

China's Ascendance as Second-largest Economy in the World Pondering Geopolitical Implications



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Prior to the tragic disasters that have recently struck Japan, Prime Minister Naoto Kan's waning political fortunes had seemed to dominate the headlines in Japan. In February 2011, news broke out that China's GDP of USD 5.879 trillion exceeded Japan's GDP of USD 5.474 trillion in 2010. There was mounting pressure on Prime Minister Kan to halt the decline of the Japanese economy. Yet, the inability of the ruling DPJ to persuade the Japanese public and a recalcitrant Diet on the merits of the Prime Minister's financial strategy resulted in a deadlock in the Diet over the proposed USD 1.1 trillion budget for the next fiscal year. As the government grappled with staggering public debt and prolonged deflation, PM Kan's approval ratings plunged to below 20%. When PM Kan himself was implicated in running afoul of the Political Funds Control Law after the resignation of former Foreign Minister Seiji Maehara, it appeared that it was all but certain that Japan would have a new prime minister soon.

Mixed Reactions to News

Yet, exactly how significant is China's overtaking of Japan as the world's second-largest economy? First, this event clearly should not come as a surprise to anyone – as China's growth trajectory has been forecasted for some time now by economists the world over. Neither should this news frighten anyone – at least in theory. In 2007, China supplanted Germany as the world's third-largest economy and, if the economists are to be believed, it will also outdo the US some time in the next 25 to 50 years.

One could therefore consider the event to be largely only a marker in China's relentless long march towards economic greatness.

In Japan itself, initial reactions to this event were somewhat mixed. The official establishment's response has been objective and forward-looking. In the *Financial Times* of Feb. 14, 2011, Japan's Minister for Economic and Fiscal Policy Kaoru Yosano commented that "the Chinese economy's advance is a happy thing for neighboring countries" and that Japan's focus is on improving livelihoods and not "fighting for a ranking". At the same time, regardless of the relatively small amount by which China has tipped the GDP scales, this event will no doubt exacerbate any existing sense of insecurity within Japan, providing fodder for the brewing sense of nationalistic sentiments on the ground. One only needs to look at the popular internet chat rooms to understand this. The image of China's apparently unstoppable rise could complicate the domestic political debate regarding Japan's economic strategy, and is very likely to intensify the differentiation of the political platforms with regard to this. In short, this article argues that the impact of the event is more social-psychological than substantive.

On the part of the Chinese, there appears to have been a subdued but jubilant public reaction when the news was announced. This

jubilance is indicative of a newfound confidence in their country's ascendance in the global order, and at the same time registers the fact that many Chinese people remain blissfully ignorant of the historical antecedents and the developmental trajectory of China's modernization. Even while China's Polanyi-esque great transformation is spectacular, it is hardly trailblazing. Four decades earlier, Japan arose from the ashes of the Second World War to achieve the status of the second-largest economy in 1968. By the 1980s, Japan had become the envy of the world and the de facto leader of East Asia, earning the label of an economic superpower. Both revered and feared, the world watched in wonder as Japanese *zaibatsus* fanned across developing countries building factory towns, while at the same time buying large chunks of premier real estate in first-tier cities like New York and London.

Is China Following Japan's Path?

Many Chinese in their jubilation might have forgotten that Japan, a country with a modest population of 120 million, had retained her place as the second-largest economy for forty-two years since 1968. This is, by any measure, no small feat. Since embarking on her reforms in 1978, China has only managed to catch up some three decades later. China is largely traveling down a path of state-guided capitalism perfected by the Japanese not too many moons ago. Today's China looks and feels a lot like the Japan of the 1970s and early 1980s. At the height of its economic supremacy, Sony Chairman Akio Morita co-wrote with Tokyo Governor Shintaro Ishihara *The Japan That Can Say No*, which advocated greater independence of Japan from the United States. This was only to be followed by a similar book, *The China that Can Say No (Zhongguo Nengshuo Bu)* in 1996. Very aptly, same place, 5L from end, change to Very aptly, in its Feb. 14, 2011 internet edition, *Time Magazine* ran an article entitled "Is China facing a Japanese future?," which stressed that, unless China learns the reasons that the Japanese have fallen behind, it faces the very same prospects that plague the Japanese economy today.

