

***Guanxi* Economics as Development Economics – Everywhere?**

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Master Course “Development Economics and
Strategies“

February 3, 2020

Guanxi Economics as Development Economics – Everywhere?

Please mark YES or NO about the following statements. Follow your spontaneous impulse!

Compare your answers with those of your neighbors.

Introduce yourselves, and let one another know, why you are in favor of this or that statement..

Yes No Assertion

1. Socialist economies are ruled by planning authorities and large state-owned enterprises. China has thus been very successful in running its economic development.
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 *Wirte*, the non-innovative, normal businesspersons.
3. In Basic Economics, the formula for gross domestic product (Y) adds up private and public consumption (C) and saving (S) on the one hand side, and C and investment (I) plus exports (X) minus imports (M) on the other: $Y = C + S$; $Y = C + I + X - M$. Enhancing growth and "development", two equations come to the fore: $S = I + X - M$ (correct for advanced countries) and $I = S + M - X$ (correct and advisable for developing 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. His motto: "To be rich is glorious!"
5. Analyzing successful economic development, you can always identify five actors: the innovative entrepreneur, typically without major wealth of his or her own, the banker B, who enables the transfer of the resources from the status-quo user of the resources to the entrepreneur, the office-holder who enforces the framework and secures the transactions, and the often overlooked and ignored party secretary and his or her party cell members - everywhere.
6. Promoting investment by enhancing savings through restraining or cutting consumption ($S = Y - C$) was a strategy used by Stalin and Mao - leading to disastrous famines. Curbing exports and promoting imports is also not a convincing strategy. Growth cum debt only makes sense in extraordinary circumstances.
7. Party cells in enterprises, administrative, regulatory or media units, civil society organisations, military hierarchies, university institutes, regulatory agencies, and housing cooperatives are mainly a means of ideological control and often a source of corruption in all communist-ruled countries.

Contents

1. Economic development: IMF and Friedman vs. Schumpeter and Keynes
2. *Guanxi* Economy / Economics in China
3. Political-Party Economics in general

Guanxi Economics as Development

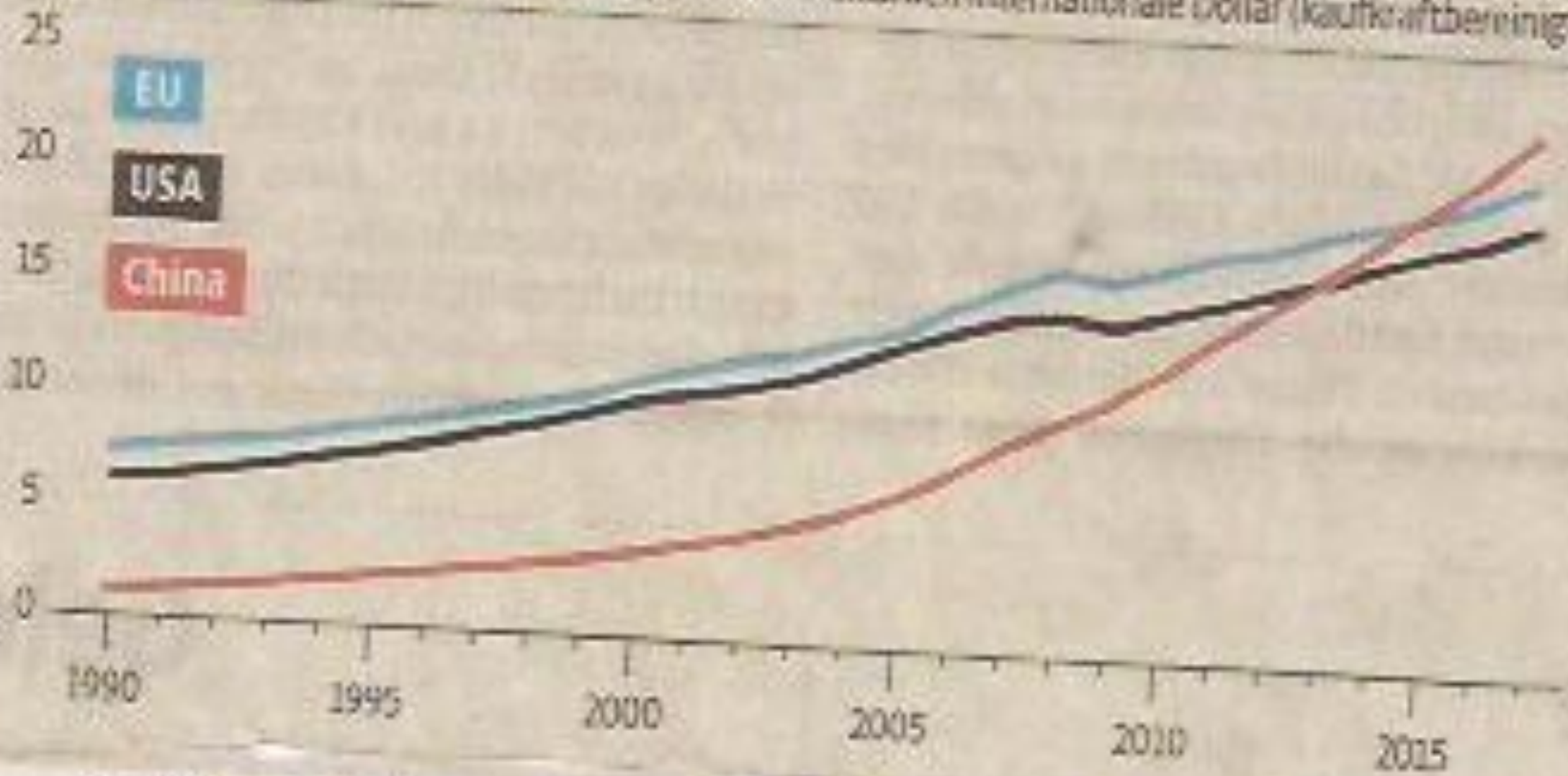
Economics – Everywhere?

Yes No Assertion

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Chinas Aufstieg

Bruttoinlandsprodukt in Milliarden internationale Dollar (kaufkraftbereinigt)



SZ, 7./8. July, 2018, p. 1

What makes China's economic development so extraordinary?

- Macro-Economics
 - Growth cum debt (Argentina) or export drive (China)
 - Structural heterogeneity of modes of production and their articulation
 - National economic order: State capitalism?
- Micro-Economics
 - State-owned, capitalist and family enterprises
 - Governance structure: *Guanxi* as Delta factor
- Applied and/or replicable **Everywhere?**

Macro-Economics of Development

IMF Working Paper 19/65: *The External Balance Assessment Methodology, Update 2018, Introduction:*

- “... current account imbalances can be appropriate, even necessary. ... countries whose populations are aging rapidly may need to accumulate external savings (by running **current account surpluses**) that they can draw from when their workers retire.
- On the flip side, young and rapidly growing economies with ample investment opportunities benefit from foreign funding and can afford to run **current account deficits** provided they can repay them out of future income.” (p.4)

Definitions of National Gross Domestic Income Y in National Accounting

$Y = \text{Consumption} + \text{Saving}$

$Y = \text{Consumption} + \text{Investment} + \text{current account (eXports} - \text{iMports)}$

$I = Y - C - X + M$; development by investment through minimizing consumption and running into debt; Mao, GDR, Argentina, others

$I = S + M - X$; development by investment through internal and “external savings” or “foreign funding”; see IMF above.

$S = I + X - M$; accumulation S is seen as a resultant of autonomous investment and current account surplus; present Chinese strategy.

National Accounting

- Statistics versus economics
 - Difference between *ex ante* and *ex post*
- *Ex-post* <afterwards> equations: Any combination is correct, because statistical numbers report about the past.
- *Ex-ante* <before> equations: Y is the result or function of and depends on x and other behavioral variables. Important for strategic decisions about the future.

