POLICY BRIEFS SERIES

The Chinese Economy: Sectors and Prospects

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Introduction

The future of the Chinese economy has sparked extensive discussions in both academia and the policy community. Opinions among China specialists are varied; some believe the economy is in the midst of a severe cyclical downturn,[1] while others maintain that a sharp decline is unlikely.[2] There are also those who believe it is still too early to tell.[3]

Indeed, China is experiencing a trend of economic slowdown. After joining the World Trade Organization in 2001, China's economy grew at a dazzling pace; the average growth rate of China's gross domestic product from 2001 to 2012 was 10.25%. However, since Xi Jinping came up in spring 2013, the average annual growth rate has dropped to 6.22%, plummeting to only 3% in 2022.[4] So, which sectors have been most affected by this economic slowdown? And what are the future prospects of the Chinese economy?

The Real Estate and Infrastructure Sectors

The real estate sector is undoubtedly a pillar of the Chinese economy, with studies estimating that real estate and related infrastructure account for between 25% and 31% of the overall economy.[5] Since the 1994 tax reform,[6] the Chinese economy has gradually evolved into a development model heavily reliant on real estate. Local governments depend on land finance, while real estate developers play a crucial role in boosting employment, urbanization, and overall economic growth. Today, Evergrande, one of China's largest real estate developers, reportedly create nearly 3.2 million jobs, stimulate dozens of related industries, and support over 8,000 firms, both directly and indirectly.[7] In recent years, however, the real estate sector has experienced a marked slowdown and grappled with a range of challenges. In 2022, for example, residential housing prices saw their largest decline since 1998. Additionally, the trading volume of land decreased by half, and real estate development investments experienced their first negative growth since 1998.[8]

The real estate sector cannot easily return to being the high-growth engine of the economy that it has been for the past two decades. In China, middle- and upper-class homebuyers often view housing as more of a financial product. However, facing an economic slowdown, housing purchases have dropped, and many people are unable to pay their mortgages.[9] This has led to a serious cash flow shortage for real estate developers, who rely heavily on bank loans and bonds to finance their land acquisitions and construction projects. Now, they're struggling to repay bank loans and other debts. Additionally, a significant portion of local government revenues depend on land sales. With this monetary shortage, developers have reduced the amount of land they purchase from local governments, resulting in a decline in local fiscal revenues. This exacerbates the risk of a debt crisis for local governments and their financial vehicles.[10]

Furthermore, the central government's "three red lines" policy is unlikely to be reversed in the near future.[11] The government faces a dilemma: relying solely on the financial nature of housing inflates the housing bubble, which could lead to a bubble burst. A hard landing is certainly not on the Chinese government's wish list. However, imposing strict financing restrictions on real estate developers does not solve the problem either.

Additionally, reports from the Chinese central bank indicate that China's urban household-ownership rate has reached 96%, with 31% of homeowners possessing two or more properties.[12] Given the central government's policy that "housing is for living, not for speculation (房住不炒),"[13] the likelihood of a demand boom in the short term appears slim.

The Financial Sectors

In October 2013, the Central Financial Work Conference designated "building a strong financial state (建设金融强国)" as a principal objective for China's development trajectory.[14] Since the early 2000s, the modernization of China's financial sectors has enhanced the capabilities of local governments, accelerated urbanization, and fostered the rise of private conglomerates. However, this rapid expansion has not been without its drawbacks, giving rise to various problems and systemic risks. In response, the financial landscape has seen the implementation of stringent regulatory measures since 2015. The 2023 Central Financial Work Conference reiterated this stance, emphasizing "risk prevention" as the "eternal theme" of financial endeavors.[15]

From the state's viewpoint, "risk prevention" is undoubtedly a vital guiding principle in advancing financial sector reform. This emphasis is grounded in an understanding that systemic financial risks can precipitate wider social and political instability, outcomes the Chinese state is keen to avoid. Central to the concept of "risk prevention," however, is the precise definition of "risk" itself. The term remains nebulous: What constitutes a risk? What varieties of risks does the concept encompass? The ambiguity persists.

