THE BROOKINGS INSTITUTION

CENTER FOR NORTHEAST ASIAN POLICY STUDIES

AN EMERGING EAST ASIA AND THE NEXT AMERICAN ADMINISTRATION

SESSION TWO: EAST ASIA'S ECONOMIC DYNAMISM

A joint conference with the Center for International and Strategic Studies, School of International Studies, Peking University

Wednesday, November 28, 2007
Peking University, Qiulin Lecture Hall
Beijing, China

Transcript prepared from an audio recording.

ANDERSON COURT REPORTING
706 Duke Street, Suite 100
Alexandria, VA 22314
Phone (703) 519-7180 Fax (703) 519-7190

Panel 1: Emerging structures of international relations in East Asia

Zhu Feng, chairman
Deputy Director, Center for International and Strategic Studies, Peking University

China increasingly active, America increasingly distracted
Ding Xinghao
President, Shanghai Institute of American Studies; CNAPS Advisory Council

Forms of East Asian regionalism
Qin Yaqing
Executive Vice President, China Foreign Affairs University

Non-traditional security issues
Wonhyuk Lim
Fellow, Korea Development Institute; CNAPS Fellow 2005-2006

Security dilemmas in Asia
Richard Bush
Senior Fellow, Foreign Policy
Director, Center for Northeast Asian Policy Studies, The Brookings Institution

Panel 2: East Asia's economic dynamism

John L. Thornton, chairman
Chair, Board of Trustees, The Brookings Institution

Is China's growth sustainable?
Chang Ka Mun
Manager Director, Li & Fung Development (China), Ltd.; CNAPS Advisory Council

What are the prospects for Japan's economy?
Seiji Takagi
Managing Director, Japan External Trade Organization, Hong Kong Office
Visiting Fellow, School of International Studies, Peking University

Will the U.S. continue to embrace globalization?
Barry Bosworth
Senior Fellow, Economic Studies Program, The Brookings Institution

Implications for greater East Asia
Long Guoqiang
Senior Fellow and Deputy Director-General
Development Research Center, State Council of the People's Republic of China
CNAPS Visiting Fellow 1998-1999

Lunch Keynote Address

China's Peaceful Development and the Harmonious World

Li Zhaoxing
Former Minister of Foreign Affairs, China
Professor, Peking University

Afternoon Keynote Address

The 2008 U.S. presidential election

Tom Mann
Senior Fellow, Governance Studies Program, The Brookings Institution

Panel 3: U.S. foreign policy under the next administration

Wang Jisi, chairman
Director, Center for International and Strategic Studies, Peking University

Directions of U.S. foreign policy after the Bush administration

Ivo Daalder (remarks read by Richard Bush)
Senior Fellow, Foreign Policy, The Brookings Institution

Defense and security challenges for the new administration

Michael Nacht
Aaron Wildavsky Dean and Professor of Public Policy
Goldman School of Public Policy, University of California - Berkeley

Focus on China and Asia

Frank Jannuzi
Senior Asia Advisor to the Majority Staff, U.S. Senate Committee on Foreign Relations

A Chinese view

Yuan Peng
Director and Senior Researcher, Institute of American Studies
China Institutes for Contemporary International Relations
CNAPS Fellow 2003-2004

Commentary

Anne-Marie Slaughter
Dean, Woodrow Wilson School of Public and International Affairs, Princeton University

JOHN L. THORNTON: [In progress] …so I'm, as I said, putting my panelists on notice that after they finish talking, I want to return to this question. So, with that general background, I'm now going to turn it over to Mr. Chang to begin.

KA MUN CHANG: Good morning, ladies and gentlemen. The topic I'm going to talk about is whether China's growth is sustainable: the very simple answer is yes. Let me explain why.

If you look at the recent development of the Chinese economy, China enjoyed very promising growth of more than 11 percent GDP with the CPI growing at 4.5 percent. This growth has caused the very rapid urbanization of China, and, we can now see that most of the growth rate in China is actually influenced by market forces. So this is a very, very important indication about the economy of China. China is also integrating the economy. Everybody knows about that.

I want to talk about the reason why I'm so confident that the Chinese economy can be sustainable. To do that, we have to look at the structural reasons behind its growth. This is crucial.

The first one is the shift in the industrial structure. This is very important. If you look at the development of the economy, you shouldn't simply look at the growth rate every year. You have to look at the structural reasons behind. For example, in the 1980s, the Chinese economy was mainly driven by the leading sectors of the economy, which were the light industries. In the 1990s, people were demanding new home appliances, some infrastructural projects, and the situation was also very good.

However, in 1997, I can remember there were lots of Chinese economists. talking about how to find the economic so-called hot spots that were the focus of the economy. They were lost to a certain extent. During that time, people were very worried about the economic situation in China. So they are looking actually at the so-called economic hot spots. In other words, what's the leading industry of the economy?

Nowadays, the situation is much easier for us to discern. It's that people are looking for new kinds of consumer goods, the first thing being durables. People are talking about the new big items—property, cars, new IT products—all those kinds of things. If you look at all these kinds of products, you have some very strong linkage effect to the economy.

For example, if you want to produce cars, you need to have the supply, you need steel or some other similar metal to build the material, and you must also be able to generate electricity and a lot of infrastructural products. According to the experiences of other countries, if an economy enters this stage, where for the mass consumer first looks to buy a car. Then the economy can be sustained for around 20 to 30 years.

The same applies to property. I would also say if Chinese people are always looking for a house, then I think it can be also. For these sectors alone, the experience in other countries that it can sustain the economy, the growth, for at least 20 years.

