

**China is back again.
But will it move forward to
become a high-income country?**

Glauco Arbix



Russia

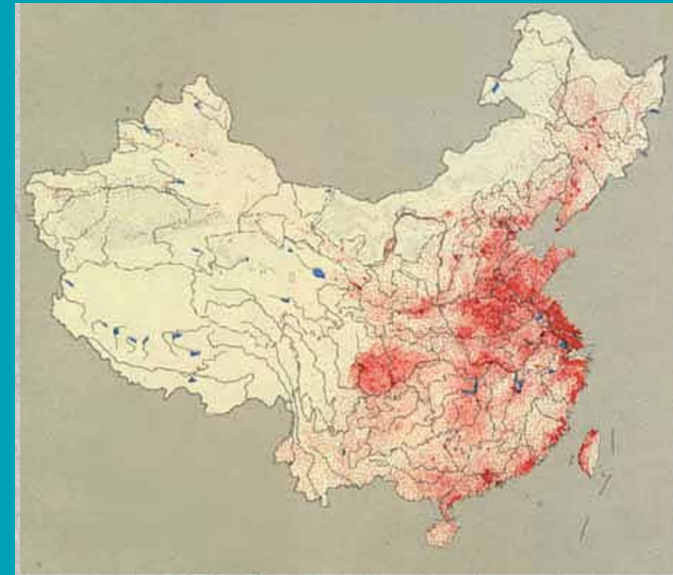
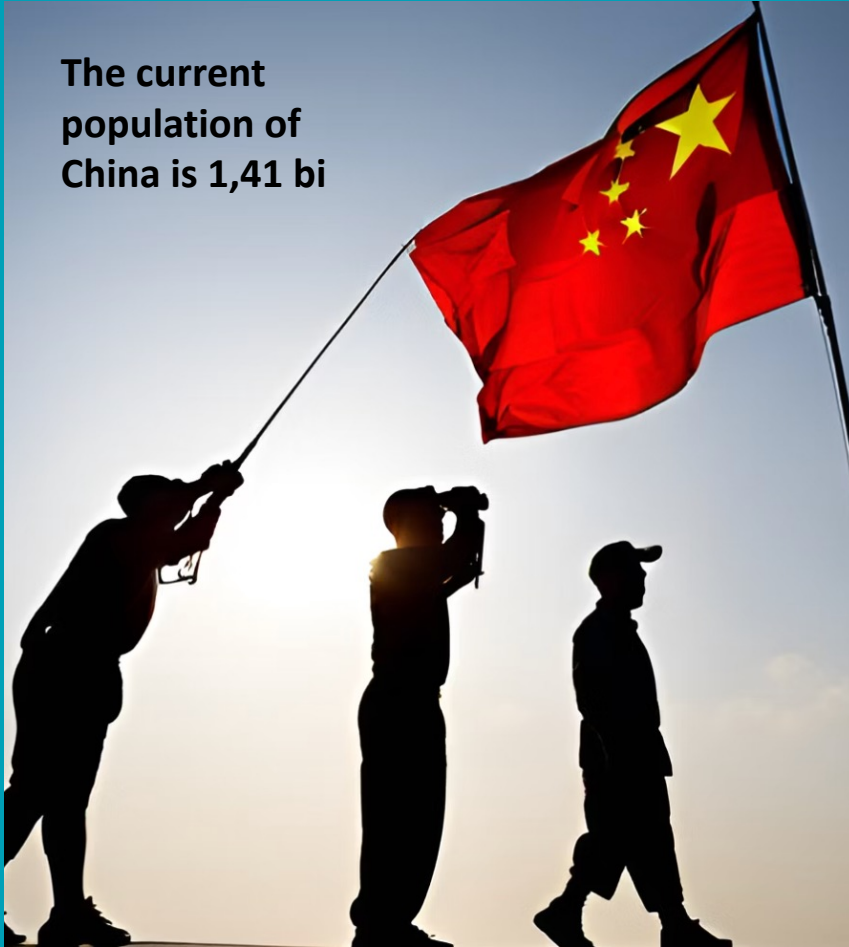
Korea

India

Taiwan

Philippines

The current population of China is 1,41 bi



Distribution and density of China's population. One tiny dot indicates 50,000 people (UN, 2022)

Industrial China



- Western Development Region
- North-East Old Industries
- Central Emerging Region
- Eastern Coastal Region

UN, 2022



Western skepticism about China's future

- On June 23, 1989, the Wall Street Journal predicted what the global economy would look like 25 years hence
- WSJ selected the countries that would be growth leaders and those it saw as future growth laggards
- On the former list were Bangladesh, Thailand, and Zimbabwe. On the latter list was China, which, as the newspaper prognosticated, would fail to shake off “the stultifying bureaucracy of hard-line communism”

Most Western analysts, especially their more orthodox economists, bet that the Chinese model would not work. The proof, according to them, would come with time. They are still waiting today.

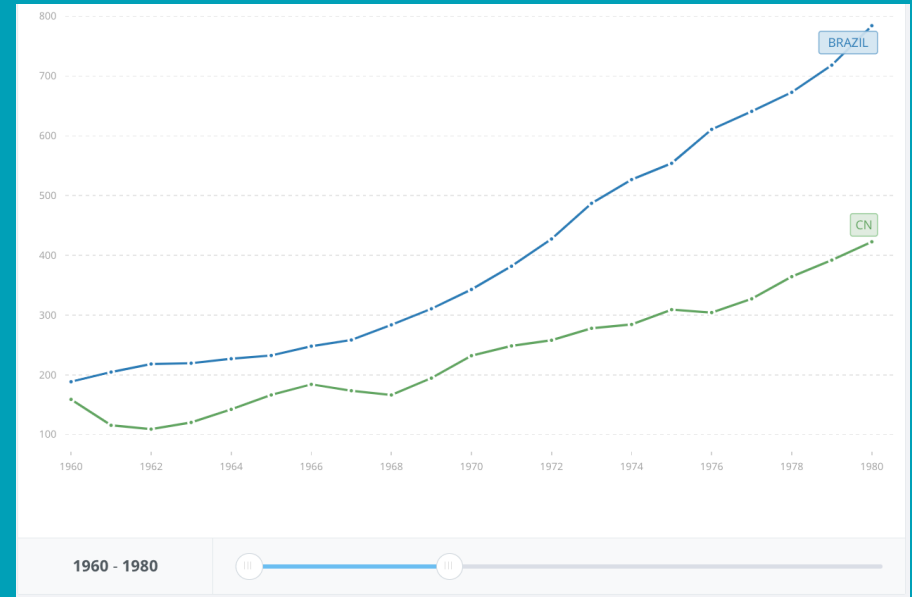
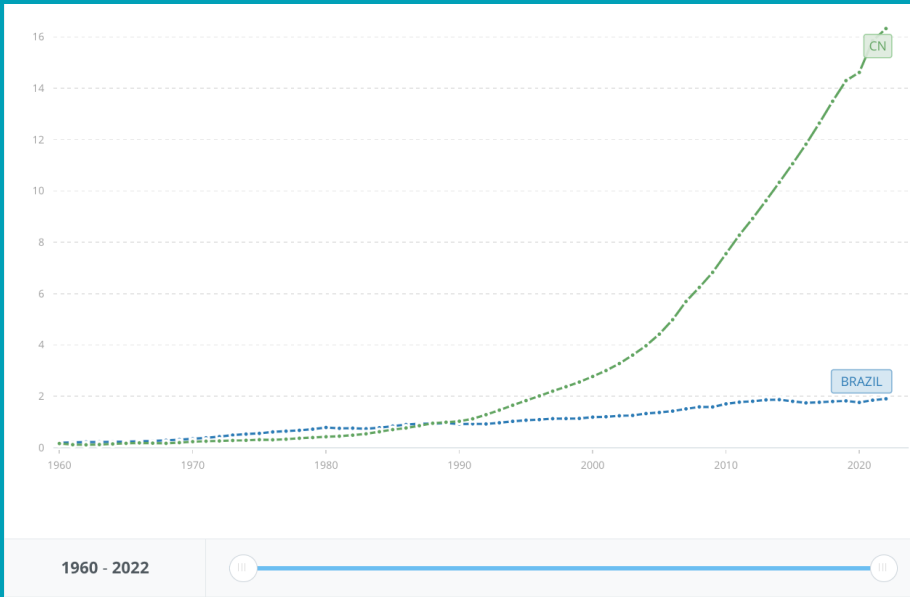
NYT, Dec 2018

When Deng Xiaoping launched China's strategy of reform and opening the economy in 1978, analysts in the West had their doubts. In their view, a vibrant market economy was fundamentally incompatible with China's authoritarian political system

Actually, China did not have to adopt Western-style liberal democracy to catch up with the most advanced countries

China-Brazil Growth (GDP, 1960-1980-2022)

