

Could China Become Like Japan in the Early 1990s?

Chinese leader Xi Jinping has fixated on the 1990s collapse of the Soviet Union and how to avoid the same fate for the Chinese economy. Would he instead have done better to study Japan and its lost decades beginning in the early 1990s? Should Xi now be thinking about the implications of his country's massive debt, declining trade surpluses with the United States and Europe, and collapse in mortgage borrowing, not to mention China's dismal demographic outlook and other challenges?

Should the rest of the world be worried about the loss, or potential slowdown, of one of the major global growth engines? Chinese officials, meanwhile, are spinning a much more encouraging scenario. What do you believe?

More than two dozen top observers offer their views.





Xi has put crucial Chinese advantages at risk.

WILLIAM H. OVERHOLT

Senior Research Fellow, Harvard Kennedy School, and author, China's Crisis of Success (2018)

In a 2018 book, *China's Crisis of Success*, which foreshadowed many of China's current problems, I highlighted the risk of Japanization which is a slowing of development caused by a coalition of traditional industrial conglomerates and politicians that inhibits reform, competition, innovation, and internationalization. Xi Jinping has heightened the risks in several ways. He wants the core of the Chinese economy to be dominated by a group of big state firms. He expects innovation to come heavily through subsidies to those firms. The Party Committee has been given veto over strategic business decisions in every firm. Bank finance has been consolidated in giant firms that cannot fund local private firms in a creditworthy fashion. Xi has immobilized a previously innovative state/Party bureaucracy through omnipresent fear of politically tinged accusations of corruption. Xi's China seeks industrial self-sufficiency. Control over the allocation of research funds has been given to Party secretaries whose interest is the opposite of disruption. Scholarly exchanges with the foreign world have been inhibited, and the educational and career value of learning English has been reduced.

But China retains key advantages. China has facilitated the emergence of innovative small and medium-sized enterprises whereas Japan has inhibited them. China has facilitated the social transformation from a manufacturing economy into a services economy whereas Japan's giant industrial conglomerates have the political clout to slow that transformation. Chinese society has remained far more outward-looking than Japan's. Frustrated, ambitious Chinese students go abroad; Japan's stay home. Chinese scientific scholarship is competitive and internationally collaborative in a way that Japan's isn't. Chinese elites speak English (and other languages) and thus have access to foreign ideas to an extent that Japanese counterparts don't. China's economy is open to GM and thousands of other foreign firms on both the supply and demand to a degree that Japan's isn't. Despite Xi's changes, these advantages remain strong.

But Xi has put crucial Chinese advantages at risk. One of China's greatest advantages has been its adaptability. Each leadership team (Mao/Deng/Jiang/Hu/Xi) has changed the country's politics and economics drastically to correct the failings of its predecessor. Xi has interrupted that process of change and correction, but we do not yet know whether he has curtailed adaptability or just interrupted it temporarily. Another Chinese advantage has been the sense of mobility, of everything getting better for everybody. Japan had that through the 1980s, but then decades of near-stagnation imbued Japanese youth with hopelessness. Why venture abroad or aspire to disruptive innovation when one's whole life experience is deadening? China is now where Japan was in the 1970s. As China's growth becomes slow, as the Party elite congeals, as fear quiets the intense debates about everything that have characterized Chinese society, the risks of Japanization will grow.

The Chinese response to economic and scholarly deadening is the opposite of Japan's. The Japanese stay home and don't sally abroad in search of greater opportunities. In contrast, most Chinese middle class and elite families want their money, their children, and often themselves out of China. Beijing risks losing its most creative minds and business ideas through repression in a way that Japan doesn't, but the Chinese exodus also feeds a vast global feedback loop that historically has facilitated revitalization. We are still in a long cycle whose early phase was driven by expatriate Sun Yat-sen. China's great economic takeoff of the past four decades is part of a shorter cycle driven by Deng Xiaoping's awareness of the four little dragons' successes together with the capital, business acumen, and money of Hong Kong, Taiwan, and the overseas Chinese networks.



China's economic fate is dismal. Japan failed to address the same core challenges China is failing to address now.

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Xi's desire to avoid the Soviet Union's political fate may have perversely encouraged him to make China more like the Soviet Union economically, through

increasing centralization. If so, China's economic fate is dismal. Japan still seems the better comparison, however. Japan thirty years ago doesn't fit perfectly well—it was comparatively richer and smaller than present or future China. But Japan failed to address then the same core challenges China is failing to address now.

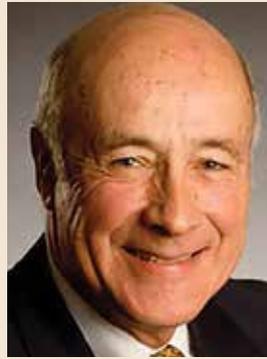
First, there are similarities in external economic orientation between China 2023 and Japan circa 1993, but they don't matter as much as they might seem to. Large economies should tend to their own houses, not rely heavily on global demand or exchange rate management. If China's goal is to continue to rise, the external-side lesson from Japan isn't to cling to a development strategy suited for a medium-sized follower economy, but to move beyond it.

The obstacles to doing so are the key points of comparison. After its wild stimulus response to the global financial crisis, China's debt burden skyrocketed and was similar in mid-2022 to Japan's in mid-1998, according to the Bank for International Settlements. The demographic situation is better, but only for the moment. The United Nations has China's median age in 2021 matching Japan's in 1992, but also China aging faster from this point than Japan did.

One of Japan's responses to its lost decades was to try to turn to innovation. It didn't work well, and innovating more while aging is a daunting task. China faces an additional obstacle—it doesn't want innovation to erode Communist Party control and is therefore suspicious of a swath of the private sector. To anticipate China outperforming 1990s Japan in innovation, one must believe state direction and resource mobilization can overcome aging, financial misallocation, and aversions to both competition and private property rights.

In light of the emphasis on political control over conventional economic performance, it's unclear how hard China will spin its trajectory. It's currently reporting slow GDP growth but still high job creation, and avoided large-scale borrowing during the pandemic. If his domestic position is secure and vital goals are being attained overseas, Xi may be more willing to face up to economic reality than the "experts" who once insisted Japan would return to glory or those touting China now.

Finally, China's record as a global growth engine is more mixed than is commonly asserted. It detracts from the rest of the world's GDP through the trade surplus. It's true that GDP has limited utility and a stagnating China matters to consumer inflation and commodities demand, among other things. But it's misleading and bizarrely simple to just count Chinese GDP growth itself as contributing to the world economy. Fortunately, since Chinese GDP will continue to slow, that's not what matters.



*The China fears
are exaggerated.*

JOSEPH S. NYE, JR.

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In the early 1990s, Americans feared that Japan would surpass the United States. Now we worry that China will, but again the fears are exaggerated.

Contrary to the current conventional wisdom, China is not the world's largest economy. Measured in terms of purchasing power parity, it became larger than the U.S. economy in 2014. But PPP is an economist's device for comparing estimates of welfare, not economic power. Even if China someday surpasses the United States in total economic size measured at exchange rates, GDP is not the only measure of overall power. China remains well behind the United States on military and soft-power indices, and its relative economic power is smaller if one includes U.S. allies such as Europe and Japan.

Nonetheless, the scale of China's economic power will remain important. The United States was once the world's largest trading power and bilateral lender. Today, nearly one hundred countries count China as their major trading partner, while only fifty-seven have such a relationship with the United States. China has lent \$1 trillion for infrastructure projects through its Belt and Road Initiative over the past decade.

