

THE BROOKINGS INSTITUTION  
CENTER FOR NORTHEAST ASIAN POLICY STUDIES

*in cooperation with the*

ASIA SOCIETY  
HONG KONG CENTER

*and the*

FACULTY OF SOCIAL SCIENCES  
UNIVERSITY OF HONG KONG

LUNCHEON PANEL

CHINA'S FUTURE TRAJECTORY AND IMPLICATIONS

**THE U.S.-ASIA DYNAMIC IN THE  
21<sup>ST</sup> CENTURY:  
CHALLENGES AHEAD**

*Tuesday, October 18, 2011  
JW Marriott Hong Kong  
Hong Kong*

Proceedings prepared from an audio recording by:

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**PANEL I: ASIA'S CHANGING BEDFELLOWS: DE-COUPLING FROM THE U.S. AND COUPLING WITH CHINA?**

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**LUNCHEON PANEL: CHINA'S FUTURE TRAJECTORY AND IMPLICATIONS**

Opening Remarks and Moderator:

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Co-Chair, Asia Society  
Chairman, Hang Lung Properties

Panelists:

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**PANEL II: THE EMERGING INTRA-ASIA DYNAMIC: WHERE TO FROM HERE?**

Moderator:

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**PANEL III: THE RISK OF DESTABILIZATION: MAINTAINING STABILITY FOR ECONOMIC GROWTH:**

Moderator:

**JOSEPH STERNBERG**

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**Closing Remarks:**

**RICHARD BUSH**

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## PROCEEDINGS

RONNIE CHAN: (*in progress*) -- but as you--it was really, Donald and myself together, that eventually resulted in the piece of land that will be the headquarters of the Asia Society. And we're opening on February 9<sup>th</sup> of next year. For those of you who are from overseas -- I see many, many friends here, Jusuf, Simon, and many others, Richard -- I encourage you to just walk up the hill a little bit, up the side, then turn around, right there. On the one side is the British Consulate, on the other side is the future home of the Asia Society. So I encourage all of you to go take a look.

Anyway, I was told that -- this morning I had a shareholders meeting of Hang Lung, so I had to leave right after the morning session -- and I was told that, in my absence, the quality has gone up tremendously. (*Laughter*) That the speakers were excellent, and the first session -- I heard so much good things about it.

So now that I'm back, ladies and gentlemen, you are in jeopardy. However, I'm happy to say that we have a fantastic group of panelists here. I think that it needs, truly, no introduction. You all know Dr. Victor Fung, one of the doyens of Hong Kong's business community, as well as the policy community. You know that he has recently founded the Fung Global Institute, and he's the chairman of it -- hailing from Harvard. And he has built a business, Li & Fung, that was founded by his grandfather, and is now one of the world leaders in logistics and many other things.

Strobe Talbott needs no introduction, except that he's an old friend of mine -- journalist, but then turned government official, eight years, the whole eight years of the Clinton Administration, serving as Deputy Secretary of State. And then he became the first, the founding director of Yale's Global Fellows Program. And I was on the Council for International Activities of President Levin when Strobe was the head. We were so happy -- before we knew it, Brookings hired him away. So, Brookings win and Yale's loss. But anyway, I'm glad to see that you are still helping Yale very much.

Fred Hu -- you all know Fred, former chairman of Goldman Sachs in China, a wonderful economist, (inaudible) in Beijing. What you don't know is that previously, when he was it World Bank or IMF? He was seconded to the World Economic Forum. And he was doing the Competitiveness Report. Actually, he has his hand in it for some years. I used to serve on the board of the World Economic Forum at the time. We used to get together in Geneva.

Wang Feng, Dr. Wang Feng, is, of course, part of Brookings in China. He has written many interesting books. I find one particularly interesting, by the title, that he edited, *Creating Wealth and Poverty in Post-Socialist China*. Dr. Wang, I didn't know that China is "post-socialist." (*Laughter*)

But anyway, Dr. Wang is a sociologist, an expert in demographics, in particular in the wealth gap in China, and so forth.

Anyway, today's session -- obviously, we all know the topic of it, that is China's future -- "The Future Trajectory and Implications."

Allow me to perhaps divide the discussion into two halves. The first half will be on China itself. And then the second half, on China with the rest of the world -- in particular, with the United States -- which is, after all, the bigger topic of the entire day's proceedings.

So, with that, I'm happy to tell you that I have decided that there should be no speeches. I think it's much more interesting if I just ask questions of our great experts here, and let them answer.

Obviously, one of the first questions that needs to be asked is about China's growth. We have witnessed in the last 20, 30 years, something that mankind has never seen, where China has lifted so many people out of poverty in so short a time. And yet, after 20, 30 years, people are asking the question: Is the growth just a quantitative one? Or is it qualitatively acceptable? Is there something that we should worry about? Obviously, we're always worried about a lot of things, especially for somebody with an active mind like Strobe Talbott. Being a former journalist, he must have a lot of questions. So do we.

So I think we will start the first part on this issue of China's growth: Is that something that is sustainable?

I will just put out some very general questions, and then I will ask that question in particular of Victor and Fred. And then I have other questions for Dr. Wang and Strobe.

So -- Victor, you and Fred make some comments about is this sustainable? Is China ready to fall off the cliff?

VICTOR FUNG: Absolutely not. *(Laughs)* Well, really, I think you asked some very good questions. It's really the quality of the growth that one should be focusing on. I have very little doubt that China, as a whole, is -- the actual numbers, the qualitative numbers -- may ease just slightly from the track record of the past 10 to 15 years -- but not my much, to be honest. I think China will continue.

But what is very significant, in my mind, is the quality of the growth. And by that, I really mean the sustainability aspects of it. What I see is a sea-change in China, in terms of focusing on the sustainability of the growth, especially looking at the -- I would say the environmental impact aspect of it, and also the social dimensions of that growth.

All you have to do is to look at the 12<sup>th</sup> Five-Year Plan, and look at the sections on green -- use of clean energy, the sections on environmental impact, the section on social impact. The proportion of that as a proportion of the total plan has dramatically increased. And as somebody operating in China, it's absolutely being enforced and implemented on the ground.

And I feel that -- you know, one of the most significant things that I really remember is -- I don't know how many of you remember Wen Jiabao, at the beginning of the

year, spent a day answering questions on the web. And at the end of that, he gave a press conference. I don't know how many of you actually focused on this.

The most significant thing out of that press conference is that he said China is at a stage of growth where it should be prepared to sacrifice one of two points in our growth rate in order to achieve a more sustainable and equitable growth.

So the other aspect -- which I know Dr. Wang Feng is an expert on -- is I think how do you actually spread the wealth around, after the wealth is created for the country as a whole? Which gets into the whole distribution of income issue. And I think there, I will be looking for dramatic improvements, if you will, or changes to the better, in terms of that composition, as well.

So, I think those dimensions, in terms of -- if you actually look at the quantitative side, I would say, then, the key word is "rebalancing." The idea of not really depending on export-led growth and focus on exports, but a lot more on the balanced trade picture, a more balanced trade picture -- not to de-emphasize exports necessarily, but to emphasize more the imports. And emphasize imports of not only components, but of finished goods. And that's crucial.

And then, also, really, really re-energizing the economy in the direction of promoting consumption. And so rebalancing away from export-led growth to what's more consumption-led growth.

And I think those will be the key aspects that I will be looking for.

MR. CHAN: Victor, I hope you are right. I've built shopping centers in China. I want to make sure that they consume a lot internally -- right?

DR. FUNG: Well, you've got the best malls in China.

MR. CHAN: Right. You bet. And let me tell you, my malls have been growing at 27 percent per annum in rent for many, many years. And, in particular, in the last two years, they've been doing fantastic.

