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China Succeeding Beyond Expectations

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China Succeeding Beyond Expectations

What are the implications if China sustains nine-percent growth through 2010? This is the basic question posed by conference organizers. The relevant time frame is what matters most. If China merely maintains nine-percent growth until the year 2010, the implications are not great. Too much is left unknown about what comes after 2010. Even with nine-percent growth over the next five years, China in 2010 will still be at a relatively low level of performance, both overall and in per-capita terms. But if sustaining nine-percent growth to 2010 means that China has launched on-going reforms that will continue to engineer institutional changes needed for a market economy's successful commercial and political management, then the resulting successful development trajectory in the rest of the century will generate profound and, from today's perspective, unexpected consequences.

The implications of merely growing at nine-percent to 2010 can be seen in Table 1. With the United States growing at three percent during the same time period, as it did over the past ten years, China's total GDP will still be less than a quarter that of the United States at commercial exchange rates (columns 7 and 8) and less than half of the U.S. level if purchasing power parities (PPP) measures are used (columns 7 and 9).

Table 1
U.S. and China Growth Potential, 21st Century

		1	2	3					4	5	6					7	8	9	10
Aver. Ann'l %	GDP Growth Rates			Thous. 2005 US\$	GDP/Capita				Trillion 2005 US\$	Total GDP				Xrate/ PPP Ratio					
	U.S.	China			U.S.	China				U.S.	China								
		Xrate	PPP			Xrate	PPP	Xrate			PPP								
2005				2005	41.	1.7	3.5	2005	12	2	5	2.00							
2010	3.0	9.0	5.5	2010	45.	2.6	4.4	2010	14	3	6	1.70							
2020	2.9	8.4	7.0	2020	55.	5.6	8.3	2020	19	8	12	1.49							
2030	2.9	7.8	6.7	2030	66.	11.4	15.3	2030	25	17	22	1.34							
2040	2.8	7.1	6.3	2040	79.	22.	27.	2040	33	33	41	1.24							
2050	2.8	6.4	5.8	2050	94.	40.	46.	2050	44	61	72	1.17							
2060	2.7	5.5	5.0	2060	112.	66.	74.	2060	57	105	117	1.12							
2070	2.7	3.7	3.3	2070	133.	93.	100.	2070	74	150	162	1.08							
2080	2.6	3.2	2.9	2080	156.	124.	132.	2080	96	205	217	1.06							
2090	2.6	2.8	2.6	2090	184.	161.	167.	2090	124	269	280	1.04							
2100	2.5	2.3	2.1	2100	215.	198.	204.	2100	159	336	346	1.03							

2005 Sources: OECD in Figures 2005, China National Bureau of Statistics and author's estimates.

Table 2
U.S. and China Population and Productivity, 21st Century

	11	12	13	14		15	16	17
	Population				Ave.	GDP/Capita growth		
	<u>Millions</u>		<u>% Growth rate</u>		Ann'l	China		
	U.S.	China	U.S.	China	%	U.S.	Xrate	PPP
2005	300	1,310			2005			
2010	320	1,340	1.0	.5	2010	2.0	8.5	5.0
2020	350	1,400	1.0	.4	2020	1.9	7.9	6.5
2030	380	1,450	1.0	.4	2030	1.9	7.4	6.3
2040	420	1,500	1.0	.3	2040	1.8	6.8	5.9
2050	460	1,540	1.0	.3	2050	1.8	6.1	5.5
2060	510	1,580	1.0	.2	2060	1.7	5.2	4.8
2070	560	1,620	.9	.2	2070	1.7	3.4	3.1
2080	620	1,650	.9	.2	2080	1.7	3.0	2.7
2090	680	1,670	.9	.2	2090	1.6	2.6	2.4
2100	740	1,700	.9	.1	2100	1.6	2.1	2.0

2005 Sources: See Table 1

Note that the PPP measured here is not that of the World Bank (IBRD), which appears to be over-stated in original 1987 terms and in any event is now seriously out of date, given the rapid relative price changes in China over the past 18 years. Results of China's first PPP price survey, conducted in 2005, will be available in 2006, and it can be concluded that the PPP-to-exchange-rate ratio of 2.0 used here for 2005 will be much closer to reality than the IBRD's ratio of over 4.0.

