

ECONOMISTS' ROUNDTABLE DISCUSSION ON CHINA'S ECONOMY

常州大学山书馆藏书章



图书在版编目 (CIP) 数据

经济学家圆桌会谈:英文/《经济学家圆桌会谈》编写组著: 袁连荣 等译.

一北京,外文出版社,2010

ISBN 978-7-119-06749-0

I. ①经… II. ①经… ②袁… III. ①经济-研究-中国

- 英文 IV. ①F12

中国版本图书馆CIP数据核字(2010)第222428号

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巴曙松 (美) 保罗·库塔索维奇 蔡继明 曹凤岐 樊 纲 郭梓林 何学彦 何志毅 胡鞍钢 (美) 克莱尔 R. 格林郎 Jr. 厉以宁 刘 伟 (美) 刘贤方 刘迎秋 (美) 马苏德·萨米 茅于轼 (美) 帕诺斯·穆都库塔斯 单忠东 王振中 吴敬琏许小年 易宪容 约翰·拉特里奇 张维迎 赵 晓

中译英: 袁连荣 刘振聪 冯 蕾 王丽美

英文改稿: David Tool Daniel Garst 袁连荣

英文审定:梁良兴 责任编辑:文 芳

特约编辑:赵代波 潘 灯

图片提供: CNS 等

装帧设计: 图题 设计·邱特聪

印刷监制:张国祥

经济学家圆桌会谈

中国经济的过去、现在、未来

©2010 外文出版社

出版发行,外文出版社

地 址: 中国北京西城区百万庄大街24号 邮政编码: 100037

网 址: http://www.flp.com.cn

电 话: 008610-68320579 (总编室)

008610-68995852 (发行部)

008610-68327750 (版权部)

制 版:一瓢设计工作室

印刷:北京中达新雅印刷有限公司

开 本: 787×1092mm 1/16

印 张: 14.75

版 次: 2010年第1版第1次印刷

(英)

ISBN 978-7-119-06749-0

08800 (平装)

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China's Economic Recovery Management in the "Post-crisis Period"

By Ba Shusong



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As it leads the world out of the 2008 global economic crisis, China now must adjust policy as it manages its economic recovery. This is faced by all other countries in similar situations and constitutes a key issue in formulating macroeconomic policy. And due to the current complex economic environment, China faces the challenge of rebalancing its internal and external policies at all levels to deal with the likely emergence of new patterns of global industrialization and finance.

In 2009, thanks to its unconventional policies, China rebounded more quickly from the global economic downturn. This response certainly played an important role in reviving global economic growth. China's economy has now entered a new expansion phase in the economic growth cycle, so the focus of Chinese economic policy is shifting from tackling crisis to recovery management. This can be seen in the government's macro-economic policy adjustments.

The core theme in the "post-crisis period" should include the following two elements:

On the one hand, while international financial system remains unstable and the global economic recovery is quite weak, internal structural adjustment should be the focus of macro-economic policy. This will further consolidate the basis for continued economic recovery. In particular, doing this will stimulate new domestic demand; this, in turn, will make for a smooth transition from the current unconventional policies, which are designed to cope with the unusual and exceptionally severe recent economic downtown, to more orthodox measures suited for normal times. On the other hand, China is going to change what drives its long-term economic growth. This objective emphasizes adjusting its economic structure and development pattern in order to prolong its expansion phase in the current economic cycle, realize a sustainable recovery, and thereby boost the global economic recovery.

Recovery Management Faces Many Challenges

The "post-crisis era" refers to the point at which the estimated market value of the global finance has been restored to its pre-Lehman Brothers bankruptcy level, the "balance sheet" of global financial institutions has been restored to a certain extent, and the financial market activities are once again brisk. From this perspective, the "Lehman shock" is subsiding and the worst phase of the global slump is over.

