

INSIGHT

Unlocking prosperity

Simon Tay looks ahead to the day when Asians could be spending more, while still struggling to get the best from their savings, and concludes Asia needs financial markets that can channel money to more productive uses

The world seems awash in public debt. Problems in Greece with its second bailout are the most prominent but other problems in European economies await. Across the Atlantic, the American political system is in a deadlock about containing the runaway federal deficit while many cities and states are struggling.

In contrast, most Asian governments have banked away surpluses and now hold comfortable reserves. Things could not seem more different. Trends, however, may be changing, and not always for the better.

The recent revelation by China's auditor general about debts owed by local governments should be taken seriously. The *China Daily* described the 10.7 trillion yuan (HK\$12.9 trillion) of debt as posing a massive peril to the banking system, since 80 per cent is owed to China's banks.

Compared to the country's overall reserves, the problem may not seem so big. Beijing can issue government bonds, as some urge, or even afford a write-down. But neither response will fix the systemic and ongoing problems. Concerns have to be addressed about transparency, rationality and accountability in government spending. So, too, must allegations about corruption.

Such concerns are not limited to China. Stimulus spending and big infrastructure budgets in other countries, too, can disguise the diversion of funds. After decades of locking away high savings, Asians find that unlocking and using them wisely can be tricky. Spending is not, however, something to be avoided or simply accepted as inevitable. Indeed, encouraging Asians to spend more is necessary to make growth more sustainable.

Who else can make up for the diminished demand from the West? A lot now depends on the Asian consumer. Newly rich Asians—mainly hordes of Chinese—buying up luxury goods are just the most obvious sign. An Asian middle class is emerging which, depending on definitions, will constitute anything between 500 million and 1 billion people.

Asia-wide consumption is projected to reach US\$32 trillion in 20 years, comprising 43 per cent of worldwide consumption. The fastest-growing markets for many companies and products will be in Asia. With this, balancing Asian pocket books will enter a new phase.

Household saving rates in Asia will be lower in future. Governments, too, will on balance save less. Surpluses will be cut as trade balances shift.



Add stimulus spending and infrastructure investment, and reserves will be depleted. Given these trends, over time, it is not inconceivable that some Asian governments might one day go the way of Greece.

Asia's current financial systems have only a limited capacity to allocate savings to those who need capital. Many Asian households still keep a large part of their wealth in property, gold and other non-financial assets. Many do

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not have bank accounts, because they lack access to banks and financial institutions, or simply do not trust them.

Governments need to create deeper and more effective financial markets. This would help unlock savings and direct them towards companies that need capital to yield higher returns. Cross-border efforts must also be considered, especially among the smaller economies.

Asians also need to seriously consider creating bonds to provide for investment in infrastructure, education and other needs. This would help governments raise and direct funds to specific needs. Public bonds could also potentially provide some discipline to government spending.

Otherwise, Asian public reserves will continue to be locked in US Treasury bills, perpetuating patterns seen before the crisis, and holding

them captive to the value of the US dollar.

Without other and more productive outlets, private savings in Asia are flooding into assets such as housing, creating artificial bubbles.

Yet, even if Asians can avoid such bubbles and bad loans, develop a more self-contained economy and self-generating growth, they must guard against hubris about Western folly. The interdependence with developed countries in both economics and politics continues. Asia's growth will require capital, know-how and skills in such quantity and increasingly higher quality that exchanges and engagements with the developed economies of the US and Europe will be essential.

Simon Tay is chairman of the Singapore Institute of International Affairs. This comment draws on work on a global think tank panel, on the future of prosperity, convened by Aviva

The far side

Paul Stapleton says the earth's long-term health is reason enough to take a firm stand on 'growth at all costs' plans, such as building a third runway

There has been considerable discussion about whether Hong Kong should proceed with building a third runway. The main issues concern whether the third runway is necessary, and whether it is affordable. Proponents argue that we need it to stay competitive in the region. The environmentalists, however, say that the landfill used to create a third runway would disturb the endangered pink dolphin and possibly lead to its extinction.

Thus, there appears to be essentially two arguments: an economic one and an environmental one, with the latter specifically focused on the future of one species.

Seldom mentioned, if ever, is a third argument that looks at the debate from a broader perspective. This perspective is also an environmental one, but one that takes a much larger scale and longer time frame. Specifically, the proposal for a third runway is based on an assumption that unrestrained growth is environmentally sustainable. There has been a lack of any discussion about the effect that the continued growth of air transport will have on global warming.