Moreover, China's economic success enhances its soft power in developing and emerging markets. And China's ability to grant or deny access to its domestic market gives it hard-power leverage. It is too early to bet on "peak China."

A good strategy requires careful net assessment. Underestimation breeds complacency, while overestimation creates fear—either of which can lead to miscalculation. China is a strong country but it also has important weaknesses compared to the United States in terms of economic, demographic, and political problems. Its labor force peaked in 2015, its economic growth rate is slowing, and it has few political allies. It has border disputes with several of its neighbors, especially India which has passed it in total population size. China depends on imported

energy that must cross the Indian Ocean, and China's financial system remains weak.

All told, the United States holds a stronger hand, just as it did with Japan in the 1990s, but if we succumb to hysteria about China's rise or complacency about its "peak," we could play our cards poorly.



The Chinese economy faces an increased risk of a Japan-style slowdown.

ZONGYUAN ZOE LIU

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China's rise began with reform-minded leaders such as Deng Xiaoping and Chen Yun prioritizing economic growth after learning lessons from the implosion of the Soviet Union. While lessons on avoiding a Japan-style stagnation may not have been immediately relevant to Chinese leaders in the 1990s, such lessons are crucial for Chinese leaders today to prevent the economy from sleepwalking toward Japanization. Besides decoupling, three domestic indicators suggest the Chinese economy faces an increased risk of a Japan-style slowdown: soaring debt, sluggish demand, and demographic changes.

While China's total debt-to-GDP ratio was 273.2 percent as of December 2022, much lower than Japan's, Chinese households' debt has increased, and their balance sheet has deteriorated over the last fifteen years. On the debt side, between 2008 and 2022, the Chinese household debt-to-GDP ratio surged from 17.9 percent to 61.9 percent, reflecting an annual increase of 17.6 percentage points. Chinese household debt reached an all-time high of 62.4 percent of GDP in September 2021 and has since stayed above 62 percent. Regarding assets, household net asset growth has decelerated since 2010. An urban household balance sheet survey conducted by the People's Bank of China in 2019 showed housing was about 70 percent of household assets, with mortgage loans accounting for 75.9 percent of total household debt. This level of indebtedness was comparable to the United States in the run-up to the 2008 subprime crisis and the burst of the economic bubble in Japan in the 1980s.

The potential for exports to drive China's growth has reached its limit. China's export-to-GDP ratio peaked in 2006 at 36 percent and has since declined below 20 percent between 2016 and 2020. Weak domestic demand tied to a troubled property market constrains China's near-term recovery and long-term growth. The slumping property market will suppress demand for industrial materials and consumer durables. If government support fails to prevent a sharp decline in property prices, it will lead to aggregate demand contraction, causing corporate profits to drop and credit default risk to increase. A troubled property market bodes ill for local governments and households because it would result in higher leverage and curtail household consumption, increasing the difficulty of expanding aggregate demand.

Demographic changes shape the long-term prospects of China's economy. China faces the challenge of getting old before getting rich: its current per capita GDP is roughly equivalent to Japan's in 1985, but the share of its population aged sixty-five and above is Japan's in 1992. The combination of aging and low fertility rates impacts China's economy through three direct channels. First, a diminishing labor force and loss in human capital will further reduce China's comparative advantage in labor, undermining its growth potential. Second, a growing elderly population will increase pension costs and social welfare expenditures. Third, population shrinkage and a diminished family formation rate will weaken consumption and reduce housing demand.

The path of Japan is not unavoidable for China if its leaders can reorient the economy to be consumption-driven with support for consumer finance and income growth.



If China follows Japan, it has nothing to worry about.

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It has become commonplace in recent years to talk about Japan as some sort of economic basket case because of its shrinking workforce, aging population, and rapidly

growing debt. Superficially, these all sound like really bad news, but on a closer look, this is hardly the case.

Other things equal, an aging population implies a rising dependency ratio, with each worker having to support more retirees. However, as anyone who has ever thought about the issue for a minute knows, the impact of even modest increases in productivity swamps the impact of the rising dependency ratio when it comes to per capita income.

The years 2010 to 2025 are the peak years of the retirement of the baby boom cohort in the United States. The Social Security Trustees project that the aged dependency ratio (the number of people over age sixty-five divided by the number of people between the ages of twenty and sixty-four) will increase from 0.218 in 2010 to 0.325 in 2025.

If we assume that people over age sixty-five consume 70 percent as much per person as the working age population, on average, and assume just 1.0 percent annual productivity growth, both workers and retirees can see a 10 percent increase in income over this fifteen-year period. And this doesn't even account for the fact that we are seeing a decline in the youth dependency ratio and also that an increasing share of the over-sixty-five population is likely to be working.

The story looks hugely better if we assume a 3–4 percent annual rate of productivity growth, which is still slower than what China has seen in recent years. And this rate of aging will not continue, it is a one-time surge in the United States and will likely be slower, if longer, in China.

This is in fact the story we see in Japan. According to the International Monetary Fund, per capita GDP in Japan was 26.0 percent higher in 2022 than in 1990. That's not fantastic growth, but it is hard to see that as an economic disaster. Furthermore, this growth has gone along with a sharp reduction in work time. The length of the average work-year has decreased by more than 20 percent over this period, according to the OECD.

Even these figures understate the gains to the Japanese people. The smaller population, compared to a counterfactual of continued population growth, means less congestion and less pollution. Japan's parks, beaches, and museums are less crowded than in this counterfactual and there is less traffic.

Oh yeah, and Japan's debt of 260 percent of its GDP is a real crisis. Until recently, investors were paying the government to hold its debt. The country's interest burden is roughly 0.3 percent of GDP. That compares to 1.7 percent in the United States.

In short, Japan is very far from some sort of economic disaster if anyone bothers to look at the data. If China follows Japan, and many other countries, in seeing a falling population, it has nothing to worry about.



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Despite similarities, Japan's past will not determine China's future.

China's economic prospects have become more challenging in recent years, with growth slowing from the explosive double-digits of the 2000s to the low to mid-single digits of recent years. Against the backdrop of an aging population, China's situation today and the Japan of the 1980s and 1990s share many similarities. Like Japan, the country's debt-funded growth has started to show diminishing returns. Chinese ghost towns are reminiscent of Japan's bridges to nowhere. Productivity growth has also slowed by about the same as it did in Japan. And where the country once enjoyed a rapidly growing, young workforce, it now faces a severe demographic crisis.

Despite these similarities, Japan's past will not determine China's future. Rather, the key question is whether the Chinese emphasis on state control is compatible with the innovation needed to unlock the next phase of Chinese growth.

China is facing the imminent end of its ability to rely on workers' shift from agricultural to manufacturing jobs to generate the productivity gains that are essential for continued growth. With the so-called "Lewis turning point" approaching (by 2025, according to the International Monetary Fund), China faces risks to growth unless it is able to build an innovative scientific and technological base that is essential to the productivity gains needed for continued growth. But it is unclear

how it is possible to develop and deploy frontier technologies while government policies aim for state direction of the economy.

State control has escalated over the past decade, most recently and prominently reflected in the regulatory crackdown on everything from video gaming to education to celebrity culture to private companies. The Chinese leadership has called for the strengthening of the state sector. The *zeitgeist* is not one of “adaptive governance” and “reform and opening up” from the era of Deng Xiaoping, but rather a type of social and economic control harkening back to Mao’s rule.

