



Prof. em. Dr. Manfred Nitsch

Freie Universität Berlin

Latin American Institute / School of Business and Economics

# **The Chinese Model of Development in a Globalized World**

University of Potsdam, Department of Economics

Karl-Marx-Str. 67, Room 1.01, Potsdam-Griebnitzsee

Thursday, July 12, 2018, 10-12 a.m.

## The Chinese Model of Development in a Globalized World

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.  | <input type="radio"/> | <input type="radio"/> | Socialist economies are ruled by planning authorities and large state-owned enterprises. China has thus been very successful in running its economic development in the last three to four decades.  |
| 2.  | <input type="radio"/> | <input type="radio"/> | Schumpeter's entrepreneur ( <i>Unternehmer</i> ) 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 <i>Wirte</i> , the non-innovative, normal businesspersons.   |
| 3.  | <input type="radio"/> | <input type="radio"/> | 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.  | <input type="radio"/> | <input type="radio"/> | At the end of the 1970's, Deng Xiaoping gave the order to establish a "Socialist Markt 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, coordinated through planning and markets – plus the <i>guanxi</i> network of Communist Party secretaries in the corresponding market partners and public agencies. |
| 5.  | <input type="radio"/> | <input type="radio"/> | 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.   |
| 7.  | <input type="radio"/> | <input type="radio"/> | Chinese foreign exchange policies have always been directed towards overvaluing its currency, the Renminbi / Yuan in order to make imports cheap.  |
| 8.  | <input type="radio"/> | <input type="radio"/> | China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets, to invest rather idle foreign exchange cash reserves gained through export surpluses, and to promote soft power.   |
| 9.  | <input type="radio"/> | <input type="radio"/> | In liberal democratic societies, political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen developmental business-oriented objectives, providing coherence beyond market, state and ideological control.   |

## The Chinese Model of Development in a Globalized World

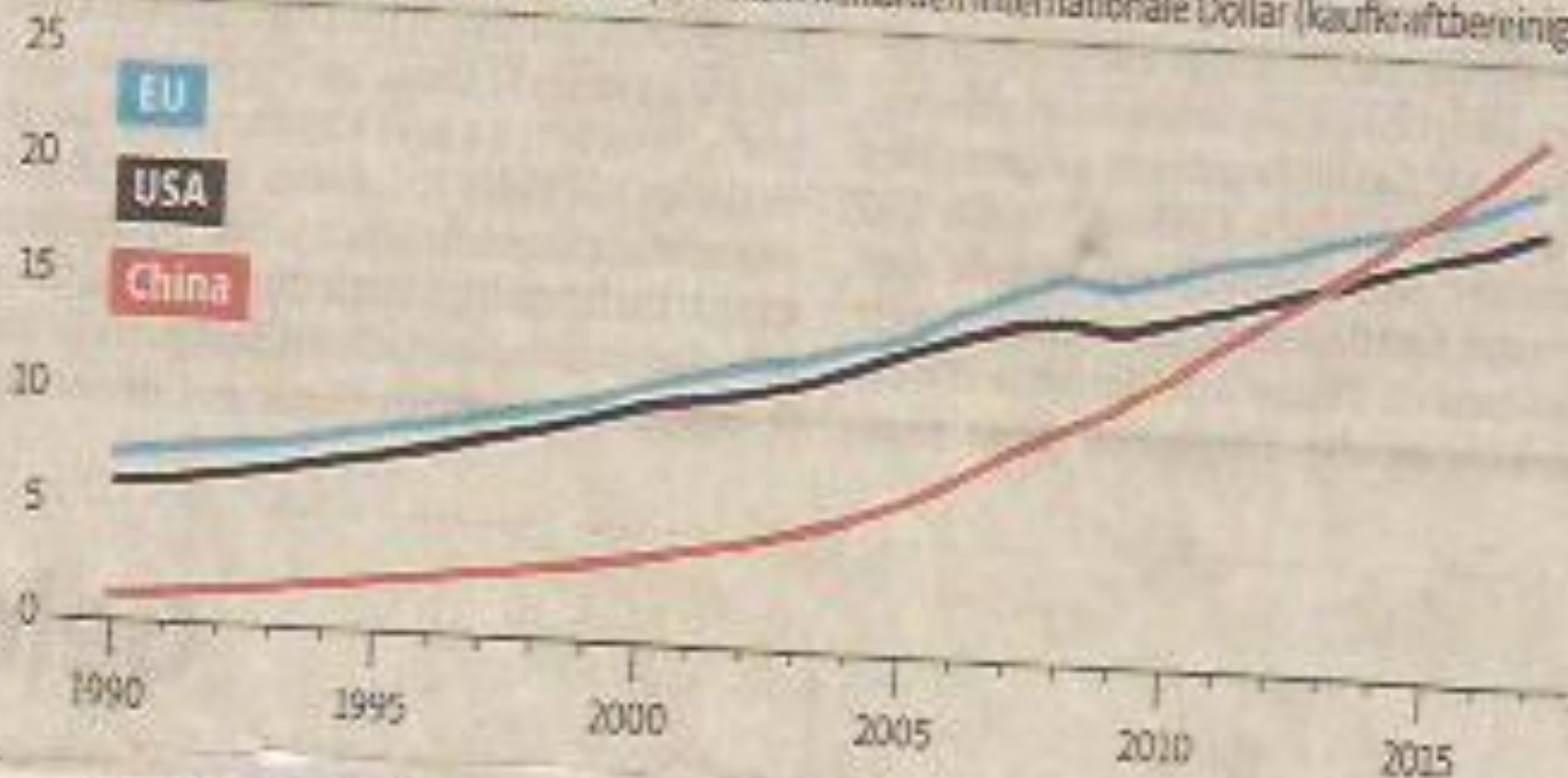
1. o o As a socialist economy, China has been successful through its efficient planning authorities, state-owned enterprises and foreign investments.
2. o o Schumpeter's entrepreneur (*Unternehmer*) owns an established firm and starts an important innovation, which leads to "creative destruction" of the *Wirte*.
3. o o Party cells in every institution are a means of ideological control and a source of corruption in all communist-ruled countries.
4. o o Deng Xiaoping established a "Socialist Market Economy" coordinated through planning and markets – plus the *guanxi* network of Communist Party secretaries.
5. o o Successful economic development needs three agents: the status-quo user of the resources, the innovative entrepreneur, and the intermediary, who enables the resource transfer to new enterprises.
7. o o Chinese foreign exchange policies have always overvalued its currency.
8. o o China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets and to promote soft power.
9. o o Political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen business objectives, providing coherence beyond market, state and ideological control.