For more than 40 years, China has maintained high growth



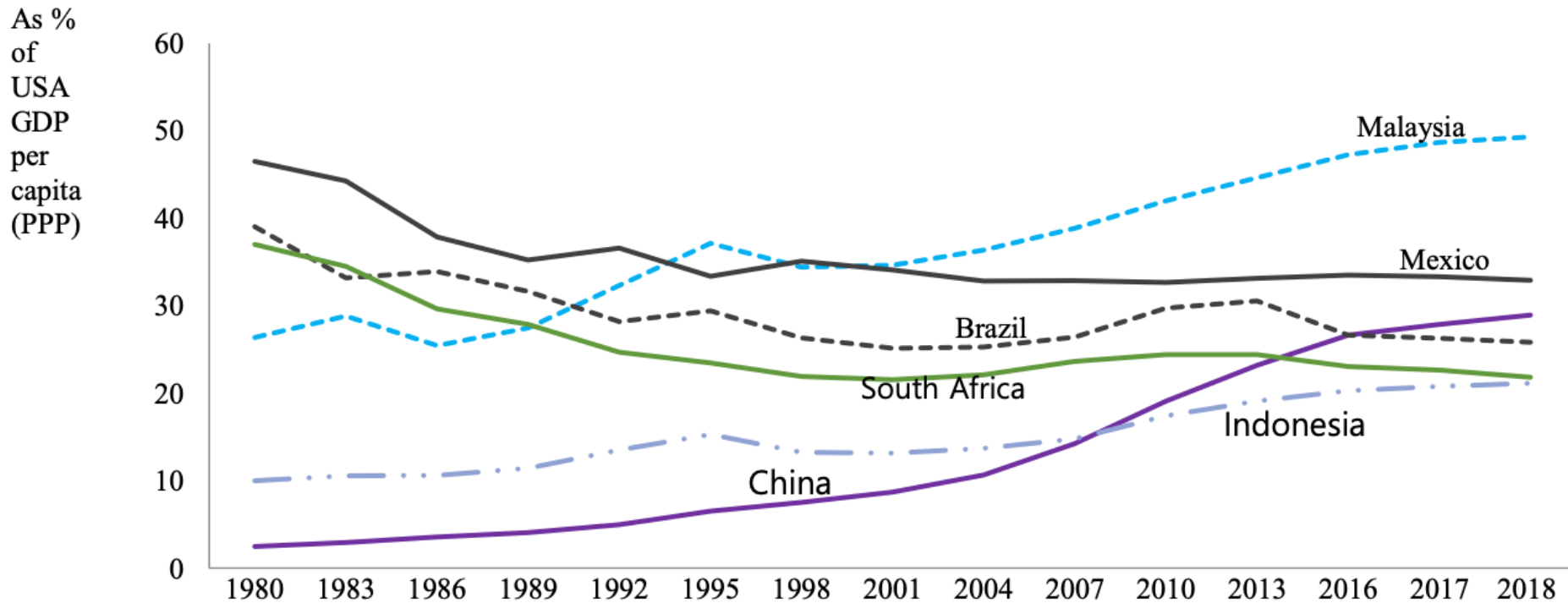
Current US dollars - WB, 2023

China attracted foreign investment, technology and embraced global markets

- **Deng Xiaping allowed foreign companies to set up factories in the newly created special economic zones**
- **Inflows of foreign direct investment, which had averaged only 0.7% of GDP (1980s), surged to 4.2% of GDP during the 1990s and 2000s. China's share of world manufacturing exports grew from 2.3% in 1991 to 18.8% in 2013**

After Deng, China has opened a new chapter after a long period of closed economy

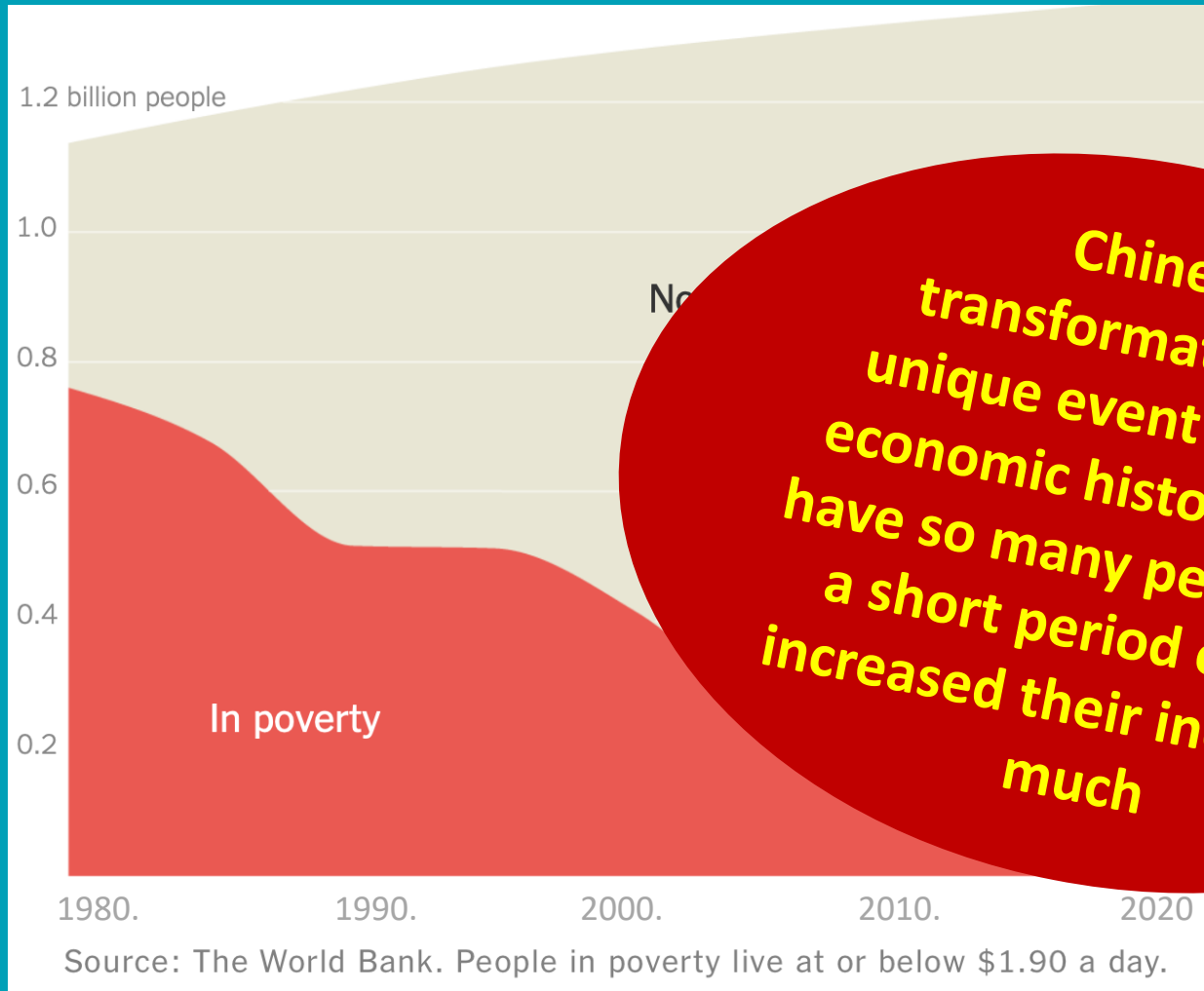
Per capita Income as % of the US (selected countries)



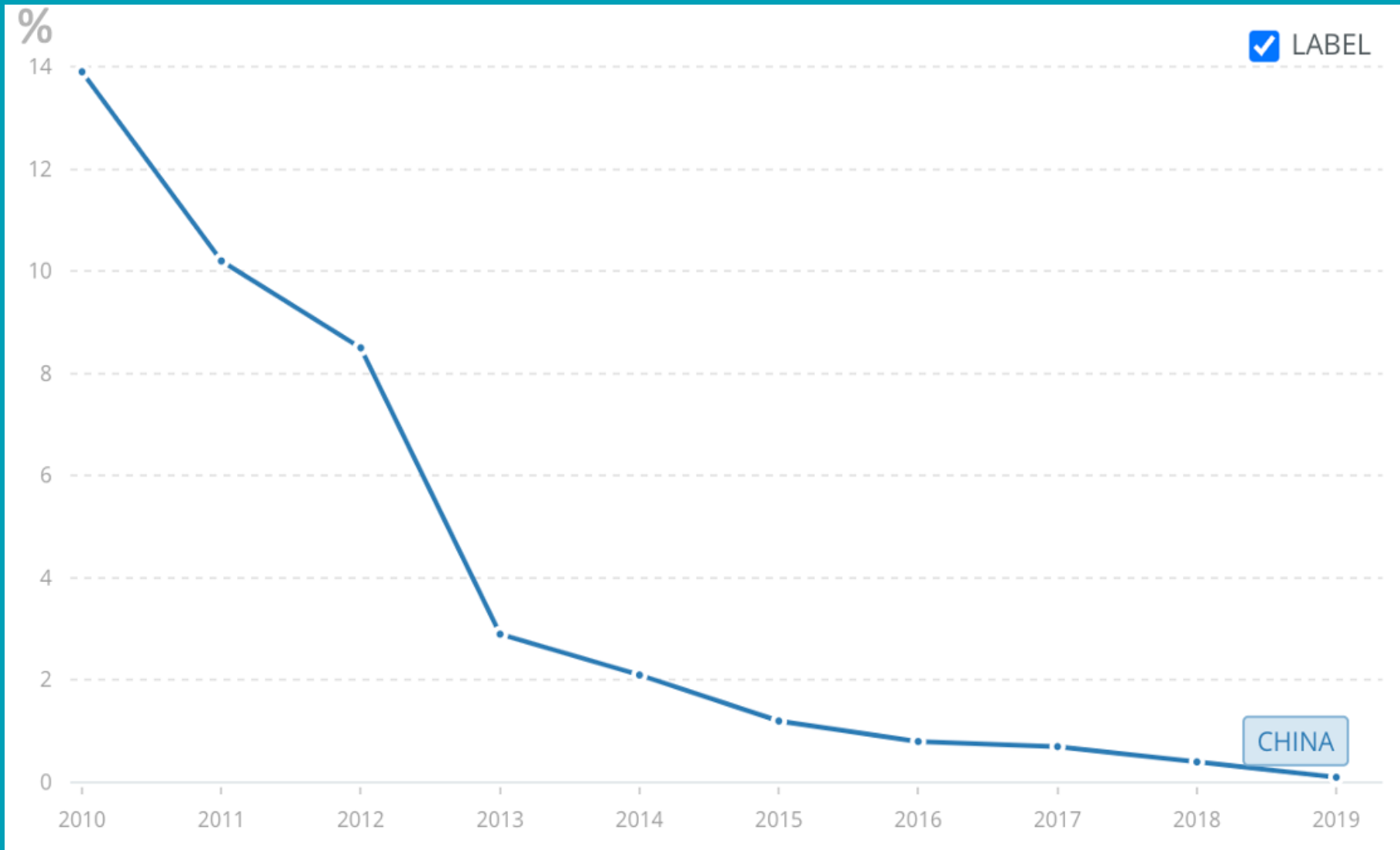
Source: Lee, K. (2022). PPP-based GDP per capita based on IMF database

China: the population living under the poverty line had decreased from more than 50% in 1980 to less than 10% in 2001

Over the past 40 years, around 800 million Chinese have moved out of poverty (\$1.90 a day)



In 2020, China eradicated absolute poverty



WB, 2022. Poverty headcount ratio at \$2.15 a day (% of population)

