

Key to Understanding China, the Enigmatic Great Power*

Júlia Gutpintér

Yukon Huang:

Cracking the China Conundrum: Why Conventional Economic Wisdom Is Wrong

Hungarian translation: A Kína-talány megfejtése – Miért nem helytálló

a konvencionális gazdasági bölcsesség?

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Conventional knowledge on China is often misguided despite wide media attention and extensive academic research. This is the claim that the book entitled “*Cracking the China Conundrum*” starts from. It was originally published by Oxford University Press at the end of 2017, while the Hungarian edition was produced by the Pallas Athéné Publishing House. The author is Yukon Huang, senior fellow in the Asia Program at Carnegie Endowment for International Peace. During his career he has acquired extensive knowledge on both Western and Chinese perspectives. Through an in-depth review of specific aspects of China’s economy, Huang examines why conventional economic wisdom cannot be applied to China, and why China’s economic and political processes generate such extreme emotions and views. We can read at least as much about China’s growing economic dominance as about its impending collapse. Its authoritarian regime is considered by at least as many people to be its Achilles heel as those who consider it the crucial factor in China’s rise. It comes as no surprise that China attracts such huge attention. Its economic rise – achieved by following a different model from mainstream Western notions – has resulted in a fundamental shift in global power relations, and as a country accounting for one quarter of global production, its economic and political steps and changes have a profound impact on global trends. At the same time, it is less clear why there is such a great divergence of views. The author believes the reason behind the differences of opinion among experts and economists dealing with China are the lack of a common and adequate analytical framework. On the one hand, models describing socialist or transitional economies cannot be used in China; on the other hand, although the operation of its economy is closer to the functioning of a market economy, it cannot be fully aligned with the latter framework either.

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

Júlia Gutpintér is an Economic Analyst at the Magyar Nemzeti Bank. E-mail: gutpinterj@mnbb.hu

Likewise, neither can the economic development models of developing countries be applied to it. The size and regional diversity of the country means it is difficult for the general public to draw the right conclusions too, since spatial factors influence economic processes in such a direction and to such an extent that macroeconomic indicators can only grasp to a limited degree. This often leads to generalisation and simplification, which together with emotional factors result in a complete misunderstanding and misinterpretation of China's economic processes.

In his book consisting of ten chapters and two appendices, the author seeks to clarify these misunderstandings and misinterpretations by analysing several aspects of China's economic and social system, often in an approach that goes against mainstream narratives. The selection of aspects is not entirely comprehensive. The author focuses on the aspects that influence the views on China to the greatest extent. In his opinion, the different global views of China are mainly shaped by three factors: its economic performance or role in the global economy, its changing activity in foreign and security policy, and the observers' political and ideological position. The author provides a deeper analysis in the book of the social, economic and political processes that determine these aspects. Due to space limitations, this review only highlights the most important processes.

Following a review of the various global perceptions of China and their changes over time, the author presents the reform period beginning in the 1980s as well as the mechanism for reforms, which is indispensable to understand the current problems. The author identifies two strong elements of the reforms initiated by Deng Xiaoping then developed during the term of Zhu Rongji, and the resulting economic transformation, i.e. the deliberate policy of regionally differentiated and concentrated development as well as the reliance on the banking system for policy purposes as the underlying causes for the current imbalances and problems of the economy.

In the following Chapter 4, the author examines these imbalances and refutes the (mistaken) beliefs surrounding them. It is a widespread notion that China's growth is unbalanced, both internally and externally. A sign of internal imbalance is that the share of consumption to GDP is unusually low, while the share of investment to GDP is exceptionally high. External imbalances stem from trade surpluses, but they have declined considerably since then, reaching 10 per cent in the mid-to-end 2000s, which hit the USA and Europe particularly hard, and fundamentally determined the view of China in this period. According to the author, the external imbalance is no longer an issue, since China's trade surplus amounted to just 1.3¹ per cent of GDP in 2017. The author emphasises, rather unusually, the role of urbanisation in

¹ Source: World Bank

the emergence of internal imbalances; he sees them as unavoidable by-products of a generally successful growth process, a reflection of fast urbanisation and regional production specialisation. He explains that the transfer of workers from labour-intensive, rural activities to capital-intensive urban activities increases the share of profits to GDP and results in higher levels of investment and growth in the economy. However, this process lowers consumption as a percentage of GDP, even if consumption grows in absolute terms.

