PODCAST

Ep. 5: China's Slowing Growth

After decades of unprecedented growth, China's economy is now facing serious challenges. Two economists break down these obstacles, and predict what lies ahead.

MARY KAY MAGISTAD — FEBRUARY 6, 2024

ECONOMY

Subscribe to the China Books podcast on your favorite platform, including Apple Podcasts and Spotify. You can also listen to all past episodes right here at the China Books Review, where a new episode lands on the first Tuesday of each month.

As featured in the *China Books Review* special edition on the economy last week, the sizzle has gone from China's decades of economic growth, as the country contends with deflation, slumping consumer confidence, plummeting foreign investment, a cratered urban property sector, high local government debt, overcapacity in manufacturing, and a private sector cowed by government crackdowns, as well as a shrinking workforce and an aging population.

For all of that, China is still the world's second-largest economy, the largest trading partner of most countries, and one of the world's biggest bilateral lenders. In 2023 China listed its economic growth rate as a respectable 5.2%, causing more than one economist to raise an eyebrow in disbelief.

How to make sense of this all? Where can we get an idea of what China's options are, to navigate these obstables and sustain its growth? In the latest episode of the *China Books* podcast, we invited two China-born economists to clearly explain the challenges that the nation faces:

China Books

Ep. 5: China's Economic Challenges, Explained

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Guests

Tao Wang is Chief China Economist and Head of Asia Economic Research at UBS Investment Bank in Hong Kong, and was formerly an economist at the International Monetary Fund. She is the author of *Making Sense of China's Economy* (2023), and has been ranked as one of the top China economists by institutional investors. Her research topics include monetary policy, U.S.-China trade disputes, and growth potential.

Yasheng Huang is an American professor of international management at the MIT Sloan School of Management, where he founded and directs the China Lab. His previous appointments include faculty positions at the University of Michigan and Harvard Business School. Huang is the author of *Capitalism with Chinese Characteristics* (2010) a history of economic reforms in China, and of *The Rise and Fall of the EAST* (2023).

Transcript

MARY KAY MAGISTAD: The headlines are pretty bleak. "China's Economy is Off to a Bad Start in 2024" – in Foreign Policy. "China's Attempts to Lift Confidence in Economy Fall Flat" from Reuters. "China's Economy has Picked up Traits Reminiscent of the Great Depression" in Forbes, with another Forbes piece that noted emerging signs of deflation in China in 2023, both in consumer and in producer prices suggested – quoting here: "too much supply of the wrong things, insufficient demand, and a strained financial environment – none of which an economy wants."

No economic miracle lasts forever, but China's slowdown still turns heads, and challenges old assumptions at least some had, about China's inevitable rise to the top rung of global power.

And to understand all this and how we got here, well, books on China's economy abound. Some seem out of date by the time they hit the shelves. But some are clear, concise, and enduring, because they help readers better understand how China's economy ticks, what undergirds the system, and which variables and vulnerabilities are most important in shaping China's economic future.

This episode is with two authors of such books.

(Music up)

This is the China Books podcast, a companion of the China Books Review. I'm Mary Kay Magistad.

When I was a China correspondent over the late '90s and oughts and early teens, China's economic growth was still sizzling – driven first by exports, then by a long construction boom, as hundreds of millions of

Chinese rose from poverty, many moved to cities, as the middle class grew, the property sector did too, and China became the world's second largest economy.

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But even in the midst of all this came warnings – including from China's then-Premier Wen Jiabao, that growth was not sustainable unless the quality of growth improved. The problem was that improving the quality of growth would take serious economic reforms that could hurt vested interests, within the Communist Party, and to those close to it. Such reforms were promised in late 2013 at the 3rd Plenum of the 18th Party Congress – early in Xi Jinping's tenure as China's Communist Party leader and president. But much of what was promised never happened. Instead, Xi doubled down on supporting the state sector, cracking down on the private sector, flexing China's muscles internationally, and antagonizing some of China's top trading partners, including the United States.

Such actions have had unintended consequences – compounding challenges China's economy may well have faced anyway. Over the past decade, China's growth has slowed, domestic consumer confidence has slumped, foreign direct investment fell off a cliff in 2023, and even went into negative numbers in the 3rd quarter, and the air has whooshed out of the balloon of China's property sector – which, at its peak, made up almost 30 percent of China's GDP, and – on paper – stored some 70 percent of China's household wealth. China's official figure for its 2023 GDP growth rate was 5.2 percent, but many economists are skeptical, says Yasheng Huang, an economics professor at MIT, and author of several books on China's economy, including *Capitalism with Chinese Characteristics: Entrepreneurship and the State:*

(03:36): **YASHENG HUANG:** Some Japanese economists have come up with a negative growth rate, negative 2 percent.

MARY KAY MAGISTAD: For 2023?

YASHENG HUANG: For 2023. And the official number is 5.2. And some U.S estimates put it between 1.5 and 2 percent. So there's a huge difference between the independent estimates and the official number.

MARY KAY MAGISTAD: What do you think? Or are you just saying there's this range, and you need to keep in mind that there is a range?

YASHENG HUANG: That's right. Yeah. So I don't do this kind of research, although I did write a paper before about statistical falsifications in China. And our paper shows that the Chinese data have been manipulated. But this is about in the past, right, not about 2023. So I don't believe in the official number.

(04:33) **MARY KAY MAGISTAD:** I'll come back to Yasheng Huang later. But keeping in mind that economists who follow China closely have a range of views, I'm including two in this episode. They overlap on some points and diverge on others, but both are respected by their peers, and both grew up in China, so – besides being economists – they each have lived experience of how systems in China work on the ground, and how they affect people's lives.

So I'm turning now to Tao Wang. She's the Chief China Economist at UBS Investment Bank in Hong Kong, and she previously worked as an economist at the International Monetary Fund. TAO WANG's book *Making Sense of China's Economy* is a clear and concise guide to how China's economy works, and to China's economic challenges:

(05:17): **TAO WANG:** I think China's economy indeed is very complicated, and it's difficult to make sense, even for someone who devotes her life, like myself, to look at China. And China's data are often confusing as well. There are questions about data reliability, but also, the simple fact is that the economy keeps changing. Old statistic coverage often no longer apply.

