

Chinese Economy: Where is it Headed?

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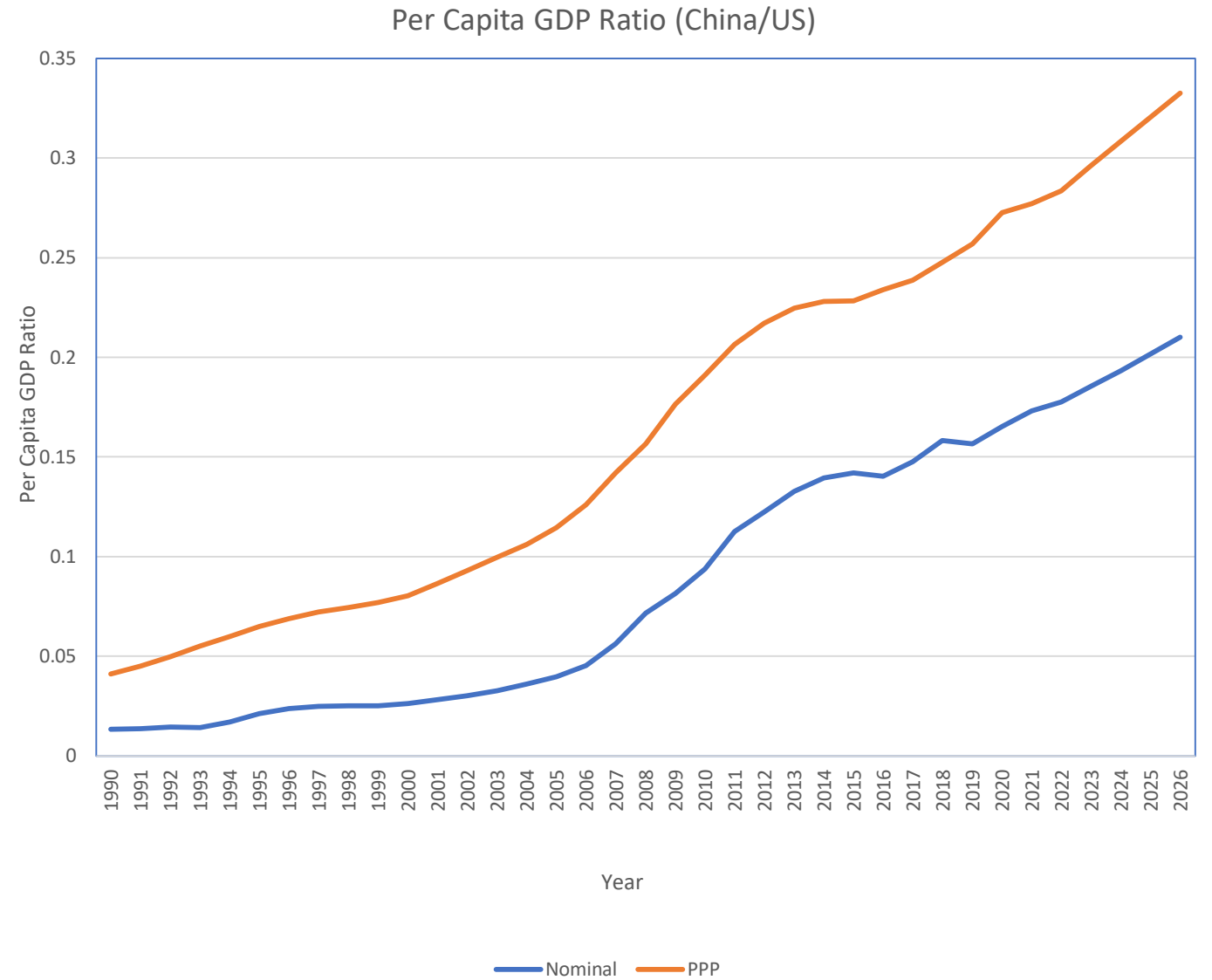
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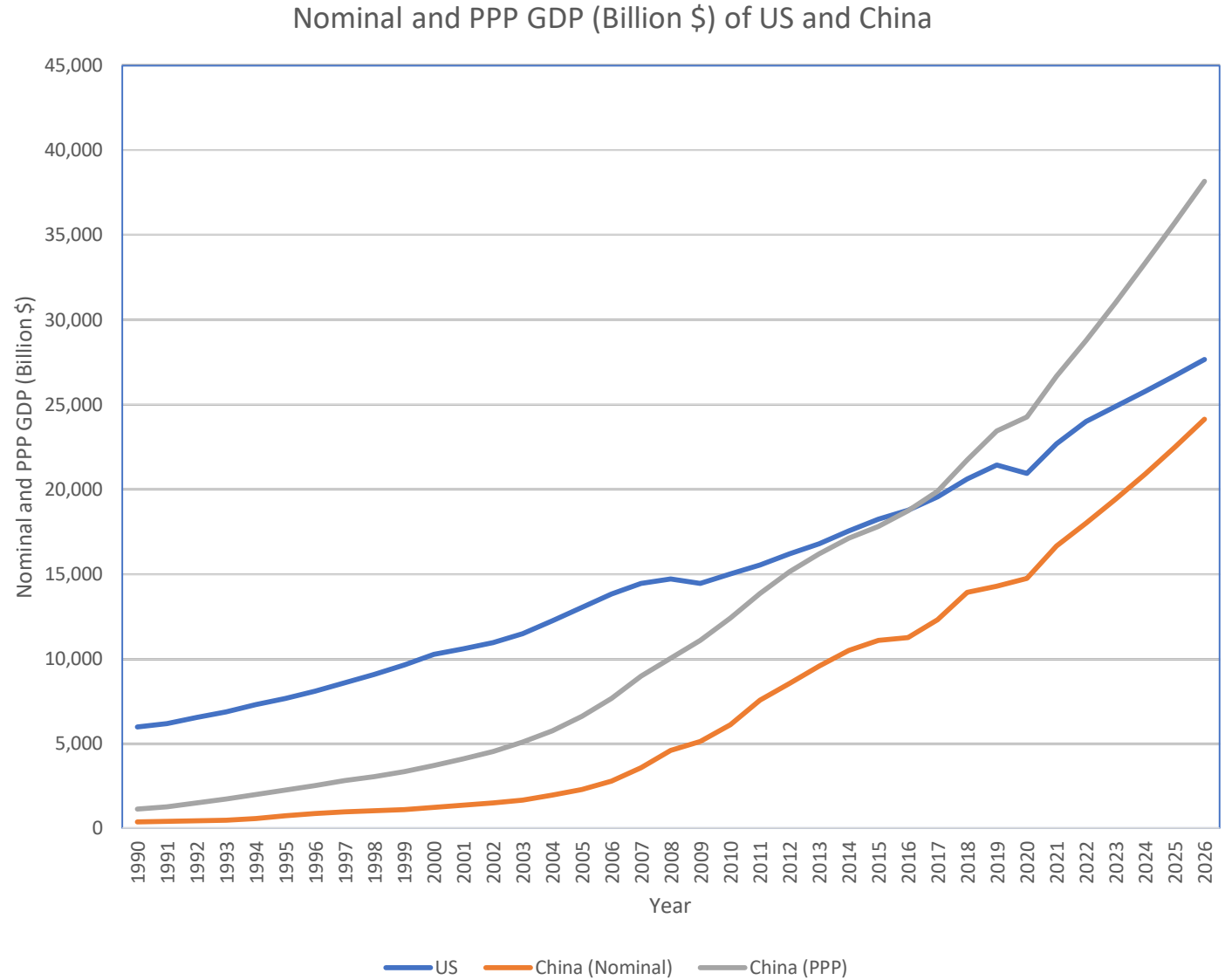
China/US Per Capita GDP Ratio (China/US): 1990-2026

