Virtual Event | Evergrande and the Chinese Economy

TRANSCRIPT

Discussion

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- John Lee, senior fellow, Hudson Institute; adjunct professor at the United States Studies Centre at University of Sydney; former senior national security adviser to the Australian Foreign Minister

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A video of the event is available: https://www.hudson.org/events/2025-virtual-event-evergrande-and-the-chinese-economy-102021

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John Lee:

Well good afternoon. Welcome to a virtual event by the Hudson Institute. My name is John Lee. I’m a non-resident senior fellow at Hudson, based in Sydney, Australia. Our guest is Leland Miller. Many of you who follow developments in China will already know about Leland. And you will have read some of his insights or thinking on the leading news channels. Leland is chief executive officer of China Beige Book International. If you don’t know about China Beige Book International, and you need accurate business intelligence on the Chinese economy, and I mean intelligence, not just information, then you really should get to know China Beige Book International. In my view, it’s one of the very best business intelligence firms in America.

Leland is an elected member of the National Committee on U.S. China Relations, an elected life member of the Council on Foreign Relations, and a non-resident senior fellow at the Atlantic Council. Now we are here to talk about Evergrande, what it means for the Chinese economy and the United States. Now almost all of you would have heard about Evergrande by now. It is China’s largest real estate developer, it has liabilities of around $300 billion USD, and it’s teetering and close to collapse. Now Leland, welcome and thank you for your time. Let’s first talk a little bit about Evergrande. My understanding is that the real estate sector in China is still highly fragmented, and Evergrande’s market share is only around 4% or 5%. Two framing questions. Why is the real estate so important to China’s economy, and why does it matter if Evergrande collapses?

Leland Miller:

Well thank you, John. I’m glad to return to Hudson and to talk about such an important subject. I think we’re on the cusp of something very big and very dramatic in China, among other things, a real paradigm shift in the way the Chinese economy grows, and the way that the Chinese economy is led by the leaders in Beijing. So I think that this is a really good opportunity to start with Evergrande and to move on to those issues.

In terms of property, property is not just another sector in China. There’s a closed capital account in China, which means that money cannot simply flow out. If Chinese households want to invest in U.S. assets, or European assets, they don’t have the options that the West does in terms of just going out and just investing and diversifying that way. So with a closed capital account, capital can’t leave China freely, and that means there are limited investment options in China.

So if you’re a household, and you’re trying to sock away some money for the future, you have options like going into equities, going into bonds. You can go into commodities. All these are speculative, of course. Or, you could put your money into the property sector. Not that individuals in other countries don’t get second homes and don’t see real estate as an investment asset, but it’s really something altogether different in China because one of the main ways where households save is by buying investment properties. And one reason for that is prices always go up. And we’ve seen that in the United States when that mindset is adopted too unthinkingly. Bad things happen.

Well, in China, property prices have gone up, and up, and up. And households have put in more and more of their savings. So right now, when you’re talking about Evergrande and you’re talking about property market distress, you’re talking about the economy, but you’re also talking about something that’s deeply personal to Chinese households and Chinese savers. So the stakes in this entire saga are much higher than if you’re talking about any other area of the economy. So it’s a really big deal right now not just for corporate China, and just from a macro perspective, but for everyday Chinese who have their savings in the property sector.
John Lee:
If I could just confirm something there, and this is certainly of interest to my country, Australia, where we still hold a lot of commodities, particularly iron ore to make steel to the Chinese. With the real estate sector, we're often told in Australia and the United States and elsewhere that the growth of the real estate sector in China is being driven by the mass urbanization in the country. Would you say that there's only one, and perhaps even less significant factor than is often played out? That property plays different roles rather than just one that's being driven by people moving from rural to city areas?

Leland Miller:
Right, well urbanization is obviously a driver. If more people are moving towards the bigger cities, then you need more houses. So there's certainly an aspect of that in the growth. But I think the biggest driver has simply been the tidal waves of credit that have been unleashed into the economy. And they have to go somewhere. Usually, when you're the average Chinese investor, and you're trying to figure out where to put your capital, and of course you're ring fenced from putting it to so many international options, and all these options abroad, which you normally might do.