MARY KAY MAGISTAD: On the reliability of statistics, you've been looking at China for decades. Are they getting better?

(05:48): **TAO WANG:** I believe so. In general, I think there have been more data coming from all kinds of sources. So, official data has become more available, but also there are a lot of industrial-level data from industrial associations. For example, I track daily property sales in top 20+ cities that comes from developers and industrial associations. I track daily truck freight movement. I track daily mobility. So when we didn't really know how many cities were in de facto lockdown, by looking at daily traffic jam index and also passenger turnover in subways, you kind of know how many cities were really being quiet and what's the economy doing. So there's a lot of supplementary data.

One issue that I wish the Statistical Bureau can change is that they often change the data classification without properly explaining what the changes are and going back to say, how can things be comparable? So if you don't pay close attention, you'll think something weird really happened. And sometimes they also stop publishing with no clear explanation why they did, and that's not very helpful.

But in general, I think data has become more available, and there's a lot of industrial level and private sector data. We also conduct our own surveys to help supplement. I mean, of course they cannot really substitute official data, because official data has much more broad coverage and it's more comprehensive. But I think we can often corroborate to verify, is this data good data or do I need to look for other sources?

(07:30): **MARY KAY MAGISTAD:** So, what are the most common misperceptions you hear, in general, but also from Americans in particular, about China's economy?

TAO WANG: One of the most common misperceptions, people generally think that China's government is monolithic – it's a one-party system and the government, top down, decides on the policies and so on. I think people may underappreciate the complex relationship at different levels of government. Local governments in China in particular, often do not have their interests aligned with the central government. And they have a lot of autonomy in implementing policies. For example, on property policy, they always want prices to go up that help finance them, while the central government cares more about risk and prices going too high, and so on. Not all the policies are well coordinated and implemented all very well.

(08:30) **MARY KAY MAGISTAD:** For the local governments, yes, they want to keep the property prices higher, but something that wasn't intuitively obvious to me when I was living in and reporting on China, until someone explained it to me was that local governments, they collect taxes, give them to the central government, which gives some portion back, not necessarily everything they've paid in. But one way that local governments can make up for whatever they need to basically fulfill their budget requirements is to sell property. Local officials know that if they want promotions, if they want to do well within the system, they need to show that their city or a province or whatever, has decent growth. But that creates this inherent tension. It's also contributed to the local debt problem. Are the incentives misaligned? Is there something about that system that is creating this set of less than desirable outcomes?

(09:23): **TAO WANG:** I think yes, for local governments, they want promotion for sure. They want their local economy (to) do well in a way that can be measured, right? And so they therefore focus more on investment that their boss can come by and see, that there is change. And to build better things, to have the economy going for them, they need resources. But they don't really have their own taxation at the local government. They share revenues with the central government. But if you want to do more, you've got to find different resources.

And so, land financing, basically local governments use the land. So they acquire from farmers, don't pay them often properly. And then they change the usage from rural to urban. When you change that usage, then the valuation of the land increases dramatically. And so they appropriate that valuation gain, and sell to developers.

(10:20): But that's not even enough for them. They also use those resources to leverage up, to increase spending, hence the debt issue that you mentioned. A lot of the local government debt, incurred by local government platform companies, are collateralized or relied on land sales revenue for payments. So when property goes down, then local governments face very big fiscal challenges.

There's another incentive issue here is, of course, that local officials, when they take up debt, when they sell land, they do a lot of infrastructure, and they have good performance – then they are promoted away. The debt issue is not shouldered by them. It would be by his successor, and the successor would take more debt and, and so on. So there's an incentive issue in terms of how to discipline local officials, how to make local government to spend responsibly. So the central government a few years ago introduced this mechanism of making local officials lifetime responsible for the debt levels. But at the same time, they did not change the requirement that local governments need to support the economy whenever the economy is facing (a) downturn. So you want them to do something, but then you also ask them not to incur more debt. So that makes it more difficult, and local government therefore went more kind of underground and took implicit debt. And now that of course is surfacing. The central government realized that those issues still exist.

(11:54): **MARY KAY MAGISTAD:** How big of a risk is that to China's economy?

TAO WANG: The local government debt is big, and there is definitely risk, but not necessarily in the way that it will cause a financial crisis or problem to the financial system. Let me explain. So local governments, of course, have a lot of debt. Officially, it's only about 30 percent – that's local government bonds. However, with the implicit debt of the Local Government Official Vehicles, the LGFVs, the platform companies, that's another 50 percent of GDP or so. So together it's quite large. And we estimate also most of the LGFVs – Local Government Official Vehicles – don't have enough cash flow to cover their interest payment. So they have definitely liquidity issue and payment issue, which is now constraining the economy. And China is facing this issue that to avoid government entity default in the market, they are cutting general government spending and cutting even public sector wages to help make those payments. And also they are renegotiating their contract with banks, so that banks can extend their loans and so they don't come to default. Obviously, it hurts banks' earnings and so on, but it makes the game continue.

(13:11): But the bigger issue is, of course, that means you cannot incur more debt to support the economy, which traditionally has been the channel through which the government always put a "put option" to growth. Whenever there's external shock, trade war, pandemic, local governments were to step in. And now, their ability to step in has been severely constrained.

That said, there are two things that prevent that crisis mode. One is that local governments do also have a lot of assets. So they borrowed to do infrastructure to invest, right? And one could argue that not all projects were profitable or productive. But I would say, you know, over half of them, let's say should be. So they have created some assets from those investments. And local governments also own shares of state-owned companies, which can be sold. So they may have net assets rather than liability. But you know, whether they want to sell, whether they can sell those assets, and timing of it, is the issue. So I think technically and philosophically, you can resolve that since, after all, local government cannot really go bankrupt. It's a matter of redistribution of assets and, with the central government intervention, it can work out. In the short term, of course, it's a liquidity issue.

