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S. Xu:

Good afternoon, ladies and gentlemen. Welcome to this session on the transformation of China's economic model. Most of you, I believe, are quite lettered and informed about China's economic changes. I will just say a few words. First of all, I would like to introduce myself. My name is Xu Sitao, Chief Economist and Partner of Deloitte China. This session is actually in cooperation with Deloitte. As you know, in the past 30 years, China has been growing at double digits. That is no small feat, but given the facts – China is the second-largest economy, USD 10 trillion, and also is the biggest trading nation – such a growth rate, clearly, is not sustainable going forward. That is why we need to discuss economic transformation, which means more growth coming from domestic demand. And of course, this adjustment is by no means easy; it is facing a lot of challenges. As you also know, not only is China the second-largest economy; China is the biggest consumer of many commodities. China's development is also affecting the global interest rate and asset market. Indeed, the reason the decision taken by the Fed Reserve, of no change of the US interest rate, has clearly been prompted by the situation in China.

So that is the backdrop. What I would like to do is assemble this group of quite distinguished panellists from both China and Russia, to have a conversation on China's economic transition. Where do you see the opportunity, and where do you see the risk? And, of course, we also have a discussant from the Russian Central Bank. I would invite our discussant to also make some remarks after the conversation among you.

Now, given the fact that China's risk has been highlighted and underscored so many times, perhaps we should begin with someone who is reasonably sanguine about China's development. I would like to invite the CEO of Glencore, Ivan Glasenberg, to say a few words. Maybe you will start, because I know you are reasonably relaxed.

I. Glasenberg:

Yes, I have to be! China consumes 40–50% of most of the commodities we produce besides oil. So China is very important for us, and maybe we are always optimistic on China because we have to be once we produce these commodities. But, even if you look at China, we can talk about going to consumer spending, more from infrastructure spending and fiscal spending. Today, look at China's consumer economy. There is a variation of figures, and I am sure the experts over there can say whether it is 40% or 45%, but it is moving towards that area where there is more consumer consumption. China is definitely trying to change the economy, and you can see that has recently happened with President Xi and Premier Li making statements. Regarding some of the steel plants or coal mines which were losing money, they have now decided they are definitely going to cut production at those operations, and we, being very big in the coal business, have seen what China has already done. Very rapidly and very quickly, they started to transform their coal business, where they are producing a lot less coal at these operations. I think they have cut about 20% production, which has picked up the coal price locally. So they are starting to transform the economy. We have seen them do the same in steel production.

Now, you can be negative or positive on China, and I remember sitting on this panel last year, and we will see where we end up today, but we all had different opinions. A few of us maybe had the same opinion, but you walked away more confused than you started. And I think a lot of people in China are confused: they do not know themselves whether people are on the Economic Council; they are changing it all the time. But it is a big economy. It is 1.4 billion people; it is a USD 10 trillion economy; it is a growing economy. So there are a lot of changes happening all the time.

However, why I am a little bit more positive than most on China: I take very simple statistics. What is GDP per capita in China? GDP per capita in China is around USD 8,000. What is GDP per capita in South Korea? And you know that

China is going to catch up to South Korea: USD 30,000. United States: USD 60,000 per capita. So you say to yourself, "Is China going to catch up?" I do not know when. You have heard the Chinese Premier Li say that China has to double GDP per capita by the year 2020, and that is why they have this focus of 7.5% GDP growth per annum, and then, okay, they have dropped it now to 6.5% or whatever it is, but that will still get them to that level. But if you believe they are going to catch up to South Korea, or you believe that eventually one day – I do not know in which generation – they will catch up to America, they have a long way to go.

Now what we also look at in the actual consumption of commodities and the commodities we produce, if you look at GDP per capita or consumption of commodities, if you take the peak during the development of the United States, the peak during the development of South Korea, even Taiwan, for that matter, China in most of those commodities, whether you take copper, whether you take zinc, whether you take steel, et cetera, it is only different at about... I do not have an exact percent, but it is between 30% to 45% or 50% in any of those countries when they were at their peak, Germany included. Even today, Germany consumes per capita more of those commodities than China does today, and Germany is well past its development process, but it still does. But you go look at the peak in South Korea. Today it is still ahead of China in what it consumes per capita, even though South Korea is pretty well developed. So if you take all that in, China does have a long way to go.

Now, I am sure there are going to be other panellists here who will talk about debt to GDP, and we are going to talk about what China can do, and the debt problem of China is going to be a problem, but remember one thing: the central government controls a big part and owns a big part of the economy. It is not like the Reserve Bank; it is not like central banks in different countries. Remember, they own most of the land. They own all the banks or most of the banks. They have only sold a small portion of the banks. They own all the steel companies.

They own a big amount of the SOEs of the mining companies. So when they need to deliver more cash into the system – there are massive savings in China – they will transfer the personal savings into the hands of the government, and they can push on. So they have a lot of tools to go ahead.

