The Rise of China
A talk by Robert Ward, Country Publishing Director, The Economist Intelligence Unit
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This Economist Intelligence Unit paper, based on a presentation given by Robert Ward at a recent conference in Beijing, takes a look at some of China’s key economic trends in a global and historical context. It provides a sense of China’s (and Asia’s) impact on the world economy and the underlying issues that China must face if it is to take advantage of the opportunities confronting it.

The context

Back in the 1980s—a long time ago—Japan was the future of Asia. In those days, when growth in Japan was less than 3%, it was considered a recession. So much has changed in such a short space of time—and of course that observation also applies to China, where a great deal has been changing in a very, very short space of time. Crises accelerate existing trends. Nowhere has that been more the case than in Asia. And China is emblematic of Asia: When we talk of Asia’s rise to preeminence in the global economy and the shift of the global centre of gravity to Asia, we often are referring to the situation in China.

We have had global decoupling, recoupling, first-time coupling . . . these all represent shifts that are extremely important. It is the reconnection of countries within the world towards Asia. To consider China’s rise, we need also to talk about the impact, including the intellectual impact, of the shift in global focus towards China and try to determine how China might capitalise on its rise to preeminence.

This bar chart below illustrates the size of the major global economies in 2020. The first thing to notice of course is that China is number one, and it will become number one in about 2020. When it does, there will be an outpouring of grief in western newspapers, as happened in Japan when China overtook Japan. In the following charts it becomes clear that there are issues with China as number one. It also becomes clear that this is an Asian century.

![GDP, purchasing power parity](chart)

Source: Economist Intelligence Unit.
In the 12 top countries in terms of GDP purchasing power shown in the bar chart above, about 5 are Asian (ASEAN can be considered a “country” for this purpose). In 2029, Indonesia will be in the top 10, so it is really an Asian century. But why is China having difficulty? Well, China’s rise has been unique in terms both of speed and of the country’s size. This is also the first time that a middle-income country has been number one. No other country has been so old and so poor at the same time, as the chart below on demography in China shows.

In terms of wealth, China today is where Japan was in the 1960s. In terms of demographics, China today is where Japan was in the 1970s. So really China risks getting old before it gets rich, but at least the Chinese population will live long enough to reach old age. The economic impact of this circumstance is far-reaching.

China is now an exporter of jobs to Asia. Ten years ago, the ASEAN countries were worried that they would lose their foreign direct investment to China. Now China is an FDI investor in the region. In 2017 it will be a net outbound investor—an achievement accomplished in just a decade. The lower-value-added goods are being shipped to countries such as Vietnam, Indonesia, and so on—and not just to Asia but also to African countries such as Ethiopia. Chinese Ethiopian-made shoes represent another transition point for China, which is changing the economic relationships within the world as a result of its economic rise—a shift is evident in items such as Chinese shoes in Ethiopia.
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The economic impact

China’s construction industry, which we think is actually the most important single sector in the world, provides a good indication of the country’s global economic performance (see the graph below). We discovered that China has enough construction capacity to build a city the size of Rome every two weeks, extraordinary. It can build Spain in a year, and it can build Europe in 15 years, so this is a very, very important sector to watch.

The rise in south–south trade is a result of the extension of Chinese economic power. Last year was the first in which emerging market–to–emerging market trade in value terms overtook emerging
market–to–developed country trade. The light blue line in the graph below is really rising fast; this reflects again the impact of China. If you strip out Japan, Korea and Taiwan, you see interregional trade also rising very fast indeed. The world becoming increasingly China-centric; it is sort of recoupling, as noted earlier, towards China and decoupling from the West. This is extremely important for the global economy.

### The intellectual impact

The intellectual impact of this recoupling is very interesting, because historically creditor nations have set the tone for the global economic debate. That was the case before the first world war with Britain and then after the Second World War with the United States. The wealth that is piling up in Asia, in China particularly, consists of foreign exchange reserves. This is where the global wealth now resides (see chart next page). The system that eventually replaces the Bretton Woods system will probably have an Asian name, maybe even have a Chinese name. The region has a unique opportunity to start to set the intellectual trends for the global economy going forward.

### Political impact

Unfortunately, the euro zone is really out for the count. This is a real shame, because the euro zone does have a great role to play in terms of rules-based governance. We think the euro zone will survive, but the crisis is going from acute to chronic. Chronic seems great after an acute situation, but unfortunately Europe will be inward looking. Also the US has serious political issues, so it will not be really setting the global trend. Thus China is presented with a unique, once-in-a-generation opportunity to start setting the global trend.

