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Nobel laureate: China needs to innovate

Edmund Phelps says world's No. 4 economy could learn from Europe; says Asian nation will stagnate unless changes are made.

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HONG KONG (Reuters) -- China should learn from Europe's mistakes and promote innovation and entrepreneurship to avoid slipping into economic stagnation in the longer term, the 2006 Nobel laureate for economics said Tuesday.

Years of nearly double-digit growth have turned China into the world's fourth-largest economy, but questions abound for how long the world's most populous nation can sustain its rapid expansion.

China's fast productivity and investment growth is bound to slow as its wages rise and it gets closer to closing the technology gap with the United States, Edmund Phelps told a conference in Hong Kong.

When that happens, wage growth will slow, reducing the incentives for people to join the labor force, as was the case in Western Europe after the post-war boom of the 1950s and 1960s.

"At this point unemployment rises, labor force participation declines and you get into problems we've observed in Europe in recent decades," Phelps said.

The way to avoid stagnation and sluggish growth that have plagued Europe for the past decades is to ensure the economy can be innovative and encourages entrepreneurship, he said.

Phelps said China's education system should be more geared toward encouraging innovative thinking, while the country's legal framework needs to become more supportive of entrepreneurial activity.

"It's got to be easy to start a company, have governmental support, legal support," said Phelps, who is a professor of political economy at Columbia University in New York.

China's financial sector also had a way to go before it reaches a level of expertise needed to evaluate innovative projects, he said.

Phelps said demand for sophisticated technologies has not yet reached the critical mass China needs to catch up with top industrialized nations.

"The increase in the stock of capital that's invested in sophisticated industry in China - to bring China to the high-tech level of the United States - is muted because there isn't the consumer demand there for it right away," Phelps said.

India, another Asian economic powerhouse, was better placed to support innovation because it has rule of law,

democracy, a history of open trade and a strong background in maths and English-language teaching, Phelps said.

However, the model of the technologically advanced city of Bangalore was not replicated across the country and poor Indian public services hampered entrepreneurial activity.

China has developed as a market for such American firms as [Dell \(Charts\)](#), [Wal-Mart \(Charts\)](#), [IBM \(Charts\)](#), [Intel \(Charts\)](#) and [AIG \(Charts\)](#).

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