Middle-Class Size in BRICS economies

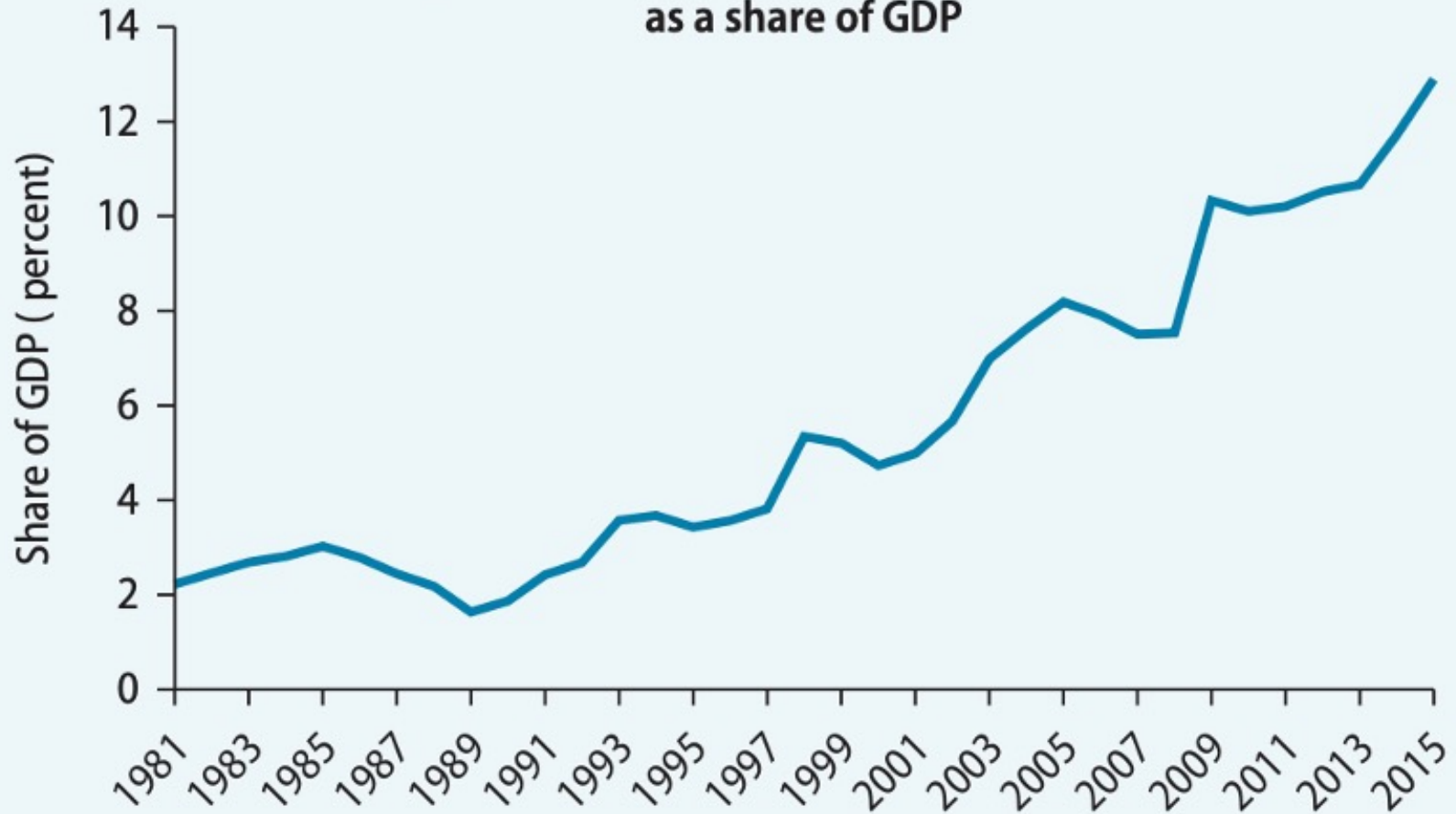
Economy	Share of Total Population in 2000 (%)	Share of Total Population in 2018 (%)	Change (%)
China	3.1	50.8	47.7
Russia	28.2	71.5	43.3
Brazil	30.3	51.4	21.1
South Africa	15.1	22.5	7.4
India	1.2	5.7	4.5

Source: World Bank (PovcalNet)

In 2000, the Chinese middle class represented 3%. In 2021 55%, around 700 million

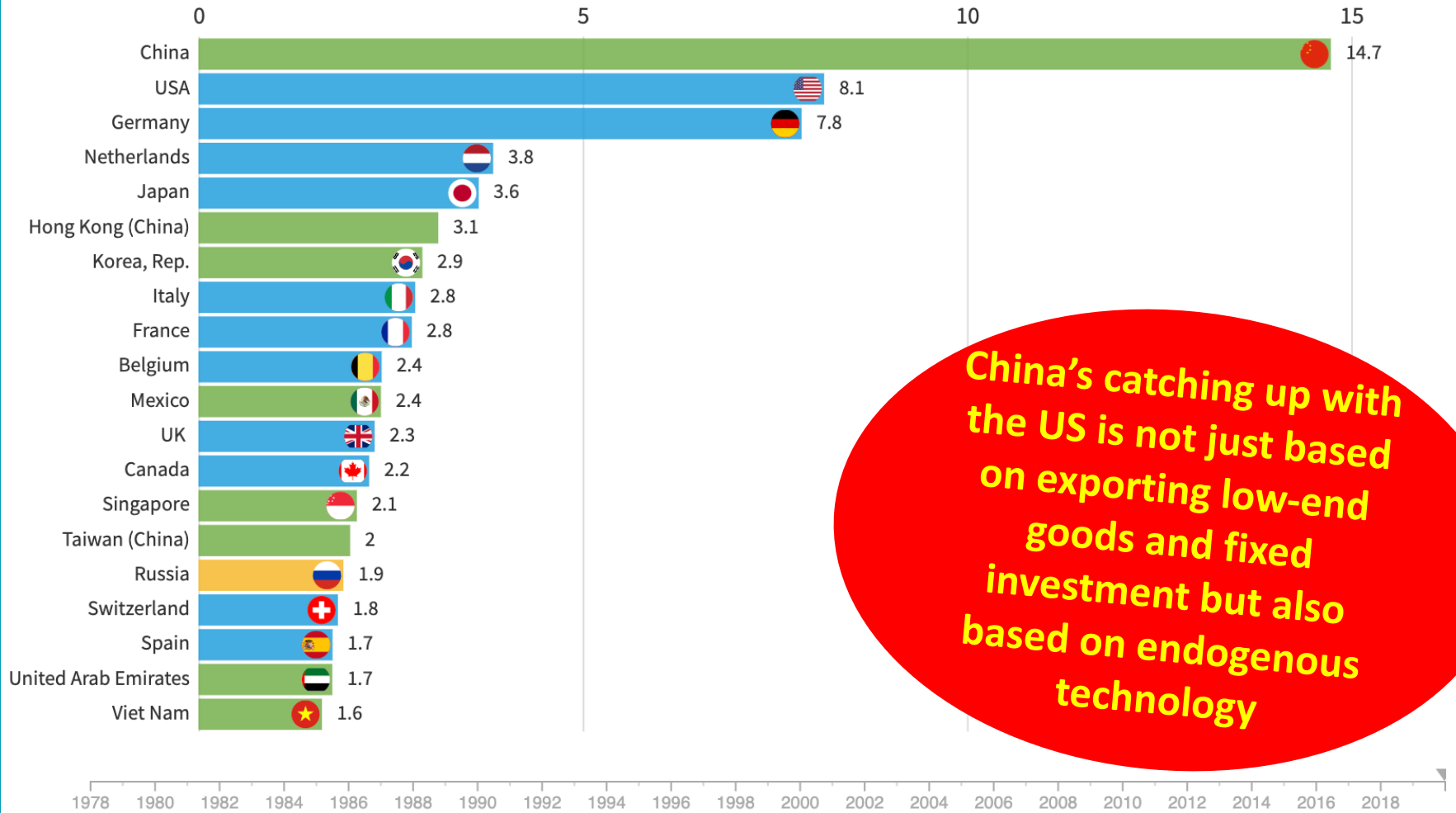
Infrastructure Investment

Total gross fixed capital formation in infrastructure,
as a share of GDP



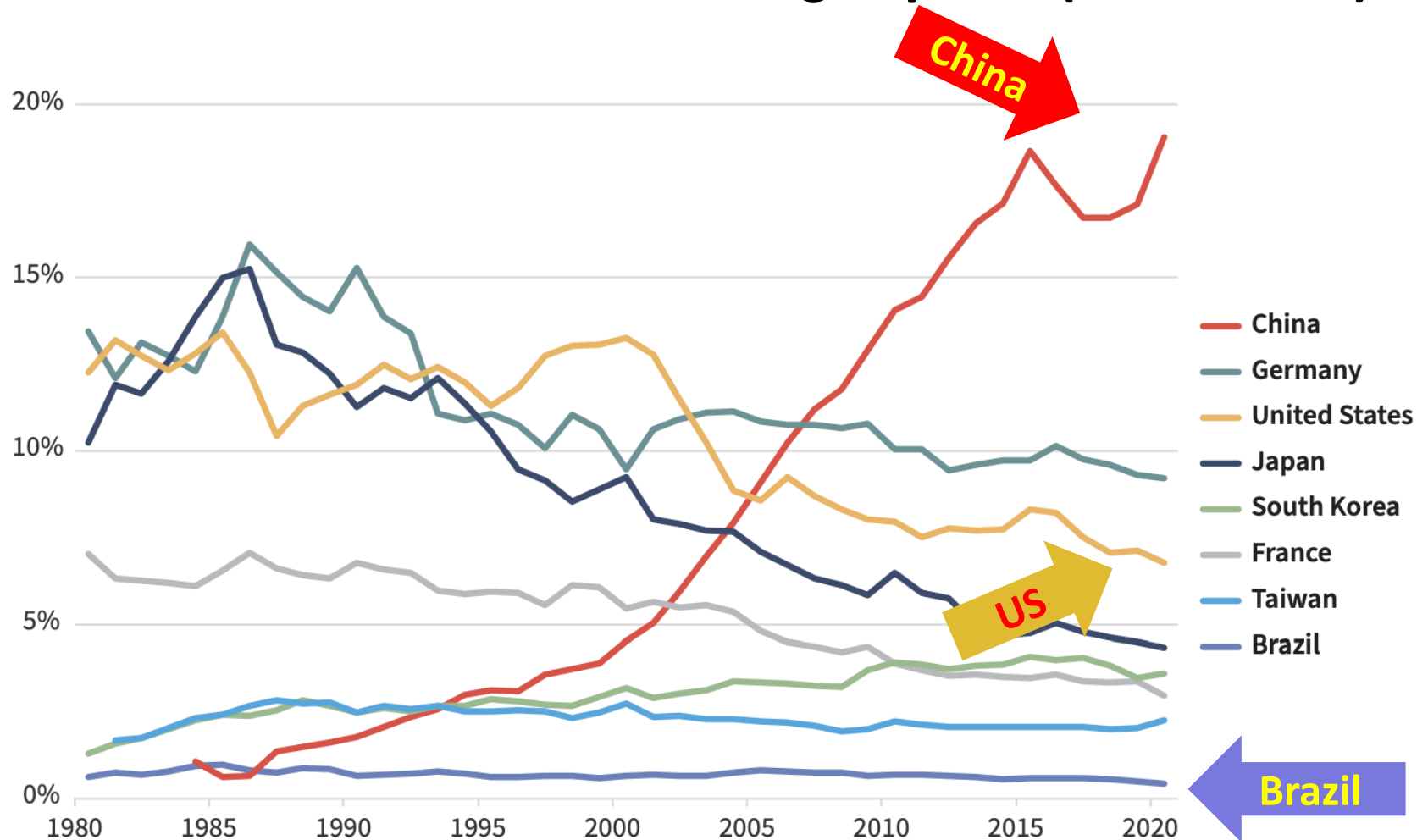
Share of Global Exports of Goods (1978-2020)

