THE BROOKINGS INSTITUTION

STRUCTURAL REFORMS AND CHINA'S ECONOMY

Washington, D.C.
Tuesday, May 2, 2012

:

PANEL 2: A TURNING POINT IN CHINA'S DEVELOPMENT

Moderator:

HU SHULI
Managing Editor
Caixin Media

Panelists:

WANG TAO
Chief Economist
UBS Securities

ZHANG LANLAN
Managing Director
CICC US Securities, Inc

BARRY NAUGHTON
Professor of Chinese Economy and So Kwanlok Chair of Chinese International Affairs
University of California, San Diego
Nonresident Senior Fellow, The Brookings Institution

* * * * *

P R O C E E D I N G S

MS. HU: Welcome to the second session of our conference today, our turning point in China's development.

I think recently China's economy has been certainly overlooked by international watchers. Compared to Europe's economic turmoil and actions and dissolving of the governments, China seems stable. A slowdown is obvious in the first quarter. Current account surplus is reduced significantly, and inflation is increasing but well within control. Of course, changes in China's economy pale in comparison with the political drama at home.

What has been described as China's biggest risk? The real estate bubble hasn't had its day of reckoning. Although the giant bubble remains, Chinese government is pushing hard for social housing and the domestic demand remains stable. Overall, macroeconomic policy has protected growth but avoided another big stimulus package.

But behind the seemingly stable façade, there are reasons for deep concern and reasons for excitement, too. We are indeed at a turning point. Some policies with long-term impacts are brief. Just to name a few: the Wenzhou financial pilot program, the expansion of RMB trading band, and the increasing costs for liberalization of interest rates.

Look beyond the border. There are external demand shocks and competition increase still to the rising labor cost. China's economic development in the past three decades was primarily driven by economic reforms that open up policy, globalization, and the demographic dividends today. The effect of the last two factors is getting weaker.

China needs more reforms to protect growth. In that sense, the country's economy is at a crossroad. We are privileged to have a distinguished group sharing with us their perspectives from both industry and academia. They are Dr. Wang Tao, China chief economist at UBS Securities; Barry Naughton, professor of Chinese economy and So Kwanick chair of Chinese international affairs at the University of California, San Diego; and Zhang Lanlan, the managing director of CICC US Securities, Inc. They're going to talk one-by-one and I will start a discussion later.

Thank you. (Applause)

MS. WANG: Thank you, Shuli, and good afternoon. I'd like to thank Brookings and Caixin for inviting me here to share my view and also, actually, give me a chance to listen to the distinguished speakers and also the audience.

In the first panel, we talked a lot about the turning point and about the challenges in China, both politically, socially, and also economically. It's okay, I can talk without the --

MS. WANG: So, normally being an economist at an investment bank, normally I talk about turning points for investors. So, it's this quarter, next quarter, which doesn't matter, of course.

I think the first panel already talked a lot about the challenges, and I think the turning point that we're talking about is really the challenges that Shuli and Vikram already mentioned, which is to -- in an environment where external demand is probably going to stay weak for a long time and China is facing demographic changes, and in an environment where we have relied very much on investment for growth, how to sustain growth in the long-term, in the next 5 to 10 years. And also, how to make that growth shared by the wider populace to improve sort of the social equality and to make that development -- I would like to use the word "development" rather than "growth" -- more sustainable. So, it's not just about GDP at 9 or 7 percent, but also socially and politically make things more sustainable.

On the economic front, before I go there I probably just want to say two points up front the two points I wanted to share. One thing is that as an economist, I tend to think the economy is more important than politics, so please forgive me. And I do not hope for a wise and powerful politician to somehow see the greatness of change in the next 5, 10 years and miraculously change things. I believe we need to change the economic incentives and the incentive structure in the economy to frame the political powers. So, I think actually economic reform is more critical for political reform that is necessary, rather than political reform has to happen first because it's very hard to ask politicians to basically give away their power voluntarily. We must use economic forces, whether it's price signals or incentive systems or taxation systems to change their behavior and change the government's behavior. So, this is point number one.

Number two is about the priorities of reform. What are the key important things? What are the things to break through? Normally, people talk about the financial sector reform as very important and being an economist in the financial sector, you can imagine how many times I hear that. However, I've also been an economist who worked in the IMF and for a long time in the IMF it's mostly fiscal. IMF is short for It's Mostly Fiscal, because a lot of the structural reforms must start with fiscal. (Laughter)

Just imagine in the U.S. You have the Fed, okay? It can print money, but how difficult is it to do fiscal consolidation. But important structural reforms are in the fiscal. It's not about the Fed printing money, isn't it? So that's the same with China. A lot of fiscal reform and public finance reform has to happen, and so that's -- I probably exaggerated a bit -- but there's also other reforms, including the state-owned enterprise reform as well as factor price and market reform.

So a question -- I think the second point is that it's much more important to actually get right these structural imbalances in the structural root cost in the domestic economy before we open up to subject all the forces -- all the imbalances to greater volatility in the financial world. So, that's the two points.

I agree very much with Vikram in the first panel about, you know, what are the key issues that are underlying some of these structural problems and sustainability in China. It is about the role of the state. It's really, I think, in the next stage when we talk about reform, we must re-think what the state, what the government should do and what they should do less or not do.

I don't think it's really about the size of the state, I think it's really about the role of the state. So, we all know, I think, that the Chinese government has very strong power not only in directly participating in the economic activity and production, but has a very strong hand in allocating resources in terms of energy and mineral resources, land resources, and capital.

When the government does the allocation, sometimes it can be very effective, actually. It can generate spectacular growth, and we had very strong growth for 30 years. To some extent, one has to acknowledge the efficiency of the ability of the government to mobilize savings and channel that into investment, and that has generated very rapid growth.

However, at certain points that becomes stifling for further development, and that path cannot continue because the state is not always efficient in allocating resources in the best place. And so, going forward for that to change we think that the market has to play a bigger role. The government, of course, made some progress but some key prices are still under the government's control. So as a result, the government rations and directly uses administrative measures to allocate the resources. So, I think an important reform is price reform. To let the energy and resource prices reflect the scarcity in China, and to let the market forces play a bigger role in pricing capital as well.

But that brings me to the second part about the state, because I actually do not believe simply liberalizing interest rates is going to do the trick. We all understand the importance of financial repression in China, which actually played a big role, as I said, in generating very fast growth and investment. The reason that I think that interest re-liberalization probably is not the simple answer is that we also must reform the micro-entities in the economy, the state-owned enterprises, the local governments who are direct participants in the economy. They probably are not very sensitive to interest rates because they do not have hard budget constraints.

