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WILL CHINA LEAD THE GLOBAL ECONOMIC RECOVERY?

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P R O C E E D I N G S

MR. PASCUAL: Good afternoon. My name is Carlos Pascual. I'm one of the vice presidents of Brookings, the Director of the Foreign Policy Studies Program here, and it's a great pleasure to invite you -- or welcome you to this session that we are having on Will China Lead the Global Economic Recovery.

It is a session that is jointly sponsored by the Foreign Policy Studies Program and within that program the China Center and as well the Center for Northeast Asia Policy Studies and our colleagues in the Global Economy and the Global Economy and Development Program here at Brookings.

This issue on China's economic recovery is both a fascinating and a challenging one. It's useful to begin by putting it in context. We have to recognize first that China has grown to where it is today both economically and politically because of its engagement in the global economy, and China may be, more than any country in the world or at least as much as the United States has been, a beneficiary of globalization, and its willingness to engage in markets both in access to capital and technology as well as taking advantage of those global markets for the sale of its products has lifted hundreds of millions of people out of poverty and has been a central factor in China's rise as a political power. It's also true that the global economic recession that we have today inevitably has affected China economically -- China's economics and its politics internally. It is placed on the order of 20 million people internally. That has had both a political and economic impact on China. And so one of the questions that inevitably arises is where does China go from here and what are the prospects.

There was a period of time not that long ago -- perhaps a year ago -- that people began talking about the concept of decoupling, that we could have an economic recession or slow-down in the United States and that countries like China could become decoupled from that. In part, that theory has been put aside, and we've already seen what the impacts of the American economic recession have been on Europe, on China, on other parts of the world. There are some who have started to argue that in fact there can be a different kind of decoupling, that you can have in fact the rise of China and the recovery of China without necessarily the corresponding rise in other parts of the world, and one has to begin to wonder well, if that's the case, on what basis does China have that economic growth?

And here we come back to questions that we have to consider. One of them is inevitably China's own economic stimulus package, the $580 billion-plus package that has been put on the table and has been used to invest domestically. Inevitably, that has had some impact. There are questions of how much of that is new money. There are questions about what the long-term impact is going to be, because, just like the United States, if you want to spend that money quickly, you end up spending it inevitably on the existing infrastructure and plans that you have. And so how much of those resources in fact actually prepare China to compete in that future economic system?

There are questions that people have on whether China is going to take this situation and continue on its global perspective. Some would argue that China fully recognizes the fact that it grew economically because of its engagement in the global economy, and so will it in fact continue with the same kind of aggressive approach toward its engagement in globalization?

There are some who will argue that China inevitably will take a more conservative stance because of its domestic concerns, that it doesn't want to have the kind of internal instability that might be linked with linkages to a global economy and so are we going to see changes in China's internal politics and economics?

And then of course there are questions that arise regarding the neighbors or in fact those that are part of China yet a neighbor in a sense -- like Hong Kong, which is already beginning to ask itself the question can it survive as a vehicle for exports from the Chinese economy, and increasingly you see within Hong Kong firms that are trying to establish themselves and their future on the basis of redirecting investment into China for China's own domestic consumption and economic growth.

And it's this whole set of questions which I think has so many people both interested and concerned because China indeed has become so big, and as a result of becoming so big one of the questions that we have to also answer is what's China's role going to be in the governance of a future global economic system? We have already seen that China's capital is absolutely fundamental and necessary, not just for the United States but for countries like Russia and Brazil that have relied on Chinese financing for the development of their own oil and gas resources. And it is inevitable that if China is going to play this major role in world governance that it's actually going to seek a greater voice in the governance of those institutions. And so what kind of function is that going to -- how is that function going to play itself out? We have already seen one Chinese proposal floated at least in some semi-official sense for the concept of moving away from the dollar as a reserve currency and the diversification into other forms of reserve currencies.

So, these in fact are some of the critical questions that are at play today and that we want to be able to get at in this panel. And in doing this, we have an extraordinary team to be able to work with us in doing it.

Moderating the discussion today is Richard Bush. Richard is the Director of the Center for Northeast Asia Policy Studies, has been someone who has been actively engaged in the politics and economics of the region for quite some time.

Giving initial presentations today we're going to start out with Xiao Geng. Xiao Geng is the Director of the Brookings-Tsinghua Center in Beijing. We are quite lucky to have him as the face of Brookings internally within China, and he has turned that Brookings-Tsinghua Center already into a central convening point of the Chinese economic and financial community.

Following Xiao Geng will be Eswar Prasad. Eswar until recently was the chief economist on China at the International Monetary Fund. He is a Senior Fellow here at Brookings in the Global Economy and Development Program. He is also a professor at Cornell University, and we're lucky to get a significant portion of his time here at Brookings.

Then we will have Cheng Li. Cheng Li is the Research Director of the John Thornton China Center here at the Brookings Institution. He is also a professor at Hamilton College.

And closing up in the presentations will be Dennis Wilder. Dennis is a Visiting Fellow with us at Brookings. Until recently, he was the Senior Director and Special Assistant to the President in Charge of East Asia at the National Security Council and was one of the most highly regarded analysts of China in the U.S. government for a period of well over 20 years.

So, an extraordinary group to take us through this discussion.

And, Richard, I will -- should I turn it over to you or do you want to just go directly to the first speaker?

MR. BUSH: Let's go to the first speaker.

MR. PASCUAL: Then I will turn it over to Xiao Geng.

And Xiao Geng, please.

MR. GENG: Thank you.

Well, I just got back to here last night, so I just want to share a little bit about the sentiment in Beijing. I think there has been a consensus now that the Chinese economy has (inaudible) and virtually all indicators show that the economy actually has started to grow again. The property market has stabilized, and so the really only worry in Beijing right now is the external sector -- you know, the exporting and the (inaudible) along the coast. They are not getting as much orders as before. Some of them just have no orders at all from the United States from United States, you know, and so really last Friday the State Council made a decision to encourage the exporting sector and actually want to make sure that China has -- will be able to maintain its market share in the exporting market. But that's a very important indicator that (inaudible) is extremely worried about the external sector.

By the way, you know, in the last few months, the State Council of China every week will convene their meeting -- the State Council meeting -- and almost each week they made some major announcement in reforming the Chinese economy, and this practice started sometime, you know, after the global financial crisis. And if we're looking back, there are some major decisions. For example, the decision to (inaudible) Shanghai into an international financial center by 2020. There has been also, you know, to maintain -- to actually -- international financial center compatible with the role of Chinese currency, RMB.

And just two weeks ago, the State Council made a decision to allow the foremost special economic zone, Shenzhen, to experiment integration with Hong Kong in the financial and other economic development. And also just three weeks ago, there was a decision to make a very comprehensive structure reform, you know, in the Chinese economy. So, the State Council in China has been very frequent in making these reform decisions.

And let's go a little bit back, you know. You know, the economic -- the crisis in China and the crisis in U.S. -- they are a little bit different. If you look at the Chinese situation, they were virtually no -- there are no -- virtually no problem in the financial sector. The banks are very healthy right now compared to any time in the past. And the problem happened in China was actually before the global financial crisis, before October last year. About a year and a half ago, the Chinese market collapsed from 6000 to 2000. If you look only at this collapse, it's actually most years than what happened in the United States. And the problem market also collapsed the same time. So, what happened in China was because of the Chinese monetary policy -- fiscal policy -- a year and a half ago was targeting inflation problem trying to control inflation and that the tightening of money (inaudible) so much that it hurts the real economy. So, there were bubbles before, maybe two years ago in China, because of this -- you know, for whatever reasons there were property bubbles, something like a bubble. But it was collapse well before the global financial crisis.

So, the global financial crisis actually gave China an opportunity to make a 180-degree turn in its monetary and fiscal policy, and that's why you can see that the Chinese authorities that made very decisive decisions to stimulate economy before chilling R&D stimulated policy was announced just, you know, right after the October crisis I said in November. So, and that the effects actually are quite good in stimulating -- I mean the major investment are in infrastructure and also the reconstruction of the earthquake area and some other, you know, areas.

And the -- what happened in China -- when the government decides to have -- to use all this as a stimulus package that banking sectors reacted, they needed it almost immediately. The practically expended it very fast. And so far so that the Central Bank and also the Banking Regulatory Commission are starting to watch closely the quality of the loans and also trying to slow down the expansion of credit.

So, throughout there were no problems of confidence. And the only really concern is really the (inaudible), which was brought about by the collapse of the exporting sector along the coast, because the exporting sector -- they basically use the so-called migrant labor -- a lot of migrant labor. So, although the value in the exporting sector created is not so big in terms of GDP but employment is very, very big because those employees and the migrant workers, they only earn $120 a month. So that becomes a very serious social concern. And the government was paying a lot of attentions to it.

