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CHINA'S REEMERGENCE AS A GREAT POWER: COMPARING AMERICAN AND JAPANESE PERSPECTIVES

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PANEL 1: CHINA'S DOMESTIC ECONOMY

PROCEEDINGS

RICHARD BUSH: I'm a senior fellow here at the Brookings Institution and the Director of our Center for East Asia Policy Studies. It's my pleasure to welcome you here, welcome you to what is certainly my Center's last program of the year and maybe one of the last at Brookings. It's the first session in a two-part U.S.-Japan dialogue on perspectives on the Chinese reemergence. And I'll explain what that means.

At the outset I'd like to thank the participants in today's program, particularly our presenters who have travelled all the way from Japan on short notice, all the other participants, moderators, discussants, and so on. I'd like to particularly thank my staff that has done a lot of hard work to put this together. It will come as no surprise to anyone in this room when I say that China's power and influence is rising very rapidly. We know all the facts about its fast-growing economy now about to be number one in the world. It's increasingly interdependent with other economies in East Asia. For the last two decades China has engaged in a sustained and systematic modernization of its military capabilities and its power projection is a new fact of life in East Asia. As China's interest in East Asia and around the world grows its diplomatic activity and its influence grow a pace. For me to note these trends is a stunning statement of the obvious. This is today's conventional wisdom. The only thing that is startling is the speed with which these trends have emerged. At the same time attitudes about China around the world have grown more varied and changeable. If you take only the United States and Japan for example, American favorable views of China declined by almost a third from 2011 to 2013, from 51 percent to 37 percent. In the same period Japanese favorable view of China declined from 34 percent to 5 percent, the biggest shift of any country in the world during that period, positive or negative.

The big question in all of this concerns the implications of China's revival as a great power for the peace, stability, and prosperity, particularly in East Asia, but the world at large. The record of the last 40 years suggests on balance that co-existence, mutual accommodation, and mutual benefit is certainly possible because that seems objectively to be the interest of all parties concerned. On the other hand power transition theory suggests that such optimism is misguided, that competition, conflict, and even war is possible. Some of the events of the last six years appear to confirm that judgment. Given the uncertainty about the future of East Asia and a haunting sense that we are living in an inflection point it's imperative that we start from a sound understanding of the drivers of these changes. Among the issues we might address are China's long-term goals, its grand strategy for achieving those goals, its approach to risk, and the meaning of its day-to-day and month-to-month tactical moves. There is a question of course as to whether outsiders can answer these questions with accuracy and confidence.

As interesting as these issues are, however, they're not the subject to today's program; we will address them in a follow on symposium in a couple of months. Today's program focuses more on the internal drivers of China's external behavior, specifically its economy and political system. And these are the subject of perennial fascination and curiosity.

China of course has the greatest interest in answers to these questions, but aside from the China the two countries that probably have the greatest stake in understanding the sources, trajectory, and consequences of China's revival are Japan and the United States. Japan has the second largest economy in East Asia after China, a lively democratic system, and it's played an important leadership role in the region for decades. The United States is the world's largest economy still. It has been the guardian of the post war international order and not inconsequentially the United States and Japan are allies of long standing. For that latter reason alone it would be good for our two countries to have a shared understanding about China and where it is going. This certainly should be possible since Japan led the study of China by foreigners in the first half of the 20th century and the United States has arguably led the study of China ever since. But there are reasons why gaining a shared understanding is not necessarily easy. Geography alone fosters different perspectives. China is separated from Japan by a Sea and from the United States by a very large ocean. Each country has its own scholarly and analytical traditions and trends. In both countries there is a range of views on the various aspects of Chinese reality. So between China and Japan perhaps the most we can hope for is a shared understanding, not an identical understanding.

But the purpose of today's program is to present what I think will be representative and mainstream views on China's politics and economy by leading scholars from both Japan and the United States. There's no great pretense here that what you will hear are the Japanese views and the American views. As I said there is a range of views in each country, but there is a value in hearing the views of prominent scholars from each country in order to observe the areas of overlap and if they exist the areas of difference.

We will begin with a panel on the Chinese economy which will be chaired by Malcolm Lee, a Non Resident Senior Fellow in the John L. Thornton China Center here at Brookings. Malcolm has a deep understanding of the Chinese economy gained both from government service in the Clinton and Obama administrations and in the private sector. The second panel on Chinese politics will be chaired by Jonathan Pollack who has studied China his entire professional career at the University of Michigan, the Rand Corporation, the Naval War College, and since 2010 here at Brookings.

Before I turn over the chairing duties to Malcolm I would like to acknowledge my debt of gratitude to Professor Akio Tanaka of the University of Tokyo. He has been my partner in this effort and I'm really deeply appreciative of his assistance and understanding.

So, Malcolm, the chair is yours. And the other people on the panel if you could come up and take your seats.

MALCOLM LEE: I'm Malcolm Lee. Thank you, Richard, for the kind introduction. As Richard said I'll be moderating the first panel on American and Japanese perceptions of China's economic reemergence.

We're all familiar with some of the facts around China's remarkable economic performance over the last three decades; I'll just highlight a few. China's economy emerged from

isolation to deliver unprecedented economic growth that has lifted over 500 million of its citizens out of poverty. China is now considered by the World Bank as an upper middle income country, the per capital national income now over \$6500. In 2013 China became the world's largest trader in goods. The value of China's trade has doubled every four years over the last three decades. There's been a significant shift in the kinds of things that China exports, from textiles and apparel to oil-based products, to high tech machinery and electronics. In 2013 China surpassed Japan as the largest holder of U.S. national debt. And in October of this year China became the world's largest economy in purchasing power parity terms according to the IMF. It has held that position with the exception of the past three centuries through most of human history. And China now comprises almost 30 percent of global GDP growth, significant at a time of tepid global growth. Despite these successes China's leadership seems to understand that its investment in export growth led model is not sustainable. President Xi has called for deep reforms of the Communist Party's third and fourth plenums with pledges to make market forces decisive, treat domestic and foreign investors equally, and to reform governance and the rule of law.

We have three very distinguished U.S. and Japanese scholars who will discuss U.S. and Japanese perceptions of China's reemergence as a global economic power, the nature and state of China's economic reforms, and their perceptions, and perceptions and implications for China's first and third largest trading partners. First we'll hear from David Dollar. David is a leading expert in China's economy and U.S.-China economic relations at the John L. Thornton Center here at Brookings. He served as Treasury's main man in China and imperiously worked at the World Bank for more than 20 years. Then we'll hear from Hank Levine, a Senior Advisor at the Albright Stonebridge Group where he advises companies as they enter and grow in the Chinese market. He served as Deputy Assistant Secretary for Asia at the Commerce Department and U.S. Consul General in Shanghai. Professor Tomoo Marukawa has just gotten off the plane from Japan and I'm told he's leaving tomorrow, so we thank you for your trip here for this event. He's a Professor at the Institute of Social Sciences at University of Tokyo and has published widely on Chinese industry and economy. We're honored to welcome him here to Brookings.

So with that why don't we start with David and then Hank and the Professor.

DAVID DOLLAR: Thank you very much, Malcolm. It's really a great pleasure to be here. I think this is a very interesting topic for a conference, you know, U.S. and Japanese perceptions about the rise of China. I'm naturally going to be speaking about my own views, but I think a number of my views are pretty typical of American analysts, particularly American economists. I'll try to indicate where I think there's pretty clear agreement among American economists.

Let me start by saying that I think American leaders and American stakeholders generally welcome the reemergence of China, we welcome the economic success of China. As the most populist country in the world it's natural for China to be one of the biggest economies. Malcolm cited various statistics. China's tremendous growth over the past few decades has had a lot of spillover benefits. China imports a lot, different types of things from different countries. This has had a lot of stimulative effect for other developing economies, for advanced economies. So I think there's a lot of economic benefit from China's success up until now.

Now having said that I would also say that I think most American analysts feel that China's growth model, its old growth model, is running out of steam. Its old growth model depended very much on exports and also on a very high investment rate, and when the global crisis hit and that really took the wind away from China's exports China replaced that with even more investment, a big stimulus program that took investment up to 50 percent of GDP. That was probably a sensible response initially to the global crisis, you know, but having maintained that for a few years China now faces the problem that it's creating excess capacity throughout its economy. You know, when you invest 50 percent of GDP you build up all different types of capacity very, very quickly and then the issue is, is there really demand to use that. And what we're seeing right now is lots of examples where there is no demand to use the capacity that's been built up.

So I'm thinking about empty apartment buildings, and whole empty cities distributed around China. So excess capacity in the housing stock, tremendous excess capacity in heavy industries like steel and cement operating at about 50 percent of capacity. And I think excess capacity in local government infrastructure. A lot of the stimulus program was aimed at building up highways, metros, airports, high speed passenger rail. Certainly China needed a lot of that, but I think the evidence is China is now building highways that have very minimal usage; some of the recent sections of the high speed passenger rail connect pretty remote parts of the country, you've got modern airports that are barely used in cities that we've never heard of. So I think there really is, you know, a serious problem of excess capacity and that's one of the reasons why the economy is slowing down because it's natural for investment to slow down as it faces over capacity and poor returns in so many different sectors.

There are other reasons why the old growth model is running out of steam. The old growth model generated a lot of environmental degradation, so China has very serious problems of air pollution and water shortage. Dealing with those is naturally going to be expensive. And then I would also say that an important part of the old growth model was the one child policy and its effects on demographics. By tremendously slowing down fertility and population growth China for a while accelerated the growth of per capita GDP, but from here on I'm afraid it's going to be paying the necessary price. China's labor force has already peaked and started to decline. The population is projected to peak in 2030 and the UN projects that over the rest of the century China's population will decline by 40 percent. You know, it's hard to maintain rapid growth when your population and your labor force are declining at a pretty rapid rate.

So I think there are a lot of reasons why the old growth model is running out of steam and it's natural for China's growth rate to slow down. So we're not going to see growth rates of 10 percent any longer, not on a sustained basis. Now having said that I think that most analysts and certainly David Dollar think that there are a range of structural reforms that China could carry out which to some extent would counteract the downward pressure, only to some extent. As I said we're not going back to 10 percent, but with a vigorous reform program China can certainly sustain 6 or 7 percent for another decade. But I do think it really depends on some aggressive reforms.

Now the key reforms are outlined in the third plenum resolution. Let me just mention a few. Of course it's good that this is recognized by the Chinese leadership and that there are on paper plans to deal with some of these issues. Let me mention a few that I think are particularly important. One is financial reform. China has had a repressed financial system that keeps interest rates low and historically has paid a poor return to households. That operates as a subsidy to investment and a tax on households. So as China thinks about changing its growth model, liberalizing the financial system, raising the cost of capital will both discourage wasteful investment, also give household savers a better return. So I think that's a natural reform. I'm also a big fan of hukou reform, reforming the household registration system so more families can move from the countryside to cities. You know, as I mentioned the labor force has already peaked, but China's urban labor force can continue to grow for at least another decade if they ease up on the hukou restrictions, because there are still way too many people living in the countryside. So if you have a steady flow of people from the countryside to the cities that keeps up the growth of the urban labor force, enables the modern sectors to continue to grow. To the extent that people are able to bring their families, that's going to be good for consumption. Anyone who moves from the countryside to the city pretty much immediately their income goes up by about three fold, you know. Even in China people consume most of their income, they don't save most of it. But also we consider health and education spending to be consumption in the national accounts; we call that government consumption. So if you've got more movement to cities including whole families the government is going to have to spend more on health and education. That's going to be good for Chinese people and that's going to be good for transforming the growth model toward more dependence on consumption.

