“China at Home and Abroad: Opportunities and Fears - Big Data China 2022 Annual Conference”

Panel One – Economic Policy in Today’s China: Between Growth, Equity and Security

DATE
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FEATURING
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Mary Lovely
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Daniel Rosen
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MODERATOR
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We are very much looking forward to this next session. It's a panel on what are the implications for U.S.-China trade, and the likelihood of future U.S. export controls, and the possible retaliation measures from China, et cetera, on industrial policy that China is trying to or perhaps, you know, are going to be really, you know, looking at.

We're very fortunate today to have three – I think, three – not three of the best, the three best sort of people who can talk to this. and I'll introduce them in alphabetical order. I'm going to ask three questions of them. We'll go through that order. They'll respond. And then we'll have some back and forth with me and the audience. We'll get to China and with questions too.

First of all, Loren Brandt. I've known Loren for many, many years. He's the Noranda chair professor of economics at the University of Toronto, and a research fellow at the Institute for the Study of Labor in Bonn, Germany. He co-edited a recent book, "Policy, Regulation, and Innovation in China's Electricity and Telecom Industries." A book that now has lots of teeth in letting you understand what's happening. And then his very sort of seminal book, taking the analysis of China's unexpected economic boom for the first three decades, how it happens and where it's going. It's called "China's Great Economic Transformation." It was in 2008. His current research focuses on issues of industrial upgrading innovation in China, inequality dynamics, and economic growth and structural change – exactly what we're going to be talking about today. Thank you, Loren, for coming.

Second, Mary Lovely. She's the Anthony Solomon senior fellow in the Peterson Institute. She's also the Library of Congress chair in U.S.-China relations with Kluge Center of – at the Library of Congress. I've tried to get that right. I hope it's pronounced right, Mary. Professor Lovely is professor emeritus of economics at Syracuse University at Maxwell School of Citizenship and Public Affairs. Her current research projects investigate the effects of China's foreign direct investment policies on trade flows and entry mode, the relationship between proximity to export markets and cross-city wage variations, and finally the influence of Chinese tariff reductions on labor shares and values of its manufacturing industry. So how this whole industrial sector in China is evolving and then interacting with the world.

And then, finally, another long, long-time friend, Dan Rosen. Good to see you here, Dan. He's the cofounder – almost everybody knows this – of Rhodium Group and leads the firm's work on China. Mr. Rosen has worked professionally on China's domestic economy and global commercial relations since 1992. I think that's when I met him. He's senior associate at the Trustee Chair here at CSIS. And he's an adjunct associate professor at Columbia University. From 2000-2001, Dan was senior advisor for international economic policy at the White House, the White House's
National Economic Council, and the National Security Council. He’s a member of the Council on Foreign Relations, and a board member of the National Council of U.S.-China Relations. Dan knows his way around these institutes, will have a lot to say, and knows what we want to hear.

So let’s get started, everyone. I’m going to – I’m going to sort of lay out just in three short paragraphs the policies – the issues that we’re thinking about here. It’s sort of – the Chinese Communist Party has long noted in policy documents that the market and the private sector have been important or even leading drivers of China’s economic growth over the past 30 to 40 years. However, as we all know, in recent years it appears that China’s leaders have concluded that this expansive role of the market has also created some new risks. Evidence underpinning this, remember the stock market crash of 2015, the environmental degradation across the country, rising inequality, excessive sways for private technology firms, and the ballooning debt of the property sector, local governments, and elsewhere.

At the same time, Beijing appears to see an increasingly hostile external environment, and Ken talked a lot about that in his keynote address, that is perceived as also increasing risk. So risk from within and risk from without. The trade war with the U.S., Washington’s high-tech export controls, the formation of unfriendly economic blocs, and potential sanctions resembling those imposed on Russia might appear high on this list of external threats that are – that China perceives.

In response to this risky internal and external macroenvironment, the CCP appears to have placed a new emphasis on security, for sure, and perhaps – this is what I study – maybe equity in ways that reorient its private sector activity and create a larger role for the government in the economy. If this reorientation is real and does not change in the future, it would represent a real fundamental change with far and potentially, probably, absolutely far-reaching implications.

OK, so that’s sort of what we’re going to be trying to discuss here today. And I’m going to ask three questions. Then I’m going to go to Loren, I’m going to go to Mary, and then to Dan. And then you guys can fight about them a little, and I’ll follow up with a couple questions, and we’ll go from there. OK?

So three questions. Number one, do you think security and equity – OK, these new forces – have indeed eclipsed growth as the main objective of China’s economic policy? I’m going to taking notes on that. I think this is the fundamental question. And if yes, what are the implications in the near and medium-range future? Based on current environment, what sectors of China’s economy do you anticipate will be the most important drivers of growth in the near-to-medium term, if any?
So, Loren, why don’t you take it away? And Mary will be next, and then on to Dan.

