Evolving Evaluations of China’s Economy: The Bad, the Ugly, and the Mean

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Although few multinational companies (MNCs) are outright abandoning China, some are selling off some of their China-based assets and diversifying their places of production and supply chains, and few MNCs are investing in China for the first time.

There is rarely, if ever, a consensus about the state of China’s economy. To some extent, this is the product of ambiguous data. Few trust Chinese official economic growth data, and there is no agreement on what might serve as a suitable proxy to evaluate the economy’s performance. Even if official data were more reliable, the country’s massive size and internal variation create additional opportunities for disagreement. Despite widespread pessimism, inside and outside of China, about the trajectory of the economy, significant differences still persist. Although China is less transparent than ever, a prominent source of disagreement are the initial positions of observers, who inevitably emphasize different elements of the economy. Their contrasting analyses translate into alternative policy implications for the United States and others.

The Good, the Bad, and the Ugly

For most of the past 30 years, evaluations of China’s economy—both inside and outside the country—were divided into three camps, what I’ve previously called “the good, the bad, and the ugly,” inspired by the title of the famous 1966 movie of this name. The “good” perspective has painted a positive picture of rapid growth built on a gradualist approach to guide the economy through multiple transitions—from plan to market, rural to urban, agriculture to industry and services, and investment-led to consumption. In this story, China’s growth has generated opportunities for other countries in what Beijing would likely call a “win-win outcome.”

The “bad” perspective has highlighted a highly inefficient financial system, which has taken savings from households and disproportionately funneled capital to state-owned enterprises (SOEs) and questionable state-led pet projects, creating a buildup of debt that would result in either a gradual sclerosis and anemic growth or a massive financial crisis.

Those holding the “ugly” view have been highly worried about China’s economic trajectory, not because of immovable structural issues such as debt, but because of poor policy choices by China’s lead-
ership that have largely favored expanding state control over supporting market mechanisms. From this perspective, reversing course, in the direction of liberalization, could provide a foundation for greater productivity and continued long-term growth, even if not at the rate of earlier years.

The Bad and the Ugly

In the last five years there has been a fundamental reordering of perspectives. There is almost no one, inside or outside of China, holding up the “good” banner any longer. That is because under the leadership of Xi Jinping, China has largely backtracked on the gradualist “reform and opening” strategy that had yielded success for so long. Internationally, China’s global footprint has grown dramatically, and domestically, the services sector and consumption are larger parts of the economy; but broader liberalization of economic activity and a reduced role for the state are no longer at the center of the agenda.

Instead, the gravity of opinion has shifted in a far more pessimistic direction. A few, consistent with the bad perspective, focus on one or another structural issue, such as debt or demography, or a combination of them. More often, the bad and ugly perspectives are merging, with a criticism of Xi’s highly statist approach and specific policy measures, which observers believe are reducing productivity and undermining China’s growth prospects. Xi may have tinkered with liberalizing reforms early in his tenure, but on the whole he has reversed course across the board. Whenever given a choice between control and markets, Xi has almost always chosen the former. Hence, state intervention to halt the stock market’s fall, a draconian zero-Covid policy, the crackdown on private tech firms, the erosion of independent corporate governance institutions within companies, an emphasis of inequality over growth, and the pursuit of technological independence over integrating into global supply chains. Under Xi, almost every policy now is framed in terms of security: energy security, food security, financial security, technology security, health security and so forth.

The concerns of economists draw heavily on the deep pessimism and, in some cases, outright sense of despondence widespread among China’s broader populace and its business community. Private conversations and interviews yield a wave of criticism of the political and policy environment and the real estate crisis and fall in home values, as well as the fears about possible war and isolation due to increased tensions with the United States. These concerns add up to a profound sense of uncertainty about the future and a loss of confidence in China’s overall direction. This has translated economically into stagnant consumer demand and restrained investment by business, meaning fewer new jobs and slower economic growth.

The global business community is particularly worried about U.S.-China security tensions, but it shares the same worries about China’s overall policy direction. Although few multinational companies (MNCs) are outright abandoning China, some are selling off some of their China-based assets and diversifying their places of production and supply chains, and few MNCs are investing in China for the first time. Excitement about China has waned among foreign private equity firms because of the uncertain prospect that the Chinese companies in which they invest will be able to go public. Hedge funds and other institutional investors are also worried about short- and long-term returns, viewing other options as less risky.

The Mean

Despite the broader pessimistic shift, there is one perspective that is more sanguine about China’s current economic prospects. Techno-nationalists, who believe a country’s economic and military power comes primarily through its ability to dominate advanced technologies, see Chinese industrial policy and all of its tools as a strength of its system. Not only is this the view of Xi and his inner circle, some techno-nationalists in the United States and elsewhere conclude that China has made enormous technological strides to overtake the West in critical sectors and become a peer in others. They point to Chinese successes in telecom equipment, high-speed rail, electric vehicles, solar, wind, and AI as evidence of China’s growing strength. And they discount the inefficiencies of China’s economy by
arguing that the Chinese Communist Party (CCP) has unlimited financial resources, the political power to dictate domestic company behavior and consumer choices, and a large enough domestic market and other resources to withstand and overcome Western restrictions and pressure.

