

Case Study – China

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Why all the talk about China?

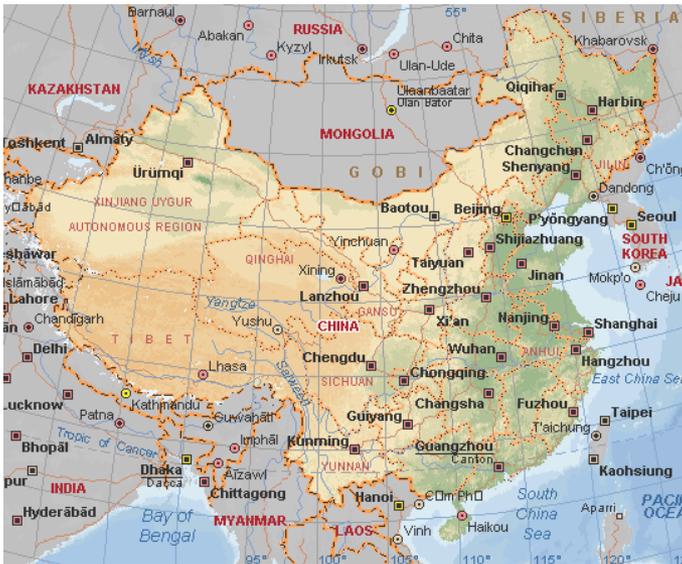
- Fast growth experience
 - Not completely unique (e.g., South Korea)
- China is HUGE
 - Largest population by far
 - Second largest economy
 - Largest polluter (CO₂)
 - Largest military (in terms of soldiers)
- Claim: We won't understand the 21st century if we don't understand China

People's Republic of China



Some Facts about China:

- 1.4 billion people
- 3,700,000 sq miles (size of USA)
- 2014 per capita GDP (nominal): \$8,100 (about 1/7 of the US)
- 2014 per capita GDP (G-K \$): \$13,000 (about 25% of the US)
- Currency: Yuan (RMB)
- One Party political system
- Major industries: Consumer electronics, construction
- Major cities: Beijing, Shanghai, Guangzhou, Shenzhen, Tianjin



Back in time.... 1793

“Yesterday your Ambassador petitioned my Ministers to memorialize me regarding your trade with China, but his proposal is not consistent with our dynastic usage and cannot be entertained. Hitherto, all European nations, including your own country's barbarian merchants, have carried on their trade with our Celestial Empire at Canton. Such has been the procedure for many years, although our Celestial Empire possesses all things in prolific abundance and lacks no product within its own borders. There was therefore no need to import the manufactures of outside barbarians in exchange for our own produce. But as the tea, silk and porcelain which the Celestial Empire produces, are absolute necessities to European nations and to yourselves, we have permitted, as a signal mark of favor, that foreign merchants should be established at Canton, so that your wants might be supplied and your country thus participate in our abundance. But your Ambassador has now put forward new requests which completely fail to recognize the Throne's principle to ‘treat strangers from afar with indulgence,’ and to exercise a pacifying control over barbarian tribes, the world over. Moreover, our dynasty, swaying the myriad races of the globe, extends the same benevolence towards all. Your England is not the only nation trading at Canton. If other nations, following your bad example, wrongfully importune my ear with further impossible requests, how will it be possible for me to treat them with easy indulgence? Nevertheless, I do not forget the lonely remoteness of your island, cut off from the world by intervening wastes of sea, nor do I overlook your excusable ignorance of the usages of our Celestial Empire. I have consequently commanded my Ministers to enlighten your Ambassador on the subject, and have ordered the departure of the mission.”

Historical Context: What was he thinking?

- England in 1793 wealthy by European standards
 - Controlled a large empire overseas
 - Had higher GDP per capita
- England was technologically advanced
- Was the emperor of China ignorant or foolish?

Ancient China

- Up to that point, China had been the wealthiest part of the world for almost all of human history
- Over the long run, the largest fairly stable empire
- Highest GDP per capita most of the time
- The 12th century Song dynasty was the wealthiest empire until just before the industrial revolution
- Huge population, technological advancements
- Imagine: Europe unified in one state for much of history and three times the population

China until 1839

- Introduction of *Romance of the Three Kingdoms*:
*“The empire long divided must unite,
long united, must divide.”*
- China had long periods of division
- Very diverse and rich history and culture
- Large number of languages (called “dialects”)
- Large number of ethnic groups
- Major emphasis on education and order
- Huge number of inventions, discoveries, etc...

Rise of the West

- In the middle of the 19th century, the UK, then Germany, Japan and the USA began to industrialize
- Steady growth passed China
- With new wealth, began to build military power to conquer other parts of the world
 - UK control of India (1858)
 - “Scramble for Africa” (1884)
 - Foreign incursion in China (starting 1842)

First Opium War

- The British East India Company made a large profit growing opium in India and selling to China
- In 1839, the Chinese government outlawed the opium trade and confiscated the drugs
- The British navy intervened on behalf of the merchants
 - Destroyed the Chinese navy
 - Destroyed Chinese towns and ports
- Treaty of Nanjing: opened ports and opium trade

Second Opium War

- 1856: A British ship seized by Chinese government on suspicion of piracy
- British seize Guangzhou
 - Joined by France, Russia and the USA
- Forced the whole country open to trade
- Allowed for foreign missionaries
- Huge debt to France and Britain

First Sino-Japanese War

- Japan had embraced industrialization and built a powerful army
- 1894: Used rebellion in Korea as pretext to invade
- Pushed further into Manchuria
- Invasion of Taiwan

Boxer Rebellion

- In 1899, a popular uprising in China against outside imperial powers
- Attempts at reforms by outsiders reversed by the Chinese Dowager Empress
 - Used “boxers” as her power base
- Response by US, Japan and European powers:
 - Invasion and defeat of boxers
 - Huge required reparations paid to foreigners

Warlord Era

- By 1911, the Qing dynasty collapsed and the Republic of China was established
- Republic quickly collapsed
- Warlord Era
 - Country divided among conflicting regional warlords
 - Opposing armies with autocratic rulers
- Sun Yat-Sen embarked on the reunification of China; completed after his death

Civil War Era

- Two sides:
 - Communists (Mao Zedong): Left wing pro-Soviet nationalists
 - Nationalists (Chiang Kai-Shek): Right wing pro-western nationalists
- United during reunification campaign
- Nationalists turned on communists in 1927
- Long struggle until 1937

Second Sino-Japanese War

- In the midst of the civil war, Japan invades China from Manchuria
- Quickly conquered all of coastal China
 - Chinese army unprepared and ill equipped
- Temporary ceasefire between communists and nationalists
- Ground to a stalemate in central China
- Became a part of World War II

Resumption of Civil War

- After defeat of Japan, civil war resumed
- Nationalists eventually fled to Taiwan
- Remain in Taiwan until today
- When the nationalists fled, the communists declared victory
- On October 1, 1949, the People's Republic of China was proclaimed

Recap up to this point

- Almost all of history: China was the richest and most advanced part of the world
- Industrialization: Some other countries pass China in a few decades
- “Century of Humiliation”: China totally unable to resist outsiders, total collapse of government
- Communist takeover

Early Years of Communist Rule

- Close ties to USSR:
 - Provided expertise and designs
- Attempts at industrialization
- Korean War:
 - Very expensive in terms of resources and population
- 100 Flowers Campaign
- Anti-Rightist Campaign
- Modest progress

Great Leap Forward

- Mao proclaimed a five year plan to greatly increase grain and steel production
- Massive collectivization of agriculture
- Centralization distribution of goods
- Steel production in backyard furnaces
- Moved people into cities and mining, and out of the countryside
- Building of enormous irrigation canals

