

The Latest Thinking

seemed to transmogrify worries about debt and austerity into more elemental, diffuse and darker impulses. “If people are afraid and feel powerless, the act of destruction becomes an act of agency, and they seek out a segment of society to blame,” said Pamela Rutledge, who studies how emerging technologies affect cognitive psychology. “Fear hampers our cognitive and moral capacities. It makes us worry about ‘not enough’ and about ‘losing what’s ours.’ It creates a divisive, us-versus-them environment that influences our behavior.”

The starkest example of that was

provided by the riots that ignited across Britain in August, for which no clear reason was evinced other than a vague, smoldering sense of class warfare. Social anthropologist Gabriele Marranci found those riots “unusual in many aspects, such as the heterogeneity of those involved, the dynamic of how they started, a lack of apparent common strategy and a lack of shared reasons for rioting. [The riots] appeared more to be a collective case of violent hysteria than an actual riot in the traditional sense.”

Perhaps the lesson of the volatile and violent summer of 2011 is

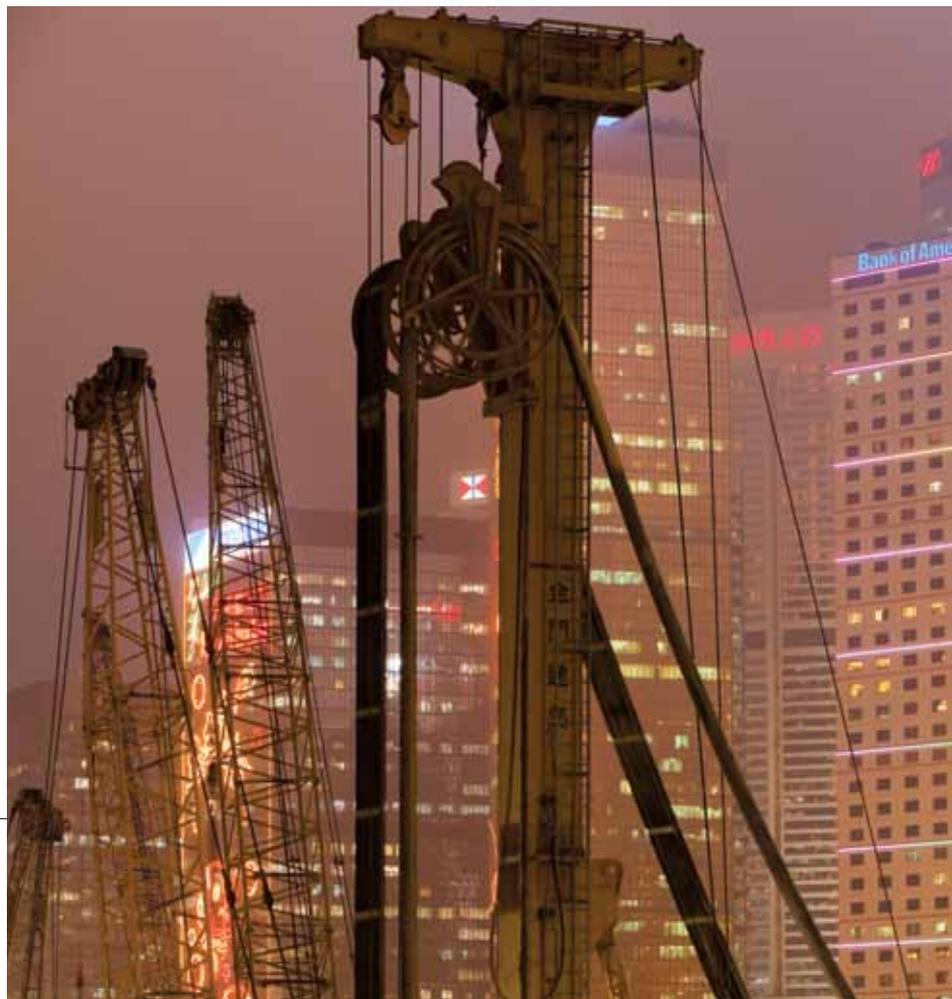
not only that our global society has become inordinately fearful, but also that it is becoming dangerously, maybe irretrievably, derivative. As technology has made us obsessed with tracking and “trending” one another’s every action, utterance and data point, we have become caught in a vortex of derivative thinking and derivative action. As we wonder “what it all means for me,” we are inexorably drawn to the dominant narrative, real or imagined, that offers some sense of solidity and solace. And in the process, we put our originality, morality, resistance and good sense at great risk. 

Can China Continue to Grow?

With direct investment underperforming, inflation flaring and a real estate bubble looming, the world’s second largest economy must find a new model for sustainable growth.

China, most experts agree, is at a crossroads. Over the past 20 years its mercurial growth, which has increasingly shaped the global economy, has been based upon massive fixed investment – roads, bridges, buildings and machinery – as well as low-cost exports, inexpensive labor and artificially cheap money. Many believe this has been a recipe for a “hard landing” – a sharp slowdown in capital spending and precipitously slower growth overall.

Among the most pessimistic is Michael Pettis, a senior associate at the Carnegie Endowment for International Peace’s Asia Program, who recently summarized his view in *The Wall Street Journal*: “China’s growth was based on large increases in government-directed investment. As a consequence, it had to run large trade surpluses to absorb the resulting



MT. IPAD: The world's information is doubling every two years, with a colossal 1.8 zettabytes to be created in 2011. Storing 1.8ZB would take 57 billion iPads that, if stacked, would be 25 times higher than Mt. Fuji. Source: IDC and Mashable.com

excess capacity in manufacturing. This can't continue. Investment, especially in infrastructure and real estate, is increasingly wasteful. With Europe in crisis, and Japan and the U.S. struggling with their debt, demand for China's exports will stagnate."