DR. FUNG: I know. I'm one of the tenants. *(Laughter)*

MR. CHAN: Thank you. And, of course, Victor mentioned about the sustainability issue. I think a lot you are not aware of this, but do you know that the -- I think it's one of the only companies in the world where every new project has met the U.S. Green Building Council LEED Gold certificate on sustainability. That company is in China. Every new project they do -- and there's about 6, 7 billion of them, all have met the LEED Gold standard.

Now, obviously, it's my company, of course. *(Laughter)* But it doesn't matter. It is in China -- right?

Now, Fred, what's your take on the growth? Quantity versus quality? Can they do it? Can they really improve the quality? Or are they just playing the quality game?

FRED HU: First of all, thank you, Ronnie.

I think the Chinese government is a silent partner to this symposium of the Asia Society and the Brookings Institution. Because we just released the third quarter GDP right before this lunch panel. It came at 9.1 percent -- okay? -- 9.1 percent. Depending on how you look at it -- you know, if you're in Brussels, in Paris, or Frankfurt, or maybe Washington, you know, you would be quite envious of this 9.1, whopping, you know, strong number.

But the market doesn't seem to get all encouraged. So just as we were having dessert, I checked Bloomberg. All China equities, red. All pointing down -- okay?

MR. CHAN: Too fast growth?

DR. HU: There is this still (inaudible) fear that, inevitably, China will have a (inaudible). That's the market psychology. However, I do think there's very little fundamental facts which would support that view. I think it's way, way too bearish.

China has been tightening the economy, trying to cool off a red-hot sudden economy, for two years in a row, with draconian measures. Not just interest hikes -- you know, eight times of increase in reserve requirement ratio -- "RRR" -- and the main one is really, you know, since you are the leading developer in China, and the government has imposed the draconian measures should go, you know, out of mind on the new home pages, you know.

MR. CHAN: Limited to purchase.

DR. HU: Yeah.

MR. CHAN: So, already existing with owners.

DR. HU: Yeah. And that's really because of the fear of rising inflation and a potential housing bubble.

So, obviously, this slowdown is unmistakable, you know. Just look at the manufacturing, you know, PMI -- Purchasing Managers' Index. Look at industrial production -- you know, retail. Notably exports. Everything is slowing down -- quite significantly.

But I will say, at this point in time, this slowdown that has taken place in China is just what the doctor has ordered. You know, to prevent rising inflation, in order to avert a housing bubble, that we have learned in the last three years, could do tremendous damage to the economy.

So, in the near term, granted, depending on what goes on globally, in the Euro Zone, in the U.S. and Japan, and in other BRIC economies, there's a lot of uncertainty with the

Chinese economy, particularly on the trade front. And I think (inaudible) should be on guard, given what you do as the world's leading trade company.

But, other than that, I think domestically we find they still have strength. And, you know, I anticipate a soft landing. So that's the near term.

But the gist of your question is really more like medium and long term -- you know, this quality versus quantity.

I think the growth model China has been relying on for the last 30 years has been very successful in transforming China into, really, the fastest growing major economy for three decades. Lifting 500 million people out of poverty. You know, becoming the world's factory, and leading export powerhouse.

So, most achievements are tangible. But, you know, this model has also shown increasing cracks and tensions and limitations. And some of them are well-recognized.

For example, it has contributed to trade -- to global imbalances. And that has been -- sadly, that's one of the key triggers for the global financial crisis. And China, as the economy with the highest trading surplus, or current-account surplus clearly has a role, has a hand in private consumption and has been quite low, I think Victor mentioned that 32 percent of GDP is household consumption. Just to give you some perspective, you know, U.S., where Strobe represents, actually has the highest consumption-to-GDP ratio.

MR. CHAN: Over 70 percent.

DR. HU: Over 70 percent. And generally, the OSD countries have, you know, around 70 percent. Our neighbor, India, has a per capita GDP about a quarter of that in China. It has 52 percent of GDP. Russia, 56 percent. Brazil, another member of BRIC, over 60 percent.

So, China, now, 62 percent of GDP clearly is too low for a lot of different reasons. So China needs to find a way to boost private consumption, to really have a broad-based growth, and benefit all the people.

And finally, quality, a big dimension, you know, we are world factory. You know, we are the big manufacturing power, in terms of value -- okay? And we are the biggest exporter.

But is China still possess preciously few world brands, okay? You know, Apple and iPhone. But this is something, you know, next 30 years, you know, China has to really move up the ladder, become more innovative as just opposed to just low-cost manufacturing. So this is the big challenge -- okay? And big, as there's no guarantee China will be able to make it.

But I'll give my best example, is looking across the strait, from Fujian or Zhejiang is Taiwan. You know, 30 years ago, when mainland China opened up, so the low-cost manufacturing in Taiwan disappeared overnight. So, Taiwan had no choice but to move up the ladder. And you know what? Taiwan succeeded.

I think the latter part here, now, on the mainland, like in Taiwan -- first of all, there's a big human capital pool, 600,000 graduates in science and engineering every year. And also overseas, you know, PhDs trained at Stanford, MIT and, you know, everywhere. So now we have seen the reverse of brain-drain, more and more highly educated mainland Chinese, across all different fields, now going back to China. So, human capital.

And secondly, entrepreneurship spirit -- you know, when Steve Jobs passed away I was invited to 10 different events -- small, roundtable, all kind of events to honor the memory of Steve Jobs. In my lifetime, there are only three people, when they passed away -- first of all, Chairman Mao, when I was like a teenager, it was kind of a national grief. Second, Deng Xiaoping. But a more mixed reaction because, you know, he has the association of Tiananmen and all that. But then Steve Jobs, almost universal grief in China, the students at Tsinghua, Beida, entrepreneurs, and even government bureaucrats -- okay?

As the main, the loss of Steve Jobs, I see hope in entrepreneurs in China. And, you know, with all the freedom, with the premium capital, with the better capital markets, you know, I do see the potential for China to move up the ladder as just being a poor imitator, become more innovative inventor, making ways in pockets of -- it might be clean (inaudible), space technology, and increasingly e-commerce and the internet.

Thank you very much.

MR. CHAN: Well, you know, Fred, this is crazy -- 9.1 percent, and you'd say that's "slowing down." No wonder some of these Westerners are worried about it. There must be something wrong, when 9.1 percent is a slowdown. When you go fast enough, you're going to have a lot of potential bumps on the way -- right? Tell us more on some of those bumps.

I'll first invite Dr. Wang. Tell us what are some of the potential bumps that worry you the most. And then, of course, then we're going to have ultimately an American journalist, formerly, Strobe, which has a great benefit of being objective -- or perhaps a little bit invested on it. *(Laughter)*

So, I don't know -- so, Strobe, say what you want to say later, but Dr. Wang first.

WANG FENG: Well, thank you. It's a privilege to be among these distinguished panelists, and also with this distinguished audience.

I think, to begin with, we have to think beyond what has happened in the last 10 years. Let's go back to 1998 -- 13 years ago. At that time, China was actually in great difficulties, in closing down its state-owned enterprises. Two-thirds of state-owned enterprises were losing money, or not making money. And they had to lay off more than 20 million people. That was 13 years ago.

And also, the urban housing reform was not finalized until that year, also. So, before that, most urban Chinese did not own their houses or apartments.

So what we've seen, really, in the sense of history, is only 10, 15 years. But this still has been tremendous for China. I just want to cite a few numbers that I think that spell both potential and also challenges ahead. We all know Chinese economy grow tremendously in the last 10 years, from something like 9 trillion RMB to 40 trillion. So we're talking about a 3.7 times increase in 10 years. The economy grew 3.7 times.

At the same time, urban household disposable income increased only 90 percent of that level, 3.5 times. Rural income increase only 60 percent, 70 percent of that level. It's less than 2 times. What has really increased is the government revenue -- six times. So 600 percent increase in government revenue.