The volatility of the stock market serves as a poignant illustration. The Shanghai Stock Exchange (SSE) Composite Index's dip below the 3,000-point mark, and subsequent slide under 2,800, has triggered widespread alarm among investors. The SSE Index has not fully recovered since the 2015 stock market crisis, oscillating between 2,500 and 3,500 points. Wu Xiaoqiu, a prominent authority on China's financial markets, argues that equating a surging stock market index with risk is a misjudgment.[16] Without an ascending index, investing in the stock market devolves into a zero-sum game, culminating in heavy losses for hundreds of millions of individual investors.

It is thus essential to cultivate a precise and coherent interpretation of financial risks to avoid politicizing such a vital concept. Still, the prevailing tendency toward stringent regulation seems to be gaining traction, a move that is ostensibly more secure for regulators. In their official capacity, they appear to prefer erring on the side of caution rather than adopting a proactive stance.

The Political Factor in the Chinese Economy

Though analyzing major sectors (such as real estate, semiconductors, and clean energy) is vital for predicting China's overall economic trajectory, it is equally important to examine the political aspects of the Chinese economy more deeply. In particular, the nature (and inherent mechanisms) of elite politics within the Chinese authoritarian regime can play a vital role in shaping the future performance of the economy.

Xi Jinping has successfully demonstrated to the world that he is a strong leader. Indeed, he has eliminated his political adversaries, transformed all members of the Politburo Standing Committee into his protégés, abandoned the principle of maintaining a "low profile" in foreign affairs, and asserted sovereignty claims over Taiwan while calling for reunification. In short, he has proven his political competence to both his regime and the world. Will Xi be able to demonstrate his competence in restructuring the economy, as he has in the political arena?

The powerful leader Xi Jinping is now truly at the center of every major decision. Unfortunately, the people around him live in constant fear of being purged, as the government's anti-corruption campaign, ongoing for a decade, shows no signs of abating. Recent dismissals of senior officials in both the government (such as Qin Gang) and the military (such as Li Shangfu) have undoubtedly left members of the Politburo in a state of heightened anxiety. The newly appointed premier, Li Qiang, seems even more subdued than his powerless predecessor, Li Keqiang, whose sudden death sparked anger and apprehension among elites and the public. He Lifeng, a key figure in charge of finance and U.S.-China economic affairs, also assumed his role under immense pressure, knowing that his predecessor, Liu He, had fallen out of favor after being Xi's most trusted ally. Clearly, He Lifeng does not wish to follow the same path. These are just two examples; in fact, all senior officials around Xi are living in great uncertainty and fear.

Now, Xi Jinping himself faces a dilemma. On the one hand, he urgently needs highly capable and competent individuals to assist him in navigating a complex economic landscape. On the other hand, any substantive measures for further structural reforms would inevitably and naturally empower those elites working on the front line, which Xi could perceive as a threat to his power. In such a power dynamic, loyalty takes precedence over competence, and flattery becomes a safer choice for Xi's subordinates. Despite Xi's deep concern for his country's economy, he is indeed facing a challenging period ahead. Xi Jinping is often considered a leader on par with Mao Zedong, but a pertinent question arises: Mao had Zhou Enlai, a hardworking, loyal, and extraordinarily capable right-hand man. Who does Xi Jinping have?

