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Transcript

GLOBAL ECONOMIC OUTLOOK: CHINA, THE EURO CRISIS, AND THE UNITED STATES

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URI DADUSH: Good morning, ladies and gentlemen, and thank you very much for joining us here at Carnegie today to discuss the global economic outlook.

Now, because emerging markets have accounted for the bulk of global economic growth over the last five years, we will come at this global outlook session a little differently. We're going to be putting the emerging markets, beginning with China, in the spotlight.

And so our expert panel today includes world-renowned experts on emerging markets and on China, beginning with my friend, a former World Bank colleague – I am the former World Bank, he's the colleague – (laughter) – Hans Timmer, who is the head of the Global Economic Analysis Group (sic) at the World Bank.

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And then, to my right, Yukon Huang, who is a senior associate in the Asia Program at the Carnegie Endowment and was for many years the country director in Beijing for the World Bank. He was also country director for Russia, another very important World Bank client.

And then, to my left, yet another World Bank veteran, Pieter Bottelier, who is a professor at SAIS and as – and an associate of the Carnegie Endowment, and also ran the Beijing office of the World Bank a while ago.

Let me kick this session off with some brief remarks on the 2011 record, and particularly on the crisis of the eurozone, which is so central to the outlook. 2011 was a disappointment because of the slowing from the fast pace of 2010, and because it leaves the advanced countries well below the pre-Great Recession trend; but 2011 was not a disaster, either. Growth in the world was in line with the 10-year pre-crisis average, largely because emerging markets continue to power ahead, though they slowed around mid-year.

Moreover, although the U.S. economy grew at half the rate of 2010 in 2011, it has recovered – re-gathered some steam – it's recovery re-gathered some steam after the summer lull. The U.S. corporate sector is in good financial shape and, judging by the events of the last 24 hours, in much better shape than the U.S. political system. (Laughter.)

However, 2011 is also the year that the euro crisis became deeper and deeper. And with Italy now engulfed in it, it represents a qualitatively different level of risk for the global economy. All five chips – Greece, Ireland, Italy, Portugal and Spain – saw GDP decline in the third quarter. And their combined debt – government debt, that is – is $4.6 trillion. That is, three times the entire subprime mortgage market in the United States at the peak. The Italian bond yield – 10-year bond yield is at 6.8 percent, an entirely unsustainable level.

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Now, most economists agree that the crisis will be with us for many years, and also agree on the shape of the long-term solutions that we must have. These include a fiscal union which should include jointly issued bonds – that is, euro bonds. It must include tight fiscal disciplines and austerity and structural reforms that make the periphery more competitive.

Most economists also agree that these reforms will take years. And you need a bazooka to help the periphery defend itself from markets in the meanwhile. This bazooka can take the form of a combination of a bigger European financial stability fund, IMF enlargement and ECB support – both the banks, which it is now doing big time, and to sovereigns in trouble when necessary.

The essence of the current stalemate in Europe and its inadequate policy response is that there is no agreement, either on how the burden of adjustment will be shared in the short term, nor is there trust that in the long term a fiscal union will not turn into a transfer union from the North to the South.

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On the other hand, everyone is aware that we all lose a lot if no solution is found. The big losers will include, of course, the periphery of Europe, but also Germany, the U.K. – which is in the EU but not in the eurozone. It will include the United States, which is Europe's bigger external creditor and for whom Europe is the largest export market; and for similar reasons, it will include China.

Even in good circumstances, Europe is likely to see a shallow recession; indeed, one that has probably already begun. And this is, in fact, the baseline that most people are working off. However, in the worst circumstances, a breakup of the euro will slow the continent and possibly the whole world into a multiyear depression.

I personally am not at all sure that the Europeans can handle the problem on their – on their own, not just because of their political divisions, but because economically, the problem has become too big for the healthy core of Europe to handle. For that reason, I have argued for IMF enlargement supported by all its members, beginning with the United States and China, as a badly needed insurance policy. So that's my introduction on the 2011 and on the euro crisis.

And now I'd like to kick off a conversation in the panel, and I've encouraged them to disagree with each other, disagree with ourselves – among ourselves and to comment as we go along. And I'm going to direct the first question to Hans Timmer and ask him how he sees the outlook for the advanced countries in 2012, and how it might affect emerging markets. I will then move on to talk more specifically about China. Hans?

HANS TIMMER: Thanks. First of all, thanks, Uri, for inviting me. It's always nice to have the opportunity to exchange views, and I hope that we can disagree.

You said that 2011 was not a disaster, but indeed, it was very disappointing. We are preparing at the moment our global economic prospects, that we will publish four weeks from now. And almost without exception the growth rates this year are lower for all countries, significantly lower next year, and even in 2013 a lower growth then we only thought a couple of months ago.

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Now, that has, of course, a lot to do with what happened in Europe, the intensification of the – of the crisis, which I see as the kind of the second phase of the financial crisis of 2008. Many European countries have entered a recession. That is spreading to other countries.

But also a couple of other disappointments were there this year. First of all, the disruption of the – of the global production network after the tsunami and the earthquake in Japan was much bigger than earlier anticipated. That you see very much in Japan, but also in the – in the United States.

And secondly, in some of the emerging economies you see that the impact of the tightening of the policy that was necessary because several of those countries were close to overeating, that tightening have slowed those economies like Brazil, like India, Turkey to some extent, and perhaps, in the coming months, also China, much more than also earlier anticipated.

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With all these developments, it is very difficult to interpret the short-term dynamics. You mentioned good news, but I wouldn't be too optimistic about that. You see sometimes the rebound from a disappointment earlier. So you had a sharp decline in production in Japan and in the – in the United States in the spring after the tsunami and the earthquake, disruption in the car industry; then you saw a rebound coming; then, in August, that rebound stopped because of the downgrade of the – of the U.S.; and now, it's coming back again a little bit. But if you take the year as a whole, it is actually not that good. And it is not as good we earlier anticipated. And if you look at the forecast going forward, those have really deteriorated given what is happening in Europe at the moment.

MR. DADUSH: Good. Do you – do you want to say something, Hans, about emerging markets at this stage? I mean, the effects in particular of the European and American uncertainties on the – on the emerging markets?

MR. TIMMER: Yeah. There are three effects already observable, I would argue, coming out of Europe. First of all, the import demand in Europe has collapsed, and that has an impact in the – on the exports of developing countries, including China. That is one channel. Numerically, it's the most important one anymore – it used to be a very important one – but it is observable.

The second channel that you already can see in the data is that capital flows to developing countries have slowed down. And to some extent, you see even a reversal of capital flows as a result of the deleveraging in the European banking system. So especially the Eastern European countries are very vulnerable to that.

And then thirdly, you see an impact of a general spread of uncertainty in the world, especially intensified after August. Across the world, across the emerging countries, you see stock markets coming down; you see – you see weakness in currencies. And that has an impact on the sentiment in those countries.

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And increasingly, because of what you said really at the beginning – that it is the emerging markets that are driving the global economy – we are very much focused on what is happening in the domestic markets of those big emerging economies, and you do see weakness there.

MR. DADUSH: Let me pick that up then, on the domestic situation, and begin by asking Yukon how he sees the challenges in China domestically. And we are going to come to the international situation in China in a moment.

YUKON HUANG: It's very easy to disagree about China. I find myself finding it very easy even to disagree with myself at times.

I want to begin by giving a couple quotes, because everyone's talking about whether China's going to have a hard or soft landing. Here's The Wall Street Journal editorial, December the 3rd, "China's Hard Landing." "There is no easy way to avoid the bust that is coming." Here is The New York Times three days ago, Paul Krugman, "Will China Break?" "China's story just sounds too much like the crack-ups we've already seen elsewhere." Here is

Bloomberg two weeks ago: Surveying all its major commercial banks, 60 percent of them foresee a financial crisis coming in China the next few years. So there's certainly a lot of reputable sources who believe that China is in for hard landing.

Let's look at some of the statistics which have just come out in the last week or two. First statistic: Industrial production grew at 12.4 percent in November. Sounds pretty good, but then that was 1 percent below October. Fixed investment grew by 21 percent in November in real terms. Sounds good, but that's the lowest rate since January. Exports grew a 13.8 percent in November. Now, that was 2 percent lower than last month. China's trade surplus was $14.5 billion in November, a very large amount. But that was only half of what it was in July. Now, depending upon whether you read the positive number or the negative number, you think China's either doing pretty well or doing pretty poorly. So this is the issue between hard and soft landings.

