

1. An Overview

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Topics

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1 Some questions about a market economy

What are the essential elements of a market economy?

- Rational individuals
- Private enterprises
- An effective legal system
- A wise state that offsets market failures

The conditions for the market economy to be efficient

- Perfect competition
- Constant returns to scale
- Free movement of factors
- Prices equal marginal utility and marginal costs
- Marginal products of labor and capital are equalized across sectors

Why a free market economy may fail?

- Macroeconomic cycles driven by financial booms and busts
- Inequality in income and wealth is socially excessive
- Private costs and benefits often diverge from social costs and benefits, so the market economy needs regulation
- Many goods and services are socially consumed, so must be provided by the government

China in transition

- Before 1978, China was a socialist planned economy
- Now, it is a socialist market economy with Chinese characteristics, though what is meant by *socialist* and *Chinese characteristics* is not always clear
- What is the target model of a market economy for China?

Where is China now?

- Most prices are set by demand and supply, though the government still regulates some prices
- China is WTO-compliant (?), with many (manufacturing) sectors are open to foreign trade and investment
- The labor market is very flexible, but with weak bargaining power for workers and discrimination by *hukou*
- Many state-owned/controlled enterprises remain, controlling some key sectors such as resources, finance, telecommunications and (traditional) media
- Large investment projects need government approval, especially infrastructure projects
- The government is doing too much in some areas such as approval for entry into sectors where SOEs dominate, but not enough in others such as education, medical care

Key points

- The market economy can be *efficient*, though not perfect, and *innovative*
- The vitality of a market economy hinges on *competition* among *free* individuals and firms who are *rational* in their pursuit of *self interest*

- *Private ownership* and *the rule of law* are essential
- The role of the government is to offset *market failures*, provide *public goods and services* and maintain *macroeconomic stability*
- The range of public consumption reflects the degree of *socialism*

2 What determines the level of income?

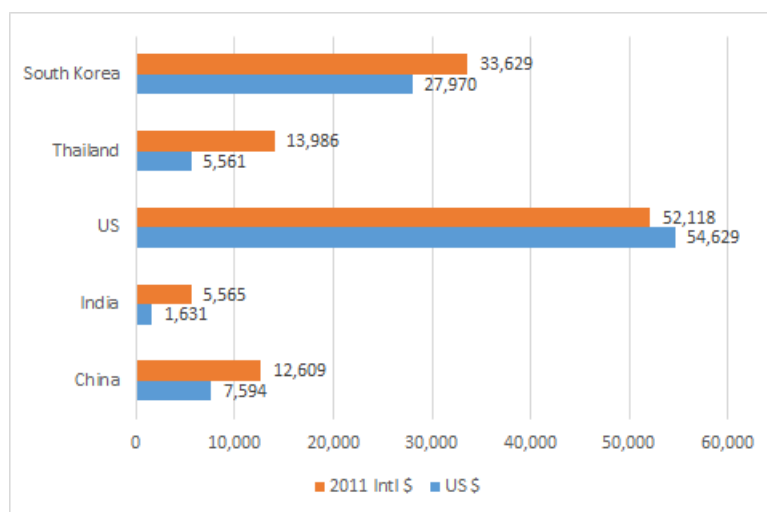
What determines income and wealth?

- Land and natural resources
- Skills and human capital
- Physical capital such as factories and buildings
- Social capital such as economic, social and political institutions
- What goods and services are produced and exported?