Argentina

- Basic formula: $I = Y - C - X + M$: Correct statistical *ex-post* equation, but *ex ante* misleading
 - Increase Investment by austerity (reduce Consumption)
 - Increase Investment by reducing X through taxes on soya et al.
 - Increase Investment by increasing M through foreign loans
- Model behind the IMF recommendation for "young and rapidly growing economies"
 - General equilibrium
 - Walras' "Ni benefices ni pertes" is fine as an **analytical** instrument to define full employment and other phenomena such as disequilibrium and windfall profits
 - Converted into an *ex-ante* **norm**, optimum allocation of resources through fully liberalized markets
 - With **full employment as an assumption**, underexploited resources are ignored – the very basis of "development" economics
 - Keynesian criticism: **Demand** is ignored and no regard for empirical facts
 - Sometimes looking like a curse for mainstream economics; misleading theory
 - Only for fair weather, when prices somewhat reflect Walrasian equilibrium
 - Overlooking bubbles and shortcomings, hog cycle, cobweb (*Arthur Hanau's Schweinezyklus*)
 - Dynamic Stochastic General Equilibrium (DSGE) models not really "dynamic"
- Historical results: From one debt crisis to the next; economic stagnation

China

- **Basic formula: $S = I + X - M$**
 - Increase accumulation by Investment
 - Increase accumulation by Exports
 - Increase accumulation by controlling Imports
- **Model behind the IMF recommendation for countries with „rapidly aging populations“**
 - Monetary economy: Prices along equilibrium market values
 - Export surplus
 - Secure employment of labor and other resources (= “development“)
 - Secure treasure for future generations
- **Micro-economics**
 - Investment as an autonomous, entrepreneurial variable, dependent on good ideas and a banker ready for a loan to the entrepreneur *ex nihilo*, access to knowledge and profit perspectives
 - Access to resources from the status-quo owners via an intermediary is eased by Party-*guanxi* networks
- **Historical results**
 - Successful economic growth
 - Strong dictatorial one-party regime

National Economic Order

- **General analytical approach:** Modes of production and reproduction articulated in structural heterogeneity; plus political regime
- **State capitalism:** Dominant state-owned companies in an otherwise capitalist / market economy; plus democratic or autocratic rule
- **Socialist market economy:** Strong state-owned companies, family-dominated small and medium enterprises, privately owned domestic and foreign firms; plus Communist Party cells in every institution and autocratic one-party rule

From Mao to Deng Xiaoping

- Mao (1950s)
 - Great Leap Forward: $I = Y - C - X + M$
 - Reduce consumption: hunger
 - Enforce investment: repression, low growth
 - Keep borders closed: isolation from globalization
- Cultural Revolution (1960s/1970s): Mao Bible
 - “... difficult task to ... make our ... country rich, strong and highly civilized ...“
 - “The main force of our endeavors is the Communist Party of China“
 - “Leadership through Party Committees“
 - “Party cadres are messenger-boys serving the people ...“
 - “The role of communists as vanguard and model is extremely important“
 - “Politics: Hundred flowers flourish, hundred opinions struggle, - that is a policy which drives forward the development of the arts, the progress of science and the flourishing of the socialist culture in our country“
- Look at our Maoists here in Europe – as good politicians, writers, professors, journalists, etc.!

Deng Xiaoping

- 1979/80 Cat black or white – “as long as it is catching mice, it’s a good cat”
- Later: Socialist Market Economy
 - Prices are set close to cost-covering / scarcity
 - Karl Marx: „Akkumuliert akkumuliert! Das ist Moses und die Propheten!“ (1867)
 - Deng: "To be rich is glorious."
 - François Guizot (French minister):
“Enrichissez-vous!” (1843)
- Party committees and secretaries survive

Micro-Economics of Development

- General features of development in market economies
- The Monetary Economy as an ideal-type "mode of production" or as an holistic concept of "capitalism"?
- The *Guanxi* Economy as a specifically Chinese mode of production
- *Guanxi* Economics and politics everywhere?

Family enterprise / household or State-owned people's brigade / Commune

Schumpeter's "*Wirt*" and status-quo wealth owner, his "*Unternehmer*" and his "*Bankier*"

Balance sheet (general scheme)

Assets	Liabilities
- real	- relatives
- financial	- friends and neighbours
cash	- market partners
- human capital	- banks, workers, suppliers ...
- social capital	- state agencies (also as owners)
- reciprocity	
- social security	Equity (ownership, <i>saldo</i> , <i>wealth</i>)
- public services	- man / husband / member
- labour rights	- woman / wife / member
- culture	- children
- natural capital	- state

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Money as a cash asset and medium of exchange

