THE ANALYSIS OF BRIC COUNTRIES FOCUS ON THE SITUATION IN CHINA

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Abstract

The acronym BRIC was used at first in 2001. It is the abbreviation from the first letter of countries Brazil, Russia, India and China. In this article I try to answer why these four countries were selected and what is the main idea of BRIC. I focus on economic and financial aspects in China, especially. I also try to outline further prospect of this country.

Keywords BRIC, financial market, Goldman Sachs, China

1 INTRODUCTION

In 2001 American investment bank Goldman Sachs introduced term BRIC in they economic paper - Building Better Global Economic BRICs. This acronym is used to refer to the combination Brazil, Russia, India and China. The main point of this term was that these four countries are rapidly developing and till 2050 eclipse the most of the current richest countries of the world.

These BRIC countries are important as a engine of new demand growth and spending power and may shift more dramatically and quickly than expected under right conditions. Higher growth in these countries could slower growth in today advanced economies.

Higher growth in these countries may lead to higher returns and increased demand for capital in these markets. The weight of the BRIC’s investment portfolios could rise sharply. Raising incomes in these countries could be an important determination of demand and changed price of range of commodities.

2 IDEA OF THE BRIC COUNTRIES

The idea of the BRIC’s economies is base on following predictions:\[1\]: over the next 50 years (till 2050) economies of these countries – Brazil, Russia, India and China could become one of the most

important world economic power according to their future growth, income per capita and currency movements. Since 2001 equity market in these countries reached remarkable increase in its value Brazil by 369%, India by 499%, Russia by 630%, and China by 201%.

The equity market performance is just one manifestation of the staggering rise in BRIC importance to the global economy. In 2001 paper, was argued that the BRIC economies would make up more than 10% of world GDP by the end of this decade. In fact, as we near the end of 2007, their combined weight is already 15% of the global economy.

During last 50 years the economic centers moved very significantly and over the next 50 years these centers can move dramatically as well. The underline of BRIC projection is base on maintaining of growth-supportive policy setting in these countries. The conclusions about future development are base on five main topics:

I. economic size,
II. economic growth,
III. incomes and demographic,
IV. global demand pattern,
V. currency movements.

2.3 Economic size

In less than 40 years the BRIC economic together could me larger then current G6, till 2025 they power could be a half of G6 and they are worth less then 15 percentages.

In US dollar terms, China could overtake Germany in the next four years, Japan till 2015 a USA till 2039. The India economy could be larger that all but then China and US in 30 years. Russia could overtake Germany, France, Italy and UK. Of the current G6 – US, Japan, Germany, France, Italy and the UK only USA and Japan would be consider to be the largest economy in 2050.

2.4 Economic growth

India has a potential to become the fastest growing economy in next 30 and 50 years. Growth could be higher then 5 percentages in next 30 years and about 5 percentages as late as 2050 if developments proceed successfully. The total growth of BRIC countries should be about 3 percentages over whole time frame.

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2.5 Incomes and Demography

Despite much faster growth the individuals in BRIC countries will be still poorer then is average in G6 economies in 2050. It is expected that only Russia will be able to catch up the poorest G6 countries. In China their income level per capital will be similar to level that is in developed countries now (about 30 000 USD per capita). In 2030 China’s income per capital will be roughly similar with Korea today.

Demography plays important role in this prediction about possible development in BRIC countries. Even within BRIC demography impacts vary greatly. The decline in working age population take in BRIC countries place later then in developed countries and will be also steeper in Russia and China then in Brazil and India.

2.6 Currency movements

Rising exchange rates could contribute to rise in US dollar GDP very significantly. It is expected that about 1/3 of increase of GDP in BRIC countries would come from rising currency and 2/3 from faster growth.

The BRIC real exchange rate can appreciate by up 300 percentages over next 50 years it means 2.5 percentages per year. It is necessary to point out that few decades are very important in economic development. If we looked back 50 years ago the Germany and Japan were in the process of whole economy reconstruction, thirty years ago Korea was at the beginning of they development and was known as a low – income nation. Over last decade the importance of China in the world economy has risen significantly. If we looked in this shift in importance of particular countries in the world economy one thing looks essential. Over 80 percentages of value generated from by the world major equity market will come from earning delivered more than 10 years away.

As developing countries growth they have the potential to post higher growth rates as they catch up with the developed world. There are two reasons for this potential. The first is that developing countries have less capital per worker then developed economies and return form this capital is higher and a given investment rate results in higher growth in the capital stock. Second is that developing countries are able to use technologies from developed countries.

As countries develop these forces fade and growth rates tend to slow towards developed countries level. In Japan or Germany was very rapid develop in 1960’s and 1970’s replaced by moderate growth in the 1980’s and 1990’s.

