

# Analysis of China's Development Mechanism

NISHIMURA Makoto

TANG Mu

For the purpose of creating a new economic model which enables accelerated environment improvement in China, the analysis of China's rapid and massive development mechanism is required, since the environmental issues have been taking place in parallel with its economic growth. Through the analysis, three main factors have been found to greatly contribute to the remarkable economic growth, namely 1) national ownership of land which enable materialization of the government's total optimization, 2) model formation of special economic zone and its imitation, 3) elevation of Sinocentrism of the Chinese people. If China acquires the mindset required to implement a "Green GDP", the authors are certain that the nation can achieve both economic growth and environmental improvement simultaneously.

## I. Introduction

China's economic development in the last 30 years has been remarkable. It far surpasses both Japan's postwar recovery and South Korea's "Miracle on the Han River" economic growth in its speed and scale, deserving to go down as the first and, perhaps, the last, in recorded history. The dynamism of the development can be easily seen simply by glancing at the economic indices. From 1979, the year after the start of the reform and liberalization policy, until 2006, the Chinese economy achieved annual average growth rates of 9.7%. The figure even went up to 10.9% for the period between 1992 and 2006, when the nation switched to a socialist market economy. As of 2006, China's GDP stood at \$2644.6 billion, 4th in the world. Its trade growth rate has

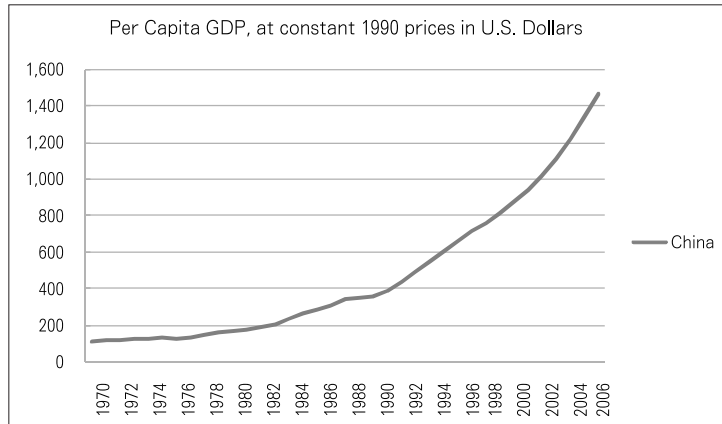
reached about 20%, with total exports of \$249.9 billion. In 1990 China was ranked 14th for total exports, lower than South Korea and Switzerland; however by 2004 it has risen to third, behind only the United States and Germany. By industry, China currently boasts the world's top production in all the following items: basic steel, aluminum, lead, zinc, tin (all in bare metal), motorcycles, television sets, DVD recorders, mobile phones, car audios, personal computers, refrigerators, washing machines, chemical fertilizer, cotton fabric, wool fabric, silk fabric, synthetic fabric, cement, and beer. China's production of PCs alone comprises 83% of global production. This fact highlights the country's economic development, cementing its reputation as the world factory.

Figure1 China's Real GDP Growth Rate



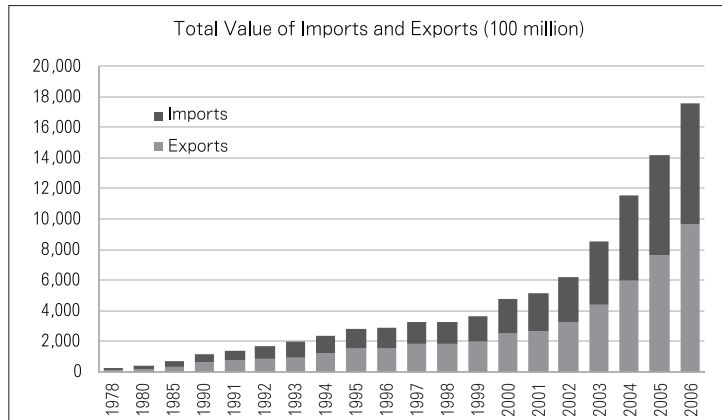
Source: UN Database.

Figure2 Per Capita GDP at constant 1990 prices in U.S. Dollars



Source: UN Database.

Figure3 Total Value of Imports and Exports



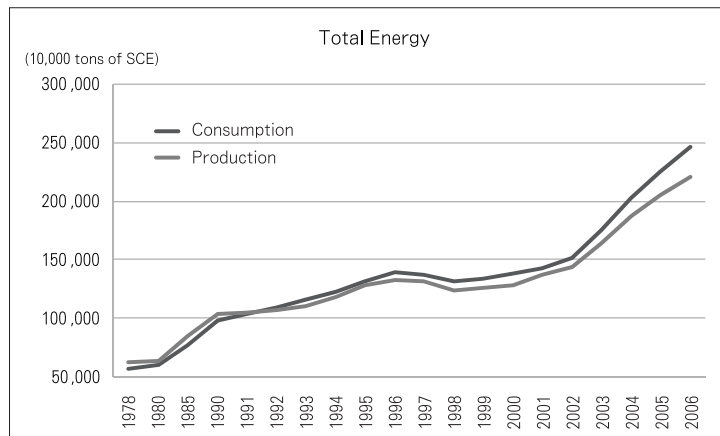
Source: UN Database.

