



Is China's Stimulus Program Protectionist?

Nicholas R. Lardy forecasts an economic rebound in China and says the government's procurement spending in its stimulus program continues a long-standing protectionist bias.

Recorded June 25, 2009. © Peterson Institute for International Economics.

Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics, talking today with Nicholas Lardy, senior fellow at the Peterson Institute, about China and the global economy. Thanks for joining us again, Nick.

Nicholas R. Lardy: Thank you.

Steve Weisman: There are fresh reports that China, India, and Brazil are headed toward growth next year. China in particular, you've said, was going to bounce back next year. Tell me your latest sense of what's happening in the Chinese economy.

Nicholas R. Lardy: I think they're off the bottom. I think that the lowest growth for China was in the fourth quarter of last year, 2008, and I think in the first quarter they've come up a bit. They're well into positive territory, and I think we'll see a continuation of that trend as we move through the balance of the year. I'm still of the belief that for 2009, as a whole, they will grow at a rate of about 7 to 8 percent.

Steve Weisman: What factor has the Chinese stimulus program been in regenerating this growth?

Nicholas R. Lardy: It's been absolutely central. It's been a very aggressive program. It started early back in September or October, and I think it was reasonably well designed. It's not just more budgetary spending. They have gotten very good traction on what we call monetary easing; that is, banks and other financial institutions have been able and willing to substantially increase credit to the corporate sector, and that has fueled a lot of economic growth.

Steve Weisman: China's growth in the past has been heavily export oriented. Is the prospect for its future growth going to change the composition of its growth?

Nicholas R. Lardy: The government has been engaged in a policy of trying to rebalance its growth and to move away from such a heavy reliance on exports. That process, I think, has actually accelerated over the past six months. They're taking quite a number of steps now to stimulate private consumption expenditure. They've talked a lot about this, even going back to late 2004, but I think it's being matched with actual policies, not just rhetoric as it was two or three years ago.

Steve Weisman: In the last week or two, there have been some news reports, however, suggesting that the stimulus program has been protectionist; that it has involved subsidies to

exports and some bias toward national champions as opposed to imports. It's a little confusing. I understand you think that some of the confusion has been caused by some of the news reports.

Nicholas R. Lardy: Well, the Chinese government did put out a new opinion a few weeks ago. They put out a paper that was posted on one of the government websites, stating that in the case of government procurement, that if foreign machinery and equipment were going to be used in a project financed through government procurement that is government-purchased, you would have to get permission in advance in order to use foreign equipment. In the end, it was very clear that the conditions under which this approval would be forthcoming were fairly limited; only if there were no domestic source of the equipment or you couldn't get the equipment on a timely basis.

But the key thing was, you have to do it in advance. This was widely interpreted in the press as a new protectionist measure on China's part. But if you look carefully at what they said, they simply reiterated policies that have been in effect for more than a decade. China had a bidding scheme for government contracts for more than a decade, and from the very beginning it been a requirement that if you're going to use foreign equipment, you have to get permission in advance.

So, I don't think it's really new protectionism. It is simply a reiteration of old policies. Quite frankly, it reflects the fact that China, like most developing countries, is not a signatory to what is referred to as the Government Procurement Agreement, which is a component, but not a compulsory component, of the World Trade Organization. Countries can voluntarily enter into this, and most have not signed up for it for one reason or another. China is among those that have not done that. So they can legally discriminate in their government procurement against foreign goods.

Steve Weisman: It's different for the United States, which is a signatory.

Nicholas R. Lardy: That's right. The United States and most high-income developed countries have signed on to the Government Procurement Agreement, but the United States and some other countries also have taken very substantial exceptions that mean that there are loopholes. The most obvious one in the United States is that state and local governments are not bound by the same restrictions that apply to the federal government.

Steve Weisman: The Buy American provision in the US stimulus program, signed into law earlier this year by President Obama, was seen by some of our colleagues as a violation of the spirit, if not the letter, of the Government Procurement Agreement. What does this do about the debate in the United States over the Buy American provision now that we see China reiterating its Buy Chinese provision?

Nicholas R. Lardy: I think we're unfortunately on a kind of slippery slope where everyone is pointing at everybody else. I think with a very substantial downturn in economic activity, there are a lot of countries looking for a quick fix, and one way to get a quick fix is to reduce your imports. But in the aggregate, of course, that can't work. Reducing your imports just reduces aggregate demand on other countries and reinforces a downward spiral that we're in, so I think these buy local provisions should be held to an absolute minimum.

Steve Weisman: Is there a prospect for this domestic demand-driven growth that we're going to see next year increasing American and other foreign exports to China?

Nicholas R. Lardy: I think China's trade surplus, which has been enormous and completely outsized, will begin to come down. Indeed, in the last couple of months, it has already begun to shrink. I think that will continue as we move through the balance of this year. So China's outsized contribution, if you want to use that word, to global imbalances, I think, is beginning to come down and will come down further. And what that means for the rest of the world is that China will be less of a subtractor of aggregate demand. In other words, instead of just flooding the world of excess goods, that excess will diminish, so that China's contribution to global growth will improve and countries that have had deficits in their trade with China will experience a reduction in those deficits.

Steve Weisman: I should emphasize Nick that you and Morris Goldstein are going to produce a book in July, which we will talk about at that time, where you assess China's currency policy. So we're not going to talk about that today. But in general, looking at the situation leading up to the publication of your book, which will coincide with the first Strategic and Economic Dialogue between China and United States, how would you assess US-China economic conversations and relations right now?

Nicholas R. Lardy: I think they're, in general, reasonably good. I think, however, there are some warning signs. China has been increasing its rebates of the value-added tax on export products, which is legal, but again not quite in the spirit of the G-20 communiqué, which said that we would avoid protectionism. The reinforcement of their buy local provisions and government procurement again is an adverse sign.

I think there will be a strong dialogue, a strong discussion, but I hope the two countries will be able to continue the very positive contribution that each has made to global recovery with their very strong stimulus programs. The United States and China have had the strongest stimulus programs, and I think we'll be, and perhaps already are in the Chinese case, among the first countries to begin to recover, and it would be unfortunate if that record of cooperation gets deluded by some slippage on the trade front.

Steve Weisman: Do you see any contradiction at all between China's support for a big US stimulus program and China also expressing concern about future US budget deficits?

Nicholas R. Lardy: It's really a matter of timing. In the short run, China, like most other countries, favors stimulus programs, and stimulus programs are more effective the more countries join in. So, I think, in the short run the United States and China have been among the biggest stimulus countries, and I think that they both feel these programs are working.

But China, as the largest holder of US financial securities, in particular Treasury securities, is very worried in the medium and longer term that the big stimulus and very large US deficits could cause inflation, which would erode the purchasing power of the value of their US financial asset holdings.

So, it's a very delicate balance. They'd like us to have a big stimulus in the short run, but they hope that as soon as recovery gets underway, that it will be curtailed, and that we will have a transition to a more fiscally sustainable program and that the threat to the value of their financial assets would be minimized. So, they want the best of both worlds, just like everybody else. They want the stimulus in the short run so there will be more aggregate demand in the global economy, which will help everybody, including China, recover. But they want a fiscal program in the medium and longer term that will preserve the value of their vast holdings of dollar assets.

Steve Weisman: Nick, thanks very much. Nice to know that on this, the Chinese and the Americans all want the best of both worlds.

Nicholas R. Lardy: Thanks.