- (Projection for 2023-2026 by World Bank).



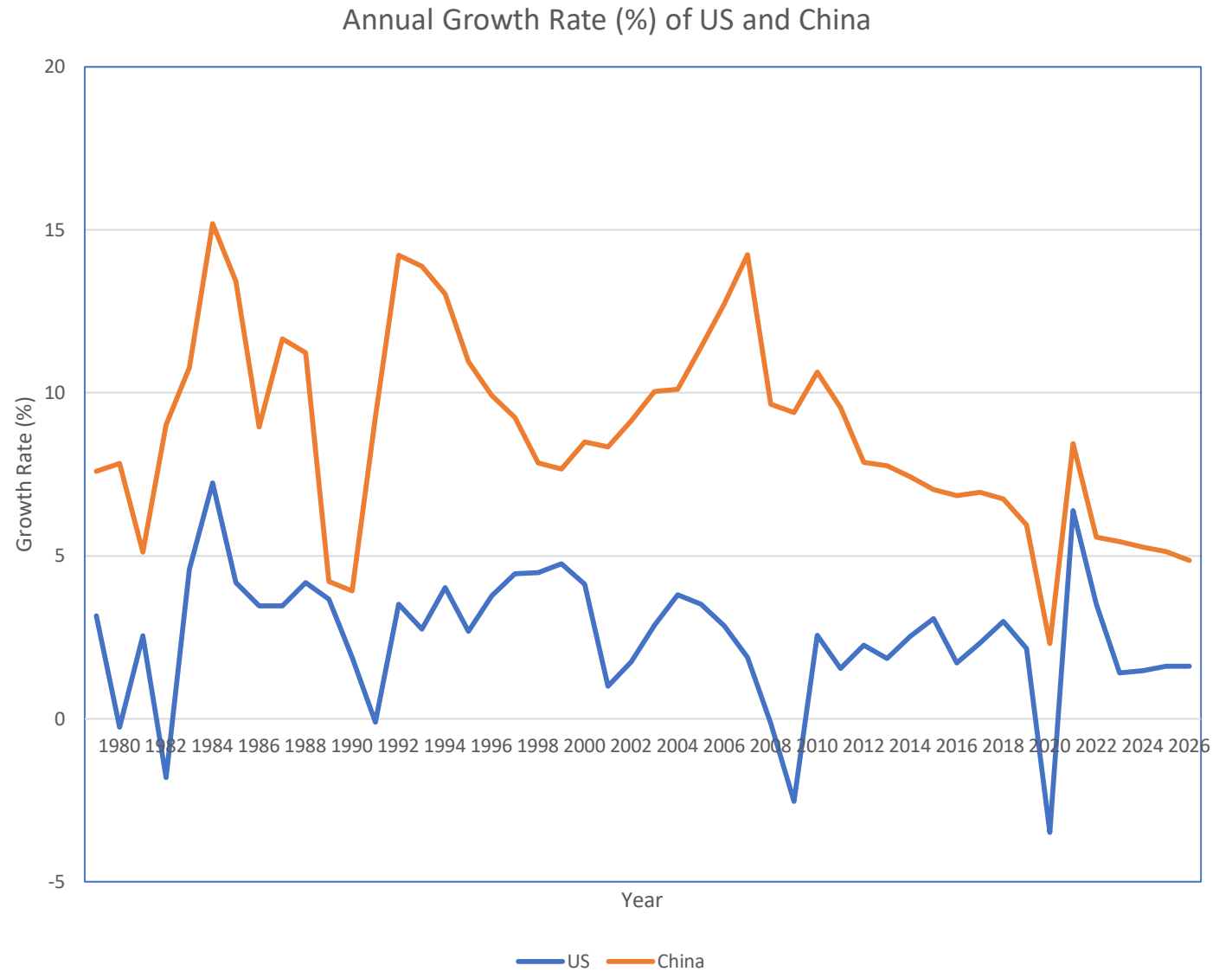
Total GDP of US and China: 1990-2026

- (Projection for 2023-2026 by World Bank).