Current beliefs about emissions from commercial aircraft hold that the impact of burning fuel in the stratosphere is considerably greater on the environment than at low altitudes. Present estimates suggest a multiplier effect of at least two, and possibly up to four, should be applied to aircraft emissions in terms of their negative impact on global warming.

Those holding the mainstream opinion which advocates the building of a third runway may argue that, if Hong Kong does not build it, some other centre will expand its own hub and take business away. To respond to this argument, a simple lesson from an isolated Pacific island pertains.

As long as 1,500 years ago, Polynesians arrived on the shore of a deserted island covered in trees. The land was fertile and the surrounding waters were rich in seafood. It may have seemed like paradise to the lost seafarers. Over the subsequent centuries, generation upon generation exploited the island's resources and the population increased until it overloaded the carrying capacity of the land. As tree-felling continued, the forests declined and the soil eroded. Eventually, there was only one tree left on the island and, presumably, the person who cut it down thought, "if I don't get this tree, someone else will". Soon after, the population of the island collapsed from around 20,000 to about 2,000.

The tie between Easter Island and the debate over a third runway may appear tenuous, but the analogy is poignant. By building a third runway, Hong Kong would be accepting the status quo mindset that believes economic growth is unassailable, and that whatever it takes to continue that growth is fair.

Hong Kong has a rare opportunity to take a stand that would make the world take notice. By refusing to buy into the prevailing "growth at all costs" way of thinking, Hong Kong can set an example. By saying "no" to a third runway, Hong Kong can draw a line in the sand and state that it will not participate in the imminent tragedy of the commons which the current climate change is almost certain to force upon us.

In essence, we can be the one who refuses to chop down the last tree and, perhaps, with regional negotiation, others will follow.

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Worry over local government debt should extend beyond default fears

Local government debt in China made the news recently. On June 27, the National Audit Office published its first audit of such debt, giving a clearer overview of debt levels on the mainland. The same week, *Caixin Century* reported that the Yunnan (雲南) government was struggling to repay its debt on a highway project, sparking fears of a "debt domino" crisis. The first piece of news is welcome; the second is worrying.

According to the auditors, the risk of local government debt is, on the whole, manageable. But analysts say the audit office took a narrow view of local government debt, compared with that taken by the People's Bank of China and the China Banking Regulatory Commission. They have also raised concerns over how such debts are borrowed, used, repaid and managed, arguing for the need for caution.

In other words, the real risk of such debt lies not in its size, but in how it is managed. Lax budget control by local governments is a chronic problem, and officials are accustomed to borrowing heavily to solve their financial woes. "Borrow first, ask questions later" is how many governments work. This is a worrying habit.

How much money have local governments borrowed so far? Can they repay it? A clearer picture of local government debt will help both policymakers and investors. The audit office says total local government debt reached 10.7 trillion yuan (HK\$12.9 trillion) at the end of last year. And, according to the Ministry of Finance, central and

Hu Shuli says the problem has its roots in China's ineffective budget reform. Fiscal accountability must be improved, and the economic role of government pared down



local government debt added up to 43.9 per cent of gross domestic product, a ratio that falls well below the international safety standard of 60 per cent.

Rising local government debt is, to a large extent, the result of the Asian financial crisis and the global financial meltdown: the debt balances of 1998 and 2009 soared by 48.2 per cent and 61.9 per cent respectively from a year ago, taking total debt levels to new records over the years.

The impact of the global downturn was especially severe: local government debt almost doubled in its wake. Local governments raised funds to supplement the central government's injection of 1.18 trillion yuan in investment, as part of a stimulus package launched to counter the recession. Although the measures helped to steady the economy and boost growth, they also increased the debt burden on local governments. Some may well run into difficulties.

How many of the 1.87 million items of local government debt could turn bad? The problems are a legacy of the contradictions in 30 years of government and financial reform in China. The abnormal growth of government debt has its roots in systemic problems.

The incomplete reforms of China's tax-sharing system—in

which local government revenues are diverted to central government coffers and then redistributed to other regions, in an attempt to promote equal development—are to blame. Among these transfers from the central government to local governments, the bulk are one-off payments for specific projects; in contrast, transfer payments for general purposes make up only a small portion of the total. The reverse is true in some developed Western economies.