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Now, most estimates are that China's growth rate of this year will be somewhere between 9.1, 9.2, 9.3 percent, and that it'll gravitate next year to something like between 8 (percent) to 8 ½ (percent). That is what I would call a common projection.

Now, what is 8 (percent) to 8 ½ (percent)? That's a soft landing. It's a soft landing because it's actually a good growth rate. It's more sustainable. It's a rate that China should be gravitating towards over the next few years. They were actually their potential in the past because of the stimulus program. So a decline – a decline of 1 (percent) or 1 ½ percent in China's growth rate is actually a good thing, although many people write about it as a bad thing. So that's a soft landing.

What is a hard landing? A hard landing might be a growth rate that goes to 5 (percent) or 6 percent. Let me talk a little bit about what that might mean. What is a collapse? A collapse is not a negative rate; a collapse will not be 2 (percent) to 3 percent. So we need to differentiate between collapses, hard landings, soft landings in China.

Now, what is the potential for a collapse or a hard landing? And most people see it in the property market. And I know that Pieter might touch upon it, and he's much more of an expert than I am in this area. But let me – let me talk a little bit about why there's such a – such a huge variation in terms of how people look at the property market in China. First of all, investment in property has soared from something like 3, 4, 5 percent, five or six, seven years ago, to 12 percent of GDP; it's quite high.

So the presumption is, this is – must be the sign of a bubble coming or collapse. It's very comparable to the fact that China's investment rate went from 30 percent to 45 percent over 10 years. Again, people think this must not be sustainable – evidence of a collapse. The number of units which are vacant in China, anywhere between 50, 60 million units – 60 (million) to 64 million vacant units of housing in China make people think that there's a bubble out there. So if you look at those numbers, you think there is a bubble.

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But there is a problem in evaluating what is the real demand in China. China is today 50 percent urban, 50 percent rural, which actually, much less urbanized you'd expect. There is the potential, let's say, of a hundred million, 200 million families moving to the urban areas in the next three, four, five or 10 years. So there's a huge kind of demand. Sixty percent of China's housing stock is substandard. It's too small. It's going to be rebuilt and turned over. So there's also a huge latent potential demand coming up. Chongqing wants to build 800,000 affordable housing units over the next three years. It has the financing; it's going to go ahead. So we don't know how much of this affordable housing will compensate for the potential reduction in what I call more commercial housing.

So what is the likely property bubble in China? And I would say, like many things, a property bubble in China is not the normal property bubble we see elsewhere. It will be a property bubble with what I would call Chinese characteristics, OK? (Laughter.) This is not a sector that is highly leveraged. Households have very strong balance sheets. But property investment and all the associated investment in China is very, very extensive now in China: There's construction, there's decoration, there's insurance, there's all sorts of activity associated with that 12 percent property development. So a slowdown in the property sector will lead to a slowdown in growth rates in China, and that will certainly have part of the impact next year in going to 8 percent.

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Now, how will it go lower? And as Uri mentioned, suppose trade in the eurozone really collapses and you have a major recession. This so-called landing of China, which is 8 (percent) to 8 ½ percent, it could fall by, let's say, a percent more by itself because of a deterioration in the European situation, so that would bring it down to 7 percent. Suppose the property bubble got more extensive and pervasive in the economy and affordable housing and other sources of demand dries up, you may be down to 6 percent. So you have the elements of a hard landing possible in the coming years, but probably unlikely.

Now, what are the elements of a collapse? Now, the collapse scenario, I would basically say, is highly unlikely. It's highly unlikely because you have very strong balance sheets; the banks have very low nonperforming low ratios; the government will step in – these are all state banks, so you won't see this – the kind of financial collapses that you might elsewheres; reserve levels are very, very high – external reserve levels are very high. The budget, actually, is running significant amounts of surpluses. Revenue is pouring into China. So the budget is actually quite strong. All this means that the government has a lot of flexibility in dealing with a potential downhill slide. And so I don't see a so-called collapse scenario as being very likely. Let me stop there.

MR. DADUSH: Thanks a lot, Yukon. That's a fairly reassuring picture. Pieter, do you – do you agree with it, about the domestic challenges of China?

PIETER BOTTELIER: The most important domestic challenges I see – and I agree with most of (what) Yukon said – are to deal with the fairly drastic slowdown in overall economic growth. I think there are two camps with different perspectives on the China situation. One camp interprets this slowdown as the beginning of the end: China will now run out of rope and unavoidably run into a hard landing situation. That's the view expressed by The Wall Street Journal and by Paul Krugman yesterday or the day before.

And another view is – which is more my view – that, yes, this is a very challenging, very difficult situation, in many ways unprecedented, but you have a very competent group managing the situation in Beijing that are not panicking at all. They feel they can keep this monster under control and use it to their advantage by promoting the structural economic changes that are at the center of their current – the 12th five-year development plan – the 12th five-year development plan – the economic restructuring, the economic rebalancing has been moved more central on the policy agenda because they have to. They have no choice.

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The slowdown, which is a broad-based slowdown, is partly domestically engineered. The government was very concerned about the property bubbles in 2009, 2010, and set out to deliberately kill the bubble – manage the bubble. They tried to do what Greenspan said, you cannot know a bubble and certainly you cannot control it. The Chinese have a completely different perspective on that thing. They're trying to control that bubble.

And the indications are that since they began to introduce all sorts of administrative restrictions on the ability of households and companies to buy apartments since April of last year, that this is showing off. The property market has cooled down enormously. The difficulty is to know by how much and what prices are really doing.

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The worst that could happen, in my opinion, is a precipitous price decline across the board in urban China. If that happens, say, 20, 30 percent over a relatively short period, you're unavoidably going to see a lot of bankruptcies in the developers – amongst the developers. And they will pull in their wake a lot of bankruptcies in the construction industry and in the thousands of supplier industries – all the construction materials.

That has not happened so far. It could happen, and if it happens it will be bad because that will be very hard to stop. My sense is that Beijing feels comfortable that they can keep this under control. Their first line of defense would not be to reopen the monetary spigots, as they did in 2009. Their first line of defense, if they fear a precipitous price decline in the property sector now, would be to undo some of the administrative restrictions on house purchasing that they introduced since April last year.

Both Beijing and Shanghai – the two largest cities – have decided, just in recent days, they won't do that. They will keep all these administrative restrictions in place. To me, that suggests that they're not worried about a precipitous price decline, at least not yet. Since that is the most important domestically engineered source of the slowdown, I feel that the chances that China will drop down to a hard landing are limited.

Now, look at the other cause of the slowdown that's on the external side. It's mostly European and American demand for Chinese exports, particularly European demand, has dropped very sharply. But exports, on the whole, are still growing. And as Yukon was saying, they still have a large trade surplus, much smaller than a few months ago but still large. And for the year as a whole, for this year, 2011, they expect a trade surplus of $150 billion, compared to $185 billion last year.

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They would, of course, have preferred a much stronger export picture than they are confronting right now. But again, I don't see any panic. They allow companies where the – that are effected by the slowdown in exports to go bankrupt. There are hundreds of bankruptcies in the exporting zones in Guangdong and Fujian. And Beijing is allowing that to happen. According to my impressions in Beijing last week, there is a strong sense amongst the (managers ?) that this is an opportunity now to push the industrial restructuring towards higher value-added production patterns, which is in their long-term interest.

So they're allowing this to happen. They're allowing the growth to come down. And the work committee – the economic work committee in Beijing last week concluded that the main priority remains domestic stability, and that can be achieved by a prudent monetary policy and a proactive fiscal policy. So if there's going to be a policy response, as there is almost certainly going to be to prevent the growth rate from falling too far below 8 percent, they will use fiscal means, which is a very important policy difference from what they did in 2009 when the emphasis was very strongly on fiscal – on monetary expansion.

So again, on that score, without being totally confident in my own predictions, I am inclined to think that those who feel that Beijing will be able to keep this under control and prevent a hard landing, they are likely to be right.

MR. DADUSH: Good. Hans, you obviously follow China, among others. I'm interested in your reactions to this, but also, you're a quantitative guy. How serious would a big slowdown in China be for Asia and for the rest of the world – a domestically induced slowdown?

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MR. TIMMER: Yeah, for me the question is not so much whether China will collapse. For me, the most important question is whether, if the situation in the world economy deteriorates, China can play the same positive role as it did after 2008, because you have to think through now more negative scenarios. You can't exclude a deeper crisis. And then we are empty handed in many countries. In the rich countries, you don't have fiscal space anymore; you hardly have monetary space. And in many of the other developing countries, the fiscal position has deteriorated also.

