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# **Monetary vs. Guanxi Economics**

Confucius meets Lenin, Keynes, and  
Schumpeter in Contemporary China

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# Worksheet: Monetary vs. Guanxi Development Economics

## Questions to be answered before the lecture begins

Please mark YES or NO about the following statements. Follow your spontaneous impulse! Compare your answers with those of your neighbours. Introduce yourselves, and let one another know, why you are in favour of this or that statement.

Yes No Assertion

1.   Socialist economies are ruled by planning authorities and large state-owned enterprises. China has been very successful in planning its economic development in the last three to four decades.
2.   Schumpeter's entrepreneur (*Unternehmer*) is the typical owner of an established firm, who starts an important innovation with disruptive effects leading to "creative destruction" of the business of the *Wirte*, the non-innovative, normal businesspersons.
3.   Party cells in every enterprise, administrative or media unit, civil society organization, military unit, university institute and regulatory agency are a means of ideological control and often a source of corruption in all communist-ruled countries.
4.   At the end of the 1970's, Deng Xiaoping gave the order to establish a "Socialist Market Economy", which opened the way to spectacular economic development through a broad set of village enterprises and private businesses, foreign direct investment and infrastructure projects, mostly coordinated through markets – and the *guanxi* network of Communist Party secretaries.
5.   The financial sector intermediates between savers and investors ( $S=I$ ) so that investment is determined by the amount of savings.
6.   In the analysis of successful economic development you can always identify three agents: the status-quo user of the resources, the innovative entrepreneur, typically without major property and possessions of his or her own; and the intermediary, who enables the transfer of the resources towards the new, innovative enterprises and the corresponding infrastructure and regulatory institutions.

Yes No Assertion (abridged version of the worksheet)

1.   Socialist economies are ruled by planning
2.   Schumpeter's entrepreneur (*Unternehmer*) is the typical owner of an established firm.
3.   Party cells are a means of ideological control and often a source of corruption.
4.   Deng Xiaoping gave the order "Socialist Market Economy", which brought about economic development, mostly coordinated through markets – and the *guanxi* network of Communist Party secretaries.
5.   The financial sector intermediates; investment is determined by savings.
6.   Successful economic development with three agents: the *Wirt*, status-quo user of the resources, the *Unternehmer*, entrepreneur without wealth, and the intermediary,, Schumpeter's *Bankier*.

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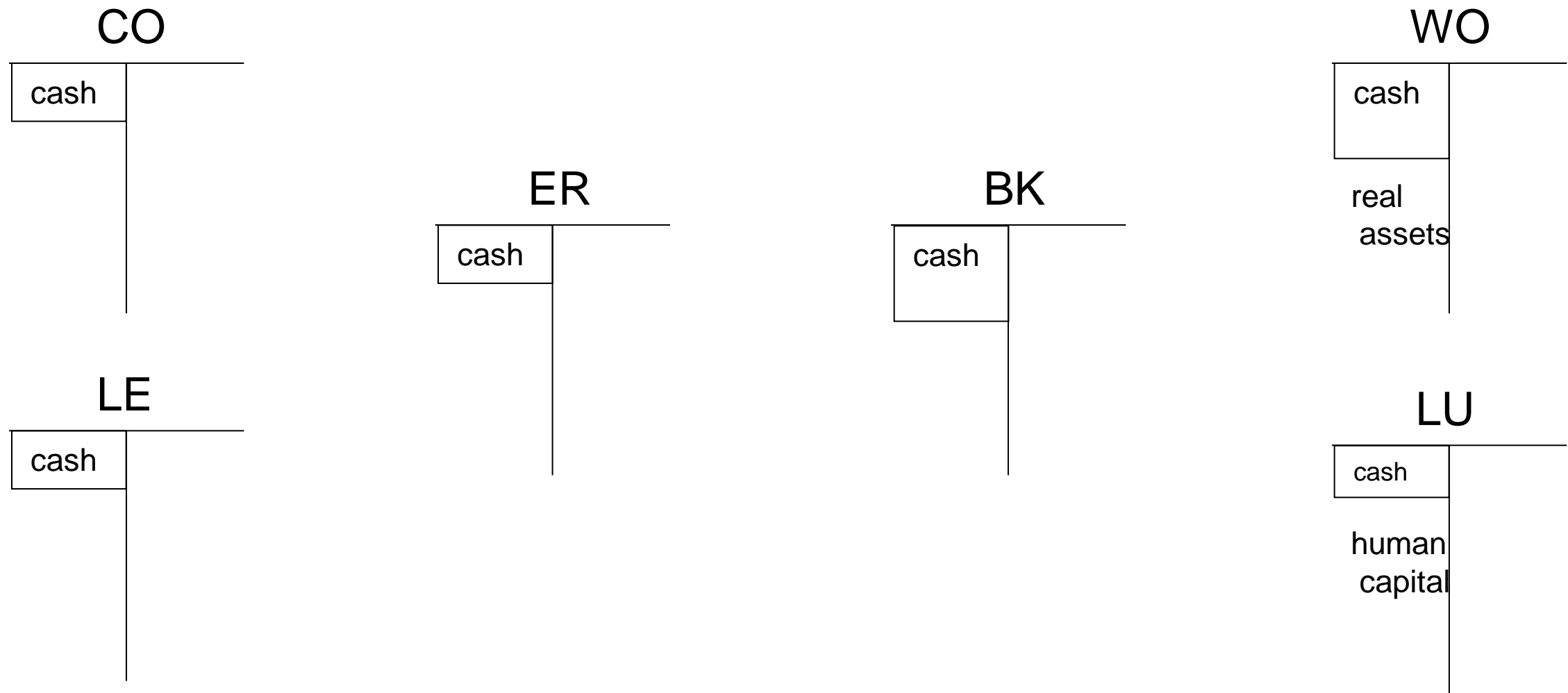
# Family enterprise / household or state-owned people's brigade / commune: Schumpeter's "Wirt" and status-quo wealth owner

