China's Transformation and Its Global Implications

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Founding Dean | Professor of China Business and Globalization
Email: bxiang@ckgsb.edu.cn
I. The Development Model of China since 1978

II. Contributing Factors to and Myths or Misconceptions about the “Chinese Way”

III. A Historical Perspective

IV. China’s Economic Prospect

V. Global Implications of China's Transformation
I. The Development Model of China since 1978: A Review

In 1992, Deng’s 1992 Southern Tour

In 1978, Reform and opening-up

In 2013, China overtakes U.S. as World's top merchandise trader
#1 in foreign currency reserves ($3.82 trillion in 2013)
#1 foreign holder of US debt ($1.27 trillion in 2013)
Largest market for many products/sectors (autos, smartphones, PCs, luxury products...)

In 2010, China surpassed Japan as the world’s second-largest economy; China replaced the U.S. as the world's largest manufacturing country

In 2009, China overtook Germany to become the world's largest exporter

In December 2001, China's WTO accession

Note: China’s GDP as % of the Global Economy
Source: World Bank
I. The Development Model of China since 1978: A Review

![Chart 1-1: China’s Contribution to World Economic Growth](chart)

<table>
<thead>
<tr>
<th>Year</th>
<th>Contribution to World Economy (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>15.28</td>
</tr>
<tr>
<td>2006</td>
<td>16.32</td>
</tr>
<tr>
<td>2007</td>
<td>20.20</td>
</tr>
<tr>
<td>2008</td>
<td>39.50</td>
</tr>
<tr>
<td>2009</td>
<td>-</td>
</tr>
<tr>
<td>2010</td>
<td>18.08</td>
</tr>
<tr>
<td>2011</td>
<td>20.77</td>
</tr>
<tr>
<td>2012</td>
<td>61.94</td>
</tr>
<tr>
<td>2013</td>
<td>28.00</td>
</tr>
</tbody>
</table>

Note: Contribution = China’s GDP Increase / World’s GDP Increase

In 2009, world economic growth was -1.1%, while China’s economic growth was 8.7%, so China’s contribution to the world economy is not applicable for 2009.

In 2012 the EU economy experienced negative growth.

Source: World Bank
## I. The Development Model of China since 1978: A Review

### Chart 1-2: China’s Share of Global GDP in 2013

<table>
<thead>
<tr>
<th>Economy</th>
<th>GDP (Billion $)</th>
<th>of Global GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>74899.88</td>
<td>100.00%</td>
</tr>
<tr>
<td>EU</td>
<td>17350.85</td>
<td>23.17%</td>
</tr>
<tr>
<td>USA</td>
<td>16800.00</td>
<td>22.43%</td>
</tr>
<tr>
<td>China</td>
<td>9240.27</td>
<td>12.34%</td>
</tr>
<tr>
<td>Japan</td>
<td>4901.53</td>
<td>6.54%</td>
</tr>
<tr>
<td>Germany</td>
<td>3634.82</td>
<td>4.85%</td>
</tr>
<tr>
<td>France</td>
<td>2734.95</td>
<td>3.65%</td>
</tr>
<tr>
<td>UK</td>
<td>2522.26</td>
<td>3.37%</td>
</tr>
<tr>
<td>Brazil</td>
<td>2245.67</td>
<td>3.00%</td>
</tr>
<tr>
<td>Russia</td>
<td>2096.78</td>
<td>2.80%</td>
</tr>
<tr>
<td>Italy</td>
<td>2071.31</td>
<td>2.77%</td>
</tr>
<tr>
<td>India</td>
<td>1875.80</td>
<td>2.51%</td>
</tr>
</tbody>
</table>

Source: World Bank
## Chart 1-3: China’s Share of Commodity Production (%)

