

THE CHINESE POLITICAL ECONOMY

Lecture 1: Introduction and the Big Picture

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Sept. 3, 2013

Who we are...

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Reading Materials

- Two books are required:
 1. Naughton, Barry, 2007, ***The Chinese Economy: Transitions and Growth***, MIT Press.
 2. Lieberthal, Kenneth, 2004, ***Governing China: From Revolution to Reform***, W.W. Norton & Co.
- We will use **learn.cbs.dk** to manage the course readings
- You can find the following materials in **Learn**:
 - Course syllabus
 - Readings will be uploaded in advance:
 - Required, beginning with a *
 - Optional, for more motivated students
 - Lecture notes (PPT slides) will be uploaded after each class

Expectations

- We expect that you read (scan) required readings before each class (the first class is an exception)
- Since this course is a selective one, we assume you're more motivated and interested in the subject
- We combine lectures with in-class discussions, thus we expect you to be “active” and contribute to the discussion
- We promise to get your intellect challenged continuously; in return, you promise to remain fully engaged and ask interesting questions

When you think of China, what do you think of?

- Huge population
 - 1.25 billion, around 20% of the world's total
- Very long history of civilization
 - Dating back to more than 5,000 years
 - The only old civilization that still remains today – a “civilization state” (termed by Martin Jacques) with continuous culture identity – Chinese are extremely proud of it.
- One of the fastest growing economies today (BRICS)
 - Averaged at 10% growth rate for the past 30 years
- Cheap labor - The World's Factory
- The world's biggest polluter
- Non-democratic, and with an intrusive state
- Communist (?)
- Threat, fear, and a potential enemy

Preview of Today

- Does China really matter?
- Robert Fogel's provocative prediction of the world economy by 2040
- A brief history of the world economy: "The Great Divergence" and *Reconvergence*
- China's geographical setting

China hype

- A lot of hype about China.
- China Shakes the World.
- When China Rules the World: The Rise of the Middle Kingdom and the End of the Western Wold.
- Eclipse: Living in the Shadow of China's Dominance.
- Beijing Consensus: How China's Authoritarian Model will Dominate the Twenty-First Century.



The
Economist

NOVEMBER 13TH–19TH 2010

Economist.com

Cuban communism: beginning of the end?

US employment goes from bad to worse

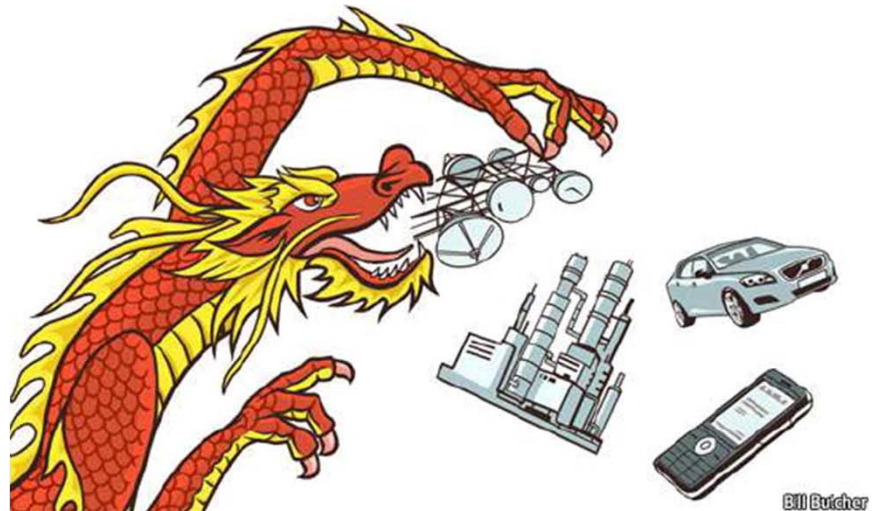
Dr Evil, the commodity speculator

Ireland under siege

Keith Richards, management guru

Buying up the world

The coming wave of Chinese takeovers



China hype

- Will overtake US in 2016.
- Already world's biggest exporter and trading power.
- World's largest foreign exchange reserves.
- The no. 1 trading partner of Australia, Argentina, Brazil, India, South Africa, South Korea, Japan.
- Consumes more than 50% of the worlds production of steel and cement, 30% of copper, aluminium, etc.

Few dissenting voices

- Peter Nolan, Is China Buying the World?
- No, Chinese companies are not yet able to make it on the global-level playing field in competition with Western multinationals.
- Their global competitors too big, too efficient.
- David Shambaugh , China Goes Global: The Partial Power.
- China's global presence is more broad than deep.

Does China Matter?

- Gerald Segal the first to strike a note of caution.
- His conclusion in 1999: China doesn't matter. An overrated second-rank middle power.
- Overrated as market, as a political power, and as a source of ideas (soft power).

The economy in 1999

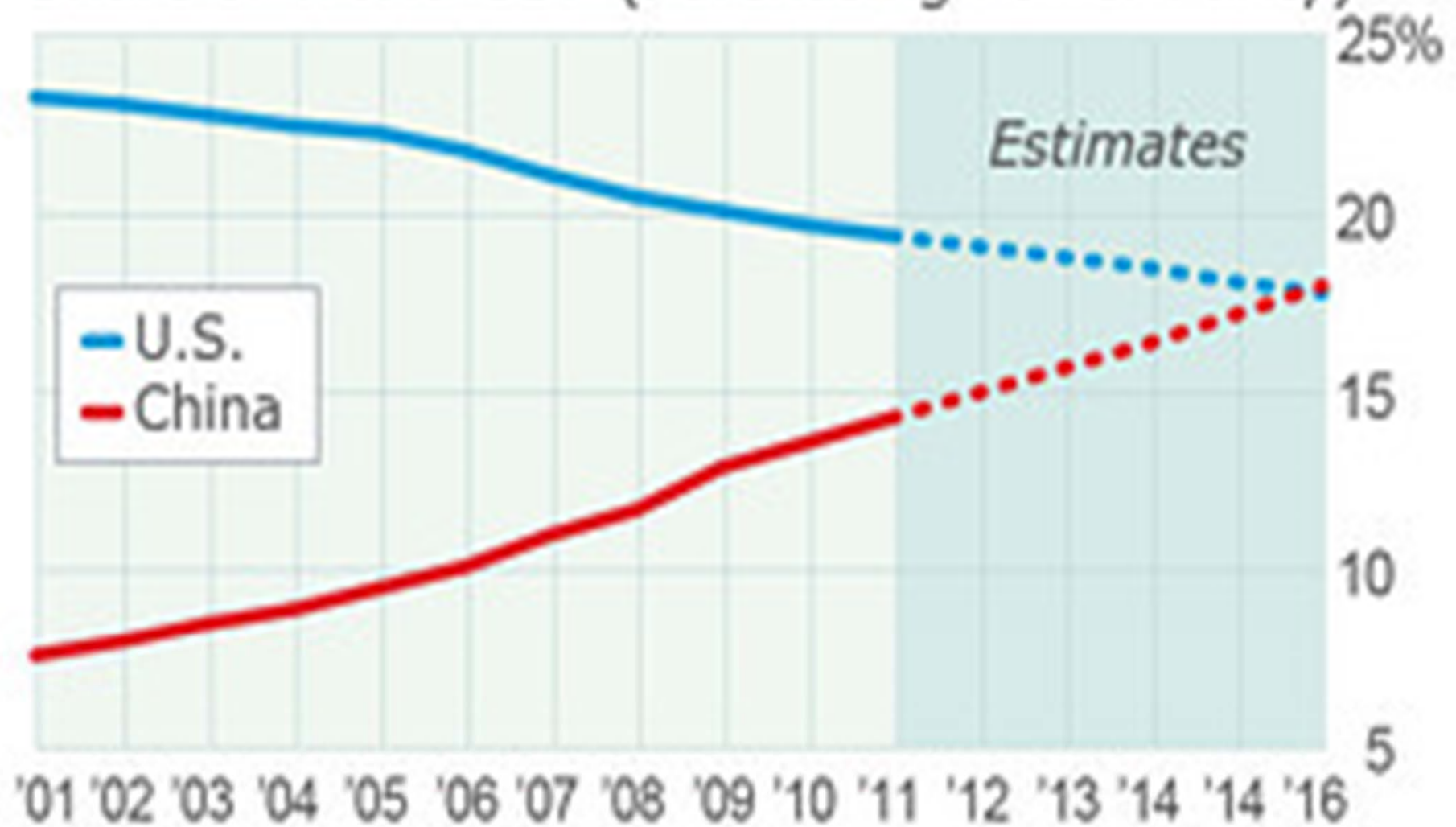
- Only 3.5% of global GDP.
- No. 7 globally, behind Italy.
- In terms of trade – also way down the list, behind the Netherlands.
- Little Western exports to China – US 1.8%; UK 0.5%.
- All kinds of problems in the economy – SOEs losing big money; huge non-performing loans, etc.

