



Frankfurt School

The Rise of China and the Consequences for the West

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I China's Economic Miracle

REFORM AND OPENING UP

“Saying that the market is limited to capitalism is wrong. Why can’t socialism practice market economics?”

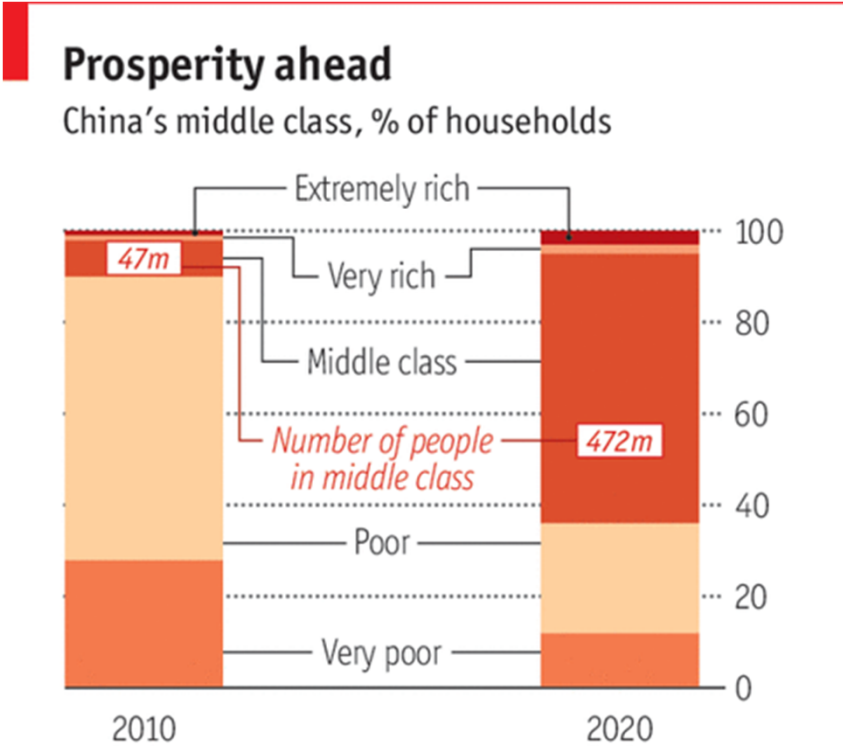
Deng Xiaoping, 1979

Reality today: China’s private companies contribute more than 60 percent to China’s GDP, 80 percent to urban employment, 70 percent to technological innovations, and 90 percent for new market entries.

CHINA's ECONOMIC MIRACLE (1978 to 2020)

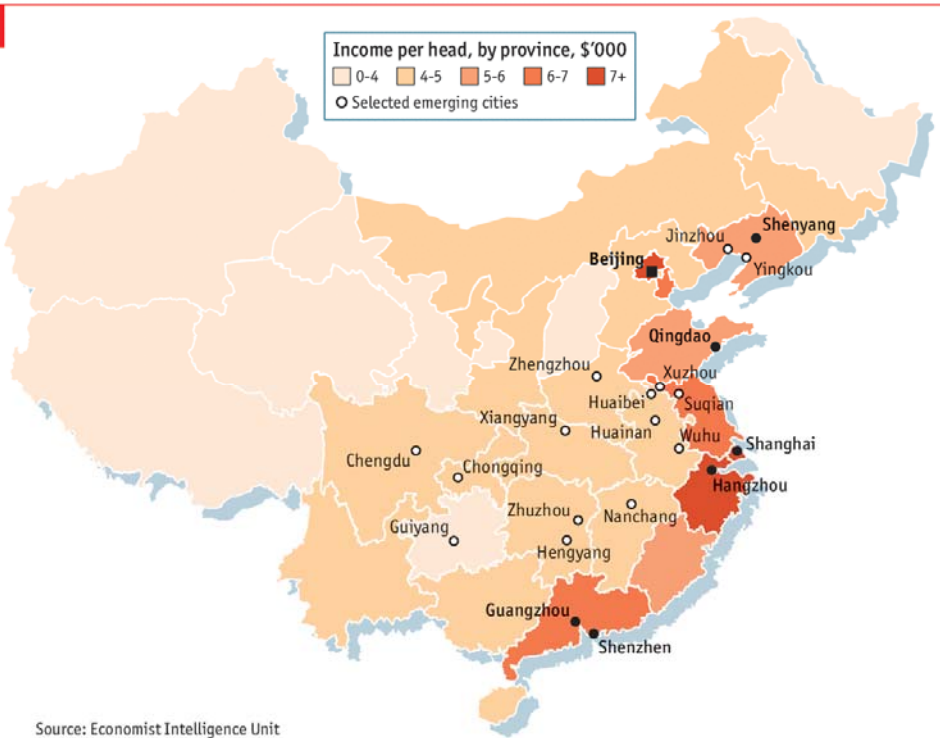
Average growth rate:	8.0 percent
Poverty:	Around 800m people raised from it
Life expectancy:	Climbed from 35 to 77 years
GDP – per – capita:	150 times higher (to about 12.500 USD)
Urbanisation Rate:	More than 60 percent

THE GREAT PROMISE FOR THE FUTURE: THE RISE OF THE MIDDLE CLASS



Sources: McKinsey & Company; *The Economist*

Economist.com

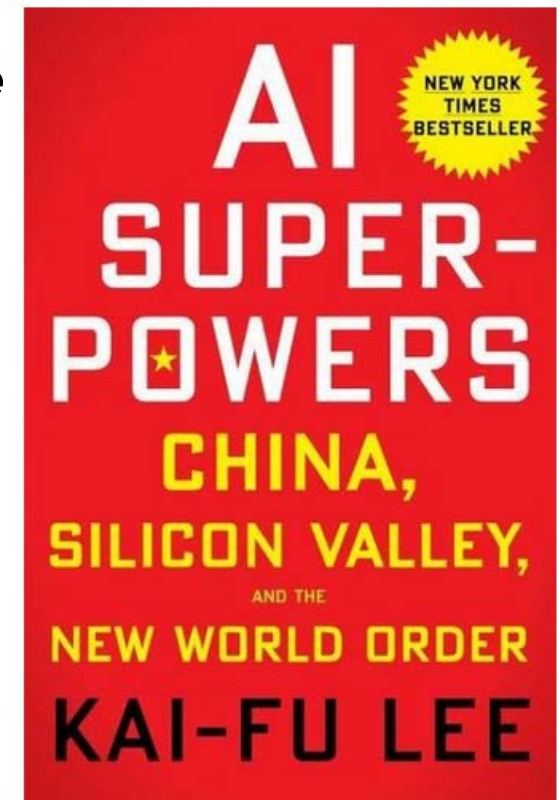


Source: Economist Intelligence Unit
Economist.com

CHINA: LEADING THE FOURTH INDUSTRIAL REVOLUTION?