On the other hand, environmental deterioration, the shadow of economic growth, has also been remarkable. The environmental situation in China could not be described as excellent even before the development. Many air and water pollutants were emitted from decrepit heavy industrial facilities, contaminating local environments. And the situation continues. The problem, however, is that economic expansion is pushing the land capacity for environmental recovery to its limit. Before sewage systems and other social infrastructure is fully built, economic growth raises household incomes and increases household effluents, which flow into rivers, lakes, and marshes and cause serious water pollution. Moreover, massive use of cheap, low-quality coal, and the proliferation of automobiles are producing chronic air pollution - especially in urban areas. These issues may not only impede further

economic expansion but also cause serious pollution-related diseases, such as those seen in Japan. The bottom line is that China needs to hurry up and improve its ecological efforts.

The purpose of this paper is to draw up plans to improve the environment, present them to the public for assessment, and eventually propose them to the environmental authorities of China, based on the hypothesis that inspiration must be obtained from China's economic expansion model, which has been making accelerating progress, to bring about accelerating environmental recovery. Every environment is unique in each area and nation, and ecological improvement models from other areas or nations can be helpful but rarely an exact answer. Thus uniquely tailored solutions must be sought. In the case of China, which, as mentioned above, has experienced economic development unprecedented in

Figure4 the Transition of Production and Consumption of Total Energy



Source: China Statistical Yearbook 2007.Ref.16

speed and scale, we reached the conclusion that a unique model must be constructed.

Economic growth is still continuing in China, and many unknown factors may arise in future. Therefore, economic hypotheses and models should be built up very carefully. Still, in light of the seriousness and urgency of environmental problems, we advance rather bold hypotheses in this paper.

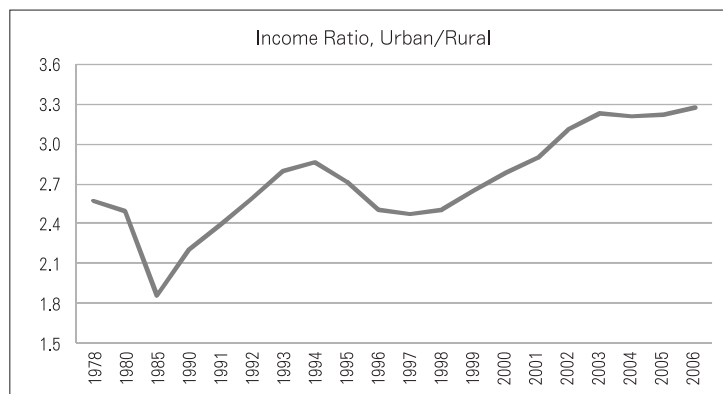
## II. Mao's creative destruction and Deng's innovation

According to the economic development model of Joseph Alois Schumpeter, capitalist economic development is driven by creative destruction and innovation. We adopt Schumpeter's model here because his long-term forecast of 40 to 50 years is so dependable that many economists rate it very highly, considering it fundamentally sound in principle. However, "creative destruction" in Schumpeter's

theory means the destruction of past phenomena by creation. In that sense, though the theory applies to Mao in terms of politics - in that he destroyed the former political systems of China with communism and socialism - in terms of the economy, Mao brought about nothing creative, only destruction. And this destruction made possible Deng Xiaoping's "construction = innovation." Therefore, to be exact, the creative destruction of the Schumpeter theory was carried out in reverse. In other words, we aren't arguing that China's economic growth is a successful example of innovation.

Some explanations are necessary here to avoid possible misunderstanding: economic growth in China is a classic case of conventional industrial capitalist development. The economy grew in China as conventional industrial capitalism budded and developed after exhaustive destruction by Mao. However, the development process followed Deng's distinc-

Figure5 Income Ratio, Urban/Rural



Source: China Statistical Yearbook 2007.Ref.16

tive approach. At the end of the 20th century the IT revolution, financial innovation, and globalization meant that developed countries had no choice but to start shifting from industrial capitalist economies to post-industrial capitalist economies. In the transition process, China did not innovate in the field of information technology which supported the IT revolution, propelled largely by the US. Rather, as the industrial capitalism of developed nations hit a ceiling due to depletion of industrial reserve, China took advantage of its massive reserve of industrial labor to become the world's leading industrial capitalist economy.

The reason we brought up Schumpeter's economic growth model is to explain the overall process by which Mao Zedong destroyed old China and Deng Xiaoping astonishingly created new China. Details of the destruction caused by Mao's measures have been revealed in a variety of documents which have recently started to be published. In particular, the Mao-driven economic policy called the Great Leap Forward was an outrage which ignored the basics of economics and resulted in the starvation of millions. The Cultural Revolution, a political and social movement, was also an outrage which resulted in widespread hardship and deprivation. Nevertheless, a portrait of Mao Zedong is displayed in Tiananmen Square even now, and he is treated with respect by most Chinese people. Why is

that? It is because Mao is the person credited with bringing China together as a modern nation-state. Until the beginning of the 19th century, China was a major empire controlling 30 to 40% of the world's wealth. The reason why China had to surrender to imperialist invasion by the great Western Powers was that it was not a nation-state at the time. Sun Yat-sen, who tried to transform China into a nation-state, died before achieving his goal, and Chiang Kai-shek took over but did not succeed. Eventually, with the Kuomintang-Communist collaboration during the Sino-Japanese War as a turning point, Mao Zedong united the nation. However, China then was not a nation-state, despite being a united nation.

