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Transcript

CHINA IN THE WORLD PODCAST

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Episode 127: The U.S.-China Economic
Relationship: Engagement and Decoupling
January 31, 2019

Haenle: Welcome back to the China in the World podcast. This is our final episode in the special series commemorating the 5th anniversary of the China in the World podcast. As part of this special series, I have been interviewing five of China's most senior and influential scholars on the U.S.-China relationship. For those who have missed the first four episodes, I encourage you to go back and listen to those discussions with Professor Cui Liru, former president of CICIR (China Institutes of Contemporary International Relations), Wang Jisi, from Beijing University, Yan Xuetong from Tsinghua, and Shi Yinhong from Renmin University.

These scholars provided fascinating insights on the past 40 years of U.S.-China relations, the current state, as well as prospects for the future. For our 5th and final episode in the series, I am very fortunate to welcome Professor Yao Yang from Beijing University. Yao Yang serves as the director of the China Center for Economic Research and the Dean of the National School of Development, both at Beijing University. He's a member of the China Finance 40 Forum, a group of 40 of the most influential finance and economic experts in China. He's a prolific writer. He writes for leading magazines and newspapers, including the *Financial Times*. He's published well over 100 research papers and is the author of a number of books on institutional economics and economic development in China. After I arrived at Carnegie back in 2010, I asked my colleague Yukon Huang at Carnegie for a list of China's most important and impressive China economists and Yao Yang was the first name on that list, and that carries a lot of weight for me. That's a serious endorsement. Yao Yang, thank you for joining.

Yang: Thank you. Thank you.

Haenle: Thanks for joining the podcast.

The U.S. and China normalized relations 40 years ago this month, and if we can, let's start out by looking out over the past 40 years of that relationship in an effort to think about the next 40 years. In your view, what are the major lessons we should have taken away from the past 40 years of relations? How do they inform U.S. and China in their approach going forward?

Yang: Well, you know in regard to the last 40 years, I think we can divide it into two phases. One is the first 30 years. American policy toward China was supported by this belief that if we engage China, China would become more like us. So the engagement policy...

Haenle: More like us you mean more market economy, politically more open.

Yang: I think that's a very important belief that supported American engagement policy toward China, and if we look back into the history, I have to say that policy succeeded. China did move toward the market and became more open. With the last 10 years, this belief has been faltering in the U.S. If you ask most American elites, I don't think you would find many of them that still believe in that. So that actually changed a lot, the American attitudes toward China.

Haenle: The impact over the last ten years is different from how Americans looked at the U.S.-China relationship 40 years ago, in 1979 when Deng Xiaoping initiated the first phase of reform and opening up in China. He did that simultaneously while establishing formal diplomatic relations with the U.S. In fact, talking last week to one Chinese scholar, he said to me, “Who else would China be opening up to if not to the U.S. and its economy?” In your view, are China’s reform and opening up in U.S.-China relations still linked today? How has the reform and opening up impacted the bilateral relationship? How has the bilateral relationship impacted the economic reform? Put simply, would greater efforts by China to deepen and expand its reform be beneficial to the future development of U.S.-China relations?

Yang: Yes, definitely, but I want to go back to the history a little bit. Most people believe China began this Open Door Policy in 1979. I think that was wrong. Actually, China opened up after President Nixon’s visit to China.

Haenle: In early 1972.

Yang: Look at China’s policy. At that time, China began to open up. I still remember as a child my father and his colleagues used to use our classroom in elementary school in the evening after their work to do what? To study English. They began to study English.

Haenle: And this is in the early 1970s after Nixon’s visit.

Yang: Exactly, which means China began to open up. I’m not sure if there’s a link between this normalization of relations between the two countries and China’s opening up policy and reform. I think mostly it’s an accident. It is just a coincidence that China began to have reform. Over the last 40 years, as I said, Chinese society has changed quite a lot, and I believe that American engagement policy played quite a role in this progress. Today, many American friends tell me, “Oh, we want to delink with China.” Or at least partially.

Haenle: It’s this concept of decoupling.

Yang: Yes, decoupling.

Haenle: Economic relationship.

Yang: Yes. I’m not sure decoupling is a good idea. First of all, it is very difficult for two countries to decouple. We have so many changes on all fronts. Also decoupling probably is going to lead to a new Cold War, probably an economic Cold War. But that is still going to be really bad for the two countries who are going to waste a lot of resources on this wasteful competition. I think it is

not good news for the whole world: the two largest countries' economies are fighting each other and other countries have to select a side. That is detrimental for global growth and stability.

