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“What to know about China’s economic ambitions and Five-Year Plan”

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Episode Summary:

In early March, Beijing released its fifteenth Five-Year Plan, detailing the Party leadership’s economic and technological ambitions for the years ahead. Jon Czin sits down with China Center colleague Kyle Chan and Andrew Polk of Trivium China to discuss Beijing’s push to move up the value chain — from low-end manufacturing toward high-tech industries like AI, robotics, and semiconductors. The two experts offer their analysis of what the plan reveals about where China’s leaders want its economy to go, how it plans to get there, and how Western countries are reacting to its increasing economic global influence.

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CZIN: Hello, you're listening to *The Beijing Brief* from the John L. Thornton China Center at Brookings, and part of the Brookings Podcast Network. I'm Jon Czin, a fellow in the China Center. This is a biweekly podcast. My co-host Ryan Hass, unfortunately cannot join us today, but you'll be hearing from him in our next episode.

So I'm very excited about today's episode. With me today are two of the country's top experts on China's economy. I've got my friend and colleague from the China Center Kyle Chan here, and Andrew Polk from Trivium China.

I was very relieved when we hired Kyle just a couple months ago because I could stop pretending that I understood the nitty gritty of semiconductors and China's technology ecosystem, and hand it over to a true expert when we got those questions about AI and flying taxis and other aspects of China's advanced economy.

And Andrew, it's a pleasure to have him here. I think Andrew and his team at Trivium, they're among the best in the business. And I think what they really excel at is understanding how this looks from the Chinese leadership's perspective. What are their ambitions? What are their own goals? And how are they trying to go about achieving those objectives?

So I'm thrilled to have both of them here to talk about China's economy and especially the most recent Five-Year Plan that just came out last month.

But before we get into the meat of it, I really want to invite both of you two to just share with the audience a little bit about yourselves and how you got here. Kyle, why don't we go over to you first. Like, how did you end up in the China business in the first place?

[1:18]

CHAN: Yeah, so I've long had an interest in, actually, development, and it's kind of an old school topic now looking back, but it's kind of morphed into industrial policy and technology policy. And I think China in particular is just a really fascinating case of the development story, of the industrial policy story, the role of the state in trying to accelerate or sometimes get in the way of this process.

I came at this looking actually originally at high speed rail in China, trying to understand how do they build the world's largest high speed rail system so quickly, and especially since they didn't just buy and import this stuff from other countries. They built it themselves. And I realized that pattern that they use, the playbook for high speed rail in terms of technology and infrastructure, they've actually used it in a bunch of other places now too. So that's how I kind of move across these different areas from development to industrial policy to technology.

CZIN: Did your frequent trips on Amtrak inspire that interest?

CHAN: Amtrak, I have a a complex relationship with, but yes, I do think about high speed rail on the eastern corridor a lot these days. Absolutely.

[2:27]

CZIN: So Andrew, how did you become a China geek? What led you to this area of expertise?

[2:31] **POLK:** Yeah. Well, like most good things in my life, it was a happy accident. I went to grad school just next door at Johns Hopkins SAIS, which used to be here on Massachusetts Avenue across the street from the Brookings Institution.

And the first couple of classes I took were macro econ classes. And that was where I really sort of fell in love. And so meant to just do macro econ, but then started taking China classes. And so ultimately got a degree that was basically in China macro. And started studying that and then working on it, and eventually the die was just cast.

I tell the story where about a year ago I was talking to an actual economist who said, you know, you call yourself a China economist. Why is that? I thought there were just economists and non-economists. Why are you a China economist? And I don't really have an answer for that, but I've been pigeonholed that way for now about 15 years.

[3:20]

CZIN: Well, that's a great segue to the broader conversation that we want to have today. It's already been about a month since China released its Five-Year Plan. Right? But this of course is one of the peculiarities of their system, the fact that they even issue a Five-Year Plan. It's a relative rarity these days. So, Andrew, would you mind walking listeners through what is the Five-Year Plan? Why is it consequential for China's economy and development?

[3:42]

POLK: Yeah, absolutely. I mean, at the highest level, China works on five-year planning cycles, essentially. It starts with the Party. Right? I mean, this is your expertise, you can walk us through that. There's a whole parallel system that the Party is laying out to its priorities.

And then the Party state, the government side, releases the Five-Year Plan every five years, obviously. And it is basically the most authoritative development document in the Chinese system. We liken it to sort of a State of the Union on steroids. It is sort of the leadership laying out not just its economic priorities, but its social priorities, its development priorities, its tech priorities. You know, it's kind of a smorgasbord, everything gets shoved in there.

