

China's Economy at a Turning Point: Outlook & Challenges



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China's economy has reached a critical turning point under the leadership of Xi Jinping. Although Xi was appointed general secretary of the Communist Party in 2012, his administration officially began in March 2013. Since then, the economy has experienced a steady slowdown, a trend that was sharply exacerbated during the three years of the Covid-19 pandemic from 2020 to 2022.

Several overlapping challenges have hindered China's return to a path of robust growth. These include the lingering aftereffects of the pandemic, a prolonged real estate slump, and the tariff war initiated by US President Donald Trump. The deeper, structural causes of the slowdown, though, lie in the Xi administration's policy direction, particularly its emphasis on state-owned enterprises at the expense of the private sector – a phenomenon popularly expressed as “the state advances, the private sector retreats.” This shift has been accompanied by tighter economic controls, which have constrained market dynamics.

Despite the significant slowdown, there are no signs that the Xi administration intends to shift course. As a result, prospects for a near-term recovery appear bleak. If this situation continues, the Xi administration may face a serious dilemma: it must sustain economic growth to maintain its legitimacy, but doing so would require a policy shift toward liberalization – something it has so far resisted. Instead, the government has continued to strengthen economic controls, undermining market mechanisms and eroding macroeconomic efficiency.

At this pivotal moment, it is necessary to closely examine the three overlapping burdens that are weighing on China's economy and assess the future outlook of an economy that is now standing at a crossroads.

The Course of China's Economy Under Xi

To understand the trajectory of China's economy, it is important to revisit the path it has taken since the “Reform and Opening-Up” policy was launched in 1978. Following the death of Mao Zedong in 1976, China stood at the edge of economic collapse. The country's revival was largely driven by the gradual liberalization of individual entrepreneurship and the conditional opening to foreign direct investment. Another key factor was the relaxation of restrictions on rural-to-urban migration, which unleashed a vast surplus labor force into the cities.

This combination of abundant labor and foreign-capital-led

manufacturing significantly boosted labor productivity and propelled China's economic growth. Institutional reforms played a crucial role in this transformation. In agriculture, the dismantling of People's Communes and introduction of the household responsibility system empowered farming households to make production decisions. Aside from the portion that had to be delivered to the state, they were free to sell their harvests. This immediately sparked farmers' enthusiasm and increased output.

State-owned enterprises also underwent reform. Government intervention in management was scaled back, and the functions of the government and enterprises were separated, giving SOEs greater autonomy. For the first time since the founding of the People's Republic, bonuses were paid to incentivize workers – an important step toward improving enterprise efficiency.

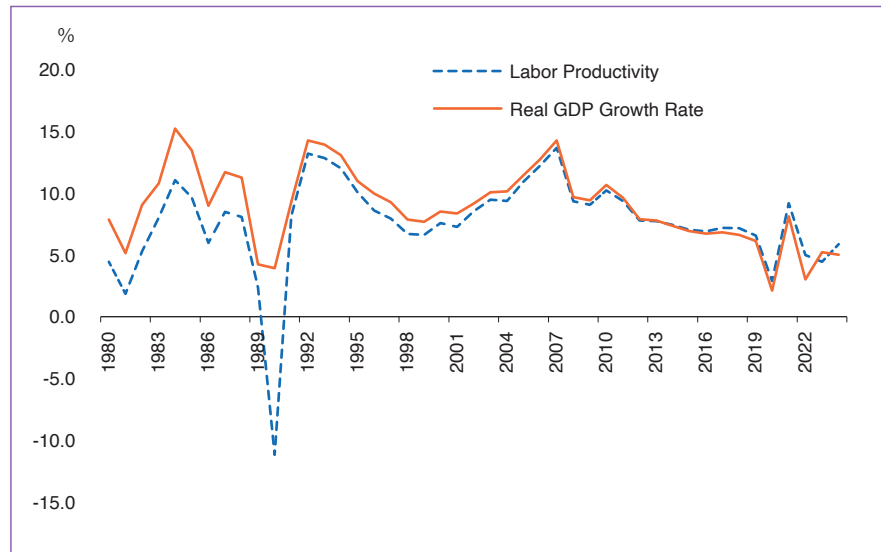
Urban reforms followed. In the 1980s, many young people who had been sent to the countryside during the Mao era returned to the cities. Those who did not possess urban household registrations (*hukou*) were barred from formal employment, but local governments, under certain conditions, permitted these young returnees to start their own businesses. These ventures, often small-scale enterprises like restaurants and clothing shops, formed the backbone of a burgeoning private sector.