Haenle: Let me ask a little bit and then we can come back to this question of decoupling because it is an important point that you raise. I want to ask you about China's looking back at the past 40 years. China's rapid economic growth over that time period has been truly remarkable. One of the questions that I explored with the other four scholars I spoke to as part of this 5th anniversary series is related to an ongoing debate that is taking place in China over what has been the most important factor in achieving this rapid economic growth. Has it been the state-led aspect of China's economic model? Or has it been the private sector, the market reforms, the free market mechanisms that have been implemented in China? Where this debate ultimately comes out will necessarily impact the future trajectory of China's own economic evolution, so I wanted to get your perspective on that.

Yang: I have to say the government has played quite a critical role. I have a theory to explain China's political economy. I've coined the term "disinterested government." Disinterest in respect to the fights among interest groups in a society. The Chinese government's priority has been more or less neutral toward interests groups in the society, and because of that the government can choose quite selective policies to promote growth. For example, in the early days, the party started the four SEZs (special economic zones) which were really selective. I still remember as a young college student, I really hated SEZs because they enjoyed so many preferential policies from the central government. But because of that, China has been growing so fast because resources are allocated to the most productive sections of the society. It has been said, I have to say, if you talk about who are the main drivers for economic growth, I have to say the private sector. No doubt about it. Twenty years ago, we did a study about the role of the private sector in China, and we reached that conclusion. Today, I still have that conclusion. I think many people have been fooled by China's infrastructure buildup, but that was quite late. We have had two waves of infrastructure buildup. One was 20 years ago. Another one was the last ten years.

Haenle: But since the global financial crisis, there's been a second round.

Yang: Right, but in the first 20 years of reform and opening, infrastructure was really bad in China. Who played a critical role for growth? First, township village enterprises (TVEs). They were mostly privately run and, entering the 90s, most of the SOEs (state owned enterprises) were declining and being privatized. So the main driver definitely was private companies at that time. But even if you look at the last 20 years, except the last two years, the share of private companies was growing and the share of SOEs was declining. Only in the last two years did the SOE share begin to increase. I think we have to look at history to draw our conclusions.

Haenle: Let's talk about the current U.S.-China trade tensions. We will fast forward to the current state of the relationship. As an economist, how do you assess what is going on? What are the key

challenges that have led to this current high point in trade tensions between the U.S. and China? All focus now is on this 90 day period announced after Buenos Aires and what will happen on March 2nd in terms of an outcome. But how do you assess what the dynamics are? What are the challenges? How did we get to this point?

Yang: I have to say that China's foreign trade policy in the past was more or less based on mercantilist beliefs. We had a dual-track exchange rate regime. After that we had a fixed exchange rate regime. We subsidized export and restricted imports. All of those are part of a mercantilist approach. The United States tolerated China for a long time. That was because China's economy was relatively small and also because of the belief that "China would become like us." Over the last ten years, the American belief was basically gone and China's economy has become so big, and the shock to the United States and rest of the world has been so huge. Let me give just one number. Ten years ago, there were only 35 Chinese companies that were in the Fortune 500. Last year, 2018, there were 120. The United States had 126.

Haenle: China has four times as many than it did ten years ago.

Yang: Only in ten years' time. So that's the shock China sent through the whole world. I think China has to bear this in mind. And I also believe that was the root cause for this trade war. So, let's look at the prospect of a settlement. I'm optimistic about a settlement by March 2nd, but this agreement is going to be tentative. It's not going to be the final settlement. I think President Trump really wants an agreement. Although, his own party and also the Democrats probably don't want to have a rushed agreement with China. After March 2nd, we are probably going to have a peaceful several months, and then at the end of the year, we are going to see the tension rise again because the United States is going to enter this campaign year. Both parties are going to pick up the talk about China.

Haenle: And the tension will resurface. Let me reconcile what you just said, which I tend to agree with. I often say, for example, that the Trump administration is putting forward concerns about the mercantilist aspects of China's economy, and that it wants more fair and reciprocal trade arrangements and doesn't understand why markets that are open to China around the world are closed off to foreign competition here. There are also issues related to intellectual property protection, which are important for foreign companies, but also important for Chinese companies. And then China's use of industrial policies that distort the global economy.

These all make sense to me. But when we talk to Chinese leaders about these questions, what we hear is that the pressure from the Trump administration is more about Trump's short-term politics, where he's trying to get political victories, or it's about a strategic effort by the United States to block China's rise. Recently the narrative has been that this is about the U.S. trying to blame China for its own problems. Is this simply posturing and rhetoric? Or is there a belief that what the Trump administration is putting forward is related to those three?

