Putting China's Economic Growth in Perspective

by

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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.

[1] The views and opinions expressed herein are those of the author and do not necessarily reflect the views of MIER.

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.

Stunted Growth?

China is actually facing barriers that will limit its potential economic growth in the future. 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.

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 country'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.

Trajectory?

China shares many features with Brazil, Mexico, and Russia. Political Economists 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.

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, 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.

In the final analysis, in the future China is more likely to focus on meeting the needs of its own people rather than engage herself in power projection.