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CHINA'S EMERGING MIDDLE CLASS:  
BEYOND ECONOMIC TRANSFORMATION

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PARTICIPANTS:

**Introduction and Moderator:**

KENNETH LIEBERTHAL  
Senior Fellow and Director  
John L. Thornton China Center  
The Brookings Institution

**Panelists:**

CHENG LI  
Senior Fellow and Director of Research  
John L. Thornton China Center  
The Brookings Institution

HOMI KHARAS  
Senior Fellow and Deputy Director  
Global Economy and Development  
The Brookings Institution

MARTIN K. WHYTE  
Professor, Department of Sociology  
Harvard University

\* \* \* \* \*

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

## P R O C E E D I N G S

MR. LIEBERTHAL: Good afternoon. I'm Ken Lieberthal, Director of the John L. Thornton China Center at Brookings. Delighted you're all here today. We are here to discuss a book that just came out on China's emerging middle class. This book results from a conference that we held a year ago, and the conference volume is now an edited volume that is, I believe, the most comprehensive multifaceted set of analyses of China's emerging middle class available anywhere.

The topic itself is one of extraordinary importance. The middle class, as it evolves, will have a tremendous -- it already is, but will have a growing impact, not only on China's economy and its society but even on things such as China's energy consumption and environmental impact. So this is an issue of enormous importance and obviously has political resonance too.

We have three speakers today, one of whom just left the room. I hope he returns shortly. I'm not sure how long he thinks this introduction is going, but, Cheng, it's about to end. Okay. Here we are. Seriously, we have three speakers. Cheng Li is both a contributor to the volume and editor of the volume. He conceived of this project and organized a conference that produced the volume, and he is the research director at the John L. Thornton China Center and also a senior fellow on foreign policy at Brookings.

After Cheng will come Homi Kharas. Homi Kharas is a senior fellow in the program on global economy and development at Brookings. He is also deputy director of that program. That is one of the five major programs around which Brookings is organized. Before that he had a distinguished career, which included serving as chief economist for Asia-Pacific at the World Bank. And so Homi will be coming up, and he's also a contributor

to this volume; but will be coming at this, I presume, from more of an economic framework to analyze it.

And then finally we have Professor Martin Whyte, who I had the great privilege of being a colleague of at the University of Michigan for many years before he, you know, decided to kind of slide down to lower standards and go to Harvard, where he has been a professor of sociology for, I guess, 16 or 17 years -- 10 years, okay. Marty has done extraordinarily wide-ranging and influential work on developments in Chinese society in the Chinese family and other issues. He will be bringing more of a sociological perspective to bear.

So first Cheng will summarize the core arguments in the book that he wants to highlight. Then we will have each of the two commentators on the book, and then we will open it up for Q & A. We have two hours, so we have got plenty of time to have a really thorough discussion of what is a topic that really warrants that kind of time and attention.

So thank you for coming.

Cheng, please.

MR. LI: Could you hear me in the back? Okay. Good.

Well, first I would like to join Ken in welcoming you all to this event, especially on such a cold and a windy day.

I want to thank my Brookings colleagues, Ken and Homi for not only contributing an intellectually stimulating forward and an excellent chapter for the volume, but also for their participation in this book launch event.

I particularly want to thank Professor Martin Whyte from Harvard, who was not involved in the book project, but whose sociological study of contemporary China, especially his groundbreaking work on social stratification and the post-communist transition

has long been inspiration to me. Marty, I look forward to your characteristically sharp critique, although a little bit nervous though.

Now in the next 15 minutes or so, I would like to cover three areas. First, I will provide an overall of the book as Ken assigned to me including the motivation for and objective of the book, the main features and the findings of the study, and the points of disagreements and consensus among the contributors.

Second, I will present my argument about the growing political role of the Chinese middle class and its changing relationship with the authoritarian regime.

Third, and finally, I will discuss how China's emerging middle class may contribute to a better U.S.-China relationship in the years to come. This is probably -- it's valuable, particularly in the light of Hu Jintao's upcoming visit to Washington.

Now my introductory chapter of the volume has the following remark. Actually our publicist immediately caught this line. It goes like this: "Among the many forces changing China's course of development, arguably none will prove more significant in the long run than the rapid emerging and explosive growth of the Chinese middle class. Never in history have so many people made so much economic progress in one or two generations."

Now this book project is driven by the need to understand this fascinating human drama in our time. The project is also motivated by the observations that scholarly communities outside China have been remarkably slow to acknowledge the existence of Chinese middle class, let alone explore its political implications.

We could hardly find a scholarly book in English on the Chinese middle class. The distinguished Australian scholar, David Goodman's 2008 edited book entitled *The New Rich in China* aimed to study this subject but concluded with strong skepticism and

serious reservations about using the term China's middle class.

Now in contrast, over 100 Chinese books on the middle class have been published in China over the past decade. The Western China studies communities need to fill this gap. Any large scale look at China always involves a great deal of intellectual collaboration, and this is certainly the case of this book project.

The contributors of this volume are diverse in terms of academic discipline, including sociology, science, economics, education, and the law, and also in terms of national origin, including Chinese, Taiwanese, Korean, Australian, and Italian, and the generation, including senior scholars such as Deborah Davis at Yale, Michael Xiao at MIT, but also include current Ph.D. students.

We examined the development and the current state of Chinese middle class from a variety of analytical perspective, including the formation and divisions of Chinese middle class, ideological and political development in light of the middle class, the role of education expansion and housing reforms, the rise of the home ownership movement, and the middle class consciousness, cross-country comparisons and subgroups like private entrepreneurs and the lawyers, and also political attitudes and behaviors of the Chinese middle class. We also pursue really quite a variety of methodology approaches, including quantitative analysis, opinion surveys, content analysis, and the case studies.

Now the contributors clash on various issues. For example, what are the most important criteria to define middle class membership? Is it income, assets, occupation, education, consumption, self-identification, or consciousness, or a combination of these criteria? Several contributors, including myself are inclined to use a combination of these criteria. And based on this approach, the middle class presently in China contributes to 23 percent of China's total population. This is about 243 million people, again 23 percent

population. This is largely based on this approach of very large scale research in China. It lasted for about eight years.

Now for more details, please read the book, you know. You can get a discount of 20 percent off today if you buy the book today in the bookstore, and after this you should go to the bookstore just not far away.

Now several contributors are uneasy with the broad definition of the Chinese middle class. That includes different groups from private sector entrepreneurs, and foreign joint venture employees, to government officials, and the state-owned enterprise's managers, and to cultural and educational elites. It's like a big basket.

Now contributors also disagree with each other regarding the volume's essential question, how will the rise of the Chinese middle class impact China's political development? All of these disputes are healthy and essential, and they put forth some provocative ideas for both intellectual and policy debates in the years to come.

Despite many contrasting views and assessments about the size, composition, and also the characteristics, and even definition of Chinese middle class, some baseline consensus have emerged out of this intellectual joint venture. Contributors agree that a new socioeconomic force has profoundly changed China's political and socioeconomic landscape. No one seems to doubt that Chinese middle class is more or less a heterogenous subset of a Chinese society, and also agree that the Chinese middle class has remained, at least up until now, a political ally of the Chinese authoritarian regime. Now these are the consensus, baseline consensus out of that volume despite all the disagreements.

Now equally important, there are more recent indications, as noted in several chapters in the volume that the Chinese middle class may soon become a critical

force for political change. This leads me to the second area of my presentation.

I argue that one should rethink the possible political role of the middle class in this rapidly changing country. Just as yesterday's political target could be today's political ally, so too could today's political ally become tomorrow's political challenges.

In a recent large scale national survey of political attitudes and behaviors across the social stratum in China, Chinese scholars sociologists at China's Academy of Social Sciences, found that the middle class is more critical of the current social and political situation, especially rampant official corruption. And the middle class is less confident in the government performance than any other social stratum.

Now the growing unemployment rate among recent college graduates, as we know, these are the people who usually belong to a middle class family, and they are the future middle class. Now they cannot find jobs. A significant portion of them cannot find jobs. This certainly sends a clear message to the Chinese government or a warning or alarm for the Chinese government.

Now in a recent forum on China's response to the global financial crisis held by the Academy of Social Reform and Development in Beijing, Chinese scholars argued that the government should pay much greater attention to the needs and the concerns of middle class. I quote here, they said, "Otherwise China's sensitive middle class will become an angry middle class." This is by Chinese scholars in Beijing.

Now middle class members are particularly resentful of the new trend toward a state monopoly or what the people in China call crony capitalism or state capitalism. They believe that the Chinese middle class, rather than the rich class, carries much of the burden in terms of helping the poor class in terms of social welfare, medical care and affordable low-income housing.

Two new widely spread Chinese terms are particularly revealing. China constantly produces some new terms, particularly within the commercialized media. I want to introduce and explain two terms. I think both are related to the middle class.