Now, what happened after 2008 is that China put basically a floor in the free fall of the world production by stimulating their economy. And the conclusion is, they can't do that in the same way as they did in 2008, precisely because of what Pieter said. That time, it was done through the banking sector by creating a lot of credit and liquidity, and you can't replicate that because that is very dangerous because it creates a lot of liquidity and a shadow banking system. And they don't want to do that.

So the alternative is that you have real fiscal stimulus, which is indeed a better way to do it. But then the question is: Can that be as effective and as large as what we are seeing in 2008? And that's where I'm not completely sure. So I see China more as, like in many other countries, reaching some of the limits of counteracting possible downside scenarios that you have to think through.

And then the final remark, to what Yukon said: The issue is not so much that China will unlikely achieve negative growth rates, because you can have a real crisis in China with small positive growth rates. It is quite possible that a lot of the financial stability is all based on growth rates of 7, 8, 9 percent. And if you (fall ?) that, you create all kinds of nonperforming loans, inadequacy in the – in the capital base of banks and all kinds of problems. Then, you're right, the government can step in. But you can have financial tensions in China with low growth rates.

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MR. DADUSH: So the message is, just like everywhere else, the safety net, so to speak, of policy in China has also eroded. That makes the containing the euro crisis even more important. And so my question – maybe Yukon will want to take it on – is, how does China view the euro crisis now? Will China – should China help Europe? Will it help Europe?

MR. HUANG: Before I get to the euro crisis, let me make one comment of – from – about what Hans' perspective is. If you – if you look at China – suppose China's growth goes from 8 (percent) – down to 8 (percent) and goes down to 5 or 6 or 7 (percent) – and in some ways, China's economy will not collapse because, like the United States, it's a big domestic economy. So it's actually not as trade-dependent as other countries are. Although the public image in China is this is an export-driven economy, it's not actually an export-driven economy.

The countries which may be more vulnerable, actually, are countries like South Korea, even Japan, Taiwan, the Philippines, Malaysia, Singapore. They've been expecting and getting 30, 40 percent increases in exports to China over the last four or five years. So they're actually quite trade- and export-dependent, more so – more so than people realize. So if there's a dramatic decline in China, and so growth goes from, let's say, 8 percent down to 7 or 6 (percent) and they have some of the financial problems that Hans mentioned, it probably can manage it.

But I actually see that there is kind of a side ripple effect on other neighboring countries in East Asia which it perhaps larger or not focused on as much as one would normally expect. And that ripple effect actually has a secondary effect too, because East Asia whole grows very rapidly, so we don't know exactly what the totality of the East Asia effect is on the world. And I think it's an unknown which is worth pondering about.

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Going to Europe and the eurozone, Europe is extremely important to China, of course. The eurozone – Europe is China's largest trading partner: $480 billion of trade last year. Europe is China's largest export destination, more so than even the United States. China gives a tremendous priority to Europe because, frankly (speaking ?), it sees it as sort of like a hedge against excessive dependence upon the United States. So China is very interested in a strong Europe. And it will try, in my view, to help, although publicly the statements coming out of China sound quite negative.

Now, why are the statements coming out of China quite negative or tentative? And the issue is, if you ask the average person in Beijing – and you see this on the TV; you go to some construction worker in Shanghai, and they ask: What do you think about the euro problem? Should China help? And the guy says: I don't quite understand this; why should China use its hard-earned savings to help lazy people in Europe whose incomes are 10 times mine? That's the dominant view in China. The government is very hard pressed to explain to its people what it means to help Europe and why it is in China's interest to help Europe.

But the key policymakers realize that under the right conditions – now, the right conditions being a framework where the Europeans are taking the bulk of the responsibility and helping themselves, a framework which is globally agreed upon, a framework in which the U.S. is involved either explicitly or implicitly – which is actually not discussed too much publicly today and I think that's a very important requirement for China – China will participate. And I think the IMF vehicle is the most logical one for them because it gives a greater assurance, it spreads the burden around, it gives them a voice that – a multilateral voice which is what they want.

So my view is that under the right circumstances, China will help out. It cannot afford not to. Europe is too big to fail in China's view.

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MR. DADUSH: Pieter, what do you think?

MR. BOTTELIER: What I think is less important than what Beijing thinks.

I agree with much of that. I think China would wish to assist in a rescue for the euro – for the euro situation if they knew how. After the last summit in Brussels, Mr. Klaus Regling, who is the head of the European stability fund, was sent to Asia to explore with potential Asian financier, Beijing and Tokyo in particular, to explore how they might support it. A first port of call was, of course, Beijing. He was received very well by the ministry of finance – they had very detailed discussions – and then left to Tokyo without a press release.

Evidently, the objective of these discussions was to see how willing the Chinese would be to support the leveraging up of the European stability fund from 440 billion euro to a trillion euro. And the answer evidently was: not now. We have to understand more detail. The Chinese realized that, in essence, this euro problem is not a financial problem; it is essentially a political problem between North and Southern Europe. And that China, by making available hundreds of billions of dollars, cannot solve the political dimensions of those problems.

Nonetheless, my sense is that under the right circumstances, the Chinese would wish to support the euro because Europe is very important to China. In our U.S.-centered world, we don't realize that from China's perspective, Europe is actually a more important trading partner than the U.S. It's also a very important source for China of technical assistance, which is – almost all the member countries in the European Union have technical assistance program in China which is, of course, not possible under congressional law from the U.S. at the present time, and they're very limited.

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From a Chinese perspective, Europe is also the most important source of new technologies to China. That may surprise many in the audience who believe that from China's perspective, all that matters is the U.S. relationship. That is not China's perspective. So China would wish to assist in a solution for the euro if they could, but they all realize that ultimately it is a regional political problem between North and Southern Europe. They have the financial means to come in in a big way.

If they were to come in, which is highly uncertain at this point, most probably they will do it through the IMF. And I think everybody is encouraging the Chinese to think in those terms. If, in addition, the Chinese would wish to purchase equity in European banks or direct investment in European companies, they will do that directly – obviously not through the IMF. So it would be a two-pronged approach: through the IMF and directly.

MR. DADUSH: Let me ask this: When Europe found itself in terrible trouble after the summit of October 27th, President Sarkozy of France picked up the phone to President Hu Jintao of China to ask for financial support. He did not call President Obama. He called President Hu Jintao. Should – am I reading too much into this? Does this mark a change in global – in international relations? Is this like the beginning of a new era? Would any of you want to pick this up? Hans?

MR. TIMMER: Yeah, I think we are already in a new era. Just to go back to a slowdown in China and the importance of that, you shouldn't think lightly about the impact of a slowdown in China, not so much because of the domestic consequences but because of the consequences on the rest of the world. We are of the view that the world no longer depends on the U.S. consumer; the world depends on the Chinese investor. And when GDP slows down a couple of percentage points, then investment will slow down much more. That has enormous consequences for the rest of the world and the high-income countries. So in that sense, the economic importance of China is already very, very significant.

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But then to go to your question on China and Europe, I think there are three reasons for China to support Europe. First of all, they are this big economic player and they will help to prevent a collapse of the world economy. So if that is needed to prevent the collapse of Europe, that is one reason for them to help. The second reason is, they want a broader international financial system than one is that is just based on the dollar. So for that reason, over the last five years, they have diversified away from the dollar into the euro. So it makes a lot of sense to support the euro to at least have a more balanced system in the international financial markets.

And thirdly, and you touched upon that already, for them it is a way to get a seat at the table in international governance. And that's indeed why I agree that they want to play this through the IMF, but they want to see something back for that. And that is, I think, for the world economy, very helpful, that this enormous economic power will have a bigger seat. And that's where the progress is very slowly because the established countries, the high-income countries, are not that willing just to give them a little bit more space, I think.

MR. DADUSH: Good. Yukon, what do you think?

MR. HUANG: I think China is in a little bit of an awkward position. I think the Sarkozy phone call recognizes the reality that China is becoming a global financial power and actually should be involved in these financial issues. But for China perspective, I think they found it kind of embarrassing that they are being put in such a focal point, and they don't like to be drawn into a role where they're playing what I call a leadership role or instigator role. They like to be part of a group. And I also think Hans is correct. They also would like to play more active role, but they haven't sorted out the way to do that in a way that's consistent with what I would call their historical policies.