Category ■ Developed ■ Developing



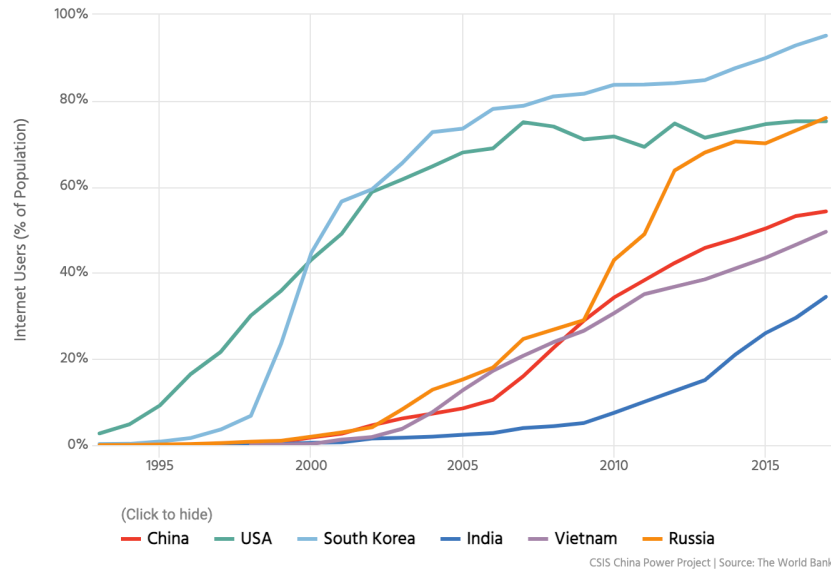
China's catching up with the US is not just based on exporting low-end goods and fixed investment but also based on endogenous technology

Share of World Manufacturing Exports (1980-2020)

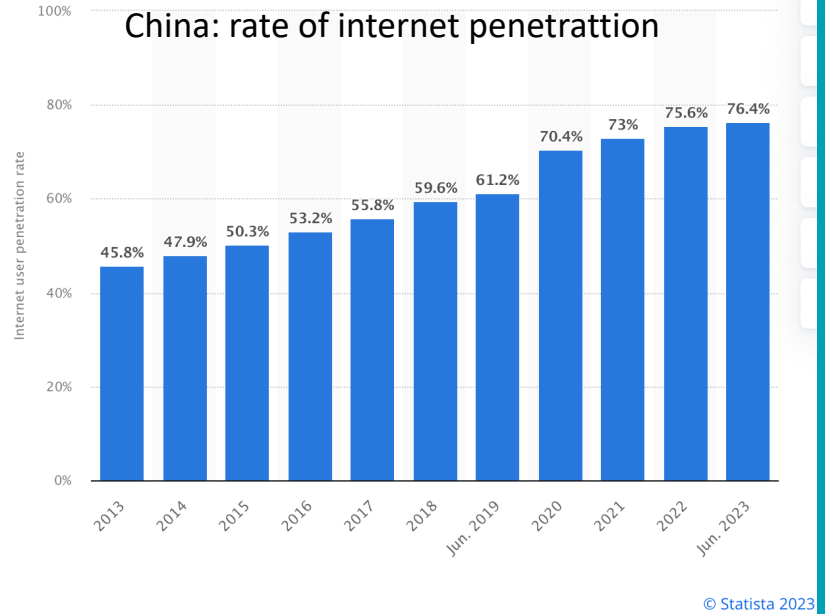


Source: "World Bank, Manufacturing exports; Taiwan Ministry of Finance, exports," CEIC, <https://www.ceicdata.com/en>.

Rate of Internet Penetration for Select Countries



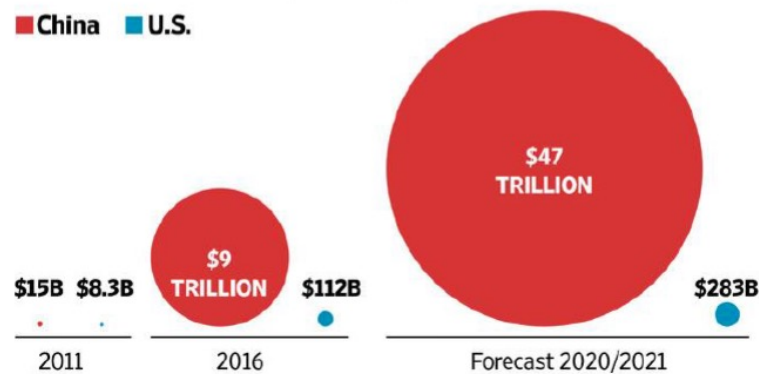
China: rate of internet penetration



No Contest

When it comes to mobile payments, China dwarfs the U.S.

■ China ■ U.S.

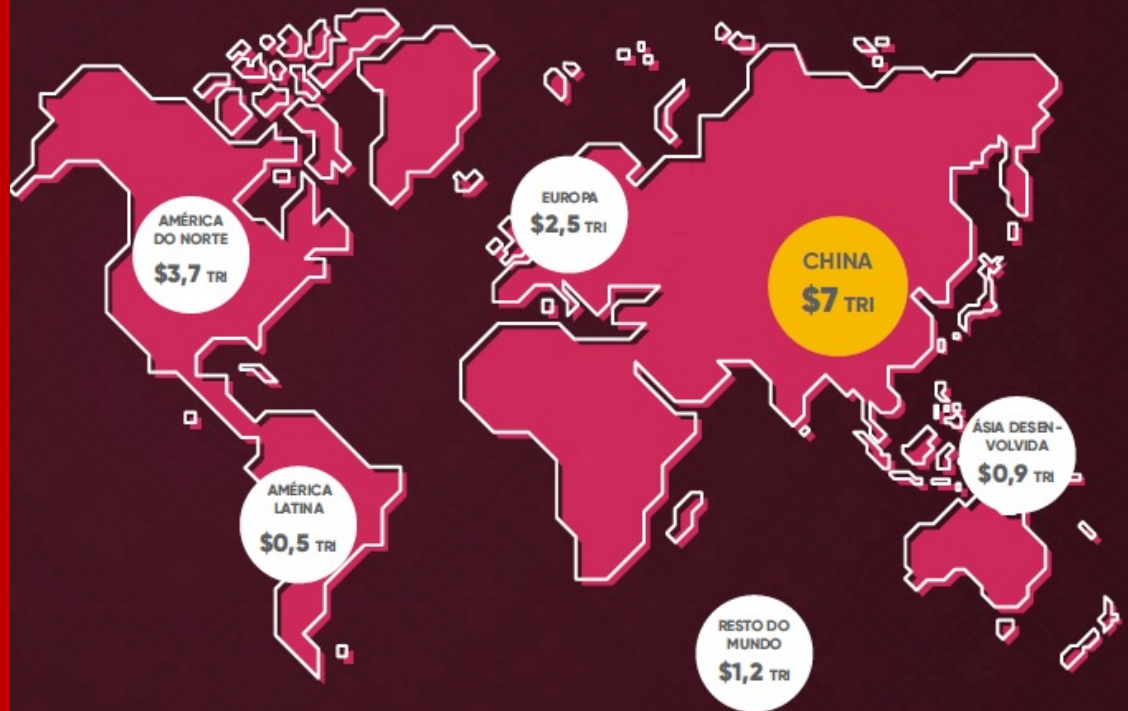


Note: Forecast for China is 2020, for U.S. is 2021.
Source: iResearch (China); Forrester (U.S.)

THE WALL STREET JOURNAL.



By 2030, global investment in AI is expected to reach US\$15.8 trillion. Of this total, in China alone, there will be 7 US\$ trillion, according to government plans