3 SITUATION IN BRIC COUNTRIES IN 2007

3.3 India

Around 1777 India was the second largest world economy, its contribution to total world output were about 20 percentages. By the end of the 1970’s India was more then 2 centuries in stagnation and its contribution was only about 3 percentages – lower peak in India history. In 1991 began period of reforms. Main purpose was reduced obstacles to economic freedom and since 2003 India has been one of the faster growing major economies. Nowadays Goldman Sachs predicts that India is possible to growth about 8 percentages until 2020 (in their first paper they predicted growth only about 5.7 percentages). As the key factor is consider if government will continue in implementation of growth-supportive policies.

The crucial point in India economic growth was turnout in manufacturing productivity since 2003. It also caused increase of efficiency in private firms. Nowadays can be speed of the India’s growth transition compare to the growth experiences of other East Asian countries. The underlying causes for the increase in efficiency of private firms have been trend accelerations in international trade, financial sector growth, and investments in and adoption of information and communication technology. These are also the cumulative effects of a decade of reforms.

The re-allocation of land, capital and especially labour from low-productivity agriculture to high-productivity industry and services is an essential dynamic behind sustained productivity growth. This process is being accelerated by higher returns in industry and services due to trade openness, cheaper credit, investments in IT and communications, and the building of highways. These processes are in their initial stages and have substantial distance left to run.

3.4 Russia

Since 1999 the Russia changed very significantly. When in December 1999 took office president Putin Russia was after contraction 35 percentages. During his execution annual GDP was about 6.8 percentages per year and in 2007 economic output will be 70 percentages larger and household consumption about 115 percentages higher then in 1999 in real terms. After rubble devaluation in 1998 GDP in US dollar terms has risen more then 6.5 times.

Current BRICs projections imply a rosy long-term future for Russia.s economy. Not only could it be the largest economy in Europe before 2050 but, alone among the BRICs, Russia has a real chance of catching up with living standards of the current G7, increasing its per capita GDP eleven-fold in constant Dollar terms between 2006 and 2050. Goldman Sachs believes this is possible despite the dramatic projected population decline (from 142mn people to 109mn in 2050) and despite a steady decline in the average annual real GDP growth rate from 4.3% in 2006-2001 to 1.5% between 2045 and 2050. But they also make clear that, over the long term, Russia’s highly centralized political framework is unlikely to be a recipe for the kind of sustained growth that would make the BRICs dream a reality.

3.5 China

China’s economic growth over the past quarter-century has surpassed all records and created a new standard in the history of economic development. With an average annual real GDP growth rate of 9.6% from 1978 to 2004, China’s pace of growth is faster than that achieved by any East Asian economy during their fastest-growing periods. Nonetheless, demographers have warned that rapid ageing will limit China’s future growth prospects and that the demographic tailwind will turn into a significant headwind.

China has benefited from strong raw labour growth from the late 1970s until now, but the future demographic outlook suggests that the growth of the labour force will slow and ultimately decline after 2030. This develop is caused by two forces drive these changes: 1) increased longevity, which is raising the number of elderly, and 2) the one-child policy, which has slowed the growth rate of young adults in the population. The implication for workforce growth is immediate and significant. When more workers reach retirement age and growth of the young adult population slows, the dependent per- worker ratio will increase and the demographic bonus will end. It means - China may get old before it gets rich. Despite the slowdown in labour force growth, improved labour quality is likely to help sustain quality-adjusted labour supply growth. China.s economic growth has coincided with a tremendous boost in human-capital accumulation. In addition to advances in education from improved living standards, the one-child policy has led to increased human-capital investment on a per-child basis. China’s population is ageing, but its economy should continue to grow rapidly with the help of a better-educated labour force and rapid urbanisation. The gains from human capital development and intensive urbanisation will help buffer the slowing labour force growth. Future growth also ensures the market potential for commodities, as well as for multinationals producing consumer goods in China for the local market. Commodity prices will benefit as China industrialises and transforms into a developed economy.

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3.6 Brazil
Brazil has underperformed not only relative to Goldman Sachs expectations but also compared with all the other BRICs. Since 2003, real GDP growth rates in China, India and Russia have averaged 10.2%, 8.0% and 6.9%, in each case far exceeding our estimates of their long-term potential (4.9%, 5.8% and 3.5%, respectively). Since 2003, Brazil has made progress towards putting in place the foundations for growth, with particular emphasis on achieving macroeconomic stability. Stabilisation has paid off: inflation has fallen, the external accounts are less vulnerable to external shocks and some progress has been made on reducing the public debt. However, stabilisation has come at a high price. Real GDP growth has averaged only 2.7% since 2003, with the adjustment explaining in part why actual growth rates were lower than the rate of 3.7% used in our BRICs studies. Since 2003, inflation has averaged 7.8%. With inflation declining to 3.0% in 2006, a strong and credible central bank should continue to help Brazil reduce the level and variance of inflation. The success of the inflation-targeting regime should gradually reduce nominal interest rates and develop credit markets; over time, this should stimulate growth.