So this shows a number of features of China. In other words, the government, as we see, has gotten a lot richer, has engineered a lot of these tremendous infrastructure building, which led to, among others, some very positive improvements. College enrollment increased by four times, when population, overall, only increased by 5 percent. So it's four times -- 400 percent -- versus 5 percent. So education is expended.

And China, for the first time in its history, crossed a milestone of having more than 50 percent of its population living in cities, and classified as urban residents. And that is going to continue in the next 10 years, with at least 200 million more people moving from the countryside to the cities. So these all, I think, pave the way for continued growth in China, in terms of the economy.

Now, the slowing down, however, even from 10-1/2 percent to 9.5 percent, or to 8 or to 6 percent, would not be a simple slowing down. That would mean that whether the government would be able to have the kind of income, revenue, to do things that it has done in the last 10 years.

Among the challenges we all know, one of them I do study, is a demographic challenge. China, right now, has -- from the last 10 years, China has already lost the size of its young labor, age 20 to 29, already shrunk by about 15 percent -- in the last 10 years. In the next 20 years, it's going to be about 20 percent more.

At the peak of China's --

MR. CHAN: 20 percent more shrinkage.

DR. WANG: For young labor force.

MR. CHAN: Yeah -- more shrinkage.

DR. WANG: Okay. Now, that is going to have a tremendous impact. We talked about salary, wage increases, this morning. It's not a government policy. It's driven by the market forces, by this labor change -- right? But what's lying ahead, is more challenging, is when the rapid aging, which has already arrived, it's going to continue. And the government will not have the same size or taxpayers in relation to retirees.

So we have an aging labor force, and you have increase burden for government to deliver the entitlements that we're trying to establish right now for pension and for health care. We all know those are two very crucial areas. And that would pose a tremendous challenge for governance for future Chinese leadership.

So a slowing down of the economy would not just be an economic matter. It could have political implications that's not fully appreciated.

MR. CHAN: You know, one of the issues you die slowly if you don't get it right. But you may not die immediately. Are there things, Strobe, that may cause trouble in the shorter term? You know, a lot of things that are considered to be, you know, ignorant and naive by the experts, but asked by outsiders -- history has shown that often they're right.

So, please answer my question.

MR. TALBOTT: Well, I'll tell you something that could cause a lot of problems in the shorter term. I'm going to pick up on Fred's suggestion that the PRC government is actually the fourth co-sponsor of this symposium, along with the Asia Society and Hong Kong University and the Brookings Institution -- which makes it, of course, a Gang of Four.  
(Laughter)

And if that is the fact, then I think we should appeal to the Chinese government to join the other three members of the Gang of Four in placing an embargo on the information that you just shared with us -- meaning the 9.1 percent growth rate -- and make sure that that stays off the record, completely within this room, and does not get back to Washington in the next 12 hours. (Laughter) Because sometime in the next 12 hours, the House of Representatives is going to debate the RMB Bill. And if it gets back to Washington that the Chinese growth rate is exactly equal to the American unemployment rate (Laughter) there is going to be an insurrection against Speaker Boehner. And the Bill will pass. And then we'll be in a whole other world of hurt.

So I leave it to the powers that be for the conference, and our partners in Beijing, to please shut up on the subject for another 12 hours.

But the conversation so far which, like the earlier ones I have learned a lot from as a student of economics -- which is part of what my job at Brookings entails -- leads me, Ronnie, if it's okay, to go from the really short term to a somewhat longer term.

This issue of sustainability has quite properly come up repeatedly. And it ought to come up more often -- notably including in the United States. In fact, particularly in the United States. And here I'm going to echo a conversation that Richard Wang Feng and I had with Victor yesterday, and his colleagues from the Fung Global Institute. And I'm going to put another statistic before the group, which I think there is a developing consensus in support of.

It's a very simple fraction. It's 1.5; 1.5 is the number of planet Earths we will need to sustain the growth trajectory we are now on, in terms of both population and economic development -- 1.5. So we have, essentially, a Hobson's choice -- a classic, properly defined,

Hobson's choice. We can either stay on that growth trajectory -- and here, I'm talking not about the People's Republic of China, or just the United States, I'm talking about the entire human enterprise -- and somehow find a way to get another half a planet, in terms of resources, and clean air, and usable water, to justify that growth, or we are going to have a really terrible 21<sup>st</sup> century -- particularly the second half.

And Victor and I, I think, agreed on the necessity for old guys like ourselves who have grandchildren -- but also people of the next generation -- to think about this, not just in terms of the collective self-interest of the 7 billion people on the planet -- and we're about to have the birth of the 7<sup>th</sup> billion person somewhere. It could be down the street. It could be on the farm (inaudible). And not only do you have to think horizontally in a comprehensive way, but we have to think trans-generationally.

And Victor and I put this very much in personal terms. He has a one-year-old grandson, I have a one-year-old granddaughter. We're getting them together. We're already arranging a globalization and a date (*Laughter*) -- I'd say 17 years from now, if that's okay with you. But mine is a girl.

But the serious point here is your grandson and my granddaughter, with the way health care is improving and other factors have a pretty good chance of seeing the end of the century. But it's not going to be a happy experience for the second half of their life, unless we can build into our concept of progress not just quantitative growth, but qualitative improvement in sustainability of quality of life.

MR. CHAN: Strobe, you said that we should keep some information from Washington, D.C. I want to bring some information to Washington, D.C.

Ten days ago, when you and I were at Yale together, I was in a room with two former U.S. Trade Representatives, two U.S. ambassadors to major, major countries, a president of a Western country, and on and on. And one of them was complaining how China's domestic consumption is only 32 percent. And that person was trying to get China to consume.

And what you are telling me, Strobe, is that if the Chinese were to consume like you guys -- we, in Hong Kong, or worse yet, in America -- then we're all doomed.

So, can you tell -- what do you want to tell Washington, D.C.? Get off the whole -- I mean, don't talk about the 32 percent? Don't tell the Chinese to consume any more? Because China cannot stand it, the world cannot stand it.

What should we tell them?

MR. TALBOTT: That. And I think Barry Bosworth, my colleague from Brookings made this point this morning in the discussion about the RMB controversy back in Washington. I'm going to loosely paraphrase what Barry said, but he basically said that this issue is really kind of a stalking horse for a macro issue, which is that we in the United States spend too much and save too little. And we have got to not only spend less, consume less, but

we have to save -- not just in monetary terms, but we also have to save in terms of stewardship of the environment.

Raja Mohan is an old and good friend and colleague of mine from India. And his country is taking off -- I don't know what the -- I went to India a couple of weeks ago, and it was a bizarre experience to come from the United States and get off an airplane and have the locals complaining about -- what is it, about 7 percent --

MR. CHAN: 7.5.

MR. TALBOTT: -- 7.5. And Tata Motors has, you know, got a big success with the Nano car. They don't have highways to drive it on, or infrastructure. But this is a we're-all-in-it-together situation.

But there is no question that a particularly heavy onus falls upon the United States of America. China, of course, has had the dubious distinction of passing us in one respect, and that is annual carbon emissions into the atmosphere -- although we're still way, way ahead in cumulative contribution to the carbon footprint of the planet.

I believe that at some point in this discussion we'll later talk a little bit about American politics. I can't wait for that. But I promise you -- I promise you -- that no candidate, at least no candidate who stands a chance for winning any office, is going to be making the case that I think -- if I understood the implication of your question, Ronnie -- we're agreeing on here. That is not a lead in, but it is an imperative.

MR. CHAN: So America is not going to take the lead in this. Instead, they are condemning the Chinese for consuming too little.

So what shall China do? Shall we listen to America? Shall we not listen to America? Should we just go our own way? Or --

MR. TALBOTT: Well, hold it. You know, now I'm going to back off a little bit. I think that we're -- the last point I made was in the context of a presidential election campaign in a particularly nasty and toxic year.