(14:31): So that's one thing. The second thing is that these debts, local government's debt, are mainly with banks. And banks have liquidity. They have the confidence of the people. There's no other place, better places, to put their savings, and China has very high savings. So it's possible to kind of roll over the debt, extend the loans for a long time, so you don't have an immediate liquidity-driven problem. So it's a big problem in one way. But on the other hand, you know, it's not a cause of a potential financial crisis.

(15:07): **MARY KAY MAGISTAD:** So then that leads back to common misperceptions. Like, from an American perspective, it's like, well, why hasn't something like 2008, the financial crisis, happened in China? And what you just explained is, the government backs up the banks, the banks back up local governments, even in times when in other countries, maybe something else might have happened.

(15:26): **TAO WANG:** Yes, exactly. And of course, behind this is the fact that China has very high national savings. So China's household saving rate is high, over 30 percent. But the national saving rate, which includes savings of household, corporate, government, all together, basically what they don't consume, what they put in investment or in banks and financial markets and so on, that's still 45 percent. So China's consumption, as a share, is relatively low. That means they put aside a lot of money. And that money, because China has controls on capital outflows, are largely sitting domestically, and largely sitting with banks. You know, for a lot of emerging market economies, they cannot do this, because their savings (are) low, they borrow internationally. And the international investor, if they don't have confidence, they move away. Then you suddenly have a problem. And in the case of China, because it's domestic debt, domestic-financed, and that there's confidence in the banks and so on, then it's very difficult to have such a kind of a crisis because you have that saving buffer.

(16:34): **MARY KAY MAGISTAD:** And of course, the government wants there to be more domestic consumption. They want households to spend more money, and people aren't doing it as much as the government would like. You've argued that part of the reason is because the social safety net isn't strong enough, that the level of confidence isn't strong enough at the moment. Why is that?

(16:54): **TAO WANG:** One important reason is households not feeling confident about their future, and especially about their pension, about their health care, also about their children's education. Those three things are the most important reason for people's increased saving.

So one reason, of course, is that China's economy came from a central planned system 40+ years ago, where everything is state-controlled, everything is according to the central plan, everybody's supposed to have full employment. But that full employment meant full benefits only applied to a small portion of people who worked in the state-owned enterprises. The vast majority of the population, which were farmers at the time, did not have such (a) system.

So now they are gradually building up. They have built a rudimentary coverage for rural people and so on, but still the gap between that two is very large. And the so-called migrant workers, 200+ million rural people with their identity as rural but they actually work and live in cities,

they don't have proper coverage. And then even in the cities, large companies, smaller companies, private companies have different coverage as well. So people of course, don't feel confident. Everybody wants to be able to access (the) best health care. They don't want to think their life is only worth tiny bit. So everybody saves extra. And the pension, coverage-wise, also, it's quite different. So it's not just the coverage is not very comprehensive, but it's also not equal. So people have to supplement a lot for themselves. And that system, I think, in the last 15 years has seen major improvement, I have to say. However, I think it's not yet enough. So people still feel not very good about their future.

I know Americans complain about the healthcare system in the U.S. I have to say that China's system is worse. And the private side is very expensive. For the people who have access to the best public system, it's great. But unfortunately that's only a very small group of people. For the majority of people, you don't even know what's the proper price, because the official price doesn't matter. You need to buy access, and you don't know where and how to buy the access. And so that creates a huge amount of anxiety in the household. And so that also incentivizes people to save a lot.

(19:90): **MARY KAY MAGISTAD:** So another group that doesn't fall into any of those categories necessarily, although some young people might be rural to urban migrants, many are. But, at the moment, something like one in five Chinese youth between ages 16 and 24, I think it is, are unemployed. How could that be happening at a time when China's workforce has been shrinking for years and the population is now shrinking too?

TAO WANG: So there are a couple of things. One is that despite the concerns about China's aging population, declining population, working-age population decline, and so on, China's bigger issue is not that we don't have enough people to work. It's we actually don't have enough jobs for the people. That's because even though the population is declining, China was not, and is not, in full employment. There's still a lot of surplus labor. That's very different from the U.S. and advanced economies when you were in full employment. And there's also rural population need to migrate out of the farming, where they're not making money, to find a good job.

The second thing, I have to qualify a bit of that data. It's not one in five of the age between 15 to 24. It's one in five of those group of people who are not in school, because two-thirds of the people of between 15 and 24 are in school. Then, (of) the remaining 30+ million, there are about 7 million unemployed. So of course, it's a waste that young people are not employed. And the reason for that, I think there are a number of them. One is that the pandemic has hurt (the) service sector very hard. And (the) service sector is the one that mostly employs young people, especially college graduates. And they are not going to assembly lines or construction sites. They're going to more services jobs. And of course, also the regulatory tightening earlier that hit internet companies, education companies was also a contributor.

(21:23): But there's a structural reason (why) there is certainly mismatch in new labor supply and what is needed in China's economy. So China expanded college admission massively over the last 20 years. China graduated 11.5 million college students in 2023. But China's economy is still a lot of lower-end services jobs, construction, manufacturing, and so on. And college graduates are not interested in being a delivery person or blue collar worker, but there's not a lot of jobs created for them. So there's a bit of a mismatch. A lot of people have degrees, but not necessarily the skills for the labor market that needs them. So I think to change that, there needs to be some fundamental changes on how to train people. I think the colleges and the government need to work more closely with the corporate sector, and understand what kind of skills are needed. And there needs to be more collaboration in retraining people as well. And of course, also supporting private sector, service sector growth to create more jobs in that front is also helpful.

(22:35): **MARY KAY MAGISTAD:** You mentioned the private sector. I wanted to jump in with a question about President Xi Jinping having favored the state sector more than his immediate predecessors. I'm wondering whether you feel that the economy is taking a hit because the private sector isn't as prominent as it was before, if in fact you think that is the case.

(22:56): **TAO WANG:** Well, I think there's plenty of research to show that the state sector is not as efficient and not as profitable and productive as the private sector. I think that's widely agreed. You know, on growth, it's not necessarily the ownership, but it's really the market orientation, whether you are disciplined and driven by commercial reasons and by market forces. The early stages of reform in China was exactly introducing commerciality, autonomy, and market price and market competition to the state-owned companies and to the economy, that drove growth.

