

What Factors Have Led To The Remarkable Economic Growth In China?

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October 20, 2021

Abstract

A contribution of various factors, the rapid economic growth in China over the past few decades has left the international community surprised and to an extent, threatened. While some scholars debate that the influence of China's centralized leadership was the most effective, many other scholars counter the claim by discussing the impact China's economic reforms and ultimately, the introduction of increased Foreign Direct Investment had on the economy and its growth. In the opinion of the author, the latter seemed more beneficial and impactful. This paper analyses the growing role played by FDI, manufacturing policies along with many others, in China's rapid economic growth while further discussing the implications of implemented policies and models adopted on the global population and communities. The focus also lies on discussing Centralised Leadership specific to the case study of China and claiming why it did not play the most significant role. This topic was chosen because of the constant interest in the Chinese economic model from global platforms. Furthermore, since this nation has gained importance in each diplomatic decision being made, it is helpful to be aware of and analyze China's policies thoroughly which seem to inspire many.

1 Introduction

Described as “the fastest sustained expansion by a major economy in history” by the World Bank, China has left the international community surprised by its sudden economic growth in the past forty years. Breaking through ineffective policies, the economic reforms of China in 1979 have contributed towards the country's economy to be amongst the fastest growing economies in the world. Having opened up to newer possibilities on the global scale, there has been an encouragement for more investment to flow inward and outward of the country. Foreign Direct Investment was introduced to the country in the 1950s through multiple Sino- Soviet joint ventures and when, in the 1990s, the Government

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increased economic liberalization, FDI climbed to more than 40 billion dollars per year in the mid-'90s. [Lau08] This, in turn, has helped China double its Gross Domestic Product (GDP) every eight years and has also helped around 800 million people rise out of poverty. [Mor19] What differentiates China from other countries? Despite having little global influence initially, how did they manage to top economic charts? What factors have proved significant in this growth and to what extent? And what can other nations learn?

Once trade liberalization had started being practiced, a wide range of opportunities opened up for the country. This reformation of the system, which had been built on the Soviet model, led to an exchange of goods, ideas, technology, and systematic changes started taking place. By the mid-'80s, the number of firms involved in direct import and export had significantly increased and by 1984, China's biggest trade partners were Hong Kong, Japan, and the United States of America. [Wan10] This paper discusses two contending arguments laid out by many scholars, such as Wang, Morrison, Zhang, etc. The first being the Foreign Direct Investment (FDI) and the second, Centralised Leadership. The paper elaborates on their influences on the growing economy. By providing analogies and evidence, this essay discusses and refutes the counterarguments to these claims. While concluding, the paper will argue for foreign direct investment to be the most instrumental factor in China's inspiring economic prosperity. I believe this topic to be of extreme importance in today's society as we must educate ourselves about the various approaches of one of the leading nations in the world. As China continues to climb up the global ladder, soon surpassing even the United States of America, it is imperative to be aware of the history and its implications on the entire international community.

Section I of this paper discusses Centralised Leadership in China by discussing its relevance and significance and then refutes the aforementioned argument by discussing the importance of economic freedom and liberty. This is done by providing examples, quotes, and discussions of findings.

Section II of this paper begins with the introduction of Foreign Direct Investment, discussing the significance in China while discussing the economic reforms of 1979. The essay continues to highlight the impacts through empirical evidence and analogies and discusses the opportunities FDI provides on domestic and international levels. The essay then moves on to refute possible counterarguments against FDI.

Section III concludes this paper by summarising the intent of purpose of this essay and the arguments which have been established. Furthermore, it explains the importance of this material in the international community and how China has served as an inspiration to the economic sphere. Lastly, the section raises questions beyond the arguments that have been established.

2 Centralised Leadership In China

Centralized leadership refers to the practice of a specific leader planning and making decisions within an organization. Walder, an American political sociolo-

gist who is specialising in the study of Chinese societies, claims this effective and realistic leadership in China helped, through gradual reforms, create a developed state which worked towards economic growth. [Wal15] Chow argues that the economic policy reforms were a method of experimentation to see which changes survived and which did not. Depending on the critical feedback from economic experiments, the government would then be able to implement these reforms in the long run. [Cho15] China being such a large country, it was not feasible to implement a handful of strategies that would prove beneficial to the country as a whole. Instead of adopting the Soviet Union's "shock therapy" of quick privatization of state-owned enterprises (SOEs), the Chinese leadership conducted incremental reform by granting limited autonomy to a select few SOEs. The centralized leadership provided increasing authority to a growing number of SOEs as the experiment continued. [Cho15] As a consequence, the SOEs were successfully converted into significant international and domestic competitors, with assets worth 690 billion dollars and accounting for over a third of China's GDP. [Leu16] However, moving on to later years, there were mainly three reasons for the change towards a developmental state. Firstly, due to economic stagnation over the past years, there was slowly becoming a loss of political legitimacy. To ensure the political support of China's Communist Party was important. Second, there was more consideration of Western and East Asia's economic prosperity. China started observing its policies and concluded that a similar structure might help them prosper too. And thirdly, the capabilities of central planning had weakened after the Cultural Revolution. [?] Therefore, while Centralised Leadership has proved impactful to the Chinese Economy, it had run its course.