Friedman's helicopter and his neoclassical monetary theory of inflation

Consumer

cash

LaborEmployed

cash

Entrepreneur

cash

Bank

cash

WealthOwner

cash

Under-employed
real
assets

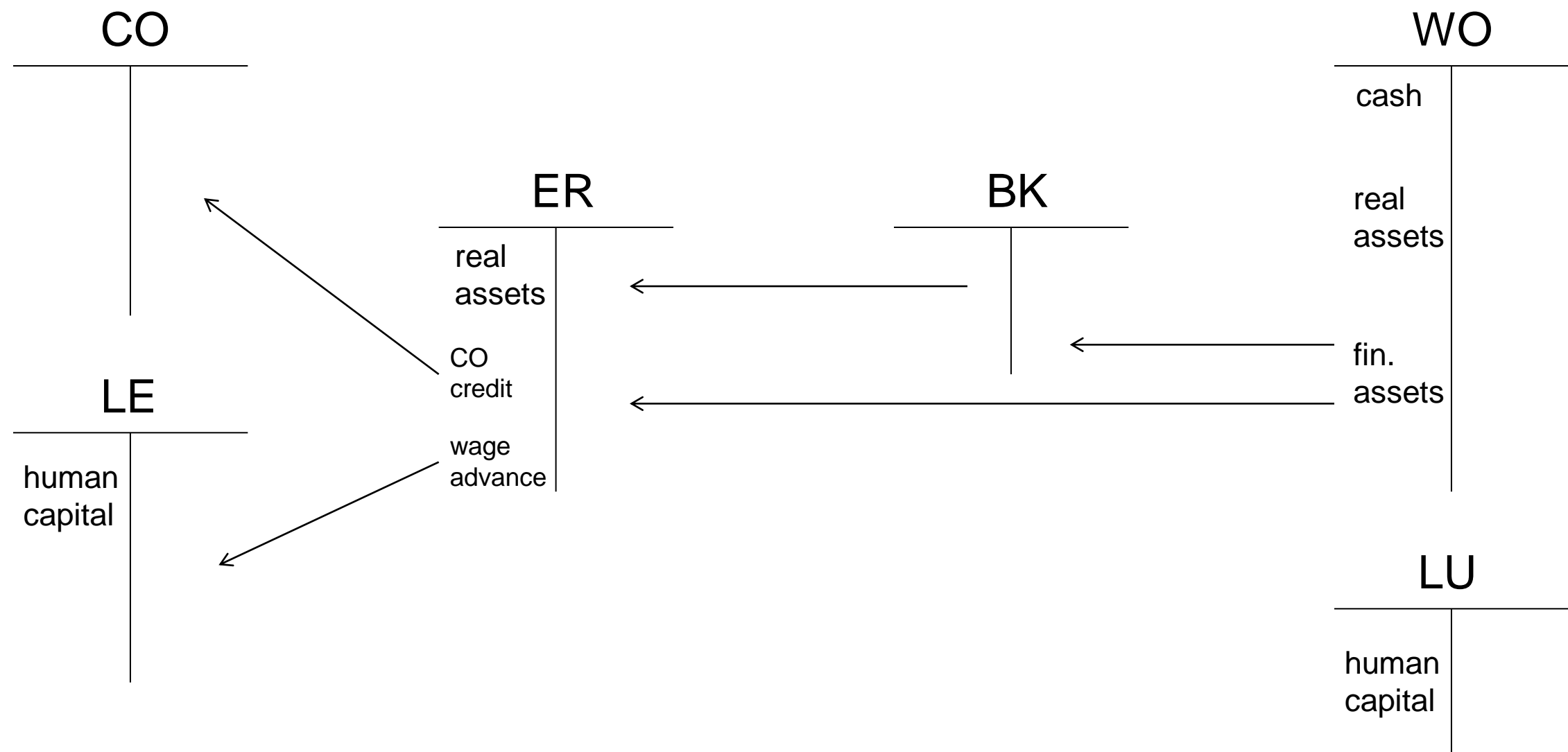
LaborUnemployed

cash

Human
capital

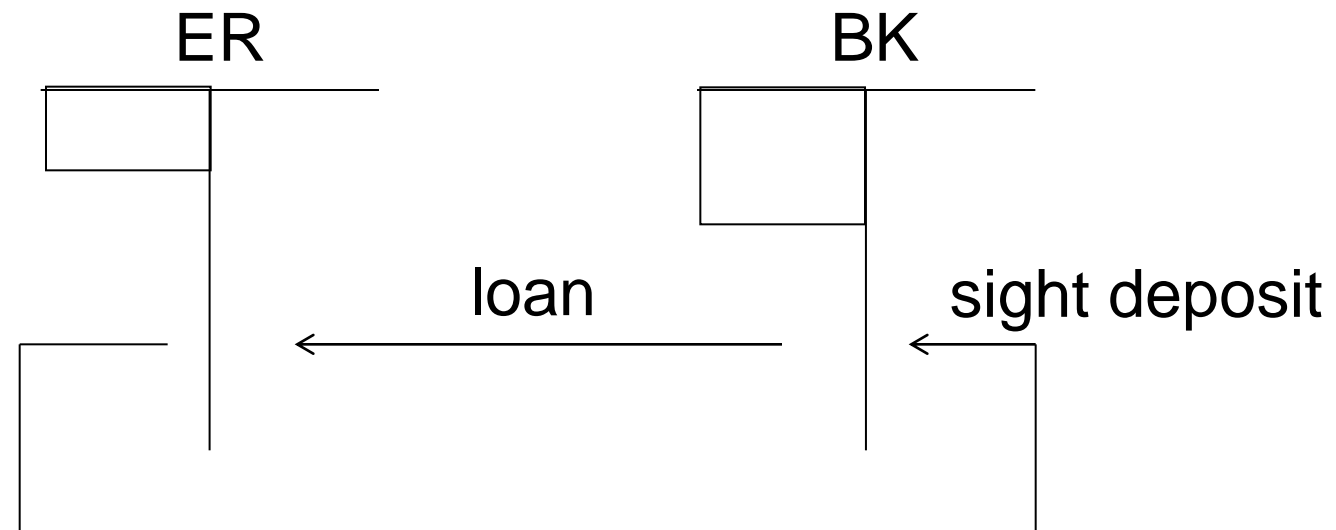
Money as a medium of deferred payment:

Keynes' monetary theory of production and the theory of finance (banks as intermediaries)



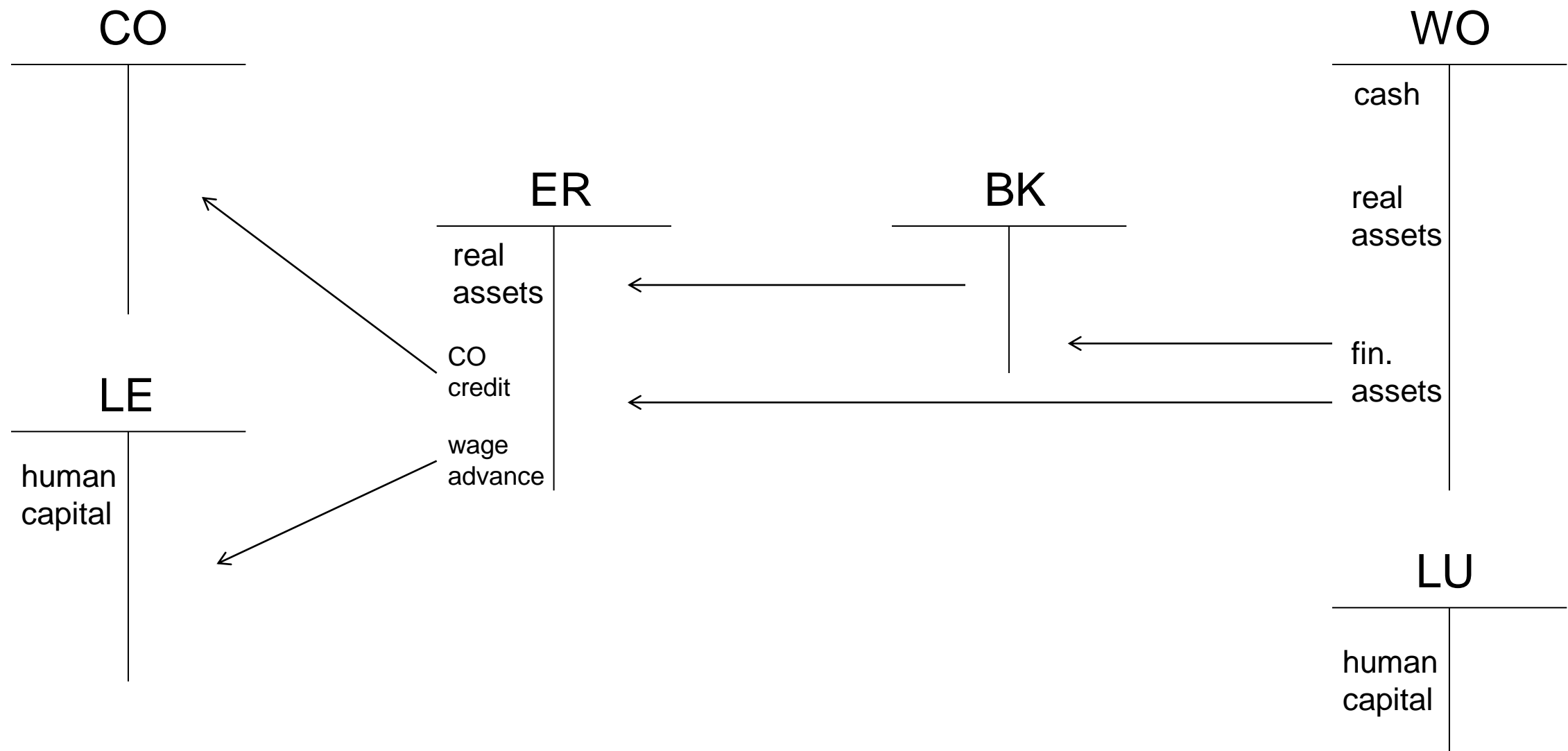
Credit creation *ex nihilo*:

Schumpeter's entrepreneur and his banker as the basic **Duo** of economic development in a monetary economy



