

The Chinese Economic Miracle: Can It Last?¹

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THIS PAPER describes the extraordinary economic miracle that characterizes China today and examines the likelihood that China's growth can continue in the future.

A BRIEF HISTORY OF CHINA: 1820–PRESENT

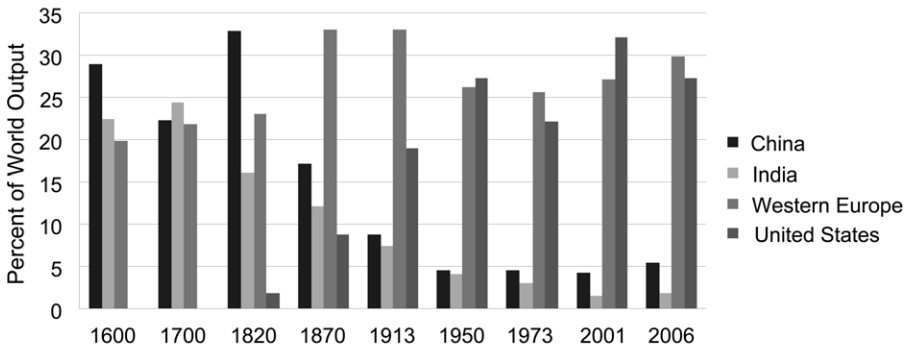
Two hundred years ago, China was the world's greatest power in terms of both economic muscle and geographical territory. While carefully prepared statistics of economic output (what economists call Gross Domestic Product or GDP) did not exist then, Angus Maddison estimates that in 1820 China accounted for about one-third of the world's GDP (see exhibit 1).

That economic dominance did not last. The Chinese economy suffered greatly under colonial exploitation and Mao's extreme economic policies. Nineteenth-century China suffered from a complacency that the historian David Landes has called an "ineffable stillness of immobility." China thought that it had no need for Western ideas. The best and the brightest Chinese citizens went into government service.

At the same time, the best and brightest in Britain and Europe were creating an industrial revolution that resulted in an enormous increase in output and economic growth. And when the British navy and marines invaded China's southern coast in 1839 under the pretext of preserving free trade (in opium), China's military technology was outdated and powerless against the British guns. What followed was what Mao called a "century of humiliation." China, defeated in two opium wars, was forced in 1842 to sign unequal treaties opening five villages (including

¹Read 10 November 2007. Slight revisions have been made.

Exhibit 1
Selected GDPs, 1600–2006



Sources: Years 2001 and 2006, International Monetary Fund, World Economic Outlook database, October 2007. Years prior to 2001, Angus Maddison, University of Groningen.

Shanghai) as “treaty ports” and to accept the secession of Hong Kong. In the first half of the twentieth century, China was invaded by Japan and suffered greatly up to the end of World War II. A civil war ended in 1949 when Mao Zedong defeated Chiang Kai-shek and established the People’s Republic of China.

Mao was determined to put China on a path of growth in what he called a “Great Leap Forward.” There was some initial success, but the state-owned firms that controlled 97 percent of the country’s output proved to be extremely inefficient, and the collective farms remarkably unproductive. There followed in 1966 a “Cultural Revolution,” bringing utter chaos and a great leap backward. Skilled workers and scientists were sent out to the farms to be reeducated, Mao’s Red Guards shut down universities, and the economy almost completely collapsed. At that time China represented about 4 percent of the world’s GDP, while the United States and Europe accounted for well over half.

Soon after Mao’s death in 1976, Deng Xiaoping took over as China’s leader, and he created a remarkable economic transformation. Calling it “socialism with Chinese characteristics,” Deng introduced capitalism into the modern Chinese economy. Deng was a pragmatist, not an ideologue. “It doesn’t matter if the cat is black or white,” Deng would say, “as long as it catches mice.” And socialism should not mean shared poverty. “To get rich is glorious,” he told his people. Deng dismantled the collective farms, encouraged private enterprise, and reopened the universities. China was transformed from a Maoist dead end into a booming economy. As the *New York Times* China bureau chief Patrick Tyler noted, “Deng trusted what Mao had never trusted in his own

