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GOVERNING GLOBALIZATION

CHINA, THE GLOBAL ECONOMY, AND BRI

Peter Nolan

THE CERTAINTIES of the Washington consensus era have evaporated. In the wake of the global financial crisis, policymakers in both the East and the West are 'groping for stones to cross the river,' to refer to an old Chinese saying, as there is no clear sight of the 'other bank.' This essay begins by examining the long-term changes in the structure of the international economy and the contradictory character of the recent era of capitalist globalization. I argue that in order to overcome the contradictions of capitalist globalization, in addition to national policies, the international economy needs increasingly effective regulation, building on the tentative institutional foundations already established.

The essay then analyses Western hopes and expectations for China's domestic reforms, and compares these with the realities of China's reform path, which has built on its 2000-year history of integrating government action with market forces, with the objective of serving the interests of the majority of the population. I argue that East and West must work together pragmatically in order to find a common path for intelligent, non-ideological regulation of the international economy in the common interest of the whole of human society—especially the 50 percent who are at the 'bottom of the pyramid.' This is a 'choice of no choice' (*mei you xuan ze de xuan ze*) for sustainable global development.

THE CHANGING INTERNATIONAL ECONOMY

China under the Han Dynasty (206BC-220AD) united an area as large as the Roman Empire. China's technological level at the end of the Han period, which included the widespread use of water power, extensive irrigation and drainage projects, silk, porcelain,

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Photo: CIRSD artwork

Founders of ancient Chinese philosophy: Confucius and Mencius

the blast furnace, and paper, was far ahead of that of Europe.

For most of the long era from the collapse of the Roman Empire until the Industrial Revolution, China and India together produced around 50 percent of global GDP, compared with around 25 percent for Western Europe and 33 percent for the whole of Europe, including Eastern Europe and Russia. By 1980 the share of global GDP produced by China and India together had fallen to 5 percent and the share of today's High-Income Economies had risen to 64 percent. Between 1980 and 2016 the share of global GDP produced by the High-Income Economies shrunk from 64 percent to 42 percent, while the combined share of China and India rose from 5 to 25 percent, and the share of developing countries as a whole increased from 36 to 58 percent.

The West's global economic, political, military, and cultural domination lasted only 200 years, compared with 2,000 years during which China was the most significant global civilization. During this brief era, one global empire rose and fell (Britain), while another rose and faces existential problems (the United

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States). This short era is coming to an end. In the era ahead, today's developing countries, which contain the vast majority of mankind, will demand an increased voice in regulation of the global political economy. There is much discussion about the 'Eclipse of the West.' However, the people, leaders, and businesses of the West have not yet fully absorbed the implications of the fact that this short era is coming to an end.

Whether the West is able to deal with this peacefully remains a core unresolved issue in international relations. The international media in the West are full of discussions about the possibility for another 'Peloponnesian War' and a 'Clash of Civilizations.' Cooperating in order to govern the global economy in the common interest can play a vital role in ensuring a peaceful outcome.

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Positive Results of the Era of Globalization

It is unquestionable that the unleashing of capitalist freedom during the era of the Washington Consensus produced tremendous positive results.

This era has arguably witnessed the most dramatic technological progress in the history of the world. The main body of innovation has been driven by ferocious oligopolistic competition between giant firms and their supply chains. The top 2,500 firms account for over 90 percent of corporate investment in R&D. Within those 2,500 firms, the top 100 companies account for 53 percent and the top 500 account for 85 percent of total R&D spending, as noted in the European Commission's *EU R&D Scoreboard* (2015). The information technology revolution has transformed the nature of most goods and services, as well as the nature of companies, and the nature of warfare. Information technology is 'inside everything.'

However, opening up large swathes of the world to investment by firms from the developed countries enables widespread benefit from the 'advantages of the latecomer.' According to UNCTAD's *World Investment Report* (2016), the stock of inward FDI rose from 11 percent of developing countries' GDP in 1990 to 29 percent in 2015 (UNCTAD, 2016). Global financial firms have played a crucial role in the globalization of non-financial firms. They provide the 'glue' to knit together global non-financial firms and their supply chains (including trade finance, IPOs, M&A, divestitures, project finance, cash management, and hedging

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risk in equity, and foreign exchange and commodity markets).

