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The role of China in the global capitalist economy: an unavoidable rise or a possible decline?

China's rise in the present global economy has been very fast by historical records. In three decades, China has shifted from a poor developing country to the status of global power progressively contesting US hegemony. Some commentators forecast that China could overtake the USA in the coming 20 to 30 years as the main centre of global economy before turning, at a later stage, into a military superpower. As always when one tries to forecast such complex events, there is high uncertainty regarding what could actually turn out. The present international crisis in the USA and Europe and its dampening effects on global demand is of course one important element of doubt. But the uncertainty concerning China's attempt to leap frog in technological innovations is another critical question. Finally, the social and political issues stemming from growing inequalities and the impossibility to express discontent, disagreement and proposals in a democratic political space creates another serious doubt about the possibility for the Chinese government to pilot China's rise without a profound political reform. Having in mind this radical uncertainty regarding the future, the objective of this chapter is to assess the present role and weight of China in the global capitalist economy and to present possible scenarios for its future evolution. We will address more specifically the following questions: What is the importance of China as a producer and consumer of goods and services in the world economy? Can China become a producer of technological innovations going past its present stage of importer and user of foreign technology? What are the main internal obstacles able to slow down or even impair China's rise?

China's paradox: the second biggest economy but still a developing country?

China is the country of paradoxes or one could say contradictions. Since 1992 China has described itself as a "socialist market economy with Chinese characteristics" when in fact it already has all the features of plain capitalism but yes, with Chinese characteristics. This "capitalism with Chinese characteristics" is a special brand of capitalism where private ownership of the means of production is officially recognised and plays a growing role, where a new bourgeoisie can openly join the Communist Party as the "nouveaux riches" but where the State and the leadership of the Chinese Communist Party still plays a dominant role in the economic and political sphere and captures , through the State-Owned-Enterprises (SOEs) a fair chunk of profit for its own sake. One salient feature of capitalism is the capacity of the owners of the means of production to reproduce itself from one

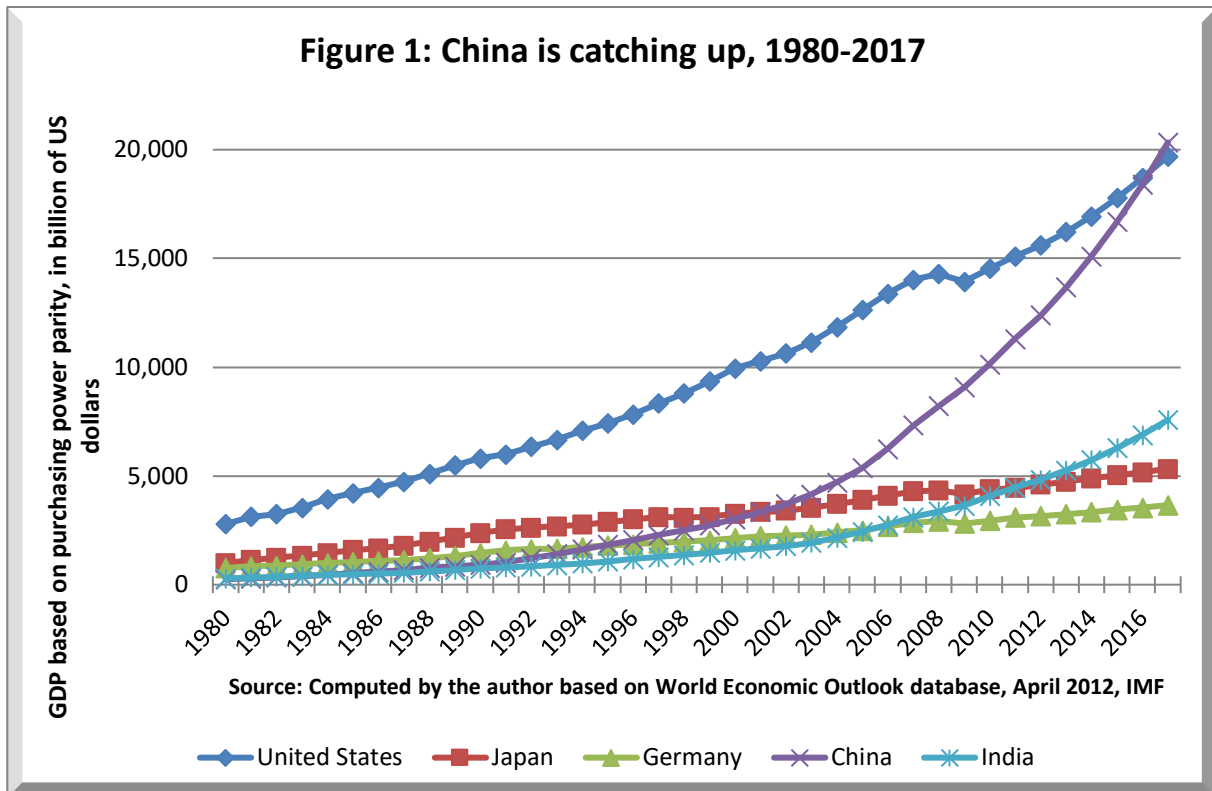
generation to another as proprietors. The Chinese characteristic is that there is a fuzzy distinction between the private and public sector and those proprietors, either of private or state sectors, are members of the communist State-Party belong to the same family and share the same interests: a high rate of economic growth and political stability. In this sense, the concept of “bureaucratic capitalism” developed in this book encompasses perfectly the Chinese brand of capitalism. According to the second national economic census held in 2008 SOEs owned 30% of the assets of the industrial and services sectors. They account for around 50% of gross fixed capital formation (investment), and employ 13% of non-agricultural sectors (Brandt and Zhu 2010). Apparently, SOE seem to play a minor role in the economy. Yet, SOEs are among the biggest enterprises in China, have a monopoly in critical areas such as natural resources (in particular petroleum), steel, telecom and transportation. Usually unknown in the West, they are investing abroad and some are becoming major multinational companies in sectors ranging from oil to banking. Two thirds of Chinese enterprises which appear in the Global Fortune 500 are SOEs. They are managed by a central holding company known as the State-Owned Assets Supervision and Administration Commission (SASAC) and are listed on stock exchanges in Shanghai, Hong Kong or other world financial capitals (Lin and Milhaupt 2011). In a nutshell, they are the core and the engine of growth of China bureaucratic capitalism. If China becomes the biggest economy in the world, one key issue is the control of world affairs it will give to the Chinese State. But can we seriously expect China to become the biggest economy in a foreseeable future? The answer is yes, although controversial.

