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Who Bit the Dragon? Understanding China's Downward Trajectory

Falak Arora- 2nd year

Summary: China's economic thrust on the world map has increased over the years. So much so that it was predicted to be the next superpower of the world. But since, a few dents have appeared on the picturesque growth. Zooming in on the fault lines would point towards a structurally weak growth model, a corrupt government, rampant investment in infrastructure and a pending need to increase workers' wages. There is a need more than ever, to shift to a consumption driven model from the present export driven model. The only silver lining is that the government seems to have acknowledged that the so-called Chinese dream needs immediate rescuing. Over the next few years, while the same growth rates will remain elusive for China's citizens, it can still be saved from Japan like conditions if the right policy changes penetrate the economy.

Rewind back to 1978 and China would have been one of the poorest countries, cowed by the puissant powers of the world. Since then, of course, China has miraculously steered its economy, such that it seems to betray its own history today. Deng Xiaoping, China's reformist leader triggered the economy's unprecedented chase in 1982 to realize its potential, catapulting China to the front. In 2012, China accounted for close to 15% of the world's GDP and has lifted more than 500 million people out of poverty since (World Bank). Although, what's redoubtable is the speed at which China has ascended to the top. China recently overtook U.S, adjusted for purchasing power parity, as the world's largest economy. Its GNI per capita is close to \$11,805 PPP dollars, almost 37 times more than what it was in the 1970s. (McKinsey)

However, ominous predictions now cloud the ‘Chinese miracle’. If its critics and the recent growth data are to be believed, China is headed for a definite slow down. Growth in China has fallen to 7.4%, the lowest since 1990 (The Economist). With rising manufacturing costs, softening demand, and property slump, there are definite signs that the economy is sputtering. Mounting debt and increasing job losses, spell bad days ahead. Chinese premier, Xi Jinping calls this the ‘new normal’, as there is a fervent attempt to shift its export-led growth model to one driven by consumption demand. The Chinese middle class, which has become accustomed to the fruits of economic growth, has been worst hit, with rising unemployment and falling wages. According to Financial Times, fall in demand for oil in China too contributed to the overall slump in oil prices.

Mapping China’s growth model would tell you that it was always built on shaky foundations and hence, the strong tremors. China’s export driven model largely follows from Japan and South Korea’s economic models, wherein exports and investment fueled by credit are the major drivers of the economy. Low wages while attracted business from around the world but kept the internal consumption demand low. Hence, the economy is dependent on export demand, which has been drying up, ever since the financial crisis. Economists now worry that China will soon experience the kind of deflation and stagnation that Japan and South Korea did.

After the financial crisis of 2008, the government induced a \$652 billion stimulus package into the economy, in a bid to avoid unemployment (Bloombergview). The government directed heavy funds into its state engines, to prevent them from closing down. China controls the banking system of its country; hence its state owned companies have an all-time access to cheap credit. The government has been accused of creating a large number of state-owned companies in industries such as energy, telecommunications, infrastructure, and auto making, which are inefficient and corrupt. The banks prefer lending money to such low risk avenues than the private players or budding entrepreneurs, thus, preventing the flow of funds into possible profitable ventures to revive the economy. This major misallocation of capital to unproductive firms, are the first signs of a debt crisis in waiting. To quote The Economist ‘For the past few

years China has been on a borrowing binge. Its total debt—the sum of government, corporate and household borrowings—has soared by 100% of GDP since 2008, and is now 250% of GDP; a little less than wealthy nations, but far higher than any other emerging market’ (The Great Hole Of China). This has given rise to shadow banking- a kind of lending that doesn’t make its way to the banks balance sheet. Such massive lending to inefficient businesses will lead to inflation and rising production costs, causing China to lose its competitiveness in exports. The past would teach us that any country with such debt bubbles have a hard landing. Japan, in the 1990s too pretended that its banks were solvent and firms productive, but is now caught in stagnation, that has lasted forever.

China is even more dependent on exports than Japan ever was. Despite the governments reassurances about plugging financial loopholes, non performing assets in 2014 have risen at a pace faster than in 2013. This has incredibly weakened the banking sector. Debt in China grew at 16% in 2014, which is even higher than its GDP growth (World Bank).

Following the stimulus programme and availability of easy money, China undertook over 100 ambitious infrastructure projects. The overdrive has been such that well built roads were rebuilt for the sake of generating economic activity. This has led to the creation of ‘ghost cities’ - completely uninhabited empty cities, with world class infrastructure. The worlds largest mall New South China mall, barely sees any visitors. China is replete with copious bridges, factories, malls etc which lie completely vacant. According to CNBC, ‘China’s problem now is that each yuan of new investment is yielding a diminishing amount of new GDP’ (China Risks Following Japan). So while short term jobs and economic activity was created, much of this new capacity was not required by the market. Adding to this enormous bubble is China’s housing sector. Easy money, encouraged developers to build properties, and expectation of inflation induced potential home buyers to save money in the form of property. But the sudden rise in housing prices has led to a large number of unsold houses. Developers are now left with a large debt which they can’t pay off and are rampantly exiting the business. The risk further remains that if these properties are not filled soon, they are likely to remain empty forever.

The surplus labour advantage that supported China's growth model has dwindled thanks to the 'One Child Policy' followed by the republic. China's population is ageing fast and by 2050 people above the age of 60 will form 30% of the population as opposed to 15% now, while the working age population will fall sharply (The Economist). Manpower, a business-recruitment firm, has estimated that workers may even need to be imported by 2030. This has created a dire need for a large pension system, since single children may not be willing or able to take care of their families alone.

China needs to rebalance its economy, away from investment and more towards consumption. A view that even noted economist Paul Krugman has supported is that in any economy with such high growth rates, consumption should form a much larger share of the GDP. Private consumption relative to GDP is still the lowest in China, as compared to other major economies. And with fears of inflation, due to rising production costs, goods are likely to become costlier, further deterring private consumption. Already due to poor health insurance and pension system, households are forced to save more. China's saving rates is among the highest in all economies, close to 51% of the GDP (CNBC). According to the IMF, "without fundamental reform to rebalance the economy toward consumption and stimulate productivity growth through deregulation, growth is likely to slow considerably." Apart from this the service sector has a large potential for creating jobs and needs heavy investment, while the banking sector needs to be given financial independence to play along the market rules.

The demographics need to be rebalanced and so China must do away with its 'One-Child Policy' completely. Farmers, in China, do not have property rights over their land. It can be confiscated by the government as and when they wish to. Such rights need to be given, especially to those at the bottom of the pyramid. There is a clamour, more than ever, for China's impending need to transform to a functioning democracy.

It is the pages of history that predict the future. China's future, of course, seems saturnine. It is therefore, important for the Chinese government, to realise its ability to alter the future, and to protect the aspirations and dreams of its people!

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Anatomy of Alliances

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Summary: "Nations have no permanent friends or allies, they only have permanent interests". This article aims to validate the above statement made by Lord Palmerston in the 19th century. The analysis of India's relations with USA, UK, China and Japan forms the basis for the conclusion that nations are guided by their own self-interest rather than historical friendship. Therefore, lasting alliances requires that both domestic

compulsions and international dynamics be accommodated.

The character of Bhishma in the Mahabharata claimed that "the force of circumstances creates friends and foes" and this sentiment was again echoed in Lord Palmerston's statement in the 19th century when he