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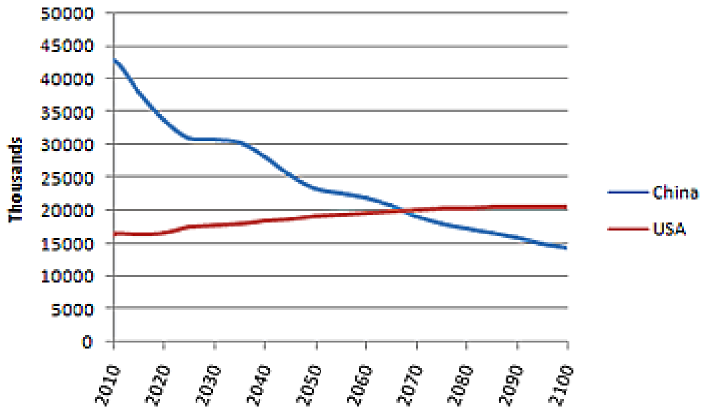
# It might not be an Asian century after all

By Spengler

Here's a thought experiment: if the United States and China maintain their present fertility rate and educational systems through the end of the century, which country will have the stronger economy? This is not a forecast, to be sure, just a point of perspective at a distant horizon.

**University graduates (assumes constant fertility and constant rates of participation in tertiary education)**




*Source: UN World Population Prospects, Nationmaster, Author's Calculations.*

The United States will have about one-third more university students than China if everything holds constant, that is, if 21% of Chinese and 38% of Americans of college age actually matriculate. The quality of Chinese university graduates, moreover, is questionable; according to a 2005 McKinsey study, only one in 10 of China's recent engineering graduates was employable by multinational companies, leaving a competent core of 160,000, about the same as in the United Kingdom. China is working hard to raise the quality of its graduates, but success is hard to measure.

China will have a bigger working-age population, to be sure, but it won't be nearly five times the American level as in 2010, but a bit less than double at the end of the century - again, assuming constant fertility. Assumptions of this sort are dodgy, to be sure, but we don't observe a lot of two-child families in China even where the one-child policy no longer applies, and very few three-child families.

China is spending more on higher education, especially to bring its elite universities up to world standards, but the demographic impact is slow. Not quite 22% of 20-year-old Chinese are enrolled in a tertiary education program, a modest improvement from 19% in 2005.

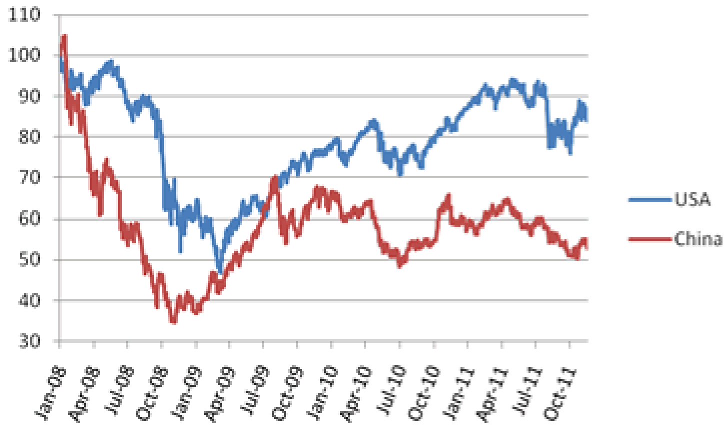
The point of this exercise is not to forecast the winner. On the contrary: the comparison shows that small changes in assumptions can have a huge relative impact over time. China's young people work harder and focus better than their American counterparts; by some estimates, more than 30 million of them are studying classical piano.

Playing classical music does, in fact, make you smarter, by building attention span, memory and real-time analytic capability. China might offer subsidies rather than penalties for second and third children. And private universities might provide opportunities for millions of Chinese who can't find a place in the state schools.

And the United States might pull out of its present funk as it did in a sudden twice during the past century: in the first years of World War II, and during the first Ronald Reagan administration.

For the past two decades, the United States wasted the lion's share of its resources, first in pursuit of the Internet bubble and then in service of the housing bubble. The country's smartest kids were groomed for investment banking from childhood - literally. Now that the bubble has popped, it can't be excluded that Americans will go back to fundamentals. America always does the right thing, Winston Churchill observed, after it has exhausted the alternatives.

**S&P 500 Index vs Shanghai Composite Stock Index (in US$)
January1, 2008=100**




Nearly four years after the crash, the market value of China's economy languishes at around half its January 2008 level, while the American stock market has recovered to almost 90% of its pre-crash peak. Why should that be the case, when China is growing at 9% a year and America at 2% or 3%, with an administration hostile to business and the world's highest corporate tax rate?