GDP per capita in 2014

Country	2011 international \$	Ratio to the US level
United States	52,118	100.0
Canada	42,817	82.2
Singapore	78,958	151.5
Hong Kong	52,552	100.8
Japan	35,635	68.4
South Korea	33,629	64.5
Thailand	13,986	26.8
China	12,609	24.2
India	5,565	10.7

Comparison with and without PPP adjustment in 2014



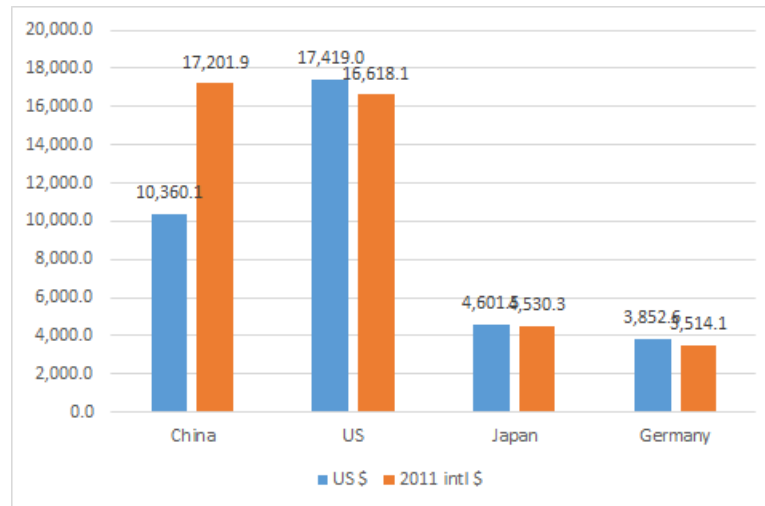
The China-US gap in consumption per capita

	China	US	China/US
GDP per capita in 1990, \$	318	23,954	0.013
GDP per capita in 2016, \$	8,117	57,589	0.141
Compound annual growth in 1990-2016	0.133	0.034	
Household consumption share in 1990, % of GDP	50.0	64.0	
Household consumption share in 2016, % of GDP	39.5	68.8	
Consumption per capita in 1990, \$	159	15,326	0.010
Consumption per capita in 2016, \$	3,203	39,643	0.081
Compound annual growth in 1990-2016	0.122	0.037	

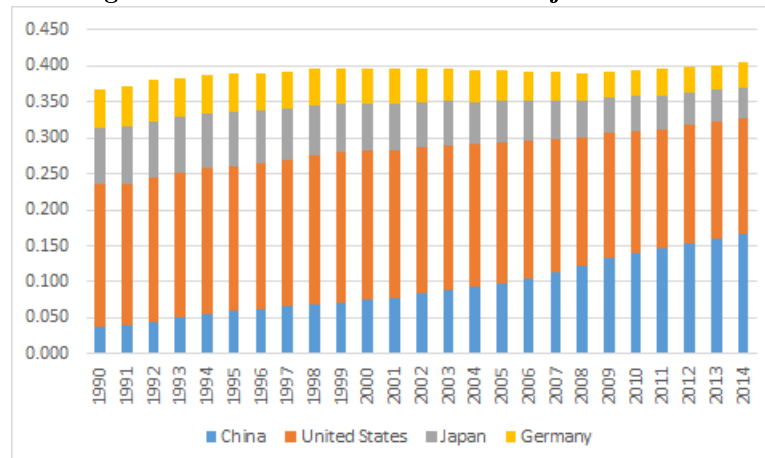
Per capita income and consumption in 2018, yuan

	Level, yuan	ratio to GDP per capita
GDP	64,521	
Disposable income	28,228	0.438
Urban	39,251	0.608
Rural	14,617	0.227
Consumption	19,853	0.308
Urban	26,112	0.405
Rural	12,124	0.188

How big is the Chinese economy in 2014 (billion \$)



Shares of global GDP: China and other major economies



How far can China's income per capita catch up with the US?