In terms of absolute size of its Gross Domestic Product (GDP), China has become the second most important economy of the world in 2010 in current US dollars, overtaking Japan and catching up to the USA. The most optimistic commentators expect China to equal the USA before 2020. These estimates are based on various assumptions involving the respective growth rate of the US and Chinese economies, the inflation gap between the two countries and the evolution of the exchange rate of the yuan relative to the US dollar. For instance, the influential review, “the Economist” thinks the convergence at current exchange rates will probably happen in 2019¹.

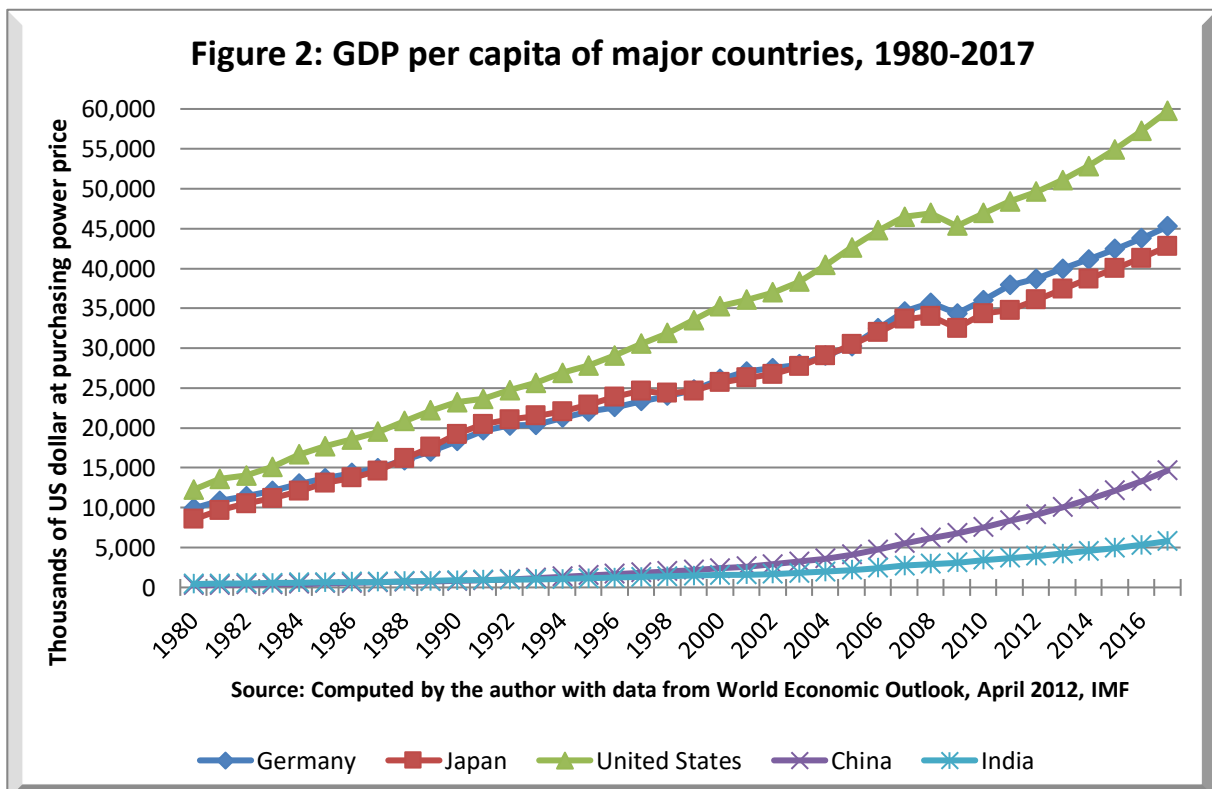
The IMF estimates that China will overtake the USA in 2017, when the GDP is measured in purchasing power parity² (see Figure 1).

