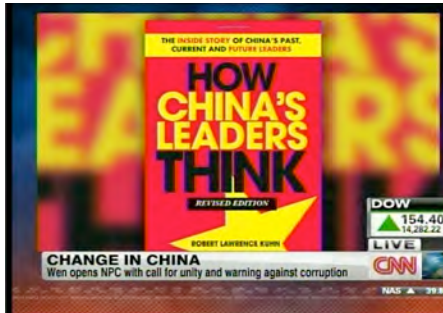


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HOST: The leaders at the National People's Congress have a long list of things to change economically and socially, but what are the chances they can achieve them over the next decade? Let's ask Robert Kuhn, a Chinese government advisor and author of the book, "How China's Leaders Think." He joins us on "Global Exchange" from New York.

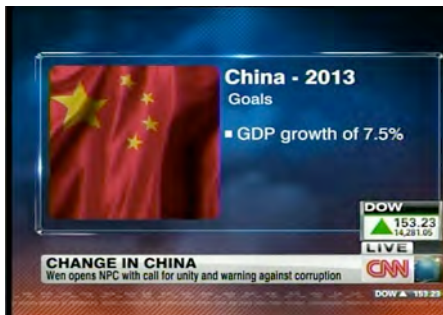
Robert, first and foremost, we've heard that growth is going to be at 7.5 percent for 2013, a little bit below expectations. Managing internal migration right now is a priority. How did you see that message?



KUHN: Urbanization, as well as modernization, are the two great drivers of China's historic development. Let's look at urbanization, because that will fuel the domestic economy. Thirty-five years ago, 25 percent of the population lived in cities. Today, more than 50 percent do. China's goal is 75 percent so that at the end of the process, sometime mid-century, perhaps sooner, a billion people will be living in cities. And that will fuel the continuing growth of the economy. Because fixed investments and exports are not going to cut it. China must develop domestic consumption, and urbanization is the mechanism by which that occurs.



People look at that 7.5 percent GDP growth. That one number is a dramatic oversimplification. You need to look at its structure, because too much – 50 percent – has been investment, and that's unsustainable. You have no airport in a city, you build an airport, great productivity. You have one, you build two, probably not much productivity. You have two, you build three, and that is a colossal waste of money.



How to continue to build the economy with investment, export and consumption? Consumption must increase, that's critical. Another factor is, *where* is the growth occurring? Rightly said, the greatest problems in China today are social and economic imbalances. China is incapable of sustaining such tremendous disparities between different groups. China use to be the most egalitarian country in the world. During the cultural revolution, everybody was poor, but they were equally poor, and there was no jealousy. Today, China is even more unequal even than India, and India has been that way for thousands of years. And with cell phones, everyone knows it. So China must address the inequalities in society. And by allocating some GDP to poorer areas, the country's total is reduced, but the inequalities are not made worse.



HOST: Robert, China has had very smoggy skies; people are wearing masks. Quality of life issues are now prominent. There is pressure from social media that we have to answer the call in the next decade.

KUHN: That's absolutely true. People are not talking about overall growth; they are talking about the gut issues that affect them. They talk about the big four social issues: healthcare, education, retirement and housing. Then, in addition, there is pollution, which is a pandemic problem, particularly in the major cities. And finally, food safety.



There are jokes about air pollution. People say, “it’s the first time the leaders have to suffer the same problem that we do.” Another: the good news is that air pollution has dropped 90 percent today; the bad news is that it is now down to the ‘Dangerous’ level. People are talking about this on social media all the time. The pressure of those major social issues are the big drivers. That’s what people are talking about. That’s what the leaders have to respond to. Growth is a means to the end; it is not the end. We in the West look to growth because that affects our economy. The Chinese are looking at those social issues, those are the gut issues.



HOST: Let’s break down the budget. \$2.2 trillion, up 10 percent in defense. \$114 billion is well behind the US. What do you make of this spending now and how concerned are you about the rivalry with Japan?

KUHN: China is certainly spending more. The deficit will be higher. They need to fuel growth. Instability would be the most serious problem. New leadership wants to maintain stability at all cost,



Growth in China’s official defense budget is down slightly from last year, 10 vs. 11 percent. Military spokesman say that is barely enough to keep even, with inflation and a large army. The truth is, China is investing in asymmetric warfare – cyberwarfare, anti-carrier missiles to deny access to American aircraft carriers.

New leadership is sophisticated. Six of the seven leaders have run two or more provinces and interacted with CEOs. Their rhetoric is populist, as they have to deal with social issues, but they’re sophisticated in international affairs. That said, in order to establish their authority, nationalism is important.



Nationalism is critical in China. China suffered from 150 years of oppression by foreigners – European countries and then ultimately Japan. The Japanese invasion is still a searing memory in China. Nationalism is real, but the new leadership, particularly General Secretary Xi Jinping, who will be president in a few days, is asserting a greater relationship with the military than either of his two predecessors did in their early days, which consolidates Xi’s power. He needs to do this because his appointment did not come from one of China’s founders. Jiang Zemin and Hu Jintao were appointed by Deng Xiaoping; Xi Jinping was not.



So Xi has come out as a strong leader, as a confident leader, which China needs, so that stability can be maintained. That said, one needs to be concerned about the South China Sea, because when nationalistic emotions run high on all sides, it’s easier to make mistakes. Chinese leaders are sophisticated and I expect they’ll avoid big mistakes.

HOST: Okay Robert, it’s always good to see you. Robert Kuhn, chairman of the Kuhn Foundation and author on China, joining us from New York.