## Balance sheet

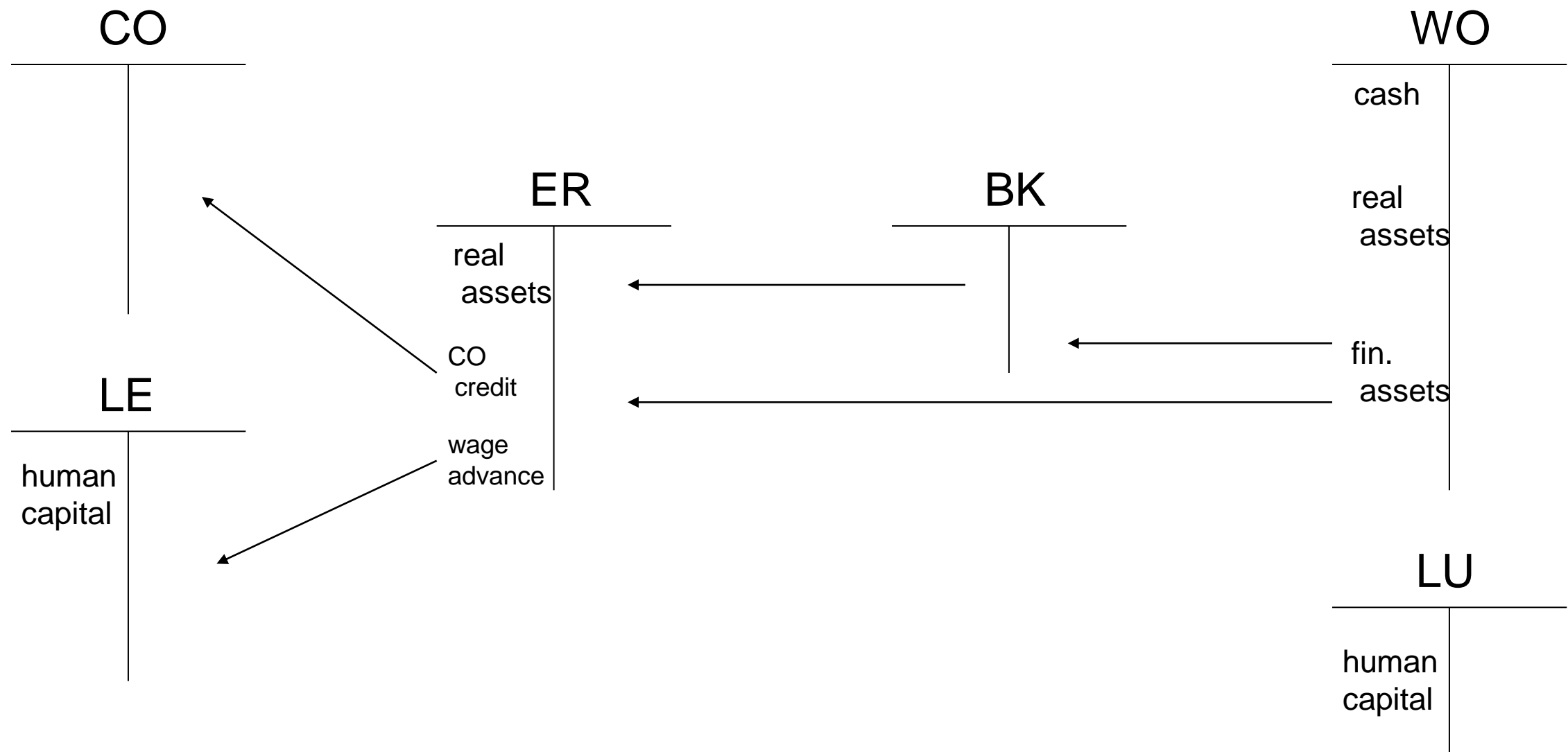
|  |  |
|--|--|
| <b>Assets</b> <ul style="list-style-type: none"><li>- real</li><li>- financial</li><li><b>cash</b></li><li>- human capital</li><li>- social capital<ul style="list-style-type: none"><li>- reciprocity</li><li>- social security</li><li>- public services</li><li>- labour rights</li><li>- culture</li></ul></li></ul> | <b>Liabilities</b> <ul style="list-style-type: none"><li>- relatives</li><li>- friends and neighbours</li><li>- market partners<ul style="list-style-type: none"><li>- banks and insurance co.</li><li>- state agencies (also as owners)</li></ul></li></ul> <b>Equity</b> <ul style="list-style-type: none"><li>- man / husband / member</li><li>- woman / wife / member</li><li>- children</li></ul> |
|--|--|