This posture, though, may be in direct conflict with the structural reforms that are necessary to increase China’s innovative capacity, including transitioning activity from the old economy to the new economy, from often inefficient state enterprises to the private sector. Private firms offer twice the return on assets and 30 percent higher total factor productivity than state-owned enterprises. Should the allocation of resources and policy support continue to crowd out private firms, the result may be SOEs with similarities to the “zombie” companies of 1990s Japan, with challenges to efficiency, innovation, and productivity enhancement.

Studies across Chinese manufacturing and mid-tech firms and across countries find that state control has an adverse impact on innovation. With a backdrop of challenging demographics and slowing productivity growth, the big question is what happens when state control comes into direct conflict with China’s growth objectives (which may already be happening). Which side of that equation wins out will play an influential role in whether the 2020s in China can escape the legacy of Japan during the 1990s.



China’s wealth-generating capability cannot flourish apart from Western export markets and technological inputs.

RICHARD C. THORNTON

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Could China become like Japan of the 1990s? I see the question as a very clever way to make Westerners think of U.S. relations with China as similar to U.S.

relations with Japan, but the relationships are worlds apart. The short answer is that China’s future relations with the United States will not in any way resemble the U.S. relationship with Japan in the nineties, as a cursory analysis will show.

The key question is what geostrategic changes were triggered by the end of the Cold War. When the Cold War ended in 1991 with the demise of the USSR, the United States immediately began to build up China as part of a plan to stabilize portions of the Eurasian landmass. (NATO expansion was another part.) As the United States poured billions of dollars in wealth, technology, expertise, and capital plant into China, more, in fact, than the combined American inputs into West Germany and Japan after World War II, Washington gave Japan a lower priority. Security relations atrophied as the war threat receded. Japan’s former bubble status as number one burst and Japan retrenched into what most Western analysts perceived to be a “lost decade.” In fact, the Japanese retrenchment should better be understood as a decision to position themselves to enjoy maximum geopolitical flexibility.

Thus, while Japan’s bubble burst as the Cold War was ending, China’s bubble is bursting as a new cold war is beginning, and China is not on our side.

Indeed, as the new cold war congeals with the Russian invasion of Ukraine, China’s support for Russia, overt threats to invade Taiwan, and both states’ unwillingness to curb North Korea’s missile rattling, to name but a few objectionable stances, demonstrate that China’s deliberately chosen future course lies outside the American system of friendships and alliances.

As Xi Jinping is belatedly discovering, China’s wealth-generating capability cannot flourish apart from Western export markets and technological inputs. Did he think that adopting a more adversarial relationship with the United States would have no discernible impact on U.S. attitudes and policies toward China? Did he think that the United States would supinely continue to prop up China as the big box store of the world, at America’s expense?

If so, he is following in the same delusional footsteps of the late Leonid Brezhnev, who also thought that the adoption of coercive military tactics would cow the United States and the West into submission. Brezhnev was wrong, Xi is wrong, and so is Putin.



The Chinese have a record over nearly fifty years of more or less facing up to problems and doing something about them.

JAMES K. GALBRAITH

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Xi Jinping’s fixation with the collapse of the USSR is surely founded on close study of Gorbachev’s mistakes, Yeltsin’s follies, and the corruption and nationalisms that destroyed that country.

The Soviet breakup crushed their industries, gave control over resources to criminal oligarchs, precipitated demographic collapse and fall in male life expectancy to the fifties, while setting the stage for wars, first in Chechnya, then Georgia, and now in Ukraine. It also produced, in 1993, an internal coup and massacre of the elected Duma by President Boris Yeltsin with full U.S. support. The video records of this are on display at the Yeltsin museum in Ekaterinburg.

Japan’s 1990s crises stemmed from financial liberalization under Reaganite pressures, rampant land and stock speculation, a colossal bust, and then stop-and-go recoveries based on public investment but always limited by higher taxes, notably on consumption. It was not great, but the final result? Japan is in one piece, at peace, still rich, and it enjoys the longest life expectancy of any country in the world, six years more than the United States.

In the 1990s, I advised the State Planning Commission of the People’s Republic of China as chief technical adviser for macroeconomic reform. The officials I dealt with were horrified by events in Russia. Events in Japan barely registered. Were I advising China today, I’d say, given the choice, they should take the Japanese “disaster” over the Soviet. But my advice would not be needed.

So, who and what to believe? On one side, a doom-and-gloom chorus, forecasting calamities, always to good reception among America’s China hawks. On the other, governing officials with many flaws—including optimism. But they have a record over nearly fifty years of more or less facing up to problems and doing something about them. Calamity remains possible. Repetitive predication of it is unsound.



“Xi Jinping Thought” is predicated on multiple myths.

PATRICK M. CRONIN

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China should but won’t likely heed the warnings of Japan’s lost decade in the 1990s. A mere dozen years before Japan’s abrupt economic slowdown, Ezra Vogel’s *Japan as Number One* extolled the winning secrets of its institutions and ethos. Then a real estate bubble, unsustainable government debt, and structural rigidities flipped the script on Japan, Inc.

Chinese officials are more focused on reviving their euphoric growth than on how Japan’s economic miracle stalled. After experiencing the lowest growth rates since the opening during two of the past three years, China’s obsession appears to be reviving pre-pandemic economic growth to avoid internal instability, not learning lessons from Japan’s dismal decade.

To be sure, few would forecast China’s GDP growth rate plummeting to an average of less than 1 percent over the next ten years. Even so, Beijing is too fixated on its exceptionalism to see the perils of Japan’s sclerotic economy closing out the last millennium. At least, political problems loom large as barriers to economic success in contemporary China.

“Xi Jinping Thought” is predicated on multiple myths. One is the longstanding Marxian conviction that socialism will inevitably triumph over capitalism. Another is the parochial presumption that China’s ascent is assured while America’s decline is terminal. A third is a dubious claim that senior officials in the Chinese Communist Party alone are equipped to engineer tomorrow’s bold new international era.

Yet capitalism and the United States endure, and perpetual anti-corruption drives still leave in power authorities who think it wise to obstruct international understanding of covid origins, impose and then in one fell swoop suspend draconian zero-covid lockdowns, and rein in big tech companies not to foster competition but to stifle it.

Xi’s mindset runs on the perpetual fear of losing central political authority and on boundless confidence that

China's experience is a far better guide to policy than the experience of market democracies. Xi has no intention of emulating the mistakes of the Soviet Union's final leader Mikhail Gorbachev—of preferring political liberalization without first achieving stellar economic development. Xi will leverage his unsurpassed position to pull all the levers of society to restore sufficient economic growth without jeopardizing political control.

Buying into the CCP narrative requires believing in magical thinking. Lacking previous means of stoking growth, including cheap labor, booming real estate, and all-you-can-invest foreign capital, Xi and his loyalists seek to conjure sustained high growth rates without relinquishing political control.

I would not forecast the overthrow of the CCP or rule out a fourth or even fifth term for Xi. But to imagine China's economy through the middle of the next decade simply muddling through suggests dashed expectations and explosive nationalist zeal.

So primed, today's apparent risks of seizing Taiwan by force might greatly diminish. America and Japan will be scapegoats, foreign actors thwarting China's great rejuvenation. High-growth-rate China has created a powerful peer competitor, but a low-growth-rate China may create an even more dangerous one.



The economic malaise China is confronting seems much worse than its official narrative would suggest.