# Contents

- 1 Economic development in a monetary economy: Milton Friedman's helicopter model vs. Schumpeter's and Keynes' monetary theory of production and development
- 2 *Guanxi* Economy / Economics in China
- 3 Party Economics in general
- 4 China's global economic policies
- 5 Abbreviations
- 6 Literature

# Chinas Aufstieg

Bruttoinlandsprodukt in Milliarden internationale Dollar (kaufkraftbereinigt)



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

## The Chinese Model of Development in a Globalized World

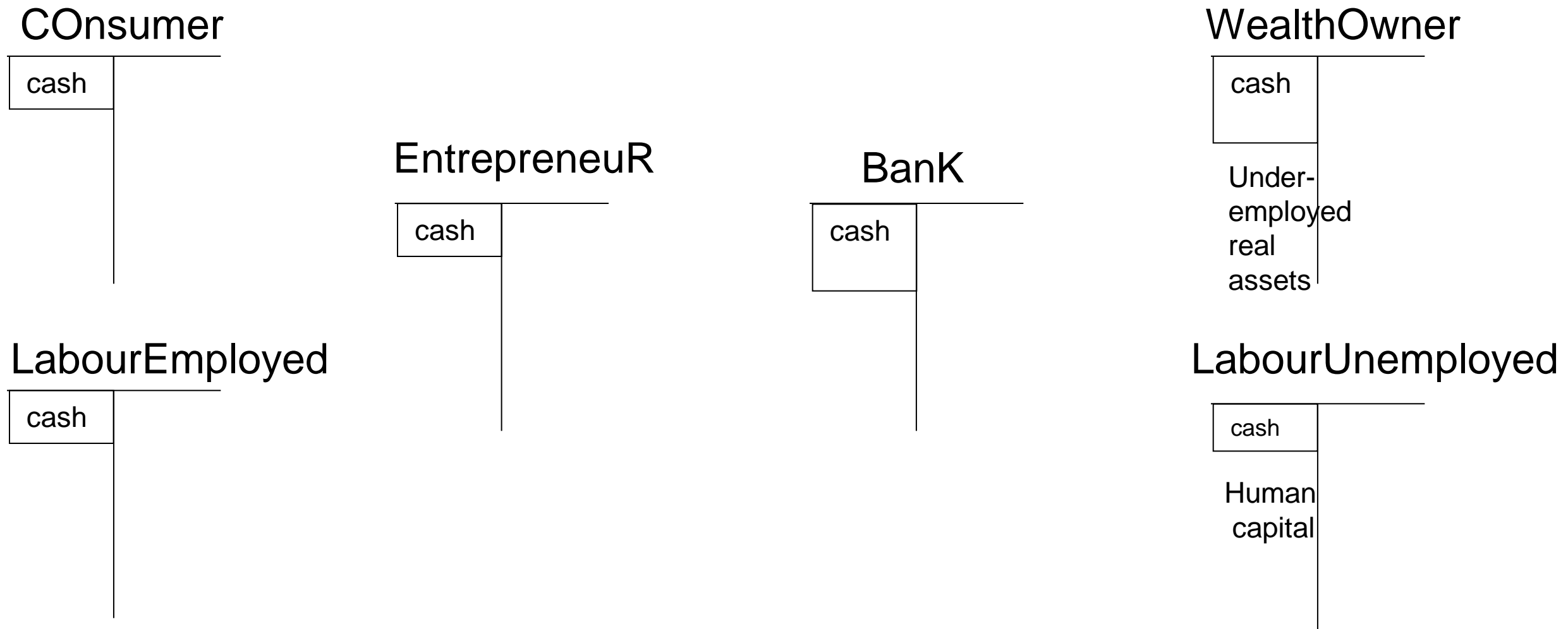
1. o o As a socialist economy, China has been successful through its efficient planning authorities, state-owned enterprises and foreign investments.
2. o x Schumpeter's entrepreneur (*Unternehmer*) owns an established firm and starts an important innovation, which leads to "creative destruction" of the *Wirt*.
3. o o Party cells in every institution are a means of ideological control and a source of corruption in all communist-ruled countries.
4. o o Deng Xiaoping established a "Socialist Market Economy" coordinated through planning and markets – plus the *guanxi* network of Communist Party secretaries.
5. x o Successful economic development needs three agents: the status-quo user of the resources, the innovative entrepreneur, and the intermediary, who enables the resource transfer to new enterprises.
7. o o Chinese foreign exchange policies have always overvalued its currency.
8. o o China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets and to promote soft power.
9. o o Political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen business objectives, providing coherence beyond market, state and ideological control.

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)**

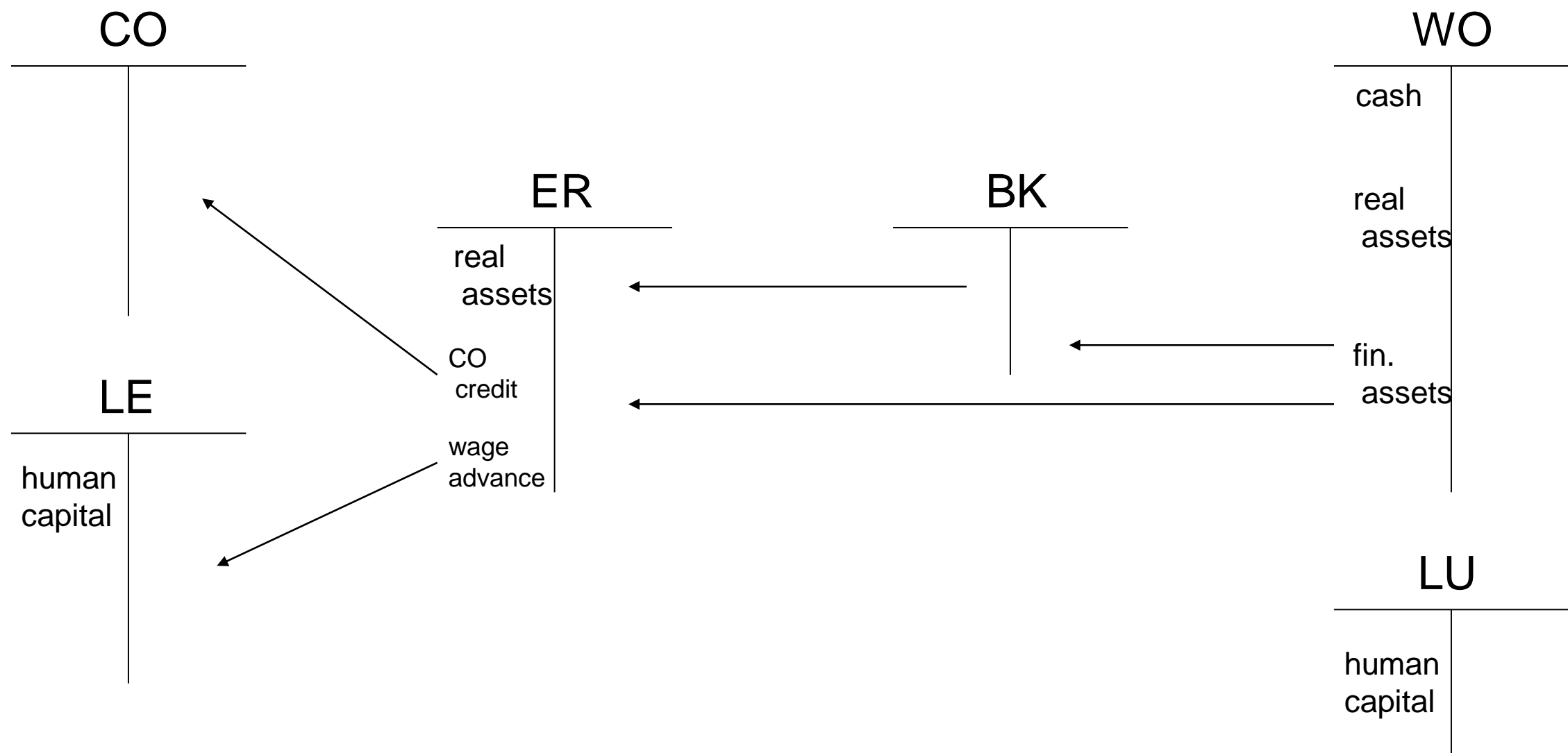
Assets	Liabilities
- real	- relatives
- financial	- friends and neighbours
<b>cash</b>	- market partners
- human capital	- banks, workers, suppliers ...
- social capital	- state agencies (also as owners)
- reciprocity	
- social security	Equity (ownership, <i>saldo</i> )
- public services	- man / husband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

