Decoding China's Economic Slowdown

ROUNDTABLE SUMMARY REPORT

In April 2024, the Stanford Center on China's Economy and Institutions and the Asia Society Policy Institute's Center for China Analysis co-organized a closed-door roundtable on China's economic slowdown and its political, social, and geopolitical consequences. China's economy registered an average annual growth of 9.5% from the start of reforms in 1978 until 2019, enabling it to become the world's second-largest economy by 2011. Throughout this period, economic performance was a key indicator of China's success and served as a critical pillar of the Chinese Communist Party's legitimacy.

More recently, however, China's leadership has taken an ideological turn under Xi Jinping and economic growth is no longer a top priority. The economy posted growth between 6% and 7% from 2015 to 2019 but only around 2% in 2020. Growth recovered to 8% in 2021 but fluctuated around 3% in 2022 and 5% in 2023. Economists have begun to question whether China's era of historic economic growth has passed. Is this the end of China's economic miracle? Is its economy in a prolonged slowdown, a tailspin, or simply transitioning toward more sustainable, "high quality" growth?

The causes of China's economic slowdown are subject to debate, and the potential consequences have not been adequately studied. This roundtable examined the myriad factors behind the slowdown and, more importantly, considered where China might be headed.

The roundtable focused on four key questions:

1. What is the mix of determinants—cyclical, structural, and political—for slower economic growth in China?
2. How much can China's recent economic woes be attributed to Beijing's own policy mistakes, and how much to tensions between China's hybrid Leninist political regime and the dynamism of a market economy?
3. What are the potential political, social, and geopolitical consequences of the slowdown?
4. If the slowdown continues, or even worsens, could the leadership's priorities shift? If so, what policy measures or structural reforms might reverse the slowdown and preempt some of the broader consequences?

The discussion was conducted under the Chatham House Rule.

ABOUT THE CENTER FOR CHINA ANALYSIS

With a solution-oriented mandate, the Asia Society Policy Institute (ASPI) tackles major policy challenges confronting the Asia-Pacific in security, prosperity, sustainability, and the development of common norms and values for the region. As part of ASPI, the Center for China Analysis (CCA) serves as a leading global center for policy-relevant, objective analysis of China's politics, economy, and society, and its impact on the region and the world in an era of growing strategic competition.

ABOUT SCCEI

The Stanford Center on China's Economy and Institutions (SCCEI) is Stanford's hub for data-driven, multidisciplinary research on contemporary China. In addition to catalyzing cutting-edge research on China's economy and institutions, SCCEI's aim is to communicate policy-relevant findings from the best quantitative scholarship on China to audiences beyond academia. By doing so, it aims to advance a more empirical basis for important debates about China and U.S.-China relations.

1. TAKING STOCK OF CHINA'S ECONOMIC GROWTH

Panelists agreed that a complex mix of cyclical, structural, and political factors has contributed to China's economic slowdown. Moreover, they agreed there is no indication the situation will improve with simple policy fixes or that the slowdown resulted from one specific factor, such as a troubled property market. Panelists acknowledged the need for more analytical clarity about the extent of the slowdown in light of the Chinese government's contention that the economy had not significantly slowed, as well as competing claims by some overseas observers that it had stopped growing altogether or may have even declined.

Without doubt, China's economy has ratcheted down to a substantially lower growth trajectory in recent years, in part reflecting the impact of COVID-19. Through 2024, in fact, the after-effects of the pandemic could still be seen in terms of weak household confidence and a strong preference for saving over consumption. Supply-side stimulus, with little stimulus on the demand side, had been deflationary and, according to the participants, would continue to be for some time. Moreover, the fall in China's nominal growth was more dramatic than the fall in real growth, which has had important implications for the global economy.

Most panelists' predictions for the Chinese economy's future growth ranged from 3%–4% over the remainder of this decade—and in some cases longer. Similarly, nominal growth rates were projected to remain far lower than in the past, with some participants estimating around 4%. Other panelists thought these predictions were too optimistic, pointing to indications that China's official data was unreliable and that, largely due to strict COVID-19 policies, economic growth was negative in 2022. According to some estimates, it has remained near zero ever since.

Panelists also discussed evidence of how much China had deviated from the East Asian development model. Comparing long-term trajectories of real growth, China has grown significantly slower than South Korea and Taiwan at similar levels of income. In part, this reflected the fact that South Korea and Taiwan were smaller economies that could rely on external demand to run high export-to-GDP ratios, which China can no longer do. In South Korea, rural-urban income had reached parity by the early 1970s, but in China, rural incomes are still less than half of urban incomes. To one panelist, China looked to be on a trajectory more like Japan in the 1980s.