It was a series of Mao's blunders that changed China to a nation-state. Here is a paradox of history. Max Weber said in *The Protestant Ethic and the Spirit of Capitalism* that modern capitalism developed only in areas which were openly dominated by economic ideologies completely opposed to capitalism. Similarly, the modernization/capitalization of China could not have budded without Mao's exhaustive destruction. Of course, if it had ended up with only destruction, it would have been an utter disaster. But an extraordinary genius, Deng Xiaoping, ruled China after Mao Zedong. That is to say, Mao and Deng jointly accomplished Schumpeter's creative destruction and innovation. Next, we

will examine the creative side of Deng Xiaoping.

“I don’t care if it’s a white cat or a black cat. It’s a good cat so long as it catches mice.” The phrase was a simple and clever way to encourage economic development in place of ideological disputes. In addition to the cat slogan, Deng established a Special Economic Zone at Shenzhen, on the outskirts of Hong Kong, bringing together selected talent, copious investment, and leading-edge technologies from overseas in an economic development model experiment. It sounds easy when you read it written down, but the reality was far from it. China was a socialist nation, so staunch that it once labeled the now-defunct USSR revisionist. The boldness required to create a special economic zone in the midst of such devout socialism is worthy of special mention. Of course, the experiment was a great success. A specific model of “a cat that catches mice” was now presented to the people of a China which had transformed into a nation-state. Resolution through *fait accompli*. In other words, people doubt the potential of a mere idea, but when presented with a concrete model which actually works, support builds at an accelerating pace, because now they can simply emulate the model. In fact, when Deng Xiaoping visited Singapore in 1978, he exclaimed that he could not believe that fellow Chinese had established the city-state.

Deng talked with Lee Kuan Yew for a good three hours, during which Deng is said to have obtained the inspiration for the special economic zone. The model that proved successful in Shenzhen was later implemented across China, with special economic zones and special development zones starting in metropolitan areas. Twenty years later, there were special zones all over the nation, except in farming villages. This paradigm of proliferation through construction and emulation of a model is the most significant part of the Deng Xiaoping “magic.” You can fully understand how powerful the methodology to form and emulate a model is when you look at the power of the Kakuei Model, created by former Japanese Prime Minister Kakuei Tanaka. The original form of the model - a triangle of politicians, bureaucrats and business leaders driving public works projects through private benefit - may have initially achieved total optimization, but it later became increasingly routine, spreading across Japan even after Tanaka died, and creating numerous sub-optimal projects with no national benefit. It continues still. This is also why the economic effect of public works projects in Japan has been so diluted.

The Deng Xiaoping magic did not stop there. Let us consider what clever tricks were employed to gain funds - “original capital” - for the shift to capitalism (though called “socialist

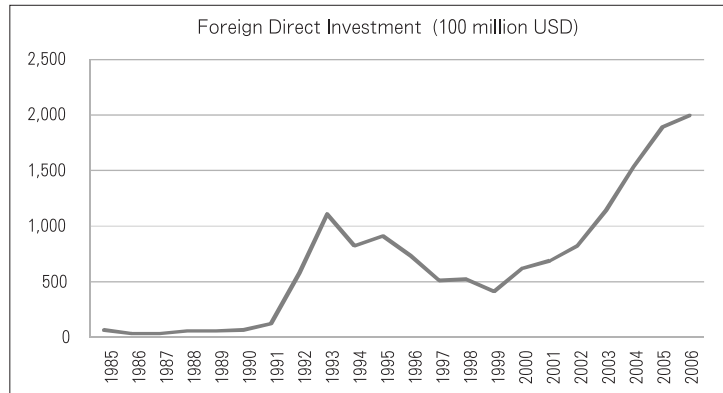
market economy”, it is actually capitalism). The principle of capitalism is quite simple: capital produces profits. Profits enhance capital, and the enhanced capital further produces more profits. This process of expanding reproduction is economic development. Yet it is extremely difficult for a developing country to put together the original capital (foreign money to be invested). Many developing countries fail to surmount the hurdle, and the project miscarries. In order to accumulate foreign currency, a nation needs to make products that appeal to foreign markets and then to export them, which requires the construction of modern factories. In order to build modern factories, construction materials - capital goods - need to be imported. Thus at the start of economic development, foreign currency decreases. For a while after the start of factory operation, foreign currency is making up the deficiency, and therefore doesn't accumulate. Nevertheless, China earned foreign money instantly, and all in the form of cash.

Deng Xiaoping delivered speeches during his southern tour in 1992, which triggered the formation of the socialist market economy. At the same time, China started selling the long-term usage rights of central areas of Shanghai and other big cities for foreign currency. The trick here was to sell usage rights rather than the land itself. The land was located not in faraway industrial complexes or

resorts but in urban centers. In other words, a great store of credit was created from zero. Considering China's subsequent development, purchase of usage rights was like buying a winning lottery ticket. However, buyers of the rights were limited to certain corporations and individuals - overseas Chinese. China could not have been modernized without the contribution of overseas Chinese. This contribution will be discussed in another section.

Overseas Chinese who obtained usage rights began to build skyscrapers in the centers of big cities. Meanwhile, European funds, which had initially been cautious about granting credit to China, were gradually tempted by the behavior of overseas Chinese. In the midst of this activity, Hong Kong formally reverted to China in 1997. At the time there was much speculation regarding likely outcomes of such a historic event. Due to concerns that many forms of freedom might be lost in Hong Kong, a lot of people moved to the US, Canada, and Australia. But as it turned out, such concern was unfounded. Hong Kong stayed almost as it had been. Seeing this, European funds hurried to the bonanza, and China secured a huge amount of foreign currency in an instant. China's foreign reserves continued to increase, and the nation overtook Japan to become the world's top holder of foreign exchange reserves in 2007. As of July 2008, the total had reached a whopping \$1,800 billion.