We also must continue to reform the governance of the banks and the risk control system, risk management system. I do not believe they have successfully made a big change in the way they are running after their IPO restructuring. Of course they have gone a long way, but just look at 2009 in the crisis. How did that 10 trillion RMB of new loans get out if they had really good risk controls?

So before we do that, I think interest rate liberalization when the entities in this have not been reformed could actually generate a lot of risk and probably credit bubble followed by financial crisis as well. So I think the SOE reform is something that we must go forward and we must tackle, and we cannot say let's just have the prices free and everything will be fine.

The reason I also say that -- here is where my visual aid comes in. I just use an example of a fact that probably everybody knows, which is in China everybody knows that consumption as a share of GDP is very low, investment as a share of GDP is very high. A common myth is that because the Chinese save a lot because of our culture, because of our lack of social safety net, but I here point to you one other fact, which is that household income as a share of GDP has also not increased. That's declined, and household consumption and household income actually go hand-in-hand.

So, what is the cause of that? Why is China's saving rate is so high that China's investment -- most of the increase in savings in the last 15 years is actually the corporate and government savings, not so much as household savings. The reason they are doing that is really in the model of growth, which is that China has gone through a rapid heavy industrialization. As you know, heavy industries are very capital-intensive, so we didn't really -- you know, another myth is that we grew because we had a lot of cheap labor, we manipulated the exchange rate and just exported our way to growth. The truth is that we relied a lot on capital-intensive heavy industries, and you know the increment of growth comes from there.

As the input in the production function comes a lot from capital, you can understand that the returns also go to capital and less to labor, and hence that income in household as a share of GDP declines. So when China talks about the income distribution it is this income distribution. It's the income distribution between labor, household, and corporate and capital that matters the most. It's not about the rich and poor. I think that belittles the structural issues that China faces.

I'm not saying that's not an issue. The incoming equality between the rich people is also an issue. But in terms of the structural change, it's also here.

So even though interest -- profit margins have remained relatively stable but profit as a share of GDP just goes up because we put a lot of capital in the economy. Okay? So to change that, here comes the questions I talked about that we must do SOE reform. One important thing, of course, is that we must remove and reduce some of the subsidies on energy, on land, on resources to industry at the expense of services and household. This is the number one.

Number two is that the state-owned enterprises don't pay dividend to the state shareholder, okay? So, they have free capital at their disposal. We talk a lot about these state-owned enterprises borrow a lot from the banks. They do, but they actually have free capital as well because the opportunity costs of the capital, of retained earnings are not redistributed to the household sector or the government is free. So, that makes them investing in capital-intensive industries. That cycle must be broken. So, that will go a long way to help actually make the savings rate come down. Therefore, the supply of capital also comes down. So under those circumstances, interest rate liberalizations have a better chance of reflecting true market signals.

Finally, I think I would just -- I'm probably running my time a bit. About the public finance reform, which I promised. I said it's mostly about fiscal. An important reason that I believe local governments are so obsessed about growth in addition to their measured -- about their GDP performance is that in China, the taxation system is such that most local revenue, most government revenue comes from so-called indirect tax, from production, VIT tax, which is tax at the production gate, at the factory gate, at the production site; business tax and corporate profit tax. Personal income tax almost amounts to nothing, very little, right? Less than 5 percent of the population actually pays income tax.

So, local governments who want to build infrastructure or social services or grow their GDP who want fiscal revenue, what do they do? They want investment, they want industry. They would sell their land very expensively to the commercial sector and households, but they will build industrial parks for free to invite manufacturing investment, and that whole incentive structure binds them towards industry. So, we must change the fiscal and taxation system so local governments are more interested in providing public service, attracting people to live there, rather than attracting businesses to plunder resources and just print GDP.

And so, another probably structural issue that many of you are familiar with is about -- is the social issues in the rapid urbanization in China. We have 200+ million so-called migrant workers in China who work and live in cities but do not have access to urban public service, and there is a lot of call for hukou reform, the household registration system. But I think the essence of that hukou is access to public service.

Here when we talk about inequality of access to opportunities and to social services, including education and hospitals, healthcare, and public security, this is basically -- and the greatest inequality, because we have a second-class population there that exists but are ignored by urban governments, right?

Some of you may know that recently the Chinese government announced that we were going to do hukou reform. People get very excited. But if you actually look at the local government, what they are doing in Beijing, in Shanghai. They're trying to close down the schools, they're trying to close down the migrant schools to chase away the people there.

Why? Because they don't get any tax revenue from those people. Their fiscal resources are allocated according to hukou people. They have no incentive whatsoever to attract those people to live there. The only way they see them is cheap resources. So, public finance reform to shape how local governments get their resources and spend their money can help address the core issue of making this urbanization actually a true urbanization rather than urbanization of land and property.

So, I will just stop here. Thank you very much. (Applause)

MR. NAUGHTON: So, thank you. It's an enormous pleasure to be able to follow four really interesting talks that hit on many important aspects of China's economy and society today. It gives me the opportunity to sort of weave around some of the things that have been said and try and connect it, in particular, add a little integument to the very contemporary situation.

So, the way I'd like to try and do this is argue that there are essentially three different turning points that are going on right now in China. In other words, we can think of turning points in the Chinese economy, but when we use that terminology we're very quickly talking about three different phenomenon that happen on three different time levels.

So first of all, we're right now in the middle of a short-run macroeconomic turning point, as essentially orthodox macroeconomic policy starts to affect the way the economy functions and the growth rate. There is second a medium not un-policy but a medium-run policy turning point, because we're facing a leadership transition and that introduces uncertainty and new possibilities into the policy framework. And third, of course, there's a very, very fundamental long-run shift in the Chinese growth model, but more importantly in the underlying factor endowments that China faces as it develops its route to the future.

And so, we should be very careful because there are symptoms of each one of these turning points that are evident to us right now and yet no one of them is really clearly under way. No one of them is clearly consolidated and happening yet, and yet we can clearly see that each of them is on the horizon, is beginning to have an impact in the way in which the Chinese economy functions.

So, look. The first one, the macroeconomic turning point. Obviously I think most everybody knows the Chinese economy is slowing a little bit, but we should also recognize that the current slowdown is very much the intentional result of policy, of very orthodox policy, in a sense. Right? Tightening monetary policy in an effort to deflate bubbles that basically date back to the Chinese response to the global financial crisis at the beginning of 2009. Of course, these bubbles needed to be deflated, so the growth slowdown should essentially be seen as a good thing because it indicates the first steps towards a healthier macroeconomic environment.

