

CHINESE COMMUNISM AND GLOBAL CAPITALISM: THE PERFECT MARRIAGE

**Leslie Young
Professor of Finance
Executive Director, The Asia-Pacific Institute of Business
The Chinese University of Hong Kong**

1. Introduction

- Western views of the rise of China:
 - conversion of the Communist bloc to capitalism?
 - threat to US hegemony?
- In fact, US and China have evolved into perfect partners, not just economically but also politically.
 - US outsources low-end production to China to avoid unions
 - China outsources high-end production to US because this would require giving business autonomy from politics

1. Introduction

Comparison and Contrast US and China in terms of:

- histories and cultures
- resource constraints
- opportunities in the global economy
- institutional innovations
- economic and political problems entailed by these innovations

2. Cultural and Institutional Foundations: China vs. the US

2A. Social Integration Underpins China's Success

2B. Individualism Underpins Western Success

2A. Social Integration Underpins China's Success

- Legalism allowed Qin (221 BC – 206 BC) to dominate North China Plain then conquer all of China
- Harshness led to revolt.
- Han (206 BC – 220) balanced Legalism with Confucius' analogy between family and state
- Daoism complemented Legalism and Confucianism by encouraging light governance

2B. Individualism Underpins Western Success

- distribution of resources in enclaves led to competing kingdoms
- marauding warbands required local defense, hence feudal system
- personal honour and obligations formed under contract
- primogeniture led to nuclear families
- institutions of law and democracy fostered by the Church for self-governance
- Sound financial system established by merchant-dominated governments
- Enlightenment enunciated ideals of democracy, law, private property and markets

3. The Economics of Takeoff

**3A. “Free” Land Fuels Capital Accumulation
in the Atlantic Economies**

**3B. “Liberated” Land Fuels Capital
Accumulation in China**

3A. “Free” Land Fuels Capital

Accumulation in the Atlantic Economies

- Industrialization shifts resources from consumption to investment.
- Free land of North America allowed Europe to feed workers during industrialization and to penetrate export markets (Keith Pomeranz 2005)
- European investment in the US was soon overtaken by indigenous investment because..
- Free land distributed to small farmers, and property rights clarified (Hernan de Soto, 2000).
- Land appreciated with arrival of immigrants and exports to Europe.
- Appreciated land provided collateral for loans to start businesses

3B. “Liberated” Land Fuels Capital Accumulation in China

- China’s industrialization today builds on the assets “liberated” in 1949.
- China can undercut other developing economies in export markets because its “liberated” land allows cheap food and accommodation for workers.
- China’s local governments attract foreign direct investment by offering cheap factory space and workers
- China can invest without sophisticated financial system because local governments generate funds by selling state land to local real estate development
- China’s state banking system recycles export surpluses by funding investments by state firms via “loans” that never have to be repaid.

4. Global Dominance via Institutional Innovation

4A. Institutional Innovation in the Rise of the US

4B. Institutional Innovation in the Rise of China

4A. Institutional Innovation in the Rise of the US

- The US sought to exploit more advanced forms of production, while upholding its ideals of private property and individual freedom under the law.
- The 1925-1929 bubble on Wall Street ended in the Great Crash and the Depression.
- Financial reforms allowed more sophisticated financial system, especially venture capital market.
- Giant US economy offered unique economies of scale and scope. But these could be garnered only by developing techniques for managing large organizations.
- Scale economies drove the development of marketing and branding to persuade consumers to buy what corporations could produce at low cost on a large scale
- Advances in finance, management and marketing fed on each other

4B. Institutional Innovation in the Rise of China

- The civil war of 1929-49 led the Communist Party to accept an extreme form of the top-down leadership traditional in Chinese organizations
- This brought the disasters of the Great Leap and the Cultural Revolution, which undermined the Party's claim to the Mandate of Heaven.
- Party had to deliver growth to reclaim Mandate
- Party returned to bureaucratic leadership, but local experiments in economic organization unleashed market incentives
- Chinese firms are integrated into local governments that compete fiercely to foster economic growth.
- Local officials now rewarded for producing growth.
- This provides them with an incentive to limit corruption as this would reduce the local growth rate.

