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The Middling Kingdom

The Hype and the Reality of China’s Rise

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By any measure, China's economic growth has been unprecedented, even miraculous. According to the International Monetary Fund, the Chinese economy grew by an average of 9.6 percent per year between 1990 and 2010. At the beginning of the recent global financial crisis, many feared that the Chinese growth engine would grind to a halt. In late 2008, Chinese exports collapsed, triggering fears of political instability and popular revolt in the country. In the end, however, the global economic crisis turned out to be little more than a pothole on the road of China's economic growth. Inflationary pressures may now be building up in China, and China's property bubble may be threatening to burst, but most economists continue to predict rapid growth for the country well into the future. Although their forecasts vary widely, they seem to share the view that China's growth will be fast -- if not as fast as it has been -- and that this rate of growth will continue for decades. These predictions are at once cautious about the near future (China's performance will not be as extraordinary as it has been) and optimistic about the distant future (they see no end to China's upward trajectory). By coincidence or design, they are moderated extrapolations of current trends.

For example, the Nobel Prize-winning economist Robert Fogel believes that China will grow at an average annual rate of eight percent until 2040, by which time it will be twice as rich as Europe (in per capita terms) and its share of global GDP will be 40 percent (compared with 14 percent for the United States and five percent for the European Union). Other economists are slightly more cautious: Uri Dadush and Bennett Stancil of the Carnegie Endowment for International Peace predict that China will grow by 5.6 percent per year through 2050.

Like many other forecasts of China's continued rise, these projections are based on careful formal economic modeling. But are they convincing? Extrapolating from current trends may make sense when predicting growth in the next year and the year after that, but once the years turn into decades, such assumptions seem more questionable. If my ancestors had invested a penny in my name in 1800 at a real compound interest rate of six percent per year above inflation, that penny would now be worth about $280,000. That does not mean, however, that reliably highyielding 211-year investments are easy to find. Things change; things go wrong. Past returns are no guarantee of future performance.

When it comes to gauging China's future growth, economic modeling can offer only so much guidance. The 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 evolving rapidly: from subsistence agriculture to smokestack industries to the latest electronics to consumer services. And at some point in the future, perhaps in the not-too-distant future, China's excess growth rates will level out and its economic growth will slow down, returning to rates more like those experienced by comparable countries.

WHEN THE GROWING GETS TOUGH

It may seem foolish in 2011 to even talk about calling a top to the Chinese market. Judging by the Fogel and Dadush-Stancil models, there seem to be no medium-term barriers to China's growth. So long as the country's urban labor force continues to expand, its educational levels continue to rise, and capital continues to move into China, the Chinese economy should continue to grow.

But are things as simple as that? For one thing, economic models tend to downplay the fact that as countries grow, growth gets harder. When economies move up global value chains, graduating from the production of simple manufactured goods to a reliance on the creativity of their citizens to develop new industries, they rise less and less rapidly. It took South Korea 30 years, from 1960 to 1990, to raise its GDP per capita from one-thirtieth of U.S. GDP per capita to one-third -- but then it took another 20 years to nudge its way up from one-third to one-half. And South Korea today is still a long way from catching up with the United States. Japan caught up with the West (and by some accounts exceeded it) in the 1980s, but then the bubble burst, and since 1990 its economy has grown by an average of just one percent per year.

What is more, these two states have been vastly more successful than most others. No other medium-sized or large country with a diversified economy has even come close to Japan's accomplishments. Of the four "Asian tigers," the richest two (Hong Kong and Singapore) are cities, and the other two (South Korea and Taiwan) are basically cities-plus and are much farther behind economically. Other poor countries that have become rich are either offshore financial centers or small petro-sheikdoms. None of them is a full-sized country with multiple cities and regions, a large rural population, and competing political constituencies. Even Japan represents a questionable model of a state recently and rapidly catching up to the West, if only because it had already achieved much of its progress before World War II. Like the leading Western countries, it industrialized in the late nineteenth century and early twentieth century, partly through ruthless colonial exploitation. Its economy was then bombed into oblivion during World War II; thus, its rapid postwar growth was to some extent a return to prewar levels. In other words, there is no example to date of a state taking a very rapid growth trajectory to the top of the world economy, raising doubts about whether China can be the unlikely exception.