<table>
<thead>
<tr>
<th>Name of commodity</th>
<th>% of Global</th>
<th>Name of commodity</th>
<th>% of Global</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pig iron</td>
<td>59%</td>
<td>Mobile phone</td>
<td>70%</td>
</tr>
<tr>
<td>Crude steel</td>
<td>46%</td>
<td>Integrated circuit</td>
<td>91%</td>
</tr>
<tr>
<td>Coal</td>
<td>50%</td>
<td>Computer</td>
<td>68%</td>
</tr>
<tr>
<td>Cement</td>
<td>60%</td>
<td>Air conditioning</td>
<td>80%</td>
</tr>
<tr>
<td>Electrolytic aluminum</td>
<td>65%</td>
<td>Washing machine</td>
<td>44%</td>
</tr>
<tr>
<td>Refined copper</td>
<td>24%</td>
<td>Microwave oven</td>
<td>70%</td>
</tr>
<tr>
<td>Fertilizer</td>
<td>35%</td>
<td>A digital camera</td>
<td>65%</td>
</tr>
<tr>
<td>Fiber</td>
<td>70%</td>
<td>Shoes</td>
<td>61%</td>
</tr>
<tr>
<td>Flat glass</td>
<td>50%</td>
<td>Aquatic</td>
<td>60%</td>
</tr>
<tr>
<td>Engineering machinery</td>
<td>43%</td>
<td>Eggs</td>
<td>45%</td>
</tr>
<tr>
<td>Car</td>
<td>25%</td>
<td>Meat</td>
<td>27%</td>
</tr>
<tr>
<td>Shipbuilding</td>
<td>43%</td>
<td>Vegetables</td>
<td>49%</td>
</tr>
<tr>
<td>TV</td>
<td>49%</td>
<td>Fruit</td>
<td>17%</td>
</tr>
</tbody>
</table>

Source: World Bank, Business Week, FAO
I. Limitations of the China Model: Not Sustainable / Not Exportable

About “Made in China”

• “Commodity” in strategy
• Competing on “price” not “value” (Domestically: middle class is still struggling to emerge)
• Primarily imitating and weak in innovations
• Some key manufacturing costs were not fully considered (environment, cost of capital, labor)

Long-term challenges

• The China model generates wealthy merchants, limited progress in developing great business institutions like IBM, GE and Siemens (with exceptions like Huawei Technologies)
• Tradition of “keeping the business in the family” creates challenges: limited leadership talent, giving back to the wider community
• Powerful role of the state and state capitalism: state-business relationship
• These economic frictions lead to diplomatic problems (Internationally: perception of “China threat”)
I. Limitations of the China Model: Value Capturing

Chart 1-4: iPhone 5’s Cost Structure

$ 650 Retail price

$ 168 The total cost of materials

$ 8 Assembled costs in China

$ 474 Gross profit

Source: IHS iSuppli
I. Limitations of the China Model: Value Capturing

Chart 1-5: The Cost Structure of a Barbie Doll

- **Retail price (Toys R Us)**: $9.90
- **Purchasing cost**: $2.00
- **Chinese manufacturers**: $0.35

Source: United States Department of Commerce
I. Limitations of the China Model: The lack of Innovations

<table>
<thead>
<tr>
<th>Rank</th>
<th>Fast Company</th>
<th>Forbes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Nike</td>
<td>Salesforce</td>
</tr>
<tr>
<td>2</td>
<td>Amazon</td>
<td>Alexion</td>
</tr>
<tr>
<td>3</td>
<td>Square</td>
<td>VMware</td>
</tr>
<tr>
<td>4</td>
<td>Splunk</td>
<td>Regeneron</td>
</tr>
<tr>
<td>5</td>
<td>Fab</td>
<td>ARM (UK)</td>
</tr>
<tr>
<td>6</td>
<td>Uber</td>
<td>Baidu (CN)</td>
</tr>
<tr>
<td>7</td>
<td>Sproxil</td>
<td>Amazon</td>
</tr>
<tr>
<td>8</td>
<td>Pinterest</td>
<td>Intuitive Surgical</td>
</tr>
<tr>
<td>9</td>
<td>Safaricom</td>
<td>Rakuten (JP)</td>
</tr>
<tr>
<td>10</td>
<td>Target</td>
<td>Natura (BR)</td>
</tr>
</tbody>
</table>

Source: Fast Company, Forbes
I. Limitations of the China Model: Environmental pollution

Chart 1-7: Exposure to particulate matter with an aerodynamic diameter of 10 μm or less (PM10) in 1600 urban areas (2008-2013)

Annual mean PM10 (ug/m3)
- <20
- 20–29
- 30–49
- 50–99
- 100–149
- ≥150

*The mean annual concentration of fine suspended particles of less than 10 microns in diameter is a common measure of air pollution. The mean is an urban population – weighted average from cities with available air pollution measures.

