PS The Big Question

Is China's Economic Miracle Over?

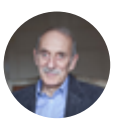
Jun 2, 2022

The Big Question is a regular feature in which *Project Syndicate* commentators provide concise answers to a timely question.

Whether the Chinese economy returns to health after the negative shock of zero-COVID policies is important not only for the country's consumers and firms and for the global economy. A severe and prolonged downturn could also damage President Xi Jinping's hopes of securing a third term in office later this year, and undermine the Communist Party of China's legitimacy.

In this *Big Question*, we ask George Magnus, Eswar Prasad, Nancy Qian, and Angela Huyue Zhang whether Chinese policymakers will be able to engineer a strong economic rebound.

Featured in this Big Question



GEORGE MAGNUS

ESWAR PRASAD

NANCY QIAN

ANGELA HUYUE ZHANG

George Magnus

China's high-growth economic miracle has been losing momentum for many years in the face of structural headwinds, which were rising before this year's GDP-sapping consequences of the lockdowns and restrictions related to Chinese President Xi Jinping's zero-COVID policy.

The headwinds comprise a broad range of growth-retarding factors, including the high burden of debt and debt-service costs, widespread misallocation of capital, a declining labor force, low educational attainment, and stalled growth in total factor productivity. The oversized property market faces a decade of retrenchment, and unemployment, especially among the young, is a growing concern.

Moreover, China's governance regime, reflected in Xi's "common prosperity" campaign, now seeks greater regulatory control over the behavior and performance of dynamic private firms, and aims to shut down the "disorderly expansion of capital."

China also faces a harsh external environment because of its challenge to the existing world order and its support for Russia. This is manifesting itself in a fundamental reassessment by governments and global firms of their engagement and interdependence. These links helped China to thrive for nearly four decades, but are under great pressure as a result of national-security concerns and perceptions of geopolitical risk, including on the part of China's government.

Zero-COVID policies will eventually become less burdensome economically, but they will reduce trust, confidence, and future investment, especially among foreign firms. The enduring issue for China is that its political leaders are not grappling with the causes of a malfunctioning economy and may make matters worse. They persist with supply-side solutions for a demand-constrained economy, and, politically, Xi's government cannot overhaul its state- and investment-centric development model.

The next economic miracle will happen if China can achieve growth of 3% or so without excessively negative side effects.

Eswar Prasad

A remarkable aspect of China's economic performance over the past two decades has been the government's ability to manage the severe economic and financial stresses that have built up as a result of the highly inefficient and risky growth model it embraced. The government has maneuvered the economy around the seemingly inevitable prospects, at various points, of a banking crisis, massive currency devaluation, and a housing market meltdown. Notwithstanding numerous ructions in financial markets and the real economy, plausible doomsday scenarios have yet to materialize.

But each of these near misses has exacted a toll. The huge buildup in domestic debt, the loss of $1 trillion in foreign-exchange reserves between 2014 and 2016, and the highly volatile prices of stocks, property, and other assets are emblematic of the challenges confronting the economy. They also highlight the declining efficacy of macroeconomic policy tools and the government's limited capacity to respond effectively to adverse domestic and external circumstances.

The government now faces several policy dilemmas, some of which are of its own making. The authorities must figure out how to continue deleveraging while maintaining growth; how to reduce energy-intensive production while the economy continues to rely on heavy industry; and how to reconcile market-based financial discipline with the strengthening of state control. Policymakers must also consider how to mitigate wealth inequality while relying on the private sector to generate more wealth, and how to encourage innovation while cutting private enterprises down to size.

Attempts to resolve these inherently contradictory impulses under the guise of market-oriented socialism will inevitably lead to further stumbles and accidents. The government's policy approach, while driven by the right objectives, could generate more uncertainty and volatility in the short run, which in turn could reduce public support for much-needed reforms to bolster long-term productivity and growth.

Finally, unfavorable demographics, high debt levels, and an inefficient financial system will increasingly constrain China's growth, even if the government succeeds in steering the economy through murky waters.

Nancy Qian

China's phenomenal economic growth in the 1990s and early 2000s was no miracle, but rather a result of intentional economic decentralization. Miracles are perfect, unearned, and unimprovable. Chinese economic policy, on the other hand, is imperfect, requires effort from leaders, and can be improved.

China's current economic difficulties as it struggles to escape its zero-COVID trap amplify problems that already existed: rising inequality, prices, unemployment, and corruption. The amplification is temporary, but the problems are not.

One way or another, China will reopen its economy and return to normalcy. It can then choose between two paths, with very different outcomes. In one scenario, the Chinese economy returns stronger than ever. Chinese leaders interpret the challenges arising from COVID-19 and the Russia-Ukraine war as highlighting the need for China to deepen and broaden its reforms, and revive the maxim of the early reform era by emphasizing people's economic well-being.

The other path leads China to economic stagnation. In this scenario, Chinese leaders interpret recent challenges as a reason to wall off the economy and return to the pre-reform mantra of prioritizing political ideology over people's welfare.

The size, diversity, and resilience of the Chinese economy give cause for optimism in the long run. But how the next few years will play out is uncertain, and there will likely be many ups and downs.

Angela Huyue Zhang

As long as China’s leaders continue to receive accurate information about the state of the economy, I believe they will do everything they can to steer the economy out of trouble. After all, economic growth is vital to the Communist Party of China’s legitimacy.

But it is important to bear in mind that economic growth is only one source of the Party’s legitimacy, alongside social stability and nationalism. This explains why the government is striking a delicate balance between trying to reach its economic growth target of 5.5% for this year and pursuing its zero-COVID strategy, which matters for social stability and national pride.

The Chinese leadership responded to previous crises in a very agile way, and I think it will do the same this time. Whether China’s economic miracle continues will depend crucially on one thing: learning. Will China’s top leadership and its people reflect upon the country’s recent challenges and identify what could be done better next time? I believe so. People tend to learn more in a difficult situation.

I am more worried about China when it rests on its laurels and fails to recognize the dangers lurking ahead. In early 2021, China was in an enviable position among major economies – it successfully got COVID-19 under control and became the only large economy to experience a dramatic rebound. But complacency often impedes learning, which is why the country is now paying a high price for its lack of a clear pandemic exit strategy.

Featured in this Big Question

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Angela Huyue Zhang, a law professor, is Director of the Center for Chinese Law at the University of Hong Kong and the author of *Chinese Antitrust Exceptionalism: How the Rise of China Challenges Global Regulation* (Oxford University Press, 2021).

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