

The strategic economic dialogue is taking Sino-US talks beyond rhetoric, but there's a limit to co-operation, writes Steven Xu

A sting in the tail?

The third Sino-US strategic economic dialogue, held in Beijing last week, achieved more concrete results than many expected. There was a good reason why the latest talks drew little fanfare. Both Vice-Premier Wu Yi (吴仪) and US Treasury chief Henry Paulson are on their way out. And certain moves taken by the United States – such as the Dalai Lama receiving an award from the US Congress during the Communist Party's 17th National Congress – raised the level of suspicion and caution in Beijing.

Surprisingly, both parties focused on real issues such as market opening, the environment, food safety and bilateral co-operation. Gone was the never-ending debate on revaluing the yuan seen in previous sessions.

Meanwhile, the People's Bank of China accelerated the pace of the yuan's appreciation against the US dollar in the run-up to the talks. The exchange rate ended at 7.36 yuan to the dollar last week. But, make no mistake, the likelihood of a second revaluation by Beijing is extremely slim, even though the central government seems to have drastically increased its efforts to cool the economy. The main reason behind the reluctance to engineer another one-off adjustment is that leaders in Beijing are aware that conventional monetary tightening is unlikely to slow the economy sufficiently.

That is why the most recent rise in the reserve requirement rate – the amount of money banks are required to hold in reserve – was not accompanied by interest rate increases.

The rationale was that, given the inefficient financial system, credit controls would be more effective in curbing unwanted investment. For the same reason, yuan revaluation is viewed as a poor policy choice compared to allowing greater capital outflow.

In a recent article in the Beijing-based business magazine *Caijing*, Hu Xiaolian (胡晓炼), deputy governor of the People's Bank of China and the head of the State Administration of Foreign Exchange, argued eloquently that using foreign capital more efficiently and easing controls on overseas investment would remain the key tools for mainland China in reducing its current-account surplus.

Not surprisingly, mainland officials at the strategic economic dialogue talks were reassuring US delegates that China's sovereign wealth fund would not be making massive, politically unpopular



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acquisitions of American firms. This week, in the latest development in easing capital outflows, the qualified domestic institutional investor (QDII) scheme was given a green light to invest in the British equity market. (The US equity market will almost certainly be next.)

Lobbying the US not to block Chinese entities' future acquisitions is important, in order for China to diversify its investment

from government debt to assets. At the same time, Chinese financial-service firms must establish a more meaningful presence in developed countries in order to follow Chinese companies overseas. Examples such as China Minsheng Bank's 20 per cent equity investment in a California bank, and China Merchants Bank's opening of a new branch in New York, are only the beginning of a powerful trend. China has many ways of exporting its vast savings.

Allowing foreign companies to tap into the domestic A-share market is one of the most important results to come out of the third strategic economic dialogue. The overvaluation of A shares reflects domestic investors' lack of choice. An expansion of the QDII or a faster pace of yuan appreciation could immediately deflate A shares. Increasing the supply of good-

quality companies makes sense, and would be a much safer way to achieve a soft landing of the A-share market.

Once foreign companies can raise funds from domestic mainland savers, foreign financial service companies – which are led by American firms – will penetrate the Chinese market more effectively.

The strategic economic dialogue is gradually easing Sino-US discussions beyond the rhetoric of "fair trade", "cheap currency" and "global imbalances". However, let's remember that there is a limit to how far China and the US can genuinely co-operate, given heightened competition for natural resources and geopolitical factors.

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The right route

To clean up air pollution, should we be doing more of the same – that is, taking an incremental approach – or making a change in direction? Going down the same path but doing more is fine if the course is right. After all, we cannot do everything in one fell swoop. But if the steering is off, then a directional adjustment is needed.

According to results of a survey released on Monday, the majority of 81,000 Hong Kong respondents would be willing to pay more for transport in return for cleaner air. This should surprise no one; poor air quality has bothered Hongkongers for many years.

The issue is: which things does the government want people to pay more for? Let's take roadside air pollution as a point of discussion. It is not only appallingly high, but has become almost a normal condition. If the public paid more for public transport, would that improve roadside air quality?

Would higher transport costs go towards subsidies to build more rail lines? Or to encourage operators of buses and light buses to replace old vehicles earlier with less-polluting models? How would commercial trucks be dealt with, since they spew out the highest amount of polluting emissions?

Taxis and many light buses have already converted to LPG; new vehicles must have Euro-IV-standard engines; and only ultra-low-sulfur diesel is available. But those measures have not been nearly enough to clean up roadside air pollution. Thus, doing more of the same – pushing new vehicles to have Euro-V-standard engines, and using even cleaner fuels when they become available – will not make much difference if Hong Kong's old vehicles are not replaced.