# Money as a cash asset:

Friedman's helicopter and neoclassical savings-first growth theory



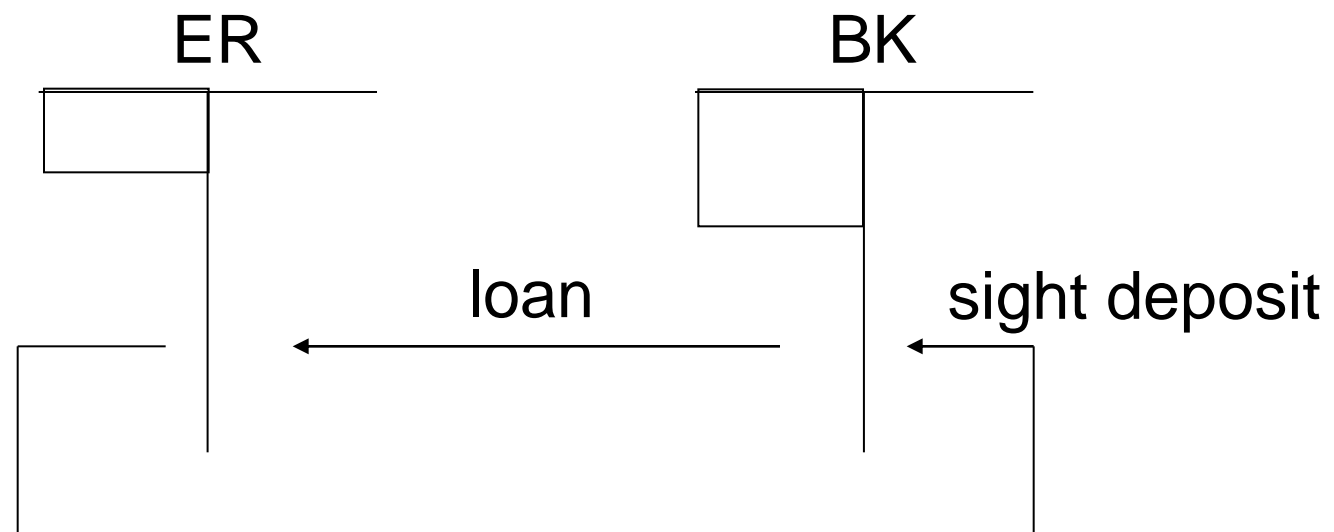
# Money as medium of deferred payment: Keynes' *monetary theory of production* and the *theory of finance*





