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Transformation process in China

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The rise of [China](#) is a story of success. The average annual growth rate of [GDP](#) in the past 38 years has been an impressive 10%. At this point, [China](#) is the second-largest economy in the world, accounting for almost 16% of global GDP. The economic rise has been accompanied by an enormous increase in relevance in the areas of [technology](#), [geopolitics](#), and [military](#). Can this success story last?

Transformation process

GDP per capita, adjusted for differences in purchase power, is an important benchmark of the state of development of an economy. Here, China has reached the important threshold of USD 18,000 per capita last year. This is roughly 29% of the developmental status quo of the USA (GDP per capita of USD 62,000). At this level, economies run the risk of falling into a stagnation phase (i.e. the so-called middle-income trap).

The model of high growth through capital accumulation has become unsustainable. The infrastructure (cities, rail tracks, ports, internet) is fully set up. Ultimately, the probably most important measure illustrating the development potential of an economy is its productivity. According to estimates, average productivity growth (total factor productivity) is around 3%.

In order to ensure the maintenance of this comparatively high value, the Chinese economic policy has in the meantime set off another, highly ambitious transformation process. Broadly speaking, it focuses on the strategic transformation from quantity (high growth through capita accumulation) to quality (higher value-added through innovation and technological change).

- The growth focus has been shifted from the production to the service sector, from investments to consumption, and from the external to the domestic industry.
- The strategy "Made in China 2025" (or MIC2025) is a blueprint for the improvement of value-added in the important sectors of the industry, geared towards the achievement of technological leadership in about 30 technology sectors. Also, a bigger share of high technology is to be produced domestically (e.g. semi-conductors). China also intends to become the technology leader in the key industry of Artificial Intelligence by 2030.
- The New Silk Road ("Belt and Road Initiative") is a collection of different investment projects outside of China with the goal of the integration of Eurasia with Africa and China.
- At the same time, the currency is being internationalised with a long-term perspective. As a result, more and more transactions – goods, services, and finance – are being settled in renminbi instead of US dollar. The Chinese currency, renminbi, is now also official reserve currency, i.e. it has joined the basket of special drawing rights of the International Monetary Fund (IMF). And Chinese securities are indeed increasingly finding their way into international equity and bond indices.

Chart: Key Indicator Productivity Note: Past performance is not a reliable indicator of future performance.

Multipolar world

The rise of China to a global power has of course created a sense of rivalry with the incumbent, i.e. the [USA](#). Said rivalry is driven by a rise in nationalist and protectionist attitude. At the moment, the possible failure to reach an agreement in the trade talks between the USA and China is dominating the markets. The controversial subjects are:

- the balance of trade deficit of the USA with China
- the allegedly forced technology transfer from US to Chinese companies
- the bad level of protection of intellectual property rights
- the protection and support of Chinese companies (protectionism)
- the future development of the Chinese currency
- the Chinese industrial policy (MIC2025)

A further escalation of the trade conflict between the USA and China would come with negative repercussions for the global economy. In that case, China would probably take stimulus measures (higher public spending, lower taxes, higher credit growth, weakening currency). However, even if a compromise were to be reached, it would not do away with the strategic

rivalry. Future conflicts are inherent to the new, multipolar, more nationalistic world order. This does not change the fact that China's success story will continue as long as good productivity growth can be sustained.

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