Results of Great Leap Forward

- This program was an **unmitigated disaster**
- Huge losses of life in 20th century:
 - Holocaust: 6 million
 - USSR purges: 10 million
 - Khmer Rouge: 1.5 million
 - Rwandan genocide: 750,000
 - World War I: 10 million (military)
- Chinese deaths (1958-1961): **30 million**

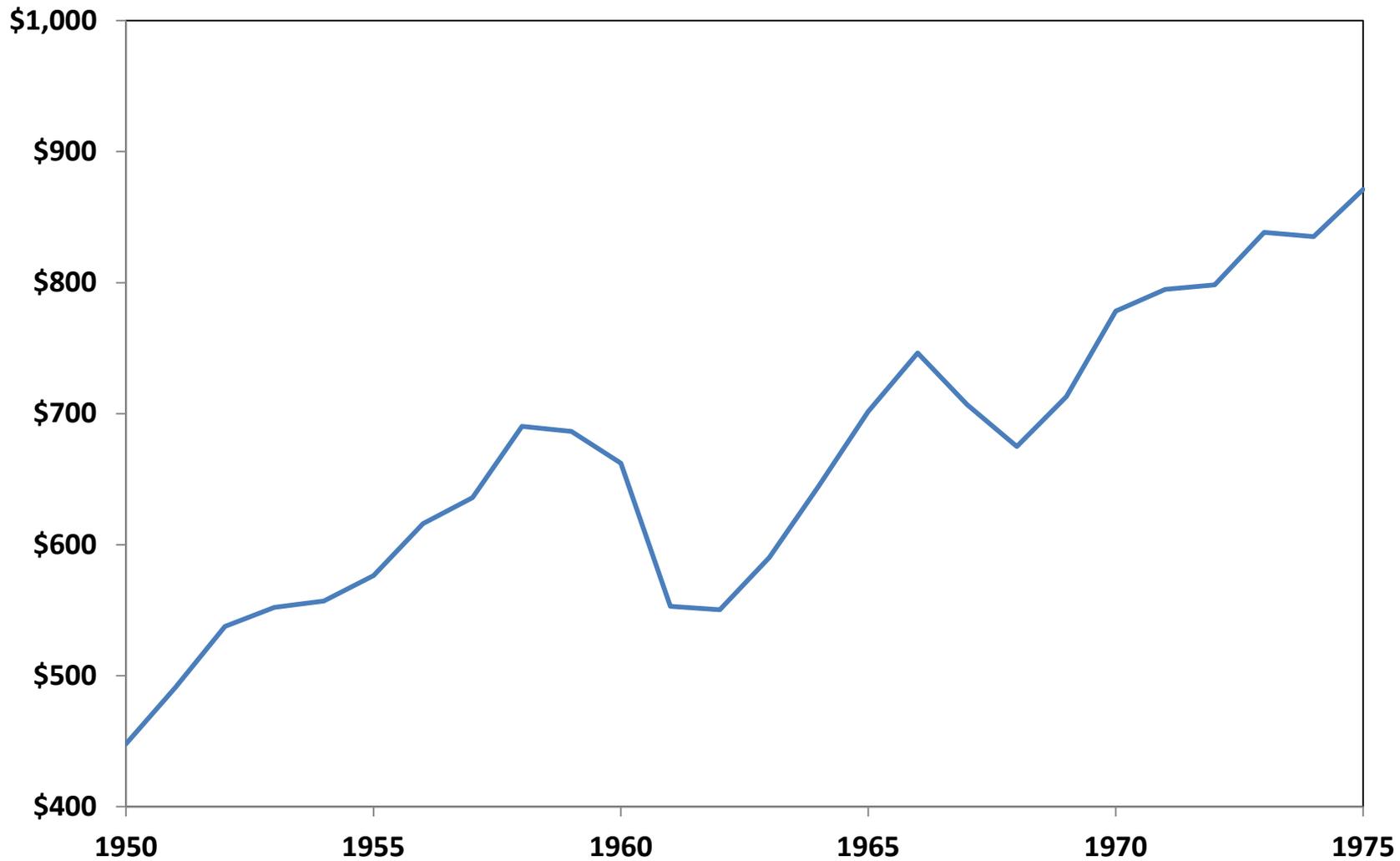
What happened?

- Not enough people to produce required food
- Government policies hurt agricultural productivity
- Steel produced in backyard furnaces was worthless
- Collectivization caused destruction of a third of rural residences
- Chairman Mao lost power in 1959
- Led to a turn back toward markets
- Moderates came to power

