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Transcript

CHINA IN THE WORLD PODCAST

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Guest: **Yukon Huang**

Episode 54: What is Going on With China's Economy?
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Haenle: You are listening to the Carnegie–Tsinghua China in the World podcast: a series of conversations with Chinese and international experts on China's foreign policy, international role, and China's relations with the world, brought to you from the Carnegie–Tsinghua Center for Global Policy located in Beijing, China. I'm Paul Haenle, the director of the Carnegie–Tsinghua Center, and I'll be your host.

Today, I'm delighted to be at the Carnegie Endowment for International Peace in Washington D.C. and speaking with my colleague Yukon Huang, senior associate in the Carnegie Asia Program, where his research focuses on China's economic development and its impact on Asia and the global economy. Previously, Yukon was the World Bank's country director for China and for Russia, he served as an advisor to the World Bank team that worked with the State Council in China to prepare the joint report "China 2023." Yukon is an A-list commentator for the *Financial Times* on China. He's also working on a new book to be published later this year, entitled "Why do views on China differ so much?" Yukon, thank you very much for being with us today.

Huang: Pleasure being here.

Haenle: So we're speaking today several weeks after China A-shares plummeted in early July. China's equity market is now at levels around 30 percent below the peak in June—early June, June 12. You talked a lot about government intervention at the beginning of the stock market going up, encouraging investors, but also after the fall. And after the fall of the stock market, many observers pointed to the 2013 Third Plenum document which, for the first time, said that the market would play the decisive role in allocating resources in China's economy. Yet the Third Plenum also stated that there would be a continued dominant role for the state sector, but that the decisive role would be the market. So what should we make of the language that we find in the Third Plenum document, and the government's heavy-handed intervention in the stock market? Is there a contradiction between rhetoric and reality?

Huang: For me, as an observer of the China scene, there seems to be a contradiction between the Third Plenum statement of the increased role of the market whilst at the same time saying the state should have a dominant presence. From a Chinese perspective, it doesn't necessarily seem like a contradiction, because you have to ask: what do they mean by "the market?" What they mean is prices of goods; energy should be freed up—that has been the case most recently in terms of energy prices—interest rates, exchange rates, capital flows, markets capital markets, should become more liberal and free—and they have been, actually, over the last several years. [With regards to] the equity market, what they tried to do actually was they said 'if we're going to make the equity market a stronger, a deeper market'—which actually was a reason for tension because it really wasn't playing a role, so in a sense they said 'let the market play a greater role,' even the equity bubble—the origins of it were grounded on the views of making the market stronger in the system.

Now, what about the concept [of] the state that plays the dominant role? What they're basically saying, of course, is the state ownership, for example, of key assets, raw materials, and the major state enterprises, is not going to change. So it's going to remain dominant. The role of the state in these markets is shaping policies and how you deal with it will remain dominant. So yes, you have this apparent kind of contradiction; yes, the market is going to be broader, deeper, more pervasive in the system, but the state's role in these markets or in shaping the outcome of the

markets is going to continue to be strong. Now of course, in the West we would not think that these two concepts are compatible: markets should be left by themselves, the state should not be intervening. But this is actually [the Chinese'] concept. The same goes for applying the rule of the law. From a Western perspective, they thought that the rule of law meant that this would actually provide a more neutral framework for everybody to operate, whereas it's actually a framework for the state, or the government, to actually control others rather than the reverse. So here I think [there has been] a bit of wishful thinking, and we've seen the reality now.

Haenle: Right. So, the Chinese government is eager for its market to be a global player. They want their financial system to be on par with the world. Given the experience and the ability to regulate the capital markets over the past month, do you think there's any change in the leadership's thinking on this issue—about how ready China may be to oversee something like an opening of its capital account to the global capital market?

Huang: I'm sure there's a rethinking, or trying to understand what went wrong with the equity market. The objective of opening up the financial market, the capital markets, I think that remains serious, and the government will continue in this vein. This has very strong political support because the concept of a China rising or China playing a greater role includes China's financial system playing a greater role—internationalizing the RMB is a key objective. To internationalize the RMB, you also have to have an equity market that's linked to global equity markets. So I don't think that'll change, but what the lesson is, is how you implement these objectives need to be more carefully. The major issue they have to face is the following: it's the role of the government to regulate this market to make sure that it performs sensibly, or is it influenced the outcomes. And I think the lesson from this of course is that it's very dangerous for the state to try and influence the outcomes. It needs to actually provide proper regulations.

Now, regulating markets is not easy. Even in the West, you can see what happened in Europe and the United States: the strongest and deepest financial systems still had instability and problems. So, it's not a task that can be handled fairly easily, and now we see a similar kind of example of a different nature in China. So I think the debate is going to be not on the objective of what they want to do. The debate's going to be [about how] to implement this better, and how do we create institutions that can make it work better? And the answer is, this is not easy. This is going to take more time. I think the implementation, therefore, will slow down, because you cannot create the kind of rules and regulations and institutions to make this work that quickly.

Haenle: Thank you very much. That's it for this edition of the Carnegie–Tsinghua China in the World podcast. If you'd like to read Yukon's new paper on China debt, you can find this one and other articles on the Carnegie website at www.ceip.org. I encourage you to visit and see all the work of our scholars at the Carnegie–Tsinghua Center. Thanks for listening, and be sure to tune in next time.