To extend this theme of the rise of state capitalism, the bar chart below shows the top 10 global exports.
countries with sovereign wealth funds. It is no surprise that China is number one, with over a trillion dollars of wealth in the Chinese sovereign wealth funds. No surprise again that Asia, if you include Australia, has about four countries in the top 10. These sovereign wealth funds, state capitalism, SOEs—call them what you will—can transform the face of global industry and global finance. Already some sovereign wealth funds are linking up with other sovereign wealth funds and bypassing the traditional centres of finance, such as London and New York. Again, China can play a key role here.

The politics discussion gets a little bit more difficult. Although China has the economic hardware, to really capitalise on this situation it needs the software, and that of course is politics. Although China is
preeminent in Asia, there is real competition for who leads in Asia. Asia is also fragmented, as shown in the map below. These are all the areas for which there are geographical flashpoints, and together they form a necklace of troubles around China. This of course is sometimes why China feels threatened, but it is also why it is really important now for China to act, to fine-tune, its politics.

Geopolitical flashpoints

In Japan, they are using a new word—Abenomics—composed from “Abe” for Prime Minister Abe, and “nomics” for economics. The term refers to a great experiment in monitory policy. But even within Japan, there is a lot of conflict about Abenomics, and some senior people believe that this experiment with monitory policy, with fiscal policy, is a bad idea. But the interesting point is that Abenomics is not only an attempt to revitalise Japan from the inside, it’s also an attempt to reposition Japan’s leadership within Asia. Even though Japan is going to be number three, as we saw, in 2020, it will be competitive again.

Ways to capitalise

The ASEAN economic community wants to kick off in 2015. This may also be an attempt to limit Chinese power in the region. So of course the soft area of Chinese policy now is so important. Whether China gets this right or wrong will really determine how effectively both the Chinese government and Chinese companies are able to really capitalise on this opportunity to take the leadership role.

Finally, it’s really all about the fine-tuning, the software, and formulating a clear idea of what constitutes Chinese national interests. Sometimes from the outside it’s not clear what those interests
actually are. Often, strikingly, in areas such as open trade, Chinese national interests actually dovetail very well with US national interests. Attempting to fine-tune the government and provide a bigger role for the Foreign Ministry is very important. We want policy to be coordinated. At the moment, policy in China is split between the Army, the President, the Prime Minister, and the Foreign Ministry; that needs to change. The country needs to speak with one voice in terms of policy. Multilateral institutions will also need a far bigger role, because China will be number one in 2020 as we’ve seen. There is absolutely no reason why the Americans and the Europeans should still dominate.

A real touchstone of the Chinese attitude towards reform will be the Chinese attitude towards the renminbi. This can be seen as a benchmark for the Chinese government’s attitude towards broader economic policy reform, but of course the renminbi is also seen as a political tool by the government, which makes it very difficult to do anything drastic about it. But until this is done, in my view, China will fail to take its real position within the global economy.

Finally, it’s really all about the fine-tuning, the software and formulating a clear idea of what constitutes Chinese national interests. Sometimes from the outside it’s not clear what those interests actually are: China does not publish national security strategies like other major powers do. Often, strikingly, in areas such as open trade and a number of international security issues, Chinese national interests actually appear to dovetail very well with US national interests. Yet, unfortunately, a sense of these shared interests does not often come through in public interactions between the two countries, reflecting how politicised the bilateral relationship has become.

Stronger voices are needed within China to make the argument that the country’s future role lies at the heart of international society. In this regard, attempting to fine-tune the government and provide a bigger role for the Ministry of Foreign Affairs is very important. We want foreign policy to be co-ordinated. At the moment, there are too many bodies involved in decision-making—from the military to state-owned enterprises—each of which is focused on its own narrow interests. Too often the foreign affairs ministry is left to pick up the mess. The country needs to speak with one voice if it is going to have any hope of reassuring others. China also needs to take on a bigger role in multilateral institutions to reflect its economic heft. There is absolutely no reason why the Americans and the Europeans should still dominate such institutions; giving China a stake in such bodies may dissuade it from taking a more unilateral path.

Finally, fashioning an ambitious domestic economic reform agenda could generate good will for China on the world stage. The new leadership appears to understand the need to reorient China’s economy towards consumption-led growth. Difficult reforms aimed at achieving this transition, such as the liberalisation of controls over the exchange rate, capital account and interest rates, are all being considered. The fact that debate is now being had over the rightful role of state-owned enterprises, and lifting restrictions on foreign investment, is also encouraging. Such changes would not only go a considerable way to unwinding the imbalances that have distorted the global economy in recent years but would also signal to other countries that they will benefit from China’s continued economic rise.
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