



## China Resists Correcting Unbalanced Economy, Risking the Future of International Trade

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The imbalances between investment and domestic consumption and between business and household shares of national income in China are causing overproduction and increasingly affecting the global economy. China is unwilling to change its economic model, but its perpetuation will lead to the deindustrialisation of other countries and disruptive political effects in the West. For this reason, the economic rivalry between China and the U.S. is likely to intensify in the coming years, with potential security implications.

**Imbalances in China's Economy.** Since the economic liberalisation of the 1970s and 1980s, China has been suppressing consumption in order to increase the levels of savings, then invested in line with state policy, allowing it to boost competitiveness in selected sectors. This effect is caused, among other things, by currency interventions and the undervaluation of the yuan exchange rate, raising the cost of imports (including the prices of goods purchased by households) and lowering the cost of exported goods on foreign markets, which is beneficial for manufacturing. The weak economic position of households and workers is also due to the lack of independent trade unions. The problem is exacerbated by the [hukou system](#), which hinders legal internal migration and can be used as a repressive tool against migrant workers and stops them from access to many public services despite paying taxes and contributions. As a result, China has a low level of final consumption expenditure (around 50% of GDP against around 70% in India and 75-80% in OECD countries or Brazil) and an abnormally high level of investment (gross capital formation) at almost 45% of GDP against over 30% in India or around 25% in OECD countries (according to World Bank data).

Low wages mean that Chinese workers are unable to consume the goods they produce, and trade surpluses with foreign countries are necessary to balance the economy. This problem was acceptable for China's trading partners when its economy was smaller (in 2000, the Chinese

economy was comparable in size to Italy's, and then in 2008, to Germany and the Netherlands combined). Today, however, China accounts for around 18% of global GDP and, due to imbalances in its economy, 13% of global consumption and 31% of global manufacturing. The inevitable result of free trade with China is therefore the adoption of a balancing role by the trading partners, which translates to the need for increased consumption with reduced production (which cannot compete with directly and indirectly subsidised Chinese production) and the acceptance of trade deficits, a problem that has been growing in recent years due to [China's economic problems](#). These issues are causing consumer reluctance to spend and, as a result, exacerbate the problem of low demand. The situation is made more difficult by the [experiences of China's zero-COVID policies](#), which have lowered citizens' confidence in the government and the economy. In addition, due to central control of investments, unreasonably high capacity has been created in many sectors with state support (e.g., China can produce twice as many solar panels per year as global demand during this time), leading to overproduction.

The experience of the so-called "China shock" (the rapid increase in imports of simple industrial products from that country to developed countries associated with China's accession to the WTO in 2001) indicates that the decline in manufacturing sector employment resulting from increased

imports from China has negative economic and social effects on trading partners and increases political polarisation. The occurrence of a second shock, this time in the field of modern technology (e.g., electric vehicles, robotics, artificial intelligence, advanced semiconductors or commercial aircraft), would be a serious threat to the political cohesion, security and prosperity of Western societies. Awareness of the problem is leading to [increased trade tensions between the EU and China](#) and a sceptical policy towards China by the current Democratic U.S. administration. Seeking to resolve it is likely to be one of the main goals of [Donald Trump's second administration](#).

**Potential Solutions.** It will be safe for trading partners to continue trading with China only after its economy is balanced, leading to an increase in consumption and thus a reduction in trade imbalances. An increase in households' share of national income would have to be financed by taxing the rich elite, removing subsidies for production or increased social spending by public authorities (central or local), linked to increased debt levels, reduced public investment or drawing on reserves. Each of these solutions entails spreading the costs across different interest groups and is therefore politically unattractive to policymakers.

The Chinese authorities have repeatedly displayed an aversion to "welfarism" and social transfers, which, according to Xi Jinping, can "encourage laziness". Beyond ideological reasons, increasing the role of production at the expense of consumption has real justification. Making partners dependent on Chinese goods includes a political dimension—China has tried to use restrictions [on gallium and germanium exports](#) to achieve its goals in the competition with the U.S., and recently interrupted the supply of batteries to a U.S. drone manufacturer supplying, among others, the U.S. and Ukrainian armed forces. Moreover, at least a partial reform of state institutions, such as improving the quality of the judiciary, would be necessary to address the situation of low confidence in the state and the market (which currently limits household consumption). However, along with raising household incomes, this could lead to an increase in the political independence of society and a loosening of central control over parts of state expenditure (e.g., local governments) which would be undesirable for the current authorities.

Previous programmes to stabilise the economy have been inadequate or outright harmful. Attempts to solve the crisis in the residential real estate market (and related financial markets) have so far been on too small a scale to return China's economy to a rapid growth path. They have been

aimed at resolving the local government's balance sheet problems, so their ultimate effect will depend on the allocation of the freed-up funds to consumption or investment. Some of the measures, most notably further production subsidies, may even exacerbate the imbalances problem. The Chinese authorities seem to be making an erroneous assumption that the current economic difficulties are sectoral rather than macroeconomic in nature, so the response may be to reallocate resources from infrastructure spending to modern industry.

Rapidly increasing the share of the defence budget in GDP may also be a potential solution, that would nevertheless be undesirable from the other countries' point of view. These measures will be short-term effective—they will lead to increased demand for specific products, which will translate into job creation and economic growth. However, investment in resources for the military will not lead to the correction of imbalances in the Chinese economy, and increasing its military power will be detrimental to regional stability.

**Conclusions.** Imbalances in the Chinese economy are a planned feature. The CCP leadership is aware of this and is not responding accordingly to correct them. At the same time, however, the imbalances are, with the current size of the Chinese economy, unacceptable to other countries and, in the absence of an appropriate response from the Chinese authorities, will lead to exacerbated disputes with and trading partners, which may take the form of a trade war.

The interests of the EU and the U.S. are, due to the similarity of their economies, converging. Consequently, it would be advisable, also from Poland's point of view, to exert stronger pressure on China, which then would be faced with a choice between correcting its economic model and a trade war with a united West, which it cannot afford due to its dependence on export markets. The lack of U.S.-EU coordination will result in lower leverage on China, as it would allow trade shifts and China's adaptation before the other partner takes action.

China's economic model in its current trajectory is becoming a challenge to international security, as growing problems may be an argument for China's authorities to take aggressive action, for example, against Taiwan, in order to strengthen the legitimacy based on nationalism (rather than prosperity) and move towards a war economy. Putting economic pressure on China must be accompanied by a careful analysis of the security situation and signalling a tough stance on it by the U.S. and the EU coordinating closely.