And, you know, state-owned companies often are not profitable. But often they are the ones who will provide free infrastructure and so on for the private companies, right? So, you know, thinking about internet, why does China's mobile payment, internet, all that develop so rapidly compared to the rest? Because the utility companies, telecom companies in the state were investing massively, commanded by the government. And that's helpful, right? So sometimes that benefit, that externality, is appropriated by the broader economy, not necessarily by the SOE itself.

(24:05): But I agree that since the mid-2000s, the share of China's state-owned sector has stopped declining. There's emphasis in the last decade about strengthening SOEs, also more Party leadership across the society, which I think makes the private sector quite nervous.

And also, I think, in the last 15-18 years, there's been an emphasis on realigning the role of the state versus the market, partly because I think China's so-called imbalance and inequality really worsened in the early to mid-parts of 2000s. So before the global financial crisis, or around that time, inequality and social unrest and social issues, and environmental damage and pollution and so on, all really worsened. And so there was a lot of reflection about, what is the cause? And there were debates on whether the reform and market orientation went too far, or is not complete. And after the global financial crisis, I'm afraid what happened in the U.S. and globally tilted the debate the other way to say, no, the state needs to play a bigger role. And since then the state has played a bigger role.

(25:24): It's supposed to be, I think, judging by the Third Plenum of the 18th Party Congress in 2013, it was supposed to be that the state should play a bigger role in regulation, supervision, environmental standards, and providing social safety net and so on. And the market was supposed to play a principal or dominant role in allocating resources. And the state was supposed to exit certain competitive areas, commercial areas, and focus on more strategic areas.

So we have seen improvement in social safety net, better environmental standards and supervision, more complete supervision and so on. Unfortunately, I think the "exit" part by the state sector hasn't quite happened. Of course, also, when one thinks of the regulation and also the fact that the state emphasize(s) on a lot of the strategic sectors and adding, for example, data, adding other parts as strategic sectors, the private sector feel their space gets encroached even further. And the private sector is feeling unsure about what the policies are going to be, regarding the private sector.

MARY KAY MAGISTAD: With what impact on economic growth, do you think?

(26:40): **TAO WANG:** The confidence of entrepreneurs and businesses have been affected, right? Especially when policies come out in a campaign style, without proper explanation, then the narrative can sometimes be hijacked by populist and nationalistic people. If the government does not come out constantly to rebut those statements, people would then think this is what the official intention is.

The government now says, no, that's not the intention. They reiterated so-called unwavering support to the private sector. But I'm afraid it takes a bit more for them to feel secure about the situation. So when confidence is hurt, then that hurts investment. There are also concerns about future other types of policy. I have foreign investors asking me, will private companies be allowed to make profit? I don't think that's a question, but you can see the perception can hurt.

[27:41) **MARY KAY MAGISTAD:** Do you think that there's been an impact on innovation? The goal is for China to be a leader in 21st century technologies, in renewable energy, electric vehicles, AI, and more. What are you seeing?

TAO WANG: I'm not sure it has already had an impact on innovation. I do worry that if China does not deal properly with the role of the state versus the private sector, it *will* have an impact on innovation. When people talk about innovation in some of the internet space, I would say, yes, there has been a lot of innovation. But there has also been a lot of development that was really circumventing or really using the loopholes of regulations, not technical innovation, in my view.

So it's more of innovation to bypass rules. That was never going to be sustainable.

However, I think there is still a lot of innovation in the economy, especially in the manufacturing sector. We see that happening in the electric vehicle space, for example, in some other manufacturing, in the green transition space as well. And there are two important reasons. One is China has a very large market. So if you innovate, you can monetize very easily. And secondly, China still has a lot of highly educated engineers and scientists that are relatively cheap compared to foreign engineers and so on.

(29:30): So going into the future and thinking about, how does innovation come? The government has a tendency to say "we mobilize all resources and devote it to making a breakthrough," the so-called whole country system. I think it works in some areas, but historically we can see innovation often come from the corporate sector or the private sector. It does not always come from the state-driven sectors, because you don't know what new technology will emerge. So you may choose the wrong winners and wrong technology to focus your energy on. And also, that competition incentivizes innovation as well. So I think the importance and vibrancy of the private sector for innovation is paramount. So going forward, if China cannot maintain such a vibrancy for the private sector, I think it will lead to slower innovation.

Equally important, I think, is openness to foreign competition, and to foreign investment as well. I know right now China, of course, is facing pressures of decoupling from the U.S., facing restrictions of technology access by the U.S. and some allies. And I think China should unilaterally open, and keep its system open. I have so far seen the government seem to express that interest that they want to embrace that continued openness. But I worry that in the new age of more talk about national security, about domestic interest and so on, that kind of continued openness could face a lot of challenge going forward. That's also not very good for future innovation.

(30:51) **MARY KAY MAGISTAD:** Let me also shift over to thinking more about China's place in the world and its international endeavors. So the Belt and Road Initiative, which Xi Jinping started a decade ago, and which had infrastructure projects in many dozens of countries. Something like 140 countries have signed up to it in some way. Some of those projects were good for the countries that signed up for them. Others, countries like Pakistan, Malaysia, others, are renegotiated, or there were concerns about costs being higher than expected, debt being greater than the country could really deal with. How much do you think the Belt and Road Initiative has had the economic impact, both within China and for those countries, that the government intended?

(31:39): **TAO WANG:** I don't know what the government intended exactly in the beginning. It helps economic prosperity, brings closer ties, and therefore also minimize(s) potential conflict or disagreement in other areas. But from an economic point of view, if other economies develop with your help, they will also import more of your products. In general, I would say that the Belt and Road Initiative, from that point of view, has had a positive impact, especially on the recipient countries. To a smaller extent, it also had a potentially positive impact on China. But China's economy is very large, and the Belt and Road Initiative investment so far is relatively small compared to China's size and China's own investment.

(32:24) **MARY KAY MAGISTAD:** About a trillion dollars, right, in loans?

