

La creciente clase media de China: un cambio de juego en el sistema internacional

The expanding middle class of China: a game changer in the international system

DOI: <https://doi.org/10.17230/map.v12.i22.05>

Juan Camilo Soto Marulanda

Universidad EAFIT

ORCID: 0009-0006-2652-8374

jcsotom@eafit.edu.co

Abstract

This research paper explores the economic implications of the expanding middle class in China for the international system. To achieve this, the study analyzes the three key arguments proposed by Chun et al. (2017) that researchers link to the middle class in literature: 1) There is the impact on entrepreneurial activity, 2) the accumulation of savings, and 3) the expansion of the domestic market. Using secondary sources such as journals and statistics, the paper evaluates how these arguments reflect on the Chinese middle class and what their effects are on the international system. I conclude that China's middle class possesses opportunities like extended trade and investment for the rest of the world as well as threats. Particularly, the lending capacity derived from the middle class gives China a strategic position that may cause economic imbalances in the international system and generate financial risk for other countries.

Keywords

Middle Class, China, International System, Accumulation of Savings.

Resumen

Este artículo de investigación analiza las implicaciones económicas de la creciente clase media en China para el sistema internacional. Para lograrlo, se examinan los tres argumentos propuestos por Chun et al. (2017) que están vinculados a la clase media en la literatura: 1) El impacto en la actividad emprendedora, 2) la acumulación de ahorros y 3) la expansión del mercado interno. Mediante fuentes secundarias como artículos de investigación y estadísticas, se evalúa cómo estos argumentos se reflejan en la clase media china y sus efectos en el sistema internacional. Se concluye que la clase media de China presenta oportunidades en términos de expansión del comercio y la inversión para otros países, pero también plantea amenazas. Específicamente, la capacidad de préstamo derivada de la clase media china le otorga una posición estratégica que puede generar desequilibrios económicos en el sistema internacional y representar un riesgo financiero para otros países.

Palabras clave

Clase Media, China, Sistema Internacional, Acumulación de Ahorros.

Introduction

This paper highlights the implications of China's expanding middle class for the international system. Even though there are varying ways to measure the size of the middle class, all agree that it has expanded in China. The paper uses the three arguments presented by Chun et al (2017) regarding the main implications and changes associated with the middle class and analyzes how these arguments impact the international system.

The first argument related to the middle class is about entrepreneurial activity. The growth of unicorn companies is associated with an increase in entrepreneurial activity and a good proxy for an expanding middle class. This in turn has significant consequences for the international system and economy. Secondly, this paper explores the implications of the high saving rate of the middle class in China and the significant role that Chinese consumers have in the total amount of savings. Thirdly, the expansion of the middle class comes with changes in consumer preferences and the expansion of the market. This paper notes the opportunities that this may represent for Latin America and the rest of the world, taking as examples the e-commerce and luxury goods markets. This paper thus contributes to the understanding of the Chinese middle class and how this represents opportunities as well as challenges for the rest of the world. Finally, the paper presents how the growing competition and economic warfare between China and the United States represent an opportunity for developing countries, as well as offering the recommendations for policymakers.

Size of the middle class

Since its entry into the World Trade Organization (WTO) in 2001 and the implementation of its Go Out policy in 2002 (referring to the country's effort to encourage businesses to expand overseas) China has undergone a period of remarkable economic growth. As the country moved towards a more market-oriented economy and actively encouraged foreign direct investment (Lichtenstein, 2006), China's gross domestic product (GDP) surged. This positioned China as the world's second-largest economy (Sicular et al., 2022). Unlike in some cases of economic growth, this development has translated into increased purchasing power for much of the Chinese population, marking a significant shift in the country's socioeconomic situation.

