TRANSCRIPT

Event
Prospects for China’s Growth and Foreign Relations in an Era of Competition
Panel 1: Scenarios for Chinese Growth Over the Next Decade: Key Factors and Implications

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FEATURING
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Welcome back to the Second Annual Big Data China Conference. I’m Scott Kennedy, Trustee Chair in Chinese Business and Economics here at CSIS. And I am delighted to be moderating this first session of the conference, “Scenarios for Chinese Growth Over the Next Decade: Key Factors and Implications.” We have – really I couldn’t find three better people to talk about China’s economy, domestic and global, than the three experts we have with us today.

I’m going to introduce each of them, and then we’re going to have a conversation about China’s economy, where we see it, where we think it’s going, what are the implications for those of you in governments, institutional investors, multinationals? What lessons should you take away? And we’re going to do all of that in under an hour. If you go to the CSIS event page for this conference, you’ll see a way that you can submit questions online live. And we will integrate those questions into the conversation as we go along.

So let me first introduce this fantastic panel.

Bert Hofman is the director of the East Asian Institute at the National University of Singapore and professor in practice at NUS’ Lee Kuan Yew School of Public Policy. Before joining NUS, he was with the World Bank for 27 years, most of that time in Asia. And from 2014 to 2019 he served as country director for China. Bert has extensive experience in advising governments around the region on a wide range of development issues. He has published on fiscal policy, debt issues, and China in Indonesia’s recent economic history. And he joins us today from Jakarta, which means that he is working harder than any of us because it’s late in the evening there.

Zongyuan Zoe Liu is the Maurice R. Greenberg fellow for China studies at the Council on Foreign Relations. Her work focuses on international political economy, global financial markets, sovereign wealth funds, supply chains of critical minerals, development finance, emerging markets, energy and climate change policy, and East Asia-Middle East relations. She’s the author of two books, most recently “Sovereign Funds: How the Communist Party of China Finances its Global Ambitions,” which was published in June by Harvard University Press.

And Zhiguo He is currently the Fuji Bank and Heller professor of finance at the University of Chicago’s Booth School of Business. But in January 2024, Zhiguo will join Stanford as the James Ervin Miller professor of finance. Zhiguo’s research focuses primarily on financial institutions, macroeconomics, and financial markets. And he received his Ph.D. from the Kellogg School of Management at Northwestern, just
uptown from the University of Chicago where he joins us now. Got his master’s and bachelor’s from Tsinghua University in Beijing.

Thank all of you for joining us on this panel today.

So let me begin, and I’m going to start with Bert and then Zoe and then Zhiguo. If each of you would imagine that we are standing on the ground floor of Guomao Number Three, World Trade Center Building Number Three, Guomao, in Beijing, and we’re going to take an elevator to the top. So it’s not a 10-second elevator ride. It’s probably like a minute because Chinese – elevators in China go pretty fast.

But in that time that we’re on the elevator together you need to give me your overall headline description of where you think China’s economy is and where it’s going. So we will then pull from these headlines for the rest of the discussion.

So you don’t have to go into great detail right now but just give the most important takeaways of the things that you think are the most important features of China’s economy. Again, we’ll start with Bert, then Zoe, and then Zhiguo.

So, Bert, what’s your thought in this elevator ride that we’re on now?

Bert Hofman: All right. Well, first of all – well, first of all, thanks for having me. Then second, look, China is doing OK. China will meet its target for this year, around 5 percent growth. The IMF has said it’s going to be 5.4 (percent) so let’s stick with that.

But at the same time they have a lot of challenges. A pretty bumpy ride out of COVID. As we know, there was a long lockdown and then a sudden exit, which greatly affected, actually, consumer confidence and that is still with us as an issue.

Second, there’s a lot of policy uncertainty. If I look at the indicators based on the media in China there’s a lot of uncertainty about where is the policy heading and that undermines to some extent investment in China.

China has a lot of structural issues that yet need to be addressed – I know we’re going to talk about it – and I put it into four Ds. So they need to address issues of debt, of demographics, of decoupling, and of demand, and those are very big issues and it would require a big policy move to address each and every one of them.
Doesn’t have to be tomorrow. Some of them have to be tomorrow – the debt issue – but a lot of them are going to be structural issues that are going to be with China and that need to be addressed.

Thanks.

Dr. Kennedy: All right. Just in time we got to the top floor. We’re going back down. We’ve opened the doors. Zoe, welcome into the elevator. Give us your big takeaways on China’s economy.

Zongyuan Zoe Liu: Thank you, Scott, for having me, and I do agree with Bert in that I do think the Chinese economy in the short run is OK in the sense that meeting the growth target for 5 percent, 5.5 percent for this year is OK but I do think there are both immediate and the long-term challenges for the economy to recover and for the growth trajectory to continue sort of an upward trajectory. I think that is challenging.

And in terms of recovery issues, I think the deep-rooted structural problems in terms of the four Ds – that demographics, demand, and decoupling or de-risking – are absolutely there and many of these are – we can think about these as both chronic, structural, cyclical, but then the – a lot of this policy uncertainty domestically, the sudden reverse of policies such as not just zero COVID but also property market policies are not helping.

So the policy uncertainty is domestically and unabated. Geopolitical tensions also exacerbate a lot of these existing structural issues. And this leads to my final point, which is there is a huge confidence gap that is combined with a lack of policy implementation details. It makes a series of supporting policies’ lack of credibility and that is both in terms of shorter-term challenges in terms of economic recovery next year and then in the long run to what extent the government has the capacity to address the structural issues.

