Opinion **Chinese economy**

Sorry America, China has a bigger economy than you

Measures that show the opposite have absurd implications and dangerous policy prescriptions

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Ultimately, bad comparisons foster bad decisions — that's why the economics profession invented purchasing power parity exchange rates © Roberto Junior/Dreamstime

Chris Giles DECEMBER 6 2023

You might have seen sober and accurate Financial Times reporting of the US economy's remarkable annualised growth rate of 5.2 per cent in the third quarter of this year. Let me give you an advanced sight of what happened in November. Forget talk of rapid growth or soft landings, the US economy shrank at an annualised rate of around 30 per cent in that month alone. It is so large, President Joe Biden must be toast and it probably spells the end of the American dream.

Don't worry. I have not lost my marbles. The calculation above is true, but it is not fair. I have taken the US economic performance in November — assumed to have not done much — and calculated that in euros or renminbi after converting US GDP using market exchange rates. Then I annualised the result. The thing that drove the result was the near 3 per cent fall in the US dollar's value during the month.

You would be right to think this is an absurd way to compare economies, but it is deeply fashionable among people who should know better. Take Mark Carney, former governor of the Bank of England, who said that before the Brexit referendum, the UK economy was 90 per cent the size of the German economy but it had declined to 70 per cent by late 2022. That change was caused by the relative decline in sterling.

Remember European angst spread by the European Council on Foreign Relations that the EU had a bigger economy than the US in 2008 and now the US was a third larger? That was simply a rise in the US dollar from a low base.

China looks like it is failing to catch up with US economic size on market exchange rates...

... but it has overtaken the US when measured at purchasing power parity exchange rates...

... and the PPP data is better corroborated by electricity generation

The list goes on. On these silly market exchange rate comparisons, many news organisations have reported that Japan will lose its spot as the world's third-largest economy to Germany this year. And, apparently, the US is still the world's largest economy with China's economy failing to catch up.

A basic requirement for international comparisons is that domestic data and international data give similar results. This is why the economics profession invented purchasing power parity exchange rates, allowing (imperfect) comparisons to be made based on the goods and services that money can buy. This matters for economic size and even military power. Remember, China funds the People's Liberation Army using renminbi. It does not source from the US.

Measured at PPP, the latest IMF data shows China's GDP exceeded that in the US around the time Donald Trump was "making America great again". It is now 22 per cent larger. The figures make sense when you look at corroborating evidence. China's electricity generation, for example, overtook that in the US in 2010. And during the 2016-22 period when China's economy was supposedly making no progress compared with the US, its generation grew 45 per cent, while it was broadly flat in America.

It comforts both the US and China not to acknowledge the changing shift in global economic power. Coming from the UK, which lost its top economic dog status in the late 19th century but still has some delusions of grandeur, I can understand American denialism. For China, it is also easier to avoid responsibilities for climate change, debt relief and other global goods if it can still maintain its minnow status. In Europe, it is convenient for those wanting economic reforms to highlight a sense of falling behind because that can make change appear more urgent.

But ultimately, bad comparisons foster bad decisions. It would be easy for the EU economy once again to become the world's largest at market exchange rates. All the European Central Bank would need to do is raise interest rates enough to push the euro up to the sufficient threshold. That might make Europe temporarily feel better, until it recognised it was suffering the mother of all recessions.

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