And another I think dimension is that because of the global financial crisis, the government start to look very closely at its international financial positions, which means it's holding of dollar assets, and there was a lot of unhappiness, you know, among the social groups and they also worry about the future, the global financial systems. But on the whole, I think the Chinese economy probably would be the first to recover from the global financial crisis.

The major challenges to the Chinese policymakers is this -- what I would summarize as, you know, there might be enough stimulus but there may be enough reform, and the reforms I mention here is -- they'll become and actually started a lot of reform, but I think in two areas the reforms are still lacking, still can do more. And the first area is the, you know, what I call the sector market stabilization. You know, in China, manufacturing sectors in China, they are benefiting tremendously from low prices of land, electricity, water, and always natural resources; and as a result, this attracts massive investment and over capacity in the manufacturing sector and also leading to very low prices for made-in-China exports. And that I think is actually a problem, because it cannot be sustained. And China needs to reform the sector market prices so that it will reflect the true economic cost, especially by taking into the damage to the environment and also the high energy intensity.

And the other reform is related to what we call today consumption. Yes, consumption in China is very low. Household consumption only occupies 36 percent of GDP. Extremely low. So there are a lot of inefficiencies. For example, lack of insurance. All the families have to have big sum of money to prepare for, you know, medical incidents. And also they are not very much in consumer financing. But more important is the income. The income -- a lot of income in China actually resides in the state-owned enterprise and the government. The government taxation, you know, which was growing 30 percent a year in the past, and the state-owned enterprises, they do not pay dividends. So, the income, which does not go directly into individual household, and that of course would affect the consumption. And I think that China should actually (inaudible) reforms privatization of state-owned enterprise and also privatization of a lot of natural resources including land. And that way it would increase the income and the wealth of private citizens in China, and that would really generate income and (inaudible) power.

And so these two areas of reforms are under discussion in China, but there has not yet been major decisions made. I think otherwise the Chinese economy itself is actually working quite normally, not like here in the United States and other part of the world. You know, people still worry about when to recover (inaudible). And in China the situation is that -- the question is how better China can grow instead of, you know, whether it will grow or not; and, in fact, it is growing already (inaudible) percent a year, and the aim is actually 80 percent, and I expect the Chinese economy probably will grow between 7 and 8.

I will stop here.

MR. BUSH: Thank you very much, Xiao Geng.

Those of you in the back, there's lots of chairs of up here in the front. if you want to sit down, you have a better view.

We turn now to Eswar Prasad to talk about China's role in the regional and global economy.

Eswar?

MR. PRASAD: The Chinese and U.S. economies are fundamentally different. When President Obama says that the U.S. economy is going to recover in the latter half of the year, it's a hope and a prayer. When the Chinese Communist party says the Chinese economy will grow by 7 percent per year, you can bet it's going to be a fact. It's not because the numbers are cooked but largely because of the very effective management of the system and because of other facets, including the fiscal virtue of the Chinese in terms of a very low fiscal deficit, in terms of a very low level of the debt. They can actually push things through the system plus of course of the fact that the banks are state owned. It's a very helpful fact when there's a financial crisis that is sweeping through the globe.

But what is really the concern is not the bottom line in terms of GDP growth, but what lies behind the bottom line, and then (inaudible) argue there are some tensions. They were looking both the Chinese economy and these eventually are going to have ramifications, because China is now an essential player on the world stage.

(Inaudible) has actually (inaudible) to the (inaudible) in some ways already. The problem is that the stimulus package is a very effective on in terms of pumping out credit through the bank system, which is largely state owned, into investment. The problem is that this perpetuates a growth model that China has already been struggling to change for a while. Essentially bank-financed investment goes to the large state enterprises, which have been getting for a long time very cheap capital and, as he mentioned, a lot of complementary factors like land, energy, and so on, which are provided at highly subsidized rates. So, although this is an economy that is struggling with very low employment growth, all the incentives in the system, through the formal financial system, are still heavily tilted toward investment-led growth, which is why investment has accounted for more than half of GDP growth during this decade. In fact during the period '03 to '06 it was close to two-thirds.

Now, investment is an important part of the study, but it does (inaudible) become a very important part of the study, especially in the last three or four years. (Inaudible) especially important in terms of when it comes to job growth. Now, China is an economy that has been growing at an average of rate of 10 to 12 percent over the last decade or so, and during this period net employment growth has been about 1 percent of GDP. Now, this was not all for the wrong reasons. In terms of part of this is because you've had a lot of state enterprise restructuring and overall a hardening of budgeting constraints from the state in crisis. So, there have been large amounts of people being laid of in the state in the crisis. But still, this is an economy that is not set up to soak up large amounts of labor into productive employment. So, that is the challenge that is still faced by the Chinese economy.

Now, as part of the stimulus package, a couple of things have been done in addition to bank credit. There has been an emphasis in trying to shift the growth market towards increasing private consumption, and again, as Xiao Geng mentioned, the private consumption is constrained by a number of factors including the low level of income going to labor as opposed to capital, the fact that the financial system is not very well evolved; and the fact that there isn't a very good social safety net. But it's not very easy in the short run to build up an effective social safety net. It's not very easy in the short run to reform your financial system and to get the financial system (inaudible) credit -- the small- and medium-size enterprises -- which can generate much more employment growth. So what has happened is that the industries that were getting a lot of investment and where there was already excess capacity building up are now going to have even more excess capacity building up. So, now you face a sort of classic problem where the Chinese economy has been able (inaudible) growth largely through investment, but it desperately needs to export still in order to export the spare capacity that is building up in droves in many industries and to generate employment growth. And then you look around the world and think about which part of the world is in a position to absolve these exports. Is it Europe? And it doesn't like it's going to be Japan. So ultimately it looks like in a very paradoxical statement the epicenter of the crisis, the U.S., is still seen as the part of the economy that is likely to be able to lead the rest of the world.

In my review, economies like China and India, the large emerging markets, can hold their own together very well, and this is where actually there is a facet of decoupling that's important. It's these economies that slow down -- they are facing tremendous challenges. But they are still able to keep growing at pretty good rates. The problem is that they're not going to be able to absorb imports, because they've not been able to harness domestic consumption, especially China, very effectively, so they cannot be engines of growth for the rest of the world economy. So, they're still going to be looking to the U.S. to be the engine, so I can immediately see attention already developing here, because in the U.S. by contrast the problem of course is that we had the private sector that had its balance sheets devastated by the financial crisis because of the loss of wealth. And now, of course, the household saving rates (inaudible) essentially zero percent of disposable income to about 5 or 6 percent. The government is of course trying to pull its weight, but there is a limit to how much we can do, and they're already beginning to see those limits coming into consideration and tensions being created in the bond and currency markets. So, (inaudible) pay the private consumer and the U.S. is going to have to step up and do what we did, telling the private consumer in the U.S. not to do, which got us into all this trouble to begin with. And so this is ultimately going to lead to a significant amount of tension on the world stage, and of course given that the U.S. and China are the key players, this is going to lead to this very specific tension between these two countries that ultimately is going to have implications in terms of setting the goal for a variety of discussions on the global front.

The problems of these two economies are very closely tied together. It's as I characterized -- I said almost a death embrace in the sense that they cannot let go of each other. China still needs the U.S. export market and in addition China is going to continue accumulating reserves, perhaps at a slower pace in the next couple of years, but its growth model almost inadvertently will lead it towards (inaudible) orientation exports, and even if large amounts of capital don't come in there will be reserves that get accumulated and there isn't much of a place to put them other than in U.S. Treasuries right now.

Xiao Geng mentioned the Chinese are very aware of what this implies in terms of potential losses on the holdings of U.S. Treasury bonds if in fact there were to be an inflationary surge in the U.S. because of a rise in deficits and a large amount of quantitative easing if the Federal Reserve cannot pull this back easily once the economy starts to recover. But what choice do the Chinese have right now? Not a great deal. Perhaps they can put some money in IMF bonds, but that's a few tens of billions of dollars. The Euro and Japanese economies don't look terribly good, so really there isn't much of an alternative to the U.S. And of course the U.S. (inaudible) right now that it's financing the (inaudible) as its budget deficits loom are going to be enormous. It's not like China is a critical player in the U.S. Bond market, because, after all, the amount of Chinese (inaudible) accumulation and the amount that's going into U.S. Treasury is not a very large fraction. But it is substantial enough, and at a time like this when sentiment when bond and currency markets is very fragile. But precipitate movement by the Chinese could in fact set those markets aflutter, because they're already very nervous, and the last thing the world needs right now is much more currency and bond market (inaudible) more than the U.S. because it just things a lot worse. So, these two economies are going to have to hold it together to make sure that the system doesn't come apart at the seams like it could seem to be very close to doing recently. Of course, (inaudible) off to China next Monday, so there will be I think very interesting discussions, but what is essential right now is that collaboration between these two countries really needs to develop into an equal partnership. In the past there was this notion of the U.S. essentially telling China what to do. The Chinese recognized this very well, and in some cases the external pressure may not have been very helpful; in some cases it may have. But I think an equal partnership where these two countries recognize that they both have both very important roles to play I think is going to be critical for international financial stability. A grand bargain between these two countries I think is essential in order to stave off pressures from the domestic political (inaudible) as well.