Even more than total GDP, per-capita GDP in 2010 will also be at a very low level, reflecting low levels of development sophistication — far lower than those for Mexico or Brazil. China's GDP per capita in 2010 will only be a tenth that of the United States at commercial exchange rates and just over a seventh of the U.S. per-capita level if PPP measures are used.

Note that these projections show the exchange-rate-to-PPP ratio falling as time goes on (Table 1, column 10), implying that at the same constant-RMB-price growth rate the PPP-dollar real growth rates are significantly lower (columns 2 and 3 in Table 1 and 16 and 17 in Table 2), as they should be. China's growth rates, by any of these measures, slow dramatically later in the century, after China reaches U.S. 2005 per-capita GDP levels some time after 2040. This is realistic, although China, with less than half the U.S. per-capita GDP at mid-century, will still benefit from catch-up technology transfer throughout the ensuing decades.

This essay assumes that China's sustained nine-percent growth through 2010 indicates the basic success of China's reform formula and emerging institutions for managing a market economy's rapid growth. Consequently, the subsequent 21st century growth implies a China that in total GDP terms becomes overwhelmingly dominant relative to the United States and attains rough parity in economic sophistication (per-capita levels) by the century's last decades.

Under this interpretation of sustained nine-percent growth, China's total GDP level will match that of the United States sometime between 2035 and 2040. It does not matter much whether one uses commercial exchange-rate or PPP conversion to dollars. The actual choice depends on the goal of one's analysis. For assessing China's ability to support military sophistication and force projection, the exchange-rate conversion measure is more appropriate, given that dual-use technologies and required manpower sophistication will trade both domestically and in the world on commercial terms. For measuring poverty levels or overall societal well-being, PPP is more appropriate, since it better captures the value of every-day local services purchased by households.

In the final analysis, nine-percent growth through 2010 means that China's economic resources will swamp those of the United States by mid-century — but not before. Chinese GDP will be 50 percent again as great as that of the United States by 2050. What will this mean for China domestically, for the United States, and for the world more generally? The remainder of this essay discusses a few possibilities.

General Implications of China's Sustaining Nine-Percent Growth through 2010

The most important point is that the implications of China's success do not depend on China alone. China will respond differently to different choices and different incentives to advance its national interests. Hence, the question "What will China do?" is incomplete, especially in the century's early decades. While China is still on a path to reaching its more fully developed potential, the United States, Europe and Japan — in collaboration with China — have an opportunity to restructure the post-World War II global order to prepare for an East Asian economy dominated by China. Once China's economic strength assumes its mid-century stature, U.S. options for guiding global institutions will become increasingly limited. America will eventually have to live with a China more powerful than the United States in whatever global institutional setting that it, Europe, Japan, China and other major emerging economies have by that time crafted.

Implications for China domestically are perhaps as great as those in the global arena. Meeting requirements for internal migration and urbanization is just one of many daunting challenges. The scale of infrastructure spending necessary for supporting these trends dwarfs China's tax-raising and formal treasury-bond selling capacity going forward. As a result, China will have to maintain and perfect its system of directed credit, drawing on private bank deposits and eventual bond markets to raise necessary funds. This directed-credit financing system in turn depends on a central bank ready and willing to back-stop the overall process with necessary liquidity whenever it is needed.

In this regard, Chinese authorities seem well prepared to meet fiscal and financial requirements for sustaining nine-percent growth. Tax revenues and collection systems are gradually strengthening and appear to be building the revenue base for servicing directed-credit obligations in future decades. China's hybrid management of fiscal and financial requirements also implies eschewing hasty moves to privatize and liberalize the financial

system according to BIS (Bank of International Settlements) standards for establishing a market-oriented banking system with an independent central bank. The BIS has no practical standards for low-to-middle income countries like China in the coming decades, and so China must set its own standards.