S. Xu:

Thank you very much. So, in short, China has many tools in the box, if I understand you correctly. I am now going to start with this panel, because you are optimistic, and I think I need to find someone who is more sceptical. I would like to invite Andy Xie. Andy is a good friend. He used to be a chief economist in Asia for Morgan Stanley. He has been consistently sceptical. Sometimes we joke in China, saying he is a ‘China bear’. So Andy, you can say a few words. First of all, do you think, based on this USD 8,000 GDP, we can easily catch up with South Korea, which is right now at about USD 24,000?

A. Xie:

Well, people call me a bear, but I think that actually I have been very positive about China’s future, because the growth in the last 30 years largely reflects the catch-up, the revival, of China. China is not another emerging economy. China was very developed in the 1930s. In the 1930s, in technology and urbanization, China was quite developed. During the 1930s, when the world was in Great Depression, China was growing at 6% or 7%. That is why Shanghai was so prosperous. So then the war and the revolution got China trapped in half a century of stagnation, basically of depression. And then we had this opening up. And so this potential productivity was released. So it is not another emerging economy; it is an old, quite developed economy being revived. So you look at the growth in the last 30 years. A lot of people say it is a miracle. But, actually, it is just that the Chinese people are capable of doing this stuff, and they just were not given the opportunity to do so. This is not some secret recipe! So it is totally

untrue to say it is a miracle; somebody made it happen. It is because Chinese people were capable of doing that.

Now, Premier Zhu Rongji in the 1990s laid the foundation for China's growth, mainly by joining the WTO, privatizing housing, and reforming the enterprises, so the whole foundation for the growth was laid in the 1990s. Now, in the last 15 years, we have not done much reform. It has been basically using macro stimulus, monetary policy, to manage the economy, quite like what the Western economies have been doing. Unfortunately, even though people still believe in monetary policy, monetary policy has not worked for 10 years, if you have not noticed! But people still talk about monetary policy reviving the economy. So this is a way that I think China made a very big mistake: managing the economy through managing the financial sector, managing the monetary policy instead of going back to the structural reforms that Premier Rongji started. And China still has a lot to do; it was not finished.

So this is where we are now. What is going on now happened in 2008, when the global financial crisis happened. And I wrote an article in the fall of 2008 predicting that China would do a huge investment stimulus and that it would be a huge mistake. That is what I wrote about. The reason was because the 2008 financial crisis was China's buyers, China's customers, going bankrupt. So China had to adjust its policy. And using investment stimulus, you are just saying that your customers will come back and buy more from you in the future. Which, obviously, did not happen. So China added USD 20 trillion of debt and created a lot of capacity, with not a whole lot of people to sell to. So China has added one problem to the challenges it was already facing. Structural reform transformation, and that is a very challenging task, and now we have a legacy issue: how to deal with overcapacity, and, on the other side, the nonperforming loans that could come from dealing with overcapacity.

I see that there is no consensus on dealing with overcapacity. Some still argue that we can do stimulus. Like, if we still have overcapacity, let us create more

projects that will use more steel. But the issue is that steel is a small part of a project. So you can spend a whole lot more money on something else just to make a steel mill employed. So you can create even a lot more debt. So this is kind of a slippery slope you are going down: you have overcapacity; you want to have everybody employed, every factory employed, and that is a slippery slope. So because of this hesitation on how to deal with overcapacity, we have basically wasted three years of dealing with the big issue: structural transformation. If you do not deal with the legacy issue, how can you face the future? So this is the way that I see that.

Chinese living standards could be raised to USD 20,000 with no additional investment. All we need to do is deal with the nonperforming loans and transfer the income to the household sector, and we need to shrink the state sector. That is the transformation: to shrink the state sector. And when people talk about China, they always say that the Chinese Government can do miracles because they have so many tools. This is the wrong way to look at China. China's problems are because the government is too big. The government is spending half of the money; it is very inefficient. So, to become a normal, efficient economy, we have to shift the money to the household sector. This way, we are stuck too. I talked about how we are stuck on the overcapacity issue, how to deal with overcapacity. Do we stimulate, or do we close down? Then there is the future. Do we want to move towards a balanced economy? That means a smaller government. Unfortunately, we are not making that decision. We are really trapped.

S. Xu:

Thank you.

We are really trapped. But I am quite glad that with the first two speakers, we already have quite different perspectives. We will come back to each of you.

I would like to invite Dr. Xiang Bing. Dr. Xiang Bing is the dean of Cheung Kong Graduate School of Business, which was created by Li Ka-shing, Asia's richest man – well, Asia's biggest tycoon. Professor Xiang Bing is known as the biggest 'bull' in China, because he is always optimistic. Whenever I talk to Xiang Bing, I say, "Are you concerned?" He always says, "No problem. Growth will deal with everything." So maybe you will say a few words.

