

THE BROOKINGS INSTITUTION
CENTER FOR NORTHEAST ASIAN POLICY STUDIES

ECONOMIC INTEGRATION IN EAST ASIA
AND ITS IMPLICATIONS FOR JAPAN AND THE UNITED STATES

A Joint Forum Hosted by
the Center for Northeast Asian Policy Studies
and the Keizai Koho Center

**Panel II: A Sustainable Chinese Economy
and Its Impact on the World Economy**

*Keidanren Kaikan
Tokyo, Japan
May 21, 2007*

Panel II: A Sustainable Chinese Economy and Its Impact on the World Economy

CHANG KA MUN, Moderator
Manager Director, Li & Fung Development (China) Ltd.
CNAPS Advisory Council Member

LONG GUOQIANG
Development Research Center, State Council of the People's Republic of China
CNAPS China Fellow 1998-1999

RYOSEI KOKUBUN
Professor, Keio University

WING THYE WOO
Senior Fellow, Brookings Institution

PAUL HSU
Chairman and CEO, PHYCOS International Ltd.
CNAPS Advisory Council Member

MR. KOYABASHI: Welcome to Panel II, focusing on “A Sustainable Chinese Economy and its Impact on the World Economy.” Let me introduce the members of the panel. To the right we have DR. Chang Ka Mun, Manager and Director of Li & Fung Development China Limited. He is going to moderate the session. Sitting next to him to the right is Mr. Wing Thye Woo from the Brookings Institution. Sitting next to him is Professor Ryosei Kokubun of Keio University. Also we have Professor Paul Hsu of National Taiwan University, and Dr. Long Guoqiang from China’s Development Research Center. Mr. Chang Ka Mun, please?

CHANG KA MUN: Good afternoon, ladies and gentlemen. I am very honored to be the moderator of today's panel. Today's topic is “A Sustainable Chinese Economy and its Impact on the World Economy.” I would like to make a few remarks to start.

Today we see a shift away from the export and investment net growth model of Chinese development economy toward more of a consumer-driven dynamic, which is actually providing stability to the Chinese economy. This could have profound implications for the global economy and the world's financial markets. It is necessary for China to rebalance its economy. The economy of China is still reliant upon exports and fixed investments, but if these trends continue, the sustainability of the Chinese growth model will be at risk. Years of rapid export growth have caused China to experience a serious trade surplus and rise of protectionism.

Moreover, a continuation of soaring investment growth would result in overheating, and more importantly, in the medium- to long-term, excess capacity and deflation. Closely related to a very high growth rate in the export sector, there is concern also over the excessive accumulation of foreign exchange reserves, which results in a sharp decline in the money supply of China. This is one major contributing factor to the recent speculation in the PRC Asia markets.

Today we have decided to speak on the topic of “A Sustainable Chinese Economy and its Impact on the World Economy.” The first speaker I would like to invite is Wing Thye Woo. Dr. Woo is a Senior Fellow in Foreign Policy Studies and Global Economy and Development at the Brookings Institution. He was a consultant to China's Ministry of Finance in 1994, and a special adviser to the U.S. Treasury from 1997. His expertise includes economic issues of Asia, international financial architecture, as well as exchange rate economics. Dr. Woo has a Ph.D. degree from Harvard University. Dr. Woo, please.

WING THYE WOO: Good afternoon. It is my great privilege to be here to present my views on the sustainability of China's growth and its impact on the world. I am particularly very grateful to KKC for giving me the high honor of speaking in this hall for the second time in two months. Thank you. I hope they thought that I made all the other panelists look good the last time, so they have asked me back again to ensure that the others would sound very smart after I'm done.

I am going to talk about China's growth sustainability—“smart money” as exemplified by Goldman Sachs. Goldman Sachs is certainly very optimistic that China's

growth will be sustained. In fact, Goldman Sachs has said that China's GDP in 2040 will match that of the United States.

In talking about China's impact on the world, one prevailing view is rather pessimistic. In the few times that I have heard former Treasury Secretary Larry Summers discuss the rise of China, he talks about the importance of handling this well because of the negative experiences with the rise of new powers in the early 20th century, namely, the rise of Germany and the Soviet Union. I, on the other hand, think that this pessimism is overdone because the biggest power that arose in the 20th century and prevailed was the force of stabilization. I refer to the rise of the United States in the 20th century. So there is a possibility that China could return to the world stage in a manner equivalent to the rise of the United States rather than in the destructive fashions of Germany and the former Soviet Union. Two of the messages I want to get across are, of course it is more likely that the rise of China would be a stabilizing one if, number one, we do allow China to take center stage, giving elbow room to China. Number two, we must strengthen the supports that are holding up the stage; in other words, we must strengthen global institutions. Of course, both are easy to say, but extremely hard to do.