So, what could the elements of a grand bargain could be? The U.S. could commit to a plan for medium-term fiscal consolidation once the economy starts to recover and an exchange. China could acknowledge the inevitable that its currency has to appreciate, not by a huge amount, not in the short run, but increasing flexibility of the exchange rate or something they need themselves in order to have a better monetary policy, in order to push forward financial system reforms. Now, both of these issues are very difficult to send to domestic political (inaudible) unless they can be packaged as part of a grand bargain, and another element of the grand bargain could be whether U.S. actively promotes a greater role for China and other emerging market countries in the important multilateral financial institutions, especially the IMF. And this will get China its rightful place on the world stage, which it clearly seeks, and (inaudible) for its views. And this I think would give the Chinese leadership the sort of cover they need in order to push forward.

Now, even at a time like this when the U.S. financial system is imploding, I think there is another very interesting element that the engagement -- that could come up in the discussions between the Chinese leadership and Secretary (inaudible) next week, which is that the Chinese used to aspire to the U.S. financial model. They did not like being pushed by the U.S. towards opening up their financial markets or liberalizing their financial system very quickly. But they did aspire to that. Right now it's not clear what they aspire to, because the U.S. model seems to have broken down. The alternatives like the U.K. regulatory system seems to have broken down, so what is the model? There is tremendous interest in Beijing in terms of understanding what it is that is coming out in terms of an intellectual framework for financial regulation in the U.S. And this I think is essential because ultimately this is of the (inaudible) of the Chinese (inaudible) process -- getting the financial system working -- because in order to improve the long-term productivity potential of the economy, in terms of rebalancing growth, and in terms of improving the welfare that is (inaudible) by the growth that they have right now. Financial system reform is really crucial, and of course in the context of China, financial system reform does not necessarily mean moving towards very sophisticated financial innovation. But it's the very basics, like getting the banking system working much better in terms of developing a broader set of markets, like the corporate bond markets, in terms of (inaudible) derivatives, like currency derivatives working very well. And here there's a real hunger in fact for technical knowledge about how to do this. And here again there is a potential for engagement between China and the U.S. But ultimately these two economies are going to have to get it together and develop a much more beneficial and cooperative relationship getting beyond narrowly focused issues like the bilateral trade balance or the bilateral issues related to the currency in order to make progress, and ultimately this relationship will set the tone for a lot of multilateral discussions in which China and the U.S. will play critical roles, including climate change, (inaudible) reform, and a whole lot of other things.

MR. BUSH: Thank you very much, Eswar.

Eswar's presentation and Xiao Geng's before it I think have made very clear that there are tensions in China on policy approaches. There are ways that institutions could be strengthened. All of those decisions get refracted through a political system that's dominated by a very small group of 35 people around of individuals at the top of the Communist Party hierarchy, and to tell us about that is our guru of Chinese elite politics, Cheng Li.

MR. LI: Well, I think it is fair to say that political dynamics is as important as economic policies when we talk about the stimulus plan.

Now, I want to address three questions. First, what are the political tensions, as Richard mentioned? Political tensions or political divides being Chinese -- in China, concerning stimulus plan. Second, what are the most important (inaudible) or mechanisms that the Chinese leadership uses to deal with these tensions or divides? And thirdly, what is my assessment of China's economic recovery and the political stability?

Now, first, political tensions and divides. In my observation, there are six divides in present-day China. There's divides in top leadership; there's divides among (inaudible) leader; there are divides among policy advisors, divides between provincial officials, divides among social classes, and finally divides among economic interest groups. Now, these divides can be listed largely if not entirely in two vertical columns. Now, let me very briefly just list each of them. Now, the first, the national leadership. As we know, China is a one-party state, but it does not necessarily mean that the Chinese leadership is a monolithic group, a group of people with same views, values, or policies. In my view, there are two things (inaudible) time (inaudible) emerges of two informal and equally powerful coalitions competing for power, (inaudible), and (inaudible) initiatives within the Chinese leadership. This is what I call one-party, two coalitions. Borrowing Xiao Peng's famous line, one pot, one (inaudible), two systems.

Now, the first group of coalition is what I call elitists. The core group is "the princelings," a (inaudible) of high-ranking officials. Their coalition was established by Chong Xiaoming and Zeng Qinghong, former president and vice president of China. Both of them come from Shanghai, both of them are princelings, currently led by Channel of National People's Congress in Banglor and the Channel of the CPPCPPCC, and actually you probably sell them for their names, but their (inaudible) in the bank is number 2 and number 4 in China's top leadership, and this group will assume that by two (inaudible) stars is called fifth generation, namely Vice President (inaudible) and currently Vice Premier (inaudible).

Now, the other hand is the coalition what I call populist coalition led by President Hu Jintao and Premier Wen Jiabao. And this group -- the core group of this coalition is so-called fund pie. The Chinese (inaudible), because most of them stop at their (inaudible) and use (inaudible). They want (inaudible) leak officials at the province and (inaudible) level during 1980s and Hu Jintao was in charge. And that coalition will soon, led by two Li's, you know, Mr. Li Vantao and the Mr. Li Coutao, and currently when he is -- Li Coutao is exactly vice premier and the events how is the CCP organization Department, and he probably will come to Washington pretty soon.

Now, let me move to second division. I would talk about the policy differences. We would talk about other groups.

The second is opinion leaders. One is the so-called liberal mainstream economists. These people (inaudible) Chinese economic discourse for almost two decades, but now they become increasingly discredit in Chinese public, because their, you know, kind of favorite abuse or obsession with mock the transition or mock the liberalization become problematic in today's work. And so if you look at -- go to Chinese bookstores, you will see some other books, usually written by now mainstream economists, become very popular. These people previously call the so-called new left. The inflexibles criticize the side effects of economic reform, talk about we should not be too naïve with economic (inaudible). And also another group, the so-called and usually quite young or relatively young, called angry youths (inaudible) in Chinese. You know (inaudible) famous book about 10 years ago that China can say no, or what's the other one, the recent -- *The Unhappy China*. There's the other two scholar book -- or semi-scholar books. One is called *Currency (inaudible)*, published three years ago -- basically predicted (inaudible) financial crisis. It's a (inaudible). Unfortunately it happened to come true. The other book is called *What China Can Do* by (inaudible), all very popular if you look at the hit rates in the Chinese website by economists. These are the populist economists that got high, you know, hits. So, that's another division.

Now, the third division is policy advisors, those people that are close to top leaders. The one group is the (inaudible) educator

Chinese nationals. Chinese have a term called "sea turtles," because (inaudible) educate nationals (inaudible), you know, with the sea turtles, so we call them sea turtles.

Now, the other group is called -- the Chinese have a term (inaudible) people. They also have a new term called (inaudible) local turtles. You know, local turtles was a sea turtles. If you have better translation, please let me know.

Now, the sea turtles criticize populist leaders, publicly criticize Hu Jintao and Wen Jiabao for two major policy mistakes. One year they think that these people, the top leaders, used, you know, their policy particularly macroeconomic control policy, which is part of 2004, until August of 2008. It's problematic, because it's really like a 180-degree shift. (Inaudible) still want to slow down economy, slow down the growth rate, but all of a sudden (inaudible) we should really keep a very high growth rate. This is one policy they criticized these populist leaders.

Now, another policy the sea turtles criticized is the so-called labor law. They believe the Chinese government, particularly these populist leaders, prematurely adopt the labor law so as (inaudible) because of the labor law there was obligations. There's a huge layoff in the foreign companies and also private sector, etc. So, really not to really protect these labors but that they hurt them. So, this is criticism from sea turtles.

Now, land turtles also have two criticisms. One is they think that those economic policymakers because these elitist princelings usually in charge of China's economist policy, (inaudible) making progress. You look and the vice president (inaudible), the (inaudible) people (inaudible), and the (inaudible). And one thing in common. They are princelings. They are part of the elitist coalition.