Nevertheless, most panelists did not see slower growth getting in the way of China continuing to do extremely well, at least in the short term, moving up the technological value chain, and capturing a larger share of global markets for a wide range of technology-intensive manufactured goods. To the panelists, China's manufacturing ecosystem remains competent, diverse, entrepreneurial, and broadly competitive.

However, as one panelist stated, China is likely leaving a significant amount of growth potential on the table. This is because, for both practical and ideological reasons, Beijing has decided against making significant policy changes to reverse the economic slowdown. China's leaders have sought to change the policy rhetoric in the direction of the private sector over the last year or so, including explicit appeals to encourage foreign investors to return. Panelists accorded this little weight, however, because Xi has spent the years since 2017 underpinning economic policy with an ideological framework centered around statist objectives such as the dual circulation economy, "new quality productive forces," and common prosperity. Ideologically, many agreed, it seems difficult to conceive that Xi will change course.

2. CYCLICAL FACTORS

Roundtable participants considered a range of cyclical problems holding back China's economy, including weak demand, low consumption, and high savings. Changing demographics also play a role, as do supply-side policies that divert substantial resources to investments in infrastructure and manufacturing. Long-standing issues in the property market are also a major factor.

2.1 Flagging Household Demand

Panelists agreed that weak consumer demand is a key cyclical factor contributing to China's economic slowdown. Unlike the United States, the Chinese government did not provide direct policy support for household demand during the COVID-19 pandemic and afterward struggled to keep nominal incomes on pace with pre-pandemic trends. Weak domestic demand was also a consequence of a stronger propensity to save—Chinese households save more than 30% of their disposable income, compared to only 8% in Europe and 5% in the United States. A few years ago, however, household savings as a share of GDP started to decline, a trend that was reversed during the pandemic as people saved more to deal with future uncertainties. The share of labor in China's GDP is comparable to the average OECD country but has declined over time. Shifting demographics will also be a future drag on growth, mainly by driving down net household savings and holding back consumption.

Over the past decade, economic policies have favored the state sector over private firms, resulting in a loss of economic efficiency, and Beijing's preference for investment over consumption has resulted in weak aggregate demand relative to aggregate supply. The consequences of these policy priorities have resulted in deflationary pressures and a sustained high trade surplus.

2.2 Excessive Supply-Side Stimulus

Top-down policies with a strong supply-side bias have driven China's massive investments in manufacturing, technology, and infrastructure. One panelist suggested, however, that it is not a question of how much industrial policy has driven China's economic growth but rather how rapid growth might have made it possible for the government to carry out its ambitious industrial policy. In times of strong growth, increasing revenues, and a high savings rate, the government had copious resources to fund its industrial ambitions and target specific industries. Some of these initiatives failed dramatically, but panelists cited a few, such as electric vehicles and solar panels, as successes. However, these sectors' profit margins are generally slim. This begs the question of how new industries and advanced technologies can revive the Chinese economy, considering the costs involved and the time it typically takes for them to pay off.

Nonetheless, panelists concurred with the view that, over many decades, China has built a vibrant, dynamic, and remarkably competitive manufacturing sector with many cost advantages. Government subsidies certainly played a role, but much of China's manufacturing success came down to the fact that the best companies are great at what they do. One participant cited electric vehicles and batteries as examples, attributing their success to a combination of policy guidance and entrepreneurial dynamism in these sectors. Another panelist pointed out that new technologies are always double-edged. BYD, for example, is competing with Tesla and other electric vehicle makers but is also competing with traditional cars. The rise of electric vehicles is undermining the huge gas-powered vehicle industry that China has spent thirty years creating.

Recently, Xi Jinping and other leaders announced that yet another supply-side initiative, "new quality productive forces," would be at the center of China's future industrial development. Centered on manufacturing, particularly advanced manufacturing, this new emphasis indicates a turn toward a different kind of economic strategy—and yet one firmly established within the framework of Xi's "dual circulation economy"—than what was followed over the past ten years. Driven by significant policy support, it aims to position China's economy to dominate future industries based on more disruptive technologies and the country's growing capabilities in research and development.

2.3 Property Sector Imbalances

As China actively pivots away from a property-heavy growth model and as rapid urbanization slows, property will contribute much less to economic growth. Panelists noted the massive corrections in China's property market, with the decline in construction starts exceeding 50%. By some estimates, the property sector and its related industries account for 20%–25% of the economy, but the government has been clear that it is not interested in countering the contraction and that the property sector must shrink. According to one panelist, this process is about halfway complete, and while the worst declines are probably over, the price effects have been much less than expected.

