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# China's Economic System

China's transformation is shaping the investing landscape, and its political, economic, and societal systems are very different from the rest of the world. To better understand China's economic system, it is critical to look beyond the headlines.

**Key Topics:**

- The stark contrast before and after market reforms, which began in 1978
- Challenges to China's economic reforms
  - China's after-school tutoring (AST) ban
  - China's property market
  - China's gradually declining high corporate debt levels
- The essence of China's socialist market economy

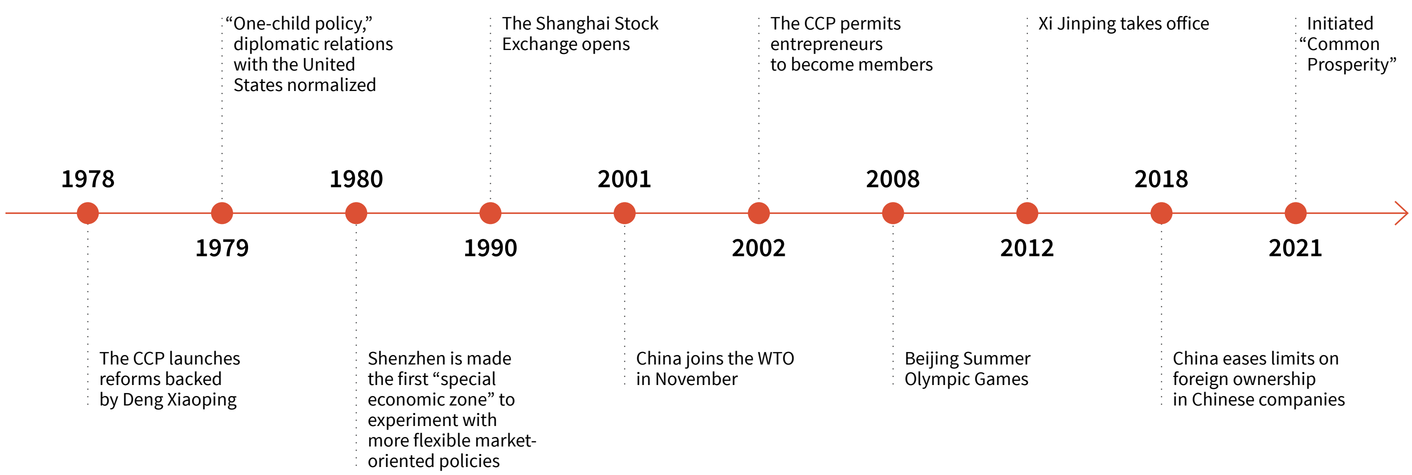
## The Stark Contrast—Before and After the 1978 Market Reforms

In 1978, China introduced a series of market reforms. Before this, the government controlled all production resources and centrally planned and managed the economy, resulting in stagnation, inefficiency, and isolation from the global economy.

After the rollout of the market reforms, China's economy evolved into one that is pro-growth, pro-market, and pro-technology thanks to initiatives that decentralized economic production, encouraged large-scale capital investment, and boosted productivity growth.

Overall, the market reforms unleashed China's economic growth potential. China's 2021 gross domestic product (GDP) was roughly 120 times the size of its GDP in 1978, and its GDP per capita grew over 200 times during the same period.

## Reforms and Opening Up




Source: William Blair.

But exponential growth can result in some challenges. In China's case, GDP growth from exports has begun to decline, a trend that was spurred by the COVID-19 pandemic; other hurdles such as a structurally weak property market and a widening income gap add to China's economic worries.

> "The market reforms unleashed China's economic growth potential."
>
> **Evelyn Kong, CFA**

The ability of the Chinese government to implement reforms to counteract these challenges will determine whether China can continue to maintain relatively rapid economic growth rates moving forward.

