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Chinese Economy

A Bird's Eye View

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The Takshashila Position Paper provides an iterative analysis of a particular topic. This is done through constant monitoring and periodically updating our assessments, taking into account any new data that might become available. We also invite readers to discuss and deliberate on developments related to a particular topic, contributing to this process of iterative analysis.

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Track Changes¹

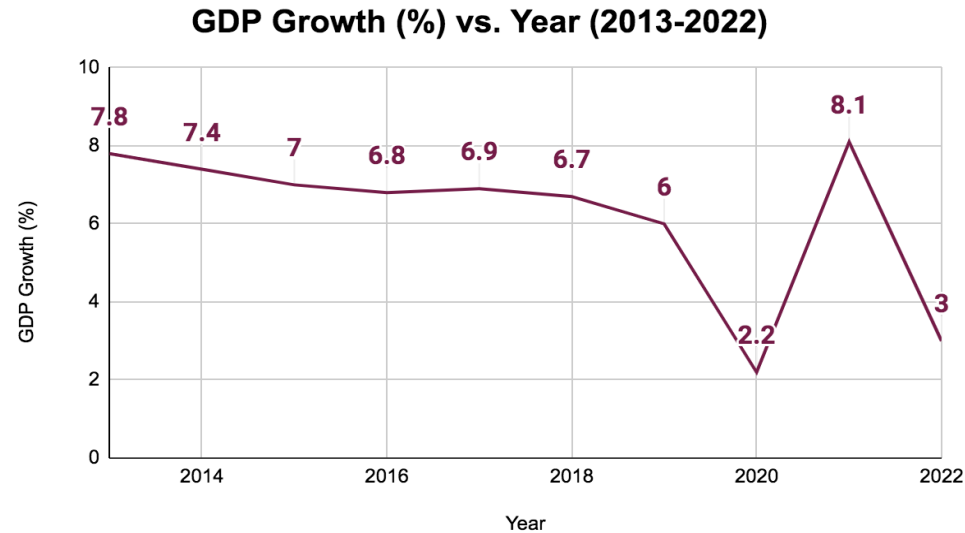
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| Version 1.0 | Published Thursday, 16 February 2023 | |
| Version 1.1 | Published Friday, 24 February 2023 | Updated after news regarding businesses adopting ‘China+1’ strategy |
| Version 1.2 | Published Wednesday, 5 April 2023 | Updated after ‘Two Sessions’, developments in US-China tech rivalry and new statistics pertaining to GDP and investment |

¹ This position paper shall be updated as and when events and ideas shape up with new trends and developments.

Key Judgements²

- The Chinese economy has suffered serious setbacks across sectors due to the disruptions induced by the COVID-19 pandemic. The restrictions and crackdown imposed as part of Chinese President Xi Jinping's flagship zero-COVID policy exacerbated the economic impact of the pandemic. Since the scrapping of the zero-COVID policy in early December and the subsequent easing of policies related to the property sector, most international financial institutions forecast that China's GDP growth will be around 5 per cent.
- However, we observe that despite positive projections, significant medium-to-long-term structural challenges persist. The quest to boost growth in the near term, in fact, will likely delay further action to address these.
- Shifts in economic policy, occurring in the three-month period between November 2022 and January 2023, indicate a more extensive focus on stimulating growth by easing fiscal and monetary policies. The immediate concerns focus on boosting confidence, addressing COVID-related challenges, generating employment, ensuring food and energy price and supply stability, supporting the property sector, expanding domestic consumption through supply-side investments and not exacerbating local government budgetary challenges.
- Some areas that are likely to see advances are industrial upgradation, core technologies-related work, market diversification, green technologies and low-carbon development. However, reforms needed to address long-term, structural challenges, such as fiscal & tax reform, hukou reform, demand-side consumption support, and developing an enhanced social security net, are unlikely to be pursued.
- Finally, China continues to play a central role in the global economy, and broad-based economic decoupling does not appear to be taking place. However, there is intensifying friction with regard to emerging technologies, where splits in the international ecosystem are evident. In addition, Chinese government actions over the past three years, have eroded foreign governments' and investors' faith in the predictability, reliability and efficiency of Chinese policymaking.