Chapter 5 focuses on debt problems and property market issues which are considered to be weaknesses of China's economy. The author too believes they are serious, but he finds the related fears are excessive. What gives rise to the greatest concern – in the author's opinion – is the significant increase, even by global standards, in outstanding debt observed over the last 7–8 years, while in terms of debt-to-GDP ratio China still ranks in the middle. However, the biggest part of the change can be explained by the extension of credit financing and the growth of the private property market. Therefore, Huang argues, the surging debt levels do not pose a problem as long as the current level of real estate prices is sustainable.

In Chapter 6, the author reviews social and political problems and the related economic issues. One of the newest and – from a Western perspective – most astonishing findings of this chapter, and perhaps the book, relates to the role of corruption in China's economy. The author believes that corruption played a special role in China's economy, a role which is different from the widely accepted narrative based on the theories of institutional economics related to Acemoglu: corruption did not impede but encouraged growth, and has not slowed down with the economic development, but has increased instead. However, the current level of corruption is now proving to be a barrier to growth, and also leads to an increase in political instability. The vast majority of corruption results from the interplay of key actors that run the economy: the Party/government, state-owned enterprises and state banks. The author compares this network of relations to a Chinese dining table with a single pillar-like leg representing these three actors that supervise the distribution of resources in very close cooperation, and work towards the common goal, economic growth, which is represented by the table top. According to Huang, this model should be replaced by a Western-style dining table with separate legs to prevent the Party or the government from exerting influence on banks and enterprises. This shows that the success of attempts to fight corruption does not ultimately depend on impressive campaigns launched by Xi Jinping, but on whether the leadership allows the market to become the primary determinant of resource distribution.

Chapters 7 and 8 discuss the impacts of China's trade, capital investments and foreign policy for the global economy, with special regard to the USA and Europe. Chapter 9 presents China's changing role in the global balance of power. In 2013,

there was a clear shift in the passive foreign policy, a feature of China until then. The key thread of Deng Xiaoping's foreign policy was that China is not a great power, nor will it ever seek to be one, and that China's rise is peaceful, which does not threaten its neighbours, but benefits the whole world. However, Xi Jinping broke with this approach in order to restore China to its ancient prominence, and he announced an active, focused, strategic foreign policy to exploit the considerably increased resources of the country. The instruments to be used for achieving the foreign policy objectives encompass a broad spectrum: from "softer" instruments like the increase of export and outward direct investments, internationalisation of the renminbi and the implementation of infrastructure developments (e.g. Belt and Road Initiative) to "harder" ones like assertiveness in the South China Sea disputes. China's role in the global balance of power is determined by its "abnormal great power" status as defined by the author, which means precociousness: China is the first developing country to become a great power, but it reached this status before being mature in several respects; its population ages before becoming wealthy, and its economic potential is disproportionate to its negotiating power and manoeuvring capabilities in sensitive global issues, mainly due to its internal problems.

In Chapter 10, Huang reviews – perhaps less coherently than in previous chapters – the current situation and possible future change in the opinions on China, in view of economic and (geo)political prospects. He points out that in the last few years, due to falling growth rates, surging debt levels and the runaway property market, pessimistic voices have become louder than ever, forecasting a "hard landing". In contrast to them, he is in the camp of optimists: he believes there is no probability of any significant negative turn in growth, and he sees a fair chance of growth at a rate of 5–7 per cent in the next 5–10 years, which is still higher than that of most developed and many developing countries. Furthermore, if a more disciplined approach is adopted to fiscal and financial management, a hard landing could be avoided. This chapter also summarises the prospects for political liberalisation. Starting out from the examples of East Asian countries following a similar path, or more exactly from their income and urbanisation level during the transition, the author forecasts that political liberalisation will be induced in the second half of the next decade. This process will surely be different from Western and Asian models. It is likely that it will begin within the Party, as a result of intensifying pressures exerted by a widening middle class. From a geopolitical point of view, perceptions about China can increasingly be seen as negative. With its political and economic measures and assertive foreign policy, it not only demands its position in the changing world order but intends to play a leading role. Given the vastly different societal values and structures, this engenders fear and hostility in the West. However, it is important to emphasise that China's influence, for the time being, is not as strong as could be expected from its economic power, since its ability to deal with sensitive international issues and to exercise soft power is still limited.

This book will certainly give readers a better understanding of China, the enigmatic great power. However, rather than the creation and application of a new, rigorous analytical framework it is primarily the special perspective of the author and the detailed nature and depth of the content that help the reader explore China's economic, social and political processes and discover the reasons for the picture painted of China. The book is definitely useful for readers who know little about China, since they get an overall picture of the country's economic and (geo)political processes. The detailed analysis of the economic and political processes coupled with the author's unusual approach can also bring new information and perspectives to those who are familiar with the issues related to China.