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**Dealing with Economic Crisis in 2008-09:
The Chinese Government's Crisis
Management in Comparative Perspective**

[preliminary draft for discussion purposes]

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The original research for this paper was undertaken for a Bertelsmann Foundation project on “Comparative Crisis Management, 2008-09”. Thirteen major countries were examined in the pilot phase of this project. The country studies (including the study on China) are based on a structured comparison (analytical criteria and indicators are standardized across cases) with a focus on processes, interactions and instruments that are shaping stabilization and stimulus policies in large emerging political economies.

1. Risk Exposure on the Eve of Crisis Outbreak and Initial Impact on National Economy

1.1 Initial conditions: Economic structure and macro-economy

Prior to the economic downturn, China's economy showed many remarkable, in some regards even unique, features:¹

- In 2007, almost 43% of China's GDP was spent on gross capital formation. Private consumption with 35% was low even compared to other emerging economies², public consumption amounted to 13% of GDP.
- In line with the previous years, GDP growth of 13% was primarily driven by gross capital formation which accounted for 41% of GDP growth and net exports which contributed 20% to GDP growth.
- China with a trade dependency rate of 66% is a very open economy by international standards. However, in contrast to conventional wisdom, China is not overly dependent on foreign exports since net exports account for only 9% of GDP.

Over the last couple of years, China has increasingly been at the center of global imbalances: In 2007 its current account surplus of 372bn US\$ accounted for 11% of GDP (much more than Germany (7.5%) or Japan (4.8%) as the other two most important export countries) and in contrast to the 731bn US\$ current account deficit of the United States (-5.3% of GDP)³. In accordance with its role as a major merchandise exporter, China in 2007 was the biggest net exporter of capital (21% of all countries that exported capital in 2007)⁴. In addition, China is a country with one of the highest gross national savings rates (2007: 50% of GDP), with corporate and private savings contributing almost half of it.⁵

China's financial system is primarily bank-based. Bank lending with 85% is by far the dominant source for external funding while bonds (10%) and stocks (4%) only play a minor role.⁶

¹ Unless other sources are cited, the statistics for 2007 mentioned here are based on: National Bureau of Statistics of China, China Statistical Yearbook 2008; National Bureau of Statistics of China, Statistical Communiqué of the People's Republic of China on the 2008 National Economic and Social Development, Beijing February 26, 2009. For a broader background on the structural composition of China's economy see Eswar Prasad (2009), "Is the Chinese Growth Miracle Built to Last?", in: China Economic Review 20 (2009), 103-123.

² According to the World Bank private consumption as percent of GDP in 2007 was 50% in Russia, 48% in Brazil, 55% in India, 71% in Mexico. See World Bank, World Development Report 2009, Washington 2009.

³ For a description of China's contribution to the global imbalances see: Karen H. Johnson (2009), Gross or Net International Financial Flows. Understanding the Financial Crisis, Council on Foreign Relations Center on Geoeconomic Studies Working Paper July 2009.

⁴ Cf. International Monetary Fund, IMF Financial Stability Report 2008, 169.

⁵ On China's savings rate see Shikwa Jha/Eswar Prasad/Akiko Tereda-Hagiwara (2009), Saving in Asia and Issues for Rebalancing Growth, Asian Development Bank Economic Working Paper Series No. 162, May 2009.

⁶ Syetam Hansakul/Steffen Dyck/Steffen Kern (2009), China's Financial Markets. A Future Global Force?, Deutsche Bank Research, March 16, 2009, 4.

1.2 Initial conditions: Policy priorities prior to crisis ⁷

A main concern for the PRC government from 2005 well into 2008 was fighting inflation which stood at an average of 4.8% in 2008 (however more worryingly for the government, the prices for foodstuffs increased by more than 12%) and preventing economic overheating. Thus, its macroeconomic policy was characterized by the slogan of the “two preventions”, the monetary policy was contractive. During the summer of 2008 under the impression of the unfolding of the economic crisis the official policy line was changed to “safeguard growth and contain inflation”.

In a broader context, the Hu Jintao/Wen Jiabao leadership since taking over subscribed to the concepts of “harmonious society” and “scientific developmental view” recognizing that a more balanced economy was needed in the medium and longer term perspective. Therefore they initiated a number of measures that should improve the income situation of rural households (e.g. by abolishing the land tax), reform the social security systems and boost the hitherto neglected central as well as western provinces (by means of infrastructure investments). The 11th five-year plan (2006-2010) clearly reflects these broader goals.

The economic record of the government in the years before the crisis is impressive: The growth rate in the years 2000-2008 was an average of 9.8%. The official unemployment rate (registered urban unemployment only) was around 4%. Against the backdrop of its capital-intensive development path however, the economic boom did not translate considerably into aggregate employment growth.⁸ According to a widely shared rule of thumb, a growth rate of 7-8% is needed just to absorb the laid-off workers and graduates entering the labor force. The government expenditures for health and education represent only 18% of all expenditures which is less than in peer countries.

At the beginning of 2008 southern China was hit by the severest snow storms in a century, thereafter Sichuan and adjacent provinces suffered from a disastrous earthquake which caused 80.000 deaths and 124bn US\$ direct economic losses.

1.3. Initial conditions: Executive, fiscal and monetary capacities to respond to the downturn

The PRC's central government is politically and institutionally stable currently and has become more effective in getting its national economic policy priorities implemented in the last few years. Open political opposition and protest typically emerge from dissatisfaction with local government behavior in cases of corruption, illegal land seizures, pollution, and ethnic discrimination. Although social protests have increased in frequency (official PRC sources speak of 80.000 to 100.000 “mass incidents” per year) they are so far usually limited to single-issue protests and have not coalesced into a cross-regional movement. As far as the lim-

⁷ For a review of China's economic policy priorities prior to the crisis cf: Yao, Shujie/Chen, Minjia (2009), Chinese Economy in 2008: A Turbulent Year Amid the World Financial Crisis, Nottingham University China Policy Institute Briefing Series No. 47, February 2009.

⁸ According to Eswar Prasad China's impressive growth rate from 2000-2008 of almost 10% p.a. only induced a yearly growth in employment of barely 1%, by far the lowest compared to the rest of Asia. See Eswar S. Prasad (2009), Rebalancing Growth in Asia, Institute for the Study of Labor, Discussion Paper Series IZA DP No. 4298 July 2009, Table 2, 38.

ited polls reveal, the population's most pressing concern is the provision of better public goods (education, social security) and affordable housing.

As a result of China's contractionary fiscal policy from 2001-2007, the Chinese government is in a very good fiscal position to act: the fiscal balance as percentage of GDP in 2007 was 0.7%, its debt to GDP ratio was only 20%, the net external position better than that of most other emerging market economies. In addition, it holds the world's biggest forex reserves with 1531 bn. US\$ at year end 2007.⁹

China's monetary policy prior to the crisis mirrored its contractive fiscal policy. Therefore, in China as in most neighboring Asian countries there was far more policy space to switch to expansionary orthodox monetary measures than in Western economies.¹⁰ However, monetary policy in China shows some extraordinary features because of its currency policy and its political system.

Against the backdrop of China's quasi-fixed exchange rate, there is a controversial debate whether one can speak of an independent Chinese monetary policy in the first place.¹¹ Of central importance to the understanding of China's monetary policy are credit quotas set by the People's Bank of China vis-à-vis China's commercial, government-linked banks so as to control the country's loan growth. In the Chinese press the ongoing imposition and lifting of credit quotas following the central government's general policy line is referred to as a "back door" policy instrument as opposed to conventional and more transparent "market tools" (standard central bank instruments such as open market operations, changing policy rates or reserve requirements etc.). Thus in contrast to Western central banks, the PBoC's role consists less in directly providing or absorbing liquidity to the money market but in being a transmission belt between the government and the commercial banks so as to influence investment growth and the inflation rate.¹²

1.4 Initial conditions: Exposure to specific market and trade risks

As already mentioned above, China as a big country has an unusually high degree of trade openness that made it vulnerable to a sharp contraction in global trade. In 2007 and 2008 China was the world's second biggest exporter and third biggest importer. To make matters worse, China is part of Asian transnational production networks in which raw materials or semi-finished goods are shipped to China where they are processed to be delivered to the world market. Thus, China's export oriented parts of the economy would be hit by any downturn of imports from Asia and a fall from Western demand.

⁹ World Bank, China Quarterly Update June 2009, 9; International Monetary Fund, IMF Financial Stability Report 2008, 46.

¹⁰ C.f. Asian Development Bank, Asia Economic Monitor July 2009, 12.