HONGYI LAI

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The economic malaise China is confronting seems much worse than its official narrative would suggest. China might well be on its way to a painful period of economic adjustment. While on the surface the overall Chinese economy may still grow, its heyday of high growth is over.

Currently, unemployment in China is soaring among university graduates, as large private firms in the tech sector and real estate have contracted after Chinese President

Xi Jinping's ruthless regulatory hammering in the past years. Now even migrant workers seeking jobs along the coast face bleak prospects, as foreign investors have relocated out of China to avoid covid restrictions, rising wages, and geopolitical risks.

In anticipation of "rainy days," consumers save instead of spend, and homeowners with mortgages rush to offload their debts and housing to reduce liability. This squeeze in consumption in goods and services adds to the downward spiral of the economy and drags down the growth rate.

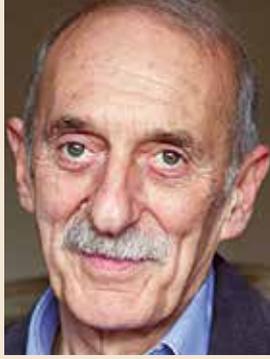
This economic malaise is a perfect storm, driven by misguided policies such as zero-covid restrictions and regulatory excesses, a long-existing aging of the population, and geopolitical/geoeconomic tensions over the chip war, Taiwan, and the South China Sea magnified by the Russian-Ukraine war since February 2022.

Chinese leaders have only started to adjust these misguided policies in the recent months. They have not been able to remedy the other two aforementioned factors, namely the appallingly low and still declining fertility rate and repercussions of geopolitical risks revealed in the U.S. prohibition of chips to China and foreign investors' aversion to risks of an Asian version of the Russian-Ukraine war caused by tension over Taiwan or the South China Sea. Beijing's hawkish external postures in Asia and apparent flirting with Russia do not help ease the geopolitical concerns, permitting the malaise to persist.

Unfortunately, even consumers, employees, and corporations worldwide will feel the pain from this emerging economic malaise in China. The bans on chip production and sales in China will undermine the revenue of chip firms in the developed economies, and chip production in America and Europe instead of Asia will drive up costs and prices and may demand government subsidies, though it creates jobs for the workers in plants there.

Relocating other labor-intensive production to a seemingly safer place in Asia would confront far less infrastructural support, relatively untrained and "undisciplined" labor, and fewer related industries as the original Chinese locations. These issues would result in higher production costs, manifested in higher prices, along with lower quality or delay of product delivery to customers. It will undercut demand, sales, jobs, share prices, and taxes.

In addition, as the biggest "world factory" slows down and the largest emerging consumption market in China contracts, it will dampen demand for a great variety of goods and services, ranging from raw materials, energy resources, luxury goods, and equipment, to services such as education, logistics, and financial services. Consumers, suppliers, producers, institutions, and governments worldwide will need to be ready to face the economic and political fallout for quite a sustained period.



*Don't bet the ranch
on China.*

GEORGE MAGNUS

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The Japan of over thirty years ago offers a useful, if imperfect, template for modern China. Both feature a high saving-high investment growth model, systemic balance of payments surpluses, a real estate boom and bust, and eye-popping economic growth rates which suddenly stopped, exposing high local currency indebtedness.

Japan suffered from, and China has, high levels of institutional rigidity centered around the close interlocking of state, bank, and corporate interests—*keiretsu* conglomerates and state-owned enterprises, respectively. The pursuit of macro policies that supported industry, restrained wage and salary income and therefore consumption, and suppressed the cost of capital is also common trait.

The outcome in China, like Japan, has been chronic over-investment and misallocation of capital, and a bursting asset bubble with knock-on banking problems. China's financial system assets of four times GDP, though, exceed Japan's 1990s peak of 2.5 times GDP. China's real estate sector has only recently tipped over, but it is much larger and faces a long period of over-supply and softer demand.

Some key differences, though, may shape China's awkward adjustment differently.

It is unlikely to have a comparable banking crisis because a state-owned financial system won't allow significant banks to fail, can move assets and liabilities around, and can draw out the pain of deleveraging and shrinkage in real estate. A closed capital account will help. Nevertheless, the growth-sapping costs of lowering debt levels in China still have to be paid, and these could have disruptive economic and social consequences.

China is much more pro-active with economic and financial regulation, which can help to manage difficult problems, but it is also keener on political control and regulation of business, which is the antithesis.

China is poorer and perhaps less resilient. Like Japan in 1995, its GDP is about 75 percent that of the United States, but its income per head is only 18 percent compared with Japan's 150 percent (now 56 percent). Reflecting this, China has lower levels of educational attainment, and

higher levels of low-paid, low-skilled jobs. Both countries' tipping points were heralded by rapid aging, measured by the peak in the support ratio (of working age adults per retiree), but the effects are more immediate in China.

Unlike Japan, China is a geopolitical rival of the United States and others, and faces a much more hostile external environment, comprising export controls, sanctions, and other commercial restraints.

Interestingly, until the Japan bubble burst in 1990 and even afterwards, Americans regarded Japan as an innovative, long-term-thinking nation that was economically superior and technologically more advanced. Racked by resentment and worry, officials and commentators feared it would go on to overwhelm and overtake their own country.

It didn't quite work out that way for Japan. Bearing in mind the striking familiarity of these sentiments in 1990s Japan and 2020s China, we shouldn't bet the ranch on China either.



*Contrary to
common perception,
the Chinese model
is much more
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more resilient.*

KEYU JIN

Associate Professor of Economics, London School of Economics

Many compare China today to the high-investment technology economy of Japan in the 1990s, but the analogy is not apt in my view. There are still 600 million people in China with an income less than 2,000 RMB per month striving to become middle income (by international standards). The consumption boost to the economy when that happens will be significant, not only to China, but also to the world.

Japan suffered from a combination of the collapse of a real estate bubble, mismanagement in macroeconomic policies, and a large decline in productivity. But Japan also stagnated at income levels close to the U.S. levels at that time. Currently, China's main economic malaise is a significant weakening of private demand due to a loss in confidence. To fill that gap, local governments are forced to borrow more and spend more, piling on to the already large amount of debt in the economy. But that does not mean

that a debt crisis is imminent, not least because the central government still has significant fiscal capacity. If China can credibly provide a hospitable and predictable macroeconomic environment for the private sector, confidence can recover, and China can overcome the near-term hurdles.

In the longer term, China is searching for a new equilibrium of slower but higher-quality growth, innovation-driven growth rather than investment-based growth. Contrary to common perception, the Chinese model is much more decentralized and likely to be more resilient, as local officials all around the country are rolling out supply chains, new infrastructure, and high-tech parks for promising technology companies. Even second-tier cities like Wuhan, Chengdu, Suzhou, Hefei, and so forth, each with an innovation model, are nurturing world-class companies.

In the new information age featuring strong increasing returns to scale, market size and digitization create snowball effects whereby companies with a disproportionate share of data and technology grow boundlessly, deploying their businesses at unthinkable scale. But this means that a stratagem of “no surprises” would be a sufficiently good one for now.



China will avoid this fate.

BARRY EICHENGREEN

George C. Pardee and Helen N. Pardee Professor of Economics and Political Science. University of California, Berkeley

It is of course true that Chinese leaders have a heightened awareness of the 1990s collapse of the Soviet Union and are anxious not to repeat that experience. But they’ve also studied Japan’s trials and tribulations and are aware of the parallels, be they that country’s trade surpluses, debt, or demographics.