But as we look at this process, we start to see right away there are many different kinds of bubbles. There's a housing bubble, there has been a housing bubble that the Chinese government has attracted a lot of attention to and a lot of very specific tailored policy measures to try and control the housing bubble. There is a local government infrastructure, and in fact a national government infrastructure bubble that, again, got completely out of hand during the course of 2009 and 2010. And there's also a high tech industry bubble that I'll talk about a little bit more in a second.

So, as Hu Shuli mentioned, there's an ongoing attempt to grapple with these bubbles. First, before we look at them a little bit more carefully, let's just say how does it look so far? What we see so far is, it looks pretty good in the sense that growth has slowed as an effort has been made to tackle these bubbles, but growth hasn't slowed so much that it looks like we're heading for a hard landing. In other words, so far we seem to be in a sustainable growth slowdown, and here's the manufacturing and non-manufacturing PMIs that give a sense of the robustness of demand. It's clearly slowed, and yet at the same time it hasn't -- doesn't seem to be nearing any kind of cliff.

And you know, the reason for this is, essentially, a relatively steady disinflationary policy being run by the People's Bank of China. So we've got a little bit of disinflation. That's good. We still have significant inflation. The CPI bounced up from 3.1 to 3.6 percent in March, so it' certainly not over, but the central bank seems to have reclaimed an authority that it lost during 2009 to set macro policy and monetary policy and to drive that policy in the direction of a more consistent and stable economic policy.

But the issue is far from over, right? Because there is still an enormous volume of resources tied up in all these different kinds of bubbles. There's an enormous volume of uncompleted housing construction, there's an enormous volume of uncompleted infrastructure investment, and the government has just begun to address these issues. So for instance, when we look at the so-called local government funding platforms, the regulatory authorities have tried to start separating them into five different categories, essentially triage, right? Which are the ones that can be salvaged, which are ones that have to declare bankruptcy.

But when we look at overall growth, as I say the pattern is growth declining. Quarter to quarter, growth rate in the first quarter of 2012 is about 7 percent -- I mean, year over year it's 8.1, but quarter to quarter it's a little slower than that. But what we really -- you know, so the question is, if these bubbles are being burst and if growth is slowing, does that mean that the economy is now reorienting towards a different basis for growth?

And the answer I think we have to say is, not yet. Right? It's not there yet. If we look at -- if we ask the question whether fixed investment growth has slowed below overall GDP growth, the answer is, no it hasn't, not yet. So, that raises a puzzle, right? If housing growth investment is down, which it is, if infrastructure investment is down -- in fact, infrastructure investment actually dropped in the first quarter of 2012 compared to the first quarter of 2011. So, what is it that's powering continued rapid investment growth and, to a certain extent, stabilizing the growth of the economy?

Well to some extent, it's that third bubble. It's the high tech industry bubble, which continues to be a very high focus of Chinese government priority. So while these older, if we may, forms of investment bubble in housing and infrastructure have dropped, investment in machinery, electronics, specialized machinery, all these kinds of sectors are still experiencing investment growth rates in the 20 to 30 and sometimes above growth rate.

So, there's a third bubble that's going on: government-sponsored investment in high-tech industries and especially these so-called strategic emerging industries, and I would argue that this is not a particularly healthy form of industrial development. It's not very likely to lead to an extremely innovative society, so it's a bubble that will also need to be burst and which will create problems down the line.

Now, let's look at the second phase of this, the medium-term. Of course political transitions inevitably bring uncertainty. And boy, we see extra uncertainty today, especially because of Bo Xilai. And still, it's necessary to point out that the transition -- I mean, the real reason why this transition introduces so many interesting new features is that it is a very much a rule-driven transition, despite Bo Xilai. As Chen Zhiwu mentioned, the fact of having term limits, age limits, these whole series of rules are creating new dynamics in the way that leaders are selected and come to power.

Now, it's natural, of course, we focus on the top leadership, Xi Xinping. Of course, that's the most important. But notice that lots of changes in economic policy over the last six months can be closely related to the rule-driven turnover of economic bureaucrats. For instance, the new head of the China Securities Regulatory Commission, Guo Shuquing, known to be a strong reformer, has already introduced several important measures that tend to push forward the development of capital markets. On the other hand, the new head of the China Bank Regulatory Commission perhaps less hawkish, less concerned with strict financial criteria than the outgoing head. In each of these sectors, we see important changes in policy driven by the turnover that is, in turn, forced by term limits and age limits.

And at the top, that means we see lots of forced change coming. In particular, we outsiders tend to look at the role of Wang Qishan, who is currently a vice premier. Exactly what role will he play in the next administration? Or Zhou Xiaochuan, who is the head of the Central Bank, which means he has ministerial rank, which means he must retire when he's 65. If that rule is applied to him, he has to retire the beginning of 2013, but if he's promoted to something like a vice premier then he wouldn't necessarily have to step down at that point. Since he's a key person in both the policy and the underlying intellectual design of reforms, that's certainly an important thing to watch.

Now, in the last couple months the atmosphere has clearly improved. Why? Well, one reason is Xi Xinping has indicated an interest in deeper economic reforms. In the party suggestions for the 12th Five-Year Plan, there's a line in there that says we should carry out a top-level design, for deeper, broader economic reforms. And you know, the Communist Party is a hierarchical system with lots of face to face and person to person transmission of information. So when this document was sent down from the party center to the party committees at every level, the instruction that went along with it was, this line was inserted into the documents by Comrade Xi Xinping. So, there's a signal that the top leadership believes that -- or the incoming top leadership -- believes that more needs to be done in terms of moving forward with economic reform.

At the same time, the problems that economists have been warning about since 2009 are starting to come true, right? The bubbles that were created starting in 2009 that finance technocrats in particular warned about? Well, now the problems are sort of increasingly there for everyone to see. So, top leaders can also see, yes, we responded to the crisis in ways that were perhaps necessary but now we've got to face the facts and deal with some of the problems.

And of course, the fall of Bo Xilai opens up opportunities. Bo Xilai was a dangerous individual, in part because he was so smart and charismatic and he articulated a vision of economic and political -- I don't want to call it change, exactly, but it certainly was change that was inimical to what China really needs, right? It was exactly a package that led away from all of the necessary changes that had to be made in the economic and political system. So, his fall and more importantly his disgrace certainly opens up new space for better policy and more effective policy.

Can we be optimistic? Not yet. It's a little too early, right? We don't yet see if there's going to be enough follow through to really create a turning point in economic policy, and we really won't see it until late 2013.

