

HENRY M. JACKSON MEMORIAL LECTURE

C
hina's Economic
Transformation: The
Global Implications

BY DWIGHT H. PERKINS

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The Jackson Memorial Lectures are presented periodically by the Henry M. Jackson Foundation to advance public discussion of important national and international concerns. The purpose of these lectures is to provide a significant forum in which major issues of public policy may be critically discussed and examined.

About the Foundation

The Henry M. Jackson Foundation is committed to the principles and values that guided Senator Jackson. International affairs education has been a central focus of the Jackson Foundation's work since its inception in 1983. In that regard, considerable Foundation resources have been devoted to the Henry M. Jackson School of International Studies and The National Bureau of Asian Research, both in Seattle.

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Henry M. Jackson Memorial Lectures

DWIGHT H. PERKINS

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Introduction

BY KENNETH B. PYLE

IT WAS JUST 25 YEARS AGO that I met Dwight Perkins when we accompanied Senator Jackson, Helen, Peter, and Anna Marie on an extraordinary three-week trip to China in 1979. Others in the group included Dorothy Fosdick, the Senator's foreign policy advisor; Scoop's longtime friends, Stan and Adele Golub; and a young Naval officer named John McCain who several years earlier had spent five years in a North Vietnamese prison cell.

His last assignment before leaving the military, John was given responsibility for accompanying members of Congress on their foreign trips. In this capacity, he came to know Senator Jackson. In his book, *Worth the Fighting For*, he writes about five or six people who inspired him to enter politics after he left the military. He devotes a chapter to his admiration for Scoop Jackson and describes at some length the trip we took to China.

We traveled on to Central China and from there, out to far west China to Xinjiang Province and the Ili River Valley and then out to the border near Kazakhstan—an extraordinary trip. In this chapter, John McCain interweaves stories from this trip with a heartfelt portrait of Scoop Jackson. He tells of his admiration for the Jackson family and describes the Senator's staff as, "the best in Congress." He concludes with these words: "The great Scoop Jackson of Washington was and remains for me a model of what an American statesman should be. He had no vices that I knew of or, for that matter, any hobbies or pursuits that would distract him for a moment from his duty. His work was everything to him. Few members of Congress have ever accumulated the record of accom-

plishment and influence Jackson had.” And McCain goes on, “Most of all, Scoop had faith in his country, faith in the rightness of our causes. He had faith that our founding ideals were universal, the principal strength of our foreign policy, and would in time overcome our enemies’ resistance. Until the day he died, he never wavered in his faith. Although many in his party and mine”—meaning the Republican Party—“would fault him for being too stubborn in a world that required subtlety and cunning, he was a hero for our time, the last half of a violent century, and absolutely indispensable for our success in the Cold War. Few presidents can claim to have served the Republic as ably, as faithfully as Scoop Jackson did.” And John McCain concludes, “He was to me and many others, an idea whose example I revered.”

One can imagine that were Senator Jackson alive today and in the Senate, he’d probably be chairing an investigation of our massive intelligence failures, asking why we had so few Arabic speakers and, undoubtedly, he would be seeking out the academic specialists who were immersed in study of the foreign regions critical to our national interest. The Senator, in fact, as many of you know, was known for his constant reaching out to leading academic specialists. He was trying to bridge the gap between academic expertise and policymaking.

Dwight Perkins and the late Mike Oksenburg were the two people he turned to for advice on China. They were particularly valuable to him in the key role the Senator played in the process of normalizing our relations with China. Dwight was a widely respected professor of the Chinese economy at Harvard when Scoop began to consult him in the early 1970s. He had published a number of books and was already serving in many leadership positions. At the time of that trip in 1979, he was chairman of Harvard’s Economics Department. It was a time when the United States was struggling with double-digit inflation, and the economists around the country were typically giving policymakers con-

flicting and mystifying prescriptions of how to tame inflation. I remember that Scoop used to kid Dwight that economics was so arcane and indecipherable a science that Harvard had to get a China specialist to head the economics department and try to make sense of it all.

While most economists were engaged in model-building and those arcane aspects of the profession, Dwight's work as a specialist in economic development has always been notable for its more practical, real-world applications. He served for 15 years as director of the Harvard Institute for International Development, which was Harvard's multidisciplinary institute for research, teaching, and technical assistance on economic development. In this capacity, he has been an advisor on economic reform to most of the governments of Asia, including China, Korea, Malaysia, Vietnam, and Indonesia.

In the mid-1980s, I invited Dwight to come to the school—renamed to honor Senator Jackson—to give a series of lectures on the Chinese economy. Those lectures were subsequently published in 1986 by the University of Washington Press under the title *Asia's New Economic Giant?* The implication was that China had become that economic giant.

It is a pleasure for me to welcome Dwight Perkins back to the University of Washington as the Jackson Memorial Lecturer to speak on “China's Economic Transformation: The Global Implications.”



Dr. Dwight H. Perkins is the Harold Hitchings Burbank Professor of Political Economy at Harvard University and director of the Harvard University Asia Center. An internationally known specialist on the history and politics of China, he has authored several books on economic development, with special references to the economies of China, Korea, Vietnam and the other nations of the East and Southeast Asia. Dr. Perkins has served as an advisor on economic policy and reform to the governments of Korea, China, Malaysia, Vietnam, and Indonesia. He has also been a long-term consultant to the World Bank, the Ford Foundation, various private corporations, and agencies of the U.S. government.