This optimistic view of China’s techno-nationalist approach is challenged by those who point to the very mixed record of Chinese industrial policy initiatives and China’s continued technological dependence on others. Rather than a well-oiled machine, they see mounting internal tensions and policymaking dysfunction that will mean a continued sizeable gap between China’s technology policy ambitions and actual commercial outcomes.

**Policy Implications for the United States**

These contrasting views of China’s economic trajectory come with quite different policy prescriptions for the United States and other advanced market economies.

Although now out of favor, if China were still pursuing, or would return to, a strategy of reduced state intervention at home and greater liberalization internationally, in line with the good perspective, the appropriate response from the United States and others would be an approach of patient integration. Akin to the long-term engagement strategy, the United States would rely on a web of multilateral institutions (such as the World Trade Organization), regional arrangements (such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, or CPTPP), and bilateral agreements to encourage China to move in a market-oriented direction and penalize it in the specific instances where it does not meet its commitments. Given how far China has deviated from this path, the likelihood of restoring a consensus in Washington in favor of such an approach is extremely low. Those hoping for such a return to a “reform and opening” strategy could help identify a series of steps China would need to take to prove its intentions to domestic and international audiences.

Those in the bad and ugly camps, which are now in ascendance, have less faith that China under Xi will accept any significant liberalization of its economy and are concerned about the effect of China’s non-market practices on the rest of the world’s economy as well as the national security and human rights risks that extensive connectivity may pose to the United States and its allies. Hence, they counsel a combination of continuing to take advantage of continuing commercial opportunities, blunting the impact of China’s economic distortions and national security vulnerabilities, and strengthening the United States’ own economic foundations and the international rules-based order. This encapsulates the analysis and approach of the Biden administration, with its emphasis on de-risking (export controls, investment screening, supply chain diversification, etc.); promoting the reinvigoration of manufacturing and technology innovation at home; and developing a bilateral agenda on reducing barriers to China’s market, trying to constrain Chinese industrial policy, and seeking to cooperate in areas of common interest, including public health and climate change.

A central underlying principle of this approach is the need to coordinate and align policies with like-minded countries to ensure that efforts at de-risking are effective and do not isolate the United States.

Those in the “mean” camp, who are most impressed by China’s industrial policy prowess but also deeply worried about its effect on the United States and global economy, are far more skeptical that the United States can effectively calibrate a relationship with China in a way that aligns with American national interests. They point to the expansion of China’s manufacturing in emerging industries and continuing large trade surplus with the United States and others. As a result, they are in favor of outright decoupling and trying to isolate China, while at the same time pushing the United States to develop its own comprehensive industrial policy to rebuild its manufacturing capacity and dominate the technologies of the future. This perspective is reflected in the analysis of former U.S. trade representative Robert Lighthizer, and in a bipartisan report issued in late 2023 by the U.S. House of Representatives’ Select Committee on the CCP.

If past is prologue, the various schools of thought about China’s economy will continue to contend with
each other without an ultimate resolution to their disagreement. But the debate is likely to become even more contentious in 2024, in part because China’s economy is likely to rebound over the course of the year and in part because of the 2024 U.S. election season. Rather than be forlorn over a potentially heated yet inconclusive period of attacks and counterattacks, Washington (and other Western capitals) could use this year as a chance to finally push the contending views to not talk past each other and clearly evaluate their relative merits.

To do so, analysts should collectively answer three interrelated questions. First, what are the strengths and weaknesses of China’s economy and how should credit and blame be apportioned? For example, where there are successes (such as in mobile phones and electric vehicles), are these the result of wise industrial policies or market liberalization?

Second, how does China’s economic behavior and performance affect the United States and the rest of the world? The policy community still does not have sufficient understanding of the overall effect on the American economy, in part because there is not agreement about which metrics should be used or which sources of data are reliable. At the same time, analysts and policymakers need to carry out a comprehensive discussion of the risks and benefits of extensive commercial ties and interdependence for the United States’ national security. The risks are increasingly obvious, but the benefits of connectivity—for improving American innovation, creating lines of communication, and increasing the costs of Chinese aggression—deserve renewed evaluation.

Having analyzed China’s economy and the effects on the United States, Washington needs to answer one final question: What are the costs and benefits of the de-risking approach the Biden administration has taken over the past few years, and what are the potential results of the alternative strategies of a return to engagement or a comprehensive strategy aimed at decoupling? To date, no overall assessment has been done of what the current approach has achieved and whether it makes sense to continue forward or move in a different direction.

Although an intense debate on China during an election year could produce a substantial amount of heat, if carried out thoughtfully, it could produce much-needed light as well.

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