For 30 years, China has prospered thanks to a low-wage, high-investment growth model—one in which workers see only a fraction of the fruits of growth and corporate profits are plowed back into ever greater capacity. That model, though, is changing: the recent strike over unpaid social insurance payments that affected an Adidas and Nike supplier in southern China shows how workers are becoming more aggressive.

If China successfully manages to move from an investment-focused economy to a consumption-based one, such a shift will have an impact on the rest of the world too. That’s especially true for the U.S., which has long ginned up its own consumption by selling Treasury bonds and other assets to foreign investors.
These are the issues Stephen Roach, a former chairman of Morgan Stanley Asia who is now at Yale’s Jackson Institute for Global Affairs, examines in his book “Unbalanced: The Codependency of America and China.”

Mr. Roach argues that both the U.S. and China need to find new ways to manage their economies. America needs to start saving more, he says, while China needs to start serving its own consumers — starting with a better social safety net. Edited excerpts:

Why did you write the book?

There’s a lot of misinformation and outdated views about China in the U.S. I hope I know as much as almost anybody about the intersection between the two economies, and I thought the relationship needed to be addressed from both sides.

What do you think is the biggest misunderstanding Americans have about China?

The U.S. continues to look at China through the same lens through which it sees itself. It looks at excess investment or low consumption or rising debt and concludes that China is doomed. The U.S. misses the fact that China not only has a different system but it also is at a totally different stage in its development. It’s certainly facing some daunting problems, but moving from a producer model to a consumer model built on urbanization still requires very high investment ratios. It still requires an active government promoting state-directed infrastructure and real estate construction. We can’t rely on our own model to assess China’s progress or lack thereof.

How would you rate China’s chances of escaping from the so-called “middle-income trap” that other emerging economies have faced?

I think the chances are reasonably good. Most developing economies do get caught in the middle-income trap largely because they stick with the same model that led them from early-stage development to middle income and they think it can provide the impetus for moving to higher income — and it usually
doesn’t. China’s changing the model, which is important, and so I’m optimistic China is on a course to escape this dreaded trap.

**What are the advantages of China's relatively centralized system of economic planning, compared with the approach in the U.S.?**

One word: strategy. Strategies don’t always work, but all economies need some form of strategy. The United States is faced with daunting transitions right now and it has no strategy — and it’s suffering because of that. We operate on a very short-term basis. That constrains us from being proactive and planning for the future on issues like saving, U.S. competitiveness, and how to address income inequality. Politicians are afraid of having a debate because they know that when we make an effort to come up with solutions to our long-term problems there’s likely to be some pain along the way. We don’t have courageous leaders who are willing to take those risks.

**You argue that the U.S. will need to find ways to save more without relying on savings imported from overseas. How can this be achieved?**

First and foremost, we need to reduce the long-term budget deficit. But families also need to get their saving rate back up. American families were duped by bubbles, especially property bubbles, into believing that they had discovered a new way to save and didn’t have to save out of their income. That bubble burst and they’re left with no savings.

The saving rate now is close to 4%, versus a 30-year average of about 9.5% at the end of the last century. It’s as low as it’s ever been for any leading nation in modern history. We need to expand existing incentives like 401-Ks and IRAs, we need to provide savings incentives explicitly for low-income individuals. Then we need to address the current unsustainable monetary policy, in which zero interest rates have crushed returns for a generation of savers.

**You’ve been pretty critical of the Fed’s loose monetary policy. Why is that?**

These policies were put in place in the depths of a horrific crisis. They were emergency measures. The emergency is long over, and yet the policies are still on emergency settings. When excess liquidity gets combined with what’s still a weak economy with considerable slack in labor and product markets, the odds suggest that it shows up in asset markets, either at home or abroad. It’s a recipe for instability in financial markets and for potential future bubbles. Which bubbles they are, no one knows.

**You emphasize that China needs to provide more in the way of social benefits if it is to bring down its very high saving rate. Do you think America’s welfare state is adequate — or over-generous?**

It’s not perfect. We have massive unfunded liabilities in both our retirement system and in healthcare. But we at least have a well-defined system of contributions and benefits. China doesn’t have that. The lack of a well-funded and secure safety net, both for healthcare and retirement, is a main reason why the saving rate is excessively high for Chinese households and continues to go higher. Uncertainty translates into fear, meaning any incremental growth in income that Chinese families earn won’t show up in discretionary consumption. That will impede a consumer-led transformation.

— Edited from an interview by Richard Silk. Follow him on Twitter @richardjsilk
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