B. Xiang:

Maybe that is the reason why we two are sitting together on the one side. But for the past 20 years, I have been debating with many friends, colleagues, academics, businesspeople, and politicians about the future of China. I have been in the optimistic group of people. Each and every time, if you look back five years, 10 years, 20 years, I underestimated the strength of China's economy. So for the future, I stick to my guns and remain optimistic. But for a few reasons. The first reason you may know: the urbanization rate in China is only 51%. Services are only roughly 50%, 52%. So we have a long way to go compared with the average. Secondly, China can grow its economy by deregulation. We do not need innovations as long as we deregulate, not like the US, where you have to have a technology, a business model of innovation, you know: Google, Facebook, Uber, Tesla, all of that. We do not need all of that. Oil and gas, financial services, telecom, education, sports, culture, and creative sectors. Healthcare is the number-one economy for the US: 17% to 19% of US GDP. For China, it is only 5.3%. We have a long way to go. They can grow the economy at a certain rate if they want it. Just deregulation. Pick the time, which sector to deregulate.

Thirdly, China is the cutting edge, embracing three major drivers of global change for the past 30 years. The first one, neoliberalism, was started by Ms. Thatcher followed by Ronald Reagan, and China followed much of that. China, as of today, the private sector is 65% of GDP of China, 80% of jobs in China,

over 90% of new jobs in China. By many measures, China is more capitalistic than any other country you can think of. No universal healthcare. Education only covered until ninth grade. No global pension system. Gini coefficient 0.47, second highest only to Brazil. So embracement of globalization. China's economy has been globalized: European companies, American companies, Japanese companies, Samsung are all doing well. That is very unique among the major economies. American companies dominating, Japanese companies, China – every kind of company doing so well.

Thirdly, impressment of social media. US number one, China number two: BAT, Xingdong, all of that. So three major changes. China is on the cutting edge, embracing all of it. We are ready. We have been globalized. We are not afraid of everything.

And fourthly, people in my age group have experienced communism, socialism, and real capitalism, by the way. Feudalism. Command economy, market economy. We have seen everything first-hand; no need to study the West. We experienced all of that. I hope we know what we are doing when we face the future.

And number five: Chinese students represent by far the largest group of foreign students of any major country. That will serve China well. And we have over 100 million Chinese people travelling around the globe. That will affect China well for the future. So this is very different from earlier times. In 1793, the first ambassador of the UK to China, Mr. Macartney, visited Beijing. Our emperor then, Qianlong, received him. When Qianlong did not like certain technology, there was no possibility for that technology to come to China. Today, even if President Xi does not like certain technology – but there are so many entrepreneurs, probably, around the globe.

The sixth point is similar: income per capita. China represents 18% of the global population. If China's GDP is 18%, for sure China will become number one, no

doubt about that. All we need to do is to be average. We do not need to do so much better than everybody else.

And, lastly, as I said, the private sector has been by far the driving force for China's economy to move forward. Yes, there is an imbalance in the structural chain, but the key driver of the force is not restructuring, not adjustment. It is dominating the role of the private sector. They will continue to be dominating. So that is the big baby in the water. They are doing awfully well. So I am positive.

S. Xu:

Okay, thank you, Dr. Xiang Bing. I will come back to you, because you seem to reject the notion that we need to have a big wave of privatization. Perhaps I could invite Maksim to make some remarks, because I think you are a little bit worried about recent policy changes in China.

M. Oreshkin:

Thank you. So, definitely it is true: those who believed in China in the past five years were those that of course made a fortune. There is no doubt about it. But the key question is, what will happen in the next five years? Why is this so important? Because we know that China's economy is really huge. China and the United States are the largest economies globally. If something bad is happening here, it is impacting the whole global economy, and for some of the regions, for example, South-East Asia, any significant negative event in China can be really devastating. There is a lot of talk about that problem in China, but there is also that problem in Thailand; there is also that problem in Malaysia, in some of the others in South-East Asia. So if there is a problem there, it will be a big event for the global economy. And the size of this event can be even larger than the global financial crisis of 2008–2009.

But, talking about the Chinese problems and the things that worry me the most, it is actually not the debt. Because, definitely, that stock problem can be solved.

There are really enough tools at the government level which can absorb the debt and continue to go forward. But the problem is with the flows. Because what is the debt? It is the situation where there is a significant mismatch between incomes and spending, and those who earn income are not spending, and those who spend do not earn income. And Andy has mentioned this: if you look at the channel for supporting the economy, the channel of growth after the global financial crisis, it was mainly through infrastructure investment. It was picking up, and especially what we see this year. China is using channels, for example, the Chinese Development Bank, other channels, to do the same kind of stimulus through the other financing sources.

So what is wrong with this? If you are investing in those projects which are not needed by the economy, it will be difficult not only to repay the debt; it will be really hard to service the debt. And such investment is negative for growth, because you are allocating resources ineffectively; you are allocating resources to those projects which are not bringing growth and which are not bringing efficiency to the economy. And of course such imbalances can go forever, and at some point the readjustment of the Chinese economy will happen. I am really optimistic about China in the medium to longer term. The story of a low urbanization level and so on and so forth: this is all true. But before China will be able to get those fruits and achieve further growth, it needs to readjust. It needs to go one step back to make a shift between the industry, the structure of the economy, and then to start to go forward in a slightly different direction, but still up.

S. Xu:

Thank you. So, in the medium term, optimistic, but in the short term, China has to tighten its belt and make some adjustments.