You're reading for clues from the state media. "Where do I put this? Does the government favor stocks? Does the government favor commodities right now? Does the government favor property?" And so I think a lot of that has just followed suit. It's been an investment asset. And it's been a very big speculative investment. If you look at the way that Evergrande itself has run, and everyone involved in China and the Chinese property sector, investors in the bonds. They've known full well that Evergrande is essentially a Ponzi scheme, and has been for years.

I think the mistake has been thinking that the Ponzi scheme doesn't necessarily have to end because the Chinese leadership would never let it end. And I think you're seeing a change of mindset in Beijing on de-risking. And so what's happened right now is that these flows of credit, which have boosted the sector for so long, they're not there for it. And this is a real potential rupture for the sector.

Because if you look at Evergrande's model, a lot of their capital came from pre-sale. And pre-sales would be taking money from a family that wanted to buy a house and say, "Look, we don't have the house yet. But in 2024, 2025, we're going to take your money now, and in two, four years, whatever it might be, we're going to deliver you a house." Now, what was that capital used for? It was used for a lot of things, but not yet building those houses. It was used to pay back shadow loans that had been made with high coupons, sort of risky investments. It was made to build other people's houses that maybe invested in pre-sales two years before.

So essentially, this is just a model Ponzi scheme. And without a steady flow of credit, and an implicit backstop from the government, this thing couldn't last forever. And now we're at the point where the government's appetite for letting this continue has ended. And we're going to see the repercussions.

John Lee:
But does this Evergrande model, and I've heard it being described as three highs and one low. That is high debt, high leverage, high turnover, and low cost. Now, is that typical of the Chinese real estate sector, and if it is, are we likely to see other Evergrande, particularly in the real estate sector? Is Evergrande really just the tip of the iceberg, or the first big pin to fall?

Leland Miller:
Yeah, Evergrande is absolutely just the tip of the iceberg. One, it's one of the highest profile. And there's other companies that have the same type of problems on their balance sheets, maybe not as egregious as Evergrande, but still very, very bad. But also, the Evergrande implosion is going to have ripple effects
that are going to be problematic for these firms. So usually, if you are a property company, you had spent years and years thinking that no matter how bad things get, that property is too important to China’s economy, to Chinese households, and thus the Chinese leadership, that if you get in a pickle, the government will come in and backstop you. They'll bail you out.

And what I think everyone is learning right now is while the government will eventually ring fence the property sector to make sure that there's no broader contagion risk, that it is absolutely the government's intention right now to cause pain in the property sector in order to teach people a lesson. And there will be certain people who are bailed out, and the government steps in to help. If you're a construction worker who loses your job, if you're someone who innocently invested your savings in what you thought was an apartment that'd be delivered a few years from now, a lot of those people are going to be taken care of, or they're government will step in to help them out in some way shape or form.

If you're an investor in a 25% coupon that Evergrande was selling six months ago, and the government had been telling you time and time again, "Don't deal in wealth management products. Don't buy speculative assets from property firms," and you did it anyways, you're going to be in big trouble. And somewhere in the middle there are of course foreign bond holders who were waiting to see how things will resolve for them. So the government will step in at some point, but right now, it's a big question of who's going to take losses. And it's going to be many firms. It's not just going to be Evergrande.

**John Lee:**

Right. I mention the word contagion. And I know you would have read that many people are talking about Evergrande, or its potential collapse, as China's Lehmann Brothers moment. But I also know that you have written quite prominently that it won't be China's Lehmann Brothers moment. Why is that, given all of the things that you've just said?

**Leland Miller:**

Right, so Evergrande is quite important, but not because it's going to be China's Lehmann moment. It most certainly will not be. The point we try to hammer away on over and over is that China is a non-commercial financial system. Unlike the West, it has a toolkit that allows it to do things that the U.S. economic policymakers can't do, people in Europe can't do. The government in China owns or controls all the counterparties.

So when you're talking about the potential for a liquidity freeze, Lehmann style, it won't happen in China because the government can always step in and tell lenders to lend, and suppliers to supply, and borrowers to borrow, and bondholders to negotiate. So the problem is not that there's going to be a freeze up, because the government can always make sure that there is no freeze up.

