The world's 'CONSUMER OF LAST RESORT'

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China, rather than the US, could soon be the world's 'consumer of last resort'. To earn that status, which would mean that Chinese rather than US consumers would be the biggest single driver of the world economy, China must avoid a 'trap' among other challenges.

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La Samaritaine department store in Paris that was founded in 1870 is of such majestic art deco and art nouveau styling it was declared a national monument in 1990.[1] The building, nonetheless, was closed in 2005 because it was ruled unsafe.[2] Since then, Amazon and e-retailing more generally have battered department stores the world over and many have closed. Yet La Samaritaine is set to be reopened – even if that is delayed until next year due to the coronavirus. And when La Samaritaine does reopen, expectations are that it will achieve the buoyant sales enjoyed by other household-name department stores in Paris. Why the optimism about old-style retailing? Chinese shoppers. They are keen buyers of the 75 luxury brands offered by LVMH, the French icon that owns La Samaritaine.[3]

The spending power of Chinese consumers has reached well beyond Paris – their outlays drove 31% of the growth in global household spending from 2010 to 2017.[4] The influence of Chinese consumers is a tribute to the economic reforms launched from 1978 in the country of 1.4 billion people. After four decades of uninterrupted growth averaging about 10% a year until the virus-induced decline in the first quarter of this year, China's GDP is 30 times its size of 1980 while GDP per capita is 24 times higher.[5]

The result is that China now has middle and upper classes of about 400 million people who are wealthy enough[6] to make the Chinese the world's biggest spenders on luxury goods[7] and foreign travel,[8] to name just two segments. The mainly urban-based spenders could soon devote more to movies than Americans.[9] They are valuable customers the world over to education providers and farmers and many more industries. They have prompted household-name companies, from Apple to Walmart, to open outlets in China. They are, of course, powering local giants. Young Chinese are especially spendthrift. While 'young free spenders' are only 25% of the population, they accounted for 60% of China's consumption growth in 2018[10] and ensured that Alibaba's 'Singles' Day' sales have topped those of the US's Thanksgiving ('Black Friday') since 2013.[11]

As most economies expand over time, the fact that China's population is 4.2 times larger than the US's 330 million tally indicates that the Chinese could soon enough overtake Americans as the world's 'consumer of last resort' – jargon for saying they will become the biggest and most reliable single driver of the world economy. The gap? US household spending totalled US$13.6 trillion in 2018 (to comprise 68% of US GDP) compared with US$8.4 trillion for China (38.5% of that country's output).[12]

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While the emergence of the Chinese as the world's biggest consumers seems almost preordained given they need consume only about 25% of what do Americans, the speed of the ascension is a more open question (virus-triggered disruption aside). China's challenge is that few countries make the transition from developing to advanced status because economic models based on low-end manufacturing exports and cheap labour can't easily make this leap.

To surmount this challenge, Chinese policymakers must modernise their economy even more. They are attempting to do so by, first, seeking to boost productivity to bolster living standards and, second, by ensuring that consumption becomes a bigger driver of this expanding economy. These fixes are likely to succeed for three reasons. The first is China has easy productivity gains within reach because much of the economy is still rudimentary. The second is that recent GDP growth (helped along by exports and investment) of an average of 6.6% per annum from 2014 to 2019 is providing economic momentum – past growth, for instance, has created jobs in cities that encourage urbanisation that prompts investment to expand city facilities, and so on. The third is government-driven increases in wages and more spending on social security are boosting consumption by increasing people's spending power and reducing their need to save. The result is China's middle and upper classes are likely to expand briskly in coming years. Before too long, the Chinese will overtake Americans to become the key single determinant of the world's economic health.