Kai-Fu Lee, *AI – Superpowers – China, Silicon Valley and the New World Order*, Boston and New York 2018

- Abundance of Data and low data protection
- Ambitious companies and entrepreneurs
- Leading AI scientists
- Strong and comprehensive political support
- Failure in the first industrial revolution



LONG-TERM CHALLENGES OF CHINA'S ECONOMY

- Declining growth rate (only about 3 % in 2022)
- Unbalanced growth model with a huge debt driven (public) investment share but weak consumption (high savings) and pollution issues
- Ageing society and lost of demographic dividend
- Comparatively still low productivity level and low value added goods due to inferior technology
- Industrial revolution is over: how to avoid the ,middle-income trap'?
- Tech-war with the U.S. and fragmentation instead of globalisation

II The Political Economy of China

THE RISE OF CHINA: AFTER THE INDUSTRIAL REVOLUTION THE MOST IMPORTANT CHANGE TO THE WORLD ECONOMY

Liberal-Democratic Model of Capitalism:

- Propagated by Britain since 1815 and continued by the USA since 1945
- Private enterprise dominates over state owned enterprises
- Democratic political institutions

Authoritarian, Party State Model of Capitalism:

- Led by China since 1978
- Steered economy with mixed ownership
- Authoritarian political institutions in a two-tier system of party and government
- But: Meritocracy and competition

TRANSFORMATION WITH CHINESE CHARACTERS: GROWING OUT OF THE PLAN

‘Dual track’ approach:

- Gradual, incremental, and experimental driven by local governments (e. g. land reform, SEZ, and privatisation of SOEs)
- No ‘shock-therapy’ or big bang (‘Beijing’ vs ‘Washington consensus’) but controlled development from command to market economy
- Late comer arbitrage: Increasing efficiency of factor allocation

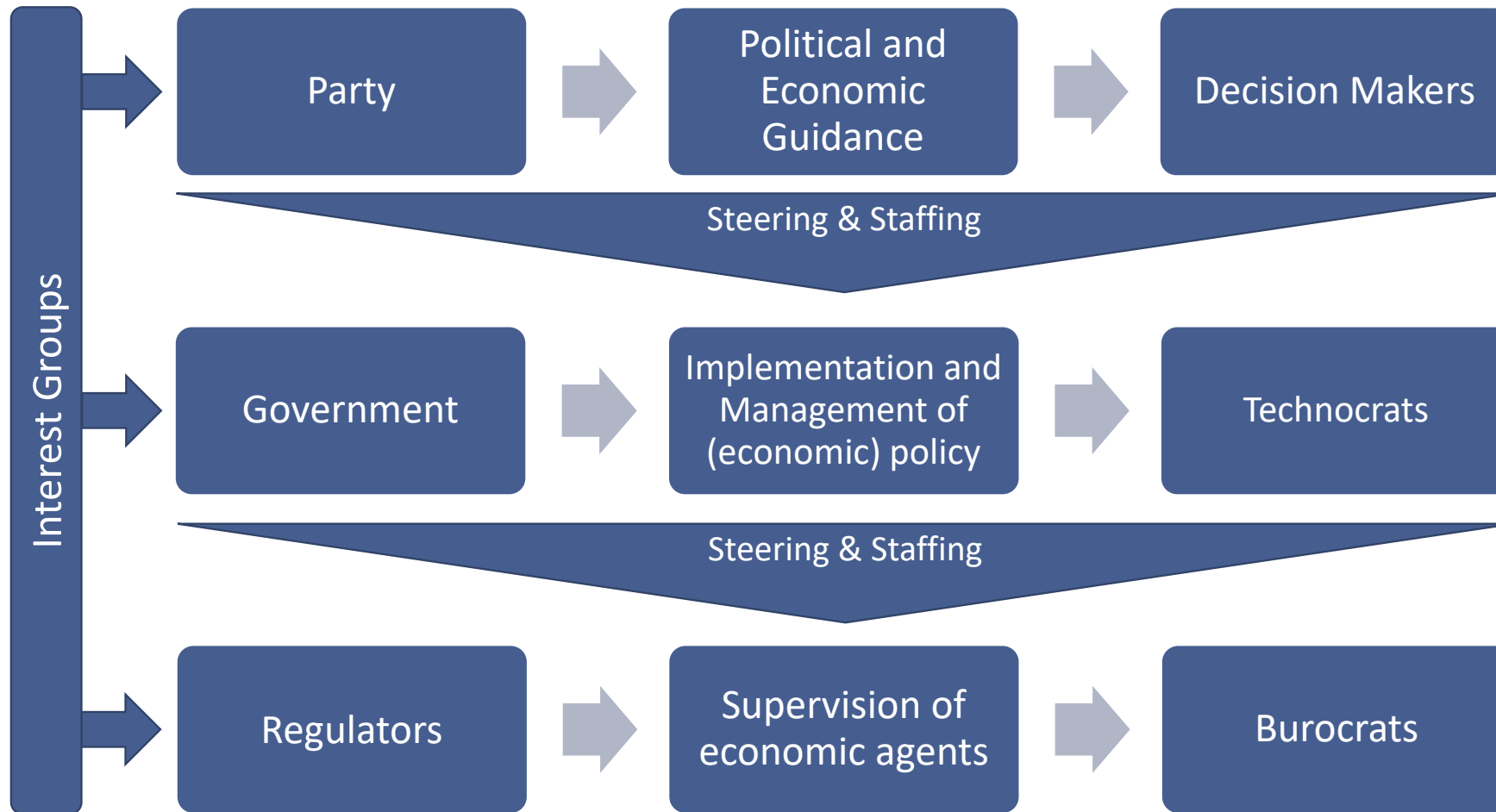
Three fundamental changes:

- Industrial Revolution: from agriculture to industry (urbanization)
- Institutional transformation: from a command to a mixed, hybrid economy
- Opening up: From a closed to an open economy

‘New structural economies’ in East Asia (China, SK, Taiwan Singapore):

- Demographic dividend used for export-driven growth by labour intensive production
- Strong facilitating role of the government: high investments in infrastructure and technology; incentives for FDIs
- Controlled opening of the capital account and managed exchange rate

THE PARTY STATE



CHINA'S POLITICAL LEADER SINCE 1978

- **Deng Xiaoping** (1978): Reform and opening up
- **Jiang Zemin** (1993): Systematic liberalization of the economy
- **Zhu Rongji** (1998): Reform of SOE's and WTO entry
- **Hu Jintao** (2003): Rebalancing and financial crisis management
- **Xi Jinping** (2013): Renaissance of the China dream