The issue of course, and this goes into sort of the broader conversation is what are the long-term problems associated with a non-commercial financial system if you're bailing everybody out, if you're chasing good money after bad, if you're repeatedly putting capital into non-productive uses, to zombie firms and to bankrupt firms, and investment products that should be blowing up but aren't, then what are you doing to your economy in the long run? You're creating an enormous problem of potential stagnation.

So a non-commercial financial system has some very serious long-term effects that are worth discussing, and are very important to the U.S.-China relationship. But in the short term, they have all the tools in the world to be able to avoid an acute crisis, or any type of financial contagion that looks like what happened with Lehmann.
John Lee:
And in the short term, if it does lead to at least a stagnation of property asset prices, can you talk a little bit about what that impact on Chinese households will be? Because I know you mentioned that because of the closed capital account, if you're a Chinese household with some spare savings you plowed into property, now if there is a stagnation in property prices, will there be a significant effect, for example, on consumption in China? Is consumption based on things like ever-rising real estate prices?

That's a short term question. A long term question is you spoke about the mass misallocation of capital because of the Chinese system. So are we seeing more a Japan-style slowdown, where more and more capital is being put through effectively managing bad investments? Or are we seeing something else? So the short term and the long term.

Leland Miller:
Yeah, so there's a lot to unpack there. First of all, just to point out that when I talk about stagnation, I'm talking about sort of long-term stagnation in the economy, not necessarily the short term. And in fact, 2022 is going to be an interesting year because it is, unlike most years, it is going to be much more politically important for the party. At the beginning, you've got the Olympics. At the end, in the fall of 2022, you're going to have the 20th Party Congress, which will be when Xi Jinping either declares himself president for life, or gives more information about how long he'll be in office. We'll figure out if there are to be successors.

So very, very politically sensitive year for China, so I don't think that a lot of the things that we're talking about in terms of sharp drops in growth and other things will be pushed forward on that short a timeline for the simple fact that it's imperative that the party does not have negative sentiment or a crashing economy going into the party congress in 2022.

But I think that the long-term implications of this are fascinating. So the question that I think you asked was essentially, “if you've got a property bubble deflating, or disintegrating, however you want to term it, what are the problems with Chinese growth going forward? Is there a replacement driver for the fact that property's not going to be there to send growth into the stratosphere?” Every time you look like you have weaker growth, you just build more buildings, and then all of a sudden your growth number goes up and you hit your target.

There is not an obvious growth driver to replace property in this, which is one reason we've been talking about the fact that growth is not likely going to slow down. Growth is going to slow down, and quite dramatically in the coming years. It'll be a political decision whether this happens in the next two or three, or whether it happens over six to ten. But it's going to slow down quite dramatically.

The consumption question is fascinating because if you read nothing but state propaganda, you would be led to believe that there is a transition from an investment to consumption, and that's going to take care of everything. But first of all, we've never seen that in our data. So if you look at the performance of retail, for instance, in China Beige Book data, it's done fine. It's never been a leader. There has never been a consumer revolution in which domestic consumption is taking over as a growth driver in China.

And more importantly, the government is not doing anything structurally to make this happen other than talk about it. So how, for instance, would you create this consumption wave if you really wanted to in China? Well one way would be to strengthen the currency a lot, so you put more purchasing power in the pockets of households, give them more ability to spend. Another would be if you took state assets and you transferred them say to the household sector so that you had more resources. Another would be if you materially broadened the social safety net so people had to spend less money.
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There's a bunch of different options in terms of ways that you could empower households and really push consumption. Almost none of those are happening right now. Maybe a little bit on the social safety net side, but most of them are actually going in reverse. I mean, you're certainly not seeing a move of state assets being transferred to private hands, you're seeing the opposite, if anything, right now.

So there's a real problem here because you are seeing what looks like a long-term de-risking of property, which will result in lower growth. And there is not a growth driver to replace it. And the growth driver that they hope, or they say will potentially replace it, which is some sort of amorphous consumption, consumer wave, domestic consumption, consumer spending, whatever it might be, is not only not picking up, and we're talking even broader than just the last two years with COVID. Not only has it not picked up to become a growth driver in its own right. The government's not doing what's necessary in order to create that movement towards a consumption-led economy. So you've got a real question mark when it comes to medium and long-term growth and where things are going.