Of course, the reform process was not without resistance. A well-known anecdote from Anhui Province illustrates the tension between old ideology and new economic realities. A street vendor who was renowned for his skill in roasting sunflower seeds gained popularity and commercial success by word of mouth. Local officials, perhaps out of envy or ideological rigidity, accused him of “following the capitalist path” and had him arrested. The case was reported to the Communist Party leadership and eventually – almost unbelievably – brought to Deng Xiaoping, the country's paramount leader at the time. Reportedly, Deng dismissed the incident, saying to his secretary, “This is an exaggeration. A street vendor selling sunflower seeds cannot cause the failure of our great socialist cause.” He later issued a directive: “We must stop ideological debates over socialism versus capitalism and shift the Party's focus toward economic development.”

This shift in mindset laid the foundation for decades of rapid growth. As shown in [Chart 1](#), real GDP growth has closely mirrored trends in labor productivity since the start of Reform and Opening Up. The correlation is unmistakable: when productivity rises, the economy grows; when productivity declines, growth slows. This underscores the importance of market-driven reforms and labor

CHART 1

Labor productivity & real GDP growth in China since 1980



Source: Compiled by the author based on data from the National Bureau of Statistics of China and CEIC

efficiency in sustaining China's economic momentum.

The Three Burdens Weighing on China's Economy

1. Damage from Covid-19

The Covid-19 pandemic dealt a devastating blow to the global economy. In the early stages, the virus was not well understood, and no vaccines or treatments were available. Democracies struggled to impose full lockdowns due to legal constraints on restricting people's movements, which allowed infections to spread rapidly. By contrast, authoritarian systems like China were able to enforce strict lockdowns solely through the orders of the Communist Party, initially helping to contain the virus.

As time went on, the virus became more transmissible but less virulent, and Western pharmaceutical companies succeeded in developing vaccines. People gradually adapted, and restrictions on daily life were eased, although basic precautions like mask-wearing were maintained. With greater freedom of movement, people's immune systems grew more resilient.

In contrast, the Xi Jinping administration maintained a rigid zero-Covid policy even as the virus's severity declined. Daily PCR tests were enforced, and people were mandated to take domestically

produced vaccines. It was later revealed that in many localities, while samples were collected, the PCR tests themselves were not properly conducted. There were also concerns about the efficacy of China's domestic vaccines. Most damaging of all were the repeated and prolonged lockdowns, which severely disrupted economic activity. Nationwide lockdowns were not lifted until late December 2022. During the three years of the pandemic, an estimated 4 million small and micro enterprises went bankrupt, contributing to persistently high youth unemployment – a phenomenon that can be described as the “long Covid” of China's economy.

2. The Prolonged Real Estate Slump

For years, real estate development has been the cornerstone of China's economic growth. Urban redevelopment generated strong multiplier effects across the economy – from construction and materials to home appliances and furniture.

The Chinese government was well aware of the sector's importance. Local governments, in particular, relied on real estate as a fiscal lifeline: since all land in China is publicly owned, they could auction off land for development and use the proceeds as fiscal revenue. The Hu Jintao administration (2003–2012), under Premier Wen Jiabao, permitted local governments to retain revenues from

land-use rights auctions – a portion of which was used to bolster pension and social security funds in response to demographic aging.