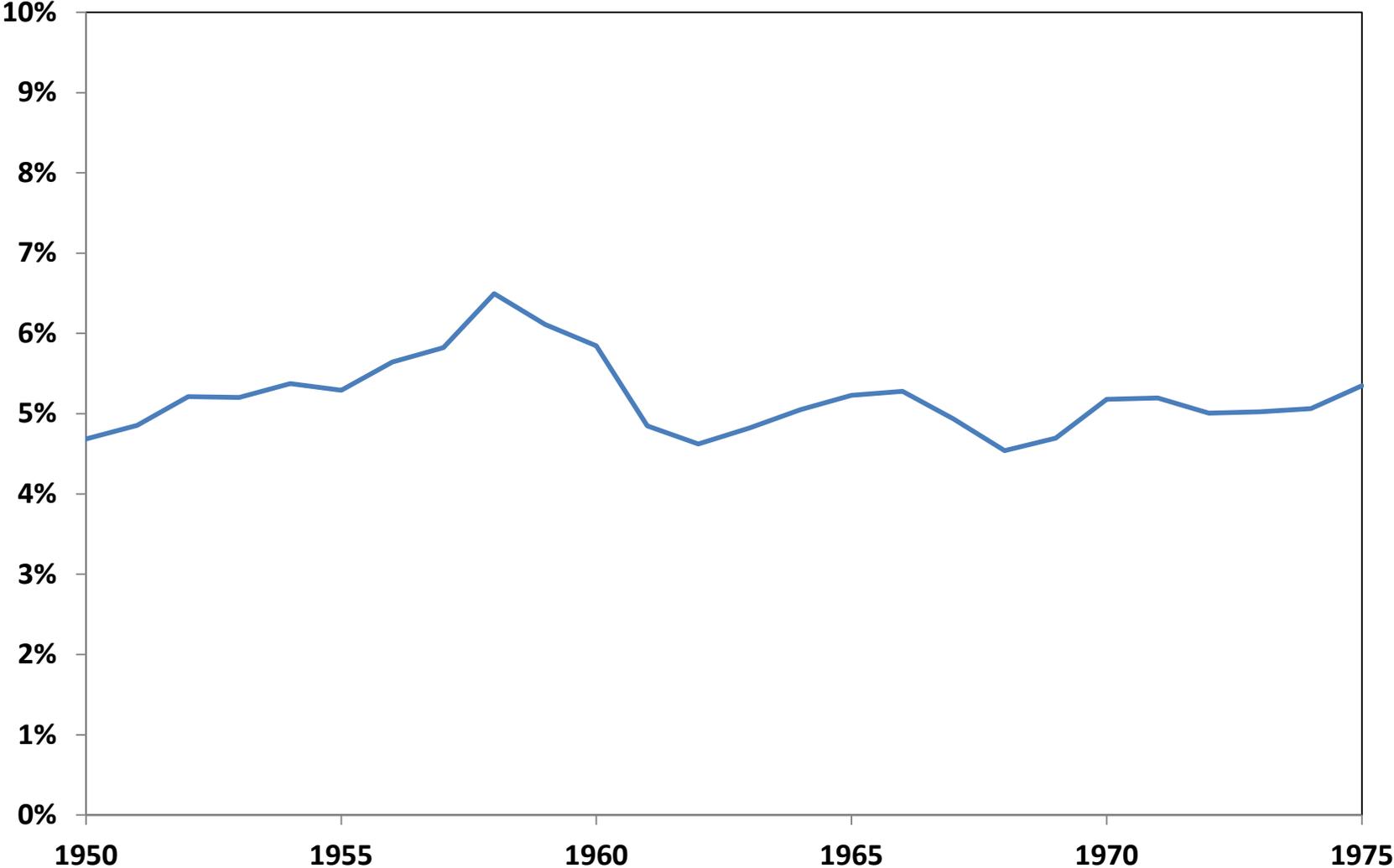
Cultural Revolution

- Mao worried that “revisionists” were taking over
- Called for the denunciation of authority figures
 - Teachers
 - Moderate government officials
- Formation of the Red Guard: youths organized to oppose moderate government forces
- Huge purges across civil society
- Destruction of historical art and artifacts
- Chaos for several years

GDP of China



GDP of China relative to the US



Rise of Deng Xiaoping and Reform

- After Mao died, Deng Xiaoping who had been purged several times, rose to power
- Implemented a series of reforms
- Decollectivization of agriculture
- Allowed for private businesses
- Opened Special Economic Zones, where foreign trade and investment were allowed
- Reopened Shanghai stock exchange

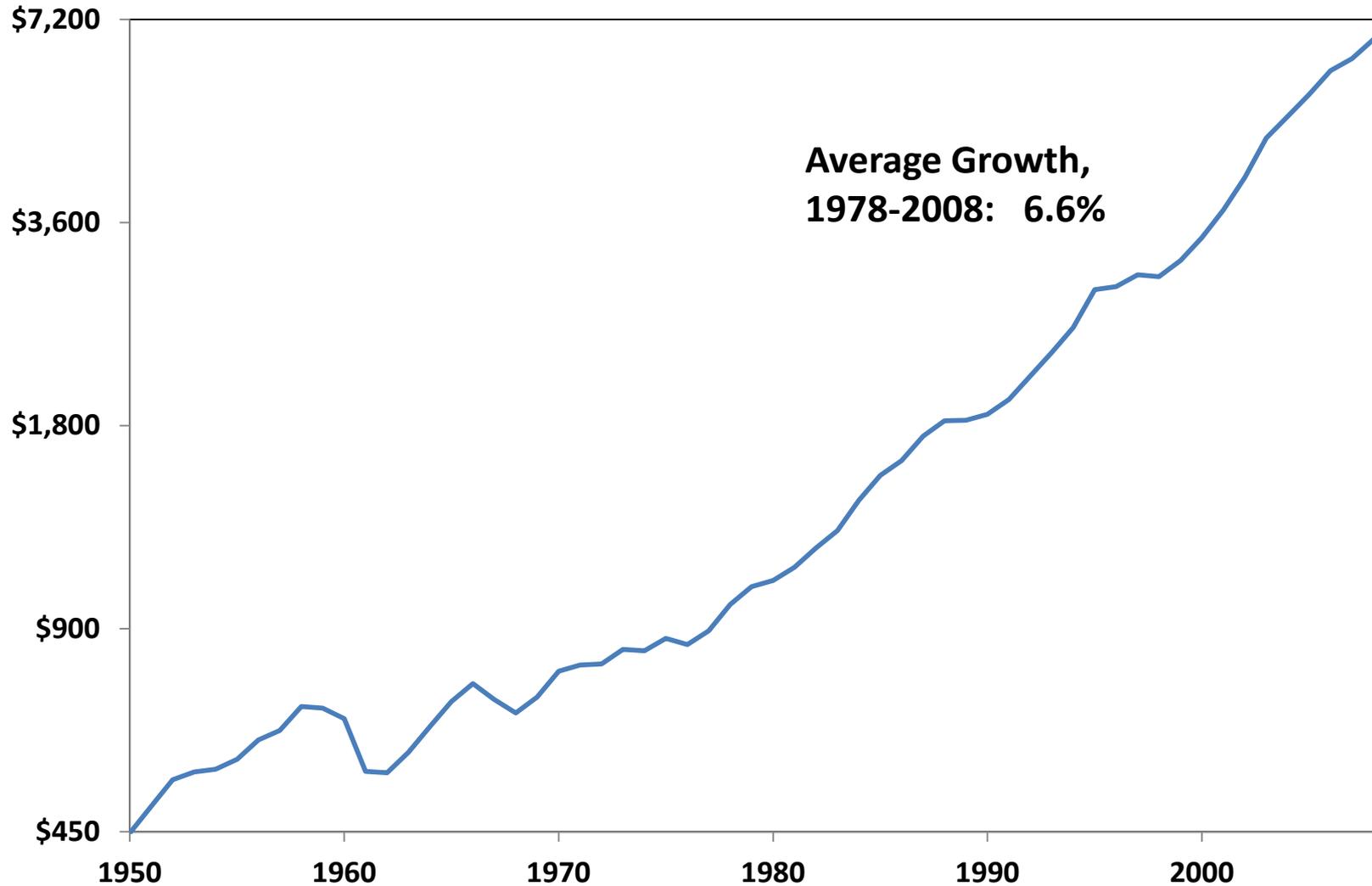
Period of Fast Growth

- Some attempts to curb government corruption
- Massive movement of people controlled over time
 - Internal migration system keeps it from happening too fast
- Huge state-owned enterprises
 - Banks, utilities, raw material production
- Huge increases in trade
- Currency value management