# Money as a cash asset and medium of exchange: Friedman's helicopter and neoclassical savings-first growth theory

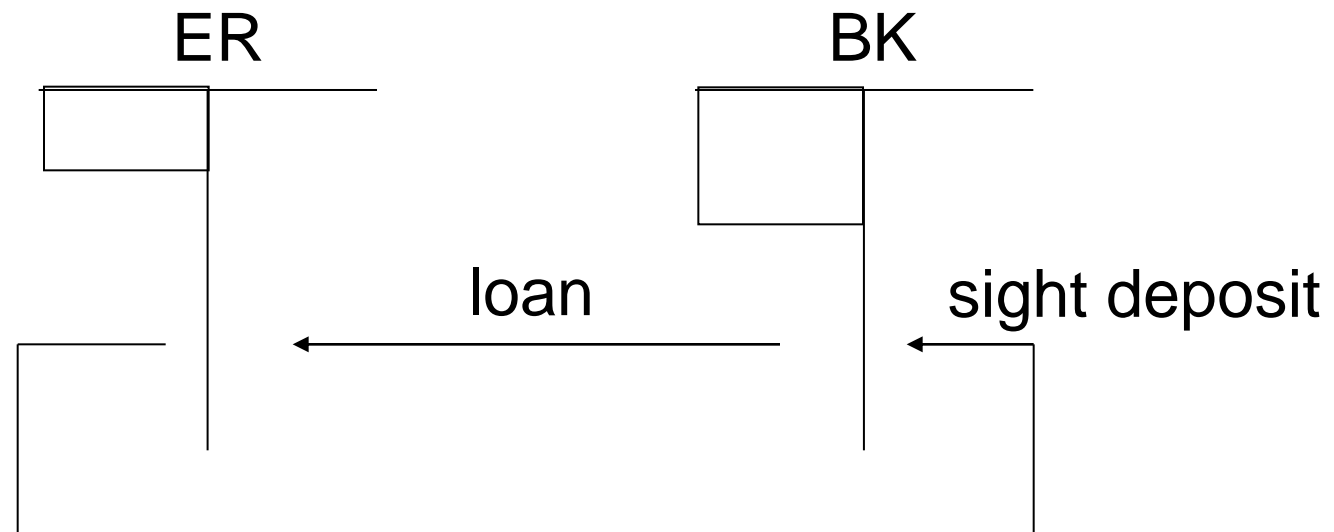




# Money as a medium of deferred payment: Keynes' *monetary theory of production* and the *theory of finance*

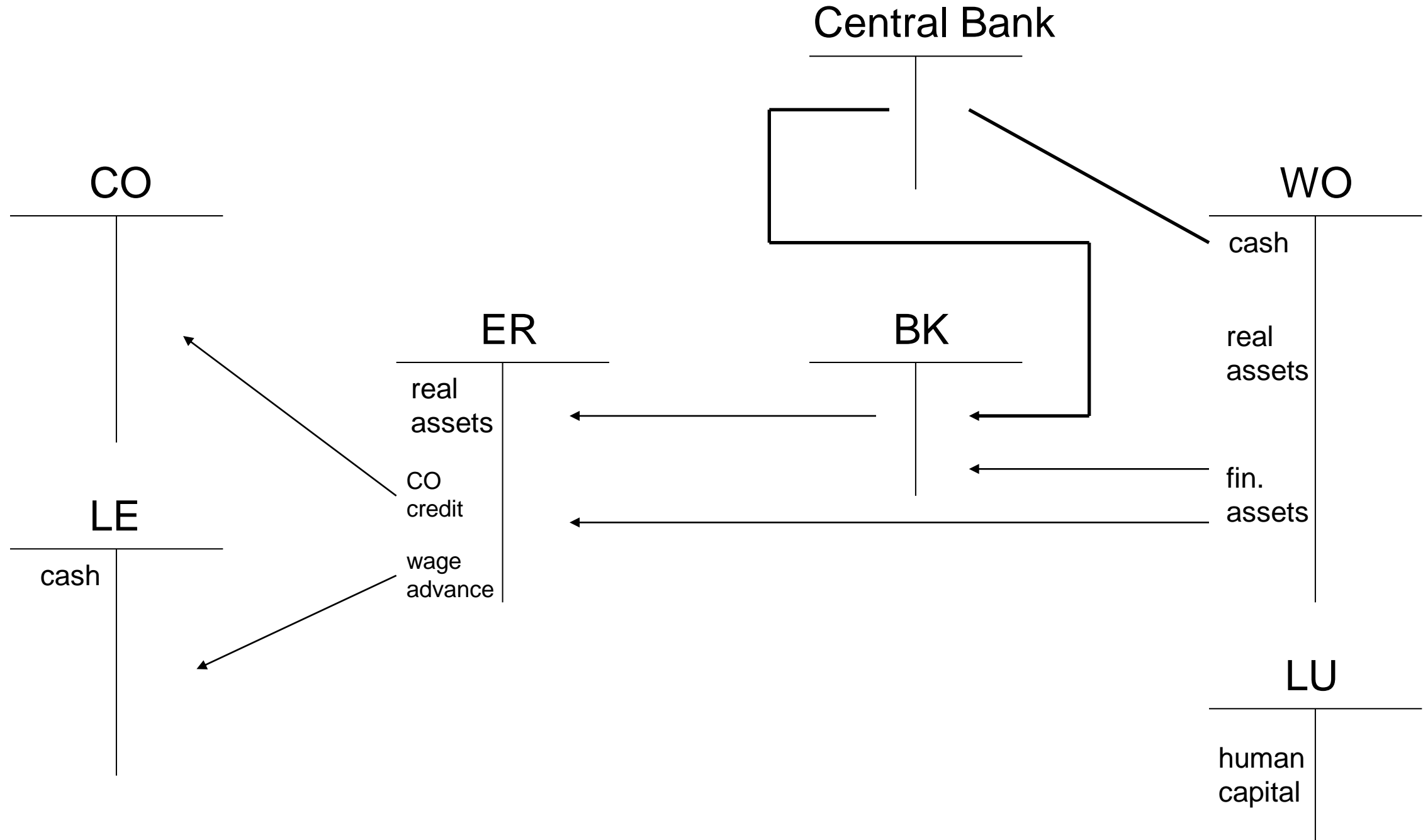


# Credit creation ex nihilo: Schumpeter's entrepreneur and his banker

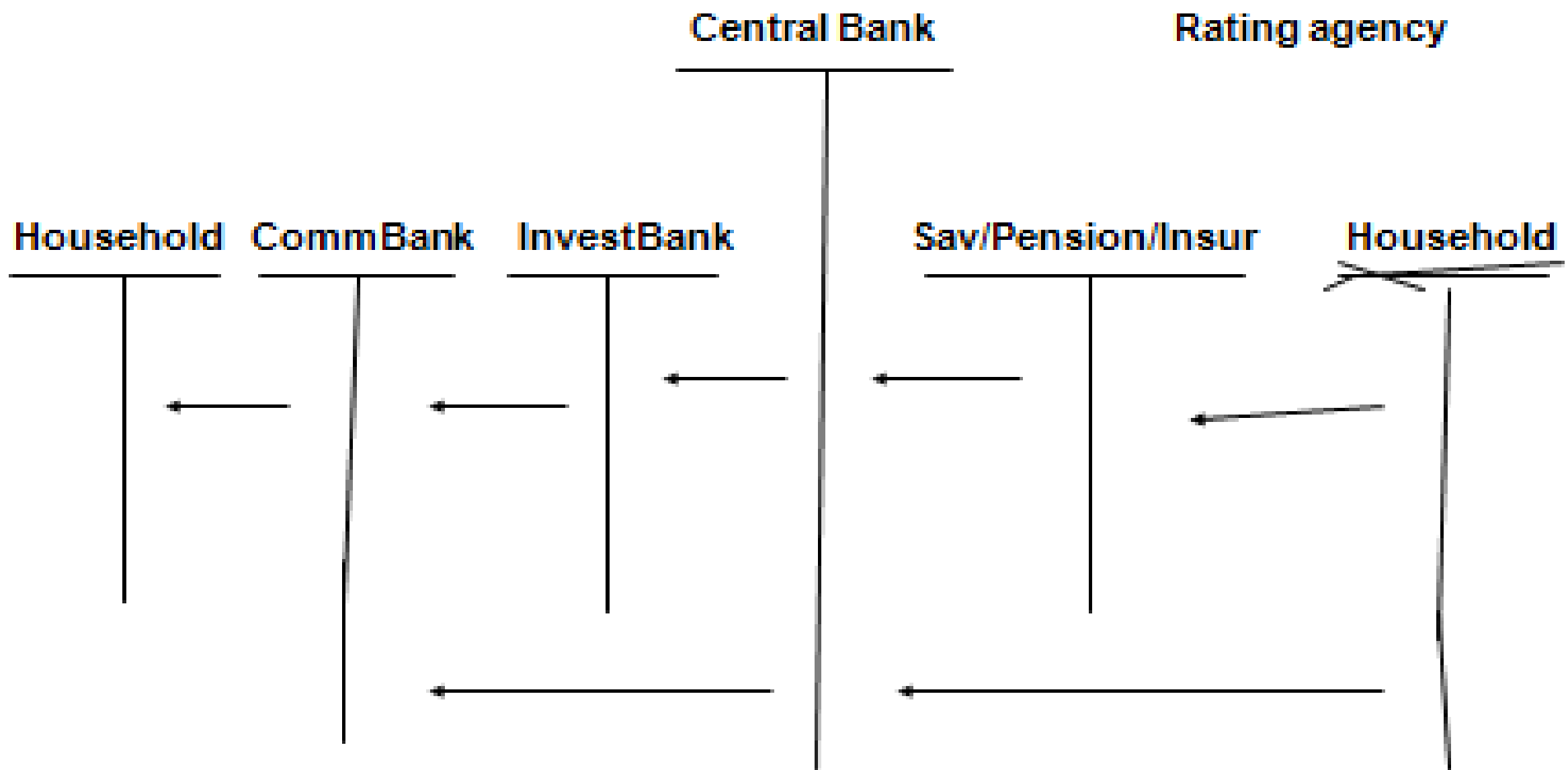