² **Acknowledgement: The authors would like to thank their colleague, Manoj Kewalramani, for his valuable feedback and comments.**



Section 1: Our Assessment of China’s Economic Developments

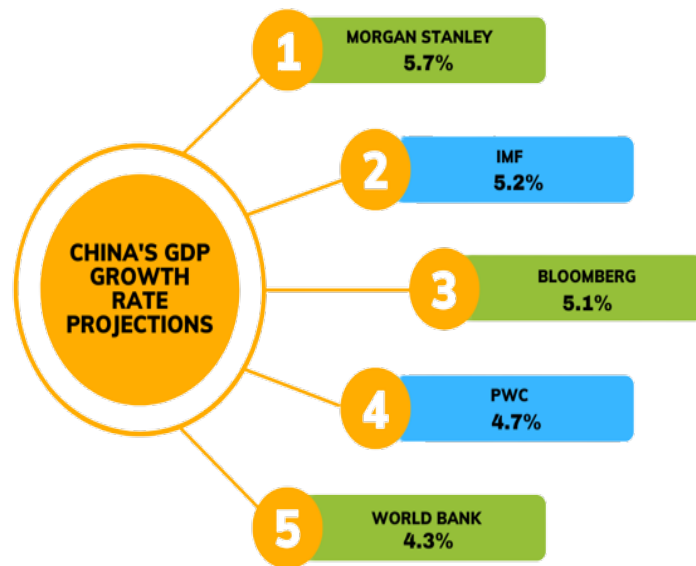
Section 1.A: What does the data say?

- Preliminary accounting results peg Chinese GDP for 2022 at 17840188 million USD.³
- Per capita GDP stands at 12,700 USD, and the goal is to double it by 2035.⁴
- As per the Government Work Report released at the ‘Two Sessions’, China’s annual parliamentary meetings, GDP is projected to grow at 5 per cent in 2023.⁵

³ “Press Release,” National Bureau of Statistics, China, January 2023, http://www.stats.gov.cn/english/PressRelease/202301/t20230117_1892094.html.

⁴ Manoj Kewalramani, “2022 Economic Data - Liu He’s Davos Speech - Chongqing’s Economic Agenda - Wang Huning on ‘Comprehensive & Strict Governance’ of Religion - Li Keqiang Calls for Energy Supply Expansion,” *Tracking People’s Daily*, 18 January 2023, <https://trackingpeoplesdaily.substack.com/p/2022-economic-data-liu-hes-davos>.

⁵ “REPORT ON THE WORK OF THE GOVERNMENT,” NPC Observer, 5 March 2023, <https://npcobserver.com/wp-content/uploads/2023/03/2023-Government-Work-Report.pdf>.



in the long term.

- Agencies like World Bank, Bloomberg (Survey of Economists), Morgan Stanley and PwC peg growth of Chinese GDP for 2023 between 4.3 and 5.7 per cent.⁶
- The International Monetary Fund recently revised its GDP growth projections for China from 4.3 to 5.2 per cent.⁷
- However, domestic compulsions and a hostile external sentiment present a bleaker picture for the Chinese economy in the short term.
- Declining population has also led to a shrinking workforce, with the working population dropping from 997 million in 2014 to 986 million in 2021.⁸
- Age dependency ratio (people dependent on the workforce aged 15-64) has risen from 38 per cent to 44 per cent under Xi Jinping.⁹
- Due to the weakening of the global economy during the pandemic, and a domestic slump in demand, exports as a percentage of China’s GDP has declined by 4 per cent in the past decade.¹⁰
- Export data from 2022 shows that the short-term boost is unlikely to sustain

