the Asian financial crisis of 1997-98, the developed world – and the US in particular – have experienced, successively, the largest stock market bubble and the biggest credit-fuelled housing bubble in their histories. This era is over. We will struggle with its aftermath for years.

So what happens now? The implosion of demand from the private sectors of financially enfeebled deficit countries can end in one of two ways, via offsetting increases in demand or via brutal contractions in supply.

If it is going to be through contractions in supply, the surplus countries are particularly at risk, since they depend on the willingness of deficit countries to keep markets open. That was the lesson learnt by the US in the 1930s. Surplus countries enjoy condemning their customers for their profligacy. But when the spending stops, the former are badly hurt. If they try to subsidise their excess supply, in response to falling demand, retaliation seems certain.

Obviously, expansion of demand is much the better solution. The question, though, is where and how? At present much of the expansion is expected to come from the US federal budget. Leave aside the question whether this will work. Even the US cannot run fiscal deficits of 10 per cent of GDP indefinitely. Much of the necessary expansion in global demand must come from surplus countries.

Managing this adjustment is far and away the biggest challenge for the group of 20 advanced and emerging economies, which will meet in London in early April. Mr Obama must take the lead. He can – and should – say he expects these adjustments to be made, but understands they will take time. He can also sustain exceptional fiscal and monetary measures in the short term, if his country's main trading partners make the necessary medium-term adjustments in their spending. China, in particular, needs to create a consumption-led economy. That is in the interests of China. It is also in the interests of the world.

Yet this is not all the US should propose. If the world economy is to be less dependent on destructive bubbles, more of the world's surplus capital needs to flow into investment in emerging economies. The problem, however, is that such flows have also always led to crises. This is why emerging economies set themselves to accumulate vast foreign currency reserves in this decade. It is essential, therefore, to make the world economy much more supportive of net borrowing by emerging economies.

What will be needed for this is far bigger and more effective insurance against systemic risks than the International Monetary Fund now provides. A crucial step is a restructuring of the IMF's governance, to make it more responsive to the needs of responsible borrowers. One of the ideas Mr Obama should propose is the establishment of a high-level committee to recommend a radical restructuring of global institutions, with a view to lowering risks of the emerging market crises that preceded the era of advanced country bubbles.

Let us be clear about what is at stake. It is essential to clean up the huge current mess. But it is also evident that an open world economy will be unsustainable if it remains dependent on bubbles. Collapse of globalisation is now no small risk. Mr Obama is present at the re-creation of the global economic system. It is a challenge he has to take up.

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FINANCIAL TIMES THURSDAY JANUARY 22 2009

Singapore fears 5% contraction in economy

By John Burton in Singapore

Singapore warned yesterday that its economy was likely to contract by up to 5 per cent this year, marking down its forecast of only three weeks ago.

The revision, which exceeds all but the most pessimistic economists' estimates, illustrates how the slowdown of global trade is affecting Asia's largely export-dependent economies.

"[Singapore's] economy is going through its sharpest, deepest and most protracted recession," said Ravi Menon, a trade ministry official, in advance of publication of the government's annual budget speech today. It is expected to include hefty stimulus measures, with state reserves to be tapped for support for the first time.

The government had published a 2009 growth forecast of 1 to 2 per cent. The revision, forecasting the export-dependent economy would shrink by 2-5 per cent, was in response to data that showed conditions deteriorated faster than expected in the fourth quarter of 2008. The government said deflation could occur, with consumer prices falling by as much as 1 per cent.

According to revised figures published yesterday, gross domestic product in the quarter contracted by 3.7 per cent from a year ago and 16.9 per cent at a seasonally adjusted annualised quarter-on-quarter basis: the worst performance on record since such data began to be published in 1976.

At the month's start, preliminary figures put the quarter-on-quarter contraction at 12.5 per cent.

Economists reckon the first quarter is likely to see deeper contraction. "Exports are plummeting" in such sectors as electronics, pharmaceuticals and chemicals, said Alaistair Chan at Moody's Economy.com. He said a "recovery will only occur in line with the rest of the world". The government said the city-state's total trade could decline by 17-19 per cent this year.

Signs of slowdown are apparent. One third of the cranes at Singapore's port facilities are idle. Lines of container ships stand empty along its coast.

"Singapore is the world's canary in the coalmine. Trade and exports in the rest of the world will be following the same pattern very soon," said Roman Scott, economic spokesman for the British Chamber of Commerce.

South Korea yesterday reported a 28.9 per cent year-on-year fall in its exports for the first 20 days of January.

The Malaysian central bank cut its benchmark interest rate by 75 basis points, much more than was expected, to try to avoid the country following its neighbouring Singapore into recession.

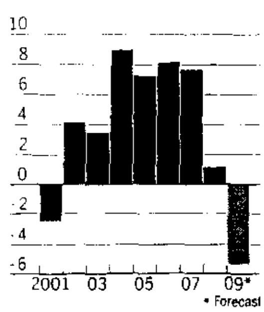
Singapore was taken by surprise by the speed of deterioration in global economic activity. "You do not [typically] see this kind of collapse in trade so early in the cycle," Mr Menon said.

> 'Singapore is the world's canary in the coalmine. The rest of the world will follow'

Stimulus measures might include financial support for small businesses, rent and wage subsidies for low income families, and resumption of infrastructure and other building projects that were cancelled last year when inflation appeared to pose the most severe threat to the economy.

Economists warn the stimulus plan could have limited impact because of the city-state's heavy reliance upon exports.

Singapore GDP growth
Annual % change



Sources: IMF, Singapore Department of Statistics

THE WALL STREET JOURNAL.
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Singapore's Limits

It's not often that a Singaporean official concedes the limits of the city state's economic engineering. But the downturn is proving so severe that the Finance Minister said in yesterday's budget speech that the government's stimulus package "will not get us out of the recession," but rather "help avert an even sharper downturn."

> It's time to rehink the corporatist model.

That ought to be a wake-up call for Singapore, where government built a modern metropolis by hoarding its citizens' capital, plowing those savings into designated industries and opening itself up to foreign trade. Yesterday's S$20.5 billion ($13.7 billion) package—a whopping 8% of GDP—looks like past stimulus plans: a broad mix of supply-side measures to help businesses, public-sector spending and cash handouts to stave off social discontent. What it doesn't acknowledge is that Singapore's growth model itself needs rethinking.

The export-led economy is falling on its face. Minister Tharman Shanmugaratnam predicts the city-state is "likely to experience" the deepest recession in its history. The government will tap its reserves to help pay for the stimulus package. Growth contracted 16.9% in the fourth quarter last year. The Ministry of Trade and Industry has revised down GDP forecasts twice this month already, and expects the city-state's growth to contract 2% to 5% this year. The pain is now leaking into the domestic economy as consumers retrench.

Singapore's economy would be more resilient if it were better balanced. Consumption composes only about 40% of GDP—far less than other developed Asian economies, nearer to 55%. Yesterday's budget doesn't do much to change long-term incentives to consume. The government announced a 20% income-tax rebate for one year, but no permanent cuts. Nor did it cut the 7% goods and services tax. Singaporean workers and businesses invest a total of 34.5% of wages into the state pension fund, but receive less than a 2% return from the government. That's a measly payout compared to what private funds return over long investment periods.

The government could unleash more productive, sustainable growth by trimming back its public sector and allowing the economy to diversify on its own. Cutting the corporate tax to 17% from 18%, as it announced yesterday, will help attract investment. But the city-state's bureaucrats have a habit of trying to pick winners, which sometimes works and sometimes doesn't. In recent years the bets have been on financial services, biotechnology and gambling. Yesterday's budget contained special tax incentives for the fund management industry. Better to let private actors make those decisions based on market forces.

Mr. Tharman said yesterday that "no one knows how prolonged or deep this recession is going to be" and he pledged further measures to help if needed. The best help for Singaporeans would be expanded, permanent opportunities to work, save and invest with more of their own money, rather than relying on government to do it for them.

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Saturday-Sunday, January 24-25, 2009

Paul Krugman

Stuck in the muddle

PRINCETON, New Jersey

Like anyone who pays attention to business and financial news, I am in a state of high economic anxiety. Like everyone of good will, I hoped that President Barack Obama's Inaugural Address would offer some reassurance, that it would suggest that the new administration has this thing covered.

But it was not to be. I ended Tuesday less confident about the direction of economic policy than I was in the morning.

Just to be clear, there wasn't anything glaringly wrong with the address — although for those still hoping that Obama will lead the way to universal health care, it was disappointing that he spoke only of health care's excessive cost, never once mentioning the plight of the uninsured and underinsured.

Also, one wishes that the speechwriters had come up with something more inspiring than a call for an "era of responsibility" — which, not to put too fine a point on it, was the same thing that George W. Bush called for eight years ago.

But my real problem with the speech, on matters economic, was its conventionality. In response to an unprecedented economic crisis — or, more accurately, a crisis whose only real precedent is the Great Depression — Obama did what people in Washington do when they want to sound serious: He spoke, more or less in the abstract, of the need to make hard choices and stand up to special interests.

That's not enough. In fact, it's not even right.

Thus, in his speech Obama attributed the economic crisis in part to "our collective failure to make hard choices and prepare the nation for a new age" — but I have no idea what he meant. This is, first and foremost, a crisis brought on by a runaway financial industry. And if we failed to rein in that industry, it wasn't because Americans "collectively" refused to make hard choices; the American public had no idea what was going on, and the people who did know what was going on mostly thought deregulation was a great idea.

Or consider this statement from Obama: "Our workers are no less productive than when this crisis began. Our minds are no less inventive, our goods and services no less needed than they were last week or last month or last year. Our capacity remains undiminished. But our time of standing pat, of protecting narrow interests and putting off unpleasant decisions — that time has surely passed."

The first part of this passage was almost surely intended as a paraphrase of words that John Maynard Keynes wrote as the world was plunging into the Great Depression — and it was a great relief, after decades of knee-jerk denunciations of government, to hear a new president giving a shout-out to Keynes.

My problem with Obama's speech, on matters economic, was its conventionality.

"The resources of nature and men's devices," Keynes wrote, "are just as fertile and productive as they were. The rate of our progress towards solving the material problems of life is not less rapid. We are as capable as before of affording for everyone a high standard of life. ... But today we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand."