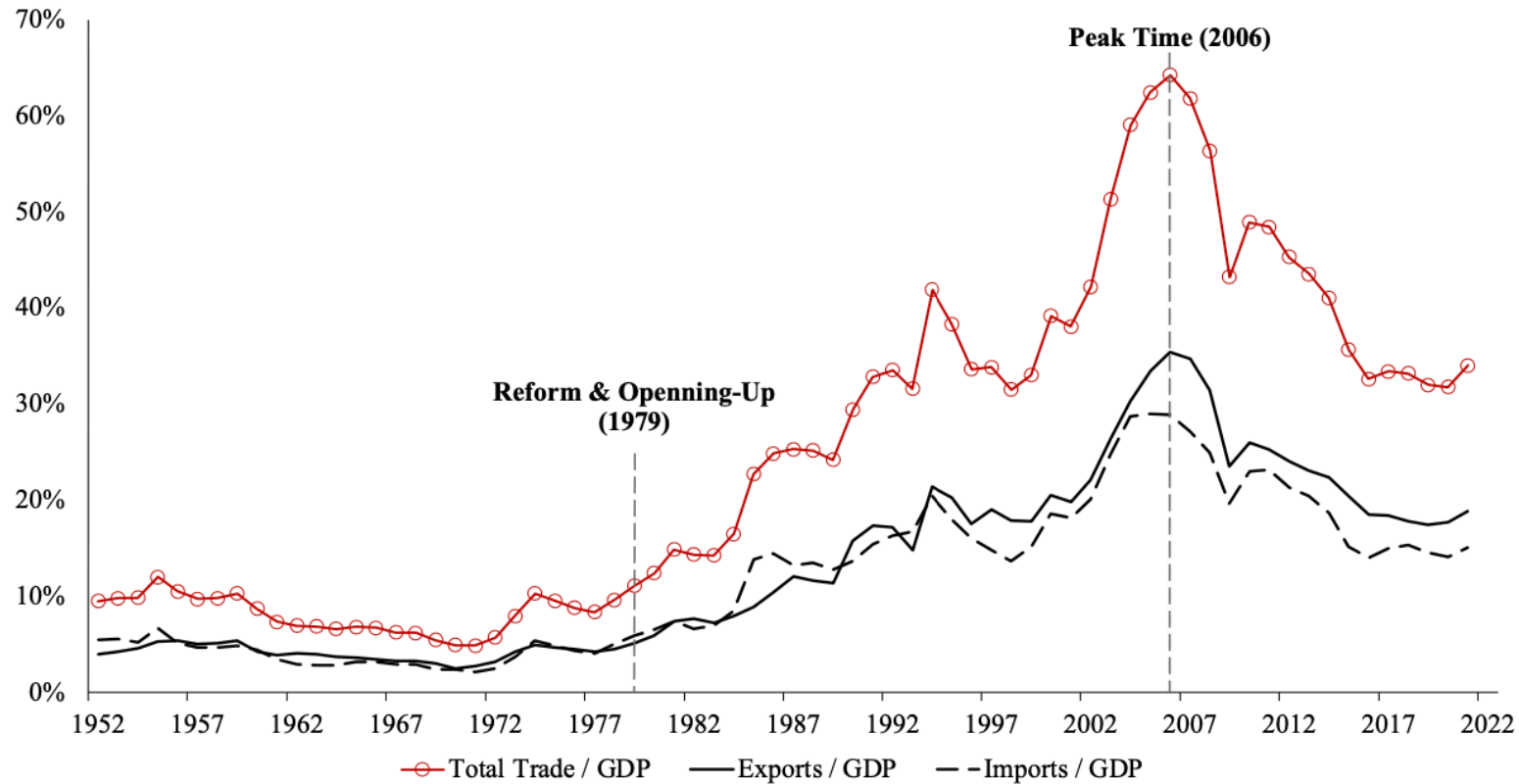


Annual Growth Rate of US and China: 1980 to 2026

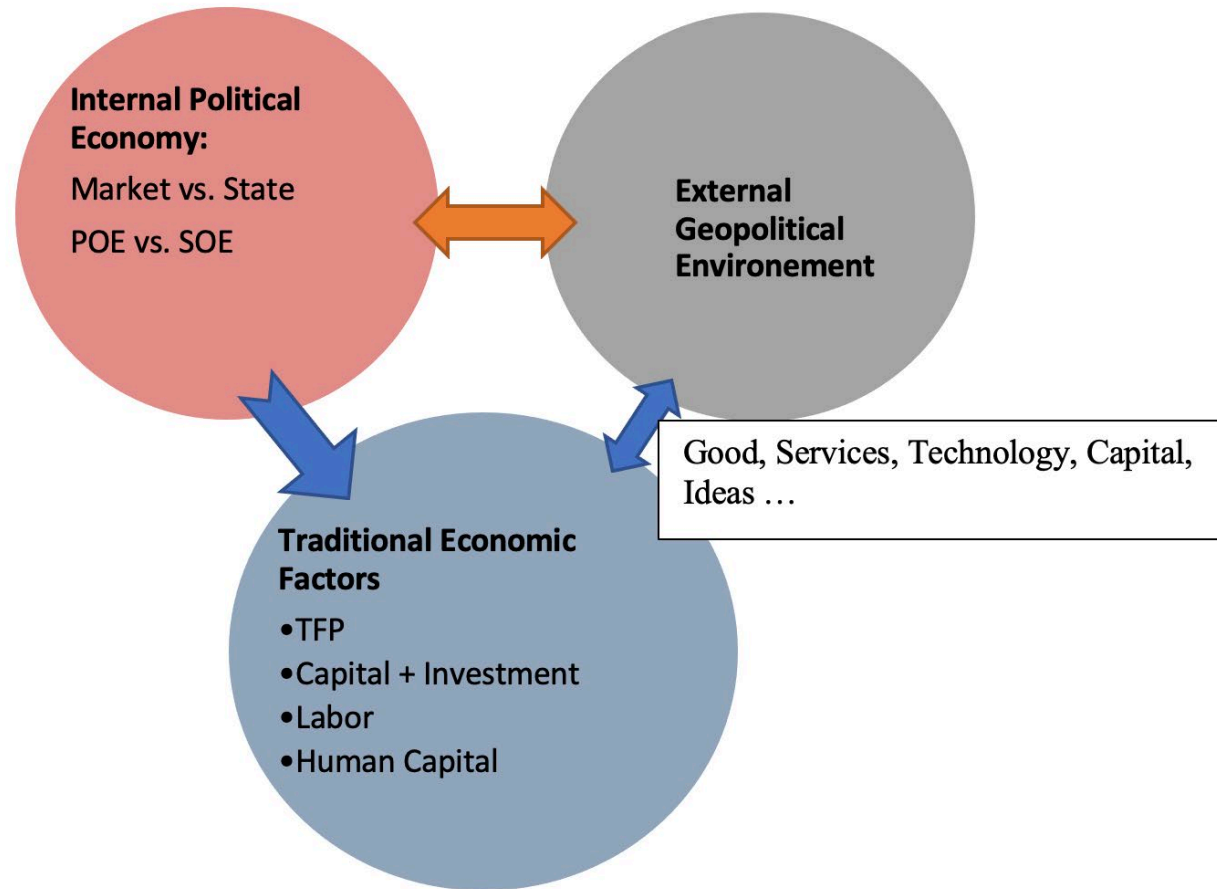
- (Projection for 2023-2026 by World Bank).



China's Exports, Imports and Total Trade Relative to GDP



The Arc of the Chinese Economy?



Arguments

1. The primary objective for the Chinese Communist Party is maintaining its power to lead China.
2. The external relationship between China and the US-led west is clearly at a historical low of the last forty years, and it could get worse before it has a chance of warming up.
3. Negative external environment in turn will move China's internal political economy toward being more centralized and less market oriented.
4. China does face some serious challenges on the traditional economic factors (population aging and declining workforce, a bubbly real estate sector, drastic income inequality, etc.), but these issues could be addressed by appropriate reform measures, unless the necessary reform efforts are blocked by vested interests spurred by the perceived external threats to China's national security, and internal threats to social stability.

“Secret Sauces” for China’s Growth Miracle (1979-2007)

- Gradual **decentralization** of decision-making powers from the government bureaucrats to individuals and firms;
- Gradual increase the **market’s role** in allocating resources;
- Use **competition** to incentivize decision makers to improve efficiency

Key Reforms in 1980s

- 1979-early 1980s: **Household responsibility system** in agriculture, which gave farmers greater autonomy in decision making and provided incentives.
- 1980s: **Special Economic Zones**
- 1980s: **Township and village enterprises (TVEs)**, engaging in small-scale, local industrial and commercial activities to absorb the surplus rural workers under collective village and township ownership.
- 1987-1988: **Dual-Track Price Reform**
- 1989: Student Protests.

