China and Globalization: The Economic, Political, and Social Transformation of Chinese Society (Implications for US-China Relations)

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Economic Change in China: A Summary

• China is a place of radical institutional change
  – It is radical both because of the objective material changes, but also because of how it has challenged our understandings of economic processes and institutional change

• It has been successful largely because of the government’s involvement in the reform process
  – Nearly three decades of reform have proven that gradualism is a superior reform model

• Institutions matter more than culture

• China has used economic interdependence as a way of dealing with political conflicts

• Democracy is inevitable (the transformation is already well under way)
Top 10 of GDP (2007)

1. US $14.1 trillion
2. China $4.9 trillion
3. Japan $4.4 trillion
4. Germany $3.3 trillion
5. U.K. $1.8 trillion
6. France $1.5 trillion
7. Italy
8. Brazil
9. Canada
10. Spain

China is second only to the US when adjusting for Purchasing Power Parity (PPP=12.4 trillion; China=8.8 trillion).

PPP is a statistic that adjusts for cost of living differences by replacing exchange rates with relative measures of local purchasing power (i.e., the cost of purchasing one bowl of rice, or one bag or grain or one general unit, with local currency in a given country).

The Economic Miracle
Indeed, the doom and gloom view of China has persistent and consistent resonance in US views of China... Why?

“Peer beneath the surface, and there is a weak China, one that is in long-term decline and even on the verge of collapse. The symptoms of decay are to be seen everywhere.”—Gordon Chang, 2001.

Wei Jinsheng, a labor activist exiled from China, and AFL-CIO Secretary-Treasurer Richard L. Trumka... discuss the union federation's petition to the U.S. trade representative. (Photos Larry Downing – Reuters, 2004)

Broken China: Beijing can’t clean up the environment, rein in stock speculation or police its companies. Why the mainland’s problems could keep it from becoming the next superpower (July 23, 2007)

The New York Times
James S. Chanos, a wealthy hedge fund investor, is Working to bust the myth of the biggest conglomerate of all: China Inc. (January 8, 2010)
The doom and gloom view of China

Sugai, a farming village in Inner Mongolia, China, was destroyed in a flood of sludge from two paper mills.

The Economist

“China’s Growing Pains: The dark side of China’s stunning book includes pollution and a collapsing state health-care system”
WASHINGTON, Sept. 5 — Large economic imbalances caused in part by America’s trade deficit with China and other countries are threatening prospects for continued global growth, the head of the international agency that monitors the world’s economy warned on Tuesday.

Source: US Census Bureau, Foreign Trade Division
Breaking Down the Reform Process

The paradox of reform in China: if China’s institutions are so weak, how do we explain China’s dramatic success? Further, if a rapid transition to private property is the cornerstone of building a successful market, how should we understand China’s situation? Key institutional features of the reforms:

1. Gradualism (experimentation)
2. Decentralization (competition)
3. Openness to foreign investment (interdependence)
4. Gradual emergence of a private economy
5. The “quiet” revolution of institutions
Gradualism
(experimentation and innovation)

• Contrary to popular belief, state control and gradual reform have increased some aspects of radical social innovation.

• Gradual economic reform in China has allowed for a degree of stability while institutional innovators have experimented with new institutional forms that have reshaped the economy from the ground up.

• Gradualism allows for experimentation with new institutional forms in ways that are often hidden from the public view.

• This has implications for political and social change in addition to economic change.
2. Decentralization (competition)

- Decentralization is also one of the key features of economic reform in China.
- To begin with, China was much more decentralized than the Soviet Union was. This meant that local control could be much more easily handed over to local officials.
- Budget constraints were hardened for municipalities and townships. Local officials have incentives aligned (“Local Governments as Industrial Firms”).
- Local competition emerges.
The Tier-Two Phenomenon
National Level EDZ - Suzhou Industrial Park
2. Decentralization (asset management)

Central Govt. (Ministry)

Factory Factory

Provincial Govt. (Bureau)

Direct control over Central Govt. firms (generally large-scale SOEs); also policy control for entire sector

Factory Factory

Municipal Govt. (Bureau)

Direct control over Prov. Govt. firms (generally large-scale SOEs); also policy control for sector within province

Factory Factory

Municipal Company

Factory Factory

District Govt. (Bureau)

Direct control over Mun. Govt. firms (generally med-scale SOEs); also policy control for sector within municipality

Factory Factory

District Company

Factory Factory

Township Govt. (Bureau)

Direct control over urban dist. firms (generally urban collectives)

Factory Factory

Village Govt.