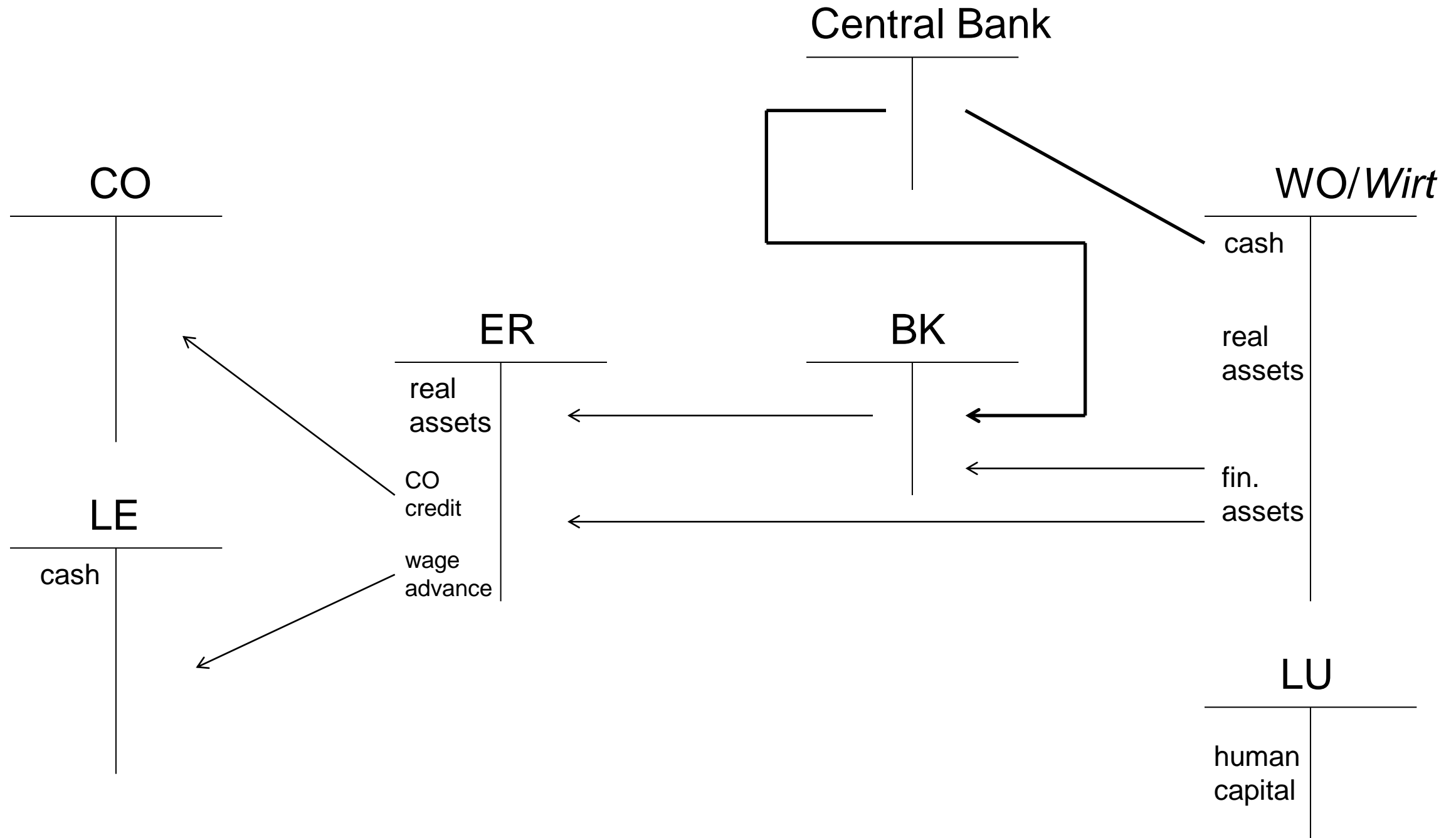
Can you trust the banker?

Critical role of the *Wirt* as the status-quo owner and user of resources in the **Trio**: Change into financial assets



Interplay of commercial and central banking

Constitution of a monetary economy through emission of universally valid banknotes; permanent flow of resources from WOs to ERs



Development in a monetary economy

- **Actors in a Quartet – with the office-holder**
 - Entrepreneur: Ideas, access to knowledge and freedom to act
 - Banker: Confidence in the entrepreneur, reliable debtor, freedom to extend loans and to call on refinance
 - *Wirt* / Status-quo wealth holder: Readiness to give up resources against (fair) remuneration
 - **Office-holder**: Police and others secure property rights and assure compliance with the law
- **External conditions**: Market economy and rule of law

Shortcomings of the monetary economy / “capitalism“?

- Ecologically and socially blind: Whatever can be bought and sold, becomes a commodity. Office-holders have to secure limits.
- Creation of credit/money in endless credit lines between banks and others *ex nihilo* makes the system crisis-prone with credit crunches *in nihilo*.
- Monetary economy does not necessarily go hand in hand with political democracy.
- Inequality is an inherent ingredient rather than a problem.

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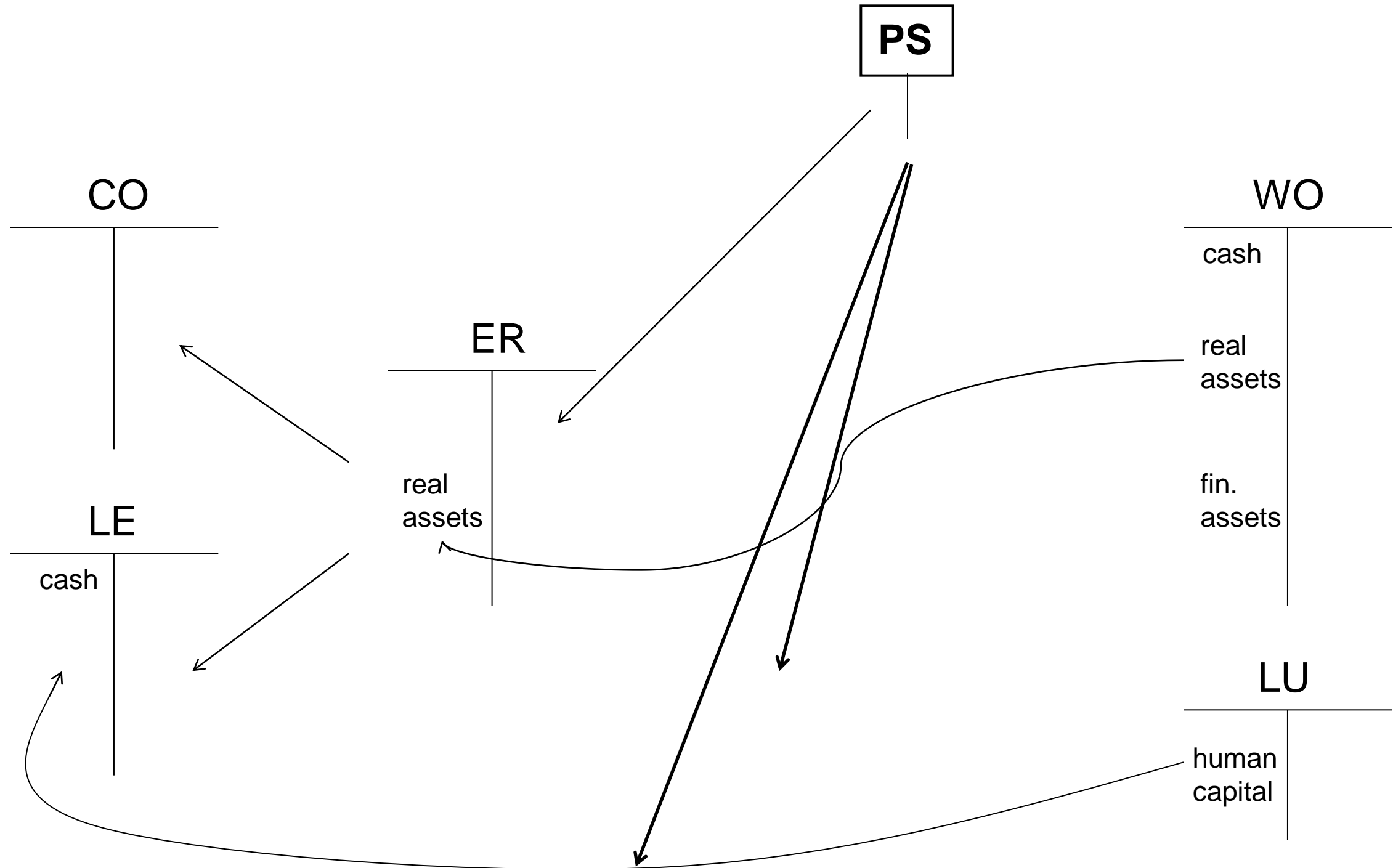
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Socialist (market) economics

- Central planning
 - Lenin's model: First World War allocation via food stamps / *Lebensmittelkarten* / *Libreta*; industrialization
 - Problems: Flexibility, speed, innovation; bureaucratization
- Markets: Prices close to or far from equilibrium: China vs. Cuba
 - Easier for consumption goods than for real estate and capital goods
 - Labor
 - International trade and investment
- Coherence
 - Barter and queuing-up
 - Market response: Demand and supply
 - *Guanxi* between Party Secretaries (PS) - for projects
 - Planning still in place – via the Directors; force and career incentives

***Guanxi* (= trustful relationship) economics I:**

Banker substituted by Party Secretary: ER-PS-WO *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 shortkeeping of *rénqíng*
 - *Rénqíng* takes the role of a domestic currency
 - Issued mostly by the **local party secretary**
 - Issuer of rewards and punishments
 - Intermediary of resources – together with the **director**, who is the guardian of the plan, of status-quo stability and the remaining majority of activities
 - “*Schöpferische Zerstörung*“ → creative destruction at the *wirt*
 - 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 director and party secretary

Strong
Budget
Constraint

Party structures

- Party membership: Mostly voluntary, career aspirations, candidature, ideological adherence
- Party committees: Members working in the (every?) institution come together in party cells and elect party secretary
- Local party structure with full-time functionaries: Organize local committees and keep in contact with neighbours and superiors – up to national level. Lenin's "Democratic centralism" in communist parties
- Double mission: Ideological control and economic development
- Risks: Honorable or corrupt practices; violation of human rights of citizens; dictatorial structures and excesses

Definition of Guānxi 关系

- Principle of reciprocity
 - Friendship/kinship based on a social, individual, emotional, committing, and long-term relationship
 - Exchange or secure favors for mutual benefit
 - 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 organisation.”

