

The factors that drove China's economic growth are now working in the opposite direction, writes Graeme Maxton

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The Western media sometimes seems overly keen to predict the end of the Chinese economic miracle (as well the demise of the euro), often showing a lack of understanding of the real forces at work in both cases.

When it comes to China, news articles rant about the unsustainable tide of debt, a banking system that will crack under the weight of too many rotten loans and a hundred property bubbles waiting to pop.

There will be a crisis, they say, and soon.

These predictions, frequently written by those hoping they will come true, are mostly wrong.

This is not one of those articles.

It is, though, about China and its economic progress. And it, too, concludes that China has reached a turning point, that the great pendulum of economic development, which has provided the country with so much growth recently, has started to swing in the opposite direction. But that has nothing to do with debt, corruption or political shenanigans in Beijing and everything to do with what is happening in the rest of the world at the ending of one global economic era and the beginning of another.

For most of the past 30 years, the world has experienced growth like never before. Global output rose from less than US\$12 trillion in 1980, according to the International Monetary Fund, to a peak of nearly US\$61 trillion in 2008, more than 400 per cent higher. The financial crisis marked the end of this surge, however, and the dark cloud of debt that remains will constrain global development for some time.

It will also constrain China.

China's growth was driven hugely by this global expansion. It was driven by the Western desire to outsource, by the push from American and European companies to shift production overseas. This was made easier during a time of greater global openness.

China's expansion and the world's progress were also fuelled by the pressure to create lean supply chains, to increase efficiency and cut costs. Low commodity prices, low wages in China and few regulations, especially in relation to the environment, made the growth easier still.

These trends allowed manufacturers to cut their prices, which allowed Western consumers to buy more. At the same time, banks in the US and Europe lent more, allowing people to borrow against their houses and cars. Credit card loans came easily.

For 30 years, Western economies grew as if on steroids, not because real incomes were rising but because the price of almost everything was falling and consumers could spend more. The growth was driven almost entirely by borrowing and supported by such opportunities for cost cutting.

The forces that maintained such a long period of global growth are now moving in the opposite direction - and China is becoming caught up in the strong undertow.

The push for outsourcing is waning. Commodities' costs are rising, as are China's labour costs. As wages rise, the value of being in China diminishes. Many companies went to China only for the low labour rates. They stitched shoes by hand, had Chinese workers assemble watches and made car

parts in different ways to take advantage of the cheap labour.

When wages rise in China, its advantage declines. It becomes more attractive to make the goods in Bangladesh, where wages are lower, or even back home again, where processes can be mechanised.

It is not just wages, though. Many companies anticipate higher shipping costs in the years ahead. They fret about a rising yuan, unfair competition, perceived anti-foreign investor regulations, tougher new labour laws and weak intellectual property protection. In October, wind turbine maker Repower was among the latest to say it will leave, citing Chinese protectionism as the main reason.

Light bulb maker Neo-Neon has gone to Vietnam, and Apache Footwear is expanding in India to cut labour costs. Steiff, the teddy bear maker, has gone back to Germany. Canon, Coach and Esprit are all cutting back their Chinese output and expanding elsewhere.

Even some mainland companies want to move away, shifting production to South Asia or Africa. Why make goods in China, many firms now ask, when the advantages are so small and growing smaller?

There is also push-back on openness to trade. The US now wants to keep China in check. As a US election year approaches, the calls for sanctions and trade barriers are likely to become more shrill.

Lean thinking is becoming yesterday's idea, too. Companies around the world are aware their supply chains have become too brittle. The earthquake in Japan and floods in Thailand proved that trouble in one part of the supply system can break the whole chain. For some firms, costs are now being added back into systems to make them more flexible.

Finally, the fuel that has driven Western consumption over the last 30 years is gone. Consumers, banks and governments have borrowed themselves into oblivion. They need to get their balance sheets back in order. Consumer spending has to shrink, banks have to cut their lending, and governments need to raise taxes and reduce expenditures. If they don't, they will all go bust.

With unemployment likely to rise alongside fuel and food costs, Western consumers face a squeeze. Wages are likely to fall, and pensions will be less generous than many once thought. So, the demand from the West for China's exports will weaken, and there is no prospect of it recovering soon.

Many economists talk airily about China's domestic consumption making up the shortfall. Sadly, it will not. Chinese domestic consumption is less than 10 per cent of the combined volume of spending in the US and Europe, and has actually declined as a percentage of the economy in the past decade.

China's economic expansion will continue, of course, and the country will fare much better than most other places in the coming years. Manufacturers will ship more goods to other developing markets, and policymakers will find ways to boost local spending, at least a bit.

But the pace of China's growth will slow, and markedly, for many years to come. The boom times are ending.

Graeme Maxton is the author of *The End of Progress, How Modern Economics Has Failed Us*, published by Wiley. The book was nominated for the Financial Times' Best Business Book of the Year, 2011