3 Arguing Against Centralised Leadership With Economic Freedom

Scholars Hanke, a professor at John Hopkins University, and Walters, a professor at Loyola College, analyzed the relationship between economic freedom and GDP per capita and found it significant and positive. Economic freedom's central elements consist of a) Secure property rights; b) Freedom from government expropriation of property; c) Freedom to engage in transactions on a domestic and international level and d) Freedom from governmental control in terms of which individuals transact. [Han97] Hanke and Walters continue by providing an analogy explaining the constituents of Economic Liberty. The rules which monitor behavior in the economic context will prevent Paul from stealing Peter's property but the economic freedom diminishes when the Government itself robs Peter, whether to pay Paul or achieve some other objective. Various other scholars support a similar train of thought, much like this paper. If we observe certain Asian countries with prosperous economies such as Taiwan, Japan, or South Korea, we can claim that democracy provides the opportunity and freedom to let the markets make the decisions, a contrast to the system followed by

China.

We, as scholars, have been given the intellectual freedom to explore our ideas and structure them how we deem best. If our topics and areas of exploration were chosen for us, we were provided with a rigid structure and punished if we did not abide by those rules, we would fail to develop creative instincts. As scholars, we would fail to understand our thought process and simply function on that of someone else's. Fortunately, this is not the case. While there are general guidelines, there is also the liberty to bend these guidelines to accommodate our perspectives. To restate my point, if you take away the freedom from the economy to do well on its own, it will be repressed under the rules of an authoritarian government. It will fail to be naturally challenged and developed. Looking at China, although it remains an authoritarian power structure, the concepts and discussions of 'fragmented authoritarianism' have increased. Authoritarianism gives the power and authority for leaders to initiate changes, while fragmentation provides the room and space for reform and change. That is why China has been able to maintain its cohesion despite the rapid change, especially in the Wind Energy Sector. Lema and Ruby, scholars from Denmark, discuss how the fragmented authoritarianism-driven policies led to rapid increases in the installed wind capacity of China. [Lem13]

4 Foreign Direct Investment (FDI)

Foreign direct investment is the investment made by one party in a country into a corporation or business in another country to establish a long term interest. Scholar Zhang, who works at the Department of Economics at Illinois State University, claims that FDI is an 'engine' of host economic growth, which firstly satisfies mainly four objectives; enhancing capital formation and employment augmentation, promoting manufacturing exports; attracts resources such as skilled labor and established brand names and lastly, results in technology transfers. [Zha01] In the particular case study of China, the economic reforms led to an escalated growth in Foreign Direct Investment, beginning in the early 1990s. According to China's 2012 Statistical Yearbook, in 2010, there were 445,244 registered foreign-invested enterprises (FIEs) which employed 55.2 million workers or 15.9 percent of the urban workforce. These FIE's accounted for a huge portion of the country's industrial output. These levels rose from 2.3 percent in 1990 to a solid 35.9 percent in 2003 and hit their peak in 2005 when FIE's were responsible for 58.3 percent of the Chinese exports and a high of 59.7 percent of Chinese imports. [Mor19]

By 2018, the United Nations Conference on Trade and Development (UNCTAD) reported that China had successfully established itself as a major provider of FDI outflows as well as a major recipient of global FDI. Hitting the historic peak for FDI outflows of 196.1 billion in 2016 and an FDI inflow of 139 billion in 2018, China was given the title of being the second-largest recipient of Foreign Direct Investment, following the United States of America. [UN19]

Now, let us analyze the case study through this analogy. Would the startup have grown even further without access to more opportunities? How else would it have reached a larger market? How would it have established itself as a leading business?