I think that, more generally -- we in the U.S. are never at our best in -- what do I call it? -- civil discourse during an election year. And we're not at our most enlightened in messages that we have to send to the world, particularly when we have a political climate that is dominated by fear and anger.

But I think overall, there are lots of people in the United States -- notably, including the President of the United States who does understand this issue about sustainability. What he has not been able to do is find a way to give it political valency and traction.

MR. CHAN: Okay -- back to China. So what shall China do? Fred? Victor? Shall the Chinese continue to spend? Shall the Chinese devise a growth model that, hopefully, is more congruent with the world's supply of natural resources? What should we do?

DR. FUNG: Well, I think there's a huge recognition, as far as I can tell, that China must really now embark on a totally different path. And I think it's been recognized. I have to again refer to the 12<sup>th</sup> Five-Year Plan which will be implemented.

Now, you know, authorities around the world, for example, on climate change, say that if you look carefully at the 12<sup>th</sup> Five-Year Plan in China, and if that section of the plan is indeed implemented, it will give the global agenda on climate change a big boost.

Now, some of these things sometimes you don't really realize. Now, of course, they say, "Well, are you going to implement it?" Well, then the only answer I have is, then you look at the track record. As far as I'm aware of it, China has only missed the Five-Year Plan once out of the last, you know, 11 times. And that's during the time of the Cultural Revolution. And so I think the track record in achieving the Five-Year Plans have been pretty good.

I think the other thing that we should be aware of is that there is a huge -- in terms of the global shifts in supply chains and so on, I think we're really seeing another sort of major shift in which the lower end of the production is really being cascaded down to other countries: Southeast Asia, Bangladesh, et cetera.

You know, I remember as recently as just two years ago, the front page of TIME magazine, your previous employer, "China: Factory of the World" -- right? People talked about the "China price." I can tell you, if you want the cheapest goods today in the world, you don't go to China. You know, you go -- I mean, it's not just a myth that the Chinese price (inaudible).

Now, China being the factory of the world -- okay. Because what is basically happening is that there's a downloading of the lower end of the production into other parts of the world. There's trade diversion. And that actually helps the trade imbalances.

But I think China itself is going to be upgrading its production. And I think the upgrading, both in terms of quality, but also in terms of sustainability and green. And I think that is important. And I think that is something that's going to feed very much into the equation.

MR. CHAN: So am I correct, then, that America may be surprised if the 12<sup>th</sup> Five-Year Plan were to be executed properly, then that China will transform itself greatly from a quantitative-led to a qualitative-led. A lot of the areas, such as sustainability that the West may not be expecting China to get there so soon, they may actually get there in the next couple of years.

Is that correct?

MR. TALBOTT: Could I just put a question, too, to the two colleagues who are going to answer that. There was no mention of exportable green technology there. Is that a big factor in that?

MR. CHAN: Wang Feng and Fred Hu?

DR. HU: I think, you know, Strobe is right that the kind of growth model, you know, China has adopted is so successful the last 30 years, it's really incredibly unsustainable -- just given the insatiable demand for energy to continue to power the industrialization, the quickness, pace of industrialization and urbanization. I think it's highly, highly unsustainable, you know, in the next three decades, or even sooner.

So, thankfully, as Victor pointed out, the Chinese leadership -- and also the business community, and academics, and the citizens -- now have increasingly recognized the pressure, the challenges. For one thing, because the Chinese people are already paying a dear price for, like -- you know, for the consequences. Because we may be still the fastest growing major economy on the planet, but we also happen to be the most polluted country on the planet -- right? So, the air pollution, the water pollution, the deforestation, you know, has really now posed a serious challenge to the health and the well-being of the Chinese people.

You know, my office in Beijing is on *guo mao zhong xin* -- the tallest building now in Beijing. So on a nice day, in a panoramic view -- gorgeous. You know, western mountain range, and northern mountain range, and the whole city. But, unfortunately, you only get one maybe out of a week to see what's around the building.

MR. CHAN: How about once out of a month?

DR. HU: So this is real. Now, with the, you know, rising middle class, you know, who now own homes which have cars and have -- the tourists going to Europe and North America and Australia, not to mention Southeast Asia. So, I think, you know, it's very reasonable they would be demanding the clean-up of the environment. You know, better quality of air and water. And, of course, food safety.

So, I think this also -- I'll be interested in what Dr. Wang says. You know, it's also interesting, social and political implications, you know, for China right now, and is a rising possibility.

Anyway, on energy and environment, I think, you know, it's a central piece of the 12<sup>th</sup> Five-Year Plan. And the government has very specific targets of, you know, energy efficiency, conservation. You know, cleaner energy sources, and also, pollution control. Of course it's always a tough balancing act. You know, I think, growth, employment, social harmony is still the overriding objective -- okay? But at the same time, they also have to balance, make sure it's greener growth, greener GDP. And the consumption, you know, that -- the question if there is room for China to increase private consumption, both in absolute dollars amount, but also percentage of GDP. But, again, we are given, based on achieving that, you know, you can have, you know, better structure. You know, again, nobody wants to stand up for how consumption (inaudible) good service. For example, you know, service consumption in China is operationally depressed. I mean, you're looking at health care. Health care as percentage of GDP in China is about 3 percent. In U.S., it's maybe too high, 18 percent. Okay? So there's big room to increase service consumption that will improve the quality and the well-being of citizens, without having it to take a toll on the environment. Okay?

So I think there are harsh choices to achieve that.

And on the energy piece, again it's kind of a source of tension even of a geopolitical dimension. You know, because of the industrialization and urbanization and demand for energy, the Chinese companies, maybe Sinopec, Petrochina or Sinochem, are forced to reach into the far corners of the Earth -- you know, Latin America, Africa, and Iran, or Libya, you know, to institute for oil and natural gas deals. So this really puts China sometimes in a collision course -- a lot of tensions, frictions, with the U.S. and the West, in general.

I believe that's a deliberative national policy, but again, the necessity of economic development, you know, to fuel the engine of growth, China would have to do that.

So that we should have energy source away from fossil energy, you know -- i.e., oil and gas -- but with things like solar, wind, and, hydro. And of course, nuclear. I think nuclear energy still remains a component of China's overall national energy strategy.

So, with, you know, innovation and (inaudible), China might be able to find a model of industrialization, and hopefully still incrementally less impactful. So -- it remains to be seen. Thank you.

MR. CHAN: Dr. Wang?

DR. WANG: I think I agree that, in terms of where China is going -- I'm getting back to a narrow science sense of the sustainable growth, which is just economic growth -- there is a good consensus, both among Chinese policy-makers and the public, where China should be going. Which is going from quantitative growth to qualitative growth. So, in that sense, the 12<sup>th</sup> Five-Year Plan laid out the goals.

The challenges are how do you get there? The one important goal that China missed in the 11<sup>th</sup> Five-Year Plan -- the most important one -- is actually their economy, the economic growth rate, exceeded what it was supposed to be in the Plan. So it was, in a sense, overheated for the last five years. And so we don't know whether it's going to be able to slow down. It might. But it's really the cost that's slowing down.

Now, there's a quite, I won't say "consensus," but widespread, a sense of urgency, and a sense of crisis among certain circles in China, that is reform in the last 10, especially five years, have gone backwards. State monopoly has extended. And central government has centralized more economic and political power than in its recent -- I mean, in China's recent history.

And the government has re-invoked administrative measures, the planned economy measures, to deal with the economy. For instance, *shang gou* -- right? You cannot buy an apartment in the city. You cannot buy cars. Or you have to build low-cost housing. So all these planned-economy era measures have been reintroduced now, the monopoly of state-owned enterprises presents a big issue, among others, to the small and medium-sized enterprises, where entrepreneurship, where the engines of growth, where employment are generated.