Key Reforms in 1990s and Early 2000s

- **January 1992: Deng's Southern Tour:** 'those who do not reform should step down'.
- **October 1992: 14th CCP Congress:** "establish a socialist market economy" and to formally incorporate the idea of a market economy into China's socialist ideology.
- **November 1993: Third Plenary Session of the 14th Party Congress** initiated a new set of reforms to establish a market system, albeit under the shadows of the government in a hybrid fashion, as the economy's main operating system.
- **December 2001: Accession to the World Trade Organization (WTO)** further committed China to further market liberalization and integration into the global economy.
- **2001: President Jiang Zemin's "Three Represents" theory** promoted CCP membership for entrepreneurs and private businesspeople, and effectively led to a "de facto alliance between the CCP and China's business class."

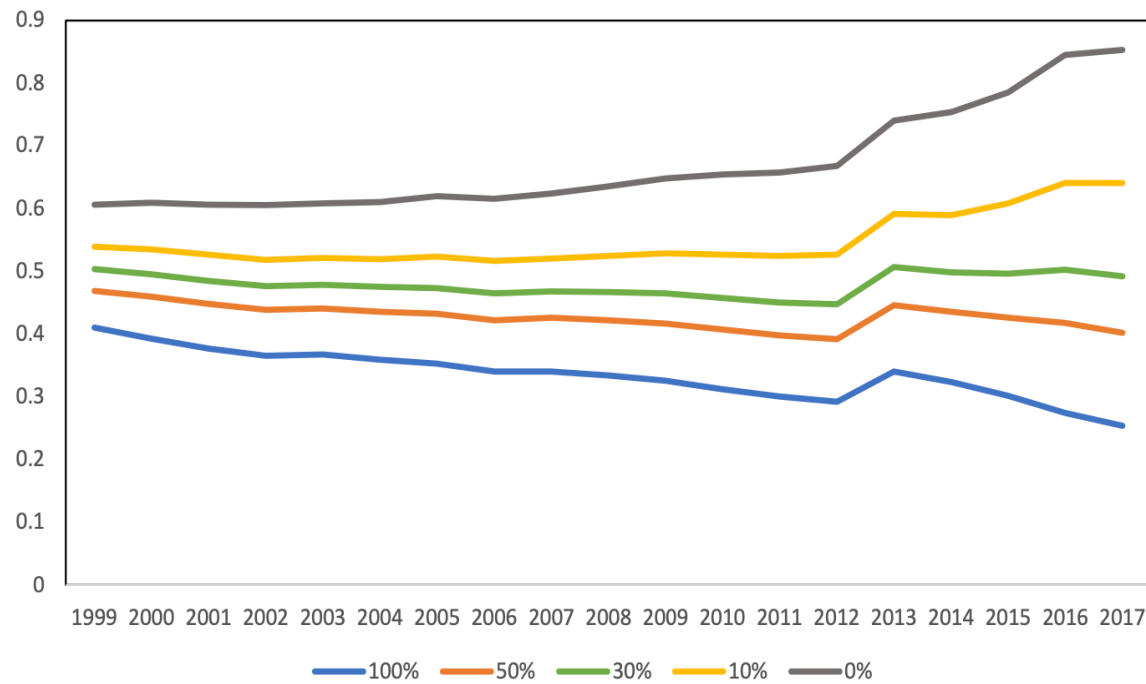
Market v.s. State Pendulum Swings Back: Five Channels

1: Leveraged State Equity Ownership

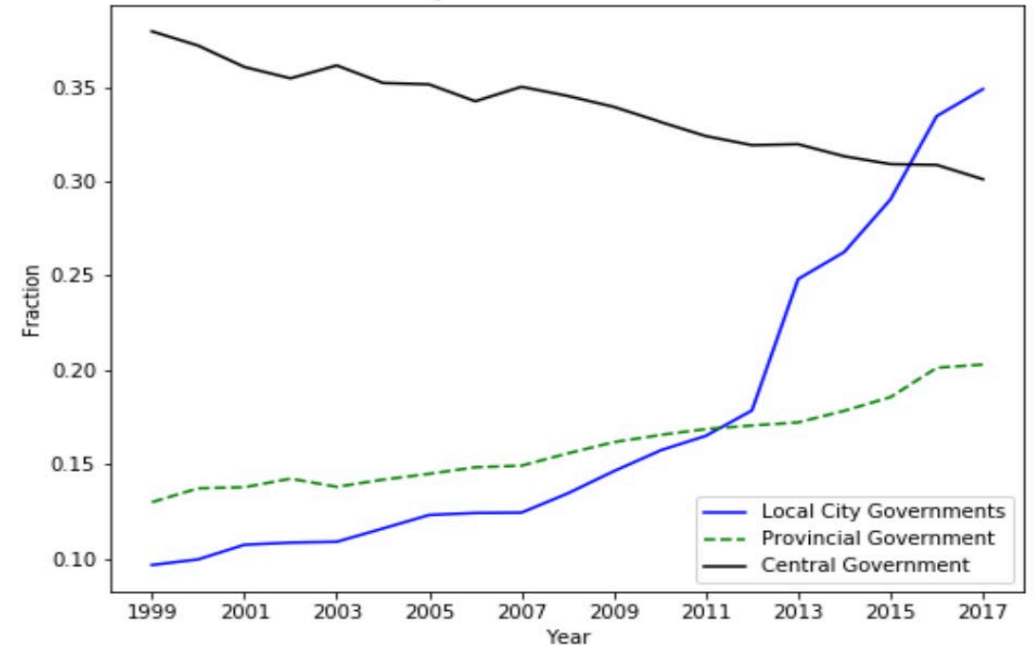
- Mixed ownership reform listed in the “60 Reform Item” of the 3rd Plenum of the 18th CCP Congress was used to leverage the state capital to control more private firms.