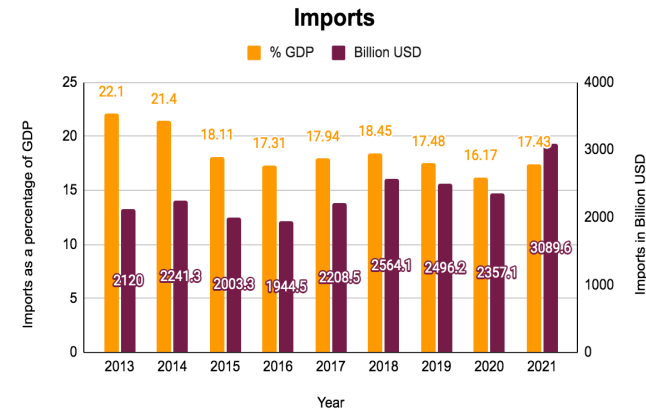
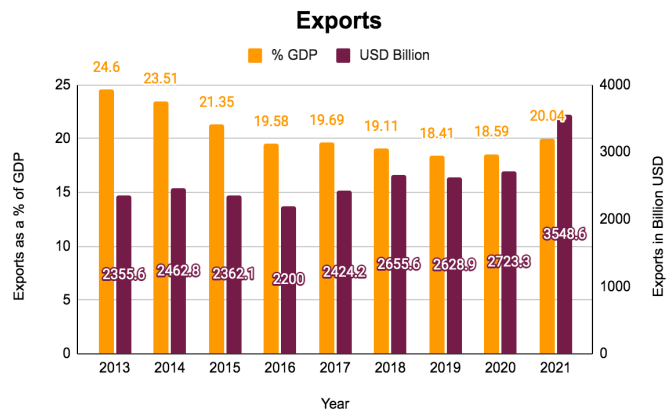
⁶ Cynthia Li, “China’s Growth Forecasts Raised Into Next Year as Country Reopens,” *Bloomberg*, 19 January 2023, [https://www.bloomberg.com/news/articles/2023-01-19/china-s-growth-forecasts-raised-into-next-year-as-country-reopens#:~:text=China's%20Economic%20Growth%20\(GDP\)%20Forecasts,After%20Covid%20Zero%20Reopening%20%2D%20Bloomberg](https://www.bloomberg.com/news/articles/2023-01-19/china-s-growth-forecasts-raised-into-next-year-as-country-reopens#:~:text=China's%20Economic%20Growth%20(GDP)%20Forecasts,After%20Covid%20Zero%20Reopening%20%2D%20Bloomberg;); “China poised for strong recovery in 2023, says Morgan Stanley economist,” *ChinaDaily*, 18 January 2023, <https://www.chinadaily.com.cn/a/202301/18/WS63c79242a31057c47ebaa5d1.html>; “Global Economy Watch - Projections,” PwC, <https://www.pwc.com/gx/en/research-insights/economy/global-economy-watch/projections.html>; “China Economic Update – December 2022,” World Bank, 15 December 2022, <https://www.worldbank.org/en/country/china/publication/china-economic-update-december-2022>;

⁷ “People’s Republic of China,” International Monetary Fund

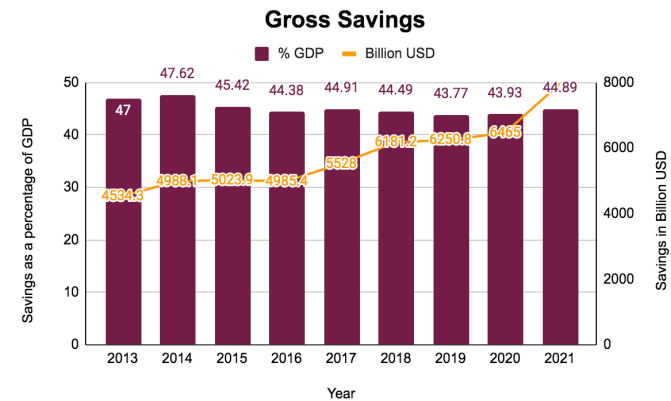
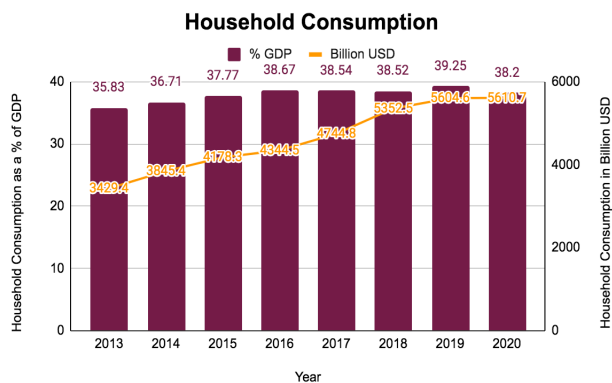
⁸ Jane Cai, “China’s shrinking working-age population to send ripples through global economy,” *South China Morning Post*, 20 December 2022, <https://www.scmp.com/news/china/politics/article/3203833/chinas-shrinking-working-age-population-send-ripples-through-global-economy>.

⁹ World Development Indicators, The World Bank, <http://wdi.worldbank.org/table/4.17#>.

¹⁰ Ibid.



- Household consumption and savings as percentages of GDP have remained stable at around 38 per cent and 44 per cent respectively between 2019-2022.¹¹ This presents a structural challenge for Beijing. For all the talk, it has been unable to stimulate domestic consumption and has rather continued to focus on supply-side measures.
- Under Xi, FDI inflows as a percentage of GDP have reduced drastically from 3% in 2013 to just 1.8% in 2021.¹²
- Loss of investor confidence due to ‘zero-COVID’ crackdowns and an overall harsh regulatory environment has compounded the strategic emphasis on decoupling.