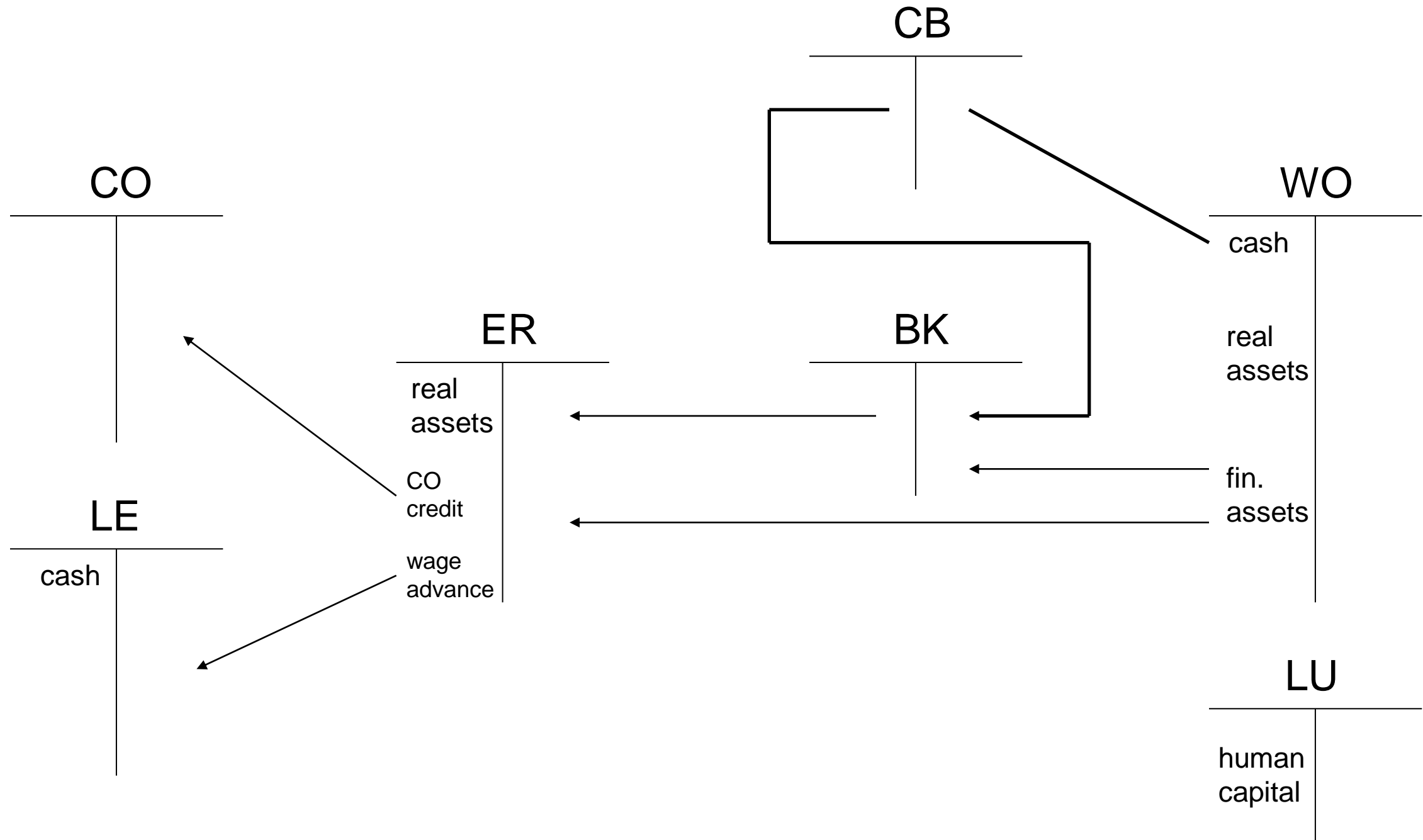
# Credit creation ex nihilo:

Schumpeter's entrepreneur and his banker



# Interplay of commercial and central banking:

Constitution of a monetary economy through emission of universally valid banknotes



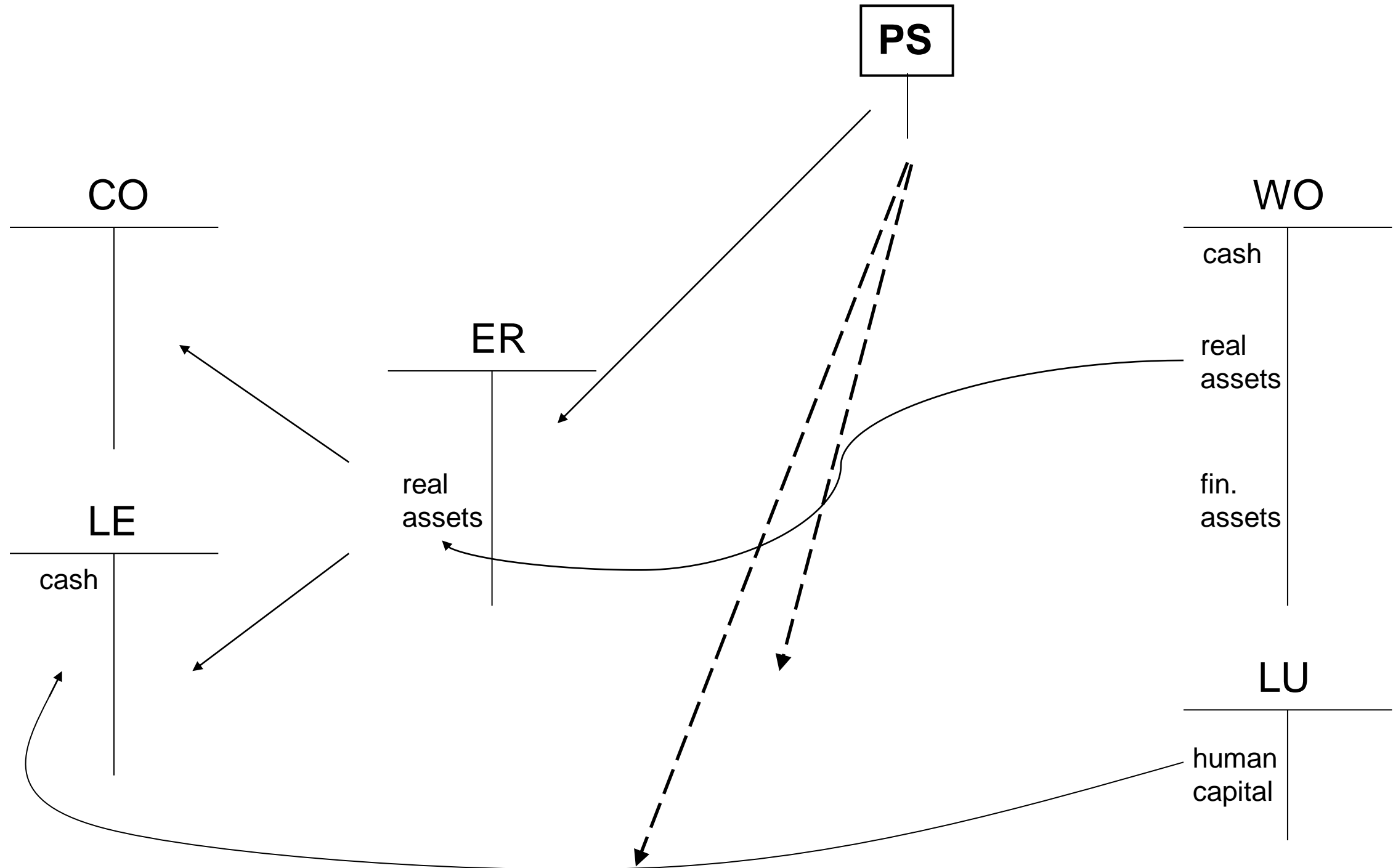
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# Socialist economics

