



Understanding
Chinese
Economy –
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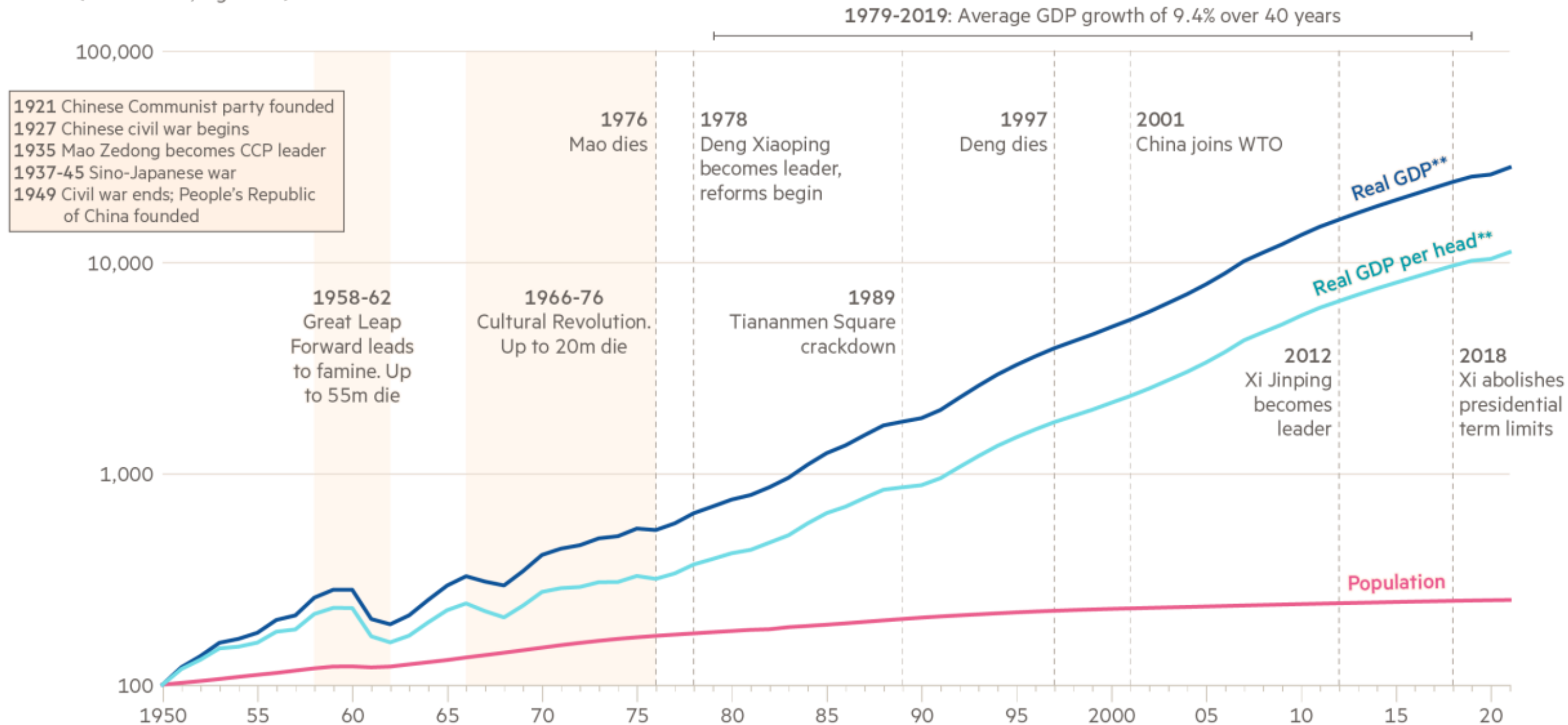


China's Political Economy

- What is China's political system and How does it affect the Economy?
- What has China learned from the failures of other communist countries?
- What has China learned from the success of its East Asian neighbors?
- Who runs economic policy?
- What influence do China's size and population have on economic development?
- When leaders have to choose boosting economic growth and maximizing political control, which do they choose?

China's changing economic and political fortunes

Rebased (1950 = 100, log scale*)



*Log scales show relative rather than absolute values. Equal distances show the same percentage movement and constant growth appears as a straight line **At purchasing power parity

FT visual journalism: Keith Fray; Chris Campbell Sources: The Conference Board; IMF; The Maddison Project

What is China's political system and How does it affect the Economy?