China's recent growth is often characterized as the country's natural, deserved return to its historical place in the global economy, but this argument is more clever than correct. According to the late economic historian Angus Maddison, China last reached parity with the West around the time of Marco Polo. China's subsequent decline relative to the West long predates the Industrial Revolution, Western colonialism, and even China's sixteenth-century inward turn. The overarching story of the past five centuries is not about China's absolute decline so much as about the West's relative advance. European economies grew substantially between 1500 and 1800. According to

Maddison, by 1820 -- before the advent of the railroad, the telegraph, and the modern steel industry, and before the Opium Wars, the colonization of Hong Kong, and the Boxer Rebellion -- China's national income per capita was less than half that of the average for European countries. By 1870, it had dropped to 25 percent, and by 1970, to just seven percent. Moreover, considering that Maddison's figures are all estimates based on purchasing power parity, China's position in hard-currency terms looks far worse. According to hard-currency statistics from the World Bank, between 1976 and 1994, Chinese GDP per capita was less than two percent of U.S. GDP per capita, and today it is still under ten percent.

In other words, China's massive economic growth over the past two decades has done nothing more -- and perhaps much less -- than return the country to its 1870 position (in terms of purchasing power parity). Optimists will see this as further evidence of China's potential: if China is at only 1870 levels, there is still plenty of room for further growth. But pessimists might note that if China could fall from this position in 1870, it might well fall from it again. There is no reason, on the face of it, to expect one outcome or the other; a conservative bet would be that China stays right where it is.

ONE-TIME BENEFITS

Another reason that economic models forecasting China's continuing rise are too simplistic is that they tend to ignore both the one-time boosts that helped propel the country in the past and the political, environmental, and structural obstacles that will limit its growth in the future. China is now in a much stronger political and military position vis-à-vis the West than it was in 1870 and seems very unlikely to descend into another century-long ordeal of repeated human and economic catastrophes. But does that necessarily mean it will grow to become the world's richest country?

China's dramatic rise over the past 20 years was propelled by two one-time bonuses: 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 counted on in the future. China's fertility rate was already falling well before the first implementation of its draconian one-child policy in 1979. The decline in fertility 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 country's human capital and to its GDP. Future generations may be even better educated, but the major gains have already been made. More important, low fertility rates over the past few decades freed up adults, particularly 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 in the money economy, boosting the county's GDP figures. This has given China a one-time boost -- sustained higher output -- but it will not help GDP continue to grow. There is little room for further fertility decline; China cannot move to a zero-child policy.

Moreover, there are today comparatively large numbers of workers born in the high-fertility 1950s, 1960s, and early 1970s making their way through their careers. Because their parents' generation is dying relatively young and because they have few children, these workers are largely unencumbered by either caregiving or child-rearing duties. Of all the generations of Chinese throughout history, this one is uniquely positioned to pursue work and create wealth. Future generations of Chinese workers will be smaller and will be saddled with the care of ever more elderly relatives. Moreover, fertility rates can only rise going forward, meaning that these workers may have more children to care for as well.

Increasing urbanization is the other one-time bonus that boosted China's economic growth during the past 20 years. Urbanization increases GDP because urban populations are generally more productive than rural ones and because city dwellers typically work outside the home in paid employment, whereas many people in the countryside engage in unpaid subsistence farming. But like fertility reduction, urbanization is a process with natural limits. China's level of urbanization is still well below that of the West, and urban expansion in China shows no signs of slowing down. (At current growth rates, urbanization in China will not catch up to urbanization in the West or Latin America until the 2040s.) But what form will this expansion take? Huge shantytowns are already forming on the edges of Beijing, Shanghai, and other Chinese megacities. The Chinese government bulldozes shanties by the hundreds of thousands every year, but it is unclear whether their residents are being relocated or just being made homeless. Whether or not the government wins its war against slum development, the days when urbanization was a boost to economic growth are gone.

STRUCTURAL STRICTURES

In addition, China is facing political, environmental, and structural barriers that will limit its economic growth in the future. For example, many analysts believe that China will not be able to move up the global value-added chain unless its politics open up. The argument is that high-value-added activities, such as branding, design, and invention, require a kind of free thinking possible only in democratic societies. China may educate hundreds of thousands of engineers, 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 is happening, but China's stifling political culture is hindering the process. It is difficult to imagine a dynamic knowledge economy emerging in a politically repressive one-party state; none ever has before.

The environmental barriers to China's continued growth are better documented. The World Health Organization estimates that air pollution in China kills 656,000 people annually and water pollution another 95,600; China's own Ministry of Water Resources estimates that about 300 million people, two-thirds of them in rural areas, rely on water that contains "harmful substances." According to *The New York Times*, officials from China's State Council have said that the massive Three Gorges Dam is plagued by "urgent problems" that "must be resolved regarding the smooth relocation of residents, ecological protection, and geological disaster prevention." China is also now the world's largest emitter of greenhouse gases. The great drought and floods that have hit China so far this year may or may not be related to its environmental record, but it is clear that China's ability to monetize its environment to promote economic growth without regard for ecological devastation is coming to an end. China's future growth will have to be cleaner than its past growth; thus, it will be more expensive. Long a densely populated country, China has always had one of the most intensively exploited environments in the world. Today, it has little environment left to exploit.

