

The Chinese Economy and the Global Inequality Debate

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Once it was clear that communism was gonna be replaced by capitalism, there was a huge debate about, well, is it better to have political reform first or economic reform first. We'll try to do them together and we'll talk about that sequencing debate which will lead us into a larger discussion of what since the 1950s has been known as modernization theory. The thesis that economic modernization will eventually produce demand for and the establishment of democracy and that will then leave us to think about the future. So, China and Vietnam Today. - China so far has built the equivalent of Europe's entire housing stock in just 15 years. In November 2015, Beijing replaced the substantially larger 1300 ton Sanyuan Bridge in just 43 hours. Between 1996 and 2016, China has built 2.6 million miles of roads including 70,000 miles of highways connecting 95% of the country's villages and overtaking the US as the country with the most extensive highway system by almost 50%. Over the past decade, China has constructed the world's longest high speed rail network. 12,000 miles of rail lines that carry passengers between cities, at speeds up to 180 miles per hour. China now has more high speed rail tracks than the rest of the world combined. - So that's one of any number of video clips one could pick to just give a snapshot of the incredible transformation of the Chinese economy over the last couple of decades and indeed, over the last decade, I went to Beijing last year for the first time in about 12 years and 12 years ago, there were lots of potholes in the streets, there was still rickshaws on the highways. You go to Beijing today, it's just miles and miles of skyscrapers and every conceivable multinational is there.

It looks like just West Los Angeles times a hundred. So you can't overstate and I will put some statistics up in a little while, but the economic explosion in China since the 1970s has been phenomenal. And then here's another snapshot versus Vietnam. - If you're talking about the 80s what Vietnam look like. You go to cities, you didn't see the light, electricity cut, no car in the street. Vietnam was so isolated from the world. - With the Doi Moi economic reforms of 1986, the government hoped to move toward what is now called a socialist-oriented market economy. When the Vietnamese government asked for hands-on

advice, the IMF did not refuse the call. - If you use the analogy of Vietnam's economy as a eagle flying up, there are two wings. One is internal institutional reform, and the other is opening to trade. - Free to start their own companies, the Vietnamese people created more than 30,000 private businesses in the first 10 years, spurring growth that averaged 7% throughout the 1990s. - If you look back in the late 80s and early 90s we had the first FDI law ever which opened up the opportunity for newly established private firms to engage international trade. - And that was complemented with a major push to attract foreign direct investment into Vietnam. - The economy has grown at about 7% per year since 1990, second globally only to China. - So these are the two most successful examples of post communist systems that have remained authoritarian but have been transforming their economies into capitalist arrangements. And that differentiates them from the other post-communist systems that have retained authoritarian rule if we think about North Korea, or we think about Cuba, they have not transformed their economies. So this is one thing that differentiates them from the other post-communist authoritarian systems, post-communist economies retaining communist authoritarian political systems.

And they account for a large part of the economic success in the world in the last decade just to take one or two decades. Just to take one example, one of the encouraging stories of our time is if you take the long view of things, number of people and even the percentage of the population both living in extreme poverty has really gone down over the past two centuries and much of that decline has come in the last few decades. Of course, this is a worldwide indicator. But if you look at what is accounting for most of this decline, you can see that the main action has been in East Asia. So this is the blue line up here where poverty again, this is number of people living on a less than \$1.25 a day, which is a World Bank's definition of extreme poverty. So, most of the changes of course, have come in the developing world. But if you compare East Asia, for example, to Africa, East Asia is by far the lion's share of the reduction in extreme poverty. Now of course, not all of that is the is China and Vietnam. There're countries like South Korea that have massively improved. There are other countries in that part of the world not to mention Singapore, where poverty rates have decreased massively. Nonetheless, China and Vietnam are relatively impressive stories on this front as well. This is a picture of reductions in poverty in Vietnam and if I'd had gone back before 2010, the numbers would have been higher up there as well. But you can see, even in this last difficult decade, and despite the fact that ethnic minorities within Vietnam are not doing as well as others, we're seeing very low rates of people living in poverty in Vietnam. China, you can see the head count living below the official poverty line is the red line. The head count below 1.9 US dollars a day is the green line. Again, you can see massive reductions in poverty by many estimates they vary, but many estimates say that since the reforms in China ushered in in the late 1970s, somewhere between 400 million and half a billion people have moved out of poverty.