Now, these kinds of relatively short-run turning points, in my mind, pale beside the really important impact of long-run turning points. Of course there's lots of awareness that China's growth model has to change. Ambassador Zhou spoke about the fear of a middle-income trap. I agree with Professor Zhou that there probably isn't a middle-income trap that China has to fall into, but it's undeniable that Chinese growth rates will slow. It will slow whether policy is good or whether policy is bad, and the fundamental reason why the growth rate will slow is because the underlying endowment of labor and capital and, most importantly, skilled labor in China is changing.

You know, one way that people look at it is to talk about a labor surplus, whether China used to be a labor surplus economy and is leaving that status. And the answer is, yes, it clearly is. But the striking thing about China is, China's going to move out of this labor surplus status extraordinarily quickly because the normal process of economic growth is going to be reinforced with demographic factors and the rapid increase in education of young people, which means that shifts in endowments will be particularly fast. In other words, the decline in the supply of unskilled labor will be unusually rapid while the increase in the supply of skilled labor is going to be also extremely rapid.

So, here's just some quick information that shows that the overall labor force is going to plateau very, very quickly within the next couple years, but more important at exactly the same time that the overall labor force is going to plateau for essentially demographic reasons, the share of that labor force going into college or graduating from college is going to -- is continuing to explode. And, therefore, just as the overall labor force plateaus, the skilled labor force continues to grow very quickly which means the unskilled labor force -- look at that -- is already declining by almost 40 million workers in this decade. And in the next decade, will decline by 70 million workers. So that means, China's export economy is going to change, it's going to change rapidly, right?

The wage pressure we're already seeing is going to continue. Again, this is not a turning point that's already happened. China's growth -- China's exports of labor-intensive manufactures continue to increase at double-digit rates in 2011, so the trade surplus hasn't gone away. But again, a third turning point that's on the horizon that faces the leadership.

So in conclusion, what do we face? Two choices. One quick argument that I want to make. Two choices. Will the new leadership headed by Xi Xinping really push for a revived economic reform agenda? The good news is, everybody's talking about it, everybody now recognizes for the first time that reform has gone backwards in the last four or five years, that at least we need to think about moving forward in the course of -- Vikram Nehru and the World Bank team did a superb job of pushing these issues on the agenda for China.

The second crucial choice for China is how will China opt to develop the skilled industrial sectors in which it has an increasing comparative advantage and which are needed to absorb the millions -- literally millions -- of new college-educated workers who are pouring into the labor force? I believe that the current approach is mistaken, it's going to have to be rethought, it's going to have to be redeveloped, it's going to have to be adapted in a way that opens up the economy to much more entrepreneurial, service-oriented, and creative activity than is the case in today's government-dominated approach to high tech industry.

And then one final argument, and that is the fact that these three turning points are coinciding does create a window of opportunity for economic policymakers because it means that a policy of conservative monetary policy combined with liberalization, standard orthodox economics is something that we're very familiar with, that economists are very much aware of, will have better effects because it will simultaneously address all of these turning points and push them forward. Conservative monetary policy, more rapid liberalization could help China make its way through each of these turning points at the same time.

Thanks. (Applause)

MS. ZHANG: First, I would like to thank Brookings Institution and Caixin Media for inviting me here. My background was as industry analyst for my -- the time that I was with CIC--China International Capital Corporation. So instead of talking about the micro-level political reform and economic reform, I'd like to focus on where we see the industry reform can take place and how is that going to improve China's productivity.

Given what Ambassador Zhou just mentioned, that China is a developing country and it will take time for political and economic reform. So, is there anything we can do on the industry reform side that can actually improve the productivity? My background as a telecom analyst since a decade ago shows that actually that's possible.

If you'll look at what had happened to the China telecommunication industry since a decade ago, nobody would imagine that China could achieve what it is achieving now in the telecom industry. There was no foreign ownership in that sector, except there was a public ownership in the Hong Kong market for some of the major telecom operators there was no private sector involvement as well. But if you look at where we are, we are one of the -- we're definitely the largest wireless and telecommunications market in the world and our operator, for example, like China Mobile becomes the largest operator in the world. They have -- by the market cap standard, and they have one of the strongest balance sheets, and sometimes it's getting too worrisome that China Mobile has, you know, about 300 billion RMB. In the listed company, probably another 300 billion RMB at the parent co. level.

And also, even if you look at the service level, the Chinese probably experience much better network coverage, much better job rates than even here in New York City. I think that's one of the things that some Chinese were complaining about when they travel in this part of the world. You have signals in the subway, you have signals in the lift.

So, how come China can achieve that but in the meantime we're facing new problems and concerns in that particular sector? For example, there are corruptions. For example, we're seeing the operators becoming a monopoly in the wireless sector, in the broadband sector. So reviewing, you know, what had happened in the last decade might be very helpful for us to understand how China going forward can reform some other service sectors. For example, the healthcare, for example, media sector. For example, the railway. You know, those are the sectors -- given the productivity that we have seen in the telecommunication sector, if that could be achieved in those sectors I would say in the short to medium term that China can continue its economic growth as well.

It doesn't mean that I don't believe in the necessity of political reform. It doesn't mean that I -- you know, we should have more reform on the ownership structure instead of having all the state-owned enterprises to dominate some very strategic sectors. But if you look at what we did right for China telecommunication sectors for the reform, first of all we separate the regulatory function, the administrative function, from the corporate day to day functions in 1998. I think that's a very important step so that we have a true regulator, we have a true Chinese corporate.

And if you look at what we did right, secondly, even at that time I think there was a foresight that we cannot have a monopoly in that particular sector. So, the government actually tried every way to separate the companies into fixed lines and wireless, and also tried to support China Unicom to become the competitive carrier. So at the very beginning there was a mindset, even though that wasn't given to the private sectors but there was the mindset that we have to have competition in that sector.

And thirdly, I think it's very important not just because they went public in the Hong Kong market and then you have the international investment community to have the scrutiny on the operators, but I think very important through that listing process there is a set of benchmarks and KPIs that those state-owned enterprises will be measured, will be benchmarked, will be evaluated. And in fact, at a very early stage of the reform, there was a greater incentive plan there to encourage the Chinese operators, actually, to do better. There was a revenue-sharing plan at the management level, at the employee level.

So those were, I think, the right things that we did but there are also things that if there is a lesson that we have to learn, and I think there are also things that we missed. For example, at the very beginning we have a very strong regulator, and that was the Ministry of Postal Communications. But later on, it was change to the Ministry of Information Industry, and now it combined with all the industries -- for example, steel, automobile -- and becomes the Ministry of Industry and Information. So, what's the net result of that? There was a lack of consistency in the regulation. There was a lack of adjustment to the market conditions, and as a result of that there was a lack of -- it was a result of a lack of staffing, lack of financial support. So, there is no figure or counterparty of the FCC in China right now. And the result is that those companies are becoming too big and they become such a monopoly in one particular sector.