There’s no question but that China’s economy will continue to slow down. Demography isn’t destiny, but it’s a factor. In my two papers with Kwanho Shin and Donghyun Park on the middle income trap (in 2011 and 2013), we identified two income thresholds where fast

growing economies slow down. China hit the first threshold in 2015 and it’s hitting the second one now. But I also think that China’s leaders have enough control of the levers of policy, and enough political autonomy, that they can recapitalize the banks, restructure the financial system, and apply countercyclical monetary and fiscal policies so as to avoid succumbing to a Japan-like slump.

The Japanese problem at root was not trade, debt, or demographics. Rather, it was pressure from vested interests not to fix the problems of zombie firms and zombie banks. I have hope, if not exactly confidence, that China will avoid this fate.



It looks like China’s situation is much worse than Japan’s.

RICHARD JERRAM

Chief Economist at Top Down Macro

We should consider two separate questions. First, are Japan’s long-running problems relevant to China’s situation? Second, can they do much about them?

There are clearly important similarities. One is the scale of excessive capital investment—especially in housing—funded by credit. There are concerns about the reliability of the data, but it looks like China’s situation is much worse than Japan’s (and for that matter, Korea’s).

As its potential growth rate slows, it will become harder for China to grow its way out of trouble in the financial system, as it has successfully done at times in the past. Chinese officials have already conducted detailed analysis of Japan’s policy mistakes and the results have long been clear, such as not allowing a dysfunctional banking system to corrode the health of the economy. The costs and consequences of rescuing banks and construction companies will be greater than in the past, but it should still be possible, especially as China is still much further from the technology frontier than Japan was in the 1990s and so has more room to grow.

The other main similarity is demographics, where again China seems to be facing a bigger problem than Japan as its shrinking population and rising dependency

rates are coming at a much lower level of development. More positively, the change is hitting China slightly more slowly than Japan, but not by much.

Demographics look impossible to fix. Japan, like many others, has struggled to find policies that have a meaningful effect on the birth rate. And if immigration is difficult in Japan, how is a country of 1.5 billion people going to import enough workers to move the dial? Where could they possibly come from? As Japan has shown, an aging population is one that is less dynamic and less entrepreneurial.

China's political structure is also more problematic. Japan's LDP lost power twice in the post-bubble era and its democracy—albeit flawed—resulted in accountability as well as a providing a valve for the public to express their frustration. The response to any policy mis-steps in China could be far less orderly.

Overall, it's hard to be optimistic. I would also note that China's success or failure is likely to be more consequential for the world than Japan's, both in terms of the impact on the global economy and the potential for policymakers to use foreign policy adventurism to distract the public from domestic troubles.



For all the hype about China's inexorable rise, its position today is worse than Japan's in the early 1990s.

DANIEL TWINING

President, International Republican Institute

In the 1980s, Washington was swept by paranoia that Japan's economic success was exposing fatal flaws in American market capitalism. Similarly, the 2008 financial crisis prompted fears that Beijing had perfected a model pairing the supposed efficiency of an authoritarian system with a dynamic economy. But just as the 1990s took the bloom off the rose for Japan, China's economy today is looking less dynamic than dysfunctional. Its core problem is the political risk associated with one-man rule.

The People's Republic of China has massively mis-allocated resources at home and abroad, overextending itself internationally with projects like the Belt and Road

Initiative, and faces a demographic crunch that will sap long-term growth. Meanwhile, per capita GDP remains only a third that of Taiwan, attesting to the importance of democratic institutions in generating a high-income economy.

For all the hype about China's inexorable rise, its position today is worse than Japan's in the early 1990s. Japan was a rich country when it began its demographic decline; China has barely reached middle-income status. Japan's government did not intentionally sabotage its most dynamic sector, as the CCP did by going after the tech industry. Unlike China today, Japan possessed a strong national education system and an enduring alliance with the world's superpower.

Most fundamentally, the PRC lacks the rule of law. It fails to protect its people's most basic civil liberties. Its political system has proven rigid and unable to respond to its populace, threatening long-term prospects for growth and innovation.

For these reasons, the Chinese Communist Party is correct to fixate on the downfall of the Soviet Union. The Japanese government of the 1990s failed to find the right mix of economic tools to return to robust growth, but democratic institutions meant it never feared an overthrow of its system of government—in marked contrast to both the USSR and the PRC.

The Chinese Communist Party has long sought to learn from the Soviet Union's demise. It conducted a decade-long study that identified forty-four lessons to be learned. For a time, China did change. It created a more predictable and rules-based elite leadership system, gave private enterprise more space to operate, and allowed citizens greater freedoms of speech and assembly.

By re-asserting the primacy of politics over the economy, Chinese President Xi Jinping has learned all the wrong lessons from the Soviet experience—dismantling consensus-based leadership, shackling private enterprise, and restoring totalitarianism. This return to one-man rule has produced a cascade of poor policies that ironically risk greater instabilities.

Japan today is a high-income country boasting the world's third-largest economy with less than a tenth China's population. Most countries would trade for Japan's economic position. To overcome its present challenges, China needs more transparent and accountable policymaking.

Only a more responsive government that incorporates a broader array of voices and decentralizes power can turn the situation around. Without meaningful political reform, the PRC looks likely to follow in the footsteps of the Soviet Union—or, more ominously, of Imperial Japan, recklessly challenging America for regional primacy and unleashing a catastrophic conflict that destroys the foundations of Chinese prosperity.



The reasons behind China's economic stagnation are very different from Japan's in the early 1990s.

GENE H. CHANG

Emeritus Professor of Economics, University of Toledo, and former co-editor, China Economic Review

China is falling into a so-called middle-income trap. China's GDP growth lost its momentum before reaching the high income level Japan achieved in the 1990s. The annual GDP growth rate dropped to 6.3 percent in the recent decade, compared with the double-digit rates during the previous period of 1990 through 2012. In 2022, the growth rate further fell to 3 percent, much lower than that of India (6.7 percent) and Vietnam (8 percent). Many economists predict the declining trend will continue, and China's economy will stagnate by the end of this decade.

The reasons behind China's economic stagnation are very different from Japan's in the early 1990s. Whereas Japan's problems were economic, such as the bursting of asset bubbles and an overvalued currency, the problems China currently faces are more fundamental, which are also associated with its system. In the past decade, China has terminated the *de facto* privatization process begun under Deng Xiaoping, replacing it with orthodox Marxism under the slogan of "Do not forget the original intention" of the Communist Party. The central and local governments exert and expand their control over the economy and society at large. They adopt discriminatory measures against private business, including charging higher interest rates on loans, setting up Communist Party cells in private firms to influence and lead the management, and even forcing firms to relinquish their shares to the government without compensation. These policies damage entrepreneurs' incentives, and therefore economic efficiency. President Xi Jinping's objection to the universal values which are upheld by the Western and global countries worsens China's external economic environment, thus impeding technology transfer and its industrial upgrading.

All these factors have contributed to the slowdown of the Chinese economy.

Like the Soviet Union or Mao's era, the current Chinese system lacks two necessary conditions for sustaining its economic success. The first condition is the protection of private property rights. Without it, the

incentive of people to work is severely damaged. The second condition is the free market under the rule of law. Without it, the market cannot function well. When these conditions are broken, an economy suffers and can even fall into catastrophe, such as the Ukraine famine in the 1930s, the Chinese famine in 1958–1962, and the North Korean famine in the 1990s.

