THE CHINESE ECONOMY: BURSTING BUBBLES, TERMINAL TROUBLES?

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It is an understatement to say that 2022 was not a great year for the Chinese economy — and the world has taken note. With gross domestic product (GDP) growth projections 'slashed' by the World Bank in June,[1] and again in September,[2] to 2.8 percent, there is no doubt the Chinese government will fail to reach its target of 5.5 percent growth. It set that target at the beginning of the year, before Xi Jinping's strict zero-COVID policy locked down city after city, precipitating what *The Guardian* called 'an unprecedented and widening mortgage boycott', resulting in a 'total collapse in confidence',[3] and creating supply chain 'chaos'[4] that reverberated around the world. Domestically, youth unemployment reached a record high of 20 percent in August, feeding into a 'jobs crisis',[5] 'deepening gloom'[6] underpinned a fall in consumer confidence, and the People's Republic of China (PRC) continued what *Foreign Affairs* described as its 'doomed fight against demographic decline'.[7] Geopolitical tensions and a struggling global economy added trouble to the mix. The United States imposed sweeping export controls that a *CNN* headline contended could 'throttle China's [high-tech] ambitions and escalate the tech war'.[8] Others worried that 'debt traps' related to Chinese investment were 'pushing vulnerable countries into crisis'.[9] If all these headlines could be taken at face value, perhaps the *Financial Times* was right to declare in its own late-October headline that 'China's economy will not overtake the US economy until 2060, if ever'.[10]

But is China really on track for the 'collapse' that Gordon Chang famously first predicted in his 2001 book, *The Coming Collapse of China* — one he still thought was imminent in 2022?[11] Or is Tom Orlik, author of the 2020 book *China: The Bubble That Never Pops*, more likely to be correct, writing in October in *Bloomberg* that although the 'China bubble is losing air', it is 'not going to pop' because of the nation's 'unparalleled record of surmounting crises'?[12]

The question of whether China can keep rising looms large in the reporting and analysis published in *Foreign Affairs*. It is a theme to which they return time and again, presenting competing narratives, with no obvious bias.[13] In October 2021, an article by Michael Beckley and Hal Brands was titled 'The end of China's rise: Beijing is running out of time to remake the world'.[14] The authors begin by asserting that, despite China 'moving

Bursting bubbles: Economists have speculated whether China is heading towards an economic collapse
Source: Drew Beamer, Unsplash

aggressively to forge a Sinocentric Asia and replace Washington atop the global hierarchy', there is little for the West to worry about because 'China's government is concealing a serious economic slowdown and sliding back into brittle totalitarianism. The country is suffering severe resource scarcity and faces the worst peacetime demographic collapse in history.' China is, in short, 'running out of people' and the 'economic consequences will be dire'. This, combined with the government's 'force-feeding [of] capital through the economy since 2008', leads Beckley and Brands to argue that 'China is tracing an arc that often ends in tragedy: a dizzying rise followed by the spectre of a hard fall'.

A second article, by Jude Blanchette in November 2021, conjures a very different picture, titled, 'Xi's confidence game: Beijing's actions show determination, not insecurity'.[15] Blanchette challenges the 'collapsing China syndrome' head-on, arguing that, while the 'doomsayers' are not entirely wrong in identifying the factors that constrain China's growth, they fail to weigh these against Beijing's potential and real strengths.

Perhaps Blanchette's most contentious point is that Beijing's biggest strength is its 'effective authoritarianism': its ability to mobilise and channel resources with 'remarkable speed'. The efforts to minimise the economic impacts of COVID-19 in 2020 is one example. While acknowledging this 'disregards the rights and freedoms of Chinese citizens', he contends that the Communist Party of China (CPC) 'in 2021 has been stronger, more capable, and in command of more resources than at any other time in its 100-year history'.

China's population is shrinking and its birth rate reached a historic low in 2022
Source: Xiangkun ZHU, Unsplash

This chapter reflects on some of the topics that obsessed the English-language press reports on China in 2022, alongside others that perhaps should have received more attention, to identify the key challenges affecting that nation's economic health. Assessing these challenges based on evidence and fact — rather than fear and fiction — is essential for understanding where the Chinese economy is headed and what might prevent it from getting there.