We still have three gentlemen. Maybe, Andrei, you can make some remarks, either positive or negative, on China's short-term economic prospects.

A. Klepach:

It is maybe not a problem of short-term...

S. Xu:

Or medium-term.

A. Klepach:

Short-term for me is two to three years. For many years, as I remember, every expert has discussed when the 'hard landing' of the Chinese economy would start; but despite all the trouble, deceleration of growth, it still now looks very impressive. What is clear, really, is that China needs (and it was declared by the government) a massive set of structural reforms, plus a different model of the economy.

Maybe I will stress one point which was not mentioned: that it is not only a problem of reorientation from export to a more domestic strong demand or technology innovation, because now China, for example, surpasses Russia by the level of R&D spending. It is, as I remember, about 1.8%. In the near future, it may be 2% of GDP. We kept for the last year at the level 1.1%. But it is not, maybe, the crucial point. What is very difficult is how to manage such a transformation by market mechanisms or by also a process of deregulation, as I well understand you. An economy that relies on domestic markets should be more liberalized, more market oriented; but at the same time, as we can see by the Russian experience, that aggressive transfer to market mechanisms can create a shock. It can create, in the short and medium period of time, many negative consequences.

China's economy is characterized by a very high level of debt, if you look at corporate debt, not only a high level of the ratio of bank lending to GDP; it is about 200%, actually. It rose too fast in the last year, because three or four years ago, it was 160%. So it is a very high rate of growth. In the Russian economy, where we moved from 30% to about 50% only, it created a lot of risk for the

banking system, for enterprise and practices, impacting negatively the economic growth in the Russian case, because the price of money, the level of market risk, is very high. So if China's economy in the financial sector starts to manage in a strictly market-oriented way, it creates a domestic shock, despite the whole problem of overcapacity. Because also, such a big amount of overcapacity in the steel industry, non-metal materials, can be handled only in a situation of some not pure market mechanisms. Otherwise, it creates a big shock, as we also see in the Russian case, where we have had a decline in construction materials for two years, maybe next year also.

This does not mean that the Chinese economy could not adapt. It only means that it needs a very flexible balance between market and pure deregulation or liberal mechanisms, and some elements of support from the federal level, maybe less the regional level, because the situation with the regional budgets or over-budget mechanism also, as I understand, looks very dangerous in China's economy. You have strong federal finances, but also in the situation of risk or reforms, move from about zero deficit or profit maybe four years ago now to the deficit of more than 2% of GDP, and I think that in the middle-term future, a budget deficit will be a normal situation for China, which also needs a transformation of financial assistance. So it is not only a problem of corporate readjustment, but you need also deep structural reforms in the financial sector. I am also an optimist. I think that China's economy or China's policy can adapt; it can find some balance. But this transformation, which is really necessary, has not only positive but also some negative consequences and has its own price, which can decelerate growth.

S. Xu:

Thank you. So in the medium term and long run, China can do well, but in the short term, there is a debt issue and there is an overcapacity issue. Mr. Mau and Mr. Machkevitch, maybe you can make some remarks on the basis of that.

V. Mau:

First of all, I want to continue the discussion of the previous two speakers, Professor Xiang Bing and Andrei Klepach. First, I would start with the point that I am definitely not an expert on China, and only experts on China should speculate on this, because they are very deeply involved and know the details. I will just share my overview regarding the situation and prospects for the development from a historical perspective. First, I want to start with the point which Professor Xiang Bing just mentioned: the 1793 visit of Ambassador Macartney, the ambassador of George III, to China, with this famous phrase of the Chinese Emperor, that all the manufactured goods which you delivered to China, China did need. China just did not need all the stupid things which you tried to deliver and would never open in this country in exchange for your strange goods of British manufacture. And around this time, China was in the first place, and it was one-third, 30%, of global GDP. And this is of course a very important starting point for understanding the further development of their country.

The second starting point which I wanted to make is that one of our famous Russian poets once wrote, '*V Rossiyu mozhno tol'ko verit'*' – you cannot grasp Russia; you should just trust in her or not. And I am afraid that to a large extent, it is also true regarding China. We can trust; we can believe that China will grow; we can believe that sooner or later it will collapse, and I am afraid that both are right, because sometimes crisis happens, and sometimes crisis is overcome. You know the third law of economic forecasting is that you can predict either date or data, but never both.

The third sort of conundrum is in fact about the statistics. We do not know what is happening, particularly now. We know that leaders of China's provinces are competing for economic growth. We understand that China is really growing. At least it has been growing in the previous 30 years. But people are starting to talk about whether it is 7% growth or 1% growth this year, which I do not know, and nobody knows. And it creates a real problem of understanding the foreseeable

future. In the long run, we are all dead. In the long run, everything will be fine anyway. But what will happen in a short period of time is a question.

I also think it is important to evaluate what I understand is happening in China compared with contemporary Russia with a few points.

