China’s Economy Has Not Peaked

Dec 16, 2024 |**NANCY QIAN**

ROME – What happens to the world economy and global geopolitics in 2025 will depend significantly on China, the world’s largest exporter and second-largest consumer market. But prevailing assessments of China’s economic health are deeply flawed.
The headlines in 2024 have been mixed. China’s GDP is growing, though the precise rate is always a matter of debate. Youth unemployment, which shocked policymakers when it reached a peak of 21.3% in June 2023, has declined to 17.6%. And the property-market crisis finally seems to be moderating, with transactions increasing following the government’s bold intervention to support the sector, which, directly and indirectly, accounts for one-third of the Chinese economy.

And yet, the dynamism that characterized China’s economy over the last three decades seems to be missing. Consumption growth is slow, as apprehensive Chinese households maintain high savings rates. Likewise, foreign investors’ confidence is at an “all-time low.” As prices drop, fears of a deflationary spiral are growing, recalling the prolonged stagnation that gripped Japan beginning in the 1990s. Against this backdrop, some now argue that China’s economy has already peaked.

But such assessments are not particularly reliable. For starters, they mostly reflect the perspective of multinationals, concerned with their own profits, or foreign businesses and governments that take an adversarial view of Chinese growth. This helps to explain why observers tend to focus on specific sectors, such as luxury goods or electric vehicles, which account for a small part of a vast and complex economy and are disconnected from the challenges confronting most of China’s 1.4 billion people and the government that manages their lives.

A second problem with much of the analysis of China’s economy is that it is not evidence-based. For example, international policymakers tend to fixate on consumption, which is low in China, even though the assumption that domestic consumption will boost growth is highly debatable. In fact, low consumption can reflect a wide range of problems, which would not automatically be solved by inducing Chinese to consume more.

Similarly, the obsession with deflationary risks stems from the assumption that deflation contributes to poor economic performance. But researchers have struggled to find rigorous evidence that deflation *causes* economic downturns, rather than just being a symptom of them, or that monetary policies that fight deflation boost growth. In both China and Japan, it is more likely that deflation and economic stagnation are caused by other issues, such as rapid population aging.

Confusion about the causes and effects of economic trends can lead to misguided and even counterproductive policy responses. Consider cuts to savings deposit rates: the idea is that reducing the return on savings will encourage Chinese households to save less and spend more. But most Chinese would only end up poorer. Add to that the declining value of real estate (the main alternative savings vehicle) and, far from spending more, Chinese households might be motivated to increase their savings. They might even think twice about having more children, exacerbating China's deepening demographic crisis.

Yet another problem with assessments of China's economic health is that they tend to treat China like a "normal" modern economy, and assume that policy tools familiar to Western economies are similarly useful. But this ignores the fact that China has very different fundamentals. The lack of savings instruments is one example. Another is land ownership: 55% of China's total land area is agricultural and is either directly controlled by local governments or leased to farmers. Even privately owned urban housing does not include the land on which it is built, which belongs to the local government and is leased to the homeowner.

There are other restrictions, too. In most countries, people can choose where they live, based on considerations like job opportunities and lifestyle preferences. In China, strict internal migration controls make it very difficult for most people – except the richest and most educated – to move to a different part of the country. In some parts of Shanghai, housing can be sold only to Chinese citizens with local residency permits under the hukou household-registration system.

Furthermore, whereas students in most middle- and high-income countries are allowed to discover their talents and interests gradually and decide whether to apply to university after high school, Chinese students are not afforded this luxury and need to invest and commit to academics much earlier in life because of the competitive and centralized education system. Such restrictions – of which there are many more – dictate the economic lives of ordinary Chinese people. They also constrain aggregate GDP growth by undermining the efficient allocation of capital and labor.

Rather than use "normal" policy tools, such as interest rates and fiscal spending, to address low consumption or deflationary pressures, China needs fundamental reforms that tackle the structural issues underlying these problems. Allowing a more market-driven allocation of land, money, and labor would give over a billion people the chance to be more productive and earn more money. This would lead to higher consumption and investment, increased confidence, and, most importantly, a better quality of life.

Such reforms would be highly complex, underscoring the need for careful design and implementation. But getting them right would pay huge dividends. China achieved remarkable growth for decades by shifting from a command economy to a quasi-market-based system. Eliminating the remaining legacies of the restrictive planned economy could lead to another wave of high growth.

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