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CHINESE ECONOMY AND POSSIBLE GLOBAL IMPACT

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Overview Of the Chinese Economy

China is an upper-middle-income country, with growth based on investment, low-cost manufacturing, and exports.[1] Since the 1978 reforms that sought to open the country, the GDP has averaged 9 per cent a year, and more than 800 million people have lifted themselves out of poverty.[2] Research has shown that huge capital investments can be credited for the rapid growth of the economy.[3] This means that investments in capital, technology, and machinery have made the economy more productive.

History Of the Chinese Economy

1979 was a landmark year in the history of the Chinese economy. Before 1978, the Chinese economy was victim to extreme stagnation, low productivity rates, stellar inefficiency, and relative isolation from the global economy.[4] It was centrally planned, tightly controlled, and produced abysmal results. However, post the implementation of the reforms in 1979, the Chinese economy grew rapidly, eventually becoming one of the fastest growing economies in the world.[5] In 2018,

[1] Overview. (n.d.). World Bank. Retrieved October 26, 2023, from https://www.worldbank.org/en/country/china/overview.
[2] Ibid.
[3] Economic Issues 8 -- Why Is China Growing So Fast? (1997, June 15). https://www.imf.org/external/pubs/ft/issues8/index.htm
[4] China’s Economic Rise: History, Trends, Challenges, and Implications for the United States. (2019, June 25). CRS Reports. https://www.everycrsreport.com/reports/RL33534.html
[5] Ibid.

the World Bank described the pace of the development of the Chinese economy as the "fastest sustained expansion by a major economy in history".[6]

Pre-reform era: Prior to 1979

The Chinese economy under Premier Mao Zedong was a centrally planned, command economy. The country's output was largely controlled by the state, with the state setting production goals, commodity prices, and allocating resources to productive activities. In 1978, nearly three-fourths of the country's industrial production was produced by centrally controlled, state enterprises in accordance with centrally planned output targets.[7] Consequently, private enterprises and foreign-invested firms were largely barred.[8] One of the primary goals of the Chinese establishment was to make the economy largely self-sufficient. Foreign trade was limited solely to the acquisition of those goods that could not be sourced or produced in China. Hence, it is only natural that firms, workers, and farmers had few incentives to be productive and produced comprehensively ineffective and poor-quality goods.

While the state apparatus claims that the GDP of the country grew at an annual rate of 6 per cent from 1953 to 1978[9], more realistic estimates are more conservative, placing the true value at around 4.4 per cent.[10] Additionally, ambitious schemes such as the Great Leap Forward and the

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[6] China's Economic Rise: History, Trends, Challenges, and Implications for the United States. (2019, June 25). CRS Reports. https://www.everycrsreport.com/reports/RL33534.html
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Ibid.

Cultural Revolution under the leadership of Chairman Mao Zedong hastened the country's economic downturn. Though the purchasing power parity (PPP) within the country doubled, living standards between 1958 and 1962 fell by 20.3 per cent, and between 1966 and 1968 by 9.6 per cent.[11]

In 1978, shortly after the death of Premier Zedong, the Chinese economy resolved to break away from its Soviet-style command economy and gradually open the economy to trade and investment from the West in the hopes that it would boost the economic standing of the country and improve the quality of life of its citizens.

Economic Reforms

In 1978, the Chinese establishment launched the Open Door Policy under the leadership of Deng Xiaoping. In alignment with the Open Door Policy, the Chinese

economy aimed to achieve economic growth through the introduction of foreign capital and investment, while still staying true to its socialist commitments.[12] The obvious aim of the Open Door Policy was to tackle the decimation that the Cultural Revolution had wrought on the Chinese economy. However, a more covert aim was to quell the disenchantment among the masses against the communist regime that the lack of disposable income and savings had incited.

[11] China's Economic Rise: History, Trends, Challenges, and Implications for the United States. (2019, June 25). CRS Reports. https://www.everycrsreport.com/reports/RL33534.html
[12] The "Three Reforms" in China: Progress and Outlook. (n.d.). https://www.jri.co.jp/english/periodical/rim/1999/RIMe199904threereforms/

In the end, the government established its famed special economic zones, open coastal cities, economic and technology development zones, the peninsula open zones, open border cities, and high-tech industry development zones. The establishment of these zones triggered phenomenal inflows of foreign investment, primarily from companies in Hong Kong and Taiwan.[13] The changes spurred an entrepreneurial boom, culminating in the emergence of many entrepreneurs and venture businesses within China.