Figure6 the Transition of Foreign Direct Investment (100 million USD)



Source: China Statistical Yearbook 2007.Ref.16

The “magic trick” involves two significant factors. These are the most important keys to the subsequent development of China. One of them is the fact that all the land in China is owned by the government, and the government can use it any way it wants. Another is that time-limited usage rights, rather than property rights, of the government-owned land can be sold for cash. The (potential) value of these two factors is tremendous; there are no other nations in the world except Singapore and Vietnam that have these two factors. It was these factors that allowed China to modernize rapidly and on a large scale. The first factor was brought about by Mao at the expense of Chinese people. Without this factor, Deng’s magic would have not been possible. Next we’ll examine the formidable power of the two factors.

### III. A social system that makes optimization possible

For a developing country, procurement of capital does not immediately mean economic development. There is another hurdle: constructing social infrastructure. Massive construction of infrastructure - not only land for building industrial facilities, but also transportation infrastructure including ports, harbors, airports, railways, and motorways; energy infrastructure including the supply of electricity, gas, and fuel; telecommunication infrastructure including cabling, telephone systems and wireless networks; and life infrastructure required for workers to live. Of these, one of the most urgent is basic infrastructure. China built its basic infrastructure with a speed and scale achieved by no other developed nation, and construction continues still. An important element here is that



construction starts with something that has top priority for the nation's economic growth - in other words, whether total optimization can be achieved or not. China under single-party rule achieves almost perfect total optimization, which has never been achieved by any other developed nation. Here we may find the classic mismatch of communist party and capitalism puzzling. Yet, if we leave the communist party aside and consider the combination of dictatorship and capitalism, they have been frequently been well-matched in world history:

- A variety of economic records set in the US during World War II have never been broken.
- In Germany, the director of the German National Bank Hjalmar Schacht, upon whom Hitler had conferred full power, displayed his uncommon shrewdness and rapidly brought the German economy back from the abyss of inflation and depression with large-scale public investment such as construction of Autobahn.
- Japan's rapid economic growth was supported in practice by the long-term stable administration of the Liberal Democratic Party.
- This was also true of the "Miracle on the Han River" under the South Korean administration of Pak Jeong-hui.
- Remarkable modernization of Singapore under the dictatorship of Lee Kuan Yew, which was the textbook of model

formation in China

- If we look outside capitalism, socialism under Stalin also achieved unprecedented economic growth.

That is to say, dictatorship can bring about total optimization of the nation's economic policy, and, with an excellent leader, implement rapid economic expansion. Why is that? Schumpeter said in his lecture entitled "Capitalism, Socialism and Democracy" that capitalism would eventually collapse, one reason for which is that entrepreneurship declines as capitalism develops. In contraposition, if capitalist supporters are powerful, capitalism will expand further. Capitalism is sustained by managers, and managers focus on managing their businesses, which in many cases puts them out of touch with the general management of society, namely politics. Therefore, supporters are needed in the political field. That is why dictatorship so often sustains capitalism.

The Chinese Communist Party has a privilege any of the dictatorships noted above would envy. That is the fact that the land is owned by the government. A dictatorship's effort to achieve total optimization is greatly limited if land is private property. Construction of the Three Gorges Dam and the big canal from the Yangzi River to the North China Plain would have not been possible in the first place if the land was not in

state ownership. Nearly two million residents were evacuated to build the Three Gorges Dam. If the site was private property, it would have taken more than 100 years just to persuade residents to move away. Consider how many years it took to build Narita Airport, which was a top priority project for Japan at the time, and you will understand the magnitude of optimization made possible by the free utilization of national land, possible for China in the past and the future.

#### IV. High capital turnover rate due to national ownership of land

The benefits of government ownership of land, which was brought about by Mao, do not end there. In China, rent from national land and arising from usage rights is paid directly into the national coffers. Though it may not seem much when put this simply, it actually makes possible massive, rapid capital turnover. To see how powerful it is, compare it with Japan's situation. In 1990s, the bursting of the economic bubble threw Japan into a prolonged recession, and expenditure and investment, necessary to boost the economy, were depressed. Corporate and individual consumers had little disposable income to spend. Land prices and rents in Japan are exorbitant, and a significant portion of corporate and individual income is spent on land. It

is unlikely that landowners, who obtain enormous amounts from land purchases or rents, will use the money for spending or investment, especially investments for industrial development. This is because landowners mostly save their incomes or buy more land. Fresh land purchases potentially push up land prices, which means the disposable incomes of non-landowning corporations and individuals will never increase. Landowners are not salaried workers, and without tax withholding, use every trick to reduce their taxes. Thus, in Japan there is a big difference between land rents and the amount going into the national coffers. Moreover, the money in the national coffers is not used for total optimization but for partial optimization, which barely contributes to economic expansion. This is an unfortunate residue of the aforementioned Kakuei Model.

Meanwhile in China, rents from national land are paid directly into government coffers, and poured into the projects most important for the economic development of the whole of China. In other words, total optimization is achieved. This creates an accelerating virtuous circle. The Beijing-Tianjin Motorway is one such example. Lack of transportation infrastructure to reach Tianjin, a port for Beijing, was one of the worst bottlenecks in the economic development of China at the time. The

opening of the motorway, as good as interstate highways in the US, eliminated the bottleneck, spurring the development of the big cities of Beijing and Tianjin. The national coffers gained an enormous amount of sales of land use rights and corporate taxes generated by energized businesses, and the money enabled further enhancement of the social infrastructure of the two cities. The cycle stimulated reproduction on an expanded scale, produced short term economic growth on a massive scale, and still continues to do so.