Now, there's another line on this chart, which I don't believe, which is the Gini coefficient which is a measure of inequality and I believe that the inequality in China has gone up a good deal more. If you look at here, this is comparing the top and bottom quintile. But again, this is data provided by the Chinese government, you can see that in terms of per capita income, they're showing an increase inequality from three times to about eight times

and land and consumption, less of a change. So I would just say two things about these statistics, these are based on Chinese government statistics. My guess is that the inequality in Chinese is a lot higher, and particularly this is comparing quintiles that's the top 20%. But just as in the US, and just as in many other capitalist countries that we'll talk about later in the course, if you look at the top 5%, the top 1%, or the top .1%, you're gonna see massive increases in inequality and that puts on the table a dilemma that's gonna be worth thinking about as we progress through the course and talk about some other countries. Which is that while inequality within countries just about anywhere in the world has gone up over the last four decades, worldwide, global inequality has actually come down, and the number of people living in poverty has come down dramatically as we've seen. But if you read say the Millennium Goals or you go to the World Economic Forum meetings, which I have done from time to time, you'll see politician after politician and policy wonk after policy wonk standing there saying, "We need policies to reduce poverty and inequality." It's like almost one word, poverty and inequality is one word, but what we're seeing here is something that's gonna come back to us in multiple ways during the course. It's not obvious that all good things go together. And it may well be the case that the price of reducing inequality, the price of reducing poverty is tolerating significant increases in inequality, we'll have to think about those trade offs in various settings.

In any event in both China and in Vietnam, you've seen massive decreases in poverty, big increases inequality in not as high by most measures in Vietnam again, now it's hard to know what statistics to believe on these matters but most scholars seem to think there's less inequality in Vietnam than in China. So the first answer why are we talking about China and Vietnam today is that by virtually any measure they have been economically successful. But then the second and in some ways more interesting reason we're gonna look at them is they challenge a lot of accepted wisdom about capitalism, democracy and the relations between them because here we have two very repressive authoritarian systems, transforming their economies into successful capitalist ones. So that's the puzzle we're gonna be wrestling with for the rest of today's class in one form or another. So let's think about what was happening in China before Tiananmen. After Mao's death in 1978, things were gonna change very rapidly, just to give you a sense, up until the end of the Cultural Revolution in China, this is a picture comparing Chinese and Japanese per capita GDP. And as you can see, this is a period of explosive economic growth in Japan after World War Two, of course, from a very low base because the whole economy had been destroyed. When people talk about the Japanese miracle, it's a little bit misleading. If we took this back to 1925, this line would have come down because of the collapse produced during the war. It's a recreation to some degree of what it existed before the war, but nothing like the levels that were seen in years afterward. But as you can see, per capita GDP in China was basically flat. There was no economic development to speak of. 1978 Mao is now dead. The third plenum of the Communist Party Central Committee, led vice premier soon to be premier, Deng Xiaoping calls for officials to start liberating their thinking, to start seeking truth from facts.

An ironic statement perhaps in light of our own discussions of fake news and manipulation of the truth that we're coping with today, but to innovate and experiment in the economy,

and officials were instructed, this is when they started, China had been very closed and inward looking and they began going in large numbers abroad, they started applying for courses at places like MIT business school, they started trying to learn from other development models and this is gonna be the beginning of experimentation with new forms of capitalism. This is also when the big special economic zones in China were created, these massive islands of experimenting with capitalism, if you like, most of the world's special economic zones and we'll talk a bit more about them in other countries later are sort of industrial parks. They are 40 or 50 firms, they get some preferential tax treatment and the idea is to attract foreign capital. The ones being set up in China were enormous, they were sort of giant cities with schools and shops and people lived in them in their entire lives. So the idea was to experiment with capitalist economics in self contained ways. This is also when they start opening up to foreign direct investment. This is when companies like Cummins truck engines come to China, one of the biggest multinationals in China today started in the in the late 1970s, early 1980s. And so this seemed to be a little bit like the Prague Spring. And indeed, in the late 1970s, people started talking about the Beijing spring and there was much more criticism of the government tolerated, people started publishing things that you would have been thrown in prison for five years or even three years earlier, and there was something of a thaw, there was something called the Democracy Wall in the Shidong district of Beijing was created, a kind of graffiti wall if you like on which people published criticisms of the government, but the vast majority of the political criticism was backward looking.