China's Economic Transformation: The Global Implications

TONIGHT I HAVE A VERY SIMPLE THEME and that is that most of the changes that have been occurring in China—changes that involve politics, human rights, and a whole lot of things other than the economy—are being driven by what's happening in the economy. And so when you think about the future of whether China is going to be fully integrated into the international economic system, obviously it becomes critical whether the Chinese are going to be able to sustain the kinds of changes that have occurred in the last 25 years over the next 20 to 30 years.

For those interested in the bottom line, the answer is obviously that changes to date have had an enormous impact and they're likely to continue. China is going to be even further transformed not only in the economy, but in society and politics more broadly over this next 25 years if they are given the chance to continue this rapid economic development. So that's the bottom line.

First, I'm going to talk about something you already know a lot about, which is what exactly has happened over these last 25 years. And then I'm going to talk about the conditions under which this transformation could continue for another 25 years. But

before I do that, I would like to say a few words about Senator Jackson's role in this whole process of opening up China.

Opening China—Jackson's Role

Specifically, I have a minor beef with his biographer, Robert Kaufman, in what otherwise is very good biography. Kaufman describes Scoop's attitude toward China in the following terms: "What those critics of Scoop did not discern correctly is that more than geopolitics spurred Jackson to crusade for closer ties with the People's Republic of China. From his boyhood in Everett, Jackson had always admired the Chinese, a sentiment inspired by the novels of Pearl Buck and by his own experience in Washington state. The marvelous reception that he received in the People's Republic of China enhanced his favorable attitude toward the regime. In contrast to the Russians, whom he found heavy and ponderous, he genuinely liked the Chinese, their sense of humor, and the elegance of their geopolitical analysis. He had a soft spot for them, and it inclined him to gloss over many Chinese brutalities for which he would have criticized the Soviet Union or other regimes. Jackson's position on China grew softer over the years." I have nothing against sentiment and I have nothing against getting softer over the years, but I would like to suggest that Jackson's interest in China was as deeply rooted in his understanding of foreign policy and the way the world worked and particularly how great powers worked.

I went with him on three occasions: in 1974, '78, and the trip that Ken mentioned in '79. I did not go in '81. During that time, I think we probably had 30 hours of discussions, 10 of those with Deng Xiaoping, 20 with foreign ministers and various other senior ministers of the government. We had many times that number of hours discussing what he was going to talk about, what we learned from the discussions we had, what the significance of it was for American policy. During that time, I can only remember one sentimental remark and that came right at the beginning of the

discussion with Deng Xiaoping. Helen's mother was born in Suzhou in China. Her grandparents had been missionaries in Suzhou, and so Scoop had begun the discussion with Deng Xiaoping with a somewhat flowery discussion of the long ties between the United States and China and the personal relationships with Helen's family and so on and so forth. After two or three minutes of that, Deng Xiaoping said, "Fine, we won't talk about the past." Somewhat by implication he said, "If you want to talk about what you did over the last 100 years, I have some views on that, but anyway, we're going to talk about the future. And, you know, when Nixon came—when President Nixon came to China—he said he came because it was in the interest of the United States to be here. And we liked that. We thought it was an honest statement." And that was the context in which Scoop made his sentimental remark.

Scoop and Deng went on to talk about whether Pakistan was going to collapse and how and why the United States wasn't doing more to beef up Pakistan. And Scoop would then say, "Well, why wasn't China doing more to help with Diego Garcia," and Deng would say, "Well, we don't have anything against Diego Garcia bases," and so on. Anyway, most important, when the time came for actually effecting policies that mattered for China and effecting the policies that I'm going to be talking about tonight, Jackson acted.

He did two things that were absolutely essential. One, he played a key role in the normalization of relations, which I think he does not get full credit for. In the '78 trip in particular, the big battle in the U.S. State Department was between those who wanted to have equal treatment of the Russians and the Chinese. And Scoop basically said, "It doesn't make any sense to do that. The Chinese foreign policy positions at this time are roughly similar to ours. The Russians are basically opposed, and we should be trying to work with the Chinese on this, and doing the same thing with

China as with Russia makes no sense.” But then, when we did normalize relations, the decision, of course, was whether Jackson-Vanik would apply to China. And Scoop, right from the beginning, made it very clear that Jackson-Vanik was not supposed to be applied to China. And, in fact, if Scoop had lived, I suspect we could have avoided a lot of battles that were subsequently fought, including with the help of the Jackson Foundation over the years to make sure that MFN—what was then called “most favored nation treatment,” now is called “normal trading relationships”—were maintained for China.

Did Scoop understand what was going to happen over the next 25 years? Well, probably not. But he did understand that China was a major power and was going to be a bigger one over time and that we had to learn to work with China and to do things that would help China move in directions that would be appropriate.

