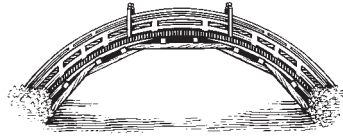


POLICY Q&A

China, the Financial Crisis, and Sino-American Relations



An interview with

Pieter Bottelier

Adjunct Professor of China Studies, Johns Hopkins University

The current global financial and economic crisis is among the most severe in modern history. The follow-on effects of the crisis, which largely originated in the U.S. mortgage market, have had an impact on the export-oriented economies of Asia, including China. Compared to the other major economic powers of the world, however, China is emerging strongly and quickly. These changing economic realities have raised a host of questions concerning the future of the international monetary system, the rise of China, and the future of U.S. hegemony in the Asia-Pacific.

This Q&A presents an interview by *Asia Policy*'s editor, Andrew Marble, with Pieter Bottelier, senior adjunct professor of China Studies at Johns Hopkins University, on the impacts of the financial crisis on China and examines the implications for China's foreign policy and global status.¹

This Q&A is divided into two sections:

- ≈ pp. 123–26 examine the economic crisis and the Chinese response
- ≈ pp. 126–29 address China's role in the new post-crisis world

¹ This Q&A draws from Pieter Bottelier, "China and the International Financial Crisis," in *Strategic Asia 2009–10: Economic Meltdown and Geopolitical Stability*, ed. Ashley J. Tellis, Andrew Marble, and Travis Tanner (Seattle: National Bureau of Asian Research, 2009), 71–102, as well as from notes from Mr. Bottelier's presentation at the Strategic Asia book launch events held in September 2009. NBR Research Fellow Jared Bissinger provided invaluable assistance with this Q&A.

THE ECONOMIC CRISIS AND THE CHINESE RESPONSE

Andrew Marble: *The financial crisis has been the most severe the world has felt since the Great Depression. How has the crisis affected the Chinese economy?*

Pieter Bottelier: The international financial crisis hit China and the world immediately after the collapse of Lehman Brothers in September 2008, when China's growth had already been trending down strongly for over a year. The downward trend was the result of domestic measures aimed at cooling the overheating economy (starting in the third quarter of 2007) and at fighting urban real estate bubbles. Toward the end of 2008, China's month-on-month growth had fallen close to zero for the first time in decades. Entering 2009, China's economy was essentially stagnating, but there was hope that a rebound could be engineered relatively quickly. In March the World Bank predicted 6.5% growth for the year as a whole. Thus, though the crisis has been painful, particularly in terms of declining exports and unemployment, China has been weathering the economic storm fairly well.

Marble: *How did the Chinese government react to the crisis?*

Bottelier: Once the government realized how serious the crisis was, it took swift and decisive action. In early November 2008, Beijing announced plans for a major economic stimulus program and began preparing many other measures to counter the socio-economic effects of the recession.

Marble: *Stimulus programs can often incorporate different elements. Can you provide more details on the actual make-up of the Chinese stimulus plan?*

Bottelier: Although it was presented as a fiscal stimulus program, it turned out to be more monetary (i.e. credit expansion) in nature than fiscal. By my calculations, the ratio of monetary-to-fiscal stimulus spending so far has been roughly 85 to 15. The stimulus program was supported by a wide range of administrative measures, including job retraining programs.

Marble: *Was China's rebound primarily the result of the fiscal or monetary aspects of the stimulus?*

Bottelier: The astonishing rebound was primarily the result of massive credit expansion—7.4 trillion renminbi during the first half of 2009, three times as fast as in the first half of 2008—to finance government-sponsored investment

in such projects as inter-city high speed rail, urban subways, affordable housing, water and waste-water works, new airports, state-owned enterprise (SOE) plant modernization, rebuilding of raw material stocks, and the like. Relatively little additional credit was allocated to expand manufacturing capacity. On the fiscal side there was significant additional spending for health care, social security, job programs, and subsidies for the purchase of durable consumption goods, from tractors to televisions.

Marble: *China's stimulus, to date, has been relatively successful. To what do you attribute this success? For instance, were there strong fundamentals in the Chinese economy that contributed to the success of the stimulus?*

Bottelier: China was in a strong position to launch its stimulus program and the program was highly effective for the following reasons:

- Because the economy was not overleveraged, as in the United States, all stimulus spending immediately translated into incremental aggregate demand; thus, there was no need for deleveraging or for increasing private savings.
- The government's overall fiscal position was very strong.
- After 10 years of intensive reforms, Chinese banks were in good shape and had ample liquidity.
- The government, at all levels, had much relevant experience with stimulus programs from the years following the 1997–98 Asian financial crisis.
- The interests of the central government and local governments were well-aligned.