¹ This is based on the assumption of an average rate of growth of 7.75% in China and 2.5% in the USA, a 4% inflation rate in China compared to 1.5% in the USA and a 3% appreciation of the yuan relative to the dollar on top of the inflation gap of 2.5%. See the Economist, “Becoming number one, September 24th 2011 and more recently <http://www.economist.com/blogs/freeexchange/2012/03/china-will-overtake-america-within-decade-want-bet>

² The purchasing power parity takes into account the fact that prices are usually lower in developing countries than in developed countries. For instance, if prices in China are three times lower than in the USA, then the Chinese GDP has to be multiplied by three to be compared with the US one.



Yet, according to the same IMF data, but measured with the current exchange rate, the GDP of China in 2017 would still be below the US by 35% but about twice the size of the Japanese economy and three times the size of the German economy (see Figure 2).



Even if these predictions are in part overestimated and only proven correct with a delay, say of ten years, the fact remains that China is closing the gap with the USA in terms of economic might and is widening the gap with the other biggest capitalist economies. It will be the first time in modern history that a non-western country is not only able to enter the small club of countries that rule global affairs but also a country which, unlike Japan, is not under the political and military domination of the USA. In other terms, fast economic development gives China the necessary power to challenge the US hegemony which no other country has been able to do since the collapse of the Soviet Union. The threat posed by China to the US is even more serious than the Soviet Union used to be since it rests on economic and not primarily military ground.

One drawback of the comparison between the US and Chinese economies is that in terms of GDP per capita, which is a crude way to measure the average income of inhabitants, China is still lagging very far behind the average income of a US citizen. As figure 2 shows, in 2011 the GDP per capita in purchasing power terms (PPP) was 46 900 dollars in the USA and 8 382 dollars in China, i.e. an almost 6 to 1 difference. Still, in 2017 according to the IMF, the difference would narrow to about 4 to 1. This is still huge. In this sense, in 2011, China still looks like a developing country with a GDP per capita below Brazil (US\$ PPP 11,769) and Russia (US\$PPP 16, 736). But these crude comparisons do not tell the full story for at least two reasons.

First, around this average, inequality of income has increased dramatically in China. This is true of every capitalist country when in the early stages of capitalist take-off even if the specificity of national political context makes future evolution different. In China, the number of absolute poor has diminished dramatically from 84% of the population in 1981 to 8% in 2008³ but the income gap between the poor and the rich has widened. The Gini coefficient, which takes a value of zero when income equality is perfect and one when income inequality is extreme, has increased sharply to 0.47 in 2008, up from 0,25 in 1985 (Huang and Wang 2010)⁴. This places China among the most unequal countries on a par with the USA and some Latin American countries. The widening gap between urban and rural household income, between coastal and interior provinces, between real income and labour productivity accounts for this growing inequality (Zhu and Wan 2012).

³ These figures are provided by the World Bank and refer to its definition of absolute poverty as earning less than US 1.25 per day in purchasing power parity which is the minimum income to meet basic needs such as eating. In absolute numbers it means that the number of poor in China has decreased from 835 million in 1981 to 106 million in 2008, which is the biggest reduction registered to date.

⁴ Inequality is certainly underestimated because rich people hide part of their revenues or refuse to answer, especially in China where the “grey economy” nurtured by corruption amounts to 15% of the Chinese GDP. 51.9% of disposable income is in the hands of the top 10% of Chinese earners compared to 47.2% in the US. 7.8% of income is in the hands of the bottom 40% of Chinese earners compared to 9.6% in the US. The Gini coefficient would in fact be 0.5. Xiaolu, W. 2010. Analysing Chinese Grey Income: 2nd Survey Study on China's Grey Income and Income Distribution. Crédit Suisse Expert Insights, Asia Pacific/China Equity Research.

Second, the tremendous size of the Chinese population gives a different dimension to the problem. In 2011, China has a population 4.3 times the size of the USA, 6.9 times the size of Brazil and 9.5 times the size of Russia. For all Chinese citizens to have the same income as the average American citizen, the Chinese GDP would have to be 4.3 times bigger than the US. This is clearly neither likely nor desirable for the conservation of the planet.

But this is not necessary for China to have a strong impact on the world economy. The high concentration of revenues and the huge size of the population combined will contribute to the formation in coastal China of a population exceeding the US but with the same average per capita revenue. According to Holz (2008 p 1688) “one to two decades from now, coastal dwellers accounting for 42% of China’s population in 2005 and exceeding the US population by 87%, may well be as rich, per capita, as the average US citizen. Focusing only on the five fastest-growing provinces in coastal China, with a joint population in 2000 that is 11% larger than the US, moves the cross-over year a few years further to the present”. This historical event, which is probable unless the Chinese economy collapse in between, which is not plausible, will lead to a shift of the centre of gravity of global capitalist accumulation from West to East. To be more precise, if we define like Kharas (2010) the controversial notion of middle-income class⁵ as the share of the population which earns from US\$10 to US\$100 a day, the Chinese middle-income class accounted for 157 million people in 2009 i.e. 12% of the population. According to Kharas’s scenario⁶, the Chinese middle-income class, so-defined, would be about 45% of the total Chinese population in 2020 and 75% in 2030: i.e. the same proportion as in the USA today. Of course, this rosy scenario which sees China turning mechanically into a developed country is a mere extrapolation of present tendencies and cannot be taken as granted for at least two reasons.