Now -- so, criticism from a land turtle, a local turtle is that these turtles is that people really their policy is too pro-West. Their military policy went terribly wrong. This is when (inaudible), particularly you invest so much -- of course you can say that's a new opportunity, but again still people criticize them.

Second criticism is that the sovereign wealth fund, the CIC, led by another, you know princeling (inaudible) and by sea turtle (inaudible) went terribly wrong. You know, they supposedly (inaudible), you know, market. But each and every investment -- it's big failure. But one thing it's really -- it's not, you know, (inaudible). They even invest the black stone, but black stone (inaudible). So, that's become a (inaudible), because, see, the (inaudible) have to (inaudible) website. I don't want to (inaudible).

The fourth division is (inaudible) the provincial leaders. This, on the one hand, is the leaders, particularly in coastal region, where they call them from China (inaudible). The other is the leader from England, particularly in (inaudible). Of course we can call them from China's (inaudible) states. The compete for policy initiatives, favorable policies, (inaudible) dynamics. Now, (inaudible) about the Shanghai, and, you know, it's a new plan for Shanghai. But, you know, things that (inaudible) Kim to power in, you know, 1989, particularly this wealth in 1990. Songha had a very fast rate of growth, and all the power -- frame of policy flowed through Shanghai, but the things in 2002 when (inaudible), the (inaudible), (inaudible) power. Shanghai's, you know, (inaudible) policy all gone. Previously, the land lease, which really helped Shanghai leaders become less and less important. So, look at the GDP growth, particularly in past 12 years and this first quarter among China's 31 provincial-level entities. Shanghai's GDP growth rate was at the very bottom, 3 percent. The high (inaudible) in the North, and (inaudible) in the West. But now the wind is about to change direction again. It's highly likely we'll go back to Shanghai with favorable policy again, so (inaudible) come to the financial center and the shipping center (inaudible) and also the incoming tax break we're also giving to people in Shanghai.

Now, the sixth division is the social classes. One is the middle class, including entrepreneurs. This -- very much concern about the stock market and the real estate market is a the concern about the real estate bubble and try to maintain the high rate for the real estate development. But on the other hand, you know, (inaudible) concern about the unemployment of the new college graduates. You know, one woman or two women could not find jobs (inaudible). These college graduates are middle class people. And also concern about the income tax. This tax is really too high.

Now, the other group is the (inaudible) group the Chinese call (inaudible) group or (inaudible). This includes farmers, migrant workers, and urban poor. And affording (inaudible) policy, particularly like every culture break, tax break, and also social where the system, more favorable policy for the migrant workers and low-income housing. Yeah, oh, you know, getting to that kind of (inaudible) social groups.

And recently, there's some policy ships I will mention just to let you -- and the sixth and last group is the economic interest group. On the one hand is the Chinese Black Collar. Black Collar. In contrast to Lack Color or broken Collar. This is referred to large monopolized companies. China's a major state only they don't (inaudible).

These (inaudible) people. Other people who dress in black, drive black cars, have secret income, live secret lives with concubines, and, most importantly, operate their business and power relations being opaque away. No transparency at all. So, that's right. A new phrase emerged called Black Collar people.

Now, on the other hand, in a small business people or small business entities, which can end transparency, can end fair opportunity and real market excess. Not market excess for these black, you know, collar people or princelings -- you know, really -- actually, in the end it's monopolize the market resources. So, that's a division.

Now, my second question. What are the most important mechanisms that a Chinese (inaudible) be used to deal with this political divide? Let me say very quickly. Based on three levels of leadership -- the national leadership -- they emphasize unity. They don't want to make the same mistakes like 1989 Tiananmen, show (inaudible) to the public. You always talk we're united together, it's very harmonious in the top leadership. At the same time, there's also clear checks and balances with the leadership -- is to look at each and every most important leadership bodies. They are equal at the body, (inaudible) numbers of people. You can look at my article in the Foreign Policy last issue. The title is "China's Team of Rivals." You know, look at the (inaudible) divides. How they divided. (Inaudible) American politics political slant in the team of rivals.

Now the second (inaudible) that policy is the mechanism -- is the (inaudible) to (inaudible) them, to transfer one to another place and to blur their formation divides for (inaudible) leader, previous (inaudible) to (inaudible) and also appoint (inaudible) former Minister of Commerce (inaudible) protégé to Chong Chi (inaudible) and appointed the protégé of (inaudible), a former (inaudible) of Beijing to be the head of (inaudible). Appoint another protégé to be the head of the agricultural minister. So, this (inaudible) to confuse people, try to blur this unclear divide.

Now, the third group, the local leaders, the policy is that -- punish them because of the accountability or what's called the responsibility. If they have a corruption problem or crisis, those people will be punished. (Inaudible) try to localize the potential social unrest, not make it nationwide. There's a famous line that says, you know -- to translate it into English will be very nice -- it's called "think nationally, (inaudible) locally."

Now, let me move to the third and final question regarding my assessment of (inaudible) recovery and the political stability. I want to make three quick points -- do I have time --

Now, these six divides would in fact, in my view, contribute to the economic recovery because a leadership will pursue a more balanced approach or balanced economic development strategy and will constantly adjust the economic policies as Eswar and Xiao Geng mentioned. Every week they have some new policies (inaudible).

And just for example, as we know, (inaudible). There's two versions. The first version is November 2008. The new version about March 2009. You will see two major changes. The spending on health care and the low-income public housing increased by 110 billion and 120 billion (inaudible) of these two areas. One is the health care; the other is the low-income housing. This is very much in line to adjust (inaudible).

Now, secondly, I want -- the second point is despite the public resentment against, you know, official corruption, monopoly of power or resources, and the serious challenges (inaudible) of unemployment, (inaudible) liquidation, resource shortage, and -- it's a long list. Despite all these things, China is in the rise, not in decline. We should make that very clear. I think probably for the United States, you know, in the national committee meeting last month I discussed the issue whether United States should worry about China's success or China's failing. (Inaudible) both. We should worry both in (inaudible) regions. But the problem now -- we should worry about China's (inaudible). Why? Because we are not ready to see (inaudible). And I remember that five years ago I listened to your talk in the (inaudible) IMF. I forgot the trace . You used a trace -- China's rise. That China (inaudible) was a prediction. But now as you join us this year, it's a fact. It's a reality. So, what's the next phase, you know. (Inaudible) a prediction for China or for the world, for other countries.

Now, let me also share with you some data. This is so important. You know, when China joined the BTO a few years ago, people in this country (inaudible) about the China (inaudible) projects would collapse. Chinese banks should -- commercial banks or state banks could not compete with the West. But now, early this year, the words "top 10 banks" (inaudible), you know, (inaudible) them (inaudible) are Chinese banks, including, number one, number two, and number three. (Inaudible) U.S. banks, including Citibank, Bank of America could not even make it to the top 10. So, this is one.

Secondly, I was in (inaudible) three weeks ago, four weeks ago. I visited the so-called (inaudible) deep water (inaudible). If you haven't been there, you should visit there. It's the (inaudible) established five or six years ago, and two or three years ago they built a bridge 20 miles long, the second largest -- longest bridge, sea bridge in the world. I just -- the first one -- the longest one also in China nearby in Hongdo (inaudible) 20 miles drive, then go to island. You see all these busy scenes, you know. Despite the problems with China's exports, they are still so busy. Now would (inaudible) contain the (inaudible) that contain the, you know, (inaudible). (Inaudible) of them located in China. Some of them of the top 10. No European ports, no American ports. The only port not found in East Asia is (inaudible), you know. So, that's the situation (inaudible).

Now, also again, (inaudible) yesterday when we talked about the Chinese (inaudible), you know, bad bank loans. Ten years ago in 1998, bad bank loans accounted for 40 percent of the total loan, last year reduced to 2 or 3 percent.

Now my last point. Now the divides also -- it's not just economic (inaudible), the six divides I mentioned earlier. They also give the other (inaudible) unhappy social groups kind of a hope or maybe illusion that someone, some leaders in (inaudible), China's headquarters, you know, leadership headquarters, may protect or advance their interest. They're still not completely hopeless. Someone will -- you know, wind will change, you know, change constantly.

Now, this dynamic in the leadership in the public thinking may provide a political safety zone for the country, so my prediction is the next few years (inaudible) the social stability (inaudible) and continue (inaudible) but eventually Communist party, the one-party system, will face some other challenges. But this will be something 10 to 15 years down the road not in the immediate future. I think now they have kind of an expiration. China's (inaudible) -- this kind of a thing.