Inflows of foreign capital, technology, and management expertise allowed China to harness its vast human resources, further contributing to the economic rise of the country. The first half of the 1980s saw exponential growth in China. The economy stagnated around the Tiananmen Square Incident of 1989 but saw an uptick during the first half of the 1990s. In 1998, the per capita income of the country was fourteen times higher than what it was in 1980.[14]

Present State of The Chinese Economy

The following section of this paper will study the Chinese economy in its present iteration along the following lines: international trade, employment, labour market, foreign direct investment (FDI), exchange rates, gross domestic product (GDP) and per capita income. It will do so by briefly looking at each of these parameters prior to the 1978 reforms and will then proceed to look at how they have evolved post the implementation of the reforms.

International Trade

[13] The “Three Reforms” in China: Progress and Outlook. (n.d.). https://www.jri.co.jp/english/periodical/rim/1999/RIMe199904threereforms/
[14] Ibid.

Prior to the 1978 reforms, under the Premiership of Mao Zedong, the Chinese economy was entirely divorced from the global markets. Entrepreneurs and private enterprises were deemed criminals[15] and the Soviet-style command economy drove economic life. The death of Mao in 1976 allowed figures like Deng and others to pursue reforms that sought to liberalize the economy and facilitate international trade. An interesting observation in China's market liberalization strategy was that it lacked a specific blueprint for the process of opening the economy.[16] However, development strategies remained unhampered by a specific outlook and there was space for the country to adapt as it went along.

The primary aim behind this liberalization project was to improve the lives of those worst affected by the Soviet-style command economies-the people.

Hence, the Open Door Policy welcomed foreign direct investment (FDI), which was previously negligible, which by 1994, amounted to USD 100 billion.[17] Annual inflows increased from less than 1 per cent of total fixed investment in 1979 to 18 per cent in 1994.[18] This foreign investment was used to build factories, create jobs, link China to the international market, and led to the transfer of important technology. In the coastal areas, foreign investors enjoyed remarkable tax

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[15] Cato Institute (n.d.). China's Post- 1978 Economic Development and Entry into the Global Trading System. Cato Institute. Retrieved November 4, 2023, from https://www.cato.org/publications/chinas-post-1978-economic-development-entry-global-trading-system
[16] Ibid.
[17] Economic Issues 8 -- Why Is China Growing so Fast? (1997, June 15). Retrieved November 4, 2023, fromhttps://www.imf.org/external/pubs/ft/issues8/index.htm#:~:text=By%20welcoming%20foreign%20investment%2C%20China's,to%2018%20percent%20in%201994.
[18] Ibid.

benefits. Economic liberalization also resulted in greater exports, which rose by 19 per cent a year during the period between 1981 and 1994. This in turn fueled productivity in domestic industries.

Employment and Labour Markets

Under the Premiership of Mao Zedong, strict restrictions were placed on the migration of the masses from the countryside to the cities. This impacted access to both labour and employment. However, with the liberalization of the economy, and the resultant establishment of the Special Economic Zones (SEZs), the labour market saw monumental shifts and the general employability of the masses improved. Not only did the SEZs require labour for production, but the new target cities also needed construction and services. Hence, the rural-urban migration laws were relaxed to contribute to the labour force, and the social and economic choice to migrate became more feasible for rural farmers. This increasing blurring of the rural-urban lines has led to a diversification of the skillset among both the urban and the rural populace. Sector employment data shows a declining trend in agriculture and a rise in employment in the service and industrial sectors.

These developments have given rise to a substantially large emphasis on the market-oriented labour market and the growing importance of the urban private sector, resulting in the downsizing of state-owned enterprises. Another landmark development in the story of the Chinese economy is the country's accession to the World Trade Organization (WTO).

In terms of employment, there has been a noticeable rise in urban unemployment owing to job losses in state-sponsored enterprises. Rural employment growth was rapid in the late 1980s and 1990s, owing to the rapid evolution of the town and village enterprises (TVEs) to meet the pent-up demand for consumer goods and take advantage of the availability of cheap labour. However, by the mid-90s, TVEs began facing competition from the private sector, resulting in rising unemployment as a result of layoffs from these TVEs.

The levels of urban unemployment compare similarly with those of other countries, however, those of rural underemployment are concerningly higher. This can be attributed to low productivity levels among Chinese farmers.

Chinese Banking System

Post the 1978 reforms, the Chinese banking system was characterized by massive government intervention, poor asset quality, and low capitalization. The Chinese banking system was previously a monolith, with the People's Bank of China (PBoC), its central bank as the main entity authorized to conduct operations in the country. From the 1980s through the mid-1990s, the Chinese government established a series of public banks that all conducted initial public offerings (IPOs) and had varying degrees of ownership by the public. Foreign banks were also allowed to establish branches in the country to make investments in public sector banks. Evidently, Chinese institutions have become more modernized after the 1978 reforms and now strive to meet global standards and make access to domestic markets for international entities easier.

