

## THREE

# The Capitalist Boom

## 1980–2008

THE CONTEMPORARY CAPITALIST BOOM in China is built on the industrial foundation laid in the Mao period. At the same time, such a boom is linked to the earlier booms in Japan and the Four Tigers—South Korea, Taiwan, Hong Kong, and Singapore—which lasted roughly from 1950 to 1990. We cannot fully understand the dynamics of the China boom without understanding those of the earlier Asian Tigers.

Many scholars explain the ascendancy of Japan and the Four Tigers as formidable exporters of manufactured goods to the Global North after World War II in terms of endogenous forces within these economies, most notably the institutions of a centralized economic governing bureaucracy, known as the developmental state, that directed precious resources to strategic industrial sectors (Amsden 1989; Wade 1990; Arrighi 1996; Hung 2009b). But at the same time it would not have been possible for these endogenous conditions to bring about rapid economic growth had there not been the all-encompassing Cold War geopolitics in East Asia. During the Cold War period, what was being fought in East Asia was actually a hot war because, from the U.S. perspective, Communist China's support of rural guerrillas in Southeast Asia and its involvement in the Korean War and the Vietnam War led the region into a permanent state of emergency. Washington regarded the region as the most vulnerable link in the containment of communism and considered

its key Asian allies—that is, Japan and the Four Tigers—too important to fail. This consideration accounts for Washington's generous offer of financial and military aid to these East Asian governments to help them jump-start and direct industrial growth. Washington also kept the U.S. and European markets wide open to East Asian manufactured exports, another advantage that other developing regions rarely enjoy. Without this openness in the Western market for their goods, it is simply unimaginable how these Asian exporters could have any chance of success. Viewed in this light, the rapid economic growth of East Asia was far from a “miracle against all odds.” Instead, the growth of Japan and the Tigers was consciously cultivated by the United States as part of its effort to create subordinate and prosperous bulwarks against communism in East Asia.

In the meantime, starting in the 1970s economic crisis in the Western capitalist world urged manufacturers there to outsource labor-intensive parts of the production process to lower-wage countries to cut costs and revive profits, and the East Asian Tigers, which had already achieved export-oriented industrialization, became the largest recipients of such industrial relocation (for more on this topic, see chapter 6; see also Arrighi 1994: epilog, and Brenner 2003). The rise of the Asian Tigers was also a culmination of three centuries of Chinese diasporic capitalism in Asia. As we saw in chapter 1, some Chinese coastal entrepreneurial families, with their cross-generation class reproduction constrained by the Qing imperial state, chose to migrate to European colonial outposts in Asia to become the middlemen of Europe–China trade as early as the seventeenth century. These Chinese traders rapidly advanced their fortunes, global networks, and entrepreneurial capabilities in the age of high imperialism at the turn of the twentieth century. In the postwar years, these overseas Chinese capitalists constituted the economic backbone of the export-oriented industrialization in Singapore, Hong Kong, and Taiwan (Hui 1995; Arrighi 1996; Hamilton 1999; Cochran 2000; Katzenstein 2005: 60–69; Kuo 2009, 2014).

Organized under a multilayered subcontracting production network spearheaded by Japan, different East Asian manufacturers occupied different segments of the value chain, and each of them specialized in exporting goods to the Western world at a particular level of profitability and technological sophistication. While Japan specialized in the most

high-value-added items, the Four Tigers specialized in middle-range products, and the emerging Tigers in Southeast Asia specialized in low-cost, labor-intensive ones. This famous “flying-geese formation” among the Asian exporters constituted a network of reliable suppliers of consumer products to the world market (Cumings 1984; Ozawa 1993).

Beginning in the 1980s and accelerating in the 1990s, China’s market reform turned it into a late-coming Asian exporter, absorbing a great amount of manufacturing investment from Japan and the Four Tigers, particularly from Chinese diasporic capitalists in Hong Kong and Taiwan. On the one hand, the export-dependent and investment-heavy path of economic growth in China resembles the earlier Asian Tigers’ pattern of development. On the other, the Chinese authoritarian state’s strength and resilience, China’s intact networks of SOEs that originated in the Mao era, and the country’s deep surplus-labor pool in the countryside contributed to its divergence from its Asian neighbors. China’s capitalist boom is tantamount to an explosion ignited by the mixing of the Maoist legacies and East Asian capitalism, each developed separately on opposing sides of the Cold War in Asia.

### Decentralized Authoritarian Development

To recapitulate, the previous chapter showed how the Communist party–state managed to extract and concentrate scattered rural surplus and build up an extensive network of state-owned urban industrial capital through rural collectivization and the “price scissors” between agricultural and industrial products during the Mao period (Friedman, Pickowicz, and Selden 1991; Selden 1993; Wen 2000: 141–271). Though the peasants were chained to their villages by the household registration system, which restricted migration from their birthplaces, their life expectancy and literacy rate improved significantly as a result of state investment in rural elementary education and public health (Hesketh and Zhu 1997; Ross 2005: 1–13). The Maoist path of development fostered a high GDP growth rate over most of the period until the mid-1970s, when the growth momentum generated by the central-planning system was exhausted and the economy came to a standstill. But it also left China with a bulk of state capital and a vast pool of healthy and educated surplus laborers in the countryside. China developed a strong state less

burdened by external debts in comparison with other developing and socialist countries. These developmental outcomes laid a solid foundation for market reform, launched by post-Mao leaders in the late 1970s as a remedy to overcome economic stagnation (Naughton 1995: 55).

The market reform started with decollectivization and restoration of a peasant economy in the countryside in the early 1980s, followed by urban state-enterprise reform and price reform in the late 1980s. In the 1990s, SOE reform accelerated, and the transformation of these enterprises into profit-oriented capitalist corporations emerged as the core agenda of reform. Throughout these stages, the main thrust of the reform was to decentralize the authority of economic planning and regulation and to open up the economy, first to Chinese diasporic capital in Asia and then to transnational capital from all over the world.

The process of “transferring power to lower levels [of government] and allowing lower levels to gain more profits” throughout the 1980s was a conscious effort by the reformist leaders at the center to create a “bureaucratic constituency of market reform” among local cadres as a counterweight to the conservative old guard (Shirk 1993: 334–35), who favored a command economy and had a vested interest in the centrally controlled industries, though the power base of this old guard in the central-planning establishment had been loosened during the Cultural Revolution (see also Andreas 2009). Cut off from subsidies from the central government and lured by the opportunities for profiteering activities, local governments with different preexisting resource endowments devised diverging strategies of capital accumulation. Some directly ran collective township-and-village enterprises (TVEs) or turned public enterprises within their jurisdiction into profit-oriented units (this mode of local development is known as “local corporatism” or “local state entrepreneurialism”; see, e.g., N. Lin 1995; Walder 1995b; Duckett 1998; Oi 1999). Some assumed the role of “referees” instead of direct “players” in the local economies. They promoted local development through such classical developmental state measures as making discriminatory rules and constructing appropriate infrastructure to facilitate the growth of select industrial sectors on which they relied for tax revenue (for a discussion of “local developmental state” in China, see Blecher and Shue 2001; Segal and Thun 2001; Wei 2002; Zhu J. 2004). Some relied on outright predation on local societies’ preexisting wealth and

on public assets through tax bullying, corruption, and selling of state-owned resources for private gain (Lu 1999, 2000a, 2000b; Sargeson and Zhang 1999; Bernstein and Lu 2003; Yu 2003; Guo and Hu 2004). The three local strategies of accumulation as described here are ideal-typical rather than empirical entities. They were in reality combined differently in different localities (Tsai 2002: 254; see also Baum and Shevchenko 1999; Xia M. 2000; Shevchenko 2004).

