Can China maintain 5% growth in the coming years?

It’s easy to make an economic forecast, but very hard to get it right. Any country’s economy is prone to fluctuations that make its future development hard to predict, and China is no different.

Economists like to use GDP per capita growth because it measures the growth in the standard of living. When looking at the past 40 years or so, the US’ per capita GDP grew from about $30,000 (USD) to more than $60,000. China, however, started from a very low level of $300 to a level now of about $10,000. This puts the US average growth rate over the past 40 years at just 1.6%, compared to 8.42% for China.

What determines long-term economic growth? Standard economics tells us that there are only three direct drivers of economic growth – investment (the accumulation of physical capital), education (the accumulation of human capital) and technological progress (the accumulation of technologies).

Investment, education and tech: Does China hit all three marks?

Historically, people have attributed China’s rapid economic rise to diverse elements such as government-imposed reform, opening up and globalization, cheap labour, demographic dividends, new industrial policy, and political stability. While significant, none of these things are unique to China. They cannot explain why China continues to outperform the Philippines or Nigeria, Ethiopia or Indonesia. Instead, we must look at what truly differentiates China’s economic growth from that of other countries, especially other developing countries.

01 Investment: Spend or save?

A crucial strength of the Chinese economy is its high savings levels and sustained attraction of high investment. There’s a stereotype that Chinese people like to save, but if you ask consumer goods MNCs where their growth comes from, they will tell you it comes from China. While China’s per capita consumption rate remains low, the growth of consumption has remained high – around 4.4% for the past 40 years leading up to the pandemic. Consumption growth in China is being driven by income growth, even while savings levels remain high. Equally, the availability of high savings (at the individual and national level) enables the financing of high levels of investment, constituting a major driver of economic growth.

02 Investment: Spend or save?

Can China maintain such high levels of growth? Is the recent growth rate of around 5% a year sustainable, or even likely? To make such a prediction, we must answer two key questions:

Q1 What has driven China’s rapid long-term growth in per capita GDP over the past four decades?

Q2 Why has China’s growth rate slowed down in recent years?
Education: Firm foundations for the future

In terms of government investment in education, China remains distinctly average. However, what sets China apart is the rising quality and widespread availability of basic education (primary and secondary).

According to the Stanford Index of Quality of Education, most East Asian economies are at the top, while developing countries are mostly at the bottom. China is the exception: It is a developing country that provides a relatively high quality of basic education. Basic education has a sizeable impact on economies – Stanford believes that a difference of two percentage points of education quality translates into 1% of per capita GDP growth. This is a large part of the puzzle.

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Ultimately, economic fluctuation may be inevitable and it’s clear that growth can be slowed down somewhat by geopolitics or policy mistakes. But, as long as China stays the course of market reform and opening up – or at least does not significantly reverse the current trend of market reforms – then it can still achieve a relatively high long-term growth rate, averaging about 5% a year in the next 10 to 20 years.

Technological progress: More than money

You might think that it is simple for governments to boost their nation’s technological progression rate – just spend more on R&D, right? However, this is not a reliable indicator of tech progress. The global average spend on R&D is just 2%. The UK has a much lower R&D-expenditure-to-GDP ratio than Germany, yet it has outperformed Germany on GDP growth in the long term.

China’s R&D spending is rising rapidly, but this is not led by government policy. This is an indigenous occurrence; it’s coming from companies, entrepreneurs and multinational companies, as well as government spending.

This trend highlights the importance of the previous two factors. China’s per capita GDP growth is being accelerated by a faster accumulation of physical capital (due to higher savings) and relatively higher quality of education – making its workforce more capable of absorbing existing Western technologies, and consequently spurring on greater innovation and technological catch-up.

How long is the economic slowdown likely to last?

If China still maintains the same comparative strengths and differentiating factors that drove its high growth in past decades, why has this growth slowed? Remember, even before the pandemic, Chinese economic growth was already slowing. But why?

The only consistent area of decline leading up to the pandemic was China’s investment rate, which was 18% a year in 2013 but fell to almost 0% by 2017. Policy played a central role here, as the government wanted to guide China’s transition from an investment-driven growth model to a more consumption-driven model, using policies to curb investment in favour of boosting consumption.

What about the geopolitics, such as the US-China trade war? The data implies that this isn’t such an influential factor. China’s US trade levels declined in 2019, but then sharply rose in 2020, 2021 and 2022. China’s trade with Europe also sharply went up. China benefited hugely from its export sector in 2021 and 2022, demonstrating that even in an unprecedented pandemic, it is hard for the world to decouple with China (and vice versa).

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