It was criticism of the Cultural Revolution, criticism of Mao, criticism of what had been done in the past, mistakes that had been made in the past. And of course, that wasn't gonna stay that way and so before long, the Democracy Wall protesters started shifting their attention from attacking the past to attacking the current leadership in China. Again, a lot of demands now for more democracy. Wei Jinsheng was a protester who came out and made very strong criticisms of the government and this went on until late 1980s, early 1981 and then there was a lot of pushback from the regime. And so much of the 1980s were this era of testing, political testing, by student movements, there were reorganization of student groups on Chinese campuses, there was a lot of criticism of the government interspersed with pushback. So Deng, came out and made very clear that when he was talking about experimentation with reform, he was talking about economic reform, he was not talking about reforming the political system and he reaffirmed what he called party rule and the socialist path. He focused on technical questions. His four modernizations had to do with agriculture, the industrial economy, the military, and technology, technological innovation. They started attacking what they called Spiritual Pollution. There was an anti-Spiritual Pollution campaign in 1983, and there was an anti-Bourgeois Liberalization campaign in 1987. And Hu-Yaobang who had been a member of the Central Committee, who had been one of the most energetic reformers was actually fired from the Central Committee of the Communist Party. So it was this period of back and forth, but a lot of growing protests nonetheless, in the 1980s. And it was also a time when the economy wasn't doing that well, particularly for consumers in urban areas, we saw a lot of inflation and that led to austerity

programs, cutbacks on spending by the government, which produced further escalation of protests although the economic reforms continued.

So if you look at foreign direct investment in China, you can see it's very low there, but it's going to accelerate dramatically over the 1990s. So then, in 1989, in the summer of 1989, if somebody had said, "Where is there gonna be political reform?" It would have been a pretty good bet especially given what was going on Eastern Europe, it would have been a pretty good bet that there was gonna be significant reform. In China, the student groups were active just as in many European countries. And this erupts in June 1989 - Hundreds of thousands of people here in Tiananmen Square perhaps as many as a half a million, even more. In the history of Communist China there has never been anything like this. For the first time in huge numbers the ordinary men and women of Beijing, the old and the young, professors and taxi drivers have joined the student protests, lending their support to what has now taken all the appearances of a peaceful popular uprising against the oppressiveness of communist rule. As the afternoon wears on here, the crowd gets bigger and bigger hoping that this protest will produce results, that the government will respond to the students demand for meaningful dialogue and begin to implement the kind of genuine reforms as opposed to cosmetic reforms that the students want. - So these protests were going on and it soon became clear that the regime was not going to tolerate them and tanks started appearing in Tiananmen Square. So that's not that different from the video we were looking at outside the White House in Russia when Yeltsin climbed the tank, and there was the real expectation among many of the protesters that the Chinese army would not attack its own citizens. And they certainly were appealing going out to that effect, but they turned out that they were wrong. - The noise of gunfire rose from all over the center of Peking.

It was unremitting. On the streets leading down to the main road to Tiananmen Square, furious people stared in disbelief at the glow in the sky, listening to the sound of shots. Heading down the road was a hazardous business but hundreds of people cheered as buses were set alight and army trucks caught fire too. They yelled and shouted. And then as troop lorries were seen moving down the road, there was gunfire from those lorries. The troops have been firing indiscriminately, but still, there are thousands of people on the streets who will not wince back. The bicycle rickshaws scooped up the injured, others were shunted onto bikes and pedaled to hospital, many were carried away by frantic local residents. There was confusion and despair among those who could hardly credit that their own army was firing wildly at them. Young people were singing the international to a background of gunfire. After hours of shooting and facing a line of troops, the crowd is still here. They're shouting, "Stop the killing" and "down with the government." A huge volley of shots just as I left the front lined cause panic. The young man in front of me fell dead, I fell over him. Two others were killed yards away. Two more people lay wounded on the ground near me. In the streets, many came up to us shaking with anger and disbelief and fear. Many were terrified, saying there would be retribution. There was not one voice on the streets which did not express despair and rage. "Tell the world." They said to us. - So that was the beginning of a massive crackdown, huge numbers of people. We never really got statistics. We believe just a number of people were killed in Tiananmen but it was very large numbers of people were killed. Huge numbers of people were imprisoned after that massive political crackdown. And

in sharp contrast, again, this is June of 1989, when the the revolution is all over Eastern Europe, the thaw is going on, the Soviet Union is not intervening in the liberalization movements in Eastern Europe and of course, five months later, the wall came down in Germany, but China went a very different path.