So these are just among a few challenges that the whole society would encounter in the next five years -- if not longer than that -- in order to translate the lofty goals of the 12<sup>th</sup> Five-Year Plan into some concrete outcomes. And that would actually be quite challenging.

MR. CHAN: Well, first of all, a lot of people have said that, you know, the last couple of years China has gone backwards, as you have explained now.

I'm just curious, Fred, isn't it something that is just so common of social programs that is, you know, it undulates. You never go in straight lines. You step forward, you know, three steps forward, two steps back, but you're still one step ahead, right? Then you go another three steps forward and then two steps back, then you're a total two steps forward, right?

So is that something of that, Fred? Or do you really worry that China is perhaps systemically going back?

DR. HU: I'm worried. I think the single most interesting reason why China has been so successful for so long is because the impression of reform and opening up, you know, to a free-market-driven economic growth, and more integration with the global economy.

The moment, I think, the government, you know, tries to slow down -- or worse, in trying to turn the clock back -- then I think the hope for, you know, the long-term sustainable growth, you know, would have been dashed.

So it remains to be seen. Right now, we are expecting the U.S. and much of the world -- you know, we are in the process of, we're interested in the leadership transition. Whether, you know, the reform momentum, you know, will be picked up again, and accelerated, you know, in the next five to 10 years, is to be seen.

But I do think, you know, it's a risk factor if the government tries to slow down. And, you know, I think the external financial crisis has also intervened, you know, with all these Occupy Wall Street, you know, anti-capitalism everywhere in Western society. You know, the leftist anti-reformers in China are also kind of emboldened. "Look. Aha." You know, "Luckily we're not like the U.S. yet." You know, "There's still time for us to pause and even roll back some of the reforms that was making us like the U.S., or the West."

So, you know, from that point of view I do hope Washington will be able to get it's act together, and to show leadership. To show, you know, free markets and democracy can work, can solve the problems of the day, the challenges of the day.

And for emerging economies like China, and elsewhere, can continue, stay along the path of free markets and increasing social and political pluralism.

MR. CHAN: Now, we want to come back -- we'll go to the relationship with the United States in a second. But, on the far side of this panel, on the other side, there's two gentlemen from the mainland of China. The three of us probably are less qualified to answer this question -- that is, the title is "China's Future Trajectory."

So we're looking at the future. And next year there's a new government -- or the year after. Sorry. There will be a new government in mainland China. Most likely, you know, we know who the president and the premier are most likely going to be.

Now, are they going to continue going backwards? Or do you think that this new group of leaders will be much more forward-looking, and perhaps move forward in terms of reform and opening? Dr. Wang?

DR. WANG: Well, Ronnie, you tactically used a term "we almost know" who will be the next leaders. And that itself actually shows, for the most important political succession in China, it's quite opaque until this moment.

We more or less know what's going to happen. I think China has made tremendous progress, from lifetime appointment to -- you know, with no term limit. And also from, you know, a personal cult to a collective leadership.

But other than that, there is so much opaqueness in the process, and itself could breed some unnecessarily political instability. That is, instability generated from the top by power struggles, not from the society at large. So, in that sense, we really don't know how they are going to implement the policy.

I think the 12<sup>th</sup> Five-Year Plan, the discussions now have been intensified within China, on the crises China is going to encounter. It's part of the preparation for the next generation of leaders. I think a lot of people are gearing up, writing reports, and doing studies, trying to get their words into the next leadership.

But what they will do, unfortunately, in the beginning may not be much. We are very frustrated with the U.S. political system, where you spend two years governing, and then two years for re-election, for the first-term president.

In the Chinese case, they have a 10-year term, but they spend like two, or more than two, years to consolidate their power. And then they spend about two, or more than two, years to think about their successors and legacy. So it's like five years wasted. So it's about the same proportion. But it's a long time. *(Laughter)* So you would not expect the real leadership to do too much. I mean, that's my sense for the short run.

But in the long term, I think there are challenges which we can probably discuss later on.

MR. CHAN: Fred, you know those top leaders. I know that. Tell us what they're like. Are they going to move which direction? Back, or forward?

DR. HU: Well, China has come a long way, as Dr. Wang said. I think wise, you know, dynamic, strong leadership in the form of Deng Xiaoping, Jiang Zemin and Zhu Rongji, clearly have helped China enormously. We continue to enjoy some of the benefits from the past legacies those leaders have left for the country.

But, you know, we're still not mature, developed society. We're still kind of, in Chinese saying, *ni shui xing zhou bu jin ze tui*, like –

MR. CHAN: Go against the flow.

MR. HU: -- stream, backwards. We can't just stop there. It's therefore, I think, matters. You know, their choices, policies, the reasoning do matter for the country. You know, because we have this historical opportunity to catch up, and possibly even overtake -- you know, if we will continue to make intelligent policy choices, and if we have the commitment.

So, I would say I'm cautiously optimistic, in just the possible -- okay? -- or maybe almost the lineup of the next leadership. You know, they are clearly younger, better educated, and more Westernized at (inaudible) university. So they are intelligent. They also pretty much have grown up and developed as leaders during the reform and opening era.

So I have to believe, or imagine, you know, they are identified with our main policy orientation that is again, free market economy and continuing integration with the global system. So I think the (inaudible).

But, having said that, personality, you know, courage also matters. If you are too cautious, then again, you may miss some opportunities.

So let's continue to (inaudible) legitimacy? But we do need strong, dynamic leaders.

MR. CHAN: Would you agree that the last eight years have been pretty cautious, pretty conservative? The last eight years?

DR. WANG: Well, if I may add to Fred, I think, actually, among the -- my sense is, among the top leaders in China, they do have -- they're not complacent. They do have a sense of crisis. Because they are very aware of the source of the political legitimacy. They're not elected by the population. And they are working with a bureaucracy that's increasingly self-serving and cynical. Cynical. They don't believe in communism or socialism. So, you know, this is not news.

So they know their sources for legitimacy lies in the popular support. And that is why the internet is not shut down. That is why labor is widespread. That's why *xinfang*, the petition system, has continued. They want to get information from the public, and they want to deliver public goods, economic growth, to the public as a source of legitimacy.

The challenge is, again, slowing down the economic growth rate is going to expose a lot of the difficulties that were hidden by the fast growth. So that is, I think, the challenge for the new leadership.

In terms of their will, I think there's no doubt. I mean, their jobs are tied to their successes. They know that.

MR. CHAN: Victor?

DR. FUNG: Well, just since we're the kind of the outsiders here, maybe just a very quick observation from an outsider's perspective. Obviously everything, you know, I hear with great interest everything that Fred and Dr. Wang have said.

I think the Chinese leadership -- and if you look at the question of trajectory, it will also be very dependent on how the entire world is evolving, and the external pressures that China may be feeling.

Say, if you look at what has happened in the last few years in terms of the state-owned sector being larger and squeezing out the private sector, I think it's a reaction, also, to the financial tsunami in 2008. And they had to do something fairly rapidly. And there was a need to inject something into the economy very quickly. And the means of doing it was actually through the state-owned enterprises, and the local governments, and so on.

And the almost had to do it. But as a result of that, they have no developed a situation. And maybe certain interest groups that have developed in China, as well.

So if you look at the field going forward, there's a lot of challenges that I think all our speakers have pointed out, that they need to balance. You know, yes, maybe, you know, I and everybody else want China to go on the path of greener growth, and sustainable growth. But if you let that economic growth slow down too much, you're going to run into social problems in terms of providing employment and so on. So it's a very fine balance.

And the external world, and the external dimension, and the pressures that that puts on the leadership will dictate a lot this trajectory.