Dr. Kennedy: Terrific. All right. We’ve reached the top. Taking the elevator back down.

Zhiguo, welcome onto the elevator for this ride up. How do you see China’s economy?

Zhiguo He: I do like your analogy of the elevator. I was there 23 years ago. At that time only one, though. The two – number two is rising. I was working at the CSEC at that time.

And this brings me – my first point was China has been much worse situation. Although then I was just a student, didn’t know then much
about how this economy is working, but the situation at that time in 2001 was much worse. So that’s my first point.

Second point that I wanted to mention is, right now is – in my mind, it is a tough transition of the structural change. But people shouldn’t complain that, you know, China’s government lacking, like, you know, decisive move to change things. It’s an extremely tough job. And let me just give one example. Let’s say, you know, people complain that China is switching the position too much. I actually think that at this point that towards the real estate market sector, they are doing their job. They are standing on it, and they will not let it too loose, because that is the issue that they have to deal with anyway. It might not be the greatest timing, but once you started it, you cannot come back.

So in that sense, is that they are facing a really, really tough job. I don’t think even Alan Greenspan, or you know, whatever the big guys that are you know here, famous for dealing with economic issues that have a very like silver bullet to address the issue. So I will stop here.

Dr. Kennedy: Well, thank you, each of you. And, Zhiguo, I think your empathy that you’re showing towards Chinese leaders and the difficulty they say, it’s an interesting departure. But we’ll come back to that, because policymakers have to make policy and they have to make choices, so we’re going to dig into those.

Let’s turn to the – actually the topic that you addressed at the end of your remarks first, which is real estate. Everybody is familiar that China has had the biggest infrastructure development boom of the last quarter century, of ever. You know, the amount of concrete poured, just in Shanghai alone and then you add in all the other cities, how much that has been the importance of real estate to local governments and their finances. I think Evergrande is in the news just about every other day.

I think I guess the question for those watching and trying to really put this in context is, how did China get here? And is – how big a drag on growth is real estate going to be now, and what’s the way out? Zhiguo, since you brought it up most directly, why don’t we start with you? And then we’ll go to Zoe, and then Bert will bat clean up on this, because certainly as World Bank director in China, real estate was on his portfolio as well. So, Zhiguo, give us your sense of the real estate challenge.

Dr. He: Okay, the way you painted the picture, obviously, you know, I fully agree. And it’s going to be – you know, if I wanted to give you my own personal account, that will be a very long answer. Obviously, I can’t. So
just to get it to several points, you said how do you get there. I think it’s because of the easy way to make the economic growth and combined with the innovative, you could say the so called land fiscal policy that everybody knew, and the time that the policy leaders just couldn’t stop. So as usually that I would explain to my students saying that, you know, you need to think about whatever the policy coming out, you need to think about what – you cannot just read the words, but think about where they’re coming from and the background information.

I said the same thing when Xi Jinping said the housing is only for live, but not for flying or just, you know, walk, right, you know, just playing with that. And I was – in the sense that just you have – I thought that this is the China economic growth and somehow that the policymakers has to rely on it to feed the economic growth to the people. That’s – in some sense it’s not a good thing. Everybody was saying it. Even the foreign, you know, external media.

So all were saying, you know, China’s growth, economic growth, all this real estate is growing again and again and again. And I’m a little bit kind of interesting to observe exactly same people who always say this is a bad thing. Now Beijing take the opposite perspective, saying that we’re going to contain it. Then they will say: Look, look, look, I said this is bad.

Those type of issues, I feel like this is actually – I’m giving credit to the current government to deal with that. So that’s the first one.

The second point is about how do you really contain it? I believe that the current Beijing government was basically saying that: Let’s stop this. Give us 30 years. Now 30 years – 30 years to most people is really, really long. And imagine that they have 4 percent of growth and keep the – keep the price of the housing, it’s constant. Then there’s no problem at all.

Now, the question, obviously, it’s a big, big plan, and I don’t think the current leader or the policymakers are still alive at that time. That gets to whether China is able to achieve it or not. That’s what I’m saying.

Dr. Kennedy: Sure. Well, if it’s 30 years, Bert’s career at the World Bank was 27. So he wouldn’t have been there at the beginning or end. And 27 career – 27 years is a long time. Thirty years is the typical length of the American mortgage. So maybe that’s about right.

Zoe, how do you look at the real-estate challenge and ways out of this?
Dr. Liu: You know, I’m going to – I have two points. The first point would go back to a piece that I wrote about it almost a year – yeah, longer than a year ago. Last year, you remember when I first discussed that the Chinese economy is not necessarily going to have a fully – full-speed recovery, specifically because of the four Ds framework. At that time, I think I was running against a lot of optimistic analysts there. And one of the Ds is about debt. And not just the macro leverage, but really at the household level, and specifically for property market.

And, you know, we can take a really – we can take an optimistic view to see that – to sort of think about the Chinese household. Many Chinese economists, you know, argue – economists in China, you know, they make the argument to say that, oh, you know, actually, there are a lot of space for the Chinese household to increase leverage. But if you just look at to what extent the Chinese household has been attempting to do, they have actually been slowly, slowly de-levering. And we are also not unfamiliar with the scattered stories about mortgage strikes during COVID.