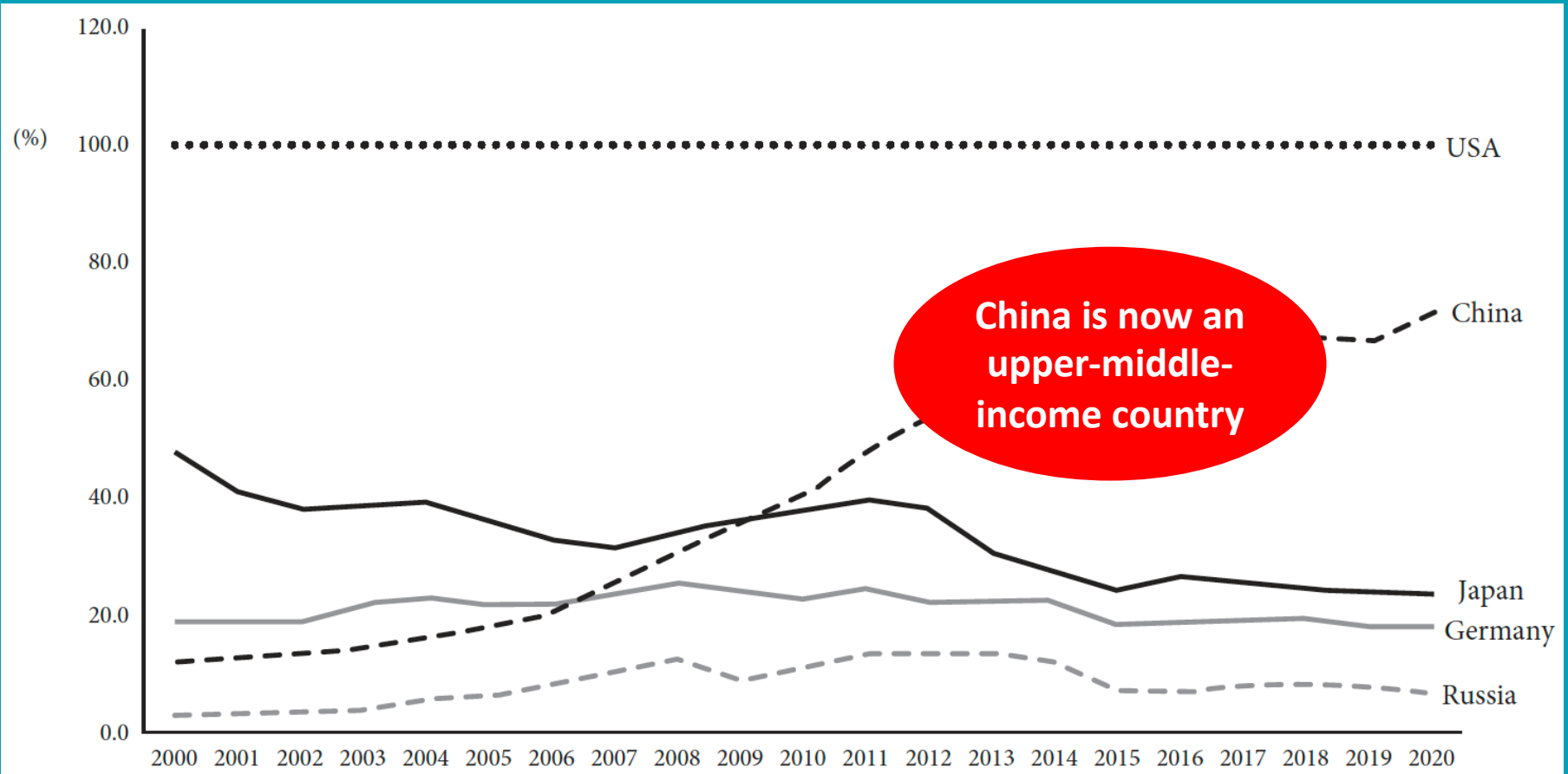


Fast and successful catch up

- When China opened its door and reformed its policies in December 1978, its per capita income was less than 10% of the world average*
- By the early 2010s, the GDP (Gross Domestic Production) per capita had reached over half of the world average, which made China an upper middle-income country
- By the late 2010s, the per capita income of China reached the 30% level of the US, which was a similar level to that of Brazil

* In terms of PPP (Purchasing power parity-adjusted dollars in 2000 prices)

Sizes of several economies relative to the US



Source: Lee, 2021, based on IMF database

**China is undertaking a monumental project to
rewrite the rules of global order**

Is it just a Chinese dream?

**Will the successful catch-up strategy enable
China to leapfrog and avoid the pitfalls of
stagnation as a middle-income country?**

Chinese official vision : China success at rapid modernization was due to its unique qualities

- **Those qualities include a unitary state with strong institutions, starting by a disciplined CP**
- **Under the CPP, those traits can guide society forward through “substantive” democracy that delivers results instead of the “formal” democracy of constitutional rule focused on individual rights, tolerance of a disorderly free civil society and electoral accountability.**

Western political ideas mask their origin with supposedly neutral principles. The era of universal values is over, and countries must accept that they speak only for ourselves.

With cutting-edge technology, China is poised to evolve a new kind of non-Western modernity that others, especially in the developing world, can admire

Historically, despite similar advances, many countries saw their economies stagnate, such as Brazil, Mexico, Thailand, Argentina. Few managed to escape, like Korea and Taiwan

There is an economic literature that characterizes this stagnation as a pitfall, known as the Middle-Income Trap (MIT)

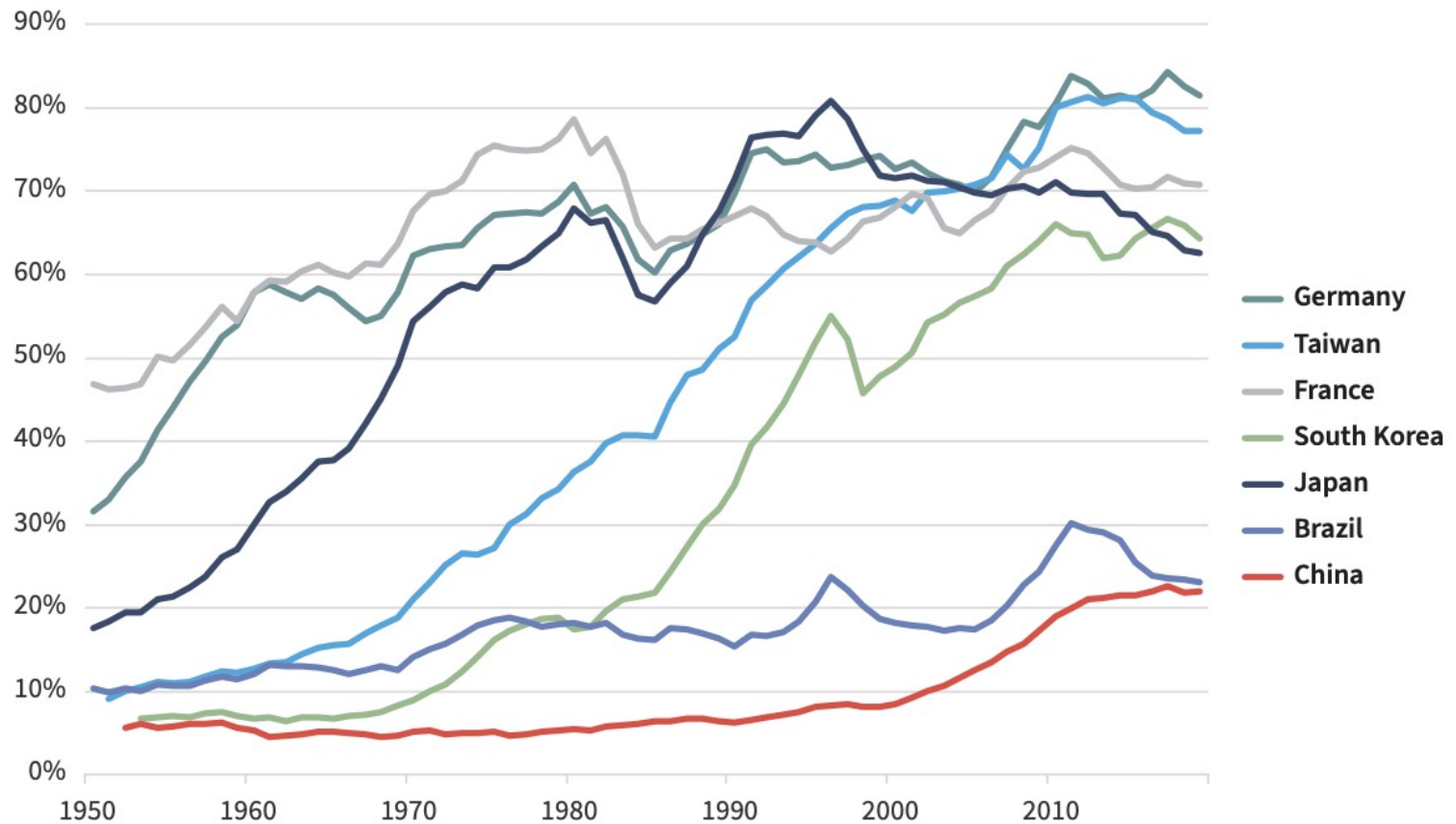
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Middle Income Trap

- MIT has risen as an important issue in the Chinese economy and is extensively discussed in the literature and inside the government
- World Bank defines the MIT as a situation in which a country's per capita GDP stays within the box of 20 percent to 40 percent of the US level for several decades

China has reached the 30% level of US per capita income, the middle point of the box range

GDP per capita Compared to the US (1950-2019)



Note: Based on purchasing power parity exchange rates.

Source: "Penn World Tables (10.0)," University of Groningen, <https://www.rug.nl/ggdc/productivity/pwt/?lang=en>; and "Expenditures-side real GDP at current PPPs: 2017 Prices," CEIC, <https://www.ceicdata.com/en>.

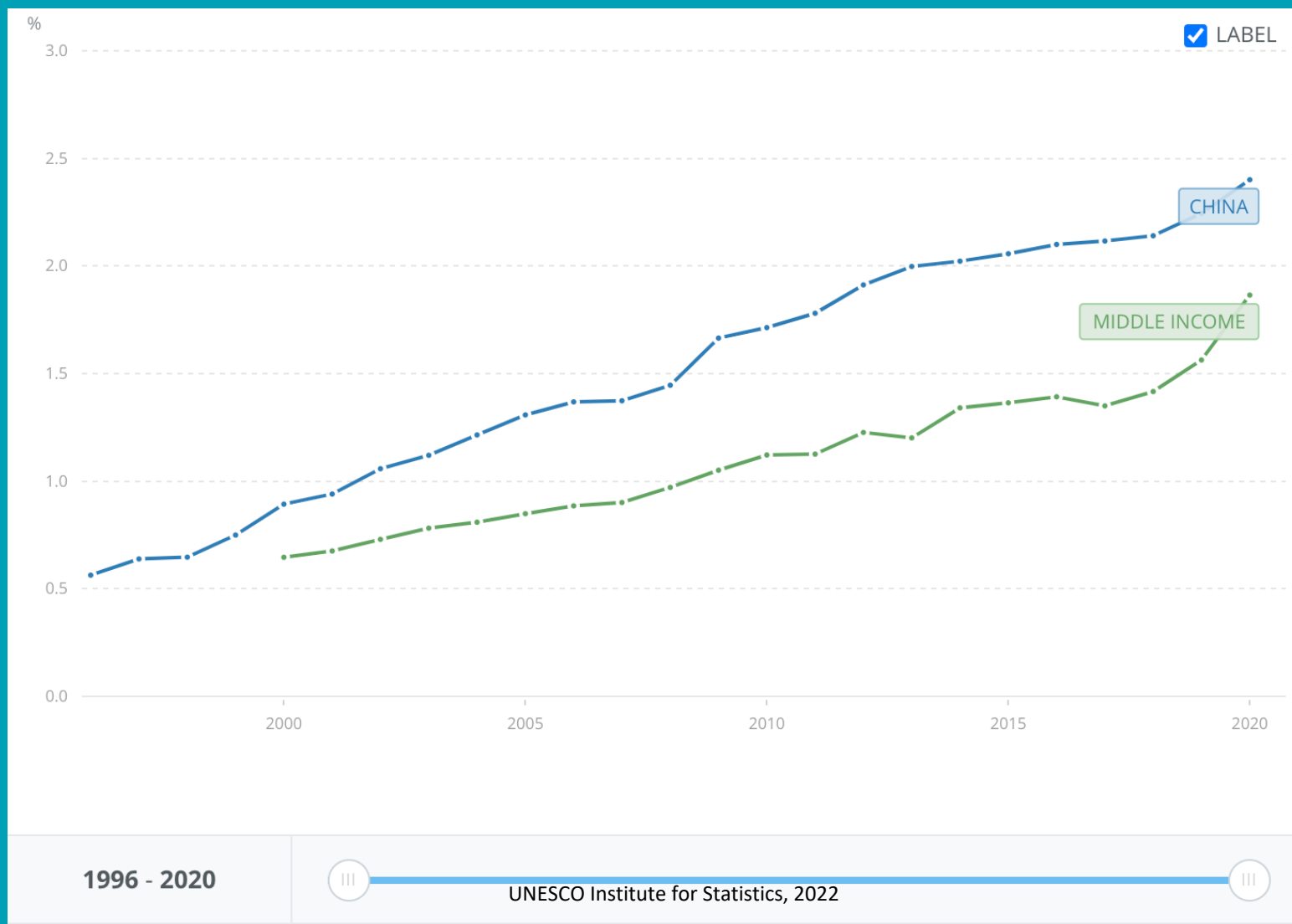
Center for Strategic and International Studies, 2022