The Past Twenty-five Years

I'd like to talk about the changes that have occurred over the last 25 years. Most of you know this, but I'd like to remind you of just how big these changes have been. If you think back to what China was like in the 1970s, China had had a period of twenty-odd years in which per capita income grew very little. Basically, Chinese people in 1978-79 were as poor as they were in 1957. Per capita GDP had increased, but most of it had gone into investment that was largely wasteful. Although there are no precise figures, the poverty in China—according to World Bank publications—is \$1 per capita per day. During this period, China probably had between 300 and 400 million people who were poor by that definition.

As part of the 1978 trip, we went to the Shengli Oil Field in Shandong Province, a rich province in Chinese terms. The oil field was full of rich oil workers, and the Isuzu trucks they were driving to and from the main town to the fields were big, modern, Japanese-made trucks. Of course, we were in limousines. But on

the side of the road, the people who lived in the villages in that area were literally in rags. It was February and it was cold. What they had to cover themselves with was patched, ragged clothing. Most of them were pulling their own carts; a few of them had animals; no one had a machine pulling anything. And these were thousands and thousands of people who were going in to market and were walking back many miles to their villages. China was a very poor place.

When he went back to his home province of Sichuan, Deng Xiaoping was reported to have been in tears at seeing the poverty. He is not the kind of person who normally would do this. Whether he really did tear up on this occasion, of course, we can't be sure.

There were no new buildings in China in this period. There were no cars on the street either except for the limousines of a few leaders and a few favored guests. The only method of transport for most of the population—these were the well-off people, the elite—was the bicycle. The only new building I can think of at that time was the mausoleum for Mao. I think everything else had basically been built in the 1950s or, in the case of the Imperial Palace, during the Ming Dynasty.

During this period, we had come out of one war with China in the 1950s and we were at the tail end of a war with Vietnam where China was at least partially on the other side. In fact, one of the reasons we went to Xinjiang and Mongolia in 1979 was because we were looking at potential Soviet invasion routes. In the case of Xinjiang, the Soviet Union had two armored divisions where they had run live ammunition maneuvers across from this position of this young officer in the Chinese army. During our visit, he spoke about how he and his platoon or company were going to defend against these two Russian armored divisions. Of course, he would have been wiped out in about 30 seconds. But they had run those live ammunition maneuvers because they were

trying to bluff China into not invading Vietnam, a strategy which, in this case, failed.

So China was extremely poor. It was also coming out of the Cultural Revolution. We don't know how many people died in the Cultural Revolution, but it is estimated to be several million. People committed suicide in great numbers. Anyone, including the senior party people, who had any kind of foreign involvement was subject to persecution.

I remember being with the chief engineer of the Spey Engine factory, the jet engine factory in Xi'an. He had taken on another job, hence he was working with me in the early 1980s. One day during that time, I was listening to Voice of America or BBC on the radio, and heard that President Reagan had been shot. I got a brief description of how and where President Reagan had been hit. I told the chief engineer and he told me that he had been shot there too. During the Cultural Revolution, he had been locked in a room along with all the engineers of this jet engine factory. And one night an 18-year-old red guard came in with a pistol and fired it around and he got hit. The point is, this was a very, very difficult period.

China Today

Now we move forward 25 years and I'll give you a few statistics. According to the official Chinese GDP, China's GDP today is nine times what it was in 1978. Per capita, it's six and a half or seven times what it was in 1978. Now, Chinese data probably overstate the change, but they certainly don't overstate it by a huge amount. So China's per capita income today is roughly five to six times what it was in 1978.

What does this level of change in income mean? I've now gone through this kind of transformation with several countries. I watched Korea get transformed, and I'm now beginning to watch Vietnam become transformed. Of course, there are Taiwan and Hong Kong, though Hong Kong started from a much higher base.

The hotels improved. People fought to get into the Beijing Hotel back in the 1970s. No one wants to stay in the Beijing Hotel now, and not just because there are bugs all over the place. They have fixed it up, but it's still not very good. But it was the best hotel. Now, of course, the city is full of five-star hotels. But that's superficial and affects one-tenth of 1 percent of the population.

The other thing you see is automobiles. The method of transport was all bicycles. Now, it's all automobiles. The traffic jams were horrendous before they built all the new highways. Now they've built highways all around Beijing and the other big cities, and there are still huge traffic jams because the automobiles are expanding at a tremendous rate. But we're still only talking about 1 or 2 percent of the population, so these are not changes that affect most people.

If you look out of a window in Beijing or Shanghai or any other big city in China today, every building you see—unless you happen to be inside the Imperial Palace or the Temple of Heaven—has been built in the last 5, 10, or 15 years. A tremendous building boom has taken place. At a time when the urban population has increased by a very substantial amount, the per capita amount of space for people living has more or less doubled.

Back in the '70s, people had radios if they had a little money. Television sets were rare. Today almost all urban households and about 30 percent of rural households have color TVs.

Probably the most important figure is that the number of people who live in abject poverty has dropped from several hundred million to around 80 million. That's still a lot of people, but it means that over a billion people do not live in abject poverty. Although as my wife, who accompanied me two or three years ago to Guizhou Province, the poorest province of China, will testify, the poor people who are still there are very, very poor. The pigs are right next to the kitchen and the people live on slats right above the pigs, and the girls that are supposed to be in school

aren't really in school and so on. So the poverty still exists, but it's a very, very much smaller portion of the population than it was in those days.