GDP

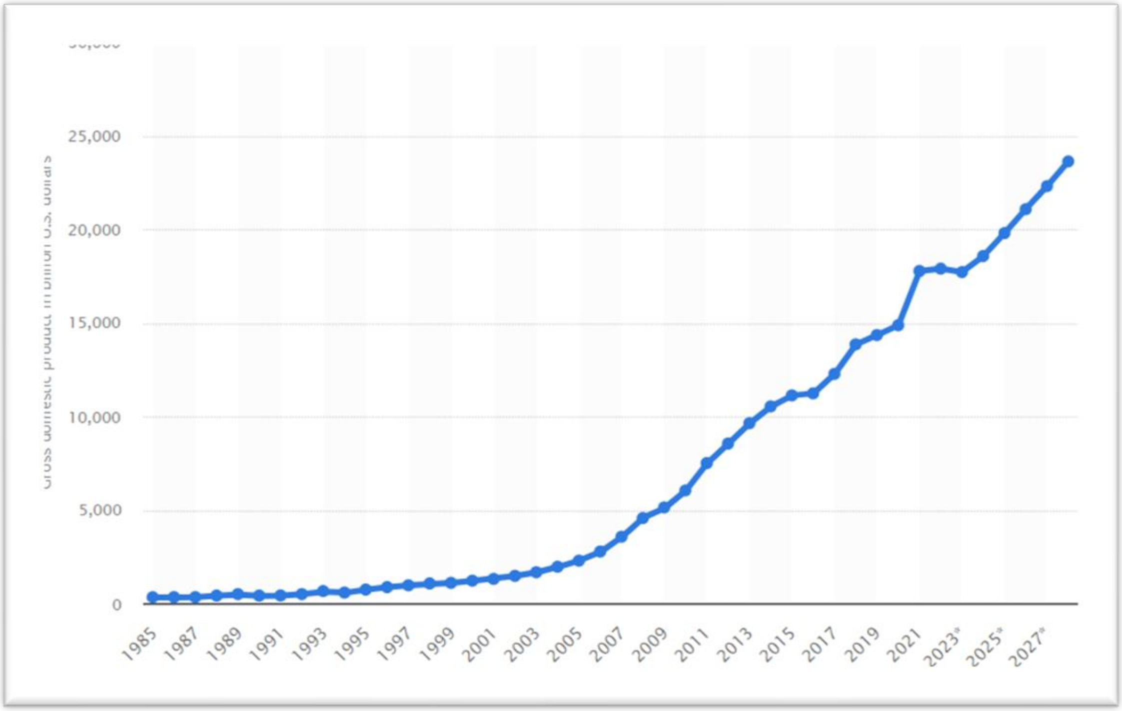

Figure 1: Chinese GDP in billion USD starting 1985[19]

Between 1978 and 2018, China averaged a real GDP growth rate of 9.5% every year.[20] This implies that on average, China has been able to double the size of its economy in real terms every eight years. Like in most countries, the global financial crisis of 2008 hit the country rather aggressively; however, the economy was able to come out the other side relatively unscathed owing to the stimulus packages it released during this time. However, the years following the crisis have seen

[19] https://www.statista.com/statistics/263770/gross-domestic-product-gdp-of-china/
[20] China's Economic Rise: History, Trends, Challenges, and Implications for the United States. (2019, June 25). CRS Reports. https://www.everycrsreport.com/reports/RL33534.html

alternating rise and fall in the country's GDP. Economists warn of devastating side effects should China and the US continue their punitive economic measures against one another.

Demographic And Social Factors That Influence the Chinese Economy: The One-Child Policy

In the coming decades, China will undergo a notable demographic transformation with its old-age dependency ratio doubling to 24 percent by 2030 and more so thereafter.

Once the world's largest population, in 2022, deaths outnumbered births for the first time in six decades in China. This is despite the government's efforts to encourage the population to have more children, including but not limited to the loosening of the one-child policy and government handouts like cash for babies and tax cuts. The one-child policy was designed in 1980 as a temporary measure to put a brake on China's rapidly growing population, and to provide respite for a country that was severely lacking in capital, investments, and essential resources. However, experts argue that the policy has continued for much longer than it should have, hence negatively impacting the fertility rate and sex ratio of the country. The government's measures now are seen as too little, too late and, hence, spells a worrisome future for the country.

Over the last four decades, the country has grown to be the world's factory and the second-largest economy. Together, these achievements contributed to increasing the life expectancy of the population, which is yet another reason why the birth rates in the country have declined. Soon, the country is set to face the grave future of not having enough people to fuel its labour economy.