For example, giving elbow room to China. Japan has risen at least since the 1964 Olympic Games and is still not a member of the Security Council, and it could have been a better director of the IMF than the last two have been. So making elbow room is not something that the international community has been doing well. Similarly, the various attempts by the United Nations for better global governance have been less than stellar. So while we know that these are necessary conditions, our record to date has not been a particularly impressive one.

While I do think the pessimism about China's impact is overdone, I think the optimism about its economic growth is overdone, too. I think the best way to think about the sustainability of China's growth is the analogy of China as a car, speeding down the road to global capitalism. It's growing 10 percent a year, it's overtaking many other cars, but there are three types of negative shocks which could cause the car to crash.

The first type of negative shock I would call hardware failure, the equivalent of a wheel falling off the car. That would be the case of the collapse of the banking system in China that could disturb production economy-wide. Think of the 1929 banking collapse in the United States. The Chinese banking system has been recapitalized twice since 1997 and to think that the ongoing recapitalization will succeed in changing behavior would, in my opinion, be the crime of hope over experience.

The second type of negative shock that could occur is a car crash because people were fighting inside the car. That would be the case of failure in institutional governance. You could think about the rising social expectations in China and the low ability of the government to respond to these expectations. Specifically, we can think about the number of mass incidents in China, which has increased by a factor of 3 over the last 10 years, and we know that corruption has gotten worse, and so social sentiments toward that has gotten much more negative.

The third type of negative shock that could cause a crash would be what I call power supply failure. It is like the car running out of gas or some outsider putting his hand in and yanking the key out of the ignition. What would be examples of a power supply failure? One would be the shutting down of China's export growth engine, protectionism in the world, and export growth, which has been China's most reliable and durable engine of growth since 1978. The second example would be an environmental collapse.

Of these three types of negative shocks, which one could we see as most likely? I presume that the judgment of the people who know best should determine which negative shock merits the most attention, and who would know it best but the Communist Party of China? In October 2006 the Party made a big change in the orientation of its economic management. Every annual meeting of the Party since 1978 has concluded that the number-one task must be economic construction. But this time, in October 2006, the conference ended with the number one task being to build a harmonious society.

I think this switch from economic construction to building a harmonious society means that the Party is quite confident about its ability to deal with hardware failure. For example, if the banks crash, what do we do? I think the central bank's bankers have a long record of dealing successfully with this problem. The selling of the banks finally is a proven method of getting a new, functioning banking system.

What is a harmonious society? A harmonious society is defined as a democratic society, under the rule of law, that lives in harmony with nature. I think the Party is saying that the two types of negative shocks that are the most dangerous to its continued rule are software failure and power supply failure.

In the remaining time I would like to go into greater detail about the possibility of a power supply failure in China. One thing we do know is that, in three years' time, China is expected to emit more CO₂ than the United States. The United States has not been an enthusiastic supporter of the Kyoto Protocol because it is the country that has the most to lose since it would have to take the most drastic and costly actions to its reducing the emission of CO₂. Just think of what the U.S. position would be once it is no longer the world's biggest emitter of CO₂ and China is the world's biggest emitter of CO₂. I think then we would see a great amount of attention focused on China's responsibility regarding climate change.

We are not talking about just the international implications. There are domestic consequences of climate change as well. Northern China has become drier largely because the increase in temperature has shifted the rain pattern of China from the north to the south—less rain in the north, more rain in the south, droughts in northern China, floods in southern China. So China's solution is to build canals to transfer water from the south to the north. Where will the water come from? A lot more of the water will have to be diverted from the Tibetan highlands so that it can be transferred to the north. But what that really means is less water for the Brahmaputra, the Mekong, and others. Right now,

India is running out of water because most of northern India depends on deep wells tapped into the aquifers and the water table has sunk by 400 feet in the last 30 years. So there is nothing to be diverted from Indian waters. What we could have in the future is not only what we have always heard economists talk about, a trade war coming from China's export growth engine, but also a fight over the global environment. I think that this particular factor is a big threat to the sustainability of China's growth and to its relations with the rest of the world.

MR. CHANG: Thank you very much. Our next speaker is Professor Ryosei Kokubun. Professor Kokubun is the head of the Faculty of Law and Politics of Keio University. He was a Visiting Scholar at the Fairbank Center, Harvard University and National Taiwan University. His expertise is Chinese politics and international relations in East Asia, and his publications include *Challenges for Chinese-Japan-U.S. Cooperation*. Please, Professor Kokubun.

RYOSEI KOKUBUN: Thank you for your kind introduction. I have been asked to talk about the current status of the Chinese economy, which simply cannot be done in the next ten minutes, so I would like to provide you with the highlights on how I see China today. What perspective do I use in viewing China today? This is what I wish to explore with you this afternoon.