Point number one: from the beginning of modern economic growth, the Russian and Chinese patterns are completely different. Modern economic growth started 250 years ago when China was one of the biggest global economies, and Russia was lagging behind about 50 years from the most developed countries. Since this time, China moved from 30% to 2%, then catching up, moving to 20% of the global economy. Russia kept this 50-year interval for all these 200-something years. Whatever happened, whatever political regime was in Russia, industrialization or no industrialization, imperial Russia, democratic Russia, communist Russia, from 40 to 50 years, a two-generation gap, and that is it. The Chinese were very different. And this is a conundrum: we do not know why Russia keeps this interval, why China lagged behind and then caught up, and what happened from this point of view.

A second point is that China, at the starting point of the reform in 1970, structurally was like Russia of 1929. Actually, that was Russia at the beginning of the industrial age, regarding GDP per capita, share of rural population, level of literacy, because Russia was just at the beginning of industrialization, and it was a real choice between a Stalin or Bukharin pattern of industrialization: whether it would be the growth of peasants or farmers to socialism or forced industrialization. China had tried forced industrialization for the previous 20 years, and then they tried to use, in a different situation, this new model. So this is very important difference from Russia, and of course the Russian transition in the 1980s was very different. Do I have a couple of minutes?

S. Xu:

Actually, if you do not mind, I do think we need to cover a few more issues, and we should get a conversation going. So if you do not mind, maybe we can just stop here.

V. Mau:

This is just to put it into context. There are two main questions regarding China. What will be the prospect of the welfare state? Because China came up to the level when it has to create a welfare state, and it will become a very important influence on the prospects of Chinese economic growth. And the second point is whether China, from this perspective (and this is very much connected to the previous question) will find itself in this middle-income trap. And these two questions will explain the development of China for the nearest future.

S. Xu:

Thank you. Just some observations from me as a moderator. First of all, I know that Ivan will be summoned by President Putin at 18:25, so I am very much aware of the time factor. Secondly, we still have another panellist and also a discussant. Maybe I will invite our discussant to make some very short remarks, and then we will go to the last panellist. Because Mr. Mau has made a point: China's statistics are tricky. So, since you are in charge of forecasting in the Central Bank in Russia, maybe you can tell us, first of all, do you believe in China's statistics? And secondly, which ones do you disagree with?

A. Morozov:

There is a Russian saying: 'You can believe, but you have to check.' And at the Central Bank, in my department, we try to check the numbers. I cannot say that they are much different from the official numbers, but we have somewhat lower numbers. What I want to say is that it does not matter whether China's economic

growth is 6.5% right now or 7% or 5%; it is the structure of the growth that does matter. And the structural transformation of the Chinese economy towards the consumption in that economy and to its post-industrial economy is what we have to pay much more attention to. For us, it is a big challenge. I want to speak about the implications of what is going on in China for Russia. After all, we are at a Russian international economic forum. And here, the implications are as follows. As far as the economy is concerned, if Russia successfully addresses the challenge of structural transformation in China, we would be able to grow faster than now. Potential growth in the medium term to longer term, Russia will be higher. If not, then we may have another drag on national economic growth coming from China. That is one important thing. The second important thing coming from the challenge has not been discussed so far, of the internationalization of the Chinese currency, the renminbi, a transformation into a reserve currency. This is also a challenge for us, and the best way – it is a sense of competition between currencies, between the Chinese renminbi and the rouble. And to be successful in this competition, what we have to do and the Central Bank has to do and the government has to do is that we have to deliver macroeconomic stability which is necessary for currency stability. For that, we have to have low inflation and a working fiscal role. This is what the Central Bank, the Ministry of Finance, the government, are working on.

If I have a couple more minutes, I would like to speak in more detail about what these conclusions stem from. In a sense, what is going on in the Chinese economy is three-speed growth. We have traditional sectors of the economy; so-called primary sectors; energy consuming, resource-consumer sectors. They lose momentum when they grow. Some of them stop growing; some of them grow, but not fast. The problem for us is that major Russian exports to China are raw materials and energy, and therefore, looking longer-term, there is not much we can extract out of that. You can try to grab a bigger market share; you can go downstream, but it is very difficult. What is important is that you can look at other

sectors of the economy that grow faster as a result of transformation, so-called tertiary sectors of the economy, about which we have already heard: education, sports, leisure, which people of income tend to consume more. Here, Russia can have a really big advantage in terms of development of the food industry, agribusiness, transportation companies, the fashion business, and so on and so forth. These business opportunities so far have not been explored. If you explore them, you can be sure that even with slow economic growth in China, the Russian economy can prosper. After all, you have a large neighbour just next door – number two now, number one in the future – and there are a lot of opportunities that we will be able to explore. And a lot of that depends on us.

S. Xu:

Thank you. I think that is an excellent point: what are the implications for Russia? We do have another very important panellist. Alexander, I know you are going to talk about China's impact in the context of regional investment.

A. Машкевич:

В свете предыдущей дискуссии я предлагаю разделить поднятые в ней вопросы по двум темам: будущее Китая как страны в целом и судьба Китая как производителя и потребителя commodities и металла. Мне кажется, это разные вещи.