And this actually speaks to the longer-term problem with regard to China’s property market, which is the diminished demand going forward. And this diminished demand, part of the reason comes from a more longer-term-horizon challenge, which is demographics. The Chinese demographic, you know, slower growth of population as well, or negative growth of population, combined with lower family formation rate, basically means the demand for housing in China in the long term is going to be diminished. So that does not speak well for the housing market from the demand perspective.

And then, in terms of all the government has been trying to address the problem, I think actually the Chinese government has been trying to do this not just from the government policies in terms of trying to stabilize the property market and trying to allow or relax controls, who can or cannot buy houses now, and not just for new houses but also for used houses; I think the PBOC has been trying to prop up China’s housing market since the beginning of the year. If you take a look at what the Chinese – what the PBOC has been trying to do, they actually relaxed the mortgage rate floors and effectively – implemented a city-by-city, tier-by-tier mortgage rate, allowing locals to have more degrees of flexibility in terms of managing the rate.

So from that perspective, I think the government recognized the need to addressing the reality that Chinese housing market actually shares a lot of similarities with those in other countries, which is it is a tiered market. But then, again, this – ultimately, this goes back to the long-term problem, which is housing reform. We went through housing –
basically, you know, in the early – in the ’80s and ’90s, the kind of, like, gosu (ph), the sort of, like, common housing – your employment is going to support your housing – that era is gone. And to what extent now the government can use policies to adjust the demand, that is really a huge challenge. Specifically when, in the long run, demand is going to perhaps diminish trajectory.

Dr. Kennedy: Well, that’s very helpful. Bert, I want to get your take on this as well. One element not mentioned yet are local government finances. And I was wondering if you could bring into the conversation not just the real estate market and the participants in demand, but on the fiscal side as well and how you see that challenge.

Mr. Hofman: Right. So that’s exactly why I need to go back 30 years, because at that point, we had a reform which began the development of the socialist market economy. A part of that was a fiscal reform package, but there was one element missing – i.e., local government borrowing. Now, the local governments already had something called local government financing vehicles. In those days they were called urban development corporations, but it was the same thing. And the World Bank, indeed, financed the very first one in Shanghai. And it was a great way to leverage money, and a great way to build infrastructure. And China did. And China did very well. And very – if you want, very contained until 2008, when the global financial crisis happened.

Local governments were told to stimulate the economy. And they did. And they went in overdrive. And they didn’t stop. And by the time of sort of – by 2016-2017, everybody knew that there was too much of it. Local governments relied too much on this real estate, land sales, and then leveraging through the local government financing vehicles. And that that was risky. Everybody knew. And then by 2020, everybody said, OK, well, we need to sort of address it. COVID happened. And that postponed the whole issue. As a matter of fact, they were called – again, upon local governments, help out on the macro stimulus. And then by August 2020, after the decisive – the first decisive victory over COVID, the government said, OK, now we’re going to address it.

And that became the three line – the three red line policy, which basically squeezed bank financing for real estate development companies. They turned to other sources of financing, including bonds issued abroad but also prepayments of apartments. That dried up after the second wave, after Omicron happened. So it was, if you want, a policy that was in the right direction, but unfortunately timed. Now, we have a big mess, frankly. And there’s a lot of confidence issues.
We’ve heard some of the solutions. I think the government is sort of trickling in some money to get the real estate companies at least to finish the ongoing housing, which is important for consumer confidence. But second, as Zoe said, we have to realize that the real estate sector is never going to be as big again as before. It’s not as big as some said. It was not 30 percent of GDP. It was something like 12 percent of GDP. But clearly, it’s no longer going to be 12 percent of GDP. It’s going to be maybe two thirds of that.

But the underlying issue is a very fundamental one. It’s the fiscal system that is not fit for purpose anymore. It is really the local governments that had to rely on this land sale and therefore basically became their own real estate developers because they needed those revenues to create growth. They need a very different fiscal system, very different local revenues, either a bigger share from the central pie or own revenues at the local level to – and also to have a very different spending pattern, much more in the direction of service delivery rather than infrastructure, because a lot of it has been done already. That’s a very major change that has yet to be done.

Then the immediate issue on the books is still how to deal with debt. I think 30 years of debt workout is a very bad idea. I think you need to bite the bullet as soon as possible. What we’ll see is with 5 percent growth that’s a lot harder than with 10 percent growth. Last time it happened it was still 10 percent growth in 2000. Now growth is a lot lower. But what will happen is the financialization of the growth – i.e., banks would have to absorb it one way or another, then they don’t pay out as much on deposit for depositors, which would in turn have negative consequences for consumption. And then probably give less dividends to local and central government. So that’s how it will be dealt with.

I don’t see any financial crisis resulting from this, despite the fact that debt levels are very high but simply because the way China is organized and the relatively close capital account would prevent a financial crisis resulting from it. But it’s going to be quite painful to work out. And that’s the lesson from a Japan, is to do it faster rather than slower, in my view. And that would help also restore some of the confidence of consumers, as well as investors.

Thanks.

Dr. Kennedy: Well, super helpful comments. One word that we did not hear yet, but I it’s, I think, underlying, is property tax. Maybe we’ll come back to that in a little bit because it’s somewhat surprising for those of us watching China, all of these experiments with property taxes, the creating of a
registry of property, yet no going forward. And I suppose that would seem as, you know, a contractionary policy, which they don’t want to do – since timing matters, as Bert said – but at some point you’d think that this may be – may be necessary.