The first is “guo jin min tui”, which translates as “the state advances and the private sector retreats.” Now this reflects the Chinese public concern about ever expanding state-owned enterprises, what Chinese calls SASAC companies. These are 21 gigantic state-owned companies, and their development usually happens at the expense of the private sector.

A recent study conducted by Chinese scholars shows that the total profits made by China's 500 largest private companies in 2009, last year, actually were less than the total revenue of the two state-owned enterprises, namely China Mobile and the Sinopec in the same year. So 500 largest private sector companies' profit is just equal to two state-owned enterprises, China Mobile and Sinopec.

Now the advantage of pursuing a career in the private sector is most evident in the recent huge wave of applications for civil service jobs in the government. I was in China last week. China just had a new, this year, test for civil service jobs. It's a huge number of people, huge number of applicants. On average, one job has 80 applicants, one job, 80 applicants.

In some jobs, like the jobs in the state energy commission or state energy bureau, one job has 5,000 applicants. So this is really not healthy, compared to 10 years ago when people wanted to go to the private sector, so called “Xiahai” but now it's the reverse. People all want to go to the government sector or state-owned enterprises. So this, again, reflects part of “guo jin min tui”—state advances as the private sector retreats.

Now the second new term is so called black-collar stratum “heiling jiejcent),



which reflects the phenomenon of an increasing number of people, rich and powerful, who dress in black, drive black cars, Mercedes Benz, and have hid their income and live secret lives with concubines, and have ties to the criminal underground, the black society, and most importantly, operate their businesses and wield their economic power in an opaque manner. So it's not white collar, blue collar, but the black collar worker. Black-collar stratum really has become a target. People really hate this group. The black-collar phenomenon reflects the increasingly close associations between government officials and the CEOs of large corporate and business firms.

Now another study recently conducted by China scholars in the Chinese Academy of Social Sciences found that if a large number of middle class members feel that their voices are suppressed, their access for information is blocked, and that their space for social action is confined, the scholars argue, a political uprising will likely take place. This study implies that what happened in South Korea and Brazil in terms of their middle class' demands for direct election, could also take place in China.

Now it is important to note that opinion leaders in today's China, including both official media and the non-official new media usually confirm the cultural cluster of the Chinese middle class.

Now the Chinese leadership seems to be aware of the potential political challenge from the middle class. It is interesting to note that at the National Economic Work Conference of the CCP Central Committee, which was really held two days ago in Beijing; the Chinese government did not discuss any proposal for the property tax for middle class housing. You know, this is widely spread that they want to have an additional tax for middle class families, but they did not discuss that issue. Instead they discussed the so-called income tax reform, basically wanting to reduce taxes for middle class and also stimulate

domestic demand.

Now let me move to my last point. How might China's emerging middle class contribute to a better US/China relationship? Now the significance of China's emerging middle class lies not only in its potential to affect domestic politics but also in its ability to shape China's international behavior.

Now a better informed and more comprehensive understanding of the Chinese middle class will help to broaden the policy options available to United States in dealing with this emerging political power or economic giant.

My introductory chapter provides two contending scenarios that reflect fundamentally different visions of China's future, one positive and one negative. Neither of which can be divorced from the trajectory of its emerging middle class. So the middle class really plays a central role in China's political behavior in the international stage. While the negative scenario cannot be discounted, the future of US-China relations depends on whether the leaders on both sides can emphasize common ground and a shared interest.

In the upcoming state visit by President Hu Jintao, forging middle class ties between the United States and China, I believe, may be a way to find more common ground in US-China relations and it can help increase mutual trust and mutual respect between the two peoples.

On the economic front, China's domestic consumption has taken on new importance. Just as the United States middle class fueled global growth for many decades, it stands to reason that the Chinese middle class could help the economic recovery of the world and also lay the groundwork for more balance in global economy in the future, which in turn, I believe, will make US economy healthier and stronger.

Now on the many issues likely to define the 21st century, a global fight

against climate change, increasing worldwide demand for natural resources, and the ever increasing conflicts and interconnected global economy. China will need to play a proactive and constructive role in each and every of these important areas. The US should keep in mind that China's ability to play this role, to truly become a responsible stakeholder in the international order, would depend on its involved domestic conditions. The Chinese middle class has acquired a relatively more sophisticated view of the world, and they have better understanding the virtue of a corporation.

The expectation underwriting this view is that if China continues to evolve peacefully in the direction of openness and integration, it may eventually have some kind of democratic change in Chinese society. So if this were to occur, then the time-honored series of democratic peace would finally be put to the test in world great power politics. So this really will be a very important development.

Now to conclude, I would like to have two quotes. One is by R. Williamson, he said, "If the American dream is for America only, it will remain our dream and never be our destiny." So China, the middle class development, is very much inspired by the American dream. I think the US should welcome China's recent development, as long as China plays a positive and constructive role in international relations.

Now I want to end my remark with a quote from Henry Ford, the man who helped create the American middle class and spread the middle class lifestyle to the world. He said, I quote, "Coming together is a beginning. Keeping together is progress. Working together is success."

Thank you very much.

MR. KHARAS: So I'm going to talk a little bit about China's middle class from an economic perspective.

And I wanted to actually start by the two motivations for this chapter, from an economic point of view, were to first ask, in the context of the rebalancing of China's growth strategy, which everybody is talking about and shifting from an export-oriented strategy towards a domestic-driven economy, is the Chinese middle class actually large enough to sustain and drive an economy of China's size so as to make that prospect actually a realistic prospect or not? So first I really wanted to look at the Chinese middle class as a driver for China's economy in the way that the US middle class is usually acknowledged as being a driver of the US economy.

And, second, I wanted to look at the question about whether, if the US middle class and the European middle class is retrenching or not expanding in the wake of the financial crisis and sort of that huge engine which has been powering global growth actually stalls, would the middle class in China and indeed in other Asian economies be large enough to power the global economy?

So in both cases my sort of entry point into the middle class is really the entry point of asking about whether this is a group which is significant enough to actually drive the economy, either the global economy or China's economy. So that's very much of an economic perspective, and that's why in terms of definition I have tended to use a definition of the middle class, which is heavily biased towards consumption. It's the middle class as a consumer in the same way as the US middle class' consumption is driving the US economy. I'm interested in looking at whether the Chinese middle class' consumption can drive China's economy and whether more broadly the Asian middle class' consumption can drive the Asian economy.

For economists when they come to look at this kind of emphasis on consumption as a driver of economic growth, there are two ways of approaching the middle

class. You can either look at it as a relative definition, which to some extent is the most intuitive. After all, the middle class is a group of people who are in the sort of, you know, the middle income distribution of the economy.

The difficulty, of course, with doing that is that if you then want to look at cross country comparisons and talk about a driver of the global economy, you rapidly get into difficulty because the people in the middle of say, you know, China's income distribution or indeed India's income distribution are going to be radically different in terms of their purchasing power expenditures, the scale of their consumption from the people in the middle of the US income distribution.

So the alternative approach is to use an absolute definition and say all of those people who have a similar income level and define this in purchasing power parity terms so that you really are trying to compare apples with apples, all of those people should be considered as part and parcel of a global middle class. And then what you need to do to define a global middle class is to define the boundaries, and I have rather arbitrarily taken as the boundaries \$10 a day per person and \$100 a day per person as the lower and upper end of the distribution for defining the middle class.

Roughly what that means and why I've used these numbers is because at the lower end, \$10 a person, you know, comes out to be something like \$14,000, \$15,000 per year for a family of four. It turns out that that's almost exactly the poverty line for the poor OECD countries. So this definition says -- you know, nobody who is considered poor in a rich country ought to be part of the global middle class. So at \$10 per day you exclude everybody who is considered poor in a rich country.

And equally I wanted to say that people who are considered rich in a rich country should be excluded, and it turns out that \$100 a day is kind of a cutoff. It's twice the

median income level for the richest rich country, which is Luxembourg. So you kind of exclude the rich portion of rich economies and the poor portion of the poorest rich economies, and that gives you a sort of range. And I've taken that range and applied it globally and in particular to China.

The other advantage of doing that is that it turns out that this range of incomes basically includes the range where economists feel that people actually start to have discretionary choices in their expenditures. They start to demand goods which are slightly differentiated from each other. They start to pay a little bit extra for quality. They start to look for brands.

So many of the things that we're accustomed to here in terms of just the variety of goods is really associated with the middle class' desire to have something that is, you know, more than just a commodity. So, I mean, it's the shift from everybody wearing Mao jackets to people actually wanting to wear clothes which are tailored to them and are looking a bit different from each other, and for economists, this is the range where actually income elasticities of demand are greater than one, meaning that you're going to be, you know, buying more and more of these goods as your income levels rise; and that generates sort of a self-sustaining momentum towards ever higher growth.

So that's this kind of this notion of a middle class which can drive growth and where you get these new activities. You get, you know, producers who are desperately keen to tap into the new trend in consumption, figure out what preferences people have. They're investing in marketing. They're investing in brands. They're investing in new products, and all of those are the kinds of things which really can drive an economy beyond just basic mass commodity production.