TAO WANG: Yeah, a trillion dollar over many years. So that's – there's also investment. The Belt and Road Initiative is not just about loans, and it's not just about the state and infrastructure. Increasingly over the last few years, it is being driven more by commercial reasons and by private companies, with a lot of manufacturing with a lot of services and property and construction and so on. That's because the government realized that there's potentially issues in recipient countries. Can they pay? There's that return issue. Also, there may be backlash, from various reasons, so that the state, I think, has become more cautious over the last few years, I would say since 2016-17 or so. But at the same time, we see a lot of increased interaction between the corporate sector going to Southeast Asia, Africa, Middle East to explore opportunities there.

(33:22) **MARY KAY MAGISTAD:** Did you see a bump to China's economy as a result of Belt and Road Initiative investment?

TAO WANG: It's hard to measure if there is a bump. Of course, some people claim that now that China's exports to developing countries is bigger than exports to developed countries is a result of that. I guess if you do serious research, one may find it, it's not such a close linkage necessarily on data. But from an economic principle, right, more foreign investment in certain areas and more infrastructure, it helps economic development in that region that will help generate more demand. So one can explain that potential linkage. But I haven't done any research to show me that it had a serious impact on China's growth itself.

(34:10) **MARY KAY MAGISTAD:** What impact do you think Trump's trade war and Biden's continuing tariffs have had on China's economy overall?

TAO WANG: Overall, it's been negative, I have to say. So the trade war obviously immediately increased U. S. tariffs on imports from China. It hurt Chinese exports. China's export market share in the U. S. has declined very sharply over the last few years. And in some cases, of course, many companies then went abroad, found other channels, export to other places, maybe also build factories in countries that are not subject to U. S. tariffs, and exported indirectly to the U. S. to some extent. But in general, I think higher costs and higher tariffs hurt China's overall exports and economy. And more importantly, I think the restrictions on technology hurt China's ability to upgrade in the very high end. And of course, that leads to more investment in the high-end technology by China itself. You know, innovation is always hard. When you do it without any help from the most advanced places, then it's even harder and costlier. So it's overall, it's a negative.

Beyond that, I think the uncertainty on U.S.-China relations and the risk that it imposes on everyone, including Chinese companies, foreign companies, U.S. companies but also other foreign companies, will hurt investment into China and people's outlook about China. It's hard to quantify exactly, but I think it will have lasting impact. On the other hand, at the end of the day, even though it's costly, it's going to be slower, I think China still are going to create its own system and catching up.

(36:00): **MARY KAY MAGISTAD:** You've said that you expect, going forward in the near to medium term, growth rates in China of somewhere in the 3 to 5 percent range. What would growth look like on either end of that range? And what are the implications for China, for the Chinese government in terms of its aspirations both domestically and in the world?

(36:20): **TAO WANG:** Yeah, so my baseline is that China's potential growth, long-term trend growth is going to slow, but still for this decade, 2021 to 2030, China's average growth can still be between 4 -4.5 percent. That means that China is still catching up. It will be still faster than the advanced countries, including the U. S.. And that also means that China will still be contributing 30 percent to a third to global growth. So that will mean China is still the largest driver of global growth.

Of course, it's much slower than in the past. The previous decade was averaged 7 percent. But as China's economy mature(s), growth slows. And China does face aging population, the demographic challenge, even though it's not a binding constraint at the moment, it does mean there are fewer people coming to the labor force and labor growth is going to slow or decline in the future.

(37:14): And then also China has built a lot of industrial capacity. So increasingly it has to rely more on innovation. Innovation is hard. And there are some excess capacities in China as well. And then of course, China does face the tech restrictions and decoupling pressures – a lot of headwinds. So I think, growing 4-4.5 percent this decade, and then next decade, probably 3 to 4 percent, that kind of range, or 3-3.5 percent, that range.

(37:43): What does it mean? I think at this pace, China's goal of reaching what they call Mid-level Advanced Country state by 2035, which nobody quite defined it, but if you think about per capita GDP of US$20,000 or US$25,000, I think that's achievable.

The next goal for China was by mid of the century, so 2050 or so, to become an advanced country. Again, not well defined. Maybe first of all get to a quarter per capita GDP, a quarter of the US level, and maybe then to 40 percent. Then we are, really at the middle middle-income compared to the Western most advanced countries. That will be a major achievement. It means that China (will be) as developed as some of the European countries like Portugal. And I think the overall economy will be more sustainable.

(38:40): But to achieve that, I think private sector will have to remain vibrant. Companies will need to be profitable. The debt level needs to be controlled. And with the stage of economic development, (a) very important thing to sustain growth and sustain social stability is to improve social welfare and public services that improve on the income and wealth equality. How to achieve that? Of course, it could be a lot of challenges ahead as well.

So if China can reach 5 percent growth, then it will overachieve what I have described, and it can do even better. It can be as developed maybe as Spain, let's say. If China can only grow 3 percent, and it's possible given the challenges ahead, if there are policy errors and if key reforms are not pushed through, China's growth goes down to 3 percent, then that catch-up would be much slower, and I think China will struggle to become a mid-level advanced country by 2035.

And then I think also on the ground, China still has a lot of underemployed people. Not creating enough jobs for them will mean potentially some social issues, and the society could become more polarized. It's already quite polarized. Of course, there will be bigger debt challenges as well in a lower growth (economy). But as I said, it's hard for me to see a trend growth this decade going down that low. I think above 4 percent is still achievable.

(40:16): **MARY KAY MAGISTAD:** In the longer term, how much do you think demography is going to be an issue? I mean, China's fertility rate right now is half of replacement rate. Some demographers are projecting forward to the end of the century and saying China's population might by then be half of what it is now. Can an economy find efficiencies through automation or other technology to grow despite having a shrinking and aging population?

(40:40) **TAO WANG:** Yeah. So China's demography looks pretty stark, and like most actually advanced East Asia economies. And a lot of economies have tried very hard to reverse the trend of falling fertility rate, with very limited success. And for China, I think it will also be a very tough trend to deal with.

From an economic growth point of view, yes, I think innovation, automation, AI can definitely help bridge that gap. Actually, I worry that despite of demographic headwind, China is facing the challenge of millions of people being replaced by technology, as in the U.S. and as elsewhere. It's a global phenomenon.