Source: WHO
Outline

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V. Global Implications of China's Transformation
II. Contributing Factors to China’s Success

- MAO ZEDONG
- DENG XIAOPING
  Opening-up and Reform
- Political System
- Global Environment
II. Contributing Factors (1):
MAO ZEDONG

United China again in 1949
Population dividends: from 540 million (1949) to 960 million (1978)
Increased social mobility: diminished social segregations
Liberation of women
Promoting mandarin
Cultural revolution (1966-1976) and "a blank piece of paper"
Soviet Union’s financial and technical assistance to new China (1950-1960), the 156 Projects laid the foundation for China’s industrialization
II. Contributing Factors (2):
Opening-up and Reform

- Economic openness
  - Reform and “Open Door” Policy in 1978

- Deepening reform
  - Deng’s 1992 Southern Tour
  - Private sector development

- Pragmatism – “Cat Theory”
  - Mitigated Ideological Debate

- Integration with the global economy
  - China’s WTO Accession in 2001

DENG XIAOPING
(1904-1997)


## II. Contributing Factors (2-1): Economic Openness

<table>
<thead>
<tr>
<th>Foreign trade dependence (2013)</th>
<th>Foreign Direct Investment (Inward, 2013)</th>
<th>Multinational corporations in China</th>
<th>The openness of domestic markets</th>
<th>Diversity of enterprise management</th>
</tr>
</thead>
<tbody>
<tr>
<td>• China 45%</td>
<td>• The world’s second largest FDI recipient</td>
<td>• Cisco: financial 70%, Railway 60%, Air traffic control 100% (Huawei in U.S.)</td>
<td>• The prevalence of foreign brand and goods.</td>
<td>• Business models</td>
</tr>
<tr>
<td>• U.S. 23%</td>
<td>• China: $123.0 Billion</td>
<td>• Volkswagen: 34% of total sales.</td>
<td>• Auto: Volkswagen, GM, Toyota, Honda.</td>
<td>• Management systems</td>
</tr>
<tr>
<td>• Japan 32%</td>
<td>• US: $187.5 Billion</td>
<td>• KFC: 51% of income and profit.</td>
<td>• Daily chemical: P&amp;G, L’Oreal.</td>
<td></td>
</tr>
<tr>
<td>• India 42%</td>
<td>• Qualcomm: 49% of income.</td>
<td>• Smartphone: Samsung.</td>
<td>• Smartphone: Samsung.</td>
<td></td>
</tr>
<tr>
<td>• Germany 73%</td>
<td>• The total import and export of foreign invested enterprises 47%</td>
<td>• Household appliance: Samsung.</td>
<td>• Household appliance: Samsung.</td>
<td></td>
</tr>
</tbody>
</table>
II. Contributing Factors (2-2): The Role of the State Sector

National level

- Economist: State Capitalism
- Seven sectors designated as key and strategic are dominated by SOEs (defense, power generation and distribution, oil and petrochemical, telecommunication, coal, aviation, shipping)

The Visible Hand

- National Development and Reform Commission (NDRC)
- “State companies make up 80% of the value of the stock market in China, 62% in Russia and 38% in Brazil” (The Economist, “The Visible Hand”, 21 January 2012)
II. Contributing Factors (2-2): State Capitalism

The Rise of State Capitalism

The Economist
Jan 21, 2012

State capitalism in China: Of emperors and kings

The Economist
Nov 21, 2011
II. Contributing Factors (2-3):
The Role of the Private Sector

Economic Contribution
• Over 50% of GDP
• 80% of employment and 90% of new jobs

The central element of China’s success in economic transformation: the private sector has overcome a wide range of discriminations and become a dominating force in China’s economic transformation

Large-scale private enterprise
• China Top 500 Enterprises (2013): 190 private enterprises accounted for 18.06% of total revenue
• Nine of the Fortune 500 (2014) companies from China may be considered private
II. Contributing Factors (3):
The Political System

Intelligent Governance for the 21st century:
A Middle Way Between West and East
By Nicolas Berggruen and Nathan Gardels

- Ruling by elites (Confucius)
- Promotion through the ranks – executive experience
- Meritocracy
- Beyond hereditary system
- CCP members exceeding 86m
- Democratization of information
- Leadership Development
II. Contributing Factors (4):
The Global Environment