But something was lost in translation. Obama and Keynes both assert that we're failing to make use of our economic capacity. But Keynes' insight — that we're in a "muddle" that needs to be fixed — somehow was replaced with standard "we're-all-at-fault, let's-get-tough-on-ourselves" boilerplate.

Remember, Herbert Hoover didn't have a problem with making unpleasant decisions: He had the courage and toughness to slash spending and raise taxes in the face of the Great Depression. Unfortunately, that just made things worse.

Still, a speech is just a speech. The members of Obama's economic team certainly understand the extraordinary nature of the mess we Americans are in. So the tone of Tuesday's address may signify nothing about the Obama administration's future policy.

On the other hand, Obama is, as his predecessor put it, the decider. And he's going to have to make some big decisions very soon.

In particular, he's going to have to decide how bold to be in his moves to sustain the financial system, where the outlook has deteriorated so drastically that a surprising number of economists, not all of them especially liberal, now argue that resolving the crisis will require the temporary nationalization of some major banks.

So is Obama ready for that? Or were the platitudes in his Inaugural Address a sign that he'll wait for the conventional wisdom to catch up with events? If so, his administration will find itself dangerously behind the curve.

And that's not a place that we want the new team to be. The economic crisis grows worse, and harder to resolve, with each passing week. If we don't get drastic action soon, we may find ourselves stuck in the muddle for a very long time.

International Herald Tribune
Tuesday, January 27, 2009

Paul Krugman

Bad faith economics

As the debate over President Barack Obama's economic stimulus plan gets under way, one thing is certain: Many of the plan's opponents aren't arguing in good faith. Conservatives really, really don't want to see a second New Deal, and they certainly don't want to see government activism vindicated. So they are reaching for any stick they can find with which to beat proposals for increased government spending.

Some of these arguments are obvious cheap shots. John Boehner, the House minority leader, has already made headlines with one such shot: Looking at an $800 billion plan to rebuild infrastructure, sustain essential services and more, he derided a minor provision that would expand Medicaid family-planning services — and called it a plan to "spend hundreds of millions of dollars on contraceptives."

But the obvious cheap shots don't pose as much danger to the Obama administration's efforts to get a plan through as arguments and assertions that are equally fraudulent but can seem superficially plausible to those who don't know their way around economic concepts and numbers. So as a public service, let me try to debunk some of the major anti-stimulus arguments that have already surfaced. Any time you hear someone reciting one of these arguments, write him or her off as a dishonest flack.

First, there's the bogus talking point that the Obama plan will cost $275,000 per job created. Why is it bogus? Because it involves taking the cost of a plan that will extend over several years, creating millions of jobs each year, and dividing it by the jobs created in just one of those years.

It's as if an opponent of the school lunch program were to take an estimate of the cost of that program over the next five years, then divide it by the number of lunches provided in just one of those years, and assert that the program was hugely wasteful, because it cost $13 per lunch. (The actual cost of a free school lunch, by the way, is $2.57.)

The true cost per job of the Obama plan will probably be closer to $100,000 than $275,000 — and the net cost will be as little as $60,000 once you take into account the fact that a stronger economy means higher tax receipts.

Conservatives are raising any objection they can think of against the Obama plan.

Next, write off anyone who asserts that it's always better to cut taxes than to increase government spending, because taxpayers, not bureaucrats, are the best judges of how to spend their money.

Here's how to think about this argument: It implies that we should shut down the air traffic control system. After all, that system is paid for with fees on air tickets — and surely it would be better to let the flying public keep its money rather than hand it over to government bureaucrats. If that would mean lots of midair collisions, hey, stuff happens.

The point is that nobody really believes that a dollar of tax cuts is always better than a dollar of public spending. Meanwhile, it's clear that when it comes to economic stimulus, public spending provides much more bang for the buck than tax cuts — and therefore costs less per job created (see the previous fraudulent argument) — because a large fraction of any tax cut will simply be saved.

This suggests that public spending rather than tax cuts should be the core of any stimulus plan. But rather than accept that implication, conservatives take refuge in a nonsensical argument against public spending in general.

Finally, ignore anyone who tries to make something of the fact that the new administration's chief economic adviser has in the past favored monetary policy over fiscal policy as a response to recessions.

It's true that the normal response to recessions is interest-rate cuts from the Fed, not government spending. And that might be the best option right now, if it were available. But it isn't, because we're in a situation not seen since the 1930s: The interest rates the Fed controls are already effectively at zero.

That's why we're talking about large-scale fiscal stimulus: It's what's left in the policy arsenal now that the Fed has shot its bolt. Anyone who cites old arguments against fiscal stimulus without mentioning that either doesn't know much about the subject — and therefore has no business weighing in on the debate — or is being deliberately obtuse.

These are only some of the fundamentally fraudulent anti-stimulus arguments out there. Basically, conservatives are throwing any objection they can think of against the Obama plan, hoping that something will stick.

But here's the thing: Most Americans aren't listening. The most encouraging thing I've heard lately is Obama's reported response to Republican objections to a spending-oriented economic plan: "I won." Indeed he did — and he should disregard the huffing and puffing of those who lost.

THE JAPAN TIMES WEDNESDAY, JANUARY 28, 2009

It's truly a global economic crisis

ROBERT J. SAMUELSON

Washington

We all want U.S. President Barack Obama to succeed in reviving the economy, but that shouldn't obscure his long odds. We need to recognize that we're grappling with three separate crises that, though interwoven, are also quite distinct. The solution to any one of them won't automatically resuscitate the larger economy if the others remain untreated and unchanged. Here are the three.

First: the collapse of consumer spending. American consumers represent 70 percent of the economy. Traumatized by plunging home values and stock prices — which have shaved at least $7 trillion from personal wealth — they've curbed spending and increased saving. That's led directly to layoffs. In December, vehicle sales were down 36 percent from year-earlier levels.

Second: the financial crisis. Lower lending deprives the economy of the credit to finance businesses, homes and costly consumer purchases (cars, appliances). The deepest cuts involve "securitization" — the sale of bonds. Investors have gone on strike. In 2008, the issuance of bonds backing credit card loans fell 41 percent and those backing car loans 51 percent.

Third: a trade crisis. Global spending and saving patterns are badly askew. High-saving Asian countries have relied on export-led growth that, in turn, has required American consumers to spend ever-larger shares of their income. Huge trade imbalances have resulted: U.S. deficits, Asian surpluses. As Americans cut spending, this pattern is no longer sustainable. Asia is tumbling into recession.

Overcoming any of these crises alone would be daunting. Together, they're the economic equivalent of a combined Ironman triathlon and Tour de France.

Consider consumer spending. The proposed remedy is the "economic stimulus" plan. This seems sensible. If government doesn't offset declines in consumer and other private spending, the economy might spiral down for several years. Last week, House committees considered an $825 billion package, split between $550 billion in additional spending and $275 billion in tax cuts.

But in practice, the stimulus could disappoint. Parts of the House package look like a giant political slush fund, with money sprinkled to dozens of programs. There's $50 million for the National Endowment for the Arts, $200 million for the Teacher Incentive Fund and $15.6 billion for increased Pell Grants to college students. Some of these proposals, whatever their other merits, won't produce many new jobs.

Another problem: Construction spending — for schools, clinics, roads — may start so slowly that there's little immediate economic boost. The Congressional Budget Office examined $356 billion in spending proposals and concluded that only 7 percent would be spent in 2009 and 31 percent in 2010.

Assume, however, that the stimulus is a smashing success. It cushions the recession. Unemployment (now: 7.2 percent) stops rising at, say, 8 percent instead of 10 percent. Still, a temporary stimulus can't fuel a permanent recovery. That requires a strong financial system to supply an expanding economy's credit needs. How we get that isn't clear.

The pillars of a successful financial system have crumbled: the ability to assess risk; adequate capital to absorb losses; and trust among banks, investors and traders. Underlying these ills has been the underestimation of losses. Economists at Goldman Sachs now believe that worldwide losses on mortgages, bonds, loans to consumers and businesses total $2.1 trillion. In March, Goldman estimated half that.

All the new credit programs — the Treasury's Troubled Asset Relief Program and various Federal Reserve lending facilities — aim to counteract these problems by providing government money and government guarantees. Probably Obama will expand these efforts, despite some obvious problems: If government oversight becomes too intrusive or punitive, it might deter needed infusions of private capital into banks. Again, let's assume Obama's policies succeed. Credit flows rise.

Even then, we have no assurance of a vigorous recovery, because the economic crisis is ultimately global in scope. The old trading patterns simply won't work anymore. If China and other Asian nations try to export their way out of trouble, they're likely to be disappointed. Any import surge into the United States would weaken an incipient American recovery and probably trigger a protectionist reaction. Down that path lies tit-for-tat economic nationalism that might harm everyone.

Indeed, if the rest of the world doesn't buy more from America, any U.S. recovery may be feeble. What's needed are policies that correct the imbalances in spending and saving. As Americans save more of their incomes, Asians should save less and spend more, so that they rely more on producing for themselves rather than exporting to us. The great trade discrepancies would shrink.

But this sort of transformation requires basic political changes in Asia. Whether China and other Asian societies can make those changes is unclear. The implications are sobering. The success of Obama's policies lies, to a large extent, outside his hands.

THE JAPAN TIMES WEDNESDAY, JANUARY 28, 2009

To beat recession, Asia spends big

Alex Kennedy
Singapore
AP

Governments across Asia have pledged a combined $700 billion in stimulus spending and central banks have slashed interest rates to spur growth and cushion the blow of plunging export demand from the West.

Will the moves stave off a lengthy regional recession?

Much depends on how Asian consumers and businesses respond to the stimulus measures — which range from construction projects in China to create jobs to cash handouts and loan guarantees in Singapore.

Some analysts say Asia could be the first region to recover from the global crisis later this year because its financial systems are on a sounder footing than those in the West, allowing consumers and companies to better take advantage of the public spending and lower rates. Banks have not needed massive bailouts, and consumer and bank debt levels are lower than in the U.S., meaning people and businesses may be more willing to borrow, lend and spend.

"Asia faces fewer structural problems than elsewhere in the world, and the policy easing has a better chance of working here than in the U.S." said Richard Urwin, who helps manage more than $10 billion of investments, including Asian assets, for BlackRock Inc. in London. "It's sensible to expect some gap opening up this year between what's happening in the U.S. and in this region."