Loren Brandt: OK. You know, as usual, these are three great questions to get us started. And perhaps, you know, I’m going to put on my kind of economic historian hat just a little bit. And I think really to look at these questions we have to put them into a little bit of perspective. And so let me take each of them in turn.

First, in regards to the security and equity eclipsing growth, you know, on the surface it kind of looks to be this way, but I’m going to argue that it’s really misleading. There’s always been tradeoffs. Take a look at the last three or four decades, there’s always been tradeoffs between economic growth and between these competing objectives of the state and the party that are tied to China’s political economy.

And so an important feature, you know, of China’s economy since the onset of reform has always been this kind of combination of dynamism, with an awful lot of inefficiency. And that I would argue that an awful lot of the inefficiency that we’ve seen in the Chinese economy through the ’80s and ’90s, all the way through today, is typically a consequence of all these distortionary policies that have been used to try to achieve all of these other kind of noneconomic objectives – be they strategic, security.

So if we thought about, you know, the ’80s and the ’90s, there we saw a massive redistribution from the nonstate to the state sector through the financial system that just about crashed the system. So here you can see this kind of competition again between growth and between supporting the state sector. By the late 1990s, these costs got so high, you know, in terms of overall, that we saw a downsizing of the state sector accompanied by fiscal as well as by financial recentralization.

These reforms were both good for growth, they basically put China again on a path that allowed it to grow relatively robustly for the next maybe 10 to 12 years. It also put an awful lot of more hands in the resources at the center to achieve all other kinds of objectives, including equity. How they used – decided to use those resources, on the other hand, is a totally separate matter. So first point that I’m going to make is that there’s always been these tensions. They’ve been there from the very beginning. We see them today.

Second question, well, what about the implications? Well, in order to kind of know what the implications are of these policies that we’re seeing, we really need to know where the Chinese economy is. And I would argue that the choices that China is facing today are much more difficult because of a deeper set of economic problems that they’re facing. These are problems
that they were facing before Covid. And so I’m just going to ignore Covid for right now. I’m going to forget – kind of ignore what’s been going on in 2020, ’21, and ’22.

But if we kind of ignore Covid for a moment, and we take a look at the Chinese economy basically from those few years before the financial crisis up to the beginning of Covid – so I’m looking at basically a 10- or 15-year period – what we will see over that 10-to-15-year period is a marked slowdown in economic growth. And so if I factor in what I believe kind of the overreporting in the national income accounts in terms of how rapidly the Chinese economy has been growing, I would say, again, that what we saw before the financial crisis to just before Covid, that we’ve seen an economy that’s – in terms of growth – it has declined from growing at maybe 8 percent per year to something that’s probably 4 percent or a little bit less, again, per year.

So in other words, that we got an economy before Covid that is growing about half the rate of what it was before the financial crisis. Moreover, the most important reason that we see the decline, again, in this growth, is because of the enormous drop that we see in productivity and in productivity growth. And so the calculations that I’ve done, calculations that others have done, you take a look at productivity growth before the financial crisis, it’s running there about 4 percent. It’s contributing at least half of the growth that we observe. Today when you take a look, or before Covid you take a look at productivity growth, it’s sitting there at less than 1 percent.

So a significant portion of the growth – the decline in growth that we happen to observe, again, over this period, is because of the decline in productivity growth. It lowered growth – the productivity growth lowered growth, but it also just kind of reduced a lot of the incentives for investment in the private sector. So what’s important is that this slowdown, it preceded Made in China 2025. It actually preceded, I would argue, Xi Jinping in 2012, and that, you know, there’s a good reason that today that we see all this added pressure on infrastructure investment and housing, two sectors with very low productivity, because they’re trying to sustain growth in the face of this decline in productivity.

Now, the sharp drop in productivity, from my perspective, is really puzzling. Go back before the financial crisis, this is an economy where per capita GDP, wages, are probably 20 to 25 percent of what they happen to be, again, in advanced countries. If you go ahead and you can take a look at productivity, eh, maybe 30 to 35 percent the levels that we happen to observe in advanced countries. What that tells us is that there was enormous potential for China to just simply leveraging, again, this gap between itself and between the rest of the world, in terms of continuing being able to grow at very respectable rates.
Over the same period that we also saw – we saw investments in human capital. We saw investments in infrastructure. We saw huge increases, again, in R&D expenditure. None of which, again, helped in that regard to try to kind of sustain the productivity growth and the growth more generally that we happened to see. Moreover, it’s also interesting to note that over this period of time that we happen to be talking about, the state sector, at least as we measure it from the perspective of the national income accounts, hasn’t gotten any bigger.

So what’s going on then? Well, I would argue that policy choices over a much longer period – so not just the last three years, not just since 2015. Policy choices over a much longer period are the reasons, again, why we see this significant growth in productivity and growth more generally. This is an economy that has become less, not more, open to FDI and competition in manufacturing and services. This is an economy that is focused on indigenous innovation. There’s more top-down science and technology policy that puts a premium on leapfrogging, moving into cutting edge, again, technologies, rather than the incremental kind of innovation at which Chinese entrepreneurs are super at.

