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China's Stimulus Lesson for America

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China's newly announced $586 billion stimulus package is almost certainly overkill for the country's needs—China's domestic demand expansion this year is too strong to warrant spending this much money any time soon. But it offers a much-needed lesson to the U.S. government about how large an effective stimulus package might have to be.

China's stimulus also arrives just in time to set a powerful example before this weekend's G20 meeting, where national leaders will discuss solutions to the looming global economic slump.

China's package amounts to 14 percent of its likely 2008 GDP. For the United States, this share of GDP translates into a $2 trillion program. The comparison shows how small the amounts under consideration in Congress really are when compared to what it takes to counter a potentially very dangerous recession. After all, FDR failed to pull America out of the Depression in the 1930s because he and his Congresses worried about the budget. It took deficit spending worth 80 percent of GDP over five years during World War II to do the job.

House Speaker Nancy Pelosi is in discussions with the White House for a $100 billion stimulus package now, with an additional package to come in January. She is also looking for a $60 billion tax cut this fall. But these add up to only a little over 1 percent of U.S. GDP in immediate stimulus. President Bush is reportedly unwilling to support even a package of this reduced scale directed mostly at infrastructure spending.

The important lesson for American policy makers is that, given the scale and potential damage from the coming recession, it needs to see its stimulus program, even if only behind closed doors, in terms of a 10 to 20 percent share of GDP, not in $100 billion denominations. Ten percent of U.S. GDP is $1.4 trillion.

Given the political obstacles to passing an adequate stimulus package all at once, however, Congress is more likely to accomplish the task piecemeal, in $100 billion parcels. One or more could go directly to state governments. A second tranche could go for road, bridge, and port reconstruction and expansion. A third could fully fund Trade Adjustment Assistance with non–trade-related extensions. A fourth could restructure troubled mortgages. A fifth could expand benefits for the armed services and veterans. A sixth could be put toward education, pre-K through college. And a seventh could go for social security supplements.

Then there are alternative energy investments, technology transfers to fight global warming, and initial payments to smooth the transition to a new healthcare system. Depending on the size of these packages, they could add up to a trillion dollars pretty quickly, and possibly at an acceptable political price. It may be the only way the United States can match China's boldness.

Some economists interpret China's stimulus announcement as a sign that its economy is in more trouble than previously thought. Not so. China's recently announced GDP and other statistics for the first nine months of the year show that annual growth slowed to 9 percent in the third quarter—all because of weakening exports. But analysts ignore information that China's domestic demand accelerated to 13 percent in the second and third quarters after correcting for inflation. The full nine-month statistics do not reveal this because China's first quarter was so weak. Without the surge in domestic demand already under way in China, the growth slowing would be more severe.

The risk from its stimulus for China is a repeat of 2003–2004, when a large stimulus package intended to combat the economic impact of the SARS epidemic turned out to be unnecessary. The resulting inflation took several years to bring under control, and then reappeared again in 2007. This time, China plans to phase spending in gradually, so there is plenty of time to ease up in the event that the proposed sums turn out to be excessive.

The overall lesson from China's stimulus is that it is going into the real economy, not into the balance sheets of troubled financial institutions. While financial bailouts might provide life support for firms with an arguably important future role to play, America is entering the phase in this crisis where the real economy needs substantial direct stimulus, and it needs to think big—like China.

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