

# Chinese Overcapacity Is Shaping *the* World

BY FUXIAN YI

*And China has  
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price in the form of  
demographic collapse.*



**W**estern leaders are collectively blaming China for overcapacity, while Chinese President Xi Jinping recently chaired a Politburo meeting that made youth employment a top policy priority. The root cause of the two problems can be traced back to the one-child policy.

## **LOW HOUSEHOLD INCOME**

Maintaining optimal levels of blood pressure and blood oxygen content in the human body is crucial because deviations can lead to illness or even death. Similarly, workers and consumers in an economy need to be in balance. Household disposable income typically accounts for two-thirds of a country's GDP to sustain household consumption at 50–65 percent of GDP, as was the case in China in the early 1980s.

Children wield significant spending power because spending on offspring is instinctual for parents. However, China's one-child policy has resulted in fewer children, reducing the total dependency ratio—the ratio of people under fifteen or over sixty-four to those aged fifteen to sixty-four—and enabling families with lower household incomes to make ends meet. Like a frog slowly being heated in water, China's household income as a share of GDP imperceptibly declined to the current 44 percent, consequently leading to household consumption falling to 37 percent of GDP, compared with 68 percent in the United States, 61 percent in India, and 55 percent in Vietnam.

The West is perplexed by the fact that despite four decades of rapid economic growth, China has not achieved the democratic transformation that the West expected when it welcomed China into the World Trade Organization in

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2001, but has been regressing on all fronts. China has been led down this path by the legacy of the one-child policy, keeping household incomes too low to develop a middle class capable of exerting pressure on the government, and leading to a sharp decline in the population of young people aged fifteen to twenty-nine, the vanguard of democratizing reforms.

In Taiwan and South Korea, the share of the youth population peaked at 31 percent in the early 1980s, creating a groundswell of enthusiasm for democratization. When those countries became democracies in 1987, the median age in both economies was just twenty-six. Similarly, when the proportion of youth in China peaked at 31 percent (with a median age of twenty-five), there was a massive pro-democracy movement that culminated in the 1989 Tiananmen Square protest. However, the proportion of youth has now dropped to 16 percent, the median age has risen to forty-three, and the country has entered political menopause from its political adolescence in 1989.

### OVERCAPACITY

China's wealth lies disproportionately in the hands of governments, enterprises, and investors, which makes enterprises more competitive, and gives the governments more financial resources for industrial subsidies and investment in infrastructure (such as high-speed rail) and the Belt and Road Initiative.

China's underconsumption is exacerbated by weak social safety nets. In 2022, for example, less than one-third of employees participated in unemployment insurance, and only one-quarter of the urban unemployed actually received benefits. More than half of all pensioners, primarily rural seniors, received an average of only ¥205 (\$30) per

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month. The only-child generation is clearly unable to support their parents in their old age. As a result, China has the highest savings rate in the world and therefore the highest investment rate.

Globally, women have much more spending power than men. Decades of selective abortion in China have led to a shortage of young female consumers and a bachelorhood crisis. The 2020 census showed that the sex ratio at the age of first marriage (twenty-eight to thirty-two for



*A propaganda painting from before 2015 in Guangdong Province reads "Planned childbirth is everyone's responsibility."*

males and twenty-six to thirty for females) was as high as 125, with 134 in rural areas. Many families with boys simply don't dare to spend, and instead save up to pay high bride prices and buy wedding apartments.

Insufficient domestic consumption has left China with a surplus of about 100 million workers, which, together with industrial subsidies and high investment rates, has led to overcapacity. China's property sector has been mired in a debt crisis in recent years, driving construction workers into manufacturing and exacerbating overcapacity. In 2023, for example, China produced thirty million vehicles and exported five million. If household income rose to a normal level of two-thirds of GDP, domestic consumers could buy all these vehicles without exporting them, and China could import much more goods.