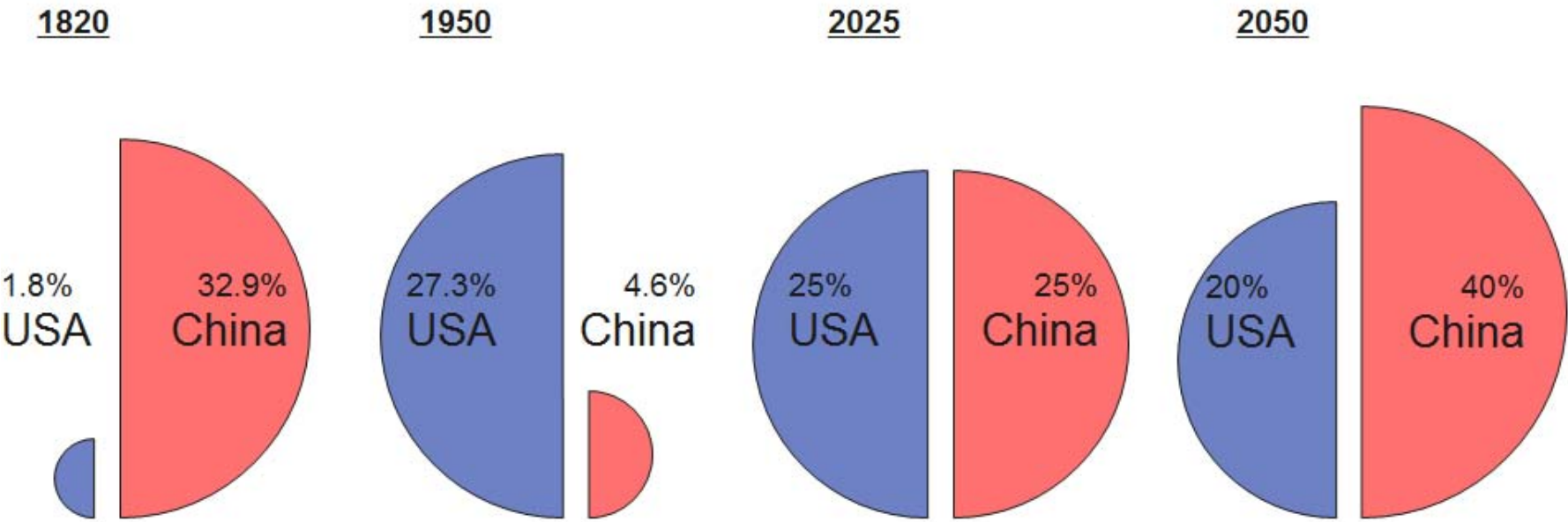
Xi(E)CONOMICS?

- The 'New Normal': Lower but more balanced and qualitative growth
- Two Centenaries goals: Until 2035: doubling GDP-per capital (compare to 2020)
Until 2049: 'strong, democratic, civilised, harmonious and modern socialist country' that realised the 'China dream' of the 'rejuvenation' of the country
- Strong leadership of the party also in economic affairs and strong leadership of the party by Xi
- Self-reliance: 'dual circulation'
- Steered Economy: Government Guided Funds and State-Owned Enterprises
- Distribution: 'common prosperity'
- Environment: Green economy

IS THE LEGITIMACY BASE OF THE PARTY STILL ECONOMY GROWTH OR DO WE FACE THE 'END OF AN ERA' (Yuen Yuen Ang, NYT, Oct 27) BY FOCUSING ON NATIONAL SECURITY AND IDEOLOGY AGAIN AS THE TOP GOAL OF THE RULING PARTY?

III China as Economic Superpower

LIFE CYCLE OF A SUPERPOWER



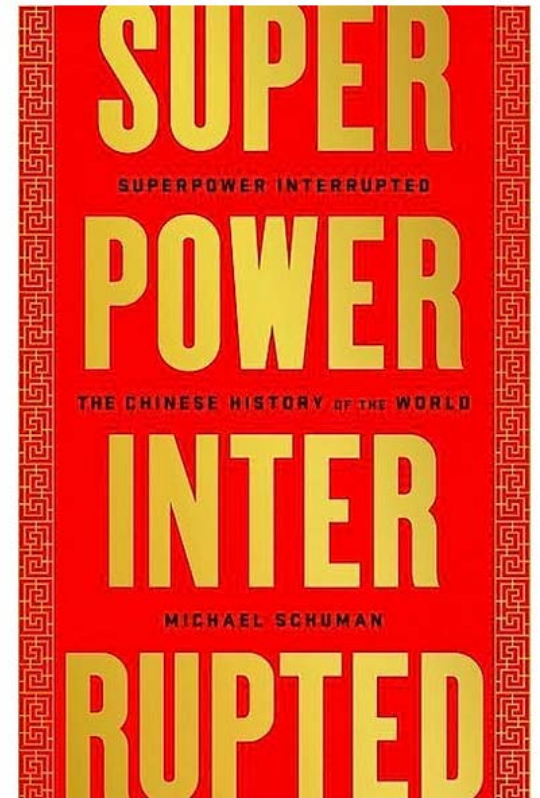
Share of World nominal GDP in percent

CHINA: THE INTERRUPTED SUPERPOWER

Michael Schumann, *Superpower Interrupted, The Chinese History of the World*, New York 2020

“In their view, the Chinese have a right to be a preeminent power in the world, and they want to return to their proper position at the apex of the world order.

This perception is, to a degree, based in actual history. China for most of its existence was the biggest, baddest, richest, most advanced civilization in East Asia.” (p 4)



INTERNATIONAL DIMENSIONS OF CHINA

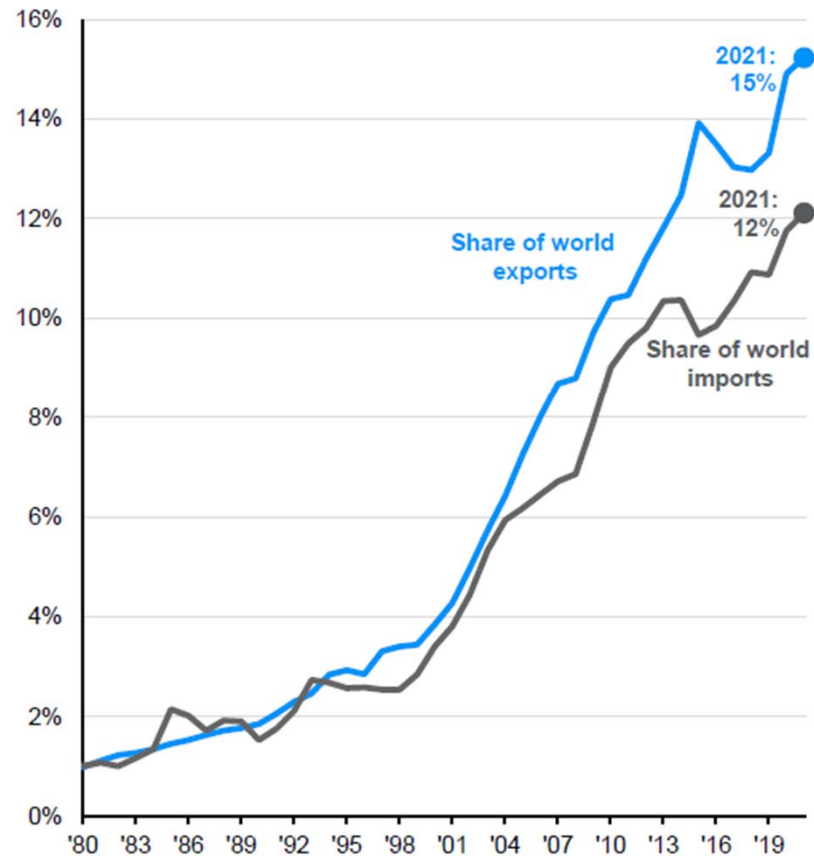
	China's Scale
People	China has the largest population of the world with 1.41 bn people in 2020 followed by India with 1.38 bn (EU: 445 bn; USA: 328).
GPD	Measured in Purchasing-Power-Parity China is since 2014 already the largest economy of the world with a current share of 17.3 % on world GDP followed by the USA with 15.8. % and the EU with 15.3 %. Measured in nominal terms it is expected that China will be the largest economy at around 2030.
Trade	China has been the world's largest goods trading nation since 2013, accounting for about 16 % of global trade in 2019
Capital	China has a large financial system (the largest banking system, and second- and third-largest stock and bond markets, respectively)
Firms	China has 110 Global Fortune 500 companies , comparable with the United States
Technology	China has invested heavily in R&D (the world's second-largest spender with more than \$ 350 billion in 2019)
Digitalisation	China has the most internet users in the world (more than 800 million) and the highest revenue of digital business (765 bn USD in 2019 compare to 698 in the USA and 434 in the EU)
Environmental Impact	China accounts for 45% of global renewables investment