Если мы говорим о будущем Китая как страны, то я супероптимист, потому что резервы у Китая огромные: либерализация, открытость, дерегулирование, приватизация. Насколько быстро они принесут плоды, мы увидим; но руководство Китая четко отдает себе в этом отчет, у него имеется собственное видение перспективы. Китай, как мы знаем, видит и рассчитывает свои действия на столетия вперед.

Другой вопрос, о котором говорил наш ведущий, — перепроизводство, и тут я гораздо менее оптимистичен. Когда Китай начнет вводить рыночные

механизмы по ограничению производства многих видов продукции, произойдет социальный шок, новый социальный конфликт. Я считаю, что в ближайшее время перепроизводство продолжится, рыночные механизмы будут вводиться не так оперативно, поэтому для всех производителей commodities и металла в мире это будет огромная проблема. Для компании ERG — жизненно важная: мы экспортируем в Китай 30% своей продукции. Еще раз говорю, это два разных вопроса, но в целом в отношении Китая я оптимист.

S. Xu:

Thank you very much. I think maybe we should have a conversation on a different subject. We do need to talk about the risk. Maybe all of you can quantify such risk and also give some predictions for the short term, because we all know that in the long run, China will do very well; it will be the largest economy. Again, I start with Ivan. Just be brief. What are the major risks? What are the predictions?

I. Glasenberg:

What are the risks? Will China get it wrong? Will the economic advisers, the president, premier, the people that manage China – will they get it wrong? To date, as Dr. Xiang said, for the last 20 years, they have gotten it right. And everyone has been doubting them. Look at the last two or three years: we have all been doubting China, and there has been a bear market in China, and there has been a big push: something is going to break up in China. But they did things right. They fought the corruption campaign. Yes, the economy pulled back. What did they do? They stimulated a bit more fiscal spending. The property prices went down considerably in most small cities and some of the major cities; they turned it around. We see a big turnaround coming in the property price. So that is good for China. There was too much infrastructure spending; they decided they

needed more consumer spending, and they moved the economy to more of a consumer-based economy. They stimulated in that area. So whatever they have done, they seem to have done right up to now.

Now, what are the risks? They make a mistake somewhere along the way. Or what is another risk which would occur? The dollar may get too strong, and they have to depreciate the currency. What is the effect of that? Are they ready for that? Do they have the measures in place to take care of that, so that we do not have a really weak currency?

It is a very big economy; you still have to urbanize. Dr. Xiang said you have 50% urbanization in the country, well below the rest of the world. So over the next five or 10 years or whatever it is that they talk about, you have to urbanize another 400 million people. So when you talk about 400 million people you have to urbanize, you are building another United States. So are they going to manage this process of urbanization to the central economy, or are they going to move, from an infrastructure/fiscal spending economy to a consumer economy? Are they going to manage this process correctly? That is the risk. However, I am bullish on that, because they have done pretty well in the past, and whenever anyone has miscalled China or doubted China, China got it right.

S. Xu:

Thank you. Professor Xiang, you do not have to prove your optimism. Just state the risks.

B. Xiang:

Before risk, I think, it is important to understand why China needs to slow down economic growth, in a path with 8% being essential for generating 8 million new jobs. Number one, starting from 2012, the total size of the labour force diminished. Secondly, we found that the faster the economy grows, the wider the inequality of income, which is actually the number-one concern to me, and to the

government, I hope. So it is not necessarily better the faster the economy grows. Number three, the pressure on the environment. So, taking all of this into consideration, China's economic growth must slow down. Very important.

In terms of risk: to me, domestically, is income worth inequality? To me, in China, we carry the flag of socialism. But if you look at it, oh my God, we practice capitalism to the limit. And absolutely no social programs of any sort. And income inequality is the second highest, second only to Brazil, of any major economy. So, to me, domestic risk is number one. I think under the leadership of Mr. Xi Jinping, we do much of a catching-up game. And internationally, China-US relations. I think when the US adjusted its China policy, maybe in 2009 – it used to be embracing China, and then there was a switch to embracing China with a hedging strategy that has two elements: pivot to Asia, security/military-wise, and economically, in a setting of TPP, TTIP without China, a new WTO without China. So China responded with a free trade deal with ASEAN and free trade negotiation with Korea and Japan, and it was this One Belt, One Road, the AIIB, and all of that. So what is the configuration of the trading system of global governance? To me, global governance or geopolitical risk is maybe the largest risk that China must manage and manage well.

S. Xu:

Thank you. So, two risks: one is the China-US relationship; one is social issues, income inequality.

Again I will turn to Andy Xie. Given the position you have taken, that reform has been stalled in the past 15 years, how is this going to be played out, and how is that is going to be affecting Russia? I think that is very important: how this is going to be played out economically.