There was certainly strong demand for housing, especially among people in their 30s to 50s. In Chinese society, it is customary for a man to own a home before marriage – otherwise, the woman's family may refuse. This was a cultural norm that drove real estate purchases. Even though the real estate market already showed signs of overheating before the pandemic, many Communist Party officials and domestic economists insisted that strong demand would prevent the bubble from bursting.

But no bubble lasts forever. During the pandemic, housing demand shrank dramatically. Developers, already overleveraged and saddled with massive debts, began to falter. The first major casualty was Evergrande, one of China's largest property developers, which defaulted in 2021. In August 2025, its stock was delisted, effectively marking its bankruptcy. This marked the beginning of a broader collapse in China's real estate sector.

3. The Trump Tariff War

The Xi Jinping administration has generally found it easier to deal with Democratic US administrations than Republican ones. The

sanctions and tariffs imposed on Chinese companies during the first Trump administration left deep scars. For Xi's government, the outcome of the 2024 US presidential election was nothing short of a nightmare.

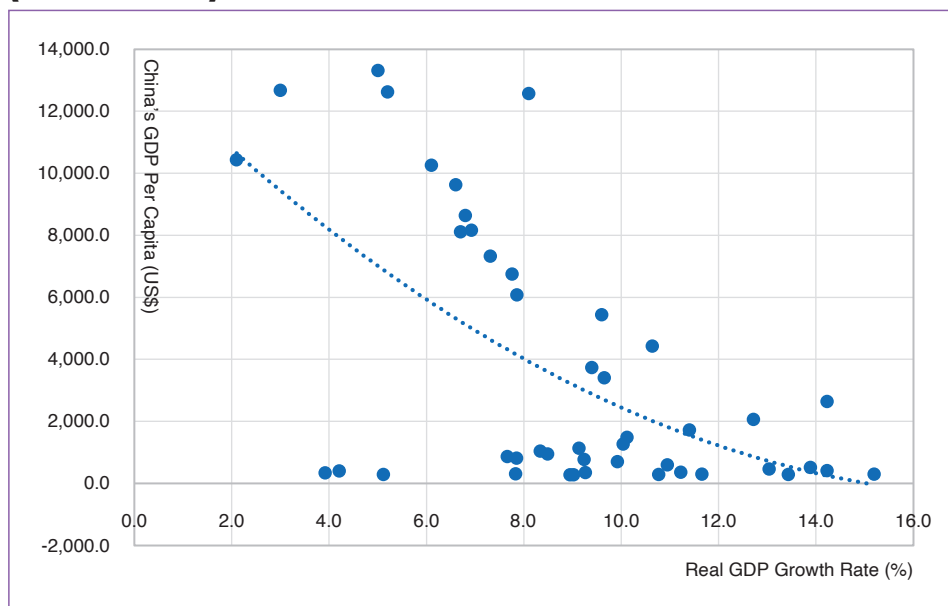
The Xi administration anticipated that the return of Trump would mean renewed pressure, and it was likely prepared to some degree. But the measures introduced since the launch of Trump 2.0 have been far harsher than expected, such as tariffs of 145% on imports from China. Although subsequent negotiations significantly reduced these rates, a provisional tariff of 30% remains in place. Talks continue, but no agreement has yet been reached.

Importantly, the 25% tariffs imposed during Trump's first term are still in effect. Taken together, the United States currently levies a total tariff burden of about 55% on Chinese goods. In addition, Trump 2.0 has tightened sanctions on Chinese high-tech companies.