Economy today

- Today all this has changed. And it has happened fast.
- Overtook Italy already in 2001, France in 2003, UK in 2004, Germany in 2006, Japan in 2010.
- Today around 10% of world GDP. In PPP terms 15%. US 23% and 19%.

The End of the Age of America

Share of World GDP (Purchasing Power Parity)



Data: International Monetary Fund, April 2011

Politically

- Second-rank middle power.
- Never agrees with the West, but plays second fiddle to Russia.
- Not a beacon to anyone. Doesn't understand the world.
- China's limited options clear when NATO bombarded the Chinese embassy in Belgrad in spring of 1999.
- Only accounts for 4.5% of global defense expenses; US for 38%.

Politics today

- China still reluctant to become globally engaged and take global responsibility.
- Prefers the US security umbrella in Asia.
- But is still allied with Russia in UN matters – example Syria.
- Regionally China's influence rapidly increasing.

Culture

- According to Segal, China has no cultural impact.
- Tiny Singapore has more impact in terms of film, literature, and arts.
- China has no soft power.

Culture

- However, Chinese films have become blockbusters in recent years – example Hero.
- China has established Confucius Institutes all over the world – almost 400. There are three in Denmark.
- Are supposed to promote Chinese language and culture.

Segal's assessment realistic?

- Segal concludes: "We need a realistic assessment of China".
- But is Segal's assessment realistic?
- Segal forgets to ask: to whom does China matter? Maybe not globally in 1999, but certainly regionally.
- Taiwan, North Korea, Japan, South China Sea.

Burning issues

- Segal leaves out a number of burning issues.
- Population.
- Pressure on resources.
- Pollution and environmental issues – now the biggest emitter of green house gases.
- Segal also does not capture the dynamics involved in the Chinese development process.

Our position

- You can see from the course description that we disagree with Segal.
- We think that China matters.
- A fundamental shift of economic power is taking place in the world today – from East to West.
- A shift of monumental importance.

Deep breath

- However, it is useful to take a deep breath and realize the obstacles that China will face.
- Lopsided economic development, lack of SOE reform, environmental issues, etc.
- Also issues concerning political and social stability.
- Will China hold together?

Understanding China

- Basically we need to understand China.
- How to characterize the economic system – Capitalism? Socialism? Capitalism with Chinese characteristics? Socialism with Chinese characteristics? State capitalism?
- Where is the economy going – can the high growth rates of the past continue?

Understanding China

- How is China governed? What are the basic building blocks of the political system? Who are the leaders, what do they stand for and how are they selected?
- Currently, high-profile corruption cases are catching the attention. Are they sign of decay and is the Party-state losing legitimacy?
- All these issues matters – not only to China, but to the world.

Bob Fogel's Forecast on the World Economy

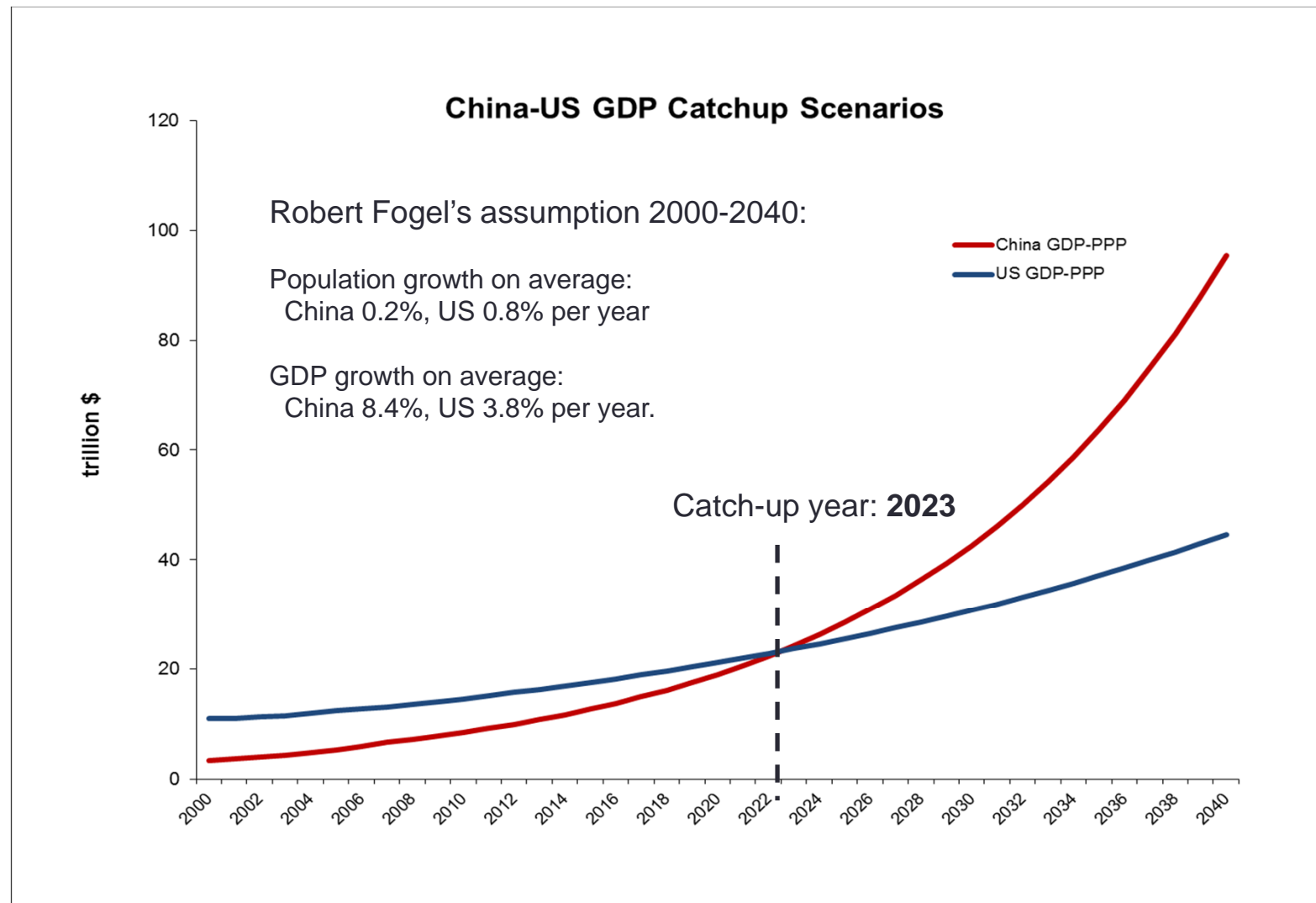
The Global Distribution of Gross Domestic Product (GDP) in 2040, by Grouping of Nations

