Asian Economic Outlook 2014:
A Dialogue with BFA Board of Directors

Moderator

ZHOU Wenzhong, Secretary General, Boao Forum for Asia

Discussion Leader

Yasuo FUKUDA, Chairman, Boao Forum for Asia; Former Prime Minister of Japan

ZENG Peiyan, Vice-Chairman, Boao Forum for Asia; Former Vice Premier, China

Mohamed H. AL-MADY, Vice Chairman and CEO, SABIC

Abdullah bin Haji Ahmad BADAWI, Former Prime Minister, Malaysia

Victor FUNG, Honorary Chairman, Li & Fung Limited; Group Chairman, Fung Group

GOH Chok Tong, Emeritus Senior Minister, Singapore

JIANG Sixian, Vice Chairman of the Standing Committee of Shanghai Municipal People's Congress, Chairman of the University Council of Shanghai Jiao Tong University

Sergey Nikolaevich KATYRIN, President of the Chamber of Commerce and Industry of the Russian Federation

Jae-Yong LEE, Vice Chairman of Samsung

Henry PAULSON, Former Secretary of the Treasury, USA

Jean-Pierre RAFFARIN, Former Prime Minister, France

Ratan TATA, Chairman Emeritus, Tata Sons Limited

The session was a structured forum where selected speakers had a short amount of time allocated to them to discuss the topics and issues important to their region or speciality.

Yasuo FUKUDA, Chairman, Boao Forum for Asia; Former Prime Minister of Japan

Japan continues to focus on Abenomic policies to move the country out of deflation. Key priorities include ensuring continuous population growth, improving the soundness and sustainability of finance, preventing economic slowdown and promoting technological innovations. Mr. Fukuda stated that Japan needs to learn from other nations, and Japanese international relations will be the foundation for Japan's prosperity going forward.

The biggest issue for the Japanese economy currently is tackling the question of how to increase wages and create a strong economic cycle. As commodity price rises, employment and consumption must develop at the same time to form a robust cycle. Currently, government, labour unions and corporations are coordinating to meet such a goal.

Law making in energy, agriculture and medical sectors is also important. Six national strategic special regions have been established to break regulation barriers, and just the day before (9 April 2014) the EPA treaty between Japan and Australia was signed, reducing Australian imposed tariffs by 88%.

ZENG Peiyan, Vice-Chairman, Boao Forum for Asia; Former Vice Premier, China

Overall the Chinese economy has decelerated, with first quarter PMI slightly over 50.2%. While there is over-demand in high-end consumption, demand for durable goods has stagnated. Increase in real estate prices has also slowed, which may be due to the government's intervention. Nevertheless, housing demand is still strong due to urbanization and land scarcity. Investments fell more evidently, due to controls exerted on both regional debt and investments on excess-production-capacity industries, and from the volatility in the real estate market. New stimulus for investments has been introduced, and improvements are expected in the 2nd or 3rd quarter.

This is a year of reform for China, especially in the economic field and, within that, the financial sector. While the RMB has depreciated 2-3% this year due to various internal and external factors, the fluctuation observed is considered normal market behaviour. Risk capabilities, especially within financial risks, are now enhanced with flexible policies in place to deal with the volatilities in emerging economies created by US QE tapering. With the tax, finance, and exchange rate reforms, China is in position to grow 7-8% per year for the next 5 years.

Mohamed H. AL-MADY, Vice Chairman and CEO, SABIC

The Middle East is one of the world's main producers of oil, and the reality of the Middle East situation is complicated. However, the development of shale gas has changed the energy mix. Shale gas production is higher than that of oil, at US$17 versus US $10 production cost per unit. People still need oil and rely on oil production.

In addition to oil, the Middle East should focus on the development of other industries. In recent years, significant investments in education, health, infrastructure, and manufacturing have been made. Dubai is a good example with economic diversification that has brought great benefits to the Middle East by means of airline, financial services, and tourism industries. Economic diversification is very important for the region, and the Middle East should continue to develop its capability in petroleum, chemicals, and fertilizer, with plans to gradually become a world leader in this areas.

Abdullah bin Haji Ahmad BADAWI, Former Prime Minister, Malaysia

Malaysia is focused on pushing the market to create new job opportunities and equip workers with skills. To reach the GDP goal in 2020, Malaysia will invest significantly in job creation, creating 3.3 million new job opportunities. Malaysia has also adopted a blue ocean strategy, currently under implementation, to promote development and growth of innovative technologies and innovative companies in Malaysia.