Allen et al (2022): Presence of State Capital in Chinese Economy

Aggregated capital of all SOEs in Chinese Economy



Fraction of Economy Linked to Governments (threshold = 0)



2. Personnel control via party cells

- According to the CCP Party Constitution, any organization with three or more CCP members should establish a Party cell.
- In 2002, less than 27 percent of private companies contained a party cell.
- In 2018, China's regulators made establishment of Party cells a requirement for any company to be listed on domestic stock exchanges.
- Around that time, Party cells within companies began advocating their boards for greater say in corporate governance

3. Regulatory Crackdown on Private Firms/Private Capital

Table 1: The Regulatory Storm: Major Milestones

Beginning of Crackdown	Target Company	Official Rationale	Outcome
Nov. 2020	Ant Financial =Fintech	Financial Risk Control of Payments Network	IPO Cancelled Ongoing Regulatory Reform
April 2021	Alibaba =eCommerce	Antitrust Violations	\$2.8 Billion fine Ongoing Antitrust Campaign
July 2021	Didi Chuxing =Ridehailing	Data Security	Suspension of downloads; Regulatory crackdown; Massive losses
July 2021	New Oriental, all =Private Education	Reduce Social Burdens; Social Equity	Abolish For-Profit Status Limit Weekend Classes and Foreign Teachers & Material
July 2021	Meituan =Food delivery	Social Equity	Guidelines for Gig Workers
August 2021	Tencent =eCommerce, gaming	Social Morality	Gaming Targeted; Outcomes Uncertain

From: Barry Naughton (2023)

4. Government Procurement and Subsidies

- Government procurement and government subsidies are also being increasingly used by all levels of the government to wield influence over private firms.
- Industrial policy is likely a tool for more government influence than for promoting advancement to the technological frontier.

5. Anti-Corruption Campaign

- My own research shows that President Xi Jinping's anti-corruption campaign may have also contributed to resurgence of the SOEs in the Chinese economy.
- Doing business with POEs becomes stigmatic because POEs are more likely to be involved in bribery.
- Government officials, even and especially those who were still "clean," have strong incentives to avoid dealing with POEs in order to self-preserve and avoid arousing suspicions that may get themselves investigated.

Why Does the Pendulum Swing Back? Relationship with the US-Led West

- Prior to the 1978 "Reform and Opening Up":

China and the US established formal diplomatic relationship precisely in December 1978, which together with Deng's state visit to the United States in January of 1979, created the favorable external environment.

Relationship with the US-Led West: 2011-Now

- 2011: President Barack Obama announced his “pivot to Asia” or “rebalancing” to Asia foreign policy initiative in 2011;
- The now (in)famous presidential debate with Republican nominee Mitt Romney where Obama identified China as America’s major strategic threat, while Romney replied with “Russia”, occurred on October 22, 2012, just weeks before Xi became the new CCP chief in the 18th Congress of the CCP (November 8-14, 2012).
- 2016--: President Donald Trump’s more much insidious rhetoric against China during the 2016 presidential campaign, then from 2018, trade wars, technology embargos etc.

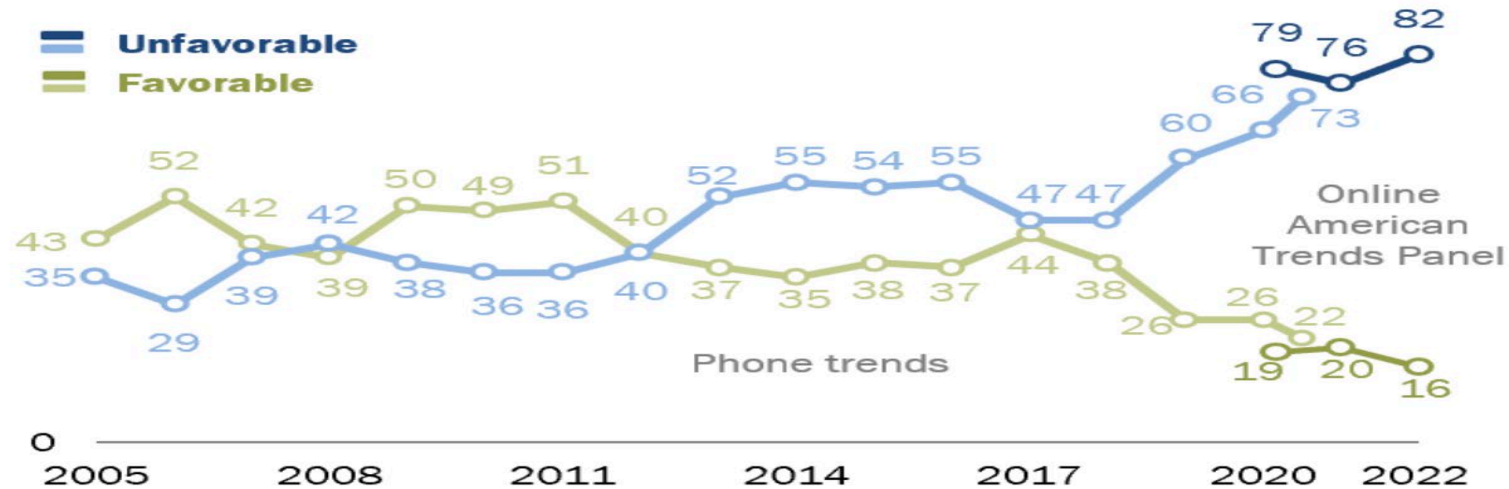
Public Opinion in the US

Among U.S. public overall, around eight-in-ten express an unfavorable opinion of China

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% who say they have a(n) ___ opinion of China

