Proceedings of the 8th International Conference on Economic Management and Green Development
DOI: 10.54254/2754-1169/111/2024.17764

An Empirical Analysis of the Impact of the 2008 Financial Crisis on China and the Response Pathways

Jiayi Gao[1,a,*]

[1]Dalian Minzu University, No. 31 Jinshi Road, Jinshitan Tourist Resort, Jinshitan Street, Jinzhou District, Dalian City, Liaoning Province, China
a. 1806423217@qq.com
**corresponding author*

Abstract: The 2008 financial crisis was the most severe global financial crisis since the Great Depression of 1929. This crisis not only reshaped the international financial landscape but also profoundly influenced the economic policies of countries worldwide. The impact on the Chinese economy was particularly significant. Through empirical research, this paper aims to deeply analyze the specific impacts of the 2008 financial crisis on the Chinese economy and to explore the strategies adopted by the Chinese government in response and the effectiveness of these measures. This study provides a reference for policy-making in the face of potential future financial crises.

Keywords: 2008 financial crisis, impact on China, response pathways, empirical analysis.

1. Introduction

In 2008, a financial tsunami triggered by the subprime mortgage crisis in the United States swept across the globe. Its destructive power and widespread impact were comparable to the "Great Depression" of the 1930s. This crisis not only reshaped the international financial landscape but also posed severe challenges to the economic policies of various countries. Amid this global economic upheaval, China's economy, as the world's second-largest, drew significant attention for its performance and response strategies. Although China was not directly involved in the core regions of the crisis, it was inevitably affected due to its deepening integration into the global economic system. In response to external shocks, the Chinese government reacted swiftly by adopting a combination of fiscal and monetary policies aimed at mitigating the negative impact of the financial crisis on the domestic economy, seeking stable growth and structural adjustment. Through an empirical analysis of the impact of the 2008 financial crisis on China, this paper aims to reveal how the crisis affected key areas such as exports, foreign direct investment, and the domestic financial market. It also explores how the Chinese government responded through fiscal policy, monetary policy, and other macroeconomic control measures. The paper first reviews the direct and indirect impacts of the financial crisis on China, including the contraction of export demand, the decline in foreign direct investment, and financial market turbulence. Next, it details the Chinese government's response strategies, such as launching large-scale infrastructure construction plans, implementing tax reductions, and increasing social security expenditures, and examines the actual effects of these measures on the economy. Finally, the paper compares the different paths and outcomes of China and the United States in responding to the financial crisis, discussing the differences in policy choices and

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the underlying economic logic. Through this series of analyses, the paper not only provides detailed data to understand the specific impacts of the 2008 financial crisis on China but also offers valuable case studies for researching China's policy choices and response mechanisms during the crisis. Additionally, the research findings of this paper offer policy references for potential future financial crises, helping countries better prepare for and respond to similar global economic challenges.

2. The Impact of the 2008 Financial Crisis on China

The 2008 financial tsunami had profound effects on the global economy, with especially significant impacts on China's economic development. Although China's financial system had not yet fully integrated with the international market and its capital account was not completely open, the impact on China from a rational expectations perspective cannot be underestimated. The 2008 financial crisis had far-reaching effects on China's economy, particularly in terms of exports, foreign direct investment (FDI), and the domestic financial market.