As you are aware, the Chinese economy has shown a most remarkable growth. The growth of the Chinese economy was dependent on foreign investment. In general, they followed an open door policy and reform, but in retrospect, I believe it was opening and then it was structural reform. They used foreign pressure and opened the domestic market in order to spur domestic reform. I believe this is what the Chinese have done.

So in the current situation we have those with vested interests who are faced with the challenge of pursuing reform. The Chinese economy is part of the Asian economy and the interdependence is very strong, so stability in the Chinese economy will also lead to stability in the global and world economy. The drop in the Shanghai stock prices instantly brought about crisis on the global market, so as you see, stability in the Chinese economy is directly linked to the interests of the world economy.

Under Hu Jintao they have followed the policy of harmony, which I believe was a right choice on their part because under Jiang Zemin the sole focus was on economic growth. This was rectified, and now the current government is following a more balanced approach. But the issue is, how do the Chinese realize and make concrete these sets of policies? It is the substance that counts.

Overall, the Chinese economy is not at a major point of transition and it could be said that they are now faced with the difficulty of endangering a true and full-fledged market economy. As far as the Chinese economy is concerned, many people view this as the emergence of the Chinese economy. That is the discussion that is taking place around the world today, and we Japanese also discuss China in this context. Some are optimistic, some have very pessimistic views. But in any event, how we characterize China, the

overall picture of China, is very difficult to grasp. In other words, do we see the economy as being representative of all of China? Although we know about the economies of major cities like Beijing and Shanghai, it is very difficult to see the inside political workings of the country. So in that context, what Japan and the rest of the world are saying is something that we all talk about. In other words, what happens after the Beijing Olympics? Will things be all right after the Beijing Olympics? In 2010 there will be an exposition in Shanghai, so maybe they will hold on until then, but will China really be viable after 2010? These are some of the hidden whispers that prevail in the Japanese business community today.

I believe we all know that human emotions play a very big part in this discussion, so the whispers of today's global community are perhaps a risky sign, and this is not without its reasons. Let me explain. If we observe China today as centered on real estate, we see the workings of a bubble economy, and there seems to be a focus on investment as the sole priority. Also there are the issues of nonperforming loans, the banking system issue, and an enormous foreign reserve buildup. More than anything, when we view China as a country today, there are intraregional and interregional discrepancies within the country. There are the gaps among different industries and also there are gaps and discrepancies among the different social classes within China. There is an increase in the number of vulnerable people in China, and China itself has said publicly that there is increasing oppositions from the people in that regard. There are also limitations in terms of its energy, there is the issue of the environment, there are issues that may possibly threaten their sustainable growth going forward. Many of these factors are now emerging. In other words, if we cite the challenges for the Chinese economy going forward, that list could be quite extensive.

So it is under these circumstances that China is still maintaining its growth, despite these various factors, and various investors and entrepreneurs around the world are still interested in the Chinese economy. At the same time, as is the case here in Japan, stability of the Chinese economy also has an impact on our own growth. So from an outsider's perspective, and perhaps more importantly through the eyes of the Chinese themselves, China is likely to face a major transition going forward, a major turning point at some time in the future. The important thing is how can China establish a full-fledged capitalist economy? Can they thoroughly institutionalize the market economy? That is indeed the issue. This, of course, requires transparency. At the same time, the issue of intellectual property rights, private ownership—how can the Chinese address these challenges in their legal framework? Beyond the legal framework, how can they actually implement solutions for these issues?

In March the so-called property law was established in China, which I believe represents progress. The issue is, how do they implement the law in concrete terms? In any event, China is now trying to shift away from an investment-oriented community to one that is consumer- and consumption-oriented. This would require people being convinced by, and people having aspirations in line with, the policies set forward by the government. In that context, I believe there is an issue that must be overcome, and not

just with economic might. That obstacle or that issue happens to be the political issue. Let me explain what I mean.

The political obstacle—what does that entail? In recent decades, much has been talked about in terms of political reform; however, they have continued to shelve this issue. Can this very massive country called China continue its current economic policy? If they are to maintain its economic policy, they will have to face the question of what political structure they want. Economic structure has political structure as its backdrop, so when considering economic issues, political issues have to be considered, too. Right now in China there are very robust discussions about the political system. However, although they are robust, the discussions taking place are not publicized to a substantial degree.

The issue pertaining to transparency in the political process is that the country is under one party, yet they still have a market economy based on one-party rule. They have to achieve a sense of transparency even under the current structure, but the more important issue is that when only one party manages the market economy, then the greatest challenge is the distribution function of the government. So can this redistribution mechanism really be done viably by one political party? This is a very daunting task, and I believe history is very clear. In particular, how does the government try to accommodate the interests of the weak or vulnerable? This perspective is lacking in China today, because there are people with vested interests among the elites of the Party and among the top leaders of the country. That being the case, how does the government create a mechanism to absorb and to reflect the views and the positions of the vulnerable? This really relates to democracy. No one expects China to achieve democracy overnight, but this is an issue that they must confront, as we are all aware.