100%

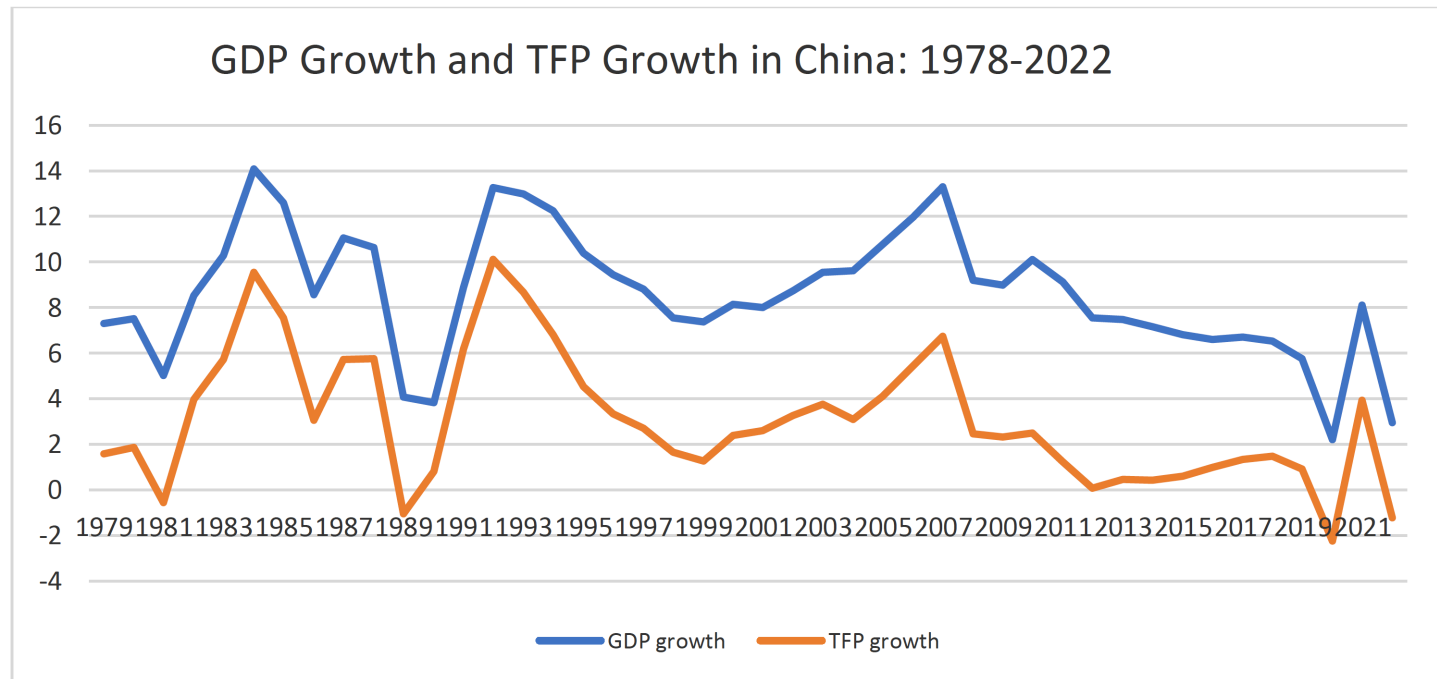


Note: Those who did not answer not shown.

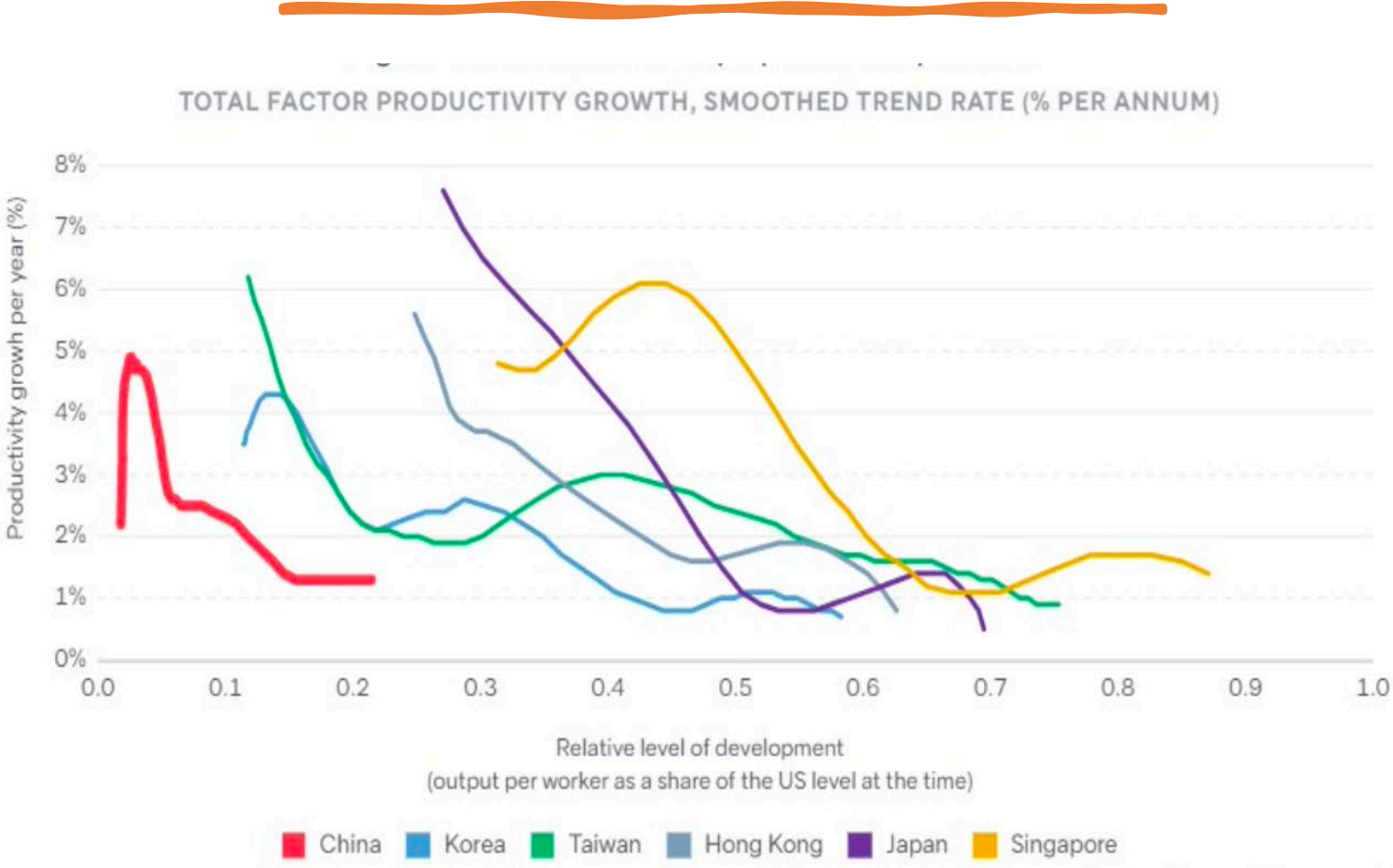
Source: Survey of U.S. adults conducted March 21-27, 2022.

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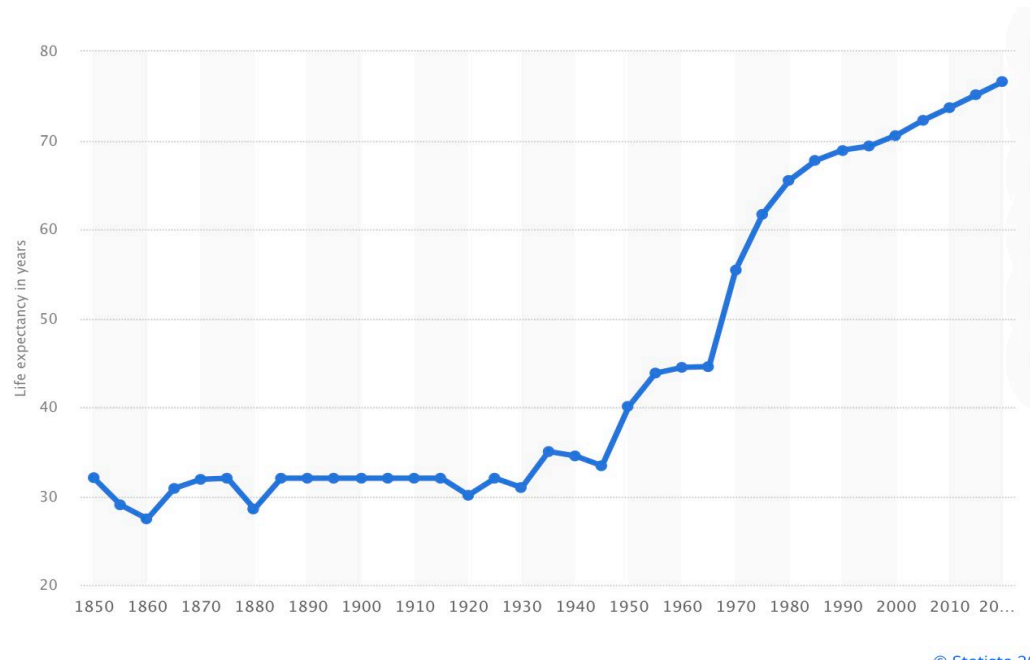
Traditional Economic Forces: TFP