Grouping	Population (in millions)	Percent of total	GDP in billions of \$ (PPP)	Percent of total
United States	392	5	41,944	14
European Union (EU 15)	376	4	15,040	5
India	1,522	17	36,528	12
China	1,455	17	123,675	40
Japan	108	1	5,292	2
6 South East Asian Countries (SE6)	516	6	35,604	12
Subtotals	4,369	50	258,083	85
Rest of the World	4,332	50	49,774	16
World	8,701	100	307,857	101*

Note: GDP in U.S. dollars of 2000.

*Total equals more than 100 percent due to rounding.

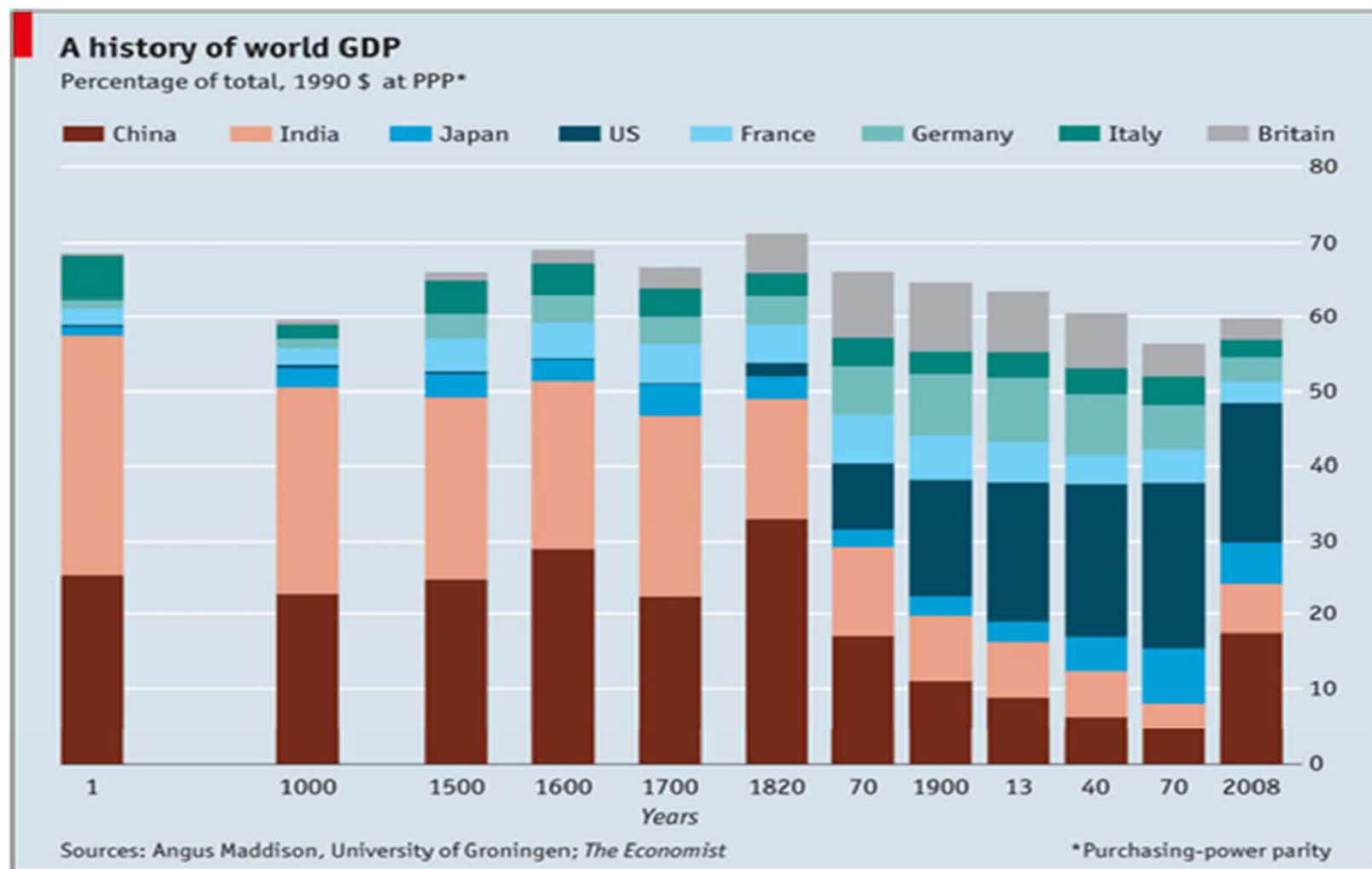
Fogel's Forecast, 2040



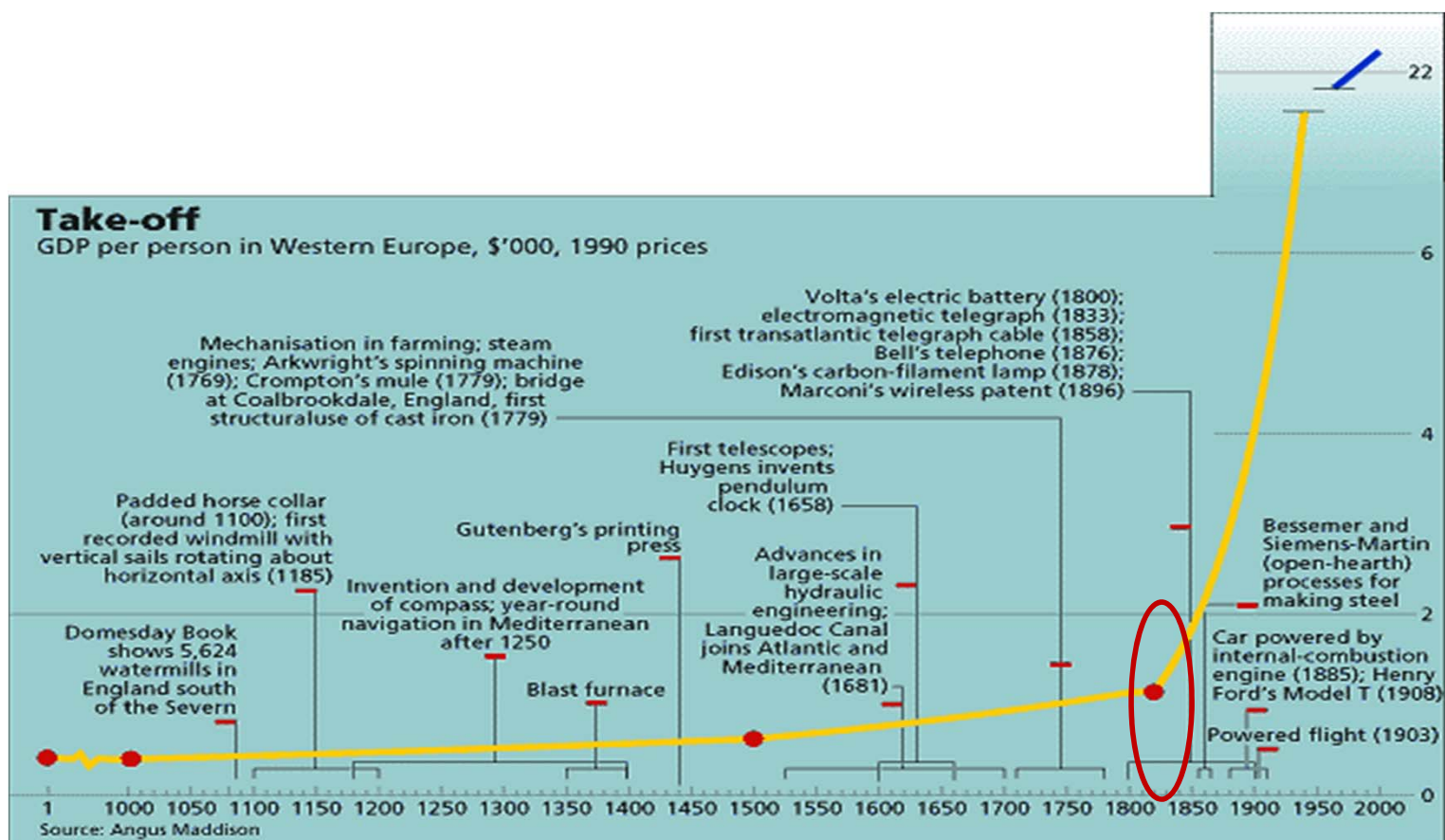
Questions to think about?