- A single party system – one party state
- Bureaucratic authoritarian system
 - Not a democracy , not a dictatorship
 - Ultimate authority resides not in the individual leader but in the communist party
- Large flows of information between local and central governments which in turn is used to address problems on ground
- There is censorship but the party has tolerated explosion of conventional and online media as it aids the party in getting firsthand information which may not flow through official channels

- In principle very centralized but in practice totally decentralized
- No division of power between local and central governments – party's central organization department appoints the senior leadership of all provinces and cities
- In reality, local government enjoy high level of autonomy and discretion

What is China's political system and How does it affect the Economy?

- The share of government expenditure which happens at sub national level was around 25% for democracies and 18% for nondemocratic countries
- China was a huge outlier at 54% (IMF- 2004) during 1958-2002 and 85% in 2014
- “ Controlling for its level of economic development, one would expect the PRC to be one of the most centralized countries in the world, instead based on the observed levels of expenditure and decentralization, it is consistent with a federal democracy!”
- In 1979, central planners-controlled allocation of 600 commodities and prices of a few thousand goods compared to 60,000 commodities and millions of goods by USSR
- In 1979, USSR had 40,000 PSUs whereas China had 883,000 of which 800,000 were controlled by city and county governments
- Decentralization of production was a strategic choice made by China, so that in case of a war, if one production cluster is affected, others will still be able to function
- Paradox – apparently centralized, one-party authoritarian state, presiding over a dynamic, decentralized economy

Leadership succession is different in China from other authoritarian systems

- Other authoritarian systems succession is tricky – generally after the death of the ruler or through a coup d'état
- China – three successive transfer of power from one living leader to another unrelated one – in 1992, 2002 and 2012 – the fourth which is supposed to happen in 2022 is postponed indefinitely
- Top Chinese leader holds three positions simultaneously –
 - General Secretary of the Communist Party
 - Chairman of Central Military Commission
 - State President
- The mechanism of leadership transition means China is more stable and resilient than the other authoritarian states
- Mandatory retirement rules for senior leaders at 70 and others at 65 means that there is a constant circulation of new personalities and ideas in government and the system does not get captured by leaders resistant to change





China's Political Economy – Single Party

China's Political Economy – Single Party

- Communist party is the sole legal party
- With about 92 million members and nearly 5 million party units across the nation, the Communist Party of China influences and oversees almost every aspect of life in China, from the government to the army, society and business.
- Reach into every organized sector of people's lives – government, courts, media, companies both PSU and private, universities, religious organizations – top officials in all these organizations are appointed by party's powerful organization department
- The Communist Party of China gained power after it won the Chinese Civil War in 1949, founding the People's Republic of China.
- Now, it oversees every aspect of life in the country, from the government and military to the economy and society.

China's Political Economy – Single Party

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- [Party cells](#), which are the grass-roots party organizations, are the most ubiquitous units of the party. According to the party constitution, all business, social and army units on the ground with three Communist Party members or more have to establish a party cell.
- The cells play an important role as “fortresses in battles” for the Party.
- They have a wide range of duties, including promoting the party's ideology, informing the public of the party's policies, implementing decisions from higher levels and organizing cadres and non-party members – or the so-called masses – to take part in social work.

Chinese Community Party Structure



- 1. Han Zheng
- 2. Wang Huning
- 3. Li Zhanshu
- 4. Xi Jinping
- 5. Li Keqiang
- 6. Wang Yang
- 7. Zhao Leji