Therefore, even as the official Chinese establishment celebrates this testament of "achievement" to the leadership of the Chinese Communist Party, the nuanced reaction of Chinese intellectuals is heartwarming. Providing dissenting voices to the celebratory ones, many intellectuals and officials are speaking out against the fallacy of measuring a nation's well-being just by looking at the nation's GDP or growth rates. The *China Youth Daily* labeled the moment "empty happiness." Many Chinese scholars have cautioned against celebrating because of the precarious nature of the problems brought on by China's rampant growth.

No one would or should by any stretch of the imagination say China is superior to Japan in any sense just because China's GDP is

TABLE 1

UN Human Development Index and Its Components (2010)

| | HDI rank | Human Development Index (HDI) value | Life expectancy at birth (years) | Mean years of schooling (years) | Expected years of schooling (years) | Gross National Income (GNI) per capita (PPP 2008 \$) | GNI per capita rank minus HDI rank | Non-income HDI value |
|------------------------|----------|-------------------------------------|----------------------------------|---------------------------------|-------------------------------------|--|------------------------------------|----------------------|
| US | 4 | 0.902 | 79.6 | 12.4 | 15.7 | 47,094 | 5 | 0.917 |
| Japan | 11 | 0.884 | 83.2 | 11.5 | 15.1 | 34,692 | 11 | 0.915 |
| Republic of Korea | 12 | 0.877 | 79.8 | 11.6 | 16.8 | 29,518 | 16 | 0.918 |
| Hong Kong, China (SAR) | 21 | 0.862 | 82.5 | 10.0 | 13.8 | 45,090 | -11 | 0.860 |
| Singapore | 27 | 0.846 | 80.7 | 8.8 | 14.4 | 48,893 | -19 | 0.831 |
| China | 89 | 0.663 | 73.5 | 7.5 | 11.4 | 7,258 | -4 | 0.707 |

Source: Extracted from the UNDP 2010 Report

TABLE 2

Perceptions of Individual Well-being and Happiness (2006–2009)

| | HDI rank | Satisfaction with personal dimensions of well-being | | | | | Elements of happiness (% answering 'yes' to having the element) | | | | | | Negative experience index |
|------------------------|----------|--|--------|---|--|---|---|--------|----------------------|--------|------------------------|--------|---------------------------|
| | | Overall life satisfaction (0: least satisfied, 10: most satisfied) | | Job (% of employed respondents who are satisfied) | Personal health (% of all respondents who are satisfied) | Standard of living (% of all respondents who are satisfied) | Purposeful life | | Treated with respect | | Social support network | | |
| | | Total | Female | | | | Total | Female | Total | Female | Total | Female | |
| US | 4 | 7.9 | 7.9 | 86 | 83 | 75 | 94 | 95 | 89 | 88 | 91 | 90 | 28 |
| Japan | 11 | 6.8 | 7.0 | 73 | 68 | 64 | 76 | 77 | 60 | 65 | 89 | 92 | 21 |
| Republic of Korea | 12 | 6.3 | 6.5 | 68 | 71 | 71 | 80 | 81 | 63 | 67 | 79 | 82 | 23 |
| Hong Kong, China (SAR) | 21 | 6.0 | – | 81 | 80 | 78 | 60 | 64 | 83 | 86 | 82 | 82 | 26 |
| Singapore | 27 | 6.7 | 6.7 | 88 | 95 | 79 | 90 | 89 | 81 | 83 | 84 | 83 | 19 |
| China | 89 | 6.4 | – | 78 | 80 | 60 | – | – | 87 | 86 | 79 | 78 | 17 |