Strategic development in oil, education, health care, and financial services are important for Malaysia. Recently, Malaysia announced the decision to reform subsidies and support service industries – these measures will promote economic development and reduce Malaysia's national deficits.

Moving forward, Malaysia is focused on improving regional cooperation, reducing poverty, and promoting economic prosperity.

Victor FUNG, Honorary Chairman, Li & Fung Limited; Group Chairman, Fung Group

Overall, China has seen major shifts in the manufacturing, service, and trade sectors. The Chinese manufacturing industry has shifted from being an export-oriented "world factory" to focus on the domestic consumer market in recent years. Dynamic changes in each production step have also created a very different manufacturing environment. In addition, recent innovations in e-commerce have made China a pioneer in how retailers would interact with end consumers.

In the service sector, the 12th Five-Year Plan requires that the service industry account for 47% of China's GDP, increasing 4% from its current 43% in 5 years. Given that developing countries have accounted for more than 60%, with some as much as 70-80% of their respective GDPs, China has room to improve, especially in the wholesale and retailing spaces.

GOH Chok Tong, Emeritus Senior Minister, Singapore

Singapore has been active in promoting the establishment of the ASEAN Free Trade Area (AFTA). The ASEAN economy is an integrated economy, encompassing 0.6 billion in population and 10 countries in the region. The four pillars of development in the AFTA blueprint include: creation of a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy. Currently, almost all the flows of goods within ASEAN are free (and tariff- free).

There is also an integrated investment agreement for ASEAN. Since rules between ASEAN countries are different, more transparency in investments is needed to act as a foundation for cooperation. Liberalising intra-ASEAN investments will help investors build confidence in ASEAN economic opportunities. Given the fact that the ASEAN economy is export-oriented, the healthy economies of Europe, US and China are expected to provide good prospects for ASEAN as well.

JIANG Sixian, Vice Chairman of the Standing Committee of Shanghai Municipal People's Congress, Chairman of the University Council of Shanghai Jiao Tong University

There are three important areas of progress in the Shanghai Free Trade Zone (FTZ): First, establishment of new systems relating to the negative list, collaborative supervisions among the customs, inspection, and quarantine departments, and a new filing system for overseas investment.

Second, the State Council approved measures to open up 23 service industries in Shanghai FTZ. 19 have already been implemented, with the remaining 4 to open up by the end of the year.

Third, introduction of reforms relating to the opening up of and innovations in finance, which are mainly reflected in the marketization of interest rate, payment and settlement, financing, capital management, foreign direct investment, and the gathering of 1,300+ financial and financial-type institutions; the negative list allowed Shanghai FTZ to introduce 619 foreign-funded enterprises in 6 months, 579 of which did not require contract approvals. Required approval for foreign enterprises is expected to reduce even further in the future. FTZ regulations are expected to be passed during the first half of this year, allowing the FTZ to further its development with more legal protection.

Sergey Nikolaevich KATYRIN, President of the Chamber of Commerce and Industry of the Russian Federation

The macroeconomic index performance indicates a stable Russian economy in general, with low unemployment rate, a fiscal deficit of 0.5% GDP the past year, and more than US$500 billion in foreign reserve. Although the growth rate is far lower than those of previous years, Russia's recent economic decline is believed to be unrelated to the recent changes.

A national plan with 25 roadmaps was made, aiming to improve the investment environment. Far East regional development is one of the important engines of the Russian economy, and the hope is to further develop cooperation with Asian Pacific countries in all aspects. Large scale projects to rebuild railways and improve transportation infrastructure are planned. In addition, the Russian leader decided to have economic special development zones in the Russian Far East and Siberia.

Jae-Yong LEE, Vice Chairman of Samsung

In 2007 the smartphone market did not exist, but now the market is worth over US$340 billion and continues to grow at an unprecedented rate, having successfully aligned the world’s two most prominent innovations, namely, computer technology and communication technology.

The smartphone industry has changed the development of the retail industry and many other industries. Although the market is expected to continue to be large moving forward, market growth may slow, and corporations may not continue to experience the same growth as they have over the last 7 years. However, in China, thanks to the development of the new 4G network, the smartphone market may experience significant three digit growth.