1. Is the rise and fall of nations *inevitable*?
 - China in the early 19th century
 - Great Britain in the early 20th century
 - The US in the 21st century (maybe)
2. What drives nation's long-run growth?
3. In the past, whenever there is a shift of world power, there tended to be turmoils, if not wars. How will the current relentless power shift to the East Asia play out?

A very long history of the world economy



A Brief History of Economic Growth in Europe



- Zero growth in the first millennium
- Almost no growth (or crawling growth at an average of 0.05%) between 1000-1050
- Europe suddenly took off around 1800s.

A Brief History: Economic Growth of World since 1820

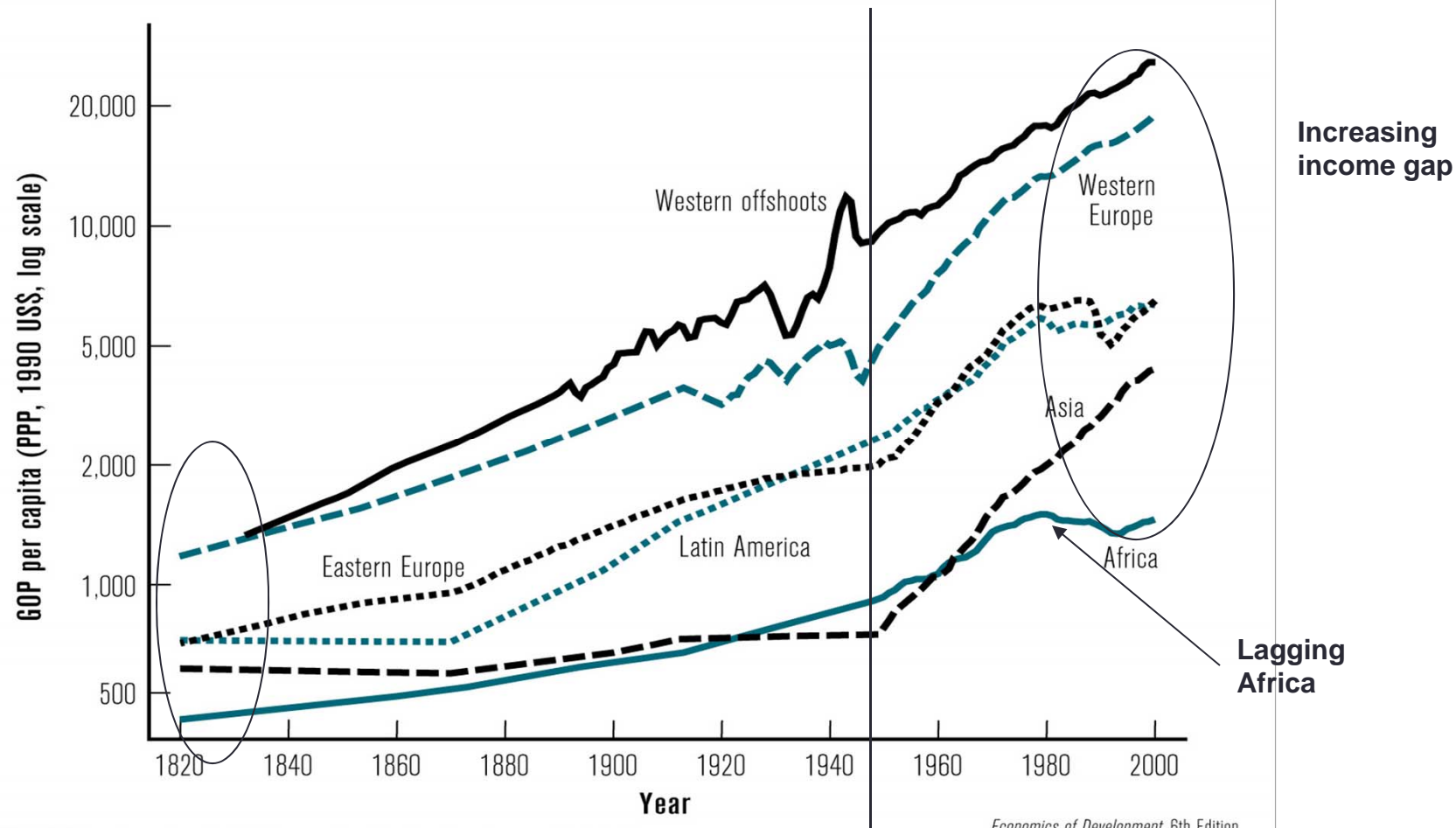
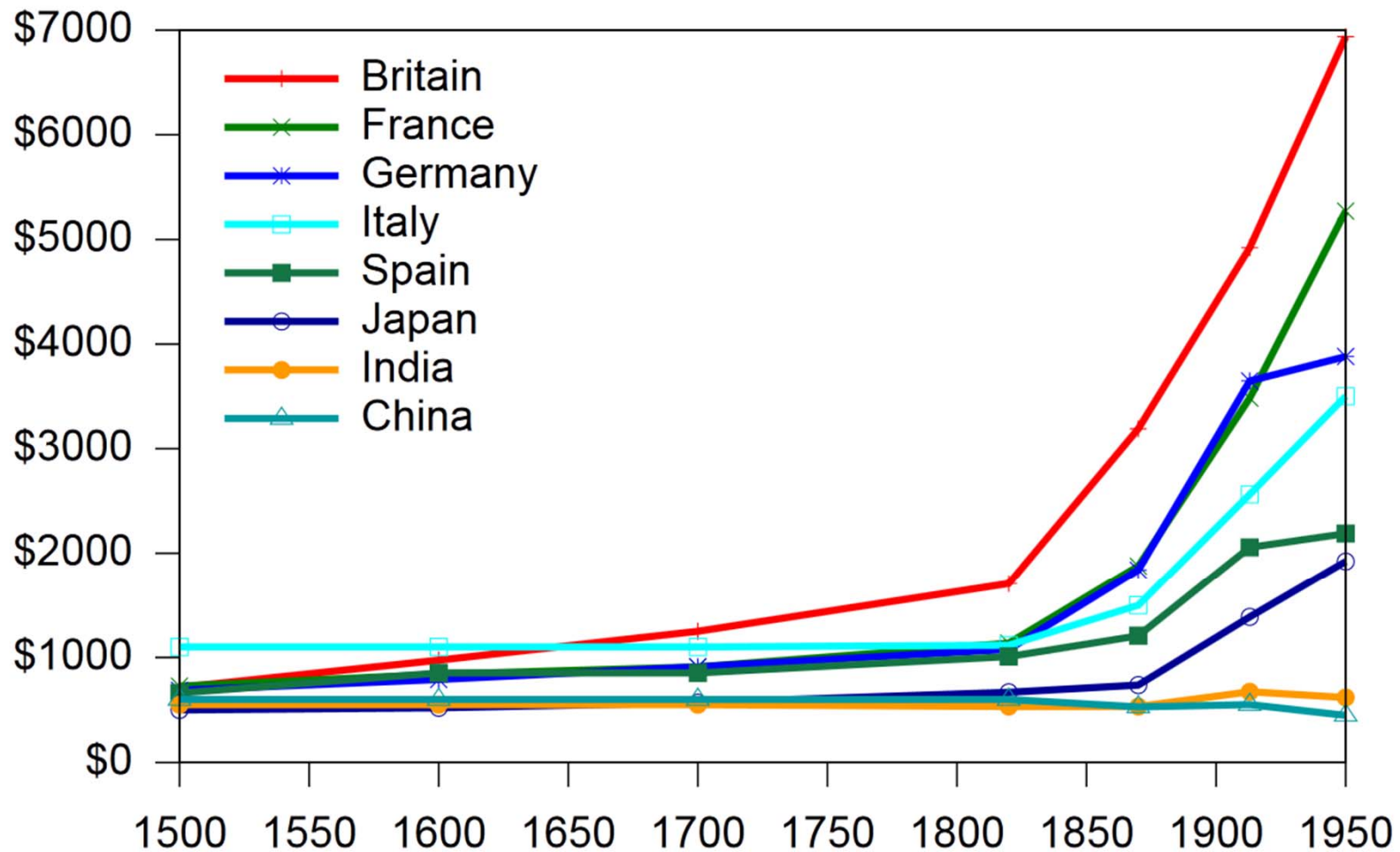