Lacking technical and management know-how as well as marketing networks in overseas markets, most local developmental or entrepreneurial states depended heavily on labor-seeking transnational capital, in particular Chinese diasporic capital from within East Asia, to jump-start and sustain economic growth. Though foreign direct investment (FDI) is not a major part of China's continental-size economy in quantitative terms, it played a significant role in driving China's labor-intensive and export-oriented industrial growth (see G. Lin 1997, 2000; Hsing 1998). As of 2004, almost 60 percent of Chinese exports were manufactured in foreign-funded enterprises, and this percentage was even higher for higher-value-added products. That figure is startlingly high in comparison with the figures for other Asian Tigers at a similar stage of take-off: 20 percent for Taiwan in the mid-1970s, 25 percent for South Korea in the mid-1970s, and 6 percent for Thailand in the mid-1980s. Measured in terms of the ratio between FDI and gross capital formation, China's FDI dependence has been among the highest in East and Southeast Asia since the 1990s (Huang Y. 2003: 4-35; Gilboy 2004; Hughes 2005).

The bulk of state capital accumulated in the Mao era became an attraction to foreign investors, who could simply connect themselves into the preexisting network of production by establishing joint ventures or multilayered subcontracting networks with local SOEs or collective enterprises. For example, foreign giants such as Boeing, Volkswagen, and Toyota started their businesses in China by collaborating with existing state-owned aircraft or automobile enterprises (Chin 2003). The "unlimited" supply of healthy and educated labor from the countryside, another legacy of the Mao era, persistently kept wage levels in China much lower than the international standard. China's attractiveness to global capital was further enhanced by the competitive pressure among local states, which raced with one another to achieve high GDP growth by offering the most favorable terms possible to foreign investors, ranging from tax breaks to free industrial land.

A consequence of economic decentralization was the weakening of the central government's authority. With local states becoming the leading agents or direct regulators of capital accumulation, the central government became an indirect player that specialized in devising the macroeconomic backdrop, such as interest rates, exchange rates, and preferential policy toward certain regions and sectors against which local states pursue development. Because of the central government's weakening power vis-à-vis that of local governments in direct economic management, some analysts have characterized China's political economy as "fragmented authoritarianism" (Lieberthal 1992).<sup>1</sup>

During the 1990s, the central government attempted to reinvigorate the power of the center in the area of administrative regulation, financial regulation, and commodities management. The 1994 fiscal reform ensured a larger share of revenue by the central government vis-à-vis local governments. But the recentralization went at best only halfway because the reform mostly recentralized bureaucratic power from the county and township level to the provincial level, but not from the provincial level to Beijing. In exchange for a smaller share of government revenue, provincial governments were granted larger autonomy in the pursuit of economic and income growth. In the end, the centralizing reform further empowered provincial governments vis-à-vis the central government and ironically aggravated the phenomenon of "perverse federalism" (Mertha 2005). The momentum of continuous empowerment of local states vis-à-vis the center is not easy to reverse, for this process is integral to market reform itself.

Under market transition, the old social compact in Mao's time, which was based on free health care, education, life-long employment, and other basic social services provided by SOEs and rural communes, was shattered. Before the late 1980s, the dissolution of this social compact was compensated by rising income offered by new market opportunities in the countryside and the shift from a scarcity to a consumer economy in the city. In the first stage of reform up to the mid-1980s, "everybody [won]" because most segments of the population benefited (Wang S. 2000: 37-39).

The social dynamics of the reform shifted dramatically when urban reform accelerated after the mid-1980s. The focus of this urban reform was to turn SOEs into autonomous profit-making units by hardening these enterprises' "soft-budget constraint," which warranted

government subsidies and government absorption of losses. The reform also intended to replace fixed, centrally planned prices of key commodities with floating market prices. Under the new pressure to make profits, many SOEs started eliminating welfare packages for workers and replacing lifelong employment with short-term contractual work. Industrial workers' falling income and weakening job security were coupled with runaway inflation and rampant corruption unleashed by price reform. The price reform, which started with a "dual-track system" that allowed the coexistence of fixed planning prices and floating market prices for such key commodities as gasoline, cement, steel, and other materials in short supply, enabled government officials and state-enterprise managers to purchase these commodities at low prices through governmental channels, to stockpile them, and then to resell them at skyrocketing market prices to the emergent free market. Through this rent-seeking activity, many cadres or their kin and protégés amassed enormous private wealth and turned themselves into the first generation of China's "cadre-capitalist class" or "bureaucratic capitalists" in a matter of a few years (Sun 2002; Wen 2004: 37; So 2005). Inflation, corruption, and class polarization reached crisis proportions in 1988, paving the way for the large-scale unrest in 1989 (Hartford 1990; Saich 1990; Baum 1991; Selden 1993: 206–30; Naughton 1995: 268–70; Zhao 2001: 39–52; Wang H. 2003: 46–77).

During the democratic movement in 1989, students and liberal intellectuals diagnosed the economic chaos and corruption as having originated in the mismatch between courageous economic reform and timid political reform. They believed that political liberalization could redress the corruption and abuses generated by the reform. The demands made by nonstudent participants in the movement, in contrast, were more social than political. They called for an end to official profiteering and protection of workers' rights in the reforming SOEs. Whereas protesting students employed Western-style language and symbols of liberal democracy—such as the *Goddess of Democracy* statue erected in front of the Mao portrait in Tiananmen—to articulate their demands for a more complete end to the socialist system, many worker participants ironically held up the portrait of Mao Zedong to express their opposition to the dissolution of the very same system (Unger 1991; Calhoun 1994: 237–60; Wang H. 2003: 57–58).

In contrast to the protestors' disunity was the increasing unity in the party-state during the upheaval. The CCP's once sidelined old guard, who detested market reform, regained their influence amid the chaotic price reform. They adamantly defended the central-planning system and advocated relentless repression of the 1989 unrest to uphold one-party rule. The free marketeers, Deng Xiaoping included, and the nascent cadre-capitalist class, intimidated by the protestors' attack on their privileges, threw their support behind the old guard despite their disagreement with the old guard on economic issues. After the various factions in the party-state acted in unison to quell the unrest, market reform stalled when the old guard were back in charge. But the free marketeers soon displaced the conservatives again under the blessing of the ailing but still unchallengeable Deng Xiaoping, who took a surprising southern tour in 1992 to reenergize the local cadres' effort to further liberalize the economy. A new political consensus based on uncompromising authoritarian rule combined with equally uncompromising marketization was put in place, setting the tone of China's developmental path in the 1990s and beyond (Naughton 1995: 271–308; Wang H. 2003: 62–72).