- Central planning
  - Lenin's model: First World War allocation via food stamps / *Lebensmittelkarten* / *Libreta*
  - Problem: Flexibility, speed, innovation
- Markets
  - Easier for consumption goods than for real estate and capital goods
  - International trade and investment
- Coherence
  - Barter and queuing-up
  - Market response
  - *Guanxi* between Party Secretaries and directors

# ***Guanxi* (= trustful relationship) economics I:** ER-PS *guanxi* plus command *ex nihilo*



# Role of the Party Secretary in every institution: Change agent vs. director

- Issuer of trust, creator of credit → issuer of rénqíng 人情
  - creation of trust through short keeping of rénqíng 人情
    - rénqíng takes the role of a domestic currency
    - Issued mostly by the **local party secretary**
    - Issuer of rewards and punishment
  - intermediary of resources
  - “*Schöpferische Zerstörung*” → creative destruction
  - But reciprocity requires remuneration for the victims and their PS
- Resumes informal and formal power of a guānxihù 关系户 (bouncer)
  - market participants need to win the party secretaries' favour
  - formally: bureaucracy and nomenclature
  - Informally: interrelation between entrepreneur and party secretary

} **Strong  
Budget  
Constraint**

# Definition of Guānxi 关系

- Principle of reciprocity
  - a friendship/kinship based on a social, individual, emotional, committing, and long-term relationship
  - to exchange or secure favours for mutual benefit
  - between two or more individuals
- Historical background: Confucian rites and ethics
  - 禮 lǐ: *rites*, today → 礼物 lǐwù: *gift, present*
  - 五倫 wǔ-lún → **five human relationships**: role model for the traditional Confucian hierarchy
    - care and concern between parents and children
    - mutual respect between husband and wife
    - harmonious relationship of the elder and the younger
    - righteousness of the superior and his subordinates
    - trust between friends

# Characteristics of Guānxi 关系

- **Basis of empathy / “fundamentals“ of guanxi**

- fictitious kinship
- common ancestry
- place of employment, same school or kindergarten
- university networks: Central Party School
- common experience/background: cultural revolution, long march, etc.
- last but not least: **party membership!**

- **Entirely individualistic (not collective) concept**

- any individual with good guanxi is considered a productive force
- “People are more loyal to people than to an organization.”

- **Emotional concept**

- basis of empathy is a basic requirement for guanxi
- “You actually don’t talk about it!”