How can we make owners replace their vehicles? The government has already announced a public subsidy scheme – the "carrot". But there's no "stick" unless owners are given a deadline, in the near future, for replacing the most polluting vehicles.

London faced a similar challenge. Its solution is to turn the whole of Greater London into a low-emission zone and is starting a phased-in scheme from next February, pushing commercial vehicle operators to upgrade their vehicles. It uses its existing electronic road pricing system to track vehicles going into the city; those with old, polluting engines must pay a penalty every time they cross the city boundary. So, if you are running a trucking business and you have to go

to London frequently, the penalty becomes an expensive operating cost; you had better buy a new lorry. The authorities also offer a replacement subsidy scheme, so the stick and carrot work together.

Launching the electronic road pricing system was a change of direction for London, and would be for Hong Kong as well. But our government has not yet been able to adopt it, although the scheme was first raised in the 1980s.

Many of Hong Kong's roads are narrow, with high vehicle density, creating our infamous "street canyon" effect that traps vehicular pollution. That in turn contributes to the extremely poor roadside air quality. With so many people affected on a daily basis, it is shocking that much more has not been done already to protect public health. Just think of how many people live and work right next to, or near, heavily used roads – and how many schools, hospitals, clinics and elderly homes are affected. It's a pity we don't have a surgeon general to champion public health; there are plenty of voices arguing for commercial interests.

The government's recent interest in building more rail lines makes sense. But it must also make clear that it will reduce road building and use demand-side mechanisms like road pricing to deal with congestion. It should use town planning to ease the street canyon effect and tighten air quality objectives, in addition to taking old, polluting engines off the road.

Unless there is a clear policy to change direction, incremental measures, including banning idling engines, will not make enough of a difference.

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Other Voices

Fiddling while a US recession looms

Nouriel Roubini

In recent weeks, the global liquidity and credit crunch that started in August has become more severe. This is easy to show: in the United States, the euro zone and Britain, the spreads between London interbank offered rates (the interest rates at which banks lend to each other) and central banks' interest rates – as well as government bonds – have grown since the crisis first hit.

To be sure, major central banks have injected billions of dollars of liquidity into the commercial banking sector. The US Federal Reserve, the Bank of England and the Bank of Canada have lowered their interest rates. But worsening financial conditions prove that this policy response has failed miserably.

Moreover, the recent announcement of co-ordinated liquidity injections by the Fed and four other major central banks will fail to reduce interbank spreads significantly, because monetary policy cannot address core problems underlying the crisis. The issue is not just illiquidity.

Many more economic agents face serious credit and solvency problems. They include millions of households in the US, Britain and the eurozone with excessive mortgages; hundreds of bankrupt subprime mortgage lenders; a growing number of distressed homebuilders; and many highly leveraged and distressed financial institutions.

At the same time, monetary injections cannot resolve the generalised uncertainty of a financial system in which globalisation and securitisation have led to a lack of transparency that has

undermined trust and confidence.

The US is now heading towards a recession, regardless of what the Fed does. Other economies are also heading towards a hard landing as the US contagion spreads.

To mitigate the effects of a US recession and global economic slump, the Fed and other central banks should be cutting rates much more aggressively, rather than relying on modest liquidity injections that are bound to fail.

Today's financial markets are dominated by non-bank institutions – such as investment banks, money market funds, hedge funds and mortgage lenders that do not accept deposits. They have no direct or indirect access to the liquidity support of central banks.

So, the risk of something equivalent to a bank run for non-bank financial institutions is rising. There is little chance that banks will re-lend to these non-banks the funds they borrowed from central banks, given these banks' own severe liquidity problems and mistrust of non-bank counterparts.

Major policy, regulatory and supervisory reforms will be required to clean up the current mess and create a sounder global financial system. Monetary policy alone cannot resolve the consequences of inaction by regulators and supervisors amid the credit excesses of the past few years. Much greater and more rapid reduction of official interest rates may at best affect how long and protracted the inevitable downturn will be.

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The west's part in producing China's deadly pollution

Joshua Muldavin

Leaders from around the world gathered at the Bali climate change talks this month to chart our collective future. Looking out of my window in Beijing – through the dense haze that envelops this city with world-record levels of smog, dust and deadly pollution – it is easy to understand why many there perceived China as the Godzilla of global warming.

A country choking on its own "success" – now producing over 20 per cent of global greenhouse gases – China makes an easy scapegoat. However, targeting it does little to address the fundamental causes of climate change, mitigate its consequences or provide lasting solutions.