Still, stimulating domestic demand can only go so far for much of Asia, and a sustainable recovery ultimately hinges on exports. News last week of sharply slowing growth in China, a contraction in South Korea's economy and a record 35 percent drop in Japanese exports in December only served to emphasize the region's dependence on the rest of the world.

Some economists expect U.S. and European export demand to stabilize by the second half of the year, but if it does not, any emerging Asian recovery will almost certainly be scuttled.

"The infrastructure spending does help to provide a short-term boost to the Chinese economy," said Tai Hui, head of Southeast Asia economic research for Standard Chartered Bank in Singapore. "But it's taking a big knock in its export sector right now."

The outlook is overwhelmingly bleak. This year's slowdown will likely rival the 1997-1998 debt crisis as Asia's worst downturn in more than 50 years. Already, economies in Japan, South Korea, Singapore and New Zealand are shrinking.

Asian exports are in a free fall. Vietnam's exports plunged 24 percent and Singapore's slid 21 percent. China's exports dropped in November and December for the first time in seven years.

Some of the region's biggest brand names are sliding into the red. Samsung Electronics last week reported its first ever quarterly loss.

China, the world's third-largest economy, has led the policy response, announcing in November it will spend $585 billion, mostly on infrastructure development.

But getting Chinese consumers to spend more is a challenge. Many families still feel compelled to save up to 50 percent of their incomes to pay for health care, education and other necessities.

In Singapore, the government is taking steps to dissuade companies from laying off workers. Last week, it said it plans to subsidize 12 percent of the first $1,670 of each employee's monthly wages, hike cash handouts to low-income workers by 50 percent, and increase public sector hiring. The government will also assume 80 percent of the risk on private bank loans of up to $3.34 million to help spark lending and investment.

"We're seeing the most powerful, most synchronized fiscal easing Asia has ever seen, and in time, it should generate strong domestic demand and a recovery," said Robert Prior-Wandesforde, cohead of Asian economic research at HSBC in Singapore.

"In contrast to the West, money isn't going toward bailing out financial institutions, it's being pumped directly into the economy," he said.

Still, with news of job cuts around the region almost every day — and more likely — a jump in unemployment will sap consumer spending and undermine governments' attempts to spur growth.

"They're trying to stimulate the consumer here in the region, but that's going to be difficult if unemployment rises," said Stephen Corry, head of investment strategy for Merrill Lynch in Hong Kong. "The economy really hangs on the consumer because the export picture is so bleak."

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Philip Bowring

The global imbalance

HONG KONG

The new U.S. secretary of the Treasury, Timothy Geithner, has sparked a potentially acrimonious debate by alleging at his confirmation hearings that China manipulates its currency. This may be politically necessary but it's not helpful. The currency debate has become sterile, obscuring a bigger and, for the global economy, more difficult issue: China's huge current account surplus, which is no longer just a mirror of U.S. deficits.

Geithner is right in some ways. China does keep tight control of its currency's value, which is easy enough given strict exchange controls, the size of its reserves and government ownership of major banks. For years China has followed a policy of export-led growth. Beijing now finds it difficult to shift away from this, even though it knows there is scant sense in accumulating ever bigger trade surpluses and reserves. Recently, Beijing has been under pressure from Chinese exporters to stop appreciation of the yuan. Layoffs are now a political problem for Beijing.

However, it is wrong to assume that just because the yuan has in recent months stabilized against the dollar after years of slow appreciation that China's currency is being manipulated to sustain exports. Over this period, the dollar has been strong and the yuan has risen steeply against European currencies, the Canadian and Australian dollars and the South Korean won, and moderately against most other Asian currencies, except the Japanese yen. On a trade-weighted basis, China's currency has appreciated by about 10 percent since August.

There is little evidence that China manipulates specifically to help exporters or sustain a trade surplus. Its desire to move closer to the U.S. dollar rather than simply follow a trade-weighted basket is a natural outcome of the denomination of most of its trade in dollars. Beijing's reluctance to moderate appreciation of the yuan against the dollar is also natural because it creates losses for China's central bank — whose assets are in dollars and liabilities are in yuan.

The real problem that China presents to the world is its current account surplus, which is about 8 percent of national output, or $350 billion a year. In the past this has been mostly a mirror of the deficits of the U.S., Britain and Australia. But as those countries go into recession, as savings begin to rise after years of debt-driven consumer bingeing, those countries' imports, not least from China, will shrink accordingly. It is quite possible that the U.S. trade deficit will disappear within two years.

That would be fine if something else was not also happening. China's own slowdown has been a major factor in driving many commodity prices to multiyear lows. The result is that while China's export surplus with the industrialized world is shrinking, its overall trade balance is increasing. Some economists are now forecasting that China's current account surplus could hit 9 percent or even 10 percent of GDP. In other words, global imbalances are getting even worse.

Some of the gains from lower commodity import prices for China (and other exporters of manufactured goods) are nothing to worry about. The oil exporters of the Gulf, Norway and elsewhere do not need more income that they cannot spend. But the simultaneous contraction of deficits in a developed country, particularly the U.S., with the rise in the deficits of the developing world will put new strains on the global system.

The U.S. can run a deficit simply by printing more dollars. The likes of India, Brazil South Africa and Indonesia cannot. They will have to borrow to sustain economic growth when their export prices fall. With private sector finance now hard to find, and given the limited resources of multilateral institutions like the World Bank, the dangers of a downhill snowball effect are clear.

There is little evidence that China manipulates the economy.

That suggests that the world badly needs China's domestic demand to grow fast, both to pull in more exports and push up commodity prices.

Further yuan appreciation is marginal to the speed with which China's domestic stimulation works. That will not be easy given China's massive over-investment in some industries and construction projects, and lack of consumer buying power in an investment-obsessed economy.

The key message for China must be how important its stimulus is for global balances as well as its own economy. It needs encouragement from its trade partners. Sniping about currency manipulation is unlikely to put China in a responsive mood, and is a worrying example of how U.S. domestic perceptions can obstruct its global leadership role.

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Objectives in Davos ▪ Klaus Schwab

Shaping a post-crisis world

What we are currently experiencing with the financial crisis and its consequences is the birth of a new era — a wake-up call to overhaul our institutions, our systems and, above all, our thinking. It is a call to remind us of the need to adjust our values to the needs of a world that rightly expects a much higher degree of responsibility and accountability.

If we recognize this crisis as being really transformational we can lay the foundation for a more stable, more sustainable and even more prosperous world after the crisis. Given the context of recent events, the Annual Meeting of the World Economic Forum is probably one of the most serious one in years. If we are focused on our objectives, Davos can play a role in a global process to get the crisis under control and look for solutions to re-launch the economy and instill new direction and hope.

Here are five specific objectives that I have for the meeting this year:

First, we need to support governments, and particularly the G-20. Governments have a crucial role to play to address the systemic risks in the financial systems to stabilize and re-launch the economy. Denial of politically inconvenient truths combined with herd instinct caused us to rely for too long on unsustainable, out-dated systems that were abused by some people who acted in unethical and fraudulent ways.

Of course, we need to have a thorough assessment of the systems failures and the mistakes we made. But it is even more important to look forward and mobilize people with one focus: to rebuild trust not only based on more liquidity in the system but even more important, based on honesty, transparency and predictability.

To provide a concrete opportunity to governments to demonstrate the will for global cooperation this annual meeting will host a summit of trade ministers. We all hope we can beat the 1930s by coming together instead of falling apart.

The second objective is to make sure that we look at our world in a holistic, systemic way. The financial crisis is not the only issue that needs a global response. As a global community, we face several risks that need to be addressed simultaneously if we want to avoid a future where we stumble from one crisis to the next. Just to give one example: Questions on energy security and climate change loom large and we hope to make a significant contribution to the forthcoming Copenhagen meeting, which will decide about the future of the Kyoto protocol. We cannot look at problems in an isolated manner — everything is connected and we need responses that are connected as well.

The third objective is to start a year-long process to help to design the institutions that the world needs to confront global challenges. Today, we have to confront a much higher degree of complexity and time pressure than the post-World War II era, when most of our original institutions were founded. We have to recognize the shifts of political power from West to East and from North to South; we have to incorporate much more expertise into our decision-making; we have to use social networking as an empowerment tool; we have to listen more intensively to the next generation.

Market forces have to be embedded into a globally enhanced and coordinated framework.

The fourth objective is to improve the ethical base for business as a constructive social actor. We need to differentiate between all those industrial, financial and service companies that provide true value to society and those that make money through paper transactions and speculation. Profit is a major driver of business, but it is clear that it cannot be profit at all costs.

Since founding the World Economic Forum in 1971, our activities have been based on the premise that business ultimately has to serve not just shareholders but society at large. What we have to do now is to enhance a mind-set where short-term motives are replaced by long-term objectives and where we move from "ego" capitalism to "eco" capitalism.

Shaping the post-crisis world means above all to incorporate ecological, global and inter-generational responsibility into everything we are individually or collectively undertaking. We need to reflect on how we want the world to be in 10, 20 and 30 years and imagine what world we leave behind for the next generation.

The fifth objective is to reconstruct the global economy. We need to restore confidence in our future. Yes, we are in the midst of an enormous challenge — to put the global economy back on its tracks. A great opportunity exists to generate a new wave of economic growth based on technologies, products and services directly meeting societal needs in eco-efficiency, healthcare, transportation and the empowerment of people. Let us not forget that entrepreneurship remains the key driver of wealth generation and that the market economy is a fundamental pillar of a free and democratic society. But market forces have to be embedded into a globally enhanced and more coordinated regulatory framework.

What I am saying today is consistent with what I have been saying for many years. But there is one decisive difference: Today we have reached a tipping point, which leaves us only one choice ? change or face continued decline and misery.

People in every corner of the world are confused, scared and angry. They ask themselves: How was it possible that decisions were made with no effective oversight, decisions that had terrible consequences not only for the global economy but for real people, who have lost their pensions, their homes or their jobs.

People sense that their leaders have let them down. They now look to those leaders — corporate, political and societal — to repair the damage. In Davos, we will gather many of the world's most influential leaders. We will not be able to hid from our responsibility to work together to rebuild shattered economies and institutions. Only with the five objectives firmly in mind will we be able to shape a better, post-crisis world together.

Klaus Schwab is the founder and executive chairman of the World Economic Forum

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Support grows for shift to European safety net

By Katrin Bennhold

DAVOS, Switzerland: Along with skiing and partying into the night, Europe-bashing has long been a favorite sport when the world's business and political elite gather here for their once-a-year winter schmoozefest.

