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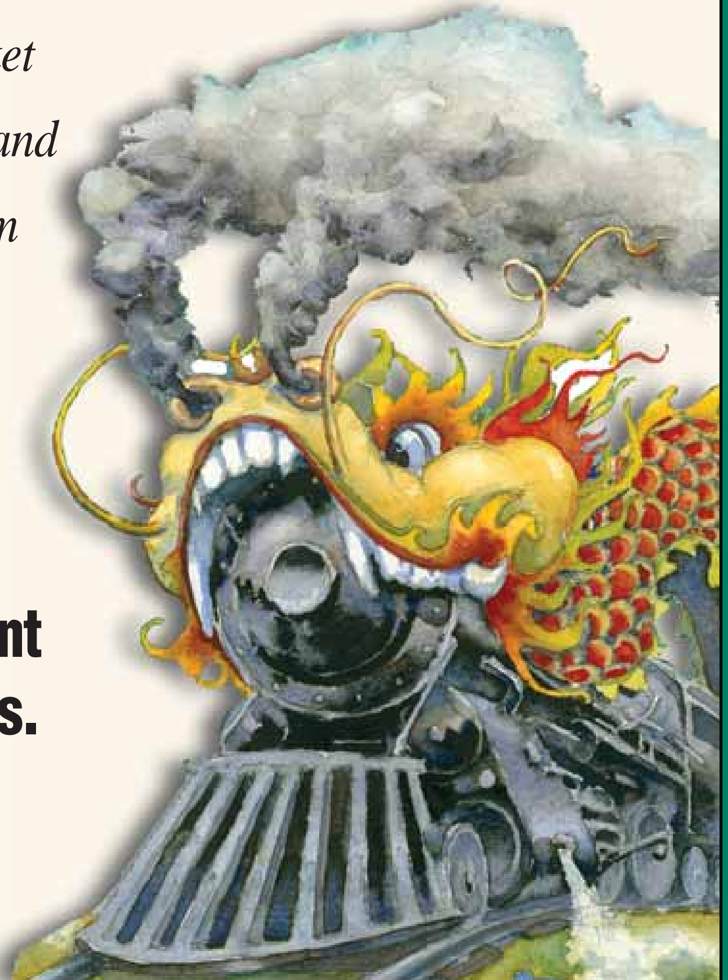
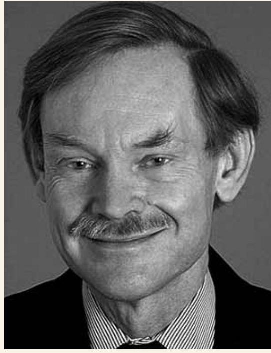
Can China Become the World's Engine for Growth?

Is China large and powerful enough? Are its impressive growth prospects sustainable? Or is today's financial market enthusiasm towards China and its global role the latest form of irrational exuberance?



More than fifty important experts offer their views.



China's challenge is to help pull the world together and not in conflicting directions.

ROBERT B. ZOELLICK
President, World Bank Group

China is already a major factor in the world economy. Since 1999, its share of global exports has risen from 3 percent to 10 percent, and in 2009 it surpassed Germany as the world's leading exporter. China is also the third-largest importer and will soon overtake Japan as the second-largest economy. In 2009, China became the world's biggest market for car and vehicle sales.

China acted quickly and decisively in the face of the global crisis with a $586 billion stimulus package. It has enjoyed a rapid recovery, which has assisted others. China's GDP growth for 2009 was 8.7 percent, slightly down from 9.6 percent in 2008.

But China, like other economies, faces significant risks. Its rapid recovery was fueled partly by an expansion of domestic credit that has the potential for generating asset bubbles, most notably in real estate.

China's dependence on export-led growth is vulnerable to protectionism and is unsustainable over time. An IMF study concluded that to maintain growth of at least 8 percent under the current pattern, China's share of world exports would have to almost double by 2020. Pressure on the Chinese government to permit appreciation of the renminbi will continue to grow, from developed countries as well as developing countries seeking to compete.

China's development as a new pole of growth is a forerunner of others. Together, China and India account for 8.5 percent of world output. With productive investments, others in Asia, Latin America, the Middle East, and even Africa will join them, creating multiple poles of growth. This multipolarity of growth can strengthen the world economy, if global and regional systems for cooperation on trade, finance, development, and environmental protection adjust, too. These changes will require a complementary adjustment of responsibilities.

China, for example, is already recognizing the need to shift from export-driven growth to higher domestic consumption. In 2008, China's household consumption accounted for 34 percent of GDP, while in the United States it was 70 percent of GDP; Japan's was 58 percent; the European Union's was 57 percent; and India's was 54 percent. China's twelfth Five-Year Plan is likely to seek to accelerate this rebalancing, but the change will not be easy.

Household savings in China, at about 22 percent of GDP, are similar to those of India. Greater public investments in education, health, and pensions may lower personal savings, although China's aging demographics may keep family savings relatively high. The real structural shift depends on lowering corporate savings, now at 18 percent of GDP. These retained earnings reflect advantageous bank financing and limited competition in some sectors.

China's pathway to a more "harmonious society"—both internally and globally—depends on structural reforms to adjust the pattern of growth, including facilitating high-quality urbanization, improved financial services for small and medium enterprises, the poor, and rural areas, greater competition in service sectors that will lower costs and create jobs, and more investment in environmental safety and other public goods.

Of course, China's structural reform agenda needs to be matched by companion adjustments in developed countries. The challenge now is not just to generate engines of growth, but to couple them so they pull the world economy ahead together and not in conflicting directions.

If China institutes changes, it could become an important contributor to balanced world growth.

AXEL A. WEBER
President, Deutsche Bundesbank

Continuous market-oriented reforms and China's integration into the world economy have unleashed the tremendous growth potential of the Middle Kingdom. After many years of growth in the range of 10 percent, China is now the world's third-biggest economy.

The Chinese development model has been based on a strategy of channelling its huge reservoir of domestic savings into export- and investment-led growth. While this strategy has been quite successful in fostering economic development and job creation, it also has led to growing imbalances with rising current account deficits and excessive accumulation of foreign reserves. These imbalances

have complicated the task of macroeconomic stabilization and hindered the efficient allocation of resources.

Against this backdrop, the challenge that lies ahead for China is to stimulate domestic demand by improving its social infrastructure and accelerating financial sector reform. Increasing public spending on social welfare, health, and education would help to reduce households' precautionary savings and thus facilitate a gradual shift to a more consumption-driven economy. Further reform of the financial sector would allow Chinese households to receive a higher return on their savings and gain access to consumer credit. Increasing the market's role in determining the exchange rate would not only support a stability-oriented monetary policy, but would also underpin the rebalancing process by facilitating a shift of resources to the nontradable sector of the economy and channelling a larger part of demand towards foreign goods.

Taken together, these measures would pave the way for China to move forward on a more sustainable high-quality growth path and also deliver an important contribution to more balanced growth in the world economy.

Though exuberance over China verges on the irrational, it nonetheless will become a global growth engine.

MILTON EZRATI
Senior Economist and Market Strategist, Lord, Abbett & Co.

Though frequently exuberance over China's prospects verges on the irrational, China nonetheless has already become a major engine of world growth and will likely remain so for some time to come. If anyone needed evidence, Beijing's ability in the 2008–09 recession to use fiscal stimulus to substitute for exports, that economy's ability to respond, and the response generally in Asia demonstrated China's already critical role in the global economy. Now with a recovery of sorts under way worldwide, a renewed flow of exports should allow China to extend its growth trajectory even as Beijing unwinds any undue dependence on last year's policy stimulus.

Longer term, it is apparent that China will need to transfer its growth impetus from exports to broad-based domestic development and consumer spending. Here there is a risk that China's leadership will overstay its present, export-led growth strategy and its emphasis on heavy industrial development. But Beijing at least has acknowledged the need for a fundamental change, and if China's leadership should lose track of that need, the clear aspirations and demands of its people should serve as a powerful reminder. But even without explicit policies to promote such a change, the process of development itself should naturally push the economy toward the Chinese consumer. Certainly, the response to last year's stimulus indicates the commercial and employment potentials of broad-based development of China's hinterland. Without denying the risks, the probabilities suggest that China will make the transition, at least in part.

Ultimately, adverse demographics rooted in Beijing's one-child policy will work against the economy's growth prospects. But, according to United Nations figures, China will remain relatively youthful for a considerable time to come. Even as far out as 2030, its working-aged population will remain relatively more plentiful than Japan's or that of the developed West. Of course, trouble might emerge beyond this point, but over such a long time horizon, too much else can happen to make any reliable forecast based on a single demographic indicator. In the meantime, the current reality of Chinese growth and the economy's potential leave more reason for enthusiasm than not, though there is never room for irrationality.

China may overtake the U.S. economy sooner than expected.

CHONG-PIN LIN
Former Deputy Defense Minister, Taiwan, and Professor, Graduate Institute of International Affairs and Strategic Studies, Tamkang University in Taipei

Since the end of the 1990s, China's economy has continued to outperform pessimistic forecasts. Several factors favoring the country's resilient growth have been under-appreciated. First, for an expanding economy, China's is the largest in scale in human history. Rules in textbooks based on past observations of comparatively smaller economies do not apply. For example, while the global financial crisis in late 2008 hit China's export-oriented coastal provinces, the inland provinces were hardly

affected by the economic downturn of the outside world. The latter then worked as a cushion for the slowdown of China's economy which began to rebound by mid-2009.

Second, Chinese leadership stresses learning which enables it to face most economic challenges head-on with timely preventive measures or ultimately effective policies. Since 2002, the Chinese Communist Party Politburo—the twenty-five most powerful persons in China—has taken group classes monthly from leading scholars in the nation on an array of policy-related subjects, half of which have been economic in nature. Eighty percent of the lecturers studied abroad. No top leaders in other major powers today are so dedicated to study so as to be aware of the most up-to-date tools for problem-solving.

Third, China's contribution to the world's GDP today is less than 10 percent, but it was 30 percent during the Ming Dynasty around the fourteenth century. Given the historical perspective, the country has more economic potentials yet to be realized.

Fourth, China's capitalist-oriented authoritarian government unhindered by parliamentarian procedure seems increasingly more capable of steering the country economically than wealthy democracies.

Lastly, China is auspiciously located in a region which just began its robust economic growth in recent decades and most likely will continue to prosper in the foreseeable future.

Freshly christened the world's second-largest economy, China may become the first sooner than expected earlier.

China's long-run economic future is hard to predict.

MARTIN NEIL BAILY

Bernard L. Schwartz Chair in Economic Policy Development, Director of the Initiative on Business and Public Policy, and Senior Fellow in Economic Studies, Brookings Institution, and Former Chairman, Council of Economic Advisers

When the global downturn started and China's exports plummeted, it seemed certain that its economy would go through an extended period of slow growth. Without its job-creating export machine in full swing, China could have easily suffered unemployment and social unrest on a large scale.

I recently returned from a visit to China and now think this view was wrong. Growth in 2009 came in at 8.7 percent and there is even a risk that the economy will overheat in 2010, with a property boom and the Chinese export juggernaut picking up steam again. Policymakers put together a large and, it seems, highly effective fiscal stimulus package and monetary policy that has been very expansionary with vast new bank lending. Perhaps China will yet stumble with too many bad loans and hasty projects, but I will leave that prognostication to others.