¹¹ For a short yet concise discussion of this problem see Morris Goldstein/Nicholas E. Lardy (2008), "China's Exchange Rate Policy: An Overview of Some Key Issues", in: Morris Goldstein/Nicholas E. Lardy (eds.), *Debating China's Exchange Rate Policy*, Washington D.C.: Peterson Institute For International Economics, 4-9. As Morrison and Lardy stress, there is no definitive measure to resolve this controversy. All comes down to a judgment of whether China's capital controls are efficient and its sterilization policy can go on.

¹² For an assessment on the role of the PBoC see James Riedel/Jing Jin/Jian Gao (2007), *How China Grows. Investment, Finance, and Reform*. Princeton: Princeton University Press, chapter 8. For the Chinese differentiation between "market tools" and "back window" policy see Jingji Guanchawang (Economic Observer Online) August 17, 2009 "*Weilai huobi zhengce tiaozheng de san ge jieduan*" (Three Stages in the Adjustment of Our Future Monetary Policy) in: <http://www.eeo.com.cn/eeo/jjgcb/2009/08/17/147976.shtml> (accessed August 20, 2009); Caijing (Online) July 29, 2009 "Keen Eyes Fixed on China's Monetary Policy" in: <http://www.english.caijing.com.cn/2009-07-29/110215562.html> (August 20, 2009)

China's financial system has been often characterized as underdeveloped, "repressed" or "deep but not broad".¹³ This means that China's broad money (M2) with 160% of GDP and household deposits with 70% of GDP are much higher than in other East Asian countries. Most of investment comes from saving not borrowing. The financial system provides cheap capital (low real interest rates) to large companies, whereas small and medium sized private enterprises often have difficulties in finding the needed resources. The financial system also discriminates against households which face often negative interest rates on their deposits. Since 2000 there has been a strong growth in bank lending averaging 15% a year, thus outstanding loans have grown more than 200% in the period to the year 2008.

China had a clear comparative advantage when facing the onslaught of the 2008-9 crisis: The central government had been very cautious in liberalizing the market for financial derivatives. The financial system thus had only minimum exposure to the most risky ("toxic") financial products. Much of what had often been characterized as a bane of China's financial sector (limited share of foreign bank assets, segmentation of stock market, controls in portfolio investments, restricted licensing of "Qualified Foreign Institutional Investors") turned out to be a boon. In addition, starting from 2000 the central government has taken aggressive steps to recapitalize major banks, improve their corporate governance and strengthen banking supervision. Thus, despite some ongoing problems (profitability, insufficient risk management etc.), the Chinese banking sector can be judged to be in a far better position than is the case for most East European banking sectors.¹⁴

In the face of this characterization of China's financial sector, it is not surprising to learn that most Chinese policy advisers in 2007/2008 were not much worried about a US-style type of crisis spreading from the financial sector to the real economy. Quite on the contrary, their utmost concern was the defense of China's real economy, i.e. stabilizing output and employment.¹⁵

1.5 Initial conditions: Comparative – structural and policy – advantages/disadvantages

Although China was not directly involved in the Asian financial crisis of 1997/98 it nevertheless drew some of the same lessons as those affected most: reduce or limit the inflow of portfolio investment, hoard foreign exchange reserves, encourage a high savings rate. Using infrastructure investment was an important part in China's attempt to stimulate its economy after the Asian financial crisis. Under former Prime Minister Zhu Rongji a 200 bn Yuan stimulus package for ailing state owned enterprises was passed in 1998, followed by a 1 tn Yuan infrastructure investment in western China from 2000-2003.¹⁶

In battling the crisis, the Chinese government has distinctive mechanisms and means at its disposal that are rooted in the political system, such as a distinctive, and historically recurrent,

¹³ Barry Naughton (2007), *The Chinese Economy. Transitions and Growth*. Cambridge/Mass.: MIT Press, 449. On financial repression see Svenja Schlichting (2008), *Internationalising China's Financial Markets*. New York: Palgrave Macmillan; Riedel/Jin/Gao 2007 chapter 4.

¹⁴ See Maria Laura Lanzeni/Veronica Vallés (2009), *Antikrisenmaßnahmen der Schwellenländer. Die Spreu vom Weizen trennen*, DB Research Aktuelle Themen 455, August 13, 2009.

¹⁵ Zhang Zhichao/Li Wei/Shi Nan (2009), *Handling the Global Crisis. Chinese Strategy and Policy Response*. Working Paper Series, April 15, 2009; <http://ssrn.com/abstract=1377049> (August 5, 2009)

¹⁶ On the post Asian Financial Crisis Chinese stimulus see: Zheng Yongnian/Chen Minjia (2009), *How Effective Will China's Four Trillion Yuan Stimulus Plan Be?*, University of Nottingham China Policy Institute Briefing Series Issue 49, March 2009; Victor Shi "China Takes the Brakes off", *Wall Street Journal* July 22, 2009.

emergency mode of policy-making which is characterized by swift centralization of decision-making and acceleration of cross-sectoral policy implementation through Communist Party command and campaign mechanisms that extend to all major financial institutions and government-linked companies. The CCP hierarchy can therefore be used as a distinctive channel to communicate emergency decisions made by the central government and push these decisions through the administrative and economic system. In addition, and equally important, central and local government bodies are still familiar with procedures of investment and credit planning that date back to Maoist times and have been phased out only over the recent decade. Thus, as soon as there was the need to set a massive stimulus investment program on track as swiftly as possible, policy-makers and bureaucrats reverted to the entrenched administrative mechanisms stemming from command economy times.

1.6 Initial impact of economic downturn on economy

Given China's risk exposure situation as a pivot of Asian manufacturing networks, it is hardly surprising that China was hit fast and hard by the unfolding downturn.¹⁷ Its GDP growth rate shrank from 10.6% in the first quarter of 2008 down to 6.8% in the fourth quarter. Even the large state-owned companies under the supervision of SASAC that had not reported losses since 2002 suffered from declining profits of about 30% in 2008 and the first half of 2009.¹⁸

Whereas from January to October 2008 China still registered double digit growth rates in both exports and imports, thereafter exports and imports declined dramatically. In the first half of 2009 exports sank 21.8%, imports even 25.4%. Among the export sectors, China's technology and capital intensive exports were hit harder than the labor-intensive ones (textiles, shoes, toys). Foreign companies especially from Taiwan and South Korea dominating machinery and telecom equipment manufacturing simply closed down their factories in Southeast and Northeast China respectively. The speed and scope of this development came as a shock for Chinese policy makers.¹⁹

The trade surplus at the end of the first half of 2009 stood at 97bn US\$. China's net export which in 2007 contributed 2.6 percentage points to GDP growth now reduced its growth rate by almost 3 percentage points. Similarly, China's incoming FDI took a sharp downturn starting in October 2008 and in the first half of 2009 with 43bn US\$ were 18% lower than in 2008.

Less by China's making but as a result of collapsing commodity prices since the middle of 2008 China's main inflation indicator (consumer price index) was down 1.1% in the year to June, the producers' prices even went down by 5.9%.

¹⁷ For the economic data see: Wayne M. Morrison, China's Economic Conditions. Congressional Research Service, CRS Report for Congress, March 5, 2009; National Bureau of Statistics of China, "China's Economy Stabilized with a Better Performance Trend while its Upturn yet to Consolidate", July 16, 2009; China Daily, July 15, 2009 "FDI in China Falls 6.8%", www.chinadaily.com.cn/bizchina/2009-07/15/content_8432292.html (July 20, 2009); Xinhua July 10, 2009: "China's Imports, Exports Continue Falling, But Rate Eases" in <http://english.mofcom.gov.cn/article/counselorsreport/americaandocanreport/200907/20090706396639.html> (July 20, 2009)

¹⁸ China Daily (Online) July 22, 2009 „State Firms' Profit Decline Slowing“ in: http://www.chinadaily.com.cn/2009-07/22/content_8457073.html (July 22, 2009)

¹⁹ Caijing (Online) August 19, 2009 "Macroview: Crisis Tests Strength of China's Export Muscle", in: <http://www.english.caijing.com.cn/2009-08-19/110227250.html> (August 20, 2009)

According to the official statistics, China's unemployment rate barely budged from 4.2% to 4.3% (from 8.86 million registered urban unemployed to 9.06 million). These figures misrepresent reality however when for example the city of Dongguan – one of China's export oriented centers – alone reported job losses of 630.000 people.²⁰ In the spring of 2009 even China's Ministry of Agriculture let it be known that 20 million recently laid-off migrant workers had returned to the countryside. At the end of 2008 there were numerous reports about Chinese officials being concerned about unemployment related mass protests.²¹

As was to be expected, China's banking sector was spared from the financial crisis, only the stock market collapsed by two thirds from the third quarter of 2007 to the third quarter of 2008 but showed a turnaround in November.