But this year, many of the critics have fallen conspicuously silent. As top executives, government leaders and a wide range of experts gathered Tuesday for the World Economic Forum to talk about the challenges facing the battered global economy, the question many were asking was this: Could the much-maligned social welfare system in Europe end up being the model for the 21st century?

In the United States, the global stock market rout has wiped out trillions of dollars in retirement savings, and rising unemployment is leaving more people without health insurance. In response, officials in the administration of President Barack Obama have been busy studying the Swedish bank bailout of the 1990s and the Swiss and Dutch health care systems. On the environmental front, the officials have been quietly contemplating whether Europe's high fuel taxes and carbon trading system are the right way to limit the burning of fossil fuels that contributes to global warming.

In China, where the demise of the American market has brought to light the perils of excessive savings at home, the government has not only recently proposed a big Keynesian-style stimulus program but has also just an-

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Support grows for shift to European safety net

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nounced a three-year plan to provide universal health care. Though modest by comparison, China's health care plan goes in the direction of what has long been considered a fundamental right in Europe.

"When the world's biggest economy and the world's biggest emerging economy look for lessons in the same place at the same time, you know something is up," said Kenneth Rogoff, a professor at Harvard and former chief economist of the International Monetary Fund, who is one of the 2,500 participants in Davos this year. "We are seeing a paradigm shift towards a more European, a more social state."

Such shifts are rare.

The Great Depression of the 1930s eventually ushered in Keynesian demand-side policies and, after a devastating world war, firmly established the need for some sort of social safety net in every major industrial democracy.

The oil price shocks of the 1970s and a wave of inflation helped turn the governing approach in the other direction, empowering Ronald Reagan and Margaret Thatcher and other advocates of lower taxes, smaller government and deregulation.

At the opening of the 2008 World Economic Forum, a front-page article in the International Herald Tribune suggested that global capitalism was again ripe for such a generational transformation. Amid the worst financial crisis since the Depression, that transformation is now in full swing.

With whole swaths of the banking sector being propped up by trillions of dollars in taxpayer funds and hundreds of billions more being dedicated to deficit-financed public spending programs across the world, the most striking feature so far is the comeback of big government.

In the world's largest and most emblematic market economy, the surge in the growth of the U.S. government is going to be financed by a huge increase in borrowing, projected to grow from 3 percent of gross domestic product last year to as much as 10 percent this year and into 2010.

"We're moving back towards a mixed economy," said Daniel Yergin, chairman of Cambridge Energy Research Associates in Cambridge, Massachusetts, and the co-author of "The Commanding Heights," a history of the last-such paradigm shift, the one toward wider acceptance of the market-driven economy.

The new shift is likely to go well beyond expensive short-term fixes. The ferment suggests that ultimately the United States may move closer to Europe, altering the trickle-down economic doctrine of the past three decades and establishing a new social contract aimed at narrowing the gap between the rich and the rest of society, officials and economists say.

Obama, who called for a "watchful eye" on the market in his inaugural speech last week, wants to make health insurance available to all Americans. Almost half of the $825 billion pledged to stimulate the economy is earmarked for extending health care and unemployment assistance, and investing in public schools.

Meanwhile, Beijing approved a health reform plan worth 850 billion yuan, or $124 billion, last week that sets out to provide free basic health care to the country's 1.3 billion inhabitants by 2011. Each person covered by the system would receive an annual subsidy of 120 yuan, starting in 2010.

As Pascal Lamy, director general of the World Trade Organization and another Davos regular, put it, "It's a cultural revolution."

It is no coincidence that this revolution is unfolding simultaneously in the United States and China, analysts say.

They were opposite poles in the hazardous gentlemen's agreement underpinning global imbalances in recent years — one accumulating ever more debt, the other supplying the world with a glut of savings.

But for all their differences, no two countries were more dedicated to the growth-above-all-else capitalist mantra. And no two countries have seen the foundations of their economic models more shaken in recent months.

In the United States, the crisis exposed an unsustainable credit culture and undid a highly sophisticated financial system that accounted for 8 percent of GDP and now needs rebuilding from scratch.

In China, where millions of jobs have been lost in recent years, the export-led

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model of the past two decades has faltered, in part because America's insatiable demand for Chinese goods has cooled. With Chinese families committed to saving for retirement, health care and education, domestic consumption in China is 35 percent of GDP, half the share it is in the United States.

"The crisis has accelerated things and made domestic demand even more of a priority," said Victor Chu, chairman of First Eastern Investment Group in Hong Kong, the biggest direct-investment group in China. "Therefore China is strengthening and deepening the social safety net."

On paper, the euro zone may look worse than both. Parts of its financial system are reeling, too, and economic growth is expected to fall for much of 2009, while many economists expect the United States to resume growth in the second half of the year. Growth in China is only slowing, not going into reverse.

But unlike the other two, Europe faces less fundamental questioning of its social contract. Higher benefits and broad-based consumption taxes serve as automatic stabilizers of the business cycle, restraining growth in good times but cushioning the downturns.

"Europe faces a plain vanilla recession," said Rogoff, the Harvard professor. "It's a deep recession and it's coming with a vengeance. But it's not a paradigm destruction."

To be sure, many remain skeptical about Europe's social model and the tradeoff between slower economic growth and greater security. Unemployment, which has consistently run higher than in the United States or Japan, is rising again, too.

Protests have broken out in several European countries, particularly among the young and immigrants who have not shared in the general prosperity. Its aging population is already pushing up the cost of medical care and retirement security.

And whether Europe's model is exportable remains questionable. For the moment, few Americans are prepared to pay for what Europeans take for granted.

Obama's advisers may be looking to Europe for inspiration and many Americans are clamoring for protections against the financial and economic storms, but raising taxes to pay for the bigger government that is on the way is still a political taboo.

Taxes in the United States account for about a third of GDP, compared with about 40 percent in France and half in Sweden.

"I do not think the American body politic is ready to recognize the tradeoff between growth and security," said Stephen Roach, chairman of Morgan Stanley in Asia.

"We want the protection, but we don't want to pay for it," Roach added, noting that European-style consumption taxes or energy taxes were unlikely to proposed in the near future.

As a result, many economists see a complex new interplay between markets and the state emerging.

"We are going into an era with deeper suspicions of both markets and governments," said Joseph Stiglitz, a Nobel economist who teaches at Columbia University. "There will be more emphasis on the welfare state, but there will also be more emphasis on incentives within the welfare state."

One open question is whether the United States and China can undergo such a fundamental economic shift without heightening the tensions that already exist.

It could reinforce strategic relations between the countries by highlighting their mutual dependence. But as the economic crisis unfolds, there is also the chance that it could also lead to protectionist saber rattling.

Last week, Timothy Geithner, now the U.S. Treasury secretary, said Obama thought that China was "manipulating" its currency, heralding a harder line toward Beijing.

Lamy, the WTO leader, warned that there was already evidence that tariffs and anti-dumping measures were on the rise, though still generally within the limits of trade law.

"So far it's nothing dramatic," Lamy said. "But that doesn't mean there isn't the protectionist temptation. There is always a time lag before such measures are put into place."

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THE WALL STREET JOURNAL.
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Economies search for growth

Davos forum focuses on halting the slide and climbing back

By Joellen Perry in Davos and Shen Hong in Shanghai

Two questions will preoccupy the world's economic elite in the snowy Swiss hamlet of Davos this week: Will the massive sums of government money pledged to prop up national economies be enough to keep the world from slouching into a prolonged slide? And where will the growth come from once bottom is touched?

At the start of the five-day World Economic Forum gabfest, the broad outlines of answers are becoming clear. Economists say fiscal-stimulus packages from Washington to Beijing will cushion the downturn but fall short of preventing a world-wide recession. And global growth, when it comes, will still be powered in good part by U.S. consumers—though they'll spend far less than they did in the debt-fueled years of the recent boom.

Chinese Premier Wen Jiabao will likely seek to lower expectations that China can extract the world from the economic crisis. He is the first Chinese leader to attend a Davos meeting in the event's 38-year history. Despite its rise as a global production hub, China—like emerging Asian economies such as India—remains too small, too poor, and too export-dependent to provide much of a buffer for the global economy in the next few years.

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Asia's inability to compensate for the drop in U.S. consumption means any global recovery will be slow in coming and marked by lower growth rates than the world has seen in recent years.

"We thought we could keep growing [globally] at rates of 4% and 5% a year, but that's unsustainable," says

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Forum focuses on global growth

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Nouriel Roubini, a prominent pessimist and Davos regular who heads RGE Monitor, a financial and economic-forecasting service in New York. Mr. Roubini's best-case scenario: After a recession this year, the world returns to more moderate global growth rates around 3.5% by 2011.

Governments around the world have pledged trillions of dollars—a precise tally is hard to come by—to blunt the impact of the financial crisis. U.S. Democrats hope to pass President Barack Obama's $825 billion economic-stimulus bill—a package of tax and spending measures amounting to 3% of annual U.S. gross domestic product—by mid-February. China in November pledged $586 billion in spending on projects including power-grid upgrades and highway construction. On Tuesday, Germany's cabinet approved a second stimulus package, part of the 27-nation European Union's pledge to spend 1.5% of GDP, or about €200 billion ($260 billion).

In total, the funds top a recommendation from the International Monetary Fund that governments world-wide spend 2% of GDP on stimulus. But it still won't be enough to stanch the bleeding. The IMF is expected to issue projections Wednesday showing global growth will be less than 1% this year.

"A deep recession for 2009 is already baked into the cake," says Ken Rogoff, a Harvard University economics professor and Davos speaker who calls the fiscal-stimulus packages a necessary but temporary boost. "We've had an asset bubble burst that's not going to turn around no matter how much governments spend," he says.

The greater risk is that the global contraction lasts several years—a scenario that could materialize if governments don't complement fiscal stimulus with equally ambitious plans to clear banks' books of bad assets and get credit flowing through the system again.

"The long history of international financial crises tells us if you don't clean up the mess in the banking system decisively," says Mr. Rogoff, "you're not going to escape a long stagnation. A modern economy with a dysfunctional financial system is not going to roll along very fast."