## V. Benefits of globalization, IT revolution, and financial innovation

The Berlin Wall came down in 1989, ending the Cold War, and ushering in an era of drastic changes with the IT revolution, financial innovation and globalization occurring simultaneously. The demise of the USSR left the US as the sole superpower. As Joseph E. Stiglitz says in his book *Making Globalization Work*, the US aggressively promoted such globalization as benefited its own interests. Buffeted by waves of drastic change, Russia, Japan, and most developing nations faced a period of prolonged recession and slowing economies. However, as Stiglitz points out, China gained more benefits from the changes than any other country. Its powerful one-party government resisted

every unfavorable consequence of globalization, accepting only those that brought advantages to China. Globalization basically comes down to trade deregulation and capital liberalization. Deregulation of trade gave China a huge global market, while opening up global suppliers for its industrial adjustment, which had been its Achilles heel. CHINCOM, COCOM and other restraints imposed on communist nations during the Cold War were abolished, China was able to procure any products it lacked from any of the nations of the world. Consider the situation facing many factories in the last days of the: “finished but not running”, which was caused by an economy unable to source all required parts and materials domestically. This demonstrates how great a bounty China obtained from its external environment, namely globalization. Globalization served as a spur to the opening of export markets as well. Globalization, based on market fundamentalism, started to polarize the world. In Japan, corporate restructuring raged in the 1990s. After that, the number of full-time company employees dropped sharply, and more lower-paid temporary and contract workers were employed. At the social level, there was a large increase in consumers with only small incomes, for whom cut-price home appliances and daily commodities sold at 100-yen shops became literal necessities. The low-income group emerging from the

polarization overwhelmingly supported inexpensive made-in-China goods, providing a huge market. Of course, these low-priced Chinese products inflicted a heavy blow on manufacturers in developed nations. Developed nations were driven from industrial capitalism to post-industrial capitalism, solidifying China's superiority in the industrial field.

On the other hand, capital liberalization, another aspect of globalization, caused a tumultuous flow of investment capital into China, and these funds built the very factories that now supply the world. That incredible 83% world share in PCs says it all. All the factories were ultramodern with cutting-edge world technology. The IT revolution especially benefited China. It not only offered the gift of the PC and mobile phone assembly industry. Thanks to IT, China only needed workers who could manipulate PCs to operate huge factories in a variety of industries that had earlier required highly-skilled workers. An example often cited in regard to infrastructure construction: China cut down on vast infrastructure costs by skipping the process of constructing the infrastructure for landline telephones, instead directly introducing the mobile phone system.

The introduction of foreign capital gave China another advantage. That was the alleviation of trade friction, especially in terms of the relationship with the US.

Japan's economic growth coincided with its export of massive volumes of textiles, semi-conductors, automobiles, and other products in which it had a competitive edge to the US, which brought about serious trade friction problems. In the case of China, however, a large proportion of the exported goods were produced in factories built with US capital, and forces within the US government suppressed aggravation of trade friction issues.

As for the connection between the financial revolution and China's economic growth, investment in China became far easier than previously because of the capital liberalization, and the most important point is that it enabled financing at low interest rates. In the 1990s, neighboring Japan was afflicted with an unprecedented financial crisis, and the government lowered official discount rates to rescue financial institutions, implementing almost-zero interest, which continues to the present. The "yen-carry trade", a financial operation utilizing the effectively-zero-interest rates, started in the market. Though there are some exchange risks, it must have been via this scheme that ultra-low-interest money oured into China. A massive amount of money flowed from the financial market into crude oil, grain, and other futures markets due to sub-prime loan defaults. After all, the nature of money is to be more stable when tied to some physical

product than when floating in the financial market. In that sense, we can surmise that it is a matter of course for money to flow into the Chinese capital market through "yen-carry".

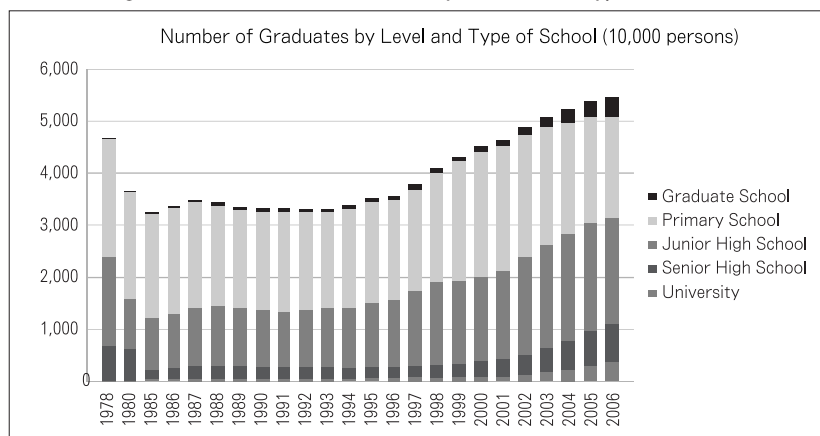
As seen so far, all of the drastic changes that occurred after the end of the Cold War - the IT revolution, financial innovation, and globalization - gave a fair wind to China. Looking from the opposite side, China had the luck to draw the current up close, and the intelligence to hold on to its luck.