2. Agenda-Setting and Policy Formulation

2.1 Agility and credibility in policy response

China's reaction to the unfolding economic crisis was one of the fastest in the world.²² As early as June 2008 on the brink of the Beijing Olympics did the first discussions in policy cycles begin. Obviously, the Chinese leadership was already in a state of alert before the collapse of Lehman Brothers. The full-fledged stimulus efforts started on November 5th with a meeting of China's State Council which announced a 4tn Yuan stimulus plan (details about the contents are described in chapter 3). This headline number of 586 bn US\$ was immediately picked up by the international press although in the words of Barry Naughton at that time "the Chinese government had simply announced a very big, vague number, which had not been fleshed out with concrete programs and projects."²³ Only some time later on did the National Development and Reform Commission (NDRC) in an emergency meeting discuss the allocation of the stimulus plan. Parallel to the government conference on November 5th there was also a Party meeting which issued a central document stipulating that 100bn Yuan in six designated areas was to be handed out in the current quarter. The importance of this party document lies less in the contents which was still murky but in the sense of urgency that it conveyed. The document was channeled through the party hierarchy communicating that there was a need for aggressive, on-time measures without caring too much about formal obstacles. The local governments all over the country held emergency meetings as soon as the Central Document reached them. Thereafter a structured bargaining process between the center and the localities set in that both sides were very familiar with since it mirrored the usual mechanisms in setting up five-year and annual plans. The center signaled the preferred types of projects and the amount of money that the localities could expect. The projects they proposed to Beijing were then checked by the NDRC whether they were to fit into the slated categories of the investment plan and how fast they could be implemented. In the end, by mid-December 2008 already the first round of the bargaining process had been finalized.

The most obvious common aim of both the central and the local governments is to curb unemployment and thereby uphold social stability. Other than that, central government interests

²⁰ Financial Times (Online) July 29, 2009 „China's Powerhouse Suffers Jobs Blow“.

²¹ Cf. Elizabeth C. Economy/Adam Segal, In China, Stimulus and Questions about Global Financial Governance", Council on Foreign Relations Expert Brief November 18, 2008.

²² For a good chronology of events see Zhang/Li/Shi 2009, 39-44 and Barry Naughton (2009a), Understanding the Chinese Stimulus Package, China Leadership Monitor 28, Spring 2009, 2-3.

²³ Naughton (2009a), 2.

often collide with local interests when it comes to the stimulus. The central government is more concerned with addressing the longer-term structural problems and boosting private consumption. On the other hand, local and regional governments/party organizations are more concerned with the stabilization of their income revenues by protecting the local industries even if they rely on energy insufficient, polluting production (e.g. steel factories). When the center addressed the local governments with the request to come up with project proposals, the local governments tried to exploit the situation and get their favored projects on the stimulus plan. It is hardly surprising that the provinces immediately came up with “ready-made” proposals by far exceeding the total budget (with 80% of the annual GDP). Thus, the central government was forced to give the local governments a lot of leeway in devising the investment projects so as to ensure a swift launch of the stimulus program.²⁴

2.2 Consultation of external policy expertise and openness to international collaboration

Against the backdrop of China’s often opaque decision-making process it is difficult to assess the amount of outside expertise that actually made its way into the government decisions. Judging by past experiences however, there probably has been a lot of intellectual input from government think tanks and other research institutes. They closely monitor the crisis reaction packages in other countries and provide the government with up-to-date assessments on foreign expertise. Analyses of research papers by Chinese academics from 2008 reveal a sense of acute threats to China’s economic well-being that called for decisive government responses.²⁵

The Chinese government has actively participated in international conferences that dealt with the financial crisis (esp. in the G 20 setting). However, the Chinese position during the conferences has been in line with its traditional foreign policy stance: The root causes of the financial crisis are identified in inadequate regulation, Wall Street greed, unchecked financial innovations in the West and flaws in the international financial architecture. The best contribution China could provide to fighting the crisis would be a successful turnaround of its own economy; every rescue package should start from and rely on the specific conditions given in each country (no blueprint for all); there should be a new international financial architecture (with the IMF playing a bigger role) that takes more into account the needs and interests of developing countries. All in all, China shied away from shouldering more and new responsibilities that were not in line with its status as “the biggest developing country in the world”.²⁶

3. Policy Contents

For the time being in-depth research into the details of China’s stimulus program is scarce.²⁷ Media reports concentrate on the lending surge by Chinese banks and the economic effects of the stimulus package so far.

²⁴ On the divergence of interests between the centre and the regions see: Zheng/Chen 2009, 6-9.

²⁵ See Zhi/Li/Shi 2009, 6-12.

²⁶ For examples of China’s multilateral crisis response attitudes see *ibid.*

²⁷ The most noteworthy examples are Naughton (2009a) and Zhao/Li/Shi 2009

3.1 Size and time frame of stabilization and stimulus policies

The stimulus has a size of 4 trillion Yuan (586 billion US\$) which amounts to 15.5% of China's 2007 or 13.3% of its 2008 GDP. It is however unclear how much money is really "new" and has not in some form or the other already been appropriated before (e.g. money for earthquake reconstruction or funds slated in the 11th five-year plan). The 4 trillion stimulus is to be spread over 9 quarters (from Q4/2008 to Q4/2010).

3.2 Targeting and coverage of policy tools

The Chinese stimulus program can be separated into the fiscal elements as part of the so called "package plan to counter the global financial crisis" (*duiying guoji jinrong jingji weiji de yilanzi jihua*) and the accompanying monetary policies (see 5.2). It should be noted that it is not by chance that we find the traditional socialistic term "plan/*jihua*" here (and not the term "program/*guihua*" that has been widely used since 2006 to clarify the difference between market-oriented long-term programs and the socialistic five-years plans of the past). The contents of China's investment plan was first made public in November 2008, in March 2009 at the session of China's National People's Congress there was a change in its composition. The following table illustrates the official distribution of the 4000bn Yuan in the Investment Plan.²⁸

Category	Plan as of March 2009 Bn Yuan - % of total	Plan as of November 2008 Bn Yuan - % of total
Sichuan Earthquake Reconstruction	1000 – 25%	1000 – 25%
Public infrastructure	1500 – 38%	1800 – 45%
Housing for low-income households	400 – 10%	280 – 7%
Rural development	370 – 9%	370 – 9%
Technological innovation and structural adjustments	370 – 9%	160 – 4%
Sustainable development (energy, environment)	210 – 5%	350 – 9%
Health care, education, culture, family planning	150 – 4%	40 – 1%

As this table illustrates, it is wrong simply to reduce the plan to its public infrastructure components (construction of roads, railways, airports, irrigation, electricity grid). Social policy programs (see 3.5) as well as industrial policies (see 3.3) also play a substantial role. They were even upgraded in their importance when the plan was revised in March 2009. These adjustments, together with the actual implementation of the plan (see 4.2), reflect the central government's concern to concentrate on measures with an immediate impact on people's livelihood.²⁹

In contrast to western countries, China has not been forced to directly support its financial system by capital injections, loans, guarantees or asset purchases.

²⁸ The table is based on: Economic Observer Online March 2009, 3 "China's Stimulus Package: A Breakdown of Spending" in: http://www.eeo.com.cn/ens/finance_investment/2009/03/07/131626.shtml (August 5, 2009); Cai-jing (Online) March 3, 2009 "4 Wanyi touzi jiegou da qiaozheng" (Major facelift for 4 trillion Yuan Investment Structure); Fazhan Gaige Weiyuanhui: "4 Wanyi touzi goucheng ji Zhongyang touzi xiangmu zuixin jinzhan qingkuang" (The Structure of the 4 trn. Yuan investment plan and the current situation of the central government's investment projects) in: http://www.ndrc.gov.cn/xwzx/xwtt/t20090521_280383.htm (August 5, 2009)

²⁹ This aspect is also highlighted in Naughton 2009a, 7.