Foreign Direct Investment plays a critical and the most important role in the prosperity of the Chinese economy. Scholar Mody, a lecturer at Princeton University, discusses how the higher levels and diverse forms of FDI represent an important force that generates a greater global economic integration. [Mod04] Without expanding to global markets and trade, it would flourish but within a domestic region, failing to achieve its potential as a global economy. While being a recipient, it is also important to invest, or export, in other corporations. Exporting to markets exposes the country to multiple markets, expanding its production. This also results in a rise in the employment rates of the state, the GDP levels further rising and allowing the administration to provide its people with better resources, facilities, and infrastructure. Foreign capital has had two positive effects; it has improved the liquidity of the Chinese economy, and thus facilitated other investments. [Ali05] FDI Explained Think of a small startup company that has been established for quite some time but never made many profits. The firm is said to have a rigid and authoritarian organizational culture, leaving many workers dissatisfied. Furthermore, there has been no proper allocation of resources towards the training and development of the employees and their objectives and approaches have been strategized based on an old and rather outdated model. Upon investigation into the business and its workings, the owner observes that stores around his have started to flourish and attract investment. They can collect assets by approaching investors. This encourages the owner to make changes to his own company. He starts 'reforming' the structure of his company. As a result, the company begins to establish itself in the market yet does not reach its potential due to a lack of capital. An investor notices this startup and invests in updated machinery, technological equipment and invests in the training of the employees. Gradually, the company begins to perform well, financially and consequently, attracting another investor and then two more. The startup transforms into an established multinational company, investors receiving huge sums as dividends.

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5 Opportunities Through Foreign Direct Investment

According to scholar Morrison [Mor19], the motivating factors behind FDI were for the Chinese government policies and initiatives to encourage firms to ‘go global’ and establish an international reputation. An economic policy reform including more FDI involvement would provide access to equipped technology through which Chinese firms can improve their manufacturing and services, bettering the domestic innovation and prove themselves as a worthy competitor in the global market. This further creates more opportunities for Chinese brands. Due to the rising labor costs and a slowing economy, there is higher potential overseas, expanding the Chinese markets and increasing the FDI levels. [Mor19]

6 Domestic Effects Of Foreign Direct Investment

Foreign Direct Investment, a revolutionary adjustment to the Chinese Economy, has proved to impact many aspects of the economy. This essay outlines the three most significant domestic effects FDI has caused.

Firstly, Foreign direct investment has proved to be a vital source of capital for China, making increasing contributions to the domestic capital formation. The FDI to GDP ratio increased from 0.31 percent in 1983 to 1 percent in 1991. [OECD00] This ratio rose to 13 percent between 1995 and 1998.

Figure 10 - FDI Inflows to GDP, GCF and GFCF Ratios in China

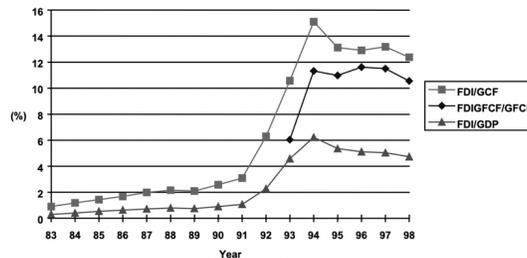


Figure 1: FDI Inflows Affecting GDP [Zha01]

Secondly, China is a state where resources are scarce but there is a sufficient supply of labor. FDI has created multitudes of opportunities for employment [Zha01] within the nation, providing job opportunities and increasing the employment levels. In 1991, foreign firms employed 4.80 million people (0.74 of the total employment) which by 1998 had grown to 18.39 million, four times the amount. [OEC00]

Thirdly, Multi-National Companies in the country have proved to pay their employees higher wages than domestic companies do. Employee compensation takes place in the forms of bonuses, fringe benefits, salaries, etc. [OEC00] Apart from variations in the distribution of their operations between (relatively high and low) wage sectors, FDI firms outperform their domestic counterparts in terms of labor productivity and capital intensity. The share of workers and apprentices engaged in direct production was 7.53 percent higher in FDI firms than that in China's domestic firms. For the technical and professional employees and managerial staff, the shares are marginally higher in FDI firms than those in China's domestic firms. However, for the clerical and administrative staff, the share is 47.03 percent lower in FDI firms than that in China's domestic firms. [OEC00] Therefore establishing that MNCs provide the labor with more opportunities and upgraded skills than domestic firms do.

Besides these improvements in the economy, scholars claim that FDI has A) Raised factor productivity as on average the size of FDI firms is nearly 100 percent larger than that of China's domestic firms. It is 170 percent larger in labor-intensive industries, 124 percent larger in technology-intensive industries, and 40 percent larger in capital intensive industries than that of China's domestic firms respectively; B) Reshaped China's industrial structure as the industry sector has been the largest and the most important recipient of FDI in China (59 percent); C) Increased domestic competition which has led to higher efficiency levels since FIEs supplied about 9 percent of the Chinese domestic demand of industrial goods, whereas imports for domestic use accounted for only 5 percent of it. FIEs held relatively strong positions in the domestic market in various industries and finally, D) Improved industrial performance as a positive relationship can be observed at the sector level between the share of foreign capital in total capital in 1995 and the annual growth rate of industrial production between 1994 and 1997.