In the end, the 1989 crackdown not only closed off the path to political liberalization but also accelerated the neoliberal attack on urban workers' rights. To break the international isolation of China resulting from the bloodshed in Tiananmen, Jiang Zemin and Zhu Rongji, the post-1989 CCP leaders originating in Shanghai and chosen by Deng, pursued an aggressive neoliberal economic agenda throughout the 1990s, conscientiously following the Washington consensus and advice from U.S. financial capital. This approach provided the cover and incentive to the Clinton administration in the United States to set aside all doubts about the CCP regime in the aftermath of Tiananmen and to adopt an engagement policy toward China in the name of promoting human rights improvement through U.S.–China economic exchanges.

In the 1990s, the liberalization of the economy and the subsequent social polarization advanced with far greater ferocity than in the 1980s. Massive layoffs of workers in SOEs, which were transformed into profit-oriented enterprises or underwent outright privatization, and complete dissolution of the welfare system embedded in public enterprises swept all major cities, creating a swelling urban underclass. Privatization of SOEs in the 1990s opened up new opportunities for senior cadres

and their associates to snowball their wealth through “insider privatization,” heralding the formation of a new class of oligarchs (Li and Rozelle 2000, 2003; Walder 2002b, 2003; Wang H. 2006). Had it not been for the post-Tiananmen authoritarian state’s firm grip on society, the polarizing yet upheaval-free liberalization of the economy would have been impossible, at least not at the pace witnessed.

Capitalism was firmly in place in China by the 1990s. The new rich—including the cadre-capitalist class, self-made businessmen, middle-class professionals, and the like—were the main beneficiaries of the party’s new political consensus of the 1990s and became the party’s new social base. Departing from the recruitment policy that discriminated against professionals with a high education in the Mao era, the CCP began in the 1990s to shore up its recruitment of young college graduates, who now constitute the backbone of China’s new middle class (Walder 2004). In 2001, the party opened the door wider by allowing private entrepreneurs to become card-carrying party members. These beneficiaries of market reform are more antinomies than pioneers of political reform. Recent large-scale surveys consistently find that most middle-class professionals and entrepreneurs in China are sternly opposed to political liberalization out of fear that it will unleash increasing social demands from below that will threaten their private gains (see, e.g., A. Chen 2002; Li et al. 2005; Tsai 2007). In this manner, China’s party-state has reticently transformed itself from a socialist authoritarian state, which upheld the planned economic system and facilitated the accumulation of state capital, to a capitalist authoritarian state, which defends the private accumulation of capital in a market system among the privileged and keeps at bay grassroots resistance to this accumulation process.

The intense competition among local governments for foreign investment as well as the pro-capital authoritarian state’s efforts to keep the laboring classes’ demands at bay contributed to the attractiveness of China to global capital, in particular manufacturing capital, which had developed in Japan and the Asian Tigers during East Asia’s postwar takeoff. Between 1990 and 2004, investment from Hong Kong, Taiwan, South Korea, Japan, and Singapore altogether constituted 71 percent of the stock of FDI flowing into China (China Profile 2011; Chinese Ministry of Commerce 2011; Chinese National Bureau of Statistics n.d.). Many of these investments were export oriented, transforming China into the

“workshop of the world.” They underline the continuity between the Chinese economic miracle and the earlier East Asian miracles, and they tie China into the East Asian network of production. They are also the main sources of the Chinese economy’s dynamism and profits. Before we examine the foreign-capital-driven and export-oriented engine of the Chinese economy, let us first look at the transformation of state enterprises that originated during the Mao era into profit-oriented corporations that remain at the commanding heights of the Chinese economy.

### Capitalist State Enterprises and Neofeudalism

One aspect of the Chinese economic reform in the 1990s that stands apart from the 1980s is the priority of turning the myriad SOEs into profit-oriented corporations. Huang Yasheng, for example, distinguishes China’s capitalist development into two stages in his widely acclaimed book *Capitalism with Chinese Characteristics* (2008). First, there was an entrepreneurial capitalism in the 1980s, when the driving force of growth were rural private enterprises and rural collective enterprises, many of which were private ones in disguise. Entrepreneurial capitalism was then followed by state-led capitalism in the 1990s and beyond, when large, urban-centered SOEs displaced and subjugated the private sector. The SOEs, no less driven by the profit motive than private enterprises, expanded under fiscal, financial, and policy favors offered by the party-state. As shown in table 3.1, SOEs dominated most major sectors in the Chinese economy.

The reform of SOEs in the 1980s never went beyond hardening their budget constraints and increasing their productivity through bonus incentives to workers, and the job security and welfare benefits that the SOEs provided to workers were not altogether abolished. Into the 1990s, aggressive reform of SOEs, which the government saw as a fiscal burden on central and local governments, was meant to turn these enterprises into profitable capitalist enterprises, whether they were still under state ownership or not. To turn the SOEs into internationally competitive corporations after the model of American corporations, the CCP invited U.S. investment banks to restructure some of the biggest state companies and sought to let these companies float in the newly created Chinese stock markets or in the markets of Hong Kong and New York.

TABLE 3.1 Total Assets of Chinese State-Owned/State-Holding Enterprises and Private Industrial Enterprises, National Total and Major Sectors, as of 2012

SECTOR	STATE-OWNED AND STATE-HOLDING ENTERPRISES (100 BILLION YUAN)	PRIVATE ENTERPRISE (100 BILLION YUAN)
National Total	312.1	152.5
Mining and washing coal	31.4	4.7
Extracting petroleum and natural gas	16.6	0.03
Mining and processing ferrous metal ores	3.9	2.6
Processing food from agricultural products	2.0	8.5
Manufacturing tobacco	7.0	0.02
Manufacturing textiles	1.0	9.0
Processing petroleum, coking, processing nuclear fuel	11.9	4.1
Manufacturing raw chemical materials and chemical products	15.9	11.4
Manufacturing nonmetallic mineral products	7.0	12.5
Smelting and pressing ferrous metals	29.8	11.0
Smelting and pressing nonferrous metals	12.1	5.4
Manufacturing automobiles	19.3	5.3
Manufacturing railway, ship, aerospace and other transport equipment	10.6	2.8
Manufacturing electrical machinery and apparatuses	6.2	11.3
Manufacturing computers, communication equipment, and other electronic equipment	8.4	4.3
Producing and supplying electric and heat power	83.1	1.3

Source: Chinese National Bureau of Statistics n.d.

In the words of Carl Walter and Fraser Howie, two veteran investment bankers who participated extensively in the transformation of China's SOEs, "Goldman Sachs and Morgan Stanley made China's state-owned corporate sector what it is today" (2011: 10). In 1993, Vice Premier Zhu Rongji boasted in a central-government speech that Morgan Stanley was planning to pour large investment into China; he conveyed the news as a boon to the troubled economy (Zhu R. 2011: 384).

The creation of China Mobile, which is among the few "National Champions" companies in China and is on the *Fortune* Global 500 list for 2014, illustrates what SOE reform in the 1990s was about. Before the 1990s, China's telecommunication services were provided through a patchwork of state-owned facilities operated by provincial governments. In the early 1990s, Goldman Sachs "aggressively lobbied Beijing" to create a national telecommunication company and succeeded (Walter and Howie 2011: 159). Under the auspices of international bankers, accountants, and corporate lawyers, China Mobile was created as a new company that represented the consolidation of previously provincially owned industrial assets. After years of American bankers' efforts in building its international image, China Mobile completed its initial public offering in Hong Kong and New York in 1997 despite the Asian financial crisis, raising U.S.\$4.5 billion. As Walter and Howie point out, China Mobile's valuation was not based on an "existing company with a proven management team in place with a strategic plan to expand operations" but on projected estimates of the future profitability of the consolidated provincial assets as compared to performance of existing national telecom companies operating elsewhere in the world (2011: 161). International bankers, as minority stakeholders of the company, and China's central government, as a majority stakeholder, thus made huge fortunes by creating a "paper company." This is just one example of many similar operations that turned government assets into profit-oriented state companies. To be sure, these paper companies turned real once they floated in the stock market, and they are projected to become profitable soon.