Although Brazil's growth performance has been disappointing, it remains comfortable in expecting to achieve the BRICs dream. The government has made progress in establishing one of the pre-conditions for higher growth macroeconomic stability. However, progress has been modest in some areas, particularly on fiscal and trade policies, while the public debt, the tax burden and the overall quality of fiscal policy have remained a major drag on growth.

In the meantime, Brazil will remain an important destination for fixed income, equities and direct foreign investment inflows, because of the high carry trade, the value of the embedded option on growth, and its sound macroeconomic policies and external credit fundamentals.

4 ANALYSIS OF CHINA

Current situation in China can be described by sentence: China may get old before it gets rich and many observers are concerned about it. Ageing has been perceived almost exclusively as a problem for industrialized economies. Fewer people has associated ageing with developing country where labour is ample and the cost of child-raising inexpensive.

There is suggested that China will become an age society in 2027. In that time China will be consider to be developed countries but it will be still poorer then USA or Japan if we take per-capita income basin in the account. There is a one chance for the China that will limit the negative influence on the labour supply from aging. The chance is in the rapid build-up of human capital and the continuous releasing of surplus labour from agriculture.

The China's economic growth goes with boost in human-capital accumulation. In addition it is related with advances in education from improving living standards and one-child policy has ked to increased human capital investment on a per-child basis. Smaller family sizes helped China to achieve success in promoting of higher education and producing graduates. This contributed to accumulation of human capital by 15 % between 197 – 2004 while labour force growth only about 13 %. This educaton helps also to support quality-adjusted labour.

China’s average population growth was from 1950 to 1978 about 2 % per year. Since then the population growth was slowed, from 1979 – 2004 it was about 1.16 %. By 2005, the population growth rate had fallen to about 0.65%. Ageing has been a hidden problem of China some time. Since 1980, the elderly population has been growing faster than the average of the world an Asia. Yet ageing was not consider a serious problem 20 years ago, because there was a large pool of young population between 0 - 15 years that rapidly replaced the elderly existing the labour force.

Having fewer babies has been useful for per capita income growth since 1975, because having fewer young dependents reduced the burden on the workforce. Strong growth in raw labour largely reinforced China's manufacturing-based industrial success. However, once the shortage of young people translates into a slower growing work-age population in the near future, beginning in 2010.

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the dependency ratio (which is the ratio of the population aged 0-14 and 65+ to the working-age population aged 15-64) will rise again. The dependency ratio will ultimately reach 70% in 2050, implying that every 10 people of working age will have to support up to seven dependents (young and senior) in 2050, compared with fewer than four today.

4.3 Human capital

Improving living standards since the late 1970s have helped China to make remarkable progress in accumulating human capital. Education was revived after years of repression during the Cultural Revolution. China has made huge progress in spreading nine-year compulsory education extensively in rural areas, and has been successful in promoting more senior secondary school students into higher education. During the past decade, China has produced college and university graduates at a significantly faster pace than Korea and Japan did during their fastest-growing periods.

Human capital has also received a huge boost from the one-child policy. Population control makes children scarcer and more valuable to their parents, and this has encouraged parents to increase their educational investment on a per child basis. Disposable income can be more generously allocated on a single child than on many, and, within a smaller family, parents can be expected to raise their average expenditures on each child. Abundant material and emotional resources are expected to contribute to improving labour quality. This should become a buffer against the raw labour growth slowdown in the future.

4.4 China’s Agriculture

China’s agricultural productivity has increased remarkably since the early 1980s, but its growth has lagged behind that of industrial productivity. Labour productivity in the industrial sector grew twice as fast as that in agriculture during 1979-2004.

The implied slower efficiency gain in the agricultural sector is partly due to less capital and poorer technology compared with other sectors, and partly due to the lower number of labour input hours per labourer. In the end, real labour input in agriculture would not decline and total agricultural output growth would not be negatively affected. This has happened in the past: since 1978, a sizeable number of agricultural labourers have migrated into cities, but agricultural output growth remained robust nonetheless.

