

SEEING CHINA CLEARLY

TAO WANG, MANAGING DIRECTOR, CHIEF CHINA Economist and Head of Asia Economic Research at UBS Investment Bank, is the author of the new book *Making Sense of the Chinese Economy*, distilling for non-economists her decades of experience analyzing the policies, ideals and realities of economic structure in China. • Wang was interviewed in New York at a recent Brunswick event by Partners Andy Browne and Seth Faison of the firm's China Hub. Browne won a Pulitzer Prize in 2007 as part of a team of reporters from *The Wall Street Journal* in Beijing. Faison is the former Shanghai Bureau Chief for *The New York Times*. • "I think it's fair to say that Tao has really had a significant influence on how the world thinks about China," Browne told the audience. "She has this way of making complex ideas understandable. She

is plugged in and knows how decisions in China get made. A whole generation of reporters in China, like Seth and me and others in this room, used to pick up a phone on deadline to call Tao, because we knew we were going to get a considered, measured view on the Chinese economy."

Tell us about you. Where did you grow up? How did you make your way to become an economist?

I grew up in Hunan, Changsha, in a period where every purchase needed a ration coupon [*liang piao*]. You needed *liang piao* to buy grain, to buy tofu, to buy eggs, to buy pork, to buy cloth for clothing. And certainly you needed a coupon to buy a bicycle, which was really a luxury. In the university where my father worked, there were only a few people who had bicycles. His bicycle was a treasured item.

TAO WANG, Chief China Economist for UBS Investment Bank, shares insights from her new book with Brunswick's **ANDY BROWNE** and **SETH FAISON**.



I grew up in that environment. I went to study economics in Beijing, in the mid-to-late '80s—the period of the great opening, of ideas, especially imported ideas. All kinds of things were debated.

I applied to graduate school in the US in a very old-fashioned way: I got a directory of US universities and thought, “New York, I’ve heard of. Boston, I’ve heard of.” I applied to universities there and asked them to send me an application. “By the way I don’t have money. Could you waive my application fee? And could you give me a scholarship?” NYU did. I was very grateful to them and studied here in the US. I found a job at the International Monetary Fund, learned a great deal there. And then I went to the private sector.

What were your goals in writing this book now?

I have been studying China basically for the last three decades and have been asked all kinds of questions. Some of the questions actually don’t change, especially in the last 15, 20 years. There’s always concern about China, that the economy’s going to blow up. So one motivation was to put my answers together. I wanted to bring more of a balanced view, because I feel that the narrative about China sometimes swings with the political wind.

In the early days, people would say, “China’s just growing because of cheap labor, exporting low levels of human rights.” Then people would say, “Oh. It’s demographic dividends,” or, “It’s WTO entry.” Or, “It’s not paying for technology.” In the last few years, there seems to be a sense that it’s state capitalism. So, I wanted to bring some context—how things have really come about. I think people sometimes use a narrative to simplify things a bit too much.

As you were doing the writing and the research for this book, what surprised you?

One thing I learned is how reform policies actually came about. Many things in China were done not because of a grand plan in the beginning—even important reforms. For example, the agricultural reform did not come from Deng Xiaoping or the World Bank. It came from a bunch of starved farmers in a village in Anhui. A couple of years later, the leadership said it was OK to do that. And then it spread to the rest of the country.

When I think about why China seems to defy the predictions of doom over and over, I think one reason is that policies and government administrations do respond to something that’s happening in the economy. They don’t always have a grand plan very far out. They seem to be always fighting the fire of

the moment. But when the fire comes, they do fight it and they always muddle through.

That's the positive side. On the negative side, those kind of solutions are always compromises, emergency solutions. They solve some problems, but they also create some distortions at the same time. Like the tax reform in the mid-'90s was widely considered a success, but that left a lot of problems that we're still dealing with today.

Can you talk more about the reforms sparked by farmers in Anhui? The impression in the West and much of the rest of the world was that Deng Xiaoping came to power in 1978 and he launched this different direction.

So there's a little village called Xiaogang in Anhui. Basically, Anhui was known when we were growing up as a very poor place where people could starve. At that time, basically, there were 18 farmers in a work unit, a little *danwei*, and the leaders decided to give the land to the farmers to plant whatever they decide. In 1978, they signed a contract. The lower-level leaders knew that if the upper level found out, they would be blamed. They put their political careers on the line.

That experiment produced a good harvest. People survived. It was a good outcome. That got reported and a few other places did the same thing. It was not until 1982 that the senior leadership decided to say it's OK to do that. Before that, there was serious debate: Is that capitalism? Is that allowed? Is that not violating the ideology?

It was not a grand design by Deng Xiaoping. But what Deng Xiaoping did bring was to allow openness, allow the experiment, rather than sticking to ideology. He wanted to be pragmatic. The goal is what they call liberating productivity. And it got people to a better place.

You have said that you see in these different periods some recurring phenomena. Tell us more about the continuity.

I think the continuity is: What policies are responding to the most pressing issues of the time? That's the pragmatism I'm talking about. In the early '80s, late '70s, the problem was how to feed people. People were starving. The economy was at the brink. So how do we get people to be not so poor? The reforms in the '80s are about releasing productivity without touching the fundamental ownership structure. It starts with the farmers' reform—but that's the collective. It's not the state-owned enterprises—the SOEs are not really impacted. They allowed some

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SOEs a little more freedom of operating, but not others. And then reform kind of petered out around '89 or so.

It got kickstarted again with Deng Xiaoping's 1992 Southern Tour. He famously said that those who do not support reform should not be in power. He was not officially in power himself anymore at that point. But those remarks put some pressure on the leadership to move ahead.