Having said that, what can be done? In other words, pertaining to the issue of democratization, what should be done now? That is the question. At minimum, there must be efforts to enhance the level of transparency, in particular, the transparency of its economy. Another important issue is tax reform. It seems that they're beginning to tax the personal income of the middle class, but what about the rich, and the top leaders? What about personal income taxation, a progressive system of taxation for the leaders of the society? How to achieve this, I believe, will influence how the redistribution of income is carried out on the national scale. This also relates to the question of the Social Security framework. Perhaps through tax reform we may begin to see a deeper entrenchment of democracy.

Lastly, since this is Japan, let me just say a word in brief about the Japan-Sino relationship. Relations between Japan and China have been seen as one source of instability on a global scale. In other words, instability in the relationship between Japan and China has cast a dark cloud over the future of this region. Fortunately, however, after Prime Minister Abe visited China in the fall of 2006, and after the visit of Wen Jiabao in April of this year, it seems we're beginning to see stability in the Sino-Japan relationship. However, there are still aspects of instability between the two countries. They relate to political and historical issues, which have yet to be resolved. One catchphrase is to create a strategically mutually beneficial relationship; I think we should welcome the fact that

such a positive note has found its way into political relations between the two countries. So the instability in the Japan-Sino relationship is beginning to include an element of stability.

It seems that Prime Minister Abe will be visiting China this fall, so hopefully the Japan-Sino relationship will continue to be stable going forward. In any event, in 2008 Japan's Official Development Assistance program to China will conclude, which means that the conventional relationship between Japan and China will graduate from one of north-south, of donor and recipient, to a new era whereby both parties are now equal partners. Japan and China are two major countries in the region. Creating a constructive relationship between these two countries, I believe, will be a source of stability for the global community. Thank you.

MR. CHANG: Thank you very much. The next speaker is Professor Paul Hsu. He is Professor of Law of the National Taiwan University. He is an expert in strategies development, intellectual property rights, as well as financial services. He is the adviser to the Advisory Council of the Industrial Development Bureau, as well as a member of the Trade and Investment Review Board of the Ministry of Economic Affairs of the ROC. He is a graduate of the School of Law at New York University. Professor Hsu?

PAUL HSU: Thank you very much for your kind introduction. About 20 years ago, Ezra Vogel wrote a book named *Japan as Number One*. There is a new book by Lester Thurow and Professor—I don't know how to spell or pronounce his Chinese name correctly—a new book will be coming out called "China As Number One." Lester is a friend, whom I saw in Taipei just a few weeks ago. He mentioned that his analysis in this book was that China will not be an economic power in the 21st Century, but will possibly be an economic power in the 22nd Century. That means we have another 90 years to go, assuming everything goes smoothly in China. I think that's a very important note.

There has been a lot of speculation about what's going to happen in the next 90 years, but I think this book should be welcomed by the leaders in China because, in my humble opinion, I don't think any leaders in China would like to see China portrayed as an economic threat to the world. My colleagues from China may be able to confirm that.

In recent discussions with very influential economists in China, I also had an interesting experience. They said, "In Taiwan there is such political chaos and we don't understand how the economy and society are still moving along. They said that if this happened in China, the government would collapse. So I gently replied, "Well, we have this thing called the private sector, we have this thing called the middle class, and we also have this thing called democracy. We don't respect political leaders too much and we actually criticize them a lot through public television, and we expect that when politicians are not performing well, after the next election they will be gone."

As you know, I'm from Taiwan. Taiwan's private sector, Taiwan's companies, and even Taiwan's individuals were the first to venture into China's market. In 1979 or even earlier, once China opened, Taiwanese businessmen, in spite of government regulations,

went to the United States, Southeast Asia, and China. They invested in big factories, small shops, a whole range of investments—and were not discouraged even during the Tiananmen incident. They stayed there while many foreign investors withdrew from the Chinese market.

Their investment portfolio is huge but not as measured by the Taiwan government. I will explain that a little later. The safe estimate is probably that \$280 billion have been cumulatively invested in China—over 70,000 big and small projects, world-class factories; a great diversification of businesses.

So I want to make some remarks from the perspective of these early explorers. Since time is limited I want to present, as a menu, some of the issues in China today so you can fill in the menu with your own dish. The first thing I'd like to comment on is the recent passage of the property and business income tax laws; I think they are of great importance. Although the recent passage of the property law didn't take away the government's right to ownership of land, it certainly provided private investment more legal protection. I would say this is only the beginning and whether this passage of the property law will allow greater liberalization must be looked at as a measure of economic freedom. How much economic freedom will China provide following a series of actions such as this passage of the property and business income tax laws?