Now, has everything improved over the last 25 years in economic and social terms? No. The public health system has fallen apart. Rural communes did a lot of things wrong, but the one thing they did pretty well was set up a public health system that was pretty good at bringing basic public health services to the countryside. I don't know whether it's been a direct result of that learning experience about public health and the earlier era that accounted for the way many of these rural villages handled the SARS epidemic during this past year. When the government finally admitted that SARS was much more serious than they thought, and people in the cities, particularly those who had come from the countryside, all panicked and began moving back to the countryside, many people worried that there would be a massive expansion of SARS in less urban areas given the breakdown of the rural health system. It turns out that in a large number of these villages, anybody who came back from an infected area into one of these villages had to live outside the village for a period of ten days before they were allowed in to be with their families. So it wasn't nearly as bad as it could have been.

Nevertheless, the whole public health system in the rural areas has fallen apart. The big increase in incomes—the doubling, quadrupling of income that's occurred during this period—has not been matched by improvements in health. That's the economic and, to some degree, the social sphere.

The political sphere over the last 25 years is, at one level, extremely easy to describe. The Chinese Communist Party is the one party that ran the government in 1978, and it's still the one party that runs the government in 2004. They have for some years allowed slightly more slots for election to the Central Committee of the Chinese Communist Party than there are candidates, so a cou-

ple of people get knocked out. But basically, it's still a one-party dictatorship.

There are some changes occurring in the area of elections, but they are almost entirely in the villages. Some villages have real elections. Others, as far as one can tell, have elections still heavily controlled by the Chinese Communist Party.

The most dramatic change is in the way people relate to you and the way they relate to each other. Back in the 1970s—not when you were with Scoop Jackson or when you were dealing with Deng Xiaoping, because then it was all hard-nosed discussions—when you were traveling in China, the number of subjects you could safely talk about was limited. I traveled with a delegation to look at small-scale industry in 1975. And we traveled with some senior Chinese economists from that era. I would swear that we never had a serious conversation in a month together that could not have been printed safely on the front page of the *People's Daily*.

There were two safe conversations you could have at dinner. One safe subject was the food. You could discuss the food at any length you wanted, and they were glad to describe the dishes. The second topic was a little riskier: whether the Chinese accompanying you had a family or not. You weren't supposed to talk about personal things in those days. But people would break down and tell you that they had a son or a daughter or five daughters, which even then was beginning to become improper as the single-child family policy evolved.

Today, if you're a reporter, it is tougher because people who talk to reporters do get into trouble. But people who talk to anybody else can say pretty much what they want if they know the person. They aren't going to directly criticize the president or the prime minister in any open way. The press is still controlled, but it's less controlled. But, of course, then there's the Internet. Although China tries to block the Internet, something like 75- or

100 million people have some access.

During the 1970s, there was something called “Cang Kao Xiaoxi” or reference news, which only went to the leadership. I remember because when we were with Scoop, we got a few copies of it. It was mostly a condensation of what was being reported in the Western press. It wasn’t a real in-depth intelligence briefing. And now, this huge population has widespread access to a whole range of ideas. So there’s been this huge change.

On the other hand, the laogai, the reform through labor camps, are still there and large numbers of people are in them. Many are there for political actions or supposed political actions.

Even in the area of the rule of law there’s some progress. Mao got rid of all lawyers. Most of the judges that came into power after that were people who had, to put it mildly, inadequate training in the law. Now there are lots of lawyers. People are actually going to court. The judges are still not very competent. The Communist Party can certainly overrule the judges when it wants to. Even individual ministries can simply ignore the writ of a judge in cases. But nevertheless, it’s changing. It’s not the rule of law, but at least it’s a process that is beginning to reintroduce law into China.

China, by the way, is not unique in Asia. Most of Asia has a very weak legal system, particularly in the commercial sphere, but also, in many cases, in criminal and political spheres as well.

So lots of changes in the economy, lots of changes in society, lots of changes in the way people talk to each other, and very little change in the way the political system is, at least formally, set up.

Yet, as I look at the new leadership of Hu Jintao as president and Wen Jiabao, there are two things that impressed me about what they did when they came into office. First, they addressed the problem of SARS, made it public, and moved rapidly. And the other thing that Wen Jiabao did in particular is that he

went to an HIV/AIDS hospital, met with the patients, spoke with them and basically brought the HIV/AIDS problem out into the open where at least China could begin to seriously deal with it. Now, that's where China is today.

Looking to the Future

The real question that I am charged with talking about is where China's likely to go in the future. I start from the proposition that most of the changes in China over the next 25 years are going to be driven by what happens in the economy—not solely by what happens in the economy, but very heavily by what happens in the economy. It's the economy that is forcing the use of law, for example. It is mostly in the commercial sphere, but eventually it will move more into the criminal sphere.

So the question is, is China likely to continue to grow at this enormous rate? The first way you can look at that is what I call the basics of growth or the basics of growth accounting. And the basics of growth accounting are very simple. I could make it very complicated by talking about translog production functions and Cobb-Douglas production functions. But the reality is that the essence of growth is made up of how fast the labor force grows, how fast the quality of the labor force increases, and how fast capital increases, and then the productivity or the efficiency with which that capital and labor is used. If you can answer those questions, you can answer what's likely to be the future of growth in any given country.