Source: Mckinsey Global Institute 2020

CHINA IS THE MOST IMPORTANT GLOBAL TRADE NATION

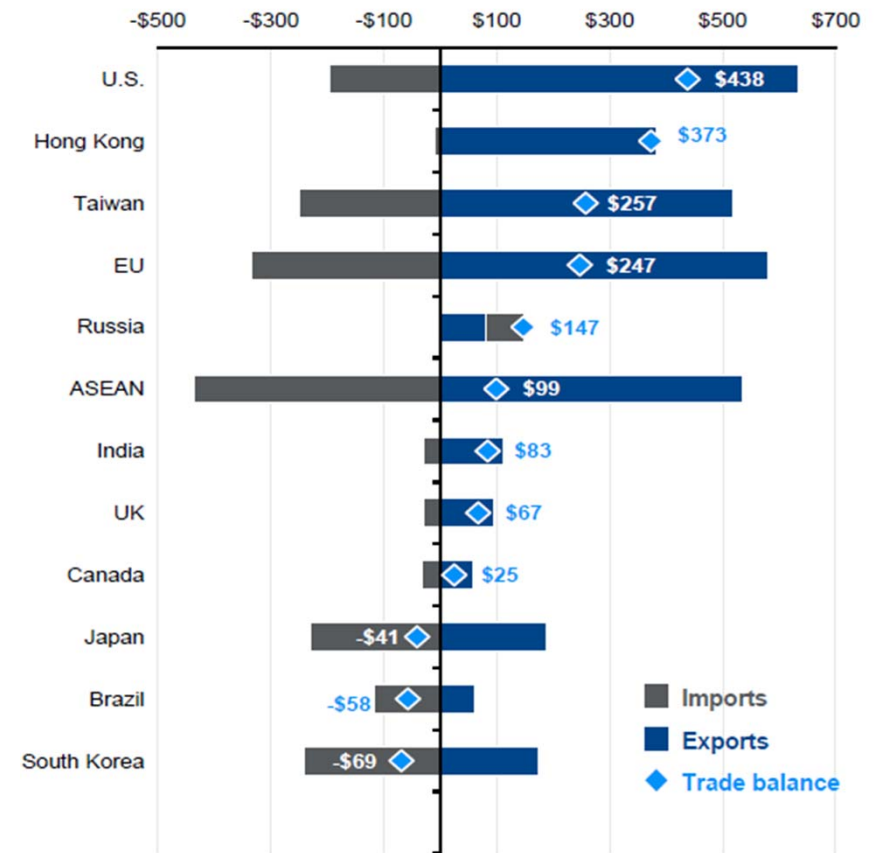
China's share of global trade

China exports and imports as % of world total, goods only



China's major trading partners

U.S. dollars, billions, rolling 12-month sum, goods only, as of Mar. 2022



(Source: JP Morgan)

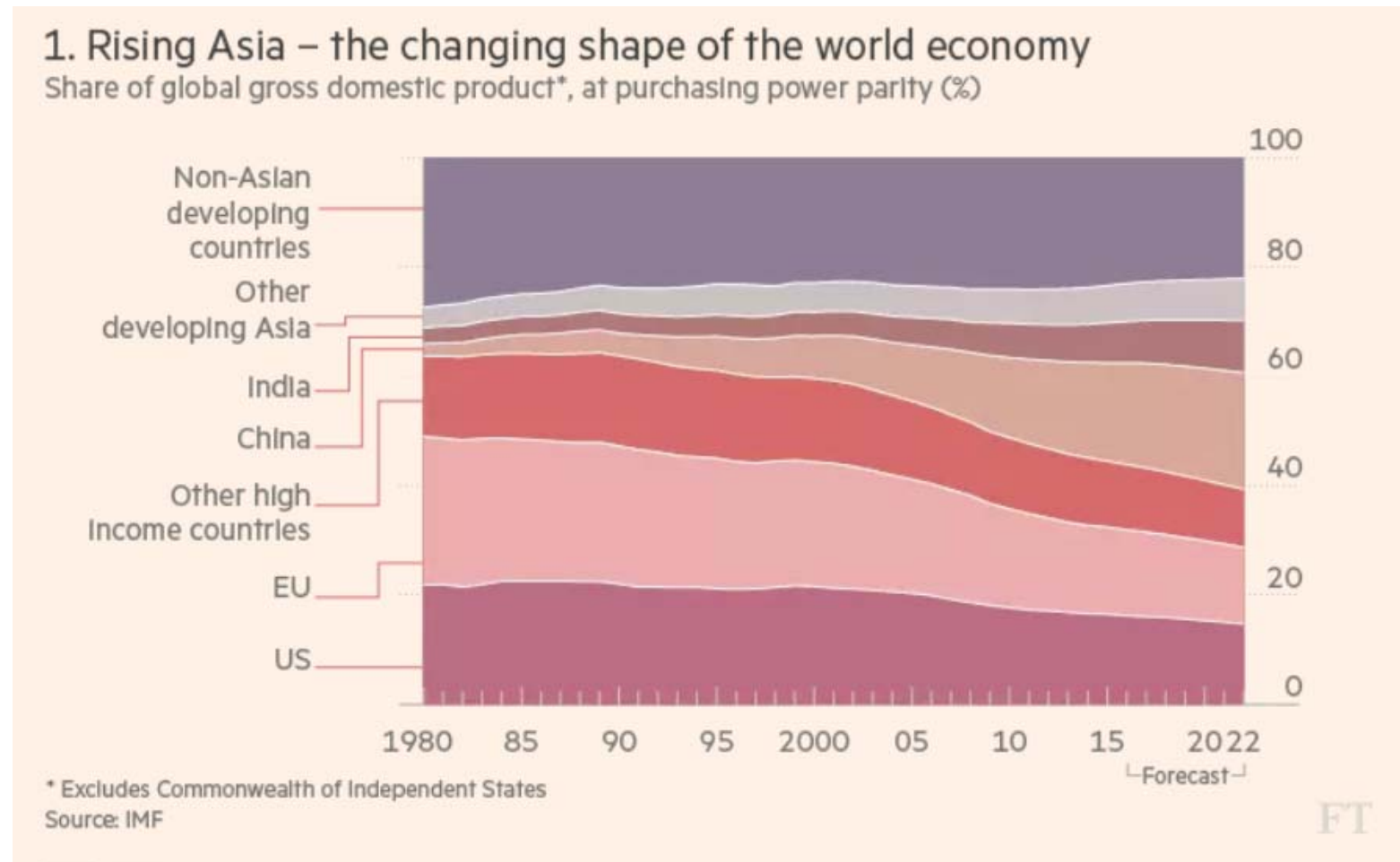
China's International Policy: Belt And Road Initiative



China's International Policy: The Regional Comprehensive Economic Partnership Agreement (2019)

- The largest Free-Trade-Zone of the world with an overall GDP of 25,8 bn USD in 2020, followed by the USMCA with 24,4 bn USD and the EU with 11 bn USD.
- Includes 15 countries like China, Australia, New Zealand, Korea, Japan, Indonesia, Malaysia that covers 30 % of the world population and 52 % of world trade. N. B.: India is not a member.
- However, trade integration is not so deep like, for instance, in the EU. Especially the service sector is not really integrated, and E-commerce completely excluded. Moreover, a significant number of sub-trade-agreement between the involved countries existed already before.
- Nevertheless, the agreement shows the dynamic of the Asia-Pacific Region and the ambition of China to take-over the leading role in the region from the USA.