While there are varying ways of defining the middle class, it is indisputable that China's middle class is currently one of the largest in the world and is projected to remain so until at least 2030 (Hodgson, 2015). According to data compiled by the China Power Team (2017), the proportion of the population meeting their definition of the middle class (daily wages ranging from \$2 to \$50) grew from only 3% in 2003 to an impressive 50.8% in 2018, corresponding to a population of 707 million of

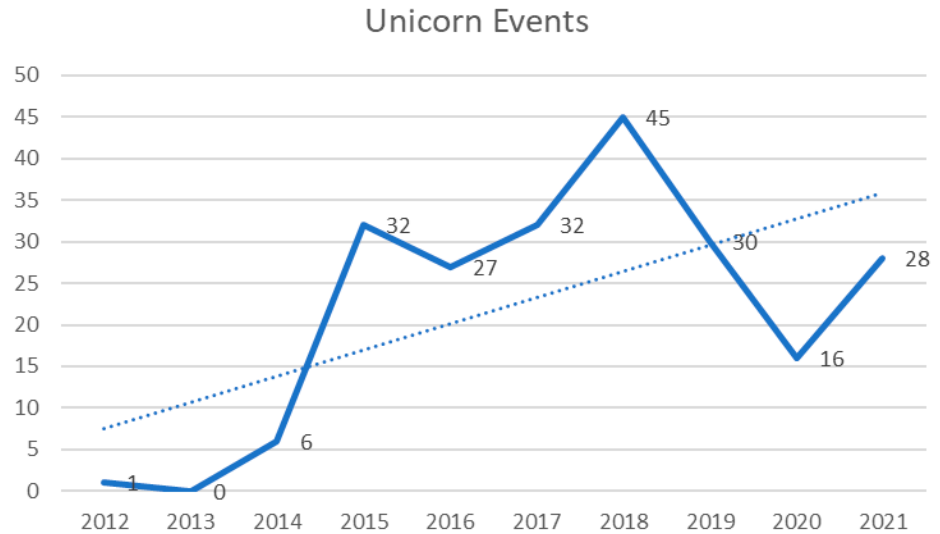
people. According to an alternative classification of the middle class proposed by Sicular et al. (2021) based on identifying individuals who are neither poor nor rich, this group accounted for 25% of the Chinese population in 2018. A further estimate by Farrel et al. (2006) indicates that the middle class constituted 42% of China's population in 2006, with this number projected to increase to 60% by 2025. These data prove that China indeed has a representative middle class in the global economy.

Middle-class and entrepreneurial activity

The first key argument related to the middle class stated by Chun et al. (2017) is that the middle class is the basis for entrepreneurs who contribute to growth and innovation. Following the logic of Chun et al., it is safe to conclude that, as China has a strong economy and expanding middle class, entrepreneurial activity has enormous potential to succeed. In this same line of thought, The Global Entrepreneurship Monitor (2019) reports that entrepreneurship is correlated with better job conditions. This same report also explains that China has a latent entrepreneurial activity that will soon impact the rest of the world. For China and its population, this is a great opportunity; however, for the international system, this means an increased presence of Chinese competition for markets. For this reason, some countries may feel threatened, generating a surge of more protectionism, as is already happening with the US-China trade war (Zeng, 2023). In addition to the above, this will also likely mean products with higher standards and quality at lower prices for the rest of the world, which can promote economic development and better quality of life for people in poor countries and throughout the world.

Sustained and persistent entrepreneurial activity creates new economic activity. This is the case in China, where data show that from 2000 to 2013 the revenues of non-state companies rose more than 18-fold (Tse, 2016). To better understand the implications of China's increased entrepreneurial activity on the international system, it is important to consider the rise of unicorns in the country. Data provided by Tracxn, (see figure below) show that the number of Unicorns (Companies with a valuation of more than one billion dollars) has been trending upwards.