'Running Out of People'?

For decades, I travelled around China asking people what they thought was the country's biggest challenge. Time and again they would say, 'Too many people'. In the 1950s and 1960s, Mao Zedong had pushed the narrative that 'many people would make China strong'. This 'population optimism' fed into China's population boom during that time (from just under 544 million people in 1949, when the People's Republic was founded, to 929 million in 1976 when Mao died).[16] Chinese demographers had already started to think

this was a serious problem, but the fate of economist Ma Yinchu 马寅初, who warned in 1957 of the dangers of overpopulation and was attacked as trying to 'discredit socialism', served as a cautionary tale for those who would say so out loud.

Deng Xiaoping, who oversaw Ma's political 'rehabilitation', including a formal apology to him from the CPC in 1979, adhered to a different narrative. He was 'population pessimistic', believing that reducing China's population growth was key to increasing per capita income. He launched the One-Child Policy in the early 1980s, aiming to bring population growth to zero and quadruple per capita income by the year 2000. He did not quite reach zero population growth, but per capita income did quadruple by 1996.

While a decline in fertility was not the only driving factor, it was a significant one. According to Cai Fang 蔡昉, former director of the Population Institute at the Chinese Academy of Social Sciences, about one-quarter of the increase in China's per capita income during its 'growth miracle' years from 1978 to 2010 can be explained by declining fertility.[17] There is a simple logic behind this demographic dividend: a reduction in fertility leads to a reduction in youth dependency and a surge in the working-age population, and because there are now relatively more workers and fewer dependents in the population, output or income per capita increases.

Fast forward to the introduction of the Two-Child Policy in 2016 and the Three-Child Policy, which was written into law in 2021. Cai strongly advocated for this policy relaxation and I, too, on non-economic terms, support it. But in purely economic terms, if reducing fertility was so important for raising per capita income, how could increasing fertility also be a good thing? Would it be catastrophic if — as looks likely to be the case — China is headed for a 'low-fertility trap' as, despite the freedom to have more, many Chinese couples now choose to have only one child?

I argue it would not be. China's working-age population is projected to decline by 18 percent between 2020 and 2050. If labour force participation rates do not change, its workforce will also decline by the same amount. Yet,

considering labour's contribution to aggregate output (currently about 60 percent), in terms of the impact on average annual GDP growth, that amounts to a reduction of just 0.35 percentage points per annum through to 2050.

Having more babies now will not change these figures much, because those babies will not join the workforce for about twenty years. Investments in education are one obvious way to boost productivity in the long run. But other policy changes could produce a faster boost to GDP growth and per capita income gains. One is raising the retirement age. Back in 2015, there was talk of new policies that would gradually raise the age from sixty for men and fifty and fifty-five for white-collar and blue-collar women, respectively.[18] These changes were touted to begin in 2022 and, true to its planning word, the State Council in 2022 announced a gradual extension of the retirement age to be achieved by 2025 — although the details of how high it will go are scant, apart from noting that it will vary according to age groups.[19] Equalising the retirement age for women — the gender with universally higher life expectancies — with their male peers could readily extend China's workforce with the stroke of a pen. (Political leaders are ostensibly expected to retire at sixty-eight, but the rules do not seem to apply to Xi Jinping, who is sixty-nine and about to begin his third five-year term in office.)

Another policy to offset population ageing would be to increase labour force participation rates, especially among women. The record on this is even less positive, with just 62 percent of women over the age of fifteen engaged in the labour force in 2021. While high by developing-country standards, this is a three-decade low for China, and on a declining trend, having fallen steadily from 73 percent in 1990.[20] With China's global gender gap ranking at 102 in 2022[21] — a sharp decline since its peak rank of five in 2008 — and the number of women on the previously twenty-five-person (now twenty-four-man) Politburo Standing Committee falling from just one to zero, there is little reason to think Xi will act to boost the number of women workers more generally. Indeed, given the high youth jobless rate, due to a record number of university graduates seeking limited jobs in an economy beset by COVID uncertainties, Xi may continue to undermine the female workforce, focusing instead on raising participation among young men.[22] Either way,

underemployment and unemployment among youth and women counter the argument that China is 'running out of people'. They do, however, reveal other challenges for China's long-term growth prospects.

