

## Course Information

### Description

China is a country that is both transitioning to a market-oriented economy and developing rapidly into a global economic power. As such, it has characteristics of both an emerging market economy and a developing country. China is large enough to create its own institutional infrastructure to support a third way between capitalism and socialism. This course examines in detail China's great economic transformation beginning in 1978 in what is often described as a "gradualist" transition to a market economy. In the last three and a half decades, the speed of China's development and its growth rates of GDP are without precedent in history.

China entered the current decade with an unbalanced economy highly dependent on both state-financed investment through a state-controlled financial sector and a growth strategy focused on exporting finished goods to the global economy with the support of foreign direct investment. The current leadership recognizes the need to rebalance the economy by promoting more domestic-fueled growth through increased consumption so as to achieve more broad-based economic development. Many social issues remain to be tackled among which are environmental degradation, income inequality and an aging workforce. After developing the economic background that propelled China rapidly into middle-income-country status, this course considers these issues (and others) to provide insights into the fundamental question of "what is left to be done" to create a fully mature, developed market-oriented economic system open to the global economy.

### Texts (available for purchase at Broad Street Books)

Barry Naughton, *The Chinese Economy: Transitions and Growth*,

MIT Press, 2007 Paper ISBN10-0-262-64064-3

Lin, Justin Yifu, *Demystifying the Chinese Economy*, Cambridge University Press 2012

Paper ISBN1978-0-521-18174-7

### Other Readings

All journal articles listed as required readings are accessible through Moodle.

## Writing Assignments

The first week consists of a “getting-acquainted” paper focused on the legacies of the Communist past and the initial economic situation in China on the eve of the economic reform. In weeks two and three, the tutorial papers focus on the early decade and a half of transition and development. Weeks five and six focus on the recent two decades of transition, opening to the global economy, and dealing with the global financial crisis. Standard five-to-seven-page tutorial papers are expected for topics in these four weeks. **All tutorial papers must be completed before the tutorial discussions.**

The fourth week is reserved for preparation and presentation of a research prospectus and précis of work in progress for the final policy paper. The tutorial culminates in the seventh week with presentations of policy papers.

## Capstone Policy Paper

(12 – 15 pages)

Each student chooses a topic of current policy interest in China and becomes our resident expert. Although the policy paper may frame the issue in an historical context, current material must be used to inform the policy options available to Chinese officials today. Economic considerations will be the main focus of the paper but political aspects may be introduced if relevant. A research prospectus and précis of work in progress for the paper along with a preliminary annotated bibliography are due in week #4. The final policy report is due in week #7 when policy experts make presentations.

**Writing tips are provided at the end of this syllabus;** you may find these useful in preparing the tutorial papers and in writing the final policy report.

### *Choosing Your Topic*

The Naughton book is a somewhat encyclopedic source for China’s economic transformation and opening to the global economy over a three-decade period. The Lin book, based on the author’s lectures for a course at Peking University (in Chinese), is more conceptual. Both books provide the background material for the choice of a policy topic. A perusal of the indexes followed by the skimming of chapters relevant to topics of interest should help inform the student’s choice. This choice should be made as soon as possible because the research prospectus and précis must be completed by week #4. The tutor is available for advice about possible topics but the initial interest should come from the student.

**Choose your topic judiciously;** experts who switch focus mid-stream lose credibility!

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*Part 1: Transition/Development: Gradualism or Procrastination?*

After the People's Republic of China was established in 1949, China's new leadership tried to promote economic development from the top by creating a massive socialist industrial complex and using direct government controls, i.e., the command economy. Mao's big industrialization push, known as the Great Leap Forward, led to economic crisis followed by a brief period of readjustment but ended in the chaotic period, known as the Cultural Revolution. In 1978, the new party leaders embarked on economic reforms that promoted growth rates in GDP and GDP per capita over the next three decades without precedent in history. The reforms were a mix of economic development strategies and policies designed to nurture the transition from the planned command economy to a more market-oriented economy. China's economic reforms have been characterized by Westerners as a "gradualist" transition from a bureaucratically managed economy to a market economy because they stress the importance of maintaining political support for reforms by minimizing the costs of change. Deng Xiaoping, the most influential of the new leaders, used the metaphor of "crossing a river by groping the stones" to characterize economic reform in China. Considering China's experience over these three decades yields insights into the interplay of policies and institutions that is designed to support a stable economic transformation and a rapid but sustainable integration into the global economy.