Figure 1.
Unicorn Events
in China



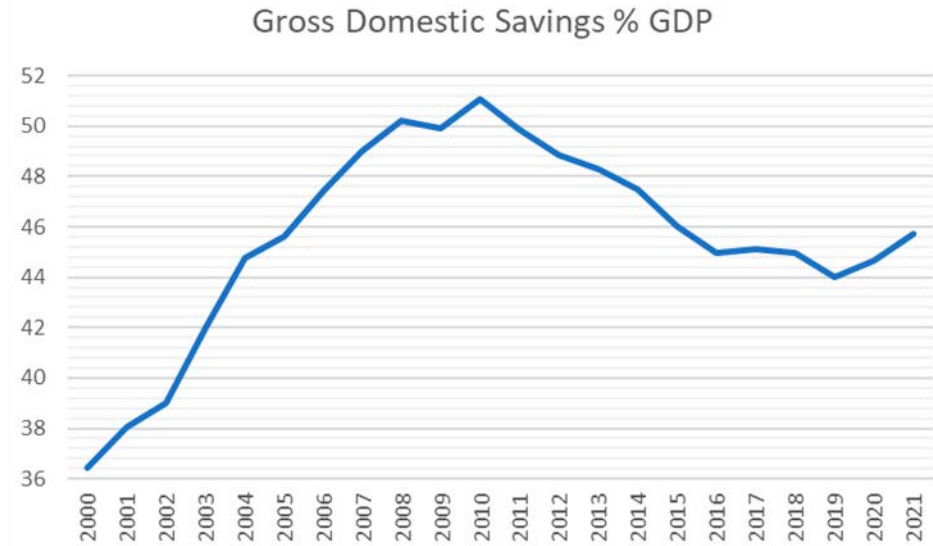
Created by the author based on data from Tracxn Unicorn Corner (2023).

This trend represents a move towards a more diversified economy, which in turn increases China's potential for trade. Furthermore, the need for companies to expand has pushed China towards greater openness with the rest of the world. As Sicular et al (2022) note, the middle class in China is primarily concerned with safeguarding their economic interests, which translates into support for reforms that promote economic growth. Given this, China is expected to continue making economic agreements, alliances, and investments abroad to provide its national market and companies with the necessary foundation for growth. A more diversified economy implies that China is expanding its industrial and service sectors beyond traditional areas such as manufacturing. This diversification opens new opportunities for trade with other countries as China becomes capable of producing and exporting a wider range of goods and services. Also, the need for companies to expand has driven China towards greater openness with the rest of the world. This in turn may indicate a shift towards a more liberal economic policy, potentially involving reduced trade barriers and enhanced market access for international businesses.

Middle class and accumulation of savings

The second argument is that belonging to the middle class fosters the accumulation of savings (Chun et al., 2017). The World Bank's data reveal that China has one of the highest national saving rates in the world, with gross domestic savings (GDS) reaching 45.7% in 2021. As shown in the figure below, GDS peaked in 2010, and while the trend has declined, the rate remains high.

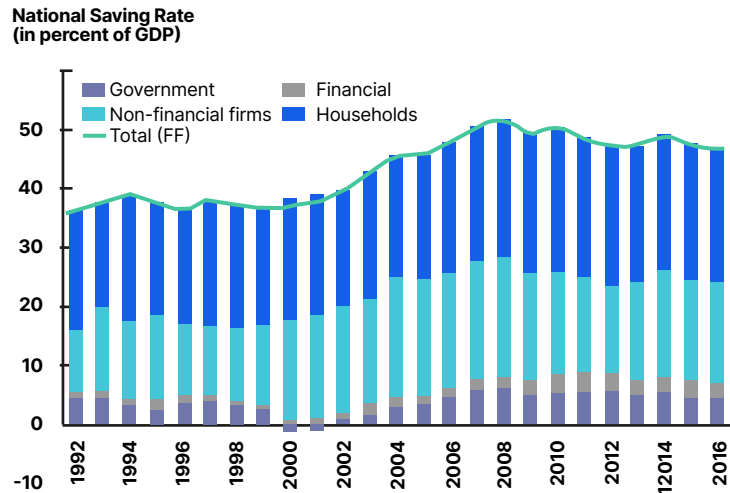
Figure 2.
Gross Domestic
Savings % GDP



Created by the author based on data from The World Bank

Data sourced from the International Monetary Fund reveal that until 2016 governmental savings accounted for a relatively small proportion of total funds. Non-financial corporations spanning diverse industry sectors predominantly enjoy significant benefits from their export-oriented operations and contribute an important portion of savings. Notably, as the economy grows, these corporations witness an increase in their savings, enabling them to undertake substantial investments on a domestic and international scale. However, it is noteworthy that the primary source of these savings comes from households, as evidenced by the figure below.