- **Principle of profitableness**

- means of exchange: guanxi are transferable to third party people
- means of deferred payment
- moral obligation, quasi legal, threat of denunciatory isolation



# Interest-bearing Guānxi 关系

你敬我一尺 (nǐ jìng wǒ yī chǐ)

我敬你一丈 (wǒ jìng nǐ yī zhàng)

If you give me a *chǐ*

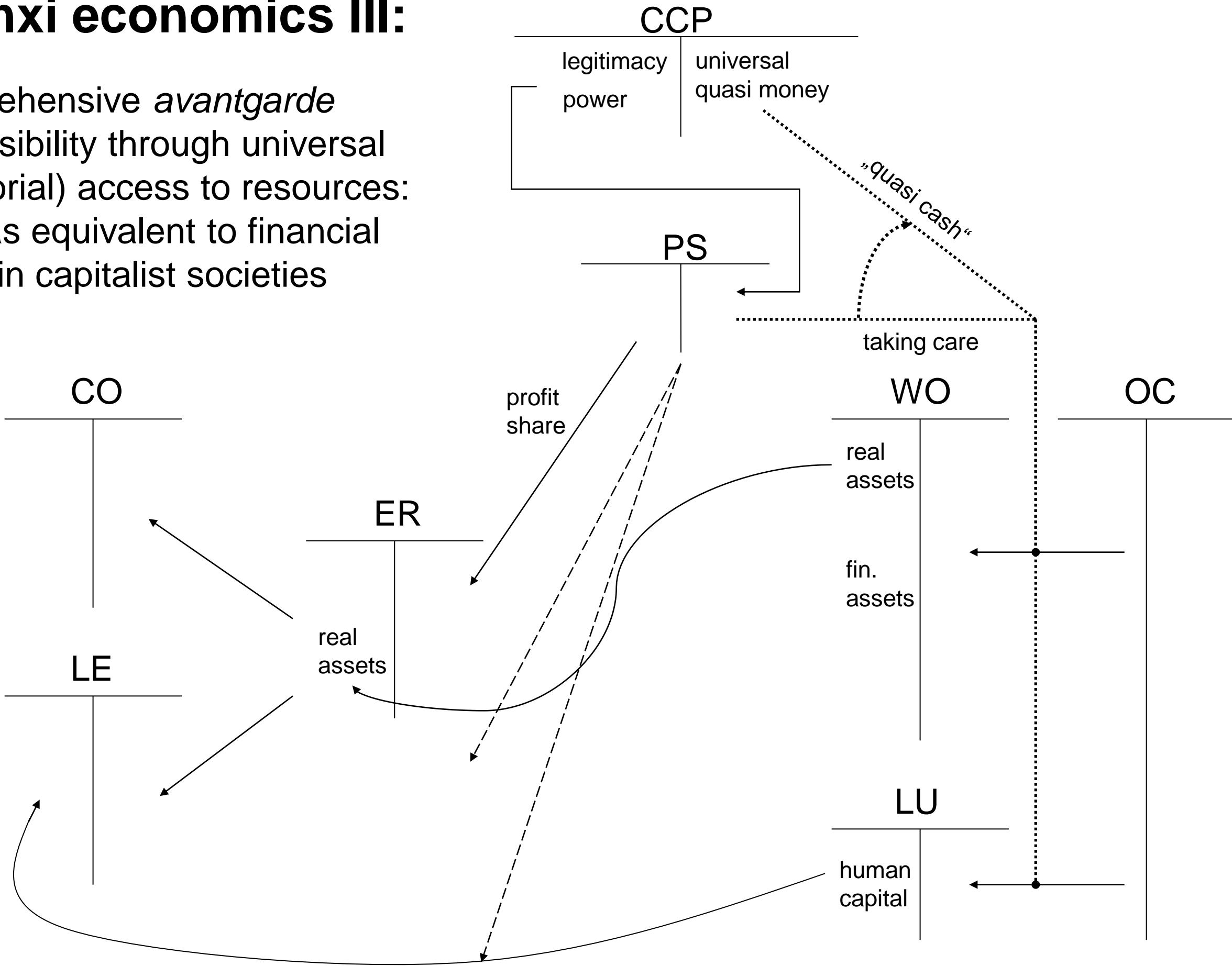
I will return a *zhàng*

- Every “guanxi debt” / “guanxi contract” is interest-bearing
- considered ignorant/disrespectful repaying a “guanxi loan” immediately
- gives the impression: the opponent is not interested on a relationship on a reciprocal basis → “simple” spot market relationship
- immediate repayment more likely by higher-ranking individuals who don’t care about a relationship to a lower-ranking individual



# Guanxi economics II:

Comprehensive *avantgarde* responsibility through universal (dictatorial) access to resources: Party as equivalent to financial sector in capitalist societies



# Quasi Domestic Currency

- Main characteristics of a monetary economy
  - central bank money control
  - currency: 人民币 rénmínbì
  - trust in domestic central bank money, rénmínbì 人民币
- Main characteristics of the Chinese guanxi economy
  - issuance of favors toward friends, clients, followers or superiors in terms of access to resources and other means of production
  - currency: 人情 rénqíng, based on
    - interpersonal and emotional relationships (basic requirement)
    - favours, gifts, presents (similar to rites 禮 in traditional China)
  - trust in human interrelations
  - trust in mutual benefits
- Both economies are built on credit – otherwise no “leverage“ for innovators
  - monetary economy: central bank money, loans and deposits
  - guanxi economy: 人情 rénqíng, trust in human relationships