If you take all of that, what you find is that today China's middle class is

actually quite small, you know. Of course, China is a big country, but in global terms China's middle class is only spending about 4 percent of total global middle class consumption. Global middle class consumption today is probably somewhere around, you know, \$21-\$22 trillion. I mean, it's enormous. It is, of course, the driver of the world economy. The world economy is about \$60 trillion. So these are very big numbers.

But China is actually small, and the reason for that is quite straightforward. It's because Chinese household income is rather a low share, 37 percent to be exact, of China's GDP, and within Chinese household income, households actually save quite a lot. So they're not spending so much. So the amount that they actually spend is even smaller. So the range of people that is spending in this middle class range that I've talked about is actually quite narrow.

Cheng Li talked about 22-23 percent of China's population being in the middle class by this kind of combination of definitions. If you take my absolute definition, you'll get a number which is half that. It's about 12 percent of China's population, 150 million, 160 million people who are in the middle class, again, defined in terms of their actual spending.

So it's small. So why then are people making such a big fuss about it? And the answer, of course, is that what matters for the global economy is not the absolute size but it's the growth; it's the delta, and this is where we find that things are really potentially quite dramatic, countries like China, which has had, you know, this tremendous period of expansion and of poverty reduction. You know, remember, China used to have the world's highest, largest numbers of poor people. Now the numbers in absolute poverty in China, according to the World Bank, have fallen to something like 100 million. So that means that everybody else, so 1.1 billion roughly, are not poor, but a very large number of

these people, about 500 million or so are actually in the range of \$5-\$10 per person per day spending, i.e. they're just below this threshold poverty line that I talked about.

And what's happening is that there is a tipping point here. You don't have nice smooth increases in the middle class. If you've got a big fraction of people who are just below the middle class threshold, then small increases in their income levels can push them over that threshold, and they become solidly a part of that middle class; and that is basically what is happening in China and to a lesser extent in India today but also in a number of other fast-growing, emerging Asian economies, so including Indonesia, including Vietnam, although Vietnam is still poor, and then some of the still populous countries like the Philippines, Malaysia, and Thailand.

So you do have this kind of phenomenon of a tipping point, and add to that the fact that just in terms of numbers of people, obviously China is so large, and you get these stories then of, you know, China being the biggest. And China is always the biggest, so it's become the biggest market for new automobiles. It's the biggest market for cell phones. I mean, even General Motors that used to sell, maybe five or six years ago -- GM was selling 10 cars in the United States for every car that they sold in China. Today the ratio is roughly 1:1.

So for all these companies and indeed countries, the new market, all their growth is coming from these new emerging markets, and when I look at the growth of the middle class over time, starting today and going forward for the next 20 years, 80 to 85 percent of the growth in the middle class is going to be happening in Asia; and a big part of that is going to be in China. So it's this sense of the tipping point and the sense of growth combined with the fact that China is absolutely so large that I think makes China really interesting to so many people.



As yet, I would say China faces a chicken and egg problem with respect to its middle class. As I said before, China's middle class is still quite small in global terms and small in terms of the share of its population. I don't think that it's large enough as yet to actually drive the Chinese economy. China today has a per capita income of around \$6,000 in purchasing per parity terms. In most economies, other Asian economies, for example, that had per capita income levels of about the same amount, maybe a bit more, \$7,000 or so, the middle class would constitute 50 percent of their population. So those countries were able to relatively easily switch over from export-led growth, which sort of, you know, powers the development of the middle class to begin with, and to then turn it into the middle class powering growth. That's sort of the virtuous circle that you're looking for.

In the case of China today, I think there is still very much a chicken and egg issue, which is that the middle class in China will not grow if there is no economic growth, and there may not be economic growth if the middle class doesn't get bigger because the current strategy for economic growth has been so heavily dependent on exports on the one hand and investment on the other hand. So if exports slow because of a sluggish global economy, and if investments slows because of overheating in property and asset bubbles and all the rest of it, China's growth could slow. And if China's growth slows, then its middle class won't grow, and if its middle class doesn't grow, then China won't grow.

So that's the basic problem. It seems to me that it's a double barrel, two-fisted reminder that I'm running out of time.

So in this, China is showing a pattern of growth which is quite distinct from that of Korea, Japan, et cetera. In those countries you had high rates of investment, you know, consumption at about 50 percent of GDP, but consumption distributed across a much broader middle class than you do in China.

So I think that a real priority for China is how does one get that middle class to expand and grow in the reasonably short term so that it doesn't also stall if Chinese growth slows down. Most of the discussion on this has focused on trying to reduce savings in Chinese households, and people have talked about better Social Security. They've talked about better health care, providing education, you know, a lot of what I would call long-term institutional changes to try to persuade people that the public sector is going to take care of their future needs, and so they don't need to save for themselves in order to do so. That type of behavioral change historically is a fairly slow process. It's not an impossible process, but it's not something that happens overnight. It's not something for which there are magical policy levers. I doubt that it's something that will really work in the kind of time frame that we're talking about to expand the middle class. So I think that there's an agenda there, which is an important long-term agenda, but is not really going to be an agenda which is going to help in the short-to-medium term.

So what are the other possibilities? Well, one possibility which I talk about in this chapter is something which is currently being tried in the US right now, it's reduced taxes on labor. For the average Chinese worker, take home pay is only about 65 percent of total compensation; 35 percent goes in a variety of social insurance type taxes. Now, I mean, that's a pretty big chunk for a group which is still not all that rich. China wouldn't need to run deficits in order to reduce those taxes. To be honest, it's generating considerable revenues right now in the profits of state-owned enterprises. Cheng Li talked about just the largest state enterprises, but state-owned enterprises, their profits probably account for 7 percent plus of Chinese GDP.

If you could find a way of getting that money into the treasury, then you wouldn't have to raise so many taxes. It's not a difficult calculus. What's difficult is the

political economy of actually figuring out the ownership rights over those profits and then transferring them to the treasury.

The third measure is, I think, financial sector reform. Now you might think that is a little bit strange to be a middle class policy, but the fact of the matter is that the share of wages in China's GDP has been falling steadily since the 1980s. It used to be about two-thirds of GDP. Today it is about half of GDP, and the reason is that China's GDP growth has become very capital intensive. It is becoming capital intensive because small new firms have no access to finance. So they suggest that about half of all SMEs do not have a bank loan. If you don't have a bank loan, if you can't generate credit, you're not going to employ people because at the end of the day you need that working capital in order to be able to meet your payroll.

So shortages of employment basically means low aggregate wages. High wages is obviously the quicker stepping stone to becoming a middle income family. I think if China did more in terms of financial sector reform and access of small and medium-sized firms to the financial sector, there is a lot of potential for increased employment. With increased employment growth you would also get increased wage growth. You'd get two-income families. You'd get a much more rapid rise in the middle class.

So I think that there is a lot that can be done to boost China's middle class. I think that China already has a natural momentum of rapid growth, which is pushing a big segment of the population into the middle class. It's really a race against time. If that momentum of current growth is sustained long enough, then this great mass of the middle class, I think, will start to take upon itself the expansion of China's economy into the future, and the result could be in 20 years and extra 500 million people also moving into China's middle class. That sort of the good news scenario.

The bad news scenario is if growth stalls early, the middle class is still too small. Even these policies that I'm talking about may not be sufficient to make that middle class into a driver of economic growth, and China could be in for a hard landing.

So that's why I think that the middle class is actually something rather important for China and deserving of further study as in this book.

Thank you.

MR. WHYTE: I'm also very glad to be here, and thanks to my former colleague and friend, Ken Lieberthal, for inviting me. He didn't mention that I became an ex-Wolverine a little before he did and taught down the road at a place called George Washington University for a few years in between, and I always enjoy coming back to Washington. And today you even arranged Boston-style weather for me to make me feel at home.

It was also mentioned that I'm a sociologist, the only sociologist up here today, and I don't imagine there are too many in the room today.

So my first couple of comments are from a disciplinary perspective, things that I think that are great about this book. Speaking as a sociologist specifically, the first is that some of you know that Cheng Li has a bifurcated career of research. He studies the very top Chinese elites and does very good work on that I gather, although it's not a turf that I tread myself, so I can't really judge it. But he also is a closet sociologist, and today in this book he is again showing his bona fides as a closet sociologist; and he is doing a great job at it.

The other thing is that this is -- he referred to this a little in his opening presentation. This is a great introduction to research being done within China by Chinese sociologists, mostly by training, some of them who are represented in chapters, either sole

authored or co-authored, but also who are reviewed by Cheng Li's own essays here that are doing excellent work on this that most of us don't know.

Basically what happens is when I started studying China, which was in the Plasticine Era, there was no sociology in China because it had been abolished in 1952. So the idea that there would be sociologists in China that I could talk to or collaborate on research with didn't come to mind, but after Mao's death in 1977, sociology was rehabilitated along with political science and other disciplines. But for a considerable time after that, sociology was a discipline in which Chinese had to go study abroad or foreigners had to come in and lecture in China. So we were the teachers and they were the students. They had to learn from us. We had all the, you know -- so we were the ones that could even study things about internal developments in China.