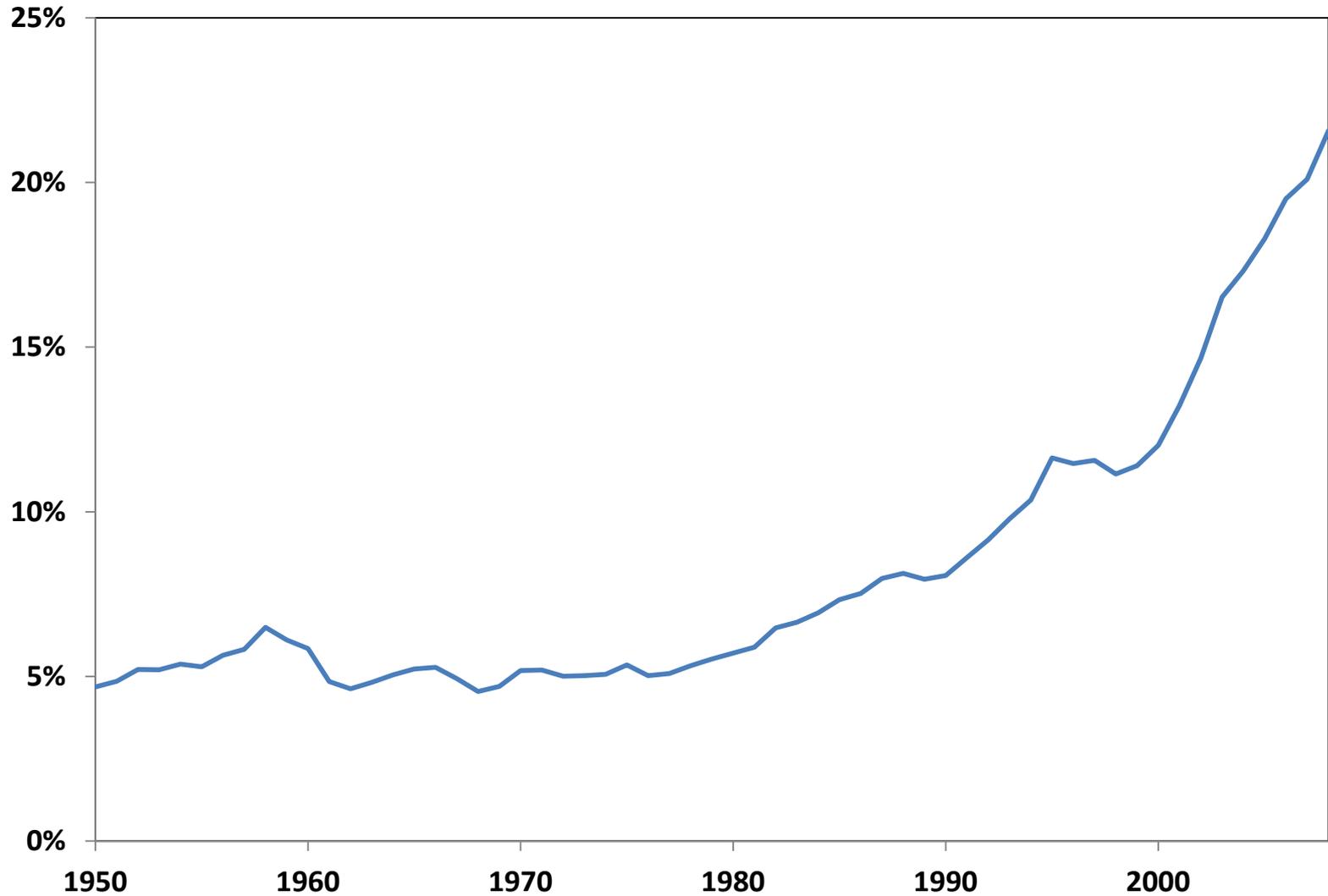
Exchange Rate Strategy

- Keep currency “cheap” to encourage exports and discourage imports
- Use taxes and capital controls to keep foreign currency out
- Use extra dollars to buy US government debt
- Built up huge supply of Chinese government savings
- Chinese consumers hurt because of taxes and higher prices