So, I'll probably -- I finish here.

MR. BUSH: Thank you.

To talk about the U.S.-China economic relationship, we have Dennis Wilder, who was a key advisor to President George W. Bush. Eswar called the U.S.-China economic relationship a death embrace. Dennis didn't create that embrace, but he was certainly squeezed by it.

Dennis?

MR. WILDER: Thank you. If I seem preoccupied over here, I'm still working on two turtles and land turtles, and are the Republicans the sea turtles or the land -- anyway. We'll move away from that.

I think this is a fascinating moment in U.S.-China relations and one that is fraught with both, as we say, opportunities and crisis. First of all, Secretary Geithner is going to China on the 31st to hold his first meeting with the Chinese, and I think the key question at stake, and Eswar has talked about this and others have today already, is really what has changed in the U.S.-China relationship because of the financial crisis. There are some things that haven't, but there are some things that are dramatically different.

Now, some, including colleagues across the street I guess, have argued that it's a whole new ballgame in U.S.-China relations. Some people are now saying it's a G-2 that the U.S.-China relationship, given that the U.S. is the world's largest economy and China's going to become the world's second largest economy if it's not already there -- but that kind of exclusive embrace is not just an economic decision, it is a strategic decision, and I think both the Chinese government and the American government have to think long and hard before we embrace the concept of a G-2. First of all, is our relationship really at a point where the G-2 makes sense? After all, the United States for decades has said that the cornerstone of U.S. policy in East Asia is Japan and not China, and we have alliance relationships in East Asia with likeminded democracies. We in the Bush administration worked very hard to build the relationship with India, rebuild the relationship with Indonesia. I think that accepting a G-2 concept starts to eat away at what has been cornerstones of American policy in East Asia for a good long time. If people are really interested in going down that road, they have to understand that they are engaging I would argue in the greatest strategic shift in East Asia since President Nixon normalized relations with China.

I would also say that if we go down this road we are going to be disappointed. This relationship is not yet at that point. This relationship is maturing. There is no question that U.S.-China relations have moved greatly in the last 30 years to a new place and a very positive place, but we are not likeminded states at this point. We do not have similar economies, we do not have similar political systems, and we need to keep that in mind. But there is a lot in the current situation that is very positive. For example, during the last presidential election there was no fight over China. That's a good thing. We have had some bruising and awful fights in the American political system over China that have ended up making presidents take very, very strong positions in China early in their administrations that then they had to ease back from when the reality of the fact that you have to have an engagement policy with China came to the fore. No one in the American political system now after this current political crisis or this economic crisis doubts that engagement with China is important. I'm not hearing a lot of those kinds of voices.

What has changed is that as Eswar has talked about, the model for U.S.-China economic relations has to change. No longer will the American consumer be engaged in binge spending on low-cost Chinese goods. Let's face it, this is good for us. It kept inflation low. We all shopped at Wal-Mart. We all bought the $40 DVD players made in Shungun and up in the Pearl River Delta. We kept our inflation rates low and we benefited from a consumerism, but does this change mean that the American marketplace is going away for the Chinese? Hardly. What we're talking about is the American marketplace coming back to a point but never coming back for the Chinese to that incredible growth rate that they saw in the past few years, and they're going to have to adjust to that. As Eswar said, that may be tough for the Chinese.

And if the U.S.-China economic relationship is going to be stable, the Chinese are going to have to grow a consumer-led economy. There is just no way around that and positive that we need in this in this relationship. I also think there's another issue that we haven't discussed today that's very important in the U.S.-China economic sphere and overall, and that is this new attention to a green revolution. In the United States we are talking instituting a cap and trade system and there is a new bill on Capitol Hill right now that is being debated on a cap and trade system. But for that bill to get past the Congress, and it's going to a tough fight under any circumstances, the U.S. Congress is going to be assured that this is not putting American companies at a huge disadvantage in relation to Chinese companies. So I think the Obama Administration is going to be under some pressure this year to find a way to get some sort of understanding and partnership with the Chinese on the clean development side and some real Chinese commitment to capping their greenhouse gas emissions. I think there's another reason, and that's Copenhagen at the end of the year. If we are going to move ahead with a new Kyoto Protocol at Copenhagen, China has to be part of that and the United States has to convince China to be part o that.

I think there are other good pieces of new in this equation of the United States and China dealing with the economic issues, and that is that already this administration has made some very good decisions. I think one of the best decisions they made was selecting John Huntsman to be the new ambassador in China. First of all, they reached across the aisle. That's always good in American politics particularly when you have an issue like China that has divided along party lines in the past. Secondly, Hillary Clinton of course made her first visit to East Asia and went to Beijing.

The third thing that works in the administration's favor is actually something the Bush Administration did, and that was the creation of the strategic economic dialogue. The strategic economic dialogue was important because what it did was create a high-level dialogue just below the presidential level, and I think that you need to understand that the strategic economic dialogue was more than going in for an hour meeting at Jun Nong High and sitting and sitting in the stuffed chairs and drinking the tea. It was about these people at the level of the Treasury Secretary, Hank Paulson on our side and of course Long Shon on their side actually getting to know each other. And if the new administration can follow that model of not just having meetings, but having really substantive 2- or 3-day sessions in which the counterparts get to know each other, that is terribly important to working through these moments that we are in on the economic crisis.

I would also say that the schedule this year benefits us in terms of U.S.-China relations in that President Obama and President Hu will have at least four opportunities to see each other in addition to these other meetings between their cabinet members. There's the G-8 in Italy, there's another round of the G-20 that will take place on the margins of the UNGA I understand, there's the APEC summit in Singapore, and then of course there is the planned trip of President Obama to China. Sop four bites at the apple this year is not bad in presidential politics between China and the United States.

Just to quickly sum up, I think the U.S.-China relationship is maturing. I think we deal with China in the context of the G-20 and not the G-2. I think there is great danger in this situation and one of the dangers I would cite is of course protectionism, either protectionism of buy America acts that go too far or protectionism in China that are much more subtle and nontransparent. I remember Hank Levine out here in the audience when he was our Consul General in Shanghai telling me what China is a federal registry. Folks, China still needs a federal registry, and that was about 10 years ago when we discussed this issue. But there are a lot of ways that China can frustrate Americans through these sort of nontransparent measures.

I think it's in the interests of both our sides to make this relationship work, obviously, and I think that part of the maturity of the relationship today is that there is great interest on both sides in making the (inaudible)

MR. BUSH: Thank you very much. We have a lot of time for questions until closing time at 4 o'clock. I think I will take a few questions at one time and then have the speakers answer them as appropriate. As you can tell, we have some very smart people up here so you don't need to ask a long question for them to understand what's on your mind. Wait for the mike, identify yourself and your affiliation if any. I'll start with this gentleman right here.

SPEAKER: My name is Dmitri -- and I speak for myself. I tried to answer the question of this meeting, Will China lead the global economy to recovery? And why? I need to explain very shortly. My answer on this question I didn't need any answer from anyone. It's no. Why? Because it's not (inaudible) is the main reason. I will give you an historical example. The Soviet Union and the United States -- if you remember it was the Great Depression, it's not Great Recession, but it was Great Depression. And it was (inaudible) by the Soviet Union from an agricultural country to industrial (inaudible) but how? With (inaudible) jobs, with gulag and (inaudible) and basically by (inaudible) can we imagine -- again I need to say time has changed. No parallels in the future (inaudible) so I don't mean to take your time, but think about it because great industrial achievements of the Soviet Union (inaudible) was achieved by two measures. Number one (inaudible) jobs without any slavery -- to exist on the planet to survive. That's it. And the second, investment from the West. How? The National Treasury Act. You can see the (inaudible) they sell gold and other mining products from (inaudible) so try to impress you think very deeply on the question of this meeting because it's very important but (inaudible) with very hard conclusions. Don't (inaudible) as Churchill said once, it's impossible to cross the gap with (inaudible) it was the basic problem of the Soviet Union.

MR. BUSH: Thank you very much. Doug Spellman?

MR. SPELLMAN: Doug Spellman from the Woodrow Wilson Center. Dennis in particular, I wonder if you could expand a little bit on the dialogue between the U.S. and China. Some people have suggested that the new strategic and economic dialogue has some in-built difficulties. One is a mismatch for instance on the important subject of climate change -- on our side it's State Department and on their side it's probably not (inaudible) the other is it's only meeting once a year and some say that this should meet more frequently and once a year will mean that the really important work will have to be done in lesser dialogues which might not be bad. But I'd appreciate your comments having been directly involved in thinking about this.

MR. BUSH: One other question over here?

