



RICHARD COOPER

Professor of International Economics at Harvard University

PARK In-kook, President of the Korea Foundation for Advanced Studies; Co-chairman of the Beijing/Shanghai Forum

Our next speaker is Professor Richard Cooper, who has been working as a professor at Harvard University since 1981 and was the Chairman of the National Intelligence Council as well as Chairman of the Federal Reserve Bank of Boston. He has been working at the top level with high-level officers, including the Undersecretary of State for Economic Affairs and Debt Assistance and Secretary of State for International and Monetary Affairs.

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My assignment this afternoon is to talk about the prospects for Chinese growth looking ahead and I will do that. However, as I am the only American on the panel I thought that I should say that I am in full agreement with what Professor Jia said about the potential and current reality of US-China relations. I think that the potential for cooperation is very strong and it is a question of skillful management in both Beijing and Washington to realise that potential. It is happening now in a number of areas and there are many possibilities going forward.

Why do we have the opposite impression? I hope that there are some Western journalists in the room. American journalists – and also many European journalists – cast the world of public affairs as a sports metaphor. It is Team A against Team B and the question is who is ahead at any moment in time and who is going to win and who is going to lose? That is absolutely the wrong metaphor for relationships among countries. We do not have to underline the point in this forum that there are many unsolved problems in the world and, as Jia said, in the US-China context there are many potentially fruitful areas of cooperation. It is our job to make sure that they mature in a successful way. It is not a sports metaphor at all; it has a positive sum potential and is not zero sum. However, both on TV and in the print media, we are bombarded with issues that are framed as if there is going to be a winner and a loser, or that there has been a winner and loser issue by issue. We therefore have the wrong metaphor in our minds when we think about international relations.

On the AIIB, I would just like to say that the Obama administration simply blundered. There is no other way of describing it and that is now recognised in Washington. They mishandled this grossly. I was personally involved many years ago in the creation of the Asian Development Bank where we had an analogous situation. We had a rapidly growing country – Japan – which had started out very poor but was becoming more and more wealthy. The question was how to engage Japanese money in constructive international endeavours. Under the circumstances – I will not go into the details – there was no way of getting a lot of additional Japanese money into the World Bank. We therefore conceived the idea of the Asian Development Bank, focused on the Asian region but open to all countries of the world. I see the AIIB as a very positive initiative by China and it seemed to me that we would have been wise to take advantage of this Chinese initiative and build on it. What no government official can say, but I can, is that the World Bank has developed a number of barnacles over the years and a little bit of competition is not a bad thing. Just as in economics, even in international organisations, some competition is desirable.

I therefore think that the Obama administration erred, but it is in the process of trying to correct matters. I suppose that I should also say that given the dysfunctional political situation in Washington there is no chance that the US will join the AIIB in the near future because President Obama could not possibly get a capital subscription through Congress. However, a new administration might consider it.

I will also just comment on Mr Park's question on leverage. Just to remind you, the World Bank borrows in the world capital market and all its loans are from borrowed money (except for IDA). It therefore has tremendous leverage. Governments pledge capital, so the loans are all guaranteed. I do not know how the AIIB is going to be set up, it is still under discussion, but that kind of model provides natural leverage.



Let me now turn to Chinese growth prospects. As we know, because we have all felt it, Chinese growth has fallen from an extraordinary 9-10% -- there are disputes over the exact number, but I think that the official number is 9.7% over the last three decades -- to 7%. For anyone who has lived in a 10% growth environment, a decline to 7% feels like a recession. However, it is not a recession. Many of us would be delighted to have 7% growth. The Chinese Prime Minister has called this the new normal. The official term is that it is around 7% and the National Bureau of Statistics has clarified that 6.5% counts as around 7%, so they are using rounded numbers. I think that that is fine and is as accurate as they need.

I suppose that the main message that I want to leave you all with is that the new normal as currently defined is actually not the new normal and that, for very fundamental reasons, Chinese growth will continue to decline over the next decade or two. That is my projection. The second point -- and this is very important because every drop in the growth rate will receive black headlines around the world, both in China and outside -- is that this drop in the growth rate does not signal a failure of policy in China. It is important to understand that. There will be a drop in the growth rate, possibly a significant one, but that does not signal a failure. I am not saying that there may not be some failures in policy -- there may well be -- and the drop in the growth rate may be more than is necessary, but the fact of a declining trend does not by itself signal a failure of policy.

Why are the growth rates going to decline? I have identified six items. I know that that is not proper in a French-sponsored conference -- there should only be three. However, six are on my list and I will go through them quickly. In my judgement, they have been the source of growth over the last 30 years, which has been fantastic. It has seen the biggest reduction in poverty in the history of mankind. Depending on how exactly you measure poverty, between 400 million and 600 million people have been moved out of poverty and now have real choices in life, particularly for their children, or child in China's case, for the first time. That is a fantastic development from a human point of view.

Why was there this great growth? I will just mention the first factor, as I am not going to dwell on it, which is education. Back in the 1950s, China embraced the strategic decision -- I am not a big fan of Mao Zedong, but this was one of the few good things that he did -- on rural education, where every peasant should become at least minimally literate. That was very important. China still strongly emphasizes education, now at a higher level, so that is not on my negative list.

The biggest effect on growth initially was to change the rules by which resources were allocated, moving, to put it simply, from a centrally planned to a market oriented system. We know from lots of experience, not limited to China, that doing that really boosts growth at least for awhile.