Wen Jiabao

Pinning hopes on emerging markets such as China to pull the world out of the downturn also seems misguided. China remains a relatively poor nation with a small slice of the global economy. Per-capita GDP in 2007, according to the IMF, was $2,483.04, compared with $45,725.35 for the U.S. And while the U.S. accounts for 20% of the globe's economy, China's share is far less .

With about half of its growth still export-driven, China is also getting slammed by the global downturn. Amid fizzling demand, China's expansion slowed to an annual rate of 6.8% in the final three months of last year. That was down sharply down from 9% in the third quarter and marked a seven-year low. For all of 2008, growth slowed to 9% from 13% the year before—making it unlikely China can maintain its long-standing 8% annual growth rate.

Chinese policy makers face a steep challenge in turning the country's growth more toward domestic demand. Job losses are mounting, for one. And patchy social protections such as meager health-care insurance and social-security funding, push Chinese consumers to save big chunks of their earnings.

Even China's massive stimulus program "won't get consumer-led growth going until they really build out a safety net," says Stephen Roach, Asia chairman for Morgan Stanley. "I'm hopeful it can happen in the next few years. But you don't create a consumer culture overnight."

U.S. consumers—who by some estimates have powered around a tenth of global growth in recent decades—are also taking a hit. Faced with rising unemployment, tightening credit standards and burst housing and stock-market bubbles, shoppers stateside have begun shutting their wallets. U.S. spending growth in the third quarter of last year fell for the first time in 17 years. Economists say the share of consumption in U.S. GDP, which hit post-World War II highs around 70% earlier this decade, could fall by five percentage points in the next five years.

But if the U.S. stimulus puts a floor under the economy and a bank-rescue package restarts credit engines, economists say, U.S. consumers will start spending again, albeit at lower rates.

"The government can't take the place of the consumer for very long," says Ken Rosen, who heads up the Fisher Center for Real Estate and Urban Economics in Berkeley, Calif. Mr. Rosen is slated to speak Thursday on a Davos panel called "Can the World Live with the Frugal American?"

"It will be a recovery based on less credit and a more careful view of spending within one's means," says Mr. Rosen. "But it will be a recovery."

THE WALL STREET JOURNAL.
THURSDAY, JANUARY 29, 2009

Revived IMF pursues less-stringent lending

By Bob Davis
And Marcus Walker

DAVOS, Switzerland—The global financial crisis has revived the International Monetary Fund, which just a year ago was pushing to sell a chunk of its gold reserves because it was making so few loans it didn't have enough income. Now, it has committed about $50 billion in loans to try to rescue Pakistan, Iceland and a clutch of Eastern European countries.

The IMF's role will be a focus of attention at this year's World Economic Forum, where political leaders of Pakistan and Latvia will discuss their experiences, as will the No. 2 official at the IMF, John Lipsky. This is a new-look IMF.

Gone are many loan requirements that developing nations found onerous: privatize social security, open markets to foreign financial firms, break up local monopolies. The changes have made turning to the IMF more palatable domestically—other nations, including Turkey, are now in talks with the IMF for loans. It may even ease the way for some heavily indebted Western European countries to seek IMF help later on.

"The change reflects a shift away from the thinking that the IMF can micromanage a country," said Anne-Marie Gulde, an IMF senior adviser for Europe.

In making the loans, the IMF sought to learn the lessons of the Asia crisis of a decade ago. Then, the fund was criticized for making demands—such as opening the way to U.S. banks in South Korea and breaking up a clove monopoly in Indonesia—that locals interpreted as heavy-handed and politically motivated.

Moreover, with the U.S. and Western Europe slashing interest rates and lifting government spending to fight recessions, IMF officials said they couldn't ask borrowers to make the tough cuts they once would have.

The IMF is far from a fast-track loan program for developing nations. Rather, it confines its demands to the monetary and fiscal policy in which it is expert. For some countries, that still can mean difficult changes. Latvia, for instance, must slash the salaries of teachers, soldiers and other government workers by 15%, while Ukraine must cut its spending at a time when the economy is expected to contract severely—a prescription that is bound to make its recession worse, for a time.

Some Eastern European countries receiving IMF assistance figure that it's only a matter of time before the IMF resumes trying to get involved with the innards of their economies.

"The IMF will use [the deepening economic crisis] to ask more and more of countries," said a central banker in Eastern Europe. The IMF says it doesn't have such plans.

The IMF's goal is to help stabilize poor countries battered by a recession that sharply reduced exports to rich countries as financing to developing countries dried up. The Institute of International Finance, a trade association of large financial institutions, estimates that private flows of capital to developing countries will drop by about two-thirds, to $165.3 billion this year from $465.8 billion in 2008.Last year, the IMF, which had a tense relationship with Pakistan, agreed to easier terms than it would have in the past on a $7.6 billion loan.

The IMF largely accepted the budget-deficit target the Pakistanis proposed, said Mohsin Khan, the IMF's former chief for the Middle East, and didn't push to end certain farmland tax breaks, as it had in the past, even though it believes the breaks are manipulated by manufacturers. Mr. Khan said Pakistan agreed to make the central bank more independent and to reduce subsidies, which should help to ease its budget problems.

One sign that the IMF strategy may be working: protests in Latvia, Hungary, Lithuania and elsewhere have been directed at governments instead. "People do not see the IMF as a big Western institution telling us what to do," says Gyula Toth, a Hungarian economist at UniCredit in Vienna.

THE WALL STREET JOURNAL.
THURSDAY, JANUARY 29, 2009

Wrong on the Yuan

By Calla Wiemer

China has taken a certain amount of heat from outgoing Treasury Secretary Henry Paulson for helping bring on the global financial crisis. But his newly sworn-in successor has just raised the temperature a notch. In written testimony to the Senate last week, Timothy Geithner invoked the dreaded "currency manipulator" label intimating that China is deliberately undervaluing the yuan. This is a heavily loaded term that the Bush administration for some years managed to dance around. Currency manipulation is prohibited under the International Monetary Fund Charter and can be taken as grounds for retaliatory trade sanctions.

The Treasury Secretary should focus on consumption.

The attention to the exchange rate is misplaced. A coherent story of global payments imbalances and the financial crisis can be told without recourse to charges of an undervalued yuan. Likewise, an agenda for getting out of the crisis and setting the global economy on a more balanced path does not depend on the yuan. The policy focus should be on stimulating consumption in China. The need for that predated the crisis but is now magnified by it.

Both China and the U.S. pursued macroeconomic policies from 2001 to 2007 that were successful in achieving high growth with low inflation. Just how successful in China's case is only revealed when real growth figures are derived, following standard international practice, by subtracting the inflation rate from the nominal growth rate. This approach shows that from a slowdown that bottomed out in 2000 with growth at just 2.3%, the pace soared to robust double digits and stayed there for seven years. The year 2001 was pivotal due to China's World Trade Organization entry, although the foundation for sustained growth had been laid in the late 1990s with state sector downsizing, housing privatization and liberalization of labor migration.

In a pattern typical of developing countries in their take-off phases, China's surging growth brought a rise in the national saving rate. What makes China's case stand out is that the saving rate started from an already high 38% in 2000. An inexorable climb from then onward elevated the rate to 51% in 2007. A litany of factors is routinely cited for why China's saving rate is high: the need to provide for one's own retirement; the need to self-insure against risks of illness, injury, or job loss; the need to meet children's education expenses; and the need to accumulate funds to support lumpy expenditures on consumer durables or business start-ups in the absence of credit markets that function to do so. But although these factors explain a high level of saving, they do not offer insight as to why the saving rate rose so dramatically during a time when, if anything, life became less precarious and the financial system became more functional.

A standard economic theory of saving—Franco Modigliani's life cycle hypothesis—explains the rise in saving. The hypothesis holds that current income is apportioned to consumption over a lifetime. This means, first, that any income growth above the norm will be disproportionately saved in the current period to be meted out for consumption purposes in future years. Since only those in their working years benefit from faster income growth, only this segment increases its consumption while those in retirement consume based on the lower income of an earlier time. The hypothesis implies, second, that a rising share of population in the workforce will also result in an increase in the saving rate. On both counts—unusually rapid income growth and a demographic bulge moving into working ages—China's rising saving rate is as the theory predicts. In other words, it has nothing to do with the exchange rate.

A rising saving rate has implications for China's external accounts. National saving that isn't used for domestic investment is invested abroad. To fund that capital outflow, exports must exceed imports. In China's case, a rise in saving was paralleled by a rise in domestic investment from 2000 to 2004, leaving the saving surplus and hence the trade surplus constant as a share of GDP at a modest 2.0-2.5%. In 2004, fearing the economy was overheating, the Chinese government clamped down on investment spending and the saving-investment gap began to widen. With investment held in check over the next few years against a continued increase in saving, the trade surplus boomed.

On the U.S. side, the capital inflow—not just from China but from the developing world as a whole plus the oil exporting countries—had an incipient deflationary impact. Upward pressure on the dollar from the demand for U.S. assets made U.S. goods less competitive, and without countervailing action this would have caused the economy to falter. Expansionary monetary policy kept that from happening, however, as the Greenspan Federal Reserve kept interest rates very low for a very long time. The liquidity boost from a credit expansion triggered by innovative new financial instruments also contributed. This combination fueled wealth gains that stimulated U.S. consumer demand and kept the economy going.

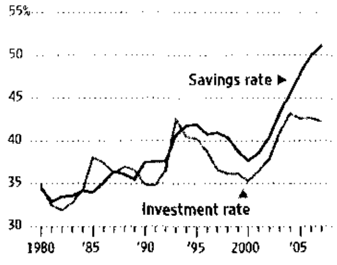
Both the U.S. and China thus enjoyed strong growth with low inflation for a nice, long stretch. The U.S. propagated this trend with low interest rates and financial innovation, while China propagated it with a stable exchange rate and ongoing reform of its economic system.

China is no different from most emerging market economies in adopting policies of foreign exchange market intervention, capital controls and interest rate regulation. It takes very sophisticated economic institutions to pull off liberalized foreign exchange and financial markets, and even then there are no guarantees of immunity against crisis. In the emerging market context, the exchange rate is an important macroeconomic policy lever. Currency appreciation reins in an economy that is overheating; depreciation stimulates an economy that is flagging. China's course of gradual yuan appreciation since 2005 proved effective in allowing the economy to grow at high speed while still keeping inflation in check.