John Lee:
You mentioned the social safety need. And let me talk a little bit about the fiscal implications of not Evergrande, but the broader of issue of what you say, the misallocation of capital, the real estate sector being built on a shaky foundation that it is. Now, we know that the local governments provide most of the social public goods in a country. We also know that they are seemingly quite reliant on the real estate market to fund a significant share of their budget. So if you can unpack that a little bit for us. I mean, what are the fiscal risks here to particularly local governments, which is also a central government problem? And given those risks, can we pretty much expect the government to if not bail out Evergrande, at least ensure that it doesn't fail in a way that leads to these systemic fiscal risks?

Leland Miller:
Right, yeah. I mean, and just to build on that last point, whether Evergrande survives or not, whether the husk of Evergrande survives or not is irrelevant from a policymaking or macro standpoint. What we care about is to what degree the government will step in and assume the liabilities of Evergrande, or will designate other state firms to take those up. And I think that's a pretty good bet.

So I think what you're going to see over the course of the coming weeks and months are going to be patriotic Chinese firms raising their hand and said, "Let us build those apartments. Let us take those responsibilities. Let us help you pay back these bondholders." Is it entirely voluntary? No, but the Chinese system, again, is a non-commercial financial system. These are actors that act at the government's behest, above purely commercial transactions. So I think that the issue here will be to what degree does the government step in, whether or not Evergrande itself lives on in some shape or form. Your other question was about the social safety net. Remind me where we were going with that?

John Lee:
Well, I guess the social safety net, it seems to me that the local governments are directly dependent on the real estate market to retain a significant share of their revenues.

Leland Miller:
Right, it's going to be a big problem. I mean, land sales have always been a major, major source of local government revenues. And then the secondary economic effects of this booming property sector have been huge. So you've got a real problem, because a property slowdown hits private sector actors, and it hits local governments too. So the question is where's the money going to come from? Sure enough, you
could always just say the government somehow will provide. It will make sure the local governments have what they need.

And I guess in some sort of amorphous sense, that'll be correct. But I think the most helpful way to look at this would be to look at what's happening in the financial sector de-risking, and with the property sector de-risking, and Evergrande, in the context of what Xi Jinping is talking about with common prosperity. And part of what has been happening, whether it's the tech sector crackdowns, whether it's crackdowns in education, it's part of a broad changing of the social compact in China between the party and the people.

And I think what's been happening for decades has been the party saying, "We are your party. And in return for your support, we will provide you with high levels of growth. And we will provide you with ... We will get you wealthy." And I think the social compact is changing right now for the simple fact that growth is slowing. We're on a one-directional path towards slower growth, no matter what's going on going forward, and there's enormous perceptions of wealth inequality that have become a political, and potentially social unrest issue in China.

So then the government's new compact is, "We're not worrying about higher growth. We're going to engineer slower, healthier growth. But we're going to spread the prosperity far and wide. And maybe certain actors got rich early, but now we're going to make sure that everybody shares in those benefits." And so how might that sort of transform itself into the economic program? I think you're going to see, and you've already started to see this, party personnel, party people put in the boards of every major company.

You're going to have local governments take minority shares, become minority shareholders in all these companies, and taking chunks of their dividends that will be pushed back to the state in order to drive their program. So this is very much ... The importance here is it's very much in line, what's happening on the economic side, what's happening on the political side, and the social side, it's very much in alignment. Things are going in one direction. And there are not obvious ways where the government's going to be able to afford its largess, so they're going to have to be creative. And I think one way they're going to be creative is they're going to have the party more active in companies, in private sector companies, and they're going to be taking more of their profits.

John Lee:

And we'll return to the new social compact if you like shortly, because I think that's a very important question. Let me just as one thing about the economic impact. As you mention kind of at the close, capital account, yes I know there are some foreign investors in Chinese bonds, Chinese domestic bonds and so on. But what's the extent of the risk for American and global markets? Should there be some kind of messy Evergrande collapse which leads to some flow-on effect? I mean, what are the implications of that for United State and other major economies? Or will it be fairly contained and restricted to a Chinese problem.