And those subsectors are big. For example, China Mobile is controlling around 70 to 80 percent of the market in the wireless space, and then basically China Telecom and China Unicom are very strong players controlling similar if not higher market shares in the broadband space. So, you have this -- because there is a lack of antitrust law -- a procedure to put a control on those areas, then what we're seeing right now in the market -- there was complaining about, you know, a monopoly and not enough responding to the market and to the smaller operators.

And it's very interesting, actually, that at the beginning of the year there was one case. It was actually the first case that was brought to the NDRC and the court to go against China Telecom and China Unicom by two very small ISP providers in China. So, no consistency in the regulatory function and there was no antitrust. So as a result of that -- and also in combination with what is lacking, which is the optimum capital structure. Because government is the ultimate shareholder and if government does not go out to present or control or manage an optimum capital structure, the result is that there was way too much cash piling at the corporate level. And as Mr. Chen mentioned -- and also prior speakers mentioned -- that the efficiency or the return of those cash flows on the balance sheet was very low.

And what's getting even worse in that situation is that because there is so much cash, then there is corruption and almost China Mobile becomes the center of many corruption cases and senior management -- quite a number of them if not three or four -- have already been put into custody. So, that's a side impact of having those piles of cash on the balance sheets. So, those are the problems that we have been seeing in this privatization or reforming of that one service industry.

So my conclusion is that I think there are a number of industries in China who are in a similar situation. If we can have the commitment to go push forward for the separation of regulatory functions from the operational units in stimulating competition, not between the private or state at this stage but at least among the state enterprises, there would be great potential of productivity achievement over there as well.

Thank you. (Applause)

SPEAKER: I've got too many questions, but I think I'm (inaudible) ask another. Yeah, anyway my question is about the income distribution because we all know that income distribution situation in China is really, really serious. I just heard that a new study about the GINI index is in the range of 2.6 already, and we know the next mark for making this -- for making the conflicts and social pressure is .4, but now we reached .6. What is the major ration measure that you recommend to resolve this problem? (Laughter)

MR. NAUGHTON: Well, I think it's very, very difficult to address income distribution directly. So, I mean, I really -- I think I'm in Wang Tao's camp about how we can move forward. That it's a question of tearing down barriers that protect profitability in the corporate sector, allowing prices to rise for factors of production, including labor and land, and interest rates, and that if you -- that that's a good wedge to begin with, and that if we -- because that's a set of policies that not only move in the right direction in terms of income distribution because they tend to take away some of the privileges that the wealthiest take advantage of, but they also move the economy in a direction of being more fair and more flexible.

I think I'd start with that, and then hope that in the longer-run -- improve Social Security, improved income tax systems would also take a step in the direction we'd like to go.

MS. HU: Wang Tao?

MS. WANG: I just want to add to that. I agree with that.

I think on China, one important thing about the income inequality is also inequality of opportunity, basically children going to school, access to higher education. I think things have actually deteriorated.

When I used to go to university we had almost half of the people coming from the countryside, very poor. Now you go to the top universities in China and very, very few are from the countryside. This is because they don't -- they already from the very beginning, you don't have access to the kind of school that will enable them to go to good universities. But also, job opportunities. I think sort of equal access to opportunity, that's a long-term solution for income inequality.

The second I think also on income tax reform. Right now the income tax is very much a salary tax that basically taxed the white-collar working class. There's no property tax, no wealth tax, no capital gains, no interest tax. No, you know, inheritance tax. Anything that the rich makes is not taxed at all so, you know, of course I have a personal incentive because I'm a working person who makes -- a lot of people probably pay half the tax of my district. So because only a few people pay, right? And most of my peers, actually, in Hong Kong. So, I think income tax reform is very important to put all the income there, every income together, and then significantly increase the threshold of income tax.

And also, the breakdown -- sort of the privilege of access of certain groups of people to resources. A lot of the wealth was created because they have excess of land, of mines, that belong to the state but they don't pay any resource tax. So, these are how -- you know, it's not about people who are innovative and who have developed products. A lot of the time, I think the complaint about the inequality is this unfair access to resources.

MS. ZHANG: Yeah, I think in addition to that I think it's also very important to get our pricing of factors right, and in that process is actually you have a better chance to achieve income distribution results.

And also, I think it is also very important that there should be a re-thinking of relationships with the society from the Chinese corporate as well, and also the rich people. There will of course be excuses that, you know, because that area is pretty dark and disruptive so people are no longer making contributions to the charity work, but I think there should be a better way to show awareness to see this is a long-term sustainable approach.

MS. HU: Okay.

MR. NAUGHTON: Could I add one thing?

MS. HU: Yeah.

MR. NAUGHTON: You know, if we really are reaching this sort of turning point in labor availability, then we should expect to see inequality get a little bit better as the supply of unskilled labor starts to reduce a little bit. So, that makes me a little bit optimistic.

On the other hand, what I hear more and more from essentially middle-class people who, you know, really are pretty well off and are certainly much better off than their parents, that they are much more concerned with the unfairness, that so many opportunities are taken by a relatively small group. So rather than it being, you know, the danger of the poor being angry, we really see middle-class resentment growing in China, I think.

MS. HU: Yeah, okay.

MR. HERREOD: Judd Herreod, documentary filmmaker.

Could I get Barry Naughton to elaborate a little bit more on why he feels that the -- I believe you called it the investment bubble in the high tech capital-intensive sector is the wrong way to go? Maybe you could talk a little bit more about innovation in that sector, how close are they to, say, fielding world-class products from that sector, and so forth?

MS. HU: Great, that's also my question.

MR. NAUGHTON: Well, of course it's a huge, huge topic and you know, China has remarkably creative scientists and engineers and it has some really wonderful startup companies. But what we're seeing in the last couple years is a lot of government money going top down, designated sectors, designated technologies. The strategic emerging industries cover 35 industrial sectors, and in each one of those sectors there is a plan that's been in process -- not an old-style, you know, centrally planned plan, but over the last couple of years drawing up has components of the 12th Five-Year Plan, a program of what kind of technologies are going to be supported, what regulatory policies will be used to support them, and sources of money.

And so, of course people respond to those incentives. They adapt their behavior and they say, this is where the money is, this is where the opportunity is. I will adjust whatever I was doing to become eligible for these monies, to -- if I'm a local official, to set up a new industry. So I think a lot of energy, a lot of activity gets diverted into essentially -- in some cases, I mean, the extreme version is sort of fake innovation, but more than that just duplicate investment in technological paths that may or may not be successful.