China built conditions to escape MIT

- China has increasingly become innovative and thus differs from other middle-income countries. R&D spending to GDP is close to 2.5% – far above the average for upper-middle-income countries
- China has many successful big businesses. Thus, it differs from other middle-income countries, which have few globally competitive businesses in finance, energy, trading and in manufacturing

As the absorptive capacity of companies in China increases, changes and the rise of new generations of technologies could serve as a window of opportunity for leapfrogging.

R&D expenditure - China, Middle income (%)



1996 - 2020



UNESCO Institute for Statistics, 2022



Since 2016 China is 1st in the Ranking of Scientific Publications

Rank	Country or economy	Country or economy economic status	2006	2016	Average annual change (%)	2016 world total (%)	2016 cumulative world total (%)
-	World	na	1,567,422	2,295,608	3.9	na	na
1	China	Developing	189,760	426,165	8.4	18.6	18.6
2	United States	Developed	383,115	408,985	0.7	17.8	36.4
3	India	Developing	38,590	110,320	11.1	4.8	41.2
4	Germany	Developed	84,434	103,122	2.0	4.5	45.7
5	United Kingdom	Developed	88,061	97,527	1.0	4.3	50.0
6	Japan	Developed	110,503	96,536	-1.3	4.2	54.2
7	France	Developed	62,448	69,431	1.1	3.0	57.2
8	Italy	Developed	50,159	69,125	3.3	3.0	60.3
9	South Korea	Developed	36,747	63,063	5.5	2.8	63.0
10	Russia	Developing	29,369	59,134	7.2	2.6	65.6
11	Canada	Developed	49,259	57,356	1.5	2.5	68.1
12	Brazil	Developing	28,160	53,607	6.6	2.3	70.4
13	Spain	Developed	39,271	52,821	3.0	2.3	72.7



Total patents in USPTO (Patent)

Top six countries and BRICS

		2017	2018	2019	2020	2021	2022 [Sep]
1	USA	180,549	172,674	198,766	196,443	178,291	126,219
2	Japan	53,365	50,944	57,465	55,205	48,405	35,820
3	China	14,038	16,101	22,294	25,737	28,680	26,116
4	South Korea	23,539	22,764	24,743	24,587	22,120	17,153
5	Germany	17,356	16,273	18,701	17,907	15,334	11,446
6	Taiwan	12,603	11,618	12,412	12,805	11,675	8,792
21	India	1,045	1,036	1,218	1,179	1,058	832
27	Brazil	269	244	269	265	218	184
28	Russia	262	223	235	261	220	183
36	South Africa	136	129	149	131	101	81
	World	352,587	341,104	392,617	390,576	363,829	269,084

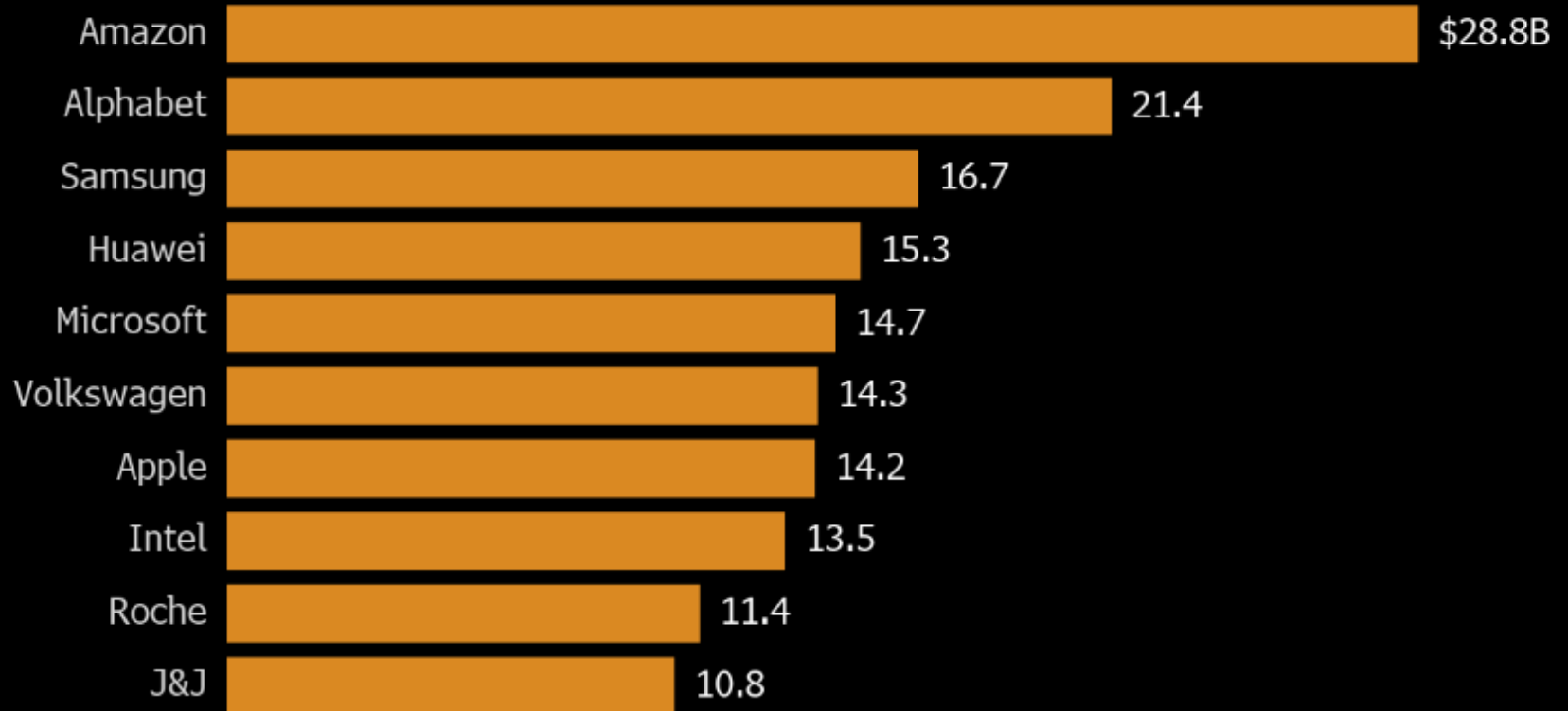
Of the 20 most valuable internet-based companies, most are Chinese and American

1. Apple 🇺🇸
2. Amazon 🇺🇸
3. Microsoft 🇺🇸
4. Google/Alphabet 🇺🇸
5. Facebook 🇺🇸
6. Alibaba 🇨🇳
7. Tencet 🇨🇳
8. Netflix 🇺🇸
9. Ant Financial 🇨🇳
10. Paypal 🇺🇸
11. Salesforce.com 🇺🇸
12. Booking Holdings 🇺🇸
13. ByteDance 🇨🇳
14. Uber 🇺🇸
15. Baidu 🇨🇳
16. Didi Chuxing 🇨🇳
17. JD.com 🇨🇳
18. Meituan-Diaping 🇨🇳
19. Xiaomi 🇨🇳
20. eBay 🇺🇸

Investment in Innovation

Amazon leads world in R&D spending, China's Huawei jumps to fourth

■ R&D Expenses 2018



Notes: Adjusted for one-time items and based on average exchange rates

Source: Bloomberg. Huawei filings

Bloomberg

Power in China

- China has 5 levels of government. The national administration, 31 province-level regions, 333 municipalities, 2,800 counties, and more than 40,000 townships. Within each jurisdiction, leaders enjoy autonomy over economic and social policymaking
- Leaders are appointed by their superiors. And the central government holds regulatory power over key economic resources
- The 5 layers, along with deputy positions, produce a bureaucracy with 10 different ranks of power and privilege.

The desire to reach higher positions creates incentives for local officials to reach goals such as promoting growth, attracting investment, preserving the environment and maintaining social stability.

Chinese Institutional Innovations

1. Township-village enterprises emerged on the fringes of central planning. They are companies controlled by local agents, which are public and private, or, neither public nor private
2. A system of contracts and prices (dual-track) persists, which makes the coexistence between the centralized State and local interests more friendly

Provinces are not just subordinates of the CCP. They are powerful stakeholders of China's political system

While Western democracies rely on mechanisms external to political leadership - such as the media, the legal system and opposition parties - to curb the opportunism of incumbent leaders, China relies on a different kind of power decentralization, one that exists along the hierarchies of the government.