Despite its extraordinary success in responding to the global crisis, I would not yet describe China as a major engine of global growth. First, China remains only a modest part of the global economy. It will be the biggest economy in the world some day, but not yet. Second, for a number of years China has followed an export-led growth strategy, which means its exports have exceeded its imports—indeed its trade surplus rose rapidly over time. This path meant that China was, on net, reducing the level of aggregate demand in the global economy. As long as demand in the rest of the world was growing strongly, especially in the United States, this imbalance did not cause global recession. America spent more than it produced and China produced more than it spent. With the global downturn, however, there is now a general shortage of aggregate demand, resulting in unemployed labor and unused capacity. Many countries have taken steps to boost demand, including the United States, and it seems that China has done an excellent job in this regard. Chinese imports are rising rapidly and this is helping many economies in Asia that are suppliers to its manufacturing base. It is a locomotive of Asian recovery.

Questions remain, however, as to the ability of China to sustain its growth path without a return to exploding trade surpluses in the next few years. A reasonable goal for China is to keep its trade and current account surpluses from growing as a percentage of its GDP. If it does that, then China would be a good global citizen, if not exactly an engine of global growth. To achieve this goal, China must rely more on its domestic demand, including demand from its own consumers, and less on demand from the rest of the world.

China's long-run economic future is hard to predict. Its growth strategy has worked very well, but eventually it will slow down, as all economies do once they develop. China will probably become the largest economy in the world, but probably it will not become the richest country, based on per capita income. Europe and Japan both stopped catching up to the United States when they reached about 75 percent of the U.S. level of income. My guess is that China will do well to reach that level. Even so, it will still be a very formidable economic power.

China still needs to overcome significant structural hurdles.

DAVID K.P. LI
Chairman and Chief Executive, Bank of East Asia, Limited

China's economy will likely grow by some 9.5 percent in 2010, enabling the country to overtake Japan as the world's second-largest economy. No wonder, then, that many are asking this question.

China's rapid growth has given rise to many winners around the world—the resource-based economies of Africa, Latin America, and Central Asia—plus Australia—foremost among them. Yet China's economy is no match for a healthy United States as an engine of global growth. In 2008, U.S. private consumption totalled US$10.13 trillion, more than six times China's US$1.587 trillion.

Having said that, there are reasons to be optimistic about China's future potential. The sharp rise in GDP over the past decade has enriched China's population of 1.3 billion. Disposable income has risen by an average of 15.5 percent in each of the past five years.

As part of the measures to support the economy following the global financial crisis, the Chinese government introduced policies to encourage the purchase of automobiles and home appliances by rural residents. Automobile production surged to a record last year, overtaking the United States for the first time. Further, the authorities relaxed the strict rules that control the migration of rural households to urban areas. Urban household spending is two and one-half times higher than rural spending. This measure will help to raise domestic consumption over time.

However, to fully realize its potential, China still needs to overcome significant structural hurdles. From 2004 to 2008, China's nominal GDP growth averaged 18.3 percent, outpacing the 15.5 percent growth in disposable income. Personal income is thus falling as a share of GDP because of the government's pro-growth policy whereby profits are channelled to corporate entities instead of individuals. To promote consumption, China will need to shift the balance firmly toward the latter.

A second structural impediment is China's high savings rate. This is rooted in the underdeveloped social security network. By enhancing welfare and pension schemes, households will become more willing to spend.

With China, all we have are hunches and intuition.

BARTON M. BIGGS
Managing Partner, Traxis Partners

As a professional investor with a major stake in China and Asia, we visit, read, study, talk to the experts—the whole analytical shtick—and have done so for more years than I care to recount. All of our sources assert their expertise and access to impeccable sources. They forecast with great conviction. In my opinion it's all babble; their record is that they are wrong more often than right but unfortunately they are not always wrong which would be valuable. As Victor Niederhoffer said long ago: "Oracles, forecasts, and prophecies are a business. They should be evaluated with the same skepticism and savvy that would be applied to a used-car dealership or an oriental rug auction. Legendary and self-administered reports of forecast accuracy should be taken with eight grains of salt."

As far as the direction of China, its politics, the health of its economy, and the rise of consumption are concerned, my conclusion is that "nobody know nuttin'" in terms of what's really going or what the numbers really are. After all, it's a command economy, and incidentally, that's the way they (the Chinese) want it. I think China is going to be the major engine for world growth for the next five years but that's solely based on hunch and intuition.

China is clearly in a position to become a major locomotive for global growth.

C. FRED BERGSTEN
Director, Peterson Institute for International Economics

China accounts for about 10 percent of gross world product (with exchange rates calculated at purchasing power parity for this purpose, per the International Monetary Fund and virtually all other analysts). It normally grows at about 10 percent per year. It thus accounts for fully 1 percentage point of annual global growth. The world as a whole usually grows at 4–5 percent so China, in a straightforward statistical sense, provides between 20–25 percent of all global expansion.

The practical impact of China's growth on other countries, however, depends critically on whether its current account balance is rising or falling. When China's trade surplus grows rapidly, as it did from 2003 through 2007, an important part of China's growth derives from demand generated outside its borders rather than at home. In this situation, its activities reduce rather than promote foreign expansion. This may be acceptable, and even desirable, if other countries are enjoying full employment (and especially if they face risks of inflationary overheating). It is clearly undesirable if the rest of the world is in recession and desperately seeking to create jobs domestically.

The crucial variable for world growth is thus the expansion of domestic demand in China. At this point in the global economic cycle, with most countries far from full employment and still seeking to assure sustained recovery from the crisis, it is essential that China at a minimum achieve all its growth from increases in domestic investment, government spending, and especially private consumption.

It would be even better for the world economy if the expansion of domestic demand in China exceeded the country's output expansion by at least a couple of percentage points of GDP. China would thereby contribute positively to growth in other countries, who could exploit the rapid expansion of Chinese demand. Since China has already recovered more completely than virtually any other country from the crisis, such a contribution would be particularly appropriate. Indeed, Chinese authorities are already expressing concern over a resurgence of inflationary pressures (and even fears of new bubbles) and have begun taking steps to slow the pace of the country's renewed boom. Sizable and growing reductions in China's still-large trade surpluses, and preferably an eventual swing into trade deficits, would make a significant contribution to these domestic stabilization objectives as well as to global growth.

China could of course easily accept substantial "deterioration" in its trade and current account position. Its surpluses, though significantly reduced over the past two years, still exceed 5 percent of GDP. It will almost certainly continue to attract capital inflows that would offset any foreseeable current account deficits. Its foreign exchange reserves of $2.4 trillion would permit it to run sizable deficits for many years even if those capital inflows declined substantially.

Hence China is clearly in a position to become a major locomotive for global growth over the coming years. In light of the fragile and uncertain outlook for recovery in many countries, both developing and high income, it is in fact critical that it do so. The composition of China's initial rebound in the middle of last year, when it achieved double-digit quarter-over-quarter growth with a sharp decline in its external surplus, was ideal from a global as well as Chinese perspective. It needs to perpetuate this pattern in the period ahead to play a responsible role as the new global economic superpower of the twenty-first century.

China is the biggest strategic development of our lives.

JIM O'NEILL
Head of Global Economic Research, Goldman Sachs International

It already has! Just ask anyone from the world's major auto companies, such as GM, VW, or Honda. China is where it is all at. Last fall, China advanced beyond one million auto sales per month, becoming the biggest auto market in the world. According to our long-term research, this is just a stepping stone along the way, and within twenty years, they will be selling five million cars per month. The same is happening with mobile phones (although here India is giving them a run for their money: together, 31 million mobiles are sold every month in China and India) and LCD TV screens. The evidence is overwhelming that such growth is occurring in all forms of consumption.

It is quite amusing to read others saying it is impossible for China to match the United States, as the U.S. consumer market is worth $9–10 trillion, and the Chinese worth "just" $1.5 trillion. This makes the basic mistake of confusing levels with change. Chinese retail sales, though not a perfect indicator, are rising 15–18 percent annually in real terms. Translated into current dollars, this is effectively an extra $300 billion per year, equal to U.S. consumption rising by around 3 percent in real terms. Chinese consumption has increased in U.S. dollar terms more since 2007 than the dollar value of U.S. consumption has declined.

Judging from the hundreds of investors I speak to, hardly anyone believes this, and as *TIE* discussed in a recent issue, many think China is another bubble. This is just the beginning. There is a decent chance that within twenty years, China will become bigger than the United States in current dollars, and all the policies that Beijing is pursuing, ranging from social security introduction to granting urban rights for migrant workers, suggest that this is the biggest strategic development of our lives, and probably our children's. To put it into real clarity, since 2001, China's overall GDP has increased by $3 trillion, the equivalent of creating two new United Kingdoms or two new Frances. In the next eight years, the Chinese will create another Japan.

China must move to consumption-led growth.

JEFFREY R. SHAFER
Vice Chairman, Global Banking, Citi, and former Undersecretary for International Affairs, U.S. Treasury

China can continue its strong growth and development for another generation or more by generating stronger sustained domestic demand growth to absorb its expanding productive potential. The supply of literate labor available from its low-productivity rural economy will allow the effective labor force in the modern industrial and services economy to grow despite an aging and more slowly growing total population. And, as its innovative capacity expands, Chinese companies will increasingly shape global markets.

There will be challenges along the way, some of them visible now: managing sectoral and regional imbalance and labor dislocations that are inevitable with rapid growth, containing risks in a still-developing financial system, reversing the trend of increasing environmental abuse, and restraining the commodity intensity of growth. But the record of the Chinese authorities in responding effectively to rising economic problems "just-in-time" suggests that these and new problems will be dealt with before they derail China's economy. Just as they responded to the Asian crisis, to the threat of overwhelming bad loans in the banks, and to the recent global recession, one can look for a strong response before a problem becomes overwhelming.

The most acute challenge facing China now is to sustain domestic demand, moving from temporary stimulus to sustained consumption growth and providing incentives, such as those given by the exchange rate, to business to refocus investment on goods and services for domestic use. China cannot sustain its growth by relying on others in the global economy to provide the demand. Implementing policies, both in China and in its partners, to support a more balanced growth path than was followed in the last decade will be critical. The record of the past thirty-two years suggests that China will do its part.

China's already an important engine.

CAROLINE ATKINSON
Director of External Relations, International Monetary Fund

China is a critical force behind the current global recovery. The government's decisive policy response to the global financial crisis has spurred a domestic demand-driven recovery in China that has delivered important benefits for the world economy.

The prospects for sustaining this increase in Chinese consumption demand are improving. The government has introduced important initiatives including an ambitious health care reform plan, fiscal measures to boost consumption, and improvements in the rural pension system. Further measures in the areas of health, education, and financial liberalization would be important to increase the purchasing power of households, raise the labor share of income, and reorient investment toward non-tradable sectors. A stronger renminbi over time would be an essential part of this broader policy package.

Even with higher sustained consumption in China, expectations about the near-term global impact need to be realistic. The Chinese economy is still relatively small in terms of its purchases in the global marketplace. China buys about 3 percent of world imports of consumer goods, and 8.7 percent of total world imports. It is therefore hard to imagine that China could fully replace the import demand of the main industrial economies any time in the near future. Nevertheless, as the world's second-largest trading nation, accounting for 11 percent of world GDP,

China is central to the world economy and will remain an important engine of global economic growth.

Using its weak currency, China will dominate the world.

TAKESHI FUJIMAKI
President, Fujimaki Japan

China will overtake Japan and become the world's second-largest economy in terms of GDP this year. It has been treading a very similar path to that of Japan forty years ago. In this sense, China is likely to enter the same economic boom that Japan experienced around 1979, when Harvard Professor Ezra Vogel wrote *Japan as Number One*. It will become a global engine for growth for a certain period of time.