## VI. Education-oriented nation (tentative)

Around the time of the Meiji Restoration, in hurrying to modernize itself, Japan spent what little money it had from its tight budget to send many students abroad and to invite talented overseas teachers and engineers, and

established its position as an education-oriented nation, advancing to become an industry-, trade-, and technology-oriented nation. China has been taking a similar path. China invested huge amount of dollars in education, sending more than 700,000 students between 2000 and 2006, mainly to the US, , and as expected, the students worked hard. The premises of China's education policy were totally different from those of Japan, and its education-orientation had an effect inconceivable in other countries. The bottom line is that a young, talented, and highly-motivated Chinese elite studied abroad, especially in the US, in quite new environments that had undergone the drastic changes of the IT revolution, financial innovation, and globalization. The members of this elite brought the results of their studies back to China, where they were given positions of great importance and allowed

Figure7 Number of Graduates by Level and Type of School



Source: China Statistical Yearbook 2007.Ref.16

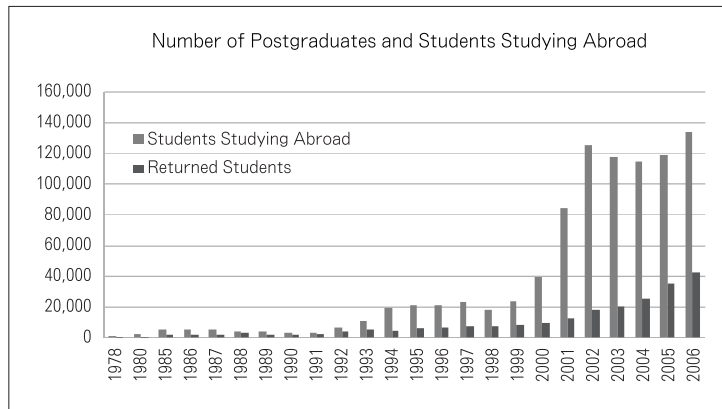
to utilize what they had learned. Usually it is not that easy to make use of advanced knowledge learned overseas after one's return home, because every country has some traditionalism and conservative pressure, a resistant force which tries to suppress forward-thinking reform moves. Japan has had all too many cases where a brilliant employee sent to the US by a company learns advanced management, returns with an MBA, is opposed by obstinate executives in the company, gets disappointed, and resigns. However in China, the elite which received an overseas education was able to propel reforms as if it were advancing into a wasteland. Again, the reason is Mao's legacy.

The old elite in China was cleared away by the Cultural Revolution. Worse, to a certain extent we can say that the Chinese intelligentsia was hollowed out. Therefore, there was little of the afore-

mentioned resistant force. What is important is that the young generation, who learned to swim in the new currents of the IT revolution, financial innovation, and globalization, filled the hollow. In Japan, it was young businesspeople in their 30s and 40s who brought about the miraculous recovery from World War II. China did not miss the bus. Far from it, it was riding in a new highway bus together with the US, looking back on other advanced nations aboard old buses.

Meanwhile, it was overseas Chinese business people who gave that elite on-the-job management training. Corporations support capitalism, and its driving force rests on the shoulders of managers. Overseas Chinese were the ones who fulfilled this important role. We cannot over-emphasize the role overseas Chinese played in the modernization of China. This issue will be discussed in a separate section. At this point, we just

Figure8 Number of Postgraduates and Students Studying Abroad



Source: China Statistical Yearbook 2007.Ref.16

make it clear that members of the elite who learned theory abroad received direct instruction from business people who worked their way through actual business, and the management was reproduced on an expanded scale, and that was the drive that propelled the modernization of China.

## VII. Contribution by overseas Chinese

A developing country starts with industrial modernization in order to modernize the nation, but there is a big catch. In many cases, people fail to notice that the “software” of industry, namely service industries - raw material procurement, logistics, and product sales - must grow along with industrial modernization; instead they tend to focus on industrial “hardware.” Immediately after the Meiji Restoration, Japan was much concerned by and frustrated over the fact that trade was controlled by foreign businesses, and performed the daring stunt of creating general trading firms in its industrial promotion policy. The move enabled Japan to push forward its modernization at a speed much faster than predicted. An unusual order issued by the General Headquarters (GHQ) after World War II to dismantle general trading houses provides support for the importance of the role played by the industrial “software” - the general trading companies.

For China, the role of general trading firms was performed by overseas Chinese organizations. Overseas Chinese means Chinese people who moved at various times from continental China to Hong Kong, Taiwan, and Southeast Asian nations. They already had a strong inclination towards commercial capital. In 1970s and 80s, newly industrializing economies (NIES) achieved a remarkable economic expansion, made active industrial investments, underwent many kinds of hardship, and became entities that had both knowledge and experience of industrial capital. As the Cold War structure crumbled, there were signs that economic activity in Southeast Asia had hit the ceiling; Japanese economic growth slowed down, and Asian currencies fell into crisis. With immaculate timing, China then launched a policy of openness, and overseas Chinese funds, seeking new investment targets, started making forays into China. As argued earlier, overseas Chinese responded enthusiastically to the unprecedented business opportunity to obtain usage rights of superior government-owned land. The background is the somewhat saturated investment situation in Asia. After the reversion of Hong Kong, investment in China entered a full-scale phase.