As the original driving forces of China's economic growth become less tenable, many experts point to domestic consumption as the engine that will replace them. "China will only continue to grow robustly if it makes the transition from an export-dependent economy to one driven by domestic consumption and investment, coupled with key reforms, including better health care and pension systems and allowing the yuan to strengthen," said Peter Navarro, professor of economics and

public policy at the University of California, Irvine, and co-author of *Death by China*.

But even as experts debate where China's future growth will come from, capital is still flowing into the country faster than it is flowing out, and the economy is overheating. In the second quarter of this year, it expanded 9.5 percent, higher than forecast, and consumer prices jumped 6.4 percent, the most in more than two years, stoking fears of inflation. Many of China's foreign exchange reserves, which now exceed \$3 trillion, continue to be loaned out by state-owned banks, and many of the new loans are going into the already overstimulated property market.

"Concerns are centered on the property market, where activity has been excessive since the government rolled out stimulus measures in 2008," said World Bank economist Ardo Hansson. The number of newly constructed housing units as a percentage of the number of households in China is already much higher than it had been in Japan or the United States at any point in their history. The average property price-to-income ratio is already about 10 across China and more than 15 in the larger cities. In comparison, the U.S. housing bubble peaked with this ratio at six.

To soak up liquidity and curb inflation, China's central bank has raised interest rates four times since last October and has also increased the reserve requirement ratio for banks eight times over the same period. Unfortunately, many argue, these curbs will greatly reduce the

demand for real estate just as a huge new supply comes to market, contracting property prices and construction activity, lowering commodity prices and overall growth, and leaving many lenders stuck with bad assets.

Michael Pettis believes it will not be easy to generate enough domestic consumption to counteract that downturn. He points out that, during the past decade, China's consumption share of GDP has fallen from 46 percent to 35 percent, while investment has grown to constitute nearly half of GDP. "If China is to replace investment with consumption as the engine of growth," Pettis said, "households must get a rising share of overall growth."

In an attempt to give the country's 1.3 billion people more spending power, Chinese Premier Wen Jiabao has targeted a 13 percent a year increase in the minimum wage and a 7 percent a year increase in per capita household income through 2015. He is also improving the social security and health care systems to help low-income households, and is raising the personal income tax threshold. These measures have begun to have some good effect, increasing domestic consumption to the point where it is significantly reducing the nation's disproportionate trade surplus. The value of China's imports hit a record high of more than \$400 billion in the first three months of this year.

However, even as rising wages stimulate domestic demand, they are making Chinese workers more expensive and less competitive globally in exactly the kind of low-cost manufacturing that has formed the

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basis of the Chinese economy. That, however, may push China's export strategy in a direction many believe it needs to go in order to create sustainable future growth. "As wages are going up at a very fast rate, this will force China to not just knock off designs from the West," said disruptive-innovation avatar Clayton Christensen. "They'll have to compete on innovation, because other countries will take the low end."

Such a recalibration of thinking may already be evident in the auto industry, where government officials have called for China's automakers to shift their focus away from low-cost, high-volume production toward producing more fuel-efficient and technologically advanced models, in part to address China's rising dependence on imported oil. "For the auto industry to develop, we should not

try to sell more, but to improve the units sold," said Li Shize, the director of air pollution control at the Ministry of Environmental Protection.

That kind of innovative production higher up the value chain may also offer China a way to sustain a more healthy export trade by selling quality and establishing brand identity in developing countries. "China's companies face tough competition in advanced markets where, in terms of brands, they are up against firms such as Apple. But in developing economies [like Brazil, India, Russia, South Korea, Indonesia or Mexico], companies such as Haier and Huawei are already building up strong brand positions," said John Ross, visiting professor at Antai College of Economics and Management at Jiao Tong University. "Expansion by [Chinese] companies in developing econ-

omies would give them rapidly increasing revenue to plow back into R&D, which strengthens their challenge in the developed markets," he said.

Even if such a combination of domestic consumption, innovation and continued export vitality does compensate for the growing weakness in capital spending, most experts believe that China's growth is likely to slow to around 7 or 8 percent in the foreseeable future. But then, as Andrew Erickson wrote recently in his research newsletter, *China SignPost*, "20 years of steady and slower economic growth could be a more attractive path than five years of above-target growth followed by 15 years of slow growth, as pollution, health issues, corruption, aging population and other sustainability challenges exact a toll." 

THE EXECUTIVE'S GUIDE TO THE END OF CIVILIZATION

In case you've been out, the Mayan calendar doesn't go beyond the year 2012, leading some to believe that the end of civilization is fast approaching. Here are some tips we've assembled for the busy executive to prepare for the possible apocalypse:

Tie up loose odds and ends: Enter the apocalypse with a clean email in-box and manageable task list. Remember to submit your expense report and power off your computer.

Stop saving for retirement: Cut contributions to your retirement plan and spend your savings quickly, like on a sports car or that holiday to Fiji you've been eyeing. If you're concerned about the early withdrawal penalties, you're missing the point.

Embrace your inner autocrat: Collaboration always gets the best results but results only matter if there's a tomorrow. Make business decisions impulsively and unilaterally.

It's time for unbridled honesty: Now's not the time for office pleasantries. Feel free to tell your CFO what you really think about his family vacation photos.

Get off the grid: Time is limited; destroy anything with a screen and instead, plan some "me time." Tennis anyone?

—Michael Distefano and Stephanie Mitchell