Leland Miller:

It'll be contained. And I am not worried at all about the fallout of Evergrande affecting global markets. What I am concerned about is what Evergrande signals. And Evergrande signals the changing of this Chinese growth model to much slower growth. And then the question is are all the countries that have been relying on China's enormous credit growth, credit tidal waves that fuel its high levels of growth, in order to boost their own economies, are these economies prepared, especially commodities producers, but all across the burgeoning markets you have issues with this.
Are they prepared for this paradigm shift? And I think the answer for the vast majority of them is no. I think that there's been this sort of fantasy that China's 8% forever. And of course, you know that there's a Chinese saying for that. It's eight forever,... And because the Chinese belief, and it was propagated by the government, was, "We'll grow at 8% forever." And I had a big bet with a very well-known Chinese economist once about whether China's going to be growing at 8% 30 years from now, and this was almost 10 years ago. He's going to lose this. He's already lost it.

But the thing is that there was a belief that Chinese growth can defy gravity forever. And at this point, we're looking at much slower levels of growth, and there's the possibility, of course, that China can handle this. It won't be easy. There'll be economic dislocations, and volatility, and all kinds of issues for the next however many years it takes to get to the other side.

But the real worry is that parts of the world that are reliant on what has been the China growth miracle, fueled by enormous credit growth essentially, especially since the Great Financial Crisis, that they haven't planned for a life after that. And they are in the life after that now. This is the now. So I think that the implications here are not Evergrande. The implications are what Evergrande signals, and that means a different growth model. And it's going to treat some countries around the planet in some very harsh ways if they're not prepared.

John Lee:
Well coming from Australia, I can tell you that more than 50% of our export earnings from China is through iron ore sales. And you should really come down here and talk a lot about commodity traders here, because there is perception that 8% can be forever. And I think part of the reason is that whole urbanization argument, which is what I was trying to get at. That they think urbanization will drive 8% for the next 30, 40 years. But that's an issue for another matter.

Leland Miller:
John, give me an invitation. I'm happy to go to Australia.

John Lee:
When our border's open, you can come.

Leland Miller:
That's right.

John Lee:
Let me get to the ... You raised a very important issue about Xi Jinping trying to transition the social compact with the Chinese people. Now, it's hard for us to understand. On the one hand we see him targeting a lot of billionaires, like Jack Ma, like Evergrande's Xu Jiayin, targeting certain sectors like the education sector, and the rationale being given that he's trying to address inequalities. He's trying to take down the big billionaires to move to a more stable economic model. But then on the other hand, you hear that in many respects, inequality in China has gotten worse and it's gotten worse because the state continues to advance, and the private sector continues to retreat, and how tolls and private firms are the ones that are struggling. What's the truth here? I mean, what is Xi trying to do? Is it more a political movement that he's leading? Or is there some genuine economic opponent there where he's trying to create far more equitable growth as he calls it?
Leland Miller:

Yeah. Look, everything in China is politics first. So I think that's the right way to look at it originally. I mean, right now, the party feels vulnerable. Few places in the world are immune to the idea that wealth inequality is growing out of control, but it's particularly bad in China. It's worse than I think anywhere else, just about anywhere else. And perception of it are a potential political problem for the party.

And so they are definitely cracking down on the most visible examples of this for political reasons, and there's no question about that. Now I think there's economic reasons too. And I think that there's other reasons. You crack down on Jack Ma because Jack Ma has been talking back to the party and to regulators for years now. So Jack was going to get his comeuppance. You look at other targets, you've got these misbehaving music stars and others, and they're going to get their comeuppance.

Some of this is politics. Some of it is certainly the party taking advantage of a very popular social issues to get on the right side of them. But I think look, a lot of this comes back to the economic side too. And if you're going to be trying to find these replacement drivers of growth, you've got this deflating property sector. You have growth dropping overall. What are you going to do here?

Well, one of the ways is to look at some of these firms as cash cows. Ali Baba, and Tencent, and all these big companies, they're cash rich. They're very sophisticated companies. Why not just tap into the back door and start taking dividends from them? Now, I don't know in what form some of this will happen. There's obviously complications when you have international investors involved. But broadly speaking, there is enormous wealth in the larger companies in China. And the idea that they're going to remain ring fenced while the party is desperate for funding, I think that's unrealistic. So by one way or another, they're going to be giving back to the party.