Samsung needs to continue to find and develop new applications and new characteristics for its products. One focus area is health care and finding viable solutions to enhance medical services.Samsung is also working with the government, insurance companies, and doctors to jointly develop this new concept.

Ratan TATA, Chairman Emeritus, Tata Sons Limited

In the past few years, the Indian economy experienced stagnation driven by high inflation, causing the central bank to raise interest rates and tighten monetary policy. However, the Indian economy has gradually stabilized, and is expected to rebound.

India's upcoming election will be the largest one in India’s history with 0.8 billion people expected to vote, among whom many are under the age of 20 and have unknown voting preferences. It is believed that the new Indian government will pay significant attention to economic development, and create policies favouring investors.

India should also enhance its cooperation with China in future. Growing alone is not an ideal strategy going forward.

Debate on Economics: Keynesian vs. Supply-Side

Moderator:

QIN Shuo, Chief Editor, China Business News

Panel:

CHEN Zhi Wu, Professor of Finance, Yale School of Management

JIA Kang, Director, Research Institute for Fiscal Science, Ministry of Finance

Lord MANDELSON, Former Secretary of State for Business , Innovation & Skills, UK

Edmund PHELPS, Nobel Prize Laureate (2006)

Stephen ROACH, Former Chief Economist, Morgan Stanley

Michael SPENCE, Recipient of the 2001 Nobel Prize in Economic Sciences, USA

ZHANG Weiying, Professor of Economics, Peking University

This televised debate contrasted aspects of Keynesian economic thought, which bases policy on demand management, and supply-side thought, which argues that economic growth is most effectively created by lowering barriers for people to supply goods and services, such as lowering taxes, reducing regulation, and encouraging innovation and entrepreneurship.

Lord Mandelson began the debate by addressing Thatcherism, stating that he did not agree with her political views, but he acknowledged her supply-side policy was perhaps the correct approach at that time, given high tax levels and the need for deregulation to increase competition. Thatcherism's shortcoming, however, was that it was too narrow and unsophisticated in its approach to the economy as a whole. Economies need strong investment, innovation, and sound infrastructure to foster productivity and competitiveness. Economies must also focus on "what is effective, what is fiscally sustainable, and what is politically stable."

Professor Phelps followed, stating that he “[opposes] both Keynesian and Supply Side economics. Both of these theories are like medicine kits” used to treat drops in employment and income. One policy is used to keep up demand, the other to fuel supply; neither develops the economy in a manner that generates rewarding work and engaging and challenging careers for the workforce. Keynesian economics has several drawbacks, including large government deficits. There is also the danger that Keynesian policy is habit-forming. Professor Phelps outlined further evidence of Keynesian policy shortcomings in the U.S. fiscal sequester, which had Keynesians up in arms, only to be followed by a turnaround in the first quarter of 2012, with U.S. stock markets up.

Professor Roach entered the debate noting that he shares Dr. Phelps’ dislike of both of these policies as a steering tool for the economy. He offered another angle: one school deals with short-term issues, one with long-term issues, i.e., cyclical and structural. “I think, in the Chinese context, there is definitely room for both”.

“One thing that isn’t talked about much in the more advanced countries is structural change," noted Professor Spence. Demand stimulus is always thought to be Keynesian, but the composition of demand can get out of balance and produce a defective growth model. This is evidenced in the most advanced countries, in which domestic private consumption and debt, government investment, and external demand (exports) play major roles. In the U.S., the resulting leverage, run-up in assets prices, and wealth effect inflated domestic aggregate demand, but then demand collapsed. While the U.S. and China may be able to adjust on the supply side, some economies, like Italy, are more structurally rigid and slower to adjust.

Professor Zhang entered the debate stating that “government versus markets” is very misleading. Keynes believes in government control, but "the spirit of the economy is not motivated by the government, but rather by entrepreneurs". He asserted that the GFC arose from misguided policy decisions by governments, and that Keynesian economics is also misleading on short-term and long-term concepts. Professor Zhang emphasized his preference for an economic cycle theory. He noted that we should refrain from misguided stimulus and let businesses fail; if governments use fiscal stimulus to keep a certain rate of growth, this exacerbates problems.

