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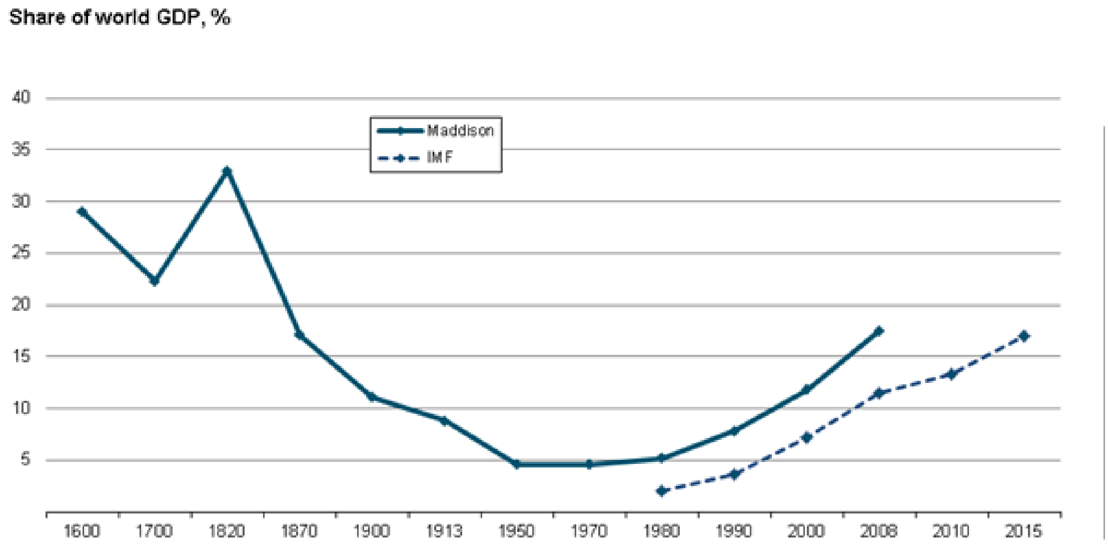
The dragon's footprints

China's already large influence on the world economy continues to grow, and to change.

China is the economy at the leading edge of the Great Convergence.[1] According to Angus Maddison's estimates, for example, its economy accounted for almost one-third of global output (measured on a PPP basis) in 1820. The onset of the Great Divergence saw that share fall to 17 per cent by 1870, 11 per cent by 1900, and to less than 5 per cent by 1950, where it stayed until around 1980. According to IMF forecasts, by 2015 China's share of the world economy will be back up to 17 per cent.[2] And according to most long-term forecasts, it will then rise further, tracing out a rough, U-shaped pattern.[3]



Sources: Data from Angus Maddison, available at http://www.ggdc.net/maddison. IMF Data from World Economic Outlook database, October 2010

For the past three decades, Chinese real GDP has expanded at an annual average rate of about 10 per cent. At this pace, the economy doubles in size almost every seven years, so with life expectancy in China currently about 73, that implies an economy that could double in size roughly ten times over an individual's lifetime. This impressive growth performance has so far pulled more than 600 million people out of absolute poverty.[4]

The speed of China's economic transformation is a defining characteristic of the Great Convergence. Is it sustainable? Well, on the simplest (simplistic?) model of catch-up growth, it could be. As of 2010, Chinese GDP per head was still only 16 per cent of US levels (at PPP rates), and if the IMF's current forecast is correct, it will have risen to only about 22 per cent of US levels by 2015. That is, it will then stand at roughly where Japan's GDP per capita was relative to the US back in 1956, right near the *start* of the period that would see Japan's period of rapid catch-up growth.

As well as speed, there is scale. China's population in 1978, at the start of this convergence process, was about 980 million, or some 22 per cent of the global total. By way of contrast, Japan had a population of 89 million, or about three per cent of the global total, when its economic take-off started in 1955.

On grounds of both scale and speed, then, there is a plausible case to be made that China's impact on the global economy is of an era-defining magnitude – perhaps even larger than those associated with the emergence of the US and UK economies in the nineteenth century.[5]

Indeed, China has already become the leading driver of global economic growth. Back in 1980, China accounted for perhaps just five per cent of global growth. By 2000, that share had more than doubled, and by last year China was contributing getting on for one-third of global growth. And China's influence is, of course, even greater than this. With Beijing following its own version of the East Asian growth model, including the latter's focus on exports, investment and manufacturing, the biggest impact on the global economy has in the past probably tended to operate through the channel of global trade: China became the world's largest merchandise exporter in 2009, and the world's second largest merchandise trader in the same year, and may have become the world's largest manufacturer last year.

The result has been a series of demand and supply shocks hitting the world economy, including, for example:

- An increase in the effective global supply of labour. A combination of favourable demographics plus a relatively high level of economic openness has seen China make a major contribution to the global supply of labour, a development which may have depressed global real equilibrium wages and so contributed to the fall in labour's share of national income seen across the global economy.[6]

- An increase in the global supply of labour-intensive manufactured products, a trend that has helped place downward pressure on the (relative) price of these products with helpful consequences for inflation-targeting central banks.