I want to shift gears now and I want to look at the other side of the equation, which is, yes, if growth is going to come off – is going to be less supported by real estate and infrastructure, it’s got to come from someplace else. In Washington, D.C., we love to swim in the idea of peak China now – that China has seen its better days, that there’s no way that growth is ever going to pick up. You might have seen the news that Moody’s downgraded China just slightly long term to A1 negative. That will just be eaten up in Washington. That’s already probably in everyone’s email inbox and their texts already. But that’s – but there’s other stories and news coming out of China. Caixin’s business index is positive that measures services. Also, as we just heard from Sean Stein in the keynote address, American companies need to be in China because there are a lot of excellent Chinese local companies, private companies, and we’ve heard about NIO and Geely and many others, which suggests that there are sources of potential growth and if you’re not in the China market you’re facing significant challenges as a result.

So for the three of you, what are the sources of Chinese growth going forward? Is it in tech companies? Is it someplace else? Is it in the countryside? Where should China be investing to support the upside of growth as opposed to just dealing with the mess? Why don’t we start with Zoe, then Bert, and then Zhiguo?

Dr. Liu: Yeah. Scott, you know, I do think that in the – I have a slightly contrarian view on this because I think China now, the electric vehicle market in China is sufficiently large enough so that China now not – is not only the largest car exporter, but also it has already built enough capacity that it can supply demand in Europe, in China, and in the United States. And if the Chinese economy went into a slower growth trajectory, I think the highly competitive nature of the Chinese domestic market is going to further drive down the price, and that does not bode well for trade relationship. And that basically means it’s going to exacerbate a lot of these geopolitical tensions, and that that is going to further cause a lot of problems for China’s growth, which basically means the confidence – international confidence – the tailwind that contributed to China’s growth is not necessarily there if this were to be materialized.

But that does not necessarily mean, you know, like – I guess the more optimistic side of the picture is that, yes, electric vehicles – or, for that
matter, clean energy transition – is – those factors are important for China, but those are – in this era in particular is more highly sensitive to geopolitical tensions. Therefore, I would bet my money in terms of – in terms of future growth or continual growth on sectors that are more resilient to geopolitical tensions.

And I sort of phrase that through three letters. One is C, with regard to the climate issue and sectors, and which – and then these areas where in particular U.S. and China can cooperate. And then secondly would be on food security. And then thirdly would be on retirement and aging.

Dr. Kennedy: OK. Terrific.

Bert, what are the drivers of growth that you see?

Mr. Hofman: Well, I’m a macroeconomist, so I don’t really know that. But, I mean, I concur with Zoe that in the short term what you actually have seen – you know, one reason why China’s still growing with more than 5 percent is because of manufacturing. There’s been a big shift of resources to manufacturing. And a lot of the credit that used to go to real estate is now going to manufacturing. And that’s pretty good for China. And that’s why they keep on growing. Zoe already mentioned the problem. Domestic demand is still not strong enough to carry that. And so surpluses are back up. And there is indeed tensions rising from the successful companies that China now has, and that are exporting electric vehicles and new energy, et cetera.

Look, the reality is that China is now at a point in time where almost every other country has actually grown more in services than in manufacturing. China’s at a – you know, they’re at a very high level of manufacturing given their level of income. But second, manufacturing will no longer create the jobs that it used to do. I mean, manufacturing is no longer these thousands and thousands of women at assembly lines making stuff. If you look at electric vehicles, there’s nobody there. It’s all robots. And so I think China will continue to grow much more in the direction of services rather than in manufacturing. Of course, manufacturing, by itself – because China is so big – even if it’s only 30 percent of the economy it will still have a major impact globally. And they would need to take care of these imbalances.

But stepping one step back, and I was only half-facetious saying I’m a macro economist, because about a year ago I gave a talk at Harvard on future growth prospects. And I came out saying, well, China can grow anywhere between sort of three and five and a half, if you look at the demographics, if you look at the savings and investment, and if you look at the possible productivity increases or total factor productivity.
Since then, in a way, nothing has changed. So the question is, would it still be three to five? I think people have become a lot more negative on sort of the total factor productivity. It has been low, but it has been low all around the world.

There’s a lot of thinking now that sort of the new model that China is pursuing, with more top-down guidance, with more state-guidance of industry, public or private, will not be as successful in creating the productivity increases that China needs to grow that fast. So I think that is a fair argument. I’m not saying that that is cast in stone, because China has always been very adaptable if things do not go right. But I would be a bit less optimistic on the upside – i.e., maybe it should be maximum five and maybe a bit more – more looking at the downside, the two to three that Larry Summers has always said is the reversal to the mean.

Now, 5 percent is still very high growth, because if you look at historical records on how much do countries grow after hitting China’s current per capita income, well, it’s only two countries in the world that beat the 5 percent in the decade after. And that is Singapore and Korea. So if you match the record of Singapore and Korea, you’re still doing very well. So something between 4 to 5 percent going forward, sounds – for the next decade – sounds reasonable.

Dr. Kennedy: Yes, that’s a super helpful comparison, of course, two small countries, where if they have an incremental boost in exports it is a significant change to their own GDP, but not to the global balance of trade, which gets to Zoe’s point about if China exports a lot of these things with reduced domestic demand what will that mean for trade relations.