FIGURE 2.1 Levels of GDP per Capita by Region: 1820–2001

Economics of Development, 6th Edition
Copyright © 2006 W. W. Norton & Company

The “Great Divergence”

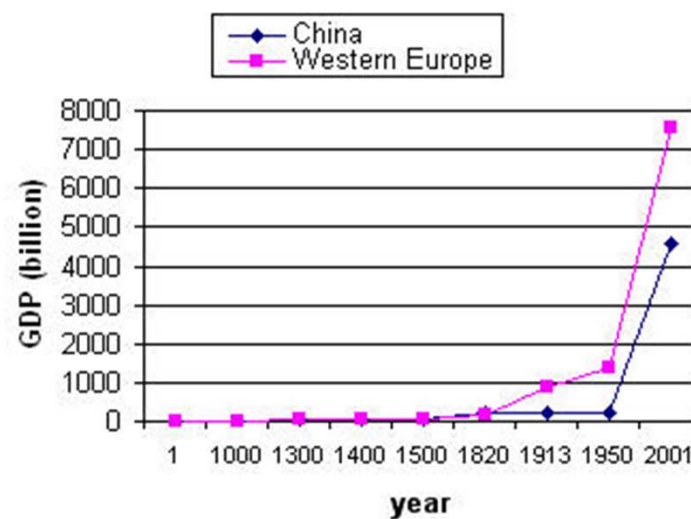
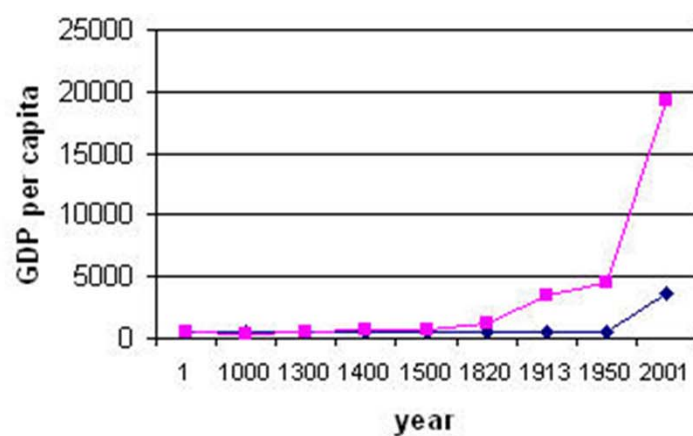


The “Great Divergence” Puzzle



The “sudden” take-off of Western Europe and the stagnation of China remains one of the greatest puzzles in human history.

China-Western Great Divergence



The “Great Divergence” Puzzle

Table 8–3. The China/West European Dichotomy, 1–2001 AD

	<i>China</i>	<i>West Europe</i>
Population (million)		
1	59.6	24.7
1000	59.0	25.4
1300	100.0	58.4
1400	72.0	41.5
1500	103.0	57.3
1820	381.0	133.0
1913	437.1	261.0
1950	546.8	304.9
2001	1 275.4	392.1
Per Capita GDP (1990 int. \$)		
1	450	450
1000	450	400
1300	600	593
1400	600	626
1500	600	771
1820	600	1 204
1913	552	3 458
1950	439	4 579
2001	3 583	19 256
GDP (billion 1990 int \$)		
1	26.8	11.1
1000	26.6	10.2
1300	60.0	34.6
1400	43.2	28.1
1500	61.8	44.2
1820	228.6	160.1
1913	241.3	902.3
1950	239.9	1 396.2
2001	4 569.8	7 550.3

Stagnant Chinese economy: no growth in income level between 1300 and 1950.