Let me just mention one other reform which personally I think is quite important. You know, China has a pretty open system in terms of trade and investment concerning manufacturing, but they've made a very deliberate decision to keep most of the service sectors quite protected. So think of modern services like financial services, telecom, media, logistics, you know, all of these are sectors dominated by big state enterprises, they're closed to foreign investment. So among the G20 countries China is rated to be the most closed to foreign investment, you know, because those are important sectors of the economy and they're almost completely closed. Now China in the third plenum resolution says it's going to open up those service sectors. I think that would be an important reform. It's linked to the transformation of the growth model a little bit more subtle, but it happens that investment primarily relies on industry and once you reach middle income, consumption is primarily services. So when we talk about China reigning in wasteful investment and relying more on consumption, it's almost the same thing as saying that industry will play a less important role in growth and the service sectors will play a more important role. We already see this. The service sectors are growing a lot faster than the industry in the last few years. But if China is going to grow based on the service sectors it really needs to open them up and make them competitive and productive in the same way that it previously did with manufacturing.

So I think there's a clear reform agenda. Those reforms should raise household income and consumption, they should raise the cost of capital and reign in wasteful investment, and they should encourage more productivity, growth, and innovation so the economy can grow based more on innovation and less on capital accumulation.

Now it's good that all of that is written into the third plenum resolution, but I feel that the actual progress reform is rather slow and you can find lots of different stakeholders in the United States who also have written on this and argued that the actual progress with reform is rather slow. So we don't see very rapid movement in financial liberalization. There's some movement in hokou reform, but the government wants to ease up hokou restrictions in the third and fourth tier cities. Not clear to me there's going to be a lot of jobs in third and fourth tier cities, the big gains would come from easing up on the restrictions in first and second tier cities; you know, we don't see that so far. I emphasize the importance of the service sectors. We don't really see much movement there. So I think there's a real struggle going on. There are obvious interest groups who oppose all these different reforms. I worry that if China doesn't reform fast enough that there is a risk that its growth rate will slow down quite sharply beyond what we've seen so far. So I think the jury is out on whether China will successfully pursue this reform program over the next few years and really continue to grow reasonably well for a middle income country, or if there's not enough reform in view, the view of many analysts in the U.S., then we could see a pretty sharp slowdown in China's growth.

Let me just mention briefly on the U.S.-China relation, I think Hank Levine is going to say more, I do think China vigorously pursuing this reform agenda not only is it good for the Chinese economy, but it would also set a better foundation for U.S.-China economic relations, should lead to a more balanced relationship between these two biggest economies in the world. So I think that's a spillover benefit, not the main reason why China should do it. I think sustaining their own development is the main reason, but it would have the effect of leading to a more balanced relationship.

And then the last point I want to make is that I think it's noteworthy that China is trying to vigorously pursue economic reform and has certainly done so in the past, but it's not pursuing political reform. The new leadership is very clear that it doesn't want to pursue political reform. And I for one wonder or question whether or not China can move from middle income to high income without more political liberalization. Things like freedom of speech, freedom of assembly, freedom of the media. I would point out that there are no authoritarian countries that have reached 50 percent of U.S. per capita GDP. Lots of authoritarian countries have made it to middle income. There's a minor exception. There are oil rich states that have high income and are not politically free, but they're sitting on huge piles of oil. If you put them aside no one has really become a productive high income economy without some more free civil liberties and political liberalization. So it's always possible China will be the first, but I think when you see a strong historical pattern like that there's likely to be a logic behind it. You can get to middle income, you know, by copying and just by moving from relatively simple processes to the early stages of industrialization, but to get to high income you really have to become a more innovating and creative economy. And apparently it's hard to do that without more freedom of expression and freedom of ideas.

So I think many American analysts certainly hope that there will be political liberalization in China which could enable China to continue to move toward high income over the next few decades. Many of us question whether if there's no political liberalization will China

really be able to pursue this economic agenda and move to high income. Thank you very much. (Applause)

HENRY LEVINE: Good thanks, and first thanks to Richard and the entire team here at Brookings for the invitation and the chance to inflict my views upon you. Let me say that I come to these issues really as a non-economist and in fact really as a non-scholar, but rather someone who has spent the last 25 years or so working at that place where China's trade and investment policies intersect with the activities of U.S. companies. And so that's the kind of the background from which I will offer my comments, and I think reflecting to a large extent the views of many of the large U.S. companies that are involved in the China market, though I hasten to add that all of my comments are of course only my personal views.

I also believe that the development of China's reform and opening policies in the past have had a significant impact on U.S.-China relations and I believe that future development of the reform and opening policies will continue to have a significant impact on U.S.-China relations more broadly, and I'll come back to that in a minute. But if we look back at the history of reform and opening in China I think we see a mixed picture from the perspective of U.S. companies. On the positive side in addition to generating huge economic benefits for China I think it's fair to say that over the years and particularly following China's accession to the WTO the reform and opening policies have generated enormous opportunities, revenues, and profits for U.S. companies in the China market, and that applies both to the question of U.S. exports to China as well as U.S. companies investing in China. In that latter category the most recent U.S.-China business council survey indicated that 83 percent of their members who responded indicated that their operations in China are profitable which is a pretty hefty percentage. So a lot of economic benefit. Now I recognize that on the dramatic growth of Chinese imports into the U.S. of course has created a mixed picture. I think it brings a lot of benefits. Obviously a number of U.S. companies and some entire industries have felt the pressure from those imports and that's something we should recognize. But in my subsequent remarks I will focus really on issues related to the operations of major U.S. companies that are trading and investing with China. So in other words issues in the China market in part because they are the main focus I would say of U.S. government policy and because I think they have the largest impact on U.S.-China relations overall.

So as I mentioned we know that following China's WTO accession a great number of opportunities opened. Certainly it's fair to say the implementation of China's commitment proceeded unevenly. Tariff cuts were implemented very smoothly, enforcement of intellectual property rights maybe somewhat less so I guess. But it would be a mistake I would emphasize to focus solely on the shortcomings of implementation or the problems that still exist. And I just reiterate that there were tremendous positive economic gains here and benefits for U.S. companies. And I think it's important to keep that in mind. Sometimes in this town as one listens to the rhetoric we tend to forget that.

But it's also true that following China's accession to the WTO as time went on the process of reform and opening seemed to slow, maybe stop, and in fact maybe go backward in certain respects and in certain industries. I think different experts have a different assessment of

when to date that change, but certainly by the later years of the Hu Jintao-Wen Jiabao administration. That was obvious I think both to American and many Chinese observers as well. And the result was that U.S. companies and other foreign companies found themselves to their disappointment continuing to have to do business in an environment characterized by very extensive Chinese intervention into economic and even commercial matters. And I think there had been some expectation that following the WTO accession the process of reform and opening would continue in a direction and at a pace that would result in less intervention. And of course the intervention by the Chinese government very often has taken the form of decisions or policies intended to benefit Chinese companies at the expense of foreign ones. This is of course most clearly seen in the sectors that China considers strategic, IT sector, advanced manufacturing, and so on. One related sort of phenomenon has been the growing sense that major Chinese companies are becoming stronger competitors for U.S. and foreign firms, but they have achieved this as a result of support from the Chinese government as opposed to sort of fair competition.

And that brings us I think to sort of where we are now and the outlook for reform and opening. And interestingly in my view -- and David talked about some of the goals of the third plenum -- and, you know, my view is that there's a lot of overlap actually between what the U.S. and U.S. companies -- the changes they would like to see in the Chinese system and the goals of China's leaders as reflected in the third plenum, in particular again this notion that much more of the Chinese economy, and I don't think they're saying all of the Chinese economy, but much more of it should be driven by market forces and by competition. And for that reason I think a timely implementation of the third plenum blueprint will address a significant portion, not all but a significant portion of concerns that we hear out of the business community. Again as David noted, you know, the outlook for implementation of the third plenum is uncertain. It will require massive changes, laws, policies, and even changes just in thinking and attitude in China. And we know that there are winners and losers in such a process so it's going to be a tough fight I think.

For that reason I will leave to other experts sort of prediction as to the specific outlook for reform and opening, the timing, but I would offer thoughts on three points as we look ahead. The first relates to the difference between reform which I see as primarily a domestic internal activity, and this goes to the issue of fiscal reform, it goes to the issue of interest rate reform, the difference between reform and opening. The opening piece being opening the market, providing more market access for foreign firms, and generating competition from outside of China. And one of the concerns I think that foreign companies now -- and I know a number of the members of the U.S. business community are concerned that as the third plenum implementation goes forward we may see a much heavier emphasis on reform with less of an emphasis on opening. As one indicator of the attention that this issue is getting the U.S.-China business council has begun issuing a quarterly score card on implementation of the third plenum or on the economic reform and opening policies specifically with an eye to evaluating the impact on foreign companies. Their most recent scorecard was issued in October. They concluded that indeed there have been some reform measures implemented, but -- and I quote, "The policy specifics do little to address core issues of concern to foreign companies." So one issue as we look forward is this kind of balance between reform and opening.

Second relates to the interaction between the rule of law and reform and opening. David spoke more broadly about political reform I guess and I wouldn't differ with his views. I would focus a little more narrowly on the legal reform area. It's hard for me to see how third plenum goals of market driven growth and innovation can succeed without strengthening of the rule of law in China at least as it relates to regulatory and commercial matters. And I understand there are much broader issues here of human rights and free expression and so on and I think they're important, but at a minimum it's a little difficult to see how you'd build the kind of dynamic economy and innovative economy that China wants without a strengthening of the rule of law. Among other things human nature being what it is everywhere around the world, unless government actions are constrained by a set of transparent and fairly enforced rules and regulations I think there will always be enormous opportunities and a tendency toward corruption, and in fact for actions that favor companies that have particular relationships with the government. And this is of course tremendously distorting in terms of economics. The fourth plenum of course sought to address this to a certain extent, and as with the third plenum results I think, you know, we will need to watch carefully and see how fourth plenum implementation goes forward.

My third and final point relates to the interaction between reform and opening and broader U.S.-China relations. Over the last 30 years the major U.S. multinational companies have clearly been a significant stabilizing force in U.S.-China relations. And though they've often been unhappy and in fact very, very unhappy about particular Chinese policies, for most of this period I think they've had a certain level of confidence that as they looked out to the medium and then the long-term that China's trade and investment policies were moving in a direction that would present increasing opportunities for them in the China market. But as reform and opening was seen to have slowed and as other issues emerged we've seen some change in attitude I think among the business community and many companies have become to have deeper concerns about the fundamental direction of China's trade and investment policies. The factors in this kind of change of attitude include as I mentioned the sense that reform had slowed or stopped in the Hu Jintao-Wen Jiabao administration. Questions then about the pace and scope of the current reform and opening plans, third plenum and so forth. The cyber spying issue, and regardless of what one thinks about that I think it shook confidence significantly among major U.S. companies and caused them to question fundamental issues of China's policies. And then most recently a very recent surge in enforcement of Chinese laws on foreign companies in ways that appear to diverge from international norms and practices. And this goes along also with a sense that economic nationalism is on the rise in China. One indicator of this was the September survey by the American Chamber of Commerce in China in which 60 percent of the companies polled said they feel less welcome in China now, and that 60 percent was up from 41 percent in the previous year. I'd emphasize that U.S. companies still support strong U.S.-China relations, but they have begun to express more anxiety over the last few years to the U.S. government. In the broader strategic area we talk about growing mistrust. This in my mind is the parallel and equivalent of phenomenon in the commercial area, this concern.

Finally let me just say then that as we look ahead one item that is absolutely critical and I consider it in some ways a subset of the third plenum almost, and that is the U.S.-

China bilateral investment treaty. I think it is clearly a part of President Xi's thinking as a tool to drive reform within China, and I think that conclusion in a timely way of a high quality bit will not only have enormous positive commercial and economic impacts, but it will also have very positive effects on broader U.S.-China relations as it reinforces the notion that China is indeed committed to opening. So far the negotiators feel they're making progress. I think we should all just hope that that continues and the deal can be wrapped up in a timely way. Thank you. (Applause)

TOMOO MARUKAWA: So I'm greatly honored to be here. I'm Tomoo Marukawa from the University of Tokyo. And I fully agree with David and Hank that reform is very important for China to maintain its high growth, like six to seven percent. And I would like to focus my talk on what I think to be the most important part of the reform and also where the biggest difficulties of reform are felt. And that is state-owned enterprise reform.