Nowadays China Mobile is the world's largest mobile-phone operator, with 776 million subscribers and more than 60 percent of China's wireless market (*Forbes* 2014). Though it is a corporation capitalized on the New York Stock Exchange, its monopoly status in the telecommunication sector is a result of state policy and its path of creation. When the



central government merged all telecommunication assets of different levels of government to create China Mobile, it fostered a monopoly corporation shielded from serious competition. To be sure, not all SOEs turned capitalist corporations enjoy monopoly status in their respective sectors as China Mobile does. Many SOEs are owned and operated by local governments and compete intensely with SOEs owned by other local governments or by the central government in the same sector. For example, in the automobile industry Shanghai Automotive Industry Corporation is a public company that originated as an extension of the Shanghai municipal government. The Shanghai government still owns 75 percent of it (Thun 2006: 103). It is one of the largest three automakers in China, but its market share in the Chinese auto market was a mere 23 percent as of 2013 (*Wall Street Journal* 2013b). It competes with other Chinese state-owned automakers such as Chang'an Motors in Chongqing, Sichuan, and the FAW Group in Changchun, Jilin. The Shanghai Automotive Industry Corporation, like other state-owned car makers, has relied heavily on its joint-venture operation with global leading automakers, such as Volkswagen (since 1984) and GM (since 1997), in making competitive vehicles (Thun 2006; Ahrens 2013).

At the aggregate level, SOEs, enjoying monopoly status or not, have been trailing the private sector in profitability. This is demonstrated consistently even in government data (see table 3.2). Their inferior performance is more remarkable if we take into consideration their size and the financial as well as policy support they receive from the government. Since the 1990s, large SOEs have been expanding with the virtually unlimited financial resources from state banks. Like other reforming SOEs, major state banks, having undergone the same internationalization and reorganization following the model of U.S. corporations, continue to be in the CCP's tight grip. The Achilles heel of this financial structure is that the party "tells the banks to loan to the SOEs, but it seems unable to tell the SOEs to repay the loan" (Walter and Howie 2011: 43).

State banks' lax lending to unprofitable SOEs and the latter's difficulty in repaying the loans led to a pileup of nonperforming loans (NPLs). The first wave of NPLs was created in the late 1990s. A few years after the Deng Xiaoping Southern Tour of 1992, which ignited the fever of debt-financed investment by local governments and SOEs, the economy cooled, partly as a result of the central government's effort to contain inflation

TABLE 3.2 Profit Rate in Various Types of Industrial Enterprises, 2007 and 2012

TYPE OF ENTERPRISE	TOTAL ASSET (BILLION YUAN)		PROFIT (BILLION YUAN)		PROFIT RATE (%)*	
	2007	2012	2007	2012	2007	2012
National Total	35,304	76,842	2,716	6,191	7.69	8.06
State-owned and state-holding enterprises	15,819	31,209	1,080	1,518	6.83	4.86
Private enterprises	5,330	15,255	505	2,019	9.5	13.2
Enterprises funded by Hong Kong, Taiwan, Macao, and other foreign investment	9,637	17,232	753	1,397	7.8	8.1

\* Profit rate = total annual profits/total assets.

Source: Chinese National Bureau of Statistics n.d.

and partly as a consequence of the Asian financial crisis of 1997-1998, which hit China's export sector severely. This cycle of overheating and cooling resulted in exploding NPLs in the major state banks' books. This surge of NPLs was in the end resolved by a government bailout. In 1999, four asset-management companies (AMCs) were created to serve as the "bad banks" that would absorb most NPLs from the troubled banks, which thus became "good banks" after this loan-transfer operation. Each of the AMCs took up the NPLs from each of the four leading state banks. The bailout saved the big four, which eventually floated in international markets at good prices. But the AMCs were not as sufficiently capitalized by the government (and hence by taxpayers' money) as many supposed. Although capitalization from the Ministry of Finance for the four AMCs amounted to 40 billion RMB, the other 858 billion of their capitalization came from ten-year maturity bonds that they issued to the rescued big four banks (Walter and Howie 2011: 54-55). The continuous exposure of the big banks to the NPLs because they held AMC bonds means that the

bailout was tantamount to creative accounting that merely postponed an NPL-induced financial crisis for ten years.

The bailout was supposed to be a time-buying device for the SOEs and state bank reform to march on. The idea was that after the transfer of NPLs to the AMCs, the major state banks would continue to improve their transparency and governance following their flotation in overseas financial markets. These banks would then become accountable to the market, and they would avoid repeating the mistakes of lax lending to well-connected SOEs. Meanwhile, the SOE reform was supposed to deepen, and the SOEs would finally become profitable and capable of repaying most of their loans transferred to the AMCs.

However, contrary to the plan, SOEs and state bank reform started to lose momentum after 2003, when the Jiang Zemin–Zhu Rongji government was replaced by the new leadership, Hu Jintao and Wen Jiabao. The thrust toward reform was totally pulled back in 2005, when the Hu–Wen regime completed its consolidation of power. Despite Hu and Wen’s apparently more left-leaning ideology, as expressed in their stated emphasis on alleviating inequality, the termination of SOE reform did not revive the system of socialist enterprises that guarantee full employment and workers’ welfare. Instead, the state sector was “caught somewhere between its Soviet past and its presumably . . . capitalist future.” The SOEs “grew fat, wealthy and untouchable as they developed China’s own domestic markets and always with the unquestioning support of a complaisant financial system” (Walter and Howe 2011: 21, 213). They became “cash machines” of the neofeudal elite controlling the party state: children or grandchildren of the founding leaders of the People’s Republic of China who came to be known as the “princelings” in China. A diplomatic cable allegedly originating from the U.S. embassy in China, according to WikiLeaks, even details how major economic sectors in China have been divided up among the families of the Politburo members through their control of state enterprises, suggesting a feudalization of the economy (*Telegraph* 2010).

By the end of the first decade of the twenty-first century, these SOEs have become the dominating enterprises in China, overshadowing the private ones. Though SOEs’ share in gross industrial output dropped from 83.1 percent in 1980 to merely 7.9 percent in 2011, and the total number of state-owned and state-holding industrial enterprises is less

than one-tenth of the total number of private industrial enterprises in 2011, SOEs’ total assets are 2.2 times larger than all private enterprises’ total assets. Whereas each private industrial enterprise owns an average of 71 million RMB worth of assets, each state industrial enterprise owns 1,652 million RMB worth of assets on average (China Data Online n.d.; Chinese National Bureau of Statistics n.d.). There is a more than twentyfold difference in their average size. SOEs in China are thus mostly gigantic dinosaurs. In fact, among the eighty-five Chinese enterprises included in the 2013 *Fortune* Global 500 list, which ranks corporations around the world by their revenues, 90 percent are SOEs (*Cairxin* 2013). Among the top-ten Chinese corporations listed in 2014, all except one are state owned (see table 3.3).