7 Impact Of FDI On China's International Trade

This paper continues to prove that Foreign Direct Investment has established its role as the most influential factor in China's remarkable economic growth by further analyzing the effects FDI has played on the nation's international trade and diplomatic relations. The most eminent benefit of FDI has been the expansion of China's manufacturing exports. While 1980 led with exports being ranked at 26th in the world, 47 percent of them being manufactured goods and with a volume of the US 18 billion dollars, the corresponding numbers in 1998 were 9th in the ranking, 89 percent, and the US 184 billion dollars

respectively. [Zha01]

According to Chinese data, in 2018, the country maintained large trade surpluses with the United States of America (282 billion dollars), Hong Kong (274 billion dollars), and the EU28 (129 billion dollars), and reported large trade imbalances with Taiwan (112 billion dollars) and South Korea (74 billion dollars). China's top three export audiences were the United States, the EU28, ASEAN while its top sources for imports were the EU28, ASEAN, and South Korea. [Mor19] [Mar20]

8 Refuting Argument Against Foreign Direct Investment

In the Journal of International Economics, Borensztein, who works at the Economics Department at Korea University, discovered, after data analysis, that “the effect of FDI on economic growth is dependent on the level of human capital available in the host economy. There is a strong positive interaction between FDI and the level of educational attainment.” [Bor95] From my interpretation, this quote suggests that if human skill levels and capabilities fall, this will result in a decline in Foreign Direct Investment. However, the scholar fails to acknowledge the heavy investment being made towards education by the Chinese administration.

Scholars Liping Liao, Minzhe Du, Bing Wang, and Yanni Yu provide valid proof and data analysis to discuss the impact of education on sustainable economic growth and focus on the particular case study of China. In 2017, the general public budget education funds in Guangdong province were far ahead, ranking first in the country with 252.255 billion yuan. [L.L19] Furthermore, China practices the approach of career progression for teachers on a competitive basis, improving their efficiency by this and also the policy of performance-based pay. These regulations encourage the teachers and educationists to perform and teach to the best of their capabilities. An effective example of this approach being a success is when Chinese students repeatedly achieved the best results in mathematics, science, and reading in a program for International Student Assessment organized by the OECD. [OEC00]

Therefore, with the help of the aforementioned scholarly examples and research conducted, this essay refutes the claim made by Borensztein by asking the readers to acknowledge the investment made by the Chinese governments towards education. To further strengthen this rebuttal, this paper provides evidence from the OECD Publishing House paper which claims that FDI's upgrade human skills. The FDI firms are more efficient in allocating labor utilization and also have a higher level of labor quality and skills. [UN19]

9 Conclusion

To summarise all the claims and arguments put forth throughout this essay, Foreign Direct Investment was the most pivotal factor behind the remarkable success of China's economy. It helped the nation on a domestic level as well as improved its international trade, establishing it as a global competitor and capable economy.

This essay begins with discussing Centralised Leadership in China and highlights its advantages but continues and concludes the first chapter with evidence explaining why it does not serve as the most influential factor as it fails to provide economic liberty. A failed practice at liberty ruins the presence of a market and its natural laws. The second chapter of this paper discusses, in detail, Foreign Direct Investment and its implications on the country. It serves to elaborate on the establishment of China as a global economic competitor which was a result of international trade, domestic and foreign developments. During my research, I have found multiple reasons and justifications to FDI playing such a big role and throughout the essay, also refuted possible counterarguments. The essay strengthens its arguments by comparing other Asian countries' economies that flourish under democracy with that of China. This paper provided multiple sources of evidence and introduced analogies to help the audience understand the arguments being put forth.

If we read this paper to analyze its position in the diplomatic community, we can use the data and analysis to understand how the Chinese Economic Growth has influenced other countries and what they have learned from it. Like China observed the West during the economic liberalization, who observes China during their own policy reforms? This paper has concluded several findings in context to living standards, diplomatic relations, education, etc. which provide a holistic review of the economic prosperity and discuss many avenues of it and therefore, the essay becomes helpful when understanding the general overview of the Chinese growth while also zooming into specific details. Further questions are also then raised; Besides the aforementioned factors, what else contributes to the growth? Do culture and geography play critical roles in economic prosperity? The future scope for this paper lies in the continuous developments in the real world. The content will constantly evolve and we must potentially rethink these arguments in the long term.

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