Another example that demonstrates the gradual expansion of freedom in the economic sector, as in many sectors, is the emergence of individually-owned operations. If you're going to China to invest, you can start a discussion with the authorities concerning whether it is possible to have an individually-owned operation instead of cooperating with a partner. Now it's a possibility; in earlier days it was not possible.

The trend of decentralization is another important thing to notice. In other words, the central government, although still retaining a lot of control, has given the local regions, the local governments, a greater amount of authority to approve investment. Now, regional, provincial, and municipal governments are competing against each other in attracting foreign investment. So there is a lot of room for what I call "economic freedom."

Two other issues that are very interesting to note are the issues of the private sector and of the middle class, which lead back to some of my earlier comments. Some of the challenges China faces are very serious environmental issues and imbalances of regional growth, as other speakers have mentioned. Challenges of developing economic freedom for investors include how to boost domestic demand, and how to enhance the service sector. Another interesting thing that has happened alongside this change in economic freedom is a shift of cultural identity and social values. You probably have noticed that recently, cultural identity and social values are gradually shifting back to Confucian ideals. When communism was first implemented the government actually condemned and tried to eradicate Confucianism, but now some of the old traditional values are being recalled.

Now I want to quickly comment on the status of Taiwan investors. Currently, Taiwan's government is very restrictive and backward when it comes to regulating investment in China. However, it doesn't stop Taiwanese businesses from investing in China. In fact, the current Taiwan government, which will not stay forever as we have a democratic system, is actually causing Taiwan companies to set up holding companies overseas. They are causing Taiwanese companies and individuals, to keep funds outside Taiwan because of their backwards policy. This is how Taiwan companies continue to put large investments into China. Also, the current regulatory environment in Taiwan encourages Taiwan companies to be listed abroad, so Hong Kong is the net beneficiary of that situation. But the important thing is that Taiwan companies refuse to be marginalized, so the Taiwan government's policies cause Taiwan itself to be marginalized.

Because of the limitation on time, I would say Taiwan investment in China and the Taiwan investment group in China constitutes one of the largest—if not the largest—genuine private sectors in China and they are very organized. Under the permission of the Beijing government there is a Taiwan Business Association in almost every small city in China. This has impacted Chinese business and also impacted the culture; this will lead to a string of long-term impacts.

I think that the current economic situation in China provides more opportunities than threats, and I expect the economic development of China will continue to be reliant on foreign investment, not only from Western countries, but also from Japan, Taiwan, and all over the world. The opportunities are tremendous, especially if you consider that the service sector is just opening up. I think one of the important messages for the service sector to open up and to boost domestic demand, these two issues are interrelated. I end my remarks here in the interest of time.

MR. CHANG: Thank you. Our next speaker is Dr. Long Guoqiang. He is the Deputy Director General of the Department of Foreign Economic Policy at the Development Research Center of the State Council of China. He was also a Visiting Scholar at the Center for Northeast Asian Policy Studies of the Brookings Institution, and he was a senior lecturer at the Department of Urban and Regional Science of Beijing University. He received his Ph.D. in economics from Beijing University. Please, Mr. Long.

LONG GUOQIANG: Thanks, Chairman. Good afternoon, everyone. It is a great honor for me to make a presentation on China's economic sustainability and its implications for the world today.

There is a saying that China's economic growth is a miracle, and if you look at the figures, yes, it is an economic miracle. In the past 28 years, China's GDP has increased 11 times, which makes its average annual growth rate as high as 9.67 percent. As a result, China has become the fourth biggest economy and the third biggest in the global trade system. What is more meaningful to me is that more than 250 million people have been

lifted out of poverty. This means that all the Chinese people have shared the fruits of economic development.

What's behind this economic miracle in China? People say that China is an investment-driven or export-driven economy. This is all true, but it is not the whole picture. Economists attribute three major factors to China's rapid growth. One is investment. China has the highest investment ratio in the world. Another are market oriented reforms, which began in the late 1970s. The third is the opening of China's economy. China shifted from a closed economy to currently the most open economy relative to other developing economies. That makes China deeply integrated into the global economy, which makes full use of its comparative advantages. The fifth is shifting that production from no productivity sectors of agriculture to manufacturing and services. China has a good supply of young and well educated labor.

At the same time, there are also challenges that China will face in the next one or two decades. These include increasing trade frictions, including the prevention of China to improve its export structure and also international pressure on the revaluation of the renminbi. Other challenges include regionalism, global imbalance, and the international pressure on China to accept greater international responsibility.