5. New Institutions, New Exploitation

5A. Neo-Capitalist Exploitation

5B. Neo-Communist Exploitation

5A. Neo-Capitalist Exploitation

- US capitalism turned from exploiting workers to exploiting the middle class, via financial manipulation, accounting fraud and tax avoidance.
- All these scandals involved subtle manipulations of the intangible assets required to operate a large, complex economy on the basis of private enterprise and markets.
- The manipulations siphoned billions from the middle class, but few were crippled and most could not quantify the personal impact of a particular manipulation.
- Therefore, the scandals have not provoked internal challenges to the capitalist system.

5B. Neo-Communist Exploitation

- China modernized through a gradual transfer of assets from state to collective ownership.
- This approach allowed its political and administrative system to substitute for immature legal, accounting and financial institutions.
- However, it left property rights unclear and non-accountable political/business leaders in control of the lucrative transfer of state assets into the market economy — an invitation to corruption.
- So China's rapid growth features widespread corruption, conflicts between farmers and local officials over land, and pollution

6. Political Economy as Information Processing

**6A. The US: Good Local Governance, Poor
National Governance**

**6B. China: Good National Governance, Poor
Local Governance**

6A. The US: Good Local Governance, Poor National Governance

- The size of the US necessitates a federal system, which ensures good local governance
- But such a system means that the US presidency can be captured only by a coalition broad enough to mobilize a majority of voters in states with a majority of electoral votes.
- This gives powerful leverage to corporations via funding of media to manipulate voter perceptions
- National leadership chosen for electoral marketability not competence

6B. China: Good National Governance, Poor Local Governance

- Entry to China's political and administrative system is through educational attainment. Promotion through competence and patronage.
- Top leadership chosen by mutual appointment so national leaders are highly competent
- China's top-down polity is burdened by sheer size, so local governments can be exploitative
- To offset poor local governance, China is promoting local democracy, law and civil society to address local social problems.

7. The Perfect Marriage — Offshore

- Globalization: capitalist hunt for prey outside the US
- The rise of China answers an urgent need on Wall Street: activities that are useful, as well as lucrative
- Advanced production can be handled by a market economy only via the ownership and trade of intangible assets
- But this requires institutions that would allow capitalists to prey on the political system
- So China has outsourced advanced production to global capitalism
- Thus, Chinese communism and global capitalism have found meaning and true happiness in each other

7. The Perfect Marriage — Offshore

- Global capitalists have shift profits offshore by transfer pricing and exorbitant fees for intellectual property and trademarks that have been located in tax havens
- Multinationals in China often pay fees for intellectual property that exceed production costs, allowing them to report profit margins that are close to zero.
- China has tolerated this tax rip-off because the multinationals tolerated Chinese rip-offs of their intellectual property. The losers from this marriage of convenience? Western taxpayers.

7. The Perfect Marriage — Offshore

- This leaves the US with large trade and budget deficits, which China helps finance by purchasing US government debt.
- These purchases ensure low US interest rates, which enable US workers to consume beyond their incomes — which have been repressed by the outsourcing to China.
- The consumption binge masks the huge transfer of income and wealth from low- and middle-income families that US capitalists have engineered via the tax and energy policies of the Bush administration — and its benign neglect of tax havens.

8. Leveraged Buyout Meets Dialectical Materialism

- What might happen when interest payments to China become intolerable for US taxpayers?
- A Mexican-style debt-equity swap would leave most tangible US assets owned either by China or by global capitalists via offshore entities.
- This prospect could trigger an Argentinian-style threat by the US to repudiate its debt, which China could counter by impounding the tangible assets of US multinationals in China.
- Then the two governments could settle their accounts by claiming back-taxes on the intangible assets that US multinationals hold in tax havens.