China's on-going reforms in its directed-credit system have additional advantages, such as building the foundations for local bond markets. These and other steps are important in the long-term parallel development of the competitive market-based financial system China will need by mid-century. China's reforms in this direction are many and rapid-fire, but such a system is unlikely to be ready until roughly the year 2040.

Chinese officials also seem to be moving in the direction of handling the inevitable social unrest that such rapid growth and structural reform will generate. Reforms will predictably disenfranchise low-productivity population groups which are nevertheless accustomed to relatively high standards of living, such as the traditionally subsidized urban-registered population. Such groups will not go quietly to new circumstances that offer fewer benefits while requiring greater work effort. Labor disputes have proliferated in China in recent years and will continue to increase as reforms put stress on accustomed lifestyle patterns. The official response has been to deal with each incident on its merits as much as possible, all the while ensuring that organized social disruption by labor groups with low productivity but high demands does not impede either reforms or the every-day functioning of the economy.

Managing the distribution of income from land is a core problem with many manifestations. After rightly discounting the near-zero productivity of huge desert and mountainous tracts, not to mention locations inappropriate for commerce, China has very little economically usable land relative to its population. Who is entitled to share in the productivity of well-located land productivity and how much? In developed market economies, these problems are solved by a combination of ownership, control, taxation and government regulation. But these relationships are poorly developed in China, and their linkages to the sources of land productivity are unclear once land has the potential to be taken out of family farming. Again, resolving these incommensurables frequently results in unrest and social violence.

For example, what is fair land-confiscation compensation to farmers who themselves have taken no initiative to modernize the uses of their land beyond farming? What should be the sanctity of a farmer's accustomed life style — should it be guaranteed to him or her? Or should he or she be required to make greater entrepreneurial or more highly skilled efforts compared to those of traditional farming just in order to maintain an accustomed standard of living? Chinese practice points to this latter standard.

Chinese thus appear to be groping their way towards an effective, if messy, solution to the land remuneration problems in many locations, although local corruption definitely exacerbates the perceptions of government malfeasance. It appears that in coming decades the distribution of income from land in China will succeed in converting land to increasingly productive uses, through methods that roughly reward those whose efforts and initiative are responsible for its new productivity. These are the incentives necessary for long-term economic reform success. Here again, China's leadership appears prepared to manage the implications of sustained nine-percent growth.

One risk to managing both land productivity and general conditions in rural areas is illustrated by Japan's experience in the early 1880s with the Matsukata Deflation. Austerity policies in this period, in conjunction with other rural programs, resulted in disenfranchising and permanently impoverishing village residents, with long-term implications for social stability, political-system evolution and even militarization promoted by army officers from abusive village social backgrounds.

In China's case the risk of rural impoverishment is linked to official limitations on importation of grains, requiring farmers to plant more land than they want to in low-profit grain crops. China's large grain-base areas are poor, and official studies of the situation offer no resolution to the "contradiction" between grain planting and raising rural incomes. Hence, an important and ultimately necessary supplement to appropriate land transfer and non-farm land-remuneration incentives is a long-term policy of farm product diversification made possible by importation of grain on a scale much larger than currently envisioned. The risks from current policy errors in this regard are an indication that authorities may indeed not be ready successfully to manage the implications of nine-percent growth. In this regard, however, the U.S., European and Japanese strategic posture toward China can make a difference, because a major reason China imports so little grain is the fear that its strategic security would be left hostage to international grain supplies if it allowed market forces to determine the trend of grain imports.

A second area where Chinese authorities seem poorly prepared for the rigors of rapid 21st century growth is the central government's oversight of and checks on corrupt and abusive local government behavior. China's government structure is basically corporate rather than federal, so the central government has little choice but to work through local government and CCP (Chinese Communist Party) officials to take action at the local level. The same is true of provincial-level leaders and their effectiveness at the county level and below. What is more, since the early 1990s, an earlier policy of separating the CCP from government has reversed itself, and local government and CCP personnel are increasingly the same people. Hence, CCP channels provide little central oversight compared to that of a federal system, when higher government levels have their own personnel, paid for out of their own budgets, performing various independent oversight tasks at lower levels.