(41:26) But the biggest demographic challenge for me over the longer term is really the enormous burdens of old age care and healthcare and pension system. The current system in China is not sustainable. China faces a very serious challenge of reforming the pension system, reforming the healthcare insurance system, and requires very tough reforms (to) push it through. It's going to be against a lot of people's interests, obviously, extending retirement age, slashing the pension benefit and potentially increase tax to help pay for that. That's not going to be very popular. So a lot of challenges ahead. How to provide care for an aging population? That's key to, I think, stability in the society in the long run.

(42:19): **MARY KAY MAGISTAD:** So a lot of challenges but also room and resources to deal with those challenges, do you think?

TAO WANG: I think there's still a lot of room and resources to deal with challenges, especially in the coming decade. For example, on the demographic side, China's actual retirement age is 54. You extend by three years by 2030, you add 40 million people to the labor force. So that's a low hanging fruit. But of course, China is facing unemployment issue at the moment, so they don't want to extend the retirement age. Also, the use of automation will help improve labor productivity going forward. Pensions coverage can be expanded. The government can certainly increase its contribution there, and improve the provision of public goods to help. So the state have a lot of assets they can use. But it's about changing the priorities, and changing the incentives at the local level, from investing and promoting economy to caring about provide public goods and services to the population. So those changes need to come through.

(Music)

(43:26): **MARY KAY MAGISTAD:** One of the many reforms China's government could consider is ending the hukou system – a sort of internal passport that was designed to restrict how much rural Chinese could move to cities and seek jobs and higher incomes to improve their lives. As TAO WANG said, hundreds of millions have moved anyway, in recent decades – they've just been barred, in cities, from getting the access to health care and public schooling for their kids that official urban dwellers do. That's a huge chunk of China's population to hold back. And MIT economics professor Yasheng Huang, author of *Capitalism with Chinese Characteristics* has written about this and much more. He thinks China's economic growth rate is already much lower now than official government numbers suggest:

(44:11) **YASHENG HUANG:** Whether it is negative 2 percent or positive 2 percent, I don't really have any view, but I think it cannot possibly be 5.2 percent. And I think, 2 percent, let's just say 2 percent. Two percent is a very substantial write-down of the Chinese growth rate. For sure it's the lowest since 1989. But the difference between 2023 and 1989 was 1989 was a very sharp shock: Tiananmen and the policies that followed Tiananmen. Whereas this time, the slowdown are rooted in more structural reasons. Therefore, it's hard to see how they can get out of that situation.

(45:00) **MARY KAY MAGISTAD:** Let's talk about the structural reasons. What do you see as the main ones that are driving this economic slowdown?

YASHENG HUANG: So many people talk about the real estate. They talk about consumption. I like to go a little bit deeper. I think the biggest problem with the Chinese economy is the economic model that they have. That economic model essentially is all about building, building airports, building infrastructure, building cities and skylines, rather than really about putting money into the pockets of the Chinese people.

So these are very different ways of growing the economy. You can actually achieve very fast GDP growth rate by building all these bridges, by building all these airports. But if you do it in a way that doesn't really substantially improve the income position of the Chinese people, it's not going be sustainable, right? And then you're going rely on foreign markets to absorb the excess capacity. And now China is faced with much more uncertain and less friendly geopolitical environment. So even that way of absorbing this excess capacity has become more limited than before.

(46:17) **MARY KAY MAGISTAD:** So given what you just said about putting money into the pockets or the wallets of the Chinese people, a substantial amount of household wealth is in property. It's, what, 70 percent?

YASHENG HUANG: Yeah. So there's, this is urban, and that's paper, right? So it's not like real financial cash. And now with the real estate slowdown, with the property prices falling, one would imagine a lot of that wealth, or quite substantial portion of that wealth, has evaporated.

If we are looking at, not the wealth per se, but if you look at the returns from the wealth, like dividend income, interest income, Chinese households are surprisingly poor in terms of their returns of the wealth, especially the rural Chinese. The rural Chinese, their – what is known as asset income – is basically, you can say zero, but it's not zero, but it's a number that is not meaningfully different from zero.

(47:21): **MARY KAY MAGISTAD:** Because they don't own the land on which they farm, even though it supposedly belongs to the people, to the cooperatives. But really local government officials can make decisions about selling it, right?

(47:32): **YASHENG HUANG:** Yeah, so the farming income doesn't show up there. And it will show up there if you own the land, and then you sell the land to develop housing project, shopping mall, it should show up there. The reason why it doesn't show up there is because Chinese peasants don't own the land. And I'm almost done with my revision of my 2008 book, *Capitalism with Chinese Characteristics*. And I look at this issue fairly carefully, getting the data and making sure that the data are right.

I was just shocked. I didn't expect to see high asset income, but I was shocked by how low it was for a country that has this incredible pace of urbanization and industrialization. I mean, if you think about the land usage, urbanization, and industrialization are about converting land from rural usages to non-rural usages. And the farmers and the rural Chinese would essentially surrender the titles of their land to the developers, right? So if they actually have the property rights of their land, this pace of rapid industrialization and urbanization would have enriched 600 million, 700 million Chinese people massively, right? So that's why, going back to the point…

(48:59): **MARY KAY MAGISTAD:** And while I was based in China, tens of millions of people got turfed off their land.

YASHENG HUANG: Yeah, that's right.

MARY KAY MAGISTAD: And forced to become migrants because the local governments were like, "hey, we need this money for development. It helps to pay our local budgets."

(49:11): **YASHENG HUANG:** Yeah. So this, it's not the case that the urbanization, industrialization didn't create wealth. It created a lot of wealth. It is just that the wealth didn't go to the rural Chinese. It went to the local governments and also central government. It went to the politically connected developers. It went to finance crony capitalism, corruption, bribes, and all of that. It did all these things, except enriching the rural Chinese. So how can you blame the rural Chinese for not spending money, and consuming cars and whatever, TV, that the Chinese economy produces?