So for instance, China has 8 or 10 large projects on plug-in battery cars. Okay, maybe, you know. But is that likely to succeed? How many will succeed, one, two? Right? So, there's just a lot of overinvestment in many sectors, and I think it's going to come back and hurt China while it disrupts the markets for these crucial products.

MS. HU: Okay, yeah.

SPEAKER: Hi, I'm Chen Qian. I teach finance at Johns Hopkins.

My question is actually to Hu Shuli. You know, I sometimes write for Caixin Media, so we are not strangers. This is not a staged question, I hope it's a hardball question.

So a lot of the audience of Caixin Media, they recently criticized Caixin for a lack of report on the recent very important incidents. (Laughter) And you know, a lot of my friends, online friends, they think Caixin could be pushing the political and economic reform by doing more investigative reporting.

So my question is, how do you position Caixin Media? Do you believe Caixin Media should be a pioneer in pushing all these, you know, reforms or just a fair, objective observer of these incidents? Thanks.

MS. HU: Thank you. Actually, it's not that relevant so I'll give a short answer.

Actually I think Caixin has been very active in the professional investigative reports, mainly in the business and finance industry. We are not that -- I think, yeah, in this cycle the Bo Xilai case understand the people are so curious and everybody wants to know the facts. We are working on something but it's hard. We haven't gotten the full picture of that, and right now we saw only piece by piece, more piece by piece, and we hope that we can get something which is really -- which is the whole story, because I think every -- we have got so many pieces. It's like as a blind man touching a big elephant. You all see different legs and never know what is a real elephant.

We feel that so far, and we are working, okay? Thank you. (Laughter) Okay.

SPEAKER: Hello, my name is Huang Yan from the finance world. I want to ask my previous colleagues about what's your view, Dr. Wang Tao's view, about the return on investment. Basically we all know current account equals saving money and investment. You mentioned a lot of the savings side. What's your view about the return on investment?

Secondly, what's your idea about -- you mentioned about the other political concerns and press concerns -- what's your view about cash motives, you know, to the investment side of cash motive savings in terms of -- you talk about a lot of stories of corporate levels. Some key questions, what's your view about return on investment?

MS. WANG: Return on investment. This being at the center of a lot of debate about whether China is a big investment bubble. You know, whether the returns on China's investment is diminishing.

I think the question, actually -- the answer is more subtle. Because if you actually look at the returns, profit margins of the industrial sector, it's been very stable. So we haven't seen a lot of diminishing returns. It's not true, it's not like in the late-'90s where investment was just pouring into over-capacity sectors producing things that are not for sale. I think Chinese companies have been smarter and the economy has changed, so that's not happening.

On the other hand, how do you explain the fact that, you know, we have a lot of investment? Especially in the last few years, in the last three years, a lot of the investment that's government-mandated, government-supported actually went to infrastructure. So if you look at the ICOR, the incremental capital output ratio, it actually is increasing. However, I think a cautious point I would point out is that infrastructure -- we should not judge infrastructure by returns of sort of fare, tickets, fare, and so on and so forth because it has externality. It's supposed to generate productivity for the whole economy over a 20-, 30-year period. So it's a little too early to say those are completely unnecessary or unproductive. I tend to believe that China still has a lot of potential to make returns to this infrastructure investment.

But another part, of course, is in property and I would say for the next 10, 20 years we'll continue to build infrastructure but not generating returns via, you know, better productivity in the manufacturing sector and we would not be able to get those returns.

So, sorry. It's not a clear answer but basically I think that the fact that we do invest a lot means that returns are relatively low. But at the moment, you do not immediately see the diminishing returns, so there is still a case for more investment but the allocation of that investment to which sectors and, you know, the pace of growth is probably debatable.

SPEAKER: Hi, I'm Huining Cao. I'm a professor of finance in the Cheung Kong Graduate School of Business. I agree with the earlier analysis on the monopolies in China. You know, monopolies are kind of bad for innovation and also, like, greater inefficiency in the market.

So my question is, you know, a reason why there's so many monopolies in China is because they are actually controlled by many of the princelings of the old leaders, like *Guanerdai*. Especially as it's kind of a distribution of wealth more to the people who have connections.

If we only have to reform -- and as economists, we know that you have to satisfy the participation constraints or like the win-win kind of idea. That is, how do we make sure these principles or these people in power can also benefit from reform? That works very hard. I wonder -- you talked a lot about the antitrust law and the kind of more monopolies. How can that be initiated, given that these people who benefit from monopolies are actually in power?

MS. ZHANG: Well, yeah. For the industry, I just mentioned the telecommunications industry. It's actually not a result because it's owned by *Guanerdai* or -- you know, that was the key. But I think there is a broader-based lack of definition of what is antitrust in China. I think there is a lack of functional regulatory body that can dive into the research of antitrust, so that how is the impact of the, you know, innovation, going to -- I think there is a lack of understanding that, you know, if you encourage a long-term monopoly antitrust is actually a reduction of innovation and even an efficient allocation of resources.

And I think also because China's telecommunication industry is one of the first industries actually going through the industry reform, and eventually after a decade we still start seeing a little regional intention, was to introduce competition. But the ending result because of the technology -- we didn't catch the technology trend because we were very reluctant to put a market share cap on the key industries. And then, it ends up with a monopoly situation in one or two major sectors.

I think this is actually a great opportunity for China to call for further reforms, and further than that I think at the legal system level there is a lack of definition of what is a monopoly. What kind of a market share will be defined as a monopoly? And I think that needs to be addressed.

MS. WANG: I just wanted to add a couple of things. I think they are actually -- so even if it's a princelings, *Guanerdai* , there are competing forces. Somebody is in the upstream, somebody is in the downstream. The downstream people will complain about the monopoly in the upstream, so I think natural forces in the economy will help.

The second thing is I think as the history of China's reforms have shown, that we are actually pretty good in developing around it. We started the economy with much of, you know -- the whole economy is state-owned, right? Instead of directly tackling the SOEs, the commanding highest industries, we let the rural sector, the FTI, the foreign sectors, and small businesses to flourish. And then gradually over time, SOE and the state as a share of GDP is much smaller. So I think that's also to allow private entrance into certain sectors. That's a way to gradually chip away at the monopoly as well.

MS. HU: Okay.

SPEAKER: Hi, I'm Felicia. I'm a junior at George High University, interning with U.S.-China Business Council. So, Professor, you talk about reforms in China's capital markets, and Ms. Zhang also talked about there's obvious development in Chinese capital markets. And my question is, looking back at the financial crisis in 2009, one reason that China wasn't affected is that we don't have a larger range of financial products, we don't have the derivatives. And I was wondering if you could comment on what do you see of the development of financial products in China?