# Interplay of commercial and central banking:

Constitution of a monetary economy through emission of universally valid banknotes



# Interplay of commercial banks, investment banks, savings banks / insurance companies and rating agencies in the crisis



# Shortcomings of the monetary economy / capitalism?

- Ecologically blind: Whatever can be bought and sold, becomes a commodity.
- 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.

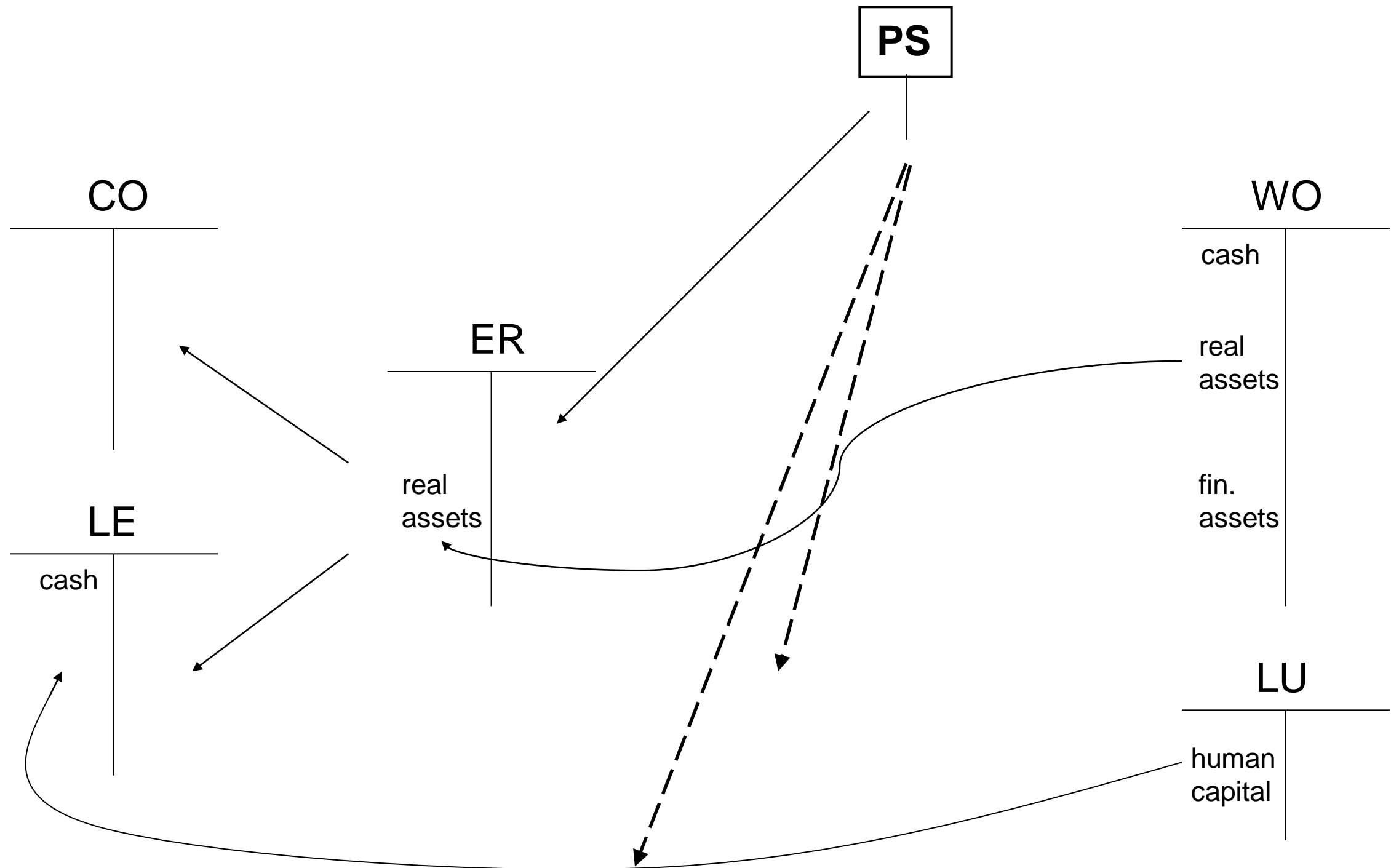
## The Chinese Model of Development in a Globalized World

