quotas for banks, raised their required reserve ratios and required them to sell off large amounts of subordinated debt.

Lardy also pointed out that steps had already been taken to moderate a potentially overheating real estate market: the government reinstated a 40 percent minimum down payment for mortgages and lengthened to five years the period that investors must hold a property to avoid paying sales tax when it is sold. "These moves dramatically cut the pace of property sales and disincentivized speculators," Lardy said. "It is also important to recognize that even a major property price correction in China would not have the systemic implications that it had in the United States" because "there is much less leverage in China's property market and the share of debt devoted to the purchase of property is relatively small" among consumers.

Lardy sees China's excess capacity as essentially a nonissue. First, he points out that Chinese firms have historically tended to hold on to outdated equipment, so Chinese data on excess capacity may overstate the case compared with other countries. Second, there is a substantial difference between excess capacity of, say, 20 percent in a mature economy growing at just 2 to 3 percent per year and in China, where growth has averaged about 10 percent for the past 30 years and any excess capacity is readily absorbed. The Chinese steel industry, for example, had excess capacity of 15 to 30 percent at the end of 2008; this was more in overcapacity than the next largest global steel producers — Japan and the United States — had in capacity. What seemed like massive excess to many observers was simply in line with China's historical growth, which has required a 15 percent increase in steel production annually since 2000. Finally, Lardy emphasizes that China's 2009 stimulus focused on financing fixed investment in infrastructure, and not on expanding production capacity in China's traditional industries.

As for the charge that the stimulus program has set back China's efforts to achieve more balanced growth by encouraging private consumption, Lardy offers a number of data points that would seem to disprove the contention. Although employment in export-oriented industries did suffer in 2009, the boom in construction-related employment created by the stimulus largely offset those losses. In addition, the government raised payments to 70 million of China's lowest income citizens, increased pension payments to retirees and offered its own version of "cash for clunkers" for vehicles and other consumer durables. All these factors, along with a substantial increase in household borrowing, combined in 2009 to raise consumption expenditures in China well ahead of GDP growth for the first time in a decade.

While Lardy believes that China's stimulus investments are likely to benefit the nation in the long term by creating an infrastructure for sustained economic growth and increased tax revenue, he readily concedes that the benefit will come at the cost of a substantial increase in government debt, equal to almost a fifth of China's GDP. While China is certainly not alone in that predicament, it clearly cannot be considered an unqualified good thing. The Chinese, Lardy said, "recognize that flooding the economy with more credit is not the way forward and that they will have to take strong additional policy initiatives to sustain economic growth."

To reduce the distortions that for much of the past decade have favored industry and exports over services and consumption, the Chinese will have to consider raising the prices of basic resources like water and electricity, levying environmental taxes and fees and adjusting, finally, the exchange rate for their undervalued currency. China has thus far shown little willingness to take such steps, however. Add to that its intransigence about reducing greenhouse gas emissions or imposing sanctions on Iran and throw in its reliance (like all other nations) on a tenuous global financial system, and you have ample reason to question the direction, economic or otherwise, that China may be taking in the near future.

Philanthropy After the Fall

Will the rigors imposed by the "great recession" compel a new level of efficacy in social investment?

The notion of socially responsible business has always worn many guises. It has been equated variously in both the public and the corporate minds with philanthropy or environmentalism or sustainability or ethics. And, almost without exception, it has seemed a bit artificial — a cosmetic overlay having little to do with business fundamentals. A number of leading thinkers, however, believe that one of the legacies of the "great" recession may be that it is enforcing the kind of real alignment between social aims and business profitability that has eluded social investors for decades.

"If you go back 20 years, companies like Nike, Nestle, Coca-Cola and Wal-Mart regarded it as a badge of honor to be seen as not soft and sentimental and socially progressive," said Matthew Bishop, *The Economist*'s New York bureau chief in a recent interview with INSEAD Knowledge. Bishop, who is a co-author with Michael Green of "The Road from Ruin: How to Renew Capitalism and Put America Back on Top" (Crown, 2010), believes the global economic crisis has prompted an urgent re-examination of how capitalism can be made to work more in concert with societal aims: "In boardrooms now, there is an understanding that, as they think long term, they have to be on the right side of social progress."