I think, fundamentally, China is not like the way it was -- the way it was relatively insulated from the rest of the world. And a lot of the direction of the trajectory of the Chinese economy in this evolution depended on the internal leadership alone, so to speak. Now, it's much more exposed, like any other country. And you've got to, as a leader, although your inclination may be towards more reform and more opening, you need to react to what the pressures are, and keeping everything on a very even keel.

So I think that is going to be an increasing factor as the world globalizes -- and, frankly, as China integrates more and more into the global economy. I think that the degree of freedom, if you would, for the leadership becomes less and less. And they become much more reacting to the global developments.

MR. CHAN: Well, this is a great transition to the next set of topics, that is China's relationship with the rest of the world.

You mentioned, Victor, that, you know, part of the Chinese leaders' consideration is really how the international arena react and respond. Has the response of the international community -- perhaps led by the United States most of the time -- has it been a positive thing to

China? On balance? Is it a negative thing? Would China have been better off if America bug off? Or is that something positive, as well? Or half and half?

Any thoughts, before we turn to our American friend on this panel?

DR. FUNG: You know, there's no doubt in my mind that China has really benefitted dramatically to its economic opening and exposure to the world. I think China's achievements to date, and the trajectory that it's been on, has very much been dependent on an open trading system and multilateral global trading system. Without that, I can't imagine where it would be.

Now, when they say, "We'll be balancing, and in the future we'll be less dependent -- " -- but let's not kid ourselves. If you cut off all those exports, I think there's going to be dramatic consequences -- not just on the value of the GDP growth, but on just jobs in China. I mean, you may argue for a long time that, yes, the value added from the export processing is very small, and it's polluting, and so on. But look at the number of jobs that that's providing. And the impact on the social stability, if those jobs disappear.

So let's not kid ourselves. I think China has benefitted dramatically from the global multilateral system, the open access. And I think China must work very hard to maintain a multilateral world. And hence, those external relationships are crucial, and it cannot turn inward to just take care of its own. I think it has to really play a much bigger role in terms of, you know, maintaining.

And, frankly, maybe now this is also a good transition, at a time when I feel that the U.S. is somewhat stepping back from taking the leadership role which it has always taken in terms of maintaining that multilateral world trading system.

MR. CHAN: Strobe, are you happy with what America is doing in the last couple of years? Do you think that America should do more of this, or less of that? How do you assess the U.S. policy toward China?

Whether you like it or not -- I'm just giving you time to think -- whether you like it or not, it's going to affect China. And I think the leaders of China are very sensitive to whatever is happening in Washington, D.C., in particular, what the White House has to say.

MR. TALBOTT: Well, Ronnie, what I'm about to say really crystallized in my slightly jet-lagged brain as you were posing the question. So I'm going to try this out.

I'm actually less concerned about U.S. China relations, and the way in which the United States is conducting its end of that bilateral relationship, than I am about the state of U.S. leadership internationally, more generally.

And I say that against the following backdrop. Victor referred to my checkered career, back when I was a journalist with TIME magazine. And in that capacity, I first started coming to the PRC, at least, in 1974, in the rear, super cheap seats of tourist class in Henry Kissinger's 707, which used to be Lyndon Johnson's 707.

So I've watched this relationship over a period of eight administrations. And I really think it's quite extraordinary, given the vacillations, and the shifts to right and left, and Republican and Democrat that have taken place during that period, at how much continuity there has really been.

The only exception to that rule was in the immediate aftermath of Tiananmen, when the American left and the American right kind of ganged up against the George Herbert Walker Bush Administration. But that didn't last very long, for a number of reasons -- I think, in part, because, going back to one of the three people who has earned those extraordinary outpourings of grief in your country, there was a recognition even on the part of people who were outraged and despairing and furious over Tiananmen, that Deng Xiaoping was a world historical figure of a very positive sort.

So my point is that from Nixon through Obama, there has been -- we could call it a "Washington-Beijing consensus" that the relationship should be characterized by engagement and not containment, by inclusion and consultation and not exclusion, and a willingness on the part of the United States to listen to carefully and take seriously China's interests and concerns, while being very clear and assertive about American interests and concerns, particularly when they differed.

And this goes to the more somber point that I'm going to make.

I think one reason for this -- there are a couple of reasons. One is that the United States, like other countries -- and I'd be interested in the comparison with China in this regard -- does have a permanent government. That is to say, it has career professionals -- Richard Bush is a perfect example of that, although he's taken a detour for the last 10 years as a think-tanker -- who maintain a kind of a steady keel, or ballast, to keep the ship of state more or less heading in the same direction.

But there's another reason, too, for the continuity in U.S.-China relations. And that is that we are essentially a centrist country, and there has been a kind of solid center in the body politic that has kept presidents who might have gone fairly hot in their rhetoric about China during the campaigns back to what I'm called the Washington-Beijing consensus. I don't think that's a phrase that's going to catch on, somehow. *(Laughter)* But you know what I mean.

Okay, but now for the bad news.

I'm not sure how much longer that's going to last. Because -- and here I'm going to -- you four gentlemen have been very candid about the PRC, and I'm going to be equally so about the United States.

The center is in jeopardy in the United States. Some would say the center has evaporated, or disappeared. I think that's an overstatement. But it is greatly diminished and weakened. And that's empirically demonstrable.

If you take, for example, the voting records of the United States Senate and break them down by party, up until a decade or so ago, maybe a little more than a decade ago, if you did them in Venn diagrams, you would see that there was considerable overlap in the voting records of moderate Republicans and moderate Democrats. We have colleagues at the Brookings Institution who have updated that Venn diagram, and there is now no intersection whatsoever. In other words, to put it in personal terms, the most conservative of Democrats in the Senate is to the left of the most liberal -- if you can use that word. Yes, you can use that word -- the most liberal Republican in the Senate. And that is reflected in the body politic, for reasons that are probably, as we say in Washington, another lunch.

But it's not good. And it's one reason why I think we will probably get through this particular presidential campaign -- I certainly agree with the exasperation, and share the exasperation, of the amount of time we spend in the United States picking our next president, as opposed to letting our current President be President. That's just a fact of life.

But I think we're going to get through the next election without China becoming a really major issue. And that's for a kind of negative reason, rather than a positive reason. And it's because of the total obsession with 9.1 percent. And I don't mean the Chinese GDP growth. It's the economy, stupid. It's the economy, stupid. It's the economy, stupid. And, yes, there will be some acrimonies about China and other foreign policy issues.

But I am concerned about what happens subsequently. And that brings me to my last point, which is what's going to happen as a result of next year's election?

And here, I will end on a slightly more upbeat note, but it's predictive, and therefore worth exactly what you're paying for it, which is nothing.

I do sense that the center is, in one sense, beginning to reassert itself. And we can see that in the Republican Party. A couple of months ago it looked as though the Tea Party might be the Republican Party. Not so clear now. If I had to bet today -- and please don't hold me to this bet unless I win it. You're going to remind me when we next see each other -- I would think that Governor Romney was going to be the nominee, and will give President Obama one hell of a run for his money. And will be a much more effective opponent of President Obama precisely because he does represent what is still a centrist country. Presidential elections are won in the center, they're not won at the edges.

And if that's true, then we have another upbeat, which is the eight-administration continuity will extend to a ninth.

MR. CHAN: This is not exactly China's future, but it is China's future, because China and the United States are tied at the hips. And so whatever happens in the United States will affect China.

So let me ask you one more question before I open to the public -- okay? Strobe, what caused the moving away from the centrists? And could there be a third party finally coming on board that can perhaps further grow? Or would the Republicans come back somewhat to the center, and the Democrats also move somewhat to the center? You mentioned

about the Republicans moving, but you didn't say anything about the Democrats moving. So what caused it?

MR. TALBOTT: Well, you actually asked a couple of questions. And you'll remind me if I forget to –

MR. CHAN: That's okay. I'll remind you.