Let's look first at the labor force. That one we know. For the next 25 years, most of the labor force that's going to be around has already been born. The labor force overall is only going to grow about 1 percent a year, because the one-child family is already beginning to take effect. But what's going to cause growth is not the actual overall increase in the labor force. It's the rate at which the labor force shifts out of the low productivity efforts of peasants in the countryside into the urban higher pro-

ductivity jobs. And countries in this stage of development typically go through a very rapid transformation from a rural population to an urban population. Over the next 20 to 30 years, China is likely to have to move probably 300 million workers from the countryside to the cities. And if they bring their families with them, this migration will involve moving maybe 500 or 600 million people. That is, in case it is not obvious, the greatest migration of labor from rural to urban areas in the history of mankind. It's a huge number. That shift alone is likely to keep China growing faster than, say, an already-advanced country by one and a half percent, perhaps even a little bit more.

China's savings and capital formation rate are very, very high by any standard. From 36 to 39 percent is the average GDP that goes into investment in China. It is closer to 20 percent in the United States. It's comparable to what was achieved in some other Asian countries during their period of rapid growth. The high rate of savings and the high rate of capital formation is driven by many things. But the most important factor that drives the high rate of savings and capital formation in this kind of country is what is called the dependency ratio. It's the ratio of the number of children under working age and the number of old people beyond working age divided by the total number of people of working age. And that figure is still very small in China. The number of children has gone way down as a percentage of the population. The older population has risen from 6 to 10 percent, but it's a still fairly small ratio by the standards we're talking about.

For the next 20 to 25 years, China is probably going to be able to sustain a very high rate of investment and capital formation. After that, all bets are off because the one-child family and the extended life spans of the older population are going to shift that dependency ratio very, very sharply.

There has been a rapid expansion of education. Compulsory education is only through nine years or so, but the numbers

are increasing and there is an improvement in quality. At the very elite level, all you have to do is look at the universities around the United States and look at the students in them and, for that matter, increasing numbers of faculty who have come from China. For the very elite, education is very, very good. Fields like physics, many fields of engineering, even economics, there are many bright graduates.

But it's not only the elite we're concerned with here. It's the other millions of college graduates who are getting better training. The quality of the labor is improving. The big uncertainty is about what happens to the productivity of this labor and this capital.

At this point, I could tell you a lot of very bad stories and convince you that, in fact, China is going to collapse. I will just mention a few of these things. China's banking system is a mess. The official figure for non-performing loans was 25 percent. I think it's come down a few percent. The actual figure, however, is probably 35 or 40 percent. Another way to put that is, all of the major Chinese banks are bankrupt. Is China therefore going to face a banking crisis? No, because unlike Southeast Asia, the debt of the banks, the deposits in the banks, and the money the banks lend out are all from Chinese; and all are domestic. The government can always get itself out of the box by printing money, in the worst case, which could cause inflation, but not a banking collapse. So it's a huge problem, and they're in the process of trying to deal with it. And if I had another hour and a half, I'd be glad to go at length into trying to describe what they're going to have to do and what they're doing. It's a major problem, but it does not lead to a projection of a collapse.

Second, China has a terrible debt problem. Officially, China's government debt is very small, but the Chinese don't include the cost of bailing out these banks, they don't include the cost of unfunded pensions. A lot of the other countries don't do it

either, including the United States. If they did include these implicit obligations, the debt would be sizable and growing. The Chinese have been trying to keep the growth rate up by dumping money through deficit financing into infrastructure across the country. So you have new airports and new highways and pretty soon China's going to have a completely integrated limited-access highway system throughout the country. They're doing essentially what the Japanese are doing with one difference. The Japanese are keeping their economy pumped up with this kind of government deficit spending. Of course, there's another country that I won't mention that's doing it and, in fact, the Chinese and Japanese are funding that other country. In the case of China, at least, the infrastructure is eventually going to be needed. In Japan, most of this infrastructure is producing useless cement, paving over things that no one needs to pave over and airports that no one wants and so on. So China has a potential debt problem.

China's exports this year are roughly the same as Japan's: \$430 billion. China's exports grew by 30-some percent last year. If they grow at half that rate over the next ten years, China will surpass the U.S. in exports. As you can imagine, that's going to cause a few problems. China, yes, it's in the WTO, but is China going to be able to increase exports by \$800 billion more over the next ten years? It doesn't seem likely. So China has a problem. The problem is, they've got to shift much more to the domestic market for growth, and that's not easy to do. If you want to make a story of slower growth, that's one of the things that you focus on. But let's assume that the growth is going to continue. Then what exactly is going to happen?

I think there are two things that I need to mention here. A lot depends on how the growth occurs. My favorite example is the migration issue. China has a control over migration today. This control has broken down partially, but China still has what is called the Hu Kou system, the registration system for people. If

you're not a registered urban resident, you cannot go to schools in the urban areas, you cannot use the urban health system, you cannot do a lot of other things. In the past, you couldn't even go into the urban areas, but now you can go in. There are 100 million people who make up what they call the "floating population" in China's cities today. There will be a major increase in that population over the next 25 years. They have to migrate because that's where the jobs will be. The question is, will the workers go and their families stay back in the countryside? If that happens, what is the implication of having 200 million single males in the cities without their families? Well, I don't think I have to get particularly graphic for you to understand what that means.