Their reform terminated halfway, SOEs continued to be unprofitable and incapable of repaying their lingering loans to the AMCs. As of 2006, the AMCs had recovered only about 20 percent of the bad loans, and the cash thus generated could barely pay for the interest on the AMC bonds

TABLE 3.3 Top-Ten Chinese Companies by Revenue in 2014  
Global Fortune 500

COMPANY	OWNERSHIP	GLOBAL 500 RANK
Sinopec Group	State owned	3
China National Petroleum	State owned	4
State Grid	State owned	7
Industrial and Commercial Bank of China	State owned	25
China Construction Bank	State owned	38
Agricultural Bank of China	State owned	47
China State Construction Engineering	State owned	52
China Mobile Communications	State owned	55
Bank of China	State owned	59
Noble Group	Incorporated in Bermuda, headquartered in Hong Kong	76

Source: *Fortune* 2014.



that major state banks held. In 2009, it became clear that the AMCs could not repay their maturing bonds to the big banks (the bonds constituted up to 50 percent of bank capital among the four big banks [Walter and Howie 2011: 51]). As a remedy, the government extended the AMC bonds' maturity for ten more years. This extension, however, is no more than another postponement of a financial crisis. In ten years' time, China's financial system will be much more vulnerable as a large portion of the massive loans created in the emergency "Great Leap Forward Lending" (Walter and Howie 2011: 69) of 2009–2010 in response to the global financial crisis is destined to explode, creating a tsunami of NPLs in the future (for more on this impending crisis, see chapter 6).

When government facilities and socialist enterprises were transformed into profit-oriented state companies, a large number of state workers were laid off because the new companies, accountable to their stockholders domestically and internationally, no longer saw the maintenance of full employment and workers' standards of living as one of their missions. As a result, the SOEs jettisoned their function to provide housing, medical care, and many other social benefits to workers. Although the export sector, which started to boom in the 1990s (which I turn to later in this chapter), helped expand manufacturing employment, the expansion was not as big as the loss of manufacturing employment brought about by the SOEs' reform. As a consequence, China ironically experienced a net loss in manufacturing employment throughout the 1990s just as it was becoming the "workshop of the world" (Evans and Staveteig 2008). The attack on SOE workers' preexisting rights and social security triggered widely documented waves of worker resistance in the 1990s (Pun 2005; C. Lee 2007; Hurst 2009). Such resistance escalated and culminated in a massive protest by retired and laid-off workers in the old industrial bastion of SOEs in the Northeast in 2002. This resistance, though unable to stop the process of de facto privatization of SOEs, did force the government to increase spending in this industrial region to stimulate local economic growth and to compensate for the job losses caused by SOE reform. The resistance also urged the government to redouble its effort to introduce social security and a medical insurance system, however unevenly distributed they might be, to make up for the destruction of the SOE-based welfare regime.

Whereas the Chinese economy and government finance have been dominated and burdened by inefficient state enterprises thriving mostly

on subsidies, financial favor, and protection by the state, the soaring liquidity in the financial system that fuels the orgy of the state sector's investment rests on the foreign-exchange reserves generated in the export sector. It is the export sector, dominated by domestic or foreign private enterprises, that is the foundation for China's capitalist boom, driving the expansion and increasing international competitiveness of the economy at large.

### Rise of the Export Machine

In the 1990s, when the SOE reform was in full force, export-oriented manufacturing also started to take off. Though the export sector had emerged in the 1980s, thanks to the beginning of the inflow of Hong Kong manufacturing capital, it did not go far because most surplus labor in the countryside was retained in the TVEs and the booming agricultural sector. The one-off devaluation of the RMB against the dollar by 33 percent in January 1994, followed by a peg to the dollar, was a deliberate boost to China's export manufacturing as a remedy to the trade-deficit and balance-of-payment crisis in 1993–1994 (Wen 2013: chap. 3, part 4). The Clinton administration's decision to delink annual renewal of China's Most Favored Nation status from any human rights consideration in 1994 and its signing of a landmark trade agreement with China in 1999, which permanently lowered trade barriers for all kinds of Chinese goods, as well as the opening of the Chinese market in exchange for the opening of the U.S. and European markets to Chinese products during China's bid for accession into the World Trade Organization (WTO) (which became reality in 2001) contributed to the growth of China's export engine. But one indispensable fuel for China's export-oriented success has been the protracted low-wage labor released from the countryside since the mid-1990s.

Many argue that China's wage competitiveness originates from a demographic windfall that gave China an exceptionally huge rural surplus labor force, allowing China to develop under the condition of an "unlimited supply of labor" and to enjoy the advantage of a low wage for much longer than other Asian economies (figure 3.1) (Cai and Du 2009). But when we look carefully, this condition is not solely a natural phenomenon driven by China's demographic structure. Instead, it is a consequence of the government's rural-agricultural policies that intentionally

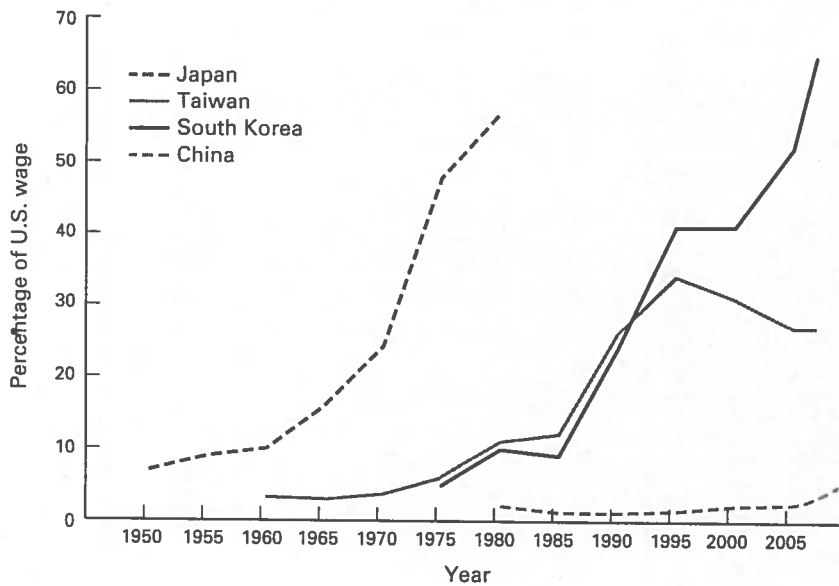


FIGURE 3.1

The hourly manufacturing wage in East Asia as a percentage of the hourly manufacturing wage in the United States, 1950–2009. Sources: U.S. Bureau of Labor Statistics 2013, n.d.

or unintentionally bankrupted the countryside and generated a continuous exodus of the rural population in the 1990s.