- **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 favors 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)

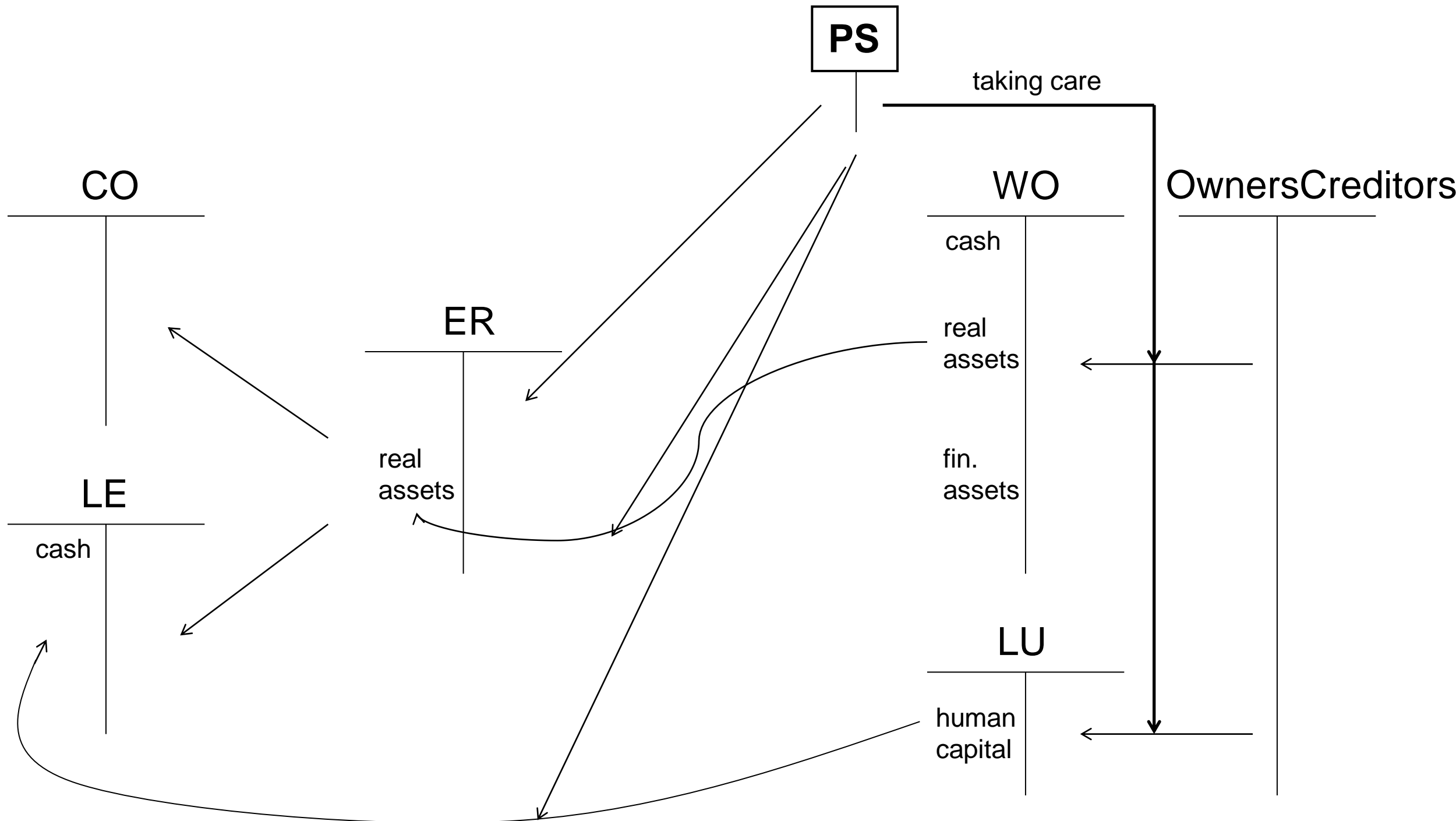
If you give me a *chǐ*

I will return a *zhàng*

- Every “guanxi debt” / “guanxi contract” is interest-bearing
- Considered ignorant/disrespectful repaying a “guanxi loan” immediately
- Would give the impression that the opponent is not interested in 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 one
- Don’t propagate, but don’t prohibit!
- Don’t talk too much about it!

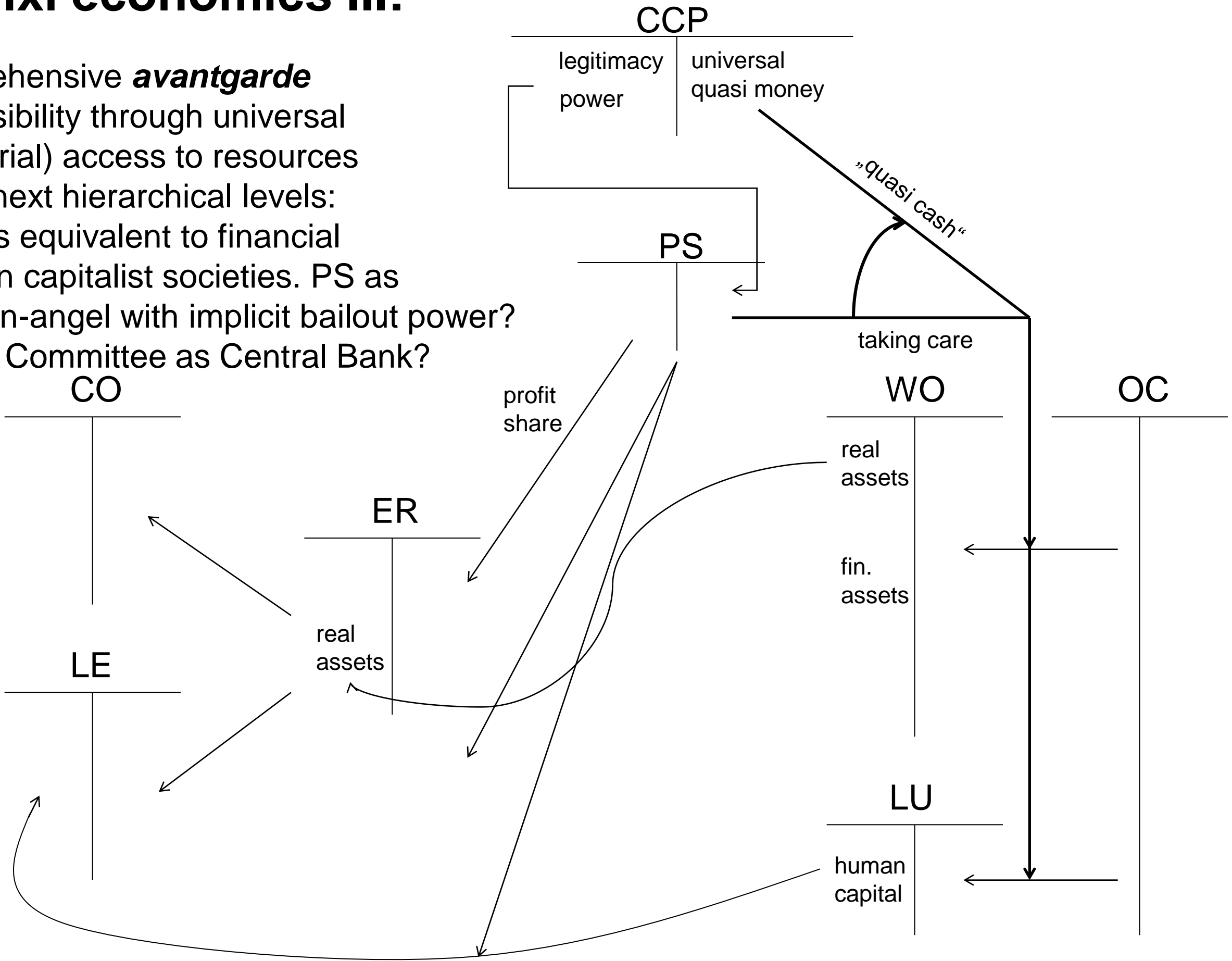
Guanxi economics II:

Command plus comprehensive *avantgarde* party responsibility through universal (dictatorial) access to resources; **Owners** and other **Creditors** of the *Wirt* are **taken care of**. Result of Cultural Revolution – Mao Bible, Red Guards (like many German K-Group member careers): Rather altruistic, less so today's princelings?