2.1. Exports and External Demand

The financial tsunami weakened global demand, particularly reducing the consumption capacity of the European and American markets, which directly impacted China's exports. [1] According to statistics, in the first three quarters of 2008, China's total export value of goods was USD 1,074.06 billion, with the export value of electromechanical products reaching USD 617 billion, though the growth rate of exports slowed. Compared to the same period last year, the growth rate of traditional export goods such as clothing accessories dropped by 21.2 percentage points, and the growth rate of other exports also declined; the driving force of net exports for economic growth decreased by 1.2 percentage points compared to the same period last year. In November, China's total import and export value was USD 189.89 billion, a year-on-year decrease of 9%, with exports down by 2.2%, marking the first negative growth in exports in seven years. Recent statistics show that entering 2009, China's export trade was hindered, with the export value in January amounting to only USD 90.45 billion, a decrease of USD 19.19 billion compared to the same period in 2008. The financial crisis significantly affected China's exports, slowing economic growth. In the fourth quarter of 2008, the GDP growth rate fell to 6.8%, with an annual growth rate of 9%, the lowest in seven years. The data reflects that the financial tsunami had a significant negative impact on China's exports and external demand, not only leading to a decline in export growth but also exacerbating international trade protectionism, affecting the structure and market distribution of China's export commodities. [2]

2.2. Foreign Direct Investment

The 2008 global financial crisis caused financial market turmoil, credit tightening, and a loss of investor confidence, directly impacting the investment capacity and willingness of multinational companies. Specifically, in terms of FDI, the financial crisis led to a significant decline in global foreign direct investment flows. According to the United Nations Conference on Trade and Development (UNCTAD), global FDI flows fell by 21% in 2008 compared to 2007, dropping to USD 1.45 trillion. In China, although the net inflow of FDI continued to grow in 2008, the growth rate slowed significantly. According to the Zhejiang Provincial Department of Commerce, China actually absorbed USD 90.7 billion in FDI in 2008, a decrease of 23.6% from the previous year. This change reflects the direct impact of the global financial crisis on FDI inflows to China. Besides the direct impact, the financial crisis also indirectly affected FDI through various channels. For instance, the global economic recession caused by the financial crisis reduced companies' willingness to expand production and increased their risk aversion, making multinational companies' global investment

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plans more cautious. Furthermore, the financial crisis might lead multinational companies to reassess their global investment portfolios, affecting FDI flows to specific countries and regions. [3]

2.3. Domestic Financial Market

The 2008 financial crisis originated in the U.S. subprime mortgage market and quickly spread to global financial markets, causing widespread turmoil. The global stock market valuations plummeted, and the Chinese stock market was also severely impacted. [4] The Shanghai Composite Index fell from its peak of 6,124 points in October 2007 to 1,664 points in October 2008, a decline of approximately 72.8%. Investor confidence was severely shaken, leading to panic selling and further declines in the stock market. The financial crisis exposed issues in developed financial markets regarding financial regulation and risk management, prompting China's financial sector to adopt a more rational approach in learning and benchmarking against foreign financial institutions while expanding both international and domestic markets and competing with foreign financial institutions. Financial innovation will increasingly emphasize risk control, and there is a concern among market participants that misinterpretation of the crisis's causes might delay the reform process of China's financial industry. [5]

3. China's Response Pathways

3.1. Fiscal Policy and Monetary Policy

Following the outbreak of the 2008 financial crisis, the Chinese government swiftly implemented a series of proactive fiscal and monetary policy measures to mitigate the impact of the crisis on the domestic economy. In terms of fiscal policy, the government first increased fiscal spending, launching large-scale infrastructure and real estate projects aimed at creating jobs, raising income levels, stimulating consumption and investment, and stabilizing economic growth. Additionally, the government introduced various tax reduction policies, lowering corporate and individual income taxes, thus easing the tax burden on businesses and the public and promoting economic activity. Furthermore, the government expanded the fiscal deficit and increased government spending to cushion the economic shock of the crisis. Special attention was given to protecting key industries and enterprises by providing financial support and preferential policies to prevent business closures and mass unemployment. [6]On the monetary policy front, the People's Bank of China adopted a moderately loose monetary policy to boost the economy and maintain financial stability. The central bank lowered the benchmark interest rates, encouraging borrowing by reducing loan interest rates, which in turn stimulated investment and consumption. Additionally, the central bank repeatedly reduced the reserve requirement ratio, releasing liquidity to enhance the stability and reliability of the financial system. In January 2009, new RMB loans amounted to RMB 1.6 trillion, a record high, fostering credit growth. The central bank also adhered to the principle of differentiated treatment, encouraging financial institutions to increase loans for disaster area reconstruction, agriculture, rural areas, and small and medium-sized enterprises. The fiscal and monetary policies adopted by the Chinese government in response to the 2008 financial crisis were timely and effective, successfully alleviating the impact of the crisis on the domestic economy and laying the groundwork for subsequent economic growth. However, over time, some policies revealed their side effects, such as the issues of overcapacity and falling prices resulting from the RMB 4 trillion economic stimulus plan. These negative impacts need to be considered and addressed in future policy-making. [7]