The relation between China's policies toward its rural-agricultural sector and its low manufacturing wage level can be illustrated by contrasting China's rural development with the rural development in Japan, South Korea, and Taiwan, where there were large rural populations and agricultural sectors to start with during their industrial takeoff. In post-war Japan, the ruling Liberal Democratic Party was active in directing resources to the countryside through spending on rural infrastructure, agricultural development financing, outright farm subsidies, tariffs against foreign farm products, and so on (Mulgan 2000). In South Korea, the Park regime launched the New Village Movement (*saemaul undong*) in the early 1970s to divert a large amount of fiscal resources to upgrade rural infrastructure, to finance agricultural mechanization, and to institute rural educational institutions and cooperatives. The success of this movement was phenomenal: it increased rural household

income from 67 percent of urban income in 1970 to 95 percent in 1974, virtually obliterating the rural–urban income gap (Lie 1991). In Taiwan, the KMT government pursued similar rural development policies in addition to making a conscious effort to promote rural industrialization in the 1960s and 1970s. The resulting decentralized structure of Taiwan's industry allowed farmers to work in nearby factories seasonally instead of abandoning their farms altogether and migrating to faraway big cities. Improvement in rural-agricultural livelihoods also necessitated export-oriented manufacturers to offer better wages to recruit workers from the countryside (S. Ho 1979; Mellor 1995; Looney 2012). Under these policies, manufacturing wages soared in the relatively early stage of export-oriented industrialization in these economies. The reasoning behind these industrialization choices that balanced rural and urban development in different East Asian economies varied. For the Liberal Democratic Party in Japan, the significance of rural votes to its electoral success explained its attention to rural development. For the right-wing authoritarian regimes in South Korea and Taiwan, promotion of rural-agricultural development was a way to minimize social dislocation that usually accompanied industrialization and to preempt the rise of leftist influences in the countryside. It was also a crucial way to ensure food security in the context of Cold War tension.

In contrast, China's industrial development after the 1980s has been much more imbalanced and the urban bias much more pronounced than in Japan, South Korea, and Taiwan during their takeoff. Since the early 1990s, investment by the Chinese government has been concentrated largely in coastal cities and towns to boost FDI and the export sectors, while attention to rural and agricultural investment has lagged behind. State-owned banks have also focused their effort on financing urban-industrial development, neglecting rural-agricultural financing. The government even deliberately put a brake on rural-industrial growth. In a speech to the central-government agricultural work conference in 1993, Vice Premier Zhu Rongji openly advocated restraining TVE growth so that resources could be freed up for the expansion of the export sector (Zhu R. 2011: 392–93). He also pushed measures to repress grain price in the wake of grain market liberalization in 1993–94 to safeguard urban livelihoods at the expense of the rural-agricultural sector (Zhu R. 2011: 430, 432–45, 493–504).

China's rural-agricultural sector was not only neglected but also exploited in support of urban-industrial growth. A study estimates the direction and size of financial-resource transfer between the rural-agricultural sector and urban-industrial sector in China in 1978–2000 (figure 3.2) (Huang, Rozelle, and Wang 2006; see also Huang P. 2000; Yu 2003; Wen 2005; Zhang 2005). Taking into account the transfer through the fiscal system (via more taxation than government spending in the countryside), the financial system (via more saving deposits from than loans to the countryside), and other means (such as grain marketing and remittance), there was a sustained and ever-enlarging net transfer of financial resources from the rural-agricultural sector to the urban-industrial sector, except for in the years when the urban economy experienced a temporary downturn, such as in the aftermath of the Asian financial crisis of 1997–1998, as shown in figure 3.2. (See also Knight, Li, and Song 2006; Lu and Zhao 2006; Xia Y. 2006; Huang and Peng 2007; Bezemer 2008.)

The emergence of this urban bias in China's development was at least in part caused by the dominance of a powerful urban-industrial elite from the southern coastal regions during China's integration with the global economy. These elites, who germinated after China's initial opening to the world, grew in financial resources and political influence with the export boom and became increasingly adept at shaping the central government's policy in their favor (see Gallagher 2002; Zweig 2002; Kaplan 2006; Kennedy 2008; Shih 2008: 139–88). Their growing leverage in the central government's policy-making process secured the priority given to enhancing China's export competitiveness and the country's attraction to foreign investment in lieu of rural-agricultural development. The urban revolts in 1989 stemming from hyperinflation and deteriorating living standards in the cities only made the party-state more determined to ensure the economic prosperity and stability of big cities at the expense of the countryside in the 1990s and thereafter (Yang and Cai 2003).

The coastal elite's grip on state power can be illustrated by the background of the CCP's top leaders since 1989. Whereas in the 1980s the Politburo Standing Committee—the highest decision-making body in the CCP—had more members with significant prior tenure in inland provinces than members from coastal provinces (excluding those whose entire career was in the central government), in the 1990s and afterward the committee members with coastal backgrounds always outnumbered

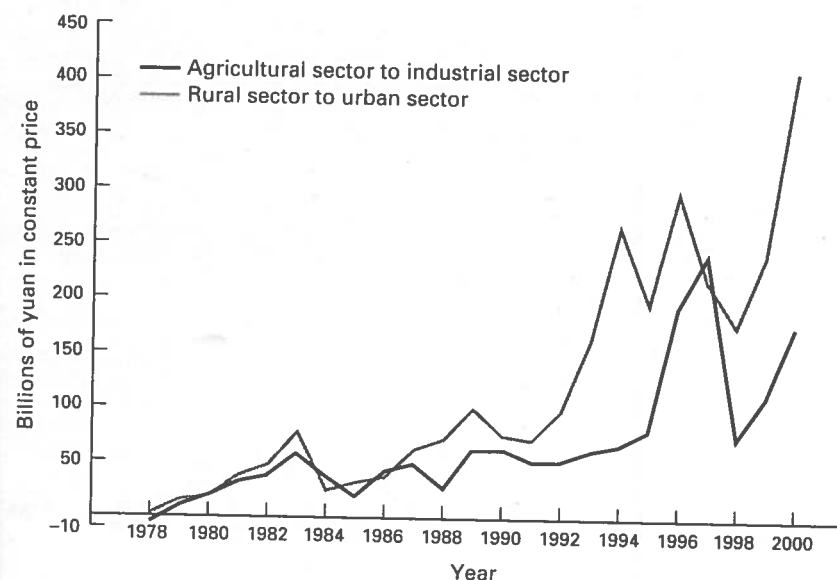


FIGURE 3.2

Total cash transfers from the rural-agricultural sector to the urban-industrial sector, 1978–2001. Source: Hwang, Rozelle, and Wang 2006.

those with a rural-inland background, the only exception being the cohorts of 2002 and 2007 (see table 3.4). In particular, two of the three top leaders after 1989, Jiang Zemin and Xi Jinping, served long years in important coastal export-oriented areas—Shanghai and Zhejiang/Fujian, respectively. To be sure, the coastal urban background of the top elite is not a guarantee of their pro-coastal urban disposition. But their promotion to the party-state power center definitely increases the leverage of the coastal local elite, many of whom are the top leaders' former protégés and acquaintances, to lobby for policies in their areas' favor.

The consequence of this self-reinforcing urban bias has been the countryside's relative economic decline and the concomitant fiscal stringency in rural local governments in inland provinces. Beginning in the 1990s, the deterioration of agricultural income and rural governance as well as the slowing growth of TVEs, which used to be vibrant employment generators in the early stage of market reform in the 1980s, forced most rural young laborers to leave home for the faraway coastal cities and the meager wages in the export-oriented manufacturing

TABLE 3.4 Number of CCP Politburo Standing Committee Members with Prior Careers in Either Coastal or Inland Provinces

	1982	1987	1992	1997	2002	2007	2012
Inland provinces	3	3	2	2	5	5	3
Coastal provinces	1	0	3	4	4	4	4

Note: Members who served in both coastal and inland provinces are counted according to the province where they served the longest tenure.