Growth of China in the Modern Era

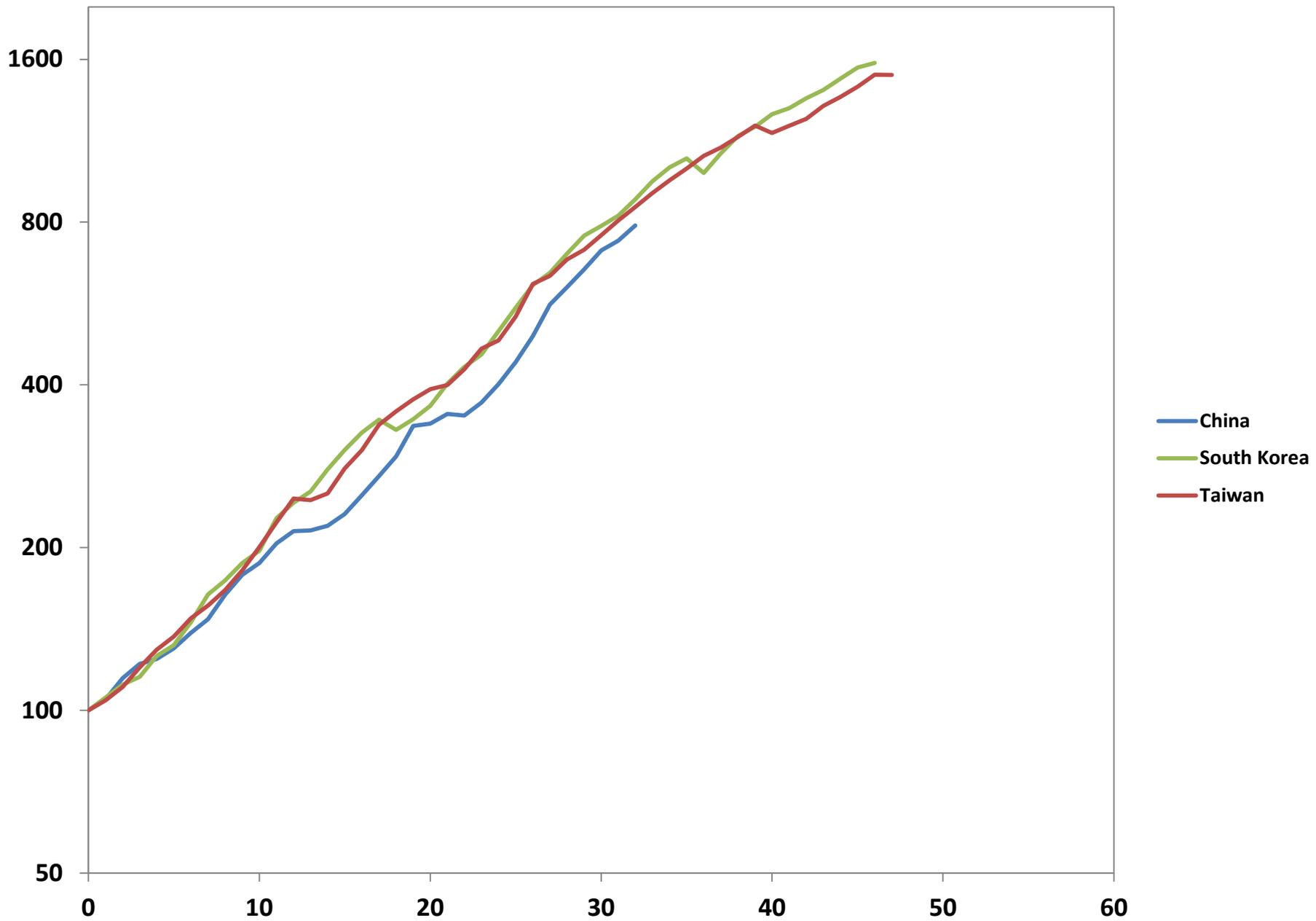


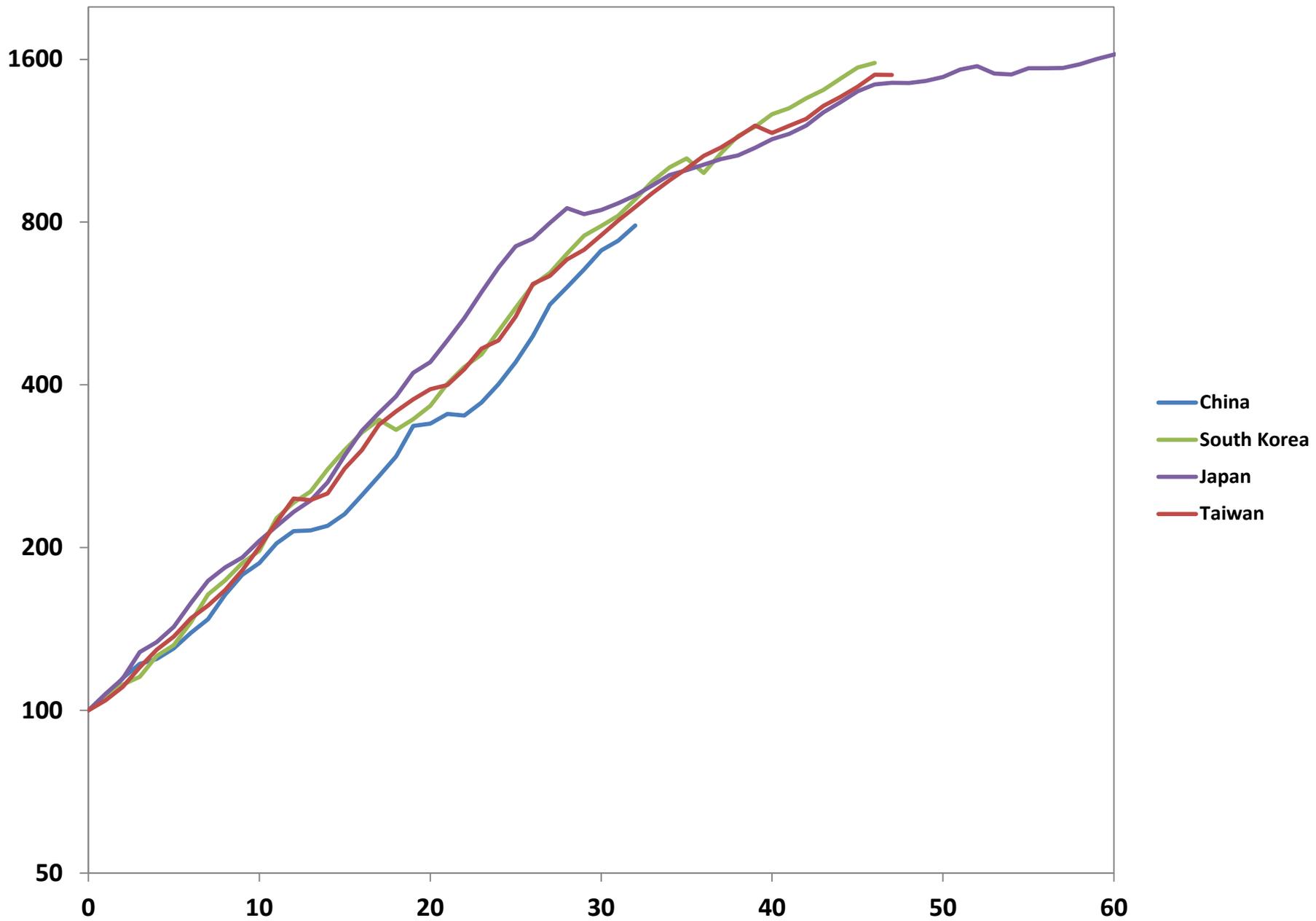
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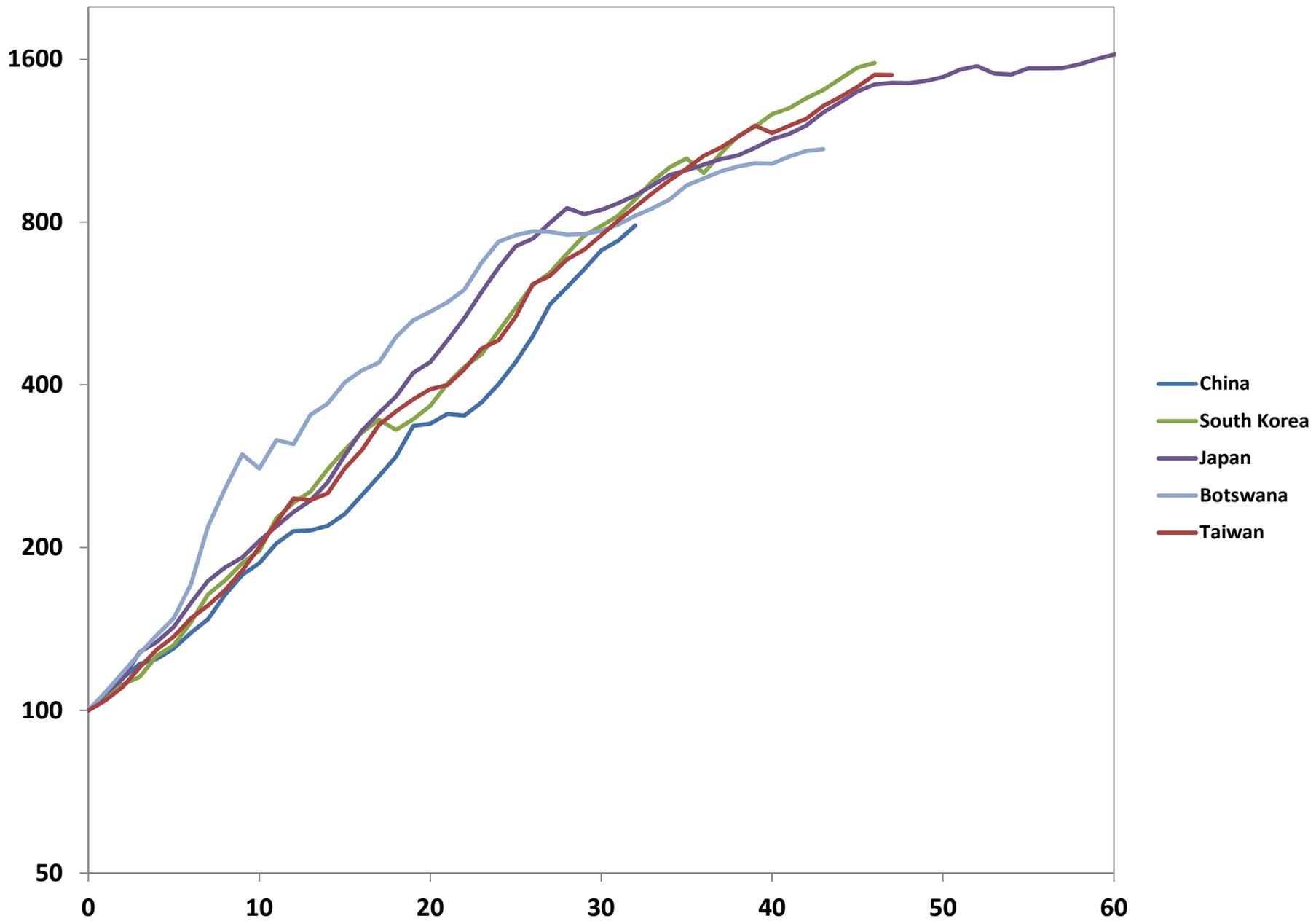


