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## THE OUTLOOK

# China May Be on Course To Overtake U.S. Economy

By **CHARLES HUTZLER**  
 Staff Reporter of THE WALL STREET JOURNAL  
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During the 1950s, China's communist government boasted that its economy would surpass Britain's in 15 years and catch up with the U.S.'s in 30. The prediction proved disastrously wrong, as did Mao Zedong's policies, which brought the economy to ruin.

But now, a half-century later, many economists say those goals look more attainable. Having grown an estimated 9.2% last year and maintained an inflation-adjusted average annual growth rate of 8% or more for the past 25 years, China's economy seems to be on a trajectory to one day overtake the U.S.'s, which has been growing at an inflation-adjusted average annual rate of about 3% for the past 25 years.

Predicting when China will achieve economic primacy isn't an exact science; it depends heavily on assumptions about future rates of growth and currency valuations, among other factors. When economists surveyed last month by The Wall Street Journal were asked to predict when -- if ever -- this would happen, the projections varied widely. Some economists said "never" while a few didn't even bother to take a guess, but most economists said China will overtake the U.S. in the next 20 to 40 years.

"If you take a survey of all the CEOs of listed companies in America and ask them, 'What's the single factor that's going to change the world,' it's going to be China," says Donald Straszheim, an economist who specializes in China and heads Straszheim Global Advisers LLC in Los Angeles. Mr. Straszheim predicts the pivotal moment will come in 15 years.

Understanding this trend is far from academic, with an impact likely to shake up businesses and governments and today's U.S.-driven world order. Having the world's largest economy will give China a greater say in global affairs. Its currency, which is now pegged to the U.S. dollar, will join the yen and the euro as globally traded currencies and in doing so will erode the dollar's position as the world's default coin of choice. China's military, which has enjoyed double-digit budget increases for much of the past 15 years, is likely to grow larger, bolstered by the huge economy.

The Central Intelligence Agency, for one, is taking note. A research arm, the National Intelligence Council, issued a report last month likening China's emergence and its impact on the world to that of the U.S. in the last century and Germany in the 19th. The report says that by 2020 the world's geopolitical center of gravity will tilt toward Asia, especially China, the economy of which will have surpassed

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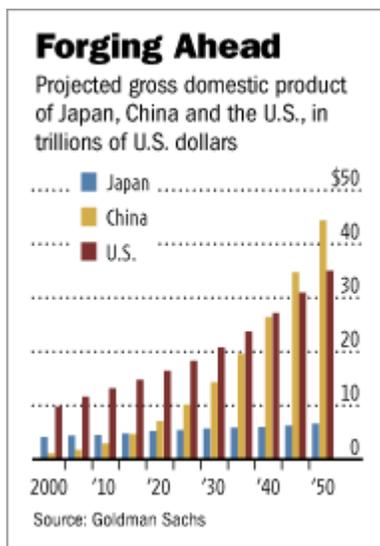
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Japan's to become second only to that of the U.S.

Events could knock China off course. The country is beset by deep-seated problems, from shortages of energy resources and water to severe environmental degradation and an enlarging gap between the prosperous and poor that could generate widespread unrest. Some economists argue that to sustain long-term growth, market economies require political freedom -- something the communist government shows scant intention of bestowing.

The more optimistic predictions aren't based solely on simple calculations of gross domestic product but take into account other factors. Factoring in future appreciations in the Chinese currency, for example, makes the economy relatively larger. Another is purchasing-power parity, which adjusts currency conversions to measure the relative costs of goods and services. Because labor and, hence, many services are so cheap in China, relative spending power is high. Using this measure, the World Bank ranks the Chinese economy as second only to that of the U.S., while in a straight dollar conversion, China is No. 6 -- ahead of Italy and Canada.



The more bullish forecasters say the future China-oriented world already is taking shape. The country is the No. 3 trader in the world, behind the U.S and Germany but ahead of Japan. Already China is trying to leverage its roles as huge consumer market and world workshop to influence the technology standards on wireless computing and communications, much as the dominance of Microsoft Corp.'s personal-computer operating system helped it become the global standard.

Underpinning these dynamics is a unique advantage: "Size does matter," says Oded Shenkar of the Fisher College of Business at Ohio State University. Author of the recently published book, "The Chinese Century," Mr. Shenkar predicts China will assume the No. 1 spot within 20 years. His estimate does include adjustments for relative purchasing power and like many economists, Mr. Shenkar says government statistics underestimate the true size of the Chinese economy, by as much, he says, as a fifth.

The lure of this big market getting bigger year by year is drawing ever greater amounts of foreign investment, \$60 billion last year, creating, Mr. Shenkar says, a virtuous cycle. "The additional investment is going to make the Chinese economy grow faster," Mr. Shenkar says.

Sustaining long periods of strong growth is hardly unprecedented. If China edges out the U.S. in, say 2041, as a Goldman Sachs research paper predicted in 2003, it will have done so in about 65 years. The U.S. took about 100 years to surpass Britain as the world's No. 1. Japan rose to second place from the ruins of World War II in 30 years.

China has many of the advantages that the U.S. and Japan enjoyed in their ascents. Like the U.S., it has land in abundance and a sizable domestic market, which drives internal demand. Like Japan, China has a highly educated population, an undervalued currency and access to capital and technology.

China also has a history of economic supremacy, having been the world's largest economy for much of the 700 years starting around 1000. In an echo of today's capital and technology transfers, the

introduction of early-ripening rice and later of New World crops like maize and sweet potatoes created food surpluses, allowing the buildup of porcelain and silk industries that dominated global trade, says Kent Deng, an economic historian at London School of Economics. As late as 1730, historians say, the country produced a third of the world's manufactured goods. China currently dominates about 12% of world manufacturing.

Yet history provides another lesson that puts the Chinese economic leviathan in perspective. Despite its dominance, the country was quickly eclipsed by the rapidly industrializing Western European nations and the U.S., in part because it failed to develop systems of scientific research and ways to commercialize findings. Much the same criticism is leveled today at Chinese companies and government, whose research and development spending trails that in wealthier nations.

But even if China manages to maintain strong growth and rival the U.S. in economic size, its people still won't be rich. According to the Goldman Sachs research, by 2040, gross domestic product per capita in China will be about one-third that of Americans. That will somewhat mute the significance of grabbing the No. 1 spot.

**Write to** Charles Hutzler at [charles.hutzler@wsj.com](mailto:charles.hutzler@wsj.com)<sup>1</sup>

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