For China, any element of an independent central presence at the local level would raise political hackles and, not insignificantly, get expensive. Nevertheless, there are hints of this tendency in the restructuring of the central banks branch network, which is now regional rather than provincial. Also, central statistical organs are supposed to have independent authority over standards and methods used at local levels, but funding is not independent. There is nothing approaching a system of independent central judicial and law enforcement systems alongside local counterparts, which one would see in a federal structure. China's continued failure to move in this direction as it becomes wealthier could signal its inability to face the anti-corruption requirements of sustained nine-percent growth.

Finally, an important Chinese domestic requirement for sustained nine-percent growth — and all it implies for this century — is ideology. In practical terms, and despite study programs at schools and universities, the CCP has already clearly moved far beyond any reliance on anti-colonial and anti-feudal references in so-called Marxist and Leninist ideologies. Emphasis on the conflict between workers and capitalists has effectively

disappeared as the justification for vesting authority in both the CCP and in China's current government.

At the same time, China has resisted shifting to a *laissez-faire* ideology supposedly giving primacy to individual choice and pushing a characterization of government authority as best when it is least. Such a *laissez-faire* direction, perhaps best associated with former CCP Secretary General Zhao Ziyang's leadership in the 1980s, is attractive to privileged groups and sectors in an already-developed economy, and it appeals to remnants of toddler and teen-age rebelliousness in nearly every adult citizen. But *laissez-faire* is sub-optimal for guiding a program of rapid economic growth consistent with establishment of the income distribution patterns necessary for generating a large middle class and the civil-society institutions required for stability in an economically advanced society.

Instead of either old-style Marxism or old-style *laissez-faire* liberalism, China appears to have embarked on the creation of a hybrid ideology which champions both welfare benefits for ordinary citizens — including a rapidly expanding scope for individual choice — and powerful government prerogatives for taking large-scale initiatives in virtually every sphere of society. The trend defies easy labeling, although a phrase such as “corporate democratic socialism with Chinese characteristics” gives some flavor of what seems to be evolving.

Evidence of efforts to create such an ideology include welcoming business leaders into the CCP and promoting the stodgy-sounding but intrinsically breath-taking “Three Represents”¹ under Jiang Zemin's presidency and CCP leadership. The Hu Jintao government's increased emphasis on both citizen welfare and CCP/government authority is an as-yet less clearly defined continuation and expansion of this same creative ideological process. The evolution of China's two-track financial system — described earlier in this essay as based on both directed-lending and nascent market forces — is a powerful example of the new ideology's practical implementation.

Considering all these domestic dimensions, China's management potential appears promising — with some noted important concerns — for handling the domestic requirements of sustained nine-percent growth and all such growth implies for China's 21st-century global economic preeminence. The rippling influence of such successful thinking and policy-making will likely be felt far beyond China's borders.

One important international dimension of China's economic and ideological successes is their potential impact on development policies in other poor and emerging-market economies. A discussion of global economic development strategies and their evolution is beyond the scope of this essay. It is important to note, however, that China's approach to market and globalizing reform is already having an effect on India, with its fitful initiatives

¹ "Reviewing the course of struggle and the basic experience over the past 80 years and looking ahead to the arduous tasks and bright future in the new century, our Party should continue to stand in the forefront of the times and lead the people in marching toward victory. In a word, the Party must always represent the requirements of the development of China's advanced productive forces, the orientation of the development of China's advanced culture, and the fundamental interests of the overwhelming majority of the people in China." (From Jiang's speech at the 16th CPC Congress). “Advanced productive forces” can be interpreted as referring to capitalistic businesses.

over the past 15 years emphasizing openness to FDI and trade, funding for infrastructure, and reform of state-owned and parastatal enterprises.