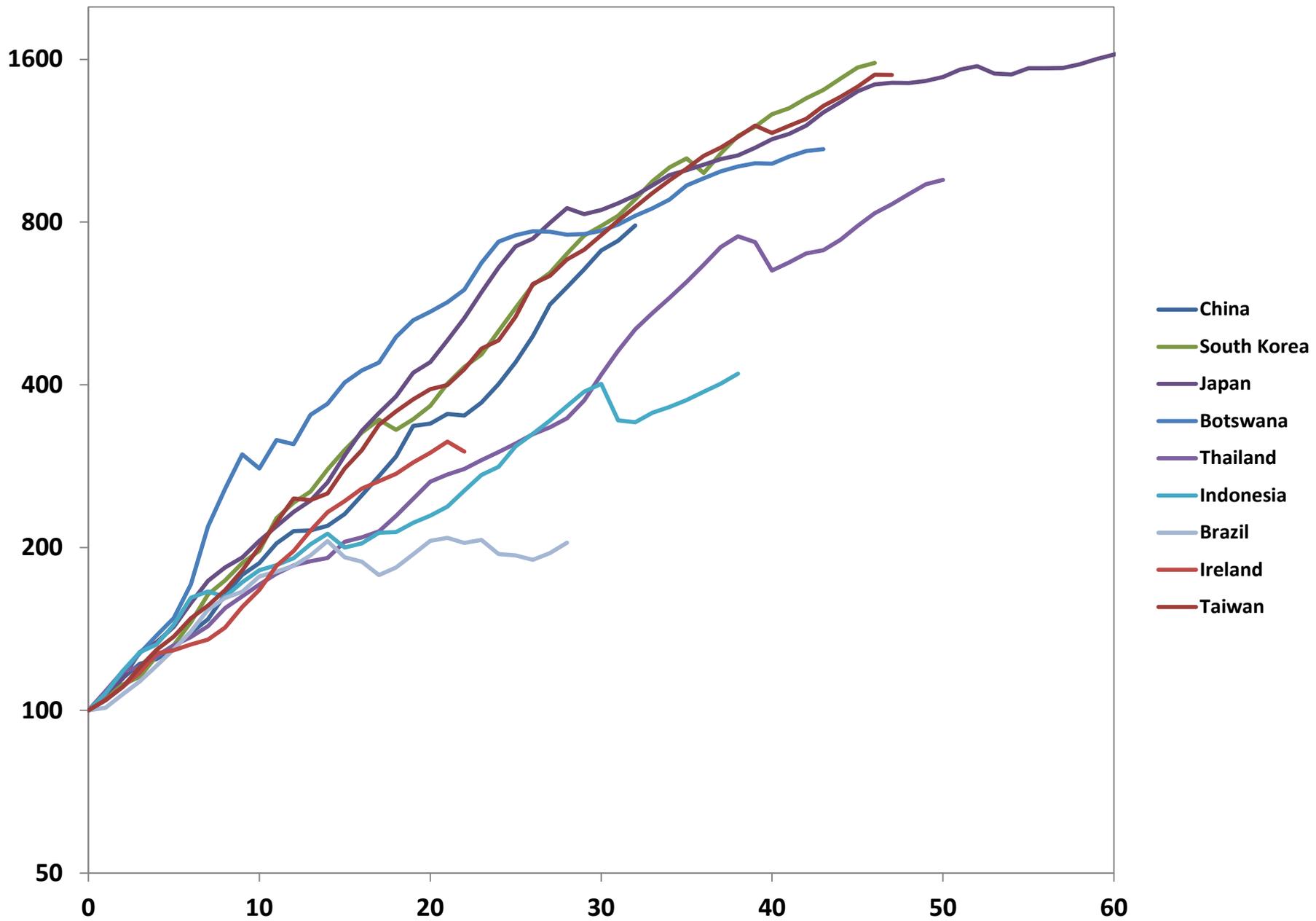
What is China's future?