Zhiguo, where do you see the most important drivers of growth coming for China in the future?

Dr. He: So, I’m half macro economist. (Laughs.) Let me put the directly to your question, which – I’ll also come back to the macro side. I went back to – a month ago, I went – a month ago I went back to Shenzhen, but, you know, another month I was in Shanghai. But so what was interesting was this EV car progress, which really, really beat my expectation. And, you know, if investors are here, you should just pay attention to it.

Now, I’m not saying that this is a – that this is the right time to invest. Obviously, this is a different question. But you are asking me about the economic growth engine. The EV car is the best example of a combination of China’s vision and also the expectation, as well as advantages. It’s not like extremely cutting edge, but it’s kind of like a service space that’s not really – (laughs) – you know, you think about
it's like chips or other things. It's not. So this is like putting all these things together, and also can boost the people's confidence. You can see that when you talk to people who are the taxi drivers who are driving these BYD electronic vehicles. They were, like, extremely positive about contributing to growth.

So on the – so this is the one positive side. The negative side, I have to say – and also when I mentioned the 30 year, it’s really – I believe this is what’s going on in Zhongnanhai. Beijing’s policymakers, they believe that they just need more time. As an economist, probably I would disagree. And I – more or less, I feel by what’s happening that – Bert mentioned that less – in time to time they have to address this fiscal issue. This is what they do. And from the macro perspective is that this China economic growth has to come from the service space.

I completely, completely agree with Bert that all other things is just – you know, you need random luck. But the service space, the consumption, this is really, really the thing that people should look at. Unfortunately, you know, in the past, right, the foreign investors, to be honest, it’s not think about welfare. This is exactly Zhongnanhai were thinking that, look, we need to do something about it. If they only look at this profitability, then you just go into the real estate. If they only look at the profitability, then they do all these other things. But in some sense, if you wanted to change the economic growth back from the real estate to consumption and service-based, then there’s a lot of painful steps to take. And this is what Zhongnanhai thinks that they need time.

The details implementations, unfortunately, I don’t think they’re listening to us. So this is the issue why we’re sitting here. And just to be honest, I’m not sure that they’re listening to us at this point. And hopefully, you know, with time, that I do know that they keep their ears open. That’s a fact that I do know. The question of how long getting there, this is something to be done.

Dr. Kennedy: Well, so I think actually there’s some consensus here about drivers of growth and challenges. So China’s got a problem with total-factor productivity. It needs to find a way to raise it. It needs to find industries that are unlikely to be subject to sudden shocks because of geopolitical risks where trade barriers or other types of restrictions come up suddenly as well.

So that points to improving human capital in China, to make people more capable and more productive so that, when they work, more value is generated more efficiently. And it also means focusing on industries where domestic demand is the primary source of support for those industries; sounds a lot like dual circulation. I don’t want to
say that for sure, but just to bring it up. You know, it’s not totally crazy when they’re thinking about those kinds of things.

So, all right, let’s switch gears now, as I just hinted, to talk about the policy environment, because I think people have been scratching their heads trying to wonder what Zhongnanhai is going to do. And it may be, as Zhiguo says, they just need more time.

I’ve come – you guys have come up with the four Ds. I’ve come up with the four don’ts. So trying to figure out why there’s not been a Third Plenum, why we’ve not seen more ambition out of Zhongnanhai lately. So the four don’ts.

The first is don’t know. They don’t know how bad the problem is. Maybe that’s one explanation.

The second is don’t have time. Maybe they know but they’re busy. They had the central financial work conference in October, all of these international meetings in November, central economic work conference in December. Maybe there was just no time for a Third Plenum.

Maybe it’s they don’t care. Maybe they have other higher priorities, such as security, or party politics, or things like that. And so they know, and they would have had time if they prioritized it, but just other things are more important. Or is it, as one of you just hinted, they don’t know what to do? There’s no consensus, they don’t have agreement on a plan, and so they’re stuck? All right, so don’t know, don’t have time, don’t care, or don’t know what to do – I want you all to pick your favorite don’ts. Or, if you’ve got a different don’t, a fifth don’t or something else, let us know.

Let’s start with Bert, and then Zhiguo, and then Zoe.

**Mr. Hofman:**

So well, I like your list but I still have a different one. Or maybe it is in the – in the don’t have time, because one of the trivial, but for the party, very important things that come along with a plenum is actually personnel decisions. And there’s still a number of important ones outstanding. And that may just hold up the whole policy package. That could be one. But, second, I do believe that there is not yet a consensus on the policies necessary. Or maybe some people know what is necessary, but they’re also very hard.

And one reason – one reason for actually doing a Third Plenum – but one reason is to actually creates some stability and regularity. And it would actually be helpful for confidence. Oh, yes, we have a Third
Plenum, and so there is an economic plan, and we know it. So I think it would be helpful. I don't think everybody would recognize it also in Zhongnanhai, so there must be another reason why it's not just happening.

One of these I've been arguing saying, there's no – you know, these are all very difficult reforms. The fiscal reforms, hukou reforms, dealing with this debt in the short and the medium run, dealing with a better allocation of capital. That sounds – in abstract sounds like a wonderful idea, but it does mean, you know, further state enterprise reforms. It's something that is not very popular politically. And a number of – a whole range of other things where you can say these are all difficult reforms.

