EconoFact Chats: Is China's Economic Miracle Coming to an End?
Adam Posen, Peterson Institute for International Economics
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I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
Perhaps the biggest economic story of the past half century is the transformation of the Chinese economy. Before the reforms initiated by Deng Xiaoping in the late 1970s, in the wake of the Cultural Revolution, China had an isolated economy, and the country was one of the poorest in the world. The changes over the past 45 years have made China a central player in the world economy. But in the last few years, during the COVID pandemic, the juggernaut has stalled. Of course, many economies suffered during the pandemic, but the downturn of the Chinese economy was especially large. Will the Chinese economy rebound? Adam Posen thinks not. As you can tell by the title of his article in the September-October 2023 issue of *Foreign Affairs*, 'The End of China's Economic Miracle.' I'm pleased to welcome Adam back to EconoFact Chats to discuss this article and the implications of slower Chinese economic growth for that country and for the rest of the world. Adam is the president of the Peterson Institute for International Economics, one of this country's premier think tanks. Adam, thanks for being a guest once again on EconoFact Chats.

Adam Posen
Thank you for having me back, Michael. You know I'm a big fan of EconoFact, and all you do.

Michael Klein
Well, I'm a big fan of the Peterson Institute as well, so we're in a mutual admiration society here. Let's start off by setting the stage. What was, in fact, Adam, the Chinese economic miracle over the past 45 years, and how did it come about?

Adam Posen
The Chinese Economic Miracle starts with, as you said in the intro, Deng Xiaoping taking over from Mao, taking over from the wreckage of the Cultural Revolution and the Great Leap Forward before that, and the closed, self-absorbed Chinese economy. And the miracle in economic and human terms is that hundreds of millions of Chinese human beings left poverty, and in a sustained way, and their incomes have grown, and so now that has had repercussions around the world. It's helped bring others out of poverty who traded with China or who benefited from Chinese production. It's changed the global order in terms of political power, which is not entirely necessarily a good thing, but is a reality. In the fields you and I work on in trade and in finance, it has scaled up enormously what's called supply chains, and the specialization across borders. It has scaled up the size of capital flows of savings leaving China to go elsewhere, so it's been transformative. To me, the key part of the miracle was that from Deng Xiaoping until roughly 2013, when Xi takes power, Deng and his successors and the other leaders of the

Chinese Communist Party largely kept their hands out of day-to-day economics. Yes, some people took bribes. Yes, you had to have some direction from the Communist Party, but for the most part, as my colleague Nicholas Lardy established in 'Markets Over Mao,' the growth boom was a private sector boom in China that lasted decades. The miracle was not just that, but that the Communist Party resisted the temptation to interfere, even though obviously they were interacting with people in a harsh way on political matters like Tiananmen Square, Uyghur Muslims, Hong Kong Democrats. My emphasis is on the economic behavior of the average Chinese person.

Michael Klein
So, that privatization was a huge change from the policies under Mao, and especially during the Cultural Revolution, right?

Adam Posen
Absolutely. It was transformation, and so when sometimes people compare it to Japan or Korea or other Asian so-called tigers, who grew very rapidly over decades, and those were also amazing, but they were coming off of not that level of poverty, not that level of disorder, and not having an autocratic government in the same sense. And it was very much an internationalization effort as well, and we know this, that Deng started with opening up various sectors of the Chinese economy to trade, but also to foreign direct investment in hopes of getting foreign technology, but also foreign business practices competition. And that this opening, of course, again, had spillovers on the rest of the world, I would argue mostly beneficial, far and away beneficial on net, but it was an extreme example of a country making a U-turn. Other large economies like Mexico and India at various times have turned around, have reversed anti-globalization policies and opened up, but none on the speed, on the size, and none, most importantly, on the sustained basis over decades that the People's Republic of China did after 1979.

Michael Klein
And as you mentioned, and as I mentioned in the introduction, it led to one of the largest increases in human economic welfare, probably in the history of humanity.

Adam Posen
Absolutely. I mean, if we say the industrial revolution brought people out of poverty in the, what is now considered the West and plus Japan, it's wonderful. But that took place over roughly 150 years and affected roughly 700 million people by the time we get to today's population, less as much less as it happened. In China's case, we're talking probably a billion out of 1.4 billion people over the span of four decades or less. It's just extraordinary.

