China walks policy tight-rope

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By Allison Jackson

The high command of China's communist leadership emerged enhanced from the global economic crisis, unencumbered by the political constraints in recession-plagued Western democracies. But while the Chinese model of top-down central planning can take credit for maintaining blistering rates of economic growth, analysts warn that leaders are walking a policy tight-rope as they head into the annual session of parliament.

In the crisis, Beijing was able to very quickly pump enormous fiscal and monetary stimulus into the economy while the Western democracies were bogged down by the checks and balances in the government," said Todd Lee, a US-based analyst at IHS Global Insight. "The flipside of this policy implementation efficiency is if the Chinese authorities get it wrong, it could go wrong on a massive scale.

China is now grappling with how to choke off trillions of dollars in credit so as to keep inflation from spiralling out of control, all without squeezing growth and stoking mass unemployment in the world's most populous country. The stakes are high not just for China, which is on the cusp of overtaking Japan as the world's second-biggest economy, but for the United States and Europe, which can ill afford another global setback now.

Experts say the perilous challenge will exercise China's ruling elite at the annual session of the National People's Congress beginning Friday and beyond, as a new generation of leaders prepares to take power from 2012. China-watchers will also look at the NPC for clues as to when the leadership intends to wind down its $586-billion stimulus program. Premature action could also choke off growth.

Eswar Prasad, the former head of the International Monetary Fund's China division, said the policy "tight-rope act" could become increasingly difficult to manage. "The growth model has created a number of potential problems - unbalanced growth, excessive investment and a dependence on exports," said Prasad, who is a senior fellow at Washington's Brookings Institution. "The main challenge facing China's leaders is to ensure that the scale of these problems increases slower than the growth in overall output, which means they still come out ahead.

Beijing is already clamping down on rampant lending by state-run banks to calm inflationary pressures, fearing asset bubbles and economic overheating as well as a surge in bad debts. Policymakers have raised bank reserve ratios three times in as many months - effectively limiting the amount of money banks can lend - and increased the interest rate on benchmark three-month and one-year treasury bills.

Long reliant on exports to fuel its economic boom, China is also trying to boost domestic demand by enlarging subsidies for the vast rural poor to buy home appliances and cars. More drastic measures such as interest rate hikes and an appreciation in the yuan currency - a move long demanded by the United States and Europe - could be in the works, analysts believe.

But Royal Bank of Scotland economist Ben Simpfendorfer said the government must do more to reconfigure its export-led economic model - even if this means retreating from its cherished goal of eight percent annual growth. "This is an economy that is clearly imbalanced and needs more structural reform," he said. Nicholas Lardy, a senior fellow at the Peterson Institute for International Economics in Washington, said a far bigger risk for the country was looming abroad, in the West.

There could be mistakes but if you look at their (leaders') track record ... it has been nothing short of brilliant," Lardy said. "I'm much more worried about the external environment ... if the recovery is very delayed in Europe or the US goes into a double-dip (recession) in the second half, then I think then they (Beijing) have a huge problem.

Resolving the imbalances exposed by the global crisis will remain a major challenge for the new leaders set to take the helm in 2012-2013, such as Vice Premier Li Keqiang, who is tipped to replace Premier Wen Jiabao. And an understanding of economics will be crucial, said JP Morgan economist Jing Ulrich. "With the financial crisis a recent memory, experience in economic management will likely weigh heavily in the selection of China's new generation of leaders," she said.

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