This most recent Five-Year Plan is actually a little bit more coherent of a document. Usually they're just, like, tacked, everything tacked together like a State of the Union. But it's a statement of priority. And then everything sort of flows from that in terms of on a yearly basis, what kind of goals are we going to hit in various areas?

And so it's really meant to be kind of an anchor for the main priorities over the next five years.

[4:50]

CZIN: I'm struck by your comparison to the State of the Union. Right? Because I feel like one of the criticisms over time is, yes, you have the State of Union speech, but does it actually result in an actual policy outcomes? Like, how closely are those correlated?

And Kyle, I welcome your thoughts on this too. Right? Like, how real is this document in terms of driving the policy process in China? Because my sense is, it's pretty foundational, right, given the top-down nature of the system and how it operates. Like you said, this is the authoritative guidance about, you know, what the state-owned enterprises need to do, the localities need to do, and it filters down.

And then my understanding is too, right, there's a raft of follow on documents, right, that kind of refine and further consolidate what's already promulgated in the Five-Year Plan. Is that right?

[5:29]

CHAN: Yeah, absolutely. It's helpful to see this as embedded in this broader sort of policymaking, policy implementation process that involves not just sort of the highest levels in Beijing, but all the different ministries and agencies, the different local governments. They are rolling out their versions of implementation plans, maybe picking and choosing areas to focus on relative to what their own local strengths are.

And I think what's interesting is to also think about what this document is not. It's not a complete top to bottom blueprint that tells everyone what to do, when. I think there's sometimes a misconception or association with, like, sort of the old Soviet style system where it does have that legacy.

But today, perhaps one of its most powerful roles is as a signaling mechanism to lay out what are the national priorities where people should kind of get aligned. And then also to then start to, in some cases, create real benchmarks for measuring progress.

And those benchmarks are taken very seriously. When they're actually laid out in a quantitative fashion, they can feed into promotion considerations for the government officials or for the standard enterprises. They're measured against that kind of yardstick.

So that's sort of how it reaches into the broader system rather than just being this piece of paper that we all have to read and try to understand.

[6:50]

POLK: And I'd just follow up to say another sort of misconception, at least in my view, is it's not fully top down. It's not just that the leadership cloisters itself and writes this thing. And there is a consultative process that sort of starts at the top, right, and they say, here's what we're thinking. And then they get feedback from industry, from local governments all the way down. And then that feedback comes back up. And then, of course, leadership finalizes it. But it's a iterative, consultative process. So it's not just this kind of fiat that's put out from the central leadership as well.

[7:19]

CZIN: Yeah, that's a great point. And I know as you two both appreciate an important part of being a China specialist is that we have to consume these texts and give them a reading kind of the way a medieval theological scholar would've looked at a, looked at a sacred text, right, and try to do that exegesis.

So I know you guys have both spent a lot of time doing this recently since the last Five-Year Plan drop. So what really jumped out to you as the key takeaways for this most recent Five-Year Plan? Andrew, I'd welcome your thoughts first .

[7:45]

POLK: Well, my thoughts pretty easy and I'll, set up Kyle here is, with the economist hat on, it's pretty clear overall economic growth and development was sort of deprioritized in a way, and there were not super clear priorities in terms of, like, the pace of economic growth and all of those things.

The one thing or one of the things that was very clearly prioritized was tech, technology and innovation. And our kind of reading of that was that if we get the tech right, if we get the innovation right, growth will come from that. And so let's focus on the main priority, which a lot of people look at it and say, well, it's disjointed in priorities in terms of economic development and the property sector and this and that.

But I actually look at it and say, no, they clearly signaled their priority and they're saying everything else is sort of subject or, subordinate to that.

[8:34]

CZIN: That's really interesting. And I heard your colleague Dinny McMahon make this point on your own podcast, right, about the growth numbers that laid out because they are low by historical standard. But he made this really interesting point that I had not appreciated, that by saying that the range was 4.5% to 5%, they kind of fudged what they wanted in terms of outcomes. Right? Like, do they want high, relatively fast economic growth or robust economic growth? Are they willing to demonstrate some flexibility? And they kind of gave the lower level cadres a non-answer. It's like, well figure it out and we'll grade your homework after based on criteria we decide.