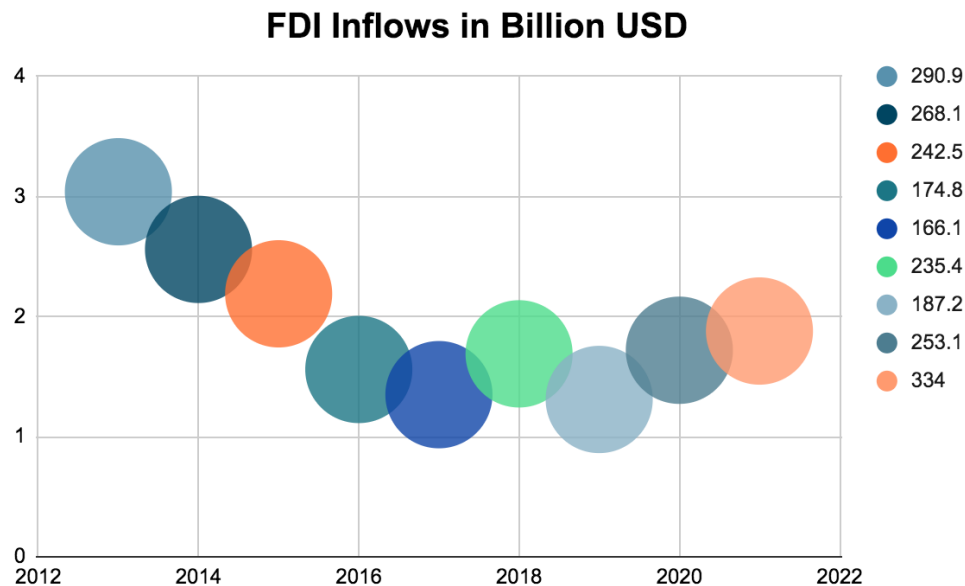


¹¹ Ibid.

¹² Ibid.

Section 1.B: Is Decoupling a Reality?

- Even though there has been pressure from governments like the US's, to incentivize companies to move operations out of China and the pandemic raised concerns around supply chain resilience, decoupling is yet to be seen in substantial terms (except in critical and emerging technologies).



- As per conclusions of the 2022 China Business Report by the American Chamber of Commerce in Shanghai,¹³ only 17 per cent of the companies they surveyed are looking to move out of China in the next one to three years, and that too, in large part because of the zero-COVID restrictions.
- However, the AmCham report also concludes¹⁴ that only 17 per cent of the respondent companies feel that government policies and regulations towards foreign companies had improved in the past year.
- As per a report issued by the Japan External Trade Organization,¹⁵ in the next one to two years, 93.7 per cent out of 697 firms based in China are either looking to expand operations, or maintain the status quo, even if it is at increased costs.

¹³ “AmCham Shanghai Releases 2022 China Business Report,” AmCham Shanghai, 28 October 2022, <https://www.amcham-shanghai.org/en/article/amcham-shanghai-releases-2022-china-business-report>.

¹⁴ Ibid.

¹⁵ “Survey on Business Conditions of Japanese Affiliated Companies Overseas: Global Edition,” Overseas Research Department, Japan External Trade Organization, 24 November 2022, https://www.jetro.go.jp/ext_images/en/reports/survey/pdf/2022/rp_global2022.pdf.

- Qualitative assessments, however, indicate that the Chinese government’s COVID policy in particular has eroded foreign governments’ and investors’ confidence in predictability, reliability and efficiency of Chinese policymaking.
- This is also evident from the fact that as per China’s National Bureau of Statistics, since January 2022, private fixed asset investment year-on-year has gone up by only 0.8 per cent.¹⁶

Section 1.B.i: Decoupling in Tech

- In the critical and emerging technologies sector, however, decoupling is showing clear signs as the US-led West and China are embroiled in rivalry over leadership and self-reliance in fields such as AI, Quantum, 5G, Semiconductors, etc. However, the rivalry in semiconductors and computation tech is the most evident.
- To begin with, the US promulgated its CHIPS and Science Act in August 2022, under which, the government has offered “industries of tomorrow,”¹⁷ including nanotechnology, clean energy, quantum computing, and artificial intelligence, funding and tax incentives, and a favourable policy environment, specifically to counter growth of Chinese technologies.
- Moreover, since October last year, the US Department of Commerce has updated its ‘Entity List’ multiple times to include Chinese entities. The largest such latest addition was in December 2022, when it added 36 Chinese companies to the same. These companies now have severely restricted access to American commodities, software and technologies, and are subject to the harsh Export Administration Regulations.¹⁸
- The new rules also forbid US citizens, residents, and green-card holders from working in Chinese chip firms.