3.3 Developmental purposes as an objective of stimulus policies

The crisis response does have in mind a broader developmental perspective. The central government is aware of the structural deficits in China's economy and therefore has slated 9% of the investment plan for "technological advancement and restructuring". The usage of these funds is embedded in the so called "long range plan for adjustment and rejuvenation" as put forward by the NDRC which identifies 10 selected industries to be supported from 2009 to 2011. The targeted industries among others include electronics (next generation internet, digital television and third generation mobile telecom) and the automobile industries. Local policy-makers have also made it clear on several occasions that they consider the crisis as a chance to push forward the structural changes so as to upgrade their industries.³⁰ These promises should not be regarded as mere lip service because China has proven in the last decade that economic crises have been used as a chance to push forward with ambitious reform agendas (especially 1999-2001 using the economic downturn then to override internal skepticism about the WTO entry).

3.4 National bias and protectionist measures

We can observe the comeback of some well known protectionist measures: Apart from its currency policy (see below 5.2), during the last couple of months there have been several rounds of hikes in VAT rebates for export industries. These are hard to track in detail since they cover different product groups with differing levels of rebates.³¹ More often than not they represent successful lobbying by local constituencies and not necessarily follow a commercial logic.

"Buy Chinese Clause": At the end of May 2009 the Chinese central government issued bidding rules that discriminate against foreign suppliers so that for example Western companies had no chance to win contracts in wind power constructions.³² Nicholas Lardy however warned against dramatization of this step. He pointed out that China as a non-signatory state to the WTO's "Government Procurement Act" was legally in a position to do so. In addition, China had only reiterated policies that were in effect for years so that one could not say it was "new protectionism".³³

3.5 Social protection

There are no new official labor market policies that can be observed. However, fully in line with China's flexible handling of such issues, there are numerous reports that party organs at every level urged the state owned companies under their jurisdiction to refrain from laying-off their staff.³⁴

³⁰ This is for example expressed by Guangdong's Party Secretary Wang Yang in an interview with the Financial Times. See Financial Times (Online) August 2, 2009 "China's Arnie Takes Advantage of Crisis".

³¹ For an example of such adjustment in export VAT rebates for bags, toys and furniture starting from June 1, 2009 see Circular 88/2009 issued by Ministry of Finance and State Administration of Taxation (*Caishui 2009 nian 88 hao*), http://szs.mof.gov.cn/shuizhengsi/zhengwuxinxi/zhengcefabu/200906/20090608_164478.html (August 20, 2009).

³² Financial Times (Online) May 2008, 2009 "Protectionist Fears Over China Stimulus".

³³ Peterson Institute for International Economics, Interview with Nicholas Lardy on Current Topics "Is China's Stimulus Program Protectionist?", June 25, 2009.

³⁴ Financial Times (Online) June 13, 2009 „China's Stimulus Is Working But Social Unrest Fears Persist“.

New social policies: The adjustments of the stimulus plan in March 2009 specifically sought to beef up the money for improvements in people's livelihood. This is especially true for health care policies. The overhaul in China's healthcare system has been a very complex business with reform measures and pilot projects differing from one province to another. Against this backdrop, it is very remarkable that the government decided in late 2008 to move forward with a system that would be dominated more by direct government provision. This policy initiative according to Naughton cannot be understood without the stimulus package. Obviously, the government has recognized that there is a window of opportunity to expand outlays for health care dramatically.³⁵

In addition, the government started two initiatives especially to promote consumption among rural households: "household apparel going to the countryside" (*jiadian xia xiang*) and "exchanging old for new" (*yi xiu huan xin*). Under these two schemes running for four years households, especially in the countryside, are eligible for subsidized electronic household items.³⁶ The government with these programs kills two birds with one stone: It can boost rural consumption and assist struggling Chinese companies.

4. Implementation

4.1 Public communication

At the beginning of its anti-crisis measures the government was very cautious not to let criticism at the package emerge. Now this has changed significantly, the reporting atmosphere by the official Chinese press is much more relaxed (see below 6.1).

From February to April 2009, when the impact of the stimulus was not yet clearly discernible, there were reports in the Chinese press that hinted at additional fiscal initiatives. More often than not, CPC Politburo members or top policy advisers were quoted as saying that additional measures could be taken if need be.³⁷ NDRC head Zhang Ping also has said a several times that the composition of the investment plan could change if there was a need for adjustments.³⁸

Even at the time of the starting recovery Wen Jiabao and Hu Jintao kept on saying that China was still at a "critical moment" or that the financial situation continued to be "grim". Therefore they, as well as other top members of China's cabinet (such as Finance Minister Xu

³⁵ Naughton 2009a, 8.

³⁶ On some details of these two schemes see: Caizheng Bu „*Caizhengbu dengqi buwei yinfa`jiadian yi xiu huan xin shishi banfa`*“ (The Finance Ministry and 7 other Ministries, Commissions issue Implementation Rules for „exchange old for new household appliances“) July 2, 2009 in: http://www.mof.gov.cn/mof/zhengwuxinxi/caizhengxinwen/200907/t20090702_175325.html (July 23, 2009); Fagai Wei „*Guowuyuan changwuhui shenji tonguo guli qiche jiadian yi xiu huan xin shishi fangan`*“ (NDRC: The Standing Committee of the State Council investigates into the implementation program of promoting car sales and exchange old for new household appliances), in: http://xwzx.ndrc.gov.cn/xwfb/t20090522_280982.htm (August 5, 2009).

³⁷ For such reports see Bloomberg News April 13, 2009 "China Mulls New Stimulus to Boost Consumption, Bolster Recovery"; Bloomberg News March 22, 2009 "China's Stimulus Spending to Help Growth Reach Target".

³⁸ Zhang Ping cited in *Caijing* (online) March 6, 2009 "Facelift for China's Economic Stimulus Plan", in: <http://www.english.caijing.com.cn/2009-03-06/110114405.html> (August 6, 2009).

Xieren) have kept on preaching that China should stick to its “proactive fiscal policy” (*jiji caizheng zhengce*) and “relatively loose monetary policy” (*shidu kuansong huobi zhengce*).³⁹ This stands in obvious contrast to statements from the People’s Bank of China, the China Banking Regulatory Committee or critical Chinese financial press who admonish the banks to stick to stricter lending rules and even tentatively use the word “exit” with regard to monetary policy.⁴⁰

The basic policy line as expressed in official documents still is dominated by the references to the scientific developmental approach and the central government economic guidelines of defending a stable and relatively fast economic growth (sometimes only referred to as “defending 8%”), widen consumption at home (*kuoda neixu*) and improve the structure of the economy.⁴¹

Public acceptance of the program: Since there are no free venues for the public to give their voice on the subject, this aspect is difficult to judge. Random looks at the Chinese blogosphere (which includes numerous discussion forums that are highly critical of China’s economic administration and policies) provide some insights. Most commentators seem to share the view of their government that the financial crisis has been one of “American making” that has hit undeserving China. In addition, many Chinese seem to give their government credit for the strengthening of the economy, and there is palpable pride that some Western media discuss whether China might lead the world economy out of recession. On the other hand, commentators in both the blogosphere and the official media frequently raise concerns about waste and embezzlement (including speculation in stock and real estate markets with diverted stimulus funds) in connection with the implementation of the stimulus plan.

4.2 Modes and time frame of implementation

It is enormously difficult to measure and assess the speed and effectiveness of the implementation process. Several factors contribute to this: Since the central government relies very much on the local governments for funding and implementation, the status of implementation varies widely from province to province, city to city, township to township. In addition, the official press reporting on the one hand gives seemingly exact numbers for some projects (“273 pieces of grain-drying equipment”), whereas on the other hand only superficial statements are offered (“speeding up the work on the South-North Water Transfer project”).⁴² John

³⁹ For statements such as these cf: People’s Daily July 23, 2009 “Chinese Premier Urges Firm Implementation of Proactive Fiscal Policy”, in: <http://english.people.com.cn/90001/90778/90857/90859/6708487.html> (August 4, 2009); People’s Daily July 23, 2009 “Chinese President Urges Adherence to Macroeconomic Policies in Second Half”, in: <http://english.people.com.cn/90001/90778/90857/90862/6708530.html> (August 4, 2009); Xinhua June 21, 2009 “Wen Jiabao: woguo jingji zheng chuzai qiwen huisheng de guanjian shiqing” (Wen Jiabao: China’s Economy is currently at a critical moment for an early recovery), in: http://news.xinhuanet.com/politics/2009-06/21/content_11575848_1.htm (July 22, 2009).

⁴⁰ For examples of these reports see Financial Times (Online) July 28, 2009 “Rise in Loans Prompts China Scrutiny”; People’s Daily July 28, 2009 “Banking Regulator: Ensure Loans Enter Real Economy”, in: <http://english.people.com.cn/90001/90778/90857/90862/6712365.html> (August 4, 2009), Caijing (Online) July 23, 2009 Hu Shuli “Editorial: Reality Check for China’s Monetary Policy”.

