Beijing hesitates at the global threshold
Geoff Dyer

This really should be China's moment, Burting with confidence after the summer Olympics, when it dominated the gold medals and presented an image that blended modernity with tradition, the country should be facing the global financial crisis with more assurance than pretty much anywhere else in the world.

While many countries are watching their currencies and companies slump, China's public finances look robust and the local banks, walled off from international capital and monitored by an overbearing regulator, avoided the obvious excesses of the past decade. At a time when capital is sorely sought-after, China has the largest pool of foreign currency reserves in the world and a procession of companies eager to make their mark in the world.

With the US budget deficits now counted in trillions of dollars rather than billions, this should be one of those moments when the shift of power from west to east gathers pace. "When a country gets into such large debt, it is very likely to lose a lot of its political power too," said the chief executive of a European multinational on a recent visit to China.

Yet within China, the triumphalism of the Olympics has quickly disappeared. China may be better placed than most, but the global financial crisis has started to hit the country hard and jolted its confidence. Sustained high growth is a central part of the pact that keeps the Chinese Communist party firmly in control, yet China's growth model is now facing close scrutiny. Meanwhile, its leaders have so far been tentative in global discussions about the crisis rather than trying to play the larger leadership role that many had expected them to seek. The inexorable rise of China has not been derailed, but the crisis has made it seem more hesitant.

The main reason for the new uncertainty is the economy, which is facing its toughest challenges since the Asian financial crisis a decade ago. The post-Olympics hangover has turned out to be a serious one -through September and October the economy slowed sharply, prompting economists to slash forecasts for next year's growth. In one particularly alarming indicator, electricity production -often a proxy for economic activity - fell 4 per cent in October from the year before.

China's slowdown has so far been homegrown. After five years of double-digit growth, the government was worried about a potential bubble in the housing market and overcapacity in a string of industrial sectors that had seen a gush of investment, as well as rising inflation. As a result, the authorities decided to squeeze new bank credit.

The problem is that this adjustment has begun to bite just as the international financial crisis started to hit the economies of China's main trading partners. Weaker domestic demand is now being contaminated by a more sluggish export performance, which will mean that the tales of export factories in southern China shutting their doors are likely only to increase.

The government has responded in textbook fashion, unveiling what appears to be a massive fiscal stimulus package. Even if the eventual size of the spending boost is unclear, Beijing has signalled it will use its financial firepower to prevent a broader slump.

Many large companies operating in China remain optimistic that the economy will emerge relatively unscathed from the crisis. Some executives argue that the recent slowdown could be because companies are over-reacting to new uncertainties, which could lead activity to swing back once some form of confidence returns.

"Overall, China is well-placed for the slowdown as long as there is not a big increase in anti-free trade rhetoric," says Richard Yorke, chief executive of HSBC in China.

Yet the fear among some observers is that the global crisis has exposed deeper structural problems in the economy that cast doubt on the durability of China's growth model.

For the past five years, government officials have admitted that the economy cannot keep relying on exports and set-piece investment projects to propel high growth rates and needs instead to stimulate more domestic consumption. Yet several years later, they have not managed to bring about this shift - indeed, while China ran a current account surplus in excess of 10 per cent of GDP last year, consumption in recent years has played an ever smaller role in the economy.

Given that both exports and investment have been wounded, the financial crisis has reinforced the need to move away from dependence on these two growth engines. Yu Yongding, an economist at the Chinese Academy of Social Sciences and a long-time supporter of measures to boost consumption, says the slowdown is an opportunity to change the structure of the economy.

"We need to make up our own minds to push in a more forceful way to achieve the objective rather than make many compromises," he says. "If we do not carry it out now, we will pay a higher price in the future."

The shift is not an easy one. Improving rural healthcare and pensions would be one way to encourage people to save less and consume more, however Beijing worries that any increased funding will simply be snapped up by cash-strapped local authorities. Chinese savers get near negative real returns on their bank deposits, yet boosting real returns, which would liberate new funds for consumption, would put huge strains on a still inefficient banking system.

Modifying the model will also require changes in political culture. If the authorities want to encourage greater innovation in companies or give greater priority to consumers over producers, they will also have to adapt their style of governance - less top-down planning and more light-touch regulation.

"The governance challenges China confronts today are as daunting as any seen since reform began in 1978," says Daniel Rosen, a China expert at consultants Rhodium Group.

The sense of uncertainty at home in the wake of the global financial meltdown has been mirrored by a cautious approach in international affairs. Ahead of this month's G20 summit in Washington to discuss the crisis, there was considerable speculation that China . would use the forum to demonstrate stronger leadership in international affairs that reflected both its new economic clout and its near $2,000bn in reserves.

In the event, China played a low-key role in the proceedings and President Hu Jintao emphasised that its main role in global efforts to overcome the crisis was to maintain a strong domestic economy.

Chinese officials may privately complain about the US government's profligacy, but they also recognise that being one of the largest holders of Treasury bonds does not bring as much leverage as might appear at first sight. China has little choice but to keep buying more US securities because a collapse in bond prices and the dollar would also have a huge impact on China's dollar holdings and its own economy - a situation Lawrence Summers, former US Treasury Secretary, called "the financial balance of terror".

The discreet approach in the talks also reflected the inherent caution of the current generation of Chinese leaders, who are not comfortable throwing their weight around too much on the international stage. "China's leaders will give a little more than a little but they will also only ask for a little," says Shi Yinhong, a foreign policy expert at Ren-min University in Beijing. "People say this crisis is some kind of golden chance for China but it is not clear that China will be able to use the opportunity."

Fonte: Financial Times, London, November 24 2008, Special Report China, p. 1.