There’s been limited regulatory reform in both the financial as well as in the ITC sector. Security and strategic considerations are going to enter in here, but I’m going to argue that what was driving this policy, this policy shift that we – I would argue, again, has relatively, again, kind of long roots, was this view that these kinds of policies that I’ve been describing – indigenous innovation, moving to cutting-edge technologies, being less not more open – were policies that they thought were necessary to sustain growth and avoid the middle income trap.

Perhaps the irony of this is that the policies that have been most likely to ensure the middle-income trap are the policies that they implemented to avoid the middle-income trap. And so kind of – Scott, then you’re kind of – so kind of short of major policy reversal, what I’m going to argue, this economy is going to continue to experience difficulty with kind of rising tensions of the sort you described.

Finally, last question, based on the current environment what sectors do you expect will be the most important drivers in the near to medium term? I think there’s two separate questions here that are really important. Which sectors will be prioritized and where the growth will come from. In this current environment, I can easily see China kind of doubling down on its current strategy, its investment in all the strategic and emerging sectors that we’ve, you know, been talking about – AI, biotech, semiconductors, supercomputing, additive manufacturing, new energy vehicles.
So all of that list that we see, if one takes a look, for example, at the most recent list that’s been compiled of the – kind of the key national labs, again, you can also see kind of where their technological – where their priorities are. But none of this, from my perspective, is going to help the productivity. None of it is going to help the growth anytime soon. And in this context, it’s important, again, to recognize that even in the United States that there’s some serious debates that are going on amongst economists about the effect that these kinds of technologies are going to have over the long run, in terms of generating kind of the productivity and the growth that we’ve seen, let’s just say in the United States, over a 100- or 125-year period.

So these are general-purpose technologies. Will they be effective in maintaining, sustaining productivity and growth kind of in the long run as those earlier general-purpose technologies – electricity, the internet? A lot of debate out there, and lots of people who know these things much more than I do, what I would say are on the – are pessimistic or not overly optimistic that these things are going to be overly successful. So in China, we have these choices that to begin with may not have fit perfectly, but there’s also again these real serious debates that are going on about how transformative these technologies are going to be.

So my own sense then is that we’re going to see kind of more top-down measures that only further reduce the growth prospects. And short of some kind of major set of policy changes of the sort that we saw in the mid-to-late 1990s, I just kind of see China just kind of muddling along.

Mr. Rozelle: Got it. Good. Thank you, Loren. Some of the great economic transformation just extending through today, and the problems and the successes that they’ve had. And, you know, will that be driving China from the middle-income level up anymore? And let’s see, I think, that’s the – that there’s some problems there.

Mary, why don’t you take over from Loren. And what’s your view on this?

Mary Lovely: OK. Thank you, Scott. It’s really a pleasure to be here. Maybe I’ve been a good student of Loren’s. I certainly have tried to read everything he writes. (Laughs.) But I agree with him. And just a couple of points to highlight. One, that Chinese growth has been slower than the headline numbers. And it’s been slower for some time. Second, that the policies that have retarded growth predate Xi. So they’re longer-standing responses to what China sees as its challenges. And lastly, that the policies largely reflect an anxiety about being caught in the middle-income trap.

I’m sure, Scott, you book didn’t make anyone in Beijing very happy, just in terms of thinking about how – you’re warning them how difficult it is to
escape the middle-income trap. I think this is something that has led them to believe that intervention is the way to go, and certain types of growth enhancing policies that would promote growth, promote competition, promote transformation really needed to be slowed down or diminished. I won’t say eliminated, because that’s too strong a word.

The prompt we were given was about security versus equality and other, I would say, more household friendly approach. And I think it’s fair to say that the West has been waiting for a very long time for the shift from export or investment-led growth to consumption-led growth. And maybe we just should keep waiting. I don’t see this shift happening anytime soon. One reason why we thought it might be coming was because the costs of not shifting to consumption-led growth seemed to be growing over time. We’ve been predicting the fact that the export growth has to slow down, that investment – types of investment that they were pursuing in property development and in infrastructure had a low return.

And so, you know, throwing money – throwing good money in a hole just did not seem to be the way forward. And they would have to shift to meet the needs of a population whose expectations were rising. So we’ve been expecting this for a long time. The factors that would underly such a move seem to be pointing in the direction of it happening. And that, of course, would be necessary to offset what is likely to be a very hard political shift in moving resources away from local governments and into the hands of households – households making choices about the allocation of resources.

So this would require the central government, local governments, to take their hands off the wheel as to what – where investment would flow, and so what would be privileged in the economy and what wouldn’t, as well as other dynamics in – that follow from a redistribution or a – redistribution or rebalancing of who controls the right or the power to choose what the economy makes. Households, we might expect, would also want to perhaps have a larger political voice. So there were a lot of issues in undertaking this transition.