Professor Chen picked up the issue of whether or not to let businesses fail or allow government stimulus, noting that entrepreneurship is vital. These bailout packages focus on government priorities in the business arena. This then poses another question: where is the boundary between government and market? He stated: "I think there are three different models…and the U.S. is the leading one," going on to describe differences amongst the three:

- Chinese Model – a government- driven model. In China, the stimulus package of October 2008 drove a turn around and high growth of >10% in 2009, following the GFC. Chinese scholars then paid compliments to this "Beijing Model"; since 2013, however, there are second thoughts about this policy and its long-term impact.
- U.S. model – a market-driven model. The U.S. economy focuses on labour, i.e., changes in unemployment. The U.S. reached a peak unemployment rate of 10% in 2009 and has since seen that decrease to

6.6%. The labour market in the U.S. is the most liberal; there was a quick, sharp rise in unemployment, but this proved temporary.

- European model – a combination of policies between the Chinese and U.S. models. In Europe, average unemployment in 2009 was 10%, similar to the U.S. rate at that time. In Europe, however, unemployment continues to rise and is currently at 13-14%. The European model did not generate a turn around because of binding and restrictive labour laws.

Professor Chen finished his comments with a quip that "In France, it is easier to get divorced than to fire someone," illustrating why the impact of the GFC still lingers and the European economy continues to decline.

Professor Jia reminded the audience that the Asian Financial Crisis (AFC) of the late 90s preceded the GFC, stating that, since the 80s and 90s, the Chinese government has been using Keynesian economics and now has many problems. In the U.S., he noted, there was no transparency in how bailouts were applied, with inaction on Lehman, allowing it to fail, followed by saving Citibank using public funds. "I agree with Professor's Yang's opinions about the entrepreneurial spirit, but I personally believe that some government intervention is needed," he asserted, noting that China should summarise global best practices in economics, then try to apply those practices to create a better framework that is specific to China's needs. Professor Jia also noted that the RMB 4TN bailout was effective in tackling the effects of the GFC in 2008, along with the measures that were also applied for the AFC, but the GFC package had specific, built-in priorities. On the whole, stimuli often lack clear focus. The "China 2.0" version of the Chinese economy means that "China needs to have reforms where it addresses issues such as the increasing gap between the rich and the poor, and balances demand and supply side reforms with each other," he concluded.

Mr. Qin then asked a question focusing on Premier Li Keqiang. In this year's government report, there is an outline of the key activities to be undertaken by the government, including reform and cessation of short-term stimuli and printing of money, indicating that the government is focused on stimulating market mechanisms and allowing the market to play its full role. He asked: "If the Premier tells you that he wants to stimulate growth, but he doesn't want to use excessive stimulus, how would you respond?"

Lord Mandelson began by noting that it would be a mistake to give into the pressure to maintain demand and stop the growth rate from falling, as this is a diversion form longer-term adjustments that the Chinese economy needs. He continued that the Chinese economy needs to shift towards greater use of markets to price and supply goods and direct foreign investment. He also asserted the need for reform of State-Owned Enterprises (SOEs), though he acknowledged that, "it is going to be a Herculean task to encourage the professionalism of companies and enterprises, particularly when they are blocking competition and innovation."

"I couldn't help but think of America as being a little bit Chinese," said Professor Phelps, '"protecting some groups against other groups and negotiating the path of the economy." At a deeper level, the U.S. has an economy that is heavily driven by a coalition of vested interests who have agreed to use the government to achieve balances that would otherwise be upset by a market economy. Measures have included regulation, regulatory carve-outs, bailouts, and subsidies. He asked: "what if we get rid of SOEs?"

Roach interceded, stating: "I would say [to Premier Li] there is enormous confusion over the growth rate right now in China. To slow down in China right now is a good thing, not a bad thing. It reflects a very important shift in the Chinese economy."

Professor Spence added that there is a "large chunk of the economy that is not subject to competition, which will diminish the level of innovation." He agreed with Professor Roach that a possible lull in growth is scary in the markets because it is hard to know whether it is a lull or a trend.