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I think that Sarkozy's appeal generate negative vibes across Europe. It gave the sense that – (inaudible, background noise) – begging to China, and it gave this sense about whether China would want conditionality and what the form of that conditionality would be. Now traditionally, China does not like to be in that kind of position. It does not like to see formal overt conditionality. Its financial assistance programs globally have always been given without conditions. But they also feel, of course, that when they provide assistance, it's between friends, and friends basically help friends. So obviously, in the long run, they're looking for something from Europe in a way that would help them in terms of their standing in the global community, in ways which are not explicitly tied to something like a European bailout package.

MR. DADUSH: Pieter? Your views?

MR. BOTTELIER: The relative shift in the global economic power from the West to the East is happening and is accelerating as a result of the current situation. But China is at the center of the East and is by far the largest economy that will become increasingly prominent in the global economy. This is a painful shift for the Western countries, but it is happening today. I think Mr. Sarkozy's legendary phone call is an illustration of the reality of the power shifts and the financial and the economic shifts.

If you look at it from a global perspective, you might call the current situation as Gordon Brown actually did in his recent book – the first crisis of globalization. What has happened is that in terms of output, in terms of production, there has been a significant relative shift from the West to the East already. The East now accounts for about 55 percent of total global output, but is still not accounting for more than about half, maybe 45 percent of global consumption. Most of the consumption is still in the West; most of the production has shifted to the East. That is, according to Gordon Brown, the first global of – first crisis of globalization. And sorting out these production-consumption imbalances globally is the challenge facing the global economy.

[00:43:02]

MR. DADUSH: Good. Before I open it up for questions from the audience, I have one last question of the panel, and it's about China-U.S. relations. We have this turning of Europe towards China. We have, on the other hand, the pivot of – the United States announced at the APEC meeting in Hawaii – towards Asia. So it seems like, you know, everybody is pivoting – (laughter) – towards Asia – (chuckles) – and towards China, to a degree.

But what is – how do you read the state of U.S.-China relations with the tire dispute and now the announcement of tariffs by China on automotive imports? What are the risks for China, coming from the U.S.-China economic and political relation? Yukon, you want to start with that?

[00:44:14]

MR. HUANG: All right, let me start off with your pivots. I mean, the European pivot, I think, is broadly welcomed by China. They've been trying to strengthen relationships with Europe. They see Europe giving China more attention as a positive thing. The American pivot toward China, as was discussed here at Carnegie a couple of weeks ago, has raised tensions. They see this as a potential resurfacing of U.S. objectives establish a more greater – a return to its dominant role in Asia with the future, and they're not quite sure what that means in a security and a military sense. So these two pivots, I think, have a different kind of perception within China.

Now, this is an election year here, coming. It's a transfer of power in China to the next generation of leadership next year. So these are – these political events are going to complicate what I would call the financial economic discussions. And it begins with what I call the anti-currency bill in the U.S. Congress, which China feels very negative about, and it's showing up in trade protectionist actions on both sides. You mentioned the tariffs on the V8 engines, SUVs going into China is being looked at very negatively on the Hill as yet another effort of China to protect its sector and causing alarming problems. China sees this as tit for tat in terms of the tariffs which were slapped upon China-produced tires exported to the United States.

Now, of a very significant – of a larger significance to many Chinese, actually, is the barriers or prohibitions that are restricting U.S. exports of chicken feet. Chicken feet account for $300 million of exports to China as a delicacy, and chicken feet are useless in the United States, but China is basically trying to restrict those. So what China is looking for is examples of things which they can sort of, like, hit at, but which are not exactly what I would call big issues because they really do have a vested interest in protecting an open trade regime. But nevertheless, they are concerned that any negative sentiments which emerge during this very heated political process, both in China as well as the United States, is going to cloud what I would call the trade financial relations in between two countries.

Now, whereas trade is in fact the big issue today, this technology transfer – IPR, intellectual property rights – the tensions which are showing for that area are probably more important in the future. The Solyndra solar panel case, in terms of to what extent should U.S. be promoting development of green technology here, to what extent is it being subsidized here, to what extent is China subsidizing the development of the green technology industries in China in a big way, the competition, the fall out – I think that's going to be a big issue. It's going to be a big issue because not only are many U.S. companies suffering, but you're going to probably see 40, 50, 60 percent of the capacity in China being wiped out in the coming year.

[00:47:26]

So it is actually a problem that will aggravate producers and governments on both sides, and they'll start to see that it's actually a problem shared, rather than a problem which is solely one side or the other.

MR. DADUSH: Pieter, any views there? China-U.S. relations, risks?

MR. BOTTELIER: I think – both sides, I think, realize and have realized for some time how incredibly important this bilateral relationship is. It's not a subject on which I claim to have a lot expertise, but it's obvious that the relationship is not only extremely important, but also extremely stressful. And it is so stressful because there is a basic lack of trust between the two giants – the United States and China.

One of the biggest victims of the 2008 financial crisis, I fear, is a Chinese respect for the American economic system – in particular the financial system. That's a hard-to-measure victim of the crisis, but it is important because there has been a very subtle shift, I think, in Chinese perceptions of the United States. Prior to the crisis, almost – although that was never explicitly expressed, it was very clear that, with the exception of the political system, the American economic model was China's model. That's what they aspired to. My sense is that that has disappeared now, that China feels that their model isn't so bad after all and that maybe they have already done enough in terms of economic reforms. That's a very dangerous conclusion if it persists and if it takes hold of the decision-making processes at – of the top leadership. I'm still hopeful that that is not the case.

[00:49:17]

During my recent (visit ?) to Beijing last week, I was actually pleasantly surprised by how many people kept stressing the need for further financial sector reforms. That was a big surprise to me. Another encouraging element is that, just prior to my visit, you had fairly high-level mil-to-mil discussions in Beijing. After the American announcement that they would go forward with the big arms deliveries to Taiwan at the beginning of the year, China's reaction was, let's cool it on the mil-to-mil relationship, which I believe has to be a pivotal part of the bilateral relationship. Fortunately, for reasons I don't claim to understand, the situation evolved in a more positive direction, and fairly serious mil-to-mil discussions were held in Beijing just prior to my visit last week.

MR. DADUSH: Good. Hans, anything to add there?

MR. TIMMER: Yeah. I think the trade frictions that we discussed but also the discussion on the currency, they illustrate that the rise of China is not a smooth process. And the fact that the United States has to give up some of its dominance, it's not a smooth process. And looking forward, that can become worse, I think, because it can (go ?) into more areas. If more and more Chinese companies want to invest in the United States, which would be a very natural process, there are other potential sources for disputes. If the Chinese companies start competing more directly with U.S. companies, then you have more frictions. If China becomes a more dominant player in financial markets, then you have more conflict.

[00:51:15]

But I think, at the same time, you shouldn't overemphasize the importance of the bilateral relation between China and the U.S. Sometimes you think that's the only thing that matters, that we have a G-2 in the world – only two countries who are dominant. And that's actually not true. We are moving towards a multipolar world. If you look a couple of decades ahead, then the importance of developing countries outside China is more important than all high-income countries together. There are a lot of other growth poles that are coming up. And for China, it is important not to continue to focus only on its relation with the United States – not even with Europe – but to think also about its relation with the other emerging economies.

MR. DADUSH: Excellent. I'd like to open it up now to the audience. Please introduce yourselves – affiliation, name – before you ask your question. The gentleman there in the middle, just here in the – on the left-hand side. No, in the middle there. Yeah.

Q: Thank you. Danny Jiao (ph) with China's –

MR. DADUSH: Please, please stand up and tell us who you are. Please.

[00:52:27]

Q: Thank you for organizing this timely event. Danny Jiao (ph) with China's Xinhua News Agency.

My question is related to the additional resources for IMF, for the panel. Recently, as the – as Britain is reluctant to give its share to the 200 billion euros additional resources to IMF, the European countries haven't got the 200 billion euros for the IMF. So should the United States and China step in or step out for the additional resources for the IMF at this particular time? And for the United States, due to the strong opposition from Republican senators, they haven't given the 108 billion euros bilateral loan, promising 29 (billion euros). And for countries like Mexico and China, they have their cost and benefit analysis (because ?) the additional resources is not related to the quota and voting share. So this is my first question.

And secondly, there is also differences among the important players. For countries like Germany, they want resources going to the general resources account to force more discipline on other European nations. And for countries like the United States, they want the money going to a specially administered account to reduce the contagion across the IMF membership. So how should countries solve their differences? Thank you.

MR. DADUSH: (Chuckles.) Good questions. Let me take a couple more and then we'll come back. The gentleman here at the front, and after that, the gentleman who just stood up. Yeah.

