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BRIEF

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# AVOIDING THE FALL: CHINA'S ECONOMIC RESTRUCTURING

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China's GDP growth has been miraculous, driven primarily by high levels of investment fueled by credit. But the country's economic growth is slowing far more rapidly than expected, even as debt levels continue to surge. It is increasingly clear that China must transform its growth model away from one that relies heavily on debt. However, that process is likely to create tremendous tension among a political elite that has benefitted disproportionately from many years of massive investment expenditures.

## Key Points

- As a consequence of its current growth model, China is pouring capital into bad investments on a scale that may be unprecedented.
- Debt levels have increased unsustainably. With investments not producing the expected returns, the country is reaching its debt-capacity limits.
- To constrain debt while maintaining high growth rates, Beijing has no choice but to reverse policies that led to its spectacular growth.
- Rebalancing can only occur if the household share of GDP, which has steadily declined for many years, rises.
- The key constraint is not economics. It is entrenched political interests.

## How China Can Rebalance

**Move swiftly to constrain credit growth.** If Beijing does not sharply reduce the rate of credit growth, China's debt will force a disorderly adjustment that could result in a sharp contraction of GDP or many years of very low growth.

**Implement policies to raise the household share of GDP.** Because households retain an extraordinarily low share of GDP, household demand is insufficient to drive high levels of GDP growth. By increasing the share of GDP that households retain, China can rebalance the economy while keeping GDP growth rates sufficiently high to protect the country from social instability.

**Transfer state assets to the private sector.** This is the most efficient way to increase household wealth quickly as a share of GDP, though a contraction of the state sector is the almost-inevitable result of an increase in the household share. This can be achieved either directly or indirectly in the form of debt absorption, and it is likely to be driven largely by politics and factional positioning within the economy. Apportioning the costs of this process among different sectors within the state will be the most difficult aspect of this kind of rebalancing.

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