Until the Nixon shock of 1971, Japan enjoyed the benefits of a weak yen at the fixed exchange rate of 360 yen to the U.S. dollar. Thus armed, Japan increased exports, and its economy took a leap forward. The generated wealth brought affluence to the Japanese people and increased domestic consumption. It was the dawn of an age of high economic growth, blessed with loads of mega-projects.

Although the Nixon shock caused a shift to the floating exchange rate system, the yen was still as low as 240 yen to the dollar even in 1979 when *Japan as Number One* was authored. Thus, Japan continued to enjoy the benefits of its weak domestic currency. The rate of 240 yen to the dollar, compared to the current exchange rate of 90 yen, shows how weak the Japanese currency was at that time.

In those days, Japan was often criticized by the international community for its huge trade surplus which, except for the Plaza Accord in 1985, Japan did not take active measures to reduce. The yen did keep on rising, but it was still weak compared to the real economy. As a result, the Japanese economy continued to thrive and eventually entered the bubble economy phase (1985–90). The yen's appreciation continued during the bubble period, reflecting the booming economy. But even at the peak of the bubble at the end of 1989, a dollar was still worth 143 yen.

On the other hand, China has experienced a sharp decline in the renminbi since 1980. Let me quote the rate against the yen, since dollar-renminbi data are not available. In 1980, 160 yen was required to buy a renminbi. Now it can be purchased for less than 14 yen. Similarly, Chinese labor is now more than twelve times cheaper than in 1980. China has kept its renminbi at a low level by pegging it to the U.S. dollar since 1994. Considering all this, it made sense that "the factory of the world" moved from Japan to China, enabling the Chinese economy to prosper with the accumulation of wealth from exports.

Incidentally, a country may revalue its domestic currency for two reasons: first, an intensifying pressure from abroad due to a huge accumulated trade surplus; and second, the benefits a revaluation will provide to the country. The greatest benefit would be to prevent inflation caused by full employment.

But with an enormous population of 1.3 billion, China will not come close to accomplishing full employment soon. So it will not need a strong domestic currency, a panacea for inflation caused by full employment, in the foreseeable future. China will maintain its weak domestic currency no matter how much external pressure it may receive. Besides, Chinese leaders seem to fully understand the benefits of a weak currency. Because of that, I believe China will use the weak renminbi to its advantage, and that the Chinese economy will dominate the world for years to come.

In this sense, Chinese leaders are different from their Japanese counterparts who did not realize the importance of monetary policy. China is also different in that Japan accomplished full employment and started to see benefits of a strong domestic currency at an early stage.

But in the longer run, the renminbi will follow the path of the yen—it will become too strong compared to the real economy and lose its global competitiveness. China will then hand over its status of "a factory of the world" to emerging economies. After all, history repeats itself.

China is hardly a promising engine.

TADASHI NAKAMAE
President, Nakamae International Economic Research

China will not boost global growth for the foreseeable future. China is accumulating imbalances of which the most serious is oversupply capacity. Yet China is still

increasing production capacity. If China were to continue to use this increasing capacity, it would need to find demand to meet the supply. This could be in the form of infrastructure investment and domestic consumption for cars or home appliances, but neither are big enough to match the fresh supply China is churning out. Additional capital expenditure would create fresh demand, but also more supply capacity in the future. Thus, pressure to increase exports is increasing rapidly at a time when the rest of the world is suffering from oversupply capacity problems as well. This will intensify trade conflicts, which are already starting to emerge between China and its trade partners.

China's steel industry illustrates its enormous supply capacity. China's crude steel production capacity is said to have exceeded 700 million tonnes at the end of 2009 (this is roughly six times bigger than Japan's, the second-largest producer of crude steel). In the second half of 2009, China produced crude steel at an annual rate of 600 million tonnes—increasing, rather than decreasing, its rate of production, despite estimates that domestic demand for crude steel was 450 million tonnes and foreign demand was weak at best. China drove up the prices of raw materials such as iron ore used to make crude steel, which it bought in vast amounts. At the same time, China drove down the price of the product, as it is prone to do, by flooding the markets with steel products. As a result, producers' profit margins were squeezed. Many are probably losing money. Banks, which lend to the producers, are amassing bad loans.

After Lehman Brothers went bust in 2008, Chinese (and global) demand contracted. China's government, like others, took measures to stimulate its economy, including aggressive policies to increase bank lending. This had two effects. The first fueled high levels of inventory investment in commodities such as iron ore. During the second half of 2009, China bought enough iron ore to produce almost more than twice as much crude steel as it was already making. The second led to speculation in real estate markets, especially housing. Asset prices rose sharply, which is starting to cause consumer prices to climb, too. (This is a phenomenon not seen in developed nations where asset inflation and consumer price inflation are usually disconnected).

Just how long China can sustain these imbalances depends on monetary policy. The central bank would be forced to tighten when consumer price index inflation accelerates or China's trade surplus turns to a deficit as imports increase more rapidly than exports. (If, as China's foreign cheerleaders say, it is the one country that is doing well amid a global economic downturn, it would be buying—and importing—more than anyone else.) Once China starts to tighten, all its recent trends— investment-led economic growth, rising commodity prices, and asset inflation—would be reversed.

This would be a big blow for China, which has vast excess supply capacity and huge corporate debt. In the early 1990s, Japan's problems were said to be "three excesses": excess capacity, excess debt, and excess employment. China's job statistics are vague but it is probably suffering from excess employment too. These "three excesses" are the reason why Japan has stalled for the past twenty years. China seems to have the same problem, but on a bigger scale. Not a promising engine for the global economy.

China's growth would have to become more sustainable.

MARK A. DEWEAVER

Founding Partner, Quantrarian Capital Management

For China to become the engine of global growth, its own growth will have to become more sustainable. This will require a bigger share for household consumption in GDP and less reliance on investment and government spending. Yet the trend of the last decade has been in exactly the opposite direction, with the household consumption-to-GDP ratio falling from 46 percent in 2000 to 35 percent in 2008.

The problem is not that households are saving too much but rather that both income inequality and enterprise savings have been rising dramatically. The share of national income available for household consumption is not only falling but also increasingly concentrated in the hands of people who are more affluent and therefore (as Chinese academic studies have repeatedly shown) have a lower marginal propensity to consume. More sustainable growth will thus require a redistribution of income away from the enterprises and the managers and local government officials who control them. But it is hardly conceivable that these beneficiaries of the current system are going to give up their share of the pie voluntarily, and the central government is evidently not strong enough to bring this about by fiat.

A more likely scenario for the near term is that the inflationary forces released by last year's reckless monetary policy will start to show up in the prices of consumer goods, leaving the central government with no choice but to put the brakes on investment. At that point the question will become: To what extent can the world continue to be an engine of growth for China?

China is fast heading toward becoming the global locomotive.

HARUHIKO KURODA
President, Asian Development Bank

One of the most striking revelations of the global financial crisis has been the remarkable resilience of the Chinese economy. There was widespread belief that China would suffer disproportionately from the crisis due to its heavy dependence on exports. However, defying all predictions, China has continued to grow rapidly. China's GDP grew by 8.7 percent in 2009 and, according to ADB's projection, it will continue to grow quickly by 8.9 percent in 2010. It is this resilience, coupled with its sheer size, which is fueling hopes that China can lead the world economy at a time when the traditional leader—the United States—is stalling.

The natural question to ask is whether such hopes are realistic. The update of *Asian Development Outlook 2009,* ADB's flagship publication, shows that China is becoming more of a consumer and less of an assembler, supporting the notion that the country is becoming a growth engine for East Asia.

Our findings for East Asia have broader implications for the world economy. China is reaching income levels where millions of consumers are buying their first car or first personal computer. Furthermore, well before the global crisis began, the Chinese leadership has been debating how to rebalance the economy away from its strong emphasis on export- and investment-led growth, toward growth based more on domestic demand and consumption. The global crisis has merely added a sense of urgency to this task. Strengthening social safety nets to curb household precautionary savings and deepening domestic financial markets to direct savings to more productive uses are among priority reforms for China. At the same time, accelerating the integration of regional markets will help foster greater consumption in Asia by helping shift the composition of trade within the region more toward final goods.

Overall, I am optimistic that China will continue to grow rapidly and in ways that benefit the region and the world economy. China is not yet an engine of global economic growth but it is fast heading in that direction.

No doubt, China is a growth locomotive for developing countries.

DAVID HALE
Chairman, David Hale Global Economics

China will soon overtake Japan to become the world's second-largest economy. In 2012, its GDP will probably exceed $5 trillion. It has already displaced Germany as the world's largest exporter. The imbalances in China's economy reflect the fact that capital spending and exports have grown far more quickly than consumer spending during the past decade. As a result, the consumption share of GDP has slipped to 36 percent from over 50 percent during the 1980s. The government's stimulus program gave a further boost to investment last year, but it also offered subsidies for purchasing autos and appliances. China's auto sales exceeded America's during 2009. China's investment spending will slow during 2010, but exports will probably rebound at double-digit rates as the global economy recovers. There will be healthy growth in consumption as the Chinese economy powers ahead, but its share of GDP will probably remain near current levels for the time being.

The intermediate-term challenge for the government will be to boost the consumption share of GDP by creating a stronger social safety net in order to lessen the pressure on households to maintain a high savings rate. Such changes will take several years to unfold. China's major contribution to the global economy during the past year has been to boost commodity prices. The surge of infrastructure spending boosted demand for copper, iron ore, and other base metals. The commodity price recovery will bolster the growth rates of Latin America, Africa, and Australia during 2010. In fact, China now consumes 25 percent of Australia's exports compared to only 12 percent two years ago.

China is also significantly boosting its investment in global natural resource projects. It has invested $44 billion in Australia since 2007. It has made takeover bids on the Toronto Stock Exchange exceeding $10 billion. It has done government-to-government deals for oil development worth $25 billion for Russia, $10 billion in Brazil, $10 billion in Kazakhstan, and $3 billion in Turkmenistan. There can be little doubt that China is providing a growth locomotive for developing countries through its voracious

appetite for raw materials. This demand is a byproduct of the fact that China has the highest ratio of investment-to-GDP in the world today.

China's transition to consumption-led growth may be problematic.

NICHOLAS LARDY
Senior Fellow, Peterson Institute for International Economics

China made significant progress in the transition to a more consumption-oriented economy in 2009. Personal consumption grew more rapidly than GDP in 2009 for the first time in almost a decade. China's trade surplus fell by a third and the contribution of the external sector to growth was negative for the first time since the early 1990s. Thus, 2009 appears to mark a turning point away from export-led toward consumption-led growth, a goal that China has espoused for five years.

But these changes may prove to be cyclical rather than marking a turning point. Much of the growth of private consumption, particularly of consumer durables, was stimulated by temporary price incentives made possible by halving the purchase tax on some automobiles and price subsidies for other consumer durables. And some of the increase in consumption was financed by a massive increase in household borrowing. This pushed up household debt relative to disposable income to levels that, while still modest compared to pre-financial crisis levels in the United States and the United Kingdom, have never been seen in Communist China.

The sharp decline in China's external surplus in 2009 is also likely to prove temporary. China's early and powerful recovery in 2009 meant that imports fell much less than exports. If economic recovery in the United States and Europe strengthens in 2010, this pattern is likely to be reversed. The relatively rapid trade-weighted appreciation of the renminbi in 2008 and early 2009 also contributed to the sharp reduction in China's trade surplus last year. But this factor is now pushing in the opposite direction as the renminbi has now depreciated by about 10 percent since the first quarter of last year.

Thus, sustaining the transition to more consumption-oriented growth will require stronger policy initiatives including a more flexible exchange rate, less financial repression, and more realistic pricing of factors of production.

China today is neither a Ponzi scheme nor a world savior.