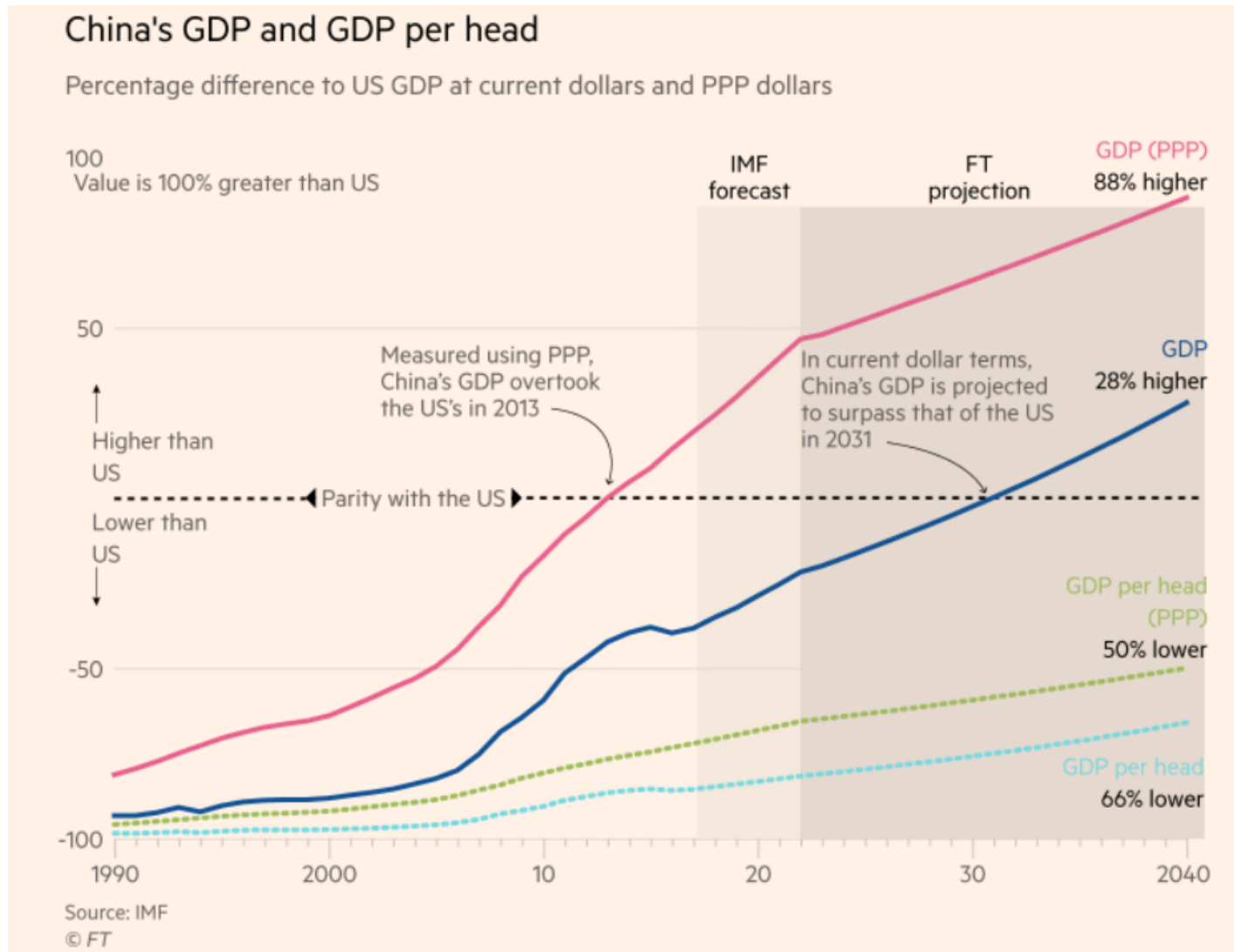
THE ASIAN CENTURY AHEAD



IV CHINA VS. USA



CHINA: THE 'POOR' SUPERPOWER

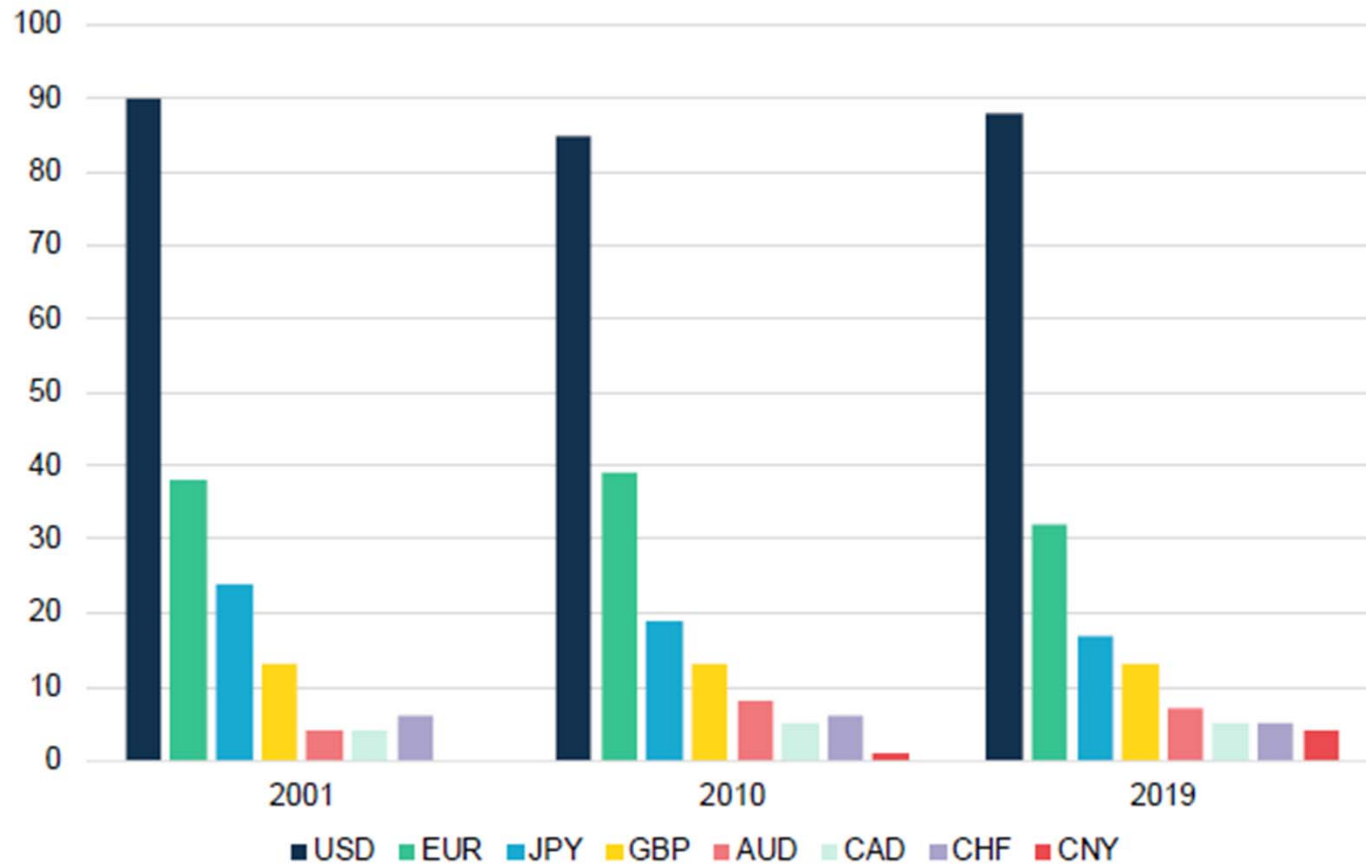


TECHNOLOGY: THE U.S. STILL DOMINATES...



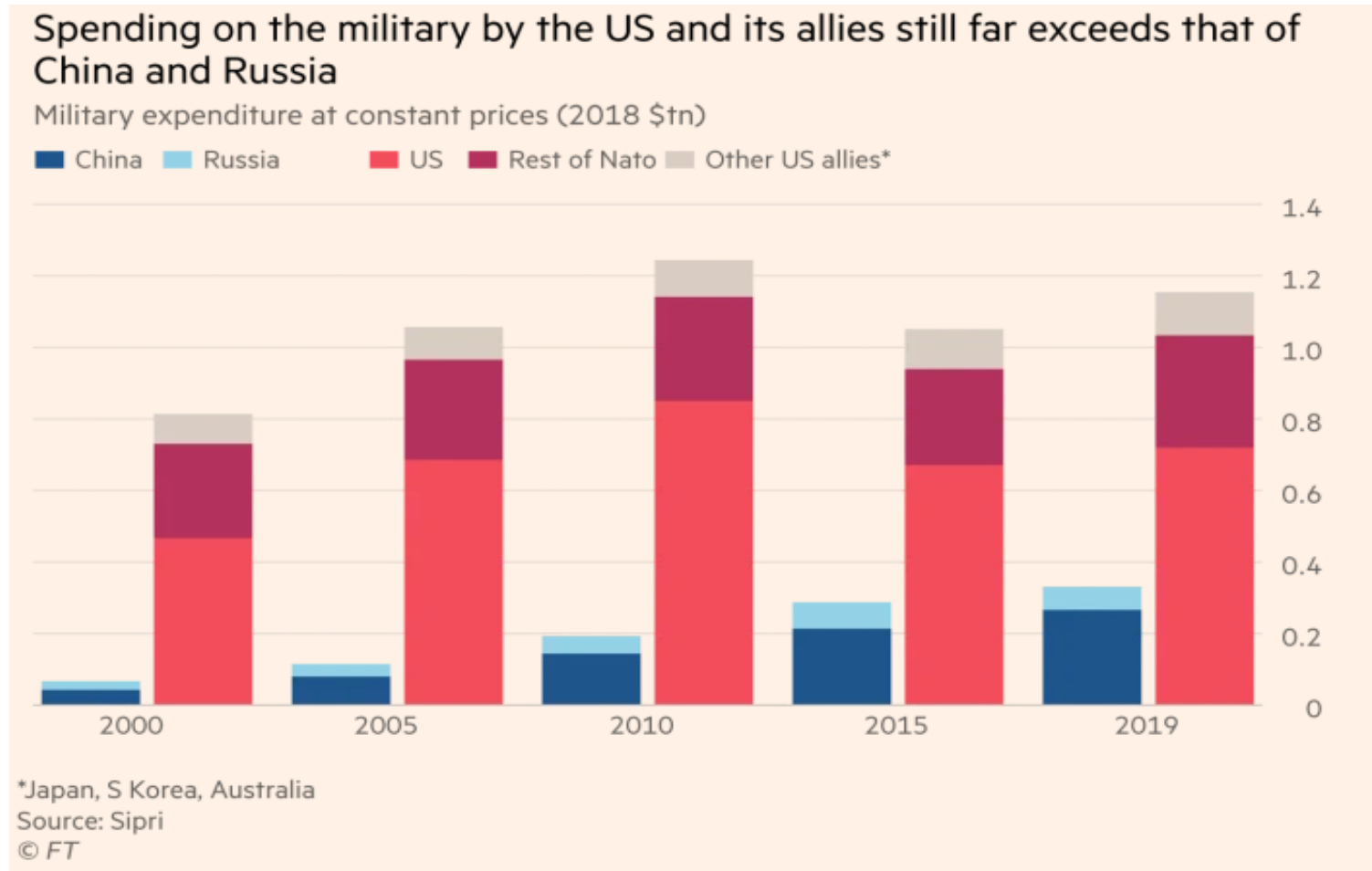