When Jack Ma's financial company Ant Group had to surrender 50 percent of their shares to the government without compensation, Ma says, "Among the richest men in China, few have good endings." His words reflect a widespread fear among Chinese private businessmen over the lack of the rule of law to protect their property rights. This is more detrimental to an economy than a high debt-GDP ratio, asset bubbles, or an overvalued currency. The *Financial Times* recently reported that "Jack Ma, the Alibaba founder and once the richest business leader in China, has been living in central Tokyo for almost six months, amid Beijing's continuing crackdown on the country's technology sector and its most powerful businessmen." This fact itself largely provides an answer to the question about comparing China to Japan.



All the clues point in the direction of China being on the cusp of a lost economic decade similar to that which Japan experienced in the 1990s.

DESMOND LACHMAN

Senior Fellow, American Enterprise Institute

All the clues are pointing in the direction of China being on the cusp of a lost economic decade similar to that which Japan experienced in the 1990s. No longer will China be the world's major engine of economic growth and no longer will China keep international commodity prices well bid.

It is not simply that China's working age population is set to continue to decline for as far as the eye can see as a result of its earlier one-child policy. Nor is it simply the result of a more restrictive U.S. trade policy or waning foreign investor confidence and a resourcing of supply chains as a result of President Xi Jinping's erratic economic management. Rather, it is mainly the result of the bursting of China's truly oversized property and credit market bubble

in the context of adverse secular economic changes and a weakening global economy.

According to the International Monetary Fund, over the past decade property lending has resulted in an increase in Chinese private sector debt by more than 100 percent of GDP. That is a more rapid rate of debt increase than that which preceded Japan's lost decade in the 1990s and the 2006 U.S. housing bust. Meanwhile, according to Kenneth Rogoff of Harvard's estimates, housing prices in relation to incomes in major Chinese cities became considerably higher than in London and New York, while the Chinese property sector accounted for almost 30 percent of the economy. That is almost double the level seen in other major countries.

One sign the Chinese credit and property market bubble has burst is the fact that after rising rapidly, Chinese home prices have declined in each of the last twelve months. Another sign is the wave of Chinese property-developer debt defaults, including most notably that of Evergrande, the country's largest developer.

The one advantage that China has over other countries is its government's control over its banking system. This makes a U.S.-style housing bust of the 2006 variety highly improbable. Instead, we should brace ourselves for a Japan-style Chinese lost economic decade with banks loaded with non-performing loans and the country populated by zombie property companies.

Judging by the Davos World Economic Forum consensus, global economic policymakers are expecting China to soon provide major support to a flagging world economy now that it's abandoned its zero Covid policy. This newfound optimism is surprising since major Chinese economic weaknesses are in plain sight.



China may not completely repeat Japan's experience in the 1990s, but it will rhyme.

LOGAN WRIGHT

Director of China Markets Research, Rhodium Group

China's economic trajectory in the next decade may not completely repeat Japan's experience in the 1990s, but it will rhyme.

It took many years of slower economic growth before most people realized that Japan was facing a "lost decade" in the 1990s. After all, the economy grew by 3.1 percent in 1996, and appeared to be recovering from the collapse of the real estate bubble in 1992 and 1993. But that was the high-water mark for Japan's economic growth for the next fifteen years. The intellectual bubble surrounding Japan's economic growth took much longer to burst than the actual bubble.

There will likely be similar dynamics involved in China's structural slowdown. Simply put, China cannot repeat the world's largest single-country credit expansion in over a century, which means credit and investment growth will continue to slow relative to the last decade. A sharp decline in residential construction is already underway. The property sector represented around one-quarter of China's economy at its peak in 2020 and 2021. Japan faced the economic and financial consequences of declining real estate prices over multiple years, while China is currently facing the consequences of overbuilding on a massive scale. The future sustainable pace of real estate construction in China will probably be only around 40–50 percent of peak levels.

To respond to slowing growth, Japanese officials unveiled significant fiscal stimulus measures to offset the decline in corporate credit demand, which had triggered a "balance sheet recession." Today, Chinese economists are using the same term to describe the problems of weak private sector credit demand, even though there has been little decline in property prices in China, so the weakening real estate market has not yet impacted China's financial system or corporate balance sheets in the same way. Rather than borrowing via government bonds to provide counter-cyclical stimulus, China's local government infrastructure investment is led by quasi-government companies, who must borrow at much higher interest rates from banks and from the bond market. Unlike Japan's experience, China's rapidly rising debt servicing costs have reduced the capacity of local governments to sustain investment growth.

China's population declined in 2022, and its working-age population has been dropping since 2013. Most forecasts of China's long-term economic growth have not readjusted after the sudden arrival of China's population peak, which has occurred much earlier than expected even just a few years ago. There are very few recent examples of major economies facing declining working-age populations, and Japan's experience is the most relevant for China. Growth never averaged above 3 percent in the three to five years after the working-age population peaked in any of those economies. As demographic pressures intensified, Japan faced prolonged declines in interest rates, weaker investment growth, deflationary pressures, and slower economic growth overall. It

is difficult to understand why the next decade in China's economy will be significantly different.



Rather than trying to fix Chinese economic problems already evident when he assumed power in 2012, Xi has obstinately exacerbated the situation.

JOHN LEE

Senior Fellow, Hudson Institute, and former Senior National Security Adviser to the government of Australia

In September 2010, I published an article entitled “If Only China Were More Like Japan.” I argued then that a Chinese over-reliance on exports and fixed investment would inevitably lead to a Japan-like permanent slowdown. However, the additional problem for China is that it had failed to do what Japan had done when the latter began its two lost decades of economic growth from the 1990s onward: build resilient civil and economic institutions, prepare for its aging population, allow the private sector to thrive, and be at peace with history and its neighbors.

What has happened since then? After ten years of Xi Jinping, China's true position is even worse than Beijing is letting on. Rather than trying to fix Chinese economic problems already evident when he assumed power in 2012, Xi has obstinately exacerbated the situation.

China's most serious economic problems stem from its state-led political economy. For political reasons, the Chinese Communist Party controls and dispenses the best commercial and career opportunities. This means that firms and individuals do well due to political connections and alignment with the Party's political objectives rather than because they are the most deserving recipients of opportunity by usual standards of economic and commercial merit.

The Party's iron grip over the most important sectors in the economy means that market and price signals are significant retarded. The property giant Evergrande might be ostensibly a private company, but it rose quickly on the back of cheap money, political connections, and going full throttle at a time when the fiscal budgets of local governments became reliant on rising residential property prices. In important respects, the Evergrande

“three highs one low” model (high debt, high leverage, high turnover, and low cost) is a microcosm of what is superficially impressive, but fragile and flawed with the Chinese approach. Economic opportunity and success based on politics and policy rather than sensible commercial decision making will always lead to the mass misallocation of resources.

Xi has doubled down on this Party-first and state-led approach. The Evergrande model has taken even deeper root throughout the entire economy under his instruction and watch. His flagship blueprints such as the Belt and Road Initiative and Made in China 2025 involve large sums of capital and opportunity being allocated to sectors and projects for geopolitical and policy purposes. These blueprints are largely about the creation of guaranteed external opportunities for favored Chinese sectors and firms. They are hugely inefficient and wasteful but threaten to distort global markets and create new avenues of geopolitical leverage for China. Indeed, Xi's plan is to permanently ensure China benefits disproportionately from regional and global commerce.