If you look at the history of the U.S. economy, especially the past 30 years, the whole U.S. economy has mainly been driven by the real estate market, the car industry, and the steel industry. So it's the reason why I'm quite confident because as a result of the structural, industrial shift.

The second is, of course, urbanization in China. You know there is a very ambitious target of the Chinese government to transform more rural populations into the urban centers. However, this is always debatable, because some people think that the cities cannot sustain that. Therefore, they are also advocating other ideas of creating a new countryside. I think it's more reasonable.

But, at least if you look at the rather rapid role of migration rates, you can see that there's a lot of demand for all the utilities in the city, especially for infrastructure and housing. So I think it's the reason why China is energetic.

I really want to look at the third issue from the demand side as well as the supply side. If you look at the Chinese economic reforms that have occurred in the past few years, you can see that there are lots of very energetic entrepreneurs rising in China. In the past, I think around five to six years ago, there was a lot of discussion about why things were fantastic according to macroeconomic indicators but on the micro level, it's very, very bad. It is this kind of inconsistency we cannot really understand, because during that time, I think the Chinese economy outpaced the market. Therefore, a lot of people were producing, but were forced to put all their goods in the warehouse.

But nowadays, the situation is different. If you look at the financial income of the government, every enterprise in China enjoys big profits. So the micro and the macro levels have become consistent. So I would say that because of the market and all the economic reform, then there is another important driver of the economy that can sustain Chinese development.

Finally, I would like to comment on the government's smart policies. I will elaborate on it in the next session but after mentioning that I do not want to underestimate the challenges facing the Chinese economy. I won't go into detail because I think everybody knows what I am referring to: balanced growth, structural problems, the imbalanced development, and the underdeveloped service sector. In addition, everybody talks about the huge Chinese export surplus and debates the issue of currency appreciation.

But this is all very debatable, because a lot of people are saying that all the hot money going into China has nothing to do with these issues. The liquidity problem in China is not totally a result of its large export surplus, but rather is due to the fact that people want to speculate in the Chinese renminbi market.

The other thing is, of course, environmental and the natural resource issues, which has caused great concern. And there is concern about disparity and there are a lot of poverty issues. I think it is very, very important issue based on the experience of other countries. If you do not devise a very good social welfare system, you really can't instill confidence in your people to spend, and the economy will not be able to sustain itself. So it's the reason why at this stage, the Chinese government is always talking about the so-called scientific model of development.

So I won't go into the details about this. Everybody knows about Hu Jintao's very, I would say, sophisticated and forthcoming principle of scientific outlook of development. But I would really want to say that this is very, very important because it addresses all the issues about people-centered balance and sustainability and, more importantly, that there is huge implication to the business environment as well as the enterprise level.

Now you know the three drivers of the economy. Domestic consumption has become more significant in driving the economy of China. So I think that if the Chinese government emphasizes domestic consumption, the impact will be that it will be more able to narrow down the trade surplus, as well as the investment on the foreign market. Furthermore, it can also absorb domestic production capacity, because there's a lot of concern about whether there is a surplus economy in China.

You should look at the right-hand side of this. This is the reason the policies of the government affect the Chinese business environment. I think with the trade surplus pressure and the foreign investment, there will be a diversion. There is a lot of control over all the problematic products, and this has very important implications for the manufacturing enterprises and it will affect the core structure of China.

I'm from a company called Li & Fung, and we encounter a lot of manufacturers in China. They are all telling you that there is a very sharp increase in the production costs. In China, in order to curb the trade surplus, the Chinese government changed its processing trade policy. I want to get back to this point a little bit later.

This table summarizes a very controversial issue, and I think a lot of people are very much concerned about production costs in China. Our understanding is that over the past two years, total costs have increased by around 12 percent and, in some sectors, there has been a 30 percent increase. If you look at the idea of the scientific model of development, I think it has a very important cause implication.

So you can see that in order to curb renminbi appreciation, they really want to stop the processing trade. In order to protect the environment, there are lots of charges laid on the manufacturing enterprises, and you can see that wages have also surged by almost 25 percent in China for the past two years.

This is a summary of what is included in the recent National Party Congress. I won't go into detail, but I just want to tell you that this is the most important initiative of the Chinese government. A lot of people are talking about the kind of policy that will be adopted by the Chinese government to counter the current economic situation, both in the short-term and long-term. I would say that if you look at the details of all the policies laid out in the National Party Congress, you can actually get a very, very good answer to it.

The first is, of course, to encourage innovation. The second is to upgrade industrial structure, also by means of scientific R&D. The third one, which is very relevant, is to work toward creating a balance between the urban and the rural populations. However, I think that the current shift is to be away from the countryside. I think that's more important. The fourth one is to improve energy efficiency and environmental conservation to enhance China's capacity for sustainable development. The fifth policy is to work on regional development. This is very important to us because the Chinese government also wants to go west and there are strong implications to this desire. We will see, in the future, that China will be more integrated into the East Asian economy. The sixth is to improve the current economic system. I think this is very fundamental for China. The seventh is developing more macroeconomic control. The final one has strong implications for the economy of the East Asia, because they are talking about a more open investment policy.

In the past, the Chinese government has always been careful about investment. But now, because of its large reserves, they are now encouraging enterprises to go abroad. You can see that Chinese enterprises are always looking for investment opportunities in East Asia, as well as other parts of the world.

The other is mainly about some short-term measures adopted by the State Council for the fourth quarter of this year. That is to tackle the short-term economic problems.

In conclusion, it is my feeling that the Chinese government is very smart. They understand all the problems, and have found some very reasonable means to tackle all these difficulties. It is one major reason why I'm quite confident, other than fundamental economic national development, that the Chinese economy can be able to sustain its development for at least 20 years. Thank you very much.