But now, from the evidence in this book, the tables have been turned. There are a large number of very talented Chinese sociologists. Some trained abroad who have gone back, but some trained domestically who are doing very good research; but most of it is published within China, not in Western journals. So those of us whose Chinese has gotten rusty, even if we're in the trade, we don't really bother to read those. So thank you very much for doing such a good summary.

Now on to the substance of what's happening with China's emerging new middle class from a sociological perspective rather than the very interesting economic perspective that we've just heard about. And there are sort of three main questions that are addressed in this book Cheng Li mentioned, to some extent, in his introduction.

First, how do you define middle class, and how do you draw the boundaries? What makes sense?

Second, how -- the issue that Homi Kharas has talked about. How large is

the middle class and how rapidly is it growing?

And then the third question, which is probably the one most people in the room are most interested in, the "so what question". Okay. It's large and growing, but is it going to have an impact on China's future development? And if so, what kind of an impact? Is it going to have an impact fostering political change, even democratization, dare we say it, or maybe political instability, or is it a force actually for social stability and continued Communist Party rule?

So I'm not going to say much about the second question because, as we've already heard, there are multiple different ways of counting the numbers of middle class coming up with different estimates. Whatever estimates you come up with, as Homi Kharas has told us, China has more than anyplace else, but then it really is a "so what question".

I'm going to spend a few minutes talking about the definitional thing because after all I'm a sociologist, and I assume you're not. So you want to know how sociologists see this. Maybe you don't, but I'm going to inflict it on you anyway.

First, for his purposes, the kind of income definition that Homi Kharas used makes a lot of sense, but for studying things sociologists are more interested in, it doesn't. And particularly for studying things even political scientists are interested in, potential for change or stability in China, you want something that is not so sort of arbitrary. You want something that has some potential for providing clear boundaries that might, as Marx used to tell us, give rise to things like class consciousness because after all if a class doesn't have consciousness, it's not going to do things that are going to be important for society.

So let me just say a couple things about what I see as the -- well, let me step back a minute and say, first, in studying America or other Western societies, there's almost as much disagreement about what the middle class is, and how to define it, and what

are the boundaries as there are for China. So this is not something that is distinctive to China just because the middle class is only now emerging and growing. We've had a middle class very substantial for more than a century certainly, and we still can't agree on it.

If you ask in a public opinion poll, Americans, what class do you belong to, in some versions about 80 percent said, "Well, I'm in the middle class." Well, how meaningful is that? What does that mean? Sociologists don't rely primarily on these kind of subjective definitions. They usually rely, as Cheng Li indicated on a combination of things, but I would say the most useful is -- it starts with occupation, okay. And the question is how does the middle class differ from what's below them, the working class, and how do they differ from what's above them, the upper class or whatever you want to call them?

And so the middle class, most sociologists, for our own society, would say it involves people who are involved in mental work occupations and rely primarily on wage, salary, and/or self-employment fees kind of incomes who don't primarily rely on income from assets, property, profits, and so forth. So people who mainly rely not on their own wages, but they're up there in the upper class, okay, and below them are the working class who are in manual labor occupations and so forth.

So I won't go into this further now, but it turns out that some of the contributors to this volume end up using criteria similar to what I'm talking. There's an essay by Li Chunling who comes up with a very similar formulation.

But one of the things that I would criticize for the volume, and some of the contributions, including hers, is that it's too expansive. So Chinese entrepreneurs and private businessmen are, for unaccountable reasons, included, from my point of view, in the middle class. Well, as a sociologist, they're upper class, or at least they -- you know, if they have enough income, they're upper class and so forth.

There is also some confusion of this in the Western literature. So if you look at Marx originally and Barrington Moore later, the bourgeoisie are not the middle class. Those are the owners. They're the capitalists, the merchants, the bankers, the businessmen. But later on in discussion when it gets to Seymour Martin Lipset, bourgeoisie becomes the middle class, okay. So we also have this slipperiness.

But what I would say is there needs to be some attention to who is in the upper class and why in China and not lump those -- so it's, from my point of view, Bruce Dickson's very fine essay in this volume -- full disclosure, he's a former colleague and also a former student from Michigan days -- it's a very fine essay on, once again, showing us that the private business people in China are not a big force for democratic change, but then I wouldn't have expected them to be because they're, you know -- I might have expected from Barrington Moore's perspective or maybe -- but not from Seymour Martin Lipset's perspective.

Well, let me go on to say what all of this has to do for thinking about China now rather than about the West. The first thing I would say is these class frameworks only make sense within a market capitalist kind of framework. Mao famously thought classes and class struggle were very important, even after socialism. And I have argued in print that he confused the hell out of the Chinese people because in the culture revolution there were three competing theories and frameworks for how you analyze classes and who is in which class, you know.

But from my point of view as a sociologist, socialist China under Mao did not have social classes, just as Marx would have said they didn't have social classes. You can't have that. It was essentially a bureaucratic allocation rank society, and one of the things that did was produce a situation in which people were very much oriented to sort of



locational features. And their orientation was entirely -- not entirely but primarily to their own *danwei*, their work unit, their locality, and where you were and what your rank was, was very important. Your educational credentials, your occupational standing didn't matter much. You didn't have much link to people outside.

One of my favorite antidotes from one of the early journalists, Fox Butterfield, who went when China opened up for the New York Times, the first New York Times correspondent. He had studied Chinese and became quite fluent, I gather, in Taiwan, and he went to check into this hotel when he first arrived. And the receptionist said *Ni shi na'er de?* Where are you, literally. Well, where am I? I'm here. I'm here to check into my hotel. What the hell you talking about. *Ni shi na'er de* means what -- what *danwei* are you from. Okay. It didn't matter, you know, other things about him. They needed to know his work unit.

So there was this kind of cellular hierarchical feature of Chinese stratification that didn't produce social classes in the sense that we understand it, okay, but, of course, market reforms have produced a whole, you know, market society, labor market, people changing jobs, people relying on human capital, occupational credentials to get jobs.

So a class structure has reemerged but along with still very powerful parts of the bureaucratic rank system that existed before. So it's kind of a hybrid society, but it still is sort of meaningful to talk about social classes. But in other respects China's stratification is very peculiar.

So the most important social cleavage in China today is not a class cleavage still. It's between rural and urban Chinese citizens from the standpoint of the kind of class analysis that I've been giving. Mostly those people are working class, you know, farmers and factory workers are working class folks, but the divide between them is huge.

From this point of view, the difference between the working class, the middle class, the upper class in urban areas is much smaller. And partly for this reason, many of the essays here throw up their hands and say, okay, we'll leave the countryside out. Okay. So even if 55 percent of the people still live there we're talking about urban China because we don't know what to do with the countryside because this class stuff doesn't really work very well there.

But let me turn now to that sort of final big question, which is the so what question. Cheng Li didn't mention this in his introduction, but in the essays here they really explore all of the possibilities and say that the Chinese government very much hopes that the growth of the middle class is not going to be a force for democratization, much less political instability, but is going to be a force for political stability. And the basic idea is that by having a rapidly growing middle class you somehow buffer the rich elites and powerful people up here against the disadvantaged people down here, and somehow that will make society more stable.

But he has talked about the opposite scenario in which, you know, middle class are more and more restive and assertive, and they pressure for more and more change.

Of course, there is a third middle scenario, which is the middle class is too big and too diverse to have any coherent effect whatsoever.

My own inclination is, in fact, to say that middle scenario is the most likely. For the purposes of China's political stability, other kinds of things, it probably doesn't make sense to talk about the entire middle class, whether it's -- I forget -- 140 million -- I forget all these numbers, but they're not class conscious. They're not going to act in concert. Partly it's because these cellular features of Chinese society that wall off still the city. You know,

this danwei from this other are still important.

A recently employed former student of mine working for Brookings in Tsinghua, Wang Feng wrote a very good book describing how, even in recent times, the pattern of income distribution in China is much more effected by these horizontal differences than it is by class like differences or educational level differences within China.

But the more important thing is that there is a lot of research in Western societies, including America that says, well, the middle class doesn't act in concert, even in a place with a mature middle class like our own society.

So, the -- you know, within the middle class are people like me, okay? But it also includes all kinds of other people who are very different from me. A lot of those Tea Partiers are middle class. But I don't see too many Tea Partiers running around Harvard for some reason or other. They don't seem to be -- so.

You know, the middle class in any society includes, you know, creative artists and intellectuals. It includes office clerks, it includes primary school teachers, it includes engineers. It includes people doing all kinds of things.

There's a sociologist who doesn't study China, David Grusky, mentioned to Cheng Li, who basically argues we have to start looking not at the whole middle class but looking at particular segments. But even within that -- I mean, I'm a sociologist, okay? Somebody who's a professor of engineering or a professor in the medical school, you know? They might not be like me at all, you know? They drive Mercedes, I don't. You know, I have a Subaru. We're very different.