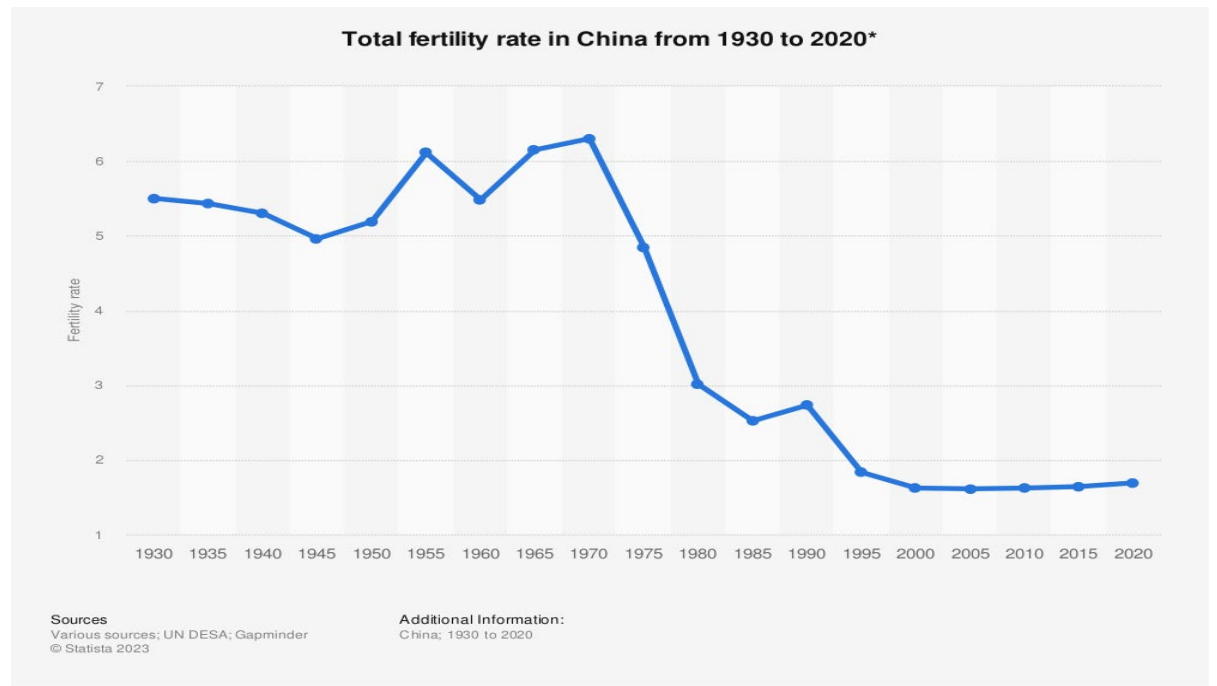
Chinese Economic Growth Miracle is **not** a TFP Growth Miracle