- No one knows.
- Look at lots of countries and try to understand





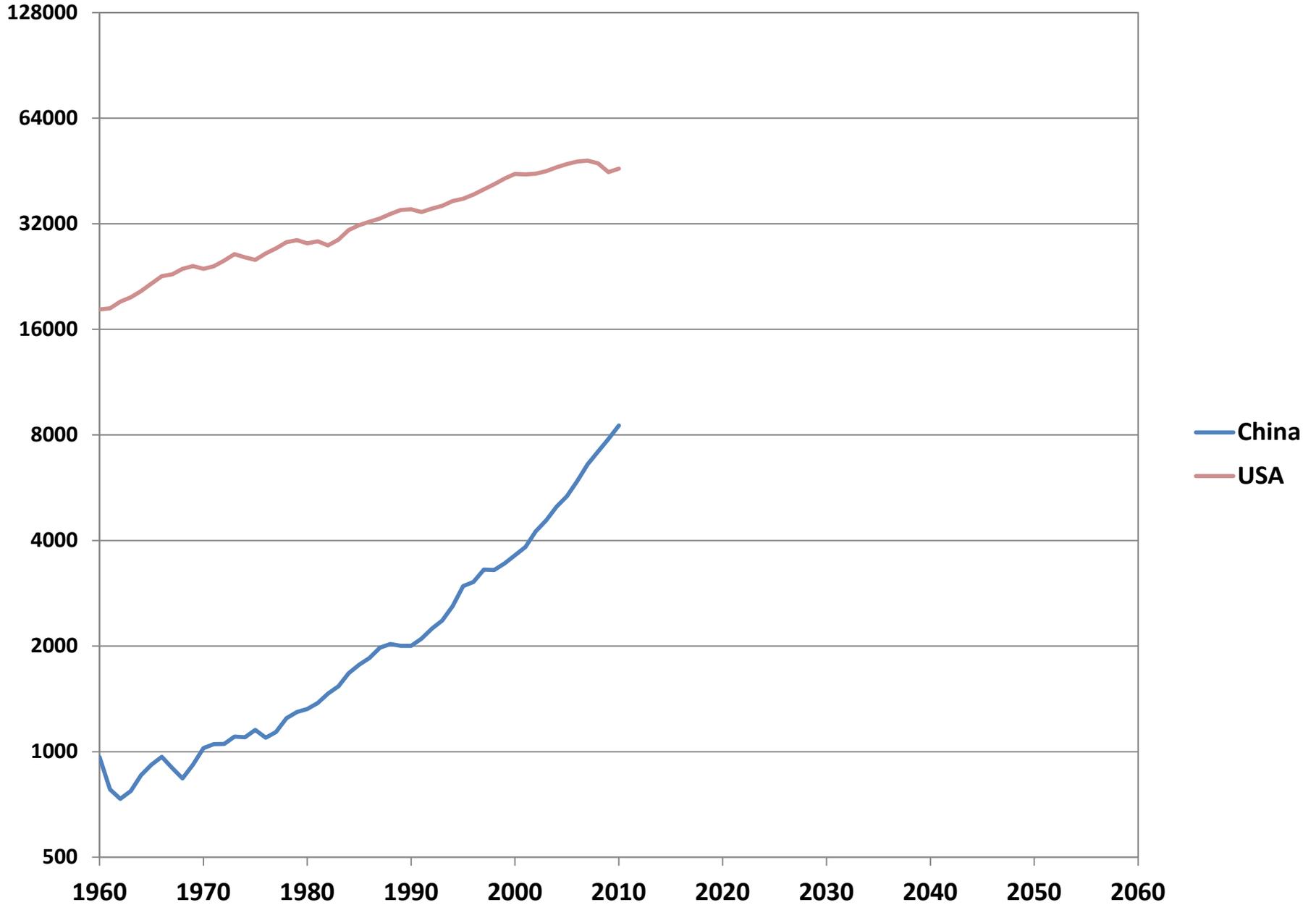




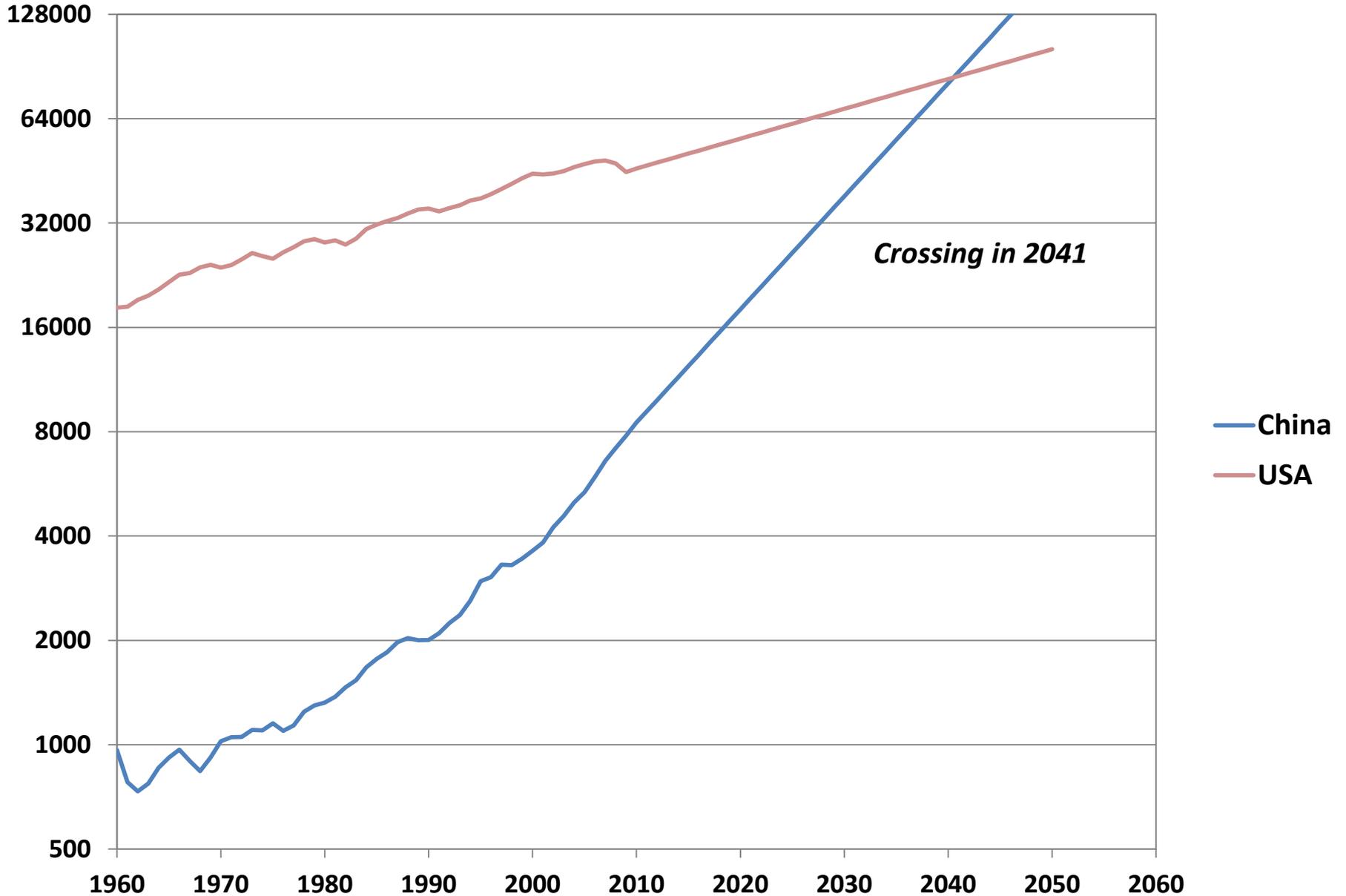
Application: China

- China has been growing fast for a long time
- Big question: When will China reach US levels of GDP per capita?

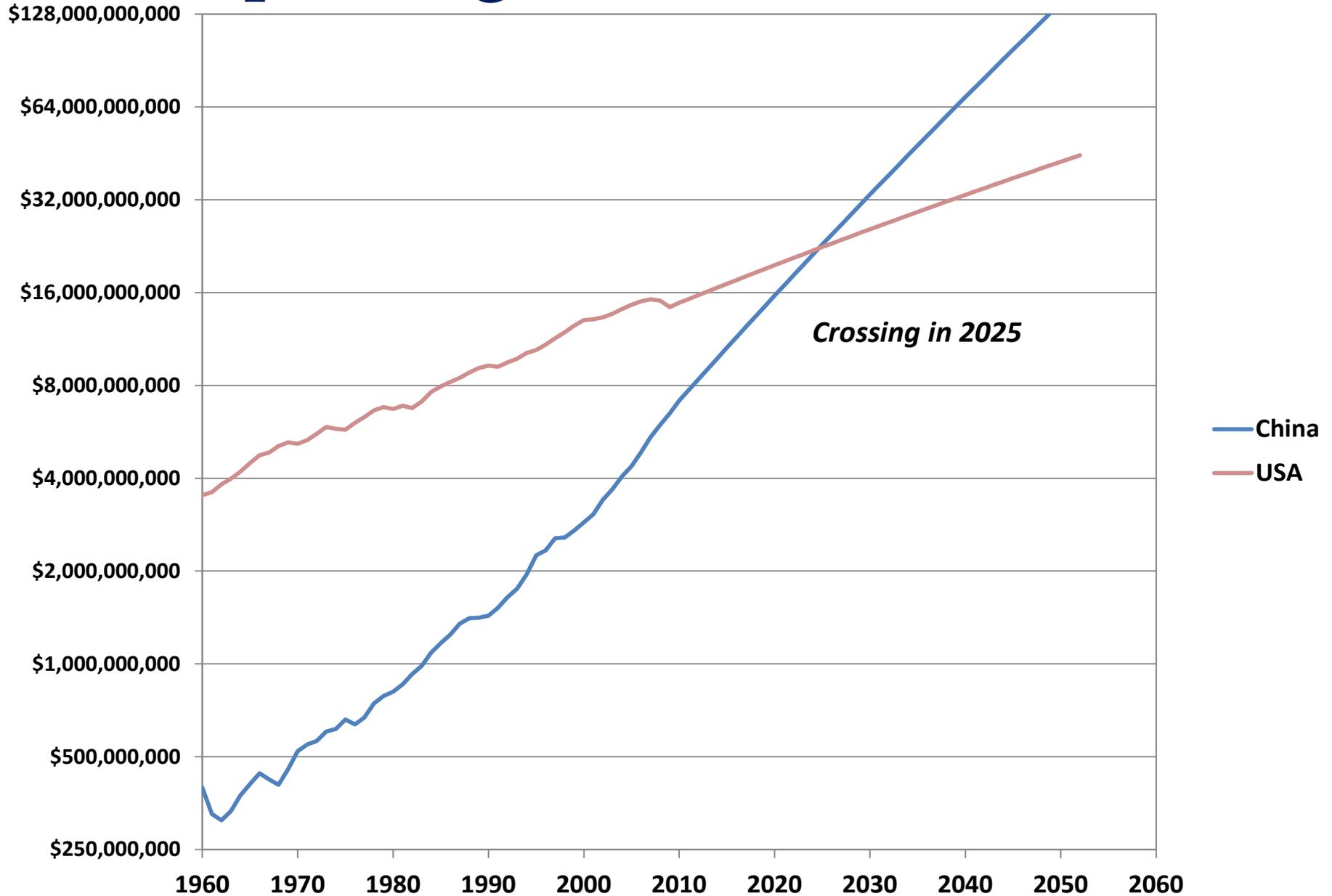
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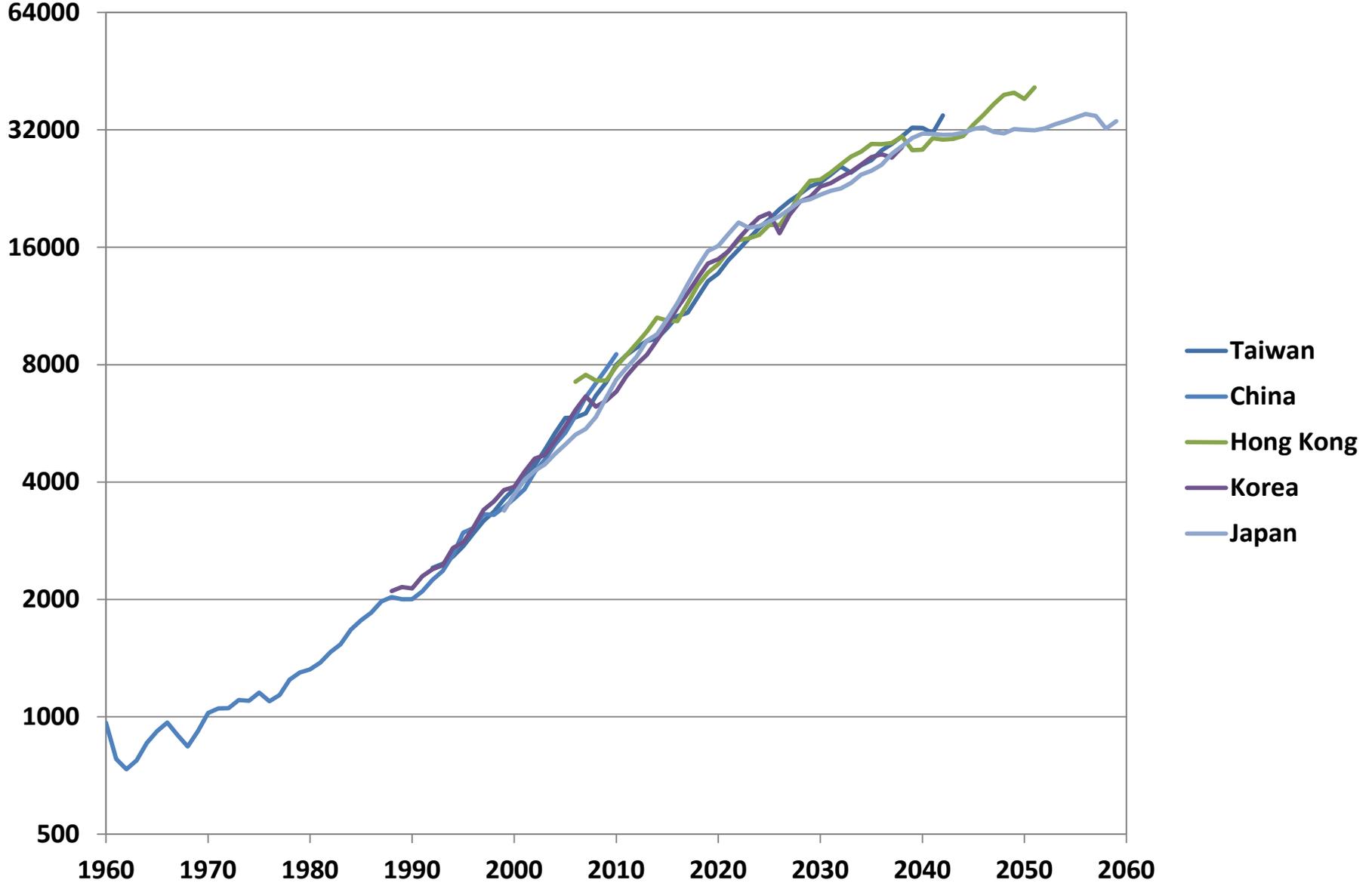
Extrapolating China's Future: per capita