What is baffling is that, despite the rather lucrative benefits that the government is providing to its population to have children, young people in the country simply do not want to have children. Despite having familial networks and employment structures very conducive to having children, young people do not seem to be interested in growing a family. Factors that contribute to couples' hesitation to raise children include the costs of rearing and educating children and the lack of substantial government support, particularly for women, at home and in the workplace. The lack of institutional support for women is a significant reason why they choose to not have children. Many employers refuse to hire women of a certain age because they do not want to deal with the costs of childcare and maternity leaves. This acts as a natural contraceptive, for women who want to be part of the workforce while they raise their own families. They do not want to choose between family and work, a pressurizing choice placed upon women from rural and working-class backgrounds. This rising demographic pressure has led to an increasing call on women to return to more traditional roles of child rearing and caregiving, much to their discontent and outrage.

China's overall population stands at 1.41 billion in 2023. By 2035, 400 million people, a third of China's population, are expected to be over 60 years of age. This staggering lack of births in the country is soon expected to translate into acute labour shortages. The pandemic, as predicted, is doing the country no favours.

Possible Global Impact of a Decelerating Chinese Economy

Without a doubt, the slump in the Chinese economy has been raising alarm bells across the globe. President Joe Biden of the United States even went so far as to call it a "ticking time bomb". China's economic woes have had an impact on global trade, tourism, currency, bonds, and luxury stocks.

Trade Slump

China is one of the largest importers of a wide variety of goods, ranging from food to metals, from numerous countries across the world, particularly in Asia. Imports from Asia, Africa, and North America were lower in July 2023 than they were a year ago. Asia and Africa were the worst hit by falling imports from China, with dropping demands for electronics from South Korea and Taiwan.

Slow Tourism Rebound

While Chinese consumers are spending more on services than they are on goods, few are looking to venture out of the country. The pandemic and the weak economy have curbed incomes in China, while the housing crisis has fostered the perception of a relative lack of wealth among the Chinese masses capable of dispensing income on international travel. It may take a while for tourism rates to return to what they once were, hitting Southeast Asian countries like Thailand hard.

Currency Impact

The fall in the value of the Chinese currency will without doubt have ripple effects for economies across the globe. The falling value of the Chinese Yuan is having a great impact on the countries in Asia, Latin America, and Central and Eastern Europe.

Bonds Lose Appeal

Cuts in interest rates in the country have resulted in Chinese bonds losing their appeal to investors, who are now looking for alternatives in the rest of the region. Overseas holdings of Chinese notes are at their lowest since 2019.

Fall in Popularity of Luxury Goods

Luxury companies like Nike reported a hard hit to their earnings as a result of the Chinese slowdown. Brands like Louis Vuitton, Gucci, and Hermes are particularly sensitive to any wobbles in the Chinese economy.

Hence, the world is in desperate need of a power to replace China. Though all hope is not lost, the global economy cannot come to a standstill and wait for China to recover. With at least half the world still struggling to recover from COVID-19 pandemic, India is starting to become an attractive option to replace China. Now the world’s largest population, India stands to gain much from the shift in focus from China. With an ever-growing population with remarkable skills and a substantial number of youth in search of lucrative opportunities for employment, India provides an unparalleled resource for countries across the globe to tap into. Australia, South America, and many more around the world have much to lose, for China is a significant importer of metals and minerals like iron ore and copper. Increasing instability in China could mean that these countries could lose out on a significant portion of their trade revenue. However, one of the most pressing concerns within China domestically is its population concerns. Within a handful of years, China is expected to have more senior citizens than youth. While this dilemma is not unique to China (as most countries in Southeast Asia are faced with a similar conundrum) the situation is particularly dire in China. For a host of reasons, it appears that the crisis is no closer to being resolved in China. There is also the question of the political landscape of China. The past few decades have seen a phenomenal rise in dissent against the Chinese establishment, and the struggle against authoritarianism and human rights abuses does not seem to end there. The country's economic failings could give global powers the space they need to raise issues concerning the country's human rights abuses.

Conclusion

The Chinese economy seems to be in hot water. Institutional rigidity, the pandemic, the domestic economic crises, among other things, place the country in a precarious situation.

The Chinese economy can attempt to encourage domestic household spending. Hypothetically, the government can do so by subsidizing essential services such as healthcare and nutrition so that the masses can allocate more funds to 'miscellaneous' expenditures that can boost the functioning of the economy. Another recommendation is for the economy to find a resolution to the housing crisis, which impairs the population's general capacity to spend, further debilitating the economy.

In conclusion, the future seems grim for China. However, this isn't the first time the country has been through tough times, and it has in the past shown remarkable grit and perseverance in the face of adversity. Hence, it is unlikely that there will be a complete breakdown of global dependence in China. However, it can be safely said that five years from now, the world order is going to be starkly different from what it is today, and China's role in that order is yet to be seen.