HIV/AIDS is now beginning to spread into the heterosexual population. Sexually transmitted diseases are a major problem in China today with widespread prostitution. China is not South Africa, it's not Zambia or Botswana, but 5 percent of the Chinese population with HIV/AIDS is still 65 million people.

The real issue is, can they figure out a way to bring their families with them? It's an opportunity as well as a threat. It's an opportunity to educate those children because good teachers aren't available to go into the poorer rural villages. Bringing those children into the cities is a decision that hasn't been made. The Chinese government is grappling with it now. It is trying to loosen up the Hu Kou system, but doing it very slowly.

The other thing that you can pretty safely predict is going to happen is that the middle class, which is already fairly sizable, will grow. I'm not sure how you define "middle class" in any country, but in China you can come pretty close by thinking of it as that part of the work force with high school degrees. That's about 17.5 percent of the population—a lot of people. It may be more than 200 million people, yet for China it's a small number. Over the next 25 years, the number is likely to grow to 400 or 500 million educated people in the cities where they can cause all

kinds of trouble. We don't know what will happen at that point.

We've seen middle class protests led by students in Korea where it was dealt with for a decade or two with tear gas, and you couldn't walk the streets of Seoul on many occasions without getting a fair amount of tear gas. Eventually, the middle class basically said they were fed up with military rule, and they got rid of it. Taiwan's leader, President Chiang Ching-Kuo, decided to set up a more democratic system. There was minimal use of tear gas there as they moved from an authoritarian system to a democratic system.

Those kinds of changes are bound to occur. The political system is either going to liberalize gradually or there will be a period of great tension, in which case it will eventually be forced to liberalize. I don't know what model will actually be applied, and I doubt if anybody really knows. I think the Chinese leadership would be glad to know.

Implications for the United States

What can the U.S. do about this? Most of these changes are not going to be determined by what the U.S. does or doesn't do. These are changes that are going to be driven by what happens in China and on what the Chinese leadership and the Chinese people do themselves. But there are some things that we can do. The most important thing we've finally gotten straight after a lot of years of going back and forth is to stay out of the way. Let the growth occur. Don't try to use economic levers that make a mess out of economic growth as applying Jackson-Vanik to China would have done. That doesn't mean that the U.S. trade representative can't go to China and argue and yell and scream. The U.S. trade representative is supposed to do that. And the Chinese will do a lot of things for which they will deserve to be criticized on specific kinds of trade. But those are minor issues.

We can continue to give publicity to the most severe cases of political repression. I think this is best done by the private sec-

tor, by the NGOs, but it clearly has a positive effect. It has a less positive effect when the government itself gets directly involved except on a low-key level. The Asia-watchers of this world and various others, I think, do a very important job of making it clear to China that it is never going to be a full member of the international developed-country world until it does better in some of these areas. But still, even in those areas, the fundamental changes are going to come from what happens within China, not from what we do from the outside.

The final point, and it's something that Scoop was particularly good at, is to recognize that the two countries have a lot of common goals. We have a common goal in seeing China succeed economically, socially, and ultimately politically. We also have a lot of very specific foreign policy goals. In the days when Scoop was going to China, it was largely to contain the Soviet Union. Fortunately, we don't have to be concerned with that issue anymore. Today we are more concerned about how to deal with North Korea. China has no more interest in having North Korea have nuclear weapons than we do. They are a little closer to the situation and more aware of the implications of trying to solve the problem with military action in terms of killing people and creating instability. We need to listen to them certainly as much as they need to listen to us.

I think you'll see major change in China continue for another 25 years. China is already unrecognizable to those who believed that it was basically a peasant society. In the future, we hope that it will continue to be the kind of country with which we can continue to work and exchange ideas.



Questions & Answers

Following his lecture in Meany Hall at the University of Washington, Dr. Perkins entertained questions from the audience.

Q: What significance would you attach to the fact that the rural Chinese are beginning to have ownership of the land and the farms?

DR. PERKINS: There is considerable significance in their ownership of the land. The problem is, they don't fully own it yet. The Chinese still do a lot of reallocation of land based on a kind of egalitarian goal of making sure everybody has something. So they still redistribute in a non-commercial way, which I think reduces the incentives. They're trying to deal with a real problem. With all these people going into the cities, the families that control that land try to hold onto it in one way or another and often use it inadequately. The families can't sell it, so they don't have an asset that way, so they instead put their poor relatives or other relatives on it, and that is a problem. In the urban areas they've gone much more toward outright commercial land ownership. But there is a very real egalitarian problem. You have these very poor people, and you want to make sure they have enough land to farm since it's all they can do. They are moving toward a full market-based land system, but they aren't there yet.

Q: Is the land problem having any effect on migration to the cities?

DR. PERKINS: The problem in the rural areas more generally is not the land problem. I mean, it's the land problem in a more fundamental sense—there just isn't enough of it. So you have about 130 million hectares or 325 million acres of available land. That's a very small amount of arable land for 1.2 billion people. And the

problem is, the yields on this land are already comparable to the best yields in the world so that you have a very serious problem of getting yields up. So income in the rural areas is not going to rise rapidly because of slow agricultural growth. And you can't raise it with price increases for the farm because they are at world prices now, and they made a deal in joining WTO that they wouldn't subsidize agriculture in a major way. They won't do what Japan did, for example, in terms of subsidizing.