Let me begin by summarizing the trends in the past state-owned enterprise reform. I think the biggest advance in state-owned enterprise reform has been made during the latter half of 1990s when Zhu Rongji was in office, a privatization of small and medium SOEs in the local governments and also a drastic downsizing of workforce. But since 1999 there has been a stagnation of reform. And one reason I think is because of the decision made in 1999 that stipulated that SOEs must assume dominant positions in so called important industries and important sectors. So in particular after the year 2009 when there was a global economic crisis, the state-owned enterprise assets increased as a percentage of GDP. And also according to my estimate SOEs share in GDP has even slightly increased since 2010. So I think was good news that in the third plenum last year there was a great advance at least in words on SOE reform. So this decision made in the third plenum has indeed created new momentum for reform. So in this decision it is written that state-owned enterprises no longer dominate the important industries and important sectors, but it is written that the state will still invest in these industries, but there's nowhere like dominant.

And also there is an interesting word, mixed ownership. And it seems to be that state-owned enterprises will be transformed into mixed ownership firms and according to my understanding, this implies that a substantial portion of state-owned enterprise shares will be sold to private investors. So this transition to mixed ownership is called *hungai* in Chinese and so in reading Chinese newspapers I see *hungai* every week. For example the biggest central state-owned enterprise, the China National Petroleum Corporation announced that it will sell its gas pipeline network in Eastern China and the selling price is estimated to be around 230 billion renminbi which is a big amount. And perhaps the second largest SOE, SinoPec already sold 30 percent of its sales subsidiary to 25 shareholders. And I think local government hungai plans or mixed ownership plans are more aggressive than central SOEs. Shanghai government announced that all SOEs in Shanghai will be transformed into mixed ownership within three to five years. And Hebei Province that there will be no lower limit of state ownership in their enterprises. And until now there hasn't been good coordination between the different ministries in the central government. It seems that everyone interpreted the meaning of mixed ownership as they liked. So there were very different interpretations of the word. So only last month the State Council has finally set up the leading group for SOE reform. And as soon as this organization was established

there took place a discord between different ministries. And one dispute is about who will be the *laoban* or owner of the state-owned enterprises. The State-owned Asset Supervision and Administration Commission insists that they will be the owner while the Ministry of Finance insists that they will be the owner. And also there seems to be a discord between SASAC and the State Development and Reform Commission about the scope of such reform. State Development and Reform Commission seems to be insisting in a wide range of industries this reform should be pursued, while SASAC seems to be very conservative. They don't want the central SOEs to be privatized.

So I think this indicates that there will still be lots of conflicts, difficulties, especially when the government will want to pursue mixed ownership in central SOEs. But on the other hand I think there is good news like the mobile telecommunications industry has begun to be opened up to many private enterprises. And also the banking sector; we saw five privately owned banks including one created by Alibaba, has just entered the industry. So generally speaking I am rather optimistic about the privatization of Chinese economy, although it will proceed very slowly.

I would like to add another word which is a comment raised by a business leader in Japan. A couple of days ago I made a similar presentation in front of Japanese business leaders and one gentleman who actually had a joint venture with a central SOE commented that this mixed ownership will not work because it virtually means partial privatization and in his view partial privatization is nonsense, only full privatization works. And also he raised the problem of personnel problem. I mean the high ranking corporate leaders' appointment still dominated control by the party, so if this problem is not solved then even some introduction of private capital will not be so effective. And I think this person is, based on his own experience, qualified to make such a comment. Okay. I will finish my presentation here. Thank you. (Applause)

MR. LEE: Thank you, Professor Marukawa. All right, we'll start with I'll ask a few questions and then I will open it up to the audience.

Three excellent presentations. I'm going to start with a question on China's reemergence and reform impact on the U.S. economy and the Japanese economy. Then we'll talk a little bit more about SOE reform. Then I would like to go to Hank's point on the implications of the changing business attitudes and what that means for U.S.-China relations and for reform and China's own goals for economic growth.

Well, first I'd like to go a little bit deeper on impact on China's economic growth and integration with U.S. and Japanese economies. And its impact specifically on U.S. manufacturing, on U.S. workers, on U.S. agriculture, U.S. innovation, and Japanese innovation, and on consumers. And I'll let each of you take any piece of that that you would like. We'll start with you, David.

DR. DOLLAR: Thank you. So the question is the impact of China and its integration with the world economy on the U.S., particularly manufacturing. So I'd like to begin by saying we shouldn't exaggerate the influence of China on the U.S. economy. Until recently

China was much, much smaller than the U.S. economy. So I'm talking about the 1990s for example. You know, China would have had an impact on some very specific industries in the U.S. like footwear, you know, garments and footwear, but I think it's hard to see a macroeconomic effect of China on the U.S. That's changing now that China is about a \$10 trillion economy, U.S. is \$16 trillion. So all the reforms that the three of us discussed, I think going forward they really could have a significant effect on the U.S. economy. But up until recently I think there's a tendency to exaggerate the impact of China on the U.S. economy. There's a long-term trend for manufacturing employment to decline as a share of the labor force for a lot of reasons. It's likely that China's emergence accelerated that trend a little bit, but I think the United States could have easily counteracted that with its own policies. So I prefer not to blame China for development say in U.S. manufacturing. I would blame the failure of U.S. policy.

MR. LEVINE: I guess I would defer both to David and Professor Marukawa on the economic aspects, but I would agree with David's comments that often the negative impact of China probably tends to be exaggerated. And I just comment that, you know, there's kind of a saying in the trade policy world that, you know, the positive effects of more open trade and investment tend to be very widely distributed across a country while the negative effects tend to be very focused. And so certainly the growth of imports from China as I mentioned has had a negative impact on certain U.S. companies and certain industries for sure, and yet the positive aspects, the raise in standard of living that we experienced because of inexpensive Chinese good, the ability over many years for the Federal Reserve to keep interest rates lower because of the inexpensive goods from China, or keeping down inflationary pressures. These things tend to be spread out and so I think there's kind of a natural political process here that tends to accentuate the negatives and downplay the positives. And again though I certainly would defer to David and Professor Marukawa on the specifics.

MR. LEE: Professor Marukawa, with respect to Japan?

DR. MARUKAWA: Well, from economic perspective I think China's rise has more impact on Japanese economy because China has long been Japan's largest trade partner. But at the same time I think even the people in the business community are quite afraid of China being so big because now the country's economy is even bigger than us. So I was shocked that last year there was a public poll, opinion poll to the Japanese business people asking about their prospects on the Chinese economy and nearly 70 percent of the people asked forecast that China will face big economic trouble within 5 or 10 years. And so that is kind of irrational in a sense, irrational kind of view on China.

MR. LEE: Thank you. Well, let's talk a little bit about China's SOE reforms. Professor Marukawa, you mentioned that SOEs account for probably about a quarter of China's GDP. Nick Lardy, one of the distinguished economists at one of our partner institutions here in D.C. has said that one-third to one-quarter of GDP that SOEs constitute is relatively small, that the return on assets of state firms is plummeting, around 3.7 percent in 2013 which is about half the cost of capital. He sees this as a huge drag on China's economic growth, particularly where state investment and services, where state investment exceeds private investment. But he doesn't

seem to worry too much about state capitalism and he says that it's more accurate to think of China as a market economy. I am interested in all of your impressions of that and so, Professor.

QUESTIONER: Start at the end?

DR. MARUKAWA: Well, I basically agree with the comment made by Nick Lardy. It seems to be a little bit exaggeration to call China as a state capitalist because the private sector is now perhaps nearly 40 percent of the GDP is contributed by the private sector. So China is now really a mixed ownership economy, but it is also true that what they think and what the government thinks as the important sectors are dominated by the state-owned enterprises. So there will be great business opportunity created by at least partial privatization of the state dominant sectors.

MR. LEVINE: I'd say that certainly Nick Lardy's economic analysis makes sense to me. I would draw a distinction I guess between the sort of economics of the issue and the policy dimensions. And I guess one could debate the question of how do you define a market economy; is China a market economy. Of course under U.S. trade law as a technical matter China is not considered a market economy, but putting that sort of definitional issue aside as I mentioned in my comments I mean the real problem is the sense that the Chinese government is intervening heavily in commercial matters in ways that support and help develop Chinese companies, whether it's through mandated unique technical standards, whether it's through using the definition of a domestic product for the purposes of government procurement, whether it's through the strategic emerging industries initiative, pumping a lot of money to certain Chinese firms, whether it's through the use of China's anti-monopoly law or other regulatory policies. So the sense that the extent to which the Chinese government is intervening in the economy and the scope of that intervention specifically to help Chinese companies relative to foreign companies is a huge big policy issue. And so one could argue about kind of is China market economy or not, but I think that's the root of a lot of the U.S.-China friction at this point.

DR. DOLLAR: I agree with Hank that there is a lot of intervention. And, you know, in my comments I choose to focus on distortions in factor markets meaning, you know, the financial system and the labor market and some of the important product markets, the whole modern service sectors are distorted in the sense of being very closed and non competitive. So I prefer to, you know, focus on some of those big distortions in government policies that have the effect of pushing both private firms and state firms and mixed firms, right; those distortions push them all in the same direction, you know. If you have very low interest rates it pushes all these firms to overinvest, right. If you've got distortions in the labor market that tend to keep wages low that affects all these firms. My own experience in China is it's often very hard to figure out who owns something. So the notion of, you know, kind of what's a private firm, what's mixed, what's state, I think it's often very hard to tell. And unfortunately Chinese entrepreneurs who thought they owned an asset, you know, and then it was taken away by corrupt local officials. So it turns out they didn't own the asset. So I prefer to go with the distortions in these different markets, you know, rather than to start from who owns what.

MR. LEVINE: Let me just add a comment if I could, picking up actually on the

last comment that Professor Marukawa made in his presentation where he quoted a Japanese business person, and that person I think, you know, hit on an important distinction. You know, there is question of ownership and as David said often it's hard to tell who owns what, but the other issue is sort of behavior and how an entity is treated by the Chinese government. And so again, you know, if you partially privatize but in fact the Chinese government continues to support that entity to build it up as a national champion relative to foreign companies, you're just in the same position as if it had never been privatized to any extent. So the real issue I think becomes are Chinese enterprises or enterprises that are wholly Chinese, are they all operating on the same level playing field in the China market along with foreign companies or not? And that's in a sense separate from the ownership issue, but again I think increasingly the U.S. government and the U.S. business community have focused on this sense of level playing field, equal treatment, putting aside to a certain extent the issue of ownership.

MR. LEE: So “state-supported enterprises” as opposed to “state-owned enterprises?”

MR. LEVINE: Right. If the effect is to give them an unfair advantage it doesn't matter whether the government actually owns them or not I think would be the view.

MR. LEE: Professor Marukawa, could you comment more on -- Hank commented on the changing attitudes, you know, of U.S. business, how are Japanese business perceiving the opportunity and the risks in China and how has that changed over time?

DR. MARUKAWA: Well, in the past I think many Japanese companies thought China as an export base, a place to make things not sell things, but nowadays more and more Japanese companies think China is a market. In the coastal areas the per capita GDP has already surpassed \$10,000, and in that case especially the services which has developed in Japan for Japanese middle or low income class has a very good chance of creating a big market in China. So we see a lot of for example *ramen* restaurant chains and convenience store chains developing in China. So thinking in this way more and more opportunities will be opened up for Japanese companies.

MR. LEE: Thanks. Why is a bilateral investment treaty from a U.S. standpoint so important? There seems to be a consensus among many that a bilateral investment treaty is probably the, you know, most important negotiated instrument that the United States could negotiate with China, but such a treaty would need to go through the Senate. And why is important and what do you think are its prospects?