¹⁶ Annual Report of the National Bureau of Statistics, China, <http://www.stats.gov.cn/english/Statisticaldata/>.

¹⁷ “FACT SHEET: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China,” The White House Briefing Room, 9 August 2022, <https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/>.

¹⁸ Judy Lin, “US adds 36 Chinese entities into Entity List, including YMTC,” *DigiTimes*, 16 December 2022, <https://www.digitimes.com/news/a20221216VL204/us-china-chip-ban-ymtc.html>.

- Netherlands and Japan, key US allies and major partners in the diversified semiconductor supply chain have also jumped on the export-ban bandwagon and have announced tightening of exports of lithography tools and other advanced chip manufacturing equipment to China.¹⁹
- In response, Xi Jinping’s recent speeches as well as the consensus from the debates at China’s ‘Two Sessions’ indicate that China is facing what it describes the West’s “stranglehold”²⁰ on its scientific advancement, and is subsequently taking steps to make its own original, innovating, and high-quality scientific and technological progress.
- Moreover, in February 2023, China has amended its export rules to ban the export of several core solar panel technologies in order to maintain its leading status and global market share in the sector.
- Most recently, on 5 April, Chinese Commerce representatives have now requested the World Trade Organization at a regular meeting to supervise and investigate the export control measures launched by US, Japan and the Netherlands, as it “violates the fairness and transparency principles of WTO.”²¹

Section 2: Recent Policy Signals

- Priority is “*coordinating domestic demand expansion and supply-side structural reform to balance supply and demand so as to create a virtuous cycle of economic development.*”²²
- Key takeaways from China’s December 2022 Central Economic Work Conference reveal that the government is going to maintain “the necessary intensity of fiscal spending” and “a reasonable abundance of liquidity,” hinting at a relative

¹⁹ Michelle Toh and Junko Ogura, “Japan joins the US and Europe in chipmaking curbs on China,” *CNN*, 31 March 2023, <https://edition.cnn.com/2023/03/31/tech/japan-china-chip-export-curbs-intl-hnk/index.html>.

²⁰ “Eye on China (25 February 2023)”: Newsletter compiled by the Indo-Pacific Studies Programme at the Takshashila Institution, <https://eyeonchina.substack.com/p/eye-on-china-25-february-2023>.

²¹ *Reuters*, “China urges WTO to sift U.S.-led chip export curbs,” *The Hindu*, 5 April 2023, <https://www.thehindu.com/news/international/china-urges-wto-to-sift-us-led-chip-export-curbs/article66701427.ece>.

²² “Eye on China (4 February 2023)”: Newsletter compiled by the Indo-Pacific Studies Programme at the Takshashila Institution, <https://eyeonchina.substack.com/p/eye-on-china-4-february-2023>.

relaxation in fiscal and monetary policies.²³ Today, the positive noises seem to have been exacerbated due to Li Qiang's appointment as Premier.

- Former Vice Premier Liu He said at the World Economic Forum in Davos in January 2023, that the government will carry out “blood transfusion” and “blood formation” in the real estate sector, i.e increasing liquidity and relaxing restrictions on the property market.²⁴
- Top regulators in Beijing drafted a ‘Three Arrows policy’ in November 2022 and a 21-task action plan in January 2023 to address developers' debt woes and deliver more residential properties.²⁵
- The central government has also urged provincial authorities to cut down mortgage rates to push the homebuying sentiment.
- There is some easing in stock market regulations as the China Securities Regulatory Commission announced it will “fully relinquish its role in reviewing initial public offerings (IPOs),” with the intention to make IPOs more transparent and attract foreign capital.²⁶
- Self-reliance and attracting global talent in core technologies have been identified as key priorities.
- Minister for Industry and Information Technology Jin Zhuanglong has stressed that the focus will be on tilting more sources for manufacturing enterprises to help them attain high-end, smart and green development.²⁷
- There is an acknowledgement that “***ensuring financial stability and preventing risks is still an arduous, long-term task.***”²⁸

²³ Arendse Huld, “China’s Central Economic Work Conference: Policymakers Set Sights on Growth in 2023,” China Briefing, 26 December 2022, <https://www.china-briefing.com/news/chinas-central-economic-work-conference-policymakers-set-sights-on-growth-in-2023/>.