Source: Martin Wolf, Financial Times, April 27, 2021

...AS WELL AS THE DOLLAR (SWIFT)...



Source: BIZ, LBBW, 2020

...AND NOT AT LEAST IN MILITARY POWER



Source: Martin Wolf, Financial Times, May 4, 2021

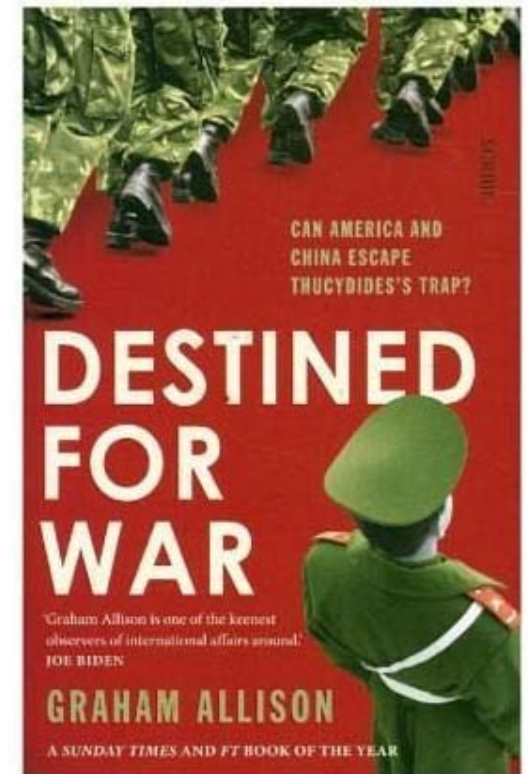
U.S. VS. CHINA: A NEW THUCYDIDES-TRAP?