[9:04]

POLK: Well, I mean, it was even worse than that actually. It was 4.5 to 5% "or better in practice." Right? And so the signal is all over the map. And I think this is just maybe an interesting point about how the system works, is it's pretty clear to us we saw in the runup, there were a bunch of different leaks from the system around what the growth target was going to be, we heard. But pretty clearly it was going to be 4.5. And then it started to hear some leaks. Oh, it's going to be 5%.

And so there's pretty clearly a disagreement. And our sort of guess is that kind of came up to we gotta publish this thing. They sat in a room, no one could agree. And so they said, okay, instead of 4.5, we'll make it 4.5 to 5 and then we'll add this addendum that says, "or better if you can." Just like, you know, corporate decisions

get made. Everybody compromises, like, it's the deadline's tonight, we gotta get this thing out.

[9:51]

CZIN: One thing, just to dwell on the growth figures too, like the one way that I've thought about this for a long time, when they put these GDP benchmarks down is that they are an input and not an output. Right? Like I feel like so many Western economists and people who grow up in other economic systems are used to thinking about it. Like, you measure at the end of the year, like, how did we do? How much did the economy grow? But my sense is in the Chinese system, it's like, no, we're telling you. This is the objective and you need to figure out how you're going to arrive at that destination.

[10:16]

POLK: Right. Well, and that's what's somewhat concerning about this year's growth target. So to be clear, the growth target we're talking about is for 2026. And the concerning part is, government policy works best everywhere but particularly in China where there is one clear objective. And if they said it's 4.5, you could say, well, that's less growth than we had the past few years, they're clearly kind of, like, taking the foot off the pedal and saying It's okay to focus on some of these other more qualitative aspects of growth.

But instead they sent this message that's all over the map. And I think that means that lower cadres will have a tough time figuring out what they need to be doing.

[10:52]

CZIN: Because they already have easy jobs. Right. Especially in the, in this dark political environment.

Kyle, what what stood out to you about the Five-Year Plan, especially on the tech side?

[11:00]

CHAN: Yeah. So overall, this is part of a longer process of rebalancing in China's broader economic system. And by rebalancing I don't actually mean so much in terms of consumption versus production. I think that's probably what a lot of Western economists, Western observers think about. There is some of that too, but in particular, China's trying to shift its economy away from this sort of high growth era where you have, you know, I mean the double digit GDP growth numbers, that time is long past. And they're trying to move away from those heady days of catch up growth of low end manufacturing and looking more towards high tech industries to be the engines of economic growth for the future.

And this has actually been a longer term process overall. But, lately it's really kind of gone into overdrive, for a couple reasons. One is, they've really now said that real estate is not going to be that engine. There's even questions about whether infrastructure, which normally was one of those engines, will remain the case.

And right now they're looking at trying to create jobs for not just the general labor force, but especially for a more and more educated workforce. And they're looking for ways to move up the value chain and the technology ladder.

So they are turning away from some of those old growth drivers towards some of these areas that they see as emerging technologies or technologies of the future. We're talking about electric vehicles and batteries, which they're already very, very strong in. We're talking about really sort of emerging technologies like robotics or areas of biotech, biomanufacturing.

There's even discussions of trying to build out brain-computer interfaces. You think about, like, Neuralink here in the United States, or reusable launch for commercial space. Like, basically what SpaceX is able to do. So they're looking at these as not only sort of, like, cool, nice to haves, but potentially the future growth drivers for their economy.

And, the last part, and this is really crucial, is the degree of urgency because, on top of this blue sky, optimistic, we can race to the moon, they feel that they need to patch up a bunch of choke points and vulnerabilities, especially given what they see as an increasingly tight international environment. And by that in particular, U.S. actions, whether it's export controls or adding more Chinese companies to various sanctions lists.

And what this means for the Chinese economy in the longer term is they need to figure out ways to patch up these vulnerabilities so that they can continue to achieve their other goals and hit their other targets.

And probably the sector that best exemplifies that is the semiconductor industry where U.S. export controls on, say, cutting edge Nvidia chips to China, and even semiconductor equipment for manufacturing chips, that has been restricted. And so China's trying to build out, to some extent, almost the entire global semiconductor industry in its own backyard and trying to reproduce so many parts of the supply chain in order to build this kind of tech self-resilience to U.S. actions going forward.

So it's a it's both a future oriented and a sort of protection or shielding measure along the way.

[14:09]

CZIN: Yeah. You alluded to this in your comments about some of the economic headwinds that they are facing. And I think that those are real as they go through this transition. And one of the things that has struck me, especially as somebody who's watched the leadership and how they behave over the long period, and I think it's really distinct to Xi Jinping, is that when there are economic headwinds, there's not this reflexive approach to resort to this kind of stimulus packages like that they did in the wake of the global financial crisis. Right?