(Applause)

SEIJI TAKAGI: Thank you very much for giving me the opportunity to talk on the prospects for Japan's economy here. I'll talk about three points: the current status of the Japanese economy, major issues affecting mid- to long-term growth, and policy responses to address these issues.

Japan overcame a decade of stagnation, which had continued since the collapse of the asset price bubble in the early nineties. Its economy has expanded from early 2002 until now. Corporate earnings have shown good results, and banking has also recovered to normal levels. According to the quarterly estimates of GDP by the the Japanese government, the real growth rate in the third quarter of 2007 compared with that in the second quarter was 0.6 percent, and this is converted to the annual rate of 2.6 percent. This growth shows that though growth has been continuing steadily since early 2002, and that the rate of growth is gradual.

Comparing the current expansion and the past expansion in terms of real growth rate, the present rate of 2.2 percent compared with past growth rates of 11.5 percent or 5.4 percent. Comparing the current with the past in terms of normal wage rate, the current figure of 0.2 percent, which is a bit different from the past. These figures support the beliefs of some people, who think that this current expansion is not necessarily improving or much better than the situation in the 1990s.

Looking at the components of this growth rate in the third quarter we see that two-thirds of the total growth came from net exports. Including the contributions of exports to the growth rate is a steady trend throughout this economic discussion. Regarding domestic demand there has been a significant decline in private investment, reducing the contribution of domestic demand to GDP growth.

Regarding short-term forecasts, the graph shows the average figures of a private think tank forecast for Japan. They predict a 1.73 percent growth in this fiscal year, 2007, and 2.11 percent for the next fiscal year. These figures are around one month old, and it seems that more economists are now forecasting a bit lower growth rate for this fiscal year such as 1.5 percent.

There are four main risk factors for the Japanese economy in the short term: of course, obviously, how the U.S. economy is going from now; and appreciation as stock prices fall; certainly, expensive natural resources price, especially crude oil; and the further stagnation of housing investment.

In regard to the housing investment, the stagnation will not stay long. Maybe it will stop in the next quarter or after the next quarter. So the main risk comes from the external side.

I'll change the topic to the major issues affecting mid- to long-term growth. The biggest issue is the population decline and aging. Second to that is the emerging inequalities, and also Japan, like other countries, needs to respond to changing global issues.

The Japanese population is, at present, 128 million, and this figure is almost the peak of our population according to some estimates. As we are seeing in this graph, our population is gradually decreasing. Maybe in 2055, the population will go down to 90 million. The percentage of the population between 15 and 64, which is sort of the working age, is estimated to be around 50 percent in 2055. So we need to expand the age range for employment. The percentage of the population above 65 is currently one quarter. In 2030, it will become one-third, and more than 40 percent in 2055. These figures show a trend in the total fertility rate: it is decreasing gradually. There is a need for a policy to reverse this trend.

This is a comparison of the total fertility rate and, except for Korea, Japan is overwhelmed. So Japan needs to tackle this difficult aging and population decline first and maybe after some years, the other countries [inaudible].

I'll turn to the second major issue affecting mid- to long-term growth, and that is emerging economic dualities. Widening economic disparities are raising concerns that the benefits of Japan's expansion are not being equally shared. Income inequality, as measured by the Gini coefficient, has risen steadily, and now exceeds the OECD average. Growing inequality is also related to shifts in the labor market. Regional inequalities are rising. Metropolitan cities like Tokyo and Osaka, and regions with export-oriented industries such as Nagoya, with Toyota very close by, are growing much faster than other regions, such as Hokkaido or Okinawa. Dualities are expanding in industries: big and small, IT-related and not IT-related, export-related and not export-related.   While enhancing growth, there is a need to address these emerging disparities. We also need to cope with several global issues. There are so many I don't need to mention, but a lot are related energy and environmental issues.

Thirdly, I'll go to policy responses to address these issues. First of all, there is a necessity to increase the number of people working, actually working in Japan. There is some need to reverse the trend of the declining total fertility rate by easing the burden of raising children. There needs to be an environment of encouraging more employment of the old and female population. Finally, employers may need to further encourage specialized and technical fields.

Second, the improvement of productivity and in-house growth potential is also essential. The improvement of education and movement of personnel to highly productive sectors is necessary. Important industries such as the service sector, which occupies 70 percent of the GDP, should receive special attention. Promotion of entrepreneurship and new investment in R&D activities are both important policy objectives.

A liberal trade and investment environment is the basis of Japan's economic growth, and Japan will cooperate with other countries in pursuing global trade and investment liberalization and trade facilitation with the WTO, EPA, APEC, and others. Other global, regional cooperation is important to Japan, to the region, and to the global world. Initially, it is important to bring in more foreign investment and highly skilled human resources into Japan.

As aging continues, social security costs will surely rise, therefore Japan needs to improve the social security system in order for it to be sustainable with a good balance between costs and benefits. In addition, it needs to continue to improve budgetary deficits. Also, it needs to cut down budgetary expenditures.

Of course, it's quite difficult to forecast the mid-term growth rate. This is a test calculation by a cabinet office for 2010 to 2011. Based on the high growth scenario, the annual real growth rate in this term will be 2.4 percent. Under a low growth scenario, the annual real growth rate would be 1.7 percent. So Japan's growth, would be around 2 percent, which would be modest compared to that of high-growth economies, such as China, but with efforts to increase productivity, Japan may be able to contribute to the global economy through innovation. Japanese companies have been competitive in many industries, such as energy, the environment related industry, automobile, home appliances and so on. So we will continue innovation in those areas.