UNDP's *Human Development Report* for 2016 notes that the 'human development index' in developing countries increased by 30 percent between 1990 and 2015. Despite the fact that the population of low and middle-income countries rose from 3.6 billion in 1980 to 6.2 billion in 2015, this era witnessed large advances in welfare in developing countries. The proportion of the world's population living on less than $1.90 (at 2011 PPP dollars) per day fell from 34.8 percent in 1990 to 10.7 percent in 2013. In East Asia-Pacific during the same period that share fell from 60.2 percent to 3.5 percent, and in South Asia from 44.6 percent to 15.1 percent. According to the World Bank, between 1990 and 2015, average life expectancy at birth rose from 50 to 62 years in low-income countries, from 60 to 68 years in lower middle-income countries, and from 68 to 75 years in upper middle-income countries.

The contrast between China and India in their providing for the needs of the populace through infrastructure investment is dramatic.

Negative Results of Globalization

There have also been negative results, for globalization is a double-edged sword. Unleashing the power of market forces resulted in profound contradictions. Although it has become quite unfashionable to refer to the *Communist Manifesto* (1848) authored by Karl Marx and Friedrich Engels, one cannot easily dismiss the increasing relevance of the prescient analysis of the contradictory character of capitalist freedom:

> Modern bourgeois society, with its relations of production and exchange, is like the sorcerer, who is no longer able to control the powers of the nether world whom he has called up by his spells

Perhaps it is more fruitful to refer to Charles Dickens' famous quote from *A Tale of Two Cities* (1859), which is also used with increasing frequency:

> It was the best of times, it was the worst of times; it was the age of wisdom, it was the age of foolishness; it was the epoch of belief, it was the epoch of incredulity; it was the season of Light, it was the season of Darkness; it was the spring of hope it was the winter of despair; we had everything before us, we had nothing before us

Another negative result of the unleashing of capitalist freedom during the era of the Washington Consensus has been the drastic deterioration in the world's natural environment. The World Wildlife Fund estimates that

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the index of the stock of vertebrate species declined from 100 in 1970 to 42 in 2012—an astounding decline of more than a half. Eminent Harvard biologist Edward O. Wilson warned that, unless there is dramatic change, human beings will soon live in an 'Age of Loneliness.' Recall also one of the twentieth century's most accomplished nature writers, Rachel Carson, whose concerns about human beings' relationship to the natural world were outlined in her environmental classic *Silent Spring* (1972). This is what she wrote:

> [Can] any civilization wage relentless war on life without destroying itself, and without losing the right to be called civilized? [...] The "control of nature" is a phrase conceived in arrogance, born of the Neanderthal age of biology and philosophy, when it was supposed that nature exists for the convenience of man

Consider also the issue of climate change. If developing countries follow the path of today's high-income countries, it will be difficult to contain the rise in average global temperatures in the twenty-first century to less than two degrees centigrade.

According to 2017 World Bank data, the average energy consumption in 2013 per person in lower middle-income countries was 639 kilograms (oil equivalent), compared with 2,195 kilograms in upper middle-income countries, 4,716 in high-income countries as a whole, and 6,898 kilograms in the United States. More than a decade ago, the International Energy Association warned that:

> a level of p.c. income in China and India comparable to that of the industrialized countries would, on today's model, require a level of energy use beyond the absorption capacity of the planet's ecosystem.

One of the most striking negative results of the era of globalization has been the concentration of business power. We have witnessed an explosive process of merger and acquisition across the upper reaches of the global business system. It has amounted to nothing less than a revolution in industrial structure. Far from Thomas Friedman's claim that the world of globalization is 'flat', and analogous to pioneering British economist Alfred Marshall's 'trees in the forest' argument, the world of globalization resembles that of both Marx's 'law of concentration of capital' and Anglo-American economist Edith Penrose, where there is no limit to the growth of the firm.

In most sectors that produce mid-technology, high-technology, and branded goods, a handful of 'system integrator' firms, mostly from high-income economies, account for half or more of global markets. The level of industrial concentration is also very high in the provision of services for

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global customers, as well as in the upper reaches of the supply chain of global 'system integrator' firms.

Indeed, firms from the high-income countries dominate global markets. For example, among the top 40 global firms (by revenue) in the auto and auto components industry, just two are from developing countries—and both of these (Astra and SAIC) are joint ventures with global giants. Among the top 35 firms (by revenue) in the aerospace industry, just one is from a developing country. Moreover, the spread of global production systems means that the relationship between global firms from high-income countries and the political economy of their 'home' country has weakened drastically. Samuel Huntington's 2004 question, 'Who are we?', applies especially to the international firm.