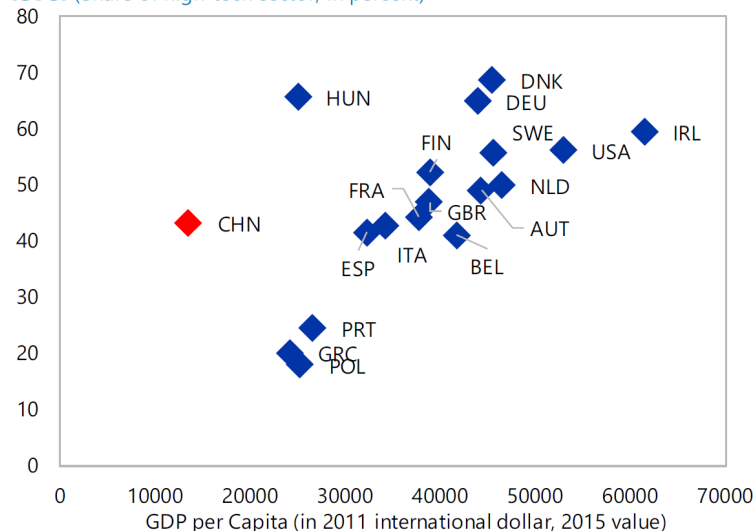
- Natural resources and land: China is less well-endowed, but so are Singapore, Hong Kong and Japan
- Skills: Chinese workers are, indeed, less educated, but the proportion of university enrollment is now more than 1/3, and rising
- Physical capital: roads, bridges, railway, airports are newer in China
- Social capital: a tough question for you to reflect
- Production structure: another tough question

Where would new jobs come from?

- One option is to move the top end up: replicating American internet economy such as Google and Facebook and German/Japanese manufacturing such as cars and machines with Chinese companies and products.
- The other option is to lift up the social floor to enable more people settle down in cities and towns, have access to good quality education and health care, have their own cars and housing, enjoy a sustainable urban economy and rich social life, and bringing up rural life to a comparable urban standard

Is advanced manufacturing the key to high level of income?

China has a more advanced industrial structure given income level (Share of high-tech sector, in percent)



Source: World KLEMS Database, China's National Bureau of Statistics.

Key points

- There remains *a huge gap* of income and living standards between China and the US as well as other advanced economies
- With price correction, China's income per capita is at *a quarter* of the US level
- Without price correction, China's income per capita is at *14 %* of the US level
- More relevant to living standards, China's consumption per capita is only at *8%* of the US level

- Such a large gap cannot be fully explained by the differences in natural resources, labor skills, and physical capital (per worker)
- Instead, the primary factor lies in *institutional quality* as referred to by many economists or *the economic, social and political system* as labeled by academics in China
- So *reform* as a kind of radical change in the quality of institutions plays a pivotal role in closing that gap

3 History and culture

History and culture

- How have some Chinese characteristics evolved historically?
- What is the Chinese dream of national revival?
- In what ways is the Chinese society shaped by historical legacies?

***Qin* Dynasty (秦朝), 200 BC**

- The end of the *Zhou* dynasty (周朝) was followed by 200 years of wars among many kingdoms, known as the period of Warring States, and the period of “Spring and Autumn”
- Finally, *Qin* (秦朝) defeated all others and unified China
- The first emperor of *Qin* (秦始皇) burned books of dissenting schools and standardize the Chinese language
- The tradition of running a country with a centralized bureaucracy started

***Han* Dynasty (汉朝), 202 BC–220 AD**

- *Han* is the name the Chinese people calls themselves
- Government with a centralized bureaucracy selected from civic examinations took shape, distinct from the feudal system (分封制)
- Confucianism (儒家) became the ruling ideology
- *Sima Qian* wrote a book of Chinese history, Records of the Historian

***Tang* Dynasty (唐朝), 618-907 AD**

- Overseas Chinese call themselves Tang People and its influence spread to Korea, Japan and Vietnam
- The Tang era was most prosperous economically and vibrant culturally, poems in the Tang era becoming part of Chinese psychic.
- China was connected to Asia and Europe through the Silk Road (丝绸之路)