MR. NAUGHTON: You should take that.

MS. ZHANG: Yeah, I think we shouldn't let the financial crisis actually stifle the financial product innovation. I think China in terms of the financial market is way behind in terms of the products available in the market over there.

For one example, we have only cash equity in the equity business. There was lack of derivative and there was -- now we have futures, but there was also a shortage of mechanism in China. So, if we don't have those innovative financial products, the problem is that we -- the Asian market cannot find the fundamental value of that market easily because you only have one mechanism and one product.

So given that, I think we should not be discouraged, which is also CS or C, amazingly, was not encouraged when what happened when this part of the world introduced -- and they still decide to introduce -- future business -- the index future, and also I think most likely towards the end of the year there will be stock borrowing as well.

So, I think those are positive changes. But in the meantime, I think what is problematic in China is that we are not investing enough to build our regulatory functions. And for example, I mentioned about the telecommunications sector.

And another example. In many, many other sectors that we want to go for reform, but the problem is that probably over the last 20 years, the people will have the financial resources, who were having the education, decided to work for the private sectors or decided to stay overseas. So there was obviously a regulatory function vacuum that was in China. We need to staff properly, we need to finance those functions properly in order to be able to have the regulatory body and to avoid the problems in the future.

MS. HU: Okay.

MR. RAY: For Tao and Barry. Sheldon Ray, Morgan Stanley, Smith Barney. There were reports in March of copper import increases into China, 50 percent over the previous year and iron ore imports up over 5, 6 percent. Iron ore prices at like six-month highs. Is this like a post-New Year aberration or is the economy picking up a little more than people expect?

MR. NAUGHTON: You work for an investment bank, you should answer that question.

MS. WANG: So, I'll start with the iron ore. In terms of iron ore and the steel sector, basically our thesis -- I didn't talk about the short term. I agree with Barry that actually we have seen a turning point in China. The steel consumption is rising. We deducted by looking at steel production rising, inventory is dropping, steel prices are rising, so this is an obvious indication that actually some construction is returning. That probably includes some social housing construction, and in the private side it's probably stabilizing.

I talk a lot about property because 35 to 40 percent of steel in China is used in property, and it is the long products, which rebars and so on, for construction that is rising. It's not the sheet products.

And as you know, China produces half the iron ore and imports the other half. The other half happens to be the high-quality ones. And so, the inventories, you know, have been reasonable. As demand starts to pick up, then people start to import more. So I believe this is true demand returning. And of course, we do have -- on the supply side we have monopoly or oligopoly so they can control the prices, so prices rise.

Copper is a much more complicated story because copper is highly speculative and so in the first quarter, not just March -- actually, imports went up 50 percent in volume year-on-year, and then at the same time in the bonded warehouses in Shanghai the copper inventory just went like that. Now currently, at historical levels. So, that does not seem to mean that under the line demand is going, but it's rather an inventory buildup, which could be speculative.

So I think, you know, for me if I just look at -- I'm not a copper analyst, I'm a macro person, but people ask me questions about the copper all the time. So, I look at that and I say, well, I can only conclude that even if underline demand in China picks up whether from construction or from power, and so on, I doubt that copper imports can go up much more because we already have such high inventory. So, I would be quite bearish on copper price at the moment.

MS. HU: In the back, yeah.

MR. HUANG: Ju Huang from the U.S. International Trade Commission. So, I have a question for Professor Barry Naughton. You mentioned China having three very important turning points, and talking about the structure change and the dominant structural changes. So, opportunity indicates two years ago, even very few people emerging from China to become a world factory, become a manufacturing center of the world. So, China is starting to export only -- become the lead exporter not only in labor-intensive products, but also technology and capital-intensive products -- or manufacture products. But because of the structural change having a fundamental impact on the world economy, in the next decades or 20 years, as you mentioned, China's dominant structure will be dramatically shifted from unskilled labor to more and more skill-intensive.

So, what does that impact where -- impact on China's industry upgrading? And also, on the rest of the world? I think that's also going to have lasting impacts on the other parts of the world economy. I would really like to hear your opinion on this.

Another point is, I am talking about China's development of the civil sector. That's really important, but we have to understand the -- for example, the business sector is mostly for the many in the manufacturing sector. If you don't have a manufacture base, how can you develop the business for the manufacturing sector?

Secondly, if you use the official Chinese statistics, I have a question. Because you see, China's system is company-based. It's not an integration-based. So a lot of state-owned companies, they have -- when they replace the workers to a company, they do a lot of service sector stuff but it's still -- China's value agencies still collect them as industry sectors.

So in many people's view, China's service sector's share in GDP is underestimated. What is your opinion? Thank you.

MR. NAUGHTON: So, lots of great questions wrapped up in that. I think it is true that China's service sector is underestimated, and thank goodness because if it's really as low as the data say it would be an even more distorted economy.

But you know, China has a huge manufacturing sector, no matter how we look at it. The official data say that it's not only the largest share in the world but it's the largest share an economy has ever had. So, yes, there's probably some overstatement in that, but certainly there's plenty of manufacturing there, and so when we think about the structural change, you know, what will be the impact on the global economy?

Well, I wish I knew, but clearly there is a sense in which it could be a highly positive driver of global growth, right? Because China is going to move out of many labor-intensive sectors and there are many, many economies ready and already thinking about gearing up on how to move into those sectors. So that could be highly positive.

It could also be positive for the U.S. because there's still -- U.S. and Germany and particular -- there's still a range of very sophisticated capital equipment that will have a larger market as China moves into the middle range of commodities, both for domestic demand and for exports. And of course, raw material suppliers would also welcome it.

So I mean, you know, it's possible to have a very, very optimistic story about what China's upgrading means for the global economy, and I hope we get there. I can't guarantee we will, but it could be very positive.

What do you think?

MS. HU: Okay, yeah.

Ms. TSI: This is Wei Tsi from the World Bank. I just want to ask Professor Naughton about how do you evaluate the Chinese young generation of labor force? Because everybody knows there is a high unemployment rate, and because of the expansion of the tertiary education in the '90s and also the single child policy. Actually, their reservational wage is pretty high and the kids don't really want to go to work if the wage is not high enough.

So how do you evaluate this labor force? And do you think they are capable of transforming China into an innovative and skilled labor-intensive economy in the future? Thanks.

MR. NAUGHTON: That's well above my pay grade, as our president said before he reached the highest pay grade.