ARTHUR KROEBER
Managing Director, Dragonomics Research and Advisory, and Editor, China Economic Quarterly

China today is neither a Ponzi scheme nor a world savior. It is an adolescent economy, filled with promise, problems, and growing pains. Thanks to prompt and massive government stimulus, it was the first major exporting nation to emerge from the Great Recession of 2008–09; all indications are that private investment and modest but stable household consumption will take over as the main engines of growth this year, when China will pass Japan to become the world's second-biggest economy.

But we must recognize what China is and what it is not. Viewed purely as an investment economy, it is already three-quarters the size of the United States, half the size of the European Union, and half again as big as Japan. Yet as a consumer, it is merely one-seventh the size of the United States, one-fifth the size of Europe, and only half the size of Japan. Most of its consumers still can afford only necessities and low-priced goods, not the full range of items common in American or European households.

The transition to a more consumer-driven economy has already begun but—as with the United Kingdom in the nineteenth century and the United States in the twentieth—this transition will take decades to complete. Demographics is already playing a role, as a gradually declining labor force entry population begins to drive up real wages and incomes. Policy is helping out, with the expansion of national health insurance and pension schemes, and the first baby steps towards creating a modern financial sector without which a mature consumer economy is impossible. Policymakers still must learn how to manage the higher inflation that comes with stronger wage and consumption growth, and reform the fiscal system to reduce incentives for local government to indulge in wasteful investment.

China will not drive global growth.

JON THORN
Director, India Capital Management HK

All of the comments that everyone makes about China are to some extent true. Most of those "true comments" are, however, irrelevant both to how China is managed and, consequently, to how China will grow.

China is not focused on global growth but on Chinese growth. On that basis, it is surprising at best the extent to which China has come to be seen as a potential cargo cult for global growth in some especially desperate Western people's viewpoints.

Domestic demand as a percent of GDP is increasing sharply due to demographics and to monetary policy, but that will not act as a driver for general global growth as China has a manufacturing base. The United States acted as a driver for global/China growth due its (overly) expansive monetary policy and underinvestment in manufacturing. China may also, but we assume it will not make the same mistake. China may at some point experience some kind of "bust," but its negative impacts will not result in a permanent diminution of growth or relative large loss of wealth, as it has large reserves and a high savings rate.

China has scale and growth; India is the only other country that also does to the same extent.

China's ability to import is still too small.

GENE H. CHANG
Professor of Economics and Director of the Asian Studies Institute, University of Toledo

In a global economic recession, the global engine of growth should maintain or create strong demand for the goods and services from other countries of the world. In other words, the country would import a lot, in terms of volume or its share in global trade, from the rest of the world. China accounts for 7.5 percent of world imports, and the United States accounts for close to 14.5 percent. However, in the 2009 global recession, because of China's massive domestic stimulus package, China's imports dropped by only 11 percent, while U.S. imports dropped by 28 percent. Hence, the Chinese stimulus package played an equal or even more important role than the U.S. economy in the economic recovery in 2009. In the near future, China's rapid growth and the related demand for raw materials, capital goods, and services would continue to be an engine for world economic growth, close or parallel to that of the United States.

However, in a broad sense, the global engine of growth is more than how much the country imports. It includes those factors such as the size and influence of the economy, the dynamics of the country, innovation, the lead in sciences and technologies, and so forth. In this sense, the United States is still the dominant global growth engine. China's economy does not compare with that of the United States in this sense in the near future.

There are serious dangers ahead.

JIRO OTSUKA
Senior Advisor, Japan International Cooperation Agency

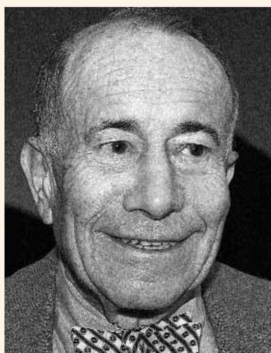
Eight years ago, in an interview with a Hong Kong reporter, economist Stanley Fischer was asked about his evaluation of China's macroeconomic management. He said, "Looking back to the several occasions where China faced difficult choices during the previous decade, surprisingly not even a single mistake have they ever made." As Professor Fischer was known for his stringent opinions at MIT, this sanguine statement sounds quite remarkable. How could China be so successful in macroeconomic management? Several reasons could be pointed out. But fundamentally, China could not afford to make mistakes during that period because of its massive demographic pressure.

The demographic tree of China shows dual demographic balloons. The first (approximately 300 million) was created during the decade of the Cultural Revolution. These baby boomers entered into the labor market during the 1980s and 1990s. Thus, the Chinese government had to create more than twenty million net job opportunities every year. Obviously, domestic-oriented industrialization could not bear this daunting task and would raise balance of payment problems. That was the background which led China to focus on export-oriented industrialization.

So far, so good. Now, the second wave, children of first baby boom, is coming into the labor market at almost comparable magnitude. The Chinese government still has to create more than ten million net jobs every year. That is why they have been and will be sticking to the 8 percent GDP growth target. Obviously, they cannot abandon the current export-oriented policy and the fixed renminbi.

But here lies serious danger. As the Chinese government officially declares that it will try its best to achieve the 8 percent growth target, that will inflate the expected rate of return and create serious distortion in financial risk allocation on a macro basis. Overinvestment and financial bubbles are the natural consequences. Worse, China's monetary policy is constrained by the fixing of the renminbi to the U.S. dollar. As China has piled up a huge amount of foreign reserves, they now have much greater room for policy maneuvers to adjust their external balance than they did in the 1980s. Already the focus has begun to shift toward domestic consumption. But financial bubbles are growing. This is the most difficult situation China has ever faced.

Let us see whether Professor Fischer (now Governor of the Bank of Israel) remains sanguine.



Positive now, but uncertainty abounds.

CHARLES WOLF
Senior Economic Adviser, Distinguished Corporate Chair in International Economics and Professor, Pardee Rand Graduate School, RAND

China is already a regional growth engine. That most Asian countries (except North Korea and Myanmar) have, in the wake of the global financial crisis, managed to reach or sustain annualized GDP growth rates of 2 percent to 4 percent is partly due to China's own more-rapid growth and its increased imports from the rest of Asia.

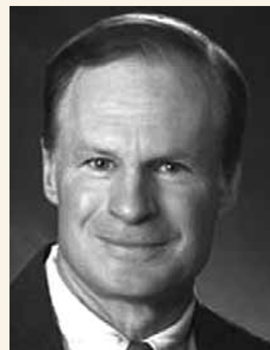
To what extent China can become a global growth engine is a harder question. Three factors favor an answer that's positive as well as large. The first factor is China's own high and continuing growth. A recent RAND meta-analysis of three dozen separate studies forecasting China's annual growth rate over the next decade provides a mean estimate of 6 percent. The implied expansion of China's domestic market is one factor tending to promote growth elsewhere, provided the market is open and competitive.

A second factor is China's current and growing investment abroad. Although its current account surplus (now about $350 billion annually) has decreased by one-third since 2007, it is still larger than that of the next three surplus countries combined. China's top policymakers explicitly envisage rising allocations of these resources for investments abroad (apart from continued purchases of U.S. government securities). Although China is inclined to devote a questionably large proportion of this investment to fossil fuels and mineral resources, its foreign investments will be a growth driver.

China's commitment at the G20 meeting in Pittsburgh to engage in substantial "rebalancing" efforts is potentially a third contributor. By boosting domestic consumption, rebalancing can provide a powerful stimulus to increased imports by China and export growth in other countries.

Of course, several brakes may slow China's growth engine. One brake is protection of the domestic market. A second brake is the inherent limit that rebalancing will place on the China's foreign investments. And the third and perhaps most constraining brake is uncertainty about how aggressively China will pursue rebalancing.

My bottom line about China's global growth engine remains positive, but, like most things pertaining to the future, uncertainty abounds.



A global growth engine needs to see beyond its near-term selfish interests.

CARL DELFELD
President, Chartwell Partners, and author of **Red, White & Bold: The New American Century** *(iUniverse, 2009)*

China's policies may spur domestic but not global growth. China's cash and credit stimulus over a year worth almost one-quarter of national GDP has produced a burst of growth, but what comes next?

The return on every marginal dollar invested in China is decreasing. In 2000, it took $1.5 of credit to generate a dollar of GDP, but by 2008 it took $7 of new credit to generate a dollar increase in GDP. The global macro picture will accelerate the China crisis because it will shine a spotlight on China's shrinking export markets and industrial overcapacity. Some examples of Chinese overcapacity are its steel capacity, equal to that of America, Japan, Russia, and the twenty-seven countries of the European Union all put together, and an aluminum capacity eight times larger than America's on a per capita basis.

In addition, China's exports grew at an average annual rate of 28 percent from 2002–08, but fell 15 percent in 2009. Despite the launch of the China-ASEAN free trade zone, China is being increasingly viewed even within Asia as a mercantilist competitor rather than a source of economic growth and opportunity. Its weak currency policy is causing weak export growth and manufacturing margins—hardly a sign of a robust growth engine.

The only option for maintaining 8–10 percent growth is stimulating Chinese consumption, but this is an engine that Beijing is reluctant to ignite because of the risk of losing control. Outside of commodities, buy-China policies will minimize imports of consumer goods and services. In any case, the largest jump in consumer spending by a country in one year was 12 percent in Japan in 1962.

A global growth engine needs to see beyond its near-term selfish interests. China does not.

So far China has emphasized import substitution and protectionism.

MARSHALL I. GOLDMAN
Senior Scholar, Davis Center for Russian and Eurasian Studies, Harvard University

Given its large population and its impressive work ethic, China has already become a global engine for growth. For example in 2010, it began to produce more automobiles than the United States. As large and as protectionist as China is, it can only produce this way by importing raw materials and components from outside its borders. So certainly producers of those raw materials will look to China for their export sales.

What remains to be seen, however, is whether China will use the wealth earned from these exports to buy value-added products from other countries as well. So far an emphasis on import substitution and protectionism has resulted in more limited purchases from other countries than might be expected from an industrial power of China's size.

But China is not the first industrializing nation to start out with a protectionist policy. Admittedly the Chinese seem to be more firmly committed to a high marginal propensity to save than was the case with consumers in other countries. But the odds are that with time, the Chinese will also be tempted to increase their spending, not only on domestically produced goods, but on imports as well. A visitor can only be impressed by the scale of consumption by the rich in Hong Kong, Canton, and Shanghai. Even in Beijing where it is politically risky to flaunt too much wealth, the new housing estates near the airport (just as near the Shanghai airport) are of a scale that would make even foreign millionaires envious. It may take a little more time, but as Thorstein Veblen would probably have argued, like the rich of other countries, the rich Chinese are likely to put a premium on the conspicuous consumption of foreign-made products. This is a universal human weakness, not just among those who are not Chinese.

A number of factors will limit China's role.

WILLIAM E. BROCK
Former U.S. Trade Representative, and former U.S. Secretary of Labor

No serious observer of China would ever underestimate its potential—much less the entrepreneurial instinct and capability of its people. Even so, there are a number of factors which could limit the ability of China to shift from its role as the world's largest exporter to one of the largest net importers. Simply put, the odds are good that Chinese GDP growth will compose a significant

part of global growth, but that is a long way from it becoming an "engine" of growth for the rest of the world.

Granted, there is an incredible demand for urbanization-driven infrastructure, and there is an equally large public demand for consumer goods. As a cautionary note, however, this surging demand may not automatically give foreign firms a marked advantage over China's highly adaptable and fast-on-their-feet domestic enterprises.

