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# Sustaining a Platinum Age

China's growth is at the same time powering and threatening global prosperity, writes **Ross Garnaut**.

China is at the centre of what may become the most powerful growth episode in world economic history. How sustainable is this episode in China? The answer depends on the approach that is taken to resolving tensions with major international partners.

China's strong and accelerating growth, with moderate inflation and growing external payments surpluses, has continued over the past year. Output growth reached 10.7 per cent in 2006, taking the average over the past three years to 10.4 per cent - almost a percentage point above the average for the first quarter-century of the reform era. It was up again, to 11.1 per cent, for the year to the first quarter of 2007.

Investment as a share of Chinese output has increased again in 2007, from levels that many had said were unsustainably high. There are no necessary reasons for the investment share to fall in the foreseeable future.

The longer strong growth continues in China, the greater is China's influence on global outcomes. Global growth looks set to exceed 5 per cent in 2007 for the fourth successive year - higher than the 4.9 per cent average of the postwar "Golden Age". This could turn out to be a "Platinum Age".

Driven by relentless expansion of Chinese demand, global commodity prices have reached and then remained at levels in real terms that are higher than they have been before for comparably long periods, without upsetting the strong trajectory of non-inflationary growth in China or the rest of the world.

The most challenging questions about the sustainability of growth today come from China's relations with the international economy.

The sharpest point of contention is the foreign exchange value of the yuan. Exchange rate appreciation accelerated against the US dollar early this year, but remained gradual to the point of exasperation to those who looked for this to be the mechanism for correction of payments surpluses. Exports continue to grow strongly, and imports moderately, as productivity growth outweighs the effects of rising labour costs and currency appreciation on international competitiveness. This raised tensions with the United States. It makes sense for China to contribute to a reduction of the payments surplus, but effective adjustment would require use of a wider range of Chinese policy instruments than feature in the American discussion, and also policy adjustment in the United States. There are risks that misjudgement on two sides of the Pacific could be damaging to both.

The use of the Chinese surpluses to purchase Western financial assets (especially US official securities) on a massive scale underpins contemporary global stability and growth by keeping real interest rates well below where they would otherwise be. Any fracture in China's trade or payments relations with the international system that emerged from developed countries' political responses to Chinese surpluses would threaten prosperity through this financial as well as real economy mechanism.

The growth and internationalisation of Chinese equity markets has proceeded to the point where market influence now goes from China to the world's major markets, as well as in the opposite direction.

China is not a major part of the historical reason that the world faces large problems of anthropogenic warming. But sustained rapid growth in China, fuelled to an unusual extent by coal, the most emissions-intensive of substantial energy sources, is accelerating the world's movement towards critical points. In 2006, China overtook the US as the largest emitter of greenhouse gases.

This potential threat to future global prosperity is the other side of the coin to the exceptional prosperity that Chinese growth has conferred upon the world, and especially to resource-rich countries such as Australia.

The answers lie in creating new markets, inside China and internationally, to enhance the social and economic efficiency of all the other markets whose deepening and improvement have generated the present Chinese and global prosperity.

Last year's Australian National University annual review of research on the Chinese economy drew attention to the approach of the point in development at which labour becomes scarce and rises in value. This triggered much discussion and new research within China on the rising cost of labour and the implications of this for the national economy.

A recent article by Wu Zhong records the results of a survey for the Development Research Centre of the State Council. Seventy-four per cent of the villages no longer have any surplus labour available for employment in distant cities.

Wu also draws attention to the Green Paper on Population and Labour published by the Chinese Academy of Social Sciences last month. The paper notes that labour will be "short" throughout China by 2009, in rural as well as urban areas. It describes an acceleration in wage increases of rural migrant workers, from 2.8 per cent in 2004, to 6.5 per cent in 2005 and 11.5 per cent in 2006.

Rising labour incomes are the fruit of the long growth process. They will support the necessary adjustment in China's payments with the rest of the world. At least for a while, they will also intensify Chinese pressure on global resources.