Over the next few years, the decline in property prices will negatively affect household confidence and wealth, further exacerbating weak consumption demand. Nonetheless, some participants acknowledged that de-risking the property sector has been a major concern of Chinese leaders for decades, and thus Xi's success should not be minimized.

3. STRUCTURAL AND POLITICAL FACTORS

Mammoth government debt and overreliance on exports were the key structural problems that the roundtable considered. Xi Jinping's policy preferences and adherence to Chinese Communist Party (CCP) ideology also contributed to China's slowdown.

3.1 Local Government Debt

The poor fiscal health of local governments is a key structural factor that has both contributed to and is exacerbated by China's economic slowdown. Total government revenue has declined as a share of GDP since 2016, reversing the trend of the previous two decades. At the same time, China's local government debt is rising and is much higher as a share of GDP compared to other OECD countries. As of mid-2023, outstanding local government debt totaled 55 trillion RMB, or around 40%–45% of China's GDP.

Some local governments struggled to manage ballooning liabilities, which severely affected their fiscal capacity. Debt-servicing costs have dramatically risen for some provinces since 2017, when most had debt-servicing costs around 50% of provincial revenue. In 2022, average debt servicing was over 100% of revenue in twelve provinces, with Tianjin being the most extreme case, with debt servicing around 200%. Another dozen or so provinces have debt-servicing ratios between 50% and 100%. Panelists agreed that localities where the problem was most serious will no longer have the wherewithal to compete regionally or experiment with new policies, which could be another drag on growth. In addition, net discretionary fiscal resources—the sum of local revenue, land revenue, and general transfers minus debt servicing—have worsened for most provinces in the past four years, in some cases because of the poor state of the land market.

One panelist commented that the central budget is running a deficit of around 4% of GDP just to sustain current commitments. Official local government bond issuances add another 3% to China's deficit spending. Even though China could conceivably increase the central deficit, budget constraints, especially at the local level, make it challenging to roll out a major stimulus package or set up real estate rescue funds, let alone make significant policy changes that would ease social pressures, such as upgrading the medical system or bringing millions of migrant workers into the urban welfare system.

3.2 Over-Reliance on Exports

Panelists discussed the large role exports played in China's economic miracle. During the reform era, China achieved consistently strong economic performance by mobilizing capital and tapping into its vast pool of labor to expand production, enabling it to become the world's leading manufacturing nation and biggest exporter. The demographic dividend has now run its course, but China's production nevertheless continues to expand. As one panelist noted, this is primarily due to present-day innovations, such as the use of robots and automation, that have made manufacturing a different game than it was twenty years ago. As a result, not only are there no decreasing returns to scale, there have been constant, or maybe even increasing, returns.

China's international export competitiveness has also been strengthened by massive state investments in technology and the rapid evolution of its manufacturing capacity. The country's export pattern has now changed to include more complex goods, and China has steadily gained global market share in industrial machinery, motor vehicles, and pharmaceuticals. Foreign enterprises are also no longer a big driver of China's manufacturing. They now account for less than 30% of its exports, and the proportion is still falling.

Even as China gained global market share in complex goods, it maintained market share in less sophisticated goods with little shedding. This allowed it to produce more, but because of insufficient domestic demand, it has had to sell more overseas, which is reflected in its balance of trade. This would not be an issue for small economies such as Taiwan or South Korea, but China is the second-largest economy in the world. Its surplus in manufactured goods presents a real problem not just for developing countries but also for developed countries with leading positions in markets for more sophisticated goods. The ensuing trade tensions could derail some of China's success.

3.3 Xi Jinping's Policy Priorities

The panel discussed how Xi Jinping's policy priorities relate to security, self-sufficiency, technological progress, and social equity rather than maximizing growth. The direction of China's economic policy has reversed over the past several years and is no longer market-oriented. This has resulted in a loss of directional liberalism, which was a major force underpinning entrepreneurial confidence in previous decades.

According to the panelists, even in 1979, the CCP's reforms always had a clear objective, which was to sustain the party's power. During the reform era, party leaders discovered that private sector growth and globalization were necessary to save the economy and therefore preserve the regime. However, they saw both the emergence of the private sector and increasing globalization as challenges that could erode CCP authority. More recently, under Xi Jinping, they have insisted that the party must take the lead to control the economy, the private sector, and foreign firms by bureaucratic means. This has put pressure on the private sector and led to a drop in foreign direct investment.