⁴¹ Li Xiaochao (Spokesman, National Bureau of Statistics) “China’s Economy Stabilized with a Better Performance Trend While Its Upturn Yet to Consolidate”, July 16, 2009. Xinhua “Xinwen fenxi: Xiaofei zengchang xi ren – xia bannian caizheng zhengce ruhe falì” (New Analysis: The rise in consumption makes people happy – How fiscal policy in the second half of the year can deliver strength) July 16, 2009 in: http://www.gov.cn/jrzq/2009-07/16/content_1367469.htm (July 16, 2009)

⁴² These examples are cited in Wall Street Journal (Online) May 22, 2009 “Spending the Stimulus: Where China’s Money Is Going”.

Making draws attention to a peculiarity of China's statistics: As soon as project funds are disbursed they are counted as having been spent even if the project might not have started yet. Something similar is true for the measurement of retail sales: Shipments to retailers are counted as actual sales to the final consumer thus distorting the picture. Lastly, to boost up the numbers and to show for their success, local government agencies have been said to have virtually handed out household equipment for free or electronic home appliances (such as washing machines) even if there is no electricity.⁴³

The disbursement schedule for the 1.18tn Yuan from the central government is as follows: 104bn Yuan for 2008, 487.5bn Yuan for 2009 and 588.5 for 2010. This plan seems to be on track. At the end of June the Ministry of Finance has announced that so far 591.5bn Yuan out of the 1.18tn Yuan have been handed out. If the roughly 200bn Yuan for earthquake reconstruction are omitted, one gets the following disbursements:⁴⁴

<i>Category</i>	<i>Yuan (bn)</i>	<i>%</i>
Rural village infrastructure	125	32
Affordable housing	52	13
Public infrastructure	59	15
Health care, education, culture	70	18
Sustainable development	26	7
Technological innovation and structural adjustments	58	15

These figures are generally in line with the research by Naughton who looked at the first two tranches for Q4/2008 and Q1/2009.⁴⁵ Thus, one can say that the projects funded by the central government have been considerably higher than scheduled in the November 2008 as well as March 2009 investment plan. Since these funds have to be matched by local money, the total outlays for the improvement of peoples` livelihood (affordable housing, health care, education, rural infrastructure) are considerably higher than is widely assumed in the West.

There are however drags on effectiveness: There definitely has been massive misuse of funds away from designated aims to flow into assets (stock market, property market) since there are much higher and faster returns on investments. Since land sales and taxes from property transactions constitute a considerable part of local government revenue, there is a strong appeal to invest the money there. Symbiotic collusion of CPC cadres in different functions leads to distortions and waste. Andy Xie tells stories of so called "land kings" at local land auctions who bid up prices with money lent from local banks so that in the end the money just circulates from one government pocket to the other.⁴⁶

There are of course problems that are typical for emerging, less developed economies: insufficient supervision capacities, corruption and fraud. However, the leadership again relies on classic Maoist strategies to make up for shortcomings, i.e. inspection tours by single top CPC cadres.

⁴³ John Making „China: Bogus Boom?“ American Enterprise Institute for Public Policy Research Economic Outlook August 2009.

⁴⁴ Calculation by authors based on Caizheng Bu (June 26, 2009) "Zhongyang zhengfu gonggong touzi cesuan anpai qingkuang", www.mof.gov.cn/mof/zhengwuxinxi/caizhengxinwen/200906/t20090626_172446.html (July 23, 2009)

⁴⁵ Naughton 2009a, 7.

⁴⁶ Xie Guozhong (Andy Xie), "You fengkuangle" (Crazy Again), xieguozhong.blog.sohu.com/128798351.html (August 4, 2009)

4.3 International/regional cooperation

As was mentioned above (see 2.2), China has been wary so far to incur more international responsibilities that might surpass its capacities. Nonetheless, parallel to its own rescue efforts, it has displayed some efforts to step up its image as a responsible stakeholder in international financial management. As such, China has offered support for other countries especially in Asia by signing currency swap agreements (e.g. with South Korea, Malaysia). China obviously wants to boost Asian financial cooperation in which it already has a center stage position.⁴⁷

5. Funding, Tax and Monetary Policies

5.1 Tax policies in support of stimulus/stabilization

The Chinese tax system even after several rounds of reforms aimed at unifying the national tax code is still characterized by a considerable degree of regional variation and informal practices (e.g. local administration granting tax exemptions for preferred industries or ad hoc levies imposed on citizens). Apart from the export VAT rebates mentioned above (3.4) the stimulus program relies on tax reductions in order to boost private consumption especially in rural areas. The most important elements are tax reductions for light vehicles, light trucks and an automobile scrapping scheme that provides for a 50% sales tax reduction for low emission cars with engines below 1.6 liters.⁴⁸

5.2 Monetary and currency policies in support of stimulus/stabilization

When the fiscal stimulus program was announced in November 2008, the government changed its monetary policy from “moderately tight” to “moderately loose”. In several steps the central bank cut its policy rate from 7.47% to 5.31% where it has stayed since then and lowered the required reserve requirements from 17.5% to 14%.⁴⁹

However, in line with China’s past monetary policies, the most effective measure taken by the PBoC was the lifting of credit quotas starting from October 2008 thereby setting off a huge lending surge of 7.37tn Yuan by Chinese commercial banks in the first half of 2009 (see below 7.2). This stands in marked contrast to only 275bn Yuan that was released by the PBoC in regular open market operations during the same period.⁵⁰

In China, the initiation of a more contractive monetary policy relies on remnant “command economy” methods that are not employed in other major economies. Instead of using market mechanisms to absorb liquidity, the PBoC as well as the Chinese Banking Regulatory Com-

⁴⁷ For an in depth analysis of China’s efforts in this context see Zhang/Li/Shi 2009.

⁴⁸ For the details see Naughton 2009a, 9 and Barry Naughton (2009 b), China’s Emergence from the Economic Crisis, China Leadership Monitor N. 29, Summer 2009, 7.

⁴⁹ On China’s monetary policy see World Bank, China Quarterly Update December 2008, March 2009 and June 2009 and Asian Development Bank, Asia Economic Monitor July 2009.

⁵⁰ See Caijing (online) July 29, 2009 “Keen Eyes Fixed on China’s Monetary’s Policy” in: http://www.english.caijing.com.cn/2009-07-29/110215562_1.html (August 20, 2009)

mission directly addressed commercial banks in June 2009 and ordered them to cap or even stop lending (as was the case with the Bank of China).⁵¹ As a result, in July 2009 new bank loans dramatically dropped by more than 75% to 356bn yuan compared with 1,530bn Yuan in June.⁵² In general, monetary measures derive from decisions made by a very small group of top-ranking economic policy-makers who define current priorities and initiate policy shifts.

China's currency policy and especially the assumed undervaluation of the Chinese Yuan against the US\$ has for years been a bone of contention between Chinese and American policy makers as well as among China scholars. From July 2005 when China ended the decade-long fixed exchange rate vis-à-vis the US\$ and introduced a more flexible management vis-à-vis a basket of currencies to the outbreak of the financial crisis the Yuan had appreciated against the US\$ on a nominal basis from 8.277 Yuan/US\$ (June 2005) to 6.818 Yuan/US\$ (September 2008).

Since September 2008, against the backdrop of China's export downturn, the Yuan has in several steps depreciated slightly in a range of 6.82-6.84 Yuan/US\$ (with a low in December 2008 of 6.87 Yuan). Obviously, Chinese policymakers have made an effort to strike a deal between supporting China's export industries without raising Washington's concerns about unfair Chinese trade measures.⁵³ However, the true amount of depreciation can be expected to be larger once exchange rate substitutes like rebates on export taxes or special loan programs for export industries are taken into account.

5.3 Credibility of funding mechanisms

The funding of China's stimulus is by far the most complex aspect of this study; it partly overlaps with monetary policy.⁵⁴ The funding of China's stimulus is unique when compared with other countries: The central government contributes only a small proportion of all funds (1.18tn Yuan out of the overall sum of 4tn Yuan.) This 1.18tn shall be raised by issuing bonds over two years. The remainder of the 4tn is to be provided by local governments, state-controlled enterprises and "the market" (i.e. government-linked financial institutions and non-public firms under government guidance).