Even more internal challenges exist, including increasing problems of the environment, natural resources, and the ecosystem; enlarging regional disparities, enlarging income disparities, and the risk of social unrest. Also, the reliance on external markets, high labor costs, and so on. People inside and outside China now think about the prospects of China's economic development, but these problems make it quite difficult to make forecasts for long-term developments. There are different views on the prospect of China's economy. The most pessimistic view is the scenario that China might collapse. The most optimistic view is that China will continue its rapid growth for decades before slowing down.

Personally, I think a third scenario is most likely to take place. I see three problems. The first is that the factors behind China's growth will still be there although some of them will have changed a bit. For example, people worry about the increase of labor costs, especially in the coastal regions. But look at another aspect—the productivity. According to the World Bank's newly released book, from the years 2000 to 2005, China's productivity increased by 63.4 percent, but meanwhile [inaudible] increased by 15 percent, and India's increased more than than 20 percent. But if you compare productivity in China with Korea, Japan. or the U.S., the level of productivity in China is still one-twentieth or even one-thirtieth of these other countries. That means that there is still great room for China to improve its productivity.

The second thing is that China is in a specific stage of rapid growth. If you look at the experience of Japan, Korea, and some other countries, when the GDP per capita surpasses \$2,000, which China just reached last year, there will be another relatively long stage for rapid growth. China's economy used to be constrained by the supply side – a shortage of capital, infrastructure, and technology, etc., but now China's economy is

constrained by the demand side. After China's GDP per capita surpassed \$2,000, there are two very strong pressures from the demand side. One is urbanization. In the past 5 years, the average urban to rural ratio increased by 1.4 percent every year, but still the total urbanization ratio is only 40 percent. The rapid urbanization will have a very strong demand for infrastructure construction, for housing, and for investment. Another thing is the desire to improve the quality of life of the urban middle class. If you look at the automobile market in China, the average growth rate in the past 5 years is higher than 30 percent. Last year China became the third biggest automobile market. Many middle-class families are purchasing their first cars and the number of middle-class families that are planning to purchase cars is even more. Also, the middle-class families want to improve. They want better, bigger houses. This is why if you go to Chinese cities you always see a lot of construction sites in the cities. This will continue at least 20 years.

The last thing is that the Chinese government has already fully realized the challenges we are facing and has begun to adjust its strategies and policies. Dr. Woo just mentioned that there are some new slogans in place. Actually, the new strategy in China is a scientific approach to development. The key words in the new approach includes domestic, consumption-driven development, resource- and energy-saving development, environmentally friendly development, sustainable development, balanced development, innovation, social harmony, win-win with the international community, and so on. It is evident that this is quite different from the strategy of before.

I don't have enough time to elaborate, but the implications of the development of China's economy are that it will bring both benefits and challenges to the world. That China will continue to provide primary goods, increase consumption supplies, prevent the increase of inflation and interest rates especially to the developed economies, and provide market access to the world are seen as benefits. The huge amount of foreign exchange reflows to the developed markets, especially to the U.S., to increase the supply of capital and also to promote the [inaudible] of primary goods that benefits a lot of developing countries. Also, China will play a more constructive and responsible role in global and regional arrangements.

The challenge is that the country needs to face the competition, to adjust its industrial structure or enforce competitiveness. Also the world's other countries need to learn how to deal with this rising China. There is also [inaudible] shocks that those who are in the bus are ready to admit a great newcomer, but if those in the bus realize that because of the newcomer the bus will be a new, modern, bigger, more comfortable bus with the greatest seating capacity, maybe the attitude toward the newcomer will change.

I would like to conclude my remarks with the following. China will continue its rapid economic growth in the coming years. It will bring both benefits and challenges to the rest of the world and the benefits will be much bigger than challenges. Thank you.

MR. CHANG: Before I invite the four panelists to discuss, I would like to raise one question. There are, of course, a lot of good things about the Chinese economy. Of course, there are also a lot of challenges encountering the Chinese economy. However,

Professor Long Guoqiang, the last speaker, suggests that there are three possible scenarios. One is collapse, one is slowdown, and one is to keep rapid growth. Professor Long is quite optimistic and says it should be scenario number three, that is, that China shall keep on enjoying rapid economic growth. So in general, the situation is very promising. I would like to ask the other three speakers what they think about the Chinese economy in general. Explain your judgment—do you agree with Professor Long or do you have another idea?

MR. WOO: Of course, I like to think that tomorrow will be a better world. However, I think there are things that China must do to help to make it so. Specifically, there are two things. One is that the world trade system, from which China has benefited so much, is under great threat. You can see that because of the entry of China, as well as of India and the former Soviet Union, the world labor force has doubled, so there is a lot of stress in the developed countries for structural adjustment.

