

# The future might not belong to China

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Replicating the success of other high-growth economies is about to become far harder

Martin Wolf

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Do not extrapolate from the recent past. China has had a hugely impressive four decades. After their triumph in the cold war, both the west and the cause of liberal democracy have stumbled. Should we conclude that an autocratic China is sure to become the world's dominant power in the next few decades? My answer is: no. That is a possible future, not a certain one.

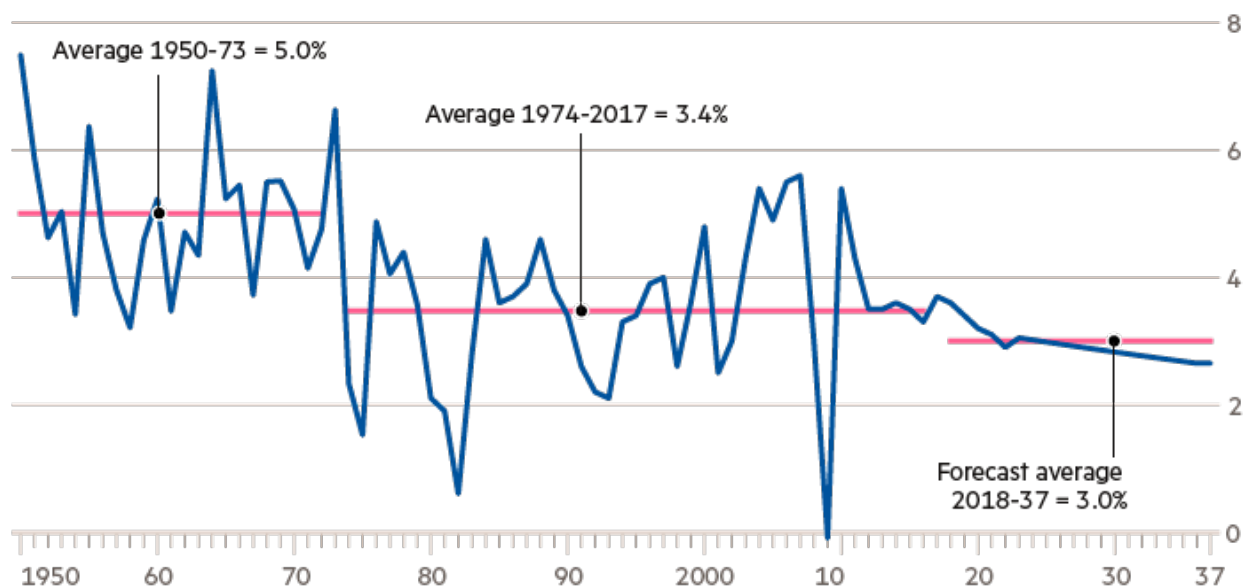


The view widely held in the 1980s that Japan would be "number one" turned out to be badly mistaken. In 1956, Nikita Khrushchev, then first secretary of the Communist party of the Soviet Union, told the west that "We will bury you!" He proved utterly wrong. The examples of Japan and the Soviet Union highlight three frequent mistakes: extrapolating from the recent past; assuming that a period of rapid economic growth will be indefinitely sustained; and exaggerating the benefits of centralised direction over those of economic and political competition. In the long run, the former is likely to become rigid and so brittle, while the latter is likely to display flexibility and so self-renewal.

Today, the fiercest political and economic competition is between China and the US. A conventional view is that by, say, 2040, China's economy will be far bigger than that of the US, with India far smaller still. But might this view be mistaken? Capital Economics, an independent research firm, answers "yes", arguing that China's period of stellar outperformance might be coming to an end quite soon. (See charts.)