China's growth, however, has relied too much on exports and not enough on domestic consumption—a problem for long term, sustainable economic growth. The remedy is to direct fiscal spending toward consumption, in particular for health care and education where China is notably lacking. Given the sagging state of external demand, strong domestic stimulus can be exercised without danger of the overheating that might call for currency appreciation as an offset. The exchange rate, then, can stay where it is. A fiscal stimulus that succeeded in restoring consumption to the share of GDP witnessed as recently as 2003, given a maintained investment share at the 2004-07 level, would cause China's trade surplus to disappear.

Saving for the Future

China's investment and saving rates as a percentage of GDP, 1980-2007



Source: China National Bureau of Statistics

Mr. Geithner, to his credit, emphasized in his written testimony the importance of consumption stimulus in China. He would do well to stick to that argument going forward and exclude further pronouncements on the exchange rate. Meanwhile, rising health care and education spending in China presents the prospect of greater demand for medical equipment and educational aids. This suggests the U.S. might do well to pursue a negotiating strategy focused on intellectual property rights and a freer market for ideas the better to exploit its comparative advantage—instead of a trade war rooted in a wrong-headed assessment of the yuan.

Ms. Wiemer is a visiting scholar at the University of California, Los Angeles, Center for Chinese Studies.

International Herald Tribune
Friday, January 30, 2009

FLOYD NORRIS

The risk of a new protectionism

DAVOS, Switzerland

Decoupling is the discredited theory of last year. It may also be the reality of tomorrow.

The world's efforts at economic recovery could well turn into a case of every country for itself. Call it "capital protectionism."

A year ago at the World Economic Forum, many chief executives and government officials hoped that an U.S. recession, if one came, would be mild and not spread overseas. The strength of world economic growth would enable Europe and Asia to "decouple" from the U.S. economy.

What happened instead was the downside of globalization. Readily available and low-cost capital played a crucial role in causing growth around the world, and its absence for all but the safest borrowers was causing pain everywhere.

But what is not the same everywhere is the ability of governments to stimulate the economy. While the United States was debating the details of how to spend a trillion dollars or more to bail out banks and stimulate the economy, the governments of some other countries have found themselves caught in the credit crunch.

In Latvia, the government got a bailout from the International Monetary Fund by agreeing to draconian measures that included wage cuts, spending reductions and tax increases. There were riots.

iht.com/biz

Join a discussion with Floyd Norris on his blog, High and Low Finance.

The president of Latvia, Valdis Zalters, was diplomatic when I asked him Thursday if he thought it was unfair that the United States could easily borrow when his country could not. "It's the way it is," he said. "The U.S. has a AAA rating. We had no choice."

The best positioned are those countries that have huge foreign currency reserves — think China — or printing presses for the international reserve currency — think the United States.

"The money is flowing out of all markets," said Ferit Sahenk, the chairman of Dogus Group, a Turkish conglomerate. "This brings a risk of refinancing, not only for the banks but for private sector debtors as well."

That risk is only increased by what Stephen Roach, the Morgan Stanley economist, called "the rising tide of economic nationalism." In both Europe and the United States there is pressure on bailed-out banks to increase lending — but not just to any borrowers.

"Some countries are encouraging their banks to invest mostly in domestic assets," complained Sahenk. "This is a new form of protectionism."

That worry is widespread. "Large economies are accessing international capital markets for themselves," said Trevor Manuel, the finance minister of South Africa. He wants the big countries to share the borrowed wealth, but fears they will not.

Adair Turner, the chairman of Britain's Financial Services Authority, voiced the same concern, calling it "the risk of a new mercantilism," centered on credit availability rather than trade.

"It is not easy to avoid this," he added. "It could get out of hand."

The onset of credit protectionism, if it comes, will be the result of a drastic shift in the financial system. Private allocation of credit played a major role in the extraordinary world growth of the past quarter century, but that system blew up when financial innovation led to a huge overextension of credit to borrowers with dubious repayment ability, whether they were subprime mortgage borrowers or highly leveraged companies.

With the banks crippled and shown to have taken risks that now look like they were foolish, it has fallen to governments to allocate credit, either indirectly by deciding which banks to bail out and on what terms, or even directly if, as some expect, many banks are eventually nationalized.

The pressures for nationalization come in part from worries that bank balance sheets are bottomless pits of toxic assets, and concern that it would be unfair to taxpayers to allow the benefits to flow to the shareholders who stood by as the banks took too many risks.

Alan Blinder, a former vice chairman of the Federal Reserve and now an economics professor at Princeton, said he did not think nationalization would be the first or second choice of American policy makers, but that it could be the third or fourth.

And he added that the risk of credit protectionism would rise if the banks were nationalized.

It is hard to imagine that governments will do a particularly good job of allocating capital to its most productive uses, given the political pressures they will face. But there is no agreement on how to get the private banking system operating in an adequate fashion.

Pumping capital into the banks has not yet worked, even if it has stirred public outrage over high pay and perks for the bankers who got us into this mess.

There is renewed interest in some kind of "bad bank" approach that would separate the toxic assets from the good ones, leaving the government with the bad stuff.

But figuring out what to pay — assuming the banks have not been nationalized — is likely to be contentious.

At the same time, there is much talk about how to reform the regulatory systems around the world, and to standardize regulation to avoid the "regulatory arbitrage" of seeking out jurisdictions with the least stringent rules.

"We allowed a series of near banks and shadow banks to grow without being regulated," Turner said. In a new regime, he added, one rule must be, "If it looks like a bank and quacks like a bank, we have to regulate it like a bank." To do that, he would give regulators wide discretion to get information on how hedge funds and other institutions are operating, with the ability to impose regulation if they start to act too much like a bank.

Some economists fear that would stifle financial creativity, and even some who think far more regulation is needed question whether regulators can amass the expertise to make needed decisions promptly and wisely.

Roach forecasts this will be the first year since the Great Depression that the gross domestic product of the entire world declines. Fiscal stimulus plans may help to ease the pain, but it is hard to see how the world's economies can resume decent growth unless and until the private financial system is operating much better than it is now.

"We've all been building this big, integrated financial system," said James Rosenfield, a co-founder of Cambridge Energy Research Associates. "We didn't consider what would happen when it disintegrated."

Shifting toward state control of finance. ***James Saft, Page 18***

THE WALL STREET JOURNAL.
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Philippines' economy grows 4.6%

Remittances bolster GDP, but global ills create job worries

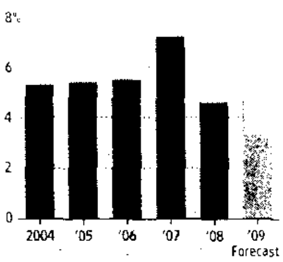
By James Hookway

The Philippines' economy grew faster last year than many analysts expected—expanding 4.6% in 2008 compared with 7.2% in 2007—but economists worry about whether the country's relatively resilient domestic consumer sector can withstand a worsening export slump.

Some economists predicted the full-year gross domestic product data would show growth of around 4%. But strong remittance flows from about eight million Filipino expatriates helped prop up consumer spending and the broader economy last year even as the full extent of the global economic crisis began to emerge, the Philippines' National Statistical Coordination Board announced Thursday.

Philippines' GDP

The Philippine government forecast economic growth of between 3.7% and 4.7% in 2009.
Year-to-year change:



Source: National Statistical Coordination Board

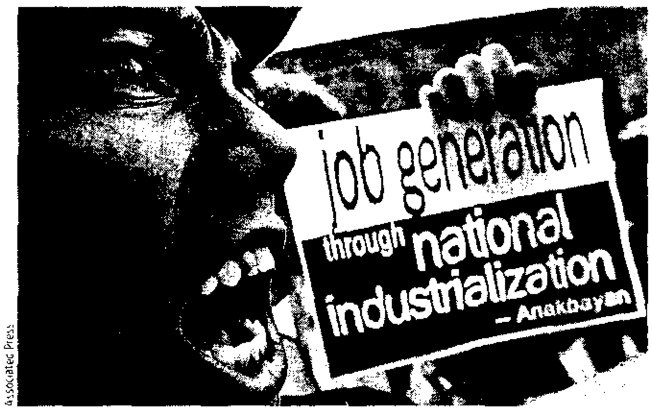
In the fourth quarter, the board said, GDP grew 1% from the third quarter, avoiding the contractions already afflicting some other Asian economies.

The Philippines' central bank expects remittance flows provided by Filipino nurses, teachers and other professionals to have reached $15 billion or more in 2008, and the total could grow another 10% this year. The inflow provides a safety net that many of the Philippines' Asian neighbors lack.

But the question on many economists' minds now is whether remittance-driven spending—combined with government stimulus—can continue to offset a slump in exports and a series of layoffs among the country's manufacturers. For some analysts, the economic data are a lagging indicator and don't offer much comfort for the current year.

On Wednesday, Philippine Labor Secretary Marianito Roque warned that in a "worst-case scenario," as many as 300,000 people in this country of 90 million could lose their jobs in the coming months. Intel Corp. on Jan. 21 announced it was shutting a semiconductor testing and assembly plant south of Manila, and Texas Instruments Inc., another big employer in the Philippines, said it also is laying off workers as part of a global retrenchment program. Total exports fell 12% year-to-year in November.

Some analysts worry that the remittance flows could also slow if the worsening global economic situation translates into job losses for the Philippines' large overseas work force. Although many of the country's expatriates work in fields considered relatively immune to a downturn, such as healthcare and education, the depth of the world's economic problems could still affect them.



Associated Press

An activist at a Manila protest on Thursday condemned joblessness at home. Economists worry that the global crisis will cut jobs of Filipinos working overseas.

"Remittance flows have held up pretty well through to November, and if they begin to reduce, we might not see it happen until the middle of 2009," said Jojo Gonzales, managing director of one of Manila's biggest stock brokerages, Philippine Equity Partners Inc.

The Monetary Board of the Philippines' central bank responded to concerns about the country's economic outlook on Thursday by cutting its benchmark interest rates by half a percentage point for the second consecutive month.

The Bangko Sentral ng Pilipinas' overnight rate is now at 5% for borrowing and 7% for lending—their lowest in a year—and Gov. Amando Tetangco told reporters more cuts could follow as the rate of inflation slows, thanks to lower food and oil prices. In December, the Philippines' consumer price index rose 8.0% year-to-year, compared with a 9.9% rise in November.

"Given the improved inflation outlook, the Monetary Board believes that there is room for further easing the monetary policy stance, which should also provide support to financial markets and the real economy," Mr. Tetangco said.