Noting that China's economic growth had already started slowing before Xi took over, panelists agreed that he was not to blame for the structural challenges he inherited, with one panelist arguing that Xi deserved some credit for the substantial growth in personal income as a share of GDP, especially for rural residents. This was mostly due to the effects of his anti-poverty program and income transfers. The growth in personal income relative to GDP under Xi outpaced the modest gains in the Hu Jintao era and the contraction when Jiang Zemin was in power. However, annual GDP growth rates have decreased substantially during Xi's rule, capping overall gains in personal income.

Panelists agreed that Xi Jinping's policies have undermined the confidence of three key parts of the domestic economy: private firms, with regulatory crackdowns; households, with COVID-19 lockdowns and the property market downturn; and the public sector, with anti-corruption campaigns. According to one participant, the heads of many private Chinese firms are aware of the unfavorable light in which the current CCP leadership views them, mainly for political and ideological reasons. Consequently, having little trust in the government, they have postponed fixed-capital investments or have moved funds abroad. Another panelist added that Xi's failure to pursue more balanced economic policies has contributed to the lack of domestic demand and falling consumption, resulting in increased Chinese exports.

3.4 Ideological Change

The roundtable also addressed the role of ideology as a critical factor influencing China's recent economic performance. Political and ideological changes to economic policy were minimal during Xi's first term, one panelist explained. A series of measures sought to increase the role of market forces in the economy, but there was some backsliding after the 2015 domestic financial crisis, particularly in the finance sector. As paraphrased by one of the panelists, a more deliberate ideological course correction was announced at the 19th Part Congress in 2017, when the principal contradiction facing Chinese society was changed from one between the people's underdeveloped state and the need to unleash the factors of production to one between unleashing the factors of production and addressing imbalances in the economy and society. (On October 18, 2017, Xi characterized the principal contradiction facing Chinese society as "the contradiction between unbalanced and inadequate development and the people's ever-growing needs for a better life.") This represented a major shift after 36 years of ideological continuity—the last time the party changed its view on the principal contradiction was in 1981.

According to the panelists, Xi concluded in 2017 that if the economy continued to evolve in the way it had, it would create problems for the future viability of the CCP and Marxist ideology and potentially have negative effects on China's social order. Therefore, Xi moved ahead on two fronts. The first was to correct the fundamental structure of the economic base, including by reining in the private sector and asserting more state control. The second was a series of tactical assaults against the social structure, including attacks on extreme wealth. This ideological shift set up a conflict over whether industrial policy or market forces would be the principal mechanism for allocating resources within the economy. It also marked the re-emergence of "to each according to his or her needs" as opposed to "to each according to his or her work," which created a new dynamic around common prosperity.

4. CONSEQUENCES OF CHINA'S ECONOMIC SLOWDOWN

The roundtable participants considered the social consequences of China's slowdown, which they acknowledged were real yet most likely manageable in light of the government's immense surveillance capacity. They also noted that China's policymakers were severely constricted by many of the cyclical and structural factors discussed above. The participants focused, in particular, on the geopolitical consequences of China's economic slowdown, which many viewed as likely severe and difficult to forecast.

4.1 Social Consequences

The roundtable participants considered a myriad of social consequences related to China's slowing economy, including widespread pessimism, social malaise, and rising crime, for which there is increasing anecdotal information. The resulting social unrest is serious but will most likely be contained by the party's surveillance mechanisms and its improved ability to tackle emerging problems. However, these developments will likely create a wellspring of resentment and could result in massive reactions from the grassroots. Capital flight and illegal migration are some of the obvious signs of social discontent today.

The government's long-standing inaction around building a more robust social safety net, including on retirement income policy, education costs, and healthcare reform, as well as the prospect of higher unemployment, are all likely factors influencing household consumers to save more. Panelists acknowledged the need for a serious debate about whether the low consumption share of GDP is primarily driven by China's high savings rate or by the low household share of income relative to GDP. With government revenue in decline and China's fiscal situation deteriorating, Xi Jinping's fundamental instinct to prioritize security and sustain defense outlays also led one panelist to consider how defense spending at the expense of social programs and other budgetary measures might fuel serious social consequences. However, another panelist opined that China remains stable, with strong support for the government, and that there is little prospect of slower economic growth leading to a regime change.

4.2 Policy Consequences

One panelist suggested that sustained low growth, low corporate investment returns (typical in China's highly competitive markets), and household incomes might inevitably affect the government's ability to carry out industrial policy in the medium to long term. In particular, these factors could limit the government's ability to sustain its massive industrial policy, and that could naturally curtail China's excess capacity and eventually lessen trade tensions. Some participants noted recent signs that financial constraints have already begun to affect the government's ability to fund industrial policy, much as financing through platforms such as the Belt and Road Initiative has also slowed. However, they believed a big investment push will nevertheless persist in some sectors, such as power generation and transmission, because low electricity prices are key to keeping China's manufacturing sector competitive.