The '90s reform was more fundamental in the sense that it was geared toward establishing a market system. There was a lot of debate. But the 14th Party Congress basically said, "We are going to establish a socialist market economy," which basically set this ideology. Can the market coexist with socialism? Basically, they said it can. It can flourish.

So they started to allow much more private ownership, reforming SOEs, establishing markets, commercial banks, the stock market and basically all the sort of nuts and bolts that a market economy should have. But as I said, some reforms also created some issues. They gave banks a lot more freedom to be commercial and so on. But accountability and responsibility weren't quite there. It led to rapid credit growth, a lot of bad debt, and so on.

That came into the late '90s. China had to restructure the banks, restructure SOEs, laid off a lot of people. And that brought up the issue that China did not have a social safety net, outside of the lifetime employment of the SOEs.

The late '90s was a very tough period of time. Millions and millions of people were without jobs. The government basically defaulted on their promise. Inequality increased a lot. To try to address that, they started building up a basic pension system, restructuring the banks and dealing with the SOEs—and start from there.

Now, people often say, "China is in a post-reform era—the last 10 years, there hasn't been any reform." And yes, if you think reform is about privatization, we haven't seen much of that in the last 10 years. The share of state-owned enterprises has not decreased. But if reform also includes some structural issues, like building the pension system, and unifying tax code, abolishing agriculture tax and so on, then that did happen.

We have also seen more regulations on the environment, more regulations on digital platforms, on the financial sector and so on. Is that anti-reform? I'm not so sure. Because there was actually a lack of regulations. It was kind of like the Wild West in China. Is that necessarily the exact right approach? It's highly debatable.



What's the outlook now?

I would say there has been some change. The ideological part, that element has increased. With the new government, and in the last 10 years with President Xi, there's definitely a more open embrace of state ownership, acknowledging that, yes, that's the bedrock of the system, and we're going to continue to keep it strong. We can make it more efficient, but we are not going to privatize it.

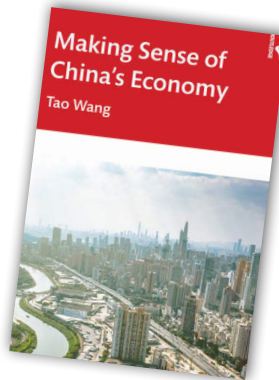
There's also an increased element of national security concerns. That's partly a kind of response to how the outside is viewing China as a threat and it's a headwind for China's growth. So there is this strengthening of party leadership and ideology, along with this desire to grow to become a modern, advanced economy, which probably means more public participation and more scrutiny from the public—there may be some tension there as well.

China faces an aging population. It's not yet a strict constraint for growth, because China is not lacking people. China still has high unemployment, high youth unemployment. And a lot of people are still looking for jobs. But I think over time that's going to be a headwind as well.

In terms of the outlook, the more pessimistic people would say, "China is turning more state-controlled. China is moving away from reform." I push back on all of those issues.

I think the government has definitely increased its role in some areas, in public services, in regulations and so on. But if I look at the share of the state ownership—yes, that did not decline in the last 10, 15 years, but it did not increase either. In terms of the tech restrictions and so on, there are headwinds. But China's level of productivity is still very low. China's per capita GDP is still less than 20% of the US level. China is not a developed country.

Economist and author Tao Wang at Brunswick's New York office, where she offered her view of China's economy.



ANDY BROWNE for 35 years was a China Editor and columnist for *The Wall Street Journal*.

SETH FAISON was Head of Communications at the Global Fund to Fight AIDS, Tuberculosis and Malaria and a former Shanghai Bureau Chief for *The New York Times*. They are both Partners in Brunswick's New York office.

Per capita GDP is less than 20% of the US? Wow.

Yes. It's still a relatively poor country. That means there is still a lot of room for China to apply mature technology to improve, to upgrade its industrial and services sectors. That could be using automation, using robotics, the transition toward greener development. China's economy is highly polluting and very energy and emission intensive. The move away from that requires a lot of upgrading and investment.

There's still a lot of potential for China to move up the value chain. On the one hand, there are headwinds. But on the other, there are forces still supporting decent growth—not as high as in the past decade, certainly not as high as the previous two decades. But still higher than most of developed countries, and higher than most of its large trading partners.

You point out in the book that the really big pieces of reform—*hukou* reform, reform of the taxation system, property taxes—have been very slow to kick in. China muddles through. On the other hand, there is a crunch coming.

China's domestic policy reform is also very hard to push through, despite the fact that it's a one-party state, because there are politics everywhere. There are strong conflicts of interest between different groups of people when it comes to who has to sacrifice. So *hukou* reform, for example, basically involves allowing the migrants, and the rural people to have better entitlements, benefits equal to the urban residents. That seems very good. But that means the existing urban population would have their benefits reduced.

Property tax should be implemented, but 90% of the people own homes and nobody wants to pay tax. So it's very hard to push through. Every step of the way, there are difficulties. In the next five to 10 years or longer, the biggest challenge for China is within.

With an aging population, you will have rising spending responsibilities on pension and health care. China's current system is not sustainable. Where will the government find revenues to fund that? It requires tax reform. It requires changes in the pension system, in the benefit structure. It requires a huge amount of political capital to push through even one of these reforms. But if you don't go through it, you could end up with a lot of social problems. I don't think that just because China has a different system from the West that these kinds of problems go away.

A leader needs to focus on certain priorities. You cannot do everything at the same time. So reform in China often has gone through the paths of the least resistance. ♦