That the massive political repression of this descent but it did not stop the economic reforms and the economic transformation. And as you can see here, this is just foreign direct investment in China, it just throughout the 1990s it increases. The fact that it's decreasing as a share of Chinese GDP tells you how much the domestic economy is developing as well. So that even though as in absolute numbers foreign direct investment is going up by leaps and bounds, it's a declining share of the growing Chinese economy which is becoming a powerhouse. And here you can see the astonishing growth rates that have been recorded in China since since 1989. You can see by 1991, they were recording already double digit growth rates and they have been the highest growth rates in the world, virtually every year since. If you look at manufacturing in China, and we'll talk more about manufacturing, this is between 2006 and 2016 as modest increases in the US and Japan, just threefold increase in manufacturing in China, just absolutely dramatic industrial take off. Comparable story on a smaller scale about Vietnam, transforms itself from an extremely poor country into a very successful middle income economy. I think it's the fifth largest economy in East Asia, but it is second only to China in terms of economic growth. So these huge success stories, and they have been studied to death. There have been armies of scholars trying to understand the reasons for this success. And in the readings I gave you, you get some sense of the variety of explanations that are out there that are trying to account for the dramatic success in China and Vietnam. And most of these explanations suffer from what economists and political scientists refer to as the pathology of selecting on the dependent variable. That is, everybody focuses all of their attention on China and Vietnam in trying to look for characteristics that explain the outcome, but of course, that's not how you do social science, we have to think about the independent variable because if you select only on the dependent variable namely in this case, economic success, you may be missing what's really causing it by not seeing other countries that have done the same things that have not succeeded.

So, for example, Alexander Gerschenkron was famous for the idea that late developers have an advantage, they have an advantage because they don't have to necessarily go through all the stages. This is sort of the opposite of a first mover advantage, which we talked about in tariffs in the EU. So the idea is that late developers can skip some of the stages. You look In Africa, you can create a banking system without banks today because people can do banking on their cell phones, right? They don't have to go through all the stages. So these were relatively late developers. Well, they were relatively late developers, but they're plenty of relatively late developers that haven't had this kind of success, all over Africa, or in much of Latin America, elsewhere in East Asia. So the fact of being a late developer alone is obviously not the advantage. They were predominantly rural at the start. So the argument this is in Moleskine London paper, the fact that they didn't have inefficient urban economies to dismantle, they didn't have a big, inefficient economies to dismantle, made it easier that as they urbanized, they urbanized in relatively efficient ways. Again, there are many

predominantly agrarian countries that have not been as successful as them. People point to Confucian values. Confucianism, above everything else values order. So they say, "Oh, well, it's Confucian values." But of course, there are countries with Confucian values that have not been particularly successful economically. The most obvious and dramatic illustration being North Korea. Confucian values haven't done anything for the North Korean economy.

Education, both China and Vietnam have made huge investments in education. They're making bigger investments for example, than we are making in education. A K through 12 education but also technical education, science education. The few things to say about that most of the investments in education have come later after the economic take off, but also there're country. Russia is an extremely well educated population, Ethiopia has now got every child in school. They're one of the first African countries to have such high levels of K through 12 education but they have not been replicating this success. There was a less entrenched command communist system, the Moleskine London piece put a lot of credence in this idea that the Soviet economy, for example, was this massively inefficient, but deeply entrenched communist economic system that once they started to dismantle it, the whole economy fell apart. China and Vietnam partly because they were mainly rural economies in the 1970s, didn't have these a big entrenched communist economic command economies that had to be dismantled. They involved gradual reform, they did not, and we'll come back to this in more detail in a few minutes, but they did not simply replace the communist system with the capitalist system. In the Soviet Union, there was no choice because the communist system itself just imploded, it just collapsed. It became completely dysfunctional and so they were starting from ground zero. In both China and Vietnam, there was a gradual experimental approach, as I've already mentioned in China in the special economic zones, opening their economies to foreign direct investment which enabled the creation of joint ventures with foreign firms and allowed the economy to grow in particular sectors, not trying to reinvent wholesale a new system. Experimentalism and decentralization. They devolved a lot of power to make decisions about economic performance to regions. Provided that they delivered what was required by the central government, there was much less micromanaging from the center of how the different economic enterprises were run and how local officials met their goals, again, putting less demand on the central leadership to know what to do in every circumstance when very often they didn't know what to do.