An Indian implementation of China's financial and reforming strategy, not to mention China's emerging national ideology as outlined above, would naturally be difficult. But recent Indian growth rates — as well as conversations with business leaders and Indian diplomats — hint that India may indeed be feeling the demonstration and incentive effects of China's success in finding alternatives to traditional state-dominated strategies and impractical laissez-faire approaches. If this is the case and if not only India but other emerging and developing countries apply lessons and motivation from China's success to launch their own sustained growth trajectories, the overall impact on the already-developed economies of the world will be much greater than the impact of China's growth alone. For the purposes of this essay, however, let us concentrate on the repercussions for U.S. and global systems that China's 21st century success is likely to have.

Many of the international repercussions of China's 21st century growth as outlined in Tables 1 and 2 are straightforward — especially trade in goods and services and its impact on the WTO. They nevertheless need to be highlighted. Other repercussions in general lie outside the purely economic sphere but nevertheless deserve at least minimal comment. These include a preeminent China's impact on Asian strategic balances, Taiwan's status, the nature of international political and financial organizations, terrorism, peace in global hot spots like the Middle East, and even reforms in the political and economic systems of OECD countries.

In general, whatever post-WWII (World War II) institutional structures and practices have merely been convenient for the U.S. and its allies — for example by only camouflaging in international legalisms what has been best for United States and allied interests or by only flowing from or supporting the global reach of the U.S. strategic footprint (terrestrial and space-based) — these structures and practices will have to change. China will be too powerful by the end — if not the middle of the century for them to continue.

The structures and practices that generate broadly acceptable international solutions to international problems — for example in the areas of disaster relief, conflict resolution, development assistance, global public health and environmental sustainability have a good chance of thriving and serving U.S. as well as Chinese and global interests. The major question is whether U.S. participation in the “changing of the guard” — from U.S. preeminence to a multilateral equilibrium in which China's power is paramount — will be constructive or not.

China's impact on trade in goods and services — enhanced by India and others — will be profound for OECD countries. The U.S. and other OECD countries' reactions can go in two basic directions. The first would be an attempt (almost certainly unsuccessful and provoking social unrest) to protect inherited domestic trends in employment and income distribution through measures such as expanded E.U.-like tariff-union agglomerations. The second would be wrenching reforms (also provoking social unrest) of these same patterns in programs that might have to borrow substantially from China's emerging ideological and management tool kit if they are to succeed peacefully. The ultimate goal is individual and global economies affluent enough to afford even greater degrees of individual choice and

political freedom worldwide than is already the case now in the United States and other OECD nations. However it unfolds and whatever the resistance, wrenching adjustments are inevitable. The question is whether they will be orderly or violent, and this in turn depends on leadership in these same countries.

The wrenching changes will be inevitable because of the scale in the shift of relative prices that China's emergence implies — not just in traded goods but even more so in traded services. Well-located land, scarce fuels, rare materials and cutting-edge skills will command ever-appreciating remuneration. But manufactured goods and more easily learned skills will continue to decline dramatically in relative worth. The roles of artificial intelligence, telecommunications, convenient and affordable intercontinental travel, sophisticated robots and all the promises of emerging technologies (fuel cells, nanotechnologies and genetically-based techniques) will make it very hard for natural barriers like distance, travel time and transport cost to protect most service jobs. Even custodial, watchman and fast-food service jobs will go increasingly to mechanical competitors, as land and housing prices force minimum wages up. The good news will be that many other “necessities” will be quite affordable. The major question will be who is productive enough to earn a good income.

Changes within the United States and other OECD countries will need to stress education, lifelong study and retraining for the entire labor force, portable health-care and pension systems and significant improvements in urban development — to recruit and keep the most productive and innovative segments of the labor force at home rather than losing them to competitors abroad. Because of the externalities and public goods dimensions of many of these requirements, such transformations will require more effective government services and investment than the current political system in the United States seems capable of generating. The management of human movement — in an enhanced Immigration and Naturalization Service sense — is just one example. Much lower teacher-student ratios — especially for the troubled and challenged child from an initially underprivileged background — is another example. Public health research is a third. Greatly expanded programs for scientific research grants are a fourth. These kinds of requirements form the economic challenge to the United States and other OECD countries of China's successful nine-percent growth and all it implies.