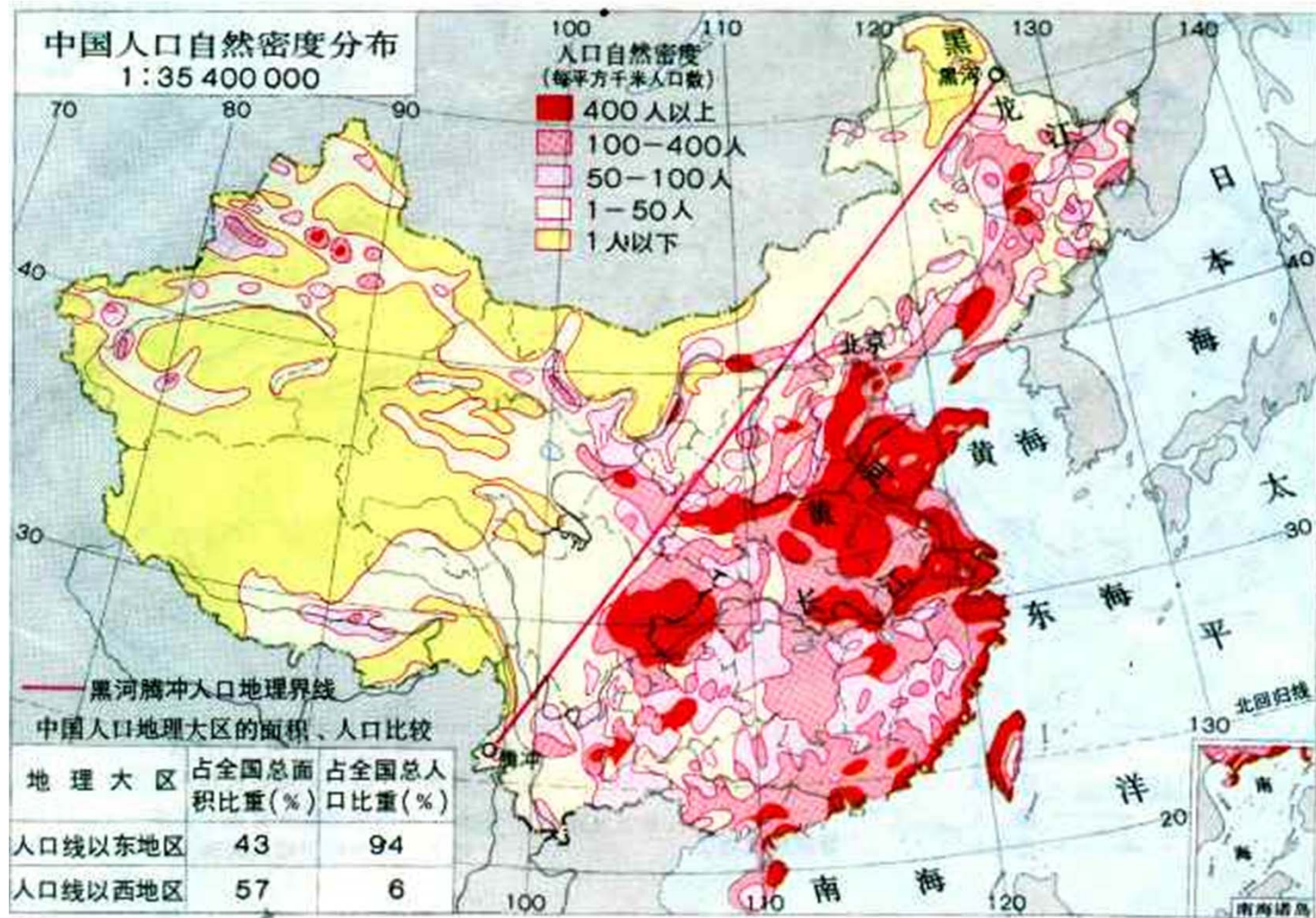
China fell behind Western Europe in living standards between 1300 - 1400s, but the real fall came after 1820s.

By 1820, Chinese economy was still greater than all Western European economies combined

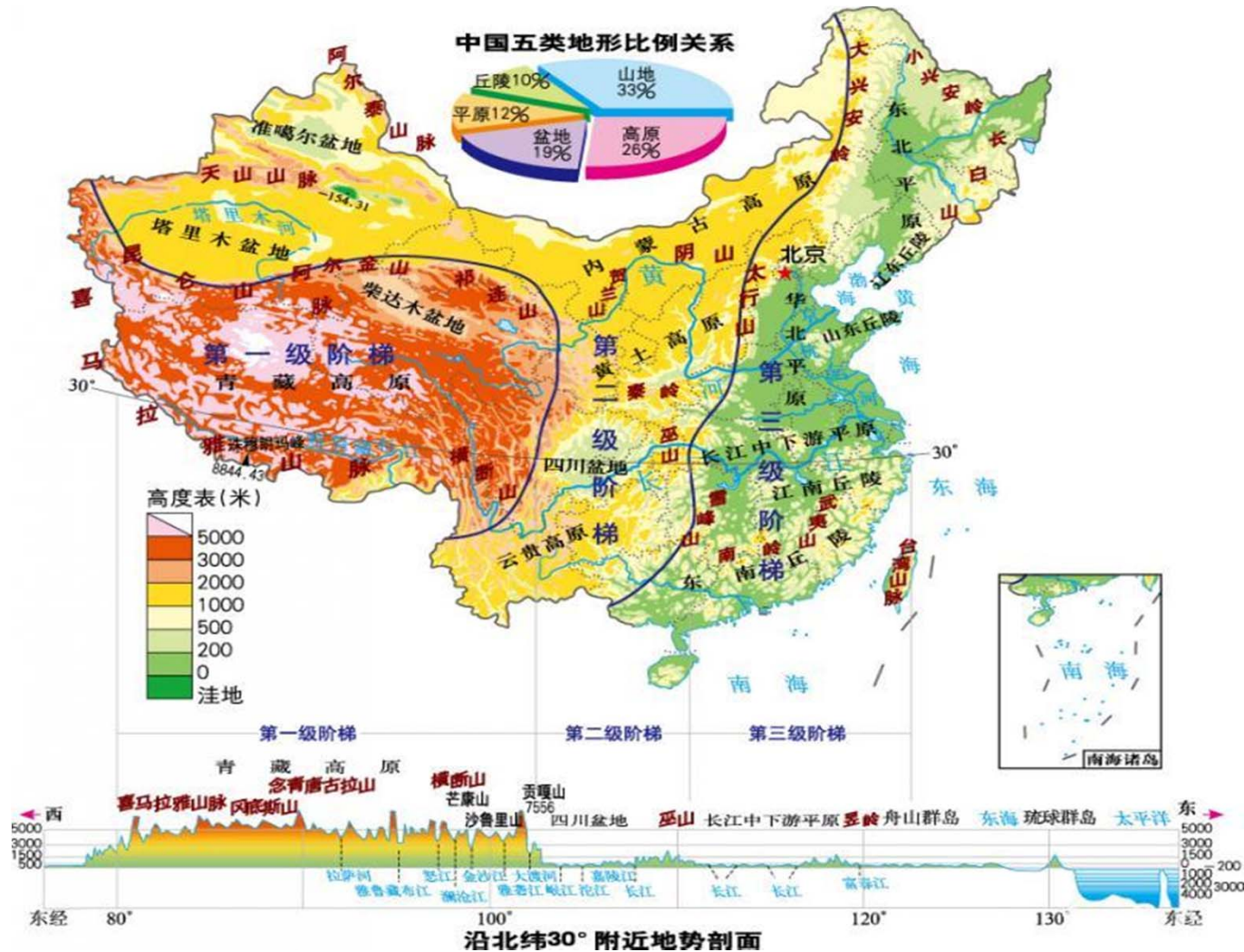
By 1950, Chinese economy was less than 1/5 of Western European's.