More fundamentally, shifting from an export-driven economy to one based far more on domestic demand will be easier when the government finally accedes to international pressure and allows the gradual appreciation of the renminbi to more realistic levels. Domestic, as opposed to export-driven, growth will also require a public with sufficient confidence to markedly reduce household savings in order to dramatically increase their personal consumption—easier said than done.

No matter how quickly the government in Beijing amends its policies to allow gradual appreciation of its currency, encourage domestic consumption over savings, and implement a more effective social safety net, these things take time. No leader can easily risk political or economic instability in a nation already moving at warp speed. Thus, China must for some time continue to rely on export-driven growth to employ the enormous surge of workers and their families from rural to urban communities.

Can China become a major engine of global growth? Yes, but I would not hold my breath.

China can only partially offset the increase in U.S. saving.

JOHN WILLIAMSON
Senior Fellow, Peterson Institute for International Economics

China's economy is sizable; one-half of the American economy in PPP terms, almost one-third even in exchange-rate terms. Its consumption is far smaller; one-quarter of that of the United States in PPP terms, and only some 16 percent in exchange-rate terms. So it would be unreasonable to expect China's consumption stimulus to offset alone the necessary increase in U.S. saving (let alone that and also the desired increase in saving in the United Kingdom, Spain, Ireland, and so forth). But it would be capable of providing a major part of the offset, and that is what it should be expected to do. Those who still look to the United States to pull the world economy out of the recession are living in cloud-cuckoo land.

The Chinese leadership has shown every sign of being willing to play their role in providing increased demand to replace that lost in the United States as the latter raises its savings rate. Up to now they have concentrated on stimulating investment demand rather than consumption, and if I were Chinese—certainly if I were one of the many poor people who still live in China—I would want to see them place far more emphasis on stimulating consumption, including by better social provision of things like education and health. But the important issue from the point of view of foreigners is that they stimulate demand in some form, and the rest of the world cannot fault them on what they have said, or so far done, on this issue.

I still take the view that it is desirable that China should accompany this with a substantial revaluation of the renminbi, which they have said very dogmatically that they have no intention of doing. The tactic of the rest of the world should therefore be to get China to calculate how large an expansion of demand (over and above that which holds the pressure of demand constant) is desirable, and hold them to it. When the fulfillment of this pledge proves incompatible with the maintenance of price stability in China, as it surely would, then the Chinese may come to view revaluation as in their national interest. It will be a pity if China suffers some unnecessary inflation in the process, but this is the price of having obstinate leaders who still suffer from elasticity pessimism.

View China with cautious optimism.

HONGYI LAI
Lecturer, School of Contemporary Chinese Studies, University of Nottingham

China is an increasingly important engine for global growth. This is so because China's high economic growth is likely to continue and outperform most if not all of the other developing nations, whereas much of the developed world is struggling with economic recovery

in the coming year. By default, China's contribution to the increase in the world economic output will be significant.

China's high growth can continue. Its level of economic development is probably equivalent to that of South Korea about twenty years ago. While South Korea could manage to grow rapidly for at least another decade until it became a newly industrialized country, so can China. China's vast size and domestic markets can serve as its additional advantage.

China's data reveal that consumption and investment have been two primary sources of growth, followed by net exports. It is true that China's growth is significantly based on government investment and fiscal stimulus. However, less government action could entail bigger risks for the economy in China, such as mass unemployment, mass bankruptcy, and sluggish growth. In addition, unlike many developing countries, China's financial system, despite its flaws, is insulated to some extent from many external risks through the control of capital movement and "managed float" exchange rate.

Finally, the government has learned to manage risks prudently and combat macroeconomic imbalance. In the past year, the government stimulus package has helped spur sales of big-ticket items such as small cars and home electronics in interior cities and the countryside, the backwaters of China's domestic consumption. Thus, governmental subsidies serve to overcome the bottlenecks in domestic consumption. Furthermore, the government has recently introduced regulations to restrain the growth of bubbles in the rapidly heating real estate markets. For these reasons, we can view China's economy with cautious optimism.

For now at least, China is not up to the task.

CHI LO
Head of Overseas Investment, Ping An of China Asset Management

The subprime crisis has presented an unintended opportunity for China to elevate itself further and faster to become a global growth driver, or even a superpower, as some have argued. But is it up to the job? Not for some years yet, in my view.

China's "law of large numbers," with over 1.3 billion people, a huge land mass, and massive US$2 trillion foreign exchange reserves (as of January 2010), does not mean that it could save the world after the global crisis. In absolute terms, China is a big economy. But its growth quality has yet to be improved and maximized. Thus, it only commands a marginal role in the global demand stage rather than being an absolute driver.

For example, China consumes about 7.5 million barrels of oil a day, compared with 49.2 million barrels in the developed economies. When global demand fell during the global credit crisis, every 1 percent drop in the developed world's oil demand would require a 6.6 percent increase in Chinese oil demand just to offset it. It is clearly unrealistic to expect China to pick up the global slack in the post-bubble economic adjustment period.

It is equally unrealistic to expect Chinese consumption to pick up the American slack and help pull the world economy back to normal growth, because the scale of the adjustment is beyond the capacity of China to deliver. For example, a fall in U.S. consumption amounting to 5 percent of GDP (which is a low estimate, given the scale of damage from the subprime crisis) would require a rise in Chinese consumption amounting to 17 percent of China's GDP. To achieve this, Chinese consumption growth would have to reach 40 percent a year; a clear impossibility. Structural change turning China into a consumption-driven economy will take years to complete.

The Chinese economy is too dangerously unbalanced.

JOHN LEE
Foreign Policy Research Fellow, Centre for Independent Studies (Sydney), Visiting Fellow, Hudson Institute, and author,* Will China Fail? *(2007)

China cannot become a reliable and sustainable engine for regional, let alone global, growth until it shifts to an economic model that significantly promotes domestic consumption—thereby correcting domestic economic imbalances, increasing the living standards of its citizens, and creating new markets and opportunities for other economies. Unfortunately, there is a direct rela-

tionship between its reliance on state-led fixed investment and exports on the one hand, and suppressed domestic consumption as well as economic and social dysfunctions on the other.

Private sector consumption in China remains suppressed for a couple of main reasons. First, China's state-led model of development breeds inequality, meaning that across-the-board incomes over the past decade have risen three times slower than economic growth while over 400 million people have seen their net incomes stagnate or decline since 2000. For example, of the US$1.5 trillion in loans extended in 2009, an estimated 80–90 percent was destined for centrally and locally managed state-controlled enterprises. This means that a relatively small number of well-connected insiders benefit while the approximately 40 million private enterprises employing the lion's share of the working population lack sufficient capital to grow and are left to fight for the scraps. This is despite the fact that the private sector is around three times more efficient in using capital and twice as efficient when it comes to generating jobs.

Second, Beijing's currency policy of pegging the yuan to a "basket of currencies" (dominated by the U.S. dollar) makes imports relatively expensive for its citizens. Yet Beijing will continue to support the export sector through currency policies in addition to subsidies and tax breaks, because the export sector is effectively covering for the weaknesses in the state-controlled sector when it comes to job generation and corporate innovation.

China has a strong and rich state sector but a weak private sector and poor citizens. Until Beijing and the Chinese provinces decide to release their grip on the levers of economic power—not likely without turmoil—the Chinese economy will remain dangerously unbalanced and offer disappointingly few opportunities for foreign businesses.

"The strong yuan is in China's best interests." Of course.

ANDREW SZAMOSSZEGI
Principal, Capital Trade

China can be the world's engine for growth, but it won't be easy. First, China must abandon the policy of undervaluing the yuan. Instead, Chinese financial officials should embrace the slogan, "The strong yuan is in China's best interest."

Second, China must raise its average manufacturing wage tenfold. Third, China must improve and enforce environmental laws. Fourth, China must embrace free trade as never before. It must reduce average tariff rates to about 2 percent, and then sign free trade agreements with low-wage countries that have weak environmental standards. At this point, many Chinese manufacturers will decide their only hope of overcoming competitive disadvantages is to fire high-wage Chinese workers and invest in low-wage countries with weak environmental standards and high tariffs.

While these four steps should be sufficient, China's leaders may need to deal with producers reluctant to fire their domestic workers, to placate the workers who have lost high-paying jobs, and to convince the rest of the country that job dislocation resulting from these import-promotion policies is more than offset by lower prices.

So fifth, Chinese planners should create a massive state-owned retailer who threatens to exclude from store shelves the products of firms too slow to fire their domestic workers. This retailer would provide cheaper products to the growing number of economic "have-nots," thereby easing the consciences of the "haves." Sixth, China should revamp its financial system to direct capital away from Chinese companies and toward Chinese consumers, who must now consume more than they produce. Workers in the financial industry should be handsomely rewarded for this unprecedented misallocation of capital.

Seventh, Beijing should adopt deficit-spending measures, enabling taxpayer dollars to purchase even more imports when the hollowed-out Chinese economy falls into recession. That should do it.

The arithmetic doesn't work.

GARY CLYDE HUFBAUER
Reginald Jones Senior Fellow, Peterson Institute for International Economics

Thanks to strong infrastructure and sound policies, China can grow at 8 percent to 10 percent annually for at least the next decade—without breaking a

sweat. That pace will fuel all sorts of hype characterizing China as the world's new growth engine.

But the arithmetic doesn't work. Suppose China surprises everyone and substitutes domestic demand expansion for export-led growth. Suppose, as a result, that the Chinese external position shifts from an average current account surplus of $250 billion to an annual current account deficit of $250 billion over the short space of five years. That amounts to a net demand stimulus, for the rest of the world, averaging $100 billion annually. What's $100 billion in a $60 trillion world economy? A rounding error.

Current policies will undermine China's role as global engine.

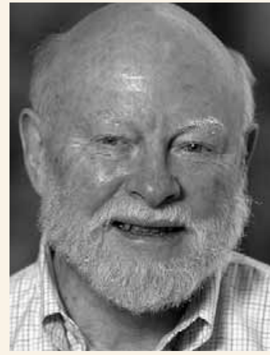
CATHERINE L. MANN
Professor of International Economics and Finance, Brandeis University International Business School, and Senior Fellow, Peterson Institute for International Economics

Current policies promote resource misallocations within China toward saving, exports, dirty industries, and real estate. Until policies are redirected, and likely even if they are, China will not achieve its potential as an engine of global growth, nor will its citizens fully enjoy the fruits of its rapid growth to date.

First, the sustained renminbi policy has undervalued labor-intensive services that could generate substantial and more geographically balanced domestic employment, economic activity, and household consumption. As the renminbi is allowed to adjust more freely (which is inevitable), the excessive resource allocation toward exports, energy-intensive manufacturing, and coastal real estate unavoidably will unwind more quickly than services and inland investment can take hold. The resulting concentrated unemployment and financial distress will take the wind out of China's sails as a source of global growth. A policy of measured change in the renminbi does not alter the fact that resource misallocations unwind at a cost.

Second, even though China's demographic transition is a clear and not-so-distant danger, government spending continues to focus on hard infrastructure rather than developing the social infrastructure of health care and the labor safety net. The stunning decline in the consumption share of GDP already undermines China's role as a global growth engine. Even if China redirects government spending toward social infrastructure (which even in the best of situations changes household behavior only slowly), the rise in the share of relatively older people implies a pattern of spending on relatively less tradable economic activities, thus eroding China's support for global growth through trade.

In sum, even if policy toward the renminbi and government investment changes (and there is limited evidence of either), the inevitable costly adjustment in the externally oriented economic activities and rising share of relatively older people will undermine China's role as an engine of global growth.



Pollution and the one-child policy remain obstacles.