For challenges extending beyond the purely economic sphere, a number of developments invite comment. For example, it is inconceivable, given China's predicted economic scale by the second half of this century, that the United States will maintain its current naval dominance in the western Pacific. China will certainly become the dominant naval power in East and Southeast Asia after 2050. Port visits, air cover arrangements, space-based support and more will all accrue to Chinese strategic forces. This is a development to which the United States will sooner or later have to become accustomed. How will this transition progress?

Taiwan's status is naturally related to naval, air and space-based superiority in and over East Asia. The implications of China's predicted growth in Tables 1 and 2 is that the Taiwan authorities' bargaining position over Taiwan's eventual status within the People's Republic will never again be as good as it is right now. Within a few decades, not only will China's strategic force projection be such that independence is unworkable, but China's cultural,

commercial and global prowess will generate powerful attractions for Taiwan residents, so that PRC citizenship or its equivalent will become a natural choice. The global political aspirations of local Taiwan politicians will quickly become irrelevant, as will U.S. strategic concerns about China's eventual control of Taiwan's prominent geographic location.

The nature and conduct of international organizations provide a third example of China's inevitable international impact as the 21st century, when launched with nine-percent Chinese growth, proceeds. Most of the major international agencies — such as the U.N., World Bank, IMF, and WTO—are either controlled by the WWII winners' circle (the U.N. family of organizations) or reflect in large part their cold-war creation as instruments to blunt Soviet influence (World Bank, IMF and GATT/WTO) by financing the rebuilding of Europe and Japan. The distribution of authority in these organizations — spread over so many relatively small if not tiny European countries, for example — will no longer reflect global economic reality by 2040 or 2050. China will demand a greater share of influence in agencies like the World Bank, including the right to name its president and control the largest single voting share. Its headquarters might be moved to Beijing to afford more convenient consultations for Chinese authorities working in Beijing, which by then will, linked to Shanghai, be the economic capital of the world.

Considering the WTO affords additional telling likelihoods. China's unilateral preponderance in world trade will give it the advantage in engineering shifts in global trade protection patterns and the disciplining of non-compliant members. The United States will be forced to open its agriculture and other here-to-fore protected sectors, and global sanctions will hurt its strategic development if it does not conform.

Many of these and other changes will narrowly seem to counter U.S. interests based on complacency and inertia of the evolving status quo, but the resulting changes will serve U.S. national interests in the long run to the degree that the necessary domestic U.S. changes can go smoothly.

Beyond international institutions and the confines of Asia as a region, China's emergence as the preeminent world economy and strategic power could offer opportunities to resolve deep-seated disputes in the Middle East and elsewhere. Without the inherited historical animosities linked to U.K., French and American military control of the Middle East — either directly or through proxies — China's interest will be closer to those of the global community at large, which focused on the predictable supply of petroleum at relatively stable — albeit certainly rising — prices. One side benefit of resolving ancient animosities could be a reduction in terrorism. In addition, better funding and coordination for anti-terrorist programs will, with Chinese financial support, enhance steps to prevent individual terrorist attacks. In this overall regard, however, and more generally, it is uncertain whether China will become the preeminent power in the world in a way that acts unilaterally and graspingly in order to guard its interests against ever-poised predators, or whether it will pour its energies into being the most influential member of a global democratic community. Such a community would see the U.S. and European economies together as roughly equivalent to China's at end-century. Other major economies would fill out the most-important-player roster.

In this choice of its end-century role, China will no doubt be influenced by the international system it is able to help shape and then inherit by mid-century. Will it be one in which the United States has unilaterally and graspingly tried to hold on to the fruits of its strategic and commercial superiority as long as possible? Or will the international system reflect the success of supra-national and multilateral arrangements for making decisions that commit resources for common solutions to common global problems? It is in this important sense that the question, “What will China become?” or “How will China act” is incomplete. It depends heavily on how the United States and Europe — and to a lesser extent Japan, India and Russia — proceed in the meantime. The answer to this question, clearly, will be determined by the character of U.S. world leadership in this and the coming few decades. After that, it will be too late.