DR. DOLLAR: Let me make a few economist points and then others could make their points. China is the second largest recipient of foreign investment in the world after the United States so it's the biggest developing country recipient. It has about 10 percent of the all the stock of foreign investment in the world is in China, so it's been a major recipient. The United States is the largest provider of foreign investment to the world, but only one percent of U.S. foreign investment is in China. So the U.S. is severely underinvested in China. There are a lot of reasons. You know, some are generic like poor intellectual property rights, but it's also the

case that China is pretty open to manufacturing, but as it mentioned it's extremely closed in a whole bunch of modern service sectors and energy and agriculture. So if you actually look at where the U.S. tends to have its outward investment, which is not manufacturing, there's some of course but the majority is in modern services and extractive industries, China is protected exactly in the sectors where the United States tends to be strong. So if we were going to have a successful BIT China would have to open up most of these sectors that have to be in negotiation. The only this is going to get through Congress is if most of these sectors would open up, so it actually would create a lot of opportunities for U.S. firms which up until now have been locked out of the Chinese market.

MR. LEVINE: Right, I'd agree with all that. You know, the core -- there are many aspects to a bilateral investment treaty, but the core of the issue at this point I think from the U.S., both government and business community perspective is this issue of dramatically removing restrictions on U.S. foreign direct investment in China, sectors that are now closed to foreign investment will need to be opened, sectors where there are various types of restrictions will have to be further opened. For example in the automobile sector, if you are an automobile manufacturer you can only go in in a joint venture with a Chinese partner and you cannot own more than 50 percent of the venture. So these are the kinds of things, this is the core of the goal. Let me note that, you know, Chinese officials themselves have spoken about the BIT as the most significant negotiation and potential for change since China entered the WTO. It also by the way goes to the issue of SOE reform because if you're dramatically opening so many sectors it will require opening a lot of sectors that are today dominated by SOEs.

With regard to the prospects in the Senate for the treaty, you know, to me -- and there are folks I know around town here who have made very definitive statements of it will never get through Senate and so on, it's kind of silly to me. We're talking about a process that will not happen for probably at least a couple of years. Some feel that two years to finish the negotiations in fact is optimistic, but even if we assume two years it's not clear what the U.S. economy will be like then and that will affect attitudes, it's not clear whether it will be this administration or another administration, it's not clear what the administration's legislative priorities will be at that time, it's not clear what U.S.-China relations will be by that time, and oh, by the way, we don't even have an agreement to talk about yet. And as David said, and I concur, that the most important factor will be the agreement itself. And if it is an agreement which clearly provides enormous benefits to most of the concerned constituency, most of the major industry groups, those groups will mobilize and will very actively work to get approval for the BIT, similar, on a smaller scale probably, but similar to what we saw when China's permanent normal trade relations status was being debated in the Congress as related to China's WTO accession. So I think speculation at this point is fine, but a definitive judgment on whether or not it can be approved really has to wait a little bit further down the road.

MR. LEE: Thanks, Hank. Why don't we open it up now to the audience; we'll have a microphone. I want you to raise your hand, if you could identify yourself and pose a question rather than a statement. Can we start here?

QUESTION: Bill Tucker. I've taken –

MR. LEE: Can you identify yourself?

QUESTION: Yeah. I'm a lawyer and an international trade consultant and a former member of the White House Counsel's Office. I've taken two multinational insurance companies into China, New York Life and ING, the Dutch company, and they restricted you to Shanghai at the beginning and then allowed you to expand out. Has that changed number one -- because this was ten or 12 years ago. And we've also, you know, represented some companies in regard to this majority ownership and, you know, there's a simple way around that and that's if you get 50 percent you simply get a Chinese partner to get two or three percent and then you own a majority interest. And we've done that with companies also. And so has that been employed by companies going into China that you know of?

MR. LEVINE; I think on the insurance companies heavy restrictions remain in the insurance sector and my sense is overall that the U.S. insurance companies that have gone into the markets shall we say have not achieved the kind of goals they had hoped to achieve. It remains the case that with the exception I guess of AIG which was grandfathered you can't go in wholly owned, you have to have a Chinese partner and I forget what the exact equity cap is. So that issue has not substantially changed. It remains the case also, I think the insurance companies continue to have concerns about approvals of branches with the sense that Chinese insurance companies can get group approvals pretty quickly, foreign companies are getting them much more slowly and one at a time. So there continue to be a number of challenges. Again these kinds of issues will very much be at the center of the BIT negotiations, or the BIT negotiations in the financial service area.

With regard to how you structure a deal, can you sort of gain effective control even though you're capped at 50 percent. I think companies do a lot of different things. I would just say that I think, you know, if you ask most of the U.S. companies involved given the preference they'd rather have the opportunity to come in wholly owned and that would make their lives much simpler. So as I say that will be an important goal across many sectors as the BIT negotiations go forward.

MR. LEE: And a BIT negotiation could become, you know, part of a template for a broader free trade agreement for Asia which the President has said that he supports in the long run. Why don't we get three questions from the back and let me start.

QUESTION: Hi, Philippe Le Corre, I'm a Fellow with the Center on the United States and Europe at Brookings. I'd like to ask the speakers one issue that has not been mentioned in the overseas investment by state-owned enterprise and private enterprises in China and I'd like to see whether this is seen as a threat by Japanese and American companies, and generally their assessment on the sectors involved.

MR. LEE: And can we get two more questions? We're going to just start working our way up from the back.

QUESTION: Thank you. My name is Kakomi Kubiasho with Kyoto News of Japan. I am wondering if any of you can talk a bit about the Chinese ambitions or interests in free trade area in the Pacific. And now we have the U.S. republicans are controlling the Congress and many people expect a new kind of momentum on the TPP negotiations, but if the TPP negotiations will fail to make progress in the first half of next year or something do you think it will not encourage China to take some actions to create the new similar kind of Pacific trade area that China is seeking by doing something like talking Singapore and Malaysia into seeking something new or something? Thank you.

MR. LEE: Okay. And one more.

QUESTION: Hello. My name is Helmuth. I would just ask the question about the impact of China's economic growth on the military development.

MR. LEE: China's military development?

QUESTION: Yes. The relationship's impact.

MR. LEE: Okay. So on foreign direct investment, David, do you want to take that one?

DR. DOLLAR: Yeah, let me lead off. So the first question was about China's overseas investment. You know, China's overseas investment is growing very rapidly. If you look at the destinations, if you leave aside Hong Kong which I think is kind of a special case because a lot of that Chinese money, you know, just goes through Hong Kong and ends up elsewhere in the world, the U.S. is the number one destination for Chinese investment and it's going into all different sectors. China bought the largest pork producer in the U.S., they bought a mid-sized bank in California, they're buying high tech. You know, so the U.S. is a very open economy and there's a tremendous amount of Chinese investment coming in such that within a few years if these trends continue there will be more Chinese investment in the U.S. than there is U.S. direct investment in China. Now that's a little bit strange because worldwide the U.S. has 10 times as much overseas investment. So, you know, it comes back to the point I made there's relatively little U.S. investment in China. What I say to Chinese friends is it's hard to see that pattern continuing if China doesn't open up the U.S. side is likely to start to feel that's this a whole new imbalance that's developing, you know, with China come in and investing in our economy. So I welcome Chinese investment as I welcome other direct investment, but would like to see China open up reciprocally and that's something that the bilateral investment treaty that we've mentioned several times, that's something it would definitely do.

MR. LEVINE: Should we comment on several of them or?

MR. LEE: Yeah, let's.

MR. LEVINE: Okay. A few quick thoughts then. One on the outbound Chinese foreign direct investment. And part of the question was, you know, is this viewed as a threat, and

I guess I could say that, you know, no company likes to see new competitors arising. And so certainly U.S. multinationals are not happy to see Chinese companies more active in foreign markets, but again this comes down to the basic issue of fairness in a sense or perception of fairness. If Chinese state-owned companies are competing globally on an equal basis with other multinationals what can you say about it; the other multinationals may not be happy to see the competition, but that's the way that it goes. The perception of course is that very often many of the Chinese companies, whether they're getting help at home or have a protected market at home, or they're getting some types of, you know, foreign assistance or assistance that helps them in foreign markets and so on, so to the extent this is perceived as a yet another example of unfair competition then it's a significant policy issue.

With regard to the free trade, I mean the Chinese are already actively pursuing other free trade arrangements and I don't think that the success or failure of the TPP is going to affect their calculation. In other words I think they want to be more activist internationally broadly speaking, they want to pursue more free trade agreements whether it's their participation in the RCEP or other mechanisms. You know, my own personal hope would be that at some point these regional mechanisms can all merge and China can be a part of the same arrangements the U.S. is, but we'll have to see. But I think China sees it in its interests to pursue such initiatives and is doing so.

With regard to the impact of the growth of the Chinese economy on military development, you know, obviously as the country has more money I guess they can put more money into military. I mean the one aspect to me that I find interesting is of course, you know, China's economic development has been based very much on its integration into the global economy that involves state-owned enterprises investing in Africa, it involves import of huge amounts of natural resources from abroad to fuel the Chinese economy. And so while much of Chinese military development as I understand it is focused on the immediate area around China, on the other hand some of the military development it seems to me, development of a blue water navy and so on is also aimed at this notion of now if we're going to have global economic interests we want to be able to evacuate our workers from a country in Africa if there is a war and revolution, we want to be able to protect the sea lanes of communication that are bringing all these resources to China. So I think in terms of what China is doing in the military area there are some implications. Beyond that again I defer to others who are probably more expert in the area.

MR. LEE: Professor Marukawa, any comments on any of the three question?

DR. MARUKAWA: Yes. So I will only comment on those that I can say something. First is on the foreign direct investment made by the Chinese. I think foreign direct investment has many aspects and of course the state-owned enterprises are making big investments, especially in the resource area, but also there are lots of small entrepreneurs and actually we have created database of China's FDI and an interesting things is that neighboring provinces, those from the provinces go to neighboring countries, so for example from Yunnan to Laos, Yunnan to Myanmar. And lots and lots of small, obscure entrepreneurs. So I don't know what they are actually doing.

And with regards to the threat, well for Japan it seems that very few Chinese companies are actually competing with the Japanese, those going to Africa perhaps. Very few Japanese companies there invest in Africa. So perhaps the Chinese are more aggressive in going into these less developed countries while the Japanese are more conservative. Unlike the United States, Chinese has very few investment in Japan and those already done by Chinese are mostly small ones. So it seems that there's not so much sense of threat created by the Chinese FDI.

Well, briefly on the free trade agreement issue, I think a country like China with its strong manufacturing force, it will be beneficial for its industry to have more and more free trade.

MR. LEE: Thank you. And just one more comment on does the United States fear greater foreign direct investment from China: I would say just the opposite. The Commerce Department and the president has kicked off a program coordinating with all the other federal agencies to promote foreign direct investment in the United States called Select USA. In fact today or yesterday evening the Joint Commission on Commerce and Trade which is one of the two major economic and trade dialogues between the United States and China was held in Chicago and has been vamped to put much more emphasis on business participation. And one of themes this year is investment. And it's no accident that it's in Chicago. And, you know, direct investment in the United States is not something the federal government has much experience in promoting; we are experienced in promoting exports, but it's the cities of the United States and it's the states who have that experience and who are hungry for the -- in fact compete for foreign investment.

So, you know, the U.S. government believes that, you know, in a time when, you know, jobs are important and the economic issues with China are vast and some of them very difficult that, you know, foreign investment in the United States and things like tourism, promoting tourism, they are the low-hanging fruit to promote because we are an open economy, we are making steps to make ourselves even more open with respect to, you know, granting a visa, longer term visas for business and travelers. So again U.S. remains open and welcoming to foreign direct investment.

So I think we have extinguished our time unfortunately. We are now moving onto political and security panels.

QUESTION: Lesser issues.