Now we see that dynamic, I think, shifting. National security – investment in national security, I think, has only – the return to that in the view of the party has only increased. High-tech investment. Clearly, the U.S. has taken the gloves off in terms of starting to, you know, remove access to its high-tech products to China. Military investment will continue, perhaps even grow. And China will continue to pursue oversea alliances, something they had, I think, pulled back on, and perhaps may be accelerating again in the future. So there’s a lot of reasons for them to seek alliances, to try to be strong, and to try to double down on their indigenous investment – I’m sorry – indigenous innovation in the high-tech sector.
When we turn to the household sector, we see that they have the same needs that they always had – need for economic security, need for improvements in education, as in Scott’s book, need for job creation with youth unemployment high. But again, this would require a shift in power. And local governments are already going to – are already strapped, coming out of Covid. And they’re going to be pushed to develop the indigenous investment strategy that the central government wants to see. So it’s hard to see how the household – the shifts to household empowerment will happen.

And so in my view, it seems that the forces that were making the pivot from investment-led growth to consumption-led growth difficult are now, if anything, even more difficult. So I – that leads me, from a slightly different position, to the same conclusion that Loren drew, which is that they have facing major policy changes but they’re likely to double down on the same strategies.

And lastly, just looking at the drivers of growth, we were asked about the drivers of growth. One would be a post-Covid consumption boom, like we saw in the U.S. It’s possible. We don’t know what the next three months hold for China. It’s actually a pretty scary time in a lot of ways. After we get through a surge, or whatever we have is coming – I hope there isn’t a surge, honestly – but whatever is coming in the next three months, households could respond. I have serious doubts about how large a boom that would be, given that the basic insecurities that they felt still exist.

And then last is whether they can double down on net exports as a source of growth. And I think that we’re seeing the problems that that will pose, including some of the things that Scott talked about in his preamble, such as attempts by the U.S., obviously, to route supply chains around China.

OK, I’ll leave it there and turn it over to Dan.

**Mr. Rozelle:** Great. Thanks, Mary. And, yeah, no, I think that those are two very complementary – and we get, like you said, Mary – get to where both of you think China is going. There is lots of – they’re going to use the same old tools that they used before, and that is there a lot of impetus for growth through there?

Dan, it’s hard to be number three behind these two guys, but I know you do a lot of work in similar areas, but also different. So, take it away. It’s your floor.

**Daniel Rosen:** Thank you, Scott. And it’s so great to be here with Loren and Mary to do this. Fantastic people and work.
So I’ll hunt around a little bit to see if I can come up with something additional to offer, because I very much agree with the analysis that we’ve heard so far. So let me first offer a prelude to addressing your three questions that has to do with your setup. The notion that the party sort of grew exasperated by the things that come along with the market, and thus had to look for some different directions, it’s kind of like blaming – saying we’re going to get rid of automobiles and public buses because they cause traffic accidents.

To blame environmental degradation, the 2015 stock market crash, and those other things on the market, that just doesn’t really seem fair. I mean, markets are a way of finding efficiency, and the best production possibility frontier, but they need to be regulated. They require modern government institutions to make them work effectively. They’re not in a jungle. We do have traffic lights, and all that kind of stuff.

And I think the problem – the problems China is encountering today, for example, the real estate catastrophe that they find themselves in, with this year’s reduction in property sales alone equaling 4 percent of Chinese GDP – there’s no way to fill that hole in. And it’s not the market that’s the problem. It was imprudent government behavior over the course of a decade since the global – the great financial crisis. So one statist intervention to have it both ways in 2010-11 has begotten the next problem, which shouldn’t be blamed on the markets.

To your thesis, Scott, that is what we’re seeing a preference for security and equity over efficiency, as reflected in the absence of total factor productivity, which Loren mentioned, indeed I don’t think so. I don’t think we can say that China has acquired greater security by turning away from basic market reform work that needed to be done over the past – over the Xi Jinping years, and in particular over the last five or six years.

And I agree with you, Scott. If you were not moderator – if you a panelist, you’d be pointing out that China has not acquired greater equity for its people, or a more common prosperity at all. In fact, the damage done to market mechanisms will be terribly regressive for the interests of the people. Unlike Japan in the ’90s, when it chose to go sideways in the name of political stability, shall we call it, China has 900 million people waiting in the wings for their turn, as you have taught us all and I can’t forget every day.

And so whatever explains the change in the political economy in the past couple years, it ain’t security and equity. It’s probably the elusive seduction of the idea of political stability. But as we’ve discovered, without growth there is no political stability. And if we just look over the past month, the limits of the sort of, you know, political pride and ego of Zero-Covid, hanging
into it too long because it’s what the leadership had attached itself to, gives rise to political instability, in fact.