Like, it used to be that if there was a problem, there was an economic slowdown, they would just hit the investment and infrastructure button. And my sense is part of what's driving that is there's just diminishing returns. Like, it makes a big difference to a locality when you build the first airport, but maybe like the third and fourth are

kind of a waste of time and money, or they're, like, they're just for some cadre to get promoted.

But some of it I sense too is from Xi Jinping. Right? Like, I've had this observation of him just casually that as he's gotten older, he seems to have gotten cheaper. Right? And he just doesn't want to spend the money on doing these things right now.

But I think that's part of one of the things that's really different from him, and I was struck last year, we were in China for Brookings right around the time of "Liberation Day." We were talking about some of the headwinds in the property sector in particular. And one of our colleagues there had a really interesting insight. They said, look, can pay for this problem with money or they can pay with time. And they pretty clearly seem to have decided to pay with time. This is like having a fever. We're just going to let it flush out of the system instead of buying Tylenol to try to treat it.

But I want to dwell on this for a second because how significant do you both see those economic headwinds and how do you see them grappling with some of the challenges in this Five-Year Planning document? Because it does seem to be that all the emphasis is on high technology. Right? Like, a lot of people, like, in the financial press in the West and elsewhere, are talking about how they need to boost consumption, but they talk about that in, like, their annual documents, right, like in the Plenum documents or from the Third Plenum in 2024, like the Central Economic Work Conference. But then they don't seem to actually do much.

So Andrew, you've had some interesting thoughts about this. Like, where does that fit in? They seem to be making a pretty big bet. And is this the right or smart bet to be making right now?

[16:03]

POLK: Yeah, there's a lot there. So I'm just kind of thinking through this. I try to think about it as looking at their reaction function. Right? And so clearly, Xi Jinping is comfortable with a lower level of growth. I always look at the 2021 resolution on history when he said, era of reform and opening is done. It's completed. Like, that was rising tide lifts all boats, grow as fast as you can. That's done. We're doing something different now. We're trying to grow more sustainably, more tech forward, those kinds of things. So we're not going to stimulate. And so kind of really putting that marker out there.

But there are serious headwinds and I think they know it. The property market is certainly one that I think is partially policy driven that they're taking their medicine, as you said. The other big one, of course, is demographics. Right? And the demographic drag.

And the way I think the technology piece fits into it is, or the way I sort of read it, is they say, we know we've got these big problems, the only way out is if we get the tech right. Right? And so we have to go all in because they know if they can't pull it off, if they can't do the semiconductors, they can't do the flying cars, they can't do the whatever else, then there's no offset to the headwinds. Right?

And so I think it's a big bet or a calculated bet by Xi Jinping, but one in which he understands that if they're not successful, they will not have a growth path and they'll get stuck in the middle income trap, and the population potentially becomes unhappy and all that stuff. So it's sort of their only way forward.

So that is where they're focused and to your point about consumption, they see, again, as I understand it, the innovation as their only path out of these challenges. Getting consumption up doesn't fix the real estate market. Getting consumption up doesn't create the ability to make semiconductors. And so it's not fundamentally something they're focused on. We as outside, often Western analysts, prescribe that they should do that, but it's just not, their priority.

[17:53]

CZIN: And my sense is too, from some of the work that you guys have done on this in particular right, is that it's not that they don't care about consumption per se, right. But it's a question of sequencing and where this --

POLK: -- correct --

CZIN: -- comes in the process. Right? Like, I feel like a lot of the prescriptions coming out of the West are about you should boost consumption because this'll alleviate a lot of the problems in your economy. But that Xi's reluctant to do that. I think partially for ideological reasons. Like, I personally think he's comfortable with the *laobaixing*, the everyday people, taking a hit because he thinks it's good for them and it'll toughen them up.

But I also think that, you know, based on some of your work, he's reluctant to take on more of that burden. Right? That fiscal burden for boosting conception. Right? Like, they have a pretty weak social safety net and he knows they're about to go through this demographic change where there's going to be a lot more elderly people that they're going to have to pay for. And so why take on that cost now, right?

[18:36]

POLK: And it it starts again with innovation. Innovation's meant to drive growth, but innovation also meant to drive consumption. So the theory as we understand it, is they would like to, you know, have more innovative companies, which then in theory should be more profitable than currently. Once profits rise, that has a cascading effect, which is those companies can pay higher wages so people have more money in their pocket. They can pay higher taxes, so the state has more money to build out a social safety net. And their share prices are elevated because of the profitability, so any investor in that company has more wealth.