Returning to Mao and Deng, both were at least partially right. High fertility rates in the Mao era did help China become powerful because, in power terms, size matters. Lower fertility then made Chinese people richer. It is true that China's population is ageing more rapidly than that of other countries at comparable levels of development, and that comes with problems. But fertility decline also leaves its citizens much better off, on average at least. As China heads into a period of population decline — beginning in 2022 — this point is worth bearing in mind, while also reflecting on the social security and other challenges that an ageing population and declining workforce will bring.

'Common Prosperity': Rhetoric or Reality?

In 1985, in pursuit of his goal of quadrupling per capita GDP, Deng famously said that some regions and people could become prosperous before others and that would help others gradually achieve common prosperity. He insisted that there must ultimately be 'no polarisation of rich and poor' because 'that's what socialism means'. Those waiting patiently for some of China's immense wealth to trickle their way have been doing so for four decades. In 2021, disposable income per capita in rural households was just 40 percent of their urban counterparts — an improvement from 32 percent a decade earlier, but still a substantial income gap.[23] By 2022, China's 539 billionaires were collectively worth nearly US$2 trillion, while the World Inequality Lab reported that the top 10 percent of its population earned fourteen times more than the bottom 50 percent.[24] Despite official claims that absolute poverty was completely eradicated in 2020 (measured as US$2.30 per person per day),[25] studies have since revealed a new pandemic-induced poverty wave, taking the poorest Chinese people further backwards.[26] Could Xi Jinping's latest solution finally give those people reason to hope? Since 2021, Common Prosperity 共同富裕, has become a signature policy goal in

Xi's Socialism with Chinese Characteristics for a New Era. Yuen Yuen Ang has written in *Foreign Affairs* that 'common prosperity' is not just rhetoric but also 'a set of instructions for government officials who are tasked with implementing Xi's vision'.[27] This vision 'is not a call for egalitarianism': it is rather a commitment to 'encouraging wealth creation through diligence and innovation'. Among other things, it involves 'proactively leveraging the important role of the state-owned economy in advancing common prosperity' and calling on those who 'got rich first to voluntarily share their wealth'.

Yet, for all the billionaires rushing to prove that they were listening by donating money to various charities, philanthropy cannot solve rural–urban inequality — or the gender, regional, and other forms of inequality that remain so prevalent in China today, which stem from gross underinvestment in health and education in the countryside. In their 2020 book *Invisible China: How the Urban–Rural Divide Threatens China's Rise*, Scott Rozelle and Natalie Hell wrote that to address these inequalities, which relate to 'structural issues within China's political system', China must first reform the *hukou* system (of residence permits), which has 'maintained and reinforced inequality through law'.[28] Second, it must recentralise the fiscal system so that poor areas are able to fund better education and health outcomes, and, third, it must shift the focus from short to long-term growth, to prepare for the future. Should the Chinese government carry out these three reforms, Rozelle and Hell contend, the country can escape the 'middle-income trap' (when countries develop to a certain point but then growth plateaus) and deliver sustainable, inclusive growth for decades to come. If it does not, in the worst-case scenario, the impact on China's long-term growth prospects would be 'catastrophic'.

China's track record offers little cause for optimism. For example, reform of the *hukou* system has been under way for several decades now, and has stepped up in recent years, especially in small and medium-sized cities. Yet, by October 2022, just one 'megacity', Zhengzhou, the capital of Henan province, with a population of twelve million, had plans in place to abolish all restrictions.[29] Abolishing *hukou* is simply not on the agenda for most megacities. For example, in June, Shanghai announced a relaxation of its regulations: its coveted *hukou* would now be granted to 'non-locals

who've graduated from the world's top 50 universities and work in the city'.[30] This smacks of a fragmented and elitist authoritarianism — as opposed to Blanchette's 'effective' kind — in which wealthier provinces and cities implement policies that counteract Beijing's equalising ambitions, ensuring that wealth continues to trickle up, not down. The impacts on China's long-term growth prospects could be profound.