Source: Data compiled by the author.

sector, creating a vicious cycle that precipitated a rural social crisis and an accelerating outflow of labor.

Besides unleashing a massive transfer of low-wage labor from the rural-agricultural to the coastal export sector, central and local governments have also been offering land, tax, and other concessions to export-oriented manufacturers of toys, garments, electronics, and other goods from Hong Kong and Taiwan to lure them to transfer their production lines to China, bringing with them their technical and management know-how as well as their connections to the overseas consumer market. This approach to developing the export sector has made private enterprises prevail and freed them from domination by monopolistic SOEs, as in other sectors.<sup>2</sup> The lack of SOE domination has created room for domestic private enterprises to grow, many of them becoming acquainted with Hong Kong and Taiwan exporters through a subcontracting network or competition. The home-grown small and medium exporters in Wenzhou are good examples of this process (Sonobe, Hu, and Otsuka 2004; Wei 2009). As shown in table 3.2, both the profit rate and the aggregate profit of private enterprises and enterprises funded by Hong Kong, Taiwan, and other foreign investment have been higher than the profit rate and aggregate profit of state-owned and state-holdings enterprises, although the latter's total industrial assets are much larger. The central role played by these private enterprises in China's economy manifests the connection between China's capitalist boom and the earlier East Asian Tigers as well as the centuries-long development of Chinese diasporic capital. It also shows that China's capitalist boom, despite SOEs' continuous domination of its economy, has been driven

primarily by the segment of the economy that is most integrated with the global neoliberal order, which warrants free, transnational flow of capital and trade.

Some may argue that given the weight of fixed-asset investment in GDP (as shown later in figure 3.4), undertaken mostly by SOEs and local governments, the China boom is at least as much driven by the state sector as by the private export sector. But most of the fixed-asset investment in the Chinese economy has been financed by state bank lending, and a large portion of liquidity in the banking system originates from a “sterilization” process in which private exporters surrender their foreign-exchange earnings to state banks in exchange for an equivalent amount of RMB issued by the People's Bank of China, China's central bank. As such, a large part of the increase in liquidity in China's banking system originates from the ballooning trade surplus that the export sector generates as long as the RMB-dollar peg is maintained and China's capital account is closed. At its height in 2007, China's current-account surplus amounted to 47 percent of the increase in money supply, as measured in M2, in the Chinese economy in that year. Likewise, China's foreign-exchange-reserve/M2 ratio throughout the 2000s remained high by international standards, never falling below 20 percent after 2004 and reaching 29 percent at its height in 2007 (see table 3.5).

This monetary expansion, backed by trade surplus and foreign-exchange-reserve growth, is channeled mostly to create bank loans that finance fixed-asset investment by state enterprises and local governments. Had it not been for the large foreign-exchange reserve originating in the thriving export sector, this large-scale expansion in liquidity and credits would have triggered a financial crisis because a small and decreasing foreign-exchange-reserve/M2 ratio is often a precursor

TABLE 3.5 Ratio of Total Foreign Reserves to M2 in China

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total Reserves/ M2 (%)	10.5	11.6	13.9	16.3	21.3	24.1	24.9	29.2	28.7	27.5	27.2	24.7	22.0

Source: World Bank n.d.

to currency collapse and capital flight, as was the case in many Asian economies on the eve of the Asian financial crisis of 1997–1998 (Sachs, Tornell, and Velasco 1996; Corsetti, Pesenti, and Roubini 1998: 36–39; IMF 2000: 14–15; Kim, Rajan, and Willett 2005). Moreover, because expansion of fixed-asset investment always drives up the import of raw materials and machinery, the absence of an equivalent or faster increase in exports will precipitate balance-of-payment difficulty, as happened in 1992–1993 (Wen 2013: chap. 3, part 4). Viewed in this light, China's thriving export sector constitutes a solid foundation for its aggressive investment growth. It is indeed the mother of the China boom.

### From Flying Geese to the Panda Circle

The United States was from the beginning the single most important market for China's exports, as it was for the earlier Asian Tigers, and was surpassed only recently by the European Union as a whole. The rapid expansion of China's export-oriented industries has already made China the biggest exporter to the United States among all Asian exporters, as shown in table 3.6.

As noted earlier, the relatively stagnant manufacturing wages and falling rural living standards have triggered large-scale transfer of rural

TABLE 3.6 China's and Other East Asian Economies' Export Value to the United States and the World (Billion U.S.\$)

	1985		1995		2005		2013	
	U.S.	World	U.S.	World	U.S.	World	U.S.	World
China	2.3	27.3	24.7	149.0	163.3	762.3	369.0	2,210.6
Japan	66.7	117.3	122.0	443.3	136.0	594.9	134.4	714.6
South Korea	10.8	30.3	24.3	131.3	41.5	284.3	62.3	559.6
Taiwan	14.8	30.7	26.4	112.6	29.1	198.4	32.6	305.4
Hong Kong	9.3	30.2	37.9	173.6	46.5	289.5	42.8	459.2
Singapore	4.8	23.0	21.6	118.2	23.9	207.3	24.1	412.2

Source: For 1985, IMF n.d.c. and Taiwan Economic Data Center n.d.; for 1995–2013, Taiwan Bureau of Foreign Trade n.d.

labor into the export sector. The growth of this sector has restrained consumption by worker and peasant households and deepened Chinese manufacturers' dependence on wealthy countries' consumers. This pattern of growth that is highly dependent on external demand is definitely precarious, and I discuss it at more length in chapter 6. But as long as the consumption markets in the United States and Europe continue to expand, as they did under debt-financed hyperconsumerism in most of the 2000s, the stellar growth of China's formidable export engine is guaranteed.

This same reliance on exports, expanding fixed-asset investment, and a low-wage regime that repressed consumption—the key characteristics of China's capitalist boom—could also be observed in the East Asian Tigers' earlier takeoff. But as shown in figures 3.3, 3.4, and 3.5, the Chinese economy's dependence on the export sector and the weight of fixed-asset investment, as measured by total export value and fixed-capital formation as a percentage of GDP, respectively, has been rising and has reached the level that other East Asian economies never attained.<sup>3</sup> However, the weight of private consumption in China's national economy, as



FIGURE 3.3

Export as share of GDP in East Asian economies, 1965–2012. Sources: World Bank n.d.; Taiwan Economic Data Center n.d.



FIGURE 3.4

Fixed-capital formation as share of GDP in East Asian economies, 1960–2012. Sources: World Bank n.d.; Taiwan Economic Data Center n.d.



FIGURE 3.5

Private consumption as share of GDP in East Asian economies, 1960–2012. Sources: World Bank n.d.; Taiwan Economic Data Center n.d.

measured by household consumption as a percentage of total GDP, has been declining and has dropped well below the level in other Asian exporters during their takeoff.

