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## China should turn to "good economy"

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One tendon only focuses on increasing domestic consumption, which may lead policy makers to no longer focus on other policies required by "good economy" .

- Interview with Edmund Phelps, winner of the 2006 Nobel Prize in Economics

Edmund S. Phelps, a famous representative of the employment and growth theory, was hailed as the founder of modern macroeconomics and one of the most important people influencing the economics process. On October 9, 2006, the Royal Swedish Academy of Sciences awarded the Nobel Prize in Economics to Phelps, then a professor at Columbia University in the United States, for his important contribution to macroeconomic policy.

Phelps' research scope covers almost all issues in macroeconomics, including price and wage decision theory, equilibrium unemployment determination theory, economic growth theory, New Keynesian price stickiness theory, and dynamic learning theory. His research shows that any policy has benefits and costs. The developer must fully weigh the pros and cons. The guiding ideology for policy formulation should always be the people's long-term well-being. In addition, in the process of policy formulation, we must take into account people's expectations of the policy, that is, the policy must be "people-oriented." These ideas are very valuable for reference in China.

Phelps has repeatedly expressed his appreciation for China's emphasis on and advocacy for innovation. He even believes that China's innovation and development may be faster than the United States. In 2014, Phelps was invited to discuss with Chinese Premier Li Keqiang. He presented Li Keqiang with his own book, "Great Prosperity." At that time, Li Keqiang smiled and said to him, I read this book. Phelps pointed out in the book that the innovations that the public participate in have brought about prosperity, that is, the improvement of the material conditions and the broad "good life."

Recently, the "China Economic Report" interviewed Professor Phelps during the 2018 China Development High-Level Forum. He described his research findings on grassroots innovation, reform and opening up, and the financial crisis.

Innovation leads the economy

China Economic Report: You explained how to ensure sustained and stable economic growth from a new perspective in the book "Great Prosperity." We all know that capital, labor, and technology are the determinants of a country's economic growth. Why do you focus on innovation, especially grassroots innovation promoted by the general public?

Edmund Phelps: First of all, one of the main reasons why I focus on grassroots innovation is that a substantial increase in the labor force may increase overall income levels, but it does not necessarily increase per capita income. The same is true of capital. Increasing capital stock can achieve economic growth, but the output of each worker does not necessarily increase.

In addition, the labor and capital elements can promote economic growth, but are limited to a certain extent. Technological progress does not have the same problem of diminishing returns on investment as capital. If the return on investment eventually drops to zero, it will not increase output and income.

China Economic Report: SpaceX, recently founded by Elon Musk, successfully launched the most powerful rocket in the world. In China, such technology research and development is basically dominated by state-supported companies or research institutions. Do you think that there are differences between China and the United States in innovation incentives?

Edmund Phelps: I think the incentives for innovation in China and the United States are essentially similar and almost identical. Most innovations have a certain

commercial value and can increase income and output. An environment and atmosphere where people are involved in innovative projects or think about potential innovation projects is very important. It will also make people's work and life more interesting. In the past when China's economy was underdeveloped, people first considered the increase in income, but now China is a middle-income country to some extent, and the work experience has become increasingly important.

China Economic Report: How do you see the role of the Chinese private sector in technological advancement and independent innovation?

Edmund Phelps: China must realize that the private sector can catch up or surpass the public sector in many products or services currently provided by the public sector. The subway was once created by private entrepreneurs. Today, the most revolutionary urban transport is Uber. In the near future, the most revolutionary change may be self-driving cars - they are all products of the private sector.

China Economic Report: The debate over whether artificial intelligence will cause mass unemployment is fierce. How do you see the development of artificial intelligence, robotics, big data and other technologies? Are these new technologies likely to cause human self-crisis?

Edmond Phelps: Regarding artificial intelligence, this is definitely a very important technological advancement. I think with the development of artificial intelligence, there will be winners and losers. On this issue, I would like to say two things.

First of all, in the technological progress of the past few decades, I believe that all groups in Chinese society benefit, and artificial intelligence will not change this. On the one hand, artificial intelligence will gradually enter people's lives in 10-20 years or even longer, instead of suddenly causing shocks on a certain day, leaving people unprepared. Therefore, there will be many opportunities for adjustment in the development of this technology.

Secondly, in the broad sense, artificial intelligence will replace part of the work, some workers may become unemployed, and the employment rate and wage growth rate will decline. This is certainly a matter of concern. But what I want to express is that if some technological progress makes the workforce more adequate, although this force will depress the wage level, the market will find new investment opportunities from the sufficient labor force. Therefore, when the development of artificial intelligence and robots reduces the capital-labor ratio (if we also count robots as labor force), but as the capital stock increases, the capital-labor ratio will increase, that is, create more, Better job opportunities. In general, artificial intelligence will reduce some job opportunities, but it will also create more opportunities for capital and create new

jobs. The public's suspicion stems mainly from not knowing that there is such a market mechanism that can restore employment opportunities.

