China Rising: Challenges and Opportunities

Manfred Bienefeld

Abstract: It is noteworthy that China’s remarkable success in economic development has occurred under a relatively statist economy, while the more liberalized economies of most other developing countries have fared far less well. This paper compares China’s experience to those of other newly industrialized East Asian countries, concluding that key to successful development is an appropriate balance between the state and markets, and between politics and economics. It is argued that to be most effective, such a balance must allow the collective interests of society to be sufficiently defined and defended against competing private interests, whether these be national or international.

Key words: international development, policy, newly industrialized countries, East Asia, China

1. China’s experiment

China’s explosive economic development over the past three decades has transformed the world economically and politically. And its impact will undoubtedly continue to grow in coming years. Especially when compared to the painful and often destructive transitions of the former Soviet bloc’s “planned economies”, China’s emergence as a successful, dynamic and relatively stable market driven economy must, on balance, be considered a remarkable achievement.

Ever since 1994, Foreign Direct Investment (FDI) has played a major role in fuelling China’s growth and in determining the nature of the impact of that growth on the people, the environments and the economies of China and the world. On the positive side, China’s ability to attract and to utilize unprecedented volumes of international investment have made it the workshop of the world, have transformed its economy and its society, and have raised living standards across the board. Moreover absolute poverty has been reduced in China on such a scale that, despite problematic trends in much of the rest of the world, the global incidence of such poverty has declined significantly over the past two decades.

Broadly speaking, China’s success has had many positive implications for the global economy. It has played an important positive role in global financial markets by providing a wide range of productive

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investment opportunities, by maintaining a high degree of macro-economic stability even during the second half of the nineties and by using its vast reserves to help to prevent a potentially destabilizing collapse of the US dollar. At the same time, its rapid growth has rescued commodity prices from the disastrous lows of the eighties, while its exports have helped the industrial world to contain inflation under often difficult circumstances.

So for many investors China appears as a land of almost unlimited opportunity. It is a stable platform on which many, if not most, things can currently be produced more cheaply and more flexibly, either for export or for a growing and potentially vast domestic market. And it is widely argued and believed that the best way to maximize these opportunities is to press for ever more open access to such investment opportunities, while insisting on the rigorous application of the WTO’s central principle of ‘national treatment.’

2. Thinking of development

While those who take this view acknowledge that China’s success has also given rise to significant challenges that need to be addressed and resolved relatively urgently, they generally believe that this could only be achieved by further empowering global market forces so that China’s allocative decisions would be more systematically and more rigorously subjected to the rationality of competitive global markets. The argument is familiar and points broadly in the direction of more deregulated financial markets and capital flows, more privatization, more flexible labor markets and strict limits on government participation in national industrial and technological development.

Because such policy regimes maximize efficiency and flexibility it is argued that they are best suited to the task of addressing the various challenges that must now be addressed, including in particular: the growth of high and potentially disruptive levels of inequality; the emergence of certain potentially serious social welfare problems; the persistent threat of financial instability; the threat of a foreign backlash against China’s phenomenally successful exports; and finally the accumulation of an interrelated series of environmental problems within China, the Asian region and the world.

However, there are reasons to believe that the further empowerment of market forces is not an adequate, and maybe not even a suitable, response to the complex set of challenges facing China and the world today. Indeed such an approach will almost certainly lead to a further deepening of the very contradictions that now need to be so urgently addressed.

Although both history and theory tell us unequivocally that competitive markets have an important, positive role to play in any effort to build stable, prosperous, humane and sustainable societies, they also
tell us that in order for such institutions to contribute systematically to human and social welfare they must be embedded within a politically and socially defined framework that can define and enforce the parameters within which those competitive forces must operate.

Theory tells us this clearly. Properly understood, even neoclassical theory tells us that in the real world many important choices cannot be left to market forces. Thus, while most societies would value efficiency, as defined by the ability to produce some given, desirable good or service at a lower cost, few would accept such efficiency if, for argument’s sake, it were attained by chaining drugged children to machines. But in order for that option to be precluded in practice, society needs to have the capacity to define and to enforce appropriately framed rules and regulations. And such “limits” must be defined not just with regard to child labor, but with regard to a wide and complex range of trade-offs between narrow, immediate economic efficiency and issues like social stability, family responsibilities, environmental protection and spiritual concerns. And these limits, in turn, must ultimately be determined and legitimated through some political process that is sufficiently transparent and responsive to be persuasive to citizens.

And history tells the same story, namely that successful economies and societies are those that manage, in one way or another, to strike a healthy and sustainable balance between the forces of politics and economics. The point was recently made, once again, by Dani Rodrik who concluded an extensive and thorough examination of the “development record” over the past forty years by suggesting that the single most important determinant of successful development was a society’s “ability to manage the distributional conflicts associated with the process of growth and change.”