Q: Thank you. I'm Tom Reckford with the World Affairs Council. I know the panel basically thinks that a hard landing is unlikely in China, but if there is a hard line – a hard landing, what do you think would be the political impact on China? You already talked a bit about a lot of bankruptcies; with bankruptcies would come a lot of unemployed people. This is a time when there are a lot of protests in China about heavy-handed activities of various kinds. Would we see some political ferment in China?

[00:55:07]

MR. DADUSH: And then the gentleman there who had stood up before. Yes.

Q: My name is Uli Shiva (ph). I am retired.

MR. DADUSH: You're with what? Sorry.

Q: I'm retired.

MR. DADUSH: Retired. Sorry. Yeah.

Q: And I see that the topic that you have chosen there – global economic outlook – I wonder if you can really exclude countries like Brazil and India. Pieter Timmer (sic), at the end, mentioned the multiglobal development, so I'm wondering whether you can really ignore them. And the second thing was, I was surprised that you did not at all – even not once – mention employment. I mean, in one of the countries – the United States – that you mentioned, there's no doubt that the next year election will be heavily influenced by the quite significant unemployment. This shift in consumption and production – how come you did not really also mention employment patterns and changes? Because they are so important.

[00:56:07]

MR. DADUSH: OK. Let's take these three questions in reverse order. And if it's OK with the panel, I'll ask Hans to answer the gentleman; and Yukon and Pieter, the question about the impact on politics; and I'll give a stab at the euro question in a while. Hans, please.

MR. TIMMER: Well, I couldn't agree more with the last question, that indeed, a lot more aspects in the world economy are important than we were able to discuss here. I briefly mentioned the slowdown in Brazil and India, but that is a very important phenomena in both countries, increasingly important for the global economy. You see a sharper slowdown in the last, say, four months, to a large extent due to domestic policies also, to a large extent a reaction to a very sharp increase in domestic demands in the period before. And those are independent developments that interact with the rest of the world economy, but should be considered and are considered when we are doing our global economic prospects.

Then the unemployment issue is also incredibly important, I think, even broader – when we are talking about the high-income countries, we have to realize that we are not talking about just a normal recession or a normal downturn. There is a fundamental structural problem in the high-income countries of lack of growth, and you need fundamental changes to come out of this situation. And already, for years, we are talking about the fact that it will take many years before you undo the damage that was done in 2008, which, by itself, is a problem. But it not only takes many years, it takes also structural reforms, and the political system is not ready to take those steps. So that's an important and very difficult problem. If you're looking at the Middle East and what is happening there, of course, you have your link with unemployment, but you have your link with structural changes, also. No, no, I agree there's a lot that should be thought about.

[00:58:30]

MR. DADUSH: Link between economics and politics in China?

MR. HUANG: Well, the papers are full of discussion on this fishing village in southern Guangdong province – Wukan fishing village – where the 15,000 residents are protesting and the top leadership is trying to negotiate what I call a fair outcome. But this is indicative of what I would call a very large increase in social unrest in China, so if you have a so-called hard landing, will this make things worse? And obviously, it would make things worse.

But from a communist viewpoint, if you try to ask what are the so-called economic factors which are likely to impinge upon politically-related sensitivities or social unrest, I would probably cite a couple. If you look at Wukan, it is example of the battle over land rights and land rights and how lands are used and how its developed and can it be taxed and who owns it – major issue in rural areas and urban areas – and China has not been able to deal with this. So this is a source of tension in many, many instances of what I would call political disputes in China.

The second issue is, what would happen if you had a collapse to what I would call China's concerns over disparities? The disparities in China, income inequalities, are largely of a spatial nature. The Gini coefficient in China is not unlike what it is in the United States or Singapore, Malaysia, so that's not the inequality that matters. The inequality that matters in China is the urban-rural one, and the urban-rural income inequality is three and a half. It's the highest in the world. So that is a source of tension between what is happening in the countrysides, what's happening in cities and how you deal with this.

Now I would say the third – the third issue has to deal with what I would call the social protection programs in China. Are they going to be strong enough if you have a collapse? And the social protection programs in China is not as strong as they should be, for a country that has what I would call communist, socialist ideals.

[01:00:29]

So a collapse – if you have a collapse, you have to ask whether it's going to increase the tension over resources, access to resources. And the answer is, it will, because land is a source of revenues to everybody, incomes to everybody. If incomes collapse, you're going to have some problems between local (and state ?) areas, localities, villages, everyone.

Inequality, will it increased or not? It depends upon who's going to be hit most by that. And will the government have the social programs that can deal with this? And I think social programs are in a state of development, and there's some vulnerabilities there.

MR. DADUSH: Thank you. Pieter?

MR. BOTTELIER: Specifically on the question of social unrest becoming more political in nature in response to a hard landing – I think that was your question, sir – it's important to realize that there's a lot of social unrest in China today with 9 percent growth, right – with rising real wages. How much of that social unrest is political in nature is hard to ascertain. My sense is that most social unrest in China is addressed – is focused on local grievances: unfair compensation for land, local pollution problems and things like that. If the growth rate were to drop to a hard landing situation, 5 percent or so, it's very likely that social unrest would intensify in China, and that it would assume a more political nature.

But I cannot answer the hypothetical question: What will happen after that? This government for 30 years has been able to maintain high growth. And in spite of that, social unrest is on the rise. The microblogging which has become so prevalent in China in the last 12, 18 months, is surely a – well, on the one hand, a source of greater grievances, because they can be more easily shared. On the other hand, the microblogging is also a safety valve on the system. People can now express their feelings more safely through the Internet. It's very hard to say. My overall sense is that China is politically stable, much more stable than most people realize.

[01:02:48]

MR. DADUSH: Good. Let me take a stab at the euro question. First point I want to make is that I think it's good news that the eurozone has committed I think its $200 million, if I remember correctly, just in the last few days, to increase IMF resources, IMF general resources. I think that is the good news.

The U.K. has not said that they will not contribute; they have said that they will consider a contribution early in the new year, and they would prefer to do it in the context of a broader G20 initiative. And here again the U.K. is a little bit the odd man out at the moment in Europe, for all the reasons that you have been following.

And indeed, the U.S. Congress is undergoing difficult debates on the previous agreed expansion of IMF resources. And I am, with one or two others across the street, among a very small number of people who are actually daring to propose that in the event of an escalation of the European crisis that would threaten the stability of the global financial system, in that event, increased IMF resources should be directed to Europe, and that requires a U.S. contribution as well as a Chinese contribution.

There are very few takers on this view. (Laughter.) But I guess that's why I work in a think tank. (Laughter.) And so, you know, I'm paid to think. (Laughter.) And I think – (laughter) – that if Italy cannot repay its debts, that's the United States' problem as well as Germany's problem. And so therefore, that's the view I maintain. And I think the Chinese ought to be following the same logic. There is a big coordination problem, but in the end you cannot say, we will rescue Portugal but we're not going to rescue Italy. That just doesn't make any sense.

Sir.

[01:05:29]

Q: Hi, my name is Randall Doyle; I work for the State Department. I'd like to ask a geopolitical question, and I think it kind of connects with everything you guys have been talking about. China, you know, historically has always looked internally for enemies or potential problems. With the recent death of Kim Jong Il; the Americans announcing a new military base in Darwin, northwestern part of Australia; the huge now energy and resources reporting in Asia, which they see as somewhat of a quasi-threat, I'm thinking to myself that, with all these pressures on the government, how is China going to – how is China going to react? Because obviously, it's got huge domestic problems. And even though we talk about, they have the money, but they're going to spend a lot of that money domestically. And yet I think we're kind of shaking them, OK, with what they see as a potential encirclement – maybe not an aggressive or, you know, overt encirclement, but it certainly does appear to many people that we're having this encirclement policy.

I wanted to ask Mr. Huang and the rest of you, how do you think the Chinese leadership, when they sit there and they deal with all these domestic issues – and then the military comes in and says: Hey, listen, the Americans are redesigning, so to speak, the security architecture in the region; how are you going to respond to that? I think this is – I think this is a huge battle that's going to take place in the leadership of the Chinese in the next (coming ?) government. And don't forget, the Chinese are going to go through a leadership change too in the midst of all this stuff that's going on globally. So I think it's extremely sensitive.

MR. DADUSH: Thank you. We'll come back to that. Take a couple more. Let's have a lady. The lady there at the – at the back. And I'll come to you as well.

