

THE TIMES

There's one cloud over China's rosy future

Anatole Kaletsky

Last updated at 12:01AM, March 14 2012

The leaders understand how to keep their economy booming, but the ageing population will be a huge problem

I have just come back from China, where the National People's Congress was holding its annual session of stage-managed debates, laying out the policies for China's development until 2018.

Like most people who return from China I feel like shouting: "I have seen the future and it works." But then I remind myself that this phrase was first used by a Western journalist returning from the Soviet Union in 1919. Having got to know China by becoming a major shareholder in one of the leading economic consultancies in Beijing, I see the country's future not in black and white, but in shades of grey.

China is already the world's most important economy in one sense. While it will not overtake the US for another ten years in terms of total output, China already accounts for a larger share of the growth in global economic activity. Thus businesses seeking new markets, or graduates seeking new employment, will find more opportunities related to China than anywhere else. And its dominance of global growth will increase in the years ahead.

While the Government projected last week that China's growth would slow from an average of 10 per cent in the past five years to just 7.5 per cent, China will nevertheless add more to global economic activity than it did in the years of 10 per cent growth. In 2006, China's GDP was \$2.7 trillion, so adding 10 per cent increased this by \$270 billion. But GDP has now risen to around \$8 trillion as a result of rapid growth plus inflation and the appreciation of the renminbi.

Despite this undeniable arithmetic the downgrading of China's growth target seemed to shock financial markets, causing a brief slump in global stock markets and oil prices. Chinese officials found this reaction baffling and amusing. Surely Western journalists and economists must have known that the "new" growth target was decided a year ago and anyway was designed to be beaten. In fact, the Chinese economy is growing by 8.5 per cent this year, with no sign of the property bubble and banking collapse predicted by many Western investors.

Yet there are enormous economic, political and social obstacles to overcome. In the first category, the obvious issue is that China, despite its almost complete literacy, its thousands of skyscrapers, its eight-lane highways, its uninterrupted power supplies and its hundreds of brand-new metro and high-speed rail lines, remains quite a poor country. Dividing its \$8 trillion GDP among 1.3 billion makes China poorer than Russia, Brazil or Mexico, never mind Greece or Portugal. Even when China becomes

the world's biggest economy, its people will enjoy only about one-quarter of the US income per head.

The idea of Chinese living standards ever catching up with the West's seems fanciful when you visit the backward areas of Western China or the overcrowded migrant workers' cottages on the edge of Beijing. To make the breakthrough from poverty to genuine affluence, China must now shift from quantity to quality of economic growth: to environmental sustainability, even more important in water than energy and air; to labour productivity; to innovation; and to efficiency of investment, currently driven more by government fiat than by economic returns.

The good news on this score is that Chinese leaders seem genuine about plans to strengthen banking, liberalise currency movement and reduce the dependence on exports. These plans to "rebalance" the economy may arouse scepticism in the West, especially the US Congress, but they deserve to be taken seriously. Rebalancing has happened already — for example, the trade surplus has narrowed from 10 per cent of GDP to 3 per cent. More importantly, officials seem to realise that China's own interests will be served by careful financial liberalisation, environmentally sustainable cities and strong support for energy transition from coal to solar, wind and nuclear power.

In short, as China moves towards becoming an advanced economy, a model of development is evolving that is still overdependent on central planning and pouring concrete. But this leads to the challenge of politics.

The idea that economic growth would gradually turn dictatorship into democracy has turned out to be wrong. If anything, democracy seems an economic disadvantage if China and India are compared. China, for example has built 30,000 miles of motorway-standard roads since 1990, while India has managed just 300 miles. Even more striking is a Western businessman's account of China's advantage over India as an investment destination. The legal system may be corrupt and unpredictable in both countries, but Chinese decisions are at least quick, whereas India's obsession with "due process" extends court cases for years or even decades.

China's single-party politics can also, paradoxically, promote creativity. Local officials are encouraged to experiment with policies in areas such as education, housing, healthcare and environmental controls. An official who pioneered a new approach to early nutrition on 1,000 children in one remote province declared to me proudly that his programme had been extended to 20 million children after just three years.

But while one-party politics may not harm China's development for several more years or even a decade, unchallenged communist government must eventually come into conflict with economic freedom, consumer affluence and the rule of law. This conflict will be aggravated in the next decade, when China runs into its most daunting social problem — the demographic impact of the one-child policy still officially imposed by the communist regime.

China's working population probably peaked this year and from now will rapidly decline. Today there are five workers aged 20 to 59 supporting every citizen of over

60. But by 2032, that ratio will have fallen to two, the same as it is today in Italy and Germany. How will China cope with the reduction in able-bodied labour? The only answer is another question one constantly hears in China: will we get old before we get rich, or the other way round? That is the biggest issue of all for China.