So the earlier point that I made, that the fundamental problem in China is this growth model, which is using the power of the government to drive out the rural Chinese from the land they occupied, pay them very little for vacating their land, and then use that money, part of it for corruption, part of it for developing all these urban infrastructure. And lot of foreign executives admire Pudong, for example. They admire the skyscrapers in Beijing and Shanghai.

To put it directly and explicitly, Pudong was a basic theft. It was usurping the wealth that should have gone to the rural Chinese and use that to build up Pudong.

MARY KAY MAGISTAD: Part of Shanghai. It's east of the river.

(50:53): **YASHENG HUANG:** Yeah. So in my book, *Capitalism With Chinese Characteristics*, I have a chapter with the title "What's Wrong With Shanghai?" I identified this probably in 2008, before the financial crisis. In a concluding chapter. I expressed my hope that Hu Jintao and Wen Jiabao were going to learn a lesson from this, and then would respond to the slowdown of the global economic financial crisis by reforming the land system, by building the social protection for the rural Chinese, and by investing in rural China, by abolishing the hukou system.

They did none of that. Instead they went overdrive infrastructure, urban skyscraper building, and all of that. And that gave the 9-10 percent of the GDP growth from 2008 to roughly 2012, creating definitely the urban wealth, creating the wealth that went to the government officials and the connected private capital, and then created this kind of superficial urban boom, and a lot of debt.

So now fast forward to 2024, the Chinese economy is operating under all these burdens that were created by that policy. So the hope that I expressed in the concluding chapter of that book, didn't turn into reality. Exactly the opposite happened since then.

MARY KAY MAGISTAD: So what now?

(52:40): **YASHENG HUANG:** What now is two things, at least two things. One is that you just have to bite the bullet, and acknowledge that the model that you operated on is a huge mistake, and then bite the bullet in a sense that you just have to put up with low GDP growth rate. The moment that I see that they go back to the old model that can increase the GDP growth a little bit, that will be the moment I'll be more alarmed than relieved.

A lot of the economists are saying, "oh, you should rescue the property sector, and you should loosen the monetary policy." And that will be precisely the wrong thing to do, because that's going to continue with that model. I just think that there's no – you can't get away with the mistakes that you have made. The sooner you acknowledge these mistakes, the better, right? So that's one.

And the other is that, really undertake deep, meaningful reforms. In fact, in 2024, the kind of reforms they need to undertake should be more substantial than the ones in 2008, because in the last 10 years, the leadership has made additional mistakes on top of the ones that were created before.

MARY KAY MAGISTAD: What's at the top of your list for the additional mistakes?

YASHENG HUANG: Crackdown on the private sector will be pretty high on that list. The COVID controls that basically destroy the confidence of the Chinese urban population – the middle class, the professionals, foreign sector, right? So now we have exit of the capital, capital is flowing out undermining the confidence of the private investors and private sector and entrepreneurs, geopolitical tensions with the United States, with Europe, with Japan, with Taiwan, right? All these are new problems with the Chinese economy that were not there in 2008. In addition to the list of reforms that I described in the concluding chapter of my book, they need to correct these mistakes too.

(54:49): **MARY KAY MAGISTAD:** What you're talking about in terms of correcting mistakes also comes with giving up some centralized control.

YASHENG HUANG: Yeah.

MARY KAY MAGISTAD: What do you think the chances are, this administration is willing to do that?

(55:00): **YASHENG HUANG:** The chances are very low, yeah. So the chances are very low, but I think we got to be just conceptually get this right. The key to solve the economic problems in China today is both economic and political liberalization, rather than the opposite of that. So the chances of that are low, but let me be very clear about what direction they need to go. Because chances are low, so that's why I'm not optimistic about the near-term growth performance of the Chinese economy. They may artificially stimulate the real estate sector again, but that's going to be adding debt to a very high debt level, already 300 percent to the GDP. That's incredibly high, right? So that can get them maybe little bit higher GDP growth rate than they have had. But that's not solving the problem. That's just kicking the can down the down the road. There's no way, even if they do these artificial stimulations, there's no way you can go back to 8-9 percent as they did in 2008-2009. There's no way.

(56:18): **MARY KAY MAGISTAD:** So then what does that mean for China in the world, in terms of its ambition and what it's able to do?

YASHENG HUANG: Well so immediately, the implications for the world are that we are going to see a surge of Chinese exports. This growth model requires an outlet. If you don't enrich the Chinese, you need the rich foreigners to basically buy your products, right?

MARY KAY MAGISTAD: Your cheap stuff, basically.

(56:54): **YASHENG HUANG:** It's just pretty simple, right? Somebody has to buy this. So the idea that Chinese leaders have, they say, oh, "we're not going to support the welfare of the Chinese people. We don't want to create lazy work ethics. So let's not give income support to the Chinese people."

Okay. So if you don't do that, then you have to give income support to the lazy Americans, so then they can buy your products. Somebody has to buy your stuff. If the Chinese are not buying it, foreigners have to buy it.

(57:32): In terms of the subsidy, the way you subsidize the foreigners is that you use your exchange rate. If you have a undervalue exchange rate, that essentially is a subsidy you hand out to the foreigners. So this idea that somehow, we are stoic. We don't want to encourage excess welfarism and consumerism. That's just such a stupid idea. The choice, given that the model that they have, the choice is between domestic consumption and foreign consumption or some sort of combination of both.

In the ideal world, I would like to see a combination of them both, rather than, shipping all these products to flooding Europe, flooding the American markets. That's just not going to be terribly good. You're going to encounter protectionism, backlash and things like that. So I'm just amazed that the current leadership is still not thinking about this fundamental problem confronting (the) Chinese economy, which is the low-income position of the Chinese people. You need to address that.

(58:50): **MARY KAY MAGISTAD:** That's really ironic when it's a Communist government.

YASHENG HUANG: It's ironic in the ideological sense. It's not ironic in terms of operation and policy practice. The central planning has always been predatory and exploitative, especially predatory on the part of the population that has the least political power. Usually it's rural Chinese. In the Soviet Union, it was the rural Russians. In China under Mao, it was the peasants. During the Reform Era, the only time when the rural Chinese got the better half of the equation was in the 1980s. In the 1990s, they also began to suffer, but their suffering was relative to the urban Chinese. They were still gaining relative to the past.