Still, the greatest barriers to China's continuing rapid economic growth are structural. Until 1980, the country was effectively closed to the world; by 1992, nearly all of urban China had been incorporated into special economic zones open to private enterprise and foreign investment. The incredibly inefficient Maoist economy is gone and has been replaced by some of the most competitive firms in the world. Creating more value than did state industries during the Cultural Revolution was not very difficult. But creating more value than today's efficient Chinese firms do will be much harder.

This difficulty will be exacerbated by major structural changes in the economy. Since 1960, life expectancy in China has risen from 47 years to 74 years, but the number of children per family has declined from more than five to fewer than two. Today's little emperors will spend their most productive years taking care of their parents. And as they do, China's economic activity will have to move away from high-productivity manufacturing and toward low-productivity health services. This shift will further limit China's future growth prospects because productivity is harder to increase in service industries than in manufacturing, mining, or agriculture. In the past, to make the most of their comparative advantage, Chinese producers focused on manufacturing for the world's industrial market. In the future, Chinese service providers will have no choice but to focus on the domestic health-care market, without regard for getting an edge.

CAN-DO OR HAS-DONE?

Many commentators, most notably the political scientists George Gilboy and Eric Heginbotham, have warned recently of the "Latin Americanization" of China, specifically its rising income inequality. In 2003, China had just one billionaire (as measured in U.S. dollars); by 2011, according to Forbes magazine, it had 115. Yet China is still a poor country: GDP per capita in hard-currency terms is substantially lower in China (under $5,000) than in Brazil, Mexico, and Russia ($9,000-$10,000), the world's three big middle-income countries. But as China catches up to them, its inequality levels are also rising to levels close to theirs.

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, Central America, and Southeast Asia. (Other examples include Indonesia and Turkey.) These countries are characterized by strong states with weak institutions, governments highly influenced by the richest citizens, and mass poverty.

At its current growth rates, China will likely catch up to Brazil, Mexico, and Russia around the year 2020 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 know mass squalor. 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. In the face of rapid aging, these countries will need to shift their economies away from growth industries and toward slow-growth health-care services.

All of which raises this question: If in 2020, China will almost certainly face structural conditions nearly identical 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. China was there in 1870, and it is back there again. Granted, China is bigger than those countries, but there is no reason to think that being big makes it different. Historical statistics show no correlation between a country's size and its economic growth.

The relative position of China in 2020 will look an awful lot like that of China in 1870 and of Brazil, Mexico, and Russia today. There is no particular reason to believe that the China of 2020 will be any more successful than these other states have been. Perhaps China's proactive attitude toward development will allow it to power through the middle ranks of the global income distribution despite a weak civil society, an aging population, and a devastated environment. And having already returned to its nineteenth-century position relative to the West, perhaps China might eventually regain its thirteenth-century superiority over the West. Structure is not destiny. And if China does overcome its limitations, it could provoke a complete realignment of the international system.

But it is more reasonable to see China's famous can-do attitude as more of a has-done attitude: a legitimate pride in recent accomplishments rather than a harbinger of future success. 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. The overall size of China's economy is thus likely to remain roughly equal to that of the United States for the remainder of the twenty-first century. 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. It will become the second indispensable country.

But given the United States' far greater alliance network and geostrategic position, U.S. hegemony is not threatened by the rise of China. The United States is encircled by long-standing allies (Canada and the countries of western Europe) or stable but weak noncompetitors (Latin America). China's neighbors are a rich and powerful Japan, rising South Korea and Vietnam, giant India and Russia, and a host of failed or failing states in Central and Southeast Asia. The United States reigns supreme over the oceans, the skies, and outer space; China struggles to maintain order within its own territory. China will, and legitimately should, play an increasing role in Asian and world politics, but it is in no position to dominate even Asia, never mind the world.

Pundits may relish the opportunity to speculate about a post-American future in which the world has to learn Mandarin, but the facts say not in this century. It is time to start treating China like a large but ordinary country. The rest of the world should neither relish nor fear the prospect of Chinese domination. Putting aside the hype and the panic, one should see in China a country that suffered terrible tragedy for 200 years and is finally returning to normal. This is a good thing -- for China, for the United States, and for the world. If the international system comes to see China, and China comes to see itself, as an important but not all-powerful participant in the global system, irrational fears will diminish on all sides, and rightly so. Tomorrow's China is more likely to focus on meeting the needs of its own people than on establishing itself as the new global hegemon.

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