Professor Zhang noted, "humanity's biggest error is that we tend to only look at short-term benefits and neglect long-term benefits. In China, there is an enormous job shortage for university graduates, but there has been an increase in migrant workers; there is a psychological tendency for Chinese people to flock to work at SOEs or the government itself because they perceive them to offer the ideal jobs. Professor Zhang felt China should create institutions that foster innovation, increase freedom by eliminating regulations, institute a judicial system that is more independent and fair, and decrease SOE's' share of the economy step-by-step.

"If I were Premier Li, I think that stable growth reform would seem unnecessary and contradictory," noted Professor Chen. He said the first thing to do is to ask the Ministry of Land Resources to accelerate the pace of reform in rural land ownership so that rural lands are in the hands of farmers. Farmers can then be entrepreneurs and add to consumption. The next thing, he said, is to approve the establishment of thousands of private banks, as these small private and community banks can lend to small and medium-sized enterprises (SMEs) and micro businesses.

Professor Jia concluded the debate by adding, "we must stick to the policy that the Chinese government should not stimulate the economy…and stand our ground and focus on the long-term instead of short-term policies." He noted that China had some benefit from the previous rounds of stimulus, but there is much room for improvement, including ushering in reform and letting the market play the decisive role. Closing SOEs, he stated, will not make a big difference, nor would it be realistic given that the number of SOEs may be upwards of 60 million and the challenge of identifying and assessing which SOEs should be shut down is impracticable. The complicating matter is how to increase energy supply in a greener and more responsible way. Prof. Jia noted the possibility of a carbon tax regime and the direct impact this would have on billions of Chinese households who would suffer the blow of rising prices. He finished by stating, "we should use economic motivation to help us deal with problems such as pollution…and the most important and urgent issue is to make sure that there is coverage for low-income families, and at the same time, encouragement of a greener lifestyle for China."

Reform: Reviving the Competitiveness of Asia & Emerging Markets

Moderator

ZHANG Yansheng, Secretary-general, Academic Committee, NDRC

Speaker

ZENG Peiyan, Former Vice Premier, China; Vice Chairman, Boao Forum for Asia

Panellists

Sidharth BIRLA, Chairman of Xpro India Limited; President of Federation of Indian Chambers of Commerce and Industry (FICCI)

Murilo FERREIRA, President & CEO, Vale

HU Zhenyu, President, China Fortune Land Development Co., Ltd

Sumit Mazumder, Vice President, Confederation of Indian Industry; Vice Chairman and Managing Director, TIL Limited

Rodney WARD, Chairman, Asia Pacific Global Corporate and Investment Banking, Bank of America Merrill Lynch

The session moderator Mr. Zhang gave a brief introduction on the Asian economy, introduced speakers and panellists, and posed the main question as to what is driving the Asian economy and regional competitiveness.

In the keynote speech that followed, Mr. Zeng, looked at the revival of the Asian economy and the competitiveness of emerging markets. The essence of the speech was that promotion of regional collaboration, openness and inclusiveness would enable development of an integrated market, with interconnecting infrastructure and strengthened economic affairs. Furthermore, building a regional co-operative and region-wide production network across Asia and emerging markets would also benefit the competitiveness of the region going forward.

The export-driven growth model of Asia is vulnerable to external risks, as experienced during the financial crisis. It is becoming increasingly unsustainable as western countries revive their manufacturing industries and reduce their demand for Asian imports. As a result, the Asian economy needs to focus on the expansion of domestic demand to promote growth. Innovation tailored to Asian core competencies, and increased marketization of new technologies would also assist markets like China to remain competitive and better position themselves in the future global production chain.

Asian countries need to establish mutual trust and deepen economic integration based on three conditions; the establishment of unified institutional trade arrangements, removal of trade barriers, and the liberalization of trade and investments. Currently, there is significant imbalance in the level of economic development across Asia, and Asian economies are loosely linked compared to Western countries as a result of historical disputes in religion, territories and marine interests. However, concrete steps have been taken to enhance integration in the region with varying regional FTAs providing an institutional framework to grow the consumer market in Asia. Examples include the China-ASEAN Free Trade Area (FTA) and establishment of the Northeast Asian FTA has also commenced.

Additionally, Asia needs better connection of finance and currency to enable the efficient flow and use of financial resources. With better linkage, the foreign exchange reserves in some Asian countries can be invested in other Asian developing economies, granting financial support for economic development. Several approaches were explored including the establishment of an Asian infrastructure investment bank; deepening the development of bond markets, and encouraging social investments in infrastructure.