²⁴ “Vice-Premier Liu He’s speech at the World Economic Forum Annual Meeting,” *ChinaDaily*, 17 January 2023, <https://www.chinadaily.com.cn/a/202301/17/WS63c6987ea31057c47ebaa2c4.html>.

²⁵ “Eye on China (4 February 2023)”: Newsletter compiled by the Indo-Pacific Studies Programme at the Takshashila Institution, <https://eyeonchina.substack.com/p/eye-on-china-4-february-2023>.

²⁶ Ibid.

²⁷ “Minister stresses stabilizing industrial economy, boosting advantages,” The State Council Information Office, The People’s Republic of China, 3 January 2023, http://english.scio.gov.cn/m/chinavoices/2023-01/03/content_85037369.htm.

²⁸ “Chinese premier stresses enhancing role of finance in stabilizing macroeconomy,” *Xinhua*, 1 February 2023, <https://english.news.cn/20230201/372d7dd4c9b247dca137d214e907d48c/c.html>.

- On the policy front, the focus is on allowing “reasonable” growth and expansion of the private sector. Both Li Qiang’s comments to the press and policy priorities highlighted in outgoing Premier Li Keqiang’s Work Report talk about promoting the “sound development of private businesses by removing barriers that hinder their entrepreneurial spirit.” However, the Work Report also sounds a warning: that the “unregulated expansion of the real estate sector” must remain under check, and policy institutions must prevent the “blind expansion of capital.”

Section 3: Bracing the Wind: Challenges Ahead for the Chinese Economy

- Demographic changes and an increasing age-dependency ratio are expected to impact economic growth over the long term. But the doom and gloom scenarios are overstated.³¹ There are significant steps, such as hukou reform, that can be undertaken to unlock greater labour productivity.
- Local market protectionism remains a structural challenge.
- Weak domestic consumption is a structural problem, particularly since the government is largely focused on supply-side measures³² in its effort to stimulate consumption.
- The geopolitical competition will limit innovation potential as well as access to critical technologies and talent. The semiconductor export controls imposed by the US and the implementation of industrial policy initiatives like the US CHIPS and Science Act indicate this.
- Even though there may be no significant steps toward decoupling, investors may look at a ‘China+1 strategy’, thereby directing their future investments to countries such as India or Vietnam.
- Banking and real estate sector moral hazards are likely to persist on account of low profitability, shaken confidence among buyers and demographic drag.

³¹ Kaiser Kuo, “Is China’s demography China’s destiny? A chat with former World Bank economist Bert Hofman,” Sinica Podcast, The China Project, 25 January 2023, <https://thechinaproject.com/podcast/is-chinas-demography-chinas-destiny-a-chat-with-former-world-bank-economist-bert-hofman/>.

³² Manoj Kewalramani, “Praising Xi’s Economic Policies - Ren Zhongping Eulogises COVID Policies - Detailed Breakdown of the New Guideline for Expanding Domestic Demand - Podcast on China’s Engagement in Indian Subcontinent,” *Tracking People’s Daily*, 15 December 2022, <https://trackingpeoplesdaily.substack.com/p/praising-xis-economic-policies-ren>.

- The recent shift in the tone of economic policy indicates a short-term tactical adjustment in governmental restrictions. Still, it may not point to strategic transformation in terms of favourable policy towards the private sector. Xi Jinping's remarks at the Central Party School in February 2023 on persisting with the strategic approach that has been outlined earlier are a case in point.
- From the array of financial institutional reforms proposed at the Two Sessions, followed by Li's remarks on keeping the 'Two Unswervings' policy (which enables the CPC to "guide" its private sector economy³³ however it likes) unchanged, and restricting the government's role to that of an implementor of the party line, we are likely to expect continued regulatory interventionism by the CPC in private sector enterprises.
- Hence, it is unlikely that we will see a return to a time before regulatory interventionism, and any over-the-top positivity in projections for the private sector's or overall economic growth, must be taken with a bag of salt.
- Without appropriate fiscal reform, local government risks will persist.

³³ Scott Livingston, "The Chinese Communist Party targets the Private Sector," CSIS, 8 October 2020, <https://www.csis.org/analysis/chinese-communist-party-targets-private-sector>.



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