The global economy is unlikely to soon fall again into crisis and recession. However, recovery management in the long term still faces many challenges, especially with respect to the diverse exit strategies adopted all over the world, the "jobless recovery" in developed countries, and rising sovereign debt difficulties.

First of all, battered by the financial crisis, for the first time in recent history, every major economy in the world simultaneously launched massive stimulus measures. However, once these economies began crawling out of the recent global downturn's deep trough, their rebounds took on different characteristics. This means that even when the overall economic environment is the same, countries choose to exit from crisis policies at different times and rates, as well as with varying strengths and policy instruments. Indeed, the sovereign debt crises that broke out in Europe in 2010 further intensified the uneven economic recovery among European countries. This, in turn, constrained the ability of European countries in exiting from existing stimulus policies.

Second, many countries are undergoing a new and unique kind of economic recovery, the so-called "jobless recovery." To some extent, the present global economic recovery is driven by massive government stimulus policies. The recovery is government-led instead of being market-driven. The government-led investment is incapable of matching the labor market supply and demand, and might lead to resource misallocation, which might result in jobless economic growth. Currently, the unemployment rate in Europe and the United States stands at the very high level of about 10%, while China's so-called "registered urban unemployment rate" can not objectively reflect real labor market conditions. In this sense, future recovery management must shift from being government-led

to a more sustainable market-driven one. At the same time, governments should make efforts to boost employment. These are challenges facing both China and other world economies.

Finally, there are increasing risks and uncertainties arising from sovereign debt crises. High government debt and deficits in many countries, some of which have already reached very alarming levels, could lead to more sovereign debt crises. Sovereign debt and currency crises may prolong the existing financial crisis. This potential risk, with the outbreak of the sovereign debt crises in Southern European countries, has caused increasing uncertainties in the global financial market.

On the domestic side, although China's recovery has strong momentum and the economy is less likely to fall into another recession, challenges continue to suddenly arise in the current economic upturn. The challenges are especially severe in the following areas. First, Europe and the United States adopted massive economic stimulus policies, which have led to low global interest rates for the long-term future. This, in turn, has limited China's ability to make critical internal economic adjustments to deal with the overcapacity in some industries resulting from high government-led investment. During the bubble period, high and rising external demand for Chinese exports has greatly increased investment to boost industrial capacity. This has made reducing excess capacity in these industries one of the biggest post-crisis challenges. And many questions have to be grappled with when the Chinese government imposes strict controls over the real estate market to head off a property asset bubble. For example, before the formation of new economic engine, will these strict controls over the real estate market affect the Chinese economy's overall recovery? At the same time, the outbreak of sovereign debt crisis in Europe will most likely affect Chinese exports to these markets. Thus how will the imposition of tight controls and the external fallout from these sovereign crises affect the Chinese economy? These are challenges policy-makers need to deal with in managing the economic recovery during the new economic development stage.

China Trying to "Re-balance"

Theoretically, sustainable economic recovery must depend on two

prerequisites: the first is achieving long-term economic growth objectives; the second is avoiding excessive short-term economic fluctuations. To secure a solid foundation for economic recovery, China's macroeconomic policy will have to be "re-balanced" by being shifted from a government-led economic recovery to a sustainable market-driven recovery. This will limit the risk of China falling into a "double-dip" recession.

"Re-balance" of Fiscal Expenditure

First, government investment may focus on urbanization, making it an important driving force in a sustainable recovery. From a long-term perspective, China will use the financial crisis in 2009 as an opportunity to promote a rapid urbanization, which is expected to accelerate greatly over the next 10 to 20 years. All of the data suggests that by 2025, China's urban population will rise to 926 million, and is expected to reach 1 billion by 2030. Thus as cities rapidly get bigger, they will require massive investment, particularly in infrastructure.

First, in the next 10 years or so, the Chinese government will make investments focusing on promoting urbanization and hence will also seek to expand domestic demand. The latter effort is consistent not only with promoting urbanization, but also with adjusting the structure of both investment and the economy as a whole. At the same time, government investment will play an important role in ensuring that China's economy enjoys a sustainable recovery.