DR. BUSH: Well, thank you very much, Malcolm, for your great sharing. Thanks to each of the presenters. We're not going to move right away to the discussion of Chinese domestic politics. We will have a 15 minutes coffee break. So please partake of the refreshments in the back and we'll reconvene in 15 minutes. Thank you. (Applause)

(Recess)

PANEL 2: POLITICS AND GOVERNANCE IN CHINA

PROCEEDINGS

JONATHAN POLLACK: Good morning. I'm Jonathan Pollack, senior fellow in the John L. Thornton China Center and also in the Center for East Asia Policy Studies. Now that we've dealt with the simple questions of economics, we can go on to the main event. I'm, of course, only joking slightly, but I do think that questions now about China's current political circumstances, leadership arrangements, power alignments, and so forth, are very, very much on the minds of all of us who study China. We're really very, very pleased to have this meeting here today because I think comparing and analyzing the views as seen from both Japan and the United States it seems to me is essential.

The order in which we will go today reflects in some measure the content that will be covered in the briefings, but I think we will allow for the three presenters each to give an overview to the audience about their arguments. We will then proceed to a panel discussion here, which I'm sure will be very lively. So the sequence as we will begin with Professor Kamo from Keio University, then Professor Takahara from Tokyo University, and then my colleague, Ken Lieberthal will give the concluding presentation. Then we will proceed to discussion and questions and answers. So, the floor is yours.

TOMOKI KAMO: So, good morning, everyone. My name is Tomoki Kamo from Keio University, Japan. Thank you very much for giving me a great opportunity to exchange and deliver my views on China.

Today I would like to discuss Xi Jinping's power. My presentation title is "Understanding the Centralized Power." Since the beginning of Xi's regime, there have been obvious changes in the policy decision-making mechanisms. So decision making also is highly centralized to Xi Jinping. For example, Xi normalized decision-making mechanism, so Xi Jinping is heading new and old, leading small groups, including the National Security Commission. We can say that centralized decision making is mechanisms, but it is difficult to say Xi has successfully consolidated his power.

Concentration of the decision making power on Xi's hands, not only Xi, but also other members of the Politburo, Standing Committee, the CCP. So among the party leadership, there has been sharing a sense of insecurity about the condition of the country. They are also sharing a desire for a strong and decisive leader, so I think Xi concentrated decision making authority. But Xi's power is not personalized power because in the past 20 years CCP's regime is promoting institutionalization. First one, institutionalization constraints are working. For example, now Xi could not overcome term limit and age limit. And second one is interparty democracy is also working.

So as you know, Xi Jinping is the first elected party leader. It was late May 2012 a senior member of the CCP held a poll. He received the highest approval rating. Even though he got the highest approval rating, we can say that at the beginning of the Xi regime, he does not

have enough authority to grip political power firmly because Xi is not Jiang Zemin and Hu Jintao. And Jiang and Hu, they were nominated as successor by Deng Xiaoping. We can say that Xi Jinping is one of the consensus-based lineup. So if Xi wants to consolidate his power, Xi has to create an authority by himself. Now he launched an anticorruption campaign, trying to eliminate his rival.

If we want to understand Xi's power and stability of Xi's regime, we should pay more attention to not only decision making mechanisms, but also collecting information mechanisms. Currently, CCP is trying to activate democratic institutions, especially in local politics. CCP has made use of democratic institutions as a means to collect the information for decision-making. For example, in the People's Congress and the CPPCC, Chinese People's Political Consultative Conference, currently. So Xi Jinping regime is building several mechanisms of dialogue with nonparty elite.

Why is it important to understand China's politics? Because the members of the democratic institutions come from a variety of different backgrounds, and democratic institutions perform a wide variety of political functions. For example, some as agents to government. So a member of a democratic institution transmits policy to their constituencies, some serve as remonstrators and convey the information to government, and some as representatives, represent the interests of the constituencies.

I would like to wrap up my presentation. Xi has successfully enforced his power foundation by centralizing decision making mechanisms. But at the same time, CCP has been promoting institutionalization so restrict Xi's power. So we can say Xi's leadership and Xi's regime looks stable, but I think there are some problems. The problems are there and is gathering information for decision making. Xi's regime needs more allies who convey the information to government and the CCP. But currently Xi Jinping launched the anticorruption campaign has caused change to the behavior of bureaucracy and against the interest groups. That is the big change in Xi's regime.

So my presentation is stopped. Thank you very much.

AKIO TAKAHARA: Good morning, everybody. I'd like first to extend my heartfelt thanks to Richard Bush for inviting us and providing us with this great opportunity. And thanks also to Kevin Scott for the very good preparations. And thank you all for coming. I believe you are very busy now on the eve of the holiday season, so you must have a lot of things to do. But, unfortunately, holiday is a word that does not exist in the dictionary of Japanese experts on China. So we can only come up with presentations, not presents, to give. But I hope you will enjoy our presentations.

Now, my focus is on CCP and Xi Jinping's leadership. And I'd like to begin by touching on what are the tasks that Xi Jinping has held for himself because in order to evaluate Xi Jinping's leadership, I think it's helpful and useful to remember what his major tasks are.

They were indicated in the definition of core interests that were presented by a

man called Dai Bingguo, the former state councilor four years ago, but these major tasks have not changed I believe in the recent years. And Dai Bingguo said that there were three major elements of so-called core interests, as you see on the slide. The first element is political system and political stability, which would include the leadership of the CCP, the socialist system, socialism with Chinese characteristics, and so on and so forth. And the second element of the core interests consists of sovereignty, security, territory, and national unity. And the third element is the basic assurance of the sustainable development of the economy and society.

We can make an interesting comparison with the party's basic line that was defined under Deng Xiaoping and Zhao Ziyang in the 1980s, and that's also written on the slide. One center that is economic construction and two basic points, consisting of the four basic socialist political principles like party leadership, the role of socialism, and so on, and the other basic point was the reform and opening.

And it's interesting to see the changing emphasis because the change in the three elements of core interests we see more concern in the party about the stability of politics and the larger role that nationalism is playing in the party's thinking and governance. I suppose the difference is a reflection of those concerns and the new role that nationalism has been playing recently.

Now, the next point is about one major characteristic of Xi Jinping's government. And by the way, there's not much logical flow in the presentation that I'm giving. I'm trying to respond to a long list of questions that I received from Richard and I'll go one by one. But I think it could be useful in arousing some discussion at the end of my presentation.

But next I'll talk about an important aspect of Xi Jinping's administration. I call it the red second generation administration. Now, what does this red second generation, *hongerdai*, mean? Well, it means this generation is the offspring of the revolutionaries. And one characteristic of these people is that they hold an identity as successors to the revolutionary principles and they have a very powerful sense of ownership of the system I would say. Well, this is some kind of display of socialism with Chinese characteristics because it much depends on *xuetong zhuyi*, the belief in lineage as it were, the belief in blood. That's very feudal I would say. But still in the political culture of China today, it's very important to be an offspring of the revolutionaries. And this compares with the concept of princelings *taizidang*. What does *taizidang* mean? Also the offspring of the revolutionaries. So the definitions are the same, but the connotations are rather different because when we say *taizidang*, it implies that they are holders of common political and/or economic interests.

Now, I said that *hongerdai*, well, Xi Jinping, of course, is an *hongerdai*. As we know, they hold identity as successors to the revolutionary principles, but what about Xi Jinping? Yes, I would say he's one of those. He is somebody who experienced the hardships of the Cultural Revolution, but I would say that his experience and his father's experience are rather different things. His father used to be one of the vice premiers of the PRC, one of the revolutionaries, and he went through a lot of hardship together with people like Deng Xiaoping. And they would never think of reusing concepts that were used very much by Mao and his clique

during the Cultural Revolution. But as we see in the case of Bo Xilai, for example, or with Xi Jinping now, they don't hesitate to use the ideas and principles that were there and the concepts that were there during the Cultural Revolution. I think that's because their experience, the *hongerdai* experience of the Cultural Revolution, is not completely negative. But they see it as an experience through which they were trained. They went through this and they successfully overcame this hardship that they had to go through. And that's a very important difference that I find.

Now, the next point is about different perspectives on high-level politics. I would say in the case of Japan -- maybe it's the same in the United States, I don't know -- there are two ideal types as to different perspectives on high-level politics. And on the one hand, there is the institution school (*zhidu xuepai*), meaning that they see high-level politics mainly through institutions. The development of institutions is so important in understanding what goes on in China's politics now. That's their view. But on the other hand, on the other extreme side, there is the power struggle school (*douzheng xuepai*), who tend to see high-level politics as a power struggle. And if you understand power struggle, you do understand most of what goes on in Chinese politics or Chinese policymaking. For example, they would have different interpretations about Hu Jintao's full retirement at the 18th Party Congress two years ago. The *zhidu xuepai* institution school would say that that's very natural because of the terms, because of the age, the age limit, because of the terms that they have for being a member of the Politburo, and also because there's this principle that the party commands the gun and, therefore, the case of Jiang Zemin ten years before was an exception. And this is how it should be; it would be wrong if Hu Jintao remained as the Chairman of the CMC, the Central Military Commission, and gave the position of General Secretary only to Xi Jinping.

But the *douzheng xuepai*, the power struggle school, would say that that happened purely because of the way that power doesn't roll out. So those are very different views and perhaps the reality is somewhere in between. We cannot completely neglect the element of power struggle when we understand Chinese politics I would say. We all know that personnel connections are so important and forming groups or factions is really a part of life in China. So groups, factions, form along similar backgrounds or work experiences, so they tend to share very similar policy preferences or policy tendencies. So institutions are important, I acknowledge, but we cannot ignore the existence of these personnel groupings or factions I would say.

Are there divisions in the leadership now? Well, we are reminded of the open disagreements that were quite obvious during Hu Jintao's administration, particularly the second administration that began in 2007. And up to now, meaning in the two years, in the past two years, ever since Xi became the General Secretary, it seems as if the divisions, the disagreements, have died down. But I would say that they are only suppressed under the concentration of power on the part of Xi.

And the serious issues that existed, that were debated so fiercely in the past -- for example, SOE reforms, we touched on that in the earlier session, political reform. You remember Wen Jiabao repeatedly arguing very forcefully that political reform is necessary to thoroughly implement the economic reforms. That debate is dormant now also. What about the fierce debate

over universal values? I think that's still very much alive. Are there any concepts such as universal values? One side would say yes, the other side would say no. And also the low profile, *taoguang yanghui* in foreign policy, the big debate I believe still goes on to this day. In fact, there is a widening gap I would say. This is pretty obvious. It's a widening gap between the left who would pay more attention to orthodox ideology, who tend to be critical more about the defects of reform and opening. They are growing in force. They are increasing their voice. I think that's quite clear.

But on the other side of the story, there are the rights people who would argue that more reform is necessary in order to solve the difficulties that the system is facing. What's interesting to me is this debate between the left and the right is linked to the debate over foreign policy or external policies. This is one banner that was hung in a village in the suburbs of Xi'an three years ago and it reads "Western universities must get out of China." It's very surprising that this debate over universal values has gone down to the village level -- it takes me about 15 minutes to explain why this banner showed up in this village. But anyway, the linkage between the debate over political reform and the debate over how much Western things or concepts they are going to introduce to the Chinese society is quite linked and that I think is a very important point. We also saw photos of Mao Zedong in the anti-Japanese demonstrations that took place two years ago. That's also a sign of the linkage.

Now, what about the relationship between the party and society or issues of governance and the civility of society? Well, what's happening now is not rule of law or being promoted, but, in fact, it is more ruled by law as we all know and also by force. Party leadership -- it's party leadership, stupid, that kind of emphasis on party leadership has been pretty obvious I would say, not only by law and by force, ruled by law and by force, but sometimes by not telling the truth. One example is this picture. When Xi Jinping visited Germany in March this year, there was a gift given by Prime Minister Merkel to Mr. Xi, which was the map on the left side. That's the map made in 1735, very beautifully done and very well done. A very accurate map, very high-quality when you think of the year that it was made. It was 1735. It's a very nice present. But when it was reported about the present, it reported -- I mean, the right map was distributed. I mean you can still find the map if you go to the Website there. And this is really not necessary. I mean the right side map, of course, includes Tibet. But actually this map was made in the 19th century, after Qianlong, so this is wrong. But they don't have to -- I personally feel that they don't have to fear the people so much, but they are just worried that if they tell the truth, it won't be received very well by the public.

