

# WebMemo



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## Weighing Chinese Manufacturing Strength

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On August 10, *The Financial Times* reported a forecast by Global Insight projecting that the People's Republic of China (PRC) would surpass the U.S. in 2009 in manufacturing. It predicts a stunning increase in China's share from 13.2 percent in 2007 to roughly 17 percent in 2009 and a roughly corresponding, and equally stunning, decrease in the American share.

In real, inflation-adjusted terms, this is jumping the gun. Even so, given current trends, it is not a question of *if* China surpasses the U.S. in manufacturing; it's really a matter of *when*. But the *when* is far enough away that we have time to better understand what it means for America.

**One Problem with the Figures.** There are several ways to measure China's growth in manufacturing. The most simple and straightforward is to do so in nominal terms, not adjusted for inflation or exchange rates. The upside is that nominal forecasts are more precise, containing the least number of variables. It's the easiest prediction and, in fact, the one generating headlines. The downside is that not accounting for changes in the value of money distorts the picture of true manufacturing activity.

On the economist's inevitable other hand, then, is Global Insight's projection of when China will overtake the U.S. in manufacturing adjusting for inflation and the exchange rate. In June 2007, they anticipated this occurring no sooner than 2021. Barely a year later, their forecast is for a new, real manufacturing king to be crowned in 2017. China's share of global manufacturing quadrupled from 1990 to 2007. So there would have to be a major

misstep for the PRC not to ultimately become the world's leading manufacturer.

**The Significance of Chinese Manufacturing Prowess.** Whether next year or 15 years from now, does Chinese supremacy on this score matter?

Psychologically, it might. Until the 19th century, China had been the world leader in manufacturing for over a millennium. It lost that position during the so-called 150 years of shame and humiliation at the hands of inept leaders and foreign powers. The reclaiming of the title could be taken as the formal introduction of a new era.

On the eastern side of the Pacific, the U.S. has been the largest manufacturer by a wide margin for over a century. It took the global mantle from a declining Britain and held off challenges from Germany, the Soviet Union, and Japan. One of those countries is extinct, and the remainder no longer nurse ambitions for empire. Likewise, an America no longer first in manufacturing may be a portent for an America no longer first as a world power.

At the moment, however, most indicators point to sustained U.S. leadership. On a *per capita* basis, American workers are obviously far more productive than their Chinese counterparts. Even in raw size, the U.S. share of global GDP will remain more

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than twice that of the PRC for at least another decade. The indispensable element of global trade today is not Chinese manufacturing exports or even oil supply but the American consumer.

Nor do there appear to be profound commercial consequences. Until the current slowdown, American manufacturing growth had remained steady while China rose. The value of the dollar has been far more important for American exports than direct competition from greater Chinese manufactures.

**U.S. Still Strong.** The story is similar at the sector level. The PRC's present production advantage in textiles and both consumer and office products will be extended. The U.S. will maintain a very sizable lead in more advanced equipment such as aircraft and semiconductors. Global Insight puts the U.S. share in semiconductors and related equipment at more than three times the Chinese share in 2006. The U.S. auto industry today still dwarfs China's.

Some change has already been wrought, of course. An obvious impact of the Chinese industrial explosion is sharply lower world prices for outputs such as clothes and computers and sharply higher world prices for inputs such as oil and metals. This has shaped new winners and losers among American companies, workers, and stockholders, and it will continue whether the PRC passes the U.S. in the next year or in the next generation. The exact date matters little.

At the national level, the U.S. traditionally thrives off of change. Efficiency and the ability to adjust to new circumstances separated us from a wasteful USSR and an inflexible Japan. It is our slowdown that has brought forecasts of imminent

Chinese economic leadership, and it is our choices that will determine where leadership will genuinely reside for the next two decades and beyond. Beyond the psychological, the sheer size of Chinese manufacturing output has little import.

All this, of course, assumes China will sustain something close to its remarkable growth of the last 30 years. That is not a foregone conclusion, and it is not possible to predict this trend with purely extrapolative forecasts. There are convincing signs that *market-oriented* restructuring in the PRC is dying or dead. Has China found a way to sustain prosperity in violation of the laws of economics? Not likely. It is the development of sound institutions based on private property and the rule of law that will ultimately determine the accuracy of scenarios painted purely from the numbers.

**Time Is on Our Side.** As China reaches for global power commensurate with its economic strength, it is important to keep in perspective exactly what that strength is. We only inflate China's image—from which it derives important benefits—when we grab for eye-catching but incomplete numbers.

A competitive China that can match its territorial and military ambitions with manufacturing output is something to take into account when we set our own priorities, both economic and in foreign and defense policy. We can count the numbers of planes and ships China churns out and work to stay ahead—something, incidentally, we are currently not doing a very good job of. We have time, though, to focus on the true nature of the problem and plan accordingly.

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