Figure 3. National Savings Rate (In terms of GDP)

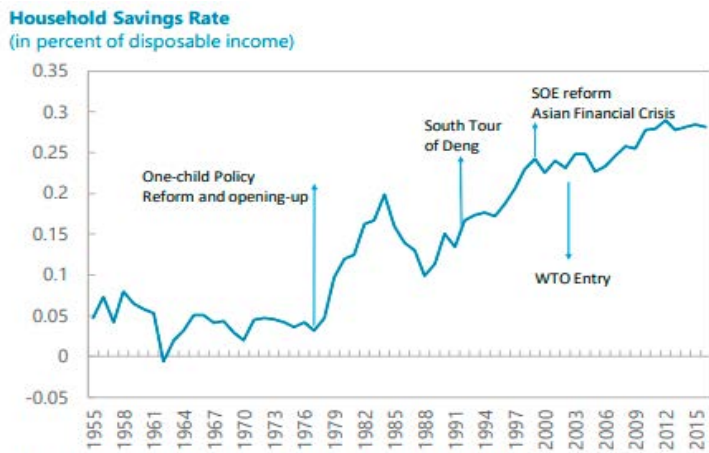


Sources: Flow of funds, IMF staff estimates.

Source: Zhang et al. (2017) International Monetary Fund.

In 2016, household savings in China accounted for 23% of the country's GDP, which is significantly higher (15 percentage points) than the global average (Zhang et al., 2017). This substantial disparity in national savings can be attributed to the strong influence of household savings as the primary driving force. The consistent percentage of savings in relation to GDP indicates that as China's GDP has grown, so have savings. To gain a clearer understanding of the growth in savings it is crucial to examine the household savings rate.

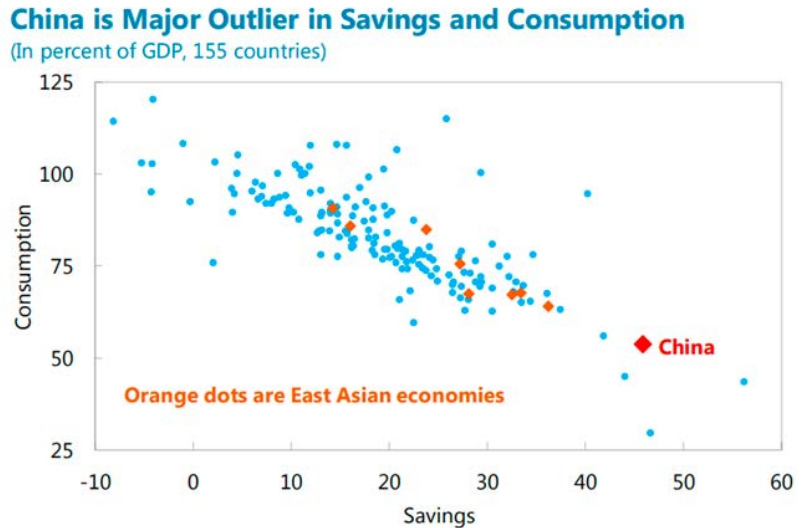
Figure 4. Household Savings Rate (in terms of disposable income)



Sources: Household Survey and Modigliani and Cao (2004)

The Figure above shows that the amount of savings as a percentage of disposable income has been increasing over the years. There are different ways to explain this growth. Zhang et al. (2017) point to the introduction of the one-child policy and the deceleration of the birth rate. These authors also suggest that the increase of savings beyond 30% of disposable income was the result of the export-driven boom after China entered the WTO in 2001. With fewer children to support, families may have had more resources to allocate toward savings. Additionally, the export-driven boom after China's entry into the WTO led to increased income for certain segments of the population and the growth of the middle class, contributing to higher savings rates. According to data collected by Zhang et al. (2017) for the International Monetary Fund, the Chinese population consumes too little in accordance with its level of income. The figure below illustrates that China deviates significantly from the norm in terms of consumption and savings patterns. The implications of this observation for the international system are discussed in the following paragraphs.

