China and the Asian turmoil

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There is some temptation to assign the blame for the current setback to Asia's development as an economic powerhouse to the sudden and unexpected downturn in the rate of growth of the Chinese economy. In its 13th Five-Year Plan adopted by the Chinese Communist Party in October 2015 that will become operational in March this year, Beijing has lowered its sights. It is now projecting the rate of GDP growth at seven per cent a year in the 2016-2020 period compared to close to the almost 10 per cent a year it was able to sustain for three decades from 1980 to 2010. There are several authoritative voices from among China watchers who believe that the rate of growth may be even lower, perhaps closer to five per cent a year. China's economic travails have been communicated through commodity markets and through the country's imports of parts and components. For instance, China had emerged as a large market for Apple products. The company assembled its popular iPads and iPhones from the components imported mostly from East Asia.

Such a slowdown is not happening without delivering shocks to the entire Chinese economy. The world — and that includes the authorities in Beijing — has recognised that the old model of economic development that had resulted in increasing the size of the Chinese economy 35-fold between 1980 and 2010 will no longer work. Once called the East Asian miracle by the World Bank, this model had a number of components. Four of these were of particular importance.

The all-powerful state provided direction to entrepreneurs, both private as well as those operating in the large public sector. The entrepreneurs used low-wage labour to produce low-priced goods in quantities far in excess of domestic demand. The state worked with the involved entrepreneurs to find external markets for the surpluses produced by their enterprises. The result of this approach was a large trade surplus that created enormous foreign exchange reserves for Beijing. Given the very high rate of domestic savings, the state did not need the accumulated foreign exchange reserves for development. They were saved. At one point, China had $4 trillion in foreign exchange reserves. Most of these were parked in the United States, a significant amount in the form of US Treasury Bills.

This model would have continued to produce results had the Western economies not been hit by what has been called the Great Recession of 2008-09. This resulted in a sharp downturn in the rate of economic growth in the West. The market contraction that resulted saw a major decline in Asian exports. Unlike a number of recessions following the end of the Second World War, the one in 2008-09 was not V-shaped, a sharp contraction followed by a sharp expansion. Instead, it is most likely to be U-shaped, a contraction followed by a long period of low growth and then recovery. Some analysts fear that this may turn out to be a W-shaped recession, two downturns before a modest recovery settles in.

The Great Recession came at the time when demographic developments had begun to take a heavy toll on the economies of the West. The rapid ageing of populations in most of Europe and in Japan was changing the age-profile of populations in significant ways. Germany, with a median age of 47 years, was the world's oldest population. This may be one reason for Berlin spreading the welcome mat for the million young refugees that arrived in 2016 from Syria and Afghanistan seeking asylum and work. This ageing was the result of sharp declines in human fertility in these countries accompanied by major advances in health sciences that prolonged life. Each year added to life expectancy increases the demand for services such as health care and welfare for the aged and the ageing. Already, services account for 86 per cent of America’s Gross Domestic Product. The markets in rich societies, therefore, cannot accommodate increasing amounts of cheap manufactures from large Asian economies.

China and other large Asian economies will have to find other determinants of economic growth. China is attempting to do this in three different ways: by increasing domestic demand for domestically produced goods, by encouraging the flow of non-manufacturing wages into family incomes, and by diverting its large construction industry to invest in building infrastructure outside its borders. For instance, by announcing that it will link itself with the countries to its west by building a network of roads, railways, fibre-optic cables and oil and gas pipelines, Beijing is inaugurating a new era of land-based connectivity. This will have two consequences. It will bring the land-locked nations of Central and West Asia into China’s economic orbit. It will also revive the large Chinese construction industry. Beijing expects to invest as much as $400 billion in two dozen countries in building this infrastructure in the next five to 10 years. To help it achieve this goal, it has spearheaded the establishment of new multilateral development institutions. As its name suggests, the China-dominated Asian Infrastructure Investment Bank will focus on building the new communications and transport networks. These are massive changes that will alter the fundamentals of the Chinese economy. In turn, they will have enormous consequences for the global economy

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