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3.2. Economic Growth and Market Stabilization Through Infrastructure Development in China

The Chinese government introduced a RMB 4 trillion fiscal stimulus plan, implementing large-scale industrial restructuring and revitalization strategies, vigorously promoting independent innovation, strengthening technological support, and significantly improving social security levels. These measures effectively promoted economic stability and growth, expanded domestic demand, stabilized employment, protected livelihoods, and had a significant impact on the global economy.

In terms of affordable housing projects, the Chinese government intensified efforts to build affordable housing, including low-rent housing, shantytown renovation, settlement projects for nomadic populations, and pilot programs for renovating dilapidated rural housing, to address housing issues for low-income families. In rural infrastructure development, the government increased investment in rural infrastructure, including biogas projects, drinking water safety projects, road construction, and rural power grid renovation, aiming to improve living standards and economic development in rural areas. Regarding transportation infrastructure, the Chinese government prioritized the construction of major infrastructure projects, such as railways, highways, and airports, addressing connectivity issues within the national highway network, accelerating urban power grid upgrades, and promoting the development of transportation and logistics. In the development of social undertakings, the government supported the growth of medical care, education, and cultural sectors, strengthening grassroots medical and health service systems, and renovating middle school buildings in rural areas in the central and western regions, thereby advancing cultural and educational progress. In ecological and environmental construction, the Chinese government accelerated the construction of urban sewage treatment and waste disposal facilities, focused on water pollution control in key river basins, and enhanced the development of key protective forest and natural forest resource conservation projects, advancing energy conservation, emission reduction, and ecological civilization construction. In terms of independent innovation and structural adjustment, the government supported independent innovation and the industrialization of high technology, accelerated industrial technological progress, promoted the development of the service industry, and advanced the optimization and upgrading of the economic structure. For industrial restructuring, the government implemented large-scale adjustment and revitalization plans for key industries, including automobiles, steel, shipbuilding, petrochemicals, light industry, textiles, non-ferrous metals, equipment manufacturing, electronic information, and logistics. In post-disaster reconstruction, the government expedited reconstruction efforts in earthquake-affected areas, increased urban and rural residents' incomes, implemented value-added tax reforms to reduce the burden on enterprises, and promoted economic growth through credit support. Regarding social security improvements, the Chinese government raised the minimum grain purchase prices, increased the standards for comprehensive agricultural subsidies, seed subsidies, and agricultural machinery subsidies, thereby boosting farmers' incomes. It also enhanced social security levels for low-income groups, increased urban and rural minimum living allowances, and raised the basic pension levels for retired enterprise workers. In summary, during the 2008 financial crisis, the measures implemented by the Chinese government effectively promoted economic stability and growth, not only yielding positive results domestically but also contributing significantly to the recovery and development of the global economy.