China's Geographical Setting

The “Great Divide” – China’s population distribution



China's "Three-Ladder" Terrain



China's Precipitation Distribution

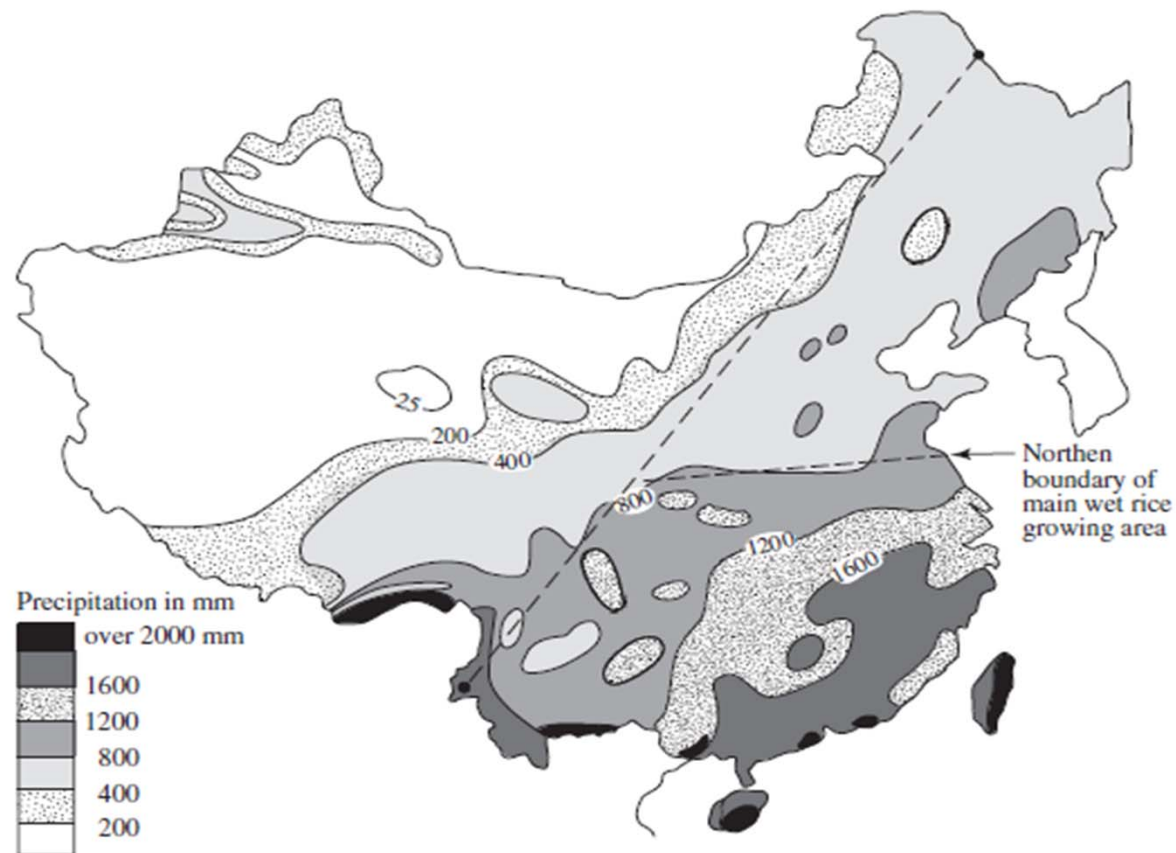


Figure 1.2
Annual precipitation

Limited Arable Land per Capita

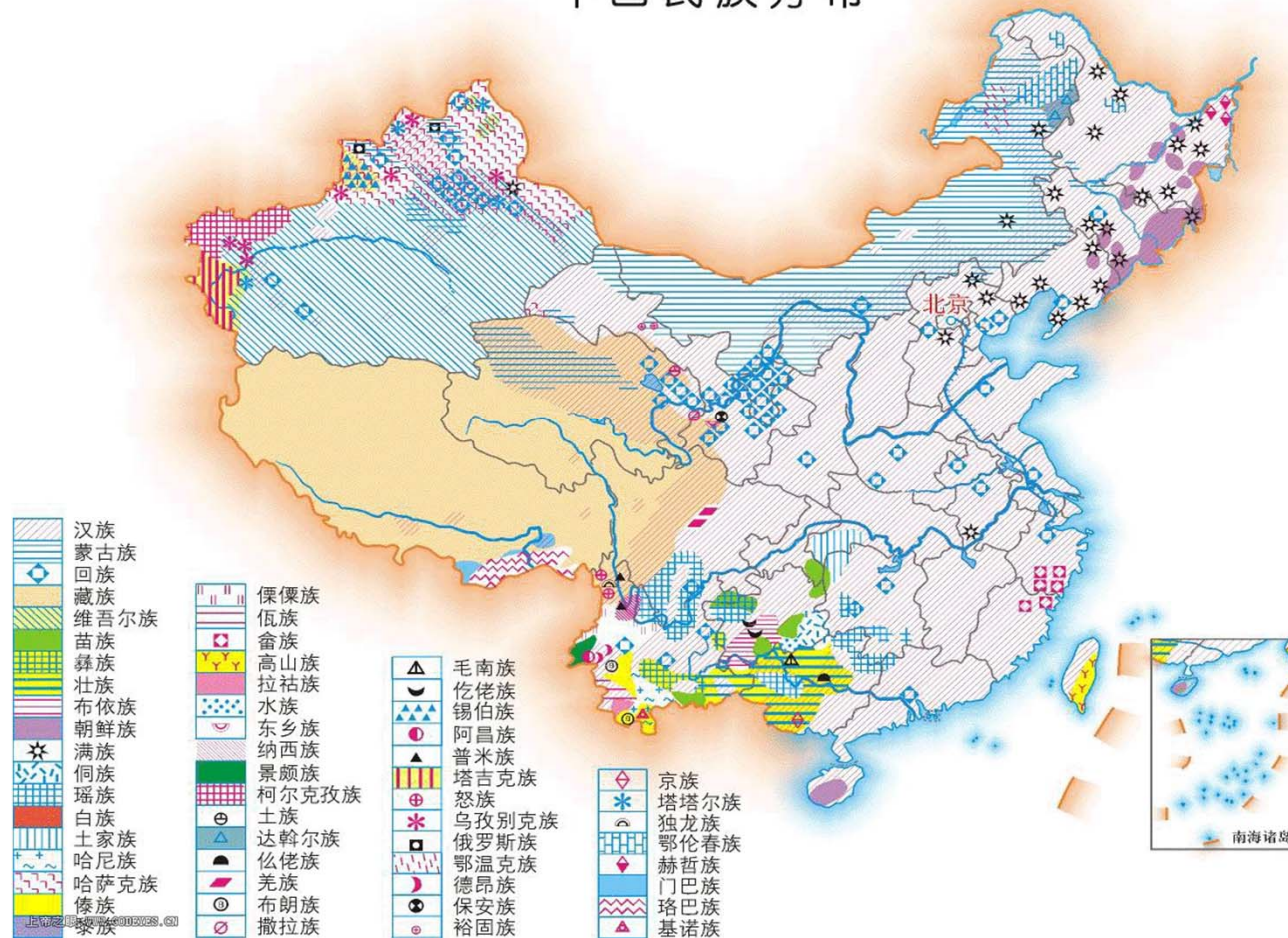
Land and population, 2002

	Land area (1) (million hectares)	Arable land (2) (million hectares)	Arable percent $(2)/(1) \times 100$	Population (million)	Arable per capita (hectare)
China	933	143	15.3	1,280	0.11
India	297	162	54.4	1,049	0.15
United States	916	176	19.2	288	0.61
Russia	1,689	123	7.3	144	0.86

A hectare is a square 100 meters on each side, equal to about 2.5 acres.