But, so -- but on the other hand, I don't insofar as this topic is important; I think there are segments that are potentially important within the middle class. And I think the government has to be more worried than reassured, okay?

One of the things -- I recently published a book called *Myth of the Social Volcano*, which was -- it's not for sale in the back. You'll have to go to Amazon; you can get a discount there, not from the Brookings bookstore. But, it's based upon a national survey conducted in 2004 to try to find out how Chinese look at current patterns of inequality and distributive injustice issues. And when we conducted the survey the presumption was very much like the government's that all those, you know, the people in the country side, the migrants, the unemployed workers, people in the interior. These people are the most grumpy and they're being left out. But people who are well-educated urbanites, they're much more satisfied.

It's almost the reverse, okay? It's not your absolute where you are, but what's happened to your family and your relative expectations. On most measures in our survey, people who are still rural cultivators are more optimistic and more accepting of the rules of capitalism and the structures of current inequality than are people in urban areas. And within urban areas, the most educated are the most critical. Okay?

So on balance, you know, the urban middle class is not -- at least in terms of distributive justice issues -- is not inclined to be more conservative than other groups. But if anything, more critical.

And there are also some other segments within the middle class that deserve, you know, our constant attention. So, creative intellectuals of various kinds, in any society, are always a force for change. Cheng Li also mentioned the whole question about university graduates. Unemployed or under-employed.

Some of you may have read -- there was a fascinating *New York Times* article over the weekend about this. China has undergone, as with most other things, maybe the most rapid expansion of university enrollments of any society. You know, within roughly

a decade there were 10 times as many university students in China as before. Well, the only problem was this was not in response to market demands or -- this was a Stalin-ist policy. We need more university graduates. We need to keep our students finishing middle school, bottled up and off the streets. So let's build more universities.

So China now has many more people being graduated from often new and second-rate universities, who are expecting to enter the middle class but are not managing to do that. They're either unemployed or they're working in the kinds of jobs that rural migrants formerly. The *New York Times* article talked about this. There's a sociological volume called *The Ant Tribe* referring to these, you know, middle -- university graduates who are now sort of downwardly mobile compared to their expectations. Seems to me, these are the kinds of people that the authorities have to be worried about.

So, this volume doesn't sing a single story, as Cheng Li mentioned. There's all kinds of different views, not only on how to define the middle class but also on the political potential for change and so forth. And there's plenty enough very high quality essays here that I -- even though I'm not involved in it, I'm not going to take a credit. All I get is a plane ticket and a nice lunch. But, I commend the volume to you.

Thank you. (Applause)

MR. LIEBERTHAL: We should be getting our speakers wired up. Yeah, thank you. I've learned from experience that it's helpful if the moderator stands rather than sits, so they can see people in the back of the room who want to jump in.

While they're getting wired up, let me just raise, if I can, one question to Cheng, give him an opportunity to kind of make one more comment on it. And one quick question to Marty. These are both for short answers while people kind of think through what questions they want to raise.

Cheng, first for you. This plays directly off what Marty raised at the end and is kind of mulling over from your remarks, which is that you extrapolated into a -- I think your own conclusion that the middle class is going to be politically very powerful. And on balance, could be a politically huge problem for the Chinese government.

I had the same question Marty had. But let me phrase it slightly differently, which is, middle class is big and diverse. Obviously a lot of them have a lot of gripes about a lot of things. Is there any evidence that they should be treated as a group and could be organized as a group? Or would act in a cohesive fashion? Or, are we going to have a lot of different types of folks -- sociology professors, engineers, and others who can arguably be swept into a definition of a middle class -- each pursuing their own gripes and their own ways, and therefore relatively manageable?

Do you have a thought on that, or?

MR. LI: Well, certainly this is a very good question. I agree there's tremendous differences within the so-called middle class. As someone said, make the term plural, middle classes. And certainly they are quite diversified.

But on the other hand, the concept itself is important. The consciousness about being a middle class and have similar lifestyle, similar kind of a consumption. And also, political identity switch. Because based on our definition of middle class, this is including state's own, you know, managers -- own enterprising managers. And also, government officials, including party officials.

Yes, that the party, you know, as we know it has 78 million people. But the interesting thing is some surveys indicate party members are even more critical of the leadership than non-party members. This is based on several studies. So, sometimes they can switch their identity if the regime becomes a problem. They can be very critical,

even communist party members.

So I think that it's really a battle to find the right identity for people. At the moment, the middle class uprising -- that era is still in the beginning. But the top-notch scholars are searching for ways; leading university research institutes are doing research. Most of that research is finding this, including CASS -- that's Chinese Academy of Social Sciences. This is actually quite conceptive academy, but the researchers actually derived some of the studies quite critical, you know, or dangerous from the government's point of view. They wanted to increase the critical, sometimes even challenge -- sometimes they find some different identities other than party membership or government officials, and et cetera.

So, I think that in the next decade that the middle class -- because they control media, because they are educated elite, because they started to talk about the home ownership movement, and also that they pay the taxes, they want certain kinds of, you know, benefit. And also recent fire in Shanghai; also make the government very nervous. This is also middle class neighborhood, right? And they are in revolt. And also, some for environment or different causes.

So, what I'm saying is, that's an ongoing battle. But it's not always the case that the middle class sided with government. The middle class has become increasingly, as a collective group -- because the concept is widely used. And look at the Chinese media. So many people talk about you become middle class, zhongchan, you know, et cetera. So in that kind of a movement, countries will play a political role itself.

I think there's a scenario that the middle class conscious will overweight other kind of identities in Chinese society. Therefore, it's a big threat to the Chinese government.

MR. LIEBERTHAL: It's an interesting point. Let me give a little bit of a counter, and then we'll move on. My counter would be: there's middle class sensibility. But that sensibility very likely includes not being a cog in a larger political movement. But rather, being quite individualistic.

And so, I mean, certainly in the West people think of themselves as middle class tend to think of themselves as, yeah, we don't do labor unions, right? We -- you know, we're individuals, well educated, have choice in consumption, have a lot of gripes, and expect the system to adapt incrementally in various ways as our gripes become more prominent. It's very different from the kind of image that you're suggesting here. So I'll just throw that out.

Marty, for you. My only question for you is I was recently in the countryside near Shanghai. And let me tell you, a lot of folks out there live a middle class lifestyle even though they have a peasant hukou. Right? And, so I guess my question is, you kind of wrote off the ones on the wrong side of the urban rural residency, hukou divide, as not really being relevant to the middle class. And I wonder, is there a serious middle class, effectively? Certainly by income categories, and in many ways by consumption categories. And increasingly, even educationally as these folks find ways to educate their kids among people with a rural hukou. Considering --

MR. WHYTE: Sure. Yeah, I didn't mean to write them off. What I meant to say that is many of the essay writers in the volume couldn't figure out how to take them into account.

MR. LIEBERTHAL: Oh, this was an artifact of the volume --

MR. WHYTE: And I think there is a growing middle class in the countryside and particularly in the suburban communities around the large cities where



people are very prosperous and where, you know, some people in these suburban communities, they don't want to become an urban -- you know, have an urban house of registration. They want to hold onto their land claims. They aren't farming themselves --

MR. LIEBERTHAL: Right --

MR. WHYTE: They're actually in some ways becoming upper class because in some of these communities, by my definition, they're living on the rents or the fees for giving up their land claims for development and so forth.

So, back -- let me just mention on, you know, this volume, again, has a lot of different voices. There's a very good essay by Luigi Tomba about the role of housing. And we've heard a lot about these homeowner's associations. One of the critical things about homeowner's associations is these have arisen from below as expressing local interest. They don't fit the traditional Chinese Leninist style mass association controlled by the party. But, as Tomba emphasizes in his essay, mostly these are people that are focused on the management of their own particular fancy housing development and they're not really concerned about what's going on in -- so there's very little from his sense that --

MR. LIEBERTHAL: As a cellular, yeah --

MR. WHYTE: -- people that live in fragrant gardens are going to be making common cause with people that live in, you know, I don't know, orange horizon over here.

MR. LIEBERTHAL: We'll open it up. Let me ask you to identify yourself. You know, name and what danwei--

MR. WHYTE: What danwei --

MR. LIEBERTHAL: -- and feel free to direct your question to a particular

speaker, or simply to the group as a whole. Begin with Yancy Molnar, here, if -- we have microphones coming up.

No, up here. Front row. He's Fancy, not Yancy. This is Yancy.

MR. MOLNAR: Thank you. Yancy Molnar with ACE.

I guess this question would go to all three of you. And Cheng Li, you touched on it briefly in terms of state-owned enterprise employees. You started out by saying how they're starting to crowd out the private sector, how many people are applying for jobs.

But where would you put in? And this is in all three categories. Where would you put in the state-owned enterprise employee that makes \$10,000, is not considered middle class by your economic definition, but has access to the state-owned company funds, and is not necessarily maybe comfortable with his living using unofficial funds? And, therefore, not fit into this middle class that maybe restless.