4. Comparison of the Effects of Response Measures by China and the United States

In response to the 2008 global financial crisis, China and the United States adopted vastly different economic stimulus measures, reflecting their respective economic structures and policy implementation characteristics, which resulted in different economic recovery trajectories. China introduced a RMB 4 trillion fiscal stimulus plan, primarily focusing on infrastructure investment and

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improving the social welfare system. This included projects such as new railways, subways, airports, and the reconstruction of earthquake-affected areas in Sichuan. This strategy effectively activated numerous construction projects, spurred growth in related industries, created job opportunities, and boosted domestic demand, leading to a rapid economic recovery. Local governments and state-owned enterprises in China also actively responded, creating a synergistic effect with the central government. In contrast, although the scale of the U.S. stimulus measures was large, amounting to over $700 billion, the allocation of funds was more dispersed, covering tax cuts, direct payments to households, and aid to financial institutions. For example, the U.S. Treasury's initial plan was to raise $700 billion through bond issuance to purchase troubled assets in the banking system, aiming to stabilize market prices and restore market confidence. While these measures alleviated some impacts of the financial crisis, they did not achieve the rapid V-shaped recovery seen in China. This is mainly because the U.S. economy relies more on consumption and the service industry, sectors that recovered more slowly after the crisis. The fundamental differences in economic development models between China and the U.S. determined the paths of their economic stimulus measures. The U.S., with an economy centered on the virtual economy, relies heavily on the financial sector to sustain economic growth. However, the expansion of financial asset bubbles eventually led to a severe financial crisis triggered by the subprime mortgage crisis. Consequently, most of the $700 billion stimulus funds were injected into the financial markets. In contrast, China, as a developing country with an economy focused on the real sector, had a relatively short history of capital market development and a lower level of openness. The global financial crisis mainly impacted China's real economy. With the weakening of Western economies, China's competitive environment in international markets also deteriorated. Therefore, China's RMB 4 trillion stimulus funds were primarily used for infrastructure development and improving the social security system to further boost domestic demand. Lastly, there were differences in the efficiency of policy implementation between the two countries. The Chinese government demonstrated strong organizational and coordination capabilities in executing its large-scale stimulus plan, while the U.S. faced more political and economic obstacles in policy implementation. In summary, due to different national conditions, the focus of fiscal policy measures to stimulate the economy varied between the two countries, resulting in different effects of their stimulus measures.

5. Conclusion

The 2008 financial crisis was a global economic disaster that profoundly impacted the economic systems of countries worldwide. As the world's second-largest economy, China, although not directly involved in the core of the crisis, could not remain unaffected due to its deep integration into the global economy. Through an empirical analysis of the impact of the 2008 financial crisis on China's economy, this paper reveals the negative effects of the crisis on China's exports, foreign direct investment (FDI), and domestic financial markets. In response to the external shock, the Chinese government adopted a series of proactive fiscal and monetary policy measures, including the introduction of a RMB 4 trillion fiscal stimulus plan, vigorous promotion of infrastructure construction, implementation of tax cuts, and increased social security spending. These measures effectively mitigated the crisis's impact on the domestic economy and achieved a V-shaped recovery in a short period. Compared to the United States, China's measures to address the financial crisis were more focused on revitalizing the real economy and expanding domestic demand. Through large-scale infrastructure investments and industrial adjustments, China created numerous job opportunities, boosted domestic demand, and facilitated rapid economic recovery. Although the U.S. stimulus measures were substantial, the dispersed allocation of funds and the economy's reliance on consumption and services led to a relatively slower recovery. Furthermore, the Chinese government's efficient organization and coordination in policy implementation were crucial factors in the significant success of its stimulus measures. Overall, the Chinese government's response to the 2008 financial crisis demonstrated its keen insight into economic conditions and decisive policy implementation. The combination of fiscal and monetary policies not only successfully countered external shocks but also laid a solid foundation for long-term stable economic growth. However, it is also essential to recognize that excessive stimulus measures can lead to side effects such as overcapacity and accumulated debt risks, which need careful consideration and timely adjustment in future policy-making. This study not only provides detailed data support for understanding the specific impact of the 2008 financial crisis on China but also offers valuable cases for studying China's policy choices and response mechanisms during the crisis. Additionally, the analysis in this paper provides policy references for addressing potential future global economic challenges, helping countries better prepare for and respond to similar economic crises.

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