SPEAKER: -- in today's "Financial Times" Cheng Li is quoted saying that China is going to the right direction according to surveys that have been done in China. What is this right direction? And will Secretary Geithner in his next week's visit to China feel comfortable with this right direction that may eventually lead to what Eswar suggested, an equal partnership?

MR. BUSH: We have three good questions. Who wants to provide an answer? Dennis?

MR. WILDER: On Doug's question, having written actually myself on this issue I guess I can't get away from a little criticism of how this has been structured. I do worry a little bit about the strategic and economic dialogue in that if you look at the way we had it structured in the Bush Administration, there were four meetings a year. There were two on the political side and two on the economic side. So each would meet every 6 months. That gave each side a lot of time and opportunity for people to really get to know each other. I went with John Negroponte for example down to Waylin, to Dye Bing Go's hometown. It was a very moving experience -- Negroponte was here a little bit earlier who went with us. We visited villages. There was a real sense of camaraderie established in that. I do worry that now we've got a single meeting with very senior players who are trying to get these people to rationalize their schedules. I hope it doesn't become a symbolic summit as opposed to a real opportunity because the whole concept was to move beyond sort of the symbolic summits to something more substantive.

In terms of climate change, I think that is another structural problem that we are going to find that's going to have to be worked on. Clearly while Secretary Clinton has Todd Stern as the lead on this, there is a huge role for the Department of Energy and a lot of other departments of the U.S. government in moving forward with the Chinese on these issues. I haven't heard yet how they're going to get through those issues and how they're going to structure the sub-working groups, but I think there are questions that need to be answered by the administration.

MR. BUSH: Xiao Geng?

MR. GENG: Just on the follow-up about the SED, actually our center, the Brookings Tsinghua Center, in Beijing hosted a number of informal meetings between the U.S. officials and Chinese experts and officials on this SED and I actually agree entirely with Dennis. The importance of the dialogue is beyond the narrowly defined dialogue because you have these working relations. A lot of emerging events like the earthquake, like the financial crisis, it get -- response through this dialogue with people looking -- and I think, yes, we see the problems both in the U.S. and in China, the different departments coordinating. This is normal, entirely normal. That's why you need these kinds of extra dialogues to actually coordinate to bring people together. So I think that really this is an innovation which helps tremendously bridging the different political cultures and economic systems.

On the other question, whether China is moving in the right direction, I want to just go back to Cheng Li's point. This division which is happening in six divisions, my perspective is this is right because if you look at this division, it's more and more like in the U.S. Chinese society now looks more and more like the U.S. society. You have different views and no one view can dominate the other. So if you look not just at the voting system, look at the way people live, how they express themselves, how they get their income, how they spend, I think China is moving in the right direction which means converging toward what the lifestyle here in the U.S. you find. People are much freer in the sense that if they want to do something, now you can do it. The government cannot stop you from doing it. If you want to say something, in most cases you can say it unless you directly -- right? So the space is actually expanding in terms of freedom.

So I agree that it is moving in the right direction especially for the people who do business with China, who travel off to China, who study China. You can see China actually is converging toward what we call the American lifestyle in both political, economic and social sense.

MR. BUSH: Cheng Li?

MR. LI: I want to answer the question with an anecdote once told by my good friend Steve Owens , the President of the National Committee on U.S.-China Relations. In the middle of the (inaudible) the pilot said he has an urgent announcement. He said I have good news and bad news. The good news is that we are ahead of time. The bad news is that we are lost. China has a remarkable and unprecedented high growth rate economically, but in a sense it's lost. It's lost into what kind of political direction China will go. But maybe lost is not the right phrase. Maybe we are in a debate, discussion or (inaudible) and so on that issue I have mixed feelings. On the one hand I actually agree with Xiao Geng that during the past three decades China basically wanted to learn from the West, particularly it wanted to learn from the United States economically but also beyond the economic domain.

At the same time, certainly China has a terrible problem in terms of the one-party rule, media freedom, the issue of human rights, religious freedom, ethnic problems, that in all these areas China still has much to do, must to improve, and particularly when it comes to the issue of democracy. Certainly you do see there are different views emerging in China. Even in the top leadership some leaders say that China's political system is better than the United States. Why we should change. But look at all these problems. Look at the financial crisis that certainly indicates there's a tremendous problem in the West, particularly in the United States. At the same time, some other leaders are probably more foresighted to talk about China's problems and talk about the need for political democracy, talk about the universal value of democracy.

You are right that I was interviewed by the "Financial Times" that was quoted today. The quote was accurate. It's not my view. I did not say China is in the right direction or wrong direction. I said that most people in China in survey after survey think China is in the right direction. We should understand why they think that way. Look at the economic things. Look at the top 10 banks, top 10 business (inaudible) and look at other statistics. Look at the improvement in social and political areas. Look at the six divides, and if I'm right that's also very healthy and very hopeful. I think it's a good thing rather than a bad thing.

But that kind of survey, I also conducted a survey myself and not only just the Chinese. They are quite optimistic about the future, believe that China is in the right direction, and that in contrast, the United States always thinks that we are in the wrong direction particularly under the Bush Administration. I'm sorry, Dennis. Bush's China probably is in the right direction. So that's the situation.

So I think the important thing is that we should be humble enough for the Secretary of the Treasury in his trip to China (inaudible) lecture how to become (inaudible) society. China does not need to be lectured. We can lead as Obama said by example by the way we treat our human rights issues, close the Cuba prison and things like this speak louder than anything else. So I think with that kind of a dialogue sometimes privately, sometimes publicly, but not just lecture them will be serve our best interests.

Again to your question about China, certainly I think that the one-party system as I said (inaudible) needs to change. Look at today's world and how many countries (inaudible) does China want to be in that club with North Korea, with Cuba? What else -- one-party system. So that's a challenge. But at the same time, I think cynicism just like (inaudible) is my friend Susan -- said cynicism like dogmatism can be an excuse for intellectual laziness. We do not study subtly, we do not seek different ways to approach the same things (inaudible) about China in the near future particularly (inaudible) does need to deal with and be involved in the challenge of lack of resources and also the kind of rise of arrogance was (inaudible) particularly among the angry youth.

MR. BUSH: Dmitri's question was rather specific, that it's the character of the Chinese system that will prevent China from leading the world out of recovery. Does anybody want to take on that question?

MR. LI: I want to answer that question. I'm sorry if I did not express myself. I think the answer actually -- my answer is no, but at the same time I think China can contribute to the recovery because the Chinese economy is not strong enough to lead to the recovery. But if the question is will China be the first country to get out of recovery, my answer is yes. So China contributes to the recovery, but it's not strong enough to lead the recovery. But we want to have an eye-catching title for the program.

MR. GENG: I want to have a follow-up comment. Cheng Li mentioned this one-party system. Actually if you look at Chinese history, it is more than one party. We have the Nationalist Party in Taiwan. We cannot ignore that because that's always a pressure on the Chinese leadership. If they are in trouble, for example, the democracy experiments, so I think you could look over the history that it is actually not just one party. The Chinese Communist Party survives through fierce struggles including war with the Nationalist Party. The Nationalist Party always serves a check on the way the Chinese Communist Party is working.

Also this relates to the question whether China can lead. At present I don't think China can become the world leader in leading the global economy or political system to evolve into a better system in the future. But I think the positive way to put this is that we should encourage the Chinese system and Chinese leaders to become responsible leaders in the future. For example, in Chinese enterprise system to be more privatized (inaudible) systems in the future. I think that the Chinese people and even including Chinese leaders do have the aspiration to become so-called leaders. It's still far away. By encouraging them to work on it, China will benefit, the U.S. and everybody in the world will benefit because the trouble we have is that China is big in terms of population.

I was talking to some of the executives of Wal-Mart and PepsiCo. PepsiCo is investing heavily now in China and Wal-Mart because is getting better now. You can imagine in the near future Coca-Cola perhaps they are going to sell more of their products into China than the United States because this is a large number. You have 20 percent population. I think we should focus on either the global standards, what kind of companies and what kind of government in the future, we have to look at -- if China, India, their systems, not going to be more than good systems, we are going to be in trouble so we could work toward that.

MR. BUSH: We have some questions on the aisle. This gentleman right here in the blue shirt.

SPEAKER: My question is about Taiwan. Do you see Taiwan -- have the U.S.-Taiwan relationship and the Taiwan-China relationship interfering or complicating the situation?

MR. BUSH: Burt Keitel .