Factory Factory

Structure of the Former Command Economy

Figure based on interviews with industrial managers and government officials. See also Walder (1992, 1995) and Guthrie (1997, 1999) for further discussion of the “nested hierarchy” of state administration.
2. Decentralization (asset management)

Structure of the Former Command Economy and the emergence of SOAMCs

- Independent AMC (relatively few in the economy)
- Subsidiary of a state office (much more common)

Figure based on interviews with industrial managers and government officials. See also Walder (1992, 1995) and Guthrie (1997, 1999) for further discussion of the “nested hierarchy” of state administration.
SASAC

• The State-owned Assets Supervision and Administration Commission (SASAC) of the State Council was founded in 2003

• Purpose: “takes responsibilities as investor of state-owned assets on behalf of the central government and aims to strengthen the management of state-owned assets in nine fields” (incl. oil & petrochem, electricity, telecom, shipping, aviation, coal).

SASAC Director Li Rongrong
SASAC and Corporate Governance

COMPANY NEWS: BERKSHIRE HATHAWAY INCREASES STAKE IN PETROCHINA (Aug. 30, 2008)

70% of shares
90% overall (since 1999)

50% acquisition (purchase made August 25, 2008)

True owner, (100% since 2003)

20% direct shares (since 2003)

9-10% stake in shares (since 1999)

The New York Times

COMPANY NEWS: BERKSHIRE HATHAWAY INCREASES STAKE IN PETROCHINA (Aug. 30, 2008)
3. Enticing Foreign Investment (interdependence)

- Enticing foreign investment
  - Cash and the export market
  - Management and technology
  - Political interdependence
### By the Numbers…

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP</th>
<th>GDP per capita</th>
<th>Per capita income</th>
<th>Exports</th>
<th>Imports</th>
<th>Trade balance (world)</th>
<th>Trade balance (US)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>China</strong></td>
<td>$3.3 Trillion(3)</td>
<td>$5,600</td>
<td>$1,290(105)</td>
<td>$968,900,000,000</td>
<td>$791,500,000,000</td>
<td>+$177,400,000,000</td>
<td>+$257,155,000,000</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td>$13.2 Trillion(1)</td>
<td>$43,730</td>
<td>$41,400(4)</td>
<td>$1,163,200,000,000</td>
<td>$1,953,300,000,000</td>
<td>-$790,100,000,000</td>
<td>-$257,155,000,000</td>
</tr>
</tbody>
</table>
The Biggest Net Importer Overall is...
Foreign Debt

Leading Foreign Owners of US Treasury Securities, May 2010

- People's Republic of China (mainland)
- Japan
- United Kingdom
- Oil exporters
- Caribbean Banking Centers
- Brazil
- Hong Kong (Special Administrative Region)
- Russia
- Republic of China (Taiwan)
Foreign Investment:
Intel Leaving Shanghai for Chengdu
4. The Emergence of a Private Economy

- Gradual emergence of a private economy (from below and from above)
  - Small-scale (*getihu*)
  - Large-scale (listing on domestic and international exchanges)
  - Small-scale to large-scale (Legend-Lenovo)
  - Economic and social impacts
    - Competition
    - Freedom from “organized dependence”
- Public-private hybrid organizational forms
  - IPOs of former SOEs
  - SASAC
Growth of the Private Economy

Figure 6.3: Growth of China’s Private Sector
(Source: Statistical Yearbook of China, 2006)
5. The Quiet Revolution

• What is Democracy? From The Dictionary of Modern Sociology:
  – “A philosophy or Social system based on the principle of [equality], the principle being particularly applicable in political aspects of life… in any social system, rule by majority, usually with regard to certain rights of minorities; a form of government wherein supreme power is held by societal members in general, such members typically exercising their power in a system of representation involving periodic free elections.”

• What makes the United States a democracy? (What are the core features?)
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