A. Xie:

I have been arguing that China has been driving the global economy for a long time, and not only in the United States. And the most important thing in China is the relationship between the state and the people. And I think that a lot of problems come down to that. China is very easy to manage, because the Chinese people work very hard; they do not look to the government for help. And in Chinese history, the government is always kind of very dangerous to you. When the government knocks on your door, the government wants to rob you. Usually, that is the case. But in other countries, people look to the government for help. So China is very easy to manage, and China is very competitive. But the problem is that the profit in China always comes from power. So in China, if you become a government official, you become rich. Historically, that has always been true. So now, in the modern time, we have the equivalent of, how do you make Chinese people work hard? You say, "You will earn money then." You design games to take their money way. You say, "Either you buy property, you buy stock, you buy this and that." You turn everything into a casino to fool people into losing money. Like we are talking about with all these urbanization things: We have 50 million empty flats, and another 50 million under construction. There are no young people in the villages anymore. China's urbanization is done, completely. There is no room. The population is going to decline very soon. So this is a fantasy, that we have got another half of our urbanizing to go. It is totally untrue! But the government likes the story, and they fool people into believing somebody else will buy the property from you. "So your property is empty today? Do not worry; the price will go up." The government has this story about how to resolve this property inventory, and the strategy was to make people borrow more money to buy. So more leverage, more debt. This is what is going on! People think of China as a big country run by a bunch of wise men, and they always know what they are doing. This is just totally untrue. These are not facts. I think the issue is that the government is playing with the people: "I always want

to fool you, to get you into a trap so that I get the money.” I think this kind of governing philosophy is extremely dangerous. The government is to serve the people, not to fool the people.

S. Xu:

Okay, Andy. To fool the people. In the end, I think, so far our discussion, with the Internet, with the dissemination of information, consumers, e-masters are becoming more rational. Maybe I am going to change my moderation. Maksim, you want to say who you would agree with.

M. Oreshkin:

I just wanted to continue what Andy was just telling the auditorium. You know that if you look at China, you will find that this is an economy which has had no crisis for more than 25 years, so it might be really important from a psychological point of view, because it is two generations in China which have had no crisis in their lifetime. So those who are under 30 years of age are not ready for any type of crisis in China. When I have private discussions with Chinese businessmen, academic people, and so on and so forth, it sounds to me really similar to what we had in Russia before the crisis of 2008. A typical phrase is that economic laws are different in China. Real estate prices increased 50% or 60% on a year-on-year basis, but it is okay. We will have a slowdown in growth, but prices will never decline. Crises have never happened and will never happen. But it went badly in Russia, in 2008. It was not only about the global financial crisis; it was about the overheating and overconfidence within the economy. It ended badly in Russia; it might end badly in China.

S. Xu:

What is the risk you see? Or do you want to say something else about how Russia is going to be affected?

A. Klepach:

I think the main risk is a risk of some regions inside China dominated by a national minority, because imbalance in growth can generate some conflict. Or it is not maybe a general growth of income inequality, but first of all inside big cities, because deceleration of growth will affect mainly not villages, but the megalopolis, which can create – as shown by Russian experience and that of some other countries – some social tension. Concerning Russia, I think despite all deceleration of growth or acceleration of growth, the main challenge or problem is how Russia first of all can transform our relation with China and maybe launch a new model of relation, because we have a very narrow set of markets or products in which we can trade or cooperate. I think we have a big prospect for oil and gas export to China, maybe much bigger than it is actually estimated by many experts, but the main challenge is that our trade in goods with high value added is very, very small. So the acceleration or deceleration of China does not affect Russia. Only if we create a window for much more deep cooperation on the detailed level, can we really accelerate our growth.

S. Xu:

Thank you. Ivan, I know you have to leave early. Would you like to respond to some of the remarks made by Andy Xie?

I. Glasenberg:

You know, I am not an expert exactly. Are there are still so many houses not being occupied in China? And is the government playing a game? Et cetera. I cannot talk about Chinese politics, exactly what is going on there. But all I can say is, the last 20 years, they have got it right. The economy has done well, whether you believe 7% GDP growth or whatever it has been at different times. It was a USD 3 trillion economy, now it is a USD 10 trillion economy, and you get different growth. As Dr. Xiang said, you cannot have 10% growth on a USD 10

trillion economy; you have to slow it down to 6.5% or 7%. But they have pulled it back; they have done things, et cetera. It seems to be working. And I know Andy Xie has been bearish for a long time, and he is going to be right eventually; I am just not sure when he is going to be right. I hope it is not too soon. But let us see.

S. Xu:

Thank you. I think maybe we will now turn to the two gentlemen on the other side. Given China's slowed-down new growth model, assuming that will be the case – I mean, we can sit here to talk about the risks and scenarios forever – but assuming this transformation is taking place, could both of you talk about risks, and opportunities for Russia? Let us just focus on opportunity for Russia. Mr. Mau, do you want to start?

V. Mau:

Of course, Russia is interested in the stable development of China. Any crisis on the eastern borders of Russia is not fruitful and rather dangerous for Russian development. I still think that the main source of crisis in China is the prospects of institutional transformation and development, the modernization of the social and political system with relation to the economic system which has been emerging, has been developing in China. Because definitely, the middle class will grow; it will demand political reform. You know, Huntington once wrote many years ago that 'No taxation without representation' is a political slogan, and the economic dimension is 'No representation without taxation'. For me, this is the main challenge. The main challenge for the prospect of China's development. Frankly speaking, I do not see serious dangers with the problems in the Chinese economy. For me, much more serious are the prospects of a cycle of stagnation in Europe for Russia, taking into account the economic relations between Russia and the EU, the level of our trade. It is much more serious, much more important. Maybe I will say a politically incorrect thing, but some people noticed that at

today's plenary session, with two Presidents and one Prime Minister, there was no single mention of China. And that was quite interesting.