What we do see is an unraveling of support for free trade. The strongest lobbying group for free trade in the world is from the economic profession. Alan Blinder has come out saying he doesn't think that free trade is such a good idea after all; it benefits the developed countries but not the developing countries. Paul Samuelson has come out in support of that idea as well. Most likely they are wrong, but the important thing is it reflects what they see of the suffering of the working class in the U.S. and the pressure of wages.

So is China doing anything to strengthen the global system of investment? The answer is that China has been very passive. Look at the Doha Round. It is stuck, and India is leading the charge to prevent it from moving forward. China has yet to raise its voice in pushing for the Doha Round to go forward. Now the U.S. is no longer as committed to free trade as before, for a very good reason. The United States made structural adjustments with imports from Korean, Taiwan, and Southeast Asia because these were U.S. allies in the Cold War against China. Now that the Cold War is over, why should the U.S. adjust as much? The U.S. commitment to free trade is unraveling, as you can see. The U.S. signed the Korea-U.S. FTA, but in general has shied away from bilateral treaties like that. The U.S. has always aimed for multilateral trade liberalization.

As the U.S. wavers, the Chinese have stepped up to the plate to push forward global multilateral trade deregulation. Let me address that specifically, not only on the trade front, but also on the global environmental front. For example, the world cannot grow without using energy. All this talk of running out of oil is quite irrelevant because there is enough coal in the ground to power us into the 22nd century. In addition, with modern processing you can turn coal into gasoline at \$50 a barrel. Basically the question is how to burn coal cleanly. From a global perspective, the cheapest way to burn coal cleanly is to put controls in the new plants and the new factories. Where will most of the new plants and factories be constructed in the world? Obviously China shouldn't be footing the bill on this for the rest of the world, because to put the cleaning technology into existing plants is very expensive. Here is a situation where China could take the lead in promoting investment in technological cooperation for burning coal cleanly.

MR. CHANG: Thank you. Do you think it will be a good scenario?

MR. WOO: When we study China, I think it is a given rule that we do not give casual predictions. That's the unwritten rule when we study China, not to give a casual prediction. This is because in doing so, many, many researchers have actually hit upon landmines, so the history of China has been quite difficult in that regard. Also, some people tend to forget their previous remarks and make totally different remarks later.

But when we are asked this question what kind of analysis can we provide, I think that is what I will be able to share with you. In other words, when we study the current China's presence, I talked about how important China is. When we talk about the importance of China and despite the fact that we consider China being very important and despite the fact that there is remarkable growth in China, at the same time they are faced with a tremendous set of problems. Chinese economic stability is important for the global economic stability. If that is the case, then these signs of dangers must be eliminated one by one. That is important. So alleviating such signs of risk one by one, I think I have tried to identify what some of those signs of risks were. So in other words, one cannot be totally optimistic about China. That I believe is the trend. At least over the long-term that is the case.

What can be done right now? In a period of transition there is a certain set of factors one must bear in mind, which I have tried to identify. One such factor relates to the political structure and system. I would imagine that in the very final phase, China will proceed to full democratization. What is required along the way? I have tried to share that with you in the course of my comments.

Perhaps it was by pure chance that I do not want to make a casual prediction. Still, I think about the Beijing Olympics. Even that discussion is a representation of the sense of uncertainty people have about China. But we have to work with China. Our economies have to be vitalized alongside the Chinese economy. That is the reality.

MR. CHANG: Thank you.

MR. HSU: China certainly faces a lot of challenges. As I said earlier, there are serious environmental issues. In some parts of China it is becoming very, very serious and it will take tremendous effort to change the situation. There is also the imbalance of regional growth, as many people have mentioned.

I would single out two danger areas. One is related to socioeconomic stability. I think a government figure stated that in 2006, there were more than 35,000 incidents of local protests in China. Some of the local protests involved violence and people were killed by the police. I think this social instability is caused by many, many issues. One of them is the imbalance of income and rural society's problems. This area requires a lot of work.

The second danger area is that China really needs a genuine local private sector and a local middle class. Of course, you can do a lot of statistical analysis, all of which would indicate that proportionately or percentage-wise, the so-called middle class only occupies a very small percentage of the population. When we talk about increasing the local consumption power to boost domestic markets, we should remember that consumption power relies on a strong middle class, which we have witnessed in other developed countries such as the United States and, to a smaller extent, Taiwan. The affluent middle class actually provides real, genuine stability in society, so in that area, China needs to do a lot of work. So I think there are a couple of areas of real concern.

MR. CHANG: Thank you very much. I would like to open the floor to questions. Are there any questions you would like to discuss with the speakers or would you like to express your views to us? The issue we are discussing is a sustainable Chinese economy and its impact on the world economy. Are there any questions?