And so to find the right package, to make a package is actually very important, because then there's a little bit in it for everybody and then, you know, the mayor of Shanghai can say, but I want this, and then the – you know, the government of Guizhou can say, oh, no, but I want this. And this is very important for our province. So I think those are the politics that go in there. And therefore, a policy package is very important.

But also – I mean, some of these issues are very important. You mentioned property tax. Frankly, I don't expect a property tax in any package, in part because that would be bad timing, because the property sector is right now a problem. But also, there are alternatives that would maybe fit – that will maybe fit the current bill better. I've argued, say, for a surcharge on the person – a local surcharge on the personal income tax, OK?

Just to mention a specific idea, it would match the common prosperity agenda much more. It would not affect real estate pricing, because it's not on real estate. But it would have more or less the same kind of function – i.e., sort of a membership fee for living in a particular municipality. So but talking that through and getting a consensus on just one of the many, many proposals that would go in there, that will require time and a considerable amount of expertise as well. So – and, yes, they've been busy. There's no question about it. This is still fairly recently after the exit from COVID, which was bumpy. So now we – now maybe, you know, I'm hopeful for January maybe.

Dr. Kennedy: Well, so it's a tough job to figure out what to do and make a package that's politically acceptable. I think if we go back 30 years, the strategy was, as Susan Shirk described, playing to the provinces, right? Is you put some discipline on the economy, but you also gave local
governments and provinces opportunities by having policy flexibilities and things like that.

Zoe, what’s the explanation for why we’ve not seen a Third Plenum or that big, giant package that Bert mentioned is needed?

Dr. Liu: For me, you know, I do take a note of the “don’ts” that you have. And I think I would want to add another don’t, which is I think we probably don’t have the capacity as a result of don’t necessarily having enough time. And they have tried – and, in addition to that, I mean, the Chinese government have implemented so many sort of micro, smaller stimulating packages, and yet the effect is not there yet. So perhaps they need more time to see what may or may not work. So that’s why I feel like right now – this is how I think about if I were in Zhongnanhai, this is the sort of situation I think I would be dealing with. I think many of us have played the game, which is, you know – like, I do not know how you describe it, but, you know, it’s like – the game would be there are so many holes and then there are – there would be – there would be some animals emerging from all these holes, one and another, and you only have one –

Dr. He: Whac-a-Mole?

Dr. Liu: Oh yes, there you go. Thank you, Zhiguo. So I think we are in that situation. So I’m extremely sympathetic in the sense that I do think that the problems are, compared with 30 years ago, I think Deng Xiaoping probably was having a relatively easier job compared with policymakers today. Dare I say that, because, you know, at that time when the growth – you know, policymaking was relatively less complex compared with the situation that we are dealing with today. So from that perspective, I do think it takes time to find the right package.

And I – actually, again, I might be the contrarian again. I do not think not having the Third Plenum, yes, there are definitely costs there in terms of people starting to ask questions, like why we don’t have – why we don’t have these expected plenum meeting at this time. But then, again, this is not the first time that the current administration broke a precedent. So then the flip side – the downside – the upside of not having that, is that perhaps it gives them more time so that they can find the more politically acceptable package.

But then I would want to conclude with my – the football fan side of me. Which is, I really – you know, my team is Seahawks. And I’d like to think that we never lose a game, it’s just that we run out of time.
Dr. Kennedy: Exactly. Exactly. Well, your comments remind me of another common saying that you hear in China, is now reform is in the deep end of the water, right? And so it’s harder than when water is shallower and there’s – and you’re feeling the stones by crossing, you know, the river. So, Zhiguo, what’s your sense of the policy environment?

Dr. He: So let me give you one personal account, that you probably remember. Ten years ago, 2013. I was there. And that was the most exciting Third Plenary happened in 50 years, probably, if everybody still remember. In that meeting, they actually gave, like, more than 10, and listed every single point that makes everybody excited. In the end, nothing is implemented. Nothing. The only one implemented was a joke from Professor Wang Yiping. He was telling me that exactly what was implemented was the reduced the burden of the students. You know, the private tutoring part. That was implemented, but nothing else.

Back to your question, I just see at this point that people always try – it seems like they try to look at the things and they try to see where it’s going, instead of real content of this Third Plenary. So everybody – I would believe that everybody would think that’s the case. So my – personally, I didn’t pay attention at all. I think – back to the “don’ts” part – I think that high level, as I said, they do not think that the current economic situation, let’s say, they can maintain 5 percent, and, you know, there’s no big smash. Even though the stock market go down another 1 percent of yesterday, they don’t think this is such a big deal.

The whole idea was basically that if you look at a 5 percent, and with better – a little bit of shifting of the structure, it’s better than every country in the world. Maybe not India, but India is slightly different. You have all these interfering other things. So when I talk to the top guys, even with these guys who have the proper economic training, they have this feeling it’s just that at 5 percent, you know, we should not compare to ourselves. We should have compared cross-sectionally, and also think about what we’re going to do in the 10 years or 15 years. Thirty years is too long. I’m always pushing them back, that they think about 10 years because 30 years is really too long. You should not think that way.