[01:07:09]

Q: Thank you. Mi Sho (ph), with China's 21st Century Business Herald, a newspaper. As Yukon said, that China ought to provide financial assistance to help the European countries if the conditions are right. And if I understand correctly, one of the conditions ought to be that U.S. also contribute.

But however, so far, the U.S. government is very reluctant to even talk about the possibility of providing resources, not to mention that in the Congress, already a few members raise their eyebrows even before this issue become a fully engaging issue in the Congress. So my question is, do you – do you think now is the time for the U.S. to seriously consider providing financial assistance to European countries? Thank you.

MR. DADUSH: Well, the answer is yes, I just said it, yes. (Laughter.) Yes, the lady here, yes.

Q: Thank you. Molly Williamson, American Academy of Diplomacy. First, thank you for this very valuable presentation. My question is the U.S.-China relationship around two vehicles; one – and they are related, obviously – one is energy and the other is the environment. The United States and China are the number-one and number-two consumers of energy, and we are together the number-one and number-two polluters of the planet. Are there ways we can work together? The disposition of many, at least in this country, is to see things in more competitive rather than cooperative terms. Are there alternative ways to work together?

MR. DADUSH: Good. Maybe we'll take one more and then come back to the panel. There's a hand there at the back, Melissa (sp), right there. It's up – it's up – yeah.

[1:09:09]

Q: Thank you very much. Damien Tomkins, East-West Center. I'm just wondering if the panel could comment on Chinese bilateral engagement with individual European countries, specifically on the periphery. I think that there's been some investment deals with Greece, Spain, Portugal. How would this affect, or how do you foresee this affecting overall EU policy towards China, maybe in the areas of human rights, environment, IPR protections?

And maybe, to jump the gun a little bit, but how do you see European high-technology transfers towards China? What does China want in return? Is it too far to jump the gun to say that they're looking for weapons, or they'll be looking for arms? Do you see that as a possibility of opening up? I think this was an issue with Chinese-EU relations in the past. And how do you see this playing out in the future? Thank you very much.

MR. DADUSH: OK. Maybe Pieter, you want to start us off on the – on the question of the geopolitical situation, U.S.-China, the pivot, the basis, et cetera. How do you see that? And I'll ask Yukon as well. Yeah.

MR. BOTTELIER: It's an area of great concern to the United States, to the whole world. The global shifts about which we were speaking I think are also reflected in strategic – changes in the strategic equations. And you mentioned some of them.

I'm not so sure that the Chinese know exactly where they are heading themselves. I think they've put claims to the South China Sea. They have expressed deep worries about the American presence in Durban (sic). Whether they are really as worried about it as the public pronouncements seem to suggest, I don't know. Don't forget that only 30 years ago, these questions were completely outside the radar screen of even the most senior Chinese. Nobody give it – gave it any thought.

I think we should be careful not to jump to conclusions about China's attitudes on these changing strategic patterns. My sense is that they wish to become a global power, that they will wish to become not only a global economic and financial power, but also a military power, at least a strong regional military power.

That poses enormous challenges for the U.S., more than for any other country in the West, of course. It will require a lot of patience and a lot of wisdom to deal with these challenges in a way that will channel these energies in a stable direction. And these challenges are facing China as they are facing the U.S.

MR. DADUSH: Yukon, anything?

[01:12:20]

MR. HUANG: I'll just add a few things. On the – on the geopolitical, this is a tough issue for China. They see the pivot as increasing tensions in the region. But they also see that the pivot was something that they actually inadvertently encouraged because they took a relatively hard line and did what I'd call some foolish things over the last several years.

So I think that the government has reassessed this issue and realized that the best way to deal with the pivot or any of the – what I call the (military ?) security issues – is to try to soften China's image in the region in ways which are seen as more of a partnership collaboration. Otherwise they would just encourage more of these kinds of tensions. And particularly in a year where China's going through a leadership change, they don't want more stress. So that's what I see as the short term.

The longer term is a more complicated issue because the longer term also depends upon what the U.S. reaction is to what evolves, and then, when you have a new government in China, what their priorities are. So I would say short and long term is very different.

On the climate-change issue, I'd just like to emphasize that to me it's a very interesting thing. In this – in the United States here, we have seen a very heated debate about climate change, its implications, its scientific basis. There is not a heated debate in China on this. And the reason is that their state council is 95 percent technocrats. Technocrats, you give them a lot of scientific information, they don't have a personal opinion. They look at it; it says there must be must climate change; we got a problem. In the United States, frankly, our leadership are not scientists. They like to debate lots of things, so you have much more personal opinion involved.

[01:13:59]

So personally I feel that China's very committed with some of these environmental goals, but they are hung up on these issues of targets, whether they should be treated the same as developed countries. But the commitment is certainly there. And I think there's also of course a strong commitment in a public sense in the United States. So I think that there should be ways for them to collaborate.

Now the form of that collaboration is a bit tricky. The technology aspects, the knowledge aspects are likely to continue to be developed here. But you got a problem, because the broad-based manufacturing aspects to that policy are likely to be done in China. And the answer to the question is, is there a potential for collaborative relationship?

And I will give you a very strong example of, yes, there is: Apple. Apple's technology, intellectual property rights, everything is developed in this country. 65 percent of the Apple revenues and sales globally worldwide accrues to Apple in profits (and industry ?) spurring the economy. But Apple products are manufactured in China. That is a win-win in some way.

[01:15:02]

And so to me that is the same issue in climate-change technology. Can you (evolve ?) one which captures the natural advantages of both sides, in the way that both sides feel like they're gaining something out of this? And right now, politically, certainly the United States – the U.S. does not feel that it has – is gaining what I would call the necessary share to make this a true partnership.

MR. TIMMER: Could I?

MR. DADUSH: Yep. Hans, please.

MR. TIMMER: Let me follow up on the climate-change issue, and how you achieve more cooperation to solve those global problems and to provide the global public goods: more cooperation between the United States and China, but more generally, more cooperation between the high-income countries and the developing countries.

And I think what is needed is that there will be a fundamental change in the dynamic of that process. Till now, the process has always been that the high-income countries, they come up with a global solution, and then they give it to developing countries. And they are looking at it, and they say, OK, that has too much of the characteristics of vested interest of high-income countries. And the climate-change proposals are a very good example of that. So I'm not interested – and, by the way, it is your problem, so thank you very much.

And in many other areas, you have that same kind of dynamics, where high-income countries are thinking globally, but from their own vested interest, and then trying to push it through in the (three ?) other countries. And what has to change is that developing countries start thinking globally, start thinking not just about their own economy, but think about the global problem and what – from the vested interest of developing countries, which still need to grow, which still have a lot of poverty – a global solution would be, and then put that on the table. And then the high-income countries should start reacting to that.

[01:16:58]

And I think what you saw now in Durban is a small step in that direction, where China was under a lot of conditions, but much more committed than before. And also, (all ?) the developing countries are willing now to think through being part of that global solution, and then you change the dynamics.

But we are not there yet. We are not there yet for two reasons. First of all, many developing countries, including China, don't have – found their voice yet to think globally. And the high-income countries are not yet ready to be on the receiving end. But I think it's absolutely necessary to get those global solutions.

MR. DADUSH: Does anybody want to pick up on the European investments – Chinese-European investments, what the Europeans want?

MR. BOTTELIER: The way I understood the question is, what is the Chinese relationship with individual European countries, in addition to China's relationship with Brussels? My sense is that the Chinese are playing both sides and have very active relationships with individual – certainly with the major European countries, and with the – with the European institutions in Brussels.

There is a high-level strategic dialogue between Brussels and Beijing which precedes the strategic dialogue between the United States and China by quite a long time. This was instituted already in the late '80s and has been going ever since. The American dialogue was started at a high level by Secretary Paulson in the W. Bush administration, and I think is an extremely important one.

But from – again, from China's perspective, Europe is very important – not only the most important trading partner, but it's also a very important source of new technologies as well as technical assistance. And that comes from Brussels, which has a large aid program for China, but also from the individual member countries.

[01:19:10]

MR. DADUSH: Other questions? Yes, the gentleman there in the middle.

Q: Alex Keyserlingk; I'm with the IFC. I just got back from two weeks in Beijing, and I would like to get the panel's view on something that disturbed me a little bit. I had a lot to do with younger people, and for the first time, I heard dissent. They were expressing their irritation at the controls put on them on the Internet, on news, on various things. And I was wondering whether the panel has a view on whether that's an exception, or is this something new that's starting to happen within the country?