First, the present rate of growth cannot be maintained around 8% in the coming decades. Many factors that have contributed to a high growth will weaken and come to an end: the shift from low-productivity agriculture to high productivity industries, the high rate of capital to labour ratio leading to a decreasing rate of profit, the shrinking labour force and the doubling of old-age dependency, the exhaustion of

⁵ The notion of a middle class is much debated in economics, sociology and political science where it does not have the same meaning. One obvious error is to think that being part of the middle class in the economic sense entails mechanically adhering to an identical sociological identity with the same political ideas and behaviour. In economics only, there are various definitions, absolute and relative leading to different measures of the middle class. For an introductory survey and alternative measure in the Asian case, see for instance Chun, N. 2010. Middle Class Size in the Past, Present and Future: A Description of Trends in Asia. In *ADB Economics Working Paper Series No. 217*. Manila, Philippines: Asian Development Bank.

⁶ This scenario rests on several hypotheses such as a technological progress of 1.3%, per year which corresponds to the average long-run rate of the past 125 years observed in the USA; a typology of four group of countries (advanced economies, converging developing countries, stalled-middle income countries and poor countries with no convergence trends); capital accumulation consistent with the past historical average; country specific demographic changes of the 15-64 age group assuming constant labour force participation rates. Advance countries would grow at 2.3% per annum in the next 30 years and convergent countries like China at 8.2%. For more details, see Kharas (2010).

natural resources and unbearable levels of pollution are some among other factors that explain why the rate of growth will decrease.

Second, and most important, the level of income and social inequalities makes it difficult to imagine a linear development of present China for economic reasons. The past experience of Brazil is enlightening as Kharas (2010 p 31) recalls: “Between 1965 and 1980, Brazil grew at an average of 5.6 per cent per capita per year, becoming a middle-income country with a per capita income level of USD7,600 (PPP). Yet due to its high income inequality, Brazil’s middle class made up only 29 per cent of the country’s population in 1980. This made it impossible for the country to rely on middle-class consumption to drive the transformation into an innovation-based economy. Since 1980 the country has remained primarily a commodity exporter, and has struggled to sustain growth. Per capita incomes today are only slightly higher than they were thirty years ago (0.7 per cent annual growth), and the middle class never took off, currently accounting for just 38 per cent of the total population”. The lesson is clear: if China wants to maintain a high rate of growth by making household consumption the main source of demand instead of investment and exports then it has to reduce the high income inequality which means a radical political and social reform.

But what if the rate of growth slows down? The consequence will be a delay in the advent of China becoming the biggest economy in the world but not a reversal of the trend. The World Bank for instance expects Chinese GDP growth to decline gradually from an average near 8.5 percent in 2011–15 to around 5 percent in 2026–30. China’s economy would then become the dominant one in 2030 instead of 2020.

China, the biggest shopping centre in the world

Another way to gauge China’s tremendous impact on global capitalist accumulation is to observe what it has already achieved instead of looking far into the future. To name a few instances, China has overtaken the USA for iron ore consumption since 1999, for mobile phones since 2001, for beer and copper since 2002, for energy consumption and car sales since 2010⁷. In short, for many products, China is already the biggest world market and for the whole range of retail sales is predicted to overtake the USA in 2014. This gives China the potential to substitute for the USA as the engine of growth for the world economy: one clear piece of evidence is the weight of China in world imports relative to other main regions of the world. In 2010, China’s import amounted to 9.3% of world imports, behind the USA (13.3%) and Western Europe (19.3%)⁸. In 2014, it could overtake the USA and Western Europe around 2020. The effect of growing Chinese imports on the world economy is already visible in world commodity markets. Because China’s growth relies very much on its industry (which accounts for 46% of its GDP), it has contributed to a commodity boom and a surge in commodity prices with long-lasting consequences

⁷ Source: « The dating game », the Economist, December 27th 2011.

⁸ Source: United States Statistical Division.

on the global economy⁹: It is deepening the over-specialisation of African countries in primary products and producing a deindustrialisation and a return to the specialisation in primary products for some Latin-American countries like Brazil, challenging decades of industrial development. To cope with the boom, countries like Canada, Australia, Brazil and Sub-Saharan countries have increased their production of commodities, investing in mega-projects to exploit hard-to-reach reserves like oil reserves beneath the layer of salt in deep water near the Brazilian coast or tar sands in Canada - with disastrous environmental consequences. This hunt for commodities has also contributed to food price hikes and inflation in many countries which have been an important factor in social unrest.