So in that way, is that – just that the policy arrangement is more or less that changed from the 30 years ago. And you might think that, OK, now what’s the biggest difference? To me, the biggest concern that they are facing is the people who knows how to do it. This is the biggest – the issue. And they try to brush it under the table only because the political environment so that, you know, you have to making sure that the people who get in the important position meet certain qualification
rather than, in the past, when Zhu Rongji was in charge, you can name all these people that – you know, everybody I was know, I know them, how do they think, is just really, really capable. Nowadays, I’m not saying that they’re not capable, but, obviously, the priority and also the thoughts are very different from the – at least the way that we think about it. So, to me, that’s the biggest issue.

And I will stop here.

Mr. Hofman: I’d like to follow up on Zhiguo.

Dr. Kennedy: Sure.

Mr. Hofman: Because I think that it’s – I mean, just – I was actually there 30 years ago, in 1993. I was also there 2014. I am a bit more optimistic about, Zhiguo, what actually happened there and what was implemented.

But irrespective, I’m a bit surprised that the politics still seems to play such a big role because the politics has simplified. Zhu Rongji had to battle with real hardline planner communist conservatives, had to deal with the aftermath of Tiananmen and the retrenchment after that. And yet, he went through and made things work, the very difficult reforms that was a bet on the future and, Scott, you mentioned earlier that gave the initiative to the province(s). But the provinces were not sure they were actually going to benefit because they knew what they had; they didn’t know what they were going to get. So there was a big – a really big struggle.

Now the politics seems to all be aligned. So maybe Zhiguo’s explanation that people don’t see the urgency and 5 percent is fine, that could be a reason for not having a plenum. And frankly, I think that would not – that would be short-term thinking, and I don’t expect the government to think only in the short term. But the politics seems to be more simple now than it was even in 2013 or 1993.

Dr. He: I would say it’s just basically too simple to make that people would like to say things that they actually think that’s truth. You know, I hope you understand what I’m saying. In the sense that, you know, there are certain qualifications that you need to meet to get to the important position, and as a result the so-called yes-men theory become more and more prevalent among that circle. And I knew a lot of people who were having the way that they would like to – it’s not save the economy, but actually – but basically is revive the economy in the right direction, I’m not sure they are willing to say that out loud. And as a result, that’s what I meant by the politics.
Dr. Liu: I guess, in other word(s), the consensus here is that a simplified politics or political process may not necessarily generate the desired consequence, or even it means there would be less-diverse options or initiatives.

Dr. Kennedy: Let me put it – let me see if I could put it this way, because I agree that 30 years ago things were not simple. China was just trying to decide should they have a market economy or not, and there were a lot of vested interests and ideological heartfelt reasons to oppose that massive shift, right? I mean, really. But I think even though maybe the politics are simpler or more – just more straightforwardly material now, some of the things that you all described as what needs to be done, to me, add up in a broader shift of who – of who's winning and who's losing, right? Because if you implement the things that you all said need to be done broadly speaking, that means that in general relatively it's going to be more challenging for state-owned enterprises, it's going to be more challenging for state-owned banks, it's going to be more challenging for those who have done relatively well in certain circumstances. And you're going to need to shift wealth and relative winning to households, to maybe rural Chinese, to others. And that is a big, big challenge to those who are in the driver's seat and to elites.

So, to me, that is just a big political economy power struggle that is not, even if you see what you need to do, to want to do it. And I think that’s one reason why the focus on high-tech is emphasized, because that's seen as a way potentially of avoiding those who were doing well from losing it going forward. But, anyway, these are – these are difficult problems, and so maybe it's a little bit of all the four don’ts. I don’t – I’m not sure, but I’m glad that this prompted a good debate.

Let’s shift to the end because we only have a few minutes left, which is the lessons for everybody else watching China. Again, sitting in Washington 7,000 miles away, talking to – where there's skepticism about whether China can ever find growth again; in New York, where you hear still the conversation about is China investable or not. I mean, Zoe, you’re up in New York often – you live there – so you hear that just walking out on the street perhaps. And you know, you hear people still saying, you know, China can’t get beyond this; there’s got to – at some point the bills will come due and they might suffer a crisis or something like that. What’s the advice that you give sort of the global investment community, and also about the levels of concern that they should have about China as well as the opportunities? And also, to governments that are watching China grapple with these things and considering potential a variety of kinds of de-risking approaches, on the national security front, as well as what you all hinted at possibly –
you know, if China has more overcapacity in EVs and other sectors, going back to feeling more pressures about traditional protectionism. So what is the takeaways here for investors, for governments watching China grapple with these challenges?

Bert, if we could start with you, then Zhiguo, and then – and have Zoe bat cleanup.

Mr. Hofman: OK. Look, I don’t want to deny any of those risk(s). I mean, clearly, for investors into China, things have become more risky due to domestic political risk and due to international risk. In the old days, you needed to invest in China, it was difficult and lots of third equations to be dealt with, lots of local governments, lots of stakeholders. But once you sorted it out, you could actually make money. Now it’s a bit more difficult because the domestic priorities have shifted and they might shift again in a rather unexpected manner. And there is a domestic – if you want, the dual-circulation agenda also implies that it’s better to have Chinese companies deliver something rather than foreign companies, even if they’re in China. So those are domestic political risks that didn’t use to be there.

Internationally, there are real risks, especially for American investors – especially for financial investors, frankly. I look at all this stuff that is – that is being cooked up in Congress. Very unlikely that most of that will actually make it into law, but the bills are pretty scary. And as an investor, take the federal employment pension fund that just announced that, well, we don’t want any China exposure – not because they don’t like China, because they think China is no longer sort of objectively investable; yes, it is. But they might be hit by some legislation or by some rule that makes it impossible for them to invest in China. That’s a very difficult risk to be dealt with.