MR. DADUSH: Thank you. Carl Dahlman here at the front, and then the lady there. Yeah, Melissa (sp), Carl Dahlman here.

[01:19:58]

Q: Thank you very much. Carl Dahlman, Georgetown University. I have a comment then followed by two questions. The comment is, in all the discussion, we've seen very clearly this tremendous shift of power to Asia, to China in particular, and how well the government's been able to deal with so many issues.

So my first question is, picking up from the earlier discussion, we see this risk of some trade frictions increasing. My question is, to what extent do you think that now, in the context of coming elections, this can really spill into a (strong ?) protectionist reaction?

The second question is, we see in the (mostly general ?) systemic thing, the success of the system that people didn't think could perform so well. At the same time, we're seeing a tremendous crisis of market-oriented democracies that are having trouble dealing with a lot of fundamentals – not the China factor, but the fundamentals of the economy, a big structural change because of population, coming out of the fiscal crisis.

When do you think that the West is going to get real about dealing with these things which are politically painful? Because the political system is focused very much on short term – two to four – five years. And the politicians don't want to talk about the kind of belt-tightening that's necessary to deal with these longer-term fiscal, financial issues coming out of the crisis, and population structure has changed. What is it going to take before this happens? We see that the – (inaudible) – it's a political problem.

MR. DADUSH: Sorry, the last question was relating to China, right? Or was it more broadly?

Q: (Inaudible, cross talk) – I'm also saying, if we look at it at the –

MR. DADUSH: Non-China. On non-China.

[01:21:24]

Q: We have China doing very well (in ?) authoritarian system. We see our market-oriented democracies having a lot of trouble dealing with the things that have to be done to position themselves better to deal with the fallout of the financial crisis in a much more competitive, interdependent global economy. And we see a lack of reality here in Washington and in Europe in dealing with these issues. What is it going to take for this really to sink in and for maturity to come to deal with this? That's a very, sort of, political economy question.

MR. DADUSH: Good. There was a lady – there.

Q: I'm Margaret Pearson from the University of Maryland. I wanted to go back to the eurozone crisis and push a little bit on Uri Dadush's assertion about a coordination problem. And certainly today, we've heard tremendous evidence that there does seem to be a great coordination problem.

[01:22:22]

Everybody seems to think, you know, Europeans, or European development bank, you know, have – (inaudible, background noise) – major source of issues, but at the – major source of solution, but at the same time that the U.S. needs to step in, and the Chinese need to step in but the Chinese are waiting for everybody else, the U.S. is perhaps caught in its own problems, and IMF does seem to be sitting back and waiting for Europe to be the central motivator for this as well.

Q: So my question is, really, looking for a sliver of hope about how these coordination problems can get solved, both if Europeans go to greater extents than they have so far to solve the problems and if they seem not to and the problem seems to unravel more and more, where is this initiative going to come from beyond just the Europeans doing what they need to do to get the multilateral and the sort of great power coordination in as well? It's a process question, I think.

MR. DADUSH: Right. OK. So we have a question on protests and on the Internet. And we have the question about protectionism in China. We have other questions. Yukon, you want to –

MR. HUANG: Well, just very quickly on the youth issue and the concerns about the restrictions on the Internet and, I would say, individual rights more generally, it is obviously increasing in China. We have to realize that this is essentially the generation that is coming that has no direct contact or context of the Cultural Revolution and the aftermath in terms of the exertion of the state and basically saying that excesses had to be dealt with fairly hard because we've had problems. So that no longer – they obviously don't see that as a necessary aspect of a – of a – of a – of their country.

So the government coming down much harder on these kinds of restrictions is to them a problem that will increase. And it's also going to increase because the employment opportunities of the university graduates are getting more serious in the coming years. They're double the graduates that have been coming out. So as a general sense, I would say the university crowd is getting restless.

[01:24:44]

MR. DADUSH: Good. Protectionism, the risk of protectionism under the new – the new government: Pieter, will it make a difference?

MR. BOTTELIER: We don't know how the new government is going to look like. We think we know some key figures that are going to play a central role at the party level and at the government level, but how the whole government will change in its policies and attitudes on trade is very hard to predict at this point. You'll have a wholesale change at the Politburo level and at the – and in the Central Committee coming at the opening of the 18th party congress sometime at – in the fall of 2012. If anybody feels confident predicting what impact it will have on China state policy, I'm not one of those.

I came away from just most recent visit that the key people I talked to, at least, are very keenly aware of the importance with China of open trade channels. And they, of course, would like to have a dig at the U.S. from time and time, as we saw with the recent introduction of counterfeiting duties on certain heavy vehicles – trucks and

SUVs. I don't know how important that is as a reflection of new thinking; personally, I'm inclined to think that it is not so important, that the prevailing opinion in Beijing is to go for an open trading system as much as they can. They've benefited from the open trading system and from WTO membership more than any other developing country, and there are very few people in Beijing who are – who question that. So, yes, there will be trade frictions, particularly with the U.S., but on balance I would expect China to open up even further.

[01:26:42]

MR. DADUSH: Good. Hans, do you want to take a stab at the second question by Carl (sp) on, you know, the structural reforms that are needed, the longer-term reforms that are needed to reflect this big global change and why they're not happening?

MR. TIMMER: (Inaudible) – and let me link it to some of the other questions also. Let me start with the coordination issue in Europe because it's, to some extent, a structural change also.

I think, first of all, it is important – the observation that it is a coordination problem. And not everybody agrees with that. Many analysts, at the moment, say that the problem of Europe is actually too much coordination and you don't have the flexibility in individual countries to do your own stuff and to have your own currency and to react in your own way to your own problems.

And I would agree with you that, actually, it is a coordination problem. The fundamental problem in Europe is that the individual countries are too small and that they are too integrated to individually deal with the problems. And one of the big problems in Europe at the moment is that you have to rescue banks and you have to supervise banks, and that is still done at an individual country level. And that creates all the fiscal problems in many countries that then has to be solved and goes back to the – to the banking sector. And because it's all organized in individual countries, it's very difficult to get coordination because there are different interests in the different countries.

And I'm ultimately optimistic that also European leaders, but also ultimately the European Parliament, understand that the only solution is to have certain issues more centrally organized. And in that sense, I must say that Europe is now ahead of the United States in attacking the current issues because in Europe, at least both – for the European Union, steps are taken to solve those more longer-term issues. And if you look at individual countries – like Italy, like Portugal – if you look at the reforms that they are implementing at the moment, there are a lot of these long-term – long-term elements in there. And that is indeed ultimately what is – what is needed. And the big problem in the high-income countries is that all the discussion is about now and backward-looking and it's not based on a vision where you – where you want to be.

[01:29:17]

Final question on the – on the point of the social unrest and the inability of governments to deal with that – I think Pieter said it also already – but it is interesting to observe that that is not just a problem when there are adverse developments. It is as often a problem when you have a success story. And so in China you have the educated people that now are in a very different way educated than even 10 years ago. In China you have the emerging middle class that wants to have a say. But in the Middle East, it was not just poverty; it was the fact that a lot of people came out of college with a higher than in the past, but couldn't get a job. And you have many of those examples where it is very difficult to deal with the consequences of progress. And I think the ultimate example you see in the high-income countries at the moment, where you have a lot of progress but the politics is no longer able to take the next step, and you are stuck now and you are losing your competitiveness with the rest of the world.

MR. DADUSH: Good. Before I ask for another round, if there is one, on the euro question, the process, as you – as you asked: I think the first step of the process is – has made progress in the last week or two. The first step of the progress – the first step of the process is, the Europeans have put in a significant additional chunk of change. The European Central Bank has very significantly stepped up its support to the banking system, issuing now three-year loans against widened – you know, less demanding collateral requirements.

This is very much part of the safety net and everybody knows, although it is not official or explicit or admitted, that the European Central Bank is acting, at the moment, to stabilize the bond markets. And for, I think, very good reasons, there is no explicit policy on that in order to maintain pressure on the countries in the periphery to undertake reforms.

[01:31:51]

So I think the first step is there. I think the second step would probably come through some kind of G-20 coordination. That's where the serious – one serious discussion took place. And the message that came up from the last meeting of the G-20 was, the Europeans first have to get their house in order and they have to come up with a credible plan and they have to put money on the table. I don't think they have done that to the extent that they should, but they have made the progress that I have mentioned so far.

