China's Supply-Side Waste and Demand-Side Failure

On March 9, 2016, an anonymous front-page article in China's *People's Daily* was published, ridiculing the debt-fueled growth strategy that propelled China's meteoric growth rates in previous decades (Cendrowski, 2016). It was later revealed that the author was Liu He, a close confidant of Xi Jinping and one of China's most influential financial officials. The following year, Xi officially declared financial risk a matter of national security, marking the beginning of a crackdown on debt. Today, the CCP is still struggling to rein in China's debt, a challenge with massive repercussions should Liu and Xi fail.

Over the last few decades, the central government facilitated GDP growth by setting growth targets for local governments to meet. To achieve these targets, local governments made whatever investments necessary, no matter how productive this spending was. Unproductive investments have grown over time as new infrastructure and real estate projects that sought to meet these GDP growth targets resulted in decreasing real economic value and increasing debt. While China's extensive high-speed rail and other infrastructure projects undoubtedly create real value (Fan et al., 2021), as an article from *The Economist* put it, China is nonetheless occupied with building "bridges to somewhere" ("Bridges to Somewhere," 2014).

Following 2008, political goals like minimizing unemployment and poverty were deemed a top priority, and China relied heavily on infrastructure and real estate to maintain positive growth rates. Projects are funded through local government financing vehicles, which hold hidden, off-balance-sheet debts that are estimated to have grown to $8.2 trillion ("China Hidden Local Government Debt," 2021). Combined with China's banks holding bad loans and high levels of corporate debt, many experts are concerned that the Chinese economy's faults could have global repercussions. Since 2008, China's domestic debt has grown at an annual rate of roughly 20%, outpacing an average GDP growth rate of 8% (Lee, 2021). Furthermore, if wasted investment were to be tracked and subtracted from GDP as in other countries, some estimates of China’s GDP growth drop below 3% (Pettis, 2017).

The country’s overreliance on supply-side growth becomes even more apparent when examining private consumption as a percentage of GDP. In the United States, private consumption accounts for around 68% of GDP (CEIC, 2021), while in China, it accounts for just 38% (CEIC, 2021). Local governments, elites, and the uber-wealthy receive an outsized portion of China’s GDP while households retain historically-low incomes (Pettis, 2020). Income transfers are necessary to boost China’s private consumption as a percentage of GDP and create a stable source of demand for future growth.

Despite their recognition of the danger of infrastructure and real estate fueled growth, China has had difficulty moving towards a more sustainable growth strategy. China has attempted to alleviate the looming threat of bad debt by weaning state-owned enterprises off of loans (Cheng, 2021). Yet, a policy shift seems to be more difficult to actualize than some may hope (Zheng, 2022). This was evident following the economic slowdown from the COVID-19 pandemic, as party officials, albeit reluctantly, relied on infrastructure and real estate to boost the ailing economy.

In the latter half of 2021, nightmares began to come true as Chinese real-estate giant Evergrande faced default. After Evergrande began reducing debts in 2020 as a result of new regulations, a lack of liquidity sowed fear in the global economy and US financial markets (Toh, 2021). And, while Evergrande remains likely to be the country’s largest-ever bankruptcy (Yu & Mitchell, 2022), other real estate developers like Fantasia, China Properties Group, Modern Land, and Sinic Holdings all face financial risks of their own (Madhok & Tappe, 2021).

Meanwhile, corporate debt continues to threaten many industries, from construction to transportation to retail (Hui, 2021). Non-performing loans held by banks now amount to $540 billion (Yan, 2021), all while a $13 trillion shadow banking sector poses more challenges for Chinese regulators (Wu & Jia, 2020).

While Liu, Xi, and other party officials recognize the threat debt poses to China, it does not make the solutions any easier to implement. China's decentralized economy gives autonomy to local governments, whose officials and elites have fervently opposed any redistribution of income (Davis, 2012). Xi's recent push for "common prosperity" is a break with the CCP's decades-old adage of allowing wealth inequality to grow in pursuit of GDP growth (Buckley et al., 2021). Attempts by the central government to redistribute wealth, then, serve both economic and political ends. Ushering in economic reforms to resolve China's demand-side failings is top priority (Kynge, 2021), though the question remains whether change is viable, both economically and politically.

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