- An increase in the global demand for those commodities required to fuel China's rapid industrialisation and urbanisation. In 2009, China accounted for about 47% of world coal consumption, more than 10% of world oil consumption and about 3% of world natural gas consumption. China also accounted for 16% of world metallurgical coal imports, 12% of world thermal coal imports, and 66% of world iron ore imports. It has also accounted for

> about 47% of global steel consumption, about 40% of global consumption of aluminium, copper and zinc, and about 36% of global consumption of nickel. Since 2000, China has been the key driver of growth in resource consumption, and the result has been a rise in the (relative) price of resources.[7]

Moreover, trade as a channel for China's economic influence on the world economy has been joined by finance. During the first decade of this century, China became a source not just of cheap labour and cheap goods (and of pricier resources), but also of cheap savings. The most visible evidence of this rising financial clout came in the form of the accumulation of a vast stock of foreign exchange reserves: by the end of last year, reserves stood at US$2.85 trillion, roughly equivalent to about half of China's GDP. China is now the world's largest overseas buyer of US government debt, with recent, revised, estimates suggesting investment in US treasuries alone at US$1.2 trillion, and total investment in US government debt at perhaps US$1.6 trillion. This, in turn, has helped keep down US and hence global interest rates – a phenomenon sometimes described as the global 'savings glut'.

Finally, China's economic success has also represented a shock to the global environment. For example, as of 2009 China was responsible for just under one quarter of global CO2 emissions, making it the world's single largest emitter.

As China continues in its current role as the spear point of the Great Convergence, its influence in the world economy is set to continue to expand from these already substantial levels. At the same time, that influence is also likely to change in character. The dragon is now set to leave a new set of footprints in the world economy.

One group of these changes is likely to come in the form of shifts in the nature of China's existing effects on the world economy. For example, China is in the process of leaving behind the demographic sweet spot that it has enjoyed over recent decades and is transitioning to a demographic regime that will be marked by a much older population and a slower rate of population growth, a shift that will have consequences for both labour supply and savings behaviour. While calling these turning points and their consequences is a tricky business, there are already observers arguing that the current, China-inspired, era of cheap goods and cheap capital may be drawing to a close.

A second set of changes will reflect the continuing development of China's economic influence. For example, the last couple of years have seen China move from being a largely passive investor in (mainly US) government paper to an important source of foreign direct investment (FDI), particularly into other emerging markets. China is also an increasingly important player in the development space, both through the growing influence of the Beijing consensus as an intellectual alternative to the Washington Consensus, through direct policy example (see, for example, the ongoing legitimisation of capital controls) and as a direct source of funding: a recent

Financial Times story highlighted the fact that China Development Bank and China Export-Import Bank between them signed at least US$110 billion of loans to other emerging market governments and companies in 2009 and 2010 – more than the World Bank over a comparable period. There are also grander ambitions at play, including for the future of Shanghai as an international financial centre, and for the international role of the RMB in providing a 'redback' alternative to the US greenback – although for now, such ambitions remain hobbled by China's current exchange rate regime.

Finally, a third set of changes relates to Beijing's growing international clout more broadly, as increasing economic weight translates into greater influence. Here, the GFC now looks to have been a watershed moment, both in terms of China's own self-image (benefitting from the boost to national confidence from successfully negotiating the downturn even as richer countries foundered) and in terms of its image in the rest of the world. One significant consequence has been a shift to a more assertive international stance across a range of issues, from the PBOC-inspired debate about the future of the US dollar as global reserve currency through the stance taken by Beijing at Copenhagen and on to the harder line taken over neighbourhood relations, including with regard to the South China Sea.

Just as the rise of the US economy, and before that the UK economy, helped shape the international economic political order of the time, so will the rise of the Chinese economy – provided it is sustained – exert a growing influence on our international environment today.

Mark Thirlwell
Director, International Economy Program
Lowy Institute for International Policy

[1] On the Great Convergence, see IEC#4. On China and the race for economic primacy, see IEC#9.
[2] The discrepancies between Maddison's estimates and the IMF's numbers are discussed briefly in IEC#9.
[3] See for example Mark Thirlwell, *Our consensus future: The lay of the land in 2025*. Lowy Institute Perspectives. Sydney, Lowy Institute for International Policy, September, 2010.
[4] Between 1980 and 2005. See table 2 in Shaohua Chen and Martin Ravallion, *China is poorer than we thought, but no less successful in the fight against poverty*. Policy Research Working Paper 4621. Washington DC, World Bank, 2008.
[5] See Alan L Winters and Sahid Yusuf, eds., *Dancing with giants: China, India and the global economy*. Washington DC, World Bank and Institute of Policy Studies, 2007, especially table 1.2.
[6] According to the IMF, the effective global labour force quadrupled between 1980 and 2005. International Monetary Fund (IMF), *World Economic Outlook: Spillovers and Cycles in the Global Economy*. Washington DC, International Monetary Fund, April, 2007.
[7] Estimates are from BP World Energy Statistics 2010 and ABAREs' commodity reports.