# Pros and Cons of the Chinese Guanxi Economy

- Most important pros

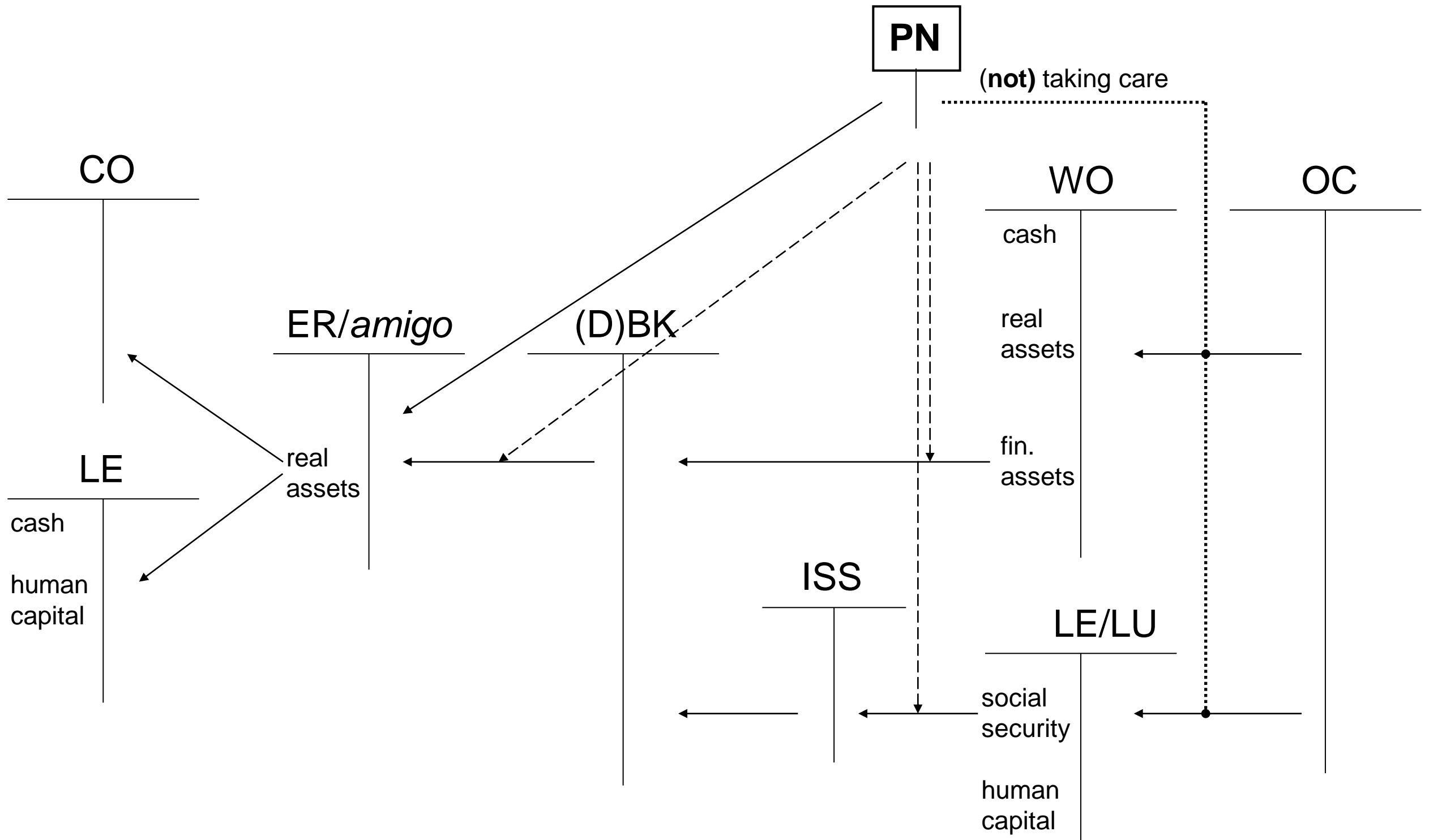
- substitutes financial sector
- generates accumulation
- enables rapid transformation without greater ruptures
- comprises efficiency incentives
  - “Besitz“ → “possession“ rather than private “property“
  - vanguard role of the Party
- reduces transaction costs
- reduces information costs
- reduces procurement costs
- reduces bureaucracy costs
- provides coherence

- Most important cons

- close to corruption
- Official arguments:
  - abuse of power and exploitation
  - negative side effect of the capitalist system
  - after-effect of the feudalist system
  - bù xuānchuán, yě bù fǒudìng: 不宣传, 也不否定
  - don't propagate, but don't prohibit
  - don't talk to much about it!