This system leaves room for innovation and competition on the part of localities, while also allowing the central authority to monitor its subordinates and hold the country together

**Catching up and even outpacing the US economy
has become a real possibility**

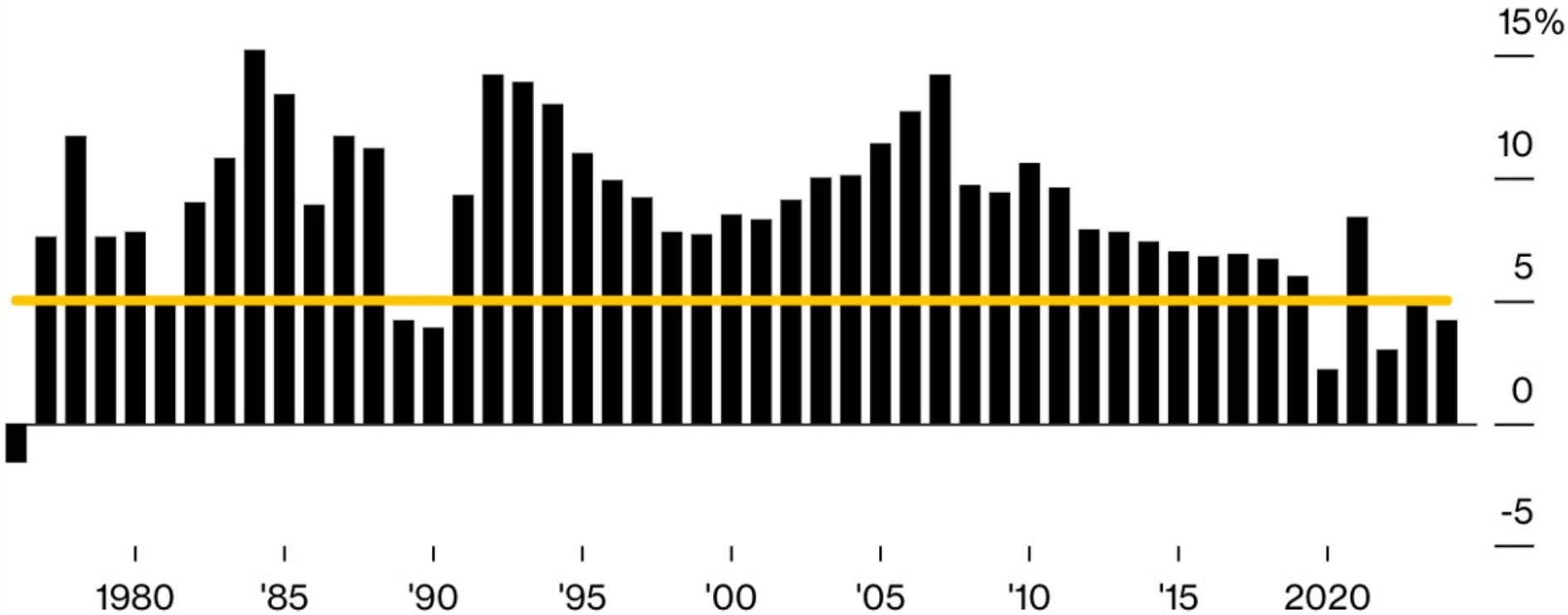
But there are many obstacles in the way

- **China needs to break the downward path of GDP and increase its productivity**
- **The US-China trade and hegemony conflicts since 2018 made it harder for China to leapfrog to a higher stage and escape MIT**
- **Conflicts provoked by the autonomy of the state, difficulties to control the strong performance of the official bureaucracy, mainly in the absence of the rule of law, are on the rise. China is now facing new sources of inequality**

China's Slowing Growth Trend

China faces sub-5% for three straight years, a record since Mao Zedong died in 1976

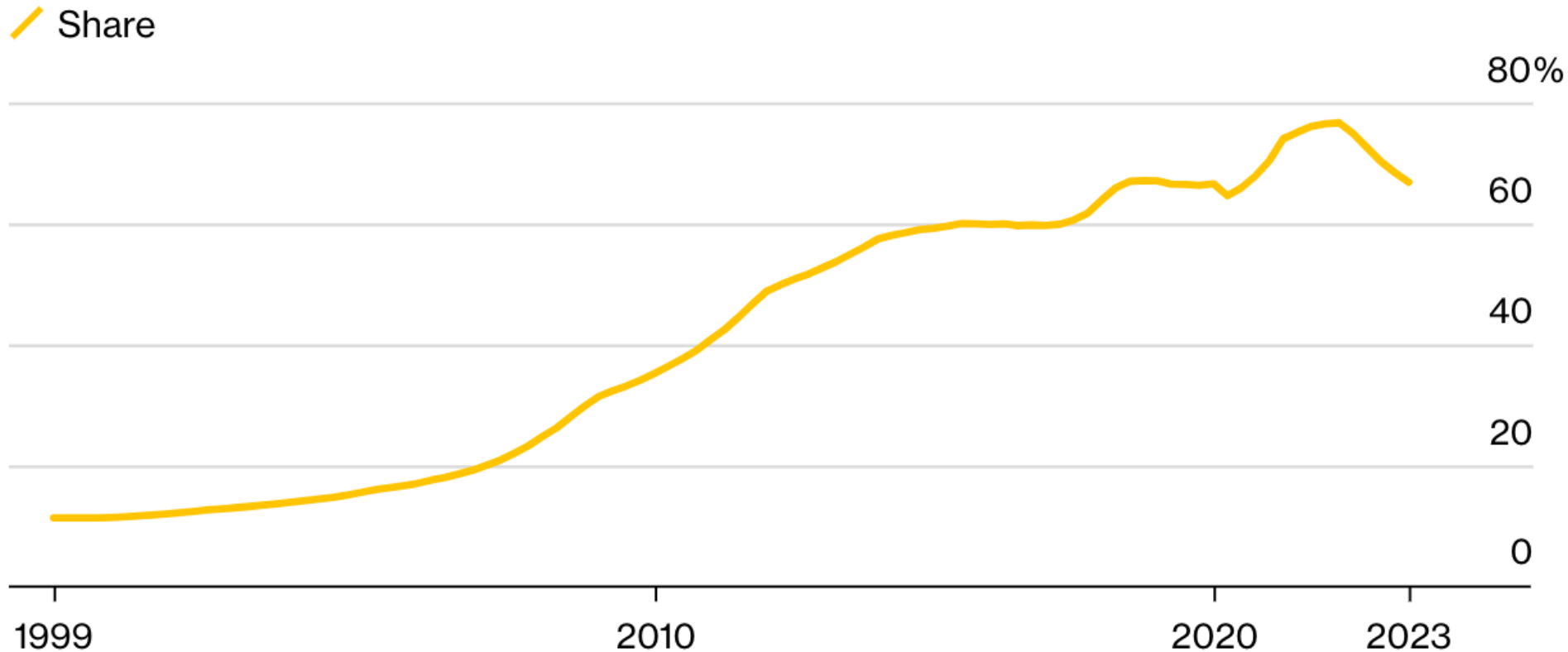
■ Annual economic growth



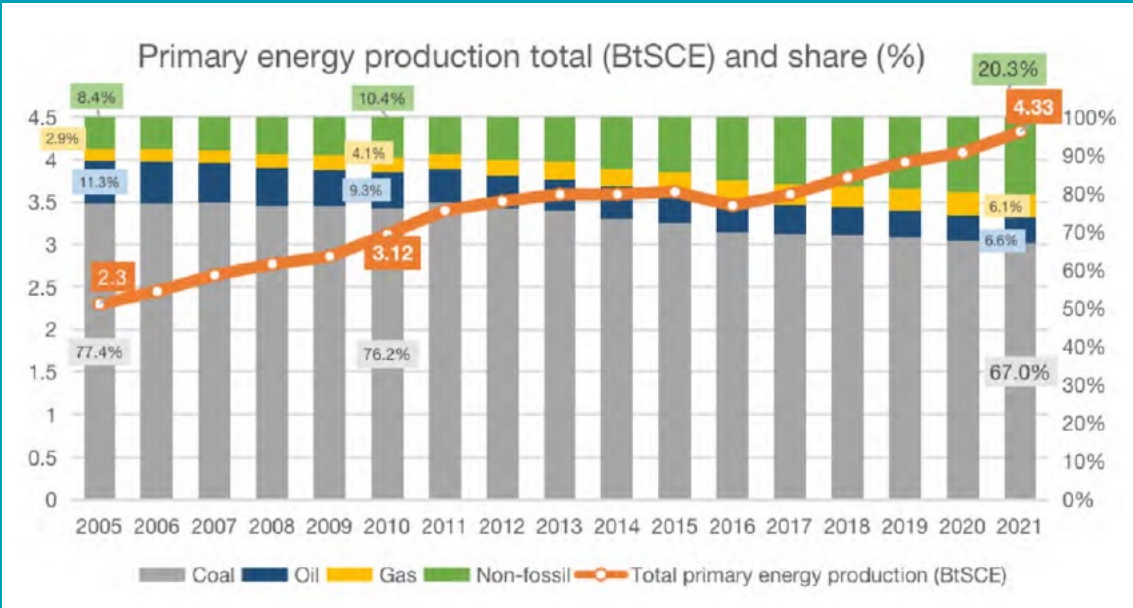
Sources: Bloomberg, National Bureau of Statistics, JPMorgan Chase & Co.

Losing Ground

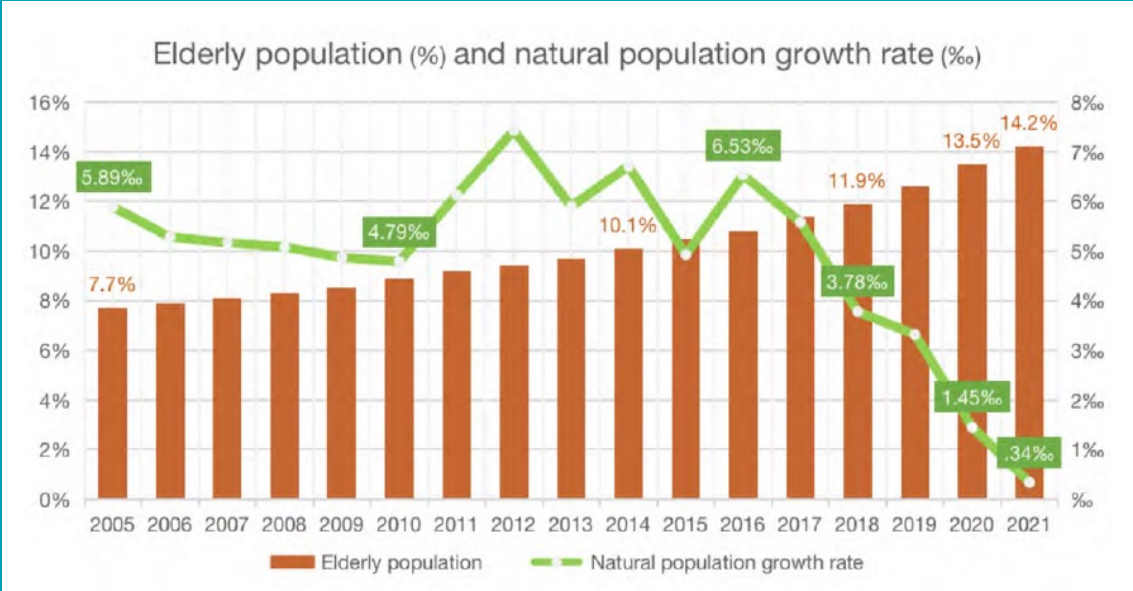
China's GDP is declining as a share of US GDP



Source: National Bureau of Statistics of China, US Bureau of Economic Analysis



Difficult transition to a low-carbon economy



Rapid population aging

The end of optimism?