The lingering effects of Covid-19 and the prolonged real estate slump are factors that weaken China's domestic demand, while the Trump tariff war is a factor that constrains external demand. These three burdens have together significantly slowed China's economic momentum. [Chart 2](#) shows the trends in China's per capita GDP and real GDP growth. If the trend line (dotted line) were sloping upward,

CHART 2

Trends in China's per capita GDP & real GDP growth (1980–2024)



Source: Compiled by the author based on data from the National Bureau of Statistics of China

there would be no cause for concern. But the downward slope indicates a sharp deceleration. Notably, the figures are based on official statistics of the National Bureau of Statistics, and they need to be discounted by 2-3 percentage points to reflect actual conditions. In other words, the forces undermining China's growth momentum are stronger than expected. Monetary and fiscal policies alone are insufficient to reverse this trend. What is needed is a bold shift in policy direction.

Xi's Dilemma: Liberalization or Stronger Control?

The Xi administration was officially launched in March 2013. With a weak power base, Xi pursued an anti-corruption campaign to purge corrupt officials, thereby toppling his rivals and consolidating his authority. At the same time, a significant shift emerged in Chinese politics: former leaders such as Jiang Zemin and Zhu Rongji had grown too old to restrain Xi's excesses and serve as an effective counterweight within the Party. Seizing the moment, Xi moved to realize his ambitions by amending the constitution at the March 2018 National People's Congress, abolishing presidential term limits. Unless he chooses to resign, Xi can remain in power for life.

Anti-corruption has become Xi's most effective means of eliminating political opponents. Only seven years after the constitutional amendment, Xi has established an unchallenged one-man rule. Within the Party leadership, no one dares to dissent. Liberal intellectuals critical of his administration have been silenced within China, and the state media now primarily serves to glorify Xi's image. In effect, Xi has reversed 40 years of reform and is steering China back toward the Mao era.

Four decades ago, Deng Xiaoping and other senior leaders were wary of a return to Maoist excesses and banned the cult of personality around political figures. Deng himself, despite being the paramount leader, refused such adulation. Mao had been revered like a god, while Deng, by contrast, remained a political leader. The question now is: can Xi become a god?

The answer is no. Xi has encouraged a cult of personality to consolidate power, but he lacks Mao's authority. Moreover, today's China is vastly different from the closed society of Mao's era: a flood of information flows in from abroad, often contradicting the official narrative. To counter this, the Xi administration has tightened the "Great Firewall" to block unfavorable news and dissenting voices.

But this creates a deeper problem. A functioning market economy requires information symmetry as a precondition for efficient resource allocation. Heavy government control over information creates inefficiencies and drags down growth. As economic growth

slows, the legitimacy of Xi's administration becomes harder to sustain. In response, the administration has been tightening control over information even further, creating a vicious cycle.

Gradual Breakdown of China's Economy

Over the 12 years since the launch of the Xi administration, the internal structure of the Chinese economy has been significantly damaged. Notably, the social fabric of trust has frayed. Trust in government has eroded, and in a market economy, trust – or credit – is foundational. Once trust is lost, growth falters. Meanwhile, Xi has repeatedly attempted to make SOEs "bigger and stronger" while imposing increasing restrictions on private businesses. If SOEs alone were capable of driving growth, then the reforms undertaken 40 years ago would not have been necessary. Under current conditions, private firms will likely weaken further under mounting government pressure.

As the world's second-largest economy, China will need to move up the value chain. But innovation remains largely top-down and government-driven, stifling bottom-up, private-sector innovation. This risks creating mismatches in resource allocation and slowing technological progress.

In the short term, China must overcome the triple burdens described above: the lingering effects of Covid-19, the prolonged real estate slump, and the Trump tariff war. The Xi administration has responded with massive fiscal subsidies, but these have mostly supported producers rather than boosting household consumption. Policies to raise incomes among low-income groups – key to stimulating demand – have not been adopted. This reflects a structural limitation: without democratic elections, the government has little incentive to prioritize the needs of low-income citizens.

As the Chinese economy grows, leaders find it increasingly difficult to identify the roots of its problems. The policymaking process itself appears to be based on incomplete or inaccurate information. Consequently, the economy is likely to continue decelerating. That said, an immediate collapse is unlikely. In sum, China's economy is broken, but its breakdown will be gradual. JS

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