1. o o As a **socialist** economy, China has been successful through its efficient planning authorities, state-owned enterprises and foreign investments.
2. o o Schumpeter's entrepreneur (*Unternehmer*) owns an established firm and starts an important innovation, which leads to "creative destruction" of the *Wirte*.
3. o o Party cells in every institution are a means of ideological control and a source of corruption in all communist-ruled countries.
4. o o Deng Xiaoping established a "Socialist Market Economy" coordinated through planning and markets – plus the *guanxi* network of Communist Party secretaries.
5. o o Successful economic development needs three agents: the status-quo user of the resources, the innovative entrepreneur, and the intermediary, who enables the resource transfer to new enterprises.
7. o o Chinese foreign exchange policies have always overvalued its currency.
8. o o China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets and to promote soft power.
9. o o Political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen business objectives, providing coherence beyond market, state and ideological control.

# Socialist economics

- Central planning
  - Lenin's model: First World War allocation via food stamps / *Lebensmittelkarten* / *Libreta*; industrialization
  - Problems: Flexibility, speed, innovation
- Markets: Prices close to or far from equilibrium: China-Cuba
  - Easier for consumption goods than for real estate and capital goods
  - 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

# ***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 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
  - 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
  - Friendship/kinship based on a social, individual, emotional, committing, and long-term relationship
  - Exchange or secure favours 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 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 favours 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*

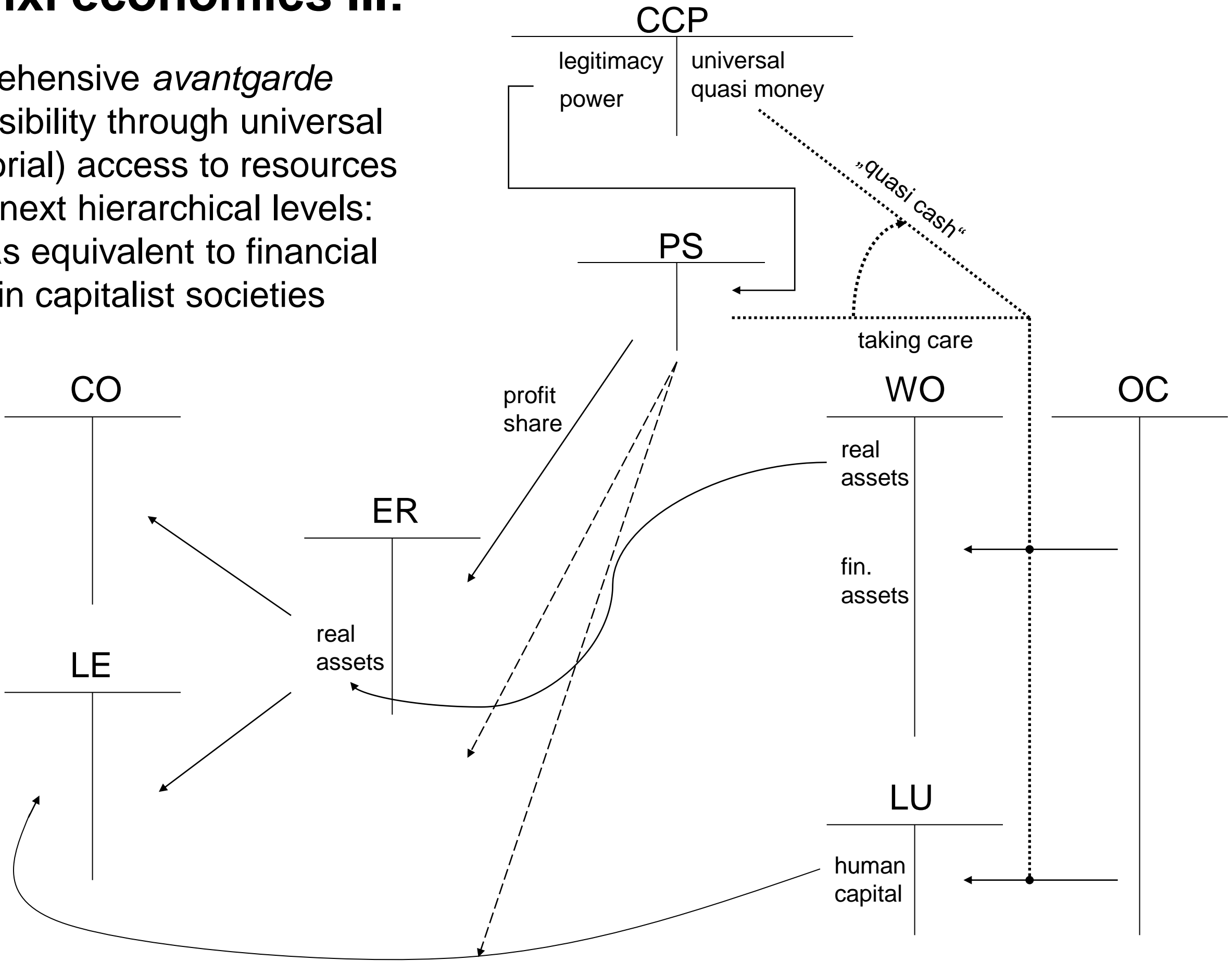
I will return a *zhàng*

- Every “guanxi debt” / “guanxi contract” is interest-bearing
- Considered ignorant/disrespectful repaying a “guanxi loan” immediately
- Would give the impression: 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



# 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



# 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 favours 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 and party 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 for Party members
- Reduces transaction costs
- Reduces information costs
- Reduces procurement costs
- Reduces bureaucracy costs
- Provides local cluster coherence
- Comparative advantage against market competitors allowing more risky business ventures

- Most important cons

- Prone to corruption
- Market and formal administrative relations undermined
- CCP authoritarianism

