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May the good China preserve us

*China is enjoying its new prestige as a global economic helmsman,
but it still has problems at home*

THE sense that someone else's loss is your gain, leading even to rejoicing at their disaster — *xing zai le huo* — is as hard-wired into the Chinese psyche as anywhere. Honed by American policymakers' past fondness for hectoring China about the need for better risk-management and exchange-rate flexibility, this emotion has come to the fore since the United States was overtaken by financial calamity. China's leaders are at pains to show their increasing sophistication, so public dancing around the corpse of the American financier is frowned upon. But many Chinese think their country is having a rather good crisis.

The realisation first reached a wider Chinese audience in early April, at the time of the G20 summit in London. There, President Hu Jintao was seated in the front row of the official photograph, next to Britain's prime minister, Gordon Brown. Among the country's elites, triumphalism found its clearest expression later in April at an ebullient Bo'ao forum, China's annual answer to Davos. There, one high official dismissed the G20, dominated by Western powers, as all hat and no cattle. Talk of a "new world order" was in the air, with China at its heart.

So much for Deng Xiaoping's dictum that China should keep a low profile and "never take the lead". The international financial crisis has become a kind of induction ceremony for China as a world power, which will go through another ritual when Timothy Geithner, America's treasury secretary, pays tribute in Beijing next month. Zbigniew Brzezinski, ex-President Jimmy Carter's national security adviser, has proposed a new "G2", where America and China get together to tackle the financial crisis, climate change and more. China has plenty of reasons not to want such a condominium, but is chuffed that Americans are talking about it. Nor does it mind if others believe it is happening anyway.

Late last year China pulled out of its annual summit with the European Union because France's president, Nicolas Sarkozy, was to meet the Dalai Lama. It agreed to renew high-level relations with the EU only after France grovelled. So this week China's prime minister, Wen Jiabao, travelled to Prague for a reconvened EU summit, with an agenda gutted of anything that might embarrass China. Just before it, David Miliband, Britain's foreign secretary, spoke to the Guardian, a British daily, with something of the fervour of a miracle-watcher. China was an "indispensable power". At the G20 in April, "what was striking was that when China spoke, everybody listened." And he quoted a joke: "After 1989 capitalism saved China. After 2009 China saved capitalism."

China has been doing its bit to act the part. It has blessed the IMF with a promise of \$40 billion of its money. It has been signing up "swap" agreements with central banks from Indonesia's to Argentina's giving them access to billions of dollars-worth of Chinese yuan in a crisis. It has encouraged experiments with an inchoate offshore market in yuan in Hong Kong. And its central-bank governor has talked loftily of the need to replace the dollar as the world's reserve currency with something like the IMF's Special Drawing Rights (SDRs).

So far, however, all this smacks of political posturing. Since most Chinese exporters invoice in dollars it is hard to see who would want all those yuan anyway. China seems in no hurry to move towards full convertibility of the yuan and greater exchange-rate flexibility. And the talk of ditching the dollar comes oddly from a country that has done little to diversify its own massive holdings of foreign exchange. Raising the issue when it did seemed more designed to make a splash and change the subject at the G20 away from anything that might embarrass China.

In public, most Chinese leaders scoff at the idea that their own policies might have contributed to the crisis. They blame over-indebted American consumers going on an unsustainable binge, leading to a gaping American trade deficit. Yet the counterpart is an unsustainable Chinese export drive, to America above all, that was built on a cheap currency. The dollars earned from the drive went flooding back to America, pushing down interest rates there, raising house prices and encouraging Americans to borrow even more to buy Chinese stuff. As Nicholas Lardy, an American economist specialising in China, has put it, the two countries were as co-dependent as a dope-dealer and an addict.

RESTOKING THE OLD FIRES

Now, with the American consumer laid up indefinitely, the world has turned to China to take up the slack. A country with so many factories geared to exports has its own reasons for wanting to boost domestic demand. So the government acted swiftly late last year to unveil a \$586 billion spending package. A notable economist says it sets the fiscal-stimulus “gold standard”.

It does, however, bring some problems. For one thing, some of the money is being spent subsidising Chinese exports. This worsens the overproduction at the heart of the crisis. And much of the rest is going on state-driven projects, reinforcing the state’s rent-seeking or megalomaniac proclivities. By contrast, household demand is not getting any real long-term boost, despite a few notable initiatives, including better health care. Indeed, demand is depressed precisely because household savings are being funnelled by the state banks, paying measly rates of return on deposits, to big companies. Loans to small businesses have actually fallen.

If domestic demand is to grow, then finance has to be liberalised to allow savers to earn an honest return and deserving companies to get finance. But this would be to challenge the state’s chief powers, which is why it will happen only slowly, if at all. In the short run, the government may either tolerate the speculative fires the stimulus is igniting, or douse them by tightening credit. Either way, China’s leaders will be too busy saving China to bother about running the world.

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