For these reasons, Chinese households and the genuine private sector who are being denied access to the best economic opportunities in the country can only wish China would become more like Japan. For America and others, the danger is Chinese economic and strategic arrogance and overreach and Beijing's tendency to use its material power to coerce smaller countries. Perhaps only a long-term Chinese slowdown will lead to the Party rethinking its priorities for the Chinese political economy and China's place in the world.



I am with the more cheerful view, despite the endless challenges China faces.

JIM O'NEILL

Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

Whatever the underlying structural state of the Chinese economy, it is very likely China will experience a V-shaped recession and recovery

picture, just like virtually everywhere else that pursued Covid-19 lockdown policies.

Indeed, given that their lockdown was so long and so aggressive, it is highly likely it may be more pronounced and a very strong economic recovery will occur in 2023, some signs of which have already started. You can see this from early survey data in China and countries that have benefited so much from China's rise such as Germany. In this case, I think the question is not one for 2023 but beyond. What happens after the post-lockdown bounce?

I am trying to be open-minded about what happens for the coming years and beyond. As the question implies with its tone, the reasons why China will end up going down its own variant of the Japan path, with a declining labor force, weak productivity, inability to reform, too much debt, poor governance, and of course China's own personal issues with the West, are all quite feasible as reasons for why the China story is over.

However, on balance, I am with the more cheerful view, despite the endless challenges China faces. There are two reasons why I feel this way. First, China has endless experience of analyzing where Japan went wrong and I am pretty sure their senior bureaucrats are as familiar with those reasons as the rest of us.

Second, with President Xi Jinping's abrupt turn on his lockdown strategy, I see signs of a shift in their approach to a number of other odd developments in recent years, whether it their style of interaction with western countries that don't behave as they might like, Australia as a recent example, to shifting their restrictive thinking about aspects of the private sector.

While many are baffled by the speed and scale of the Covid-19 shift and find reasons to add to doubts about the leadership, this is indicative of a western mindset bias. On the contrary, as his predecessors often showed, when there is a identifiable problem, respond to it as quickly as possible, and move on to dealing with the next crisis. I wish some other countries could behave this way, including my own United Kingdom, more often.

Obviously, how China manages remains the most important marginal thing for the world economy given its huge influence over the past twenty-five to thirty years. Get it right, and world growth will probably get back close to a trend of 4 percent on a purchasing power parity basis. Get it wrong, and we may be struggling to stay above 3 percent.

While it is once again fashionable for some to think of India being the next China, this is simply not possible given the baseline, and even if India grows by faster rates than China this decade, which I personally think inevitable, it won't be until the 2030s, when India has become bigger than Germany and Japan, that it starts to have China-style influence on global GDP growth.



Many of China's self-inflicted problems may retard economic growth, and this is something Japan did not have to contend with thirty years ago.

RICHARD C. KOO

Chief Economist, Nomura Research Institute, and author, Pursued Economy: Understanding and Overcoming the Challenging New Realities for Advanced Economies (Wiley, 2022)

The Chinese are keenly aware of the risk that their country might go the way of Japan thirty years ago. Even before the bubble burst last year, many were asking me for advice, knowing I have first-hand knowledge of Japan's post-bubble difficulties.

There are similarities as well as important differences between the two countries. The key similarity is that both experienced the collapse of a debt-financed bubble. When asset prices plunge relative to liabilities, households and businesses are saddled with excessive debt and forced to deleverage. But if someone in a national economy is saving or deleveraging, someone else must borrow and spend those funds to keep the economy going. When few are left to borrow and spend the deleveraged funds even at zero interest rates, the economy invariably plunges into a balance sheet recession.

The key difference between China today and Japan thirty years ago is that the Japanese—like everyone else—had no knowledge of balance sheet recessions because the discipline of economics had failed to consider this type of downturn. The Chinese, meanwhile, are fully aware that when the private sector is deleveraging the public sector must act as borrower of last resort to prevent a deflationary spiral. China is therefore unlikely to fall off the “fiscal cliff” or waste time on monetary easing or structural reforms when the problem lies in underwater private-sector balance sheets.

One problem here is that Chinese companies began sharply reducing their borrowings long before the bubble burst, while households have continued saving. That has forced the government to act as borrower and spender of last resort since 2016.

The recently discontinued zero-covid policy also depleted the coffers of regional governments, which have traditionally shouldered most of the burden of fiscal stimulus. If additional stimulus is needed to counter the

looming balance sheet recession, they might have to find creative ways to finance it.

Another difference is that in Japan's ugly trade frictions with the United States in the 1980s and 1990s, the dispute was purely economic. Today's U.S.-China confrontation, meanwhile, is deeply geopolitical and may have devastating consequences for the export-oriented Chinese economy if the decoupling continues. At a per capita GDP of \$12,000, China also finds itself in the "middle income trap." That, together with greater regulatory uncertainty under the Xi administration, may explain why Chinese companies are borrowing and investing less.

A further difference is that while Japan's slow growth is often attributed to poor demographics, the Japanese population did not start declining until 2009, nineteen years after the bubble burst in 1990. Meanwhile, China's population began shrinking the same year the bubble burst, in 2022.

In the short run, the Chinese economy should pick up now that the zero-covid policy is over. And the Xi administration does not need to worry about political opposition to fiscal stimulus, since it tolerates no opposition. But in the medium term, many of the self-inflicted problems described above may retard economic growth, and this is something Japan did not have to contend with thirty years ago.



A reduced growth rate rather than a "Japanese-style" decade seems the more likely outcome.

ANNE O. KRUEGER

Senior Research Professor of International Economics, Johns Hopkins School of Advanced International Studies, and former First Deputy Managing Director, International Monetary Fund

Prognostication about China's economic and political future has always been difficult and surrounded by great uncertainty. Worse, to a greater extent than in many countries, political uncertainty is compounded by economic uncertainty and vice versa.

Political uncertainty is high for several reasons. First is the economy itself: the government has maintained its

legitimacy by delivering on rapid economic growth. If that growth falters, pressures on the political system will certainly increase.

Second, the past several years have witnessed a reversal of the earlier trend in which economic activity was increasingly allowed and even encouraged in the private sector. As activity shifts back toward state-owned enterprises, the effects of SOE inefficiencies will depress the potential growth rate.

And third, the problems of the construction sector are far from resolved and that in itself poses a threat to both economic growth and political stability.

Chinese economic uncertainty abounds. The difficulties of the construction sector alone are sufficient reason to create pessimism. Likewise, the reversal of the earlier reforms toward the private sector will likely constitute a drag on growth.

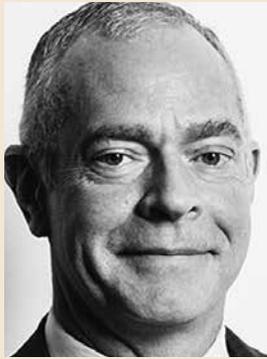
The fact that the *hukou* system has been and will be so difficult to unwind further will surely be a negative factor both by discouraging migration to more productive regions for employment and by weakening the education and development of those unable to obtain education, health, and other social benefits because of lack of *hukous*. Earlier, China could grow rapidly in part because of the abundant supply of cheap labor which flowed in from rural areas. While there are still many rural residents, the challenges of bringing them and *hukou*-less urban residents into coverage in the system will be enormous. In addition, demographic factors of a declining labor force and growing elderly population will exert a downward pull on the economy.

Moreover, there are geopolitical questions. Prospects of armed conflict cannot be ruled out, but even without that, the drag of heavy military spending will be a factor. The uncertain geopolitical situation will surely impact economic activity and also affect internal politics.