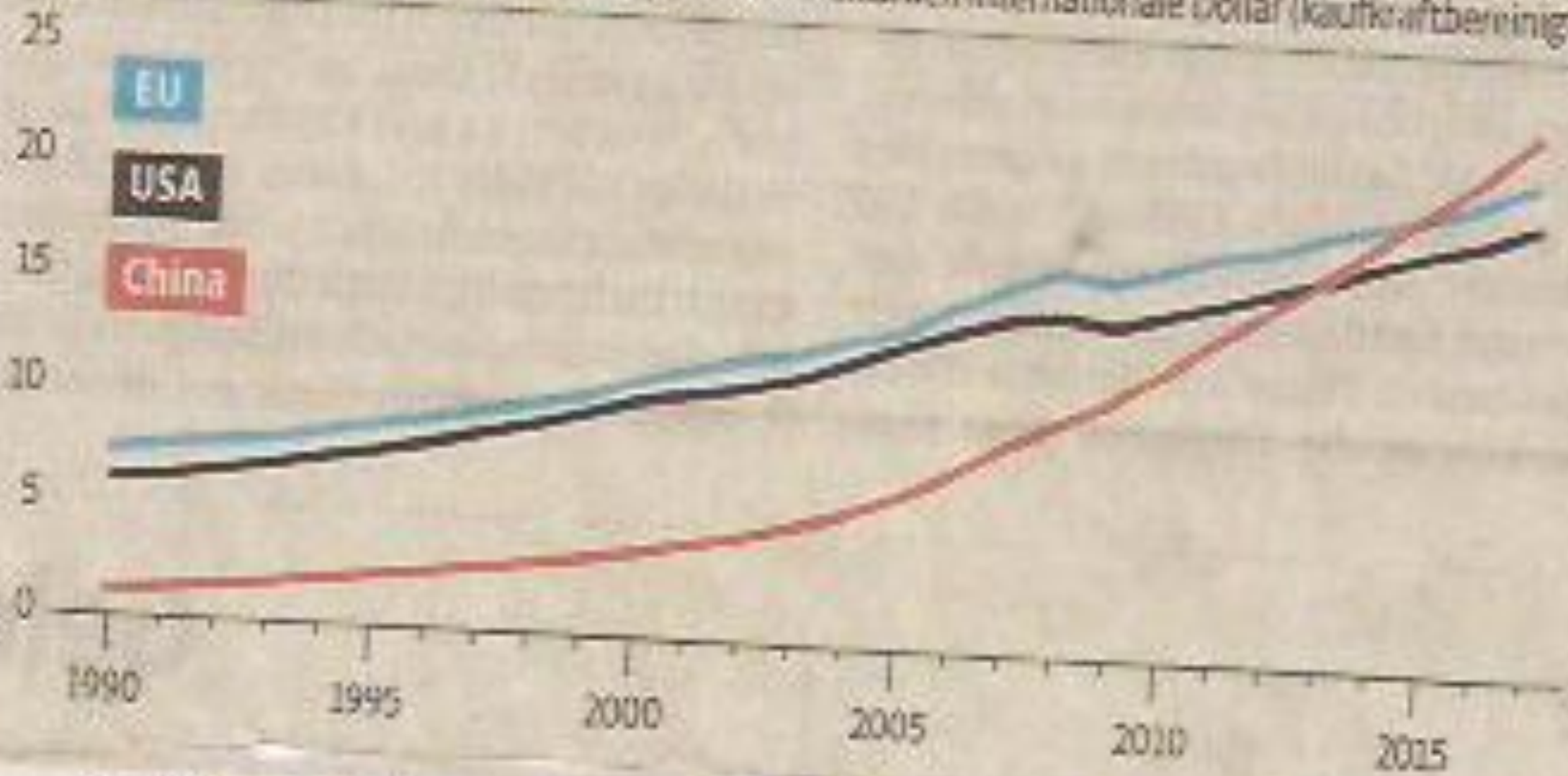
- Official arguments:

- 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 too much about it!



# Chinas Aufstieg

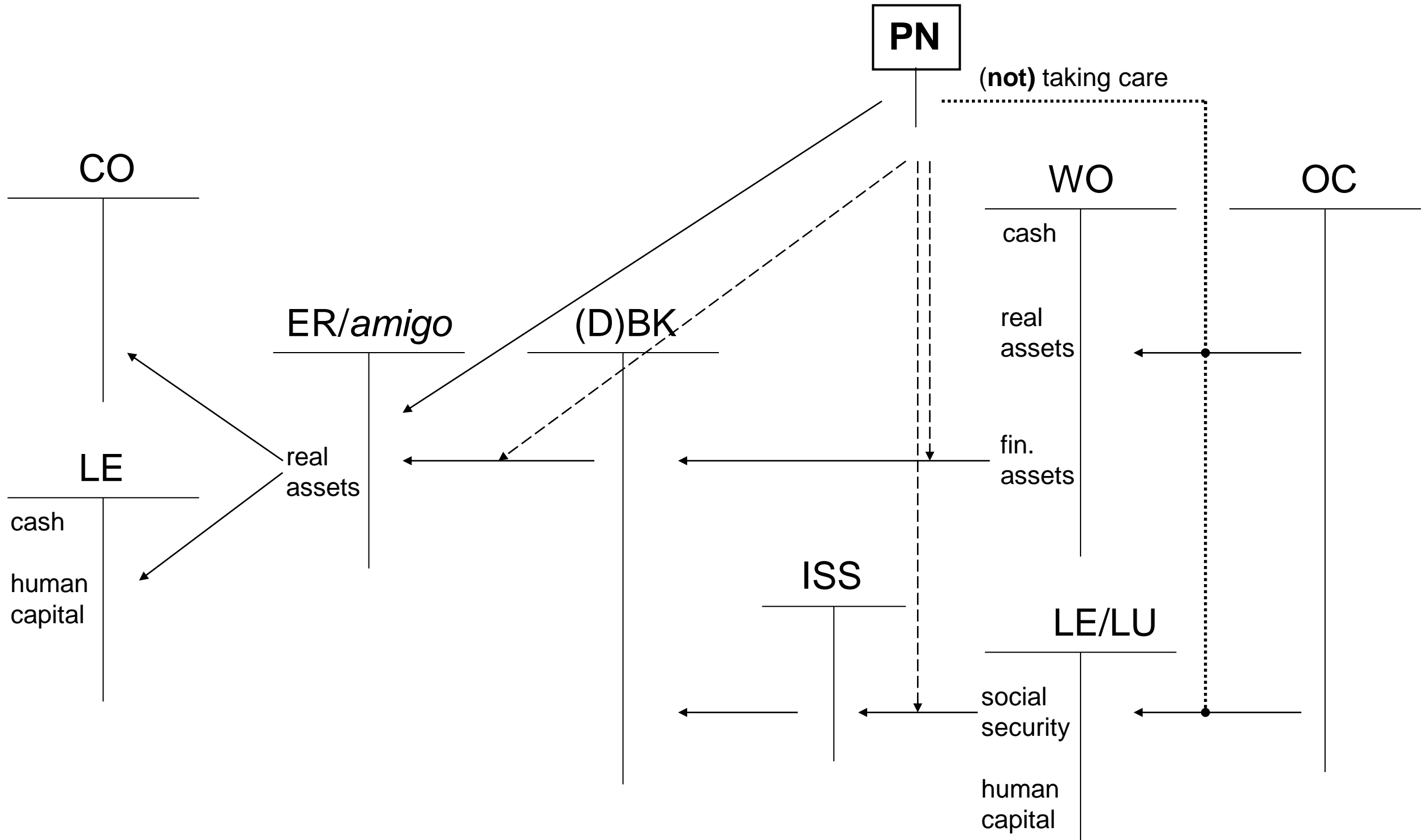
Bruttoinlandsprodukt in Milliarden internationale Dollar (kaufkraftbereinigt)