Many Japanese companies are working in the regional and global trade and investment network, and they will contribute more in the future to the global growth through that regional and global network. Furthermore, the Japanese experience responding to fast-aging society will be very useful to other countries that will face the same issue some years after Japan.

I thank you for your attention.

(Applause)

BARRY BOSWORTH: Thank you very much. I was, in this session, asked to speculate a bit about prospects for U.S. political attitudes towards the global economy, particularly in this upcoming election. To begin with, I just want to make a couple of simple points. I think that I may sort of echo a bit what John Thornton said at the beginning. You stole some of my lines, as a matter of fact.

The first thing to remember is that the United States has a surprisingly weak link to the world economy from an economic point of view. We have a large foreign policy presence, but a very small economic presence. For example, exports to the world from the United States are 7.5 percent of the United States's GDP, compared with 35 percent for China. That is one reason people in China would say the global economy is good for them, because it's a very important and very large portion of the Chinese economy. It is not a large part of the American economy.

Second, most Americans have long perceived the global economy as basically having a negative effect on their lives. They understand, I believe, that they gain as consumers—and they like to have their choice of inexpensive products that come from Asia, for example—but they have a lot of fear about job losses on the other side.

In booms, consumers dominate and fears about foreign trade decline. In recessions, they come back. So if the United States should go into a recession, in the current situation, you can expect a dramatic increase in anti-global feelings in the United States, and a lot of politicians speaking out against trade policies.

The third aspect of it, I think, is that there has long been historical political opposition in the United States for multilateral policies, and we don't like supranational organizations. The United States was at a unique period in its history with the outbreak of the Cold War in which it ever agreed to enter into many of these international agreements. Now that the Cold War is over, a lot of the political support for such activities is vanishing in the United States.

Fourth, the United States's large external trade balance heightens the public perception that the international trade system does not support American interests. So there's been a huge loss of national consensus on new international economic policies. It was camouflaged in the early parts of the Bush administration because since the Republicans controlled the Presidency and the Congress, they decided to ram through their own version of an international trade policy. But now that the Congress is in the hands of the Democrats, this has now broken down. There is no fast-track authority. The WTO negotiations are dead, and the President will not, in his term, ever again get authority to negotiate an international trade agreement.

I think trade policy is emerging as a major issue in 2008, particularly among the Democrats. Some of them strongly oppose any extension of international trade agreements. I think within all of this, the relevancy to this group is the current focus on the United States's economic relations with China. This is one way, I think, of demonstrating some of the concerns about the international imbalances.

This year, the United States is estimated to have something a little bit under an $800 million current account deficit with the rest of the world. That represents about 6 percent of U.S. GDP. The U.S. has currently got a foreign debt of about 20 percent of its GDP. If those numbers stay the same, about 6 percent a year. It's obviously an unsustainable economic situation.

When you look on the other side, if the United States has got this huge deficit, who's got the surplus? Asia. Obviously, countries in Asia would say the economic situation is highly beneficial to them. They like the current economic situation. The United States does not.

Japan has always had as current account surplus, and I think a lot of the rhetoric you're going to have here the next year is going to sound just like 15 years ago when there was a debate with Japan. When Americans had difficulties, they wanted to blame Japan for their problems. When they have difficulties this year, they'll want to blame China for their problems.

But this time the difference is that Japan continues to have a lot of surplus, but China has a truly astounding surplus, particularly when you realize how small China is compared to the United States. You're talking about a current account surplus as a share of GDP that's more than three times greater than that of the United States, and it's going to spiral up again even further over the next year head.

Also, an interesting shift that's now occurring is that Europe used to have a surplus as an offset to the American deficit, but with the rise in the value of the Euro, European economies have now fallen into a current account deficit. A European leader was just here in China, and what's the first thing they want to talk about? Exchange rate policy—because even more than the United States, who's got a big exchange rate change vis-à-vis a problem with China? Europe. Now it turns out that both the United States and Europe are both focused on the Chinese exchange rate system.

The rest of the world, I think, is pretty much unaffected, except you should remember that Middle East countries, OPEC producers have an offset as well and will continue to have a surplus in future years.

I think we can also be clear about what all these imbalances reflect. First of all, an incredibly low rate of savings in the United States; the United States has been on a consumption boom. Americans spend almost all their income, and signs are they'll continue to do it in the future.

On the other hand, remember there has also been very weak investment in the rest of the world, particularly after the Asian financial crisis. When that crisis hit, the United States sort of became the engine for growth in the world economy. There was a current account deficit before the Asian crisis, but it was really quite small. It has exploded since 1997 basically because the world is using the U.S. market to keep itself going. So it's the ability to export to the United States's market that's been crucial to continued growth here in Asia. When that ends, there's going to be difficulty.

Secondly, there's the need to recycle the OPEC oil surpluses with high energy prices, but there's also growing focus on exchange rate interventions by China and other countries seeking to maintain an export-led expansion.

Here's a way that maybe illustrates just quickly why it is the United States is not terribly impressed or interested in trade with China. Most Americans would say we import an incredible amount of goods from China but, in fact, we import about the same share of our GDP as Japan does, a little bit more than that of Europe. We do not stand out as being particularly unusual on the import side.

What's unusual is that the U.S. exports almost nothing to China, and the current account is different between the United States and Japan. When Japan says economic relationships with China are good, it's because Japan exports a lot to China. The United States does not.

Here's another way of looking at it. You can see the large current account deficit of the United States is now about 6 percent. What I think I would like to impress today is that I think it's over. We are now headed in the opposite direction. The American dollar is falling at present. It's going to continue to fall in future years, but the U.S. current account deficit is going to go down and the ability to use the American market as the engine for growth in the world economy is basically coming to an end.