*Week 1: Getting to Know China: Legacies & Starting Conditions*

Readings

*Naughton*: Introduction & Chapters 1, 2, 3 & 4

*Lin*: Chapters 1, 2, 3, & 4

**Tutorial Paper Week #1 On the Eve of Economic Reform: China's Initial Situation**

Your tutorial paper should integrate the issues in the following prompts into a coherent essay.

- Describe the salient economic features of China on the eve of its economic transition.
- Characterize the imbalances and distortions inherited from the previous economic system that are likely to hinder the development of a market economy in China.
- Characterize, in your own words, Lin's notion of the comparative advantage-defying, catching up strategy. Do you think that Naughton would agree with this assessment of China's pre-reform history? Support your position.
- Identify the most important economic problems facing the policymakers in China at the beginning of its transition to a market economy.

**Expected Length:** No more than six (6) but at least four (4) double-spaced typewritten pages in **standard font** of **normal size**, e.g., this assignment is typed in Times New Roman, size 12, with standard page margins.

## *Week 2: Growing Out of the Agrarian Economy*

### Readings

*Naughton*: Chapters 5, 6, 10 & 12

*Lin*: Chapters 6 & 7

Perkins, Dwight “Completing China’s Move to the Market,” *Journal of Economic Perspectives*, 8:2, (Spring) 1994, pp. 23 - 46.

Qian, Yingyi “How Reform Worked in China” Chapter 11 in *In Search of Prosperity: Analytic Narratives on Economic Growth*, Dani Rodrik (ed.) to p.314.

### **Tutorial Paper: China’s Reform Strategy: Growth and Market Development**

Spurred on by economic reforms beginning in 1978, China’s development and its growth rates in GDP and GDP per capita transformed the economy from an agrarian one to a mixed-market system. Naughton separates a thirty-year period into two phases of reform using 1992 as the dividing year when Deng restarted economic reform after the Tiananmen Square demonstrations in 1989 with his “Southern Tour” visit to the existing Special Enterprise Zones (SEZs). Naughton characterizes the first phase of economic reform up to 1989 as “reforms without losers” and “growing out of the plan” but he considers the second phase as “reforms with losers.”

- Provide an overview of growth in GDP by identify any differing aggregate trends across the two phases. Identify and distinguish the main engines (factors) of China’s rapid growth during the two phases by comparing their impact on overall growth.
- Characterize, in your own words, Lin’s notion of a comparative advantage-following development strategy (CAF). Would Lin consider the growth strategy in the first phase to be CAF? Why or why not?
- How does the changing composition of plan and market during the first phase of the reform relate to Qian’s notion of transitional institutions?
- Focusing on the transitioning-to-the-market aspects of rural reforms, why does Qian consider TVEs to be a transitional institution? Would Perkins agree?
- Would Perkins and Qian agree with Naughton’s assessment of the first phase as “reforms without losers”? Why or why not?

**Expected Length: No more than seven (7) but at least five (5) double-spaced typewritten pages in standard font of normal size, e.g., this assignment is typed in Times New Roman, size 12, with standard page margins.**

### *Week 3: Becoming the Workshop of the World*

#### Readings

*Naughton*: Chapters 13, 14 to p.333 & 15

*Lin*: Chapters 5, 8, 9 & 13

Jefferson, Gary and Rawski, Thomas, "Enterprise Reform in Chinese Industry," *Journal of Economic Perspectives*, 8:2, (Spring) 1994, pp. 47 - 70.