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

# Guanxi economics IV everywhere:

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



## The Chinese Model of Development in a Globalized World

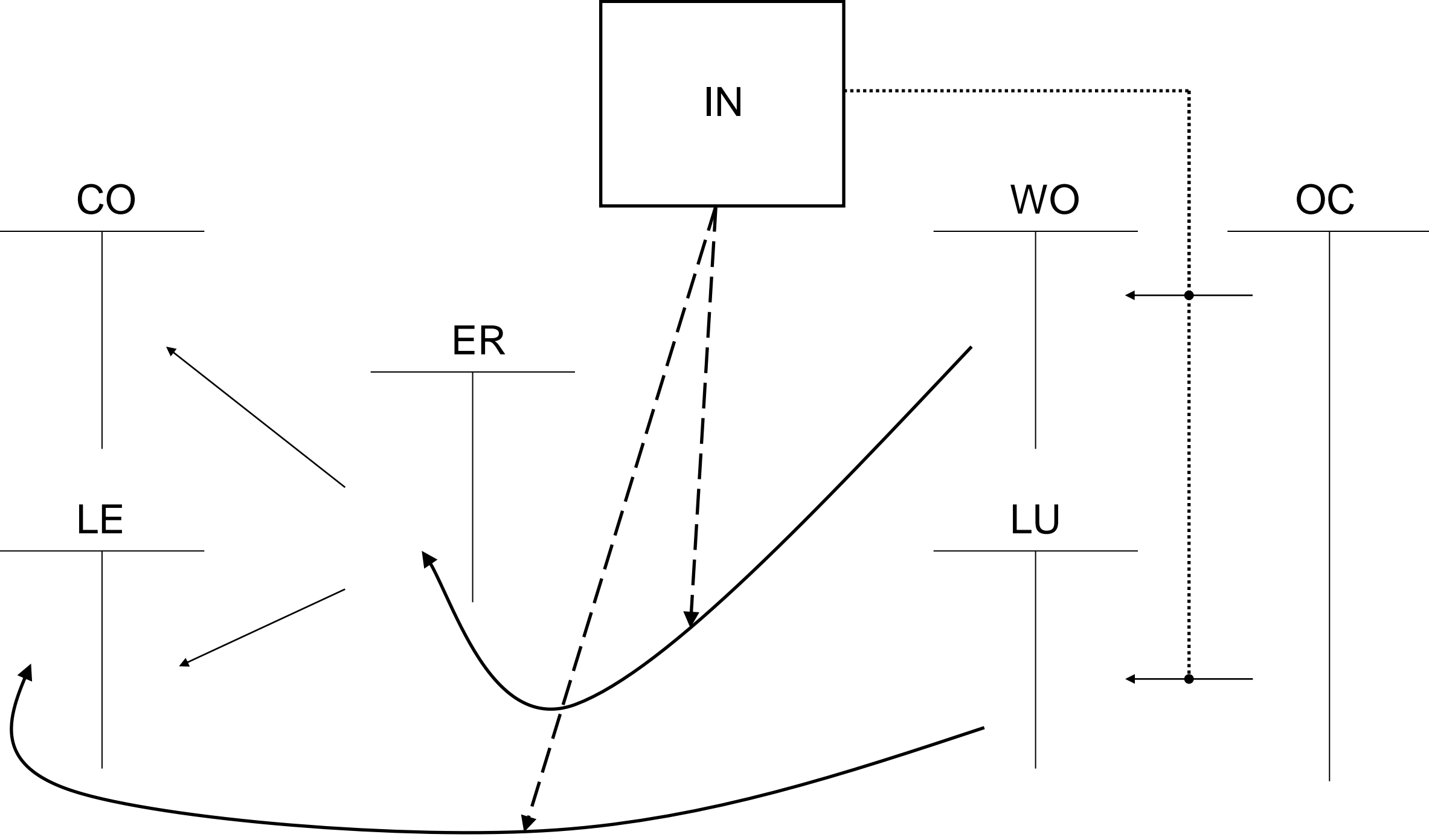
1. o o As a socialist economy, China has been successful through its efficient planning authorities, state-owned enterprises and foreign investments.
2. o o Schumpeter's entrepreneur (*Unternehmer*) owns an established firm and starts an important innovation, which leads to "creative destruction" of the *Wirt*.
3. o o Party cells in every institution are a means of ideological control and a source of corruption in all communist-ruled countries.
4. o o Deng Xiaoping established a "Socialist Market Economy" coordinated through planning and markets – plus the *guanxi* network of Communist Party secretaries.
5. o o Successful economic development needs three agents: the status-quo user of the resources, the innovative entrepreneur, and the intermediary, who enables the resource transfer to new enterprises.
7. o o Chinese foreign exchange policies have always overvalued its currency.
8. o o China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets and to promote soft power.
9. o o Political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen business objectives, providing coherence beyond market, state and ideological control.

# Party Economics

- 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“
    - Traffic rules respected - or not
    - Big data – “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 an actor / sphere *sui generis* aside market and state? “Corruption“ is a poor concept.

# Summary I:

Institutionalized **secondary** distribution of capital  
Chinese experience with pressure on the *Wirte*: Great Leap Forward and  
Cultural Revolution – both failed to generate development