China Economic Report: Then, how should we curb employment losses caused by innovation, especially employment losses in labor-intensive industries?

Edmund Phelps: The main solution is employment subsidies, especially subsidies for low-wage workers. This is a relatively good way of embodying their values. It can increase the level of wages in the market as a whole and increase job opportunities.

In addition, taxes can also make a difference. The wages of laborers who produce consumer goods are increasing, and the capital goods used to produce consumer goods are also increasing. However, the laborers who produce capital goods do not receive wage increases corresponding to inputs. Some industries that produce capital goods have reduced their jobs under the impact of innovation, but they have not been able to create new jobs. Tax policies should be redistributed for these issues.

Sino-US trade conflict

China Economic Report: How do you evaluate Trump's trade policy?

Edmund Phelps: I can't exactly know what Trump's trade policy is and I don't think anyone else knows it. What is currently certain is that punitive tariffs will be levied on certain Chinese exports. Trump believes that this measure can restore or increase the employment level of some industries that are impacted by Chinese exports. From the standpoint of the United States, we must realize that if the United States wants to export goods to China, it must import some Chinese goods. Trump does not understand this at all or does not care at all.

In addition, whether technological progress or free trade has led to more unemployment? At present, unemployment in the United States, Britain, France and other major innovators is more serious than that in Germany, the Netherlands, and other major trading nations. In the case of the United States alone, U.S. manufacturing output increased and employment fell. This is clearly more affected by technological progress, such as the coal industry. If it is trade that affects manufacturing, the result should be a simultaneous decline in output and employment. Therefore, China is treated as a scapegoat to some extent. Interestingly, I have mentioned this many times in the past few months.

## 40th anniversary of China's reform and opening

China Economic Report: What are the next issues that China should pay attention to in deepening the process of reform and opening up?

Edmund Phelps: In terms of opening up to the outside world, I think that if China continues to open up to US companies, it will help accelerate China's technological progress. From this perspective, I don't recommend that China change its attitude towards Western countries. Open policy. This is a win-win situation. Next, I hope that China will pay attention to regions and countries where wages and income are very low.

In terms of domestic reform, China is shifting from investment to consumption and from heavy industry to service industry. I think that China should reduce its attention to consumption because it only improves the internal structure of the economy. One tendency only focuses on increasing domestic consumption, which may lead decision makers to no longer pay attention to other policies required by "good economy". I think China must pay more attention to the workforce and enhance its work experience - from Adam Smith to Alfred Marshall. A large number of economists all use this as the core of economic thinking. When people are awake, a great deal of time every day is spent on working and thinking about the work. People's wisdom, creativity and imagination are all produced in the work. Therefore, improving the work experience is critical. If someone asks you about your job satisfaction and your satisfaction with life, do you think there is a difference between the two? I think basically there is no difference, job satisfaction may account for 90% of life satisfaction. If people are not satisfied with their work, they will be dissatisfied with their lives; on the contrary, if they are satisfied with the work, then nothing else will be of much concern.

China Economic Report: How do you see the role of the government in promoting market-oriented reforms?

Edmund Phelps: As the economy develops, the government will naturally acquire more tools that can be used for economic and social governance. People may feel that the role of the government is getting stronger and stronger. I do not agree with this criticism. To fully meet the various public service needs requires an unusually large public sector, which is likely to crowd out the activities of the private sector. However, you cannot say that the government has sacrificed the rights of citizens in the process of its role. I completely disagree with this view. I sometimes think about what China's socialism means. I think one of the important characteristics is to focus on people's development.

## Ten years of financial crisis

China Economic Report: The financial crisis in 2008 swept the world. There are still many countries that have not yet emerged from the recession. After reviewing the crisis 10 years later, what do you think is the most important lesson?

Edmund Phelps: The topic of crisis is a topic that has fascinated me. It has also been a topic that has attracted me to study economics for a long time. For more than 20 years, I have been concerned about employment fluctuations, as well as uncertainty, incomplete knowledge, and the role that expectations are expected to play in it. The economic crisis mainly involves the problems of the business cycle, which may be caused by extreme and unexpected changes, and may also be caused by market sentiment.

There is no doubt that the economic crisis will occasionally appear. I have a friend who works in a hedge fund who once said that asking when the economic crisis will happen is like asking when the German tanks will once again enter France.