Figure 5. Relation between consumption and savings.



Source: Zhang et al. (2017) International Monetary Fund.

The robust middle class gives China a strategic financial position in the international system. In economic terms, savings are equal to investment, which means that, as people save more, banks can lend more money for investment (Pettinger, 2018). This translates into huge amounts of money directed towards foreign direct investment, which has far-reaching implications for the global supply chain and distribution channels, as China is well-positioned to exert control over these channels since it is the main investor in developing countries (Gálvez et al, 2022). This interest in having a strategic position

is further corroborated by China's 14th Five-Year Plan (2021-2025), which explicitly states its intentions to wield greater influence over the supply chain of essential raw materials and agricultural products. For instance, The Belt and Road initiative is another manifestation of China's bid to assert its dominance by actively participating in the development of channels and infrastructure for international commerce, thereby expanding its sphere of influence in foreign countries (McBride, 2023). These efforts by the Chinese government have been effective, proven by the fact that by 2018 China became the largest investor of most Latin American countries and one of the top trading partners in the region (Ding & Mano, 2021). The Chinese government and businesses can afford these large investments thanks to the middle class.

The increase in savings translates into an increase in lending capacity. This means that more countries, particularly developing nations, are falling into debt to China, exacerbating existing economic disparities (Horn et al. 2020). The data support this claim, as evidenced by Buchholz (2022) who reports that China is the leading lender to low-income countries, holding 37% of their debt in 2022. In contrast, the rest of the world holds only 24% of bilateral debt. However, the consequences of such lending have not always been positive, as illustrated by the case of Sri Lanka's default, which resulted in China acquiring control over a part of the country's infrastructure. This highlights the potential for China to exert significant influence over other nations and even interfere in their territories, granting it greater power and influence within the international system.

Consequently, China is now recognized as a net supplier of funds to international capital markets, which amplifies its influence on the global stage, bringing both positive and negative consequences, as countries can finance infrastructure with low interest, but with the risk of not being able to repay. In terms of policy actions, developing countries must be careful when taking these big loans, because China is willing to lend money to countries with precarious credit (Sutter et al., 2021). If these countries are not able to renegotiate or pay back their debt, China may take control of certain assets and infrastructure.

The accumulation of capital in China enables the country to provide loans at low-interest rates, leading to an influx of liquidity in global markets. This excess liquidity can drive up prices and create inflationary pressures. The interference caused when these funds are borrowed overseas has already had major implications for the international system and even affected developed economies (Bertocco, 2014). To mention one case, China has contributed to the high debt accumulated by the US in the first decade of this century. Bertocco (2014) explains that the more China was willing to lend, the more the US was willing to borrow; this dynamic became an underlying factor behind the mortgage crisis that occurred in the US in 2008. This proves that the middle class of China impacts the international system with their savings.

There have already been responses in the international system to this threat. For instance, the US government has proposed alternative funding sources, such as the Internation-

al Development Finance Corporation (DFC) created in 2018, which has offered countries like Ecuador the opportunity to re-finance their debt with China (Sutter et al., 2021). This has led to an ongoing battle for control and influence between the US and China, which in the end has resulted in more opportunities for other countries.

