Comparative Advantage Fuels China's Growth

China's President Hu Jintao recently reported the strongest economic growth in three years, noting that his country's economy (or GDP) was 10.2 percent larger in the first quarter of 2006 than it was in the first quarter of 2005. This strong surge in economic activity--the strongest in three years--has many analysts wondering whether the Chinese government will take any action to prevent their economy from overheating.

The Chinese government tried to control similar rapid growth in 2002 by urging bankers to clean up bad loans and ensure that new loans are based on creditworthiness requirements and by reigning in developers and Communist party personnel who pursued projects without central government approval. But many economists say that China's actions to stem the economic tide will not be nearly as noticeable this year. China is experiencing low inflation; domestic consumption is growing stronger, and economic growth is not as concentrated in large factory and public works projects as it has been in recent years. Add to these factors China's clear comparative advantage in its virtually inexhaustible labor resource and the strong growth rate could last for many years.

Economists speak of comparative advantage when a country--such as China--has a lower relative or comparative resource cost than do other countries. In this case, the comparative advantage over the U.S. and European countries consists of China's ability to produce labor-intensive goods like textiles, which can be produced cheaply in China where labor is abundant and inexpensive. One Chinese economist, Lu Zheng, says this comparative advantage in labor could last two decades and play an important part in promoting Chinese economic growth.

Many countries, including the U.S., would like to see China apply some economic restraints, but such intervention does not look likely in the near future. "I don't expect them to take any drastic action; they are comfortable with higher growth," said Frank Gong, the chief economist for greater China at J.P. Morgan Chase. "They will keep growth like this for a while."

1. Define comparative advantage. Can you apply the concept more locally--say, to yourself and your roommates or friends?

2. How does comparative advantage promote economic growth?