Secondly, there is the Diaspora. Largely by its own election, China had isolated itself from the world economy during the 1960s and 1970s. When Deng Xiaoping started his reforms and decided to engage with the world economy it was largely from a base of ignorance on the mainland. However, there were many people of Chinese origin in Hong Kong, Taiwan, Singapore and elsewhere around the world who were familiar with Chinese culture and the language and who also knew how to deal with foreigners -- the funny Americans, the peculiar Europeans and the Japanese. They provided a bridge between the mainland and the rest of the world that I think was very significant in initiating growth.

Those two things are still present and, as Zhang said, there is still some room -- which is what he means by 'deepening the reforms' -- to change the rules, particularly in the financial and energy sectors where the state still plays the dominate role. However, most of the growth gains of this transformation of the rules have already been exploited. The issue does not therefore go away, but as a source of growth it does go away. Similarly, mainlanders have now learned how to deal with foreigners and therefore being able to draw on the Diaspora has gone as a source of growth.

The third factor is the demographic dividend. China has gone through a period in which the ratio of population that is of working age grew extraordinarily rapidly from the late 1980s to its peak two years ago in 2013, depending on how exactly you define 'working age'. Provided that people were employed well -- and that was the case in China -- that was an important source of growth. That source of growth is not only going to go away, it is actually going to go into reverse. We are on a plateau from now until 2018 or 2019 and it then begins a downward slope which deepens in the next decade and into the 2030s. As a source of growth, the demographic dividend is therefore going to go into reverse as Chinese society ages and people leave the labour force more quickly than they come into it. This is a relationship



between retirement and the number of young adults coming into the labor force – delayed further these days by longer periods of education.

The fourth factor is rural-to-urban migration. What is really important here is not literally rural to urban but agricultural to nonagricultural activity. For any country that starts poor, the labour force is overwhelmingly in agriculture and by best practice standards the agriculture is extremely inefficient, otherwise the country would not be poor. Therefore, at its core, economic development from a position of low income is moving people out of agriculture into more productive economic activity – manufacturing or services.

China has done an astounding job here. In 1980, 70 percent of the labour force was engaged in agricultural activities and at the last count – and I am always a few years out of date and things are changing so rapidly that that makes a difference – it was down to 33%. It has dropped from 70% to 33% and it is now probably down to 30% because a few more years have passed. It is astounding to have moved 40% of a huge labour force out of one sector into other sectors that are more productive in economic terms. Countries such as Korea and Japan, which are now rich, have less than 10% of the labour force in agriculture, and the US, which produces an agricultural surplus, has less than 2%. China therefore still has some way to go; there is still some growth potential there. However, it is much less than it used to be because the most energetic and active people have already moved out. The average age of people remaining in agriculture has gone up and, by observation, it is the least mobile people who have stayed. The potential for growth in the future is therefore still positive but at a much lower level than during the last 30 years.

Fifth concerns investment. It is official Chinese policy, approved by everyone who looks at it closely, to de-emphasise investment in favour of public and private consumption. This is part of the rebalancing of the Chinese economy. However, a lower ratio of investment to GDP means, other things being equal, a lower growth rate. On top of that, the rate of return on investment in China now is considerably lower than it was a decade ago. Remarkably, the return on investment in China stayed quite high for two decades, partly for the reasons that I have mentioned – the demographic dividend and moving people out of agriculture. However, for the last decade, the rate of return has declined. On both counts, therefore – a declining ratio of investment to GDP and a declining rate of return on the investment that takes place -- the growth rate can be expected to decline.

My final item is exports. As I mentioned, China started as an almost closed economy 35 years ago and grew its exports at the extraordinary rate of 17% a year. This is measured in dollars so there is a bit of world inflation in there. Seventeen percent for 30 years is a stunning growth rate for exports. China is now the world's biggest exporting country. What a little country can do and get away with to increase its share, a big country – and China is now a big country – cannot do. The days of increasing China's share of world trade significantly are therefore over. It is going to have to ramp back, and we have already seen this in export performance. Basically that means dropping to the rate of world growth – again measured in dollar terms – which will be 5% or 6% a year. Export growth will therefore go from high double digits to mid single digits.

On all of these counts, we will see a significant decline in the growth rate in the coming years and that will have international impacts. I will not elaborate on those as they are known to most of you, but I want to repeat what I said at the beginning that although every drop will produce adverse headlines around the world, these are very fundamental factors and do not signal a failure of policy. It is important for both Chinese and non-Chinese to understand that.

Thank you.

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I think that Mao Zedong will be extremely happy to hear an American professor give a eulogy on his 50 years of policy on rural education.

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It is a very short list.



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If I had one question out of your six very insightful elaborations, and on the urban migration issue I fully agree with your argument, at the same time, China's urbanisation rate is officially 52% – although I do not know what the rural situation is. President Xi Jinping has declared that the target is now 62%. The 10% will therefore be intensively upgraded. I think that that is still due to be in 20 or 30 years' time but for at least the next 10 years there could be room for further development utilising the extra 10% organisation process.

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I can comment on that and perhaps Zhang can help us with the numbers. The key point in my comments was moving people out of agriculture. It is a technical question, but you have to ask how China defines urbanisation. My understanding, which may not be up to date, is that towns up to 10,000 are counted as rural and a lot of the movement that I described was people moving off the farms into towns. There is therefore a semantic or definitional question there.

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Thank you.