Middle class and expansion of the market:

The third argument offered by Chun et al. (2017) is that the consumption power associated with the middle class encourages diversification and expansion of markets. This has both domestic and international implications for multinationals which, as important actors in the international system, are taking notice of this trend. At the macroeconomic level, the middle class is expanding domestic consumption and raising the levels of private investment. According to Barton (2013), the middle-class account for 20% of the GDP, and this is expected to increase. This is creating a trend of growth in personal services, which “has contributed almost 40% of the economy’s productivity growth over the last decade” (Barton, 2013., p.145). This large latent market is an opportunity for businesses operating internationally and explains why companies like Walmart and certain start-ups are trying to penetrate the Chinese market by making large investments (Cheng, 2019). This involves a movement in the international allocation of resources that impacts the way business is done around the world and leading to increased adaptation to the Chinese market.

Additionally, the increased disposable income associated with the middle class creates more demand for goods and services, as well as a demand for greater quality. As Sicular et al. (2022) have pointed out, this shift towards domestic demand-driven growth can help balance the global economy away from export-led growth. Consequently, this trend has also led to an increased focus on setting up economic agreements and promoting exports and investment in China. As a result, the global center of economic gravity is shifting away from the Western Hemisphere towards the East, creating potential benefits for enterprises and other countries that can capitalize on this opportunity. For the international system, this may have different implications. First, as the domestic market in China develops and more companies install their operations there, boosting the domestic demand-driven growth, exports from other countries will vary: demand for some products will increase, but others will be produced locally (Sicular et al. 2022).

Implications for Latin America

The expanding Chinese middle class represents opportunities for all countries, but is particularly relevant for agroindustry in Latin America. The growing purchasing power of the middle class brings a shift in consumer preferences and is correlat-

ed with the demand for more varied and better food, including meat, consumption of which has been increasing. This represents an economic opportunity for Latin America as it has a latent exporting capability according to the reports of ECLAC (Freitas & Bielschowsky, 2018).

Moreover, the demand for soy and grains is growing in China, but its self-sufficiency is limited (Gooch & Gale, 2018). To guarantee the supply of these types of products, the country is investing in the agricultural sector of different regions, mainly in southeast Asia, but also in Latin America. This region is the first supplier of agricultural products to China (Gooch & Gale, 2018). This represents an opportunity because China considers Latin America a pantry of agricultural products (Freitas & Bielschowsky, 2018). Further investment will spur development and the most efficient use of its endowments. In terms of policy action, countries such as Colombia have recognized this opportunity and created institutions like ProColombia to support companies in penetrating the Chinese market, as well as programs aimed at attracting Chinese foreign direct investment and tourism.

E-commerce Market

There are also other trends that countries, companies, and institutions must keep in mind. For instance, the growing access to the internet allowed the China's e-commerce market to become the largest in the world in 2020 (Carmer-Flood, 2020). As can be seen in the figure, by 2020 China accounted for 53.4% of the global share in the e-commerce market. This has strong consequences for international trade: as consumers turn to online shopping, they may increasingly buy goods and services from foreign companies, which could create new opportunities for international trade and investment.

Table 1. Global E-commerce Market

(2020)

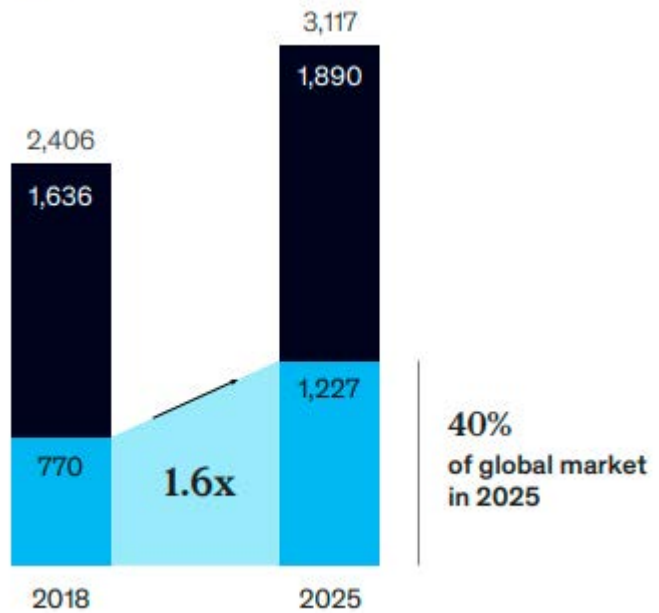
Country/Region	Value (Billions of US\$)	Global Share (%)
China	2,090	53.4
North America	749	19.1
Europe	591.2	15.1
Asia-Pacific (excluding China)	358.3	9.2
Rest of World	125	3.2

Source: China Power, 2017, updated 2021

These data are valuable for other countries as motivation to improve their interconnectedness with China and to promote more efficient and competitive distribution channels to reach Chinese consumers, while for businesses they call for more online presence.