Marble: *How has China's economy performed in the year that has passed since the stimulus program was launched?*

Bottelier: China's economy has emerged from the crisis with an impressive rebound that is now beginning to turn into a broad-based recovery. Year-on-year growth during the first three quarters of 2009 was 7.7%, in spite of a negative net-exports contribution to growth of 3.6 percentage points. Quarter-on-quarter growth rates tell an even more dramatic recovery story, from almost zero growth in the fourth quarter of 2008 to about 15% in the second quarter of 2009 and about 10% in the third.

Marble: *What is the likelihood that the current, stimulus-induced growth pattern that has spurred this recovery will continue?*

Bottelier: At this point, growth remains heavily dependent on stimulus-induced investment, which is clearly not sustainable, but in the third quarter of 2009 we are seeing more and more indications of a broader-based recovery. Nonstate investment began to pick up significantly, the property sector is booming again, and consumer confidence has returned as business confidence is rising. Credit expansion slowed after June 2009. Consumer demand remains surprisingly strong.

Marble: *What could happen if China does not adjust its stimulus spending?*

Bottelier: The enormous credit expansion since December 2008 not only has financed state-sponsored investment but also has led to excess liquidity in the corporate sector and in the economy at large. Excess liquidity contributed to rapid increases in land and urban real estate prices in some cities, to increased (unsupervised) financial intermediation in gray money markets at higher rates of interest, increased speculation in the stock market, and increased corruption. If non-financial enterprises with excess liquidity can profit from financial operations more easily than in their core business, there is a risk that a corporate-based shadow banking system will develop, as happened in the United States in pre-crisis years. In China's one-party political system, however, the government has regulatory and administrative control instruments—largely through the Chinese Communist Party and the Ministry of Personnel—that the United States lacks.

Marble: *Does the Chinese government recognize that its growth model of recent years is not sustainable? If so, how is China addressing these structural challenges facing its economy?*

Bottelier: China needs to reduce dependence on growth in exports and manufacturing investment. The need for significant structural reforms in its economy is clearly recognized by Beijing and requires changes both on the demand side and on the supply side. A lot of remedial measures are being put in place at both ends. China is significantly increasing budget spending on social sectors—especially health, social safety nets, and pension reform, significantly—and is promoting rural and urban consumption growth through a wide range of budget-financed subsidies. The problem with consumption in China was not that growth has been slow—China was and is the world's fastest-

growing large consumer market—but that GDP grew even faster, causing the consumption/GDP ratio to fall to a very low level (under 36% in 2007). On the supply side, the government has ordered large-scale restructuring plans for major industrial sub-sectors such as steel, non-ferrous metals, automobiles, plate glass, chemicals, cement, and textiles, but implementation of such plans will be difficult because of likely opposition from vested interests. The export lobby, which includes many local governments in eastern provinces, and industry groups have considerable power.

Marble: *Is the increasing role of the government in the economy in any way slowing or even turning back China's larger economic reforms launched in 1978?*

Bottelier: The role of the state in China's economy has certainly increased in the aftermath of the crisis, as it has in the United States, but there is no indication that China is fundamentally rethinking market reforms. In my opinion, reforms will continue, with delays in some areas. Even in the financial sector there is evidence of continuing reforms, but with even more emphasis on the need for stricter regulatory controls than before. Perhaps the greatest challenge that lies ahead for China is on the supply side in manufacturing. The excess capacity problem is serious in many industries. The government may be tempted once again to export its way out of this problem, which would lead to additional trade frictions with the United States and other trading partners.

CHINA IN THE NEW POST-CRISIS WORLD

Marble: *You have discussed how the Chinese economy is recovering from this severe recession by the effective implementation of a timely stimulus plan. By comparison, the United States and most other Western economies have continued to languish in recession or show only little growth despite their own stimulus plans. These divergent responses to the economic crisis are changing the geopolitical landscape not just of East Asia but of the world. How has the crisis affected China's leadership position in world economic and political affairs?*

Bottelier: The crisis is changing the international economic and political landscape in important ways. The crisis and its aftermath will almost certainly accelerate China's economic and political rise and enhance its prestige in the developing world. It is also likely that China will be more inclined to

exercise global leadership in the economic and financial arena. In contrast, U.S. credibility in the economic and financial area has suffered significantly as a result of the crisis. China now prides itself on not having followed U.S. advice to accelerate financial sector reform and opening. Moreover, China and other emerging market economies will intensify their search for alternative models of economic organization and management. Beijing will, for instance, promote the international use of the renminbi as a settlement currency while at the same time pushing for international monetary reform. Additionally, China will try to reduce dependence on Western consumer markets while promoting South-South trade. The country will also step up investment in the resource-rich economies of Africa, Latin America, Australia, and Canada.