Yang: I think for the mercantilist approach to trade, China has passed that stage. Trade is not that important as a component of China's future growth. And on the other hand, in order to increase China's people's welfare, we should open up our market.

Haenle: For China's own interest?

Yang: Yes. For China's own interest. So for that part, I think China should open up, lower tariffs, get rid of those restrictive policies on foreign goods. On the other hand, the Trump administration also wants to change China's domestic institutions and policies. I think on that...

Haenle: This is the perception in China that the Trump administration is trying to change China's system of government, the economic model and the political system included.

Yang: I would say the political system probably not included. But look at SOE policy. I'm not saying we should not talk about that, but that's more difficult than trade issues and also intellectual property rights issues. Those issues are quite clear. China should have change, and I believe that is good for China too. But SOE policies, even within China, we have a lot of debate. Worldwide there are a lot of debates. So now we're clear where we should draw the line. If I were asked to give a recommendation, I would say let's settle down intellectual property and trade issues first, then we can go on to talk about SOE policy, innovation policy, industrial policy. Those can be negotiated, but that's going to take probably a longer time for the two countries to reach agreement.

Haenle: That's my sense, when I talk to Chinese officials and Chinese experts, the things that I hear are some cautious optimism that a deal can be reached. China can buy more products. China and President Trump seems to be fixated on the trade deficit and China buying more products. This is more, I think, about President Trump than anything else. Most economists say the trade deficit is not the important trade statistic to look at and that buying additional products from the U.S. is more of a band-aid fix than a long term fix. I also hear Chinese officials and experts say we can do a lot in terms of market access, opening up markets in China, and making significant improvements in the area of intellectual property.

But then, in terms of the others, the SOEs, the subsidies, the more state-led aspect of China's system, it seems those are more difficult and will take a longer time to address. Is that your sense of where China is on this? And then my question would be: you are optimistic about an outcome on March 2nd. But the two questions I would ask are what is China willing to put forward in this context in the 90 day negotiations? Do you think that will be broad enough, deep enough, and fast enough in terms of pace to satisfy the needs of the Trump administration? And second, how can the Trump administration, when asked the question, which they will be asked, how is this deal

different than any other deal where China agreed to do things but then didn't follow through? How do they answer that question?

Yang: I'm optimistic about the March 2nd deal. I think that the deal is going to be about intellectual property rights, trade issues, and also market access issues. And then on the U.S. side, the U.S. is going to say, "Oh we're not going to raise the tariffs anymore, so we are going to stay at 10% tariffs." So that will be the deal I think.

Haenle: In addition to buying more products? Agricultural products, etc.

Yang: And then the hard question is your second question. I think the Democrats and Republicans alike will ask this question. How can we ensure that China opens its markets since China has been saying this for a long time? For that I would propose a kind of bilateral effort to do some third party assessment. The U.S. would appoint one think tank and the Chinese would appoint another think tank. Those two think tanks could join hands to act as a third party to do this assessment.

Haenle: Some sort of mechanism for enforcement and verification to make sure the agreement is actually implemented in concrete terms. I think that is quite a good recommendation. Yao Yang, I want to close our discussion here by talking about the future of the U.S.-China relationship. We are moving into what people described as a more competitive relationship, and as an economist thinking about the future framework and how we update and modernize the framework, what would be the key considerations to inform this new approach?

Yang: I think even with some agreements between the two countries, the U.S. is still going to restrict technology transfers from the U.S. to China. Huawei is a good case in point. So in the future, probably a partial decoupling is inevitable. Although I don't think that's a good idea.

Haenle: And you're talking specifically about technology?

Yang: Yes, I think that would be the partially decoupling side. Probably the U.S. is going to make a mistake on this because in the short run, yes, China probably will progress more slowly. But in the long run, China is going to get richer and richer, so it will increase tremendously its investments in technology. So in the future, probably China will have faster technological progress in the end. I don't know the consequences of this competition, but then probably the two countries are going to create two separate technological systems, and then that's going to be bad for the whole world.

Haenle: So the U.S.-China relationship looking forward, the key domain to look at is this competition between the technology spheres. And this is something that, to go back to something I said at the beginning, this is something Yukon Huang is looking very closely at as well. So to hear

that from the both of you, I think we need to pay attention. Professor Yao Yang, thank you so much for taking time today to talk to us on the China in the World podcast.

Yang: Thank you.