You're seeing it through charitable donations, which is particularly laughable when you have all these companies come to party meetings and pledge 1% to 3% of revenues or something as their philanthropy of the year. But it's going to come through dividends. It'll come through philanthropy. It'll come from just taking rich people's money, whatever it might get you. It's the old Saudi-Russia model. So there's a lot of ways to do it, but this is the direction we're going.

John Lee:

Right. Let's move away from the property sector and just talk a little bit about the post-COVID Chinese economy. The last few weeks I've been speaking to some of Australia's richest people who are heavily invested in China. They are quite optimistic that China's post pandemic economy is doing quite well, and will do quite well in the next year or so. So besides the real estate sector issues that you raise, is that what you're seeing on the ground? I mean, from a short term point of view in terms of manufacturing and other capital expenditures beyond the property sector and so on? Is that going okay, or do you think there is still sort of your nay COVID funk?

Leland Miller:

Yeah, so a lot of this depends on what timeline we're talking about. I mean, earlier in the COVID recovery, there was this idea that China had this enormously successful bounce back from the COVID shutdowns. And in some ways that was true because nobody did it better than the Chinese did around the world. But the idea that Beijing was back to 2.6% or whatever it was year-on-year GDP growth a few weeks after they opened up, they reopened up shops and factories and stuff, that was fiction. They were pulling growth forward because they wanted to push the political idea of the party has vanquished the virus, now look at growth now. Or we're almost back to normal.

Now that was never true. But directionally, we saw some of the same drivers. So let me take us back here to what we saw from the beginning. At the beginning of this COVID recovery, we saw basically the
same thing as the government story. We didn’t see the intensity of the recovery that they did, but essentially, China had a supply side stimulus. They got factories up and running, workers back to work, and they recovered very, very quickly, and this was an industry-led recovery. I mean, manufacturing was doing fantastic. Retail and services were lagging though.

Now, this continued, and continued, and as we got into 2021, China watchers almost unanimously were of the opinion that well we're about to see the recovery normalize. And as a result, we're about to see this giant retail bounce back, this consumer spending surge the second half of the year as retail and services caught up to manufacturing and property and all other areas of the economy.

Not only did that not happen, but we looked in China Beige Book and we saw some of the worse retail sector data we've seen in years. There was no chance of a retail bounce back. So people were I think over-confident to that point. But when they didn't see the retail bounce back, sentiment flipped almost entirely the opposite way. And you saw this retail bounce back that everyone expected wasn't happening. You say the policy crackdowns begin and enormous wealth destruction. It was clearly freaking people out.

You saw the RRR cut, I guess, the reserve requirement ratio cut, at banks, which looked like this policy move, a very defensive, protective panic policy move. Everything happening seemed to look like the Chinese government was on the defensive. And sentiment flipped, and everyone got very negative on China’s growth recovery, and started expecting stimulus. And we never saw stimulus either. It wasn't in our data, and I think that people were surprised that the de-risking continued, and that the old playbook of answering weakness in the data with aggressive stimulus no longer played out.

We can see the conditions are still tight, even with the weakness that we're seeing in the economy. So I think to answer your question, the reason I did in such a long-winded way, is at the beginning of the COVID recovery, I think people were too optimistic on what they were seeing. They thought China was recovering and almost back to normal and things were much better than it was. Now, I think maybe people are a little bit too pessimistic because they see these scary policy crackdowns. They see the Evergrande implosion. And they see the fact there wasn't a retail bounce back. So things are not good.

But they're not terrible either. And one of the reasons why you haven't seen the party panic and go to very aggressive stimulus to boost everything up like most people expected is that if you look at China Beige Book's job growth numbers, overall job growth, service sector job growth, manufacturing job growth, they're okay. They're looking okay. The economy's not great, but things are sufficiently stable enough that they're not forcing policymakers to flip the policy script to re-leverage.

And so this has just flummoxed everyone, because usually, you get your bounce back, and when you don't get your bounce back, you get stimulus. And we haven't seen any of that. So I would say that right now, I would think it'd be very hard to be bullish on the economy. But the idea that the economy is so weak that there's no choice but to have economic stimulus rain down in order to boost the economy, I think that that's flawed.