Guanxi economics II:

Comprehensive *avantgarde* responsibility through universal (dictatorial) access to resources on the next hierarchical levels: Party as equivalent to financial sector in capitalist societies. PS as guardian-angel with implicit bailout power? Central Committee as Central Bank?



Quasi Domestic Currency

- Main characteristics of a **monetary economy**
 - Central bank money control
 - Currency: 人民币 *rénmínbì*
 - Trust in domestic central bank money
- Main characteristics of the **Chinese *guanxi* economy**
 - Issuance of favours toward friends, clients, followers or superiors in terms of access to resources and other means of production
 - Quasi 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 and party relationships
 - **Struggle for hegemony (in the beginning) or hybrid complementarity (now)??**

Legalism as a necessary ingredient

The office-holder

- Property rights
 - Howsoever **secondary** distribution takes place, property rights are its very essence.
 - Possession rights are more important than property when it comes to “development”.
- Chinese Legalism (not the same as "rule of law")
 - **法 *Fa* (*Law*)** is the term for the “hard” power for enforcing the right to use resources – and for other facets.
 - Confucianist “soft” power ***Guanxi* practice and *Fa* “hard” executive power combined** – that seems to be the Chinese growth model today.

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Party Economics: The overlooked fifth player in the economic development Quintet?

- Recent steps by Chinese authorities
 - “Xi Jinping Thought“ in Constitution
 - One-party rule in Constitution
 - Social-credit for behaviour – good and bad
 - Grassroot building of CCP cells everywhere
 - Against “illegal religious activities“ – communism as a dictatorial religion
 - Traffic rules respected - or not
 - Big data plus Party cells – More than “Big Brother“? (George Orwell)
- „Eine KP-Zelle innerhalb der Konrad-Adenauer-Stiftung?“ SZ,9.7.18, p.2
- Party cells in joint ventures in China
- Party cells or secretaries in firms with Chinese investors abroad?
- **How to deal with party/politician economics?**
 - Is it a sphere beside markets and state? – A mode of production *sui generis*? Probably yes!
 - Hegemonic struggle between central bank and central CCP committee or hybrid complementarity?
- “Corruption“ is a poor analytical concept.

Party structures in China and beyond

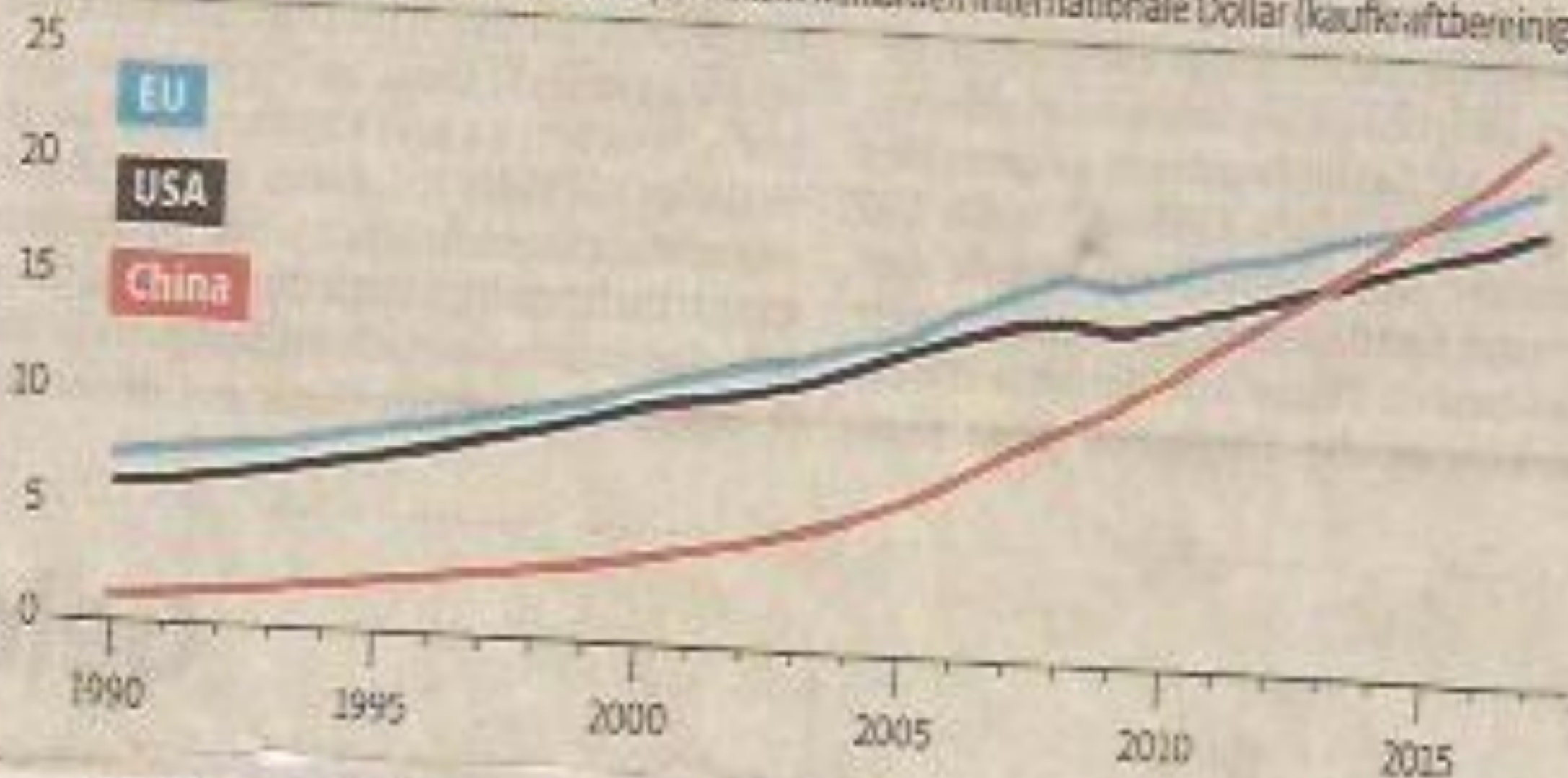
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- Double mission: Ideological control and economic development
- Risks: Honorable or corrupt practices; violation of human rights of citizens; dictatorial structures and excesses

Methodological Individualism as a meaningful approach to party economics

- Credo of methodological individualism:
Only individuals take decisions. Interests, fears, objectives and goals of nations, classes, firms, families, trade unions, cooperatives and other collectives are only relevant, when their mission internalized by individuals. When doing research, stick to the individual! In development economics, have a look at projects, because they are the very essence of economic growth!
- Party members promote themselves by promoting projects; when successful, they experience personal satisfaction and open up career perspectives.
- Part-time party secretaries in enterprises promote themselves by building networks with like-minded individuals in full- and even in less than half-time positions.
- With a Mao-Bible and Deng's "*Enrichissez-vous!*" background, Chinese party members have had specific personal motives to enhance economic development in the 1980s and 1990s.
- With comrades / party brothers, colleagues in every company in the value chain and in every infrastructure and research institute, in every police station and regulatory agency, your network can speed up bigger projects beyond the prescribed, "official" path.
- Directors are inclined to support their party secretaries with their projects, because their own career had passed that stage, and the reputation of their institution is enhanced rather than damaged.
- There are honorable and corrupt Entrepreneurs, Bankers, *Wirte*, and Office-holders, just as there are such Party Secretaries and Party members.