Michael Klein
And part of that, of course, was because the industrial revolution started at a time when no countries were industrialized, but the Chinese revolution began when much of the rest of the world was industrialized and China was able to leap frog in a way because the technologies were there, the trading partners were there, the knowledge of how to organize an economy to be more efficient, that was there as well.

Adam Posen
There was a lot to learn, and there's a lot to benefit from, which goes to the point that, as I know you believe and I believe, that globalization for the most part is win-win, that other people's wealth and knowledge, it isn't stolen, it is a positive spillover, it reinforces and helps everyone. But it is also important to recognize that it wasn't just automatic, just that the Chinese copied things. The Chinese economy did, of course, just as the US copied things from Britain in the early 19^{th} century, but that there were millions of daily decisions by the party, but also by individual business people, individual workers, to change their lives to improve; that were ultimately what made the difference.

Michael Klein
So let's switch from that miracle to something at least a bit more recent. The title of your article suggests that the rapid growth may have come to an end, and in fact, the last few years have seen the worst economic performance in China since its miracle began, but this actually predated the pandemic, right? It started in the mid-2010s.

Adam Posen
Yeah, and I think, Michael, it's important to sort out, as I know, EconoFact listeners do, what's sort of the medium-term trend growth rate of an economy, and then the ups and downs of the business cycle. Obviously, Chinese growth fell in 2008, and again in 2020, when global growth fell. So the issue is more about the trend, and we know that all economies, including China, over time, their growth rate slows down as they get closer to the frontier of technology, of urbanization, of high income, because they're simply the biggest leaps are taking people out of the rural informal economy into cities, the biggest leaps are providing them with capital and machinery and training, and then as most of your society has that, the gains tend to be smaller. What I'm arguing, and what I think is apparent in the data, is that on top of that long-term process, a set of policy decisions since Xi took power have made that worse. On top of any structural problems or long-term developments, essentially, Xi's starting in roughly 2013 when he takes office, and particularly after 2015, starts imposing a lot more restrictions on [inaudible], interventions into the private sector, and this is very different from just, you know, U.S. or European companies whining about over regulation. This is very intrusive policies, and in particular, I argue that they're having what is now called now 'economic long-COVID,' because when 2020-2021 hit, and China goes into lockdown after COVID, it is so draconian and so arbitrary in the way it gets enforced, that the average Chinese person ends up having in their face the interventions in a way that it hadn't been since now.

Michael Klein
So, I like that term that you coined, economic long COVID, but let's talk a little bit about acute COVID in China as well, or 'economic acute COVID.' Can you describe a little bit what the zero COVID response was, and how that had an incredible impact on the Chinese economy, even more so than what we saw with the shutdowns in Western economies or in Japan?

Adam Posen
Yeah, so, again, to be very clear, all of our economies, except possibly Sweden, did shutdowns to varying degrees in the face of the COVID pandemic, and, you know, some countries that were islands, like a Japan or New Zealand, shut down global travel, shut down some [inaudible] some

imports. So, what made the Chinese experience different was two-fold. First, the severity of the shutdowns, that it wasn't just like in the U.S., you weren't supposed to walk around too much, you had to wear a mask, you were encouraged not to go out if you didn't have to…you literally were imprisoned essentially in whatever place you were when the shutdown gets announced, be that your home or your place of work. And secondly, the arbitrary nature of it. So, it wasn't done on a national basis uniformly, it wasn't done with clear time marks. With the central government party approval, individual cities and regions would suddenly announce everybody from this street west is in lockdown, everybody from this street east is not, and this would affect millions of people at a time, and of course was enforced by police, party apparatchiks in a very terrible way. And there's a lot of journalists reporting on the kinds of shortages and disruptions and people out of work and people not getting access to prescription medications, fires. I mean, again, that wasn't everybody's experience in China, but everybody in China knew people like that, and everybody pretty much in China went through an extended period of at least a few months of that kind of total lockdown. And again, to bring it back to the economics, what of course we always talk about is government policies, how much uncertainty is involved with them. And this imposed a lot of uncertainty because party officials could change their mind about the duration or the geographic extent of these policies very quickly.