The challenge of capital flight from emerging markets was also discussed with Indian representatives emphasising that India is not experiencing capital flight. However, the high infrastructure and system costs for investment in India make it less competitive to investors than China or ASEAN. The opinion of the panellists was that the cause of Indian economic slowdown was more of a structural problem than a cyclical phenomenon as the majority of the Indian economy is domestically driven. Infrastructure development along with other solutions to structure issues can create a better environment for attracting more capital. Additionally, India's competitive advantage lies in its 350 million youth population, creating great opportunities with heightened demand for more jobs. As Asia is advancing in age compared to India, there exists opportunity for inter-regional cooperation in manufacturing and financing capabilities in India.

The fear of the impact of US Federal Reserve tapering quantitative easing policies has led to the flight of funds from emerging markets around the world in 2013. However, in 2014, money has started to flow back to emerging markets as investors become more confident in Asian economic prospects, and adjustments including reducing subsidies and allowing currencies to depreciate were adopted by certain Asian countries. Central banks in Asia have also started to accumulate foreign reserves as a buffer for potentially arbitrary US monetary policies in future. These adjustments indicate that Asian economies are aiming for more self-independence from Europe and North American economies.

Rodney WARD suggested three possible routes for further reform in China's financial system; deposit insurance schemes, interest rate liberalization and further development of the bond market. When discussing the role of FTAs, several panellists agreed balanced negotiations between participating countries are crucial and must support less developed countries to cultivate their own comparative advantages. However, going too far or too fast in establishing FTAs may have negative economic or social implications for less developed countries.

Dialogue with Henry Paulson: China's Reformation and Sino-US Cooperation

Moderator

ZHOU Wenzhong, Secretary General, Boao Forum for Asia

Speaker

Henry PAULSON, Former Treasury Secretary, United States

Mr. Henry Paulson, the former US Treasury Secretary and now serving as the Chairman of the Paulson Institution, discussed global economic prospects.

Overall, Mr. Paulson has a positive outlook for the global economy, and believes that many markets are seeing sustained economic recovery from the financial crisis. However, he cautions that the growth of the global economy will be slower, when compared with the growth of the past. Focusing on the US, Europe and China, Mr. Paulson believes that the financial markets in the US have normalized with stability being boosted by greater banking regulations and increased liquidity. In Europe, banks are making progress in terms of capitalization. China will be crucial in its role as stimulus for the global economy but should be careful about bad debts, the shadow banking sector and loan and credit issues.

Turning to the US economy, Mr. Paulson stated that this has been growing significantly since Q3 2009, at around 2% per annum. Driving this recovery are sectors such as technology and energy, though the US needs to continue to focus on restoring competitiveness in order to achieve sustained growth. Fundamental reforms will also be required to achieve higher growth rates. However, the US still has not dealt with some fundamental problems that precipitated the financial crisis, such as housing policies, or policies that encouraged the US to save too little and borrow too much.

As for Europe, it would be a number of years before the economy there would fully recover. The European Central Bank has had a positive influence over the economy. While it does not solve the problems itself, its function is to give the political system time to solve the problems. Mr. Paulson also believes that the EU requires fundamental reforms in various parts of the economy, for example, the labour market.

When asked what lessons had been taken away from the financial crisis and what could be done to prevent future crises, Mr. Paulson gave his view that as long as there are financial markets and banks, crises are going to happen. But he added that for the US, it was about dealing with problems as soon as they are identified. Prior to the crisis, the US did not have the tools to deal with the impending crisis but Mr. Paulson believes that US does possess the tools now to be proactive in dealing with problems before they lead to crises.

As for China, Mr. Paulson believes that it has the capacity to deal with financial crises but the pressing issue is more on the demarcation of the government's responsibilities, for example in the event of a failing bank. Another issue for concern is the relationship between government, banks and SOEs and a flawed municipal system that is dependent on real estate sales.

When asked whether Mr. Paulson concurs with the forecast that China's growth rate will slow to 6% and whether we are seeing the beginning of a financial crisis in China, his view was that every country is going to have problems with bad debts and failing institutions. China is heavily relying on debt to finance infrastructure but the situation is still manageable because: 1) central government does not have a lot of debt; 2) Chinese citizens are not over leveraged; 3) China's leadership is strong in that it understand the problems of the country.