RONALD MCKINNON
Professor Emeritus of International Economics, Stanford University

Coming out of the credit crunch and global downturn in 2008, China has become the current global engine for growth. China's massive "fiscal" (but really bank-financed) stimulus announced in November 2008 has buoyed its domestic demand sufficiently to offset the huge 50 percent (peak to trough) fall in its exports. Other Asian economies are ramping up their exports to China, and the door is open for more exports from Europe and the United States.

China's massive internal saving, most recently from a surge in enterprise profits and government revenue, combined with closer control over the banks, gives it flexibility in redirecting the flow of finance within the economy without building up huge, possibly unsustainable, government debt. Although perhaps overinvesting in some forms of physical capital, China has built up its human capital most impressively: spreading basic literacy while turning out very large numbers of highly qualified scientists and engineers.

China has an interim pollution problem as large numbers of people migrate from agriculture into industry—but that migration may well be ending because younger people

have been largely absorbed. To compensate, China is at the forefront of developing green technologies, from photovoltaic cells to nuclear power.

Chinese technocrats should be commended for generally wise decisions in steering the economy. The one dark cloud (apart from pollution!) that could stunt the country's future growth is its one-child policy. However, this makes their unwillingness to abolish Deng Xiaoping's one-child policy (circa 1978) even more inexplicable.

There are many reasons for optimism.

CHEN ZHAO
Chief Global Strategist, BCA Research Group, and Managing Editor, BCA Global Investment Strategy

I am very optimistic about the long-term prospects for China's economic growth. Some say that the country "will grow old before it grows rich." The demographic trend, if it persists, is indeed somewhat worrisome, but demographers should not forget another very important fact: China is a poor and developing country where labor productivity growth is mostly generated by labor migration from rural areas to the industrial sectors, while labor force growth plays a very small role (if not negative role in terms of increasing per capita income) in creating economic growth. China still needs to move 300 to 350 million people from its countryside to its cities, and the migration of these vast "surplus laborers" will buy China another twenty to thirty years of high labor productivity growth, even with zero population growth. Besides, the Beijing government is beginning to relax its one-child policy in major cities in an effort to front run the potential problems caused by an eventual exhaustion of this "surplus labor," perhaps twenty or thirty years down the road.

Another reason for optimism is the emergence of consumer spending as a key driving force for the economy. Conventional wisdom suggests Chinese consumers have consumed too little, and saved too much. This is a misperception. China's gross national savings rate is about 50 percent of GDP. However, the household savings rate has stayed rather steady for the last ten years, ranging from 20 percent to 23 percent, or roughly same as India's. A key factor that has kept China's gross national savings rate at very high levels is corporate savings, which currently stand at 23 percent of GDP, although the government sector has been a big saver as well, adding a net 4 percent to gross national savings.

There are complex reasons why China's corporate-sector savings rate is high, but it is wrong to think that the Chinese have only saved, not spent. For the last ten years, the average consumption growth in China is 15 percent in real terms, faster than any other country. Similarly, both the corporate sector and government have sustained a persistent, large-scale capital spending boom to modernize China's business and economic infrastructures and they have done so without borrowing a penny from abroad.

Two final points. First, both Chinese consumption and capital spending are equally good for the rest of the world, as they all form final demand. Second, it is far more prudent for China to finance its industrialization by using its domestic savings rather than borrowing from abroad. Therefore, those who argue that "China has saved and invested too much" are missing the point. As long as China continues to save and invest, its economy will continue to outgrow others. This is Economics 101 and a proven successful strategy by many industrialized nations.

China is still running on investment-led economics.

DANIEL H. ROSEN
Principal, Rhodium Group, LLC, Visiting Fellow, Peterson Institute for International Economics, and Adjunct Professor, Columbia University

China can become a engine for global growth, but so far it has not made the policy transition to do so. China is still running on investment-led economics, which pull in plenty of resources here and now, but deplete growth in the future as returns on capital diminish. How can there have been $1 trillion in high-return investment opportunities just overlooked in the past, which are now so easily approved for investment? There weren't. The newest crops of investment projects are increasingly questionable, otherwise they would have been the first to get stimulative lending, not the last.

China's demographics are not the problem, they are the solution. Though the total population is peaking, most are rural; urban, modern China has decades to grow. However, the luxury of building up ever-larger trade surpluses is, like the era of easy increasing returns to investment, over. For China's urbanization to drive domestic growth, let alone make a meaningful contribution to global growth, policy must support the emergence of a consumer-driven China. There are only two things you need to watch to see if that is going to happen. First, wage-paying, labor-intensive businesses will need to be offered the same risk-adjusted price for leverage that state enterprises enjoy (instead of two to six times that rate). And second, the nearly $3 trillion in savings hoarded by enterprises (instead of distributed to shareholders) and government (instead of spent on public services like healthcare) will need to be turned back to households to promote spending. For Beijing to say it will make the adjustments needed to promote this, but only after export-led growth returns to past trends, is unreasonable and irrational.

Beijing needs to make the necessary reforms.

DIANA CHOYLEVA
Director and Head of UK Service, Lombard Street Research

China has the potential to become the world's growth engine if Beijing makes the necessary reforms to unleash consumer spending and to invest the nation's savings efficiently. China has become the world's manufacturing hub, but the emergence of its consumer remains an illusion. The share of household consumption in output has declined to 35 percent in 2008 from 46 percent in 2000. China saves excessively, more than half of income, making it difficult to develop a mass consumer market. Savings are high for structural reasons: the lack of proper provision of social security, pensions, and health care, and the inability or unwillingness of the mostly state-owned banks to lend to household and private firms.

China's growth has been fuelled by exports and wasteful investment. The investment rate rose to an unsustainable 44 percent in 2008. If China's trend growth rate is assumed to be 10 percent and the profit share of income to be 40 percent, the gross return on capital is 9 percent, which after depreciation leaves nothing for net return. China was able to save and invest excessively without plunging into demand deflation because there were other willing borrowers and spenders. In a world of deficient demand, China's mode of expansion can only be achieved at the expense of other countries' growth.

The best policy for Beijing is to allow the yuan to move freely and to open up the capital account. An appreciating currency will raise incomes and wealth and lower the desire to save. Unless China generates its own consumption, the huge size of its economy is a disadvantage. China is exhausting its catch-up growth potential fast. At purchasing power parity, output is already 55 percent of America's, twice Japan's ratio in the 1970s. Generating wasteful industrial capacity or building "roads to nowhere" is neither helping China nor the rest of the world.

China is already the leading contributor to global GDP growth.

PAUL J. ALAPAT
Managing Director, Amba Research

To a large degree, and particularly since the Great Recession, China is already the leading contributor to global GDP growth. This contribution will grow even more as the Chinese population ages, and there is an inevitable diversion of household incomes to greater consumption spending. Public funds will increasingly power domestic capital formation as China catches up with the industrial world, and builds up its stock of physical infrastructure. The demands of social stability in China, furthermore, will demand that a certain minimum rate of GDP growth is achieved every year even at the risk of excessive public investment.

The immediate question, then, is not about the quantum of China's growth, but about its quality and sustainability. That presents the main danger as the global economy latches onto the coattails of China for incremental demand generation. Rapid growth, anywhere, creates internal frictions as the rewards from rapid economic transformation are never equally, nor fairly, distributed. And when such economic redistribution takes place within a system of poorly devel-

oped and institutionalized checks and balances—an independent judiciary, well-entrenched property rights, a free press—the dangers become magnified.

Excessive credit growth, subsidized cost of capital, an undervalued currency, and centrally directed resource allocation will create mispricing and sustained shifts away from fair value. As with bubbles anywhere in the world, it is not a question of if, but when the asset bubbles in China burst. When that happens there will be damage to the country's banking system and a material disruption to growth.

Lastly, once a certain threshold level of per capita income is reached, economic freedom requires political freedom for a stable civil society. The uncertainty of that transition still lies ahead of China.

Is China willing to take steps to correct its market factor distortions?

CARLA A. HILLS
Chair and CEO, Hills & Company, and former U.S. Trade Representative

Last year, China grew by close to 9 percent, maintaining its position as the world's fastest growing economy, far outpacing the level of economic activity in the industrialized world. This year, China is likely to replace Japan as the world's second-largest economy and as the world's single-largest trading nation. Over the last half decade, its purchases of food and natural resources from countries in Africa, Asia, and Latin America have contributed to the substantial uptick in their growth, helping to insulate them from the full brunt of the recession of 2009. Today China is a global engine for growth.

The important question is whether China can continue in that role. The answer depends on whether China is willing to take steps to correct its market factor distortions that result in gross under-pricing of land, energy (electricity and fuels), capital, and water. Doing so would right the imbalances in its domestic economy that are widening the wage gap between urban and rural workers. It would discourage excessive investment, particularly in heavy industries like iron and steel.

Incredibly, the five most energy-intensive industries in China account for over 40 percent of its energy demand and create most of the pollution, yet employ fewer than 2 percent of China's labor force. According to China's Ministry of Environmental Protection, environmental degradation costs the nation between 8 and 13 percent of its GDP. A more balanced domestic economy would boost opportunities for China's small- and medium-sized enterprises, create jobs, stimulate domestic consumption, and reduce environmental degradation that is the cause of some 750,000 deaths in China each year. In addition, domestic rebalancing would contribute measurably to rebalancing the global economy, which would help guarantee China's future growth and ensure that it continues as a global engine for growth.

It all depends on what you mean by an engine.

RICHARD KATZ
***Editor,* The Oriental Economist Alert**

It all depends on what you mean by an engine. Typically, people mean playing the role that the United States has played: running a big trade deficit that injects demand into the global economy. China has no intention of becoming a trade deficit country; the Asian financial crisis of 1997–98 made Asia fearful of being so vulnerable to the whims of hot money flows.

Beijing does intend to rebalance its growth by boosting consumer spending as a share of GDP so that it is not so reliant on a mammoth trade surplus. During the 1990s and early 2000s, its trade surplus averaged a reasonable 2 percent to 3 percent of GDP. Then, suddenly, its trade surplus exploded, going from 2.5 percent of GDP in 2004 to around 9 percent in 2007. As a result, in 2005–07, the rising surplus drove 20–25 percent of all GDP growth. The implosion of Chinese exports in 2008 due to the U.S. recession shows how unstable that reliance can be. Beijing's rebalancing efforts, if successful, will lower the trade surplus relative to GDP, but will not turn that surplus into a deficit.

In another, completely different way, however, China is already an engine of growth and will be increasingly so over the coming decades. Adam Smith famously wrote that productivity is a function of division of labor, which, in turn, is limited only by the extent of the market. Trade extends the

market. It boosts productivity growth by enabling each country to specialize in what it does best, by enabling industries even in small countries to achieve competitive economies of scale, and by exposing companies to healthy competition from the world's best. That's why countries that trade more—that is, have a higher trade-to-GDP ratio adjusted for population size—tend to grow faster.

China is usually thought of as an export superpower, but it is also an import superpower. Both roles enhance the global division of labor. Back in 1978, when Deng Xiaoping's reforms began, China's share of world trade was only 0.7 percent. By 2008, its share of world merchandise exports was up to 9 percent and, at 7 percent of global imports, it was just slightly behind Germany as the world's third-largest importer. Moreover, 80 percent of its imports are manufactured goods, and these manufacturing imports now add up to 20 percent of Chinese GDP. That's far above the 7 percent figure for Japan, 10 percent for the United States, and close to the 23 percent ratio for Euroland. A very high proportion of China's own exports and domestic consumption contain manufactured inputs from other countries.

If China can bring its trade surplus back to a reasonable level, then, just by sustaining its own growth and high trade-to-GDP ratios, China will aid the growth and development of its trading partners.