Q: Is education an important part of the growth story?

DR. PERKINS: Oh, it's enormous, the growth of human capital. And obviously, the elite is only a small part of the story. And even in areas like agriculture, the ability to introduce modern agricultural technology depends on the ability to read in order to use different kinds of chemicals and machinery and so on. So the expansion of the primary and secondary school system is an extremely important part of the story. And in that growth equation, you would give human capital a major part. It would be a major part of the story. And one of the reasons why China is likely to continue to grow rapidly is because that human capital is going to continue to grow very rapidly, much more rapidly than the labor force because they still have a long way to go. So China has got to go to where 20-some percent of its population have university education. They aren't even remotely there now. Compulsory education only goes through lower middle school.

Q: You mentioned where corruption seems to be well publicized.

DR. PERKINS: Well, I think there are many in the top leadership who are very bothered by corruption. There's no question corruption is a very serious problem across the board in China, both at a petty level and at a more serious level. The attitude of the leadership toward corruption is "We can deal with it. We, the leadership,

can deal with it by tougher prison sentences and even death for financial corruption of a certain level, a particularly large level.” My own view is, that won’t work. Ultimately, the source of corruption, the biggest source of corruption is the vestiges of the old central planning system and all the regulations and licenses which every low-level official can effectively sell if they so choose. You can’t solve all the problems by moving toward a pure market economy, but you can get a long way toward that by moving in that direction. Certainly there are people in the Chinese leadership that I think understand that, but do they generally understand that? I would say no. Corruption is a threat to the regime, because ultimately it could bring down the Communist Party. So far the regime is succeeding economically, so a lot of people are probably willing to stay with it. But if it becomes totally corrupt, then it undermines their capacity to govern. Then they switch to nationalistic appeals and somebody may start lobbing missiles at Taiwan. And there are all kinds of ways of trying to gin up nationalism as a way of getting around declining political support, but all of them create problems for either international or domestic stability.

Q: Sir, how do they raise revenues in China? Do they have a payroll tax?

DR. PERKINS: That deserves a long, technical answer, which I won’t give you because I can’t—I don’t think I can get it all. But one of the major factors is the value-added tax, which is a somewhat more efficient form of a sales tax. Historically, they used what they called a turnover tax, which is also a kind of sales tax, plus a profits tax. The state enterprises no longer have large profits, so there’s not much from a profits tax. So they basically have a value-added tax and they have customs duties. There is an income tax, but it’s not a very major source of tax income. They’ve had a big problem with revenue. It went way down, but they’ve been building it back up. They had a lot of taxes that they turned over

to the provinces and the lower levels to collect the taxes, a kind of tax-farming. But they're trying to move back from that to having a more modern tax system, of which a value-added tax is the key. I think I'll stop there.

Q: Can you speak a little bit more about what you see as the economic tensions between the need for growth versus stability?

DR. PERKINS: Well, if you think of liberalism or liberal views as the ability to speak freely and related matters, when you look at the reason for going on the Internet, it really wasn't driven by a desire to have people have access to all this information. It was a very conscious decision by the top leadership that they were not going to be able to be leading in science and technology and economic development unless they gave that kind open access to the Internet. I've also watched this very closely in Vietnam where they were much more reluctant in the early stages to allow that kind of access, and so they made it very difficult. It used to take 20 to 25 minutes to delete your one email and get onto the next. Vietnam has also now moved—is beginning to move. So that's a piece of an answer. Perhaps not so easy to accept is that as the economy becomes more complex, it becomes increasingly inefficient to try to solve commercial disputes, mergers and acquisitions, bankruptcies, to have those issues solved by some government official using his discretionary authority to do it. That increases corruption, and it creates all kinds of problems. In a modern market economy, those decisions are all made by the companies themselves but monitored by rules that are enforced by an independent judiciary. And if you're going to move in that direction—and China is still in the very early stages—much of Asia in the commercial sphere is in the early stages. China is not the worst. Actually, Indonesia probably wins the prize for having the worst judicial system in Asia at the moment. But you've got to improve the judicial system. And if

you improve it for one thing, it seems to me, you're going to improve it for more than that. As you move toward having an effective judicial system in one sphere, the leadership itself will want to eliminate arbitrariness in political decisions of who goes to the laogai and who doesn't and so on. So creating the rule of law, which is a long, multigeneration process, is something where economic development plays an absolutely essential role in making it possible. If you're in Europe and want to be a member of the European Union, you cannot be a part of the European Union unless you meet a whole series of conditions. It's not as explicit, but if you're going to be a part of the international system and be treated completely as an equal, eventually you're going to have to deal with these kinds of human rights issues. Otherwise, you're always going to be to some degree outside the system. And China clearly wants to be a major part of the system. That's what globalization is all about.

Q: My question has to do with property, rights of ownership, and what you just said right now about needing to meet some criteria. There was also an article a few months ago about automobiles and how knockoff vendors are selling under different brands, and previous to that, toys. Is this something that's taken seriously by the Chinese leadership?