### HIGH YOUTH UNEMPLOYMENT AND LOW FERTILITY RATE

China has always pursued a trade surplus to digest excess capacity, three-quarters of which in 2001–2018 was with the United States, providing tens of millions of jobs for China. Between 2001 and 2018, Chinese imports of goods from the United States amounted to only 23 percent of what China exported to the United States, compared to a ratio of 72 percent for U.S. trade with the rest of the world.

Although this excessively unbalanced trade did aid the U.S. bond market and Americans, who benefited from low prices and low inflation, it also undermined the U.S. manufacturing sector and tore society apart. The U.S. share of world manufacturing value-added fell from 25 percent in 2001 to 16 percent in 2021, while China's share rose from 4 percent in 1991 to 31 percent in 2022. Arguably, the United States is the second-biggest victim of China's one-child

*Continued on page 60*

*Continued from page 41*

policy. Rust Belt counties are the main sufferers, and they propelled Donald Trump to the presidency in 2016.

China has paid a terrible price for its overcapacity in the form of demographic collapse. Both the two- and three-child policies have been abject failures, because ordinary families cannot afford to raise even one child due to low household incomes. Despite measures to encourage child-bearing, the fertility rate last year was only 1.0 nationwide and 0.6 in several provinces, the lowest in the world.

When other countries reached China's current tertiary enrollment rate, the service sector provided 70–80 percent of jobs. However, due to underconsumption, China's service sector provides only 45 percent of jobs, which makes it difficult for college graduates, who are primarily engaged in the service sector, to find jobs, resulting in high youth unemployment and declining marriage and fertility rates.

The U.S.-China trade war that I predicted in 2009 finally erupted in 2018, leading to a significant reduction in China's trade deficit with the United States, exacerbating unemployment pressure in China.

#### CHINA AT THE CROSSROADS

China's overcapacity won't last forever, as the country's manufacturing sector is about to follow Japan's path to decline. The combination of the 1985 Plaza Accord, a shrinking labor force, and an aging population has reduced the share of Japanese goods in total U.S. imports from 22 percent in 1985 to 5 percent in 2022, which in turn has led to a decline in Japan's global share of manufacturing exports from 16 percent to 4 percent over the same period, and a decline in Japan's global share of manufacturing value-added

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from 22 percent in 1992 to 5 percent in 2022. The number of Japanese companies on the Fortune Global 500 has dropped from 149 in 1995 to just forty-one today.

Similarly, the U.S.-China trade war has reduced the share of Chinese goods in U.S. imports from 22 percent in 2017 to 13 percent in the first four months of this year, and that could soon fall below 10 percent. Manufacturing is

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shifting away from China. The U.S. market is irreplaceable because only the United States can afford large deficits, as the dollar is the world's reserve currency. Other countries would be in a debt crisis if they imported heavily from China but failed to export roughly equal amounts.

An average of 23.4 million births per year from 1962 to 1990 made China "the world's factory." But as of last year, even China's exaggerated official figures put births at just nine million—and that number is expected to fall to six million in a few years. Migrant workers, who make up 80 percent of China's manufacturing workforce, are shrinking in numbers and aging rapidly, with the average age rising from thirty-four in 2008 to forty-three in 2023, and the share of those over fifty rising from 11 percent to 31 percent. China's tertiary enrollment rate has surpassed Japan's, and the younger generation is reluctant to engage in manufacturing. Thus, even without a trade war, China's manufacturing sector is poised to shrink rapidly, but probably not as rapidly as Japan's, because China has a larger domestic market, a more complete industrial chain and ecosystem, and is investing heavily in artificial intelligence and robotics.

China runs deficits with countries such as Saudi Arabia, Russia, and Brazil due to imports of oil and gas from them. If the Chinese authorities are wise, they should reduce imports of other goods from these countries to free up market share for U.S. goods, so as to make U.S.-China trade more balanced and avoid losing the U.S. market. Above all, China should raise household incomes to avoid a rapid decline in manufacturing by boosting domestic demand to absorb excess capacity, and to increase imports from the United States to balance trade and thus reduce political hostility between the two major powers. It could also expand the middle class, thereby benignly reshaping China's society and economy, and most importantly making Chinese politics more compatible with Western democracy. ◆