MR. TALBOTT: -- to answer one of them.

I think the cause has a lot to do with the fractionation of the American community -- if I can put it that way. And I'll just give you one example of it. And it's going to sound a little bit self-referential or parochial, because I still think of my -- the only profession I ever chose was journalist.

But it's what's happened to the media. I think the media is an extremely important factor in any society or polity. And we used to have, when I was a reporter -- back in the good old days -- we used to have a national media in the United States. And anybody in this room who knows the U.S., you'll understand exactly what I mean.

I mean, we had essentially three television networks -- ABC, NBC, CBS. That was it. We had three news weeklies -- TIME, Newsweek, and U.S. News and World Report. We had two wire services -- AP and UPI. We had maybe six national newspapers. And that was the national media.

And not only is that quantitatively a pretty small number, but they all had essentially the same view of America's identity and its mission. And that is gone.

And we have all these echo chambers -- in cyberspace, in talk radio, and so forth and so on. Add to that the fact the actor of fear, and particularly, pessimism on the part of the American people and -- going back to our children -- well, you've got to start with our children, in case you hadn't noticed (*Laughter*) -- our children are less optimistic, in the United States, that their children are going to have a better life than they've had -- -for good reason -- than we had for our children, and our parents had for us. And that's a new phenomenon.

And I think that it has made people fearful and angry. And when you're fearful and angry, you're more susceptible -- one is more susceptible -- to demagoguery and polarization.

Now, I'm sorry, you did ask another question. Have I basically answered the question?

MR. CHAN: You have basically answered the question.

MR. TALBOTT: Yeah? Okay.

MR. CHAN: Will there be a third party?

MR. TALBOTT: Oh -- no. Third parties don't work. By the way, you know, our founders didn't envision a two-party system. Quite a number of them didn't want a two-party system. We ended up with a two-party system. We're stuck with a two-party system.

And every time there's an attempt at a third party, it ends up playing a spoiler role, you know -- Ross Perot or whatever. But it doesn't produce presidents.

MR. CHAN: Well, if there were no Ross Perot, you may not have spent eight years in the White House. *(Laughter)*

MR. TALBOTT: Oh, don't think the guy I worked for doesn't know that.  
*(Laughter)*

MR. CHAN: Right. Right. Okay, ladies and gentlemen, it's time for questions. There's a gentleman in the middle, and there's a gentleman by the wall. Okay?

QUESTION: My name is Hiro Matsumura, former CNAPS Japan fellow. My question goes to Mr. Fung and Mr. Hu. You somehow stated that maybe China has to make a transition from export-based economy to a consumer-based economy. Correct me if I'm wrong, but I had the impression that you were reasonably optimistic to predict a consumer-oriented economy in China.

But, to achieve that, they've got to achieve the measure or redistribution. And to achieve measure of redistribution based on --

SPEAKER: Control. Yeah.

QUESTION: -- and maybe (inaudible) corruption of the state and state and party officials -- not only at the central government, but also at local government level.

How can you be optimistic to change this? You know, in order to predict China's future trajectory, you cannot go on without discussion about political reform. And then you haven't discussed it at all. But somehow, you are very much optimistic. This is why you make that kind of statement. Please let me know why you are so optimistic.

And then, you've also stated most basically the 1 percent, 2 percent of GDP you have to shift to working class people. And then that -- I don't think -- that may not be sufficient. But for purposes of argument, let me assume that is correct.

But how -- what kinds of policy innovation would bring about a 1 percent or 2 percent GDP redistribution to the working people? I don't see that.

And then the second question is --

MR. CHAN: Let's hope the second one is not as long as the first one.

QUESTION: And the other one is, people in China have to cover the medical expense and after retirement salary. So they have to learn to save, not to spend.

In order to achieve, in order to promote people to spend, the government has to make a re-prioritization of fiscal spending -- possibly, or probably, including a major shift of military spending to the social welfare and medical coverage. Is that possible to tackle? I'd like to know why you are so much optimistic.

DR. FUNG: Well, I'm actually an optimistic guy. *(Laughter)* But, you know, you're actually right. I think the whole rebalancing, you know, away from the export-led economy to the consumer-driven economy is a daunting task. Let me address different aspects of it.

First, I think when you want to actually promote more private consumption, you really need to deal with the whole distribution system, the internal distribution system, and the efficiency of the distribution system. I maintain that that's going to be a huge building program.

I don't think anybody -- nobody knows how to distribute in China, in my view -- including the local people. They're really now in the process of putting together that distribution network. And a lot of it has to -- inefficiencies in the distribution, even internal to China, has to do with the way the regulations are put together today. And a lot of competition between provinces, between cities, and so on. And those are also the reasons for a lot of the corruptions at the local level, and so on.

You know, very often -- you know, we get a lot of logistics in China -- our trucks go to the border of a province, you unload the trucks. Why? It's not licensed to go in the next one. And you go in the next one, and then you go on -- et cetera, et cetera.

And so I think there's a need for a fairly major reform of the internal distribution system. And that reform increases the transparency and, indeed, I think will also really have some major impact on the potential corruption going on at that sort of level. The other, of course, is that I would just point to the growth of the internet. I think the proportion of total retail sales that will go through the internet in China will be much higher than in other, even advanced, economies. It's just the way the China consumer market is growing up, because of the leap-frogging of the technology, especially with the hand-phones, and so on. And I think that gives it a lot more transparency and a lot more efficiency.

But the other point which you are really raising is, in order to rebalance, you need to develop consumer demand. There are two things going on there.

One is there is a move to really redistribute income by, actually, a number of means, including, in the Five-Year Plan, a 13.4 percent increase in the minimum wage every year for five years. And that actually puts money in the hands of the low economic classes that would tend to consume.

The second factor is the organization trend, which has already taken place in China in the last five years. One percent of the population is being urbanized every year. That

will continue in the next Five-Year Plan. And organization, as you know, results in housing -- which Ronnie is very delighted about (*Laughter*). But once you have a new house, you need a new refrigerator, you need a new washing machine, and it goes on.

So, I think -- but the most fundamental thing, there's a secret weapon, also, here, which people don't talk about, which I think is very important. China has a huge economy now providing production for export markets. They're actually products that are very well designed, world quality, very good prices, value for money -- but not available to the Chinese population. They're exported.

There's actually a huge bureaucratic barrier cutting China's total production economy into two worlds. That is being relieved. And then you get the re-channeling of that into the domestic economy, it also answers the question of what do you do with all this production when you put less emphasis on pure exports. But it also makes available to the Chinese consumer a whole range of production, in terms of quality, et cetera, and value for money, which they have never seen before.

And I think that is another major factor that people haven't focused on, in terms of priming the economy. But you're also right. And I would turn to Dr. --

MR. CHAN: Yes -- Dr. Wang, I think there are several issues.

DR. HU: The final, the final thing about getting in the way of consumption is the concern -- is the high savings rate. And the high savings rate is a concern over security of the retirement and medical.

MR. CHAN: Dr. Wang.

DR. WANG: Well, some of this is, again -- I mean, to say "high savings," or "consumption," it's historical. Which means that China also has an age structure that has a large segment of the population in the middle age. They need to save for their retirement, and they need to save for health care -- which is a big problem.

Now, as you know from in Japan, the savings rate has been declining rapidly as these people reach retirement age, starting to spend. So we are seeing the savings rate also as a demographic phenomenon that's not going to last forever. That's only one of the factors.

Now, Chinese people are great consumers. We all like to buy stuff -- right? And look at Hong Kong -- right? It's the shopper's paradise. The Chinese come to Hong Kong, they buy -- they buy all stuff. They don't consume for reasons. One is for savings. And the other is really for income growth.