Earlier Thursday, Economic Planning Secretary Ralph Recto said the government's growth target for 2009 was 3.7% to 4.7%, adding that he expected government spending on construction programs also to help lift the domestic economy. "Our economy is expected to remain resilient and prepared for the eventual economic rebound," he told reporters.

Mr. Gonzales at Philippine Equity Partners said he expects the country's economy to grow 3.1% this year—below the lower end of the government's target. "It's just enough to keep per-capita incomes rising," he said.

—Cris Larano and Cecilia Yap contributed to this article.

THE JAPAN TIMES SATURDAY, JANUARY 31, 2009

OPEC has a lesson for China

Sebastian Mallaby
Washington
THE WASHINGTON POST

At his confirmation hearings last week, Tim Geithner branded China a currency manipulator. This is a designation that the Bush Treasury Department never formally affixed to the Chinese. It may signal a nerve-racking shift in how the United States manages its most pivotal relationship.

Treasury Secretary Geithner is correct that China manipulates its currency. What's more, this manipulation is arguably the most important cause of the financial crisis. Starting around the middle of this decade, China's cheap currency led it to run a massive trade surplus. The earnings from that surplus poured into the U.S. The result was the mortgage bubble.

China's leaders protest that they are being unfairly scapegoated. Yet while there are rival accounts of the origins of the crisis, neither has the explanatory force of the blame-China narrative.

The first rival account is that the crisis reflected failings of U.S. financial regulation. Such failings exist, but most have been around for years. The mortgage bubble reached its craziest extremes in 2005-07, when China was flooding the world with cheap capital.

Moreover, regulatory failings exist not just at one regulator but many. The Securities and Exchange Commission failed to check risks at broker-dealers such as Bear Stearns. State insurance regulators failed to prevent the collapse of AIG. The Federal Reserve failed to see that banks were pouring capital into toxic securities that they then held off their balance sheets. European regulators were no better, even though they had adopted a supposedly more up-to-date set of capital standards. The lesson: Faced with a deluge of cheap money, no regulatory regime can be expected to prevent bubbles.

The second rival account of the crisis accepts that its origins lie less in regulatory failings than in economic pressures. But it blames the bubble on two mistakes at home rather than on the glut of capital from China. Americans should have controlled the urge to splurge, the thinking goes, and borrowed less Chinese money. And the Fed should have shut down the easy-money party by raising interest rates.

If Americans' insatiable appetite for loans explained the flood of Chinese capital into the U.S., we would have seen the evidence in a rising price for those loans — that is, higher interest rates in the bond market. But bond rates were strikingly low at mid-decade. This strongly suggests that it was the *supply* of lending that went up, not the *demand* for it. Chinese money flooded into the U.S. because of the push factor from China, not the pull factor from Americans.

Geithner is correct that China manipulates its currency. What's more, this manipulation is arguably the most important cause of the financial crisis. Starting around the middle of this decade, China's cheap currency led it to run a massive trade surplus. The earnings from that surplus poured into the U.S. The result was the mortgage bubble.

Could the Fed have raised interest rates to avert the bubble? The Fed's monetary policy was indeed too loose. But as Martin Wolf argues in his recent book, "Fixing Global Finance," it's not clear that higher interest rates could have prevented the trouble. Once China decides to export vast quantities of capital, that capital has to go somewhere. Higher interest rates in the U.S. might have encouraged the world's savers to park even more of their capital in this country.

So there is no getting around China's culpability. The country relies on the sort of export-focused growth strategy that other Asian Tigers have pursued, with the difference that China is too big to go this route without destabilizing the world economy. The real question is whether it is diplomatically fruitful to push China to change. The Bush administration tried and failed. Why would the new team fare better?

The wrong answer is to say that U.S. President Barack Obama's guys will be tougher. However egregious China's currency policy may be, it's counterproductive to punish Beijing with sanctions. For one thing, a trade war is the last thing the world economy needs. For another, as Geithner explained, the immediate priority is to get global growth going, so it's more important to persuade China to extend its fiscal stimulus than to revalue its currency. Besides, reforming China's exchange-rate policy is not the only way to wean the country off its high-savings, high-export model. The savings rate partly reflects China's lack of social safety nets. If the Chinese spend some of their stimulus on pensions and health care, they will be heading in the right direction.

Still, there is an opportunity to nudge China toward currency reform, and the Obama team should take it. China's leaders are not fools: They can see the effects of their policy not only in collapsing Wall Street banks but also in their own collapsing exports. The bubble that China inflated has brought China's foreign customers to their knees. Because China pushed its export model too aggressively, its export markets have cratered.

Think of it this way: China's position is akin to that of OPEC in the early 1980s. Two oil shocks taught oil producers the limits to their power: When they jammed prices up, the world economy sputtered and motorists bought smaller cars — and oil priees fell precipitously. OPEC learned to balance its lust for higher oil prices with the fear that customers might revolt. China's leaders may be ready for the same lesson — and Geithner's words may encourage them to learn it.

Sebastian Mallaby is a fellow for International Economics with the Council on Foreign Relations.

International Herald Tribune
Saturday-Sunday, January 31-February 1, 2009

Decisions at Davos ▪ Kofi Annan

A time of crisis — and hope

DAVOS, Switzerland

As the world's wealthy and powerful meet in Davos, the world looks a gloomy and uncertain place. We don't know how deep or long-lasting the downturn will be. But we do know there is plenty of pain to come.

In every crisis, however, there is opportunity. If we have the courage to learn the lessons of the last 18 months and put them into practice beyond the economic sphere, we can put in place new foundations to reshape our world for the better.

For the roots of this crisis go beyond an abject failure of financial governance and neglect of warnings of the risks being run. Connections between economies have been revealed which were clearly not fully understood, let alone regulated. There may have been endless talk of globalization. But it is very clear there has been a lack of recognition of what this means for us all.

We have learned decisively that no country, no matter how prosperous, can control the forces of globalization on its own. The lack of inclusive processes and institutions needed to manage the risks and ensure all gain from the benefits has also been exposed.

The present crisis has already led to unprecedented international co-operation. There has been coordinated action to protect the financial system from collapse, to try to stimulate the global economy and find new rules and structures to prevent this disaster being repeated. But while the G-20 is a better and more legitimate forum than the G-8, it does not go far enough to give the poor and excluded a voice. After all, they are the ones most affected by the decisions made.

The real lesson of the past year is the urgent need to build on and extend this multilateral approach. It means accepting that the rich and powerful alone can no longer rule the world.

It means, too, recognizing that the only lasting solutions to the challenges we face will be those which have the security, opportunity and welfare of all at heart. Fairness and equity can no longer be an afterthought. No one's stability, security and prosperity can be guaranteed unless we strive to tackle the gross inequality of wealth, opportunity and influence in our world.

What is needed is a fundamental change of mindset. Solutions to the financial crisis must look beyond the impact on the market, financial institutions and developed countries. They must also focus on jobs, family incomes and the effect of the slowdown on the poorest countries.

Market forces are the engine for economic growth. But they need to be well regulated to ensure fairness and equal opportunity for all.

We must show that we understand the challenges of globalization and act together to confront them.

The present crisis has underlined the importance of governments in effective regulation of the market. But they must also look beyond their borders and at the long-term picture. Richer countries cannot use the excuse of tighter finances to renege on their aid promises to the poorest on the planet. As protectionist instincts are emboldened, the danger is that those least responsible for the present crisis will be hardest hit.

Africa's progress, in particular, is under threat. We need not just to continue but to increase support to help the continent overcome its problems. Development aid must be targeted at encouraging long-term economic growth, good governance and human development as well as immediate crises. We need a uniquely green revolution in Africa, transforming every aspect of farming to ensure food security.

It is Africa — and the developing world as a whole — which will be hit hardest, too, by climate change. It will affect every country and society, but the most severe impact will fall on those who have done the least to change our atmosphere.

We can waste no time. There must be a radical, effective agreement at Copenhagen this year based on climate justice and the principle that the polluter pays.

The developed economies must take the lead in cutting emissions. They must also fund the transfer of knowledge needed to help the rest of the world to grow their economies and to adapt to the inevitable change in our climate already under way. No other approach will work.

Breaking our addiction to fossil fuels and investing in green technologies will also help us deliver energy security, jobs, prosperity and economic growth.

This will require robust and inclusive global economic, financial and political institutions. We need fundamental reform to involve a far wider range of countries and voices in decision-making. Without this, the solutions reached will neither match the scale of the problems nor have the legitimacy to be effective. As the woeful international response to the conflicts in the Middle East and elsewhere highlights, our structures are at present incapable of meeting the challenges of today, let alone tomorrow.

The new American administration gives us hope that, in all of these areas, progress can be made. But other governments and actors must play their part. At Davos, our business and political leaders must show they understand that our world has shifted for good and that we have to change with it or perish.

Kofi Annan, a former UN secretary general, is cochairman of the World Economic Forum's 2009 annual meeting. This Global Viewpoint article was distributed by Tribune Media Services.

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Davos and the spirit of mutual misunderstanding

John Gapper

This was not the week to be seen in Davos and, if you were there, it was not the time to remain calm.

Despite the blue skies in the Swiss skiing resort, the World Economic Forum's annual meeting, usually a feelgood festival of political leaders and chief executives vowing to work together to solve the world's problems, was distinctly fractious.

The audience cheered in one debate when Nassim Nicholas Taleb, author of *The Black Swan*, said it was time to punish bankers by forcing them to hand back bonuses. Vladimir Putin, the Russian prime minister, angrily swatted down Michael Dell, the head of Dell Computers, over the latter's impertinent suggestion that Russia needed technological help.

Finally, Recep Tayyip Erdogan, Turkey's prime minister, walked out of a debate with Shimon Peres, president of Israel, saying he had been given insufficient time to reply to Mr Peres's remarks about Gaza. Mr Erdogan, who was met on his return to Turkey by cheering crowds, said Mr Peres talked to him "in a manner not in line with ... the spirit of Davos".

The Davos spirit, along with others, is usually imbibed freely by those who journey to Switzerland for a few days of debates and parties. Klaus Schwab, a German-born professor, has fine-tuned a genial event at which executives can mingle with, and lobby, presidents and prime ministers. Occasionally, Davos is a venue for concrete action. Turkey was party to one of Mr Schwab's proudest moments – the 1988 Davos Declaration between Turkey and Greece that helped to avert war. Mostly, however, it is a place where good intentions are expressed and antagonists turn into panellists.