I mean, in the long-term do Chinese young people have the skills and adaptability to drive China to a much higher level of skill and capability? Of course they do. I mean, it's so obvious, right? They are so capable and so hungry, in many ways. So, of course. I'm very optimistic about what Chinese young people are capable of.

Now having said that, a lot of them -- you know, we've had a very, very rapid expansion of the educational system, so most people coming out with tertiary degrees have pretty mediocre educations at this point. I mean, obviously there are some great universities in China and some of them are moving towards the frontier, but the majority of these people are coming out with, you know, relatively low-quality education and they're going to need to supplement it by lots of on-the-job experience. They have to find work first, so there are a lot of challenges to overcome before we get there.

MR. MEYER: Kevin Meyer, (inaudible). Dr. Tao's belief that market resource allocation is favorable to state allocation and Dr. Zhang's talk about futures markets and derivatives and shorting the market makes me wonder whether you're advocating the introduction of American-style casino of capitalism to China. Is that position -- if you are -- philosophical, or are there metrics by which we can measure the success of resource allocation in an economy?

MS. WANG: It's not philosophical, to start with. I think that it's all relative. I think in the U.S. you have probably gone too far with your regulation without proper supervision, whereas in China I think we cannot actually look at the U.S. and say, that's completely wrong, we should go back to our system. Which, unfortunately, I think, is the greatest lesson Chinese policymakers may have learned, and it's the wrong lesson, in my view. We are so far and still reforming the state control to say that, you know, we shouldn't repeat the U.S. We shouldn't, but we still are a long way from repeating the U.S.

I am a great believer that the state -- you know, the state should have some control, should have better supervision and regulation to sort of set up the framework where people have, you know, equal access and level playing field.

Right now, actually, in a lot of parts of China it is a casino, except it's a casino for the privileged few and not for, you know, the people who have autonomous desire to grow. It's the people who have the control of the resources. I think that -- so, for the U.S. case, you probably need better regulation, but in the Chinese case we need deregulation, still. We need the market to play a role, because right now their signal is not there. It's basically a government who decides -- who picks winners and who choose winners in industry. Barry gave the example of high tech. One year the government decided, we need to do green tech. 200 countries invest in solar power. In 2 years, the capacity increases by 500 times, okay? So, this is, you know, a casino with the state control and with the market not playing a role anymore.

So I think, you know, we are coming from another spectrum.

SPEAKER: Thank you. My name is (inaudible). I come from the University of Maryland.

And I want to ask questions about China's young people, about their adaptability of the job market. Because I have noticed two states that last year the Chinese youth participated in the CFA test, and about the government officials entering tests. Both of these two tests, the numbers are at a historical high in the last years.

So, I wonder when there is a situation that the government upsets lots of Chinese youth to enter, and the financial market they provide high salaries, and salary packages for the youth. All of these young people, they want to find jobs in these two areas, and so what about the other job market areas? Because I have also noticed that there is a huge shortage in the industry, especially in the labor-intensive areas.

So, if no one else intends to force China's young people to participate in the other areas, I wonder if such trends will continue and if that will harm the future of China's economy?

Thank you.

MR. NAUGHTON: So, you're referring to the fact that more and more young people are taking the exam to get into the civil service? So, some 500,000 young people took it last year and then the other sector is the financial sector.

Because they are rational people, right? This is where the money is --

MS. WANG: This is where the money is --

MR. NAUGHTON: -- and the power is, and so I think in some sense it reflects well on Chinese young people but somewhat poorly on the Chinese system in the sense that you would hope there would be many more sectors that offer, you know, really high potential career returns.

And I think there are, and after all, 500,000 people apply for the government but only 2 percent make it. So, the other 495,000 are going somewhere else.

MS. WANG: Yeah, I think one thing is the reform of our education system. For example, that in universities the more students you get the more resources you get from the Ministry of Education, and so they don't care if the students actually find jobs. So, there is a disconnect between what society, what business wants, and what the universities are producing. So, reform of that is necessary.

The second thing is that I think for business they have had a very good time just in tackling the surplus labor. They didn't have to provide training. They don't -- a lot of them don't even provide a working contract, right? Migrant workers work there for 10 months and then you go home. Next year, you reapply again. But as labor becomes shorter in supply, then businesses feel the incentive to provide a contract and on-the-job training, they see the benefits of retaining people.

You know, I have big hopes that we will be able to adapt on both sides because economic incentives are changing.

MS. HU: Anyone else? Okay.

MR. LI: Xue Li from SAIS. My questions go to Hu Shuli. You talked about the case of muckraking. Because, you know, consider about China's context to do the muckraking is very dangerous in China.

I just wonder, how do you deal with the law? Because there is the potential boundary for you to deal with these kind of radicals. How do you control these things? So as the case, like *jijinneimu*, when you decide to publish the book. What do you think about seeing the boundary and not outside the boundary?

Thank you.

MS. HU: Actually, boundaries are there in China but the thing is never think about the boundaries, otherwise you will do nothing. So, we just think where is the news and we cover the news.

In our case, we follow -- the more news and journalism in China. (inaudible) is a powerful journalist in China. Thank you.

So, okay. Thank you very much. (Applause)

We have come to the end of the conference, and so on behalf of the Brookings Institute and Caixin, I would like to say our sincere thanks to all the speakers who gave the remarkable talks here and gave their frank and thoughtful interactive discussions with our audience. I also want to say thank you for all the audience for your attention and for interest about the topic we gave today, and also for your active discussions with our speakers. Thank you very much.

MR. LIEBERTHAL: First of all, I want to add with our thanks to Caixin Media for its wonderful cooperation on this, and especially to Hu Shuli. I want to mention that a good part of this will be available on our website, a transcript and perhaps all the slides or most of the slides. We still have to discuss with the various speakers. So, be sure to come to the website after a couple of days and you'll be able to get a good record of what you've just heard this afternoon.

Again, thank you all. Oh, and on Caixin's website you'll have, what, a video of this or a transcript?

MS. HU: Video and a transcript, and also reports.

MR. LIEBERTHAL: And small reports. So, all of us are famous in China now, okay? Probably in English and in Chinese, or Chinese voiceover?

MS. HU: First in Chinese, first. But the transcript will be in English at the same time. Afterwards, it will become Chinese, later.

MR. LIEBERTHAL: Okay. Bilingual on Caixin, monolingual on Brookings. And thank you all very much for coming. (Applause)

* * * * *

CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Carleton J. Anderson, III

<u>(Signature and Seal on File)</u>

Notary Public in and for the Commonwealth of Virginia

Commission No. 351998

Expires: November 30, 2012