China's economic growth ascendancy is overblown.

GARY KLEIMAN
Senior Partner, Kleiman International Consultants

China's economic growth ascendancy is overblown given the mainland's laggard status as an equally advanced and integrated global financial market. State-directed lending has resulted in regular banking crises and rescues, with the non-performing asset overhang from the 1990s due to join a fresh chunk from the current consumption/investment stimulus programs. On the A-share market in Shanghai, government ownership dominates listings, and foreign participation remains confined to a quota scheme that is a tiny fraction of its multi-trillion dollar capitalization. B-shares have been shunned due to illiquidity, and the new Chi-Ex small-company exchange designed to revive Shenzhen has regulators who could advocate a stricter regime warning of limited disclosure and bubble-like speculation there as well. Local corporate and government bond markets are also inaccessible, and municipal and state enterprise issuance has mushroomed as part of the recent credit boom which officials may be unable or unwilling to fully guarantee. Derivatives development has been glacial compared with other big emerging markets such as Korea and Brazil, whose exchanges now top world rankings, and authorities have allowed domestic counterparties to renounce private contracts with international providers. By virtue of its size and commodities demand, China has become a dominant economic force, but when measuring financial system scope and sophistication, other developing countries may be just as equipped to assume locomotive roles.

China first needs to revalue its currency.

ERNEST H. PREEG
Senior Fellow in Trade and Productivity, Manufacturers Alliance/MAPI

China will become a global engine for growth, but the timing depends on the restructuring path to more consumption-based growth, including major currency appreciation. This is an enormous policy challenge which has not yet been adequately addressed.

The challenge is to increase domestic consumption from about 35 percent of GDP to 50 percent, while reducing the trade surplus. The initial recovery path, however, points to resumed export-led growth. Chinese exports of manufactures rose by 33 percent between the first and third quarters of 2009, while the trade surplus in the third quarter—the first quarter of global recovery—was up by \$18.8 billion, or 21 percent, compared with the second quarter. A similar increase in the surplus is likely in the fourth quarter.

There will be little Chinese direct impact on U.S. growth. U.S. manufactured imports from China are more than six times exports, and only 5 percent of global U.S. exports go to China. This means that even if U.S. manufactured exports to China grow 20 percent in 2010, it will only amount to 1 percent growth in global exports.

A substantial revaluation of the Chinese currency, in addition to reducing the external surplus, would also strengthen China as a global engine for growth. A 50 percent revaluation would mean 50 percent larger GDP in dollar terms and thus greatly increased imports as a generator of growth abroad.

The outlook is that China is heading back to excessively export-led growth, which conflicts with the G20 framework for balanced, sustainable growth. This will increase pressure from others for China to revalue its currency and take further steps to achieve more balanced growth. Only when this actually happens will China rise to become a global engine for growth.

RICHARD DOBBS
Director, McKinsey Global Institute, and Director, McKinsey & Company, Seoul

JONATHAN WOETZEL
Director, McKinsey & Company, Shanghai

Only if the Chinese economy is rebalanced.

The longer-term answer to this question—at least outside commodity sectors—depends on how much the Chinese economy rebalances toward consumer expenditure.

With private consumption at over $1 trillion, China is already the world's fifth-largest consumer market. However, China's consumers still punch far below their weight. As a share of China's GDP, consumption stands at only 36 percent—only half the share in the United States and two-thirds that in both Europe and Japan.

Long before the recent global economic downturn, China's leadership had recognized the need to move its investment- and export-centric economy toward consumption. Making this shift will not be easy, requiring sustained and sweeping reforms to finance and industrial policy to stimulate consumer spending directly and increase household income and employment. The McKinsey Global Institute projects that China could boost the consumption share of the economy to more than 50 percent of GDP by 2025 from the 39 percent we would expect without policy action. China would account for more than one-quarter of all new consumption worldwide over the next fifteen years, adding more than 10 percent to the growth in global consumption. That would pick up a significant amount of the slack left by slower U.S. and European consumer spending. However, even in this case, China will not replace the United States as the world's largest consumer: China's consumption would reach 40 percent of U.S. consumption, up from only 12 percent today.

The nature of China's state-run system allows the central government to implement investment-oriented policy initiatives rapidly—China started spending the stimulus package announced in November 2008 within the same quarter. Spurring consumption, however, will require systemic reform, which may take longer to realize.

For now, China is still too small to serve as a global locomotive.

GEORGE HOGUET
Global Investment Strategist, State Street Global Advisors

China impacts the global economy through multiple channels: trade and commodity; global monetary; investment; environment; and emerging market policy leadership and co-ordination. In the long term, as has been said, "It is not a question of whether China will change the international system, but how."

But in the short term, even though China will soon surpass Japan as the world's second-largest economy in nominal GDP terms, it is still too small to serve as the global growth engine. Annual personal consumption in China is roughly $1.5 trillion versus $9.8 trillion in the United States. China's consumption is growing rapidly (auto sales in China exceeded U.S. auto sales last year), but the structure of output in China is distorted by China's exchange rate regime. Rebalancing the Chinese economy will take several years, and will require difficult political as well as economic choices.

In the intermediate term, say ten years, China will become an increasingly important contributor to global growth, provided it progressively but prudently liberalizes the economy. China's ongoing large acquisition of reserves exacerbates distortions in the economy and is likely to lead to growing trade (and possibly investment) frictions. China's capital account liberalization will be one of the major developments in global capital markets in the next ten years. But with M2 currently growing in excess of 25 percent per year, if the experience of other countries is any guide, China may face large nonperforming loans in the next few years and significant excess capacity.

Chinese policymakers have been extremely skillful in responding to the various shocks in the world economy over the past twenty years. But for China to become a sustainable global engine for growth, the development model it has pursued so successfully so far will have to evolve rapidly.

The proposition that any single country can drive global growth is dubious.

RICHARD JERRAM

Head, Asian Economics, Macquarie Capital Securities

Industrial output and exports for most Asian economies are close to, or above, pre-crisis peaks. Output in China is hitting new highs each month, and the disruption in late 2008 was brief and relatively limited. However, G3 imports are still about 15 percent below peak levels, so something else has driven the Asian revival. China is part of the story, but the policy response in the various economies across the region has been the major factor.

The proposition that any single country—even one as large and as fast-growing as China—can drive global growth is dubious. It also seems contradictory to think that a country with a deliberately undervalued currency can be driving global growth. For most countries, it is internal policy settings and structural issues that determine the bulk of economic performance. China can help—and has already been helping over the past year as it has sucked in Asian imports—but it is not a substitute for sensible domestic policy. Exports to China have not been the main factor behind the rapid growth rate of the Indian economy in recent years, just as a 20 percent rise in exports to China has not prevented nominal GDP in Japan from falling 6 percent over the past five years.

Mathematically it seems inevitable that China will make the largest contribution to global GDP growth over the coming year, as its sheer size combines with a near-10 percent growth rate. But that is not the same as being the engine for global growth.

Already China is an engine, but not the engine.

ALLEN SINAI

Chief Global Economist and Strategist, Decision Economics

China is already a global engine for growth! It is not *the* engine, but an engine, along with the United States, and Asia generally, for global economic recovery and expansion.

The U.S. and global downturns of 2007–09 have turned to recoveries in 37 of 47 countries analyzed and forecasted by Decision Economics. China is in a "V"-like pickup with real economic growth up 10.7 percent year-over-year in the fourth quarter of 2009 from a trough of 6.1 percent in the first quarter. Sharp "V" upturns are likely to occur in a number of Asian countries as well, from 2009 to expected real growth in 2010—South Korea (0.3 percent to 6 percent), Taiwan (5.1 percent to 5.9 percent), Hong Kong (5.5 percent to 6.6 percent), Singapore (2.1 percent to 7.7 percent), Malaysia (2.2 percent to 5.8 percent), and Thailand (2.8 percent to 5.1 percent).

China's real economic growth is expected to easily exceed 10 percent in 2010, up from 8.7 percent in 2009. But it is the upturn from the trough and impacts on Asia, directly, and then indirectly for the rest of the world that has made China a global growth engine. As the third-largest economy in the world, soon to become the second, Asian economies, and thus the world economy, are benefiting from the Chinese upturn.

The transmission channels for China as a global engine of growth include—

■ Trade flows—enhanced and increased for all countries who are major exporters to China, particularly Japan and South Korea, the second- and fifteenth-largest

economies in the world. Increased Chinese economic growth means increased exports for these countries, then increased exports for most all other Asian economies;

- Commodities prices and commodity-export countries—rising commodities prices, particularly industrial, agriculture, and crude oil, which increases the nominal exports of commodity-producing export economies; in many instances developing countries;
- Financial markets—increased economic growth and earnings spell higher stock prices; in turn, a stimulus to private sector spending, more or less depending on the country.

The United States most certainly also is a global engine of growth, having exited from its recession, with real GDP up 2.2 percent in the third quarter and near 4 percent in the fourth. In 2010, a 2.5–3 percent gain in real GDP is expected, a good-size swing from 2.5 percent in 2009. As the largest economy in the world by far, almost by definition the United States is a global engine of growth.

But a changing global economic geography with growing size and importance for China, India, Asia *ex* Japan, and other emerging or developing countries finally has resulted in a situation where the United States is no longer the only global engine for growth.

Is China's global growth engine transitory or permanent? Most likely, it is permanent given current economic trends and prospects, financial markets prospects, increased flows-of-funds and investments outside the United States, a changing distribution of global wealth and income that is moving East from West, and the changing global economic and political lineup, such as the G20 instead of G7.

Not for at least ten years.

YOSHIHIRO SAKAI

Senior Advisor, Development Bank of Japan, and Adjunct Fellow, Center for Strategic and International Studies

China can become the global engine for growth but it will take ten more years. If global market enthusiasm towards China is based on the growth seen in western and inland China, it is definitely the latest form of "irrational exuberance."

Economic growth will not appear across the entire nation at once. Growth in China, if you will, metastasizes from one densely populated area to another—case in point: the Zhujiang Delta in the 1990s, the Yangtze Delta in the 2000s and, probably, Bohai Rim in the 2010s. After the Lehman shock, economic growth in western and inland China outpaced other areas as huge public investment flowed in. The population in each of these areas is greater than that in any European country, but the important issue is that the population in these developed and urban areas amounts to less than 20 percent of the national population. This means that many Chinese still live in undeveloped and poorer conditions. Therefore, the Chinese government should maintain an export-led economy.

We should also understand that comparing China and Japan is like comparing apples and oranges. Japan is a global engine. China, on the other hand, holds the most non-U.S.-owned Treasury bills, but given China's great population, the per capita share of Chinese citizens is much less than that of the Japanese. According to the Human Development Report of the United Nations, China is ranked ninety-second (below Albania or Dominican Republic). China needs more money to take care of its people and the associated risks of failure are that much greater. There are some minority issues such as those surrounding the Uighur people and Tibet, as well as problems stemming from increasing wealth disparity.

China can only shift into a consumption-oriented economy once it has addressed and gotten under control its issues relating to population, territory, and poverty issues.

New migrant reforms could play a role.

SASHA GONG

Candidate for the 46th District of the Virginia House of Delegates, 2009, and author,* Born American: A Chinese Woman's Dream of Liberty *(Nimble Books, 2009)

The interdependence between China and the industrial world has shaped the new global economic order. Facing difficulty stimulating domestic consumption, the Chinese have relied on massive exportation and on lending their huge reserves of savings to the West, both of which

have encouraged overconsumption in the West. Will this model continue, or will China be able to transform itself into to a consumer-oriented society? This depends largely on whether China can build a functional social security system.