The greatest contribution made by overseas Chinese was the investment in China, businesses related to overseas Chinese, including those of Hong Kong

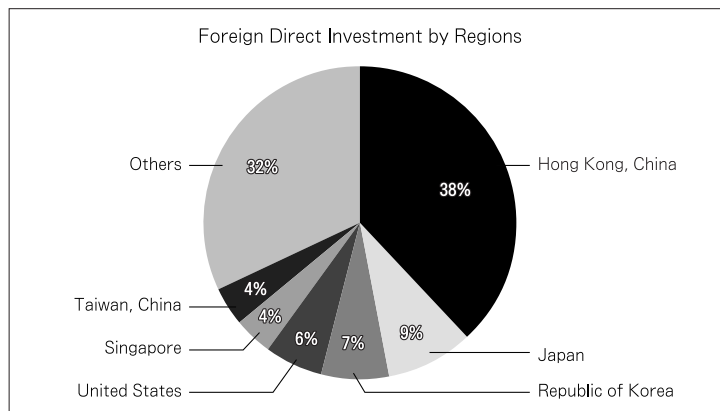
and Taiwan, accounting for an overwhelming proportion of the foreign direct investment (FDI): more than 50%. Overseas Chinese businesses landed in China after training themselves in commercial capital. It means that they were not just investors but also promoted industry themselves and ran the businesses.

Dispatch of business managers is the second most significant contribution of overseas Chinese. Those who believed in and supported these managers were students who had learned leading-edge IT and FT (financial technology) abroad, especially in the US. Unlike Japanese, overseas Chinese often take family-oriented or autocratic management styles. Because of its origin in commercial capital, decision-making is fast and bold, which has much to do with the speed and scale of the modernization of China. However, thanks to their experience with indus-

trial capital in Southeast Asia, all of the investment of huge sums, which was bold, or even reckless, in the eyes of advanced nations, was successful. That is because they had confidence in their cost competitiveness, made possible by an inexpensive industrial workforce, and because they obtained accurate market information via the network set up across the globe.

The third Overseas Chinese contribution is their extensive and reliable human networks spread across Europe, the US, Japan and other advanced nations. They undertook everything from procurement of raw materials for factories built in China to distribution and sales of products, providing schemes of system communication management (SCM) and data communication modules (DCM), which would take decades to form in other countries. High-speed communication using the Internet worked incredibly

Figure9 Foreign Direct Investment by Regions



Source: China Statistical Yearbook 2007. Ref.16



powerfully between trusted parties. Each business deal was immediately judged and made, and the decision was faster and more appropriate than those of other advanced nations.

Their fourth and fifth contributions may be bigger social gaps and relatively low environmental concern. Overseas Chinese are tough, having survived various kinds of persecution against foreign capital in Southeast Asia, and took on business in China aggressively based on the law of the jungle. They thus had a strong mindset to consider social disparity as a matter of course, an attitude inherited by their successors, the members of the elite. Meanwhile, as foreign capital with little sense of responsibility, they had no experience of tackling any environmental problems; they behaved in the same manner in China.

Overall, their positive contributions far exceeded negative ones. Without the existence and cooperation of overseas Chinese, the modernization of China would have taken much longer.

## VIII. Relationship with the US

Nations that formed an amicable relationship with the US became rich while those hostile to the US suffered terribly. This is a historic fact rather than a lesson learned in the 20th century. It is said that Deng Xiaoping also often made

such remarks. Deng therefore devoted much effort to diplomacy with the US in order to develop and maintain a good relationship.

As discussed in the chapter on globalization, the IT revolution and financial innovation, all three were established by the US, and other nations were forced to accept them. But China turned them to its own benefits just like the *tomoenage* Judo throw in which, by falling backwards, you throw your opponent. Take a look at the nation's balance sheet. China purchased US government bonds with the huge sum of foreign money it had gained from trade, while inviting private investment from the US to boost industry: a two-way relationship. The US offset its enormous trade deficit with investment in China. Though each balance sheet was rather distorted, if a consolidated balance sheet were to be drawn up, it would be quite neat and well-balanced. It means that in the world after the Cold War, China and the US developed a mutually complementary economic relationship, and are in a honeymoon period. Deng's dream came true.

Will the honeymoon period be sustainable? The US is very tolerant while it occupies a clearly superior position. Once its overwhelming predominance is in jeopardy, however, the US becomes frosty, childish in its behavior. We should perhaps expect to see US

attitudes change abruptly as China rapidly gains power.

## IX. Capitalist ethos of China

Finally, the basic ethos that enabled the rapid, large-scale economic development of China needs to be discussed. According to *The Protestant Ethic and the Spirit of Capitalism* by Max Weber, capitalism requires capital, technology, and the spirit of capitalism - the capitalist ethos - to germinate. As we have been discussing, China's economic expansion is real, we can infer from this that China possessed capitalist ethos. So where did this capitalist spirit come from? At least in the socialist China of people's communes, low productivity and lack of objective rationality were the rule. Why did the capitalist ethos awaken all of a sudden with a nudge from Deng's "cat"? Though this proposition needs further research, we can surmise that the key is the high pride that preexisted deep in the hearts of all the Chinese. That is to say, China, which boasted one third of world GDP in 1800, quickly found itself bowing to the powerful nations of Europe and the United States, and the nation's prides, or Sinocentrism, sank deep in the Chinese psyche to fester as an inferiority complex. This pride emerged and came into bloom as nationalism when Mao Zedong united the nation, but again subsided during the repeated failures of

economic policy, stagnated, and in the tumult of the Cultural Revolution, was pressed to the limit. Deng's open policy freed the suppressed pride and set it loose. Instead of the Protestant work ethic, there was Sinocentrism to generate the spirit of capitalism.

