Xi Is China's Great *Vulnerability*

By Robert Shapiro

Isolated dictators are particularly vulnerable to catastrophic mistakes.

While China shares some of Japan's economically damaging features, their differences suggest that China is unlikely to replicate Japan's decades of economic stagnation or pose problems for the global economy. The wildcard here that could derail China's economy is not its debt burdens or demographic changes but rather its president, Xi Jinping.

It's correct that China and Japan have both run up very large debt burdens, public and private. But while government borrowing accounts for the majority of Japan's debt at $9.8 trillion or 263 percent of GDP, most of China's outstanding debt involves private companies, households, and local governments using private vehicles. In 2022, China's formal government debt stood at about $13.1 trillion, equivalent to 72 percent of its GDP. To be sure, most of China's private debt, estimated at more than $52 trillion, represents loans from its state-owned banks, and state-owned companies borrowed much of it. But while an erosion in investor confidence based on Japan's government debt burden could imperil that country's credit and currency, borrowers from China's state-owned banks can default without consequence for global investors.

Beyond that, the debt specter is something of a red herring in both cases, because China and Japan can finance their debt burdens through domestic savings. Since 1990, Japan's gross domestic saving rate has averaged 28 percent of its GDP, and since 2010, China's gross savings rate has averaged almost 47 percent of GDP. China's savings are so large that it has also become a major international lender. Institutions in foreign countries, including the U.S. Treasury, owe a total of $5.6 trillion to Chinese entities

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compared to $2.4 trillion in outstanding debts that Chinese entities owe foreign institutions.

The significant economic issue here is not the size or financing of China's debts, but rather the quality of the investments that Chinese companies and local governments financed through debt. Here, China should remind us of Japan. Much as Japan ran up its large government debt in order to maintain employment by overspending on infrastructure and other public works, China's state-owned banks have supported thousands of substandard projects largely for the same reason. One result is that new housing developments and office buildings in places such as Xining, Qinghai, or Xi'an, Shaanxi, cannot find buyers or occupants, and new airports in Ürümqi, Xinjiang, or Chengdu, Sichuan, cannot attract enough flights and customers to break even.

As a consequence, thousands of non-performing loans have left China's state-owned banks technically insolvent or nearly so. But the significance is very different in China than it would be in market-based countries, since there are no investors in China's big banks and the government keeps them operating and lending regardless of their real balance sheets. So, instead of setting off a crisis that could sink China's economy or usher in a period of stagnation, the thousands of failed projects and failed companies have produced the equivalent of a mild slowdown with modestly higher unemployment.

Nor do China's demographic issues pose a serious economic threat. To be sure, China's population is aging rapidly, and its labor force declined from around 800 million in 2015 to 780 million in 2021. But the education and skills of that labor force also rose substantially over the same years, so China can produce more with fewer workers. China's aging population also doesn't portend the serious claims on public resources that can threaten investment and growth as they have in Japan or Italy where the demographic shifts are even more severe than in China. The reason, of course, is that China doesn't provide universal government pensions or guaranteed healthcare for its elderly. Tens of millions of older people living in poverty and unable to afford medical care is a long-standing norm in China; and since the Xi government is brutal and unaccountable, their suffering does not presage real change for the foreseeable future.

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And even with more moderate growth in the recent past, China along with the United States is likely to remain an engine of world growth because both economies are so large and so extensively integrated with global trade. Consider how much the two countries support production in the rest of the world. In 2021, China imported $3.1 trillion in goods and services from abroad, second only to United States with imports of $4.0 trillion. Together, China and the United States imported 13 percent of all the goods and services produced by every other country. Those are powerful engines.

Apart from the unknown, there is at least one clear, potential threat to China's growth and progress: President Xi's determination to concentrate all important state decisions in himself and a loyal coterie while building an advanced surveillance state to identify and eliminate any nascent challenge. The combination deprives Xi and his government of the broad array of information and analysis that prudence and experience require for cogent decision-making. All individuals are fallible, and isolated dictators seem particularly vulnerable to catastrophic mistakes. A strongman's missteps that can sink an economy may involve foreign affairs—to wit, Vladimir Putin today—or domestic matters as with Mao in the 1950s. And certainly, Xi's irrational approach to the pandemic suggests that he is not immune from terrible decisions that would imperil China's economic prospects. ◆

The debt specter is something of a red herring.