The same point is embedded in the observation that the most successful developing economies of the post-war period have generally been “developmental states,” like those of the East Asian Newly Industrializing Countries (NICs) which did put heavy emphasis on market forces and on the need to engage with international markets from an early stage, but within a framework of activist government policies designed to build strong national technological and institutional foundations that would ultimately allow the society in question to develop the ability to “generate and appropriate technology rents” since that is the only basis on which it is possible to become a competitive high wage economy, for the simple reason that those relatively high wages must somehow be “offset” by some “other advantage” within a competitive environment.

While it is theoretically possible for such capabilities to be freely transferred without significant government intervention, history provides few examples of such good fortune. And all of those that it

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does provide involve small economies taking advantage of some particular resource-based (Kuwait, Dubai), or locational (Ireland, Hong Kong), advantage.²

3. China: Success and challenges

When thinking of China in this context, it is useful to note that China’s remarkable success has been achieved during a period when it was, and remains, a relatively statist economy and when other developing countries, most with far more liberalized economies, have fared far less well. In other words, China’s experience like that of the East Asian NICs before it, points to the conclusion that the key to successful development lies in finding an appropriate balance between state and market, and between politics and economics. A balance that can allow the collective interests of society to be effectively defined and defended against competing private interests, whether these be national or international.

From this perspective, China’s—and the world’s—future is seen to hang in a precarious balance. On one hand, if today’s more problematic trends continue—meaning if income inequality continues to grow, if finance continues to be liberalized, if the political process continues to be increasingly dominated by financial and corporate power, and if China continues to develop primarily into an export platform for international capital—then it will become increasingly difficult for it to achieve the sort of balance between politics and economics that might potentially allow it to deal with those growing social, political and environmental challenges that now loom so urgently on the horizon.

It is essential to understand that such successful policy regimes do not—and should not be expected to—consist of some given set of policy instruments. Their essence lies in their objectives and in their adaptability to local circumstance, though there are certain necessary conditions that must be met if such policy regimes are to have a chance of succeeding, including: the sovereign power to pursue an independent monetary policy and to impose capital controls when this is deemed necessary;³ a responsive political system explicitly concerned with the long term national interests; a moderate level of income inequality, so that economic power cannot easily be translated directly into political power; and an


³ Keynes argued passionately that this was the sine qua non for a society’s ability to “pursue its own favorite social experiments.” In a letter to Harrod, who had questioned Keynes’ emphasis on the need for national capital controls, he wrote: “In my view the whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this.” Cited in Crotty, J.R. (1983) “On Keynes and Capital Flight”, Journal of Economic Literature, XXI, March.
international policy framework that does not impose heavy sanctions on any society seeking to implement such a policy regime.\(^4\)

Moreover, in this case, it would also find it difficult to reorient its productive capacities more towards its domestic markets since such a pattern of development would restrict national technological development and therefore China’s capacity to “live with” rising real wages, which, in turn, would exacerbate internal tensions as well as magnifying the risk of a protectionist backlash from its trading partners. Finally, such a backlash would then generate dangerous political tensions that could ultimately lead to conflict and that would certainly further encourage international efforts to foment and support separatist tendencies within China’s large and diverse polity.

On the other hand, it is also true that the Chinese government is clearly cognizant of these challenges and that it has taken steps to deal with many of their more serious manifestations. Thus, both income inequality and the environment have received significant attention in recent years and demands for further financial liberalization continue to be met with a certain (though waning) amount of healthy skepticism. And, maybe most importantly, efforts to promote the development of strong national technological capabilities even within the narrow confines of the World Trade Organization (WTO) appear to be bearing fruit in many sectors. And, for the moment, real wages continue to rise though China’s trade ratio continues to be extremely high for an economy of its size.

And so, as always, the future turns out to be a race against time as various interests struggle to turn the Chinese miracle more to their advantage. But even if China does manage to protect—or to regain—its capacity to create an effective and rational framework for the market forces that it has so successfully unleashed, this would only create the possibility of a successful resolution of the environmental challenge facing China and the world since that challenge can only be met if China—and the world—can find some way of redirecting the current process of socio-economic transformation towards the more leisure intensive, and less material intensive, pattern of work and consumption once associated with the concept of the “leisure society.” And that may prove to be the most formidable—and difficult—task of all. And yet, without it no “sustainable” solution is possible.

\(^4\) This point is made rather graphically in the concluding chapter of World Bank (1993) The East Asian Miracle: Economic Growth and Public Policy, World Bank: Washington D.C which notes rather nonchalantly that many interventionist policy instruments that were used successfully by the East Asian NICs could no longer be used in future because new international agreements would now ensure that anyone seeking to use them in future would face immediate sanctions from the leading trading powers.
References


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