## Slowing growth

Annual growth in global GDP (%)



Source: Angus Maddison, IMF, Capital Economics forecasts from 2018 onwards  
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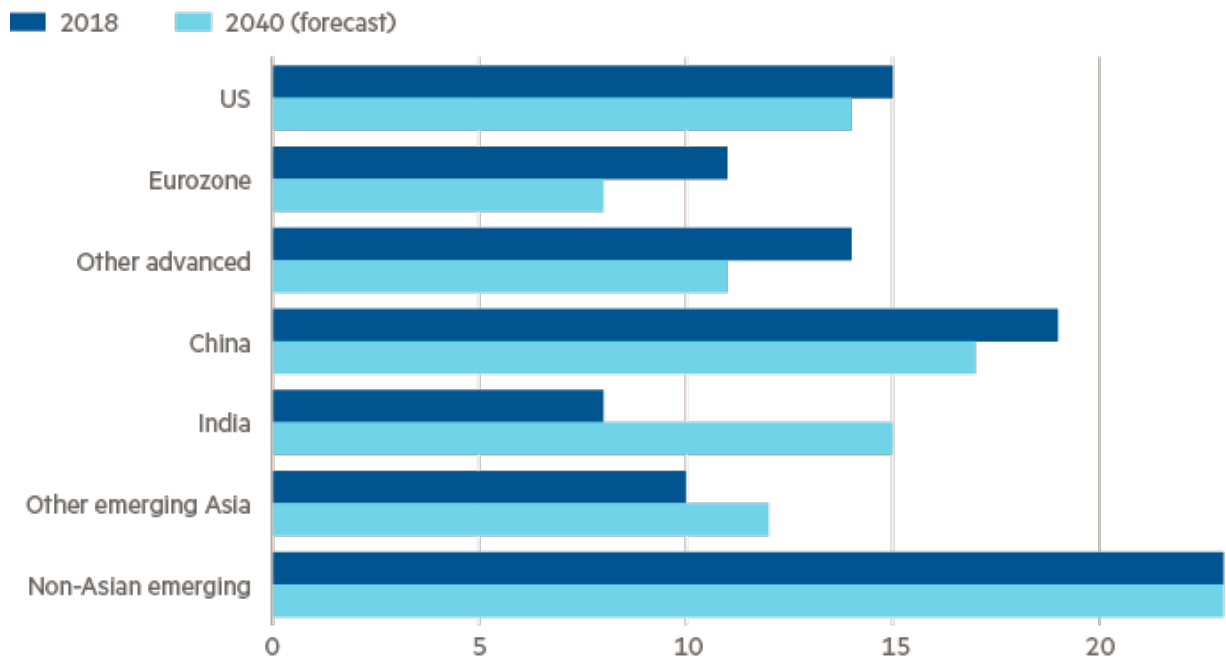
There are two powerful arguments why this view will prove to be mistaken: first, China has great potential for continuing catch-up on the productivity levels of the most advanced countries; and, second, it has a proven ability to generate sustained rapid growth. It is brave to bet against both potential *and* capacity. But, argues Capital Economics, in its “Long-Term Global Economic Outlook”, we should. As with Japan in the 1980s, the policies of ultra-high investment and rapid debt accumulation, which kept China growing so fast after the 2008 financial crisis, make it vulnerable to a sharp deceleration.

Crucially, China’s investment rate, at 44 per cent of gross domestic product in 2017, is unsustainably high. This extraordinary investment rate did maintain the growth of supply and demand after the 2008 crisis. But China’s public capital stock per head is already far bigger than Japan’s at comparable incomes per head. Slowing urban household formation means that fewer new homes now need to be built. Not surprisingly, returns on investment have collapsed. In sum, investment-led growth must come to an early end.

Because of its size, China has also hit the buffers on export-driven growth, at a lower level of income per head than other high-growth east Asian economies. The trade war with the US underlines this reality. China’s working-age population is also declining. Given the huge rise in debt as well, sustaining fast growth will be very hard.

## Growth slows especially in China

Shares of global GDP at purchasing power parity (%)