<table>
<thead>
<tr>
<th>Peace</th>
<th>No large-scale confrontation between the great powers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neoliberalism</td>
<td>Deng Xiaoping (1978), Margaret Thatcher (1979) and Ronald Reagan (1980)</td>
</tr>
<tr>
<td>Democratization of information</td>
<td>IT, Internet, mobile Internet</td>
</tr>
<tr>
<td>Globalization</td>
<td>China's accession to the WTO on December 11, 2001</td>
</tr>
<tr>
<td></td>
<td>Sino-US relations, TPP and TTIP</td>
</tr>
<tr>
<td>Other exponential technologies</td>
<td>Computer, Internet, Mobile Communications, New Materials, New Energy, Biotechnology</td>
</tr>
<tr>
<td>Geopolitics and global governance</td>
<td>Rise of emerging markets and changes in global governance and in geopolitics</td>
</tr>
</tbody>
</table>
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III. A Historical Perspective on China’s Transformation: Chinese history (221BC-1840)

- Qin (221BC-201BC)
- Han (206BC-220AD)
- Sui (580-618)
- Tang (618-907)
III. A Historical Perspective on China’s Transformation: Chinese history (1840-1949)
III. A Historical Perspective on China’s Transformation: Chinese history (1840-1911)

- Opium War (June 1840-August 1842)
- Treaty of Nanking of 1842
- Sino-Japanese War of 1894
- Treaty of Shimonoseki of 1895
III. A Historical Perspective on China’s Transformation: Chinese history (1912-1937)

Sun Yat-sen (1866 – 1925)

Monarchy abolished on Feb. 12, 1912

Provisional president and founding father of the Republic of China ("Nationalist China")

Yuan Shikai (1859 – 1916)

First president of the Republic of China (1912-1916).

On 12 December 1915, Yuan proclaimed himself Emperor of the Chinese Empire under the era name of Hongxian (洪宪皇帝). After 83 days, he resigned on 22 March 1916.
III. A Historical Perspective on China’s Transformation: Chinese history (1937-1945)

The second Sino-Japanese War (July 7 1937 and August 15 1945)
III. A Historical Perspective on China’s Transformation: Chinese history (1912-1949)

Civil war (1945-1949) between the Nationalist and the CPC

Establishment of The P.R. of China on Oct. 1, 1949
III. A Historical Perspective on China’s Transformation: Chinese history (1949-Present)

MAO Zedong
1949-1976

DENG Xiaoping
1978-1989

Jiang Zemin
1989-2002

Hu Jintao
2002-2012

Xi Jinping
2012-
III. China’s Re-emergence: Historical Perspective on China’s Transformation

Chart 3-1: As of late 1820, China produced 30% of world GDP

Source: “The World Economy: A Millennial Perspective”, Angus Maddison
III. China’s Re-emergence: Historical Perspective on China’s Transformation

China’s “leadership” approach: which is characterized by non-interventionist and non-expansionist behavior

- In the early Song Dynasty (960-1271), with its dominance in nautical technology, “China’s fleet could have carried the empire into an era of conquest and exploration. Yet China acquired no overseas colonies and showed relatively little interest in the countries beyond its coast. It developed no rationale for venturing abroad to convert the barbarians to Confucian principles or Buddhist virtues.”

- Early years of the Ming Dynasty, between 1405 and 1433, seven voyages lead by Admiral ZHENG He, In terms of size, sophistication, and number of its vessels (100 to 300 ships carrying up to 27,000 men), “it dwarfed the Spanish Armada (which was still 150 years away).” No conquests were contemplated, no colonies planned, and no evidence of territorial ambition.
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IV. China's Economic Growth Prospects: When will China overtake America in GDP?

**Goldman Sachs:** China will overtake the United States to become the world's largest economy.

**World Bank:** China is likely to become a high-income economy and the world’s largest economy before 2030.

**The Economist:** China’s Annual Real GDP growth will be average 7.75% for China and 2.5% for America.

**IMF:** China's share of the global economy will hit 18%, while the United States' share will lag behind at 17.7% *(Adjusted by PPP)*.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP China</th>
<th>GDP America</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>9.24 trillion</td>
<td>16.80 trillion</td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2030</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2035</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
IV. Prospect of China’s Transformation: Reasons for Optimism/Economic Factors