This is a painful adjustment for everyone, but the surprise will be it's actually going to be pretty easy for Americans. When the exchange rate falls, what's going to happen? The United States is going to be able to sell more in world markets. It's at full employment today, and it's likely to face increasing employment opportunities in future years.

Where are the painful adjustments? In the countries that can no longer expect to have an export surplus with the U.S. economy.

What stands out most in that respect? Asia. Asia is incredibly vulnerable to an American economic slowdown in reversal of its trade deficit policies. It's a particularly unique situation for China, because until about three years ago China never ran significant current account surpluses. It basically had balanced trade. All that changed, and this imbalance with China developed in the last three years, but it's worsening at a rapid rate at a very bad time for China because if the U.S. boom is going to end, China finds itself very exposed in the external dimension of trying to sustain its economic growth.

I think if we look in the future, we're going to see an extreme increase in discussions about exchange rate policies. The U.S. dollar will decline in value, and the Euro will appreciate. The pressure is going to basically mount on Asia, and the focus of that will be China's policies about trying to maintain a fixed exchange rate policy.

The multilateral trade negotiations as a result of these pressures are basically dead. I do not think that they will be renewed any time in the near future. Whether it's a Democratic president or a Republican president, there is no longer consensus in the United States in favor of active trade negotiations. I don't think that's terrible for the world economy, because the current trade system is actually doing quite well.

On the trade rounds, I think we do face a lot of pressures going forward. Public support in the United States for renewed trade authority does not exist. I think the Democratic Party has splintered over the issue of trade. Maybe the biggest thing, as mentioned at the beginning, is we never had much exposure.

Why did Americans support the growth of an international trading regime in the past? I think the basic reason was the Cold War. The United States wanted to build an economic system as a counterpart to the Soviet Union, and try to bring in countries that were somewhat independent into support of the American side. So, basically, in trade negotiations, the United States government was in the business of trading political advantage for economic advantage, support for us in the Cold War in return for access to the U.S. market.

That tradeoff is now dead, and there's no interest in the United States in trading political for economic factors. That means it's going to be economic interest versus economic interest, much more direct conflict over who's going to gain out of the trade negotiation. I think the United States remains basically ambivalent about the value of those negotiations.

There is currently a bilateral negotiation between the United States and Korea for a free trade agreement. I think that has become very unlikely to be approved. It has to be voted up or down, but at the present time I don't think we have the votes in the U.S. Congress to pass it.

The final one is the Doha Round. To restart the Doha Round, it requires that the United States get fast-track authority again for the new administration. I don't think that's possible to achieve regardless of who wins the presidential election. Therefore, for the time being, I think the United States will be a bystander in international negotiations over trade.

I do not think, though, if we end up with this that the United States is about to pull out of the global system. That would be a gross exaggeration of what's going on. But the United States does not see great benefits anymore to continue the expansion of the system through very active government policies. I think it will be a period where, for many years, the current system will be largely on its own, trying to manage and sustain the trade system without a new round of negotiations.

Thank you.

(Applause)

LONG GUOQIANG : Barry told me just now that economists are more likely to use PowerPoint. I'm afraid I'm not a qualified economist, because I cannot prepare PowerPoint as my assignment was to do a presentation based on the three former presentations.

I would like to express my appreciation to the three panelists for their excellent presentations. They provided excellent scenarios of the three major economies, both in short term and long term, and the prospects of possible strategies and policies.

So, based on the presentations, what are the regional implications for East Asia's economy? I would like to make three points.

Firstly, the East Asia economies need to continue to deepen cooperation and improve economic relationships with the United States. The reason is very simple. Even in the long-term, the United States will still be the biggest economy, especially in terms of its scale, its innovative capability, and its influence in the world economy. In the past, actually, the United States was the most important economic and trade partner to East Asia.

To improve cooperation in the short-term, I think from Barry's presentation, we see that East Asia runs the biggest trade surplus, about 700 billion U.S.

dollars. Most of the trade surplus is recycled to the U.S. financial markets. In the short term, I think the East Asia economies should adopt a strong U.S. dollar policy to prevent the continuation of the so-called subprime loan crisis on housing in the American financial market.

The second point is because of the booming of the Chinese economy there is a restructuring of the Japanese economy, mainly based on the aging of the population and the possible adjustment of the U.S. policy toward a multilateral system. I think the East Asian economies should very seriously consider accelerating the pace of this regionalism.

In the past, from the trade figures, we can see that the intra-regional trade in this region has greatly improved. The fiscal reason, actually, I think maybe is very unique in this region. Intra-regional trade is mainly driven by relocation of the production capability from Japan and from the newly industrial economies to less developed economies in this region. As the result of the relocation in this region, it has already improved the regional production network. This trend will continue because of the change of the three economies just mentioned.

There are a lot of choices, as in the presentation by Professor Qin in the last panel. There are a lot of choices, a lot of articles, and a lot of facts in the process of globalization in this region. Actually, the present dilemma of the game theory has provided a very clear solution for the economies in this region. The only solution to accelerate regionalism is to improve the cooperation among the economies.

The last point is that China needs to accelerate its transformation of its development model from the former input-driven economy to an innovation-driven economy. In the external sectors, China also needs to adjust its strategy from export-oriented to a new strategy of mutual benefit external strategy.

Actually, we need to adjust from relying on external demand and we need to accelerate domestic consumption, and also we need to improve relations with the international community by means of further opening-up China, improving its position in the global production chains, and acting as a responsible player in the international community. Thanks.