MR. KEITEL: I'm Burt Keitel. Thanks very much for the great program. I want to ask Xiao Geng first what have you heard about the surroundings of the policy announced in December to turn the Pearl River Delta into a model for the restructuring of the whole Chinese economy? It seems to go back 2 years there were reports by the middle of last year having closed 15 percent of Pearl River Delta factories that were too small or too polluting. How much of the 20 million reported migrants who are out of work may represent a premeditated restructuring on the part of the government that's now helped out by the crisis? And Xiao Geng and Eswar, April was the first time we've seen the trade surplus actually decline and that's the GDP component in growth. It looks given the surge in surplus last year that that decline is going to be stronger through this year. What's your take on the race between the decline in the external demand and the beefing up of the stimulus?

Finally to the three of you there on my left, Secretary Geithner is going this weekend. There is a popular view that China was a principal component of preparations for conditions for the global crisis, the debt embrace or the savings imbalance. Yet the timing doesn't seem to be right and the balance surplus is from Northern Europe and non-China Asia and so forth are much larger and much earlier. Yet there are people in Treasury who seem to think that this is an important point to engage China on. Do you think that's the case? What's your view on that idea that China helped the conditions for the global crisis and is this something you think that Geithner will want to discuss?

MR. BUSH: The gentleman in the tan suit?

SPEAKER: My name is George -- I am an independent scholar. My question is that I think Dr. Li mentioned the vulnerable populations, the peasants and the migrant workers, they are right now the vast majority of the Chinese people. My question here is would the projected China economic increase compensate for these people's economic conditions with any kind of social upheaval, because my concern is that if these people are not going to have some sort of a standard of living increase, there will probably be a real big problem for China.

MR. BUSH: The gentleman right there?

SPEAKER: Thank you. A really great program. I have a question for the whole panel. One of the things that came out in the discussion was looking toward the future that for the recovery we need to have a consumer market and one of the implicit things was that you didn't see this emerging in the short run in China. How about medium and long run? To what extent do you think the Chinese economy really can restructure more of domestic demand dealing with the whole issue of the social safety net, the savings rate, the controlled interest? What will it take for that to happen? And that also has an impact on the environment. Thank you.

MR. BUSH: Why don't we take the questions in reverse order, start with that one and then come to the at-risk population and then we can divide up Burt's question, and I'll do the Taiwan one.

MR. PRASAD: First on the specific questions about the economic recovery, I'm just an economist. I don't think too deeply so I can't rise up to your intellectual challenge, but I think it's going to be difficult to see China rising up and being the leader of the world recovery, but it is going to hold its own together and in these circumstances that's pretty good in itself.

In terms of the trade picture, I think the bamboo shoots are probably much further ahead than the green shoots here and that's going to have an implication in terms of what happens with the trade balance in the short term. Even if we do see that declining, I think in the latter half of this year with the U.S. economy beginning to recover, I think we will begin to see import demand from here picking up and I anticipate that the trade balance is still going to become an issue especially the bilateral trade balance between these two countries.

What happens with currency policy of course is crucial because right now the U.S. dollar is gradually depreciating and if the Chinese stick with their soft peg with the dollar and let the renminbi ride the dollar down it's going to be very difficult to see anything else other than a trade balance that begins to come back up in the latter half of this year. But I think the currency appreciation again is not the critical component right now in terms of sorting through the domestic problems. It's going to be a part of the medium term solution but getting the financial system working well, it's going to be essential to solve this savings investment imbalance problem which is what shows up as the massive current account surplus and for that I think the financial sector response is absolutely key. This again is not something that can be done very quickly, but the Chinese are very clearly focused on it both in terms of what they've been doing until the financial crisis hit and even in terms of what they've been doing with the stimulus package. They are trying to build up a much stronger social safety net, improve the amount spent on health care, improve the health care delivery systems and so on, the financial system recovery I think is in fact or reform is going to be set back. I think what we're going to see as a consequence of the lending boom that is part of the stimulus package is going to be some problems down the road. Of course the Chinese have a lot of room on the fiscal front in order to recapitalize the banks if problems arise, so at the moment nobody is really that concerned about the medium term. The banks are holding together and they have the resources to pull it back.

In terms of the broader strategic issues, I'd like to make two points. One is about China's rise. Cheng Li was kind enough to remind me of perhaps one correct prediction I'd made and I promise not to make any more predictions because they probably won't work out, but I think what is the big issue is for the world and for China to get used to China's rise because China is now a dominant power and I think China is beginning to grow into its role. We see it coming out in strange ways. The assertiveness that we have seen in terms of Chinese policies or statements about the reform of the international monetary system seem very aggressive, but I think it's their way of trying to find their voice on the international stage. At the same time, the rest of the world, the U.S. included, has to figure out exactly what China's role is in this world system because as Dennis and Cheng Li pointed out, the notion of the U.S. lecturing the Chinese simply does not work anymore, in fact, we've seen a -- from the Chinese where they have been trying to lecture the U.S. on the right policies. So ultimately this has to evolve into a relationship that China does take its place on the world stage and along with that do some certain obligations. It's true as the Chinese leadership regularly reminds is that China is a developing country, but it is a large country and along with that privilege of being a large country and an important member of the global financial system come certain responsibilities in making sure that they live by those responsibilities is a critical part of the system.

Then to keep things exciting let me also suggest that slight difference with Dennis Wilder on the issue of the structure of the strategic and economies dialogues, but to differ with him I need to use one of his points. His point is correct. I think that the geopolitical interests between China and the U.S. are not exactly congruent. Where there is in fact congruence is in terms of the medium term economic relationship and here there is a very clear commonality of interests because China opening up having more balanced growth, having a more well-functioning financial system is good for China and it is good for the U.S., and for the U.S. to get its house in order and to be able to grow in a sustainable way is good for China. So there the interests are in fact very clearly aligned, but on the other front they are not that closely aligned, so I think it may make some strategic sense to tie together an area where there is a clear confluence of interests with areas where there isn't as much as a clear confluence so that progress can be made in the areas where there is some conflict. So although these are important and independent items, I think putting them together may have certain logic to it.

MR. BUSH: Xiao Geng, do you want to comment on any of the questions?

MR. GENG: I think a very important distinction here, yes, there is an imbalance and China saves too much, the U.S. consumes too much, but we have to realize that high savings is not the problem. If you have high savings, you have also efficient high investment. Then you will have very high growth. The problem is the overconsumption in the United States is not efficient. The overinvestment in China is also not very efficient. The trouble really is we have to back to the monetary policies in the United States. If you have such low interest rates, such rapid expansion of credit without control, you will get a bubble in the United States and that bubble actually will go back to China and whole world. So really what we need to think about is how to discipline the central banks in the whole world in each country especially in the United States because the United States there is no doubt is the leader and probably the lender of last resort Federal Reserve, and the last resort not just for the United States but for the whole world.

So this goes back to the (inaudible) model, the Chinese export led model. The export led model I think on the whole is fine as long as there are no distortions in imports. If you have cheap land, if you have cheap electricity, of course export led can be very dangerous. You will have damage to the environment, you will have an unfair competitive edge. That's wrong. But if every price is right, you cannot blame exporting. If you export and also import as much, you will get balance back. This also relates to what we call the consumer because everybody now is pushing China to stimulate consumption, but Chinese consumption from the household point of view is quite optimum. So the real problem is really we have to coordinate on monetary policy so that investment and consumption in both the United States and China is efficient. The worry I have is that because we are in the mode of emergency crisis management we forget about very basic economic efficiency. In order to achieve very basic economic efficiency, the price of capital which means the real interest rate has to be reasonable both in the United States and in China, but because China and the United States are so closely related economically, U.S. monetary policy will have a big impact on China's monetary policy. So that that is really the area I think China and the United States should work together.

MR. BUSH: Cheng Li and then Dennis.

MR. LI: The Treasury Secretary probably more than anyone else knows that (inaudible) percent -- Treasury bonds are owned by Chinese. When trading recovery dollars, China invested $1 trillion in our market. We need China. So then lecturing the Chinese and criticizing the Chinese, blaming them is the worst thing you can do. Again particularly at the time when China has very strong national resentment, the Chinese general public could not understand that -- developing country, poorest per capita, is helping the richest country but you still blame us. Ultimately it's an issue whether we see China as a part of the solution or part of the problem. I think we will continue to see China and China acts like as a part of the problem, I think that we are really moving in the wrong direction in the world. I don't want to comment on technical things because Xiao Geng already did a good job.