Therefore, the lessons of the past cannot provide us with lessons. After the last round of the global financial crisis, we introduced the Volcker rule. Now the bank's capital adequacy ratio, liquidity ratio, and leverage ratio are far better than those of 2009, and the risks of the relevant economic sectors are also greatly reduced. Of course, new commercial crises may still appear in most regions of the world or in the world. This is mainly due to the lack of a stable basis for asset valuation. If asset prices decline, investment will shrink and employment will shrink. But overall, we are now experiencing prosperity and will continue for 1-3 years. Even if major changes cause a crisis, we can expect to overcome the crisis.

China Economic Report: What lessons have been learned by macroeconomists since the financial crisis in 2008? How do you think macroeconomic theory will develop in the future?

Edmund Phelps: What I learned from this financial crisis is that structural forces are far more powerful than the public knows. I think most economists have gradually agreed with this view. Although Keynesian economics and the concept of aggregate demand appear to have regenerated after "death" in college, in my opinion, a macroeconomics with a better foundation will develop within ten years. This new economics needs to abandon the assumption that the future is a known one, and the assumption that action has known consequences, the nature of the probability

distribution that can be known. Perhaps this new area of economics will be the area that Chinese economists will enter.

China Economic Report: The Fed has ended quantitative easing and started the process of raising interest rates. Do you think this will cause the US economic recession or even the global economic recession?

Edmund Phelps: The US economy has been out of the recession for about three years. The inflation rate is rising, so the Fed will continue to tighten its monetary policy. Of course, quantitative easing policies have been implemented for so many years, and tightening monetary policy may surprise the bond market.

In the course of the normalization of monetary policy, the economy may return to a natural level, or it may experience a traditional economic recession. However, even this does not mean that the US economy will collapse, and the world economy will not collapse.

#### Interview notes

If one constantly reviews how he has come along, he must be very clear about his own history, and he should start from the middle school students to have a good stay in the past and explore the future direction. Edmund Phelps is such a person who keeps on reviewing and looking forward; an economist who is courageously introspective and struggling. Since 2013, we have had the privilege of communicating with Professor Phelps many times – about his economic thinking, his thinking about innovation theory, and his attitude towards love and truth.

In the first year of the famous Amherst liberal arts college, Phelps hovered in the minds of Hume and Plato. Until the advice of his father selected the economics course, Paul Samuelson's name gradually became the protagonist of his mind. But the love for economics that lasted for half a century is not just a father's suggestion. Born in 1933, Phelps grew up at the end of the Great Depression. From his literacy, Keynesian government intervention in the economy continued to enter the public view.

But Keynesianism is not the end of this outstanding economist. "My economic thought started with Keynesianism, but then gradually deviated from Keynesian claims and continued to refine the theory of knowledge; after that I was caught in a debate with neoclassicalism." Phelps The area of macroeconomics has left a gap and

has opened up a new world in the micro-economic field, eventually establishing a bridge between these two fields.

Recalling his academic career, Phelps is incomparably clear. It was the second spring of a person's academic career - Viviana Montedo - "We love each other deeply".

At the age of 40, Phelps experienced a failed marriage. It is not easy for a wise head to get the understanding and support it deserves. In desperation, he moved from the University of Pennsylvania to teach at Columbia University. In New York, he became acquainted with Viviana, a good woman from Buenos Aires, when Viviana had two children. They both fell in love in 1972 and married in 1974. Today, this pair of people are already full of children, but their love is still the same. "Viviana is very supportive of my work," Phelps said. It's no wonder that every email he sent with Phelps was copied to his wife, and every meeting he and his guests brought with him was Viviana. Phelps has a clear memory of every moment in life, because the people who share those moments with him are always there. Phelps said to Viviana that you are in charge of me and that I control the world; Viviana responded to him. It used to be, but now it is only you and me.

Perhaps it was this late but overwhelming love that gave Phelps the motivation to set off again. After personal life was once again settled, he began to enter a period of academic prolificacy. During this period, he conducted extensive research on issues such as economic fairness, rigid structure of the labor market, and rational expectations. It was this second academic adolescent achievement that earned him the 2006 Nobel Prize in Economics for his contributions to understanding the relationship between inflation and unemployment expectations after 30 years.

The joys of friendship, love, and the pursuit of the truth paved the way for Phelps's happy life. As he himself said, "Our life is coherent and fluid. The next moment is always with a momentary imprint. It is clear what the past is like and the future will be clearer." His knowledge of humanity is enough for future generations. Introspection, and the introspective masters, along with his knowledge, left a moving impression in the long river of human history.