And so that allows me to sort of speak to the implications part of my initial answer to you. Any country ultimately that puts political stability, right, which is the opposite of market dynamism – it’s trying to lock in market structures that exist today despite technology shocks and despite what markets are telling us about what’s worth winding down and what should get more investment, right? As long as you try to stand where the leadership is effectively standing today, and we just heard an hour or two ago that the Central Economic Work Conference has been postponed due to Covid, so it’s not going to take place on schedule this week, or next week, or what it would have been.

So policymaking is not being made. None of the problems are being addressed, right? And the implication of that will be enough slowdown in growth to force a reckoning that will inevitably and ultimately cause Beijing to turn back toward getting back on track with policies that will deliver efficiency and growth. So I think it ultimately will be self-correcting. Alas, almost a decade has been lost already, or at least half a decade.

To the final point, and then we’ll get to discussion, what sectors will provide the growth in the future? I’ll assume, for purposes of answering that, that this reckoning is permitted to take place. And so the question is, if China gets it right and stops clogging up its own arteries with over-attachment to elusive stability, then what could generate growth? Well, we’re over-invested to the tune of tens of trillions of dollars in property and other areas of heavy industry, but we’re underinvested to the same magnitude in human capital investments. The health care and rural health care and education, Scott, that you spent your entire life advocating for.

We have a whole new multitrillion dollar need to invest in environmental mitigation, climate mitigation. Seawalls to avoid Shanghai slipping under water, essentially, and becoming uninhabitable, and all sorts of other massive price tag things in the interior. And there’s lots of other sectors as well that can be part of a strong story, as Loren also pointed out. This is not a country that’s tapped out yet in terms of growth. Simple regression to the mean means that it’s not 8 percent anymore, but 4 percent or 3 percent on a $17, $18, $20 trillion base is the most exciting thing in the world – if they let that happen. But it’s not more property. And it’s not more local government-funded infrastructure with very low social returns. And let me stop there.

Mr. Rozelle: Yes. So the big reckoning, I think what Dan says, is that, you know, are they going to go back to this – to using the market to make decisions and get rid of, you know, the – what Dan calls the search for political stability
interventions into this market, and the emphasis on these sectors of the economy that have sort of tapped out. That's the reckoning. And I think the economists, at least Dan, was a little bit more optimistic than I hear most of the political scientists around. But let's see.

Open it up. Loren, do you want to talk about Mary or Dan, or Mary? Why don't we just go across the – do you have anything to add to that? And then I've got a couple questions for you. Then we're going to open it up for questions from the audience. Mute, unmute, Loren. (Laughs.)

Dr. Brandt: No, I think I'll hold off at this point. Lookit, I think that our perspectives, again, were kind of highly complementary in that regard. And so I'll just hold off again for the moment. I don't have too much more to add.

Mr. Rozelle: Mary.

Dr. Lovely: Yeah, I think it was absolutely fascinating. When we think about China since, you know, trying to stop clogging its own arteries, which I thought was just kind of a brilliant allusion, what kind it do to really revive the market economy? What have been its major missteps, and what could it stop doing, or what could it start doing? So a lot of us would point to the allocation of investment, financial intermediation, getting, you know, funds to the new sectors, the new players. I think that's probably at a lot of the top of our list.

But reviving productivity in the service sector is very important, given the share of GDP that services now recommend, and how they've largely – you know, the tremendous hit that they took during three years of Covid. Growing productivity in the public sector – in education, in government services, in higher education. These are problems that we struggle with in the West. So I would be very interested in what my, you know, fellow panelists think about key areas for China to target if they're going to do that.

Mr. Rozelle: Yeah. Dan?

Mr. Rosen: Well, just to riff off of that, which I like so much, I think what is needed is a guarantee with a down payment that government is going to do what government needs to do, which is ensure that parties in the market will get a fair hearing if there’s a disagreement about who owns what, and they need to go into court. Government will do what government needs to do, provide health care and education enough for China to get through its middle-income fork in the road right now.

What government oughtn’t do is figure out which firms, which industries should have which market share at which year in the future, relative to non-Chinese businesses, which ought to be part of the Chinese marketplace as
well. So if government does what it needs to do you’re not going to restore potential growth of, call it, 3 ½-4 percent, something like that. You’re not going to do that in the next two or three years.

But smart money, smart companies will crowd in or choose to stop what they’re about to do, which is leave China, as Terry Gou at Foxconn had to write to the general secretary personally and said, if you don’t – read my lips: If you don’t stop this Zero-Covid craziness, we’re leaving, full stop. And everybody else in my cluster of making consumer electronics will leave, right? So that can still be stopped. Whether that is stopped, and China arrests this erosion of credibility, that’s a $20 trillion decision.