Source: Extracted from the UNDP 2010 Report

slightly larger than Japan's. This is foolhardy and ignorant. By all measures, China is still a poor country. The average Chinese worker is still much less well off than his Japanese counterpart. On a per capita basis, the average Japanese is ten times richer than the average Chinese. One would only need to look at any World Bank, United Nations or International Monetary Fund statistics to see the developmental gap between China and Japan. Across all key developmental indexes, Japan is at a much higher plane than China. Japan's urban infrastructure, social security, health care and education systems are light years ahead of China's. (See *Table 1*, extracted from the UNDP 2010 Report.)

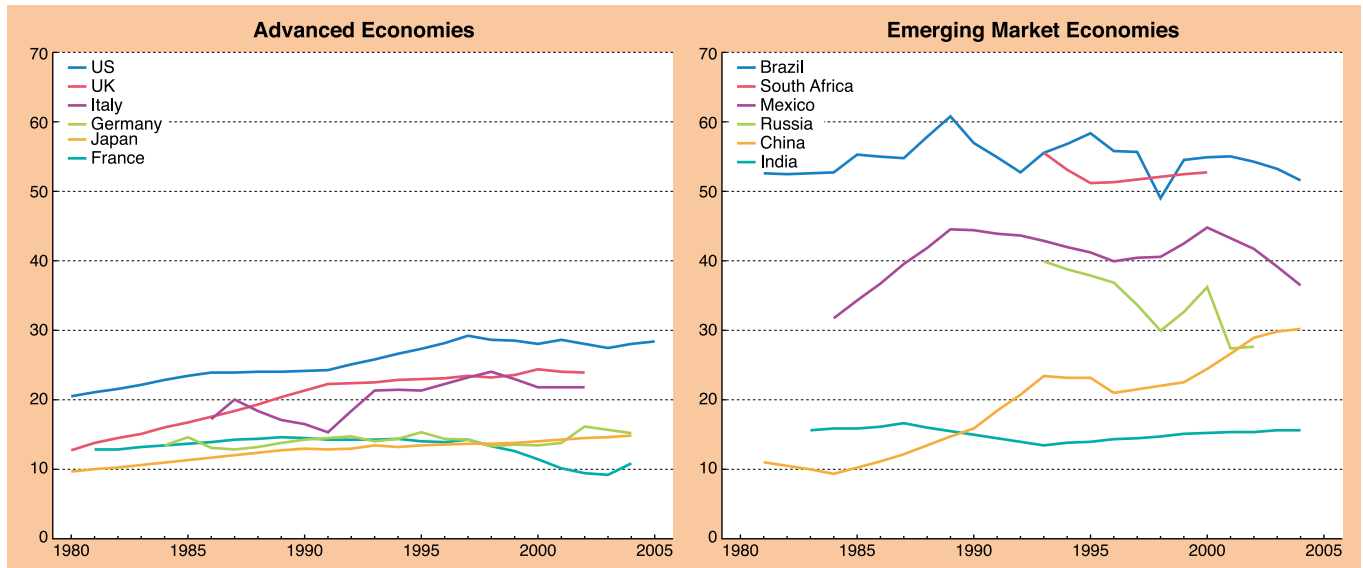
Indeed, this has not gone unappreciated by the Chinese people nor escaped the Chinese government's attention. The *Telegraph* reported on March 30, 2011 that Chinese Premier Wen Jiabao has recently

told PRC officials that it is their job to make the people happy. Their performance will be judged by public satisfaction as opposed to high-profile projects undertaken or infrastructure built. Translated, China's vast bureaucracy is asked to pay attention to quality of living indices like healthcare, education, clean environment and access to affordable housing. Indeed, Chinese academics are now researching the development of a "National Happiness Index" (*Table 2*).