Secondly, the effort to "re-balance" fiscal policy may boost consumer spending and harmonize the structure and growth of different regional



economies within China. In order to enhance the endogenous forces propelling the Chinese economy's recovery and ensure its sustainability, another future task of fiscal policy is to emphasize balanced economic growth.

On the one hand, consumption will take up an increased share of the GDP, thereby re-balancing the structure of domestic demand and making it the leading force driving economic growth. This means that fiscal policy may well focus on the following two tasks: 1) increasing people's disposable income amount through transfer payments, especially those of poor rural families; and 2) reducing people's need to save for a rainy day by enhancing social welfare services.

On the other hand, fiscal policies will help lead to a more balanced regional growth pattern. In China's latest economic rebound, its central and western regions recovered much faster than did the eastern coastal regions. In 2008 the real GDP growth rate in the central and western regions exceeded that of the eastern region for the first time during the past 19 years, which significantly narrowed the development gap between these different regions.

"Re-balance" of Monetary Policy

China adopted a so-called "moderately loose monetary policy" in dealing with the crisis in 2009. This monetary policy really amounted to making credit easily available. To be more precise, expanded lending played an important role in increasing monetary liquidity and stability. At this point, China's monetary policy differs fundamentally from those of developed countries, as it is now shifting from hugely boosting lending to being a policy better suited for normal economic conditions.

Although there are different ideas on what constitutes a reasonable and balanced credit supply in academic circles, the credit supply in 2009 was, by any standard, seriously unbalanced and led to tremendous turmoil in the actual economy and financial market. According to empirical data from within China's banking sector for a long period of time, the relatively balanced ratio for credit

supply each quarter is roughly 4:3:2:1. The future economic growth in a short period may be "higher first and stable later", with the distribution of the credit supply likely being 3:3:2:2.

In addition to balancing the credit supply, the structure of lending activity must be considered in the effort to secure a more reasonable growth pattern. The large-scale and long-term investment projects and infrastructure construction initiated in 2009 still require large amounts of credit during the next two to three years, which ensure some continuity in China's overall investment climate. In addition, a large number of private firms and state-owned enterprises (SOEs) still require capital for their production and operation. Thus it is critically important to maintain sufficient liquidity in the economy. However, a huge increase in the credit supply is now the main cause for inflationary expectations. Thus the future lending policy will definitely aim at optimizing the credit structure by bringing its overall size under control, enhancing capital constraints on banks, and maintaining tight control over irrational credit growth and abnormal fluctuations on a month-to-month or quarter-to-quarter basis.

International Industrial Transfer and the New International Financial Structure

From a larger range of perspectives, we can draw two important conclusions from reviewing the causes and consequences of the latest global financial crisis:

Given the forces driving international economic growth and the distribution of manufacturing activity, the financial crisis underscores that previously viable technologies and industries are now outdated. China currently is facing the challenges posed by international industrial restructuring and new technological breakthroughs. In the international financial system, the massive U.S. fiscal and current account deficits will necessarily lead to a long-term decline in the dollar's value. The international financial and monetary order is also undergoing a series of profound changes. Against these twin international backdrops, China is actively involving itself in the reconstruction of global industrial chains. This will gradually boost the visibility of Chinese producers and brands on the world market and also lead to the regionalization of the RMB, giving China an active role in reconstructing the international monetary system.

Restructuring the International Industrial Chains and Upgrading Exports

China has long followed an export-oriented development strategy. Its lower labor costs and rising labor productivity make it an important part in the world's industrial supply chain. A long-term balance has been formulated between China's advantages as a supplier and producer of goods and the division of global manufacturing. However, as the world economy enters a "post-crisis period", finding new sources for economic growth has become a pressing global issue. Thus the global distribution of manufacturing is undergoing significant changes, as are international industrial supply chains. This has given rise to unprecedented challenges and opportunities to China's export trade. Upgrading foreign trade will be a main element of China's ongoing involvement in economic globalization.