Demographics

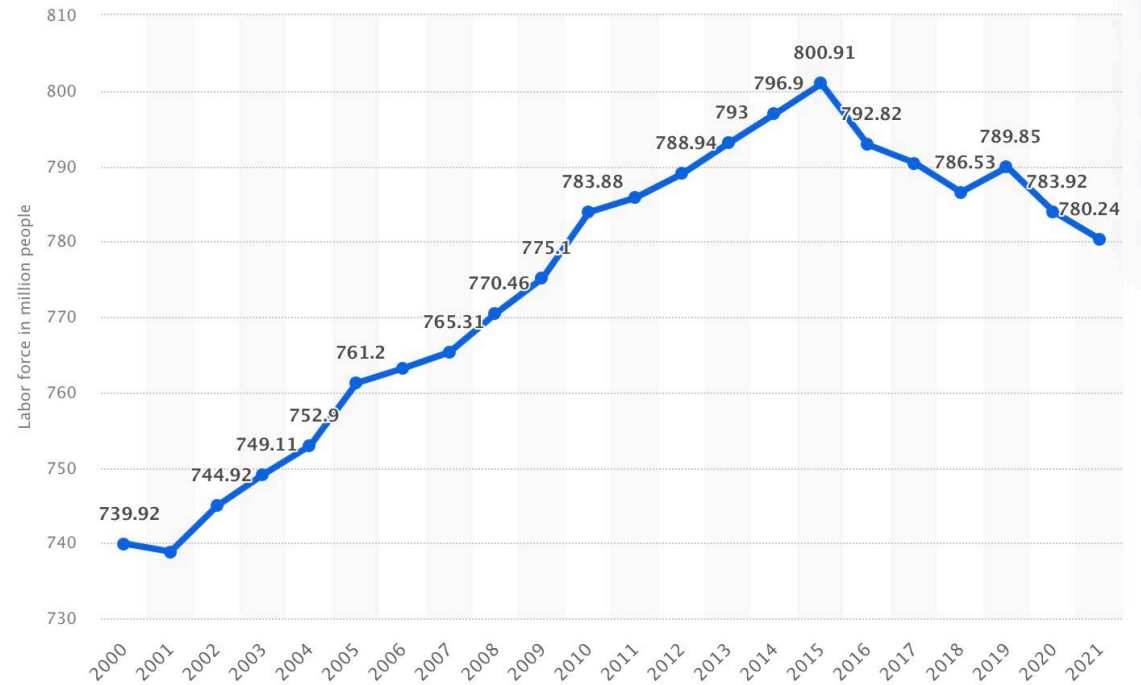



Increasing Life Expectancy at Birth



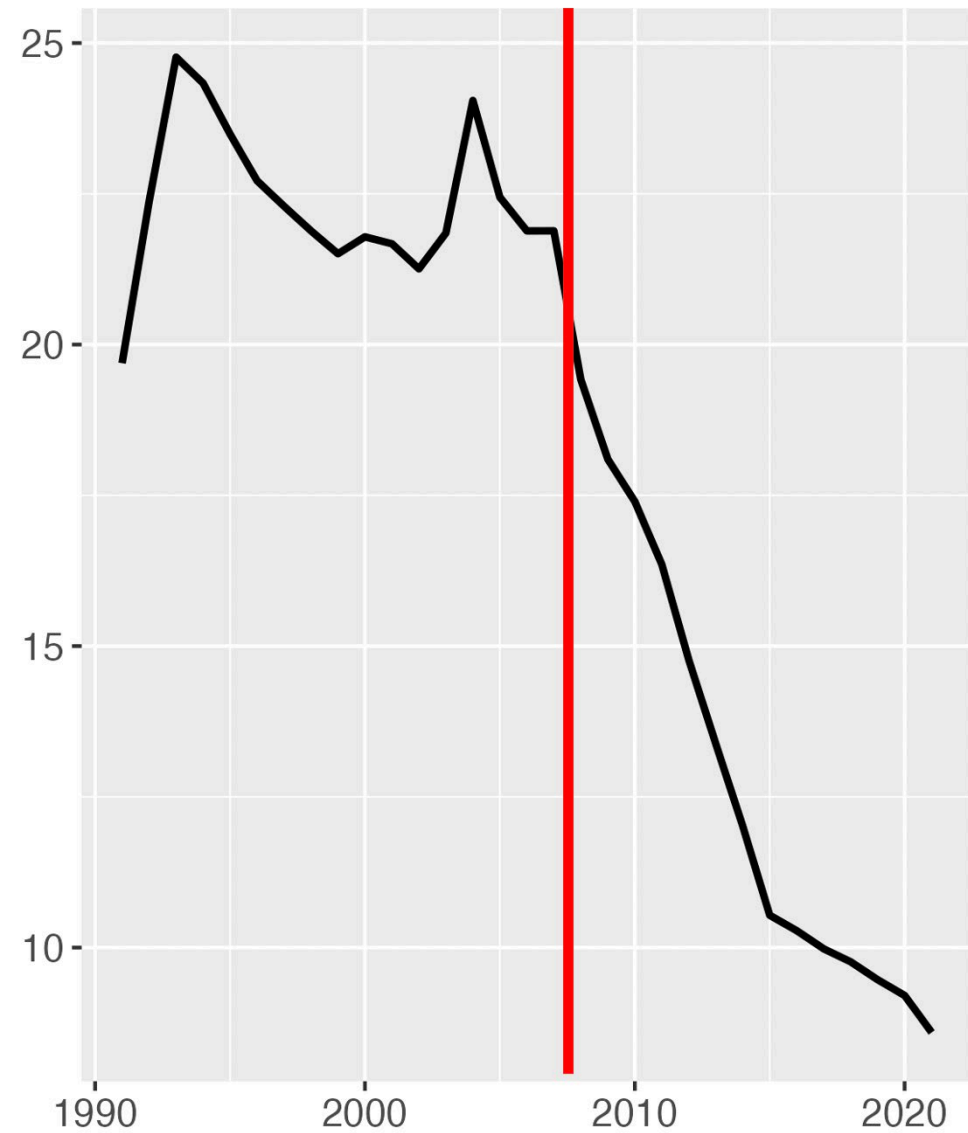
Declining Fertility

Declining Workforce in China



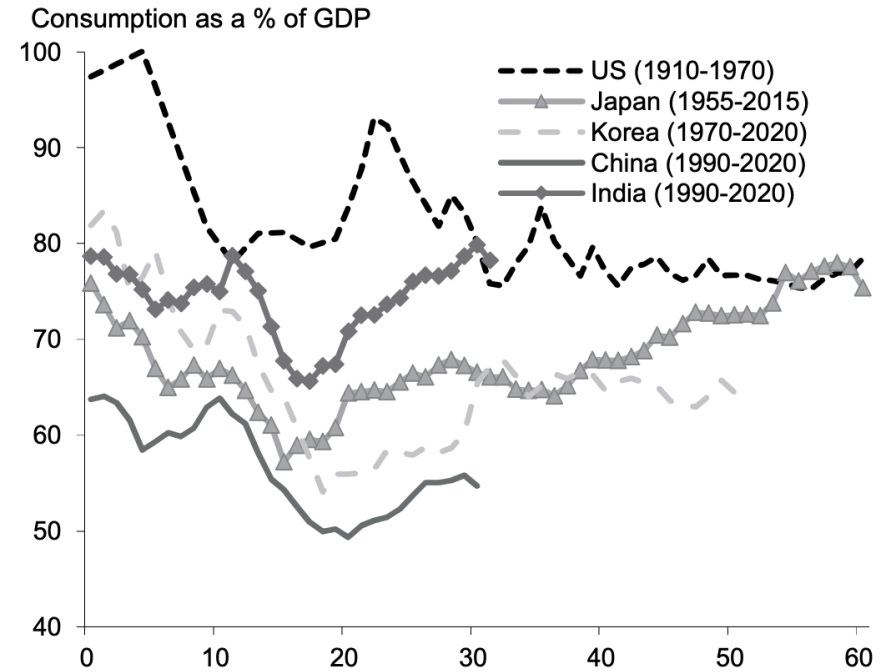


Return to Capital (%): 1990-2021



Song: The Chinese Slowdown

Consumption-Driven Growth is the only Sustainable Growth



My speculation

- **If, and it is a big “if”**, China focuses on its internal market deepening reforms to increase its TFP growth rates of 4% annually, then the Chinese economy could grow at annually 6% level in the next 10-15 years; this would be the best-case scenario.
- If China instead stops its market-oriented reform in favor of centralized decision making, top-down planned resource allocation, and marginalize the private businesses, then the TFP growth could grind to **zero**, so is its overall economic growth.
- However, even in the worst-case scenario, the **quality of economic growth** is likely to be improved in terms of environment and ecological protection.

Predictions of the Chinese Growth

- **Justin Lin:** China could *potentially* sustain annual per capita growth rate of **8%** up to 2035; and argues that most likely China will be able to achieve 5-6% annual growth rate, barring “black swan” events such as the Great Financial Crisis, wars from geopolitical conflicts, or another global pandemic like Covid-19.
- **Chenggang Xu:** annual growth rate of Chinese economy would decline steadily **from the current 3.5% annually to 2% annually or even lower.**

Predictions of the Chinese Growth

- **William Overholt (2023):** forecasts that “China’s trajectory roughly follows the template of the smaller dragons, for similar reasons. Given its loss of powerful drivers and its demographic problems, **China’s potential growth after 2030 is probably similar to the little dragons (3 percent) or to the U.S. (2 percent).**” In addition, he cautioned that “Xi Jinping’s over-centralization, Japan-style industrial policy, kneecapping of the private sector, and political controls will probably reduce growth below its potential.”
- **Jesús Fernández-Villaverde, Lee Ohanian and Weng Yao (2023):** **China’s relative per-capita GDP level will asymptote to about 41 percent (from about 25 percent in 2019, PPP terms) of the U.S. level around 2050.** Furthermore, given China’s forecasted demographics, they predict that, **by 2036, U.S. output will grow faster (2.19%) than China’s (2.06%)** and that, **by 2100, the U.S. economy would again be larger than China’s in PPP terms.**

Thank You!

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