And so that creates an environment where the state can support consumption and individuals have more money to spend anyway and more income and wealth. And so I totally agreed. It's not that they don't care about it all, but again, that thinking is we start with innovation, we get that right, good things will flow from it.

[19:25]

CZIN: Yeah, I think just for the listeners, I mean, that causal chain I've had to go through and reread your stuff several times to get that logged into my brand, but I think that's really important. Right? Because I think that seems to me to be the really compelling internal logic and the best way to try to understand why they're doing what they're doing. And why they're not just kind of boosting consumption or engaging in some kind of robust stimulus package as they have in the past.

POLK: And that's why they're so, one reason among many, why they're so focused on involution. which is value-destroying innovation.

CZIN: Yeah.

POLK: Right? Which is, companies becoming better but not becoming more profitable because that totally undercuts that approach.

[20:00]

CZIN: Yeah. And I think one of the things, I mean this is true not just of Xi but I think across kind of the last couple generations of leaders, because they've been engineers in part before Xi, put this fixation on the technology and innovation piece of it. Right? So there has been this continuity over time. And Kyle, I I don't know what you were doing penance for, but you went, went back and read all the Five-Year Plans, going back to the 1950s.

But what do you see as being kind of new and idiosyncratic in this particular iteration of the Five-Year Plan and Xi's focus of it on it, and what do you think about this as a bet? Given the constraints that they're operating under, is this a wise bet or is it, you know, potentially foolhardy bet to be making on these high tech sectors as kind of the key to future economic growth?

[20:39]

CHAN: Yeah, that's a great question. In terms of, you know, what did I learn from reading all these Five-Year Plans so that the rest of you don't have to, that process was really interesting because it confirmed what I had suspected, which is that China has been focused on science and technology for a very long time. That has been a really big part, especially in the reform era from, you know, go back to the sixth Five-Year Plan in the 1980s and you go forward. There is a big effort to learn from the rest of the world to try to build on technology from, you know, the global frontier, and then to bring China up to that level.

No longer is it about catchup, no longer is it about matching the global frontier or matching sort of, like, the industry median. Now it's about building globally competitive firms, global brands. So China's really focused on not just making sort of, like, me too companies that can, you know, make stuff that the rest of the world can do, but just cheaper. They want to build globally competitive firms, globally competitive brands that will stand out technologically where there's real value there beyond just a price war, a race to the bottom on price.

And so that's where the innovation part comes in, which Andrew really, really nailed, where they want to have their companies and their universities and sort of the broader, you know, science and technology ecosystem amplify that ability to allow China to not only continue to grow, but to really operate at the global frontier.

And so that's why also when you see some of these bets for the technologies, I mean, some of these are risky bets. They are unproven technologies. There is a huge sort of range of uncertainty for how they can go, whether it comes to nuclear fusion, for example, or quantum. Many of these technologies are ones that have been talked about for a long time because they're always just 10 years away or they're always just five years away.

Some are a little more proven. Right? So next gen battery technology. Another example of a risky bet is the humanoid robot focus right now, which has been really fascinating to see, not just because of what it could mean, the potential market, potential implications, but literally to see these robots, which have improved actually quite substantially over time.

But you can see that some of these platforms, like from Unity, have now become global platforms for hardware, for robotics development. And I think that's one area where, you know, who knows, maybe this humanoid fad will fade away. Or maybe we'll be watching the Beijing humanoid robot marathon for years to come. Open question.

CZIN: Dancing with the star robot.

CHAN: That's right. That's right. I mean, you can come up with a whole Olympics routine.

But I think for China, they feel like it is much better to make that bet, to make that investment. Even if these don't all pay off, that some of them may end up becoming the new EV industries or the new what shipbuilding was once for a lot of other economies of the past.

[23:32]

CZIN: And how does involution play for this? And for the listeners who are not steeped in reading this clumsy phrase, right, involution is what the Chinese call, I think roughly, it's roughly synonymous with what we call the over-capacity problem. Right? Or the two are intimately related. Basically that China, because they're not so focused on boosting consumption at home, they're basically making way more stuff than they can sell in their own domestic market. So a lot of that is getting pushed to Europe, to the United States, maybe less so to the United States over the past year. But to other parts of the world.