And before we even get to making super smart choices at the margin about this kind of new electronic vehicle versus the battery segment, whatever, we just need to clarify whether China intends to do this rationally going forward, or according to some sort of political calculus, which market folks just aren’t going to get out of bed in the morning. They’re going to keep laying flat or they’re going to leave.

Dr. Brandt: So, Scott, let me just kind of add just, you know, two points there. I mean, these kinds of discussions, you know, that we’re having about kind of redefining what I’ll call the role of the state, the regulatory role of the state – you know, these are discussions that have been going on in China for a relatively long period of time. And I just kind of go back, and I look at the document that preceded Made in China 2025, you know, China 2030, you know, that was an awful – a lot of that, a focus of that, was on regulatory reform and the state. Redefining what the role of the state was.

Now, I think it recognized how important that regulatory reform was, because they saw that this day was coming. I mean, if you happen to have an economy where there’s a huge productivity gap with you in the West, there’s all kinds of – you know, all kinds of gains, just like of latent potential that’s happened to be sitting there, and you’ve got savings rates of 40 or 50 percent, what that implies is that you can direct, you know, half, you know, to really kind of dynamic sectors.

You have an enormous amount of resources that you can go ahead and that you can use to try to kind of smooth over, achieve all other kinds of political economy objectives. I think that’s one of the things that we forget, that this resource reallocation that we see – be it through the financial system or how the state happens to be influencing where capital happens to be going, this is achieving, again, all kinds of objectives. It’s achieving all kinds of political economy objectives in that – you know, in that regard.

And so this is just that tension that we see. And the market is itself – as economists we kind of believe in creative disruption. We know how messy it
is if we take a look at the set of firms today, you know, even in the United States or in the West, there’s very few, again, today that were there that were important 20 years ago, 30 years or 40 years ago. And again, in China it’s just kind of hard to imagine that similar kind of disruption, you know, occurring. We’ve seen new firms emerge, but they acquire, again, all kinds of power and interests as they go ahead and as they acquire size.

So we’re really talking about processes themselves, just even in the economies. It’s messy, but typically it has political implications as well. People’s political power rests, again, on these firms, on these groups. And so as you allow that creative disruption to go ahead it can have all kinds of implications for a political process, and I’m just not sure that this is a political system that’s ready to weather those kinds of consequences of that kind of disruption.

Mr. Rozelle: Good, good. I’m going to ask a couple questions. What I’d like to remind the audience is it’s time to ask these guys. And you’re going to have priorities here. on the YouTube screen there, there’s a button to ask questions live. And so it’s your chance to get at these guys.

And one of the questions I see that comes from them is one I’d like to direct right back at Loren, sort of on – push you just a little more on what you said, a little more specificity. So if China did try to sort of – sort of back off politically and let the market sort of dive in, what are the implications? Which types of domestic firms or in general domestic firms could really sort of lead with innovation, productivity, or competitiveness? What’s being sort of capped off there? I know you’ve talked about this both in general comments and just now. Is there any deeper down – what would you go tell, you know, Xi Jinping with your one-on-one meeting? Probably his economic advisors would be a better meeting to have. Just unmute yourself.

Dr. Brandt: Scott, my own sense is that there are lots of opportunities in lots of sectors, not only in manufacturing. Mary also highlighted services. I mean, services, again, is one of those sectors we don’t talk nearly as much about, and we don’t talk about it nearly as much because we can’t measure it. I mean, it’s a lot more difficult to measure, but clearly the kinds of gains that there are in terms of kind of – in terms of kind of reform in the – in the service sector, you know, that have been highlighted, and I think that maybe even Dan or Mary mentioned again a number of those in services, where there’s just all kinds of rooms, again, for improvement.

But my general sense is that, as I kind of take a look across industries, you know, one of the things that kind of sticks out to me is that when I kind of see what’s happened with productivity growth. And this is maybe just a little bit more kind of on the technical side. But when you take a look at where productivity growth has been coming from, you know, in China, a lot of it
came from new firms. These new firms that were entering, these barriers to
to entry were coming down. China’s just incredibly entrepreneurial. And I’m
just a big fan, you know, of Chinese entrepreneurs.

They were identifying opportunities. They were moving into them. They
were leveraging kind of the supply chains. They were leveraging, you know,
the foreign direct investment. They were leveraging everything. They
identified market opportunities and they moved, again, into those areas. So
these new firms were unbelievably important. What we’ve seen over the
course of the last 10 years, that the dynamism, the contribution that these
new firms are making, the kind of productivity growth, has just disappeared.
You know, they had been at one point better than what kind of all of those
existing firms are. Now that – when we see these new firms that are
entering, they’re no better than the rest.

So China has lost that source of dynamism and productivity growth. The
exact reasons for it, again, are not exactly clear. Is it because there are these
kind of one-time gains that they exhausted as they lowered these barriers, or
is there something much more systematic, again, that’s going on that makes
it extremely difficult for entrepreneurs to be able to go ahead and to enter,
again, a lot of these industries, again, where we see new opportunities
emerging?