Challenges in Spite of Growth

At this juncture, what is worrying is not so much the rate at which China is growing, but rather the way China is growing her economy. One only needs to turn to the huge amount of literature highlighting the problems with the growth of China and related problems – from

Gini Coefficients in Selected Countries



Notes: Country coverage and years shown are limited to maintain constant country coverage. See Appendix 4.1.

Excludes Hong Kong SAR due to data unavailability.

Figures after 2000 are based on earnings data for full-time year-round workers.

Pre-1992 figures are based on data for West Germany.

Sources: Choi, 2006; Povcal database; WIDER database; IMF calculations

energy depletion to environmental degradation and social unrest. As the *Chart* from the IMF shows, China's Gini co-efficient (as at 2005) is substantially higher than Japan's.

Japanese economist Susumu Yabuki and Stephen Harner have written extensively on the problems associated with China's political economy, discussing a wide range of topics ranging from whether China has an economic bubble to how much of a risk China presents for investors and trading partners. Lester Brown has compelled us to think about whether China will be able to feed itself. Economists have also debated whether China's growth has been primarily driven by capital accumulation or whether it is a culmination of total factor productivity increases – and while not conclusive, my hunch is that it is the latter. Ross Terill noted the “illusory nature of the market in most of the Chinese economy” – and if we know anything about the tight linkages between corrupt officials and big business in China, this is probably true. Gordan Chang's book *The Coming Collapse of China* has predicted several problems that would culminate in the demise of China, notably the problem of the State-Owned Enterprises (SOEs) and the banking system, as well as the associated problems of bad debts and the growing disparity within and between provinces.

Conventional wisdom also tells us that over-investment and excess capacity exact a toll on banks. Over the last two years, China's turbo-charged economy has been primed in a big way by the government stimulus and aggressive lending by state-run banks. Now it would appear that many economists are warning that the money supply is too large and fear that inflation will cause severe problems in the years to come. Premier Wen Jiabao said at the end

of the recent National People's Congress that combating inflation would be key to his government's work this year. In a nutshell, whatever the Chinese government does has repercussions way beyond her border. If left unchecked, China's uneven economic growth and the attendant problems could have huge implications not just for China but for her neighbors as well.

Looking to Future

There are a few important points I would like to share in conclusion. First, given the parity of the Chinese and Japanese economies, the fundamental question remains: can the Japanese and Chinese collaborate and move towards a forward-looking relationship based on genuine friendship and collaboration? Or will China's ascendance as the second-largest economy in the world further intensify the competition between them amidst diplomatic niceties? What will Sino-Japanese relations look like if China continues with its upward trajectory and Japan continues with its existing weak growth and the economic gap between them continues to widen? The interaction between China and Japan over the past few weeks in the aftermath of the tsunami disaster in Japan tells us a lot about the existing trajectory of the relationship between China and Japan. Of particular interest is how the media portrays the issue of assistance to Japan. The Chinese press reported quite widely Japan's rejection of China's offer to have the PLA Navy Ship *Peace Ark* assist in the rescue efforts, highlighting the different responses of Japan's Ministry of Foreign Affairs (MOFA) and Defense Ministry. Over the

same period, the media in Japan highlighted the buzzing of a Japanese ship by a Chinese helicopter in the East China Sea. The deployment of the USS *Ronald Reagan*, and the high-profile assistance of the US did not go unnoticed in Beijing. In Chinese eyes, Japan appears to be a lot more receptive to assistance from the Americans than that from the Chinese. Without doubt, this is interpreted very differently in Tokyo. China and Japan have missed a large number of opportunities in the past to build on their bilateral relations, and in this regard, what they do as they move forward is vital to the geopolitical and economic landscape of East Asia and beyond.