MR. LI: Well, should I?

MR. LIEBERTHAL: Yeah.

MR. LI: I think that the state-owned enterprises, you know, during the past decade or so moved up and down a couple of times. And for most of the 1990s, the state-owned enterprises were in trouble because it did not perform well.

Then all of a sudden during the past decade they became very economically successful, largely because of monopoly. Not because of the market they became competitive. This is partly related to government subsidized, or indigeious innovation or protection, and et cetera.

Just to give you an example, China Mobile. As I mentioned that it accounts for half of the profit of the old 500 combined. And, its rank on the Fortune 500

moved up in the past decade from 400 to 300 to 200 to 100. This year it's ranked number 77. But no one will say that the company is based on -- that the innovation, technology breakthrough. There's no incentive, because of monopoly. Half of the income in 2006 comes from so-called roaming fees.

MR. LIEBERTHAL: I think the question is about the employees --

Mr. LI: Yeah -- the employees also become incredibly rich. And just last week they caught -- they are using high-ranking or middle-rank. Like the CEO of China Mobile, in Sichuan recently caught himself; he got \$100 million USD bribery for other things, and embezzlement.

So the middle level, state-owned enterprises -- particularly so-called SASIG (?) companies become incredibly rich. These are really not middle class, but the rich class. They are the people, black collar workers, you know. The heiling jieceng -- people hated them.

MR. LIEBERTHAL: But what about the people below that?

MR. LI: But below that or lower, I think recently they have a good job, very secure, with old kind of benefits. And they differ from the civil servant. Civil servants work directly for the government offices. These are the state-owned enterprises. Both of the low-level, they are part of the middle class, but are not rich. But, they have secure jobs.

And what I said early on is, the private sector really suffered during the past 5 to 10 years because they no longer, like 10 years ago, became the real value for becoming rich, like the Deng Xiaoping era in 1980s and also including 1990. But now they cannot compete with this kind of lack of security, lack of benefits, lack of the bank loans, so many other things.

So, I agree with Homi that in the future the developing middle class largely depends on whether this private sector can revitalize. But to answer the question, it's that income is decent, it's pretty high. It's good job, people envy, but also the middle-level leaders and also the CEOs and whatever. These are the incredibly rich people.

MR. LIEBERTHAL: Anyone else on this? David Gries is about four rows back on -- no, here, here. Up front, right.

If people stand when I call on them, it will be easier to get the microphone to the right person. Thanks.

MR. GRIES: David Gries. My danwei is China Vitae.

My question goes to the reaction of the Chinese government -- let's say the communist party -- to the expansion of the middle class. We have a number of examples of how the government through the Three Represents and other measures has tried to recruit business people and non-government people into the party. And using some of the figures that you have used and also one of the charts in Bruce Dickson's chapter where he figures that one third of the entrepreneurs are party members, we certainly know that most of -- probably all executives, middle level and up, of SOEs are party members. All the senior government people, of course, are party members.

So, you're probably up to 100 million people right there out of a middle class that might be double or triple that. How do they weigh in this equation? I mean, where -- or is it, as Professor Whyte suggested, that all these groups are divided into sub-groups? So maybe they don't weight as a single portion?

MR. LIEBERTHAL: So the key is whether party members are a key differentiating impact of middle class consciousness?

MR. GRIES: That would be part of it, yeah.

MR. LIEBERTHAL: Okay, good. Next --

MR. GRIES: And what is the party's view through all these people that I mentioned of what's happened?

MR. LI: Well, as you mentioned correctly that 34 percent or probably higher of the private entrepreneurs are CCP members. But at the same time that, you know, state-owned enterprises most -- actually, probably 99 percent -- are party members, these middle- and high-level SOE managers.

So, but these two groups themselves are also quite different. So it's really during the past decade or so that kind of the Three Represents the idea to recruit entrepreneurs in the party -- even did not announce already it's a reality -- make the party membership more diversified.

Even not only party members -- if you look at the local government leaders, they are also quite diversified in their views. Sometimes when I talk to local leaders in China I found that if the regime changed, it will not affect them that much. So again, at the moment they support the central government. It's their interest to see the stability. But also there's argument to argue that obsession with the stability is really not right. It's still only just want to reinforce one party rule, not open system for more competition. So that view is also shared by some party members.

So I think communist party members -- even some of the local leaders -- you can even go up. You know, Wen Jiabao himself was censored, has been censored by the establishment. You do see the diversified views.

So, this diversity, you know, in the leadership, in the society, it's a very healthy development. This also gives the multiple identity for any individual to choose around. So, as we know that identity is flexible, manipulate-able, changeable, right? So

again, we should not only look at whether you are a party member or you are a state-owned enterprise. You then have a set of views. Sometimes there's also, within the same sector, they have different views depending upon the situations, their economic well being, or their political opportunities.

So, to answer your question, they are quite diversified.

MR. LIEBERTHAL: I would also remind you that local level leaders at every level of the hierarchy are promoted more on the basis of a demonstration of a high capability in bureaucratic capitalism than on any other single criteria. So, you're --

MR. WHYTE: Let me also just mention one finding from my study about feelings of distributing justice.

Party membership is not an important predictor in almost any of the scales that we use. So there are both party members that are more critical and less critical. We expected party members to be more favorable and less critical, but that was not -- the rural, urban thing made a much bigger difference. Education made a much bigger difference than party membership.

MR. LIEBERTHAL: I'd like to jump to the back of the room if there are any questions in the back of the room. I don't want you to feel excluded here, but we can only get to the vast middle here. I don't know whether there's something to do with what they're hearing from the podium. Matt, here --

MR. WHYTE: Michael Deroot has been asking for --

MS. ZHANG: My name is Karen Zhang; I'm with, actually, Jiangsu with the Phoenix TV.

But my question is actually only represents myself. Because is it a question that I've been asking myself and seeking an answer forever and still can't find

any solution. Don't know where to go. So since --

MR. LIEBERTHAL: Please.

MS. ZHANG: Yes. Actually from my experience I have a lot of friends that are actually between those heiling -- the black collar, right? And those people with stable jobs. A lot of people, these are very educated people and these people, they own houses, they own cars, they have babies. But for me it's almost impossible to identify their occupation. I don't know what they do; I don't know where the income comes from. It's like, a lot of friends are, like, my friends living in Beijing and in Shanghai and in those big cities actually live like that.

So I was just wondering, what can they do? If they find a job, it's impossible to cover their living cost, apparently. And if they don't have a job they all try to do some business and try to be successful, but apparently it's very hard, it's very competitive.

So I was just wondering, what should they do to remain -- I mean, these are very unstable elements in the society, in the country. They could either go up or down. So I was just wondering, what should they do? And what can the government offer these people in order to keep their level?

So, that's my question.

MR. LIEBERTHAL: Okay. So we're looking for career counseling here. (Laughter) I'm not sure whether anyone wants to respond to that or whether it's an interesting question but --

MR. LI: I think you have a varied observation that there's multiple ways to become part of middle class or enter the well-to-do or well-being or xiaokang, you know, families. And stock market. The housing reform, to a certain extent, created a middle class. All of a sudden, their property becomes, you know, several millions, you

know, whatever. Or, et cetera.

But the problem is that now becomes increasingly difficult to join the middle class, particularly in major cities like Shanghai, Shenzhen, and Beijing, because housing becomes so expensive. You must know the movie, TV series called *wouju*, probably translated into English like *Live in Shoebox*. You know, it's the difficulty to get the housing that people desperately want to become part of that middle class. So, that movie itself really becomes a strong critique of the government. And also corruption of -- the official corruption.

So, you know, on one hand you see the different message on one hand. Wen Jiabao said he'll watch it, you know, he himself early on also lived like a shoebox. Apparently endorsed that movie. But also, the propaganda department wants to censor, wants to ban that film. Eventually, actually aired several times on the national TV.

But, this will tell us the vulnerability of the middle class and their political position can constantly be changed. If their stock crashed, if this government started to have a tax on middle class property -- you know, property or housing, the middle class will revolt. This is, you know, through the Chinese media discussion. They already become a strong interest group for change.

Now, but does this really tell -- the government should open more channels from both state and also private sector to really expand the middle class. This is a return to David's question. Does China start ideological change in 2002, when Jiang Zemin talked about enlarge the middle class, then become legitimate. So a lot of publication occurred during that 10 years.

So, I think that battle is still going on. But again, the policy implication for the middle class, you know, can very quickly, you know, mobilize the society -- part of



society which is, in my view, is the most crucial part of society because it dominates the media, it dominates political opinion.

MR. LIEBERTHAL: I will say there is also a lot of evidence that when a stock market crashes you get debility and despair rather than revolt and --

MR. LI: Sure.

MR. LIEBERTHAL: So, these are very open outcomes.

Jonathan Pollack and then I will come over here and then back there, okay?

MR. POLLACK: Yes, I'm Jonathan Pollack and my danwei is the Thornton Center.

MR. LIEBERTHAL: Welcome home.