And they knew that they didn't know what to do. Competition within the state sector and between the state sector and the private sector, so they created big state owned enterprises, particularly in China, but they introduce competition among them and they required them to compete in the private sector and they shut down inefficient state companies. It should be said that it's very difficult to get a grip on the differences between the state sector and the private sector that means very much in China, partly because the many of the private sector companies get funding from state banks, but also because many of the top leadership of private sector firms are members of the Communist Party, and have to be members of the Communist Party. And so that raises the question while they might be nominally private, but what does it mean in terms of their influence ability by the party. On the other hand, the flip side of that is that it means that the leadership of the Communist Party is hearing a lot about the needs of business all the time, because there are many

business people, business leaders are in the Communist Party and making the case for what they need. So the system is relatively competitive for a state sector dominated economy. Export oriented growth model. Again, this is pointed to by many scholars that this export basic producing for foreign markets, manufacturing goods for foreign markets has been extremely successful. There are many other countries in the world, again, that have produced for foreign markets that have not been as successful. Relatively good accountability and the rule of law. So, the system of accountability it's interesting.

In China while you can't attack people for political reasons, you can attack officials for being inefficient and corrupt. And that has usually been the path by which people have pushed for accountability and reform. Yuhua Wang in the chapter I put in with the readings from his book, "Tying the Autocrat's Hands" points out that there's been a pretty effective increase in the demand for the rule of law with respect to commercial matters, not political matters, commercial matters, in the sectors of the economy that are dominated by foreign investment. And the reason he gives and I think it's plausible. The reason he gives is that domestic firms have access to elites to solve their problems through informal networks, the so called *guanxi* relationships that they build. Distinguishing *guanxi* from corruption is often easier said than done, but they have access to informal dispute resolution mechanisms, whereas the foreign firms do not. And so the parts of the economy in which the foreign firms are big have been where there's been a lot of demand for the creation of courts to resolve disputes. And Wang who's a very impressive political scientist at Harvard makes the case that it's this demand for the rule of law as a condition for attracting foreign investment that has fed that development. Of course, the subtitle of his book is Tying the Autocrat's Hands something and The Rise of The Rule of Law in China. I was recently at a panel with him where he said, "Maybe we should now be talking about the rise and decline of the rule of law in China." Because, as I said earlier, slide showed you foreign investment is becoming a less important part of the Chinese economy to the extent that the demand for the rule of law is coming from the foreign investment sector, it might be diminishing. Leadership. So, leadership. Several people have noticed that if you look at authoritarian systems, that one way to classify them is that those that have managed to renew themselves will find mechanisms of renewal versus those that have not.

So, if you think about the Arab monarchies in the Middle East, they stagger on until the king dies. Pretty much that's what happens in monarchies or dictatorships in Africa and Latin America, they stagger on until the dictator dies. And even in the Middle East, Assad is followed by his son, you get another Assad. And this is true in some of the communist authoritarian systems like North Korea, Kim Jong-il, Kim Jong-un, again, you have you have aging ossifying leadership's that don't manage to renew themselves and so kind of drag the country into the abyss as they become geriatric, whereas some authoritarian systems seem to have come up with mechanisms to renew themselves. If you said to most people, maybe most people in this room, who are the leaders of Vietnam? Most people would have no idea who they are. It's a triumvirate, they do get replaced over time, or you think about Burma. Again, there's no cult or personality. These are countries in which they have renewed themselves. And in China, after Mao, it seemed like they had really figured out a way to avoid the trap of charismatic leaders. Indeed, Bo Xilai had been a member of the Communist

Party who was quite charismatic and some years ago, was kicked out and thrown in prison and his wife had allegedly been involved in a murder. Many Western scholars interpreted that as he was too charismatic and the Chinese didn't want, they tried charisma, they saw where it went with Mao and they were into this model where people would not be able to be at the helm for more than a decade. And so it seemed like to extent that you need young, vigorous leadership, countries like China and Vietnam had solved this problem which is hard for authoritarian systems to do, because there's no automatic mechanism of renewal and if a charismatic figure comes along, it's very difficult to get them out. So that was another reason people pointed to. So this is, I think, 11 reasons you could pull out of those review essays and no doubt people could come up with more.