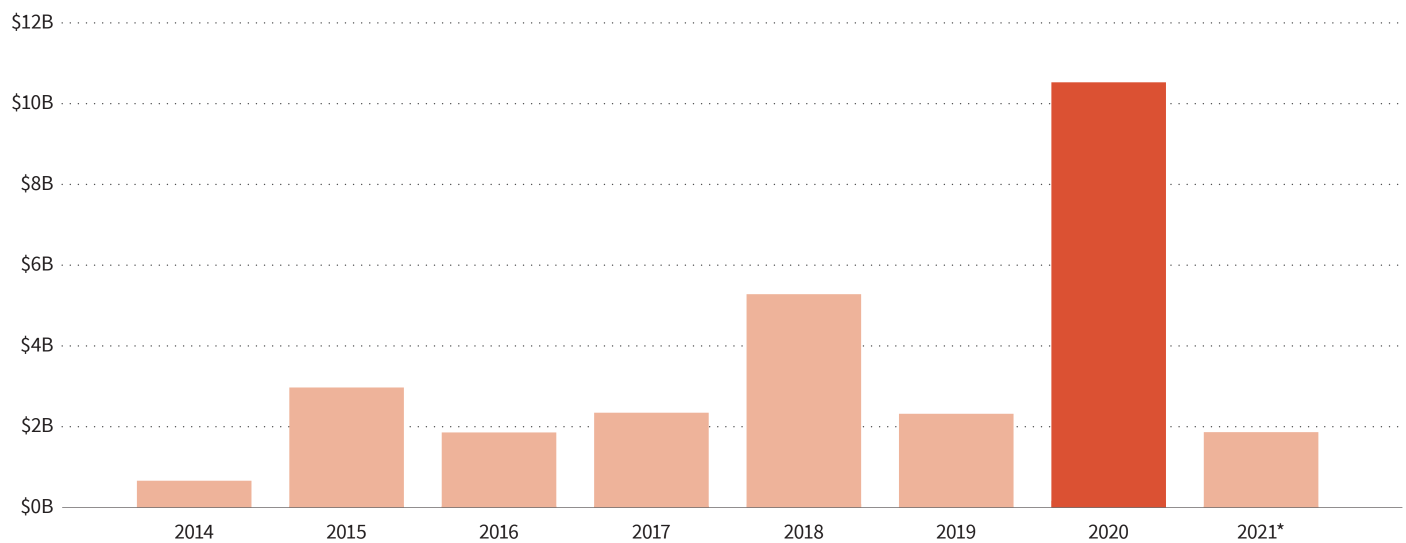
### Economic Challenges Emerge

There are three key examples that showcase how certain economic challenges have manifested and how the Chinese government intervened.

The first example is China's after-school tutoring (AST) ban, which was in response to a slowdown in China's GDP growth, growing concerns of social inequality, and an unfavorable demographic makeup. Leading up to the ban, venture capital funding for education technology companies surged in 2020 as the industry sought to leverage parents' anxiety about their children's education to maximize demand (as the chart "China's Education Boom—Value of Deals" shows on page three). The AST ban directly reduced education spending for most Chinese families, allowing for more kinds of household spending, and resulted in increased access to high-quality online education resources.

A second case study focuses on the structural slowdown of China's property market and its deep links to the financial sector and Chinese household wealth; the Chinese government is working on reducing reliance on the property market for growth. The third example highlights China's high level of corporate debt, which the government has rolled out policy reforms to address.

China's Education Boom—Value of Deals




Source: Bloomberg; as of May 28, 2021. *2021 data is through May 28

**China's Socialist Market Economy**

China's socialist market economic model is unique; it's a hybrid model that combines top-down (socialist) and bottom-up (capitalism) forces. The essence of this model applies socialism as a social system and the market economy as a resource-allocation mechanism so that the two approaches can coexist.

The core element in China's economic model is the relationship between the government and market systems, which has evolved over the decades.

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At the 12th Chinese Communist Party (CCP) National Congress in 1982, an agricultural-based economy was still in effect; the market only played a supplementary role to central planning. By 1992, the government decided, at the 14th CCP National Congress, that the market should play a fundamental role in resource allocation to drive the economy. And at the 18th CCP National Congress in 2012, China's government further minimized its own role, with the market now playing a decisive role in the economy.

Today, China's government will only intervene on the economy in instances when it believes it has an appropriate role to play. But the balancing act is ongoing—picture a pendulum constantly swinging between market forces and government macro intervention.

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