During the first term of Hu Jintao and Wen Jiabao, the rural Chinese got a bit of the support from the government, and there were things that were improving. Then the 2008 financial crisis changed their policy direction completely. And many of the problems that we are seeing today were rooted in the way that the Chinese government responded to the 2008 financial crisis.

What is very interesting about that is that when the Chinese government did that in 2008, their policy response won widespread praise from Western economists. It is just amazing. And they thought it was visionary and proactive. And also they thought that their policy response was big, sizable. I'm not going say all of that was wrong, but a lot of it was built on sort of these short-term infrastructure spending at the expense of the income improvement of the average, especially rural Chinese.

(60:51): It's really interesting. If you read the books and articles by Western macroeconomists, they will compare what China did in 2008 to the FDR Administration.

MARY KAY MAGISTAD: Franklin Delano Roosevelt, in the '30s and '40s.

(61:11): **YASHENG HUANG:** That's right. It's a kind of Keynesian response. The similarity is so superficial. Yes, there was (a) macroeconomic Keynesian response under FDR, but they also reformed the system. The Social Security system was created. The social protection was strengthened. The labor rights were enhanced. So it was not just about spending more money. It was about improving the income position and income security of the American people. None of that was in the 2008 response by the Chinese government.

So what Roosevelt did was laying down the foundation for the prosperity of the American economy, not just in terms of responding to the war, but also laying down the foundation for American economic growth after the Second World War, right, when you have social protection, but also free market economy.

The Chinese government in 2008 solved the short-term GDP problem. But they lay down the foundation for all these problems down the road.

(62:32): **MARY KAY MAGISTAD:** One last question. To what extent does a more slowly growing China or one with very little growth at all become more politically unstable at home and more reckless abroad?

YASHENG HUANG: Yeah. So, about reckless abroad, I feel mildly optimistic that China is going to moderate their geopolitics rather than intensify their geopolitics. And I think evidence so far is more supportive of that view. You know, the Xi Jinping-Biden Summit, the two sides are now talking to each other, right? And they're trying to be nice to Americans now, superficially for sure, cosmetically for sure. But nevertheless, if you take these steps, it is much better than you take steps in the opposite direction.

MARY KAY MAGISTAD: But the idea that's been knocking around for as long as I've been covering China, since the mid-'90s is if the economy hits the skids, that'll be when China tries to take over Taiwan.

(63:35): **YASHENG HUANG:** I don't quite buy that. So we don't really have any sort of data and solid evidence, because we don't know what Xi Jinping thinks in his head. Nobody knows. But I think to the extent we have some evidence, so going back to the 1970s, after President Nixon visited China, that visit obviously led to a rapprochement between China and the United States. That was immediately followed by moderation of domestic politics, domestic policy practices.

And I believe that when U.S. and China manage their relationship well, it is unlikely China will be taking reckless geopolitical actions against Taiwan. So the key for the Taiwan Strait is a working, pragmatic relationship between China and the United States. And we do see the emergence of that, after a period of tensions and problems for sure. But I think we are beginning to see some restoration of normalcy. So I feel, good, I feel optimistic about that.

(64:57): But in terms of the domestic implications, I think that's more uncertain to be honest. The government there, spends a lot of money. So if they don't generate GDP, the kind of big programs that they have, how do they fund those programs? How do they pay the government employees? How do they pay the soldiers? How do they pay the police? And that's going to be, that imbalance between the income they get from rapid GDP growth, which is not coming in now, and the expenditure that they have on the other side, that imbalance is going to be more and more problematic.

And then you are going to see some rising unhappiness, dissatisfaction, and loss of the legitimacy of the Chinese government. Whether or not that translates into revolution and instability, nobody knows.

(Music)

(66:00): **MARY KAY MAGISTAD:** For a couple of decades, a question that has surfaced and resurfaced is – will China get old before it gets rich? That may now be happening. China has the world's second-largest economy, and the world's second-most millionaires, both, after the United States in the number one position. But China's per capita GDP is just one-sixth that of the United States. And China has considerable income disparity, both between rural and urban Chinese, and between the wealthiest and the poorest in general.

China's leaders claim to have eradicated extreme poverty in China. But they're using a per capita GDP poverty line that's half of what the World Bank says is appropriate for China's current status, as an upper-middle-income country. In fact, the World Bank's chief economist, Indermit Gill, did research before joining the Bank that suggested that China is almost as well off today as the United States was in 1960 when it became a high-income economy. Back then, the United States was setting its per capita GDP poverty line at almost 10 times what China is using now – and, as Yasheng Huang said, the United States had a stronger social safety net to help those who fell below that poverty line.

In a few ways, China's leaders have tried to have it both ways on several things: calling China a developing country, when it comes to how World Trade Organization regulations should apply to them, but saying they don't want to give hand-outs to Chinese who are barely making it. Acting like a global economic leader, which is now the top trading partner of most of the world's countries, and a top lender, through the Belt and Road Initiative, which China calls a win-win, but often charging market rates with short pay-back periods, so many BRI countries are now struggling to pay back those loans.

Whatever the contradictions abroad, China's years of growth masked its contradictions at home. It's harder now to dodge the need for structural reform, without paying a high price. A pressing question is which price Xi Jinping and his government are more willing to pay – making the reforms and losing some centralized control, or keeping tight control, and risking economic decline and all that comes with it, in terms of prosperity at home, and of China's place in the world.

(Music up)

That's it for this episode. Many thanks to Tao Wang and Yasheng Huang for sharing their insights.

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Thanks for listening. See you next time, on the first Tuesday of the month. Meanwhile – happy reading.

(Music out) ∎

Podcast image: A pedestrian crosses the Eastern 3rd Ring Road, Beijing (Mary Kay Magistad)

Mary Kay Magistad is deputy director of Asia Society's Center on US-China Relations. An award-winning journalist, she lived and reported in East Asia for more than two decades, including in China for NPR (1995-99) and PRI/BBC's The World (2003-13). She has created two critically acclaimed podcasts, *On China's New Silk Road* and *Whose Century Is It?* She is host and producer of the China Books podcast.