And the truth is, nobody knows, there's no silver bullet here. There is some combinations of these things, there things like luck but these are out there as the main explanations for why these countries have been so successful, right? It then puts on the table the question, well, how sustainable is this success? Should we be expecting it to continue going forward? And can we have long-term successful capitalist authoritarianism? This, if you like, is the question put on the table by the success of these countries now over a period of two decades beyond the wildest dreams economically of any observer, and maybe anybody even in those countries along with very repressive political regimes. And, so how do think about that. Well, there's some questions to wonder about with respect just to the economies. One is that since 2008, we have seen a resurgence in the growth of the state sectors of these economies. This is partly, as I intimated, at right at the beginning of today's lecture, that now that the Washington Consensus is in bad odor, people are now talking about the Beijing Consensus. Until 2008, China made no attempt to export its development model elsewhere, they would kind of back on their heels about the Washington Consensus. That is no longer true. Not only is the state sector in the Chinese economy expanded, they are now training people from many developing countries in economic management pushing a very different model of state-led growth from the model that was being purveyed in the Washington Consensus. And to the extent that the state sector is gonna be less efficient, that raises questions about how sustainable these growth rates are. Because even though relatively efficient, compared to other command economies, they're less efficient than the private sector in those countries and elsewhere. Then there's what Steinfeld in that "Playing Our Game" book that I put on there calls, the smile curve of profitability, and so, this is the idea which he actually takes from somebody calls Stan Shi.

This is the idea that if you look at where the biggest profitability in manufacturing comes from, most of it is either at the R&D phase, research and development upstream, or it's in the manufacturing and marketing downstream. If you think about where's the money made out of an iPhone? It's people who come up with the basic technologies, make a lot of money, and then the people who put it together, do the marketing, make a lot of money. So the solid curve here, what it's telling you is that there's not that much money to be made in the manufacturing, this is just low wage labor and these are these people working on assembly lines. That's not the source of great profitability but that has been where most of the economic action has been in these economies. The dotted line is that realizing that the Chinese have started to try and move further up the smiley curve in both directions, so they

tried to get more involved in research and development and more involved in marketing and sales. But of course, they do that largely by imitating, sort of creating if you like, generic versions that are copying technologies and then copying marketing methods. And if you do that, that tends to move, it means everybody else can do it too. And so if you like are sawing off the branch you're sitting on, and so it's not clear that they're gonna be able to continue to be profitable. Picking winners. Economists always criticize central planning because governments pick winners and governments don't know how to pick winners. They don't know where are gonna be the successful parts of the economy. That is less of a problem in the early stages of industrialization. You know what you have to do, you have to build cities, you have to build roads, you have to build housing, you have to put in electricity, you have to put in water. Once you get into complex economies, it's very much more difficult to know where the successful innovations are gonna be and where they're not gonna be.

And so the government's might start to make a lot of bets as governments often do when they start to pick winners. So as growth becomes more complex, it becomes less likely that you're gonna have even relatively efficient political leadership's successfully keep picking winners in the economy. Changing leadership and corruption. The story I told about China's leadership in the last five years seems to have gone out the window. So now as Donald Trump complains, Xi Jinping might be there for life and Trump is clearly somewhat envious about that idea. But the 10 year term limit has now been abandoned at his request and he is a very charismatic figure, certainly the most powerful Chinese leader since Mao. And so it may well be that the mechanism for ensuring leadership renewal is breaking down, or has perhaps even broken down. In Vietnam, they had almost a separation of powers system with different leaders, responsible for different parts of the political and legal system and that also seems to be breaking down or at least under strain from reports that it's possible to get. I already mentioned Yuhua Wang's point that to the extent that the rule of law in the economy was dependent on demand from the foreign sector, that might be going away as foreign investment as a proportion of the Chinese economy is actually shrinking. And given the trade wars that we are now in, they might be shrinking a lot further than we talked about before. And so that plus the leadership changes might mean that we're gonna see increases in corruption again, inefficient management, different forms of corruption. Then the next thing and this is gonna now we're gonna start transitioning to talking about politics is that when you create big industrial workforces working on assembly lines, eventually they start to make demands, they start to want higher wages. And this is so called flying geese theory of economic development.

This is the idea that capital is gonna go to wherever labor is cheapest. And so, if you look here, these are wages in China, Mexico and Vietnam, what you can see is that since the beginning of this century, wages in China have gone up quite dramatically and they're now substantially above wages in Mexico and wages in Vietnam, which while they've gone up, have gone up nowhere near as much. And so, if you look at this is called the labor cost index, which basically measures the cost of producing one unit of output. You can see that they are two. The cost of labor has gone up in China quite dramatically during this century and that has meant that the geese are flying out of China, they're flying to places where labor is cheaper. This is the Nike plant in Ho Chi Minh City, which I visited in March of 2001.