Notes

1. Jeffrey Frankel, "China's Great Leap Backwards," *Project Syndicate*, October 20, 2023; Adam Posen, "The End of China's Economic Miracle," *Foreign Affairs*, August 2, 2023; Paul Krugman, "Why Is China's Economy Stumbling?" *New York Times*, August 10, 2023; Michael Pettis, "Can China's Long-Term Growth Rate Exceed 2–3 Percent?" Carnegie Endowment for International Peace, April 6, 2023.
2. Eswar Prasad, "Has China's Growth Gone from Miracle to Malady?" *Brookins Papers on Economic Activity*, spring 2023.
3. Nicholas Lardy, "How Serious is China's Economic Slowdown?" Peterson Institute for International Economics, August 17, 2023.
4. Data from World Bank; calculations by the author.
5. Kenneth Rogoff and Yuanchen Yang, "Rethinking China's Growth," 78th Economic Policy Panel Meeting, October 19–21, 2023.
6. The 1994 tax reform was an overhaul of the Chinese fiscal and tax system in favor of the central government, resulting in a shortage of money for local governments and an increasing reliance on land finance.
7. "Report to Guangdong Provincial Government to Support Evergrande's Asset Restructuring (恒大集团关于恳请支持重大资产重组项目的情况报告)," Evergrande Group, August 24, 2020.
8. Wei Hou Kai and Li Jing Guo, *Annual Report on the Development of China's Real Estate* (中国房地产发展报告) (Beijing: Social Sciences Academic Press, 2023), 2–4.
9. "Increased by Thirty Percent, the Number of Foreclosure Houses Reached a New High (同比增长超3成，法拍房数量再创新高)," *Securities Times*, November 1, 2023, https://www.stcn.com/article/detail/1021808.html.
10. The latest report by authoritative Chinese economists estimates the total amount of local government debts at 90 trillion, 88% of China's GDP, with 65 trillion of infrastructure debt. See, Li Daokui. "Chinese Local Government Debt: Scale, Causes, and Impacts (地方政府债务研究: 规模、成因、影响分析)," Institute for Chinese Economic Practice and Thinking, Tsinghua University, October 25, 2023.
11. Beginning on January 1, 2021, the Chinese government started implementing the strictest policy yet on the real estate market. It stipulates that the asset-liability ratio after excluding pre-sale funds should not exceed 70%, the net debt ratio should not exceed 100%, and the cash-to-short-term debt ratio should not be less than one. See, for example, Cao Chen, "Under the 'Three Red Lines': Safe and Stable Operation Becomes New Challenges for Developers (三条红线新规下安全稳健成房企新课题)," *Securities Times*, August 31, 2020.
12. "Central Bank Survey Shows: Thirty Percent of Urban Households Have Two Suites (央行调查显示三成城镇家庭两套房)," *China Economic Weekly*, Issue 9, 2020.
13. The Chinese central government has reiterated the policy of "housing for living, not for investing" (房住不炒) since 2016. This policy has been promoted by Xi Jinping, Li Keqiang, the Politburo, the State Council, the Ministry of Housing and Construction, the People's Bank, the Banking and Insurance Regulatory Commission, and the Ministry of Finance. For a summary of the policy, see *Annual Report on the Development of China's Real Estate*, from 2016 to 2022.
14. "Central Finance Work Conference has been held in Beijing (中央金融工作会议在北京举行)," *Xinhua News*, October 31, 2023, http://www.news.cn/politics/leaders/2023-10/31/c_1129951150.htm
15. "Central Finance Work Conference released important signals (中央金融工作会议释放重要信号)," *Xinhua News*, November 1, 2023, http://www.news.cn/politics/leaders/2023-11/01/c_1129952721.htm.
16. Wu Xiaoqiu. "Restoring market confidence is the current top priority for China's capital market (恢复市场信心是当前中国资本市场的重中之重)," speech at the 2024 China Bridge Market Capital Annual Conference, cited from Sohu.com, January 23, 2024, https://www.sohu.com/a/753830743_674079.

About the Author

Hao Chen is a political economist specializing in Chinese economic and political development. His research interests include state-business relations, leadership politics, and urban governance. His current research projects explore the role of state capital in the Chinese economy, the rise and fall of China's private conglomerates, and patterns of purges and survival among political elites in China. He has published in *The China Quarterly*, *Studies in Comparative International Development*, *Journal of Public Management*, among others, and his research has been spotlighted in *The Washington Post*. He was a distinguished visiting professor at the Schwarzman Scholars Program, a postdoctoral fellow at the University of Southern California, and a research fellow at Harvard Business School. Hao received his Ph.D. in political science from Boston University.

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The Rajawali Foundation Institute for Asia at the Ash Center for Democratic Governance and Innovation advances research and teaching about policy challenges both within the region and Asia's place in the global community. We work to deepen understanding of the region, explore possibilities for innovation, and advance important initiatives that will affect millions of lives in Asia. Additional information is available at rajawali.hks.harvard.edu.

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