A simple answer is that it is safer to buy the stocks of American companies that sell to China than to buy Chinese companies. The world learned in 2008 that even the freest and most transparent large economy, the United States, might crash due to the negligence and cupidity of regulators, congress, ratings agencies, and financial institutions. Without an open and rambunctious democracy that responds to errors and corrects them in the full light of day, modern capital markets don't work.

Another way to gauge China's problem is that its gross domestic product (GDP) quintupled over the decade through 2010, while its stock market doubled - so that market capitalization has fallen sharply relative to GDP. The value of Chinese companies represents a much smaller proportion of the Chinese economy than it did in 2000. America's stock market is worth roughly what it was a decade ago, while nominal GDP is half again as much. The ratio of market capitalization to GDP also shrank in America, but not nearly as far.

America has had its share of corporate fraud, for example, WorldCom and Enron. But investors by and large trust American corporations to report their earnings accurately, with the exception of the banks, who are a long way from recovering trust. China still looks like the Wild West to overseas investors, and not without reason: China is a great leap away from Western standards of governance and rule of law.

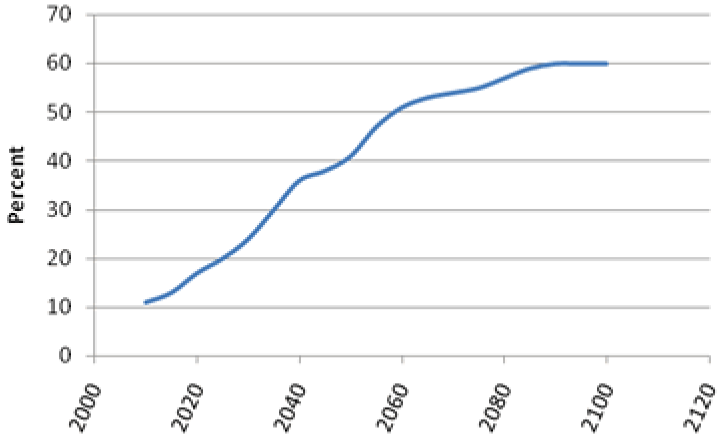
Growth is not a small consideration: if you put $1 into the Chinese market in January 2000, you would now have $2, but $1 invested in US stocks would still be $1. What is troubling is that just three years ago, the Chinese investor would have had not $5, but $2.

The risk to China is not a hard landing, but complacency about the country's visible success. China has accomplished the largest migration in history, and continues to shift nearly 15 million people a year from the countryside to cities. Its demographic problems will not impact the economy for two decades or more, because so many of its people are moving from rural poverty to urban productivity.

Although the overall Chinese population is poised to decline, the absolute number of Chinese engaged with the world economy will continue to rise rapidly for some time. And the present generation of university graduates, for all the deficiencies of tertiary education, is the largest, most qualified and most ambitious in Chinese history.

If China fails to promote fertility, though, the aging and eventual shrinkage of the population will pass a point of no return around 2040. The proportion of elderly dependents will jump to 40% in three decades, which is difficult but not impossible to manage; but unless China regains replacement fertility well before then, the elderly dependent ratio will rise to 60% by 2060, and the Chinese empire will implode.

**China's elderly dependent ratio, assuming constant fertility**



*Source: UN World Population Prospects*

China might fail on demographics, but it also might fail in a number of other ways. If the Communist Party resists democracy, corruption will remain out of control. China will lose entrepreneurs to the Anglo-Saxon world or other countries where capital is available in free markets. Inventors will form companies in the United States rather than China to ensure that intellectual property is protected.

Worst of all, China might draw precisely the wrong conclusion from America's financial crash, and conclude that a command economy offers advantages against a crisis-prone brand of capitalism. And it might conclude further that a weaker United States is in Chinese interests. And the danger is that China might do so just when America - after the 2012 presidential election - gets back on the right track.

China's greatest challenge is not American strength but American weakness. America has no designs on any part of Chinese territory (unless Hollywood decides to invade Tibet), and the Pax Americana in the Pacific creates a backdrop of stability in which China's economy has flourished. If China looks inward more than outward, and regards America as an enemy rather than as an unthreatening rival, it will decline.

*Spengler is channeled by* ***David P Goldman****. His book* How Civilizations Die (and why Islam is Dying, Too) *was published by Regnery Press in September 2011. A volume of his essays on culture, religion and economics,* It's Not the End of the World - It's Just the End of You, *also appeared this fall, from Van Praag Press.*