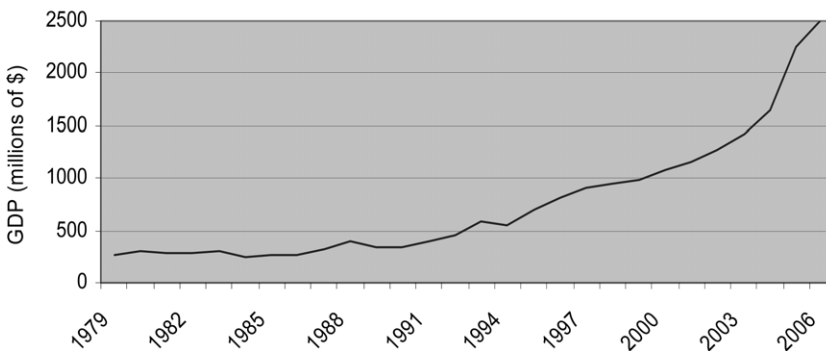
people—their unstoppable energy. Mao had sought to control it, to channel it for revolution. Deng’s simple genius was to turn it loose.”

CHINA’S STUNNING ECONOMIC ACCOMPLISHMENTS

Exhibit 2 displays the remarkable growth of the Chinese economy from 1982 though 2006. Growth rates have averaged more than 9 percent per year over the whole period. Over the past two years, growth has exceeded 10 percent. Shanghai in less than twenty years was transformed into a city of stunning skyscrapers and upscale apartment complexes that dwarf those punctuating the New York skyline. China now has 170 cities with more than 1 million inhabitants (the United States has 10). There are more than 400 million subscribers to wireless service in China, and in five years the number is expected to exceed 600 million. Hundreds of millions of Chinese citizens have been raised out of poverty. There is no historical antecedent for such successful economic development.

Examples of the transformation abound. Forty years ago China’s rail network was less developed than that of the United States during the Civil War. The government put a positive spin on the situation by posting a huge sign on the Beijing railroad station: “Better a Socialist Train That is Late than a Capitalist Train on Time.” Today segments of China’s rail system are vastly superior to those in the U.S. China boasts the world’s only commercially available Maglev train, which travels at 260 m.p.h. using magnets to elevate it above the track. In terms of purchasing power, China is now the second largest economy in the world. And China, having occupied the center of the world stage by hosting

Exhibit 2
The Growth of the Chinese Economy
China’s Gross Domestic Product, 1979–2006



the 2008 Summer Olympics in Beijing, is preparing what is likely to be the most impressive World's Fair ever in Shanghai during 2010.

WHY CHINA SHOULD CONTINUE TO GROW

I am convinced that China will continue to grow rapidly. The country's growth thus far has been concentrated in the eastern regions. The middle and western sections are relatively poor and undeveloped. Millions of unemployed and redundant farm workers live in the rural areas, and they are anxious to share in the wealth that has been created in the east. Government policy is firmly behind moving development westward; the stated goal is to achieve a quadrupling of per capita income by 2020. Substantial infrastructure investments in power plants, roads, and rail networks have already been made and are continuing at a rapid pace. Government policymakers are well aware that China was the world's largest economy two hundred years ago, and they are determined to enjoy that distinction again.

Perhaps the most convincing reason to believe that China's growth will continue is the boundless energy of the Chinese people. Sir W. Arthur Lewis, a Nobel laureate in economics (and an APS member), was always quite clear about the overriding importance of culture in explaining why some nations grow and others stagnate. The necessary conditions for economic development are a population with a strong work ethic, a commitment to education, a willingness to take risks, and an entrepreneurial spirit. The genius of Deng Xiaoping was to turn that spirit loose.

