



## A \$17 Trillion Alliance Can Save World Economies: William Pesek

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Commentary by William Pesek

Jan. 21 (Bloomberg) -- China's economy overtook Germany's to become the third-largest in 2007. Japan may be next to be leapfrogged, if China can sort out its relationship with the U.S.

The Chinese economy is now 70 times bigger than when leader **Deng Xiaoping** traded hard-line communist policies for free-market ideas in 1978. No nation in history has raised more out of poverty in so short a time.

That leaves the Group of Seven nations with quite a dilemma: Who draws the short straw and informs Canada that it's out of the club? Yet the real issue is one of relevance in a world now dominated by the Group of Two -- the U.S. and China.

It's a crucial point as 2009 unfolds and the old leadership framework loses more teeth, if that's even possible. The G-7 -- Canada, France, Germany, Italy, Japan, the U.K. and the U.S. -- has been completely useless over the last two years as markets crashed and economies plunged.

The Group of Eight -- the G-7 plus Russia -- is an even bigger waste of energy and travel budgets. It wasn't created because of Russia's commercial might, but fears that the 11th- biggest economy was too nuclear to fail. G-8 summits are only memorable for photos of world leaders awkwardly donning local costumes. Conference call, anyone?

### G-2 World

The U.S. and China should do the global economy a favor and formalize the G-2 process. Summit meetings, communiques, press conferences, the works. Only, this framework must be about more than photo ops, vague language and polite discussion. It must be about the world's two most important economies working together to avoid disaster.

"There's no more important economic relationship, and 2009 will prove it," says **John Calverley**, Toronto-based head of North American research at Standard Chartered Plc. "The world will be watching as never before."

U.S. President **George W. Bush** should have done it. Some argue that the "strategic economic dialogue" initiated by former Treasury Secretary **Henry Paulson** amounted to a G-2. Not so. It wasn't a meeting of equals, but a way to cow China into boosting its currency. U.S. officials seemed aghast that China came to the table with demands of its own.

When it comes to global stability, few things matter more than China's massive holdings of U.S. Treasuries. That may be seen in Paulson's need to liaise with Chinese officials before the U.S.'s stimulus plans were announced. If China doesn't buy much of the debt the U.S. issues, who will? And if **China** balks, the rest of Asia may, too.

### China's Money

That's why the G-2 needs to be a genuinely equal partnership. It can't be a developed nation holding more chips than a poorer one. That was fine two years ago, before a meltdown in the U.S. imperiled

global growth. Now that the U.S. is arguably looking a bit like a developing economy itself, the high horse has to go.

At least \$650 billion of China's \$1.9 trillion of reserves are in U.S. Treasuries. A move to sell those assets would boost interest rates and further damage China's export industries. Mutually assured economic destruction limits options and leverage in Washington and Beijing. President **Barack Obama** should act fast to hold this arrangement together.

Japan has problems of its own. It is back in recession, and deflation is sure to follow. Even though Japan steered clear of the toxic debt killing the U.S., the stocks that banks hold in friendly institutions -- so-called cross-shareholding -- are plunging in value and weighing on profits.

#### Japan's Woes

Now, Japan is about to churn out loads of bonds to pay for stimulus plans. China also will be issuing ever-growing amounts of debt to boost domestic growth as its export industries collapse. The 4 trillion-yuan (\$586 billion) stimulus plan announced in November is just the beginning.

Premier **Wen Jiabao** said as much on Jan. 19 when he warned that China faces a "very grim" job market in 2009. Wen added that the government must pay more attention to public welfare and social stability. That's a vital, yet pricy, proposition for the nation of 1.3 billion people.

Add in Europe's stimulus needs, and the world is about to see a "crowding out" phenomenon unlike any other in history. Governments will leave little room for private debt issuers.

While no big economy is blameless, the U.S. caused this crisis with an all-regulations-are-bad fanaticism, irresponsible central banking and basic greed. It's now the world's problem and it will take global efforts to restore calm, particularly from the U.S. and China.

Europe is an important economic region, and one grappling to cooperate for the sake of prosperity. Its fortunes rely on how well the U.S. and China can catch their collective breaths and start growing again.

The U.S. economy is worth \$14 trillion, while China's is worth \$3.3 trillion. The G-7 was yesterday. The G-2 is today and tomorrow. It's time for folks in Washington and Beijing to stop pointing fingers and get to work.

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