And at the moment the iron fist of Xi Jinping and Wang Qishan his friend, with whom Xi Jinping shared a bed and a quilt during the Cultural Revolution when Xi Jinping visited Wang Qishan in Shanxi Province. So they've been pals from very young days. They are suppressing any dissident voices through force in both party and society. But that's the situation for the time being, but can they really last? Can they institutionalize these anticorruption measures or not? And a lot of the Chinese themselves are looking forward to the results of the fourth plenum, but the expected or the hoped results haven't really come out.

I'm coming towards the end. I've been living in China for the past two months or

so. I'm now a Visiting Scholar at the Peking University. And I really feel that people are changing. The last time I lived in Beijing was from 1996 to 1998, and they have a stronger desire for equality, democracy, and fairness. If you just had a quick look at this interesting survey that was conducted by the Institute of Sociology of the Chinese Academy of Social Sciences last year, they were asking what should be the standards for judging what a good society is. And the answers, I mean the people who answered the questionnaire could choose four or five choices from a list of values. And most of these choices, the values consisted of so-called socialist core values that the party's now promoting. And the top was equality. People wanted equality most. And second was democracy. God knows what they had in their mind when they voted for democracy. But number three, wealth and strength. And number four, civilization and fairness and justice. And patriotism only came at eighth place. So I do wonder if Xi Jinping, in his attempts to unite the nation, unite the party through nationalism, arousing nationalist sentiments through his promotion of the concept of the China dream, will succeed or not. And I find that in China increasingly the people are worried about their futures. Thank you very much.

KENNETH LIEBERTHAL: Thank you. I'm delighted to have the opportunity to participate in this panel, and I think this panel and the previous panel have provided an enormous array of insightful comments about both substance and process regarding China's development under Xi Jinping. I will say it's a little hard for me to differentiate clearly a Japanese view versus an American view here. I think on both sides there's an overlap in trying to sort out the complexity of what is going on in China now. And with that in mind I'll give you my view. I happen to be an American, but you'll see strands of a variety of the presentations we've heard to date woven together in the remarks I want to make.

Let me divide my presentation into two parts. One is at the center in China, at the national level. Here I think Xi Jinping clearly recognizes, accepts the reality, that structural reforms are necessary for China's economy for many of the reasons we heard on the first panel and that the growth model of the last several decades, while successful for its time, is not sustainable and, indeed, has created problems that now really are major challenges for the coming decade.

Xi has also rapidly centralized agenda-setting initiatives in his own hands. He's been I think extremely skillful in being able to drive the major objectives that the system is now committed to over the coming eight to ten years. And he's pursuing a vigorous anticorruption campaign I think in part to consolidate his power, but in part also because corruption has become such a huge issue in party support and it has become predatory in a way that also makes it more difficult to carry out the reforms that really are necessary for the sustainability of the system. So he quickly seized the initiative and we've all seen how dynamic a leader he has proven to be. And the anticorruption campaign clearly has been a major consistent theme right from day one of his assuming top power.

But turning the directions and scope of reforms into actual concrete policies has proven not surprisingly even at the center to be a difficult task. And one thing I learned very early on doing interviews in China back in the 1980s was the reality that for officials at all levels of the system, rhetoric is shaped by these broad goals, but actions are shaped by the concrete

policies. They look for what specifically they have to do, what their specific requirements are within their jobs, and that is a key motivator for how they actually perform, so that overall not surprisingly we've seen a relatively moderate pace of adoption of detailed policies in pursuit of the broad goals articulated by the third plenum. The bottom line, therefore, at the center to my mind, is that Xi is very strong in terms of shaping the overall objectives, but is not in a position to simply dictate actual policies to achieve those objectives. Those are subject to a process, and many of those are still being debated and will be for quite some time because they're very difficult issues to resolve.

I think, though, the tougher issues in terms of how the reforms will actually play out concern implementation of these policies through the provinces, cities, counties, and townships where you have over 30,000 political units, territorial political units, each with a party leader, each with a relatively articulated bureaucratic apparatus, each with a lot of local rules and regulations that apply in their locality. Keep in mind that more than 75 percent of government expenditures in China take place from the provincial level on down, not by the center. So while the center collects a lot of the money, the responsibilities for spending that money on programs are really driven by the provincial and lower levels because that's where most of the activity actually takes place.

If you look at these levels below the center, at the bottom four levels of China's five-level political system from center to province to city to county to township, there are some basic realities of policymaking and policy implementation that I think is important to keep in mind. Within each locality, within each county, within each township, go up the line within each city and province, the top party leader, the party secretary, has enormous power and latitude within the broad framework of larger policies set at a higher level. The key incentives for heads of territorial party committees have been within their own locality to produce GDP growth every year while maintaining social stability, which is not necessarily easy given the policies driven by rapid GDP growth as a topical and avoiding incidents that embarrass the system as a whole -- avoiding major scandals and that kind of thing -- so that at each level you have a powerful leader who really has a great deal of latitude and is accustomed to exercising it and is rewarded for producing GDP growth every year while maintaining social stability and avoiding major scandal.

Policy implementation, moreover, is level by level, which is to say that you don't have the center directing a county as to what to do. The center will send out its rules to the provinces, which will then transmit them to cities, then to counties, then to townships with a considerable amount of latitude acting in the spirit of the policy at each level. For many local level leaders, finally, the last 15 years have been great. These have been years overall where the system has worked well for them. They've had extensive authority. They've had pretty clear success criteria. And they've had the ability to amass major wealth for them and their families as they have met those success criteria.

And since those criteria have been criteria for promotion, you find now that people who had the key party positions, the top party leader in each territorial unit up through the provincial level, are people who have shown themselves to be very capable, very pragmatic, can-do kinds of people, but have been promoted on the basis of their ability to produce the results

that the last 20 years have called for. Many of the reforms and the anticorruption campaign itself are thus unwelcome, threatening, and potentially require very different skills to do well in the future. So while at the top, at the top of the center, there is a clear understanding of the importance of structural reforms. As you go down through the key leadership in provinces, cities, counties, and townships, that awareness is understood, but not pressing. It obviously varies by locality, but overall, this is not a set of political leaders who have felt that this system must change in order to do well.

Now, Xi can use the centralized party secretary system, use CCP leadership to overrule local bureaucratic routines and local personal networks and drive a limited set of agenda items through political means. But, frankly, a problem that they have here is that other than the anticorruption campaign, most of the objectives that they have laid out for the next eight to ten years have not effectively been translated into operational success criteria for local level leaders. And, in fact, many of these objectives broadly have different implications for local leaders. So don't engage in a lot of investment, but don't let unemployment get high. Do increase urbanization, but at the same time pay attention to environmental pollution. But urbanization requires construction of a lot of infrastructure. There are just all kinds of contradictions in these broad mandates from the perspective of a local level leader in trying to figure out what he or she will really be evaluated on and will move ahead in the system on.

Also, many of those new priorities are very difficult given the way the system has functioned to date in that they stress at the end of the day quality over quantity -- but the system has been very good at measuring quantity over quality -- and require effective cooperation among different territorial units across the boundaries of those units. But the system to date has really rewarded having your own unit do well and have the externalities as much as you can pushed onto other units -- neighboring, downstream counties and so forth. So, again, it kind of fights against a lot of the fundamental structures, incentives, and capabilities that have been seen as key to the success of the development model over the last several years.

The big exception to ability to implement all of this to date has been the anticorruption campaign in no small part because that has teeth. It brings severe consequences to its targets. And it has at least some identifiable criteria. But there's a long history of anticorruption campaigns that have produced substantial -- but inevitably temporary -- effects. And typically one of the effects of those campaigns has been to dampen initiatives by local leaders who don't want to call attention to themselves. But then that creates problems for the reforms that are seeking local leader initiatives and experimentation. It also generally disrupts bottom-up transmission of accurate information because, again, people don't want to get caught off where their careers may be at stake in a politically tense environment.

Now, over time one of the elements of the reform effort is to reduce the role of government by enhancing the scope of the market, enhancing the scope of the private sector, and enhancing inputs from civil society. To the extent that that occurs overtime, that can mitigate some of the problems that I've just been focusing on. But I think these changes to reduce the role of government will overall take a substantial period of time and are going to be constrained by two important competing priorities. One is simply the priority of limiting risk to the system. It's

a very big, complicated system and the top leaders are well aware of problems of market failure and that kind of thing. And secondly, a determination at least at this point to keep the agenda substance and timing in the hands of the core party leadership at each level, which isn't totally contradictory to the notion of the pulling back of government intervention and allowing the market a bigger role and so forth, but it tends to play out that way. There is a real tension, some of the comments that David Dollar was making in his presentation.

So, the bottom lines are the broad reform agenda is very wide-ranging and consequential and necessary. Secondly, I expect generally careful and relatively sound policies to emerge at the central level overtime to accomplish the reform goals, but these are going to involve substantial time and work and are not simply decided by Xi Jinping. Don't mistake the big announcements for actual policies. Third, to measure reform effectiveness, I think we have to continue to devote very considerable attention to such things as the evolution of operational incentives for key leaders at each of the territorial units at the four levels of government below the center because those will drive the behavior of people who have enormous impact within the territories that they are responsible for. And at this point -- and this is based more on interviewing than anything else -- my sense is these operational incentives are very far from having been worked out. It's just what the balance is, how you measure it, what the criteria are -- it's not easy to be a local territorial leader in China now and know what you need to be doing and what the tradeoffs are given that no one can accomplish everything.

So, one final comment, which is that inevitably, frankly, the aspirations of the reforms are extremely wide-ranging. That's a good thing. They need to be. These are ambitious objectives that are really important for the system. But inevitably, things aren't going to go as planned. And I suspect that at the end of the day, as with Deng Xiaoping's era, one of the key determinants of the success of Xi during the course of his entire tenure is going to be not only whether he's consolidated power and whether he's pushing reforms, but how effectively he manages the many things that will go wrong and manages to keep a political momentum behind the broad thrust of the reforms as he has to make tactical adjustments, pull back, find opportunities to move forward, and to resolve a lot of things that simply are difficult to manage in a complex country undergoing major change. Let me stop there. Thank you.

DR. POLLACK: Since I'm mic'd up already, let me take advantage of this time to thank all three speakers who have really raised a very, very wide range of issues and suggest to me to some extent without trying to force these generalizations some not necessarily big differences of opinion, but a different focus that each of them has in looking at where China is today, what the major issues might be, and the means by which conflict and conflicting interests can or cannot be resolved.

I'm also struck overall by what in political science we, of course, call the level-of-analysis question; that there may always be an intense focus on what's going on in Beijing and several of the other major cities, but on the other hand, as Ken has reminded us, this is a very big, very complicated, multi-layered system and a lot of the real action may not be in the capital. I'm almost reminded of the old Steinberg *New Yorker* cover of the map of the world that looks at the world from New York and maybe to a bit of the near suburbs, but the rest of the world seems

very, very distant. Maybe there's an interesting way to look at this in the context of developments in China.

Without in any way trying to intrude on the kinds of questions, what I took from these presentations raises some questions that I hope the panelists can address. The first is whether the problems and challenges that China confronts, particularly at a time of transition in its overall economic strategies, is qualitatively different from the problems that have been faced in the past. And if so, what are those differences?

Related to this, of course, is the question of how deep are the stresses and contradictions within the system? We have a tendency sometimes I think in our analyses to look at the era we're looking at and to assume that things are that much more intense and difficult. But all of us have been at this for a while. We've seen other periods of political stress in China. It would be important I think to highlight whether and how the present is significantly different.