It was run by a Vietnamese management company, with about 20,000 Vietnamese women working in it there. The whole thing consisted of, it looked like four giant football stadiums. This is about an hour's drive outside of Ho Chi Minh City, which used to be Saigon. It looks like four giant football fields but all of them built out of aluminum. You can see they could be packed up and put into a bunch of planes and flown off to somewhere else at relatively low cost. And here are some of the people working, what strikes you about these pictures? What's notable about these pictures? Yeah. - They're all women. - They're all women and they are all Vietnamese, the management of old Taiwanese and all the men, by the way, almost all men. Yeah, what else is striking? I don't know if the picture is quite captured. It's incredibly labor-intensive. These machines looked like they're 20 or 30 years old. Making a Nike running shoe is split into about 35 different tasks, one person is cutting the little pieces with a cutting machine, one person is putting glue, it's an unbelievably labor-intensive because labor is so cheap. That after all is why they went there and indeed, I spent the day there and walking around with the mid-level manager, and I asked him his personal history and he said, "Well, I used to manage a plant like this in China.

" So I said, well, what's the biggest difference between managing a plan like this in China and manage a plan like this in Vietnam? And the answer was, "The Vietnamese argue less at work harder." And I'm sure that was exactly true because the Chinese workers had been doing this kind of work for longer and they had started developing aspirations and so Nike had moved the plant to Vietnam. And so the idea would be that of the flying geese theory, that eventually demands for higher wages would cause the geese to fly. And, Vietnam will get this benefit for a while, but then the geese will fly to Cambodia, or wherever the next place is or maybe Zimbabwe. Now, this is also exacerbated the coming economy by the probability that a lot of these jobs are gonna eventually be going to technology that is, the technology is gonna become so cheap, that it will no longer be worth it to pay even starvation wages and so the geese might stop flying all together. But it's again gonna put stress on economies that are dependent a lot on manufacturing for feeding their populations. Slowing growth and regime legitimacy. A lot of people have argued that the legitimacy of these regimes depends upon their delivery growth, yes, they don't have elections, so they don't have political accountability but people have been satisfied because the standard of living has been going up, they've been doing a lot better economically, they're employed, and they have had prospects for upward mobility. As as growth slows in these economies, which almost every economic projection predicts that it will, that's gonna become harder and harder to sustain and so you're gonna get pressure, and maybe resurgence of political dissent and they're gonna be strains on those economies. So despite the many reasons that people cite for the success, there are reasons also to wonder how sustainable these models might be.

And this leads us to thinking about the relationships between political and economic reform. During the transition in Eastern Europe in 1989, people started worrying a lot about this and these were the debates about shock therapy, should we have a dramatic reform right away, get the paint over with and then do political reform? Or should we do political reform first, or do them in tandem. And I've put three people up here because they ideologically from very different places. Adam Przeworski is a former Marxist, he wrote a book called

"Democracy and the Market" in 1991. Janos Kornai "The Road to a Free Economy" is a riff off Hayek's road to *Saf deb*. So he was a kind of libertarian, and Jeff Sachs was a kind of middle of the road policy wonkish economist but they all made the same argument, which was essentially this, if you think about a collapsing communist economy, as the old system is dismantled, eventually people are gonna be thrown into distress and it's gonna get so bad per capita income is gonna fall below the poverty line. Eventually, things will get better, yeah. But what if you democratize here, then all of these people are gonna be angry and they're gonna use their democratic rights to stop the reforms and so instead of turning the corner, you're gonna just keep crashing down. And so the shock therapy people said, No, let's not democratize until this point, once the worst economic pain has been experienced. So these technocrats had the same kind of hubris as we were talking about last time, they really thought that they understood everything about market economies but they got a lot of things wrong. For example, both paths have turned out to be successful. If you compare Poland that had shock therapy with the Czech Republic that went with gradualism, they both been among the two most successful former communist economies in Eastern Europe. Of course, Poland's four times the size and so on, but they both have had very successful development paths.

So it's not clear what made that much difference. The other thing that it ignores and this is really important, it's not only the losers from reform who mobilized, it's the winners who mobilized as well. The people who get things out of the reforms don't want things to go away. And so it's far from obvious that democratizing while you're doing economic development is only gonna empower the people who wanna stop it but on the contrary, it might actually help economic reform go along. The economic advantages of gradualism get lost. So one of the big secrets of success in China and Vietnam was this to track pricing system where they created a second economy next to the state sector, not instead of the state sector. So basically people were told, if you can produce at the government set price, what's your quotas required, on top of that you can produce as much as you want and sell it at market prices. And so that was one of the ways in which a market economy was created alongside the socialist sector and didn't depend upon its destruction. Those are the kind of advantages you forgo when you go for shock therapy. And this leads to a broader set of questions about modernization that I just want us to end with, which is that the old modernization theories said that economic development would inevitably produce demands for democracy. And I'm giving here one, you can find a million statements like this but here the person is saying, "The effects of socio and economic change, "rising literacy and common urbanization rights, "along with the improvements "of communications technologies "reduce the cost of collective action, "delegitimize autocratic rule, "and foster demands for greater democracy. "As a result, authoritarian regimes "which have a relatively easy time "ruling poor and agrarian societies "find it increasingly difficult and ultimately impossible "to maintain their rule once socioeconomic development "reaches a certain level.