Technically speaking, local governments must not incur debt by borrowing from local banks or by issuing bonds. Therefore the central government has introduced some new ways to circumvent this restriction: The Ministry of Finance has issued bonds on behalf of local governments, private companies are allowed to issue corporate bonds for projects with promising future yields. By far the most common way however is for local governments to make use of "city investment companies" which borrow from banks on their behalf. Thus in reality, this means that the lion's share is made available through the banking system, as described above. This is a very efficient way of tapping money since the local banks do not hesitate to lend for government-guaranteed projects. What is more, some local and regional party leaders obviously competed among each other about who would provide more funds for the projects sup-

⁵¹ This is not to say that "market mechanisms" were not used at all. The PBoC raised repo rates or issued notes that the commercial banks had to buy. These steps however paled in comparison with the non-market tools.

⁵² Financial Times (Online) August 11, 2009 "China's Economy Cools as Lending Slows".

⁵³ For an in-depth analysis of China's exchange rate policy see Morris Goldstein/Nicholas Lardy (2009), *The Future of China's Exchange Rate Policy*, Washington: Peterson Institute for International Economics, Policy Analysis in International Economics No. 87, July 2009.

⁵⁴ For an overview and some of the details see Naughton 2009a, 3-6.

ported by the central government.⁵⁵ In addition, Chinese banks in the past have been willing to inflate their loan-writing because asset and market share are major criteria for assessing their performance.

When looking at the composition of the sources of bank lending there are some interesting details: The single biggest lender has been the Bank of China with more than 1tn Yuan. The other three big state owned-banks lent 859bn (Agricultural Bank of China), 709bn (China Construction Bank) and 865bn (ICBC) bringing the total of these four to 3433bn Yuan (46.5% of the total). With the central government more and more vigilant about their lending since May, the medium-sized joint stock commercial banks, policy banks and city commercial banks have been the driving force for the lending growth as “Caijing” magazine reports.⁵⁶ Loans that had hitherto been restricted to provincial capitals only, now also flow to second or third-tier cities.

It is unknown how much local governments have borrowed mainly by relying on their city investment companies. Some Chinese media report lending by Chinese local government of 10tn Yuan.⁵⁷ For many localities paying back the loans is based on continuing revenues from land sales and corporate taxes that are of course contingent on the overall economic situation. The financial conditions of some localities that have not been able to come up with their “matching funds” on time, have already slowed down the implementation of some projects as the National Audit Office of China has reported.⁵⁸

6. Feed-Back and Lesson-Drawing

6.1 Policy feedback and adaptation

As indicated above (see chapter 3), there have been revisions of the original stimulus plan of November 2008 in March 2009. Furthermore some minor changes have been enacted in the regulations on social policies.

Policy learning has taken place in areas that did not directly translate into changes of the stimulus contents. As shown above (4.1 public communication) however the handling of the stimulus has changed: With the economy gaining momentum, the Chinese leadership obviously felt more and more confident so that criticism of certain elements of the stimulus has been allowed. There is now more transparency and consistency in the official reporting about the stimulus package. Agencies such as the National Audit Office have bent over backwards to make clear to the public that concerns about fraud and corruption are taken seriously. By far the most spectacular case involved the criticism of the lawyer Yan Yiming from Shanghai who called for transparency in the appropriation of the government funds. When this initiative

⁵⁵ The Financial Times cites a Chinese economist who was taken aback when learning from a provincial governor that he considered the surge in bank lending as his greatest political success in 2009. See Financial Times (Online) July 8, 2009 „China’s Banks Lend with Communist Zeal“.

⁵⁶ Caijing (online) June 30, 2009 “Where Did That 7 Trillion Come From?” in: <http://english.caijing.com.cn/2009-07-30/110218623.html> (August 4, 2009)

⁵⁷ Financial Times (Online) July 15, 2009 „Beijing Keeps Foot on Accelerator“.

⁵⁸ Economic Observer Online June 1, 2009 “Mitigating Debt Bomb for Chinese Local Governments”, in: http://www.eeon.com.cn/ens/finance_investment/2009/06/01/138892shtml (July 23, 2009)

was supported by thousands of Chinese “netizens”, the NDRC was forced to publish the exact distribution of the funds for the respective projects on its homepage.⁵⁹

6.2 Institutional restructuring

So far there has been no major institutional restructuring undertaken in China that would be comparable, for instance, to the establishment of bad banks or the overhaul in financial market regulation initiated in other major economies. In general, Chinese economic and financial bureaucracies have been under constant institutional reshuffling for many years now. However, the regulatory authority of new supervisory bodies in the financial sector is still shaky.

The 2008-9 stimulus program has already exerted a discernible influence on the distribution of powers and funds among China’s major economic bureaucracies. Those administrative bodies that are in charge of planning and implementing the stimulus have clearly benefited from the program. This is especially true for the National Development and Reform Commission (i.e. the comprehensively reorganized, former State Planning Commission), the Ministry of Finance, the Ministry of Railways (which commands the most centralized and nationally integrated administrative apparatus among all government ministries) and the Ministry of Industry and Information Technology (which is in charge of a plethora of newly launched industrial policies).⁶⁰ The increasing powers of these “big spending” economic bureaucracies have come to the detriment of “non-spending” regulatory and supervisory bodies and, most conspicuously, the Ministry of Environmental Protection which not only saw its funds reduced in the revision of the original stimulus plan in March 2009 but also has been sidelined in its role as a watchdog for investment projects.⁶¹

7. Tentative Impact on Economy

Keeping in mind that the official Chinese data are to be treated with caution⁶², the stimulus fulfilled its main short-term aims (defending the real economy so as to uphold 8% growth, buying time for the export oriented economy, hedging the rise in unemployment so as to guarantee social stability) but so far has done by far not enough to address the medium and longer term structural deficits of China’s economy. On the contrary, it even has reinforced some of its most salient imbalances.

⁵⁹ On the case of Yan Yiming see New York Times (Online) January 7, 2009 “Lawyer Demands that Chinese Government Open Its Book”.

⁶⁰ On the role of the Ministry of Industry and Information Technology see Naughton 2009b, 5-7.

⁶¹ The Chinese Economic Weekly “Economic Observer” based on official Chinese numbers reports that out of more than 200,000 investment projects now under way only one out of 590 projects has the formal approval of the Ministry of Environmental Protection; Economic Observer Online July 10, 2009 “From Stimulus to Restructuring” <http://www.com.cn/ens/faecture/2009/07/10/143395.shtml> (August 19, 2009).

⁶² At least the following facts warrant a cautious handling of the Chinese numbers: As has been so often the case in the past, the added GDP numbers as reported by the provinces exceed the numbers as reported by the National Bureau of Statistics. See Financial Times (online) August 4, 2009 “China’s Growth Figures Fail to Add up”. Derek Scissors has calculated that the figures at the expenditure side of the GDP (fixed investment+retail sales+net exports) equal 112% of GDP. See: Derek Scissors “China Refuses to Adjust Its Economy” Heritage Foundation Web Memo Number 2546, July 16, 2009.

7.1 Economic and political effectiveness of the crisis response in period under examination

The stimulus has so far been effective in upholding China's GDP growth in the range of 8%, the governments official target figure. In the first half of 2009 China's industry output rose by 10%, GDP registered a growth rate of 7.1 % (Q1/2009; 6.1%, Q2 7.9%). On a quarterly basis (data are not published on a quarter-to-quarter basis in China) the second quarter even saw a hefty 16.5% growth compared to the previous one.⁶³ This is no small feat because at the turn of the year quite a lot of analysts deemed a negative growth rate possible. In the meantime, most international organizations and financial institutions have revised their growth projections near or even above China's official 8% target.⁶⁴ That the Chinese economy might have bottomed out is also mirrored in China's business climate index and enterprise confidence index which both have climbed into positive territory lately. These data come at a time when inflation seems not to be around the corner as China's consumer price index (-1.1% year on year in the first half of 2009) and the producer prices (-5.9%) show.

7.2 Structural distortions (potentially) caused by the stimulus policies

The rebound of growth in China comes at the cost of several continuing structural imbalances that the stimulus package also sought to address in the first place. The Chinese economy is now even more dependent on investment in fixed assets which grew 33.5% on a year-on year basis. Retail sales as a proxy for private consumption also picked up, however only at a rate of 15% (which is nevertheless about twice as much as in the previous years). If China's 7.1% growth rate for the first half of 2009 is decomposed it shows that investment accounted for 6.2% points, consumption only for 3.8% points (net exports for -2.9% points).⁶⁵

This is not the place to discuss in depth whether the boom in fixed asset investment is based on commodities speculation and leads to damaging excess capacity.⁶⁶ Some preliminary thoughts may suffice: Most of the investment is targeted not at specific industries (steel, chemicals) but at infrastructure, which rose by 58% in the first half of 2009. Even after considerable efforts to close China's infrastructure bottlenecks in the past 10 years or so, there is still a lot to do, especially in improving railway transportation which considerably lagged behind highway construction. Therefore the officially reported increase in railway investments (up 126%) over road transportation (up 55%) may be judged positively.