The west has worked long and hard to transform China into what it is today: an industrial platform for the world where some of the most noxious, hazardous production processes are concentrated. Western governments and corporations have not only benefited, but have helped lead China down this road.

In addition, western consumers have directly profited from the inexpensive products that pour from China's factories. Fundamental to the rise of its emissions is the rapacious growth of consumption, and the championing of it, especially in the west. The carbon dioxide embedded in mainland China's exports to the United States in 2004 alone is estimated at 1.8 billion tonnes, equivalent to 30 per cent of the US total.

The World Bank, Japan and western donor countries have provided over US\$200 billion in loans to China, since the early 1980s, to create the infrastructure that has enabled it to be-

come the world's factory. Multinational companies received contracts to help build its infrastructure. Combined with its large, mobile, low-cost workforce, all this made China highly attractive to globalising firms.

Simultaneously, western leaders have promoted neoliberal economic policies, increasing capital mobility. For 25 years, corporations moved factories to China, often partnering local companies and subcontractors to take advantage of lax environmen-

China's global integration means its environmental destruction does not stop at its borders

tal and occupational conditions. China's global integration was further enabled by Beijing's own devotion to rapid growth at any cost. Paradoxically, the resulting environmental destruction threatens that very growth.

The long-term, destructive environmental consequences of China's development path are well known to the country's leaders and citizens. Official statistics now point to pollution as the primary cause of death. And global warming's catastrophic consequences for China provide strong incentives for action. The rapidly shrinking Himalayan water tower foretells a dire future for billions in China, India and Southeast Asia as Asia's rivers dry up. This helps explain China's increasing engagement

at the Bali talks. But China's global integration means its footprint of environmental destruction does not stop at its borders.

The world's companies pull global resources through China from far-flung corners of the planet – timber from Siberia, Mozambique and Myanmar; petrochemicals and minerals from Sudan, Indonesia and Bolivia. The impacts on global warming through deforestation, for example, are magnified far beyond China itself.

The west must acknowledge its own role in shaping and benefiting from China's global integration and rapid increase in consumption of resources. Instead of being diverted by the relatively easy answer of blaming China – or any other single country – for rising greenhouse emissions, we must focus on the real root of the problem. That is, a highly unequal and unsustainable international system of production, distribution and consumption that insulates winners from losers, and delivers the greatest share of the benefits to a lucky few while jeopardising the future for everyone else.

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America's tortured soul stands on trial

Tom Plate

There are times when, from a moral standpoint, men and women simply should not remain silent. In such times, seemingly fine lines need to be turned into unequivocal hard lines. This is when the men and women of conscience stand out.

Consider the controversy about torture that is bedeviling America. It may be hard to believe, but only one serious presidential candidate has so far been outspoken about the need for the US never to use torture.

At a time when potential leaders ought to be standing up, by and large they are falling all over themselves in an attempt to avoid taking firm policy lines that might alienate potential primary voters.

But moral waffling is not the style, on the vital question of torture, for Senator John McCain. And he should know: he spent time in a Vietnamese prison, where he was severely mistreated and other American soldiers were tortured.

He recently said: "These tools are not American tools, and the easy way is not the American way."

It is the difficult moral dilemmas in life that give definition to our character and soul. All the candidates favour a high-quality health care system. No one is happy about the rich-poor divide. No candidate, as far as I know, offers anything other than a contemptuous view of Islamic terrorism. Those are the easy questions. But should the US way of interrogation permit the torture of a suspect who may have valuable, even explosive, information?

Two major ways of approaching this question are perhaps most incisive. One approach uses cost-

benefit analysis: would the quality and quantity of information obtained by torture justify the barbarity of the technique? The problem with this philosophical approach is that sometimes, if not often, the information is not useful or may be erroneous.

The second classic approach is more principled. It does not try to add up the gains and losses of using torture, but would absolutely ban certain classic torture techniques as unambiguous no-go areas for US interrogators.

But don't desperate times call for desperate measures? The answer is that desperate times test true moral fibre in ways that ordinary times can't even approach.

In 1981, I wrote a book with Andrea Darvi, now my wife, titled *Secret Police: The Inside Story of a Network of Terror*. Its conclusion was that America is different from bad nations only when it stays on the morally right side. "A secret police force is a horribly blunt and effective instrument of suffering," I wrote. "This book is intended as a warning."

Today, more than a quarter of a century later, at least one candidate for the White House takes a similar view. It is no wonder that both the *Des Moines Register* and *The Boston Globe* – major newspapers stalking the Des Moines and New Hampshire primary tests – recently endorsed Senator McCain. No one needs to agree with him on every issue. But at least he stands for something – and it is something very important: America's national soul.

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