# Guanxi economics IV everywhere:

Politicized development banking between *desarrollismo* and *amigo* banking for champions or microfinance



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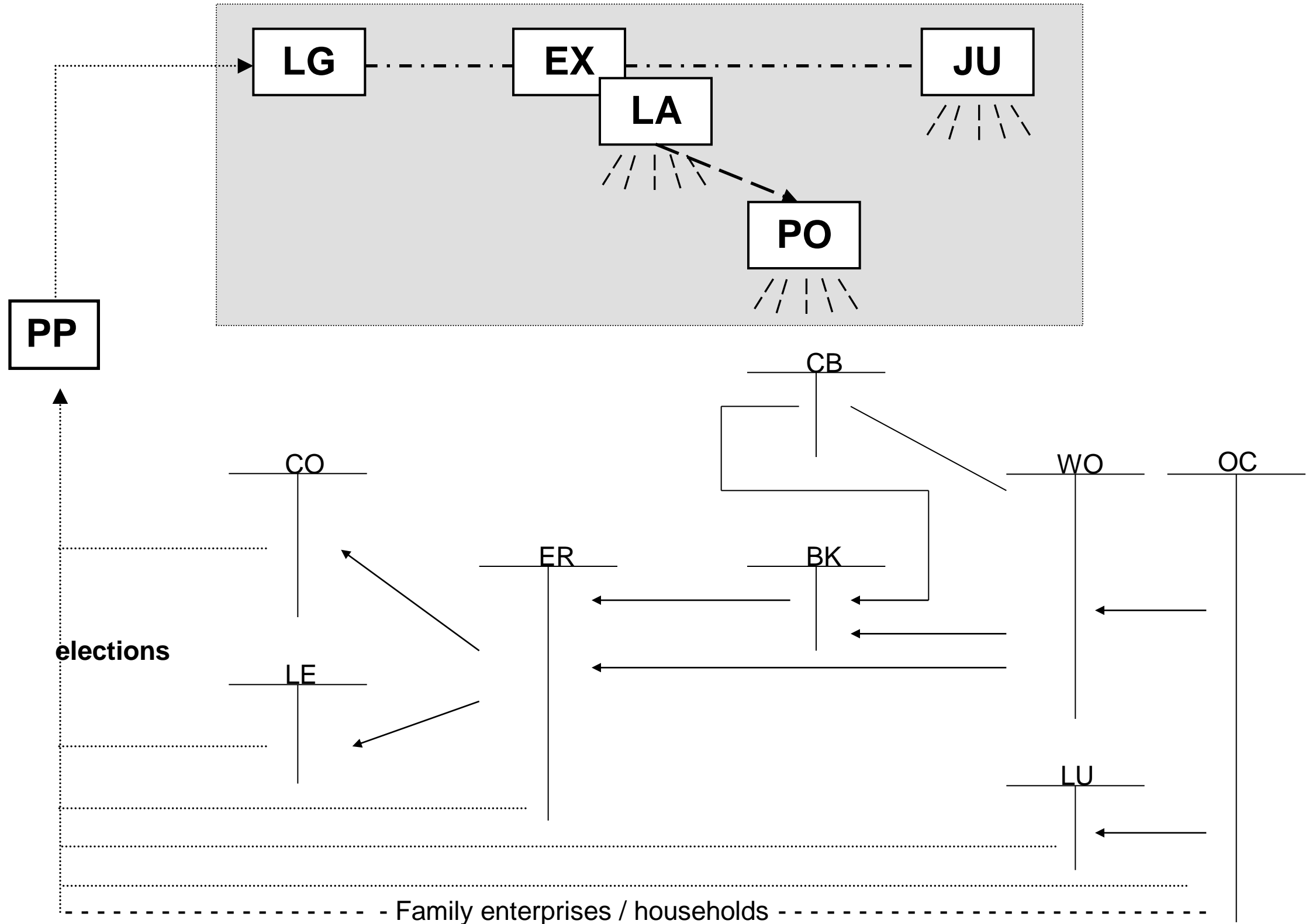






# Summary II:

Economic development, market economy, democracy,  
and welfare state



# Watch out!

## Don't retry!

- Precarious constellation between the implementation of a monetary market economy and the maintenance of the socialist, mono-party-dominated economy
- Struggle for hegemony between Central Bank and Central Party Committee
- Chinese growth history: Result of a stalemate in the Party under Deng Xiaoping
- “Trouvaille of history“: Chinese bonanza

# Abbreviations

BK – bank

CB - central bank

CCP – central committee of  
the Communist Party

CO – consumer

CP – Communist Party

ER – entrepreneur

EX – executive branch  
of government

IN -- intermediary

ISS – institute of social  
security

JU – judiciary

LE – employed labour

LG – legislature

LU – unemployed labour

OC – other creditor(s) /  
owners / victims?

PN – politician/s

PP – political party/ies

PS – party secretary

ST – state (as fiscal entity)

WO – wealth owner

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Thank you

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