Extrapolating China's Future: Levels



More Serious Prediction



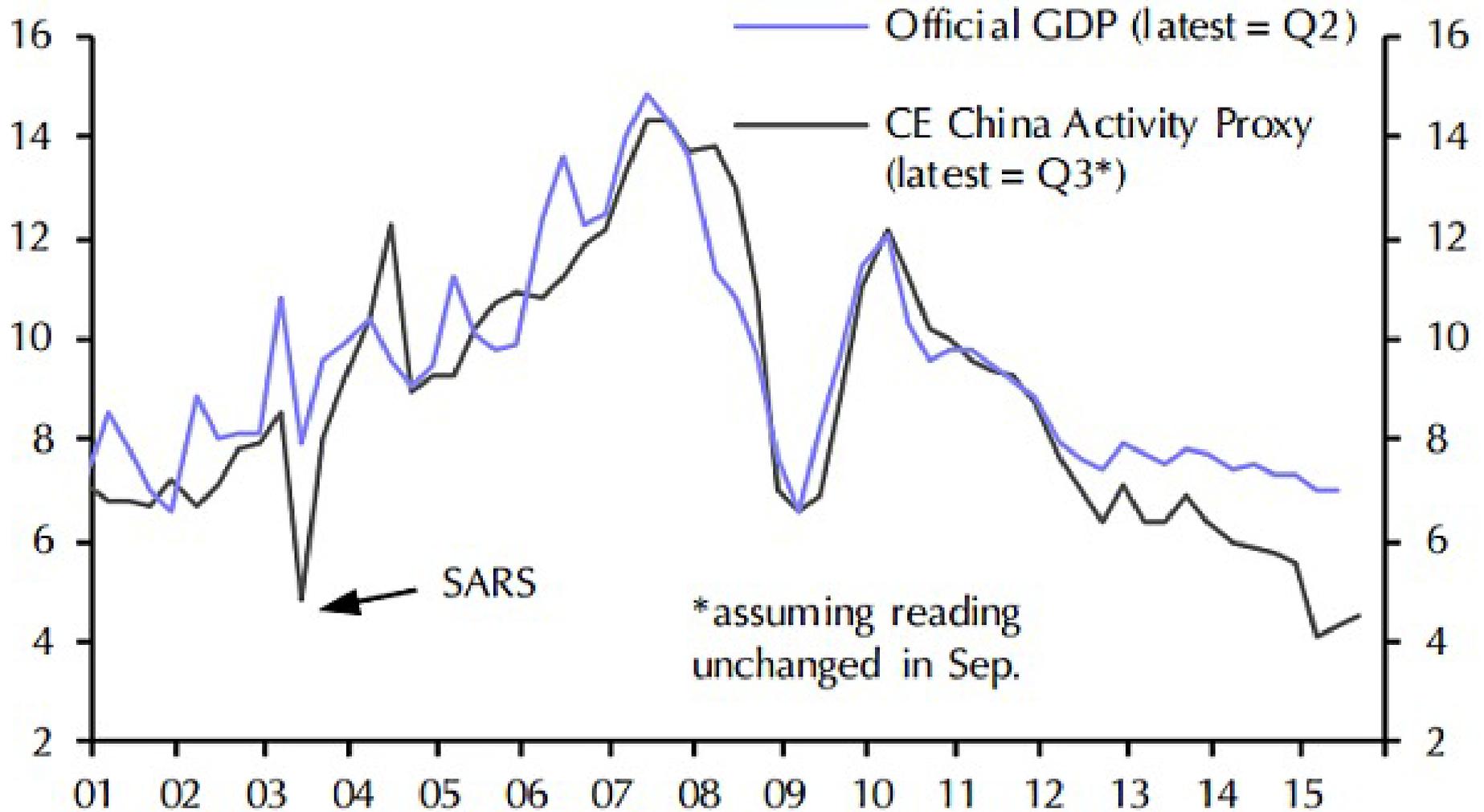
Growth Experiences

- Things to notice from other growth experiences:
 - Countries typically grow for a long time, then stop
 - How long their growth lasts varies widely
 - The growth slowdown is typically sudden (unforeseen)
 - Usually the slowdown comes in the form of a recession (negative growth)
 - Countries stop growing before they “catch up” with the US

Contemporary Situation in China

- In 1980 China had a LOT of problems
- Solved some problems, which created growth
- However, many problems were never solved:
 - Financial system
 - Corruption
 - Bad government investments
- Need to keep solving problems to keep growing
- Worry: Short term solutions to systemic problems

Private Estimates of GDP



Stock Market Swings



Source: Bloomberg.com