## X. Conclusion

So far we have analyzed the mechanism of economic development which has supported China's high growth, and found that social structures, economic systems, and a national character unique to China lie behind this miraculous economic expansion.

There are three points we would like to stress again here. The first is that national ownership of land was the most significant factor to support China's economic growth. In the last 150 years, China has made unimaginable sacrifices in order to establish itself as an independent nation state and industrialize. As a result, the government owned the nation's land, unprecedented among advanced nations. Because the government's ownership of land brought about total optimization, China, with the world's third greatest land area and largest population, was able to achieve economic growth of amazing scale and speed. This is the precious gift bestowed on modern China by Mao Zedong and his revolution and destruction. However, this fact is so

taken for granted by Chinese people that most seem to be unaware that this unusual system of government ownership of the nation's land is the foundation of economic development. They should come to a new appreciation of the value of national ownership of land, achieved through the colossal sacrifices of the Mao days, and should be firmly resolved to keep the system intact. Leasing land use rights can be allowed to some extent, but relinquishing land ownership in any form would be a suicidal act and would deprive the powerful government of the Communist Party of its authority, which would never revive again.

Secondly, the system adopted by Deng Xiaoping of using successful cases in special zones as a model to spread reform across the nation suits the Chinese situation very well. Among famous Deng quotes are "Cross the river by feeling for stones" and "Let some people and some areas get rich first, and help other people and other areas to get rich together." In China, such a vast land with such a huge population, it is too risky and too difficult to implement reform all at once nationwide. It is more efficient and practical to use reform experiences obtained in special economic zones as models and lessons to recommend it across the nation. This can be applied not only to implement economic growth but also to resolve environmental problems. That is, to improve the

environment in China, creating "special environmental zones," which have priority to employ new technologies and serve as role models, would be desirable. We will discuss the use of the economic development models in detail in our next paper.

Finally, the great pride, or Sinocentrism, of the Chinese people is the key to dealing with future environmental issues. Solving these problems requires a mindset, or ecological awareness, in each and every Chinese person. China would indeed be respected by all the world, becoming literally the new world leader, if its economic development model were reset to create an economic growth pattern that also pursued and implemented the "Green Gross Domestic Product (Green GDP)", an economic growth index taking the environment and resources into consideration, rather than focusing on the GDP-oriented economic expansion represented by the US. We are certain that China can achieve both economic growth and environmental improvement at the same time, if the nation acquires the mindset required to implement a "Green GDP" of which the Chinese could truly be proud.

## References

- Andy Rothman (2006), *Reinventing China*, CLSA Asia-Pacific Markets, (Sept).
- Beijing Loosens Grip on Economics Zones (2006),

- South China Morning Post*, (April 5).
- Carsten A.Holz (2005), *China's Economic Growth 1978-2005: What We Know Today about China's Economic Growth Tomorrow*, (July 3).
- C.Fred Bergsten, Bates Gill, Nicholas R.Lardy, and Derek Mitchell (2006), *China: The Balance Sheet*, Public Affiars.
- Deng XiaoPing (1994), *Selected works of Deng XiaoPing*, vol.1-3, People's Press.
- Fang Zhenghui,ed (2004), *Stories of China's Reform and Opening-Up*, Shenzhen: Story of China Publishing.
- Hu Jintao (2005), *Why China Loves Globalization*, Globalist, (June 7).
- Jasper Becker (1996), *Hungry Ghost-China's Secret Fame*, John Murray Publishers Ltd.
- Joe Studwell (2004), *The China Dream: The Elusive Quest for the Greatest Untapped Market on Earth*, Profile Business.
- John Gittings (2006), *The Changing Face of China: From Mao to Market*, Oxford Univ. Press.
- John Pomfret (2006), *Chinese Lessons: Five Classmates and the Story of the New China*, Henry Holt.
- Joseph E. Stiglitz (2002), *Globalization and its Discontents*, New York: Norton.
- Lee Kuan Yew (2000), *From the Third world to First: The Singapore Story*, HarperCollins.
- Lee Kuan Yew (2004), *Lecture in Nanyang Technological University of Singapore*, (<http://www.ntu.edu.sg/corpcomms2/releases/Speech%20by%20SM%20Lee%20Kuan%20Yew%20at%20CL%20Conference.pdf>), (June23th).
- National Bureau of Statistics of China (2007), *China Statistical Yearbook*.
- Philip Snow (2003), *The Fall of Hong Kong: Britain, China and the Japanese Occupation*, New Heaven, Yale University Press.
- Robin Hutcheon, (1991), *A Burst of Crackers: The Li & Fung Story*, Li & Fung Ltd.
- Tom Doctoroff (2004), *Billions: Selling to the New Chinese Consumer*, Palgrave Macmillian.
- United Nations Statistics Division, UNdata base.
- Weber, Max (1988), *Die protestantische Ethik und der Geist des Kapitalismus*, Iwanami-Syotenn.
- Woetzel (2006), *Checking China's Vital Signs: the Social Challenge*, McKinsey Quarterly, special edition: Serving the New Chinese Consumer.
- Worldwatch Institute (2006), February 16<sup>th</sup>.
- (Graduate School of Economics, Nagoya University)
- (Japan International Cooperation Agency)