Instead, Mr. Paulson believes that the real challenge lies in fixing the current municipal finance system in China. He observes that every financial crisis has been caused by insufficient or inadequate government policies. In China, he feels that municipal finance is not sustainable. Budgets must be accountable and transparent, and the current system needs major structural and tax reform.

On the subject of reform in China, Mr. Paulson believes that the main concern is whether the pace of reforms will be quick enough and to what extent competition will be introduced into the market. The scope of reform proposed by the 3rd Plenary Session is extraordinary and he acknowledged in particular the on-going anti-corruption campaign as a positive development.

However, Mr. Paulson believes that the job to reform China is a heavy burden as the economy is vast and structural reforms will be complicated. He offered up some key items to put China on the fast track to reform:

•Putting foreign companies on a level playing field;

•Municipal finance as an area for focus for reform;

•Defining the sectors to be opened up for competition;

•Recognition that the private sector is the future, especially in job creation.

In closing, Mr. Paulson shared some pieces of advice on ensuring the success of reforms. Sequence is very important. Also a slow and steady approach may not be sufficient to get the job done here. Steadiness is necessary, but slowness is not going win the race. Competition will be the key. Mr Paulson acknowledged that reform is a very difficult challenge and that both President Xi and Premier Li are really committed to delivering it.

Reflections on the Great Recession

Moderator

HE Gang, Executive Editor-in-Chief, Caijing

Speaker

Justin LIN Yifu, Professor and Honorary Dean, National School of Development, Peking University, Vice Chairman of the All-China Federation of Industry and Commerce

The Root Cause of the Financial Crisis

Justin LIN's book Against the Consensus, published in 2012, illustrates the divergence in western and eastern viewpoints on the financial crisis in 2008. The West argues that the financial crisis was caused by the purchase of American sovereign debts at a very low rate, which pushed down the interest rates, burst the US real estate bubble, and resulted in the decrease of the international reserve of East Asian countries through the contagion of US dollar. However, LIN suggests that the core problem lies in the Federal Reserve's aggressive monetary policy of lowering the interest rate in the midst of the dot-com bubble. Mr. LIN believes that the crisis should not be attributed to other countries and external causes, but rather to the lack of restriction in regards to America's domestic monetary policies.

Beyond Keynesianism

Post-recession, most developed countries invest in domestic social welfare systems, which might work in the short run, but do not increase productivity and capacity in the long run. Developing countries, on the other hand, are in need of developing their domestic infrastructure, but cannot generate enough money domestically to invest. LIN's theory of "Beyond Keynesianism" suggests cooperation between developed countries and developing countries by encouraging developed countries to invest in the development of infrastructure in developing countries. Through this win-win strategy, developed countries can benefit from this investment to start structural reform, while developing countries have infrastructure in place. Mr. LIN commented that viewing the world economy holistically can help both developed and developing countries survive the recession.

National Currency vs. International Reserve

Taking US dollar as an example, Justin LIN introduced the conceptual difference between national currency and international reserve. National currency is the medium of exchange one country uses domestically. When a national currency is used as an international reserve, conflicts of interests appear especially during recession as the nation's monetary authority would most likely prioritize its domestic concerns. During the 2008 financial turmoil, chain effects started taking place as the US favored domestic monetary expansion policy to increase domestic spending, which significantly affected the rest of the world who holds dollar as international reserve through contagion effect. Economists suggest using Special Drawing Rights (SDR), which is a basket of national currencies. However, since adopting any national currency as an international currency would always result in conflict of interests, SDR would not be the solution either.

Should RMB be an International Reserve Currency?

LIN is confident that China, as the largest country in the world for international trade, can still continue its high growth of 7-8% in the coming 10 to 20 years. Approximately 45% of exports from China are settled in RMB, whereas the US Dollar still dominates nearly 60-70% of trade settlement in the world. Because of the wide acceptance of RMB in East Asia and the scale of the economy, there is potential for the RMB to be adopted as the reserve currency in the future. However, this may not be the ideal situation for China, as it would not address the conflict that is latent when the same currency is used both as a domestic and international currency.

