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Paulson: China Economy in Deep Trouble

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Don't look for an Olympic bounce to offset China's very real economic problems, says U.S. Treasury Secretary Henry Paulson.

With the games behind it and international attention shifting, China must now contend with domestic economic problems, says Paulson.

"Serious troubles in China's economy could threaten the stability of the U.S. and global economies," writes Paulson in Foreign Affairs.

Several problems looming on China's economic horizon could impede the nation's unprecedented growth and stifle it for years to come.

China's workforce is moving to urban centers and demanding higher pay; there is an ever-widening gap between the rich and the poor; and the country faces a dangerously depleted energy supply, along with shortages of commodities.

"Americans who worry that China might overtake the United States are worrying about the wrong thing," Paulson said.

China's population will be mostly urban in the coming years, climbing above its current 40 percent to 45 percent. The urban populations of Western Europe and Latin America stand at about 75 percent.

Attracted by urban salaries more than triple those of rural areas, some 10 million farmers annually have been moving lately into China's cities.

Yet as the Chinese population grows older, there will be fewer workers to support them. By 2015 and beyond, the work force will start declining, a consequence of China's decades-old laws restricting family size.

Adding further to China's future problems is the country's omnivorous appetite for commodities and raw materials, with demands for energy topping the list.

Although far from being exhausted, China's natural resources, including breathable air, arable land, and potable water, have been substantially diminished and will continue to shrink as consumption increases.

Shortages of electric power and gasoline already are notable. If these shortfalls continue and increase in step with increased consumption, economic growth could be significantly impaired.

Paulson, in addition to his warnings on the Chinese economy, had some recommendations which could encourage diversification and sustain the nation's growth.

Among them was his call for flexible pricing and a flexible exchange rate that more accurately reflects economic fundamentals.

"A more dynamic and competitive financial sector would also channel resources for investment into the new, less capital-intensive industries, such as the services and information industries, that will drive China's growth in the future," Paulson also said.

Paulson's view is supported by China scholar Homi Kharas, of the Brookings Institution, and previously the World Bank's chief Asia economist.

"The strategies that have helped China grow from poverty to its current levels will not yield the same dividends in the future," says Kharas, quoted in The Wall Street Journal.

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