Chinas Aufstieg

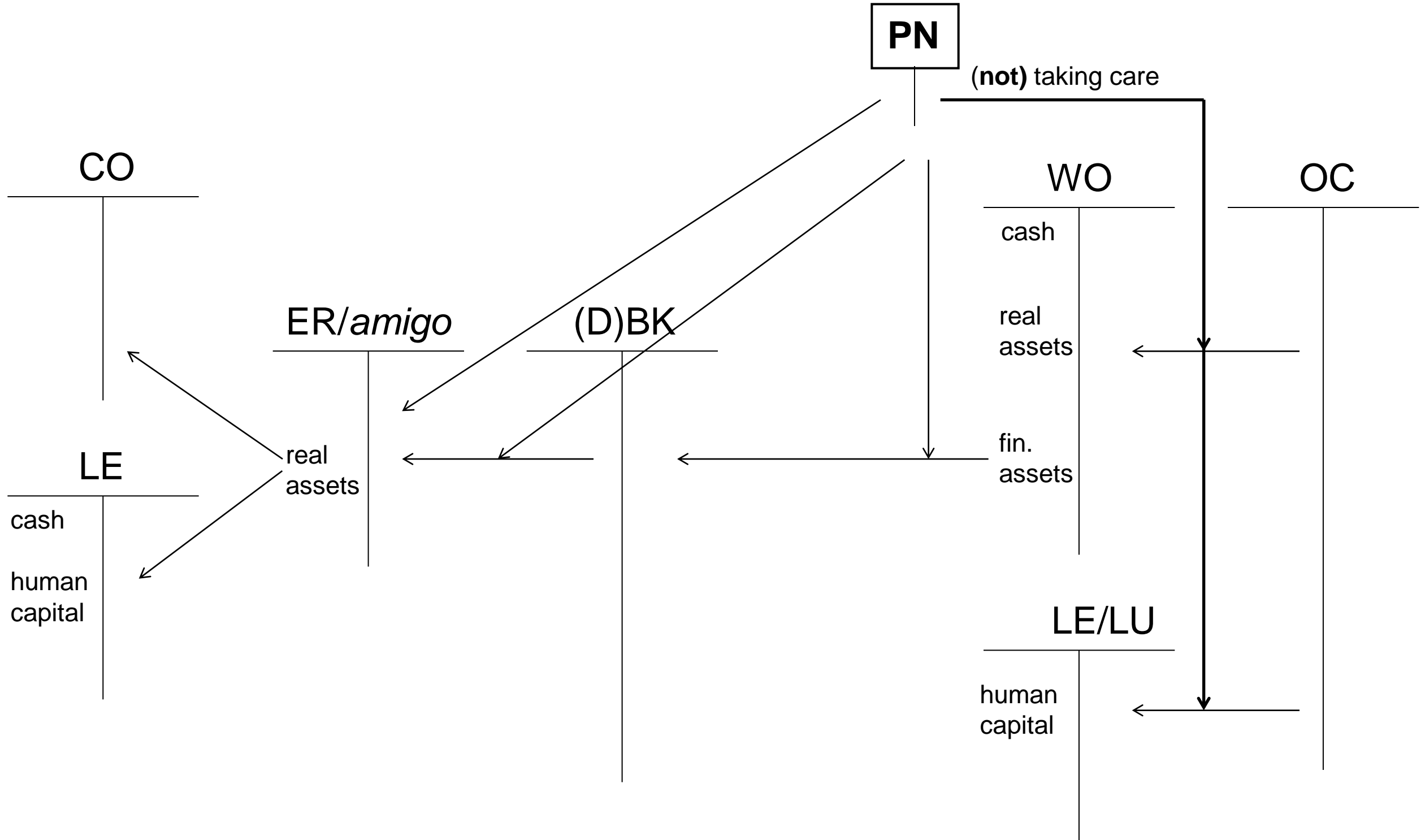
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Guanxi economics IV everywhere:

Politicized development banking between *desarrollismo* and *amigo* banking for business champions, who give grants to politicians/parties/Party

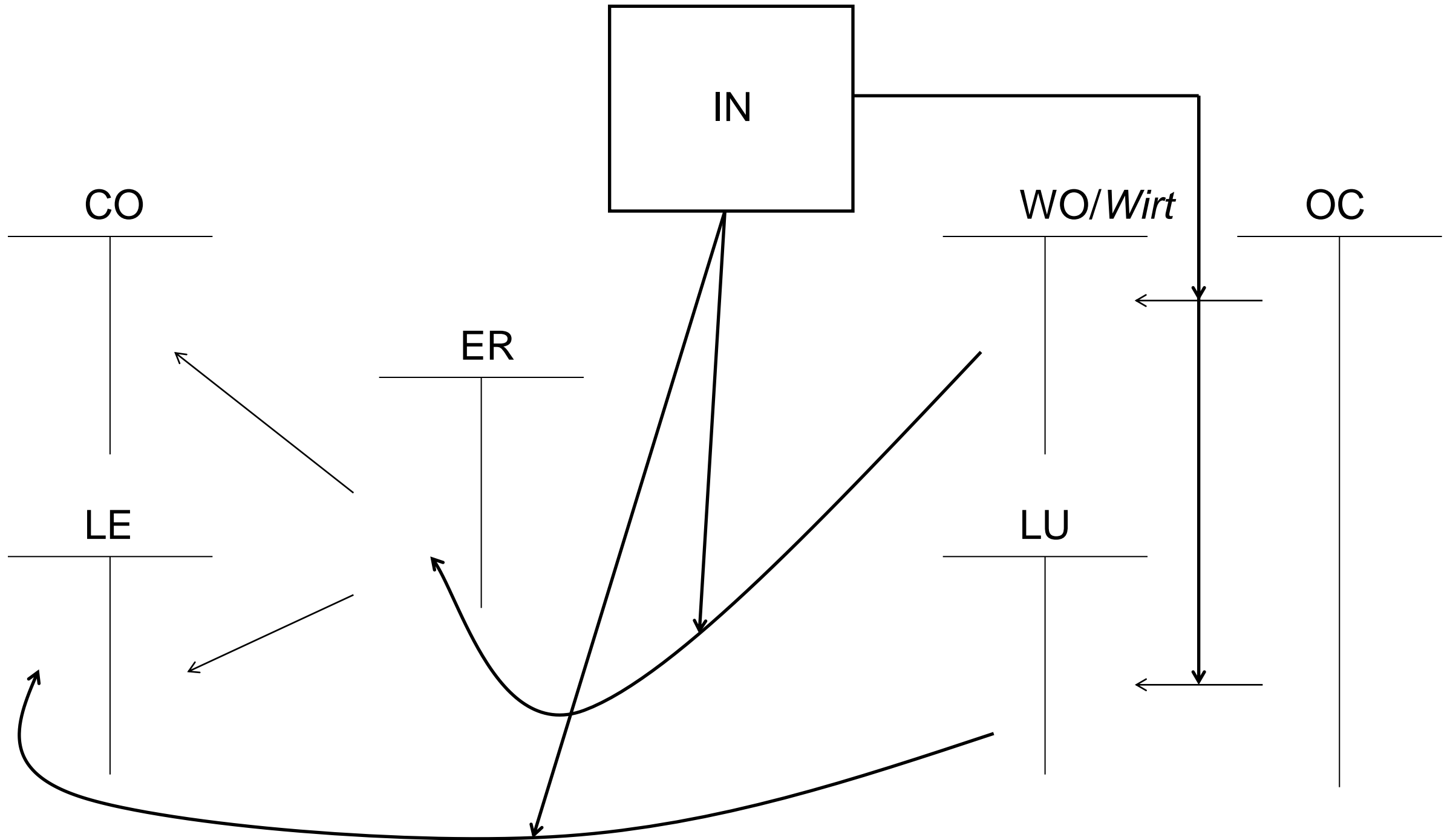


Party-*Guanxi* everywhere?