Qian *op.cit.* p.314 to end

#### **Tutorial Paper: China's Industrial Transformation: Only Partial Success?**

Naughton provides a more pessimistic characterization of the second phase of economic reforms after 1992 dubbing them as "reforms with losers." Rawski and Jefferson conclude their analysis of the first phase of enterprise reforms in China with an optimistic statement concerning China's ability to harness its potential for further gains without creating intolerable political tensions or social costs. Based on the experiences in the second phase of reforms, Lin and Qian come to a more pessimistic view of the reform of the industrial sector.

- On what do Rawski and Jefferson base their optimistic assessment of industrial sector reform?
- Characterize, in your own words, Lin's notion of "enterprise viability" and relate it to CAF and CAD development strategies.
- Why does Qian consider large state-owned enterprise reform to be a failure rather than a transitional institution?
- Explain thoroughly why Qian and Lin do not find the earlier optimism of Rawski and Jefferson born out.
- Would Qian and Lin agree with Naughton's assessment of the second phase of reforms? Why or why not?

**Expected Length: No more than seven (7) but at least five (5) double-spaced typewritten pages in standard font of normal size, e.g., this assignment is typed in Times New Roman, size 12, with standard page margins.**

### *Week 4: Research Prospectus and Précis of Work in Progress*

A research prospectus and précis of work in progress contains three essential components.

1. The **motivation** for the research and a statement of the **research question**. A clear statement of the focus of your research with a specification of the research question should be provided.
2. A statement of the **research approach** to be taken and **the progress** made should be provided. The following questions may provide useful prompts for presenting and developing the research approach. However, they are not intended to be a list of exam questions to be answered individually.

Please use judiciously!

- How do you intend to answer the research question?
- What evidence will you seek?
- What supportive argumentation will you use?
- What are your anticipated results?
- How do you expect to support any resulting policy conclusions?

In addition, a **brief statement of the work you have accomplished** to date should be included. This statement should identify any difficulties that you foresee in dealing with your research question so that the instructor can provide help in a timely manner.

3. An **annotated** bibliography. This consists of a list of sources that you have found to date for your research project. Each citation is accompanied by **two** or **three** sentences that link the material in the source **directly to your research question**. You **must** explain why you think that this source will be useful in dealing with your research question. The references should be arranged alphabetically by the author's last name. Be sure to include full information in your citations. See the references at the end of the chapters in *Naughton* for examples of proper formats for citations.

#### **Expected Length:**

Sections 1 and 2 **combined** should be **three (3)** to **four (4)** pages.

Section 3 should be **two (2)** to **three (3)** pages.

## *Week 5: China's Twin Surpluses: Global Opening and the Consequences*

### Readings

*Naughton*: Chapters 16 & 17

*Lin*: Appendix

Aizenman, Joshua, "The Internationalization of the RMB, Capital Market Openness and Financial Reforms in China," NBER Working Paper #20943 (February) 2015

McKinnon, Ronald, "China's Exchange Rate: The Plight of an Immature Creditor," *East Asia Forum* (3<sup>rd</sup> October) 2010 <http://www.eastasiaforum.org>

Si, Wen "Evolution of the RMB Exchange Rate Regime," manuscript, Institute of World Economy, Shanghai Academy of Social Science, December, 2014.

Yao, Shujie and Liu, Change, "Trade Policy Review for China: Continuing Globalisation Amidst the World Financial Crisis," *The World Economy*, 10:11 2012

### **Tutorial Paper: The Joys (and Sorrows) of Globalization**

As an emerging economic power, China opened up gradually to the global economy culminating in its accession to the WTO in December 2001. After Deng's "Southern Tour", China focused on an export-led growth strategy and a policy of encouraging foreign direct investment (FDI), which resulted in China's twin surpluses. As Si documents, the exchange rate regime was rationalized in 1994 and subsequently the RMB was pegged to the US dollar from 1997 to 2005.