Andrew, you mentioned this in your comments briefly about how involution is damaging to those long-term aspirations for innovation. Like, my layperson understanding of this is basically that because China's not so focused on boosting consumption at home they're producing more stuff at home because of their advanced manufacturing that they really can't sell at home, they have to sell it overseas.

But this, you were saying earlier, is a major drag on innovation. So, you can you lay out for our listeners what kind of problem that is, what Beijing's trying to do to remediate it, and how serious do you think they are about addressing this problem?

[24:28]

POLK: I mean, the main issue I think is maybe unsustainability. It is certainly related to the overcapacity issue, but I think the main concern is both overcapacity, but just this. Insanely intense competition destroys value. So when you're innovating, you should be creating productivity and raising value. Right? But instead, you're effectively destroying value and and and slamming profit margins. And the whole point is to have companies be more profitable. And so it's sort of this race to the bottom.

It actually, interestingly, the consumers love it. Right? So it's not just in the EV sector and all these things. It's also in the food delivery sector. And that means if you live in Beijing or Shanghai or wherever, you can get a very cheap meal delivered to you very quickly. And so it's a complex challenge that has upsides and downsides.

But I think fundamentally it's unsustainable and it slashes profits for companies and it's no way to sort of run an economy. And it's also becomes insidious, like, right, where does it stop? Right? And so I think that's why Beijing fundamentally wants to stamp it out.

[25:31]

CZIN: But do you think they're serious about it? Like, because they've been talking about it and they've recognized it, but it, it's hard then, because then that means you have to kill off companies, or exit the market is the more polite way to say it. Right?

[25:41]

POLK: Right. I reserve judgment. I think we're in this stage where they're getting serious. They're talking about it at the high level of the Party state. I think the problem fundamentally is they're not quite sure how to address the issue. Right? And so I think they're serious about it, but they don't have a plan to --

CZIN: -- yeah --

POLK: -- deal with it.

[25:57]

CZIN: I've been really struck by the involution problem too, because I think it's one of the chief pathologies of their system right now. Right? And it's kind of reflective of what we were talking about at the outset, right, about the Five-Year Plan and this long-term planning process. Like, they're investing so much into the tech sector, but you then have this intense competition among the companies that have received these incentives, or you have a lot of private companies up on their own.

And now it's a problem of how you walk it back, right, and how do you reign in some of those resources? But what's striking to me right now is that this is really kind of the

key dysfunction in their economy, right, because it's also feeding deflation as prices go down. There's kind of this vicious cycle aspect to it.

But the net effect of it for China geopolitically is that it's actually enhancing and magnifying their global reach. Like, they're getting more and more of the market share in Europe or in the Global South. Right? And that's not true of our own internal dysfunctions or of Europe's internal dysfunctions, whether politically or in their economies. Right? So that is one of the really striking takeaways is like, yeah, China has these problems, but it's actually enhancing their global influence.

And I think what's striking too is that when you talk to Chinese economists about this problem, well, aren't you concerned about overcapacity? And they say, well, as long as there's demand in the West for cheap products, whether that's consumer products or intermediate goods that go into making other things, this isn't going to go away.

So the main way you can address this is by welcoming more Chinese investment, which feels like, you know, as a former U.S. policymaker, that's like heads, eye, wind, tails, you lose kind of proposition.

POLK: Totally.

[27:18]

CZIN: Right? Kyle, did you have anything you wanted to add on this front?

[27:21]

CHAN: Yeah, I just wanted to add that some of the the sort of weirdness with the policy landscape in this in this area is that you get policymakers in China kind of like hitting the brake and the gas at the same time. Because, you know, they're signaling we're getting serious about involution, we don't want this overcapacity thing to continue. It's not good for long run profitability and innovation.

But at the same time, a lot of the local governments that are supporting continued, say, EV production, they are still held to these same goals, these same benchmarks of, needing to show that they are supporting these industries, to show that they are bringing in more revenues, to show that they're improving local GDP growth.

So I've never envied these local government folks because they're kind of between a rock and hard place all the time, it seems like. But especially in this case where they're being told in multiple things and they need to kind of like figure out how to balance this all. In the meantime, you know, you have the rest of the world feeling pretty ambivalent about the effects of all this and--

CZIN: -- it's still a good way to put it. Yeah.

CHAN: -- wondering what to do. I mean, you have the consumers who are like cheap stuff? Great! But then you have a lot of the firms, a lot of the local producers that are, like, wait a minute, this is going to be a big problem and a growing problem if this continues.