In the short term, the recession has certainly had a profound negative impact on philanthropy and social investment. According to Maximilian Martin of the University of Geneva Faculty of Economic and Social Sciences, the 18-month recession left foundation endowments down 30 to 40 percent in the United States and 20 to 30 percent in Europe. In 2009, about two thirds of foundations in the United States reduced their payouts. In the United States alone, 460 foundations lost 80 percent or more of their endowment assets. Not surprisingly, many foundations instituted hiring and salary freezes and severely cut budgets.

Although Martin admits that these downward adjustments will hold back net worth and endowment assets for years to come, his recent paper, "Managing Philanthropy after the Downturn: What Is Ahead for Social Investment?" (Viewpoint, Social Science Research Network, 2010), makes the case that the recession has already begun to create fertile takeoff conditions for future philanthropic investment by forcing philanthropists to be smarter — to increasingly seek to leverage their capital, lower costs, spread risk and simplify and consolidate their efforts. He discusses several strategies that are gaining favor, including time-bound subsidies, joint capital pools and "synthetic" social businesses.

A time-bound subsidy is essentially a catalyst for an initiative that will later seek commercial financing to fund further expansion. "Proof of concept often needs grant money; and scaling up requires commercial money," explains Martin. "Time-bound subsidies are an instrument for philanthropists to ensure that once initiatives no longer need subsidies, the philanthropic money is redirected to some other area where it can make a difference." Martin points to Banco Compartamos, a Mexican microfinance bank with 1.4 million clients and a total active loan portfolio of $550 million, which began life as a grant-funded nonprofit.

In situations where grants alone cannot do the job and investment capital is often unwilling to go into the riskier or less conventional markets where the need is greatest, a joint capital pool offers a solution. It seeks to combine philanthropists, social investors and commercial investors into consortia or funds that take into consideration the different risk tolerance, return objectives and expertise sets of each group. "For example," says Martin, "a charitable foundation may be

inclined to provide grant funding while a social investor may be willing to provide subordinated debt at a relatively low interest rate and a purely commercially minded investor would make equity investments based on the consideration that part of the risk has already been absorbed by the other types of capital providers."

Finally, Martin believes that more and more businesses will begin to operate as "synthetic" social businesses. "That is," he says, "a business venture whose social purpose is encoded in the

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Above: Keith Negley. Right: Hal Mayforth

holding structure of the company. This means that a philanthropic foundation holds a significant ownership stake and special voting rights with the mission to make the good or service available to as many people as possible around the world." A synthetic social business is developed just like any other business, operating according to private-sector principles and making use of private-sector management talent. But since the company inherently seeks to serve the broadest possible swath of society, it is more likely to produce in higher volumes at lower margins and use tiered pricing strategies and the like.

One such organization is The Petra Group of Malaysia, which provides financial and management support for early-stage technology businesses. Petra is 60 percent owned by the Sekhar Foundation, the company's charitable arm, which supports a multitude of environmental, educational and children's causes around the world. "You can't do anything that's going to make a global impact unless it's commercial," says Petra's president and chief executive officer Vinod Sekhar. "We should be smart enough to be able to do that and do some good along the way."

Michael Bishop echoes that sentiment: "Relying on charity is never a good place to be, whereas if you have a profitable business, then you're always going to find investors."

There are at least two potential problems, however, with this vision of "new" philanthropy.

Martin articulates the first problem in his paper, saying that as investor demand grows for social investment opportunities, their commercial aspects would dominate and "their social impact standards risk being watered to the extent that social investment would become largely a marketing exercise." That is to say, we'd essentially be back to square one.

The second problem has been voiced by, among others, former Ford Foundation director Michael Edwards, author of "Small Change: Why Business Won't Save the World "(McGraw-Hill, 2010). Edwards asserts that business by its very nature is not equipped to address long-term social transformation, which, he says, is neither easy to measure nor always cost-effective in profit-maximizing terms. It requires a different set of operating values that emphasize cooperation over competition, collective action over individual effort and systemic solutions over immediate results.

The real solutions, says Edwards, lie in "businesses acting more like civil society, not the other way around." At the end of the day, that may turn out to be an important insight not only for determining the post-recession future of social investment, but for figuring out how to eliminate the problems that got us into the recession in the first place.

INTERESTING...

ARE YOU A TEXTAHOLIC?

Consumers are more attached to texting than ever. 39 percent of users admit they text at the dinner table, 26 percent say they text on dates, and a surprising 13 percent confess they can't even abstain from texting in their house of worship.

Source: Kelton Research, 2010