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The issue of class structure and rising inequality, both among and within states, is also of concern. Even though the global Gini coefficient fell from 0.73 in 2000 to 0.67 in 2011, the latter figure is far higher than in most countries. As former World Bank Research Department lead economist Branko Milanović has written: "If such extreme inequality existed in smaller communities or in a nation state, governing authorities would find it too destabilizing to leave it alone, or revolutions or riots might break out." According to the same author, the main explanation of the continued large extent of global income inequality remains the "citizenship premium," with around 70 percent of global inequality attributable to the wide differences in national output and income per person.

The distribution of household wealth is even more unequal than income. The top 1 percent of the world's adult population own 51 percent of global wealth, the top 5 percent own 78 percent, and the top 10 percent own 89 percent, while the bottom 50 percent own 1 percent.

Finally, we come to the all-important issue of finance. The era of globalization saw the rise of giant global financial institutions, mainly U.S.-based, with an explosion of mergers and acquisitions across regions, sectors, and countries, culminating in the extraordinary group of giant mergers during the global financial crisis itself. According to the July 2009 issue of *The Banker*, the share of the top 25 banks in the total assets of the top 1,000 banks increased from 27 percent in 1997 to 45 percent in 2009.

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In addition, regulatory capture by giant global financial institutions led directly to the de-regulation of financial markets in the West. This released the inherent propensity of de-regulated financial markets to produce self-reinforcing asset bubbles and credit expansion. In the words of Nobel Prize-winning economist Robert Shiller, bubbles in financial markets are "so natural that one must conclude that if there is to be debate about […] speculative bubbles, the burden of proof is on the sceptics to provide evidence as to why [they] cannot occur."

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The financial crisis in the West shook the entire system of global political economy to its core. In May 2008, former IMF Managing Director Horst Kohler commented that "the only good thing about this crisis is that it has made clear to any thinking, responsible person in the sector that international financial markets have developed into a monster that must be put back in its place."

The Bank of International Settlements responded to the crisis by establishing the Financial Stability Board, which included not only the high-income economies, but also China and India, as well as six other developing economies. The FSB played a key role in implementing the Basel III regulations, to be introduced between 2013 and 2019. These increased the required bank capital in order to better absorb shocks, introduced counter-cyclical capital buffers, and reduced the role of complicated, hard-to-understand financial derivatives on bank balance sheets.

However, the high-income countries were reluctant to share power in the key global financial institutions with developing countries. Although they agreed to a small increase in the voting rights of developing countries in the IMF, America's voting rights were only marginally reduced, which meant that Washington continued to have a veto over major IMF decisions. Moreover, the Director General of the IMF continued to be a European and the chairman of the FSB hailed from the high-income countries.

The main route for resolution of the crisis was reliance on monetary policy to re-ignite asset prices through quantitative easing and a policy of near-zero interest rates. The balance sheet of the world's major central banks increased

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from around $4 trillion in 2007 to almost $14 trillion in 2017. In mid-2016, the volume of negative-yielding government bonds had reached a global total of $13 trillion, amounting to around 30 percent of global government debt. By 2016, U.S. stock market capitalization had recovered to over $27.4 trillion, far surpassing the pre-crisis peak. In global cities and many high-income countries, house prices resumed their upward trend. In June 2016, the *Financial Times* wrote that bond prices had risen steeply, with a "voracious investor appetite for sovereign paper."

Capital has poured into financial assets, while investment in the real economy has slumped and the high-income economies are growing at a snail's pace. It is far from certain that the 'monster' of global financial markets is under control.

Indeed, the West's financial system may well face another 'Minsky moment.' In 2016, the IMF warned of the possibility of 'a return of financial turmoil itself, impairing confidence and demand in a self-confirming feedback loop.'

- How are the multiple contradictions of globalization to be resolved?
- There is much that individual countries can do, but global regulation will play a crucial role in stabilizing the global political-economy.
- What role can China play in this process?
- What light do China's domestic reforms shed on this role?

The West's Perceptions of China's Domestic Reforms

In the 1980s and 1990s there was a wide perception in the West that the communist parties in command economies could not lead the transition to a market economy.

For present purposes, it is enough to quote from three authoritative sources on the subject—all from 1990—starting with the words of Harvard economist Janos Kornai: "Right now, in the beginnings of the transformation process […] it is time to take great steps away in the direction of a minimal state."

Next, consider the words of Poland's two chief economic advisers, Americans David Lipton and Jeffrey Sachs:

> The bureaucracy cannot be relied upon for efficiency in regulating monopoly prices, promoting infant industries, or implementing industrial policy. […] The collapse of communist one-party rule [is] the *sine qua non* for an effective transition to a market economy. If one proposition has been tested by history, it is that the communist parties…would not lead a process of radical reform sufficiently deep to create a real market economy.

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