- Political parties link politics and society
 - Business: Election campaigns, lobbying
 - NGOs: Votes and projects
 - Neighborhoods: Infrastructure
 - ...
- China: Dictatorial one-party regime
 - Party membership opens career
 - Experience with CCP's effect on economic development very positive (contrary to Soviet Union, Cuba and North Korea)
 - Performance and propaganda make Party membership attractive for talented youth
- Experience with networks of political parties elsewhere
 - Brazil, South Korea, Japan, France, Germany ... - campaign finance in corruption trials
 - Recent German anecdotal evidence with economic miracle in the 950s, Rhenanian German capitalism, Bonn-Berlin transfer of the national capital; Berlin airport project, coal policies ...: Political party networks always important – enhancing or hindering economic growth, honorable or corrupt.
 - “Don't talk about it“ is not an appropriate motto for academic research on important topics.
- China's soft power influence on other authoritarian regimes fomented by successful *guanxi*
- Transparency, investigative journalism and further academic research necessary!

Summary I:

Chinese experience with pressure on the *Wirt*: Great Leap Forward and Cultural Revolution – both failed to generate development and cost lives. Economic development requires **secondary** distribution of capital.

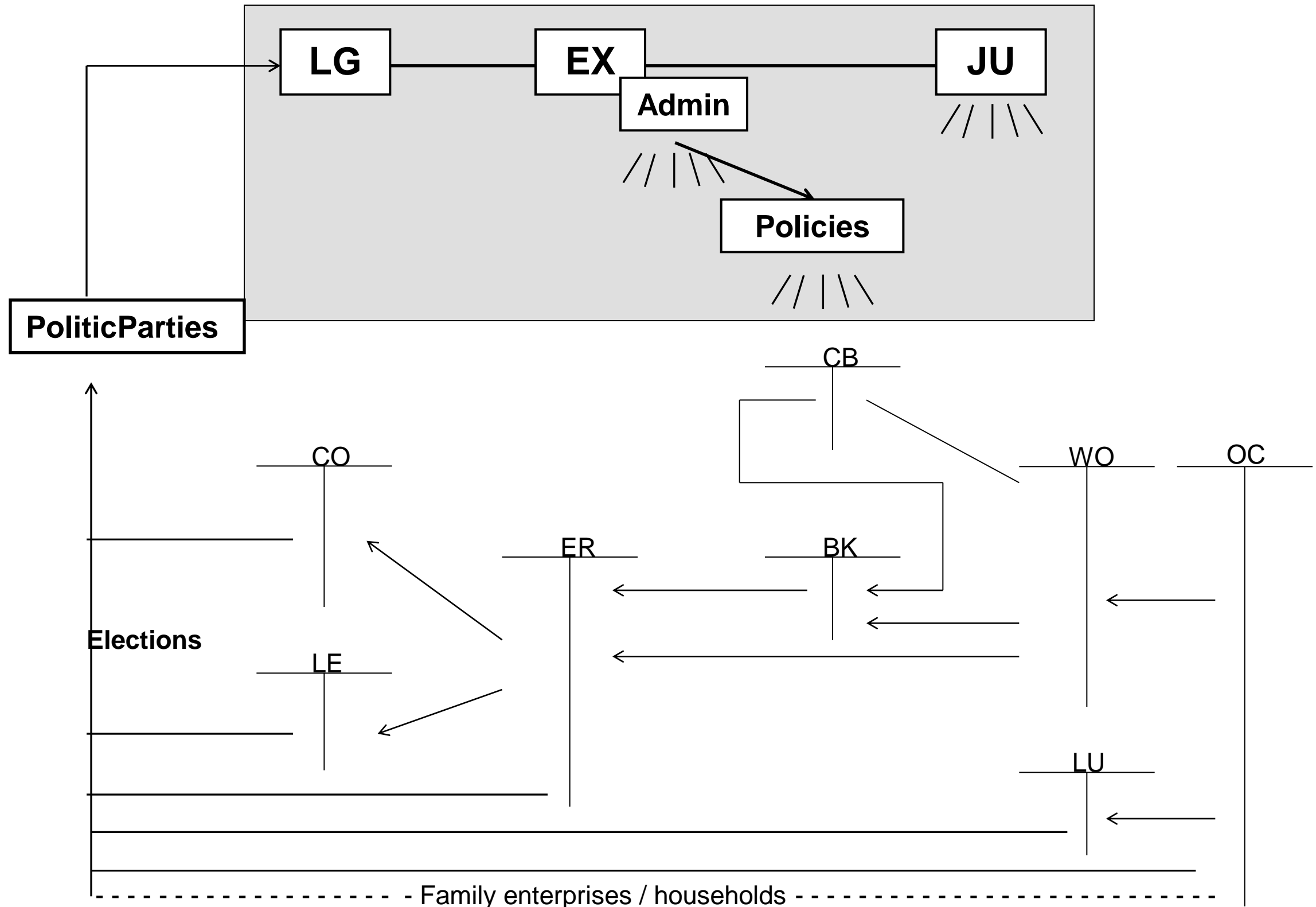


Summary II: China's history

- Precarious constellation between the implementation of a monetary market economy and the maintenance of the socialist, mono-party-dominated *guanxi* economy
- Struggle for hegemony between Central Bank and Central Party Committee or hybrid success story
- Chinese growth history: Result of a stalemate in the Party under Deng Xiaoping and of Red Guards' engagement ?? Still the same with the princelings ??
- “Trouvaille of history“: Chinese bonanza; beware of replica!

Summary III: Socialist or Social Market Economy?

Economic development, market economy, democracy, rule of law, and welfare state **can** go hand in hand.



Summary IV: Political Party networks can enhance growth

- Chinas stupendous economic development was enhanced by political party networks
- One-party regimes have a certain advantage, but party connections are also present in multi-party democracies
- Boom periods and the success or failure of great projects should be analyzed under the **quintet** hypothesis
- Corruption as the great risk

What explains China's extra growth?

- Schumpeter and Keynes instead of Walras
- Monetary economy, state economy, economía familiar, people's commune economy and guanxi economy – combined and articulated modes of production under a rather efficient, though authoritarian leadership
- Outstanding feature of China: Communist Party at the political helm and within every institution
- Thesis: This *differentia specifica* is responsible for the extra “**Delta**“ Δ in China's economic development
- What else?

Global macro-economic policies

- Keynesian mercantilistic strategy
 - **Undervalue** your currency and control inflation
 - Promote exports and accumulate FX reserves
 - See accumulation correctly: $S = I + X - M$, instead of falling into the hunger and debt trap with $I = S + M - X$
- Internationalization of the Renminbi / Yuan
- Treaties and agreements on foreign exchange swaps, trade, investment and projects with many countries and groups
- Acceptance of inequality: Gini Index 1983: 0.28; 2008: 0.49; 2012: 0.60 (OECD: 0.24-0.36)
- “Made in China 2025“: High-Tec; Cyber security
- 2021: Aim: “Moderately prosperous society“
- 2049: Aim: “Fully developed and advanced nation“

Global reach policies

- After a very modest beginning: Quite active on various international fronts, filling the void, left by Trump's USA
- BRI – Belt and Road Initiative (with Silk Road Fund)
 - Initially “One Belt One Road” or “New Silk Road”
 - Central Asia, Europe (Piraeus, 16+1, transport lines, etc.), Latin America (oil, canal project, smart cities, land, infrastructure ...)
- BRICS – Bank, IMF/WB and UN reforms, North Korea
- Promotion of business champions abroad and internal protectionism
- Soft power, but also *Fa* or “Sharp Power” (Economist)
 - Confucius Institutes within universities
 - Hiring of spies for intelligence services
 - TV and Radio Stations blockbuster movies
 - “Avoid critical comments” by partner countries, businesses, media, etc.
- Military build-up (China South Sea, Africa, Arctic, Blue Helmets/UN)
- Napoleon: “China is a sleeping giant. Let him sleep. When he wakes up, he will move the world.” (SPIEGEL; 11.11.17, p. 22)

Thank you

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Abbreviations

BRI – Belt and Road Initiative

BK – bank

CB - central bank

CCP – Central Committee of
the Communist Party

CO – consumer

CP – Communist Party

ER – entrepreneur

EX – executive branch
of government

FX - foreign exchange

I - investment

M - imports

IN -- intermediary

JU - judiciary

LE – employed labour

LG – legislature

LU – unemployed labour

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

PN – politician/s

PO -- policies

PP – political party/ies

PS – party secretary

S - saving/s

ST – state (as fiscal entity)

WO – wealth owner

X - exports

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