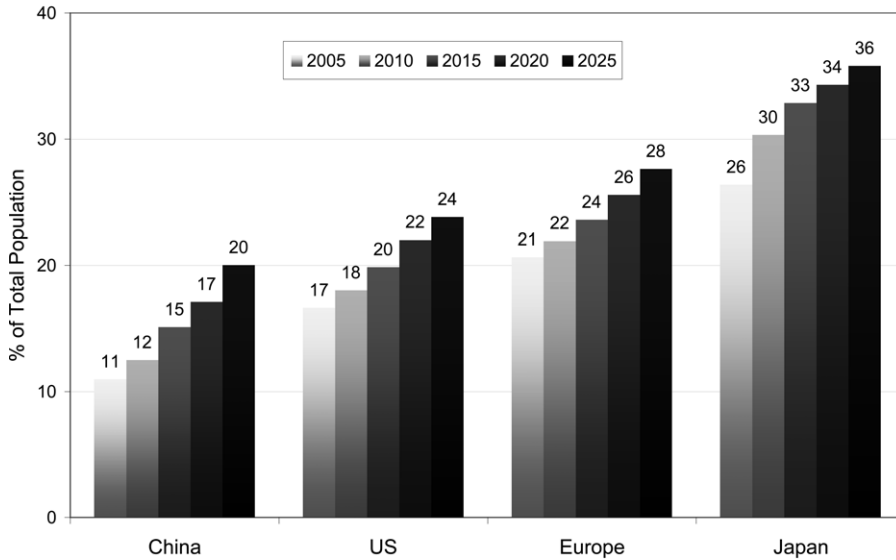
THE FUTURE: PERCEIVED RISKS

Not everyone is convinced that China will continue on its rapid growth path. Indeed, many China experts see a plethora of serious problems, and some have even forecast a meltdown. Let me conclude by examining the serious risks facing the Chinese economy and ask whether these widely perceived impediments are based on fact or fiction.

Risk #1: A huge aging population will drag down the economy

Aging populations pose economic challenges in the United States and throughout the world. Retirees tapping into underfunded Social Security and Medicare systems, while smaller numbers of working age people are available to support such welfare systems, have doomsayers making dire predictions. The *Wall Street Journal* recently ran a story with the warning, "Of all the impending Third World aging tsunamis, the most massive is set to strike China." In fact, China should be in far bet-

Exhibit 3
Population Aged 60 Years or Above,
as Percentage of Total Population



ter shape over the next forty years than Europe, Japan, and even the United States. Exhibit 3 shows that the so-called dependency ratio in China (population aged sixty years and above as percentage of the total population) is more favorable in China even in 2025. And China will not even rank among the top twenty-five countries with the largest percentage of those over sixty in 2050.

Risk #2: Tensions with Taiwan and Japan could disrupt the economy

There is no doubt that enmity among China, Taiwan, and Japan is thick. But so are the economic ties among them. Taiwan and Japan have outsourced a substantial share of their manufacturing to China, and they have made substantial investments in mainland China. All three governments are quite practical. They know that a military conflict could destroy all three economies, and it is highly unlikely that a shooting war will break out.

Risk #3: Environmental degradation will suffocate the economy

China has paid a heavy price in pollution for the growth it has achieved. Beijing and Shanghai are among the most polluted cities in the world.

But the government has responded with a number of green technology initiatives. For example, the worst polluters have been put on a “no loan” list denying them access to bank loans. And China has become a leader in solar technology. A good test of progress in the fight against pollution was provided by the 2008 Summer Olympics, after Beijing pledged that the air would be fit for the athletes to breathe.

Risk #4: Uneven distribution of income will lead to rural unrest

Income distribution in China is even more uneven than it is in the United States. The distribution is uneven not only between the rich and the poor but also between the wealthy eastern part of the country and the poorer central and western regions. Rural unrest is a significant problem for the Chinese government. But such problems are unlikely to restrain future growth. Growth is part of the solution. The goal of creating “a harmonious society” will be more easily achieved through continued growth and the development of the central and western regions.

Risk #5: Corruption will sap economic growth

Widespread corruption and lack of transparency have been issues in China for some time. While alleviating the problems must be considered a work in progress, considerable gains have been made. The Chinese government is committed to eliminating corruption at all levels and to increasing the transparency of economic dealings. Corruption may never be eliminated completely but it is unlikely to hinder future growth.

Risk #6: Bad bank loans will sink the system

China’s banks have made considerable numbers of loans to inefficient state-owned enterprises that are unable to pay back either the principal of the loan or even the periodic interest. Many observers believe that such so-called “non-performing loans” (NPLs) are a cancer on the financial system and note that heavy debt loads were associated with the collapse of the four “Asian Tigers” during the late 1990s. The difference is that these NPLs are basically a responsibility of the Chinese government, and total government debt is a very small percentage of China’s GDP. Moreover, much money has recently been infused into the banking system, and the problem is quickly ameliorating.

I am not claiming that the Chinese economy is free of problems. The point is rather that some problems have been overstated and that

progress has been made in alleviating others. Change is taking place in the right direction.

China's growth rate will inevitably decline from the torrid double-digit expansion of the past two years. But China will continue to grow at rates higher than those of any other country in the developed world. Within twenty years, China should have not only the largest population but also the largest economy in the world.

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