Second, most of the other countries in the region did not respond overtly after news broke that China had assumed the place of the second-largest GDP in the world. The subdued reception by China's neighbors registers the inevitability as well as the unfathomable consequences associated with China's rise. Back in the early 1990s after the Berlin Wall collapsed, a central question that plagued analysts from London to Tokyo, and from Singapore to Washington, was the question of the "China Threat." Would a prosperous and richer China be less of a threat than a poor and revolutionary one? Two decades on, the answer is still not apparent. By and large, concerns have not dissipated. The People's Republic was largely credited for arresting the competitive devaluation of currency in the 1997-98 financial crises, as it was hailed as the bedrock of financial stability in the recent financial crisis. China has shown itself to be one of the main engines, if not the bedrock, that underpins regional economic growth in what in retrospect were two very financially tumultuous decades. China's bilateral problems with Japan aside, the Chinese political leadership today is seen as forward-looking and progressive compared to the previous generations of leaders. China's sustained growth has lifted almost 400 million people out of poverty and almost every Chinese person is doing better than they were a decade ago. Even if India achieves the same feat in time to come, the Chinese Communist Party has the privilege of claiming to be the first political party in the world to make this achievement. This only serves to inspire countries with authoritarian regimes that might for their own reasons be convinced that economic growth can be divorced from political liberalization. Hailed as a political alternative, China's rise provides not only a powerful mode of governance but also a powerful diplomatic counterweight, at least in Asia. In short, the point here is that we are seeing a China which is more capable of asserting leadership in Asia. Is Japan's position as Asia's de facto leader over the past four decades quietly being displaced? The important question here is not just how Japan might react, but rather how China herself and the rest of Asia perceive the situation. Any perceptual and policy gap between China's aspirations and the region's thinking would have major repercussions across the region.

Third, China's growth has had a profound impact on the political-economic landscape of East Asia and beyond. Today, more so than ever, most if not all Asian countries, including those that practice

autarky and self-isolation such as North Korea and Myanmar, are becoming increasingly dependent on China for their growth. This is probably true also for the US and Japan. What is significant here is not just the centrality of China in the global economy, nor the interdependence cultivated, but rather the asymmetrical nature of the relationships China has built. Most countries are reliant on China as their factory, and increasingly as a market. Economists like Holtz have argued that after decomposing China's GDP growth into labor and other variables, we can infer that, given continued sound economic policies, demographics alone suggest China's continued economic growth in the near future. A truism that any first-year undergraduate would know is this: as countries develop, growth slows. Given the increasing asymmetry of the regional countries' relationships with China, is the world prepared for a slowdown in China's economy, say 6-7%, in the coming decades?

Fourth, economists worldwide agree that, barring major catastrophic events, it is only a question of time until China assumes the largest GDP in the world, displacing the US. While projections differ as to when that will happen, we are already seeing the weight China plays in the global economic system. In sum, what we have here is this: the world's largest communist party is at the helm of the second-largest state-led market economy, projected to be the largest in two decades or so, if not sooner. The Party is directly responsible for one-fifth of humanity's living conditions and indirectly affects the well-being of her Asian neighbors and the global capitalistic system. Even though China's GDP is a fraction of that of the US, this event is symbolic of the closing gap between the two, an event which has more serious geopolitical repercussions. China has emerged to be one of the largest holders of US Treasury Bills, holding with Japan approximately 70% of the five trillion dollars of debt issued. As one of the two largest creditors to the "Leader of the Free World," will China be willing to subsume and live by the post-1945 international structure and system that the Americans have built? Will America's banker be willing to continue as her farmer and factory indefinitely?

Clearly, China's ascendance raises more questions than it answers. Some of these problems are obvious and immediate, and others latent, structural, and only beginning to surface. Given the lessons we have learnt from the subprime crisis in the US, and the fact that the world increasingly depends on China as an engine for economic growth, there is plenty of thinking and research to be done. We should understand that the developmental challenges emanating from China's economic modernization are not only China's but everyone's business, and we should see China's growth for what it actually is. Events such as a change in the GDP rankings perceived against this background therefore mean very little. **JS**

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