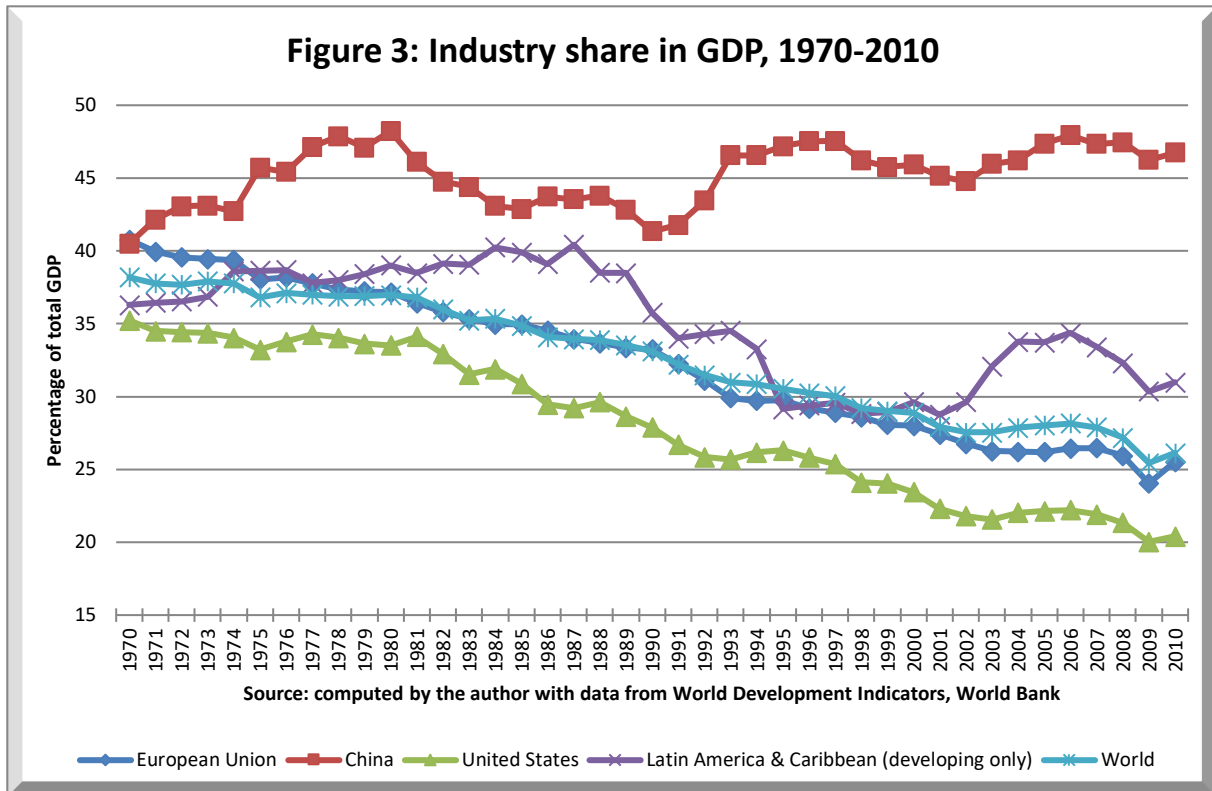
China, the factory of the world

Of course, China is not solely responsible for these events. But its unique role of “factory” of the world, beyond being the main “shopping centre” of the world gives China a special responsibility. In effect, a big part of Chinese imports is used to produce goods which are then exported to the rest of the world, in particular North America and Europe. This phenomenon, known as global production chain (GPC), which has existed for many years, has acquired a special importance with the capitalist globalisation that started in the middle of the eighties. It means that the various operations, from the design of the product to the manufacture of the components, assembly and marketing, have spread across the world. This international fragmentation of the productive process is especially important in Asia where China is the hub of many GPCs spread across Northeast and Southeast Asia. At the core of the GPCs, one finds the biggest multinational firms from North America, Europe and Japan and increasingly from emergent countries. These firms many of which, were present in Asia for decades, have found in China the best place to assemble parts and components produced elsewhere in Asia and to a lesser extent North America and Europe, to turn them into final products that can be exported anywhere. The reasons to locate final assembly in China were obvious: an unlimited supply of very cheap labour, disciplined by official trade unions and other repressive state institutions, and a vast and growing domestic market. By law, these multinationals had to make partnerships with Chinese firms which were then in a position to learn from the foreign partner, from technology to production and marketing. The huge foreign direct investment that has poured into China since 1978 combined with strong domestic investment from State-Owned Enterprises (SOEs) and new private industrial enterprises contributed to a spectacular industrial development (see Figure 3).

One can see that Chinese industry, measured as a share of GDP, experienced a period of decline between 1978 and 1991 due to the shock created by

⁹ China imports around 50% of world production of iron ore and coal, 45% of lead and zinc, 40% of aluminium, copper and nickel and 10% of oil.

the reintroduction of market mechanisms but subsequently recovered and now represents 47% of GDP.