● New member of Standing committee

Source: AFP

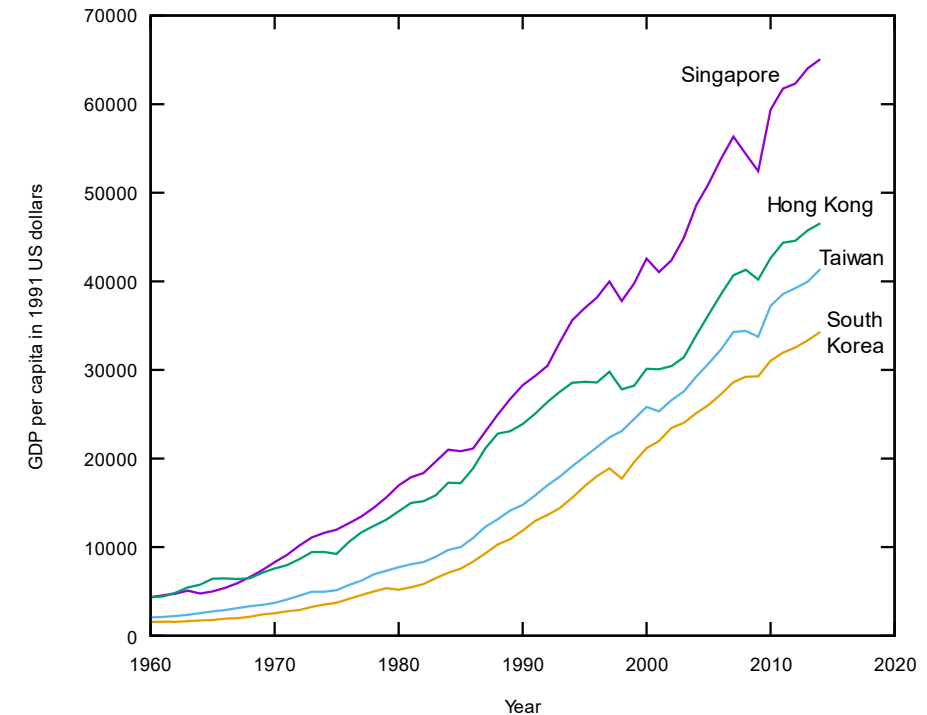


What has China learned from the failures of other communist countries?

- The economy did not grow fast enough leading to frustration and resentment, and the failure was due to insufficient use of market mechanisms
- The CPSUs propaganda and information systems were too closed and ideologically rigid, preventing officials from getting accurate and timely knowledge about conditions both inside and outside soviet union
- Decision making was far too centralized and hence far too slow
- Once reforms started under Gorbachev, they undermined the core principles of party's absolute monopoly over political power

What has China learned from the success of its East Asian neighbors?

- When China emerged from its period of Maoist isolation in 1979, its officials and scholars travelled around the world and found that China has fallen behind in economic and technological terms not only behind west but also its smaller eastern neighbors such as Japan, South Korea and Taiwan
- By 1979, Japan was world's second largest economy and was poised to wrest global technological leadership away from US
- South Korea, which was the poorest country in Asia, under the leadership of President Park Chung-hee (1961-79) has become a nascent industrial powerhouse
- Taiwan, a poor agricultural province of China, in 1949, where the defeated nationalist government of Chiang Kai-shek took refuge after losing civil war to communists, was on the verge of becoming a world class exporter of electronic goods



What has China learned from the success of its East Asian neighbors?

- Developmental State – Robert Wade (1988)
- “land to tiller “ agricultural reforms
- Export oriented manufacturing
- Financial repression
 - Regulated low interest rates – so that cash flows from economic growth are not captured by “rentiers” living off interest income, but instead subsidize borrowing to fund state investments infrastructure and corporate investments in industry
 - A tightly managed and typically undervalued exchange rate so as to make the country exports cheaper globally
 - Capital controls, to prevent companies and rich individuals from taking out national wealth offshore and instead compel them to reinvest in the domestic economy

What has China learned from the success of its East Asian neighbors?

- Land to tiller – breaking up big estate or plantations and creating small rural landholders
- In populous countries, with large pool of rural labour, per acre yields on small owner cultivated farms are much higher than large farms tilled by tenant farmers or wage labour
- This creates a significant agriculture surplus which can be captured by the state which could be captured by the state due to fragmented nature of ownership
- These resources thus provide the seed capital needed for basic industry and infrastructure

What has China learned from the success of its East Asian neighbors?

- Export led manufacturing
- Poor countries technological capital which rich countries more productive
- A technology catch up process has to happen
- Exports help in two ways
 - They provide foreign exchange needed for paying for technology and capital equipment
 - As the composition of exports change from agriculture produce, handicrafts to more sophisticated goods and services, they help the country to compete in international markets so that the technology and management practices are of global standard
- Exporters engage in constant process of upgrading the technology – through purchase, licenses, reverse engineering and sometimes outright theft as against producers who are reliant on domestic market alone

Who runs economic policy?

- In most countries, economic policy is moving from top level strategies devised by PM or President and his key advisors and implemented by key agencies such as Central Bank, Ministry of Finance, Ministry of Trade and sometimes a planning commission
- In China, several layers of bureaucracy exist between the top leader and specialized agencies

What influence do China's size and population have on economic development?

- China is the world's largest country by population – 1.4 billion
- It is the fourth largest by area – almost equal to the size of USA
- “ When you multiply any problem by Chinese population, it is a very big problem. But when you divide it by China's population, it becomes very small”
- China's size means that any challenge it faces – unemployment, environment degradation, social unrest – exists on an unimaginably large scale but so are the resources available to tackle the problem. The key is to marshal these resources and deploy them effectively