In sum, China faces the "perfect storm" of uncertainty. If growth falters, it will come for reasons mostly very different from those that led to the Japanese lost decade. That Japanese decade was powered by the descent and reversal from a pronounced asset bubble into a period of dropping asset prices and that impact on real economic activity.

Although China could experience such a reversal, the factors mentioned above are at least as likely to depress the growth rate. If a financial crisis starts, it will be because of overbuilding and related issues in the construction sector. The other factors would then intensify the severity of the decline.

If I had to bet, it would be on China's "muddling through" with reduced growth and difficulties in key sectors. In the absence of severe geopolitical stresses, a reduced growth rate rather than a "Japanese-style" decade seems the more likely outcome.



The Chinese economic system is fundamentally incompatible with that of the United States.

GREG MASTEL

Senior International Trade Advisor, Kelley Drye & Warren, and former Chief Economist, Senate Finance Committee

It seems hard to believe today, but in the 1980s and 1990s Japan was seen as a dire economic threat to the United States. The U.S. trade deficit (then a relatively new economic reality) was surging, driven heavily by imports from Japan. Key U.S. industries, like semiconductor production, faced stiff and often unfair competition from their Japanese counterparts. Members of Congress shot campaign advertisements of them destroying Japanese products with sledgehammers. And the term “Pearl Harbor” was grossly overused.

A decade or so later, Japan struggled through an endless recession and faced down a serious demographic crisis. Japan remains a formidable manufacturing and technological power, but it is not seen as a threat to the United States.

In the last two decades, China has largely replaced Japan as the chief U.S. economic adversary. The Chinese economy now rivals the U.S. economy for world leadership. Many of the same U.S. industries, like semiconductor production, again face stiff and unfair competition, but now from companies based in China rather than Japan. The U.S. trade deficit with China is now running about five times the current level of the U.S. trade deficit with Japan.

The differences between the U.S. rivalry with China are far more important than the similarities with the previous rivalry with Japan. First and foremost, the U.S. struggle with Beijing is more deeply rooted than it ever was with Tokyo. The Chinese economic system is fundamentally incompatible with that of the United States. The leadership of China is named the Chinese Communist Party for good reason and it wields a degree of control over its economy and companies that is inconceivable in both the United States and Japan.

Second, as anyone who reads the Chinese press can surely attest, the vitriol directed at the United States far eclipses any criticism ever uttered by Japanese officials. And this is literally a daily drumbeat of criticism aimed at Washington on almost every issue, from covid to Ukraine.

U.S. criticism directed at China—however overheated it may sometimes seem—is barely critical at all compared to China’s daily raging. If more Americans paid even passing attention to the ravings of the Chinese press, a much deeper and darker rivalry would be widely perceived in the United States.

Finally, China is a direct military threat to the United States; Japan has not been for seventy years. Long a nuclear power, Beijing is surging ahead with efforts to expand its naval fleet and develop hypersonic missiles—all of which are aimed at the United States. China’s longstanding threats to Taiwan, its neighbors in the South China Sea, and even Japan could almost any day spiral into a full-fledged military confrontation with the United States.

In a mix of diplomatic euphemism and wishful thinking, the Biden administration refers to China as a “competitor.” At its worst, the relationship between Washington and Tokyo could be fairly characterized as one of competitors. But the real term for the relationship between Washington and Beijing is something between “adversary” and “enemy.”



China’s situation is very different from speculative housing bubbles in Japan and the United States.

JAMES E. GLASSMAN

Head Economist, JPMorgan Chase & Co., Commercial Bank

China’s economic progress in this millennium deserves a place in the Guinness Book of Economic Records. China’s GDP has leaped from \$2.5 trillion at the turn of the millennium to \$16 trillion currently, according to the World Bank (2015 U.S. dollars). In only a few decades, China’s economy has expanded to the size of the U.S. economy. (The Central Intelligence Agency estimates that China’s real GDP would be closer to \$30 trillion if the renminbi were at purchasing power parity, double where it is currently.) In other words, China has accomplished in a few decades what took developed economies more than two hundred years over the Industrial Revolution to achieve. Of course, China has been able to do this by gaining access to the massive open consumer markets of the developed economies. Notably, the rising

living standards for many of China's 1.5 billion population are a stark contrast to the failures of the nonmarket system that led to the 1989 collapse of the Soviet Union. Just as important, China's development has deepened the economic linkages with the developed economies that, for all the differences, promote greater geopolitical stability—and, yes, competition—by building greater economic interdependence.

China's story is an important reminder, at a time when many assume that the global pandemic will lead to deglobalization, that globalization is powered by the ambitions of underdeveloped economies whose living standards are far below those of the developed economies. Underdeveloped economies, not the developed economies, will determine the evolution of globalization.

Is China in danger of suffering the plight of Japan's lost decade in the wake of her speculative excesses in the late 1980s? China's debt levels are substantial and mortgage borrowing has collapsed. Nonetheless, China's situation is very different from speculative housing bubbles in Japan and the United States because the excesses are a side effect of an ambitious centrally managed economic modernization program that needs infrastructure to accommodate the internal migration that the economic architects anticipate. Whereas asset values rose far out of line with fundamentals during the speculative bubbles in Japan in the late 1980s and in the United States in the 2000s, China's asset values may not be that far out of line with her expected fundamentals. In other words, in contrast to the situation in Japan and the United States, where asset values fell back to more sustainable levels, China can anticipate that ongoing economic development will lift fundamentals into better alignment with current debt levels.

China's greatest economic challenge likely lies in her evolving demographics. China's population is no longer growing (it was expanding 1 percent annually at the turn of the millennium). China's working-age population is slowing even faster, placing a greater burden on the working generation to support the wider population. This is a story that has left a visible mark on Japan's economic performance and that many others—India is the rare exception—are working through.

However, China's demographic challenge will be more daunting than it is for others. That's because, despite the progress to date, China's living standard remains far below those of the developed economies. For example, China's GDP per capita is only 20 percent of the U.S. level. What is it about demographics that matters? Slower population growth leads to slower economic growth, but that's incidental. The evolution of living standards holds the key to a nation's well-being. Japan's aging population, with its working-age population (age 16–70) declining faster than its overall population, appears to be taking a toll on living standards. For example, Japan's real GDP per capita reached 75 percent of the U.S. level in the early 1980s, according to the World Bank, but has been falling back over the decades to now under 60 percent of the U.S. level. That's still high but it is a disappointment. Given the hopes of the Chinese population, a failure to narrow the gap with developed economies further would surely be disappointing.

The obvious antidote to demographic headwinds is investment in technological innovation to boost the productivity of the existing workforce. Market incentives are fueling innovation in the United States and China's economic leaders likely will focus more investment in this area to counter the growing burden on its workforce.

Fears that a loss of momentum in China's economy will be a burden for the global economy probably are exaggerated. One reason is that a large sector of China's economy is devoted to the production of goods consumed by others. China's exports have fallen from the 35 percent of GDP peak in the early 2000s to 20 percent. Nonetheless, this is still twice the export share of the United States economy. In that sense, China's economy is less of a global engine of economic growth than it is a producer. That will change in time, of course, as the Chinese consumer economy matures.

The road ahead for China will be challenging owing to rapid demographic changes. Nonetheless, in contrast to the disappointing trend in the evolution of living standards in Latin America, which peaked at 20 percent of the U.S. level in the early 1980s and has drifted down to 13 percent currently, China has reason to be optimistic. ♦

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