This appears in stark contrast with the decline of industry at the world level down to 26%, in the US down to 20% and even in Latin America down to 31% in 2010. Even if it were too simplistic to attribute the full decline of the share of industry in the western world by the rise of industry in China, there is a link between the two which corresponds to transferring industrial production from the West to China. Nor can we explain the export boom of Chinese products by the sole role of the global production chains managed by multinational companies. Exports resulting from assembly by GPCs are called “processing exports” and in China represented over half of total Chinese exports in 2009, up from around 5% in 1981 (Zhang, Tang and Zhan 2012). This is indeed a spectacular development which shows the importance of multinationals in Chinese trade. At the same time it shows that “ordinary” exports realised by Chinese companies are responsible for the other half of Chinese exports which is an impressive result in itself. One important question is to determine the relative share of imported parts and components and domestically produced parts and components in total Chinese exports, in processing exports and ordinary exports. According to Zhang et al. (2012) the share of foreign parts and components in total Chinese exports is 32.2 % meaning that the share of Chinese parts and components in Chinese exports is 67.8%, which places China in an intermediary position. It is less than in the USA and Japan, where it reaches about 75%, but higher than in Taiwan (53%), Korea (63%) and Thailand (65%). Of course, for processing exports, the share of domestic content is lower (44.4%) than for “ordinary” exports where it is very

high (92%). A closer look at processing exports reveals that the domestic content is significantly lower in capital-intensive and technologically sophisticated products like household video and audio equipment manufacturing, motor and generator manufacturing and electronic devices and communication equipment (Zhang et al. 2012 p 39:40). This shows that China's increasing export of these products linked to technological innovations such as the Iphone is largely due to its participation in GPCs.

This raises the important question of the reality of China's progress in technological upgrading and its capacity to sustain its industrial development and because of the importance of industry in Chinese GDP, its capacity to develop as an independent country and not a country subordinated to foreign multinationals.

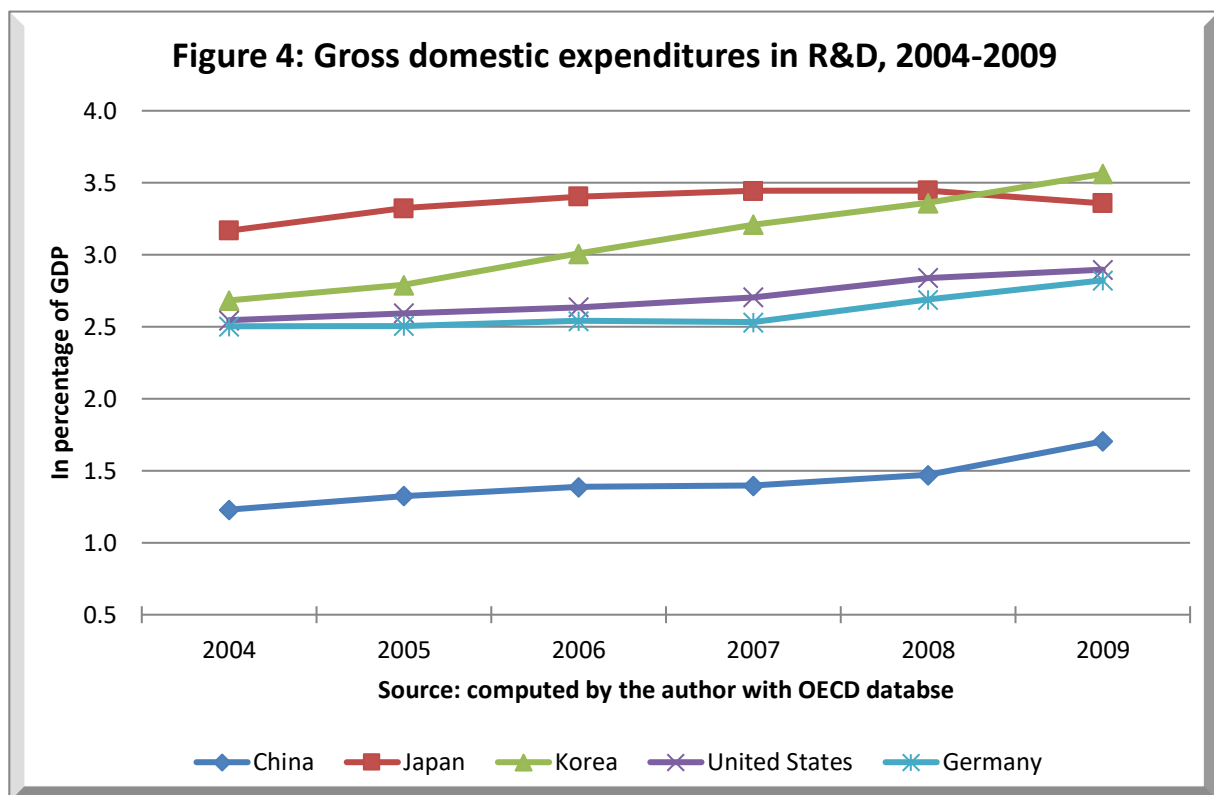
China joins the race to technological innovation

Assessing the capacity of China to catch up in the technological race is a difficult task. There are many questions for which there are no answers and no possibility to provide an answer. One can only rely on what is known and what the most relevant theory of technological progress, the theory of national system of innovation (Freeman 1995), can help us to understand about Chinese transition from accumulation of production capacities to innovation capacities. This theory emphasises the role of the state in creating basic infrastructure, and in investing in education and scientific capabilities. It also underlines the importance of social institutions to facilitate the interactive process of development of technology between enterprises and support institutions and between enterprises themselves. Altenburg, Schmitz and Stamm (2007) have studied in detail this transition in the case of China and India and their conclusion stresses how the sheer size of their economies and growth dynamics increases the possibility of leap-frogging certain developments and catch up with OECD countries. It is worth quoting them at length on this precise point:

“... Fast growth and high savings rates enable China, and increasingly also India, to invest not only in huge infrastructure projects but also in major R&D programs, to set up first-class research and training institutions and technology parks, to acquire foreign licences and even entire firms, to provide competitive salaries and well-equipped research facilities to lure top researchers away from the United States and other industrialised countries, and so on” (Altenburg et al. 2007 p 338). They are helped in this task by the growing share of knowledge that can be transformed from tacit to explicit and thus traded and the participation of their firms in global value chains which gives access not only to markets but to international pools of knowledge, international professional networks. Most of all, because China is politically independent from the USA and European countries, it has been able to “... trade access to foreign technology for access to its national market” (p 337).

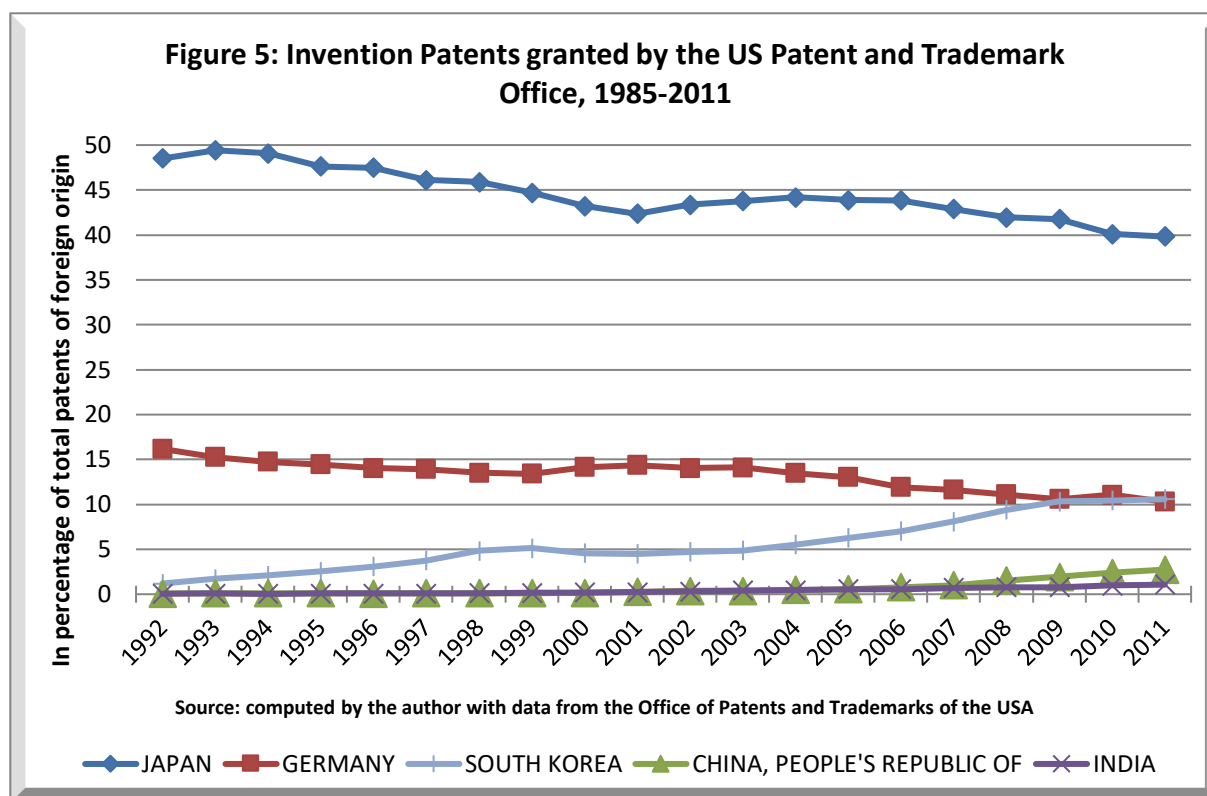
Thanks to the combination of these specific advantages, China has been able to climb up the technological ladder but has not been able to make any breakthrough so far in radical innovations. In terms of expenses in research and development,

Chinese effort has increased a lot these last years in line with the program announced in 2006¹⁰ to make “China an innovation-oriented society by 2020 and one of the world’s leading innovators in the longer term” (Wu 2010). The key word is “indigenous innovation” in 11 strategic areas such as energy, water resources and environmental protection. By 2020, 60 per cent or more of China’s economic growth must derive from technological progress. According to Fabre and Grumbach (2012), this is a conscious decision of the Communist Party Political Bureau to base China’s long-term growth on technological innovation to substitute a growth pattern based exclusively on capital accumulation and labour mobilisation. Fabre and Grunbach (op cit p 4-5) calls a “real leap forward” the big push in education and science which started in the years 2000 as opposed to the “Great leap forward” of 1958-59 which was based on the negation of science and technology and the expulsion of scientists and intellectuals in general from position of power in the Chinese Communist Party and the State. The number of graduates has risen from 1.7 million to 7 million between 2000 and 2008, 39% of them following a scientific curriculum compared to 5% in the USA (Fabre and Grumbach 2012 p 4). To reach the objective “2020 program”, China is to spend by 2020 about 2.5 per cent of the country’s gross domestic product in research and development. In effect, China’s expenditures reached 1.70% of GDP in 2009, up from 0.71 in 1990, which represents a major effort. Yet, China is still lagging behind Korea, Japan, the USA and Germany where R&D expenditure has also grown recently well beyond 2.5% (see figure 4).