MR. POLLACK: Thank you. My question really goes to an issue or terminology that Cheng Li raised several times, but I'm going to try to link it to what Homi Kharas said, because, Cheng, you mentioned specifically identity. And I know the volume is not focused on, if you will, identity politics. But it seems to me that there is a very important relationship between identity and how that gets channeled. And that question of a tipping point, which at some level, it seems to me, is a numbers game. Is there a sufficient critical mass, and is there a linkage here -- potential linkage here that cuts across the concerns of different constituencies?

Now, that's not what we're here to discuss, but I'd be curious about the thoughts of any of the panelists about whether or not in the channeling of aspirations of one kind or another you see possibilities for those kinds of linkages to emerge in coming years?

MR. KHARAS: I think that as China's economy has obviously becoming

--

MR. LIEBERTHAL: I'm sorry. Can you hear Homi in back? You can, okay, I'm sorry. I wasn't -- please.

MR. KHARAS: China's economy is obviously becoming much more complex. Many more different types of occupations and jobs. One of the, you know, difficulties in defining class with respect to occupation is that occupation is, in turn, a very dynamic concept. And the kinds of occupations that you have today, with many people being, you know, self-employed, differ considerably with the kinds of occupations that you might have had 20 years ago. So, it's hard to get that sense of movement.

But, it -- I would slightly take issue with Cheng Li's characterization that it's becoming harder to enter the middle class in China today. I actually don't think that that's true. I think that the numbers joining the middle class are extremely large. So, many people are becoming successful in joining the middle class today.

By virtue of that success, it means that there are, you know, others who are finding it harder. So, I mean, obviously you do have some that get squeezed out. But they're getting squeezed out because of the success of what I would call the majority. That's why I think that there is this tipping point. And, it reflects itself in a number of different ways.

So I think there's a recognition today in the party that the middle class is actually a very important segment of society that needs to be catered to. And I would say that this notion that many party members, apart of the middle class, in turn has led to a change in policy away from a fairly significant focus on poverty reduction -- which really was at the heart of so much of China's previous Five-Year Plans and their economic policy, at least, towards now this sense that the strategy has to change away from being just one

concerned with poverty alleviation and concerned with policies to address those at sort of the bottom of the income distribution to addressing the concerns of those in the middle of the income distribution.

And just rolling that all the way back to the first question, I think what's happening in state enterprises is state enterprises, in turn, have shed so many jobs over the years. Productivity in state enterprises has risen so much that the workers who remain in state enterprises now typically have become members of the middle class because they have stable jobs, their productivity is much higher, they are actually earning a fairly good wage, and they're entering into this category of people that has discretionary income to spend, especially if they're in households with, you know, two incomes.

So, I get the sense that these things are coming together. And sort of the economic surveys that one sees suggest that people by and large are quite content with the opportunities they have of joining the middle class. Polls suggest that people in China are extremely satisfied with the direction of the economy. If you narrow that down to the middle class in China in the new Pew Global poll, they're even more positive about that, certainly in terms of international comparisons. They're very positive about that.

So, you know, yes there are going to be challenges. But by and large, I think, you know, a big chunk of people, what they see is real opportunity. And real opportunity to join this lifestyle of having car ownership, home ownership, cell phone ownership -- I mean, ownership over material goods, white goods, all kinds of consumer durables, et cetera. And, you know, a very different lifestyle. And that's slowly spreading in China from a goods-orientation towards a services-orientation. And that's also part and parcel of the emergence of a middle class economy is because middle class typically tend to demand more and more services and services which are different from just public

services. Its private services catered to their needs.

MR. WHYTE: If I could just weigh in on this. To be a sociological quibbler, again, it seems to me part of the disagreement has to do, again, with who's in the middle class and who's in the upper class.

As we've heard the black collar described, if there are people who have money to spend lavishly and are not working at jobs, they're in the upper class. They're not in the middle class, in my terms. And maybe it's an empirical question; is it harder to get into the upper class? And, what is the upper class?

But, in terms of entry into the middle class, which is not, mostly, the black collar -- the black collar is somewhere up above there --

MR. Li: Sure --

MR. WHYTE: -- and it seems to me it's definitely growing.

MR. LI: Yeah, I want to add. Actually, I agree with you, Homi. But I want to make a distinction between perception and reality.

The reality is middle class is expanding in very fast pace in China. And not only the major cities, but also the second-tier or third-tier cities. It's really in fast-paced development.

And also, that even rural areas you see the phenomenon when workers don't want to leave because they suddenly realize their land is very, very, you know --

MR. LIEBERTHAL: Valuable --

MR. LI: -- could be valuable. So if the real rural reform started in the rural area, you also want to aim to create the middle class. That will be a really wonderful, wonderful development for China. But the government at the moment is still very nervous.

But the perception is -- because perceptions can show by major, you know, group in cities. And when their children or middle class graduates cannot find jobs, they always complain. And also, by the fact that China, like India and many other countries, you see parallel and seemingly contradictory development on when can you see the rise of middle class. The other, you see increasing economic disparity and the gini coefficient actually increase. Both are true. But they emphasize economic disparity, and to make a political point.

And particularly urban, major cities it's very difficult to find housing. Almost hopeless to join the middle class. So they want to make a lot of noises. But the reality of the whole country, there's a fast development going on. I agree with Homi that you will see the number actually increase. And according to Wuxing and others, each year there will be 1 percent of China's population -- namely, about 7.7 million people -- join the middle class.

MR. LIEBERTHAL: 1.1 percent is 13 million.

MR. LI: Sorry? Well, the labor force is what I --

MR. LIEBERTHAL: Oh, the labor force. I'm sorry --

MR. LI: Yeah, labor force.

MR. LIEBERTHAL: Please, sir.

MR. OKIGUCHI: My name is Kuni Okiguchi with Washington Research and Analysis. And, Homi knows me from my previous generation.

But when I came to the United States in 1960, I think that was a time when Japan's per capita income was more or less comparable to what China's per capita income is today. And then you had this whole series of 10 percent per year growth for 20 years, and then before soon you had Japan's per capita income at 30-, 40,000 per capita

level.

And I regard Japan to be more or less an independent province of the Chinese cultural sphere. (Laughter) By virtue of -- because having achieved this high income, they don't quite spend it the same way as, say, Europe or, especially, United States. Their housing remains small, they essentially -- is a bureaucratic, socialist country. They rely heavily on trains and so forth.

So my question is, should you -- I think Japan was a 1/10th scale model of what is happening to China. But it is wrong to see China as a single entity. But in terms of it would be easier to look at Shanghai area, Hong Kong area, Guangdong area. In fact, Taiwan is a quasi-independent portion of China. Then you have Singapore, Hong Kong, et cetera.

So, should you not pay more attention to the development path of China through the previous models, such as existed in Japan?

MR. KHARAS: I mean, I think that the huge difference between China today and Japan at that time is that in 1960, by the kind of definition that I'm using here, Japan had 48, 50 percent of its population in the middle class. So it already had a group that was able to drive economic growth.

So, you know, I think if you were to crudely characterize the way in which Japan developed it was that the export-led push actually created this middle class and then, to a certain point in time, the middle class took over and drove the Japanese economy. Because exports were actually not a very large fraction of Japan's total GDP -- led to rapid convergence. Japan had very good technological adaptation from the West, and it had a domestic market which was large enough in these terms in order to sustain that growth. And meanwhile, exports also made sure that there were no balanced payments,

constraints, et cetera.

You see exactly the same pattern happening in Korea. You see the same pattern in Taiwan. What you don't see is that pattern happening in China, because China's household income is such a small fraction of its GDP. And China's middle class is still such a small fraction of its population.

So from that point of view, China actually looks today much closer to what Brazil looked like in 1980, when Brazil also had the same per capita income as China. Brazil's middle class was about 20-odd percent. And Brazil stalled. And it had grown to that level on the back of agricultural commodity exports. And when that started to taper off, it did not have the potential to generate the kind of domestic-led, self-sustaining growth because it had a rather small middle class. It's only today when the Brazilian middle class is now quite substantial -- again, just over 50 percent -- that Brazil is showing signs of renewed growth vigor.

So to me, this big question is, how can China get a significant middle class rapidly enough to be able to counter what will inevitably be a reduction in demand for exports? And, a reduction in the -- its ability to consistently increase the share of investment in GDP? I mean, investment in GDP can't keep rising forever. And you're already seeing signs of fairly gross misallocation of resources within China. And, you know, there's, you know, a fairly significant need to shift and rebalance.

So I think that that puts a huge premium on, you know, coming back. What policies can be put in place reasonably quickly to expand the size of the middle class?

MR. LIEBERTHAL: And as I recall, you identify those as reducing taxes on labor, financial sector reform, and basically capturing more SOE profits that allow the

government to have less of a burden on individuals?

MR. KHARAS: Right.

MR. LIEBERTHAL: Is that right? As I understood that, you excluded -- I mean, by implication excluded -- housing reform as a major component of this? And building a social safety net?