The other important point when you look at kind of the productivity growth
is that one of the things that you do not observe is the best of the firms

getting bigger. If you take a look at a country like the United States, or
Europe, a lot of the productivity growth is coming because resources and
market share are being reallocated to those very, very good firms. That’s
probably the source in the United States of 50 to 60 percent of the
productivity growth. You look at it in the context of China, that’s just not
happening. That’s just not contributing. So there’s something there about
the nature of the market environment in certain sectors, again, that I’ve
looked at over time.

And I talk to these entrepreneurs. I say, well, lookit, you know, why don’t
you make these investments that are going to allow you to upgrade, move
again into kind of more demanding kinds of sectors. And what they say:
Hey, lookit, you know, these investments are huge. I’m really uncertain
about the market opportunity. I’m uncertain if I make all of these
investments if I’m going to, in some sense, be treated fairly by the market. So
there’s an awful lot of impediments that are kind of out there in terms of
how the market happens to work – it gets to a regulatory question – that,
again, are going to be in some sense kind of undermining the incentives that
lots of these entrepreneurs have to be willing to go ahead and to make huge,
huge investments.
Now, if you take a look at a sector like EVs, what I really like about EVs now is that this is a sector that unlike, you know, kind of the internal combustion engine auto sector, that was a sector that was unbelievably restricted in terms of who could enter. You know, if you were a multinational, you had to enter via JV. If you were a private-sector firm, good luck trying to get a license – at least, you know, up until recently. In terms of licensing agreements, very difficult, again, to kind of license technology.

What we observe in EV today – today is, you know, there's just – there's lots of firms, and that we see firms basically kind of in every kind of market segment. You know, we can see the high-end kind of, you know, EV manufacturers. We see it in Tesla. We see it in some of those Chinese companies. But what we've also seen emerge is some lower-end EV manufacturers in China that are finding market; that are providing, again, sources of demand for battery manufacturers, kind of – kind of medium-size battery manufacturers. This is exactly the kind of dynamic that we've seen in other contexts that ultimately contributes to a really dynamic, growing industry.

And so what I would say, that there's lots of opportunity out there but a lot of it has to do with this framework, the regulatory environment in which these firms happen to be, you know, operating. If you can figure out ways to go ahead and to reform that environment – (laughs) – I guarantee you that you'll see exactly the kinds of results that you're looking for.

Mr. Rozelle: Yeah. Yeah, I agree. I just know a story that I've had given to me about an investor who took a very – what he thought was a new technology that had lots of potential to the biggest companies in China to try to get them, and they basically said: We're laying flat these days. We do not think we should even move into these new sectors because there's so much uncertainty. It's exactly what you said. But there's that potential there, and I think that that was very good.

Mary, you can add onto that or there's a question about the implications for U.S.-China trade and likelihood of future export controls. Are there going to be retaliatory measures back from China? You know, is this going to sort of hold back this potential that Loren says – I think we all know is out there? What are your – some of your ideas on that?

Dr. Lovely: Well, let me just pick up on one of the last words that Loren used, which is uncertainty. The U.S. actions are adding more uncertainty to not only where Chinese firms should invest, but also our U.S. firms should invest. You know, we see firms reaching out to – you know, they're even reading the academics – (laughs) – trying to figure out: What is going on? Where is the U.S. government going to go next? What investments are safe? Am I – am I
secure operating in China? Am I secure exporting from China to other locations? Am I secure even importing from third countries that use imports – inputs from China? So I think we’ve seen government actions on both sides raise uncertainty for firms.

I think we know that the relationship has largely been on a downward trajectory. And despite the recent meeting between President Xi and President Biden in Bali, I don’t think we have any more, you know, certainty that that downward slide will be stopped. We know that there’s little political will in the U.S. to adjust the trade war tariffs, unfortunately. There’s certainly more national security-minded export controls coming down the pike in the U.S. The U.S. is really beginning to pick up speed and focus attention on the Indo-Pacific Economic Framework, and with that comes a lot of jawboning and perhaps investment – some investment leveraging by the U.S. to move supply chains away from China. So we have the treasury secretary, Janet Yellen, for example going to India, talking about the U.S. loan guarantees for solar – new loans for solar – and then, of course, talking a lot about friendshoring. And I think the Indians have clearly gotten the message.

So, you know, so far we don’t really see what it means when President Biden says we’re not seeking decoupling. On the Chinese side, of course, we haven’t had much help in terms of making the case that they’re moving away from things that the U.S. objects to.

So we’re continuing to see, I think, a lot of – Loren said that a lot of the seeds for what’s happening now were planted right after the global financial crisis. That goes back a long way. I think we’re seeing a lot of seeds that came out of Chinese industrial policy. For example, we know that in solar China was rapidly gaining market share at a time when it basically was doing no domestic installations, which makes this industrial policy basically an export subsidy. And the U.S. did not respond, and we’re still mad about it, and so now we’re doing industrial policy on a whole bunch of things. So I think we see the seeds of this planted a long time ago, and it does not seem to me that in terms of U.S.-China relations that we have hit the bottom yet.