As a result of the lending spree by Chinese banks the broad money M2 grew 28.6% in the first year of 2009, more than 10% more than at the end of 2008. New loans grew a staggering 34.5% in the year to June, on average Chinese banks lent a monthly average of 1.23tn Yuan.

⁶³ This is a calculation by Goldman Sachs as cited in: Economist July 16th, 2009 „A Fine Rebalancing Act“.

⁶⁴ For international organizations the growth rates are 7.2% (World Bank China Quarterly Update June 2009), IMF (World Economic Outlook Update July 2009), ADB 7.0% (ADB Development Outlook 2009), OECD 7.7% (Economic Outlook June 2009) Investment Banks like Goldman Sachs (8.3%) or JP Morgan Chase (8.4%) even have higher forecasts. See Bloomberg News June 18, 2009 “World Bank Raises China Growth Forecast, Says Stimulus Is Adequate”.

⁶⁵ China Daily (Online) July 16, 2009 “China's GDP Grows 7,9% in Q2” in: http://www.china.org.cn/business/news/2009-07/16/content_18147032.htm (August 20, 2009)

⁶⁶ For a critical assessment see: Andy Xie “Fear the Dark Side of China's Lending Surge” *Caijing* (Online) June 19, 2009; for positive judgements stressing that China's infrastructure situation is still very much underdeveloped see: Min Ye “China`s massive Stimulus and US Steel Companies”, *Morningstar* (online) July, 30, 2009; Qing Wang “Railways vs. US Government Bonds: Putting China's “Overinvestment” in Context”, *Morgan Stanley Global Economic Forum* July 29, 2009.

The total lending at the end of 2009 could even reach more than 10tn Yuan, well above the official target of 8tn.⁶⁷ This trend implies the danger of a significant new rise in Non-Performing Loans and quite some local governments might end up over-indebted so that the central government in the end could be forced to pick up the bill. Already now the Chinese press is full of warnings that there might be a time bomb ticking and that there was a clear need to find other ways for local government financing.⁶⁸ The lending itself still heavily goes to the big SOEs whereas cash-strapped small and medium private enterprises still face bad borrowing conditions so that they have to resort to the informal financial market.

As to asset price bubbles, Chinese share prices have soared 80% from their lows in November 2008, the housing market – at least in some of China’s big cities – also shows signs of a bubble inflating. There is the widespread conviction that the government will do whatever it takes to prop up the markets ahead of the 60th anniversary of the founding of the PRC.

Regarding dependence on foreign demand, the stimulus from a Chinese perspective has not explicitly been aimed at reducing one’s trade dependency or to help in bringing down the global imbalances. Nevertheless, as a side effect of this year’s shrinking trade China’s current account surplus will considerably decrease⁶⁹ thereby possibly limiting criticism about “China’s mercantilist trade policy”. Basically untouched despite of all the recent Chinese criticism of the US\$ as the world reserve currency and the accompanying rhetoric about a more prominent future role of the Chinese Yuan have been the effects of China’s exchange rate policy. Only the composition of China’s US\$ holdings has changed, not so the trend that China keeps buying US\$ thereby driving its foreign exchange reserves still higher (to 2.13bn US\$ at the end of June 2009).

8. Distinctive Features of China’s Crisis Response

China’s crisis response shares important features with other large emerging political economies (e.g. central bank interest rate cuts, tax rebates and reductions, no need for direct bail-out of financial institutions). Yet, there are several salient elements in China’s approach to crisis management that result from the distinctive structure and dynamics of its political economy and that set China apart from other countries.

China’s crisis response was among the fastest in international comparison. In terms of policy agility, the only countries that come close to China’s speedy response are Indonesia and South Korea whose governments have apparently drawn major policy lessons from traumatic national experiences with the Asian financial crisis of 1997-99. Whereas quite a lot of countries (Brazil, India, South Africa) in the summer of 2008 considered the financial crisis to be a sectoral phenomenon that would cause only a minor “ripple” to the “real economy”, the Chinese leadership from the very onset of the crisis was concerned about a negative impact on overall social stability (a similarly alarmistic judgement of “systemic” threats was made by the Rus-

⁶⁷ People’s Daily August 4, 2009 “Loans Dip Likely in July, Analysts Say”, in: <http://english.people.com.cn/90001/90778/90857/90859/6717683.html> (August 4, 2009).

⁶⁸ See for example: Economic Observer Online July 30, 2009 “We need to Find a Better Way of Financing Local Governments”, in: <http://www.eeon.com.cn/ens/Observer/editorial/2009/07/30/146151.shtml>. (August 5, 2009); Economic Observer Online June 1, 2009 “Mitigating Debt Bomb for Chinese Local Governments”, in: http://www.eeon.com.cn/ens/finance_investment/2009/06/01/138892.shtml (July 23, 2009).

⁶⁹ According to Paul Cavey the current account surplus will fall to 6% in 2009 and 4% in 2010. Cited in The Economist July 30, 2009 “The Spend Is Nigh”.

sian government, but not by policy-makers in other emerging countries who apparently saw themselves as much less threatened by the crisis than their Chinese or Russian counterparts).

The swiftness of the Chinese policy response was facilitated by reverting to certain command economy mechanisms (concerted, big investment and credit pushes initiated by government decree) that stand in a striking contrast to the very differently structured policy processes in other major emerging countries (eg. personalized leadership in Brazil, consociational approach to policy-making in South Africa).

The size of China's stimulus package exceeds that of all other emerging countries. Even taking into account the unreliability of official statistics, China's anti-crisis efforts in absolute numbers come second only to the US and by far dwarf all other packages in relative terms (China's stimulus package according to divergent estimates amounts to 10-15% of its GDP whereas in other emerging countries the respective numbers range from 0,5% to 3% of GDP only).

Regarding the contents of the stimulus program, even though China's approach parallels the social policy thrust in many national crisis packages, two aspects stand out: On the one hand the Chinese government used the "window of opportunity" to push through reform in health care that had met with heavy criticism and opposition in previous years. On the other hand, whereas most countries sought to cushion the negative aspects of unemployment (by extending unemployment benefits, roll out new training schemes for the newly unemployed), Chinese authorities tried to avoid unemployment in the first place by instructing government-linked companies not to lay off people and thereby help to preserve overall social stability.

Contrasts with other countries also exist in China's industrial policies: Whereas most countries (even Russia and South Korea with a high degree of large companies dominating some sectors) in one form or another have propped up their small and medium sized enterprises, SME support measures have been a blind spot in China's crisis response (at least at the national level, less so in provinces such as Zhejiang or Guangdong whose economic dynamism relies on private SMEs).

As to a longer-term developmental perspective and the determination to use the crisis as an opportunity for industrial restructuring, the Chinese government has issued a series of sectoral industrial policies that are, with individual exceptions, judged as ill-prepared and probably ineffective even by Chinese planners themselves.⁷⁰ In terms of strategic technological upgrading and especially "green technology" promotion, China's industrial policies lag markedly behind the foresighted goals and measures that have been included in the South Korean government's crisis response.

Although the implementation status of China's stimulus policy is difficult to track because of wide geographic variation (in a way similar to the Indian case) one is stunned by how fast China has managed to get projects going when other countries have suffered from month- or year-long time lags due to weak administrative capabilities (e.g. Indonesia) or bureaucratic-legal hurdles (in most advanced political economies). Based on China's official statistics (and – as mentioned above – there are methodological problems that have to be taken into account) China has spent about 50% of the envisaged money already within less than one year. South Korea by comparison is lauded by the OECD as an international benchmark for having executed 17% of its planned projects. This Chinese performance is facilitated by accumulated

⁷⁰ This judgement is based on a series of interviews conducted in government planning bodies in spring 2009 in Beijing, Chongqing, and Guangzhou.

experience with planning and implementing large-scale projects in “big push” style over the last two decades (accompanied by a lack of political or legal accountability in case of failing projects).