MR. KHARAS: No. Actually, I could have said more about housing reform. I think that would be an important component of this --

MR. LIEBERTHAL: And the social safety net, you should be used --

MR. KHARAS: The social safety net, I think, is a --

MR. LIEBERTHAL: -- but only very slowly?

Mr. KHARAS: -- long-term institutional, you know --

MR. LIEBERTHAL: I raise those only because so many people immediately leap to those --

MR. KHARAS: Right. So, I think it's -- I think the social safety net is a very important issue.

MR. LIEBERTHAL: Yeah.

MR. KHARAS: I just don't see it taking effect fast enough to, you know, make the kind of changes. I mean, that's the 20-year solution.

MR. LIEBERTHAL: But what I hear the economist saying here is China is -- runs a serious risk of entering a period of much slower growth than they anticipate because of changes in the external demand structure --

MR. KHARAS: Right.

MR. LIEBERTHAL: -- and an inability to make that up domestically, despite throwing a lot of money at different sectors to try to do it.



MR. KHARAS: Yeah.

Mr. LIEBERTHAL: Is that right? Interesting. We have time for probably two more questions. Yes, sir. Back here and then over here.

SPEAKER: Professor Whyte talked about the recent expansion of the Chinese higher education system. I've heard a lot of anecdotal stories saying that the expansion has been pretty awful in terms of the quality of graduates, especially once you get beyond the first tier schools and beyond the hard sciences. Do you have any comments about that?

MR. LIEBERTHAL: Some of us professors do like to think that it takes more than building a bunch of buildings to have a first-class university system, but we're prejudice. Anyway, but let me turn it over.

MR. WHYTE: Well, China has gone through some very strange maladies. Again, thinking as a university professor. Under Mao, there was a period of seven years in which there were no university students enrolled at all. Now, that's -- you know, that doesn't seem like a good way to run a railroad. And now they've done kind of the opposite. They've gone to the opposite extreme of mandating from above and what I call a Stalin-ist style. You must expand, you must produce more.

And I think inevitably -- I mean, you know, China is an extraordinary place with, you know, a huge number of talented people. But, you know, I don't think you can create overnight high-class institutions. Some of the best universities have actually been more successful in resisting this. So, Beida has not expanded nearly as rapidly as some of these provincial universities and so forth. They're trying to hold the line in order to preserve control and quality and so forth.

So, I think it's very -- I literally think it's one of the most bizarre things that

Chinese leadership has called forth in the last, you know, 12 years or whatever. And I really can't quite comprehend why they are doing this. And, why they don't see the potential risks in it.

But I think in terms of quality, that there are even lots of Chinese students enrolling in these institutions that are complaining at, you know, this is not the quality education I was led to expect, this diploma I'm going to get does not say the University, it says the Branch Campus, the Subordinate of the -- you know, there's a lot of anger and anxiety of this whole question about the multiple tiers of schooling that are now being created and the quality differences and the reputational differences among them.

MR. LIEBERTHAL: Homi, did you want to jump in here?

MR. KHARAS: I mean, there's -- obviously when you have numbers of this magnitude you're going to get some issues on quality. But if you look at labor market analysis, the skills -- the wage premium for people who actually have a university certificate is not declining. If anything it's still going up. So, despite all of the, you know, major problems with generating high-quality and supply in the labor market, you're not seeing evidence that these degrees are being dismissed as being worthless.

Now that might be that what's happening is that the university system is playing a role not of adding human capital, as we would normally like to believe it does, but of simply screening people in terms of abilities and capabilities. But that, in turn, can be a valuable function for the labor market.

MR. LIEBERTHAL: That's an important point.

We just have a short time, so let's -- yes.

MR. REAM: My name is Gary Ream from the Cato Institute. And my question was how does interaction with foreign products and foreign information help

shape the Chinese identity in the middle class -- individual identity?

MR. LIEBERTHAL: So, how does interaction with foreign products and foreign --

MR. REAM: Information.

MR. LIEBERTHAL: -- and foreign information help shape middle class identity and kind of individual identity?

MR. LI: Well, Chinese middle class are crazy about the Western products. You know, I don't know whether they are rich class or middle class. I tend to think they're middle class, you know.

The story that I read in LV stores in Paris. You know, they have to close early on every afternoon because the Chinese customers are waiting in a long queue every morning to get their three -- there's limits for three, you know, bags. You cannot buy more than three. But these are very expensive bags. Each of them cost 5,000 Euro, or maybe even, you know, \$10,000 USD. But that's the consumer power. They love Western brand names.

MR. LIEBERTHAL: And all made in China.

MR. LI: Well, not necessarily. Actually, (inaudible) worship foreign brand names. This is related with the fact that China's state-owned enterprises, despite the rapid growth, they cannot have their own brand names. They have to, you know, merge with or borrow or buy, you know, foreign brand.

Now, in terms of information, I think middle class are increasingly unhappy with the difficulty to access information. And the fact is that, you know, so many things are blocked. And the YouTube is blocked; some of the things that they could previously access are now blocked. I think the government should be careful if they

block too much. As I quoted, some of Chinese scholars -- they will be very, you know, angry. Middle class wants to change that.

So you're absolutely right. The question about the foreign products and also the information. Access to information is crucial.

But on the other hand, middle class is also quite nationalistic. You know, you can also say that because they think this is first time in the PRC history, maybe, since Opium war China becomes a major power. And, they want to have -- you know, deserve respect and et cetera. So, that kind of dynamic exists, both are true.

MR. WHYTE: Let me just mention one -- my first -- this first student from China that finished a PhD after I got to Harvard. Her parents came to attend the commencement. They hadn't been in the U.S. before, and she was driving them around Cambridge, and her mother turned to her and said, oh, they have Starbucks in America, too. (Laughter)

MR. LIEBERTHAL: That's the kind of line you want to end on, but there's one questioner who has been waiting for a long time and I neglected to call him. So, go ahead with it. Sean, can you bring it? Thanks.

MR. MITCHELL: Thanks. By definition, this will be a short question.

Mr. LIEBERTHAL: Preceded by name and affiliation.

MR. MITCHELL: Oh, I'm sorry. Gary Mitchell from the Mitchell Report.

I thought I heard you say, Cheng, early in your remarks a line that sort of seemed like a throwaway. And I wanted to come back, see if I got it right. And if I did, maybe you could just flesh it out a little bit.

I thought I heard you say something about the fact that it might be a worthy goal during Hu's visit to forge middle class ties --

MR. LI: Middle class ties --

MR. MITCHELL: And I thought to myself, what does that look like?

What -- if you were going to do that, what would you do and who is the beneficiary?

MR. LI: Yeah, that's a good question. I'm so glad you raised the issue.

Now we -- today we're looking at China. There's so many bad things. Look at the media report, all negative. Liu Xiaobo, Chinese government handled so poorly. Chinese sense of media targets NGOs, state-owned enterprises in the name of innovation. Really, Chinese protectionism or mercantilist practice. So all these negative reports.

But we tend to overlook some positive development in China. You know, sometimes we continue to demonize China. Sometimes rightly, but in general it's wrong. Because country changes so much. If there's -- if a country has a middle class, it will more likely make that country become a more normal country, normal state. That can build up a confidence from us, or mutual trust. Because these people probably are similar to us.

Look at the young people in China, in Beijing, in Shanghai, Shenzhen, or Nanjing. They're quite similar to the young people in this country or the young people in Taiwan, in South Korea, in Japan. And that has a profound implication in terms of mutual understanding and et cetera.

I think the U.S.-China relations, there's a lot of disputes. But at the same time there's common ground. And in my view, China's middle class not only can eventually change China's international image because they want to meet international norm and standard, potentially, but also can really contribute to global economic development. This is only still the beginning of China's rise of middle class.

You know, you said there's a 12 percent. But we expect, as you mentioned, that in about 10 years China will be the largest middle class market. So, ultimately China should be a part of solution rather than part of the problem. So therefore, emphasizing the middle class ties could be a way to cause confidence on both sides. Make China have more confidence and behave appropriately.

I'm not saying that we should ignore the human rights issues, religious freedom, and the Internet freedom, et cetera. And at the same time addressing these positive issues can also make Chinese look at their own, you know, problems. So, rather than just demonize them and point finger to them. But emphasize the positive development gives Chinese people confidence.

Now, Hu Jintao's visit is not just to represent himself or represent the Chinese Communist Party, but it represents emerging power with 1.3 billion people. And, including increasingly ever-expanding middle class. So really, we're talking to this audience that it will contribute to the good relationship of this country. This is what I mean by emphasize the forge of middle class ties.

MR. LIEBERTHAL: I think this discussion has brought out vividly both the complexities of the issue and the importance of the issue. And I really want to thank our three speakers. Cheng, for putting together the volume in the first place, which I want to remind you is available at a 20 percent discount as you go to your right out there where the bookstore is still open. Homi Kharas and Mary Whyte, for doing excellent commentaries and all three for responding to very good questions. And you, for raising those questions.

So, if you'll join me in thanking our panelists. (Applause)

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