Op-ed: What Japan's 1980s boom and bust can tell us about the Chinese economy

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In the 1980s, Japan was the envy of the world.

Its economy grew rapidly to become the second largest in the world, led by a strong central government, a surging and increasingly productive manufacturing sector, easy access to money and credit, and protective trade policies that spawned huge surpluses with the U.S.
Then the bubble burst, followed by three "lost" decades of economic stagnation.

While history doesn't repeat, it does often rhyme, and the Japanese experience may very well offer important lessons that are relevant for China, the current second-largest world economy. Three, in particular, stand out.

An aging population

- China is aging at one of the most rapid paces of any major economy with remedies difficult to find.
- The migration from rural to urban areas represents the biggest driver of a population that's expected to decline at an accelerating rate over the next three decades. Urban living typically coincides with declining birth rates given the higher expenses.
- Even with its more liberal 2-child policy adopted in 2015, China's birthrate last year was the lowest in 70 years of communist rule.
- An aging, shrinking population means China will need robust productivity growth to continue experiencing meaningful economic growth.
- Similarity to Japan: This massive demographic headwind is almost identical to the pressure that hit Japan hard in the 1990s.

Goodbye manufacturing advantage

- China's manufacturing advantage is disappearing.
- Companies primarily moved production to China in recent decades to access its cheaper labor. Manufacturing, however, has changed. The products we consume generally are

less labor-intensive in their production, and production methods themselves are less labor-intensive, as machines keep replacing workers.
- This erosion in China’s competitive advantage is being driven further by cheaper labor options among neighboring Asian countries.
- Similarity to Japan: Similar constraints on the energy and competitive manufacturing fronts slowed Japan’s rise, as well.

Not so mixed

- China’s “mixed economy” isn’t all that mixed.
- While Chinese authorities have introduced capitalistic elements, China for all intents and purposes remains a command economy with the government firmly in control.
- This presents major challenges to its future development, writes Cato Institute Senior Fellow and China specialist James Dorn, who sees “no free market for ideas that is essential for innovation and for avoiding major policy errors.”
- These challenges have been most evident recently in Hong Kong, as the financial center of Asia has deteriorated rapidly into a state of open rebellion, and in trade talks with the U.S. and other countries that are openly accusing China of intellectual property theft in its efforts to improve its ascendant but still inferior technological standing.
- Similarity to Japan: Japan was not viewed with the same disdain or suspicions, but its highly homogeneous society and keiretsu business structure hampered its ability to adapt as the global economy became more digitized and diverse.

This backdrop helps explain China’s concerted efforts to catch up, and surpass, the U.S. in the technologies that are driving the digital revolution—goals memorialized in its Made in China 2025 strategic plan.

In a world where labor represents a smaller share of overall input costs, the center of the U.S. is perhaps becoming the world’s most attractive “emerging market.” It has cheap and easy shipping routes to attractive end-markets on the East and West Coasts, abundant oil and gas resources, ironclad intellectual property protections, one of the lowest tax rates in the world, an educated workforce and policymakers who are keen to bring investment back to the U.S. China very well may have made a critical strategic error in being too forward with its ambitions in unveiling these goals, underestimating the U.S.’s resolve to maintain its place as the preeminent economic power.

China knows it can survive and thrive in a world led by the U.S. The U.S., on the other hand, does not know that its values and interests would be safe in a world led by China. As such, consensus appears to have formed in a bipartisan manner, both in the halls of Congress and among the public at large that the U.S. needs to defend and protect its intellectual property. Policymakers will likely continue to push back on advanced technologies while finding ways to incentivize companies to “come back home.”

Given this long-term strategic struggle, we expect heightened tensions will continue to play out between the U.S. and China, in part because Chinese authorities might be forced to play a weaker hand.

Over the course of 2020, relations are at risk of descending toward a more Cold War-like scenario, further enflamed by rising resentment at China's lack of transparency in the initial stages of the Covid-19 pandemic. Ultimately, as long as the U.S. remains committed to protecting its economic interests, its advantages in terms of economic freedom, population growth, technological superiority and more efficient allocation of capital are likely insurmountable.