Past restrictions from the household registration system (or hukou system\(^8\)) and various other barriers have largely prevented surplus labourers from migrating into cities to work for higher compensation. These requirements are being phased out in a number of areas, and Chinese authorities are also initiating hukou reforms to eliminate rural-urban disparity. Several large cities have suspended the temporary residence permit requirement for migrants, and a few provinces are working to unify urban and rural household registration records so that residents will be free to move within the province. Non-hukou barriers also contribute to a high cost of migration.

A review of the world standard of agricultural population and output suggests that China will experience a further decline in both the proportion of work force and the value added in output in agriculture relative to the rest of the economy. It is assumed that 20%-27% of the agricultural labour force (approximately 98-128mn) is surplus today. People aged 15 - 29 are most likely to migrate into cities, because the ability of township and village enterprises to absorb surplus labour has declined. This implies that a gradual relaxation of the hukou system and other migration barriers could potentially release 25-32mn young labourers into the industrial or service sectors.

Further there is assumed that a total of 27mn surplus labourers will exit the agriculture sector by 2050. The migration flow will presumably start with a 1mn release in 2006, adding 200,000 in the

\(^8\) Hukou – is the name for household registration in China. Its origin is dated back to 3,500 years ago. A new hukou system under the communist regime was established in 1958. It is strengthening the mobility constraint to prevent rural residents from moving into cities and urban residents from migration between cities. From 1958 until the 1980’s urban-rural migration was virtually forbidden except for official planning purposes. Since China transfer to market economy – urban rural migration become more feasible for those who have complete their education of seek job in informal sector.
second year and gradually more in subsequent years. Since the remaining labourers in this sector will likely increase their labour input to compensate for those who have departed, this implies the economy will have a net gain of labour input worth 27mn people in total.

4.5 One child policy

A change in the one-child policy would help sustain China’s population growth in the long run and improve its demographic structure. It is possible that gradual and conditional easing of the one-child policy beginning in 2010 would significantly boost the total population by 2050. The government is reported to be considering a gradual lifting of the one-child policy from as early as 2010. A World Bank proposal would allow each woman aged 35 and over to have two children (regardless of gender), beginning in 2010, followed by an annual lowering of the 35-year age limit by one year. Initial shocks from a relaxation of birth quotas may cause an upsurge in fertility rates in the early years. Ultimately, birth rates are likely to stabilize at a level that is higher than in most developed countries, but lower than that in most developing countries.

Together, these results suggest that by the time China becomes old, it should be fairly developed, but still not richer than the US or Japan in terms of per-capita income. An effective rule to define rich is per-capita income and its threshold of $10,000 as the threshold of ‘developed country’ status. Economies above this line are fairly developed. For China, this day may not be too far away. Our analysis shows that by the time China becomes an aged society in 2027, its per-capita GDP should have surpassed $10,000 (in 2005 terms) in all scenarios. However, even by 2030, the most optimistic scenario suggests that per capita GDP could reach nearly $22,000 (2005 prices), but stay well below BRICs estimates of per capita GDP in the US ($61,000), Japan ($60,000) and Germany ($51,000) of that year.

5 CONCLUSION

The idea of BRIC was first introduced by Goldman Sachs investment bank in 2001. Nowadays we are 7 years later and we can look at which prediction fulfills or not. At the beginning of the article there is also some basic knowledge about prediction or determined factors. Nowadays we can say that BRIC countries develop well in some cases better than was predicted by Goldman Sachs only one exception is situation in Brazil that does not correspond with prediction and situation in other BRIC countries as well. But reason for it is in economic changes that are occurred in Brazil in other to establish macroeconomic stability. Development on India is forced by migration from agricultural part to urban canters. The development in Russia is good. Russia has a power to become leader in European economy.

The situation in China can be summarized in several points.
- China’s population is ageing, but its economy should continue to grow rapidly with the help of a better-educated labour force and rapid urbanisation. The gains from human capital development and intensive urbanisation will help buffer the slowing labour force growth.
- The strong economic outlook will provide renewed opportunities for China’s Asian neighbours, as well as compensate for the relative slowdown of the G7 economies.
- The development in BRIC countries is promising but we must take into account that all studies about BRIC countries only suggest possible situation in future and there is still particular level of uncertainty about future development.
- Ageing is likely to benefit specific sectors such as insurance, pharmaceuticals, biotech and health foods. We also foresee increased opportunities for the financial-services industry to offer a larger variety of products as they cater for the need to accumulate and preserve wealth. New industries (such as nursing homes) and new property opportunities (such as vacation homes) are likely to gain as well.
- Consumption patterns will not only shift because of ageing but, more importantly, due to behavioural changes brought on by added human capital and rapid urbanisation.
The development in BRIC countries is promising but we must take into account that all studies about BRIC countries only suggest possible situation in future and there is still particular level of uncertainty about future development.

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