***Qing* Dynasty (清朝), 1760-1911**

- The Manchurian people assimilate themselves consciously in Chinese culture and China became revitalized by merging culture and wild instinct
- In the 19th century, China was knocked open by the gunboats of western powers. The first Opium War marked the decline of the Qing dynasty
- During the same period, Japan followed a more successful path of learning from the west and economic take-off
- The defeat of *Qing* in the Opium War casts a long shadow of humiliation to the Chinese people, so *rejuveniation* of China (中华复兴) has been a national aspiration ever since

The Republic of China, 1911-

- Sun Yat-sen led revolutionaries to overthrow the Qing dynasty and established the republic of China in 1911
- The Nationalist Party and the Communist Party split in 1927 and a bitter civil war ensued
- In 1931-45, Japan invaded China. The two parties became temporarily united after 1937 to fight the Japanese
- In 1946-49, the civil war broke out again and eventually Mao Zedong beat Chiang Kai-shek

Confucianism

- Confucius (551-479 BC)
- Chinese official ideology for the past 2,000 years
- *Ren* (仁), or goodness, benevolence and humanity and rule of virtue (德治)
- Loyal (忠) to the emperor and filial respect (孝) to parents and elders
- Paternalistic government and the state is an extension of a family
- Asian values versus American individualism.

Some Chinese characteristics

	Western	Chinese
Basic social units	Individuals	Family and the state
Properties	Individual ownership	Family/state ownership
Behavior	Freedom	Social duties
Motivation	Competition	Obedience and harmony
Social organization	Rule of law	Rule of virtue

The mentality of a lackey / “slave talents (奴才)”

- Master
 - Also known as head of a family/clan, or Chairman of the Party, or party secretary of province or an region or an organization, or boss of a company
 - He is wise and sacred, issuing orders and decrees, dominating his lackeys
- Slave / lackey / minion
 - Serves and pleases the master obsequiously
 - No individual identity, and be filial and loyal as preached by the Confucianism, or the current version: “not forgetting your heart” (不忘初心) - make China great and serve the people by following Xi Jinping

Two contrasting dreams of rejuvenating China

- What make the emperor feel happy:
 - more land and seas under his/her rule
 - More fighter jets, warships and missiles
 - Grandiose global summits and tribute paid by foreign “vassal” states
 - The Belt and Road Initiative (BRI) and pay foreign students to study in China
 - More police and the Great Internet Wall
- What make people happy:
 - Let people with rural *hukou* settle in cities
 - Equal access to quality education, health and old-age security
 - Free expression and assembly, dismantling the internet firewall
 - Make the leader accountable to the people

The implications of China's historical legacies

- China has a long history of centralized government
- The balance of power tilts more to the ruler than to commoners
- To rule by the will of the ruler is stronger than the rule of law
- The Chinese centralized government has been rationalized by the Confucian ideology / the national aspiration of a global power
- It will take time to foster a culture of individual rights, freedom of speech, rule of law and political democracy which would turn upside down the order between government and people

What does “being Chinese” mean?

- A modern society
 - People, or individuals, are their own masters with full human rights
 - The state should be accountable to the people
 - Universal values of liberty, democracy and the rule of law
- A traditional/Chinese society
 - The people are enslaved to the ruler or the Party
 - The society is ruled top-down by a centralized/authoritarian/totalitarian power/Party
 - Loyalty and patriotism overwrite individual freedom and rights

Key points

- The Chinese people is proud of its long history and feels emotionally about the dream to rejuvenate China
- But what “being Chinese” means is controversial
- From the perspective of the ruler, people is enslaved to the Party and motherland, should be grateful and obedient, suppress their interests and freedoms so as to enable the ruler feel secure, powerful and glorious
- From the perspective of the common people, there is no such a thing as being “Chinese,” for they are rational and want to be free, cares most about improving their lives
- From the official perspective, a market economy with “Chinese characteristics” is really a castrated market economy

Review Questions

- What makes a market economy a superior efficient system?
- What makes an advanced economy?
- Is there anything special for being Chinese regarding an authoritarian and collectivist tradition?