Chains of Debt

China's overseas and internal debt 'crises' were an ever-present topic in Western media throughout 2022. The former is invariably linked to accusations of 'debt-trap diplomacy' — a phrase ubiquitous in Western discourse about the Chinese government's Belt and Road Initiative (BRI) and other global investments. Deborah Brautigam, a scholar of China–Africa relations, has described how within twelve months of the first appearance of the phrase 'debt-trap diplomacy' in 2017, nearly two million search results could be found on Google. The concept, she says, somehow began 'to solidify into a deep historical truth'. Yet, Brautigam draws on a database of more than 1,000 Chinese loans to Africa to argue that she 'has not seen any examples where … the Chinese deliberately entangled another country in debt, and then used that debt to extract unfair or strategic advantages'. Other scholars support this finding, including in the oft-cited case of Sri Lanka, as in Lee Jones and Shahar Hameiri's report on *Debunking the myth of China's 'debt-trap diplomacy'* in which they, like Brautigam, conclude that the debt-trap narrative is 'simply incorrect'.[31]

This is not to say that the Chinese government is innocently and only pursuing 'win-win' development in its global economic engagements, including through the BRI. Of course, it is pursuing power and influence as well. And some of its multinational companies — state-owned and otherwise — behave badly in the process. Again, this is indicative of a less than entirely effective authoritarianism: not all domestic actors behave in accordance with the wishes of the centre. It is also true that countries across the globe have taken on substantial Chinese (and other foreign) loans that

could cause them — and their Chinese lenders — problems in the future. The lack of transparency in many BRI projects could make those problems more significant than anticipated. The full facts in this particularly complex zone, where geopolitics, economics, and grand strategies intertwine, is impossible to ascertain. But we should at least rule out the fictions.

This is harder to do when talking about China's internal debt challenges, including in the real estate sector. According to one narrative, the Evergrande crisis that began in August 2020 (when it was revealed that the country's second-largest property developer was more than US$300 billion in debt) has now spilled over to the industry to the point where there is 'a total collapse in confidence, and only [more] government intervention can save the day'.[32] A *Financial Times* report in October characterised China's 'property crash' as a 'slow-motion financial crisis'.[33]

In the same month, writing in *Bloomberg*, Tom Orlik pointed out that '[f]or more than a decade, analysts have warned that excesses in borrowing and building have pushed China's property sector onto an unsustainable trajectory'. Yet, when policymakers 'get ahead of the problem by cutting off sources of financing to overleveraged developers', those same analysts are the ones who cry out for more intervention, not less. Orlik sees it differently, describing the history of China's real estate sector as a

> series of exuberant booms and near-disastrous busts. Every time it appears the end is nigh, policymakers have tweaked the dials on down-payment requirements, mortgage rates, and financing for developers to get things back on track. They're doing so again, though this time their goal isn't engineering another boom, but moderating the pace of decline.[34]

Crises are, by definition, unpredictable events and economists are notorious for incorrectly predicting them. Simply put, the risks are high and rising, and there is contention about how well the Chinese government can mitigate them.

Conclusion

Tom Orlik has used the term 'Sinophrenia' to describe a 'condition of modern commentary that combines the belief that China will imminently collapse with the belief that it is taking over the world'.[35] The article by Beckley and Brands falls into this category. In contrast, Jude Blanchette's article might seem 'Sinophoric', although placed in the broader context of his writings, this would be inaccurate. He previously described how President Xi's gamble on consolidating power in his own hands has set him on a 'current course [that] threatens to undo the great progress China has made over the past four decades'.[36] In October 2022, he observed that 'authoritarian systems and authoritarian leaders always appear solid on the outside — until suddenly, they don't'.[37]

No-one doubts that the lockdowns in response to Xi's zero-COVID policy made 2022 a very rough year for China's economy (and its people). With the Russia–Ukraine war, rising tensions in the Taiwan Strait, and the ever-escalating rivalry between the United States and China, the geopolitical headwinds are growing stronger. Add to these the economic headwinds identified here and it is certainly possible to construct a narrative of crisis or collapse. But it is also possible that the Chinese government will demonstrate more flexibility than it has in recent times, adopting effective policies that not only stave off crisis, but also set the country on the path to long-run, sustainable, and inclusive growth.

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