MADE IN CHINA: MUCH ADO ABOUT NOTHING?

Comment By: Samirul Ariff B Othman

China's economic growth has been breathtaking. The Chinese economy grew by an average of 9.6 percent per year between 1990 and 2010, according to the International Monetary Fund. During the recent global financial panic, some feared that the Chinese growth engine would come to a grinding halt. However despite Chinese exports faltering in 2008, the nation did survive the bumpy ride without experiencing political instability or popular revolt. Despite concerns about inflationary pressures and China's property bubble, but nevertheless most economists continue to predict sanguine growth for the country. They seem to be of the opinion that China's growth will be rapid and that this rate of growth will continue for many more years to come. It is noteworthy though; these predictions are adjusted extrapolations of current trends.

The cornerstone for these projections is based on stringent methodical economic modeling. But are they fail-proof and time-tested? Extrapolating from current trends will only make sense when predicting growth in the next year and the following year, however once the years become decades, such assumptions certainly become more questionable.

To see things in perspective, if Christopher Columbus had invested one cent in a trust fund in 1492 at a real compound interest rate of six percent per year above inflation, that penny would now be worth $95,919,936,112. The final worth of a penny invested at 6% compound interest for 513 years is 95 billion.

Unfortunately though, reliable high-yielding 513-year investments are impossible to find. What is very certain though is that things do change; and things can go wrong. Therefore past returns are in no way a guarantee of future performance.

To be fair, when it comes to projecting China's future growth, economic modeling can offer only so much guidance. These models predict future economic outputs on the basis of projected future levels of economic inputs, but future economic inputs are impossible to predict. In the end, there is little to do but extrapolate from current inputs. But inputs, as well as other key features of any economy, change over time. China's economy is transforming rapidly: from agriculture to industries to the latest being consumer services. And at some point down the road, China's high growth rates will level out and its economic growth will slow down, returning to rates more like those experienced by other developing countries.

These econometrists are of the view that so long as the country's urban labor force continue to expand, its educational levels continue to rise, and foreign capital continue to move into China, the Chinese economy would continue to grow. But are things as simple as that? For one thing, economic models seem to have one fundamental flaw; they ignore the fact that as countries grow, growth actually becomes more difficult. In other words the rate of growth decelerates before eventually reaching a steady-state phase.

When economies move up global value chains, graduating from the production of light manufactured goods to a reliance on the knowledge & innovation of their citizens to develop new industries, they climb less and less rapidly. For example it took South Korea (1960 to 1990) 30 years, to raise its GDP per capita from one-thirtieth of U.S. GDP per capita to one-third. Paradoxically it then took another 20 years to jolt its way up from one-third to one-half. And yet South Korea today is still a long way from catching up with the United States.

Even though Japan managed to rapidly catch up with the West, it ought to be noted that she had already achieved much of her development before World War II. Thus despite its economy being devastated during World War II; its rapid postwar growth was to some extent a return to prewar levels. There is no example to date of a state taking a very rapid growth trajectory to the top of the world economy.

Leapfrogging

Another reason that economic models forecasting China's continuing rise are too simplistic is that they tend to ignore the two one-time bonuses that helped the country to leapfrog. The two one-time boosts are the population's declining fertility rate and its increasing urbanization. Both factors have led to massive increases in economic productivity, but they are finite processes and cannot be hoped to recur in the future. China's decline in fertility rate in the 1970s meant that throughout the 1980s and 1990s, both families and the state could focus their limited resources on a relatively small number of children. Now, these children are in their mid-30s and are actively contributing to the development of the nation's human capital and to its GDP.

Equally important, low fertility rates over the past few decades enabled women to enter the formal labor market. Hundreds of millions of women who would have worked in the home or on the farm are now working and thereby boosting the county's GDP figures. Widespread urbanization is the other one-time bonus that boosted China's economic growth during the past two decades. Urbanization increases GDP because urban populations are in general more productive than rural ones and because the former typically work outside the home in paid employment, whereas many people in the countryside engage in unpaid subsistence farming.

Impediments

China is actually facing barriers that will limit its potential economic growth in the future. Some argue that China will not be able to move up the global value-added chain unless it is a more open society. High-value-added activities, such as branding, design, and invention, require a kind of freethinking possible only in democratic societies. China may educate its population, but if it continues to stifle their creativity, they will never succeed at the highest levels of the global economy. China will not reach the top ranks of the global economy (in terms of GDP per capita) until its schools, companies, and people learn to innovate more than they have in the past. This maybe happening, but China's stifling political culture is holding back the process.

Stunted Growth?

China shares many features with Brazil, Mexico, and Russia. Sociologists have identified these four countries as belonging to the "semi-periphery" of the world economy, a group of states that are not as rich and powerful as the developed democracies but not as poor as the small countries of Africa and Central America. These countries are characterized by strong states with weak institutions and governments highly influenced by the richest citizens in addition to mass poverty.

At its current growth rates, by the year 2020 China will likely catch up with Brazil, Mexico, and Russia around in terms of per capita GDP. At that point, all four states will have per capita national income levels between $10,000 and $15,000 (in today's dollars). All will also have similar levels of economic inequality – levels far higher than those in the developed countries. Their people will not experience serious hunger or malnutrition, but they will see chronic squalor on a massive scale. About 40 percent of these countries' populations will live in large cities, and about 20 percent will live in rural areas, with the rest in small cities and towns. Their fertility rates will have fallen somewhat under replacement levels, and about two-thirds of their populations will be between the ages of 16 and 65.

Trajectory?

If in 2020, China will almost certainly face structural conditions similar to those in Brazil, Mexico, and Russia, why should anyone expect it to grow any faster than them? Brazil and Mexico have belonged to the middle-income league for generations. Russia was in that bracket in the early twentieth century and returned to it immediately after the collapse of communism. Granted, China is bigger than those countries, but there is no reason to think that being big makes it different. Statistics show correlation between a country's size and its economic growth. Therefore, there is no particular reason to believe that the China of 2020 will be any more successful than these other states have been.

It is more reasonable to assume that like other middle-income countries, China will likely continue to grow slightly faster than Western countries, although not as fast as it did between 1990 and 2010 and with much more volatility. But its population will start to fall soon after 2020, whereas the U.S. population will keep rising. This is not to say that China will not become a major world player. Even if it reaches only parity with the United States in terms of overall GDP and attains only about one-quarter of U.S. GDP per capita, it will still be a power to be reckoned with. However, tomorrow's China is more likely to focus on meeting the needs of its own people rather than establishing itself as the new global hegemon.

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