The US consumer will still be crucial to the world economy and global financial markets, of course. China's consumption could take far longer than expected to overtake the US's because things can go awry with any economy at any time, especially one with China's debt at 260% of GDP.[13] The rise of the Chinese consumer comes with disadvantages for the world and China. One drawback for the world is that China's government is willing to weaponise its consumers to achieve political goals.[14] The risk for Beijing of a rising middle class is that history shows the nouveau riche are more likely than the poor to demand political reforms (due to the phenomenon called the 'revolution of rising expectations') though there's no sign of unrest in Mainland China.[15] The growth in the middle and upper classes, by default, means that inequality is rising in China, a recipe for political disgruntlement. Even with swelling middle and upper classes, China is still a poor country when measured on a per capita basis (average annual income of US$7,723 in 2018) because it contains hundreds of millions of poor.[16]

But that's more or less the point. Even if China expands at only sluggish rates, the GDP per capita is likely to rise enough in coming years to double the number of Chinese considered middle class. As such, the next stage of China's industrial revolution is geared to transform the world economy.

TRAPS AND TURNING POINTS

In 2015, Chinese Premier Li Keqiang addressed the country's annual parliamentary meeting in the Great Hall of the People in Beijing. "Deep-seated problems in the country's economic development are becoming more obvious," Li told the 3,000 delegates at the National People's Congress. The country "must rely" on reforms "in order to defuse problems and risks (and) avoid falling into the 'middle-income trap'".[17]

With the last phrase, Li was referring to a term two World Bank economists[18] invented in 2006 to describe the stall in growth developing economies undergo after they have mobilised labour to rise from low- to middle-income status, a phase, when workers shift from agricultural to manufacturing, that is notable for high productivity gains. Once reaching middle-income ranking, when the shift of labour from manufacturing to services slows productivity growth, most countries fail to raise living standards to those of advanced countries. Their handicaps typically are that they lack the skilled workforces, high-end manufacturing, financial sectors, institutions, governance standards and rule of law that advanced countries possess. [19]

While China's political system precludes the rule of law, governance standards need to improve, the state sector is bloated and the country has an ageing and soon-to-dwindle population, China is better placed than most developing countries to match the ascent of Hong Kong, Israel, Japan, Korea, Singapore and Taiwan from developing to advanced status. Studies on the middle-income trap (a concept that has its critics) have found that countries that possess educated populations and diverse, sophisticated and non-standard export bases best pilot their way from middle to high income. [20]

Given that China has these advantages, Beijing's overarching productivity fix is to allocate resources more efficiently by preferencing the supply-and-demand mechanism over central planning. The country is ripe for productivity gains because many of its industries operate below modern standards in terms of technology and practices. One IMF industry-based study released in 2019 forecasts that with reforms China's productivity is likely to jump from 30% of the US level in 2015 to 45% by 2030. Such achievable productivity gains are likely to ensure that China achieves robust economic growth over most of the 2020s before growth slows to 4% p.a. by 2030, the study found. [21]

Steps underway to boost productivity include the opening up and reforming of the financial sector to better funnel savings to productive use. Other moves to boost productivity include easing operating and entry restrictions on private and foreign competition, revamping state enterprises, making it easier for businesses to get power, strengthening protections for intellectual property and fostering technological advancements. [22]

Higher productivity will allow China's policymakers to hasten the shift to a consumption-led economic model.

To boost consumption as a percentage of output, Beijing increased wages by an average 8.2% p.a. from 2008 to 2017 – which means they more than doubled – a result well above the 0.63% p.a. score for the US over those 10 years. [23] Authorities have corrected mispricings of the yuan and interest rates to boost consumption – a higher yuan makes imports cheaper (while hurting exporters) while higher rates give savers more income (while raising borrowing costs for state firms). Within fiscal policy, they made the tax system more progressive, widened the tax base and boosted social spending. [24]

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For all the country's challenges (that now include growing tensions with the US and its allies), Chinese authorities are succeeding in their quest to make the country more productive and one driven more by consumption. China surged to 31st on the World Bank's 'Doing Business 2020' rankings – from 78th place two years earlier. [25] Consumption growth accounted for 76% of GDP growth in 2018 compared with only 47% five years earlier. [26]

China's rising consumption helps the world economy and no doubt Chinese spending will be evident at the reopened La Samaritaine once global travel is back to normal.

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