Graham Allison, *Destined for War: Can America and China Escape Thucydides' s Trap?*, London 2017

THE NEW ,SYSTEM COMPETITION'

„*China is the most consequential geopolitical challenge.*“
U.S., National Security Strategy, Oct 2022

- **Military:** Dominance in Asia-Pacific (AUKUS) and the South-China Sea (incl. Taiwan)
- **Economy:** Technology dominance (i. e. chips)
- **Governance:** Bretton Woods Institution vs. BRI and AIIB
- **Currency:** USD vs. RMB



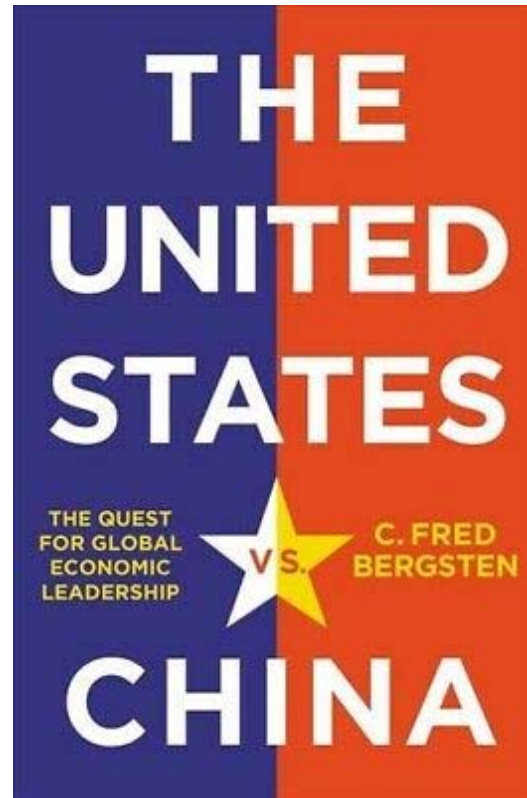
U.S. PERCEPTIONS OF THE RISE OF CHINA: ,CONDITIONAL COMPETITION' OR ,CONFRONTATION'?

The World According to China

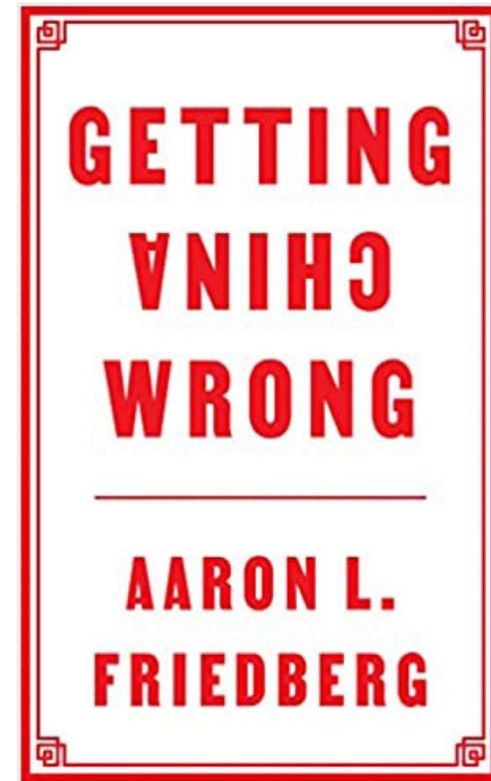


Elizabeth C. Economy

Proposition: China wants to replace the U.S. as the no 1 superpower. The U.S. has to react adequately.



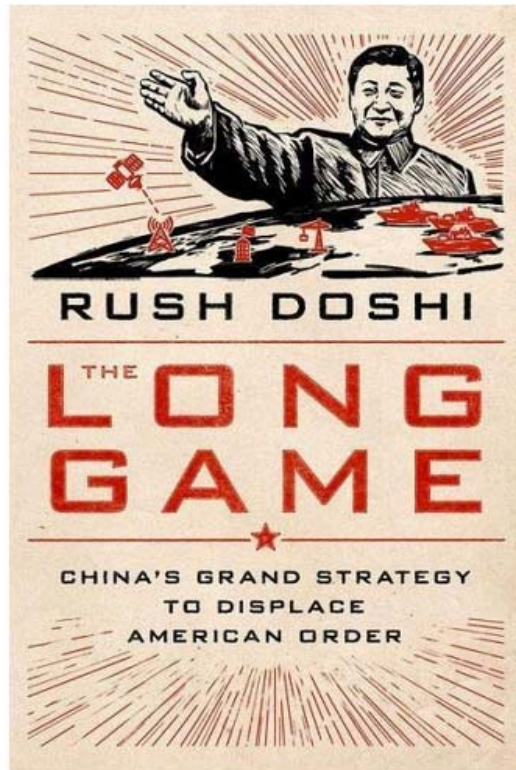
Proposition: Containment of China is impossible, ,conditional competition' is the right answer to defend the U.S. as the leading superpower.



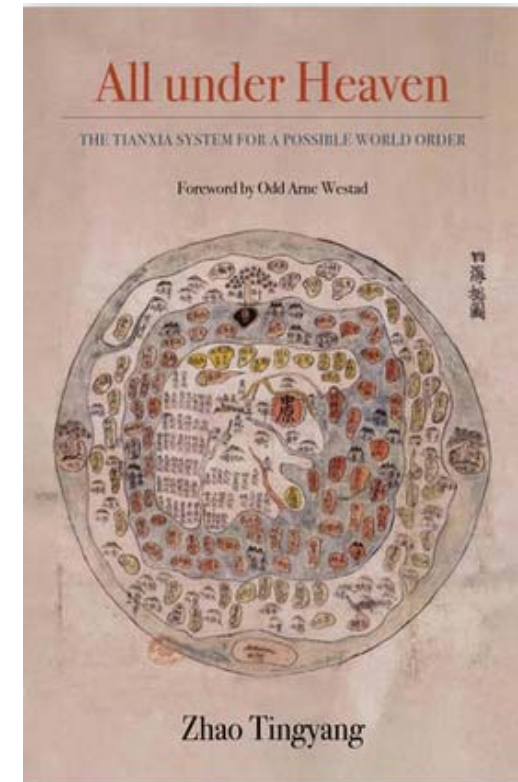
Proposition: The U.S. needs arms build-up to guarantee the position of the no 1 superpower.

DOES CHINA WANT GLOBAL DOMINANCE?

Rush Doshi, *The Long Game: China's Grand Strategy to Displace American Order*, Oxford 2021



Tingyang Zhao, *All under Heaven; The Tianxia System for a Possible World Order*, London 2021



A NEW ECONOMIC WORLD ORDER AHEAD?

America-West Led World Order: Dominance of Bretton Woods Institutions and Dollar as Leading Currency



Fragmentation: American-EU vs. China-Russia



What Will And Should Be The Role of Europe?

V CHINA AND EUROPE / GERMANY



DEPENDENCY FROM ON CHINA?

- Making sense of the concept: (i) cluster risks - (ii) critical dependencies from imports / commodities (iii) Chinese investments in 'critical infrastructure'
- In principle, Germany does not 'critical' depend on China like from Russian gas because of the higher diversification of business with China and the lower respective shares each.
- Example Trade: China is Germany's largest trading partner more or less on the same level like the U.S. For German exports the U.S. dominates, for German imports China. Around 9 % of the value added of German exports are realised with China and about 2 % of Germany's value added comes from imports from China.