ALEXANDER VORONTSOV: My name is Alexander Vorontsov. I am from the Russian Academy of Sciences and was a Brookings CNAPS Visiting Fellow in 2005-2006. Thank you so much for your very helpful, well-grounded reports.

My question is this. There is a point of view among many experts that the 2008 Olympic Games in Beijing will result in economic disparity that will override the nation's mobilizing inspiration to host the Olympic Games in the best way possible. After the Olympic Games, this social and economic disparity and possible social unrest could aggravate and even remove the stability in the country, seriously effecting its economic rise. What is your attitude toward such an evaluation, and how would you assess this possibility? Thank you.

MR. CHANG: Do you want Professor Long to answer the question?

MR. VORONTSOV: Maybe, yes, the Chinese representative may be a little better.

MR. LONG: China is facing a lot of challenges, including the problem you just mentioned, Alexander. I think China is different from other small economies because China is such a big country, so the Olympic Games' contribution to the growth of such a big economy is very limited. Even after the Olympic Games, perhaps the growth of investment in Beijing might slow down because investment in the infrastructure increased very rapidly to meet the demands of the Olympic Games. But if you put it into the context of the whole country, the impact will be very, very limited. Plus, they have taken into account the social unrest. I don't think that people have any dissatisfaction with the government just because of the Olympic Games, so I think the Olympic Games will have no impact on China's social unrest.

MR. CHANG: Are there any other questions from the floor? I would like to ask all the speakers to give final remarks on these topics.

MR. WOO: It is very easy to use the past to predict the future. However, that cannot possibly be a persuasive strategy because there would be no turning point in history. Therefore, simply to say that Chinese growth has been highly successful in the past and will continue along that particular path is of course very possible, but it would require China to undertake some very dramatic reforms in order to keep growing. In particular, the other speakers have talked about social order and changes in institutional structure, and obviously one point is that the state must be more responsive to the expectations of its citizenry. I think this is why a harmonious society is similar in description to a democratic society under the rule of law.

Now the question is, will China be able to undertake these difficult reforms because it will require a free press and an independent judiciary system, in addition to free elections? I think that, yes, the future could be a glorious one, but it needs a lot of hard work, not only within China, but also in keeping up its relations with the rest of the world, in particular to prevent trade wars and squabbles over international environmental questions.

MR. CHANG: Professor Kokubun, please.

MR. KOKUBUN: When we consider the state of economic development between Japan and China, we must think of the year 1964, when the Olympics were held in Tokyo. I think the Tokyo of the past shares some similarities with the China of today. Some might say that China is now at a stage where the Japanese were some 20 years ago, during the oil crisis on the 1970s. Some say that, no, China is very much like Japan was immediately before the Plaza Accord in terms of foreign currency and foreign exchange. Even Korea went through a process of democratization prior to their Olympics, so 1988, there are many parallels that one can draw.

However, we have to consider the China of 2008 in its own context, which is the context of globalization. It is true that China is a very large country, but it also faces different historical factors faced by all the countries. So China, one nation, is faced with many different factors that many different countries experienced all together. So in other words, they have not gone through the series of historical phases. It is necessary that they establish its institutions one by one. The key is finding how we create a capitalist-based market in China. Thank you.

MR. HSU: I would like to make two somewhat philosophical remarks. The first is that it is no fun being a great power in the world. I think the United States is experiencing that, and I think Chinese leaders should also think about that a little bit. To become a world power, a country must take on a lot of responsibility and many burdens, so there should be no rush in China becoming a world power. Rather, China should focus more on creating a harmonious society.

But that leads to my second remark. I think China has developed to the stage now to really consider relaxing a little bit on freedom of speech, freedom of expression, and to provide the Chinese people with a more relaxed lifestyle. I make this comment because I

live two lives: when I visit China and stay there running a business, and when I stay in Taiwan. When I compare the two lifestyles, I think China should be confident enough to relax its controlling of speech and publications and all that.

MR. LONG: Although I am optimistic about China's economic growth, as a Chinese citizen I would like to emphasize the challenges and difficulties we are facing in the coming years. We need to do a lot of things to deal with all the challenges. In the past the institutional reforms mainly focused on economics. In the future we need to shift the focus to political and social aspects.

Another point I would emphasize is international cooperation. A rising China is not a threat to the world. Both China and the rest of the world can benefit from a prosperous and stable China. Thank you.

MR. CHANG: Thank you very much. We talked about a very substantial topic, a sustainable Chinese economy and its impact on the world economy. Because it was such a big and challenging topic, I think we ran out of time. Despite that, our distinguished panelists gave us a tremendous amount of insight for further discussion and progress, so we are very grateful to have had such a productive dialogue during this session. Could we please give a very warm round of applause to our panelists? Thank you very much. We'll see you back at 3:00.

[Recess]