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China’s Economy—Hard or Soft Landing?

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A panel at The Heritage Foundation on March 11 discussed whether China’s economy is heading toward a “hard” or “soft” landing. Heritage’s Walter Lohman chaired this panel of experts, which included Dr. James Dorn of the Cato Institute, Pieter Bottelier of the School of Advanced International Studies at Johns Hopkins Univeristy, and Heritage’s Dr. William T. Wilson.

Dr. Wilson talked about the danger of a hard landing because of the potential debt crisis. “I think China has the capacity to handle the financial crisis. But the question is whether China can manage this without a significant slowdown in growth,” Wilson said. The evidence suggests that countries have never undergone this level of debt buildup without a financial crisis.

Despite having the world’s second largest economy, China’s economic miracle may not be sustainable. According to the McKinsey Global Institute’s new report, fueled by real estate and shadow banking, China’s total debt has nearly quadrupled since 2007, from $7 trillion to $24 trillion. China’s debt, which is 282 percent of its gross domestic product (GDP), is manageable, but it is larger than that of the United States or Germany. Moreover, a recent article in *The Economist* suggests that China’s working-age population peaked in 2012 and is now on a downward trend. Investment also looks to have topped out at 49 percent of GDP, a level few countries have ever seen. China’s technological gap is narrower than in the past, implying that productivity growth will be lower, too. In addition, significant environmental pollution has threatened China’s economic growth.

China’s Communist Party leaders have realized this problem. President Xi Jinping proposed the “new normal” theory that, first, the economy has shifted gear from high speed to medium-to-high-speed growth. Second, the structure of the economy is constantly improved and upgraded. Third, the economy is increasingly driven by innovation instead of input and investment.

Meanwhile, Chinese Premier Li Keqiang delivered his second government work report and announced that China would cut its target growth rate to approximately 7 percent on March 5, 2015. He pointed out that the Chinese government would deal with the slowdown in economic growth by simultaneously making difficult structural adjustments and absorbing the negative effects of economic stimulus policies. However, whether the promises of economic restructuring would be implemented effectively remains uncertain.

Dr. James Dorn stressed the importance of the rule of law, free markets, and protection of property rights. These are also key factors contributing to China's long-term sustainable development. The Heritage Foundation*/Wall Street Journal*'s *2015 Index of Economic Freedom ranks China* 139th. Although China's performance is lower than the global and regional averages, its overall score is 0.2 point higher than last year, with modest improvements in freedom from corruption, business freedom, and labor freedom. However, declines in investment freedom and controlling government spending may still be significant problems. Moreover, vested interests and lagged political reform are also obstacles to further reform.