- **Fear of China's Strengthening or Fear of Chinese Decline?**
- **Thucydides' Trap or Tocqueville's paradox?**

Probably, China needs to get out of two traps

- **Thucydides' Trap** refers to the confusion that occurs when a rising power threatens to displace a ruling power. “It was the rise of Athens and the fear that this instilled in Sparta that made war inevitable.”
- **Tocqueville's paradox:** the idea that revolutions happen when rising expectations are frustrated by abruptly worsening social and economic conditions.

Tocqueville's Paradox

Tocqueville's Paradox refers to the idea that as societies become more equal, they also become more individualistic and less likely to engage in collective action. This can lead to a breakdown in social cohesion and a lack of trust in institutions, which can make it difficult to address common problems and pursue shared goals.

In the modern world, Tocqueville's Paradox presents a significant challenge for policymakers and social activists who are seeking to build more inclusive and equitable societies. Here are some strategies and solutions that can be used to overcome this paradox:

1. Fostering Social Connections

One way to overcome Tocqueville's Paradox is to promote social connections and encourage people to come together around shared interests and goals.

2. Investing in Public Goods

Another solution is to invest in public goods and services that benefit everyone, regardless of their individual circumstances or interests.

3. Building Trust in Institutions

A third strategy is to build trust in institutions by promoting transparency, accountability, and responsiveness to the needs and concerns of citizens.

4. Encouraging Civic Engagement

Finally, encouraging civic engagement and participation can help to overcome Tocqueville's Paradox by giving people a sense of ownership and investment in the collective good.

The necessary increase in competitiveness

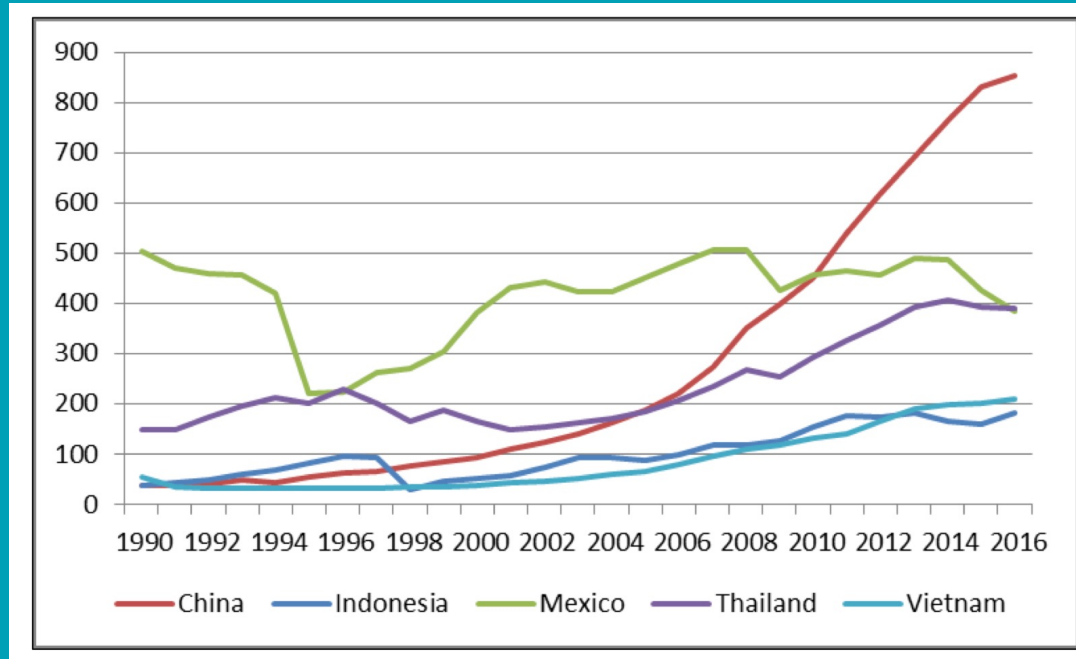
- **The MIT is a situation in which middle-income countries face a slowdown of growth as they get caught between low-wage manufacturers and high-wage innovators.**
- **Their wage rates are too high to compete with low-wage exporters and the level of their technological capability is too low to enable them to compete with advanced countries**

US against China

China's sudden rise as the number two giant economies (from 10% in 1980 to 65% size of the US economy in 2018) alarmed the world and, particularly, the US

The US took actions to stop China from growing into another superpower that would threaten its hegemony

China has lost the advantages of low wages and has more difficulties to attract investments



Economist Intelligence Unit, 2018

Tariffs and restrictions to exports and to access critical technologies (such as AI, semiconductors, biotechnology and batteries) are huge obstacles for China's plans

China's Internal Contradictions

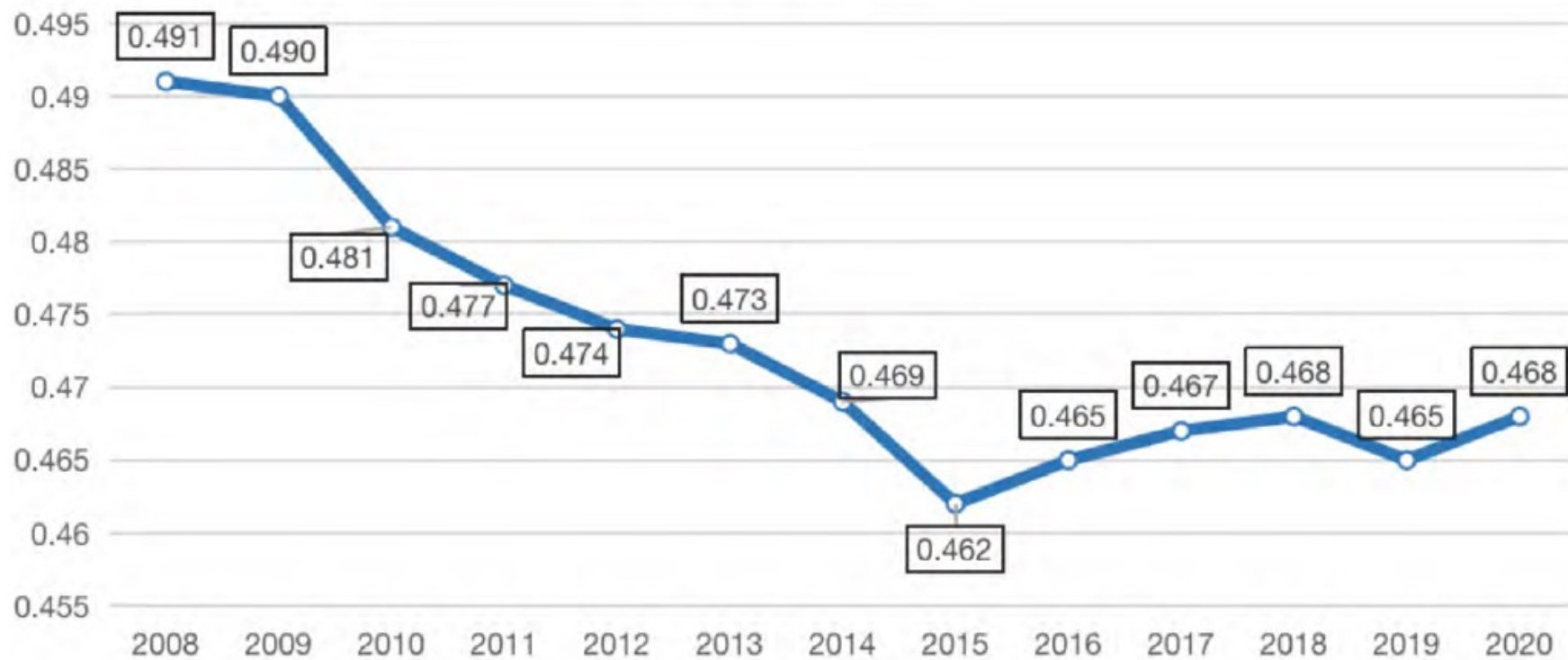
- The State led capitalism in China rules the country by a combination of an autonomous State–party bureaucracy and a loose rule of law
- While such State capitalism may bring in legitimacy through economic performance, the weak rule of law tends to bring in discretionary power of the bureaucracy (and corruption), which would lead to more inequality
- There are conflicting views on the future inside CCP

These dysfunctions tend to increase inequality and political tensions that could undermine China's efforts to avoid the middle-income trap

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Inequality grows since 2015

Gini coefficient



Political Trajectory and Conflicts

Timeline

- 1911: Republic
- 1949: People's Republic of China
- 1949-1952: Agrarian Reform
- 1954-1958: Cooperatives, collective farms, communes
- 1958: Great Leap Forward.
- Forced industrialization generates tragic results
- 1966: Cultural Revolution
- 1976: Death of Mao
- 1978: Deng Xiaoping initiates reforms
- 1984: Start of deregulation
- 1990: Diversification and export
- 2001: Admission to the World Trade Organization
- 2011: China is the 2nd largest economy in the world
- 2012: Xi Jinping is chosen manager.
- 2018: Term limit is abolished

1st generation of reforms (1978-1988)

- 1978: Four Modernizations: agriculture, industry, S&T and defense
- Search for harmony between the dictatorship of the proletariat and cultural and historical aspects
- 1980: pro-market state coalition (reduction of rural collectivization, emphasis on industrialization, creation of export special zones to attract FDI)
- 1984: Emergence of Dual-Track System and the Township and Village enterprises
- 1990: China defines itself as a “socialist market economy”

Internal conflicts and new reforms

- 1989: Most statist wing of the PCC regains power (Tiananmen massacre)
- 1992: China is declared a socialist market economy with Chinese characteristics
- 1992: CCP announces capitalist instruments are compatible with socialism
- 1997: start of privatizations

**More appropriate:
State-led-capitalism with Chinese features**

Big Threats

- Strong tensions with the U.S. and Europe
- With 1.4 billion inhabitants, China needs to constantly grow at high rates
- There are unresolved issues with Taiwan
- Income inequality rises
- China lost wage advantage with impact on competitiveness
- Decline in productivity since 2007-8 crisis



Leapfrogging is Uncertain

China has not yet developed a strategy that can enabling the country to reach high-income status.

China will need to develop capabilities amid the commercial, technological and political war with the West



Thanks



