This meeting marks a milestone

- 20 years of CDF
- 20 years of open discussions of China’s development strategy and reform
- Discussions of 10\textsuperscript{th}, 11\textsuperscript{th}, 12\textsuperscript{th}, 13\textsuperscript{th} Five Year Plans
- Now setting the stage for the 14\textsuperscript{th} Five Year Plan
- 20 years of enormous success for China
  - Largest economy in world in PPP
  - Huge increase in income per capita
  - Almost 800 million moved out of poverty
  - China has become a middle-income country
  - In some areas, China is a world leader
Much work ahead

• China’s is still a developing country, though a large one, with one fifth per capita income of most advanced country
  • Needs to close gaps in technology, knowledge, human capital
• Large inequalities—rivaling US, the worst in advanced world
• Long way to go to ensure equal opportunity for all
• Large environmental problems
• Institutional problems
  • Excessive dependence on short-term debt-driven growth
    • Challenges in creating stable equity markets
      • Equity provides better risk distribution
    • Challenges in creating long bond market
      • Many key investments are long-term
      • More stable than short-term finance
  • Insufficient tax base for government, especially local
  • Greater economic diversification
Key message from previous years

• What matters is *quality growth*, not just GDP
  • Which means environmentally, economically, and socially sustainable
  • Inclusive growth
  • Stability

• Has to be approached from both demand and supply side—keeping two in balance
  • “Wrong” supply side measures can weaken demand and impede sustainable reform
  • “Right” supply side measures can strengthen demand, increase output today and in the future, and help achieve other goals
Important lesson from US

• Supply side measures taken in the US (tax reductions at the top, deregulation) led to *lower* growth over long run, more inequality, greater instability, less opportunity (share of new firms in decline), more concentration of market power

• Studies elsewhere confirm results are more general

• Other countries have undertaken different policies
  • With same global environment (same globalization, same technological change) have achieved better outcomes
  • Shows that policies matter
First question: What is real source of the wealth of a nation?

• In the capacities of its people

• In their knowledge (both knowledge about the world, and their human capital)
  • Importance of universities, knowledge institutions
  • Dangers of disinformation and attacks against and restrictions on “truth-discovering, assessing, and dissemination” institutions

• In their ability to work together, cooperatively and with stability
  • Importance of “social organization”—including rule of law
  • But not any rule of law—feudalism is a rule of law that didn’t work

• Key insight: distinction between wealth creation and rent-seeking
  • Many people become rich through exploitation of others and rent-seeking
  • But this cannot be the basis of the creation of the wealth of a nation
Helps explain natural resource curse

• Why countries with large amounts of natural resources often don’t do well and are marked by high levels of inequality: these societies developed into rent-seeking societies

• China has been remarkably successful, in spite of lack of natural resource

• But land is China’s really scarce resource

• And there has been excessive focus on real estate
  • Giving rise to potential bubbles and instability
  • Source of much of corruption
  • Giving rise to inequality
A supply side agenda for China

- Continue and expand investment in research, education
  - Including pre-school and in rural areas
    - High return, essential for equality of opportunity
- Continue and expand opportunities for women and aged to actively participate in labor force
  - Especially important with demographic changes
  - Greater flexibility in hours, family leave policies, child care, etc.
- Redirect investment away from real estate
  - Property tax
  - High capital gains tax on real estate gains
Supply side measures ensuring *quality growth*

- **Environment**
  - Carbon tax, together with strong regulations, and measures to ensure against any adverse incidence
  - Including good public transportation systems
  - Carbon tax will have positive demand and supply side effects
    - Retroffiting the economy to create a green economy
  - Key message of the “Green New Deal” is that the societal transformation to a carbonless economy can be transformative
  - Cost of not undertaking transformation greater than the cost of doing so
  - China has shown the way in developing low-cost solar panels, of enormous benefit to entire world
Supply side measures ensuring quality growth

- Creating livable cities
  - Which is where most people will live
  - With good health care, education, green spaces, public transportation
  - Happier and healthier people are more productive—supply side measure
  - But investments to create these livable cities are also a demand side measure
  - Livable cities have to be well-planned: zoning is crucial
    - But 21st century zoning is different from 20th century
    - Reflecting changes in demography, economic structures
Removing impediments to growth

- **Importance of finance**
- Overall, as financial markets in West grew (e.g. in US from 2½% of GDP to 8%) did not serve society well
  - In spite of “innovativeness”—some of innovativeness was in rent-seeking
  - Failing to perform key role in intermediation
- China depends excessively on debt finance and too much of finance based on large banks and shadow banking system
  - Excessive leverage source of instability
  - Key information is local, especially as China transforms itself into an innovative, service sector economy
Broad reforms in financial sector

• Richer ecology of well-regulated financial institutions
• More local and regional banks
• Closer regulation of equity markets, with greater emphasis on long-term investments and growth
  • Financial transactions tax to discourage short-term speculation
• Encouragement of venture capital funds
• Deleveraging over-leveraged parts of economy can be consistent with increasing leverage elsewhere
  • Some parts of Chinese economy have not been able to obtain sufficient funds
Removing impediments to growth

• In all economies, there are barriers to entry
  • Some natural
  • Some created by incumbent firms with market power

• **Competition is essential for a dynamic economy**
  • Part of basis for China’s success—competition among TVE’s and others

• Increasingly, many economies are being characterized by an increased concentration of market power

• It is essential for China to guard against this—this is a key **supply-side** measure
Government will have to play an important role in supply side measures

- Promoting innovation—basic research, education
- Promoting restructuring of economy
  - Industrial policies to promote new sectors of the economy
  - Active labor market policies to help people move into sectors of the future
  - Social protection to make sure that no one is left behind
  - Regulations to protect the environment
  - Taxes to encourage productive economic activities, to discourage rent-seeking activities
  - To promote other supply-side measures
- Promoting the private sector
  - Through encouraging a financial sector that serves society
  - And providing assistance (e.g. transmission of knowledge) where appropriate
  - Ensuring that there is competition
What I have not emphasized—overcapacity reduction

• Overcapacity reduction has largely achieved its original goals
• Always strange to call “overcapacity reduction” a supply side measure
  • Actually reduced potential supply
  • Key aspect: rationalizing supply, focusing on most productive enterprises
• As growth slows, China may have to pay more attention to problems of excess capacity
  • When a country grows at 10%, excess capacity in a given area quickly disappears, social cost relatively low
  • Takes much longer to deal with when growth is 6%.
A balanced agenda

• This is a demand *and* supply driven growth agenda
  • But not just a consumption-driven growth—China still needs investment

• This is a public- *and* private-sector-driven growth agenda
  • Many domains in which private sector will be driving force
  • But government has to set the rules of the game, address limitations of markets (under-regulated markets have created or contributed to problems of inequality, environmental degradation, unlivable cities)
  • Government will have to play important role in key services citizens want—health, education, security in retirement
A pro-active rather than reactive agenda

• Driven by China’s own evolving needs and capacities

• But adapting to changing global situation
  • America’s walking away from a rules-based multilateral trade system creates new uncertainties
  • Uncertainties unlikely to be removed even after Trump—new global perspective

• China has to keep focused on its goal of increasing living standards of its own people in a sustainable way
  • Using its own model—social market economy with Chinese characteristics
    • Adapting it to changing circumstances not only globally but also with China, including changing aspirations of China’s citizens
    • Continuing the strategy that has worked so well for four decades—crossing the river by feeling the stones
      • Pragmatism is key to success
      • Important to learn from successes and failures both in China and elsewhere
      • Many of the challenges confronting China have never been faced before
      • Policy design will be increasingly critical