¹⁰ The “National Medium and Long-term Program for Science and Technology Development (2006–2020)”.

Another limit of the Chinese effort is that in 2008 only 17.2% of total expenditures on research and development were dedicated to research in itself¹¹ down from 30% in 1995. In the USA, a stable average of 40% is dedicated to research (Wu 2010 p 354). This is a matter of concern for the long term for it means that China is not really geared towards cutting-edge innovations but rather towards adaptation of innovations conceived in other countries. This assessment is confirmed by the small progress in terms of patents registered in the USA by Chinese firms belonging to the “inventions” category (see Figure 5).



Although Chinese patents have grown in absolute numbers to 3,174 in 2011 up from 119 in 2000, it amounts to 2.7% of total patents registered by foreign firms this year above India (1.1%) but well below Japan (39.8%), South Korea and Germany (about 10% each).

These observations must not lead to dismissing China's push in technological progress. Scientific research takes time, patience and consistency. But it shows that money alone cannot bring short-term results and that leapfrogging is not always possible, especially if the social and political national context is not conducive to not only fast innovation but also mastering of technological progress. The example of the recent development of high-speed train is illustrative on this point. China has embarked in a vast programme of railroad construction to become the biggest country equipped with high-speed train connections. The government and the leadership of the Communist Party have pinned their own and the country's prestige

¹¹ The rest, 82.8%, is dedicated to development.

on the program. It plans to have 19,000 km of high-speed railway in 2014, up from 649km in 2008. But on July 23rd, 2011 a collision between two high-speed trains which killed 40 and injured 191 people, shed a crude light on the limits of leapfrogging in the Chinese context. Officials attempted a cover-up, prompting public outrage, but this time to no avail. For the first time in years, public outrage turned against the president and the premier Wen Jiabao, who took a long time to pay his respects to victims. Usually, top leaders play the good guys who have to struggle against and punish the bad guys at local levels. This was the case for instance when the Sichuan earthquake killed 69 thousand people, among them many children in faulty-built schools. This time anger flowed on the Internet, Twitter and even the media: officials were at pain to censure it. This dramatic accident is the result of vast corruption from the Minister of Transport and other top rank officials¹², of corruption in enterprises which constructed the railways which preferred to use sand and stones instead of concrete to make more profit, and poor management of a complex rail network. It reveals the difficulty or impossibility to build at breakneck pace huge infrastructure that has taken decades to be constructed in other countries¹³. But more fundamentally, it reveals the difficulty in mastering complex technology in a country where there are no counter-powers to limit corruption, to correct bad decisions, to improve quality, and to challenge the legitimacy of decisions taken by bureaucrats. High-speed trains are too expensive for the majority of Chinese people, they serve primarily businessmen not the hundreds of millions of daily commuters who still suffer from the lack of efficient and secure public transport and often have to use motor vehicles.

Conclusion

This example, which in addition to the many food scams that create anguish and suspicion among the population, shows that it will be increasingly difficult for the Chinese Communist Party to pursue its development strategy to transform China into a developed country, even the biggest one, while maintaining a tight grip on a society that is getting more educated and more informed of the reality outside China. The Tiananmen Square massacre in 1989 happened before 500 million Chinese became Internet users. China's economic development may hit soon the limits of what a dictatorship can control and forbid while still trying to unleash innovation and development. We are not pretending that there exists a technological determinism which would favour the democratisation of a society once a certain level of development of productive forces is achieved. Many hopes have been dashed in Southeast Asia in this regard. On the other hand, it is hard to imagine, for many reasons, that the future biggest capitalist economy, China, could be a dictatorship like it is today. The growing number of workers and farmers protests in China since 2008 in a context marked by a change in regime in the labour market with the end of

¹² The Minister of Transport was sacked in February 2011 before the accident after he was accused of having skimmed off as much as 1 billion yuan (\$152m) in bribes and of keeping as many as 18 mistresses.

¹³ Japan's bullet train has had just one fatality in 47 years, a passenger caught in a door. See, *The Economist*, August 6th, 2011.

surplus labour (Fang and Meiyang 2012) and the emergence of a second generation of migrant workers who do not accept the sufferings endured by the previous generation (Ngai and Lu Huilin 2010), not to mention the thousands of protests in the countryside against land grabbing, confirm the hypothesis that China is entering a new phase of growing social conflicts which will not be resolved by mere repression. Whether economic structural change will be combined with political change is an open question. But, as we have seen previously, China will not become a high per capita income country without a strong reduction in inequalities and this will not occur without a profound democratisation of Chinese society.

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