We’re going to be doing some research on this particular topic, sort of asking companies on their strategies in light of political risk. Very, very interesting. You get a very diverse agenda, but the most extreme risk is for companies that – and we don’t ask American companies, by the way, but companies that have both American markets and Chinese markets, because they’re afraid that they might actually get hit on the American market if they continue to serve the Chinese market in particular circumstances. So these are real risk(s). But even with that – so that’s an investor risk.

What does that mean for China’s growth? Well, it does mean something. Nobody knows what it means, what this – what a(n) increased decoupling, increased de-risking would mean for China’s growth prospects. The extreme projections are pretty dire. The IMF
has made some projections. But even that you would say, well, it's still acceptable. Their extreme decoupling scenario would make China lose 6 percent of GDP over a decade. So that’s point .6 percent growth every year, if you want. That’s a very significant blow to growth. But it’s – but China would still grow. And I think we’ve already seen in light of the sanctions on semiconductors that China’s doubling down on indigenous innovation to avoid some of the risks that is coming from the international politics.

So for – the investable question is a different question from will China grow. I remain convinced that China still will continue to grow relatively rapidly. But will it be investable for, say, American investors is a much bigger question. Thanks.

Dr. Kennedy: Zhiguo.

Dr. He: Yep, investable. I guess at this point most people will say not investable, according to what we have learned, all the issues that you’re talking about. In the past, the legal system has not changed that much, right? Nothing changed. It’s just the way it has – the way it’s being done has changed. And people saw that things can be done in this way. Therefore, they just, you know, shy away from it.

In the short run, I would think that’s probably still the best strategy for the foreign investors to do. If you want, I think that, you know, there’s a word called “racetrack” in China, is that, you know, that Zhongnanhai will pick a certain racetrack that they would like to support. That’s broader view of industrial policy. And those things are still – you know, I would say that if I have money, I will put it in, just because the downside risk is low to be honest. The EV is one of them, It’s also the aging issue. And if you think about it, especially the aging issue, it is something like extremely consumer based. So whenever you get to the consumer base, I do not see very much of the conflict, all the things. And so in that sense, from the top policy perspective, you will say that I will just guess that people indeed should await. I mean, there's nothing to stop you to jump in first. And think about it. The aging issue is going to be long. So it doesn’t hurt to wait at all. But I do believe that there are many, many parts still that you could be thinking about investing without it triggering all this political de-risking, geopolitical issues.

Dr. Kennedy: Zoe, you get the last word.

Dr. Liu: Scott, this brings me back to the two iron laws that you were talking about earlier, which is the first one is China is big and it has a lot of domestic and regional variations. And the second would be China does not really move linearly, and in particular, under the current
administration. So just focusing on whether China is investable, I think it really depends upon two factors, right? One is the investors’ investment horizon. Then secondly would be risk tolerance, knowing that the risk tolerance really has – also means you have to be nimble in terms of adjusting to rapid change of domestic policies and regulatory environment.

So from that perspective, I do think that China is still investable, as long as your risk profile and investment horizon fit into this whole picture. But again, there are two important things. The first one is to protect the downside risk. And I think a lot of this de-risking, decoupling, a lot of these stories are focusing on ultimately protecting downside risk. But that cannot – for an international business, that cannot mean you should only focus on protecting downside risk by throwing the baby together with the bathwater without increasing the upside of return, which means you have to have exposure to the Chinese market for all the reasons that Bert and Zhiguo, you and Sean earlier mentioned. So from that perspective, I do think trying to find the right partner with China and trying to be nimble to navigate through domestic regulatory environment and identify the tracks – or Zhiguo was talking about it, the saidow (ph) – that are less geopolitically sensitive perhaps would be the strategy that I would go with.

Dr. Kennedy: I want to thank the three of you – Zoe, Zhiguo, and Bert – for taking this elevator ride with us and bringing everyone else along. This has been a fascinating discussion. And I think what it proves – and this isn’t meant to be a small point – is that China’s economy is still quite complex in the direction it’s going in. There’s no – we haven’t reached an endpoint where it’s obviously going to go in one direction or another, crisis or growth. There’s a lot of different avenues and pathways China could still follow. I think it would be nice for all of us watching if the Chinese leadership would hold a big plenum, tell us their plans, explain the challenges, and what they’re going to do. That would give us a lot of new food for thought so we could more easily evaluate the opportunities as well as the challenges.

You’ve done a great job, the three of you, identifying both the challenges, as well as the opportunities in China, but also for foreign businesses and governments watching. I want to encourage those who are watching today’s event to also go look at our Big Data China feature on the CSIS website. We have reports that we’ve published recently about China’s GDP growth numbers and alternative proxies, the AI sector, the China shock, human capital, and other features that dig further into the topics that we discussed right now. So I want to thank the three of you and all of you for watching.
We'll be back in about 10 minutes for the next panel on U.S.-China scholarly exchange, which will be moderated by Scott Rozelle and feature Molly Roberts of UC San Diego, Deb Seligsohn of Villanova, and Chenjian Li of Stanford. So don’t turn that dial. We’ll be right back. Thanks so much.

(END.)