There’s No Need to Declare Economic Calamity in China

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For the past two decades, any sign of slowdown in China has been greeted with headline-grabbing proclamations of China’s impending financial collapse. And each time, nothing even close to collapse has occurred.

Yes, China confronts major challenges to properly regulate runaway local government debt and shadow banking. Yes, China’s G.D.P. relies excessively on investment, much of it inefficiently spent on state-owned enterprises or excessive property development. And yes, China faces headwinds that almost surely will slow economic growth, including rapid population aging and the end of easy growth from structural change and catch-up growth.

However, to declare calamity on the basis of these challenges belies a fundamental misunderstanding of the Chinese economy and how it is managed. First, not all of the investments have been bad, and China still has some room to run before reaching relative income levels at which growth slowed substantially in countries like Japan and Korea. Second, China’s banks and households are not plagued with highly leveraged real estate debt. Many homeowners who benefited from housing reforms own their houses outright while many others purchased housing at market prices well below current valuations. Regulations restrict the purchase of multiple homes and require down payments equal to 30 and 60 percent of loan value for first and second home purchases. In any case, China’s central government can easily recapitalize banks if necessary. Even though central and local government debt now total more than $5 trillion compared to a G.D.P. of $9 trillion, the Chinese central government also controls $3.9 trillion in foreign reserves and $7.4 trillion in state enterprise assets (local state owned enterprises have similar value). Moreover, China’s government officials are now aware of the key challenges and are taking steps to address them.

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It is true that China’s investment share of G.D.P. is extreme -- nearly 50 percent, making a shift to consumption-driven growth desirable. The government can spend more on public services and strengthen social insurance programs, since citizens who feel more financially secure will save less for precautionary reasons and spend more. More important, it can promote job and income growth by undertaking fundamental, long-awaited reforms that liberalize the key macro prices (exchange rate, interest rate), open up the capital account; promote greater factor mobility by dismantling the household registration system and clarifying land property rights; and improve state-owned enterprise performance by diversifying ownership and introducing greater competition.

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