Mr. Chairman, Minister Wang, Sir John, good morning, ladies and gentlemen. It is my great pleasure to be here today. I want to thank Minister Wang Mengkui and his colleagues at the Development Research Center of the State Council for inviting me to participate in the China Development Forum. I am especially honored to be asked to discuss the excellent speech of Minister Xiang Huaicheng.

Minister Xiang has given us a comprehensive review of the role of fiscal policy in attempting to achieve sustainable and stable economic growth in China. Fiscal policy, in the form of principally public investments in infrastructure, has been most instrumental in maintaining Chinese economic growth during the East Asian currency crisis of 1997-1998. And by maintaining Chinese economic growth during that period, and thus forestalling pressure to devalue the Renminbi, it has also contributed greatly, even though indirectly, to the subsequent East Asian economic recovery.

I am in total agreement with the views of Minister Xiang as expressed in his speech, I wish to take this opportunity to add a few supplementary remarks.

First, the accelerating pace of economic globalization, caused in part by the information and communication technology revolution, and in part by the world-wide reduction in trade and investment barriers, has several important implications. (1) The transmission of unexpected external shocks are now faster; and the incidence of external shocks has become more frequent, and the shocks themselves have greater domestic impact; (2) There is also much greater potential economic volatility. Industries have become much more footloose, and the sub-division of supply chains, again made possible by the ICT revolution, has made it much easier and faster to change suppliers and thus shift demands from one country to another. (3) With the faster transmission of information, there is also the potential of a faster response. A faster response is, however, not necessarily an unmitigated blessing--it can be more susceptible to mistakes, and it has a great potential for causing instability.

Fiscal policy can be used actively to smooth the economic fluctuations caused by changes in external demands and other external factors and to facilitate the necessary industrial adjustment and transition. For example, public infrastructural investment projects can be used to take up the economic slack caused by a downturn in exports. In order for such a policy to be effective, it is best that there is a stand-by list of infrastructural projects on the shelf, ready to go at a moment’s notice, and ready to be suspended or slowed down when the macroeconomic circumstances change. The U.S. inter-state highway system is an example of such a stand-by public investment project. It has taken decades to compete and has contributed greatly to the U.S. economy. There should also be provisions for a social safety net, which can take different forms and not just limited to welfare payments. For example, transitorily unemployed workers may be allowed to borrow from their own individual retirement accounts to help tide them over spells of unemployment (and required to repay into these accounts upon finding new jobs). The government must also make increased provisions to support education--to train workers and potential workers to have general and flexible skills rather than industry or enterprise-specific skills. It must also provide for the re-training of displaced workers, and early retirement of older workers who cannot be effectively retrained. In order to protect the economic and financial system from the most harmful effects of large, unexpected shocks, there may have to be various types of circuit breakers (even the New York Stock Exchange has circuit breakers) on the financial and capital markets and indeed on the foreign exchange markets. The idea is not so much to work against the market, but to slow it down enough so as to prevent a stampede that may have been mistaken but have irreversible systemic effects. We should remember that friction is stabilizing.

Second, aggregate demand deficiency, or synonymously, excess productive capacity, is a real possibility not only in China but also in the world. We have seen it not only in China for the last few years, but also in the United States, where the economy is beginning to enter a period, hopefully not too prolonged, of aggregate demand deficiency. While increased fiscal expenditures can take up the slack caused by the deficiency of domestic enterprise investment and consumption demand, they should be focused on the addition of productive, at least eventually productive, capacity. Whether these investments can be productive can make a large difference on the economy in the medium and long run. Moreover, fiscal policy should be used in such a way that it has the ability to change the expectations of the domestic enterprises, investors and consumers. If expectations cannot be turned around, if the public perception is that there is going to be business-as-usual, as in Japan, fiscal policy will have no lasting impact. Fiscal policy is only effective in the medium to long term if it can change expectations of entrepreneurs, investors and consumers. That expectations can be self-fulfilling is well documented. The 1992 southern tour of the late Mr. Deng Xiaoping is an example of how expectations, once turned around, can be self-fulfilling (as long as the underlying productive capacity is there). In every cycle of rapid economic growth, there is always a focal point. In the United States, in the 1950s, it was the housing sector as households migrated from the cities to the suburbs. In the last few years, the internet was the backbone of the rapid U.S. economic growth. The challenge for the Chinese economy is to find such focal points of growth. I think it can be found in the promotion of owner-occupied housing, in urban renewal and urbanization, and in education. Finally, fiscal policy is a much more important and effective instrument for macroeconomic stimulation (as opposed to restraint) than monetary policy because of the relatively primitive development of the Chinese capital market.

Third, public infrastructural investment in transportation, communication, power and education is necessary to lead and to stimulate development in underdeveloped regions. These investments, by necessity, must lead development. It must be put in place first before there is demand. It is the public investment that creates and stimulates enterprise investment demand rather than vice versa. This is especially true for the development of the Central and Western regions. These public investments do not crowd out private, or non-government, investments. In general, I believe the government should undertake only those infrastructural investments that the private, or non-government sector, is unwilling to make. This includes, for example, investment projects the benefits of which cannot be readily internalized. In fact, it is probably a good idea to private public investments if and when they become self-sustaining and to recycle the proceeds for additional public investments so as to minimize the financing needs from the government budget.

Fourth, in order to support and sustain the fiscal expenditures, China must undertake to improve its fiscal system, which, as Minister Xiang mentioned, it is already in the process of doing. The introduction of a comprehensive income tax, the full monetization of wages and salaries of public and state-owned enterprise employees; the separation of the government wage scale and the enterprise wage scale, etc. are essential prerequisites for a fair, equitable and workable income tax system. The Chinese budge deficit is 2.9 percent of GDP, according to Minister Hsiang. We in the United States have had much higher budget deficits. The current Chinese public debt burden is less than 15 percent of GDP, as mentioned by Minister Xiang. If all the non-performing loans of the banking system are included as public debt, the ratio of public debt to GDP will probably rise to between 40 and 45 percent. By comparison, the U.S. and Japanese ratios are over 60 and 100 percent respectively (and these ratios do not include non-performing loans, which are significant in Japan). The current scale of fiscal expenditures is therefore quite sustainable under current economic conditions. Moreover, some of the government expenditures are of a one-time nature, e.g., the payment of the retirement benefits for existing retirees. The number of such individuals are fixed and can only decline over time and the retirement of existing and new employees will be funded through their own respective individual retirement accounts. The fundamental expectation on public infrastructural investments is that with a lag, the public infrastructural investment projects will generate sufficient additional economic activities, so that eventually it will result in not only a higher GDP but also a higher total tax revenue. These investments should have a positive overall social rate of return, although not necessarily directly.

Fifth, what about inflation? Is the fiscal expansion in China likely to lead to an over-heated economy and inflation? Here, I think the relevant questions to ask are: Is there crowding out? Is there excess aggregate demand? The answers to both questions are no. Inflation is not likely to be re-kindled under current economic circumstances. However, this also reinforces the importance of having an on-the-shelf-list of good projects that can be launched or postponed depending on the macroeconomic circumstances. In addition, the marginal social cost of public infrastructural investment in a demand-deficient environment is very low.

Thank you very much.