4.3 Geopolitical Consequences

The roundtable participants concluded that China's current trajectory will lead to much greater trade tensions and an inevitable backlash from advanced economies. Some panelists considered tit-for-tat trade policies unavoidable. One predicted that this would not only involve electric vehicles, batteries, and renewables but also a wide range of materials across the supply chain, including critical minerals. This poses a serious challenge for not only China but also for the global economy—in a world where overall consumption growth is not particularly robust, trade negotiations are more likely to be considered a zero-sum game.

China is a domestically driven, technology-upgrading manufacturing story, and this is reflected in its expanding share of global exports. As China sought successfully to become the world's factory, its industrial model fundamentally disrupted the operations of global markets across all sectors. Moreover, it did not vacate space for less-developed manufacturers from other developing countries as it moved into more sophisticated sectors, one panelist observed. Today, China runs a trade surplus with 173 customs territories and a deficit with only 53, most of which supply it with natural resources. Panelists acknowledged the need to debate how much the rise of China's manufacturing sector and export growth was the result of competitive, market-oriented forces and how much was due to government policies. Participants agreed that attributing China's export success entirely to government support was too simplistic. More consequentially, the growing competitiveness of Chinese manufacturers, from the less sophisticated to the most sophisticated, has contributed to a surge in net exports that poses a formidable problem for the international economy.

Another panelist added that manufacturing was set to make the largest contribution to China's economic growth in the near term, and manufacturing exports would continue to expand significantly despite frictions and pushback from the United States and the European Union. Eventually, constraints on industrial policy may force Beijing to address, at least partially, some of the imbalances fueling concerns about protectionism. Another panelist considered that China's current trajectory was unsustainable, no matter what Xi Jinping wants. In the end, international tensions will drive domestic adjustments.

China has sunk huge costs into building up its industrial base, including a substantial amount in subsidized loans, and the financial system is highly levered to a strategy of using a few key industrial outputs to generate growth. Consequently, were trade negotiations to take place between China and another country, the panelists deemed it highly unlikely that Beijing would agree to cap exports in light of the economic costs that it would have to bear. The huge financial and political sunk costs that the party-state has already invested in China's enormous industrial base are perhaps even more salient. It was unclear to the roundtable participants that China's leaders would budge in a significant way in the face of European and American protectionism.

5. FUTURE DIRECTIONS

Participants did not see much likelihood that the Chinese government will introduce policy changes that significantly influence its economic growth trend. One possible course of action for the government might be to come up with a substantial policy package to restrain excess capacity alongside domestic reforms to boost consumption. The overarching aim should be to cool trade tensions and create employment. In light of substantial adjustments in the property market, Beijing could provide more support, such as building more affordable housing, to keep the construction sector occupied and boost employment. Beijing could also divert more resources to the service sector.

One panelist agreed that creating more domestic demand would help ameliorate trade conflicts. However, China's leaders are disinclined to fundamentally change the economy's consumption-investment balance, which they believe is central to the country's investment-driven, technologically-intensive growth model. "Letting consumption forces rip" was not part of the plan. Nonetheless, the panelist added, in a few years, China's manufacturing juggernaut may look much less imposing than it does now due to the economic headwinds China will confront.

Another panelist relayed that some Chinese policymakers know they have a real growth problem, despite untrustworthy economic data, and are searching for creative ways to solve the predicament. The challenge is threading the policy needle between what can and cannot be done (i.e., taking elements of Xi's ideology and giving them an ideologically acceptable boost without undoing them). For example, social equity measures could be used to construct a new narrative around common prosperity for the people and thereby boost domestic demand. This might include introducing effective social insurance or something more dramatic, such as reforming the household registration system, which would be politically disruptive but provide a confidence boost to the economy. However, evidence does not point to a demand-side solution to the growth dilemma, this panelist concluded. The solutions advanced by Beijing in recent years began with supply-side structural reform, then moved on to "new quality productive forces," which are part of the dual circulation economy and new development concept. The new development concept is the core principle of Xi Jinping Thought, which is all about supply.

6. CONCLUSION

To conclude, panelists agreed that the consequences of China's economic slowdown are serious and important but by no means foreordained. Some saw signs from Beijing that a new economic policy direction might be forthcoming from China's leadership. Regardless of whether China takes a new direction or maintains the status quo, however, the process will be worth watching as it plays out in real time.