To be perfectly frank, I doubt whatever process you put in place that you are going to get a very large involvement outside of Europe, unless the United States is in the lead. So, you know, you place your bets: How might it happen? Unfortunately, it might happen under duress, just like the TARP program was resisted and caused a – first rejected by the Congress, and caused a financial panic, and then accepted by the Congress a week later. That kind of circumstance might develop.

And then I think, you know, the treasuries around the world are going to be on the phone to each other, and the key senators are going to be called and et cetera, and then the situation might change. I don't know. I don't know. But I do believe that it's very unlikely that a large package will be negotiated without U.S. involvement.

Any other questions? I think we'll take one more round, and then we're going to draw this to a close. If there is one – the lady there.

Q: Thank you. My name is Esther Zoyu (ph) and I'm with China Central Television, Washington bureau. I am Chinese, but I'm going to ask question on U.S. economy because in recent months we've seen some (newly ?) economic indicators that are pretty upbeat, including the surging housing data and lower unemployment rate and some growing PPI and et cetera – and also, the GDP figure that is prone to be released tomorrow will probably be positive as well.

So my question is: Can we take these as signs of U.S. economic recovery and – because as you mentioned, that the upcoming presidential campaign next year. So what efforts do you think the government should make the most in order to prod the U.S. economy? Thank you.

[01:34:50]

MR. DADUSH: OK. We'll take one more and then we'll turn it over to the panel. And I'm also going to ask them make any final 30 seconds interventions that you want to make.

Q: Thank you. I'm Jeannie Win (sp) with Voice of Vietnamese Americans. I follow up with her questions and would like to link a few other points being raised earlier.

We talk about global, so would you touch on the Euro-Asia market, and would you touch on the Shanghai Cooperation Organization. Would that be (on the radar ?)? And would you also touch on the issues of the approach of the U.S. and TPP, how would China react to that? And what the – in related to energy and jobs, employments, and her questions about the economy, how would you see the future investment of China in the U.S. as manufacturers in creating jobs in this country?

MR. DADUSH: OK. That's a large number of questions. (Laughter.) I'm going to ask you to pick a couple of them, Yukon and Pieter. But first, Hans, do you want to comment on the question on the United States and also give us your 30 seconds parting message?

[01:36:17]

MR. HUANG: The positive news in recent days in the United States is good news because it shows that the U.S. is not sliding together with the – together with Europe into a recession. It is not good news because now all the problems are over. This is a kind of a rebound that comes after a very weak first half year. And so you should look at it in very cyclical terms and almost as technical changes, but not as an illustration that the fundamental problems have been solved. In the U.S., investment in the housing sector is still one-third below where it was before the crisis, and probably it should remain very low. So you can't get a recovery from a small recovery in the housing sector; you get a recovery from restructuring the economy, and we are far from that. So I'm seeing it in a positive way, but I'm still very worried about all high-income countries, including the United States.

My last 30 seconds is very much in line with the question about all the other events in the – in the world. And I'm always surprised at – in these discussions, we never touch on Africa, for example, while if you look ahead then there are fascinating developments in Africa. Many countries are growing 6 percent a year. Many countries have seen fundamental reforms in their economy. It is a continent which is very rich in resources, can potentially benefit a lot from the Chinese interest. And 10 years from now, when we look back, then we say, hey, something happened in Africa. We hardly talked about Latin America at the moment, where the situation now is fundamentally different from what it was 10 years ago, and they play a very different role in the – in the global economy. And that means, for me, that in these discussions, we are still too much focused on what is happening the high-income countries. But the world is getting bigger and bigger.

MR. DADUSH: Thank you, Hans. Yukon?

[01:38:38]

MR. HUANG: One quick comment on – about these regional agreements, whether it's the Shanghai Cooperation Conference or the TPP or whether it's the East Asia – ASEAN plus one, plus two, plus three, plus six or whatever as you go here. (Laughter.) It's getting confusing, of course, because these are different country groupings, and they have overlapping responsibilities, whether it's on trade or financial security. So I think there's going to be some shaking out over the future as to how much is this a sensible overlap, how much of it actually increases the focus. And I think from a China perspective, they have some views about – that some of these things are not working out the way they would like.

On the TPP, my personal view would be, is the objectives of the TPP I think are very sensible ones, but I find it hard to see how you can go address those objectives without a China participation. That just strikes me as kind of odd, and I think that's what China is asking himself: Should we, or why is this not a grouping that we are being asked or encouraged to participate in as opposed to being excluded?

[01:39:43]

And the Shanghai Cooperation is very specific, of course – the Central Asian, the (Soviet ?) and the security issues of that particular region here.

I think the only – the lasting comment I would make is what I think has come up in the course of discussion: China's links, global links, regional links are really important to China. It's very much in favor of an open economy. It wants to strengthen trade links. It wants to increase the capital flow links, not so much the money coming in. Is – but as Hans has mentioned, the big issue for China is, how do I actually increase the flow out? And the flow out is not only to establish more direct relations, but the flow out is the likely channel to reduce pressure on RMB appreciation. If you don't want to RMB to be under pressure, you got to encourage more money to flow out of China, and it should.

If you look at the former Soviet Union, when it fully opened up its trade capital account, what you saw, in fact, was, the Soviet currency collapsed, actually. It collapsed not because it didn't make sense; it collapsed because Soviet citizens and households and firms realized that it made sense to diversify their holdings. So a reshaping of portfolios would change the value of the RMB in the future, and I think that's a big issue that's looming out there. But how fast it'll proceed, who knows.

MR. DADUSH: Very good.

MR. BOTTELIER: My 30 seconds?

MR. DADUSH: In your 30 seconds, you answer to those questions. (Laughter.) Take your pick.

MR. BOTTELIER: Yeah. Well, the global economic outlook is extraordinarily uncertain and complex at this point. And it is so uncertain because the three major economic pillars, the United States – or, I should say – yeah, the United States, Europe and China, are all facing very difficult conditions. If the U.S. is unable to come to terms with the longer-term fiscal issues facing this country, which are extremely serious, it's very hard to be optimistic about the longer-term U.S. outlook. If the Europeans are unable to come up with a plausible solution for the euro, it's hard to be optimistic about Europe.

[01:41:53]

China, it's in a way perhaps the least troublesome of the three, in the sense that the economy still is growing very fast at the moment; real wages are still rising at the moment. All the layoffs in the manufacturing sector that we are observing don't translate into higher levels of unemployment or falling wages. China's real wages in the manufacturing is still rising. That shows you something that this is still a fast-growing economy, in spite of the slowdown, which is broad based and this has been going on for the last 12 months and will continue, I think, for the next 12 months.

My – I don't want to discount the risks and I cannot really assess the political risk. But on the economic side, I think there is a high probability that China will be able to manage a slowdown in such a way that they will actually benefit in terms of economic restructuring. We see that the external imbalance is slowly coming down. The global – the current account surplus as a percentage of GDP is unlikely to be higher than about 3, 3 ½ percent this year.

Compare that to 11 percent in 2007. The domestic consumption growth rate at least – although the data are not conclusive – suggests that the extreme imbalance between China's share of consumption in GDP – the lowest in the world – may bottom out. The last three months seem to suggest that household consumption has been growing faster than GDP, which is what is needed to bring about some restoration of balance on that side.

[01:43:39]

The big concern I have, of course, is that – is the leadership change coming within 12 months, that a new team will make big mistakes. They may not correctly assess the nature of the problems. And if China begins to make big mistakes in their policy framework, then all bets are off. There is nothing that guarantees China's success.

MR. DADUSH: Thank you, Pieter.

Well, my 30 seconds is to resonate with Hans' comment. This is to a Washington audience, now. Hans said, the world is getting bigger. So this is one message. The world is getting bigger, with China, with the multiplicity of growth poles in emerging markets. And that, of course, is a huge opportunity for the United States. In many ways, the United States is the economy best positioned to capitalize on these trends – its innovative capacity, its openness to foreign cultures, its establishment of the rules under which the current global economy operates.

But there are also very big risks in the world. Just as the world is getting bigger, some of the foreign risks are getting bigger too. And none is bigger, in my view, than that of Europe at the moment.

So I guess for a Washington audience the message is: There are more opportunities out there, but politicians here need to be much more aware of the risks coming from overseas. And it is remarkable to me just how insular the policy debate and how concentrated on the microquestions the policy debate has become in this city, and how little awareness there is – this is from the global superpower – of the risks that are out there and, I believe, of the opportunities.

So I'll leave it at that. And I'd like to thank, on behalf of Carnegie and, I believe, on behalf of all of you, the panel. I think they did a terrific job. Thank you very much. (Applause.)

(END)