[28:36]

CZIN: Yeah. And so I think that's a great segue to what I want to talk about in the last part of this program is about the international ramifications of this. Andrew, I know you were just on the road for the last three weeks. God bless you for your trains, planes, automobile adventure across the Eurasian land mass. But there has been this constant chatter about the pushback that the overcapacity problem is eventually going to invite. But I feel like we see very little evidence of it so far. Even in the United States it seems to have disappeared as an issue. Right? Like, almost exactly a year ago when we had "Liberation Day" and the start of trade war 2.0 with China, this was one of the animating ideas. Right? Like, we have to push back against this flood of Chinese goods.

And a lot of them have gotten diverted from in the United States. But people keep saying this is not sustainable, there will be pushback. But I don't really see much evidence of it materializing. Like, maybe a little bit here, like Mexico, Turkey, but it's kind of the fact that you can list them all on one hand, the countries that have really pushed back on this or taken some kind of measure, I think is in and of itself is quite telling. Right?

[29:26]

POLK: Totally. And so I was just in Beijing, I wasn't at the China Development Forum, but I talked to a bunch of people who were there. And for listeners who don't know, the China Development Forum is an annual gathering where a bunch of foreign executives come and they hear Chinese state leaders, usually the premier and others, talk about how great the Chinese economy is, and we welcome foreign businesses and all of this kind of thing.

This year, from the premier on downward, the message was we have a export-oriented growth model, deal with it. And I even talked to one European diplomat who said he felt like the message was, stop whining because our companies are more competitive than yours and they're just beating you on the global stage.

That's kind of always been the attitude, but the fact that that rhetoric is much more in your face to me suggests that Beijing is becoming more comfortable with its model. But also to your point, it's making a calculated bet. Everyone's whining, but no one's actually pushing back. And so until someone makes us change our model, we're going to double down on it.

[30:27]

CZIN: Well, I feel like part of the challenge, too, is like even if you push back, how does that actually work? Right? Like, let's say Europe, you know, did what they call the bazooka, right, the anti-coercion instrument against China. If you build these high tariff barriers, the net effect could be to make your own domestic companies less competitive internationally.

[30:42]

POLK: Correct. And you can't really just react on your own because, you know, the U.S. tariffs, I mean, they have diverted low end manufacturing goods from the U.S. market, but basically just into the European market. So it's just made the problem worse for everyone else. So it has to be, you know, sort of a global action. And a bunch of countries have to say, we are not going to buy this stuff and And so it's a really difficult problem. I think the Chinese kind of feel like they are going to be able to sort of continue to do it with impunity.

[31:11]

CHAN: Yeah, and it's an issue that affects different countries differently, different markets differently depending on where you stand in sort of the industrial value chain. So I think right now, for example, Germany, the, like fabled *Mittelstand* of these small and and medium size suppliers for industrial goods. They are feeling pressure, especially right now from their Chinese competitors versus, like, if you are in Australia and you are thinking about the auto industry, well, you don't have an auto industry of your own. So your attitude towards China's overcapacity for EVs is, well, that's cheaper EVs for us and we're going to just buy a whole bunch of those. And so you see BYDs and, you know, other Chinese brands on the streets there.

And in some cases you have a Mexico or Brazil where they try to kind of do multiple things at the same time with tariffs. But also trying to court Chinese investment. And maybe you try to leverage that to industrialize or reindustrialize, you know, automotive or clean energy supply chains.

And that's sort of, from the Chinese side, that's sort of, like, a message that is coming out pretty clearly. They want that kind of model. They don't want the tariff, the tariff or outright block pathway. They would rather have these sort of, like, partnerships, maybe even local for local, like local production.

And the devil's in the details there because, right, it comes down to are these Chinese firms sharing technology? Are they using local workers? How many? Are they creating local jobs? And are they supporting not just local assembly, but the deeper supply chain?

And so I think for a lot of that, each country is going to have to wrestle with some of these details if they're going to accept that kind of deal. The U.S. is an outlier in many ways because I think in a number of really key areas, like for electric vehicles, we've kind of said no for now outright.

[33:01]

POLK: This is a really key point. We've looked at the data and China's exports are trending more and more and more heavily towards intermediate goods. Right? And so they're not just exporting finished goods. And the ultimate impact of that is it's going to be very hard to dislodge Chinese exports from supply chains because they're not selling the final product. Like, you can do the manufacturing or the assembly anywhere in the world, but you're still going to need to buy the stuff to make it from China. And I think that's sort of a strategic move.