Michael Klein
And that's one of the things I found really interesting in your *Foreign Affairs* article. Other countries rebounded when they relaxed their restrictions, but China didn't. And you tie that into the uncertainty and the random quality of the COVID policy in China. Can you talk a little bit more about how that would affect people looking forward, and why it would make them reticent to undertake things that could help sustain the economic rebound?

Adam Posen
Thank you, Michael. I appreciate the references. I think it's important, as always, in economics, particularly macroeconomics, to ask against what baseline. So there's been a lot of chatter. There was a bunch of stuff published by investment banks and investors in the end of 2022, to early 2023, about how China was going to boom after COVID policy was ended in December 2022. And that didn't happen. And then there's been a bunch of people arguing about or asserting about the decline, the slow growth. What I've always tried to focus on is what you said, which is given a baseline that they had this horrible lockdown, that there should be pent-up demand that just like in the US, just like in Europe or Japan or most other countries, people didn't spend on travel, didn't spend on going out, didn't spend on various goods, didn't get to experience various services while they were scared and while they were at risk of lockdown. So in the US, and to a lesser degree, but a very clear degree in all these other countries, there is a decline in savings, a boom in consumption for a few quarters when it reopens. And what we see in China is at the end of 2022 or first quarter of 2023, there's a pretty anemic jump in travel of people literally going to see relatives or friends they hadn't seen, and almost no boom in consumption at all. And I want to note, this is before the overt problems in the real estate banking sector had kicked in. It wasn't due to that. So, I argue, as you mentioned, that it's about the decision making of normal average, however you want to call it, typical Chinese households and small business owners. And we see this in the data. They're more scared that the Chinese Communist Party, in my view, can arbitrarily take away their property rights or access to their livelihood, access to their work in a way that they knew in theory was possible, but wasn't in their face prior to this. And this was

reinforced by the way zero COVID ended, the zero COVID lockdown ended, that they initially the party leadership said, well, we're going to slowly end this over a few months. And then suddenly they announced, nope, it's all over. And they had a surge in the disease when they did that. So in macroeconomic terms, your average household, your average small business, I want to emphasize small business, which are run by families or individuals-they are more liquidity preference right now. We see this in the data, they're keeping more and more of their high savings in bank accounts and liquid assets. They are less purchases, both for small business and for households of durable goods like wash machines, cars, equipment. They are basically scared, I would argue, it's in the data, to leave things, leave their assets in money or tied up investments that are hard for them to turn it to cash that are easy for the party to lock down. And this will have persistent effects.

Michael Klein
Another thing that I found very interesting in your *Foreign Affairs* article was saying that China is following a pattern common among authoritarian countries. So the lessons that we're learning from what we observe in China can be applied to other countries as well. Can you talk a little bit about that, Adam?

Adam Posen
Thank you. There is an established, Michael, political economy of authoritarian countries. They're not all the same. But there is a general pattern, which we've seen in Turkey under Erdogan, initially in Venezuela under Chavez before it turns into late Chavez and Maduro, in Orban in Hungary, definitely in Putin in Russia, just to cite recent examples, where when a would-be autocrat gets into power, initially they are very pro business, usually big business, they're trying to make allies and friends and pass out favors. But they also adhere to what I term the ‘no politics, no problem' point of view. And this was very explicit, for example, in Putin's Russia. As long as you don't protest against the government or try to create party activity or civil society activity, I'll leave you alone in your private life. And this is not usually sustainable. As the autocrat gets into their second or third term in office, they can't resist anymore saying, I'm in charge, I want to direct the economy more than had been the case. And this is where I see Xi succumbing to a temptation which Deng and the other leaders of the Chinese Communist Party had resisted.

Michael Klein
And do you think that's also occurring not only because they want to sort of spread their reach, but because the policies themselves create more popular discontent, because they're adversely affecting the economies?