Probably the most distinctive, or even unique, feature of the Chinese case consists in the funding mechanisms. Whereas in other countries the financial resources come from the national government (mostly as part of the regular budget and raised through government bonds), in China the bulk of financing is contributed by local authorities which themselves have tapped the local branches of state-controlled banks. In China we have thus witnessed a highly unusual role of the central bank that has in effect acted as a transmission belt for government orders to flood the country with liquidity. In contrast to the common international practice of stimulus funding, underlying financial risks are therefore not included in China’s formal state budget or in the balance sheet of the central bank but only appear (possibly/partially) in the books of China’s big retail banking institutions.

9. Concluding Remarks

As the dynamics of the current economic crisis are not yet fully understood and still unfolding, one has to be extremely cautious in making statements on the success or failure of the government-sponsored stimulus and stabilization programs under scrutiny as well as the causal mechanisms, medium-term consequences and international/regional repercussions attached to it.

Consequently, there is considerable debate as to whether the Chinese stimulus is a success or not. To some it is “the gold standard” of all stimulus packages (Nicholas Lardy). Others simply dismiss it as “old and comparatively small” (Derek Scissors) or as a “missed opportunity” for China.⁷¹ It is extremely difficult at this point to determine the causal mechanisms for China’s economic rebound and, more specifically, to gauge the role of the stimulus plan in this. Based on growth accounting, it is the infrastructure investment boom that predominantly has driven growth so far, with private consumption buoyant yet still lagging behind and net exports even shaving growth off. However, the stimulus itself in 2009 only makes up for about 2tn Yuan out of a total of 13tn in fixed investment.⁷²

Thus, the Chinese stimulus program might be best understood as a means of political signaling, expressing the leadership’s strong commitment to reverse course in the autumn of 2008, i.e. stop the contractionary fiscal and monetary policies that had been designed to prevent overheating in the economy and instead mobilize all available resources to jumpstart growth again. The stimulus thus relied heavily on an investment-led growth pattern that had yielded impressive results in the past.

Nevertheless, the Chinese stimulus should not be reduced to its public infrastructure components only. Long-term developmental goals as well as improvements in people’s livelihood

⁷¹ For a positive assessment see: Naughton 2009a; Nicholas Lardy „China’s Role in the Origins of and Response to the Global Recession”, Peterson Institute for International Economics, Transcript of testimony at the hearing before the US-China Economic and Security Review Commission, February 17, 2009; for a rather sceptical look see Derek Scissors “China’s Stimulus: More of the Same , And Not That Much More”, Heritage Foundation April 20, 2009; DB Research “Responding to the Crisis: Did Brazil and China Miss an Opportunity?”, DB Research Talking Point, Aug 17, 2009.

⁷² Naughton 2009b, 4.

rank high on its agenda. The focus on investment is not a result of flawed design but a consequence of the central government's decision to give local administrations a lot of leeway so as to ensure a prompt economic turnaround even at the cost of postponing the necessary adjustments. With China's economy on its way to reach the 8% annual growth target in 2009, the government is facing criticism by a growing number of outspoken economists, policy advisors and business journalists demanding to turn political attention now to the unresolved structural imbalances in the economy.⁷³

The interactions of China's stimulus with the international/regional economic environment and other countries' stimulus measures are also far from clear. In many accounts China is seen as the driver behind the upturn in East Asia.⁷⁴ This however should not be interpreted as China pulling the rest of Asia out of the recession by virtue of its increased demand for foreign goods. A surge in Chinese demand can mainly be observed for certain commodities (oil and iron ore in particular) whose imports registered new records in mid-2009 but which China does not buy from its East Asian neighbors. Quite on the contrary, China's merchandise trade with its Asian neighbors suffered more during the downturn than its trade with the US or the EU. China may be winning market shares in many countries. Its imports from Asia, however, are still declining even if there is some bottoming out.⁷⁵ Therefore China's contribution to the Asian rebound may have less to do with hard economic facts than with investors' psychology. China as early as November 2008 signaled to the outside world its unwavering commitment to fight the economic crisis, thereby backing up a positive judgement of the potential for economic recovery and helping to drive commodity and stock markets up around the world. The Asian emerging countries however relied for their recovery mainly on investment and consumer spending at home as part of their own aggressive fiscal and monetary stimulus packages.⁷⁶

⁷³ See for example: Caijing (Online) August 18, 2009 "Careful Steps Toward a Stimulus Exit Door" <http://english.caijing.com.cn/2009-08-18/110226471.html> (August 19, 2008). See interview of the Economic Observer with the former PBoC Vice Governor Wu Xiaoling: Jingji Guanchawang June 29, 2009 "*Jiegou tiaozheng ying you shichang zhu dao*" (Economic Restructuring Should Take the Market as the Guiding Principle), in: <http://www.eeo.com.cn/eeo/jjgcb/2009/06/29/141681.shtml> (August 20, 2009)

⁷⁴ See for example Financial Times (Online) June 11, 2009 „Decoupling Gains New Group of Cheerleaders“.

⁷⁵ According to the official numbers from the Chinese Ministry of Commerce trade with Asia declined by 25.3% in the first half of 2009 whereas trade with the US and the EU sank by 16.6% and 20.9% respectively. China's imports (i.e. Asia's exports to China) during that period: Japan: -25.1%, ASEAN countries -27.8%, South Korea -22.9%, Hong Kong -41.4%, Taiwan -36.7%. On these numbers see Ministry of Commerce, "2009 nian 1-6 yue wo dui Yazhou guojia (diqu) maoyi tongji" (Statistics of China's Trade with Asian Countries (the Asian Region) from January to June 2009) in: <http://yzs.mofcom.gov.cn/aarticle/g/date/1/200907/20090706418881.html> (August 21, 2009)

⁷⁶ The Economist August 15, 2009 „On the Rebound“.

Statistical Appendix:

The Chinese Economy Before and During the Global Financial Crisis

	2007	2008	2009
GDP PRC (bn CNY)	25,73	30,07**	21,78 (Q1-Q3)
GDP (value added by sector)			
Primary Sector	11,1%	11,3%	10,3%
Secondary Sector	48,5%	48,6%	48,9%
Tertiary Sector	40,4%	40,1%	40,8%
GDP (demand side)			
Government consumption	13,3%	14%	
Consumer demand	35,4%	35%	
Investment	42,3%	43%	
Net Exports	8,9%	8%	
GDP World (bn US\$)	54347	60587	
GDP China (bn US\$)	3280	4421**	3189 (Q1-Q3)
GNP/capita World (US\$)	7958	8613	
GNP/capita China (US\$)	2360	2920	
GDP growth rate (%)	13%	9%** Q1: 10,6% Q2: 10,1 Q3: 9,0 Q4: 6,8	7,7 %(Q1-Q3) Q1: 6,1% Q2: 7,9 Q3: 8,9 Q4: n/a
Contribution to GDP growth			
Government/Private consumption	5,1 pp. (39,4%)		4,0 pp. (52%)
Investment	5,3 pp. (40,9%)		7,3 pp (95%)
Net Exports	2,6 pp. (19,7%)		-3,6 pp (-46%)
Fixed asset investment growth	+24,8%	+25,5%	33,4% (Q1-Q3)
Retail Sales	+16,8%	+21,6%	+17%
Savings Rate	49,9%	52%	56%
Inflation Rate (CPI)	4,8 %	5,9%	-1,1% (Q1-Q3)
Unemployment Rate	4,0%	4,2%	4,3% (H1)
Fiscal Balance (% of GDP)	0,7	-0,4	-3,3*
M2 (bn. CNY, growth %)	40,34 (+16,7)	47,52 (+17,8)	58,8 (+29,3)
Trade (bn US\$)	2174	2560	2210
Exports	1218 (+25,7%)	1429 (+17%)	1200 (-16%)
Imports	956 (+20,7%)	1131 (+19%)	1010 (-11,2%)
Trade Balance	262	298	196
Trade/GDP	66,3%	57,9%	48,9% (Q1-Q3)
Exports/GDP	37,1%	32,3%	26,6%
Import/GDP	29,2%	25,6%	22,3%
Current Account Balance			
Total (bn US\$)	372	426	261*
% GDP	11,0	9,8	5,6*
FDI (inbound, bn US\$)	74,8	92,4	63,8 (-14,3%) (end Q3)
FDI (outbound, bn US\$)	21,2	55,9	32,9 (+0,5%) (end of Q3)
Forex (at year end, bn US\$)	1530	1946	2273 (end of Q3)

Sources: National Bureau of Statistics of China, World Bank, China Ministry of Commerce

* 2009 est. by World Bank

** China revised its 2008 GDP to 31,40tn CNY (4600bn US\$), its growth rate to 9,6% in December 2009