Source: Capital Economics

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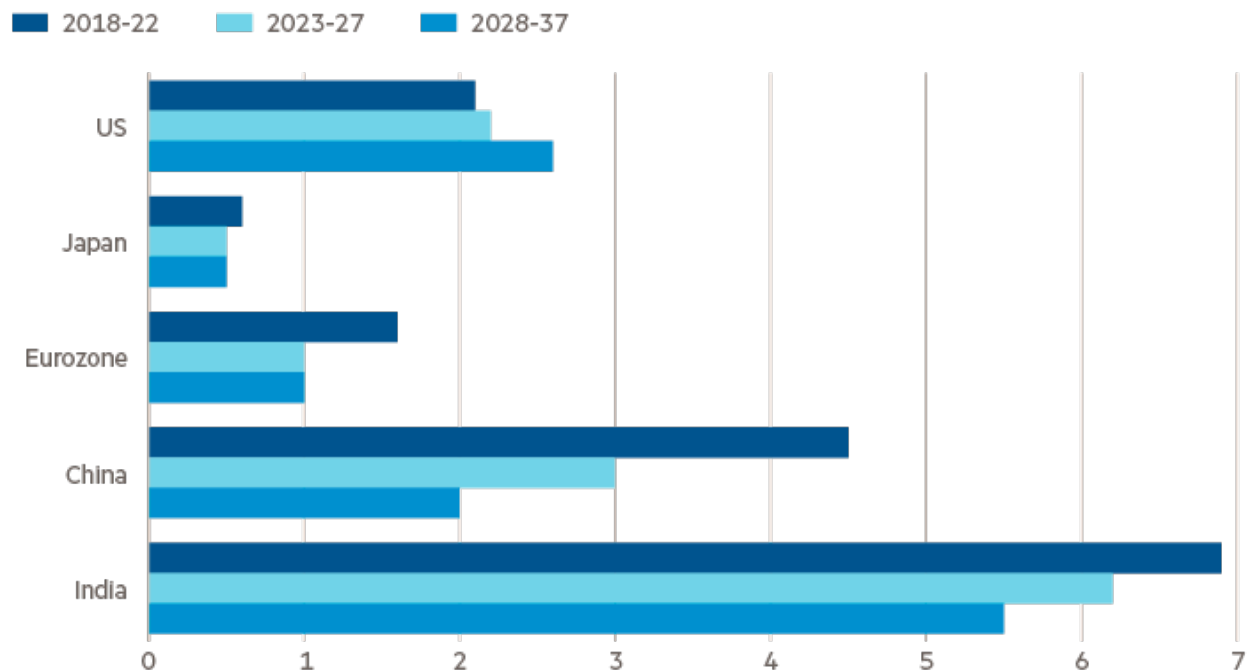
Future demand will depend on the emergence of a mass-consumer market, while growth of supply will require an upsurge in growth of “total factor productivity” — a measure of innovation. Yet, in 2017, private consumption was only 39 per cent of GDP. If it is to drive demand, the savings rate must tumble and the share of household incomes in GDP must jump. Neither will be easy to achieve. But the biggest hurdle of all, especially to the needed upsurge in productivity growth, is the shift towards a more autocratic political system.

For one and a half decades, China has benefited from the reforms introduced by Zhu Rongji, premier from 1998 to 2003. No comparable reforms have happened since his time. Today, credit is still being preferentially allocated to state businesses, while state influence over large private businesses is growing. All this is likely to distort the allocation of resources and slow the rate of innovation and economic progress, even if an outright financial crisis is avoided.

In sum, China may well fail to replicate the success of other east Asian high-growth economies, in becoming a high-income country in short order. It will surely be far harder for it to do so, because the distortions in its economy are so large and the global environment is going to be so much more hostile.

## India rises

Forecast growth in GDP, average over period (%)



Source: Capital Economics

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Meanwhile, suggests Capital Economics, the arrival of robotics and artificial intelligence might re-ignite productivity growth in the west and, above all, in the US. If one wished to be optimistic, one would also hope that experience of Donald Trump's incompetence and malevolence will be salutary. His hardcore supporters are a minority. Majorities of the disgusted should win and then bring about the renewal of economic competition and social concern that the US needs.

The most interesting other economy is not Europe, which seems destined for a slow relative decline, but India, due to be the world's most populous country in the near future. India is far poorer than China and so still has great potential for fast catch-up growth. Capital Economics forecasts 5-7 per cent annual growth until 2040. This is at least conceivable. India's savings rates and entrepreneurial capacity are high enough to deliver such a rate. It will need much policy reform. But India's politics are increasingly focused on economic performance. This does not guarantee success. But it does make it more likely.

Disheartened liberal democrats must not despair. The euphoria and hubris of the "unipolar moment" of the 1990s and early 2000s were grave mistakes. But the triumph of despotism is still far from inevitable. Autocracies can fail, just as democracies can thrive. China confronts huge economic challenges. Meanwhile, democracies must learn from their mistakes and focus on renewing their politics and policies.

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