(Applause)

MR. THORNTON: Okay, now, we have a little bit more than 20 minutes. So, while you all are thinking of your questions, I'm going to start with a question of my own for Barry. I just want to clarify something, and this is both a near-term question and then a longer-term question.

In the near term, if we assume that the United States is in a recession or an economic downturn or approaching a recession, what is the impact of that on the Chinese economy?

Then if that's the beginning of the next, let's say, decade, going back to the comment you made. You said something to the effect that the changes that were happening in the world, that the U.S. could adjust to those relatively easily, and it was going to hurt Asia more than the United States. Talk us through the politics of that and how you see that over a longer period of time, how you see that playing out both inside the U.S. and then outside the U.S.

DR. BOSWORTH: I think the worst possible outcome is there are a couple of bills in the U.S. Congress that I think will get renewed life that would call for a tariff probably against China alone. This is also the thing that's now being talked about by the Europeans.

I think in a recession, public support goes up dramatically because the U.S. does run a type of labor economy that runs big risk if you lose your jobs. What makes the American system work is you lose your job—lots of people lose their job, but they can always get another one. But, in a recession, they worry about getting another one, and so this lack of security, economic security, plays a big role in American politics and things will shift a great deal.

One of the reasons that's even come up at all at the present time is you say: Well, the economy is very strong. What's the problem?

And, it is. At the aggregate level, it's growing rapidly. But people at the bottom of the distribution have not been doing very well in recent years, and so the Democrats have found there's some support for this economic insecurity issue in the current election even though we don't have a recession at the present time.

Why do I think it's going to work out easily? The fundamental problem is the United States has a large current account deficit. The only way you correct that is the value of your currency falls.

It's true; they have to increase saving in the United States or reduce investment. I think the latter is more likely than the first in the short run, but for the U.S. to have a restoration of domestic savings investment balance then the external sector has to adjust. The only way that can happen is for the dollar to go down in value, making imports become more expensive and exports cheaper.

This is not theory. We've been through this exact same process before, in the mid-1980s. The dollar fell about 25 to 30 percent, and we went back to current account surplus.

What was it? It was a boom for the United States and a lot of problems for other countries because they no longer could run trade surpluses with the United States. The burden of it in that time fell largely on Europe. I think this time the burden of it is going to fall largely on Asia, and so I think there will be a lot of strains.

I think that the answer to such concerns is exactly what was said: Asia has to accelerate its regional development because it has to develop alternative markets to the United States, with a concentration on China in particular. When the domestic growth faltered, the Chinese redirected everything into the external sector, which has put China at risk at the present time. China's domestic demand growth slowed down dramatically after 2005, and the substitute for it was to go to export-sustained expansion. But that was a very sharp change in China's policies, and it's left them at this time in history in a very exposed position if the United States dollar should continue to fall in value and the adjustment continues on the American side.

MR. THORNTON: Thank you. Sir?

QUESTION: Erich Shih, TVBS News Washington Bureau Chief and former CNAPS Visiting Fellow. Two short questions, the first one to Mr. Chang and then Dr. Long: In terms of China's economic growth and its ability to be sustained, one thing that the people in the West have voiced concern about is the social stability issue, and it's coming back year after year. What are your views for social stability vis-à-vis economic development for 2007, and a short-term projection?

It's the same question for Mr. Bosworth. It's a follow-up on Mr. Thornton's question with a twist. Should the U.S. economy go into a recession, what are the other factors in your mind that could contribute and compound that situation and possibly lead to a global recession? Thank you.

MR. CHANG: Yes, I think the Chinese government understands there are very, very important social issues. Therefore, when you look at the National Party Congress and the Chinese Communist Party, they always emphasize economic, political and cultural development, but they are also talking about social development, stability, and building a harmonious society.

If you look at the financial expenditures of the government this year, you can see that most of the expenditures, especially the incremental part, are targeted at tackling those issues.

I would say that social unrest is a real thing in China. However, I think it won't affect stability building in the sense that as people in general become richer, they understand that stability is really important for the Chinese economy. I think this is a real issue, and that the Chinese government uses what I would say are practical means to tackle it. I think it won't affect the stability of Chinese development.

DR. LONG: The Chinese government has already realized the importance of social programs, and they, in recent years, have targeted such programs. The central government allocates funding to the construction of social harmony. I think this is a very important thing for the future of Chinese development, and the government has already adopted a lot of measures, for example, to improve social security, and to improve the income of the farmers. If you look at the figures from the Ministry of Public Security the mass incidents have already decreased.

If China can balance that with rapid economic development, most of the problems can be solved through the development. The government has a strong ability to solve such kinds of problems. With implementation of the strategy of social harmony, the situation will get better and better. Thank you.

DR. BOSWORTH: I think the U.S. recession can translate into a global recession, basically because in the mid-1980's the offset to the adjustment in the United States was that Japan stepped in and for about a five-year period was the engine for global growth. But this move was very costly to Japan, and I think they deeply regret the fact today that they ever played that role in the mid-eighties. They're certainly not going to play it this time around.

I think you're very hard-put to find a country that's going to step forth and be, so to speak, an engine for creating demand for the global economy. I think that puts countries back on their own resources. They're going to have to do things themselves to stimulate domestic demand within their own economies. I think that's a particularly big and difficult task for China, to be able to accomplish that at the present time.

QUESTION: Thank you for your excellent presentations. My name is Alexandre Mansourov. I'm from the Asia-Pacific Center for Security Studies. I have a question about the foreign exchange reserves. Six years ago, before 9/11, foreign exchange reserves in East Asia stood at three trillion dollars. Now, six years later, they stand at 5.7, I think, almost six trillion dollars, and the greatest portion of it is in China, Japan, Russia, and other countries.