DEPENDENCIES FROM CHINA: SOME FACTS (2021)

Cluster Risks: Sales of German MNC in China: VW and BMW around 33 % of all cars.

About 20 to 30 % of overall revenues generated in China:
Covesto, Infineon, Adidas.

Imports: German Automotive industry, data processing equipment, and electrical gear companies depend on 70 percent or more on inputs from China, i. e. chips.

Commodities: China is Germanies most important supplier for three critical raw materials: graphite with a share of 32 percent, rare earth-metals with 50 %, and magnesium with 26 %.

Investments: Chinese investments peaked in 2017, since then decline.
Stock: 12 bn € (98a bn of German investment in China)
Largest transactions: Geely in Daimler (9.69 % stake), take-over of Kuka by Midea and Hauck & Aufhäuser by Fosun (HNA in Deutsche Bank already sold).
'Critical infrastructure' in a meaningful sense is so far not affected at least not in a dominant position by Chinese investments in Germany. Last example: 24.9 % investment of Cosco in a service provider of Hamburg harbour terminal.
Elmos (by Silex / Sai) 'critical'?

,DECOUPLING' FROM CHINA?

Germany's economic relationship with China:

- Since 2015 the largest trading partner, more than 1 working places in Germany are related to exports to China, and almost 6.000 German companies in China.

Costs of ,decoupling': Roughly 50 bn € or 1,4 % of national income.

Source: Kieler Institute, Policy Brief, Nr. 153, July 2021

Statement of CEOs of German MNC to China Business:

- Interest-based trade policy without negating human rights and other issues (vs. value-based policy).
- Business in China contributes significantly to international competitiveness of German companies, whereas decoupling would cut off the German industry from the growth dynamic in China.
- Competitor, Partner, and System Rival: stress should be on the first two.

Source: FAZ, 10. Nov. 2022

IS CHINA AN 'ALL-OUT-COMPETITOR' (BORELL) FOR EUROPA?

Despite the fundamental consensus of democracies and the inviolability of human rights, Europe's interests are different to that of the U.S.:

- Europe is by China not challenged as a superpower.
- Europe does not have global dominance in technology, currency or military.
- Europe is not a 'Pacific power' with own interests in the South China Sea.

Europe's interests on China:

- Mutual beneficial economic and business relations.
- Further opening up of China's market for European companies on the same level playing field than for Chinese companies in Europe (i. e. Comprehensive Agreement on Investment).
- Equal treatment of foreign companies with domestic companies in China.
- Cooperating for better environmental protection.

CHINA BUSINESS: OPPORTUNITIES AND SPECIFIC COUNTRY RISKS

Opportunities:

- Big and dynamic economy with huge markets for German FDIs and exports.
- Cost-efficient imports for the industry and consumers in Germany.
- Preservation of working places and international competitiveness of Germany companies by Chinese ODIs if not ,critical infrastructure' is involved.

Specific China Risks:

- Tech War of the U.S. and military actions about Taiwan.
- Return to ideology by CPC and downgrading of (foreign) private business.
- Escalation of human rights violations.

Consequences:

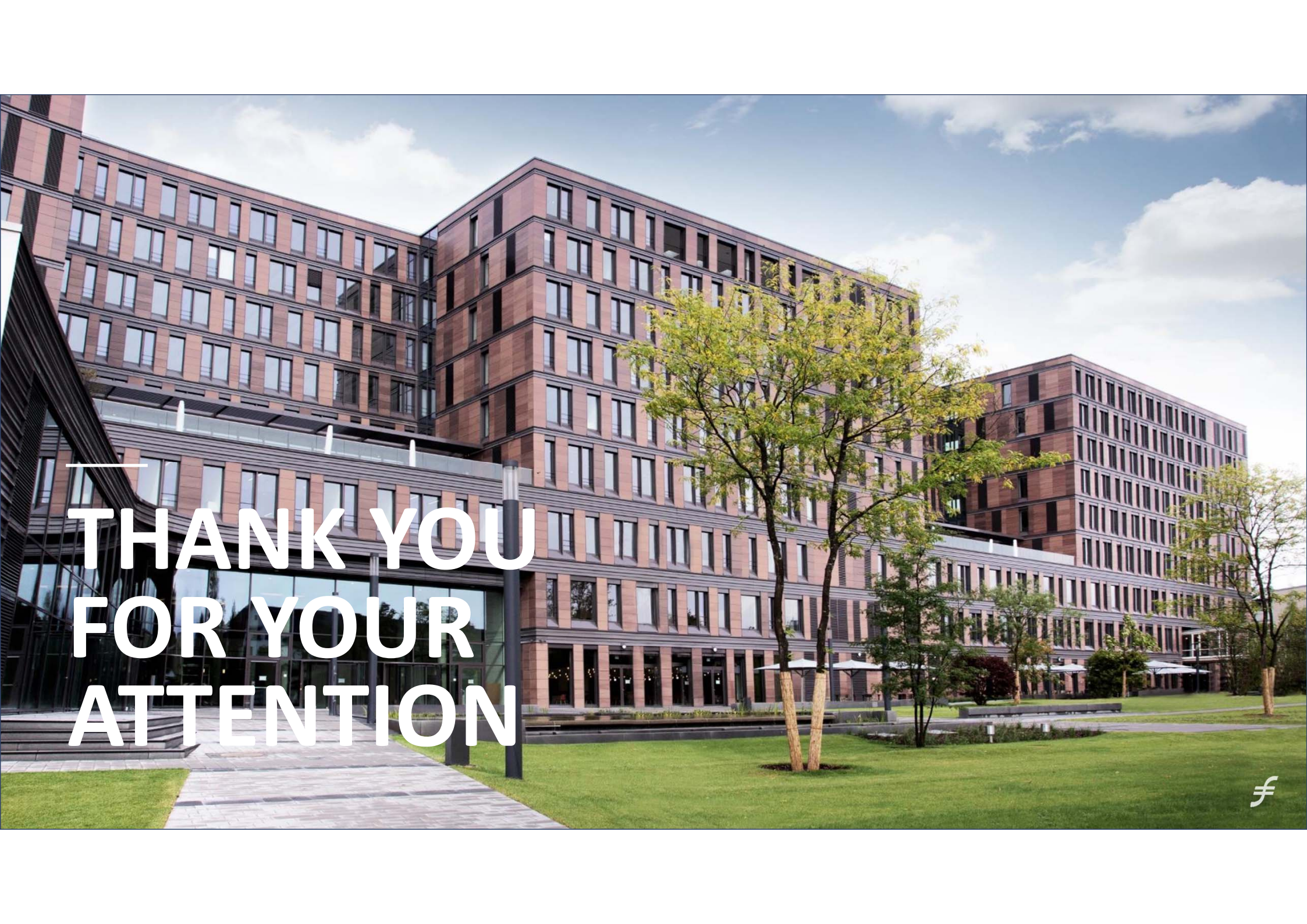
- *Higher degree of diversification if possible/efficient over time (figure out respective substitutes) .*

The Bottom Line

“The 19th century belonged to England, the 20th century belonged to the US and the 21st century belongs to China. Invest accordingly”

Warren Buffet, 2007

*After Xi-Biden meeting on 14. Nov. 2022:
Berkshire Hathaway announced 4 bn USD investment in TSMC*



THANK YOU
FOR YOUR
ATTENTION



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