" That was a scholar talking about China five years ago. The trouble with modernization theory is that that logic is very unclear. Why exactly is modernization gonna produce a demand for democracy? And if you sort of trawl through it, you find at least three

arguments there. So the most famous one, first made famous by Barrington Moore was that it's all about the bourgeoisie. No bourgeoisie, no democracy. And I've mentioned some other modernizations theories there. And so there the thinking seemed to be that as you got a middle class, a middle class is gonna want bourgeois freedoms, they're gonna want to be able to travel, they're gonna want their kids to have opportunities and so they're gonna put pressure on the regime to change. Nonetheless, if the bourgeoisie are getting everything they want, it's not obvious that they really gonna demand changes, particularly if their lifestyles are improving. Certainly no inexorable logic why that might happen. So then a second variant, this really goes back to Marx and Engels, but I put up some more recent scholars of it. It's not about the bourgeoisie, it's about the working class. It's the working class, no working class, no democracy. And you've gotta have an industrial working class that is gonna get angry as its relative and perhaps absolute position eventually deteriorate and they're gonna demand. So it's gonna be pressure from below. And so this is what these scholars argue in different ways. Then a third group of scholars say actually it's all about war, that when governments fight wars, what they need is people to pay for the wars and people that fight the wars. And so they're gonna have to make concessions when they tax people with income and they're gonna have to make concessions when they ask people to go and fight. I should have put Michael Klarman's book up here, "Unfinished Business" he points out that every single increase in political conditions for African Americans in the US has been associated with a war.

That getting them to fight has involved making political concessions. There again you have to wonder, Well, now when you no longer need large armies to fight wars, you can be doing it with drones and so forth, maybe that pressure won't be there. And we've been fighting wars for the last two decades on debt. So we don't have to make concessions to the unborn who are gonna be paying these debts. So there are these different logics but the upshot for the future in thinking about the future is that democracy is not inevitable; it depends upon contingent historical struggles. There's no reason to think it will spring from processes of economic development and modernization. They're conditions unto which it will, becomes more likely and we'll talk about them later but it's not obvious. Even if these economies do falter and wages stagnate and they start to lose legitimacy, they might just become more repressive. There's no obvious reason to think that they will democratize, perhaps they will, but perhaps they will double down. And in a post-Foucauldian world, this may take the form of what he referred to as the gentle way in punishment rather than throwing large numbers of people into prison. - So picture your life in a place where everything you do, what you buy, how you behave, is tracked. The government gives you a score. And the score is a measure of how trustworthy you are as a citizen, and determines what you're allowed to do, like ever. boarding a train, getting a mortgage, all goes back to this score. It's called social credit. The system's eyes are in big data, artificial intelligence, and roughly 200 million surveillance cameras. The scores go from 350 to 950 and are based on habits and behavior. Buy clothes or diapers, it's good. A lot of alcohol, too many video games. Not so good. And it's mandatory. When it goes national, social credit scores will be assigned to every one of China's citizens for life. In 2014, the Communist Party called for a system to allow the

trustworthy to probe everywhere under heaven, while making it hard for the discredited to take a single step.

The model is a place called Rong Chang it's in Chandon province. It's orderly, streets are spotless, cars slow down, which is unheard of in China. Words like honesty and credibility appear on propaganda posters. Display cases show pictures of Rong Chang most honored citizens. You start with 1000 points, and you can print out your report anytime. You lose points for things like jaywalking, littering, tossing cigarette butts, or spreading rumors. Cameras do a lot of the surveillance work, but it's pretty analog too like posters that list the ways you can gain or lose points. And each night, local TV shows the surveillance highlights of the day. And then there's Juan Yi, she's an information collector, a paid enforcer who walks around and writes down deeds about her neighbors. Like the man who carried a drunk person home, things like this are good deeds she said. But the farmer overheard swearing and being rude, yeah, bad deeds. Her quota is 10 a month. She likes the work, thinks the city's better for it.



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