Of course, the management of the foreign exchange reserves is becoming an increasing challenge in terms of performance, in terms of efficiency, especially when the dollar value is declining, and will be increasingly difficult when the long-term interest rates in the U.S. come down. So what do you do? The recent trend is the emergence of sovereign wealth funds.

My question is to Barry. From the U.S. standpoint, what are the potential difficulties in terms of the entry into the U.S. markets by the sovereign wealth funds, and how can those difficulties be mitigated or overcome by the governments of these nations? Thank you.

DR. BOSWORTH: I think they just highlight the dilemma that these countries face. You cannot have a sovereign investment fund and invest in non-dollar assets, and still maintain a policy of a fixed exchange rate against the U.S. dollar.

The only way, for example, that China can maintain the current exchange rate is it just pours this money into the U.S. economy. Now it would help some to diversify it. You could hold some equities, some corporate bonds and not just all government bonds. But, as you've seen with the mortgage debt crisis, there is some risk associated with that, and governments don't manage risk very well.

The other alternative, which is to diversify as a way to handle the risk and move into a lot of other currencies, I think is a very good idea but it doesn't maintain status if you're going to have a fixed exchange rate.

People are talking past themselves when they keep saying: we're going to have sovereign wealth funds, we're going to keep our fixed exchange rate.

You can't do both, particularly in the current situation when lots of other investors, private investors, are losing faith in the continued reliance on the U.S. market. You're fighting against the trend. You have to pour in more money to try to maintain your exchange rates against the dollar. So I don't think the sovereign wealth fund solves the problem of the exchange rate.

I think it's excellent investment advice. Taiwan, I think, is a country that stands out in my mind that would love to give that advice to others, given their experience in the mid-1980s. They lost their shirt when the U.S. dollar went down in value. Singapore lost incredible amounts of money in the mid-1980s. Those two countries know what it's like to lose it. So I think there are some lessons for others to learn from it, but it's not an answer to the exchange rate policy.

I would also argue I don't think sovereign wealth funds are a good idea, basically, for most countries. There used to be what are called provident funds back in the 1930s. A whole lot of countries ran their social security systems with them, and they all went bankrupt in the Great Depression. Governments don't manage risk well.

A country like china has lots of other uses for its foreign exchange reserves. In particular, why don't you spend it to try to improve the education system? If there's such a shortage for college students to go to school here in China, you could take all this foreign exchange money and send them abroad. There are lots of ways to spend the money. This seems like a really low return.

I do think we've walked away from the 1997 crisis. We've learned a lesson: don't rely on the IMF; protect yourself; and countries better have reasonable levels of reserves. I think that's absolutely right and East Asia deeply believes that.

But the current levels of reserves are absurd. They're not consistent with that notion. They're much more aimed at trying to maintain a specific exchange rate which is not in the interest of the country in the long run.

QUESTION: Wonhyuk Lim, former CNAPS fellow and fellow at the Korea Development Institute. I have a question for Dr. Bosworth. I don't know if it would be relatively easier for the United States to make adjustment to exchange rates, flat changes.

I see a somewhat different implication for what we had in the 1980s and early 1990s. When the United States was basically at a trade deficit back then, it did have to make some adjustment. I mean we remember Bush 41 in a statement about "read my lips, no more taxes," but it did have to get its fiscal policy in order. Also, it did have a somewhat mild recession in the early 1990s that led to the election of Clinton in 1992.

Although I read that Japan kind of created a bubble by trying to be a growth leader in that period, I don't think the U.S. experience back then adapting to exchange rate change, was not all that painless.

In this case now, it seems like there's going to be less emphasis on fiscal policy. Yesterday's *Wall Street Journal* had an article saying that tax cuts could be floated as a more intellectually defensible proposition next year, when the United States is more likely to be in recession than it is now. If that's the case, if the savings/investment balance is restored, not through increased savings but more through contracted investment, I think the adjustment the United States will have to face will be pretty significant. The question is, do you really believe the U.S. adjustment will be less painful?

DR. BOSWORTH: I think I fully agree with you. In trying to make a point, I kind of overstated it. I don't think this will be painless for the United States, but it will be much more painful for other countries, who are trying to find some way to offset rapid declines in demand.

The U.S. problem is if we don't act, what do we get? A little bit of inflation pressure, drive up the interest rates; the Fed can handle that.

But I agree. Painless? No, not completely, but manageable. For the U.S., this is a much more manageable situation than it is for the people on the other side, but I think your cautions are all well taken.

QUESTION: Zhu Wenhui from Hong Kong. I am a former CNAPS fellow from 2004-2005. I have a question to pose to Barry. As you mentioned, one response to the regression of the U.S. dollar and the slowdown of the U.S. economy [inaudible]. If you look at the details of this kind of equation, the ultimate object of this kind of network is the most efficient management by the Chinese economy. [Inaudible] which means the whole region will depend more than before on the U.S. market. [Inaudible] an economic slowdown or the U.S. attitude towards globalization will impact the whole region; China, the tigers, and Japan.

Furthermore, China's exports have shifted gradually in the last year, from U.S. to European markets. So that is the reason for the E.U.'s trade deficit increasing 20 million U.S. dollars every hour. So how do you see this change because if you look at the demise [inaudible]. What I mean is that the whole equation is basically some kind of production network, efficiency.

DR. BOSWORTH: You go first. You proposed it. I agree with you.

DR. LONG: Thank you. Thanks for Wenhui's question. He pointed to the real situation, the relationship between the East Asia region and the United States.