- Explain the impact of the twin surpluses on China's balance of payments. Why does Aizenman characterize China's policy as a mercantilist one?
- Discuss the interrelationships between trade policies and the exchange rate. Explain why McKinnon views China as an "Immature International Creditor". Do you agree?

As Yao and Liu report, inward FDI and China's trade balance increase considerably after 2001. Aizenman and Lin discuss China's response to the Global Financial Crisis (GFC) and the subsequent need for rebalancing the economy.

- Relying on the readings for information about the pre-GFC period, characterize the major imbalances that develop prior to the onset of the GFC in 2008.
- Are Lin's and Aizenman's suggestions for rebalancing the economy consistent with each other? How do they address the imbalances that you have listed?

**Expected Length: No more than seven (7) but at least five (5) double-spaced typewritten pages in standard font of normal size, e.g., this assignment is typed in Times New Roman, size 12, with standard page margins.**

*Week 6: China's Unfinished Business: What is Left to be Done?*

Readings

*Naughton*: Chapters 18 & 19

*Lin*: Chapters 10, 11 & 12

Woo, Wing Thye, "China meets the middle-income trap: the large potholes in the road to catching-up," *Journal of Chinese Economic and Business Studies*, 10:4 (November) 2012, p.313–336

Naughton, Barry "China's Economic Policy Today: The New State Activism" *Eurasian Geography and Economics*, 52:3 2011, p.313–329

**Tutorial Paper: China's Incomplete Transition: Avoiding the "Middle-Income" Trap**

Lin claims that China's transition is incomplete; he writes: "The key to deepening the market-oriented reform is to improve the financial structure." In his recent article, Naughton argues that China responded to the GFC by turning to a more state-directed economy. Woo claims that a new strategy is now required if China is to avoid becoming stuck in the "middle-income trap."

- In your own words, characterize the "middle-income trap." Naughton argues that China's response to the GFC represents an enormous gamble to leap forward and avoid this trap. Explains this position. Would Woo agree? Why or why not?
- What are the other major aspects of the Chinese economy that continue to impede the completion of its transition to a market economy? How does your list compare with that of Lin? Compile such a list for Naughton and for Woo based on their articles.
- Consolidate these lists and address the overarching question: What remains to be done to put China onto a sustainable path to an unflawed market economy and to make China a global economic power?

**Expected Length: No more than seven (7) but at least five (5) double-spaced typewritten pages in standard font of normal size, e.g., this assignment is typed in Times New Roman, size 12, with standard page margins.**



*Week 7: Expert Policy Report*

**Expected Length:** Twelve to Fifteen pages with a bibliography at the end that is not included in the page count.

**WRITING TIPS**

1. Every paper should have an **integrative theme in the introductory paragraph**. The integrative theme specifies the position that will be defended; hence, it serves as a selection tool to guide the writer in determining what to include in the final version of the paper.

**Write no paper without an integrative theme.**

2. The easiest way to develop a strong argument is to force differences. Sometimes this can be done effectively in a point-counterpoint framework. Evidence and well-structured logical arguments are the foundations of good analytical writing.

**Make sure that your paper deals with the topic in sufficient depth.**

3. Each paragraph must have its own **integrity** and be brought to **closure**. A paragraph is **NOT** a laundry list of assertions. **Nor** should a point-counterpoint development be left unresolved to drift into oblivion.

**You should be able to state the basic point of each paragraph using a four-word phrase.**

**Each paragraph must bring the point to closure.  
CONCLUDE a paragraph; don't simply end it.**

4. A paper is like an hourglass. The **introduction** begins from a broad perspective to motivate the paper and narrows by stating the integrative theme. The body of the paper **develops fully and solidly the position** in the integrative theme. Paragraphs make individual points; they are arranged sequentially to support and defend as strongly as possible the position taken. The conclusion does **not** simply restate the position or recapitulate what has been done. Rather the **conclusion** should **convince** the reader that the writer has supported the position compellingly.

**Convince the reader of the strength of your analysis in the conclusion.**

**FROST YOUR CAKE!**