- Urbanization Rate: 53% in 2013 (as compared with 83% for U.S.)
- Service accounting for 46% of GDP in 2013 (79% for the U.S., 2012)
- Global Workshop/1st or 2nd largest markets/potential for the coming decade
- Population dividends until 2020
- Sectors to be further deregulated: such as financial sector, telecommunications, media, sports (like the English Premier League and NBA), cultural and creative industries, health care
IV. Prospect for China’s Transformation: Reasons for Optimism/Other Factors

- Being open-minded and curious
- Entrepreneurial drive, and values of enterprise and self-help
- Chinese Diaspora, overseas Chinese students and the new wave of immigrants
- China's population accounts for 19% of the world
- Population dividends in the context of globalization and information democratization
- Some potential positive legacies of the “Cultural Revolution”
- Economic openness and embracing globalization experience
- Rich experience with diverse systems: socialism and capitalism; planned and market economy
- China’s historical prominence in the global economy
- China’s long history and uninterrupted civilization, plus Confucian values
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V. Global Implications – 1: Development models
V. Global Implications – 1: Development models

The New York Times

The Opinion Pages | OP-ED COLUMNIST

The Big Debate

MAY 19, 2014

It's now clear that the end of the Soviet Union heralded an era of democratic complacency. Without a rival system to test them, democratic governments have decayed across the globe. In the U.S., Washington is polarized, stagnant and dysfunctional; a pathetic 26 percent of Americans trust their government to do the right thing. In Europe, elected officials have grown remote from voters, responding poorly to the euro crisis and contributing to massive unemployment.
V. Global Implications – 1: Development Models/Drifting to the Middle

Government debt (% GDP)

(High)

200%

100%

Inclusive growth

Japan

Greece

Italy

United states

Germany

China

Gini coefficient

(High)

0.3

0.4
V. Global Implications – 2: Economic Openness and Embracement of Globalization

Reform and opening

Global Implications

History

Open history: Tang (618-907)
V. Global Implications – 3: Political System and the New Social Contract
## V. Global Implications – 3: Limitations of the Western Model

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereign debt crisis</td>
<td>The difficulties of solving sovereign debt crisis under the current social contract</td>
</tr>
<tr>
<td>Myopia</td>
<td>Political cycle as short as 4-5 years</td>
</tr>
<tr>
<td>Leadership deficit</td>
<td>Democratization of information “Ruling by elite” seems more unattainable</td>
</tr>
<tr>
<td>Limited executive experience</td>
<td>Compared with the CCP</td>
</tr>
<tr>
<td>Power and money come together</td>
<td>Can democracy effectively mitigate widening income and wealth gap?</td>
</tr>
</tbody>
</table>
V. Global Implications – 4: Sustainable Development

Unity of heaven and man ("天人合一")

Redefine the relationship between man and nature
A key element of sustainable development

CHUANG TZU (庄子)
(399–295 B.C.)
V. Global Implications – 4: Global Governance (Harmony versus Uniformity)

Harmony versus Uniformity ("和而不同")

- Ineffective global governance (state-centered political system vs. globalized economy)
- Unilateralism (U.S.) or Multilateralism (G7, G20, WTO, TPP)
- 1) Diversity is a prerequisite for harmony; 2) Diversity is a necessary condition for progress of civilizations
- The possibility of collective misjudgment
V. Global Implications – 5: “Dynasty Cycle”

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Dynasty</th>
</tr>
</thead>
<tbody>
<tr>
<td>618-906 (288 years)</td>
<td>Tang Dynasty</td>
</tr>
<tr>
<td>960-1279 (337 years)</td>
<td>Song Dynasty</td>
</tr>
<tr>
<td>1279-1368 (71 years)</td>
<td>Yuan Dynasty</td>
</tr>
<tr>
<td>1368-1644 (276 years)</td>
<td>Ming Dynasty</td>
</tr>
<tr>
<td>1644-1911 (267 years)</td>
<td>Qing Dynasty</td>
</tr>
<tr>
<td></td>
<td>Northern Song Dynasty (960-1127)</td>
</tr>
<tr>
<td></td>
<td>Southern Song Dynasty (1127-1279)</td>
</tr>
</tbody>
</table>
V. Global Implications – 6: “East-West Two-way Traffic”
V. Global Implications – 7:
Collective Myopia of Humanity
Thank you

Bing Xiang, Ph.D.
Founding Dean | Professor of China Business and Globalization
bxiang@ckgsb.edu.cn