The "post-crisis period" is an opportunity for Chinese firms to re-integrate practical products, technologies, brands and resources. It is also a good time for them to move up in the global industrial chain and in the value chain. After the financial crisis, China is likely to become a global manufacturing leader and make significant breakthroughs in new cutting-edge technologies. At the same time, the development of emerging industries can also make Chinese firms grasp the latest trends in global manufacturing industry, and thus avoid acquisitions of those industries that may be eliminated or renewed in the next economic cycle.

The global industrial structure is undergoing dramatic changes. In this changing context, China's policy makers and entrepreneurs will become more conscious of the function of the global market rules. With respect to global rules, China will also move from being passive learning from and adapting to global rules to actively shaping the decision-making behind their formulation and implementation.

The Reconstruction of International Financial and Monetary Order

At the height of the international financial crisis in 2009, the yuan was pegged to the U.S. dollar and allowed to float within a narrow band. This peg strongly supported the U.S. dollar and therefore helped stabilize the global

financial system. As the global economy entered a "post-crisis period", the yuan came under an increasing pressure to appreciate. In fact, in the present circumstances, it is not important when the yuan will return to bi-directional fluctuations with a slight appreciation. Even if the currency was back on such a track, its appreciation would be very limited. Moreover, even if the yuan appreciated, China's capital and trade surpluses would be largely unaffected. This is because China's surplus in international balance of payments arises from structural factors and can not be eliminated by raising the yuan-dollar exchange rate. The 2005-2008 period is a case in point: at that time, the yuan appreciated more than 20% against the dollar, but China's trade surplus with the U.S. surged sharply. And in 2010, when China's trade surplus sharply declined, the U.S. trade deficit remained high and its unemployment rate was still rising.

China has adopted two policies for the short- to mid-term that are focused mainly on reforming the internal price system and making structural adjustment. One is the market-driven reform of factors and resources, which will contribute to the international balance of payments and domestic resource allocation. The other is to adjust regulations over foreign exchange reserves, giving businesses, residents, and financial institutions greater rights to use foreign exchange. At the same time, it is inevitable that the United States will make internal structural adjustment, for if it fails to do so, no real progress can be made in stabilizing the world economy.

In this context, a new international economic and financial pattern may come into being, where emerging economies and developing countries will occupy a higher position and play a bigger role in the international monetary system. The clearest sign of this shift is the fact that China will have more Special Drawing Rights(SDR) shares in the International Monetary Fund(IMF) conditionally. An international economic and financial pattern where the interests of both the developed economies and developing economies will be given equal weight would certainly be more stable and robust and better equipped to cope with crises.

Economists' Roundtable Discussion on China's Economy

Innovations in China's Economic System

By Cai Jiming



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With the deepening of China's economic reform, China's basic economic system has gradually changed since the reform and popening.

China's reform has been officially termed economic reform rather than economic system reform. The reason lies in the fact that economy and economic system are two different concepts in China's politico-economic vocabulary. The economic system is the basis of the social system, reflecting the essential characteristics of a society, but economy refers to the specific forms taken by certain economic systems.

According to the traditional theory, the basic characteristics of the socialist economic system cannot be changed but improved in its own development because of the incomparable superiority of the socialist economic system. On the contrary, the diversified economies as specific manifestations of the socialist economic system can be selected and adjusted through continued reforms.

However, it is impossible not to touch upon the traditional economic system with the deepening of economic reform. On the one hand, the economic system itself must be suited to the nature of the productive forces and adjusted continuously according to the objective requirements of the development of productivity. On the other hand, people's understanding of the basic capitalist economic system, the basic socialist economic system, and their essential characteristics is constantly changing. With the development of modern capitalism and the practice of socialism, the capitalism that Marx criticized no longer exists; the essential characteristics of socialism in the future that Marx