So it was a pale-faced and shaken Professor Schwab who called a snap press conference on Thursday evening with Mr Erdogan to calm things down. "We always hope for the Davos spirit, a spirit of mutual understanding. It is a positive spirit, a constructive spirit," he said, in the manner of one whose hopes have been dashed.

He should not have been surprised. The WEF had an impossible task this year – to forge harmony out of tension, particularly over the financial crisis and how the world can recover from it. Instead, Davos became the place where the pent-up dismay and anger over what Wall Street wrought boiled to the surface.

A lot of bankers were not there to hear themselves being blamed for the economic crisis. Lloyd Blankfein, chief executive of Goldman Sachs, stayed away and cancelled the investment bank's usual party. Bob Diamond, president of Barclays, had been due to co-host a mountain-top dinner for clients but decided at the last minute to remain at home.

The star turns this year were the seers who warned of economic downfall. As well as Mr Taleb, Nouriel Roubini, a New York University economics professor, sat on many panels to warn that the worst is yet to come for the global financial system. The absence, or low profile, of bankers left little to counteract this pessimism. Some were in town – Jamie Dimon, chief executive of JPMorgan Chase, gamely held a party – but they were no longer dominant voices. Josef Ackermann, chairman of Deutsche Bank, humbly moderated a panel of central bankers, the new masters of the financial universe.

This year's forum showed what happens when the world economy ceases to finance global co-operation and goodwill

Apart from the bankers, the other absentees were members of Barack Obama's new administration. The only official representative was Valerie Jarrett, Mr Obama's friend and amanuensis, who made a boilerplate speech promising a new era of US leadership and co-operation without providing many details. The words were fine but the accompanying action – a near-boycott of Davos – was less reassuring.

The gap was quickly occupied by Russia and China, with combative appearances both from Mr Putin and Wen Jiabao, the Chinese premier. Mr Putin took a deliberate jab not only at Mr Dell but Americans in Davos last year who had "emphasised the US economy's fundamental stability and cloudless prospects".

Beneath the verbal sparring, the week exposed some big obstacles to the stated aim of many speakers – to ensure that the world tackles the economic crisis together, rather than being drawn into a repeat of trade protectionism in the 1930s. That brought the Smoot-Hawley Tariff Act of 1930 but the problem now is more one of capital than trade.

Last year in Davos, it seemed that co-operation – in the form of sovereign wealth funds from Asia and the Middle East voluntarily investing in troubled western banks – could save the system. This year, less wealthy countries fretted that the US will instead use *force majeure* to soak up capital. It will print Treasury bonds to finance its banking bail-out and its fiscal stimulus.

Meanwhile, financial globalisation is under threat. The US government may push bailed-out banks such as Citigroup to sell overseas operations to raise capital and Gordon Brown, the UK prime minister, has attacked banks such as Royal Bank of Scotland for taking UK deposits and using them to lend overseas.

Thus, the spirit of financial co-operation is running low, which accounts for the short supply of Davos spirit. This year's forum showed what happens when the world economy ceases to finance global co-operation and goodwill.

In theory, the forum is the place where jaw-jaw replaces war-war and the global elite finds a way to get along. In practice, there was little that a pleasant get-together in the Swiss mountains could do to help.

No wonder Prof Schwab looked so stricken.

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MALAYSIA

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Malaysia coalition loses election

Opposition support shows threats facing region's incumbents

By James Hookway

KUALA LUMPUR—Malaysia's ruling coalition lost a key parliament by-election on Saturday, underscoring the dangers faced by incumbent governments in Southeast Asia as their export-dependent economies begin to absorb the full impact of the global slowdown.

The vote in Kuala Terengganu, a predominately Muslim city on peninsular Malaysia's east coast, dealt a setback to Deputy Prime Minister Najib Abdul Razak, who is expected to take over as the country's leader in March.

Mr. Najib had orchestrated a high-profile campaign on behalf the government's candidate, hoping to demonstrate his political clout with a victory.

Instead, the opposition coalition showed it still commands considerable voter support after racking up unexpectedly strong gains in a national parliamentary election last March.

Parti Islam Se-Malaysia, or PAS—part of the country's strengthening opposition alliance—took 51% of the votes cast, as ethnic Malay and ethnic Chinese voters switched support from the National Front to the Muslim party to signal their frustration with the government.

PAS politician Mohammed Abdul Wahid Endut won by 2,631 votes in a battle which saw a turnout of almost 80%.

Incumbent governments elsewhere in the region are under pressure. In Thailand, where a prolonged political crisis last year paralyzed policy-making, Prime Minister Abhisit Vejjajiva's shaky new coalition government, which was formed in December, must now struggle with an economy on the brink of recession as opposition parties loyal to former Prime Minister Thaksin Shinawatra try to destabilize it.

In the Philippines, where elections are due in 2010, prospective presidential candidates are already distancing themselves from President Gloria Macapagal Arroyo. Political analysts there say her deputy, Vice-President Noli De Castro, is likely to run as an independent rather than representing Ms. Arroyo's party.

The Malaysian economy is also in trouble. The government says gross domestic product could grow 3% this year, but many private sector economists are less optimistic. Citigroup Global Markets says GDP is likely to expand just 0.5% in 2009. Demand for Malaysia's biggest manufactured export, electronics components, is slumping and prices have fallen sharply for oil, natural gas and palm oil, the country's biggest commodity exports.

At the same time, race-based politics continue to play a pivotal role in this country of 27 million people. Since independence from Britain in 1957, many of Malaysia's ethnic Chinese and Indians—who collectively make up more than 30% of the population—have mostly lent their support to the National Front coalition led by the United Malays National Organization, the dominant party of the country's Muslim ethnic Malays.

But as the economy slows, many non-Malay voters are tiring of a decades-old affirmative action policy designed to help the majority ethnic Malay population catch up economically with the generally wealthier ethnic Chinese community.

"Chinese voters are now giving up on the government. They've had enough," says James Chin, a political science professor at the Malaysia campus of Australia's Monash University.

In last March's national elections, many minority voters as well as a significant number of ethnic Malays switched their support to an opposition alliance led by former deputy prime minister Anwar Ibrahim.

The coalition's main components are Mr. Anwar's People's Justice Party, the Chinese-based Democratic Action Party and PAS, the Islamic party.

As a result, the National Front lost its long-held two-thirds majority in Malaysia's parliament, effectively forcing Prime Minister Abdullah Ahmad Badawi to accelerate a handover of power to his deputy, Mr. Najib.

Mr. Najib, 55 years old, is expected to take over as premier in March after he formally wins election as UMNO party president, a post for which he is running unopposed.

The British-educated son of Malaysia's second prime minister, Mr. Najib campaigned hard in the Kuala Terengganu by-election to fill a parliamentary seat held by a National Front member of parliament who died last year.

After Saturday's defeat, Mr. Najib tried to play down the importance of the election loss for the government. "Of course, this is a setback for us," he told reporters, but added that "We will not be disheartened by the result."

Independent analysts predicted that the National Front's recent decline could continue. Although Mr. Najib doesn't have to call another national election until 2013, his rival, Mr. Anwar, is working on convincing at least 30 government lawmakers to defect to the opposition in order to take control of Malaysia's 222-seat parliament.

"The slide continues," said Khoo Kay Peng, an independent political analyst and consultant. "The National Front should count its blessings for not losing by a bigger majority."

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Malaysia's Islamists weaken coalition

By John Burton in Singapore

A crucial opposition by-election victory has delivered a big setback to Malaysia's National Front government raising new challenges for Najib Razak, the incoming prime minister, as he prepares to take over in March.

Anwar Ibrahim, the opposition leader, said the victory will strengthen his efforts to topple the government this year as the ruling coalition's slim parliamentary majority shrinks.

The Islamic Party of Malaysia (Pas), one of three parties in the opposition alliance, won the by-election in the state of Terengganu by a strong margin, taking the seat away from the government.

The result could influence local elections scheduled for this year in the state of Sarawak, which holds the balance of power in the National Front government.

A government setback in Sarawak could trigger defections by its parliamentary members to the opposition, posing a threat to Mr Najib's survival.

Sarawak and its sister Borneo state of Sabah have complained of being neglected by the central government. The two states have 42 seats in the 222-member parliament, in which the government holds a 27-seat majority.

Mr Najib played down the the idea that the by-election was a referendum on public support for the government, which suffered its worst electoral setback in national elections last March since taking power at independence in 1957.

Terengganu is an important swing state and is seen as a barometer of political sentiment among Malaysia's ethnic Malay majority, which makes up the vast majority of the state's population. The polls revealed a big shift in the Malay vote to the opposition.

An erosion of support among Malays for the government would probably doom it. Malaysia's ethnic Chinese and Indian minorities generally support the opposition.

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Winning in Malaysia

Malaysia's opposition coalition won another parliamentary seat in a by-election Saturday. It's yet another warning to the ruling United Malays National Organization that voters want a change.

Saturday's poll in Kuala Terengganu was held in Terengganu, a Malay-majority region and traditional stronghold of Parti Islam se-Malaysia (PAS). That party lost the seat in 2004, but regained it in Saturday's by-election. The candidate, Mohammed Abdul Wahid Endut, campaigned on a platform promoting Shariah law and fighting corruption. The ruling UMNO campaigned on a more secular platform and promised old-style UMNO populist spending to create jobs. PAS won Saturday's election by 51.9% to 47.7%.

The victory can be seen as a referendum less on Islamic law than on the ruling party, which has lost popular support over its perceived corruption and handling of the economy. It is a blow, too, to the aspirations of Deputy Prime Minister Najib Razak, who campaigned heavily for the UMNO candidate.

The win also exposes the tensions inherent in Mr. Anwar's coalition, which includes his People's Justice Party, the mostly Chinese Democratic Action Party, and PAS. Although all parties pitched in to help PAS win on Saturday, Mr. Anwar has said repeatedly that the opposition supports moderate Islam. That rubs uneasily with PAS's pro-Shariah platform.

The opposition coalition is still 52 seats short of a majority in Parliament, though Saturday's win brought it one seat closer. In Parliament and in future polls, Mr. Anwar would do well to focus his efforts on the broad-based issues that mattered in Kuala Terengganu—corruption and economic liberalization—rather than PAS's Islamic bent. That's a winning formula for all of Malaysia.