At the same time, the question of how conflicts are resolved or managed. Is there a transition here in how this is undertaken that we need to understand as we analyze China's present and future?

The last point I would want to make and then we'll open this up is how the consequences, reverberations of the actions that are taken, things that cannot necessarily be foreseen -- all of the panelists I think had a slightly, to-be-determined quality to China's future, and I think that's appropriate. It highlights to me and I suspect to most of us just how complicated and in some ways uncertain China's future evolution may be.

In any event I don't want to take more time than that. I want to compliment all of them. If anyone wants to react perhaps to some of the issues here I posed, but as soon as possible we would like to open this up to questions from the audience.

DR. LIEBERTHAL: I'll just make a quick comment on one of your questions, which is to say how different are the current types of issues from issues in the past? Because let's face it, in the past at any time any of us has been able to list a daunting array of challenges that the leadership confronts and they have generally speaking surprised on the upside in the sense of their pragmatism and capacity to manage the challenges and basically move the agenda forward.

I think the biggest change now is that crucial to future success is the capacity to become more effective in terms of quality and innovation. And the question -- I don't know the answer to it; my instinct is kind of similar to what we heard on the first panel, but I'm not fully sure of the answer -- is that this will require greater openness in the economy, but also intellectually in expression. The leadership rightly is reaching out for more input from society, but it is creating very strong negative incentives for social activism. So, for example, you take one of their biggest single problems, which is environmental. I'm not aware of any major country that has cleaned up its environment without a powerful nongovernmental green movement as part of the mix because the government is inevitably dominated by the industries and resource companies that have been there all along. So it's that element that gives me the

greatest pause going forward.

DR. TAKAHARA: On the same point I share Ken's views that perhaps there hasn't been a dramatic increase in the variety of problems that the leadership is facing. Most of the problems were already there I'd say ten years ago, 20 years ago. But the magnitude of each of the problems has increased so much like abuse of power, for example. Power corrupts. Absolute power corrupts absolutely. We see that unfold in China and all the issues that Ken just mentioned. They've always been there.

And now perhaps a new question would be the slowdown of economic growth, if that's coming. That's a very big new challenge. And how the fiscal situation will change or not because of that. I think that's going to be the crucial issue.

DR. LIEBERTHAL: If I could push you a little on this, Professor Takahara. I think you placed great emphasis in your presentation on right-left distinctions, and, of course, that's a classic theme as we have looked at China. But what would you see as the link here between the intensity of these problems and how China evolves, or if it can evolve, towards a stable set of outcomes in terms of policy and how to implement policy?

DR. TAKAHARA: I would say the difference in class. The income distribution is so skewed now that the left has a very solid base of voice as it were. There is a lot of the poorer side of the population that would support their ideas in criticizing marketization, which we don't see very often if we live in big cities like in Beijing or Shanghai. And the fact is that Xi Jinping is rather tolerant about the expression of these leftist ideas compared to his predecessors. Why is he? Is it because of his inclination or is it because he finds a balancing force necessary to counter the rise of the right side on the other side? I am not exactly sure, but what I see now is the development of both sides, both the left and the right, and it's kind of a tug of war. It's becoming more intense I would say year by year.

DR. POLLACK: I think a perfect question will –

DR. KAMO: So, Xi Jinping is facing an old-new problem, new-old problem, because it's how collect the information is because in ten years, 20 years, China's society has been dramatically changed. So every social group, the dreams and goals are quite different. So Xi Jinping government, how to collect, how to organize, how to study the program?

DR. POLLACK: I was going to say so it's not a China dream, it's China dreams, it's more than one.

DR. KAMO: Yeah.

DR. POLLACK: Well, thank you for all of the presenters for those additional comments. The floor is open. Please number one, identify yourself. And number two, be as concise as you can in the interest -- I see somebody waving -- oh, yes, right there. I even know who it is. That's not why I'm recognizing him, but that's Tony Kane.

QUESTIONER: My name is Don Kirk. I'm a journalist. I spent a lot of time in Korea.

MR. POLLACK: Well, I was actually -- go ahead. We'll come back.

QUESTIONER: I'm sorry. Am I --

DR. POLLACK: No, that's all right. I was pointing in your general direction, but someone had --

QUESTION: Well, let me just -- I'll just keep the question brief.

DR. POLLACK: Identify yourself again?

QUESTION: Don Kirk. I'm a journalist. All the emphasis is on internal domestic policy it seems. I'm just wondering whether the presenters could discuss the complex and differences that may be going on inside the leadership regarding policy toward North Korea, for instance, and possibly Japan as well, in other words Northeast Asia. Thank you.

DR. POLLACK: All right. If I could just interject, there will be a round two of this dialogue scheduled for some time in February, late February that will be specific. So I'm not in any way slighting those issues, but we will try. I mean if there's time to address them, fine. But I would think that for now we should really try to examine some of the questions raised by the panelists, if we could. So not --

QUESTION: North Korea's so timely now.

DR. POLLACK: Of course, it is.

QUESTION: The Sony issue and all that.

DR. POLLACK: Yeah, I understand, and we'll see if there's time we'll come back to it. Tony Kane was --

QUESTION: Well, I'm not sure if you're not going to have the same problem with my question. Tony Kane from American Councils for International Education. I was missing some of the input from another country, Russia, and from the standpoint of -- it seems to me that what Xi Jinping is facing is not just issues of how to do things differently, but what other models to look for. And I certainly think that he seems to admire a lot of what Putin is doing. And like your sign in the village about the western universities getting out of China, I certainly think that what Putin is doing he's doing that in Russia. And I see Xi Jinping admiring that different approach to trying to solve some of these problems from what his predecessors have done. And I just wondered if any of the panelists would care to comment on that.

DR. POLLACK: I think that this is much closer to this not being a foreign policy issue, and I'm not slighting the first question, but I think it is appropriate too -- do any of you think that Xi Jinping is looking to Russia for shall I say inspiration or example?

DR. LIEBERTHAL: Xi from the very start had built-in a strong relationship with Putin and a warm relationship with Russia as a top priority. He went to Moscow first as he traveled abroad and that was not by accident. I think he in part has been hoping to have successful examples of authoritarian political systems -- and Russia fundamentally remains authoritarian -- that succeed in the modern world. And Russia's degree of success, at least initially, was something to be pleased about, number one. Number two, Xi believes in a strong leadership model clearly, a very bold leader, and I think when left on his own has been very tough on tactical issues in foreign policy. We've seen him shift a little bit very recently, but fundamentally very tough on tactical issues. And I think, frankly, he admired Putin's decisiveness.

The question is in part what lessons is he taking from Putin's predicament now? And those predicaments are very severe. One lesson he's taking I think is this is a good time to do energy deals with Russia, not to help Russia, but to lock in cheap energy while Russia is at a severe disadvantage. What broader lessons there are, we'll have to see.

DR. POLLACK: Thank you. Yeah, we should also note obviously that Putin may be a teacher by negative example, too, the kinds of things that China wishes to avoid. Professor Takahara?

DR. TAKAHARA: I think there's an interaction. It's not only the Chinese learning from the Russians, but the Russians learning from the Chinese. I remember reading in the Chinese press several years ago when Putin's party and the CCP began this regular exchange, a once-a-year kind of a thing, and Russian delegates praising the China model, saying that there's a very good linkage between the legislature, the executive, and the judiciary; this is fantastic. That's what Russia was saying.

DR. POLLACK: Yes, right there.

QUESTION: Mike Mosettig, PBS Online NewsHour. How far can Xi push the anticorruption campaign without totally upsetting the apple cart? He's already gone past the taboo of going after a former member of the Standing Committee. And in view of what the professor said about on the one hand he's got to deal with the popular discontent, but to Ken's point, what better incentive is there for local leaders than to get obscenely rich as they've been doing in the last decade or so? What kind of incentive do you replace that with?

DR. TAKAHARA: That's a very difficult question because I hear from my Chinese friends that many young capable civil servants are now leaving their posts because they cannot see how they can increase their income without corruption. And compared with the salaries that their former classmates are getting in these private enterprises and the big SOEs, it just doesn't make sense for them. So I suppose one question that Xi Jinping has to think very

hard is how to maintain the incentives of these capable young leaders in government.

DR. LIEBERTHAL: One element that I have or a major element that I haven't seen taken up seriously yet in China is the need to very substantially increase compensation for civil servants so that you turn the assumption that you can leverage your position for all kinds of benefits for your family and so forth to more what Singapore has done or Hong Kong has done where you recruit top talent and retain top talent by paying them what they would have made had they been in the private sector. But I haven't seen that come close to a reality in China yet. So I agree they're in a very difficult period where they'll have much more trouble retaining top talent.

DR. TAKAHARA: Increasing the salaries is an obvious measure to take, but then you have to think about the poor. What would the poor side of the population be thinking when they see these formerly corrupt officials now getting a salary hike?

DR. POLLACK: Well, yes. Yes, I saw here and then over here.

QUESTION: Hi. I'm Donald Burns from South China University of Technology in Guangzhou. If you, if the panelists, if each of you were Xi Jinping, what would be keeping you awake at night?

DR. POLLACK: Good question.

DR. LIEBERTHAL: This panel.

DR. TAKAHARA: Well, he may be all right for the rest of his term if he's going to leave in 2022, but anything could happen tomorrow. That's the view of some people in China as you know. But other people would say that very bad things could happen if there was some natural disaster like a big earthquake or some epidemics. So is the leadership ready for those contingencies I think is a very immediate question that they have in their minds.

DR. KAMO: According to the study on authoritarian regime, so dictatorship they are facing two problems. One is how to share the power with elite and the other problem is how to control mass people. So Xi Jinping may also have to pay attention to problem, how to commitment with the elite, for example, Politburo Standing Committee members. So my answer is that. Thank you.

DR. POLLACK: Yes?

QUESTION: My name is Li Yang. Thanks for your presentation.

DR. POLLACK: Could you identify yourself please?

QUESTION: Li Yang. Thanks for your presentation. I just wonder as the world turns and you see Arab Spring and you see people unsatisfied in America, in the world. So I just wonder, is there any scholars or any other organization they don't say GDP is good because GDP

is measure of a lot of these services. So if you think that Xi Jinping is about anticorruption instead of just rhetoric or is he really going to do something good for us, well-being for the general public, for Chinese people.

DR. TAKAHARA: As a member of the hong er'dai, the red second generation, I do think that he does have this determination to make things better for the people and society. But at the same time he has to win in the power struggle and up to now, the only people that he has prosecuted in the anticorruption drive are people from the other side of the power struggle. So people are beginning to raise questions about his sincerity. That's point number one.

But point number two, Mr. Xi likes Confucius very much. He went to this academic meeting of the scholars who do research into Confucianism who gathered from all over the world. And he gave a speech clearly saying that he is for the revival of Confucianism as it relates to the revival of ethics in society and so on and so forth. But I know, we all know, that inside the party there are people who are against that idea, and that is also one of the debates that they've been having. What to do with Confucius. Do we keep the statue of Confucius outside the museum, or shall we take him inside?

So I think this question is going to remain for some time. People will keep on discussing what to do with Confucius. What are the ways to restore the ethical system in society? It's not an easy question.

DR. POLLACK: Let me maybe pose this question if you will in a way that we often do it in democratic societies. If we were to look at Xi Jinping's approval rating, would you want to guess what that level is at and how sustainable it is?