On December 23, 2009, the PRC State Council announced that beginning in 2010, migrant workers—the vast majority of the labor force of China's export-oriented industries—would be allowed to carry most of their social security funds if they leave their jobs or move across provincial boundaries. Before, they were allowed to take only their own contributions—8 percent of their wages—compared to their employers' 20 percent share. This new law, together with other reforms, may alter the dynamics of the development model that has been fueling growth in China and the prosperity in the world.

Failure to stimulate domestic consumption among low-income people has come in part from an inadequate social security system. Two hundred million migrant workers who work, live, and pay taxes in urban and industrial areas have been expected to move back to their poor villages and leave behind the wealth they created, including the lion's share of their social security fund.

The new reforms have the potential to increase domestic consumption for the long run. If they succeed, we should see a steady transfer of wealth from rich to poor areas, and a more secure future for millions of working families, which will bring about a boost of domestic consumption for which China has been longing.

With continued economic reform, China will likely continue as a major global growth engine.

DANIEL T. GRISWOLD
Director, Center for Trade Policy Studies, Cato Institute, and author,* Mad about Trade: Why Main Street America Should Embrace Globalization *(Cato, 2009)

If the Chinese government sticks to the path of economic reform, its economy could grow strongly for years and even decades. Combined with its huge population, China's expanding economy will likely continue as a major engine for global growth.

In the decade leading up to the recent recession, China accounted for about 20 percent of global growth. That share jumped during the global recession, but will probably fall back again as the rest of the world recovers and the effect of China's own stimulus spending wears off.

For the next couple of decades, China's contribution to global growth could rise to nearly one-third. The key to China's sustained growth will be economic reform, including ever-lower barriers to trade and foreign investment; closing of remaining state-owned enterprises in favor of private companies; a banking system driven by market decisions, not political dictates; increased private land ownership; and the continued migration of workers from the countryside to faster-growing urban centers. An additional source of growth should be a greater emphasis on domestic demand and less on exports.

Limiting China's growth will be its aging population and more slowly growing workforce because of its one-child policy. Its growth rates will also inevitably fall to levels more sustainable for a middle-income economy.

All this makes it likely that China will remain an engine for global growth, but it is unlikely that it will ever be the lead engine for global growth. Even after three decades of reforms and spectacular growth, China still accounts for only 11 percent of world GDP. The mega-economies of the United States and the European Union and emerging economies such as India and Brazil will continue to account for most of the world's growth even if China maintains a healthy growth rate for decades to come.

Its investment must increase relative to its saving.

BERNARD CONNOLLY
Managing Director, Connolly Global Macro Advisers

A major concern of the Chinese government is, while avoiding socially disruptive inflation, to maximize the absorption of surplus labor by the modern sector via fast growth. But in a still-poor economy with distorted demographics and little social insurance, precautionary saving is high, largely as a buffer against the uncertainties of old age. Thus output growth has depended on high, and largely export-oriented, investment rates and on an undervalued exchange rate. To put it another way, the relevant real interest rate in China is

probably below the trend real growth rate, suggesting dynamic inefficiency (and over-accumulation of capital). Raising the real interest rate to match the potential growth rate would produce a substantial appreciation of the currency (and an expected subsequent trend real depreciation), but the resulting "liquidation" would crush levels of output and employment: there is a deep-seated structural problem. And as long as this situation persists, China will continue to be a drag on growth in the rest of the world.

For China to become an engine of growth for the rest of the world, its investment must increase relative to its saving. Saving would have to decline very substantially for that to happen without adding to a capital expenditure bubble. The major factor must be demographics. As the ratio of retirees to workers in China rises steeply, the policy focus of the government will shift to ensuring that retirees can maintain acceptable levels of consumption. Consumption should rise relative to output. That is helpful for rest-of-world growth. But retirees will want to run down the financial assets they built up against the contingency of surviving into old age. If the government allows them to do that by running down its stock of foreign exchange claims, an implicit assumption on which the global Ponzi game has partly been based will be falsified: another terrible financial crisis could result. If instead the Chinese government were to tell its retirees that their savings had been given to the rest of the world, there would be severe social and political tensions.

We're making a lot of assumptions.

WILLIAM M. CALDWELL IV

Chairman and CEO, Advanced Cell Technology, Inc.

China's economic growth appears inevitable for the foreseeable future. Influencing its economic future are two intertwined potential "bubbles" that have become the subject of much debate. The first bubble involves the near-term implications of a possible overheated economy fostered by unprecedented government stimulus coupled with unfettered bank lending. The second is a vulnerable authoritarian regime promoting its self-interest through such measures as exchange rates and carbon emissions while ignoring the interest of its trading partners and the adverse impact their actions wreak on domestic social harmony.

China possesses the ingredients to insulate itself from any prolonged detour from sustained economic growth. With half the population poor and agrarian but unceasingly shifting to factories, per capita GDP at one-tenth that of the United States, and continuing government investment in infrastructure and favored industrial sectors, China's public policy mandate for 8 percent annual growth would appear sustainable for the next several decades. A "rapid growth scenario" moderates any near-term economic hiccup in which asset prices can decline but quickly regain value. Any near-term excess capacity can be more readily absorbed via increased domestic demand. Bad loans are more manageable to work out given time.

China's "charmed diplomatic offensive" promoting peace, prosperity, and prestige abroad is undermined by its policy of maintaining an undervalued currency. This exacerbates global trade imbalances, thus weakening the economies of its trading partners. A predictable reaction of protectionist resistance in its major foreign markets and wary behavior by its border partners will restrain its world economic impact unless China's self-interest policies are modified. Current domestic practices (for example, lack of oversight of patent policy) preclude meaningful technology transfer via China's trading partners, thus impeding China's move up the economic technological value chain. As countries such as Vietnam and India challenge its global position in providing cheap labor, China must stimulate internal consumer consumption to supplement possible declining export growth.

China's current political stability is dependent upon fulfilling economic expectations and repressing challenges to its authority. Increased corruption fostering crony capitalism, a trend towards monopoly of privilege and power in the face of a growing middle class, and stifling free thought by repressive oversight of information flow—witness the clashes with Google—translates into domestic decay and populist malcontent. Assuaging social discontent by subsidizing necessities at the expense of polluted living conditions is not sustainable. New leadership in 2012 that ignores these realities increases the likelihood of societal upheaval resulting in possible regime change and a bursting of the second bubble.

China's economic growth policy should stress internal consumption which can rebalance trade by providing new market stimulus for its trading partners. Assuming an enlarging consuming middle class, alterations in foreign exchange policy, significant investment in the environment, and a freer flow of information combined with an increased tolerance for freedom of speech, this huge economic engine could emerge as the primer for world economic growth by the end of the next decade. This is a lot to assume!

Until 2012, any doubts as to China's role as growth engine will seem silly.

NORBERT WALTER
Walter and Töchter Consult, and Chief Economist Emeritus, Deutsche Bank

Well, what else could be an appropriate description of the last quarter of a century, a period of 10 percent growth annually for China and 3 percent for the rest of us? But much of these twenty-five years saw strong growth in other parts of the world such as the United States and—until 1990—Japan, as well as in parts of the emerging world. In 2008–09, when much of the world was mired in the deepest recession in seventy years, China for sure was the center of growth, with a feisty 8 percent.

Consider the continued accommodative stance of Chinese monetary policy—another US$300 billion in foreign exchange reserves creates abundant domestic liquidity. Thanks to the biggest Keynesian stimulus package the world has ever known, 2010 will probably see a growth figure in the double digits again. Since the rest of us, particularly the mature part of the world, will hardly grow by more than 2 percent, China will be the number one growth center. Its weight in world GDP and world trade will be even higher.

Thus, China's stunning optimism is warranted. Chinese capitalism is the winning model. And consequently, the markets' optimism towards China is fully understandable.

Up until 2012, any doubts as to China's role as growth engine will seem silly. However, I am pretty sure that as in all other cases, easy money, combined with large-scale government spending, will lead to excess. And important bottlenecks are being overlooked. Beijing and Shanghai, just two examples, are overbuilt with too-expensive offices and other commercial buildings. After Shanghai's expo in 2010, this will show. For decades, authorities have looked the other way when freshwater pools in northern China were exhausted, when aggressive agricultural production poisoned China's arable land, and when emissions caused by industry and transport ruined the air quality in metropolitan areas. To repair this damage, measured GDP growth will decline to levels around 7 percent after 2012. After 2015, the shortage of young skilled labor and an even more pronounced shortage of young women of childbearing age will be the reason behind a further deceleration of trend growth to 5 percent.

China's best time as the world's engine of growth is now. After 2015, others will have to take over if global economic growth is to be kept at 3 percent. India may be a candidate. However, the United States will also come back after the years in purgatory and reclaim its role as world leader.

There are three uncertainties.

GREG MASTEL
Senior Adviser, Akin Gump Strauss Hauer & Feld, and former Chief Economist and Chief International Trade Adviser, U.S. Senate Finance Committee

China has achieved remarkable successes in the last three decades, but there are still three great unknowns about China's leaders and the role they envision for China's future.

The first unknown is whether China desires to truly be a world leader or is really focused only on its own interests. China's rhetoric clearly indicates an aspiration to be a leader—at least among developing countries. But there are a number of recent examples, such as China's role in global climate change talks and in the Darfur, that leave uncertain the depth of interest Beijing truly has in being a world leader.

The second unknown is whether China is willing to allow its economy to mature into a source of strength for the world economy or will continue to follow an essentially export-led model for development. There are good demographic and economic reasons for China to move into a new, mature economic role, but at least some in China seem to stick stubbornly to policies such as keeping Chinese currency artificially weak, which imposes an unsustainable burden on its trading partners.

The last and perhaps greatest unknown is the political stability of the current regime. As Tiananmen Square demonstrated two decades ago, there is an underlying desire for political change in China. But to this point, the Chinese leadership has been effective in suppressing it. Are the Chinese people willing to swap economic success for political freedom forever or is serious political unrest and

turmoil that would change China one way or another just a serious economic downturn away? Most China observers dismiss dramatic internal unrest in China, but most observers of the Soviet Union also dismissed the possibility of change until the very end.

If these three unknowns are resolved positively, China should blossom into a leader in all dimensions of global affairs. But if any of them do not resolve positively the world could be facing a selfish, internally focused China that could be a source of instability rather than strength for the world. Unfortunately, each of these three great uncertainties is too significant to dismiss.

China is wide awake and shaking the world.

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Napoleon once proclaimed that when China wakes, "she will shake the world." With Deng Xiaoping's liberal economic reforms of 1978, China began to wake up. She's wide awake now. Last year's growth rate was a red-hot 8.7 percent. If GDP is measured by the International Monetary Fund's purchasing power parity metric, China will account for a whopping 50 percent of global growth in the 2008–10 period.

If we go back to 1981, China's economy (again measured by the IMF's PPP metric) was tiny. It accounted for only 2 percent of the world's economy and contributed only 2.6 percent to world growth. Growth rates have remained relatively elevated since China's free-market reforms were instituted. Accordingly, the economy's size has expanded as a portion of the total global economy. In consequence, China's contribution to world growth has steadily increased from 2.6 percent (in 1981), to 9.7 percent (in 1991), to 17 percent (in 2001), and to an IMF projected 27.5 percent (in 2014).

If we use a country's percentage contribution to global growth as a metric, then China has already become a global engine for growth. Indeed, China's contribution surpassed that of the United States in 2006, and in 2014 it is projected to be 27.5 percent versus the U.S. contribution of only 12.1 percent.

Unless foreign envy spawns parochial protectionism, China will continue to be the biggest contributor to world growth for the foreseeable future. This is a case in which the trend is your friend. ◆