A strong middle class is often associated with a higher expenditure in luxury goods (Rehman, 2022). China is not the exception to this. According to McKinsey (2019) Chinese consumers are now the drivers of expending in luxury worldwide, and China is expected to account for 40% of global market in luxury good consumption expending.

Figure 6.
Growth of expenditure
in luxury goods (In
Billion renminbi)



Source: McKinsey (2019).

The data provided show that between 2019 and 2025 the expenditure in the consumption of luxury goods will almost double. The explosion of the middle class is propelling this growth, and households continue to purchase in luxury categories even as growth in China's economy has eased (McKinsey, 2019). This same report also shows that 70% of expenditure in luxury goods by Chinese consumers is done abroad because there is pleasure in buying luxury in its place of origin. This represents an economic opportunity in terms of tourism to countries like Italy, where more than 40% of luxury goods are produced (Achille & Zipser, 2021). Finally, McKinsey (2019) notes that the growth of the beauty industry in China and the expected growth in travelling abroad of Chinese consumers are trends that represent huge opportunities for multinational and international businesses.

Another important trend is that China is declining its global exposure (Seong et al., 2021). This means that China is increasingly becoming a domestic-driven economy, which means that much of its growth in the last years has been tied to its domestic market, a trend accelerated by the pandemic (Seong et al., 2021). For international actors like companies, this demands a well-established presence in the Chinese market as consumers start to prefer locally-produced products. However, given the size and potential growth of China it will still be important to invest in a supply chain and innovation footprint to serve the Chinese economy (Seong et al., 2021).

These trends indicate opportunities for luxury goods companies, tourism in countries with luxury goods production, multinational businesses, and businesses focusing on China's domestic market. Adapting strategies, understanding consumer preferences, and establishing a strong presence in the Chinese market are key considerations for international actors aiming to leverage these economic implications. In terms of policy action, states should prioritize their relations with China to favor themselves economically and exploit these opportunities. Other actors in the international system such as non-governmental organizations can analyze the trends, and for instance, the environmental implications of luxury goods and even the e-commerce market, to gain insight and make better decisions that align with their interests.

In conclusion, expanding the Chinese middle class has brought the creation of new markets and diversification of the economy, generating opportunities for many countries. In terms of policy actions, countries can either promote supplying China with resources or promote investment in China. In general terms, the expanding middle class means more prosperity for the international system as living conditions improve not only for China but also for the countries that benefit from this trend and more quality products produced linked to entrepreneurial activity in China.

Overall, increasing lending capacity fueled by China's rising savings has created a complex global scenario with both positive and negative consequences. While countries can finance essential infrastructure projects, there is an underlying risk of potential default and loss of control over critical assets. This evolving dynamic between China and the international system has prompted responses aimed at mitigating risks and diversifying funding sources, leading to a struggle for control and influence between major powers. Latin American countries need to understand these implications and use them in their favor. Taking the opportunities brought by the expanding Chinese middle class to develop the agricultural sector and complementary infrastructure would be case in point.

Policymakers must take appropriate measures to respond to these changes, which may include protectionist policies or alliances and agreements with China depending on their national interest. Further research is needed to examine how the growth of the middle class is shaping China's global relationships with other states and actors in the international system. It is hard to predict how the international system will react, but

with current information it is evident that developing countries are becoming more dependent on China. Also, the ineffectiveness of efforts by other countries to mitigate this Chinese presence are largely ineffective may induce more countries to expand the relations with China.

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