The Imbalance of the Chinese Economy and the Stability of the Global Economy

Xiaopeng Luo

The serious imbalance of the Chinese economy is a major contributor to the last global financial crisis. The mechanism of how the imbalance contributed to the crisis can be explained by the Chimerica model by Naill Ferguson. By transferring significant size of savings to the US, China created an environment of low interest rate for the global economy. Under the environment, the cost for capital was low, while the return to the capital was increasing, as result, the expansion of financial market crossed the boundary of the existing doctrine and monitoring capacity of the global financial system.

So the presentation will focus on the question: Why China can not consume more so its economy can be balanced?

To answer this question, the challenge is to understand the logic of the Chinese economic system.

The speaker presents a model called "Rent-sharing through hierarchy" to analyze the Chinese economic system. Applying the concept of legal rights from the state theory by Barzel (2002), the speaker identified two different legal rights in all states: status rights and asset rights enforced by state.

The key proposition in this model is that: The relationship between the status rights and asset right in China is profoundly different from the West as China has an imperial state system rather than a nation state system. To maintain centralized political control over vast space with sustainable cost, the Chinese state primarily defines and enforces status rights, leaving assets rights secondary to the status rights.

The two kinds of legal rights were tradable, while the status rights dominated the asset rights. This arrangement allowed most transactions protected by private enforcement, but the state can still tax assets through control of status rights.

The Communist revolution created a collective rights system which keeps the tradition in the relationship between the status rights and asset rights. The collectives of higher ranking in the unified social hierarchy entitled both greater status rights and assets rights while the collectives in low rank entitled low status rights and asset rights.

The reforms decentralized, de-collectivized and monetized the rent-sharing through hierarchy. The lower rank units, while still have low status rights, were allowed to keep more assets as long as the state and the higher ranks can keep larger share in the total rent. The individuals at lower rank units can buy higher status rights with their assets.

The system gives too little assets rights to create jobs for the Chinese peasants, and the state sector was increasingly threatened by the competition from the rural industry. This tension was greatly reduced by the FDI that created jobs for migrant workers in export manufactures in the costal area.

Increasing the domestic consumption ratio means to transform the rent extracting state into a welfare state, adjusting the exchange rate policy alone can not do the job. The transformation is a huge political and cognitive challenge to the ruling party. There are strong interest groups as well as great knowledge gap to block the change. The model of nation state does not fit China, the Chinese have to find its own model to build a modern state.

Since there is no quick fix for the imbalance of the Chinese economy, the stability of the world economy will continue to be affected. China should help the world with better coordination in international investments, the world should joint China to accomplish a successful communication revolution.