Actually, I just mentioned the regional production network and its final market, which is still in the States. China imports upstream inputs from East Asia economies and re-exports to the States after assembly. We call it process trading.

The trade surplus of China to the States is actually the trade surplus of the region, not purely China. If you look at the figures, China's trade deficit with bordering economies, except Hong Kong, is almost the same amount with China's trade surplus with the States. If there is a trade sanction against China, I think it's not only against China. It's against this region, and no one will win.

Actually, I share the same view with Professor Qin in the last session, that the States has a very special role in this region's regionalism in terms of its relationship with it.

DR. BOSWORTH: I agree completely with that. I would only add what can be done. I think people have not sufficiently realized the extent of the change in China's policy in just the last few years. Up to 2005, China did not run large current account surpluses. It was a balanced growth economy. Domestic demand grew just as fast as exports did. Exports were a constant share of GDP until about 2002.

Then with the WTO agreement, all these countries thought they were going to take advantage of China, right? They forced Beijing into giving up a lot. Instead, what happened after 2002 is that trade exploded on both sides, exports and imports. It was great for all the countries.

But since 2005, exports have continued to grow rapidly out of China, while imports have leveled out. It's kind of a puzzle. Why are the imports not growing as a share of GDP anymore in China? The basic reason is the weakness of domestic demand here in China, and they have been working fast enough to try to offset that.

The rest of the story is that, since 1997, East Asia outside of China is no longer a high investment economy. They used to be known for high rates of capital formation, but investment collapsed in 1997, and never recovered. The Chairman of the U.S. Federal Reserve says the world is awash with savings. We've got a savings glut. More accurately, we've got an investment shortfall, and most of the investment shortfall was here in Asia if you exclude China.

These other countries got to either stimulate investment domestically to offset this problem or find some other domestic demand stimulus. A good example that someone mentioned earlier was Korea, who tried to stimulate investment, and there was a big consumption boom in Korea, but they ran into debt problems, which swung them back the other way.

But I think Asia has got to look out for itself more. It's got to have more balanced growth either within individual countries or within Asia as a whole. It can't just be a production network dumping products in other parts of the world. You can't sustain that type of growth, and that's not the way Asia got to where it is today. That's not the history of Asia, it has not always been running big export surpluses. Rapid export growth, yes, but matched by rapid import growth.

MR. THORNTON: Any final questions?

QUESTION: Andrew Moravcsik from Princeton and Brookings. By the way, before I ask the question to the whole panel, John, you should include in your large countries of the world a United Europe? There are a lot of countries in there that are so interdependent that exports plus imports are more than 100 percent of GDP. I think if you did include United Europe, there would be four large regions and countries of the world in 2008.

MR. THORNTON: I think you're an optimist.

DR. MORAVCSIK: This is for the whole panel, but let me start by pushing back on Barry. You say that this will be a wrenching adjustment for countries of the world, and particularly for a place like China that's not ready for the adjustment to the new role of the United States.

Now, let me understand this clearly. China has six trillion dollars. It definitely wants to make exactly the adjustment that you say they should make. They want to increase domestic consumption. It's a desperate policy imperative for social, political, and technocratic reasons. Until 2005, they had exactly that kind of policy. So they've had it for two years. Now they're going to go back to the policy they had before that.

So what's the wrenching adjustment? It seems to me that it's actually just going back to business as usual, and it's the right policy. Maybe for some other countries, it's a problem. I'm wondering why the rest of the panel isn't pushing back hard and saying, in fact, this is going to be a pretty easy adjustment for China. Where's the beef?

DR. BOSWORTH: If I'm supposed to answer that, I think I would agree. It's very easy for China to do. It has the resources to do it. It just lacks the will. It won't change the exchange rate. China hangs on, I think, in stubbornness because if the Americans want it, it must be bad. If the Europeans want it, it must be bad. It's easy to do, I mean in that respect, but I think it's a fearful thing.

If there's one country that would really be hurt by a recession, it's China.

China has all these people who need jobs even more so than people in the United States. I agree with the Chinese government. They should be very fearful about the risk involved in letting that exchange rate go without knowing you've got the domestic demand stimulus in place. It is not going to be easy to coordinate the resource shifts that are required.

DR. MORAVCSIK: Then I'll be provocative before the rest of the panel jumps in. I'm a political scientist, so when I see a government that has an obvious thing that technocratically it should be doing, and it isn't doing it, I think they are very strong political and distributional reasons why it doesn't choose to do it. Why is it that China, which has been talking about doing precisely this policy for five years, hasn't done it?

DR. BOSWORTH: You have to ask the Chinese government, but part of the answer is: they have. This is an issue of the pace of change, right? China has loosened up. They are worried about going too fast.

I think there is a huge concern about this 150 million people who still need jobs. That's on a scale that someone from the United States can hardly think about, and we cannot be so glib as to say, oh, you should do this as though there's no risk involved at all. There's a lot of risk involved.

I'm just saying there's not going to be a lot of choice on China's side if the United States falls in a recession. It looks to me like the dollar has now fallen, and that the rest of the world is not going to be able to support this.

Even six trillion dollars worth of reserves is not enough for East Asia to run what was called a strong dollar policy. I don't think that East Asia can do that. That's basically the fundamental problem.

MR. THORNTON: Okay, I'm sorry. I'm going to have to bring this to an end because we're running a little late and we've got lunch with the former Foreign Minister.

I want to thank our panelists for a riveting conversation—we can continue this later—and also encourage all of you in the audience to go out and spend all your money this afternoon very quickly.

(Applause)

(Recess)