[33:30]

CZIN: Yeah. I mean, it's a a really thorny challenge for policymakers. Right? I don't envy my colleagues who are now in the chair trying to deal with a lot of this. But part of my understanding too, to circle back to the Five-Year Plan, my understanding when we talked in the fall, Andrew, was that if they get even kind of a gentleman's B on grading this Five-Year Plan and their ambitions, that it's going to make the current trade imbalances, which last year exceeded a trillion dollars for the first time ever, look like child's play at the end of this Five-Year Plan.

Like, how, how realistic do you think that is, that they end up in that place? And, do we see anything that can kind of cause that to change course. Right? Like will their own domestic pathology slow that down or not really?

[34:07]

POLK: I mean there, must be some theoretical limit to the Chinese export machine, but I haven't seen it. And I just, I've been in the situation where I keep saying they can't do it again, they can't do it again. They keep doubling down, they keep, you know, pushing exports more and more. And through whatever path that is, diversification or cutting, you know, prices to very, very slim margins. And so I think they're going to push it to the theoretical limit. And I kind of don't really know what that looks like.

But I will say, America has its own view on it. But the folks who are really freaking out are the Europeans. The Germans in particular are losing something like 10,000 industrial jobs a month. They are worried that China's export machine is going to fully hollow out large parts of the European industrial base. And that's a disaster, right, in terms of jobs and wealth creation and all that stuff. And so I think the Europeans are going to be pushing back a lot harder very soon.

[35:01]

CZIN: Kyle, what are your thoughts on this, about the trajectory China's on and how the rest of the world can deal with it? Can we deal with it in any kind of meaningful way?

[35:09]

CHAN: Just to echo Andrew's point, like, especially for the European case, it seems like Europe is sort of one of the last holdouts in terms of wanting to believe in a sort of WTO, fair trade institution system, and wanting to go by the rules. And when they think about placing tariffs on Chinese goods, they do so in a very sort of careful, calculative way, trying to make estimates based on what they believe to be Chinese state subsidies for, you know, various firms. And I do wonder if that will change over time as the jobs and manufacturing crisis becomes more acute.

So, you know, at this stage we might not see the kind of pushback that people have been expecting or talking about. But I wonder if going forward, that theoretical limit in terms of what share of total manufacturing exports China can take up, whether that

limit will ultimately be basically the political reaction of these different countries in the long run.

[36:04]

CZIN: Super interesting. So last question for you guys before we wrap up. We've covered a lot of ground in today's conversation. There's more on the cutting room table. We didn't really get to talk about AI, everybody's favorite topic, and aspects of the technology competition. But that just means we can come back to it in a subsequent episode.

What would be your one key takeaway that you would want listeners to walk away from this conversation with in terms of understanding China's economy?

[36:25]

CHAN: I would say that technology really is the key right now. Chinese policymakers, Chinese leaders are, you know, to use a colloquial term from the day, they are super tech pilled. They're doubling down on investment in science, basic research, technology, innovation. And they want to build the Teslas and SpaceXs of the future. And literally are challenging exactly those firms in some of those spaces.

So I think the message to American audiences is we need to be thinking about our own investment in the broader innovation ecosystem from public science, basic research, to supporting our firms and making sure that they can take advantage of sort of the global trading system, and become globally competitive and be able to meet their Chinese peers on the world stage.

[37:12]

POLK: I would say that I think people need to keep in mind that China's economy is at a really momentous transition point. And we're not sure what the end point of that transition will look like. And the practical realities of being in a transition point are there are huge economic headwinds and vulnerabilities and huge economic strengths at the same time.

And so you can kind of tell whatever story you want about the Chinese economy right now. Their real estate market's terrible, consumption's weak, deflation, all that stuff. And yet world leading EV companies, world leading battery companies, they're competitive in AI, all of that stuff. So it's all true at the same time.

We had a question that we didn't get to is how do you grade the Chinese economy? And my answer was going to be, it's an incomplete.

CZIN: Right.

POLK: Because it's a really momentous, I would even say historic transition point, and the outcome's going to be hugely important for China's own governance and growth and all those things, but also hugely important for the global economy. But we just don't know where it goes yet.

CZIN: I think that's a great point to end on.

[music]

Andrew, Kyle, thanks very much for joining us today and coming on the show. For more in-depth analysis from our team, visit the China Center on the Brookings website at [Brookings dot edu slash China](https://www.brookings.edu/china). And you can also subscribe to our monthly newsletter, the China Bulletin, for the latest update from the China Center.

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