DR. PERKINS: People get interested in intellectual property rights, just like a lot of things, when there are large numbers of people in the country that realize that they are suffering or their economy is suffering because these rights aren't protected. You can do a little bit, as we have, with the U.S. trade representative by pressing the Chinese and others. This is not a unique problem to China. When I first started going to Asia, Taiwan was the center of all kinds of good things like \$30 Encyclopedia Britannicas. I use the words "good things" facetiously, this is the home of Microsoft after all.

But, and one used to be able to buy copies in lots of other countries. China's in the early stage of this. Clearly, large numbers of Chinese don't think twice about piracy of various kinds as did many of us when we were younger. Not myself, of course. To give you just a simple example, I was having lunch with one of Deng Xiaoping's daughters a few years ago, and she was really up in arms because they had just put out a pirated version of her book. She understood what intellectual property rights were about. She wasn't in a position to do much about it, however. There are a lot of industries China simply won't be able to develop very effectively if it doesn't deal with the issue, and that's what's going to drive change.

Q: This is a three-part question. First of all, do you think it's desirable to revalue the Yuan? Second of all, how do you think the Chinese government would react under international pressure to do so? And if the Yuan is revalued, what effect will that have on the economy?

DR. PERKINS: First, the Chinese don't want to revalue the Yuan because it is one of the reasons they're able to grow exports so rapidly, and the more rapidly they grow exports, the more rapidly GDP grows, so they're resisting. In my opinion—and I've said this numerous times there and at the IMF, everywhere—they've got to move toward a flexible exchange rate simply because you don't want to have to change the exchange rate in a crisis, because then it gets out of control and causes all kinds of other bad things. So they need to get a floating rate of some kind, and what better time than when the odds are it will float up rather than down? And I think eventually they will do that. Will pressure from the Secretary of the Treasury have much influence on this? No, I don't think so. It's far too important an issue for them to deal with it as a political thing.

Q: Do you think they are likely to revalue soon?

DR. PERKINS: If I knew the answer to that I could make a lot of money.

Q: In your earlier remarks, you were implying that if China loses its mandate from heaven, that restless, educated middle classes may cause serious political problems. What about people in the countryside where the mass of people live? Is there still a tradition of peasants rebelling that's thrown over many empires over the course of the last few thousand years?

DR. PERKINS: It's good history, but it's probably not good futurology. You know, 50 percent of the Chinese work force is now not in agriculture. The urban population is still less than 50 percent. But over the next 25 years, I would be surprised if the urban population plus the suburban population is less than 80 percent of the total. So the peasants, the farmers, are not going to be the leaders of the next revolution, rebellion, or whatever. It's almost certain to be much more of an urban phenomenon. Historically, well-educated people like to have some participation in the political process, and the tension tends to build if they don't get it, especially when the leadership makes bad mistakes. So I think all of the pressure for change is really going to come from what is happening in the urban areas, not what's happening in the countryside.

Q: A huge part of the economic progress is due to the fact that U.S. corporations are doing their manufacturing there and then reimporting it to the U.S. What happens if other countries do the same to China and attract investment away from China? What happens to the Chinese economy?

DR. PERKINS: Well, you're raising an issue that actually is a very current issue for Southeast Asia. The problem is actually at the

moment the opposite. A lot of the foreign direct investment has been shifting out of Malaysia toward China. And the reason for it is partly that you can get the skilled workers and the low-paid workers, much lower paid than Malaysia. But it's also that you have the huge Chinese market if you're going to put a factory someplace. My own sense is that companies if they have any sense, will diversify and many of them, particularly the American ones, tend to be diversified anyway across many different countries for these kinds of activities. Clearly, if foreign direct investment all of a sudden turned around and left China—which would happen mainly, I think, if there were a war with Taiwan or something like that, not because of the economic situation—then China's growth would slow markedly. Leaving aside the affect of military actions, growth wouldn't go to zero because \$50 to \$60 billion worth of realized foreign direct investment, every year is a small fraction of Chinese total investment, which is in the neighborhood of \$400 or more billion dollars a year. The remainder of that investment is all domestic. So foreign direct investment is not the only driving force of the Chinese economy. It's an important driving force. It brings in a lot of things in addition to the money, but it's not the only thing.

Q: You mentioned before that it's difficult for the Chinese to develop a domestic market, and I was wondering why. Maybe it's a cultural reason, but I would imagine it would be easier with an expanding middle class.

DR. PERKINS: I probably failed to state it very clearly. It's very hard to make a shift from an economy that's heavily export-oriented to an economy that's primarily producing for the Chinese domestic market. It's not impossible to do it, and China's going to have to do it. The problem is, you have to produce somewhat different things. You can't produce quite as much of any given thing. One of the reasons being that if you're producing for a middle-

class market, the Chinese middle-class market would be exhausted whereas for the world middle-class market you can keep on producing and expanding at a rapid rate. I'd like to give you a more definitive answer, but it's the kind of issue that economists all ought to think about but don't because most countries that they are looking at don't have to make these kinds of adjustments. It's developing countries going through these tremendous changes in a short period of time that have to make adjustments like that quickly, and major structural adjustments of that sort are hard to do in a short period of time. The U.S. and Europe don't have to do that.



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