The other question that I think is very important is that China is in a major transition from an export led economy to a domestic demand economy, old issues you raised are very, very important. We still do not see any profound or fundamental change. But China has a number of cards to play. I think the most important one which they decided last October is what they call land reform that they haven't used because of the current financial crisis. It was slowed down. This is a plan with 77 policy initiatives which use a language you could understand. It's three movements. The first move is the move of land. People can sell or lease the land use, not land ownership, but it's almost the same as sale of land ownership. First is the movement of land. Second is the movement of people, so that people can move from rural areas to urban areas. As we know in the next two or three decades, there will be about 300- to 400 million people moving from rural areas to urban areas. The economic impact will be overwhelming from all respects (inaudible) the third move is the move of capital. Capital, particularly small businesses will get capital in rural areas. So just imagine if it is successful, in addition China already has a middle class in the urban areas, in the next two or three decades China will have witnessed a rise of the middle class in rural areas. So that will stimulate domestic demand, reduce economic gaps, certainly will help those migrant workers to settle down in urban areas, make collective farming (inaudible) successful. So that's probably the next phase of China. Again, China has a lot of policy initiatives to be used that haven't been used yet, so it's not entirely desperate in many ways. I think that that's providing hope to move in that direction, and certainly the Chinese government already thinks that in the long term future that could be a solution.

MR. BUSH: Dennis?

MR. WILDER: Two quick points. First of all, I want to extend and revise my remarks. I sounded as if I was against the combining of the strategic and economic dialogues. What I'm worried about is going to one meeting a year. The structure is up to the administration to decide how best to structure this. But I think it's very important to understand that when you come down to just one meeting a year, you do not get the same bang for the buck as doing this every 6 months, and the American governmental bureaucracy, I can't speak for the Chinese one because I've never worked in that system, but in the American system you work for these meetings. You build programs toward these meetings, and if you only do it once a year, you don't get the same kind of momentum you do if you do it every 6 months. So that's my point on that.

The second point, getting back to Burt's question of blame game, I was very worried when the financial crisis started because Chinese officials were saying the American financial crisis, and my heart really sunk because I thought if that term sticks in China, we're going to have a huge problem. To the Chinese credit, they got away from using that term and they started to talk about the global financial crisis and that sort of thing. I hope on the American side people don't try and get into saying somehow China is to blame for these problems. Let's leave that all to historians to work out how we got into this mess. Let's look forward and not back. So I hope that nobody going with Geithner is going with that kind of message that you owe us because you created this problem. First of all, I think Americans have benefited hugely as I said from cheap Chinese goods and we certainly benefited from the export markets that were created in China for American goods. So we shouldn't forget that we've benefited a lot of this relationship.

MR. BUSH: On the Taiwan question, for the period 1994 to 2008, there was a negative spiral in China-Taiwan relations where each side believed that the other was going to challenge its own fundamental interests. Each side acted on its fears rather than its hopes. The spiral was mainly political, but it took on a military dimension. The tragedy of it was that it created obstacles to China and Taiwan working out a complementary economic relationship that was in the interests of both sides and perhaps retarded Taiwan's ability to maintain its competitiveness as a strong link in global supply chains that reached from the United States through Taiwan to China.

Since 2008 because of political initiatives in with Beijing and Taipei, that spiral is now reversing. The immediate consequence is that the political obstacles to economic interaction are being removed as we speak. How far the process will go is something that no one can predict, but it does give Taiwan the opportunity again to focus on how to remain competitive. As far as the United States was concerned, this negative spiral created difficulties for us because we didn't want to see some kind of conflict. The reversal of the spiral is to our great benefit.

Let's have one more quick round of questions. The lady right here?

SPEAKER: I have a question for Dr. Xiao Geng. It's about the auto industry. Since that these days it's a very hot topic with the slowdown of automobiles going to the countryside. Also the stimulus package -- the auto industry gives -- has become a very important component of the stimulus package. So compared with the U.S. where the U.S. auto industry is suffering quite a lot these days, we have seen a lot of headlines on this, China's auto industry seems to be doing really well. Last quarter I think we saw that auto sales have even jumped by almost 20 percent. So my question is, do you see this as a result of the government stimulus or a result of people having more confidence and want to consume more automobiles? Also as we know that the automobile is really the source of air pollution and soaring oil demand, so how do you think that the Chinese government should balance the pros and cons of this? Also how would -- impact the investment and consumption of China's economy? I know that China wants to lead a green economy.

MR. BUSH: That's enough. You've asked several questions. Thank you. Right here.

MR. OWENS: Gene Owens. I'm an international environmental consultant. I was struck by the comment made by Professor Cheng, think nationally and blame locally. In trying to carry out environmental policy in China for the GEF in this case, we found that there was a degree of apathy at the central level, whereas if we went out to the provinces, they were actually willing to undertake some initiatives in this case for renewable energy or whatever. We called this framework the tail wagging the dog and it was very characteristic of the two positions within the one-party system. I think that answers some of the questions that were brought up by Dennis and others. Other than that, I simply wanted to endorse that much of the discussion here is what is being looked at from the center and not what is happening among 1-1/2 billion people. It's very hard to look at it that way.

MR. BUSH: Thanks. Right there.

MR. CHEN: I'm -- Chen, professor of finance from Johns Hopkins. I have a comment and I have a question. The comment is about Chinese economists. I was talking to a group of Chinese economists about whether China can lead the global recovery, and our conclusion is we don't care that much, that we have enough problems to care in China, the restructuring of the earthquake and the unemployment rate is so high, the graduates from the colleges, the great inequality among the rich and the poor, so we don't really care about whether China can lead in the recovery or not.

My question is actually about real estate property because I specialize in real estate, and I do think that China has a bigger bubble than the United States according to some of the metrics we've used, like home price to income ratio in China is like 20 to 15 percent, where in the United States at the highest point it's like 5 to 6 times income. And also looking at DTI, debt to income ratio, that's also pretty high. So home prices actually didn't deflate or didn't crash, the real estate market didn't crash, and I think one of the reasons is because in the beginning of this year while the builders are kind of on the brink of lowering their prices, but at the same time the banks are extending credit as (inaudible) so actually the home builders can still sustain a high price which I do not think is sustainable at these price levels. So if home prices in China drop 30 percent? Would the banks still consider their bad debts still at 2 percent? In the United States it used to be that people think mortgages are very safe investments. It turns out not to be the case. So why do Chinese banks think they are so safe with such high home prices and so much concentration on home mortgage investments? Thanks.

MR. BUSH: Thank you. We have an auto question, an environmental question, and a bubble question.

MR. LI: Maybe two of them. Quite straightforward. The auto market, I think the problem in the United States, my view is that, yes, you have General Motors with problems, but I don't see Toyota with problems. In the case of China, most auto companies there are joint ventures. You have all the American brands and Japanese brands. Almost from every country they have joint ventures manufacturing in China. Also the high system in China just completed the national network of highways, and the auto ownership rate is extremely low compared to the United States or any other country. So you don't need to worry about the kind of potential market. Growth is actually is very quite normal. Even from the environmental point of view, it's not really a big problem right now because the Chinese economy is simply so big and most autos in China actually are quite new, because of competition of the joint ventures they have to put in the latest technology. The standards are not that low compared to other countries. So I think it's quite easy to understand why the Chinese market is performing so well, but some sectors of the auto market in China the U.S. -- largely because of structural problems.

The property market, yes, you are right, but you have to remember the urban workers' wages are growing like 15 to 18 percent a year. So, yes, right now compared to income, the property price is high, but if you think about it, you're going to buy the property and own it in 30 years in the future and your income is growing like at 15 to 18 percent a year. So eventually your income will be enough to pay the mortgage. So that's why you don't see the Chinese property market drop so much, largely because the expectation of income growth is very, very strong.

MR. GENG: Two questions. One is about the local element. I think there is also another phrase to talk about China. The Chinese people refer to it as the national government is rich, local government is poor. Wealthy nation, poor locality. But previously local major revenue is by lend-leasing through companies (inaudible) or whatever, but now the central government wants to restrain, so suddenly the revenue decreased, at the same time you have environmental concerns or other kinds of things, so it's a tremendous burden for local leaders. So I think that when we will promote the environment, green GDP or all these kinds of things, we should really pay attention to local interests, local -- refer to it really provinces, municipalities, counties and towns at four or five levels. So that's an issue that's emerged.

For your comment that Chinese do not care, certainly I think that Chinese top leaders disagree with you. Wen Jiabao said very clearly we are in the same boat. China could benefit from the global recovery and your Secretary of State in her recent trip to China said very clearly that the United States and China can contribute and benefit from each other's success. If we continue to think that we have nothing to do with global things, I think that really it will be very dangerous for China and China's economic interests.

MR. BUSH: Thank you very much all of you for your presentations and your great answers. Thank you all for coming and for your great questions. I'd also like to thank Lucy Brooks whose staffed the program in her usual outstanding way. Have a great weekend.

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

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