Marble: *You mentioned two points in your last answer, the use of the renminbi as a settlement currency and international monetary reform. In terms of international monetary reform, the crisis has eroded U.S. economic and financial credibility and opened the door for China to push for these reforms. What are the major Chinese interests and concerns motivating such demands?*

Bottelier: China's lack of confidence in U.S. fiscal and monetary policies is the main factor underlying a proposal by Central Bank governor Zhou Xiaochuan to reform the international monetary system. The essence of this proposal is to modify the International Monetary Fund's (IMF) existing special drawing right (SDR) by broadening the SDR's currency base and turning it into an international reserve currency backed by real assets. This proposal would enable the new SDR to also be used as transaction and settlement currency within and between countries.

Marble: *How are these proposals for reform being received by the rest of the world?*

Bottelier: China's SDR reform proposal has met with considerable international interest in principle, except in the United States, where the proposal is mainly seen as an effort to undermine the status of the dollar as the world's premier reserve currency.


Marble: *In terms of the renminbi, how is China pushing for a more important role for its currency in the international financial system?*

Bottelier: In the wake of the international financial crisis, China has begun to encourage the use of the renminbi as an international settlement currency. Beijing has extended lines of credit in renminbi to a number of countries and concluded local currency swap agreements with South Korea, Malaysia, Indonesia, Belarus, Argentina, and Hong Kong. On May 18, 2009, during a visit to Beijing by President Luiz Inacio Lula da Silva of Brazil, the two countries announced they would work out an agreement making it possible for importers in either country to pay for exports from the other in its own national currency. This announcement is perhaps the clearest indication so far of the intention of both China and Brazil to promote South-South economic relations and reduce dependence on the U.S. dollar. An early indication that the renminbi may have a limited role as reserve currency—even before full convertibility has been achieved—was a recent announcement by Malaysia’s central bank that it might include renminbi-denominated assets in its foreign exchange reserves.

Marble: *China is emerging from the economic crisis with greater economic and political credibility, giving Beijing more latitude to push for the aforementioned changes in the financial system that would come largely at the expense of the United States. How do you see the crisis changing the Sino-U.S. bilateral relationship?*

Bottelier: The crisis has both changed the way that China perceives the United States and sensitized the United States to the realities of financial and economic codependence with China. A positive outcome of the crisis could be a more relaxed and constructive bilateral relationship, as Beijing begins to feel more Washington’s equal. China realizes that it cannot benefit from a weak U.S. economy and will continue to take the Strategic and Economic Dialogue and other bilateral forums for dialogue very seriously. Less defensiveness and greater self-confidence on China’s part may make it easier for the world to achieve results in difficult negotiations on bilateral and critical global governance issues, such as climate control. But reduced respect for the United States could lead to new tensions, especially if Beijing’s greater self-confidence is perceived in Washington as arrogance. The United States must continue to accommodate China as a rising power, in part by intensifying and expanding the bilateral dialogue with China, as agreed upon between Presidents Obama and Hu at the April G-20 summit.

Marble: *Several observers of the Sino-U.S. relationship have argued that China's influence is so great that a G-2 (group of two) of global governance between the United States and China is needed. How have Chinese leaders reacted to these calls?*

Bottelier: China rejects the notion of a G-2-type relationship with the United States but at the same time recognizes that the resolution of many global governance problems requires good bilateral relations with the United States. China seems more inclined to reduce dependence on the United States, develop South-South economic relations, and emphasize the importance of Europe as a possible example for economic and currency cooperation in Asia. 

Pacific Affairs

An International Review of Asia and the Pacific

Isn't it time to subscribe?

Do you need to know more about current affairs in Asia and the Pacific? We offer up-to-date and in-depth analyses of the most important issues.

Time-Space Punctuation: Hong Kong's Border Regime and limits on Mobility - Migration and Mobility.
By Alan Smart and Josephine Smart

~

Mongolia: Transmogrification of a Communist Party.
By Morris Rossabi

~

The Communist Party and Financial Institutions: Institutional Design of China's Post-Reform Rural Credit Cooperatives.
By Lynette Ong

India in the Indian Ocean: Growing Mismatch between Ambitions and Capabilities.
By Harsh V. Pant

~

The Attitudes of Urban Chinese Towards Globalization: A Survey Study of Media Influence.
By Francis L.F. Lee, Zhou He, Chin-chuan Lee, Wan-Ying Lin and Mike Yao

~

Does the President's Popularity Matter in Korea's Local Elections?
By Byung Kwon Song

Published Quarterly:

Annual Subscription Rates - Vol 82*

Print & Electronic- Individuals \$ 150; Institutions \$ 260

Print or Electronic- Individuals \$ 100; Institutions \$ 205

Surface Postage included - Add \$35 for Airmail

*For Subscribers Outside Canada - Rates are in U.S. Dollars or equivalent funds

10% Discount for a 2 year subscription

For more information please view our website: www.pacificaffairs.ubc.ca

Telephone: 604-822-4534 Fax: 604-822-9452

Celebrating 82 Years