DR. LIEBERTHAL: Depends upon who's asking the question. Seriously, I'd like to go back to the question that Akio was just addressing because I think it's actually critically important. I think in China if you want to have a really interesting discussion, you just raise one question and then sit back and watch Chinese discuss it and that's the question of social ethics. And this is a country that has always been governed with a strong conscious value attached to social ethics; social ethics being Confucianism, or Mao Zedong Thought. Mao had a very strong sense of social ethics that differed from Confucianism, but still where the government develops, exemplifies, and proselytizes a set of ethics for society. I think one of the biggest crises China now faces is a prolonged absence of an agreed-upon set of social ethics. And a common perception in society that sure, friends are good friends, but when it comes to broader social ethics, the breakdown is very severe. And they talk about that even at a high leadership level, but I have seen extremely little done that would actually move this along toward a set of goals that people understand and with a set of means that actually would contribute a lot to that. And I think it is probably one of the biggest concerns that they have and rightly so.

DR. POLLACK: I'm not trying to fit Chinese politics in a democratic template or Western template, but I would almost want to think -- I mean given -- I agree with you that this is a fundamental issue the Chinese may feel, but I wonder whether Xi as he thinks about his long tenure in office, assuming his health remains good, does he have a second term agenda, if you

will, that he thinks might be more practicable? In other words, if he's tackling something like corruption now, hoping that he can demonstrate that you can after it at least to some extent, because it's almost like it would be a legacy issue. I mean I hate to put it in Western terms, but he must be asking. We ask maybe why he doesn't sleep well at night, if he doesn't sleep well at night. Is he a politician with the kind of imagination, vision if you will, that could think about these kinds of questions and maybe articulate them at a subsequent point in his leadership?

Pure speculation, but I think a lot of the questions we're asking here are ones of not only how capable is this man, but how discerning, how much does he comprehend that these issues weigh very, very heavily on how Chinese citizens look at their own society and look at their country's future. In other words, it's more than just simply the amassing of material wealth. Is there something different as well that needs to be achieved if he will achieve genuine legitimacy?

DR. TAKAHARA: I suppose that question will depend on what Tomoki mentioned; that is what sort of information is he really getting. Is he really getting information about the truth of what the people feel about society like the Institute of Sociology's research results? Are they reaching Xi Jinping? If they are reaching him, then most likely he will think along those lines. What the people are really wanting is, first, equality.

Then why isn't he doing more on taxation reforms, for example? Well, he's trying to improve on social welfare. That we can see. But I suppose there is more that he can do. Now, only recently he's ordered this reduction in the salaries of the top level leaders in the SOEs. That's one measure, but is it only that? I mean that's a systemic change.

DR. LIEBERTHAL: But even there you see the kind of contradiction that he confronts almost everywhere. The top leaders of the national oil companies have just taken tremendous salary reductions and that reflects domestic complaints. These top leaders have the rank of vice minister, and vice governors of provinces have been complaining. They have the same rank as someone who heads an oil company, and the person who heads the oil company is making ten times their income legitimately on the salary scale. But that person who heads the oil company didn't get the job because a search committee had a global search and hired the person who had the best performance record. It's a party decision. And many of them seek eventually, having made their money and everything, to become government officials in a province or at a central ministry. You know, it's an integrated system.

So you have a matter of equity, but then the heads of the oil companies say essentially look, when I sit down at Davos, I'm talking with people who are making ten times what I'm making. If you limit me to making whatever, \$100,000 equivalent a year, I'm not in the conversation. And so how do you get, how do you reconcile a system where the top positions in the major economic units are still party positions, the incumbents decided or chosen by the organization system of the party and yet you're dealing in a global economic environment? How do you reconcile these contradictions? And those kinds of contradictions are everywhere, so there's a lot that can keep Xi up at night.

DR. POLLACK: Under socialism, yes. Yes, I see a hand way in the back.

QUESTION: I'm Dennis Halpin from the U.S.-Korea Institute at SAIS. I had a question about Hong Kong and what's been going on. I wonder what the scorecard was because in one sentence it looked like Xi Jinping waited out the students and the people in Hong Kong got tired. The students went away, but they said they'll be back.

And the other curious thing was him choosing this fall to bring up one country-two systems as a model for Taiwan, a core interest, just at the same time that all this unrest was taking place in Hong Kong.

So how does Hong Kong and what happened there play into Xi's leadership skills and the evaluation of him by the other leaders in Beijing?

DR. POLLACK: Anyone want to have a crack at that?

DR. TAKAHARA: I tend to see the Hong Kong demonstrations along the line that started by the Sunflower Movement in Taiwan. The issues are similar in a way in the sense that they were both initiated and implemented by young people, particularly those in universities, who were having this frustration that because of the money and people that come from the mainland, they think that the real estate prices have gone up as soon as they hoped to buy houses, particularly for the young people. And they're generally frustrated about this inflow of mainland people, mainland money, and what have you.

So I suppose Xi Jinping must have been very worried that this will come also to mainland China because similar issues are there in the mainland. And in that sense, he must be praised by other members of the leadership that he handled it very well and he succeeded in his propaganda campaign that began at a certain point of time, real time, and convinced the Chinese people that this was not a good thing for Hong Kong and this is not a good thing for mainland China also.

DR. POLLACK: Other questions? If not, we will return to the first question, at least as a preview of coming attractions. I mean questions related to China's regional strategies, questions of North Korea, are very, very big ones, but do you want to pose your question again, sir, just to refresh the audience's –

QUESTION: Yes, thank you. I didn't think I was going to have a second chance at this.

DR. POLLACK: Sometimes you get second chances.

QUESTION: Well, I was just wondering about divisions and differences of opinion and viewpoint and emphasis when it comes to a policy towards North Korea, which is obviously very difficult for China and Japan as well. But I was particularly interested in North

Korea since it's so much in the news this very week. Thank you.

DR. LIEBERTHAL: I think there is widespread agreement at the top in China. By the way, Jonathan is the North Korea expert here, so he's going to wrap up with his gloss on this. But I think there's widespread agreement that the North Korean regime is not helpful either to the people of North Korea or to China at this point, and China is undertaking all kinds of measures to demonstrate their chagrin with North Korea. I think if we see a fourth nuclear test in North Korea, we will see China become even tougher.

Having said that, I think the debates in China are over fine. These guys are terrible in the North. They're a pile of trouble for us. They are not moving in directions that are helpful. But then tactically, what do you do about it? How do you best manage that? And I think there -- I hear a lot of different views in China, but I don't hear anyone in China saying we are like lips in teeth with North Korea and these folks are people that we share weal and woe with. Those days are long gone. It's kind of a problem of what do you do with a system where you fear its collapse and the consequences that that could have. You fear its success in terms of development of operational nuclear capability, and these are very tough folks who when you push them, tend to push back harder rather than giving in. So how do you manage that? And it kind of resonates to me with somewhat of the kinds of debates we've had over policy toward Cuba over the years and a lot of other things, not clear where to come out.

DR. POLLACK: Akio, have you been able to interact with Chinese scholars and others during your time in Beijing? Do you get a sense of how this issue resonates or does not?

DR. TAKAHARA: I think the case of North Korea and the case of Japan could be a little different.

DR. POLLACK: Yes.

DR. TAKAHARA: In the case of North Korea, yes, it seems quite clear that Xi Jinping, himself, does not like the North Korean leader very much and that sort of defines the basic line as it were in the attitude that the Chinese have been taking towards North Korea. However, over the issue of whether North Korea should remain as a buffer in geopolitical terms, the importance of North Korea as a buffer -- there's a debate over that.

And about Japan, the leaders' meeting that happened on the 10th of November was very good. I can talk a lot about that. But anyway, it was supposed to be a big signal to the Chinese people that the face has changed; that now it's not confrontation or tussle, but rather cooperation. However, looking at the Chinese media after the meeting, I can see that there is opposition within the Chinese leadership as it were, particularly coming from the military people. We hear voices criticizing Japan for this and that, so I can sense that there is a voice that is trying to argue otherwise that it's not time yet at least, the time has not come yet to make compromises with Japan or ameliorate the relationship.

DR. KAMO: So can I answer the question about the Hong Kong issue?

DR. POLLACK: Oh, sure, go ahead.

DR. KAMO: I want to answer the Hong Kong issue. For Xi Jinping's point of view, it is a big challenge because the Hong Kong show how to use the social media, how to do through demonstration. So if the Chinese students learn from the Hong Kong issue, it's big challenge for Xi Jinping.

DR. POLLACK: Very, very good. If I could just make a couple of comments about China and North Korea and then, since we don't want to deny people the opportunity, get some lunch, although I think this has been an excellent, excellent panel.

There's no question but that the center of gravity in deliberations about North Korea has shifted, part of it at the instigation of Xi Jinping, but partly reflecting China's own shall we say disappointment with the North. This is a long-running story. It's not of recent vintage, but there have been successive events that have not validated the underlying assumptions that China has tried to make about how you could imagine some kind of a policy transition in the North. Rather, even as North Korea is a much more -- I don't want to call it freewheeling, but there's a lot of economic activity there. There are a lot of North Koreans who are getting wealthy. But if I look, at least as shattering to Chinese thinking as their continued nuclear tests was the execution of Jang Song Thaek, young Mr. Kim's uncle, who was the primary interlocutor for the leadership of China on economic matters with North Korea, someone who was well-traveled in the world. And, therefore, the question of whether or not you even have a means by which you could reach leaders in Pyongyang is an open question.

But there's no question in my mind that the progressive alienation and distancing of China from North Korea, even if no one is in effect saying we're just going to write them off, you still are searching for some kind of a way that you could have a quasi-normal relationship, all of this at a time that the relationship with the Republic of Korea continues to advance. I mean, Park Geun-hye, the president of the ROK, has now met with Xi Jinping I believe on five separate occasions. There's a sense in which they have not only a personal chemistry with one another, but more to the point, if China's leaders look at where their equities lie on the Peninsula, their relationship with South Korea -- China now does almost as much trade with South Korea as it does with Japan. The numbers are really very close. That's an extraordinary figure if you think about the fact that Japan is a much bigger economy. The levels of interaction, there are now 70,000 Korean students in China and there are 70,000 Chinese students in Korea. So the question we're really asking is that if leaders in Beijing ask themselves, let's look at the two Koreas and see where our interests lie, I think we can see what the answer is.

That said, there may be some genuine concern or worry about the possibility longer term of an erosion or major upheaval within the North, although that hasn't been manifested yet. But in my own view, I think the tone of how Chinese, even prominent Chinese, not just scholars, but others who have had major involvement on these issues, continue to change. The question is whether or not future actions that North Korea might undertake would trigger a larger reassessment on the part of Xi and others. And on that, we will have to wait and

see.

It is interesting, by the way, as I anticipated, if young Mr. Kim is to travel abroad, his first trip abroad I had anticipated would not be to China, but would be to Russia. And the Russians have now extended an invitation to him to travel to Russia in May for the celebration of the victory over Germany. Whether he goes or not remains to be seen, but as I would see it, it's almost like this issue is a microcosm for China, recognizing that the implications of this, depending on which way developments go inside the North, will have a huge triggering effect on China. And the Chinese are trying to find ways to limit the risks, limit the assistance, but not in a way that at least yet calls into question the existence of North Korea if you will. China's not at that point, but certainly the changes in deliberation and debate have really been quite striking over the last few years, and I suspect that that is going to continue.

I admit the Chinese have made clear as recently as yesterday as have the Russians that their argument is that human rights do not belong in deliberations in the U.N. Security Council. Still we're going to see them go through the motions. I don't know that the -- again, the North Koreans obviously don't like to be shamed, although they're kind of shameless in a lot of their own behavior, but the Chinese and the Russians both see this as not appropriate at the ICC. Whether it materializes in a way -- I mean realistically Kim is not going to be dragged before the International Court for human rights violations, but it does suggest how the tenor of international debate about North Korea, quite apart from the nuclear issue, has undergone I think a significant transformation. And the Chinese and the Russians, even if they try to slow this discussion, they can't ignore it, but they'll try to limit it.

Let us -- please a round of applause for really an interesting panel. We are adjourned for lunch I guess, right? Richard, do you want to --

RICHARD BUSH: Thank you very much, Jonathan, and all the presenters. This has been a very great presentation. I have nothing more of substance to say except have a wonderful holiday! Thank you.

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