China's Ethnicity Geo-Distribution --- homogeneity with limited diversity

中国民族分布



China's Geography in International Setting



Also read Kaplan, *The Geography of Chinese Power*, Foreign Affairs, 2010.

<http://terpconnect.umd.edu/~kmcm/Articles/The%20Geography%20of%20Chinese%20Power.pdf>

Geography and Economic Development

- The aforementioned geographical characteristics largely determines
 - The regional uneven patterns of growth and development
 - China's optimal defense strategy
 - China's growth and power projections, now and in the future, probably will be felt more by the Pacific Rim countries (the US, Japan, Australia), rather than the Atlantic Ocean (the Europe)
 - will become less so with the emergence of new innovations in the communication and transportation technology

Recommended...

- Watch this TED video by Martin Jacques, *Understanding the rise of China* at http://www.ted.com/talks/martin_jacques_understanding_the_rise_of_china.html

Optional Material:

Unraveling the Great Divergence Puzzle

The “Great Divergence” Puzzle

- Is technology the answer?

Knowledge driven technology takes time to accumulate. This seems to explain the sudden takeoff. But why did it come along in the 18th century Western Europe?

- Western science had already moved significantly ahead of that of other societies by the beginning of the 17th century, yet it was another 150 years before the real surge in western growth began.
- Greater puzzle to this argument is China's supremacy in science and technology alike was dazzling at the start of 15th century, yet there was no surge of growth in China.
- Science and technology can get far and then stop. The same happened to Islamic science, which had achieved great sophistication around 1200.

The “Great Divergence” Puzzle

- Three contributing factors
 - Values
 - Readiness or appetite for change
 - Europe: Entrepreneurs, risk takers → new ideas, innovations and explorations
 - China: its elites valued stability above all. New ideas, especially foreign ones, were often met with suspect
 - Enlightened self-interest
 - Adam Smith (1776): in a free market, an individual pursuing his own self-interest tends to also promote the good of his community as a whole through a principle that he called “the invisible hand”. In *The Wealth of Nations* Smith provides an example that illustrates the simplicity of the principle:

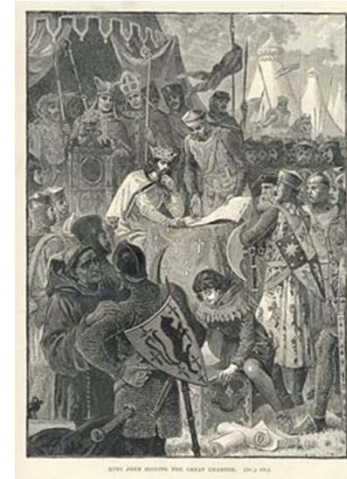
“It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard to their own self interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.”
 - The will to exploit nature for man’s benefit is what we call “incentives”
- Specialization and trade: move away from self-sufficiency

The “Great Divergence” Puzzle

- Three contributing factors
 - Values
 - Politics
 - Europe: Pluralism
 - For the past 1500 years, no unitary system of control has ever been imposed across Western Europe as a whole
 - Competition between governments, producers and traders, economic organizations
 - In religion: unified religious authority broke down with Luther’s Reformation
 - China: Highly centralized
 - China achieved unification around 200 B.C., and remained so during most of her history for the next 2,000 years, although often interrupted by northern nomad invaders.
 - Remained dominant in East Asia, no similar rivalry between states in Europe ever existed
 - highly homogenous: dominant Han people, and one Confucius teaching
 - Government’s deliberate suppression of independent thoughts and local experiments

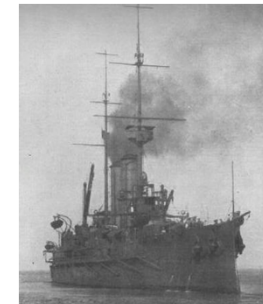
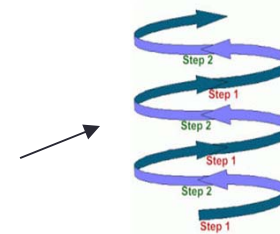
The “Great Divergence” Puzzle

- Three contributing factors
 - Values
 - Politics
 - Economic institutions
 - Western Europe
 - Property rights protection
 - Magna Carta(1215): protected private property from confiscation by the Crown. Provided right incentives to economic growth
 - Other laws: contract, arbitration, etc.
 - Enlarged markets through trade
 - Among European states
 - International trade: New World, among colonies
 - China
 - Arbitrary seizure remained common in China (also in Asian and Islamic worlds), and merchants were forbidden to get too rich
 - China’s old rigid civic examination system hampered the selection and promotion of the most talented people to science and technology.



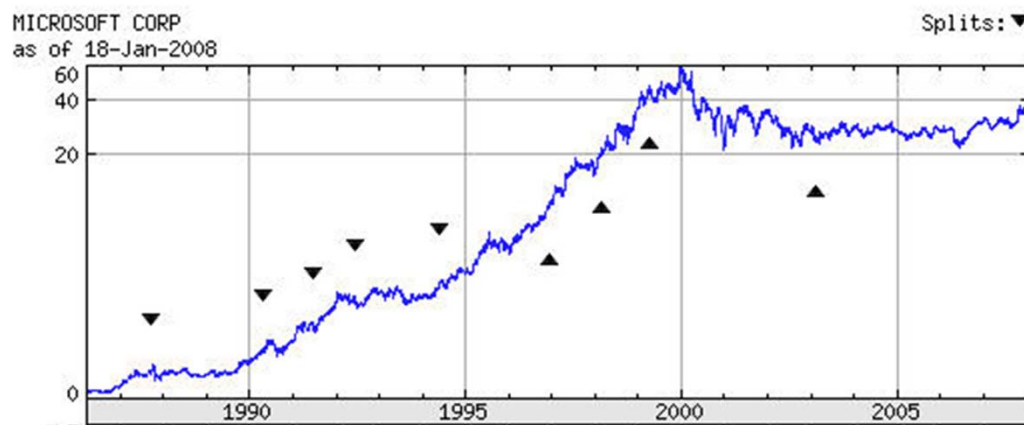
The “Great Divergence” Puzzle

- Is profit extraction from elsewhere the answer?
 - Source of extractions
 - Colonization
 - Slave trading
 - The discovery of the New World
 - The extra profits offer the much needed capital for investment, thus put Western Europe onto a “virtuous cycle”
 - The discovery of New World relaxed the restraint on natural resources such as land and coal. It also provided much needed coal and cotton to fuel the industrial revolution.
 - A much bigger market for industrial goods: combined size of Americas plus Europe
 - But the question still remains why Western Europe first got the sea power to colonize other countries.



The “Great Divergence” Puzzle

- The rise and decline of nations
 - Is country's economic growth similar to the growth of firms?
 - The case of Microsoft



- Was China's own success the reason for her stagnation?
 - A theory of stagnation
 - “Winner's Curse” or “high equilibrium trap”?

The “Great Divergence” Puzzle

Summary

- To solve the puzzle, the key is to find out what are the factors that existed in Western Europe but did not exist in somewhere else, especially in China.
- Peter Temin’s (economic historian) insights – (he sees) “the industrial revolution not as coal and cotton but as an entrepreneurial and innovative economic culture that finds its most powerful expressions in coal and cotton”.
- Differences in institutions, especially those institutional changes along the way that promote “incentives”, are probably the most promising route to unravel this puzzle.