Adam Posen
Yeah, I want to stress that this is a longer term feedback loop. And again, it will vary from country to country. So for example, under Putin, before his barbaric invasion of Ukraine, oil prices were up, and the Russian Central Bank, and the people running the finance ministry were doing a pretty [inaudible] job of making sure there were plenty of assets to pay people's pensions. So it isn't always that immediately the economy falls apart. But what we do see and we're seeing now in China, I would argue, is a two-fold problem. The first is just growth slows down, always slows down, and people get upset. And the fact that they're more dependent on

party politicians or party officials to get access to good opportunities, weighs on them. But second, and I think more profoundly, you get a dynamic where, as we know, in macroeconomics, when a government undertakes stimulus policy, whether it's the central bank cutting interest rates or the central government cutting taxes or increasing public spending, part of the impact of that is on people's expectations…via people's expectations. And if people are not sure that the government is going to carry through on a policy, change the terms of policy, very arbitrarily move it, they're going to react less to that policy. They're going to discount it. And that, I would argue, is what we've seen in China for the last year, that they've undertaken a series of stimulus policies of various kinds, like targeted interest rate cuts to get people to buy autos and durable goods. And the reaction of the public, the general Chinese household, has been very weak. So I think that that's part of the dynamic. And then specifically with respect to Xi, I think there's an additional feedback loop that's been shown in the most recent data, that he already was leaning towards putting more credit and more investment into the state-owned enterprises. And as he gets frustrated that the private sector is not responding to stimulus, he puts in more money into the public sector companies, and that he hopes gets him a bigger bang for his buck on stimulus. But that, of course, reinforces the fears and uncertainties in the private sector.

Michael Klein
Adam, another dimension is also that these policies in their arbitrariness have spooked foreign investors as well, right? And so there's this dimension where not that China is de-linking from the world, but that foreign investors are much more concerned about putting investments in China that could be expropriated.

Adam Posen
Yes, I think that's important. And it's consistent with my argument. And it shows up in important ways, like we've seen the relative weakness of the yuan, the Chinese currency against the dollar. I mean, largely because of the Fed tightening and the Chinese not on monetary policy, but also supplemented by this. And there's a lot of anecdotal evidence about rich people and business people moving capital out of China into places like Singapore and elsewhere. That said, the biggest point is that this has productivity growth effects, trend growth effects. It's not about a currency crash like in Greece. There's no huge capital flight of that size. What is happening is you're getting–partly because of US China conflict, nothing to do with what I was describing – you're getting less reliable access of foreign companies into China in their ability or their belief that they can take home profits or take home goods. And again, that was all never entirely safe. It was always [inaudible] worrisome than the prospects for getting your profits home or securing your investment in China than it was in some other places. But I think it's gotten much worse and we see this in the data flows. And to go with something you and I have spoken about in the past, this is actually more important in some ways than trade. The interference with trade that we see with tariffs on both sides is not efficient, but trade sort of finds a way around. With this kind of investment flow shifts, then there's much more pressure on the Chinese economy.

Michael Klein
Adam, you stress in your *Foreign Affairs* article that we shouldn't be triumphalists about this, that weak China is not necessarily good for the world. Can you explain that?

Adam Posen
I'll try to explain it. I think going back to where we started, the story of China's economic growth was wonderful on its own human terms for the Chinese people, but it was also good for the world economy. It gave us in the familiar metaphor another engine on the airplane for growth. So sometimes when the U.S. was in trouble, like in 2008-09, Chinese growth continued. It gave us innovations and more efficient production and cheaper goods of various kinds that increased people's real incomes around the world, and that advanced technology. Even though some IPR, intellectual property, was stolen, a lot of it was generated by China, and a lot of it has been to the world's benefit. So there were a lot of good things, and a slower-growing China simply is not going to be producing as many of those good things, and a more volatile Chinese economy is going to have some spillovers on the rest of the world economy. Again, China, like the U.S., is largely a closed economy, and it's very big, and it's not in imminent collapse, but it's not something to be triumphalist about. I would just throw in as well, there is a discussion in the political science-international relations literature that the President Biden mentioned – some people feel there's evidence that when the economy is in trouble, particularly for an autocrat, they sometimes get more adventurous and more aggressive in foreign policy to distract from that. My understanding from political sciences is the evidence weakly supports that. It's not necessarily true, but it is worth considering that you have a China that has more problems, is possibly more willing to lash out or to be aggressive.

Michael Klein
Well, Adam, I commend your article in *Foreign Affairs* to all of our listeners. I enjoyed it and learned a lot from it, and I appreciate that you came on to the podcast today to talk about that article and share your insights with our listeners. So, thank you very much for joining me and all the best.

Adam Posen
Thank you, Michael, and thank you for continuing to make EconoFact a forum for these kinds of ideas. I really appreciate it.

Michael Klein
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