The projects are approved by central government departments before the funds are given out. But, in an effort to balance local interests, the amount given out often ends up being only a portion of what is needed. Thus, local governments are expected to contribute a share, with other sources contributing the rest. In some underdeveloped regions of the central and western parts of China, funds for a project are usually raised through loans, mainly from the banks.

These one-off transfer payments make it hard for local governments to control their budget. Moreover, the central government decides how these payments should be used, muddying the division of responsibilities between central and local authorities. It also discourages local governments from improving their public finances.

In the central and western regions, these transfers add up to about 60 per cent of the finances of the local governments, leaving a substantial amount of off-balance-sheet loans that escape the scrutiny of the national and local people's congresses at different levels.

At the end of two financial crises, China is left grappling with the unchecked expansion of the government's role in the economy. To resolve the local government debt problem, we need to ask not only how we can repay the debt, but also how we can limit the government's role in the economy.

The problem of local government debt is, directly or indirectly, the result of ineffective budget reform. The national and local people's congresses should study ways to improve supervision of government budgets, and enhance fiscal transparency and accountability. This is the way to stop debt snowballing.

The audit report is only a "health check"; the cure lies in undertaking reform. Many have called for local governments to be allowed to issue municipal bonds. While this proposal may be beneficial in the long run, the first step is to map out how the system could be overhauled before rushing to carry out piecemeal reforms. Local governments cannot afford to ignore the warning sounded by Yunnan's troubled finances.



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Oath of allegiance is now a passport to servitude

Paul Karl Lukacs is bewildered by author's decision to become a US citizen

On July 4, best-selling British author Simon Winchester became a citizen of the United States. Why would he want to do that?

In the past 50 years, an American passport has morphed from the most coveted international document into a mark of Cain that many expats would love to return by post. Being a US citizen now means being tethered to a surly government with no respect for its citizens' rights but a ravenous appetite for power and obeisance. It's a mystery why Winchester would want to move permanently into that house.

Winchester has published 22 non-fiction books since 1975, some with Asian themes. In *Korea: A Walk Through The Land of Miracles*, he hiked from one end of the peninsula to the other. *The Man Who Loved China* told the life story of an eccentric Cambridge don who compiled a 24-volume encyclopedia of Chinese intellectual history. And, in the 1980s, Winchester wrote about each of the remaining pink bits of the British Empire, including Hong Kong, for *Outposts*.

So why would an author who walks a global beat chain himself to the US? In a *Newsweek* essay, Winchester described the generosity experienced during a 1963 hitch-hiking trip across the US as well as the professional success he has since achieved.

"I felt so deeply grateful to America in consequence, beholden," he wrote. "I now truly

wanted to throw in my lot, to play in full my part in America's making and its future."

Gratitude may be a virtue, but there's no reason to waste it on a country that, as its first order of business, requires new citizens to acknowledge the state's power to compel bodily labour. As prescribed by law, its oath of allegiance is only eight clauses long, but three of them refer to the federal government's ability to force Americans to bear arms, to work in the armed services and, ominously, to "perform work of national importance under civilian direction".

That is only the beginning. When Winchester returns to the US from his many trips abroad, he will not be warmly welcomed. Papers notwithstanding, he will be interrogated with suspicion, and, if he invokes his constitutional right to silence, he will be detained. If Winchester makes powerful enemies, he will see that the prohibition against double jeopardy is a mirage and that he will be required to defend against federal charges, state charges and a federal civil suit—while his funds are frozen.

Winchester will learn that the government wants his bankers to spy on him, his phone company to spy on him, his airline to spy on him, and the makers of electronics and software to install "backdoors" to enable even more spying.

In time, Winchester may become appalled at Americans' docile submission to anyone with a gun and a badge. Airport agents

inspect the diaper of a 95-year-old cancer patient. Customs officers seize cash lawfully carried by people near a border. Local police arrest citizens videotaping public patrols. And most Americans do not care. They comply.

The political class and populace of Europe may not be any better, but comparatively tiny nation-states lack the resources to implement worldwide Stasi-level surveillance. The US, with few financial constraints, operates the largest espionage network on the planet.

Now that Winchester has taken the oath, there is no escape. Congress will legislate his conduct at home and abroad. President Barack Obama claims the authority to declare Winchester an enemy of the state and order his execution without judicial process. Renouncing US citizenship can cost hundreds of thousands of dollars in penalties.

Citizenship in a second-tier European Union state—one with economically imposed limits on its power—is infinitely preferable to being a subject of the Eagle Empire. It's too late for Winchester. But it's not too late for everyone else looking for a new passport.

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