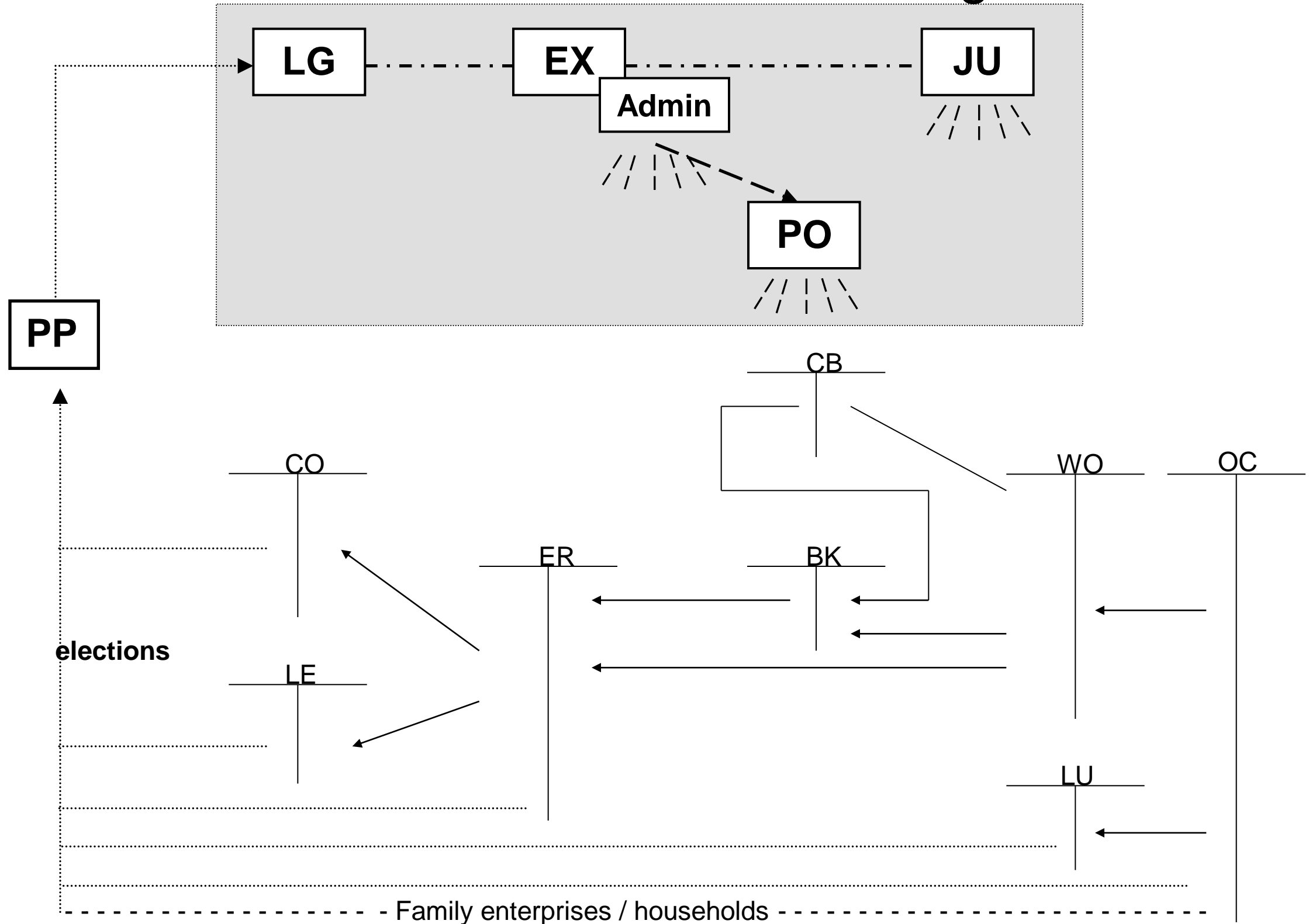


# Legalism as a necessary ingredient

- 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
  - 法 *Fa (Law)* is the term for the “hard” power for enforcing the right to use the resources.
  - Confucianist “soft” power, *Guanxi* practice and *Fa* “hard” executive power combined – that seems to be the Chinese growth model today.

# Summary II:

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



## The Chinese Model of Development in a Globalized World

1. o o As a socialist economy, China has been successful through its efficient planning authorities, state-owned enterprises and foreign investments.
2. o o Schumpeter's entrepreneur (*Unternehmer*) owns an established firm and starts an important innovation, which leads to "creative destruction" of the *Wirte*.
3. o o Party cells in every institution are a means of ideological control and a source of corruption in all communist-ruled countries.
4. o o Deng Xiaoping established a "Socialist Market Economy" coordinated through planning and markets – plus the *guanxi* network of Communist Party secretaries.
5. o o Successful economic development needs three agents: the status-quo user of the resources, the innovative entrepreneur, and the intermediary, who enables the resource transfer to new enterprises.
7. o x Chinese foreign exchange policies have always overvalued its currency.
8. o o China's "Belt and Road Initiative (BRI)" is a clever strategy to gain export markets and to promote soft power.
9. o o Political parties are vehicles for the (s)election of persons who are to decide on rules for everyone. In authoritarian regimes, they can also strengthen business objectives, providing coherence beyond market, state and ideological control.



# Global 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 debt trap, hoping for *growth cum debt* by assuming growth of investment by imports  $I = S + M - X$
- Internationalization of the Renminbi / Yuan
- Treaties and agreements on foreign exchange swaps, trade, investment and projects with many countries and groups
- Inequality: Gini Index 1983: 0.283; 2008: 0.491; 2012: 0.60 (OECD: 0.24-0.36)
- “Made in China 2025“: High-tec; Cyber security;
- 2021: “Moderately prosperous society“
- 2049: „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 (Pireus, 16+1, transport lines, etc.), Latin America (oil, canal project, ...)
- BRICS – Bank, IMF/WB and UN reforms, North Korea
- Promotion of business champions abroad and internal protectionism
- Soft power, but also „“Sharp Power“ (Economist)
  - Confucius Institutes within universities
  - Hiring of spies for intelligence services
  - TV and Radio Stations
  - “Avoid critical comments“ by partner countries, businesses, media, etc.
- Military build-up (China South Sea, Africa,
- Napoleon: “China is a sleeping giant. Let him sleep. When he wakes up, he will move the world.“ (SPIEGEL; 11.11.17, p. 22)
-

# 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 and of Red Guards' engagement ?? Still with the princelings ??
- “Trouvaille of history“: Chinese bonanza

# 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

I - investment

IM - imports

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

PO -- policies

PP – political party/ies

PS – party secretary

S - saving/s

ST – state (as fiscal entity)

WO – wealth owner

X - exports

# Selected Literature

- Davies, Howard et al. (1995): The Benefits of “Guanxi”... in: Industrial Marketing Management, Vol. 24, No. 3, 207-214
- Fang, Jianming 方建明 (1994): Moderne Lehre von der boshafte Tücke und der dickhäutigen Schamlosigkeit 白话厚黑学.
- Hodgson, Geoffrey M. (2004): The Evolution of Institutional Economics.
- Huang, Guangguo 黃光國 (1988): Konfuzianismus und die Modernisierung Ostasiens 儒家思想與東亞現代化. Taipei
- Jin, Yaoji 金耀基 (1990): Konfuzianische Ethik und Wirtschaftsentwicklung 儒家倫理與經濟發展.
- Kornai, János (1995): Das sozialistische System.
- Lebowitz, Michael A. (2000): Kornai and the Vanguard Mode of Production; in: Cambridge Journal of Economics, Vol. 24, No. 3, 377-392
- Nitsch, Manfred (1999): Vom Nutzen des monetär-keynesianischen Ansatzes für Entwicklungstheorie und -politik; in: Schubert, R. (ed.): Neue Wachstums- und Außenhandelstheorie. Berlin, 183-214
- Nitsch, M. / Diebel, F. (2008): Guanxi Economics: Confucius Meets Lenin, Keynes, and Schumpeter in Contemporary China; in: Intervention, Vol. 5, No. 2, 77-104
- Riese, Hajo (1995): Geld: Das letzte Rätsel der Nationalökonomie; in: Schelkle, W./Nitsch, M. (eds): Rätsel Geld, Marburg, 45-62
- Wen Zongyi 文宗一 (1982): Wohltaten vergelten und Rache nehmen: Analyse von Tauschhandlungen 报恩于复仇: 交换行为的分析.
- White, Lynn T. III. (1998): Unstately Power: Local Causes of China's Economic Reform.
- Yang, Mayfair Mei-hui (1994): Gifts, Favors, and Banquets. New York

Thank you

Manfred Nitsch

[manfred.nitsch@t-online.de](mailto:manfred.nitsch@t-online.de)