Mr. Rozelle: Thank you, Mary. That’s very, very useful.

I have one more set of questions that comes from – I’m not going to say who. It’s a very – a person that you would all know. And I’ll ask Dan this, but the others can pipe in quick. We’re going to try to – try to wrap this up in the next five minutes or so.

But what are your views of two groups of people in China relevant to this future economic trajectory? Chinese technocrats in government, have they lost their influence? And Chinese economists, do they have any seat at the
policy table? Is anyone listening? Are they – can they be dragged in or are they there already and not listening? What do you think about that, Dan? Is that something you can talk to? Or – and final, final comments, and then we’ll wrap up.

Mr. Rosen:

I mean, none of the economists I know would like to be associated with the policy outcomes of the past five years or so. So they would probably say, yeah, no, I haven’t been able to get my memos read, I guess.

But look, I mean, there are technocrats, right? That’s the term we use for folks like Liu He, Lou Jiwei, many, many people over the years who – they passed our smell test for whether they could have a coherent, internally-consistent conversation about a policy package that would be fit to the observed evidence of performance and potential in the economy – in the Chinese economy. And their ideas ended up being reflected in policy, right, and giving rise to productivity and growth and things that we could measure and see that were proof that that stuff works.

And so we know they existed, for starters. There is a certain school of thought right now that they were always a sort of – an illusion, a set of ghosts stood up by the Ministry of State Security, right, and that we kidded ourselves into believing that that even was a part of the Chinese political economy and system. That’s not true. They were real. They are real.

And I love to point out – I love to argue that if we look at the Xi Jinping years, the first half of it was chock-a-block with efforts to take the next step in implementing marketization and reform work. Cleaning up the shadow banking system, center-local fiscal reform, lowering the capital account to allow Chinese firms to go global, starting to internationalize the renminbi, ultimately even years later the redlines in property, these were all, you know, constructed out of a clear diagnosis of what the nature of the economic problem was. And we – and this was 2012 through 2016. Introducing independent boards of director participation at state-owned enterprises to improve governance outcomes, right; the 2013 60 decisions that Xi Jinping and Liu He, you know, introduced at the very beginning; all those things had the right stuff.

And we know that it wasn’t just smoke and mirrors because they tried to implement all those things. But we also know that by 2016 or so all of them had shown that they would cause so much political rattling and instability that it was going to be very uncomfortable to follow through and finish the job. And in all of those areas, they pulled back once they realized how destabilizing these policies to push through the middle-income level were going to be.
So it’s still in the mix. Every now and then over the past – and then beyond that point, beyond 2016, the central tendency is to go out and try to find some magic third way that would avoid any political instability while still getting Loren his productivity back. And guess what? I mean, the hard lesson for the rest of us in the 20th century was that you can’t have it both ways. You can’t both have the horse-and-buggy industry not annoyed at you and create a new internal combustion engine industry. (Laughs) Something’s got to give. There’s going to be losers. China 1978 to 2012 was willing to wrestle with the hard stuff of structural adjustment and losers. Lately, not willing to do so, too scared about the political risks entailed in trying to follow that course.

And so technocrats are there. If they are allowed the power and authority to implement these painful adjustment policies where not everybody wins, then they will, you know, be part of the solution. Right now, they certainly can’t come out of the shadows comfortably and play that role.

Mr. Rozelle:

Dan, Loren, Mary, we’re at time now. I think what I took away from this is that, you know, all three of the panelists have this sort of same idea that this isn’t, you know, a last-five-year rise out of the new administration, as we call it, but it’s part of the system that China put together that had lots – that created a lot of growth early. But you know, as it starts to mature as a big economy, there’s tradeoffs that have to be made and some of them are painful, that they don’t want – they don’t allow that pain to happen, you know, that – you know, to trade off – (laughs) – the horse and buggies for the internal combustion engine. I actually really – I see that everywhere and I think that it forms the basis of the problems that the panelists have sort of said China’s facing and that’s caused – put us where we are today.

Thank you guys very, very much. I think it was a great complement to Ken’s opening speech and it’s going to be the foundation for panel number two that’s coming up in five minutes. It says 12:30; it’s going to be 12:35. It’s on “Covid-19 Policy: Impacts and Exit Strategies.” And no one could have prepared for this session if – (laughs) – they prepared their speech two weeks ago. And I have six friends with Covid right now in China – (laughs) – in seven – in five different cities, so it’s a lot there.

We’re going to take a five-minute break. The next panel’s hosted by Ilaria Mazzocco, who runs Big Data China Program for us, administrates it along with Scott Kennedy. Thank you very much. We’ll see you guys all soon.

(END)