A. Klepach:

Yes, concerning the previous plenary session, yes, maybe strictly China was not a point in this presentation, but what is important is the idea of a larger Eurasian Union, which forms the basis of the SCO [Shanghai Cooperation Organization], for *bezopasnost'* [security], which in a large set will include India, Pakistan, Iran, but it's in China. So it was not strictly mentioned, but that is a focus.

S. Xu:

Thanks. Alexander, you made a point: you are positive on China, but you feel to deal with overcapacity, the social cost is so high. Therefore, you are not too optimistic. Can you offer any suggestions, whether from experience in Russia or any part of the world? What would you suggest to the Chinese policymakers?

A. Машкевич:

Хороший вопрос: как найти выход из любого положения? На саммите G7, которой недавно собирался в Японии, обсуждали очень серьезные протекционистские меры и заградительные барьеры для китайского экспорта, разрушающего мировой рынок. Я думаю, никто в мире ничего не сможет сделать до тех пор, пока руководство Китая не примет однозначное решение: нельзя продавать продукцию ниже себестоимости и невозможно за счет госбанков перефинансировать такие предприятия-зомби. Очевидно, что рано или поздно это приведет к еще большим проблемам, чем увольнение сотрудников сегодня. И я думаю, что руководство Китая к придет к такому решению. Это очень сложный, болезненный и долгий процесс, но все равно рыночные механизмы возобладают, я в это верю.

S. Xu:

Thank you. I understand that it is quite late. I want to wrap this up very quickly. Maybe each of you can just give one prediction on China's economic growth rate in, let us say, the next five to 10 years. I will begin with Dr. Xiang Bing.

B. Xiang:

China's economy can grow at 5% or 12% if they want to. It is just a matter of political consideration, social conflict, pressure on the environment. Because they can control the pace of deregulation. They have so many reservoirs; they can just lift the gates, and the water will come out. So I think they know what they are doing. And so far, so good!

S. Xu:

Thank you. So I do not know how closely, Andrei, you follow China, but maybe how fast do you think China can grow on a sustainable basis in the medium term/long run?

A. Klepach:

I think in the medium term, it is about 5% or slightly less.

S. Xu:

Now we take the view from the Ministry of Finance. I know you do a lot of data crunching. Your take?

M. Oreshkin:

We see the growth in China in the medium term somewhere between 3% and 5%, but after readjustment within the next two to three years, which might be really painful.

S. Xu:

Andy, assuming not all consumers are rational, but can be tricked or fooled by the government: the medium-term growth rate?

A. Xie:

The growth is composed of increasing capital, labour, or productivity. And we have the labour force declining, capital stock overcapacity, so you cannot push that. So it is really up to productivity. I did some research years back. In the boom time, China's productivity was rising at about 4% to 5%. But can we have 4% to 5% in the future? It is possible, but you really have to work hard. So right now, I think that if we do not work hard and really open the economy, deregulate the economy, shrink the state, then 5% is possible, but it certainly is a challenge. Right now, the growth rate in China is what the statistics bureau says; there is nothing you can do! If the statistics bureau says it is 7%, how can you prove otherwise? I think that the problem is that the real living standard is not rising, so the growth cannot be real. So I think the next two years are crunch time, before the 19th Party Congress. China has to take a political decision. This political decision is about the direction of the country. And there need to be a lot of personnel changes in economic management. The people who led China down to where it is today must be held accountable. And if nobody is accountable for what has happened, how we can move forward? So this politically is going to be very difficult. Can President Xi really take China in a new direction? We have to see it in two years. There are only two years to go.

S. Xu:

The two gentlemen on the left: do you want to make any prediction on China's growth? You do not have to.

A. Machkevitch:

Very short. It will be really painful for the whole world and for China, but I am sure: in another five years at least, 5% or 6%, China will grow for sure.

V. Mau:

I mentioned the third law of economic forecasting. I shift to the second law of economic forecasting: crisis happens later than you predict, but earlier than you expect. I am afraid it applies to any country, including China.

S. Xu:

Thank you. I think, on that note, we should wrap up this session. We have talked about some very important issues: not just economic growth, but also institutional changes and political economy. There is a political calendar, courtesy of Andy, who brought this up. Next year, next fall, there will be the 19th Party Congress. Every five years, China has to do this to choose the top seven people. So let us see which way the country is heading. But I think one consistent message which I am getting from this panel is that we need to manage the growth trajectory, and deregulation is very important. Of course, there are lessons from Russia, as Andrei said, the shock therapy. I mean, in Chinese culture, you never have shock therapy; it is just not in Chinese culture.

There are no answers. I am sure such discussions will continue, perhaps next year, and we will look at the same issues again. I would like to thank all the panellists for your excellent contribution, and also I want to thank the audience.