Furthermore, LIN has projected that in 2030, the world's economy might still be unstable and that by making the RMB an international reserve currency, China would be forced to open its door to all capital investment, resulting in excessive liquidity in the market, creating bubbles, and pushing the RMB to appreciate. When the RMB's appreciation reaches a certain threshold, China would lose its competitive advantage, resulting in the outflow of foreign investment and the bursting of the bubble. Therefore, even though China might be proud to become one of the major international reserves, it comes with significant risk and responsibility.

Paper Gold

Due to the deficiency exhibited in both the utilization of national currency (e.g. USD) as international reserve and Special Drawing Rights (SDR, which is a basket currency), LIN suggests to use Paper Gold as a medium of exchange to settle international transactions. Paper Gold, unlike the Euro, is a credit-based reserve currency, which avoids conflicts of interests. With these benefits, LIN believes that 'Paper Gold' will be the new standard for settling all international transactions.

Reviving the Silk Road: A Dialogue with Asian Leaders

Moderator

ZHANG Guobao, Chairman, the Advisory Board, National Energy Commission

Panelists

H. E. YANG Jiechi, State Councilor, People's Republic of China

H.E. ThongsingThammavong, Prime Minister, the Lao People's Democratic Republic

H.E. Nawaz Sharif, Prime Minister, Islamic Republic of Pakistan

H.E. Kay RalaXananaGusmao, Prime Minister, the Democratic Republic of Timor-Leste

Surakiart SATHIRATHAI, Former Deputy Prime Minister & Minister ofForeignAffairs of Thailand

This dialogue with key Asian leaders from countries that make up the new Silk Road – Pakistan, China, Laos, Thailand, and Timor-Leste – revealed two broad themes of shared resonance. The first theme is advancement of the transportation, trade, financial, and other linkages that will form the foundation of the Silk Road. The second theme is that the most profound benefits will be not economic, but in the realms of communication, cultural exchange, and shared understanding, which will help bind Asia internally and with Europe, maintain peace, and promote inclusive development for all.

The Silk Road was an Asian creation, State Councillor Yang pointed out, a product and symbol of cooperation, respect for diversity, and independence. Today, the countries of the new Silk Road are growing at 6.4% per annum, double the average for developing countries. China believes policy, transportation, currency, trade, and "heart of the people" issues like student and cultural exchanges are central. Already China is helping build the infrastructure (like the China-Thailand road) and participating in regional efforts like ASEAN+3 and the Chiang Mai currency swap initiative.

Prime Minister Sharif noted that Pakistan links Asia to the warm waters of the Arabian Sea and provides a land route to Iranian oil. He lauded the infrastructure and energy projects planned over the last ten months of discussions on the Pakistan-China Economic Corridor. Pakistan is working on governance, has cleared liabilities in the energy sector, passed an austerity budget, abolished discretionary grants, cut subsidies, and is trying to create a business-friendly environment. P.M. Sharif reiterated Pakistan's desire to become a full member of the Shanghai Cooperation Organization, the dispute resolution forum being particularly productive.

Other speakers emphasized how important it is that the new Silk Road lead to improvement in the daily lives of people and protect the environment. Prime Minister Gusmao and Minister Sathirathai also emphasized that dialogue, cross-cultural understanding, and the exchange of ideas are perhaps its most important features, with P.M. Gusmao suggesting the Silk Road can promote thinking beyond national interests and power politics, for the good of humanity.

Minister Sathirathai also laid out three "do's". Do: (1) Be comprehensive. Infrastructure should link north, south, east, and west Asia and external parties, e.g., pipelines (Pakistan-China), rail (into Europe), etc. (2) Use technology. Customs, passports, quarantine, and other aspects of cross-border barriers may be lowered through use of coordinated advanced technology. (3) Be clear. Resolving border disputes can reduce uncertainty. He stressed the need to try to integrate local populations into the production chain and ensure they benefit from regional integration, and he also urged delegates not to let disappear what he feels are critical forums for regional dialogue like the Boao Forum for Asia.

The Silk Road is no longer only a geographical concept but a cross-cultural one that binds nations together. The path of the Silk Road represents social and cultural diversity, encompassing many different cultures, practices and religions, and all panellists agreed that development of connectivity in policy, transportation, trade and people would promote greater friendship and peace within the region. All panellists expressed their full support to enhance and continue to forge ahead with silk road initiates in the future with the shared belief that regional corporation be the lynchpin in strengthening Asia's economy and global growth moving forward.