Besides continuing the East Asian model of export-oriented development, China's capitalist boom also has been reconfiguring the geography of production in East Asia, making earlier East Asian exporters increasingly integrated with China's export engine through the regionalization of the industrial production network. When China had just started to establish itself as the most competitive Asian exporter of products at various levels of technological sophistication in the 1990s, earlier Asian exporters, including Japan and the Four Tigers, together with a group of emerging exporters in Southeast Asia including Malaysia and Thailand, were put under intense pressure to adjust. The export competitiveness from China forced a great amount of export manufacturing to relocate from other Asian economies to China. The *Economist's* report "A Panda Breaks the [Flying Geese] Formation" in 2001 best describes the challenge that China posed to its neighbors at this time:

Most of China's neighbors react to the mainland's industrial rise with a mix of alarm and despair. Japan, South Korea and Taiwan fear a "hollowing out" of their industries, as factories move to low-cost China. South-East Asia worries about "dislocation" in trade and investment flows. . . . China is no goose. It does not conform to the . . . stereotype [of a flying goose], because it makes simple goods and sophisticated ones at the same time, rag nappies and microchips. . . . China makes goods spanning the entire value chain, on a scale that determines world prices. Hence East Asia's anxiety. If China is more efficient at everything, what is there left for neighbors to do?

(*Economist* 2001)

Some argue that the erosion of manufacturing profitability under the competition from China was an underlying cause of the Asian financial crisis of 1997–1998 (Krause 1998). Amid the turmoil that the rise of China's manufacturing power raised in the existing export-oriented industrial order in the region, China's neighbors painstakingly restructured their export engine to minimize head-on competition with China and to profit from its rise. In the flying-geese hierarchy of the old industrial order in East Asia, each economy exported specific groups of finished consumer products to Western markets, with Japan exporting the most



TABLE 3.7 Exports to China Versus Exports to the United States as a Percentage of Total Exports from East Asian Economies

	1985		1995		2005		2013	
	China	U.S.	China	U.S.	China	U.S.	China	U.S.
Japan	7.1	37.6	4.95	27.5	13.5	22.9	18.1	18.8
South Korea	0.0	35.6	7.0	18.5	21.8	14.6	26.1	11.1
Taiwan	0.0	48.1	0.3	23.7	22.0	14.7	26.8	10.7
Hong Kong	26.0	30.8	33.3	21.8	45.0	16.1	54.8	9.3
Singapore	1.5	21.0	2.3	18.3	8.6	10.4	11.8	5.8

Source: For 1985, IMF n.d.c. and Taiwan Economic Data Center n.d.; for 1995–2013, Taiwan Bureau of Foreign Trade n.d.

technologically advanced products, Korea and Taiwan exporting less-sophisticated products, and Southeast Asia exporting the least-value-added ones. The rise of China fomented a new, Sino-centric export-oriented industrial order under which most Asian economies increased the weight of their export of high-value-added components and parts (e.g., for Korea and Taiwan) and capital goods (e.g., for Japan) to China, where these capital goods and parts were employed and assembled into finished products to be exported to rich countries' markets (Ando 2006; Baldwin 2006; Haddad 2007).

As table 3.7 indicates, exports from South Korea, Hong Kong, Taiwan, and Singapore to China surpassed their exports to the United States during the 1990s and 2000s, and Japan's exports to China rapidly came to equal its exports to the United States. By the 2000s, the Japan-centered flying-geese model of Asian regionalism had been replaced by a Sinocentric production network in which China exports most final consumer products to the Western markets on behalf of its Asian neighbors, which provide China with the parts and machines necessary for the assemblage of such products (see figure 3.6).

The regional integration among East Asian exporters is well reflected in the correlation between the ups and downs of export figures in China and those of its Asian neighbors. For example, Asia's recovery from the financial crisis of 1997–1998 and Japan's renewed growth after 2000 are

attributable, at least in part, to the accelerated economic boom in China, which absorbed their manufactured components and capital goods. And when the global crisis unfolded in the fall of 2008 and consumption demand in the United States started to contract sharply, the export value of China's Asian neighbors plunged immediately, but the export value of China itself did not dive to a similar extent until three months later. This lag was caused by the fact that the declining exports of China's neighbors were largely a function of the plunging orders for parts and capital goods by China-based manufacturers in anticipation of plunging orders for the final products from the United States and elsewhere in the months that followed (Setser 2009). The interconnectedness of the Asian network of production also can be illustrated by the manufacturing of the iPhone, which contains key components from Japan and Korea (with Korean components constituting the largest share, 43 percent) and is assembled in China, as shown in table 3.8.

Under this Panda circle of Sino-centric production network and East Asia's increasing dependence on China for export growth, the limits and vulnerability of the Chinese development model, signaled by its overdependence on consumption demand in the rich countries and the



FIGURE 3.6

The Sinocentric and export-oriented network of production in East Asia, c. 1990–present.

TABLE 3.8 Breakdown of an iPhone 4 (Retail Value: U.S. \$600)

COUNTRY / COMPANY	COMPONENTS	COST (U.S.\$)
<i>South Korea</i>		
LG (or TMD)	Liquid-crystal display	28.50
Samsung	Flash memory chip	27.00
Samsung	Applications processor	10.75
Samsung	DRAM memory	13.80
<i>United States</i>		
Broadcom	Wi-Fi, Bluetooth, GPS chips	9.55
Intel	Radio-frequency memory	2.70
Texas Instruments	Touch-screen control	1.23
Cirrus Logic	Audio codec pack	1.15
<i>Germany</i>		
Infineon	Receiver/transceiver	14.05
Dialog	Power management	2.03
<i>Italy/France</i>		
STMicroelectronics	Accelerator and gyroscope	3.25
<i>Japan</i>		
AKM	Compass	0.70
<i>Other</i>		
Wintek or TPK Balda	Touch screen	10.00
Not known	Camera, 5 megapixel	9.75
Not known	Camera, video graphics array	1.00
Not known	Battery	5.80
Not known	Other parts	46.25
COMPONENT TOTAL		187.51
ASSEMBLY COST		6.54
MISCELLANEOUS		45.95
PROFIT		360.00

Source: *New York Times* 2010.

relative slow growth of its own domestic market (as examined in detail in chapter 6), are translated into the limits and vulnerability of other Asian economies.

In this chapter, we see how China's capitalist boom originated from both the educated, healthy rural surplus labor in China as a legacy of the Mao period and the export-oriented, labor-intensive manufacturing in the East Asian Tigers. Though the state sector in China, another legacy of the Mao period, is huge, and fixed-asset investment within that sector constitutes a large part of China's economic dynamism, such debt-financed investment is very much grounded in the increasingly large liquidity and foreign-exchange reserve engendered by the export sector. In the latest stage of development, China's export manufacturing has complemented its forward linkages to the export markets in Western capitalist economies with strong backward linkages to components and capital-goods exporters in neighboring Asian economies. The China boom is therefore heavily reliant on the free transnational flow of investment and goods. It would have been impossible without the rise of global free trade since the 1980s. Besides importing components and capital goods from its East Asia neighbors, China has started to be a major buyer of raw materials and energy from other developing countries in Latin America and Africa. It has also started to export its manufactured products and capital to these distant countries in increasing amounts. The next two chapters focus on whether and how China's increasing trade and investment linkages with other developing countries are reshaping the pattern of global inequality, the context of development, and the geopolitical balance of power in the developing world.