We don't have time to talk about this, but income inequality has been an ongoing issue in China. And that has turned into wealth inequality which will not be easy to correct. And it's transferring to the second generation very quickly -- just in a matter of 10, 20 years.

But what the government has tried to do is redistribution, raising minimum wage by policy, by welfare programs, by starting national pension, national health care. The strategy right now is to spread the net, and then wait for the future governments and the economy to increase the level of these sort of safety net support.

But to do that -- actually, it's not just a matter of redistribution. It's much harder than that. For instance, the state monopoly, that's a big factor in driving up wage differentials. Now, how could the state -- government, itself -- control the expending power of the state-owned enterprises, when a quarter of the central government revenue comes from profits and taxes of these monopolizing companies?

So there's a lot of work to be done, in a way, to reign in itself, the government itself, from the easy taxes of the state-owned enterprises which, themselves, are a major source of income inequality. It's not just people are making different incomes across the same professions. It's really these organizations, the (inaudible) in China, are really emerging as important sources of income inequality.

MR. CHAN: Strobe?

MR. TALBOTT: I can't resist just jumping in here, because I think that the point that Wang Feng was making about China is very manifest in the U.S., too.

Income inequality is perhaps the most dramatic statistic -- even though it's not the one with the most political valiancy -- even more than the unemployment rate. And in the week that Richard and I and are colleagues have been traveling, Occupy Wall Street has gone viral and gone global.

But it is going to be a huge factor in the U.S. in coming years.

MR. CHAN: I think all the issues that were raised were -- you know, they were existing ones that we all know. The fact is, (inaudible 01:24:33) consumption has been going up. The numbers about, you know, dropping to 32 percent, and so forth, that's really partly a reflection of the sudden increase of government spending because of the 2008, 2009 financial crisis that the government pumped money into it. And, hence, it is not the domestic consumption that came down. The percentage came down, but actually it's been growing very well. Otherwise, my stocks would not be performing so well.

The gentleman by the wall.

QUESTION: Scott Harold of the Rand Corporation -- formerly with the Brookings Institution. And I really thank you for giving me an opportunity to ask my former boss a question. *(Laughter)*

I'd actually like to ask a pair of interlinked questions -- one that goes to the economists on the panel who are looking at China's future trajectory, the other to Strobe about where that trajectory is leading U.S.-China relations.

We've talked kind of around the issue of political economy. Victor, your first point was that, you know, China is going to make the targets that it has in the 12<sup>th</sup> Five-Year Plan. And Fred and Wang Feng also talked about these trajectories, and the goals that it has.

I guess I'd like to ask, however -- everyone who studies China knows that the center is a very powerful actor, but it's not the only actor. And, in China, it often has a hard time achieving compliance from local actors. It was just mentioned, the problems of shipping across provincial borders. Local corruption is a problem.

I guess I would like to highlight the fact that the center often has a hard time achieving both its goals, and achieving information about where it's at in terms of reaching its goals. And, secondarily, to note that there is a problem with local performance, which is generally keyed into a very easy metric, which is GDP growth -- which goes directly to Wang Feng's point about how are you going to see a reduction towards greener growth, or more environmentally sustainable growth.

So the first part of my two-part question is: Can you talk a little bit about how the center might begin to craft metrics that would be politically sustainable, that would be politically measurable in ways that can incentivize local cadres to actually achieve those goals that you think the center is aiming at.

Second, for Strobe -- you know, you talked about those longstanding ties between the U.S. and China. I think there has been a very strong consensus in the U.S. for the last 33 years, at least, that engagement is the strategy through which Washington should engage Beijing. You mentioned longstanding civil servants who kind of add the ballast there.

But I wonder if you can reflect on what these last three years have brought to the relationship -- not merely because Washington seems to have in some ways lost some self confidence, but also because countries in Asia -- most notably China -- appear to be gaining confidence that Beijing is going to be, or is actively being more assertive.

And so this longstanding assumption that the U.S. has had that if we engage with Beijing it will eventually liberalize economically and then politically, seems in some ways to potentially be undermined, and that that confidence that Washington has had is perhaps eroding - - perhaps to the detriment of long-term U.S.-China engagement.

MR. CHAN: Thank you. Strobe, why don't you take that second question first. And I'll ask Fred --

MR. TALBOTT: I'll be fairly quick

MR. CHAN: -- how the central government can make sure that the local government play ball.

MR. TALBOTT: I'd make two points -- maybe too telegraphically, but I'd rather err on that side. I think that over the last three-and-a-half actually there is good news that you can play forward, with regard to a certain degree of not just acceptance of Chinese growth, but even

seeing the upside of it for the United States. And it goes to the point that Barry Bosworth was making in the first panel today.

But as China rebalances its own economy towards more consumption -- that is a huge market. And it is no accident that Tom Donahue and the American Chamber of Commerce, and the Heritage Foundation -- our good friends and neighbors on Think-Tank Row -- have a lot to complain about on various aspects of American foreign policy, but not engagement with China, because it's a big market.

With regard to this -- you know, whether there's going to be a backlash against Chinese -- how shall I put it? -- the more hard-edge assertiveness of the Chinese policy around the world which, of course, is driven by mercantile and resource motive -- I actually see the backlash more in Africa and in Latin America. Raja Mohan's not here, but he'll be here later, and he may speak to that in the panel.

But I've been struck, through our Africa work at the Brookings Institution, that there is a drawing back from the Chinese in base, and an encouragement of India to come back in. And given the history of the '70s and '80s, that's quite dramatic, because they feel that they would like to diversify their portfolio in terms of one-billion sized countries investing in their countries.

MR. CHAN: Fred?

DR. HU: First we should note, you know, China is not the only place where the center might have difficulty, you know, controlling their regions. (*Laughter*) I think (inaudible), you know. Europe, you know, what's going on. There's no really easy way to get a consensus, much less to take common actions to deal with the problems of the day.

Having said that, I do think the Chinese, insofar as we remain as a one-party state, the central does have a very, very powerful tool to rein in the local governments or bosses. That is, if whatever the governor, or mayor -- they owe the favor from the central government, you know, bestowed by the central government, for their political career. Then I think that's where easily to get people, you know, on the line -- sooner or later, okay? I think that's very, very powerful.

Now, that's probably more like Dr. Wang's domain, or political science's domain in this room. As an economist, I would say, you know, our forebear Qin Shi Huang, pushed for the unified China. You know, he was really the first continental, centralized the state. And, you know, it's been over two millennium.

I think, economically, you know, given the sheer size, scale, and diversity of China, probably it makes sense for us to have sort of an alternative system where the central still plays a very significant role, but the regions will also have greater autonomy -- and accountability. What I mean is a kind of fiscal vigilance structure.

You know, I don't know how many of you in this room have heard of this acronym, LGFV -- Local Government Financing Vehicle -- that's been in the press over the last

few months. That's one of the triggers, the sell-off of Chinese equities which I think occurred for no reason. Because, you know, you're putting some of the local governments financing vehicles as a public stimulus in 2009, now they're in trouble -- okay?

Why have the seventh country, you know, in the world, the fastest growth in GDP, we should have this kind of vehicle, or may, you know, struggle to serving that debt, is really the future of our fiscal, you know -- the system is really so centralized. You know, the central government ordered the local government to fund monetary nine-year composite school system, clean up the environment, to (inaudible) housing, to build the infrastructure, highways, or high-speed rails.

But, you know, local governments have no independent tax revenue. So they are forced to do what? Financial intervention. Just like Washington did, you know, a few years ago -- okay?

And, you know, I think if we were to truly solve the problem, we have to have a better fiscal system which is balanced -- both, centrally or regional decentralization and accountability and autonomy. Thank you.

MR. CHAN: Well, I was told that we have to end at two o'clock. It's right at two o'clock -- so, sorry, there's no more time.

Ladies and gentlemen, a round of applause for our speakers. (*Applause*)

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