

China Showed Many Countries the Way to Economic Progress, But That Model Is Now Past Its Prime

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China's credit and debt-driven growth model is nearing its limits. The convergence of demographic, geopolitical and financial conditions that enabled its industrialisation no longer exist in the same form.



People look at their phones at an intersection at Taikoo Li Sanlitun in Beijing, July, 30, 2024. Photo: Vincent Thian/AP.

This column is the second in a two-part series analysing the deeper structural contradictions within China's growth model, and what developing economies should carefully learn, and avoid learning, from its economic rise. [Part one](#) is linked at the bottom of this page as well.

If the first phase of China's rise was built on suppressing household consumption to accelerate industrial expansion, the second phase is increasingly shaped by the consequences of that choice. The deeper problem with China's growth model was never simply that households consumed too little. It was that the widening gap between production and consumption had to be absorbed somewhere else in the system.

For nearly three decades, that burden was carried through an extraordinary expansion of investment, credit and exports, allowing the economy to postpone the limits of weak domestic demand while sustaining historically unprecedented rates of industrial growth.

That arrangement generated spectacular gains in infrastructure, manufacturing capacity and poverty reduction. But it also produced a structural dependence on debt-financed expansion, and that is now becoming increasingly difficult to sustain.

A month after Chinese policymakers reiterated their commitment to “**high-quality development**” and technological self-sufficiency, another set of numbers revealed the scale of the challenge confronting the world’s second-largest economy. Producer prices remained trapped in deflationary territory, property investment continued to contract and local governments across several provinces struggled under mounting fiscal stress tied to land revenues and infrastructure borrowing.

Individually, none of these developments appear extraordinary. Together, however, they point toward something more structural. The growth model that powered China’s rise for nearly four decades is encountering limits that can no longer be absorbed through investment expansion alone.

China’s extraordinary rise was never built on household consumption. For decades, the economy expanded by combining suppressed domestic demand with relentless investment and export growth, allowing the state to sustain industrial expansion at a pace modern economic history had rarely witnessed.

The model generated remarkable gains in infrastructure, manufacturing capacity and poverty reduction. But it also created a deeper imbalance that is now becoming increasingly difficult to contain.

When household consumption remains **below 40%** of GDP, an economy of China’s scale cannot sustain growth internally through consumption alone.

Earlier, East Asian developmental states such as Japan, South Korea and Taiwan addressed this problem through exports during their initial industrial phase, followed, as the economy matured, with gradual wage increases and stronger household consumption. China followed the first half of this trajectory, but resisted the second.

Instead of the latter, it expanded two substitutes for household demand to industrial scale. The first was export, supported through exchange-rate management, industrial subsidies and state-directed credit. The second was domestic fixed investment, financed through a banking system heavily oriented toward state borrowers and local governments. Credit flowed into infrastructure, manufacturing capacity and real estate on a scale that eventually produced its own contradictions.

China’s total non-financial debt has now climbed to well **above 300%** of GDP, up from roughly **135% in 2008**. That trajectory is not merely a story of rising leverage. It reflects an

economy that increasingly substituted debt and investment for organic household demand.

Corporate debt, concentrated heavily in state enterprises, now stands at **roughly 130%** of GDP. Debt linked to Local Government Financing Vehicles amounted to roughly 41% of GDP by early 2024, according to IMF estimates. Much of this borrowing financed projects with weak commercial viability but strong political incentives. Growth targets frequently mattered more than long-term returns.

Real estate became the clearest expression of this model. At its peak, property-related activity accounted for nearly a quarter of China's GDP. But a growth strategy centred on continuously rising land values and debt expansion was always vulnerable to reversal.

When the property market turned, it exposed far more than corporate overleveraging. Evergrande collapsed under liabilities **exceeding \$300 billion**.

Country Garden **followed soon** after. The crisis in China's largest real-estate developer, starting 2023 with loan defaults, revealed how deeply local government finances had become tied to land sales and property development. In many provinces, land transfers evolved into a primary revenue source, blurring the distinction between private-sector fragility and public-sector fiscal stress.

The deterioration is also visible in China's efficiency metrics. The Incremental Capital Output Ratio, which measures the amount of investment required to generate one additional unit of output, has risen sharply over the past two decades. China now requires substantially more capital to generate the same level of growth than it did during the early 2000s.

This reflects more than diminishing returns in individual sectors. It signals the exhaustion of an investment-heavy model that once benefited from rapid urbanisation, catch-up industrialisation and abundant labour.

Total factor productivity growth, which exceeded 4% annually before the global financial crisis, has slowed sharply. Manufacturing capacity utilisation has weakened, while producer prices remained in deflationary territory through much of 2023 and 2024, reflecting excess supply relative to domestic demand.

Demographics have further deepened these pressures. **China's fertility rate** has fallen close to 1.0, far below replacement level. The working-age population peaked nearly a decade ago and has been declining steadily since. The demographic dividend that once sustained labour-intensive manufacturing and competitive production costs has weakened structurally, not cyclically.

The state's response has been to redirect industrial policy toward what Beijing calls the "New Three" sectors, electric vehicles, batteries and solar technology.

These sectors are intended to replace property and infrastructure as the next engines of growth. Yet they increasingly display familiar patterns of overcapacity. Chinese EV production capacity alone is projected to far exceed domestic demand by the end of the decade.

The resulting surplus will inevitably seek external markets, often at prices supported by subsidies and state-backed financing. This is not merely industrial policy in the classical developmental-state sense. It is also an attempt to externalise domestic demand weakness through exports, repeating a pattern that had already generated trade tensions in sectors such as steel and solar manufacturing.

This is where the implications for the developing world become harder to ignore.

China's economic transformation has acquired an almost mythic status across much of the Global South. From New Delhi to Jakarta to Nairobi, policymakers increasingly invoke the Chinese experience as proof that state-led industrial policy can compress decades of development into a single generation.

But China's industrialisation unfolded within a highly specific convergence of demographic, geopolitical and financial conditions that no longer exist in the same form.

WTO accession in 2001 opened global markets at a moment when Western corporations were aggressively offshoring production. American and European consumption, fuelled by debt expansion during the 1990s and 2000s, absorbed Chinese exports at extraordinary scale.

That external environment has changed fundamentally. Global trade is fragmenting along geopolitical lines. Rich-country governments are subsidising supply-chain diversification and strategic decoupling. The Western consumption engine that absorbed Chinese overcapacity for decades is itself slowing under debt, inflationary pressures and an increasingly large population of the ageing.

The lesson developing countries should take from China, then, is not that industrial policy fails. It is that industrial policy is conditional. Its success depends on state capacity, institutional discipline, fiscal space, export access, demographic structure and geopolitical timing. These conditions cannot simply be replicated through imitation alone.

China's rise genuinely transformed the material conditions of hundreds of millions of people and reshaped global manufacturing geography in ways that will endure for

decades. But the full arc of the experience also reveals something else: A growth model built overwhelmingly around production rather than distribution eventually begins to confront the limits of its own success.

And those limits are no longer contained within China alone.

Read Part One by the same authors: [How China's Global Ambitions Short-Changed Its Consumers and Domestic Economy](#)

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