We will see stimulus. We will see an easing of conditions. We will see support from the government. But it will be on a political calendar over the next year, not based on economic weakness. So you got the Olympics. You have the party congress. There's no way that the party's going to allow the economy to be sharply weak into the party congress, or sentiment to be fading. So you will see stimulus, but again, this'll be based on political needs, not economic necessity. And that's completely changed from the past.

John Lee:

Incidentally, from where you stand, American firms who are not caught up in the policies of trade and economics in China, but who want to get back into China, or invest further in China in the short term, where are they at in terms and in mind space? Do you think that they are understanding accurately the
sorts of things that are happening that you've just spoken about? Or do you think they still have either unrealistically optimistic or pessimistic readings on China? Where is the American business mindset right now?

Leland Miller:

Yeah, look, there are a lot of very sophisticated people working on market entry and market expansion in China. And they understand China, but there's no question that they have been trained to be optimistic. They've also been trained to trust Chinese partners on the ground, to trust Chinese numbers, to trust Chinese policy statements. And that's not good for your long-term health because the party is going to have a political message, not an economic message. And you get trampled.

So I think the issue here is that there have been a couple of moments over the course of the past 5, 10 years in which people have suddenly had an ah-ha moment. And they said, "Okay, things really do work differently now." I think when you started seeing the trade war intensify, that was one of them. When people realized that having China as part of the supply chain really need to be thought out better. Now, keep in mind, a lot of companies, most companies that produce in China, foreign companies, produce for the Chinese market. But there's a lot who use China as sort of an intermediate step, or an early step, and for years, we and many other would say, "Look, you have to have a plan B. You have to have a plan C." And, no, no, no, it was always about earnings per share and about streamlining operations. I think one of the recognitions, the Big Recognition, capital B, capital R, that we've seen in the last sort of four to five years has been that between COVID, and between trade tensions, and between geopolitical tensions, and a lot of these things are not going away. Now supply chain breakdowns.

You have to have a plan B and a plan C. It's not about maximizing return now. It's to make sure your business doesn't get shut down. I think that there's a lot companies that have had a real, real about face in the last several years in terms of how their operations work. They're natural optimists, but I think the most of them are coming to the realization that this is a much more difficult land of opportunity than they thought when they first invested.

John Lee:

Yeah. We're running really short on time, so I'm going to end one final, perhaps glib question, but I think a very important question. Now Leland, would you rather be Joe Biden or Xi Jinping managing the respective economic problems that those two people have? Who would you rather be and why?

Leland Miller:

Hands down, Joe Biden. And look, here's the predicament that Xi Jinping is in. And it's partly his own fault. When Xi broke with tradition and basically changed the party constitution and changed the traditions of government that he would not be handing off the reigns of leadership after 10 years, what he affectively did as well is make Xi Jinping very synonymous with China's economy, with China writ large, which means all the burdens of China's restructuring, all the burdens of China's relationships and economic slowdowns and societal problems, they're on him.

They're on the party first and foremost, but they're also on Xi in a very serious way. So I think he has a much, much larger burden, and much harder task than Joe Biden does. Joe Biden, at some point his term will end, or his term or terms will end. And he'll leave, and someone new will come in, and then they'll get crushed. And then someone after that will get crushed. In a democracy, you get to throw the bums out over, and over, and over. China doesn't have that release valve, which means pressure builds
up on the party more and more. And because Xi has made himself synonymous with China in such a stark way, a lot of this pressure is falling on Xi Jinping.

So I would not want to be Xi. I think he has enormous tasks ahead. I think what he's doing right now is quite revolutionary. We had gotten almost to the point where nobody thought he was actually going to start pushing these major structural reforms because they're painful. But he's got a long way to go. And this is going to be a long road. And it's going to be a very volatile one. So no, I would not want to be President Xi right now.

John Lee:
Well Leland, I've had a lot of fun in this conversation. I've learnt a lot, so thank you for coming on Hudson Institute webinar. And I hope to catch you in Australia or in the United States pretty soon. Thank you. Thank you, Leland.

Leland Miller:
John, thank you. And thank you to Hudson.