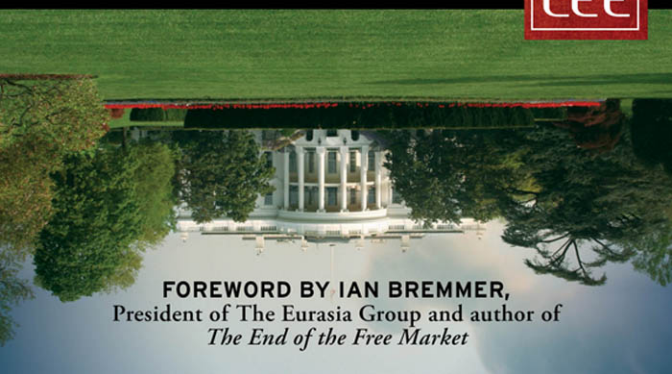




WHAT THE U.S. CAN LEARN FROM CHINA

AN OPEN-MINDED GUIDE TO
TREATING OUR GREATEST COMPETITOR
AS OUR GREATEST TEACHER



FOREWORD BY IAN BREMMER,
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An Excerpt From

***What the U.S. Can Learn From China:
An Open-Minded Guide to Treating Our Competitor as Our Greatest
Teacher***

by Ann Lee

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INTRODUCTION**A New Year's Resolution**

Never doubt that a small group of thoughtful, committed citizens can change the world, indeed it is the only thing that ever has. —MARGARET MEAD

AS INDIVIDUALS, WE ARE NOT QUITE SATISFIED with ourselves most of the time. We are keenly aware of our shortcomings and try to make resolutions to correct them. Whether it is to lose weight, quit smoking, or address some other personal issue, we know we will fail unless we work hard to achieve our goals, stay focused, and remain committed to success for however long it takes to materialize.

As a nation, we have had a similar process. Throughout history, various constituencies that were not content with the status quo have coalesced to create political movements to change national policy. When the United States had to resolve an internal contradiction between the Constitutional rights of life, liberty, and the pursuit of happiness and the institution of slavery, abolitionists in the 19th century were prepared to fight to their death for what they believed. Similarly, the women's suffrage movement in the early 20th century lasted almost two decades before the right to vote was granted to women.

Today, the United States faces another moment of discontent. What some labeled *malaise* under the Carter years—the slow erosion

of the American Dream for most citizens—culminated into a financial crisis of global proportions in 2008.¹

This crisis in turn has morphed not only into a domestic economic crisis with government adding trillions of dollars to its debt and persistent high unemployment, but also into crises of governance and of confidence.² Americans are frustrated by the state of current political dysfunction and have palpable anxiety that it cannot be fixed. The clear mandate Obama had with his 2008 election landslide was challenged two years into his presidency after the Congressional elections when Republicans took over majority leadership in the House. Americans have begun to suspect that neither party can deliver on their promises to represent their interests and have made their displeasure known through Gallup polls, Tea Parties, and even renouncements of U.S. citizenship.³

While a great polarization of interests does divide the country, I believe it is less about Republicans versus Democrats and more about the haves versus the have-nots.⁴ The haves want to continue outsourcing labor to developing countries and see booming financial markets through continued lax financial regulation while the have-nots want a job with a decent wage and a future where their children have a fair chance at improving their lives. How these disparate priorities get resolved will have profound implications for growth and movement in the American domestic economy. Feelings of apprehension and uncertainty over these outcomes underscore the common worry that the nation may not maintain its competitive edge.⁵

These worries couldn't come at a worse time; America has been suffering from the worst economic situation since the Great Depression while elsewhere around the globe, more people are demanding a share of the economic prosperity that America has enjoyed for decades.⁶ Understandably, many Americans feel threatened by all this new competition from the developing world. On one side, China, boasting a population of over a billion low-wage workers, has absorbed most of the dirty manufacturing jobs that have long left

America. India also has absorbed many American jobs, but mostly in the service sector like customer-service call centers, computer software programming, and even legal work where Indians can perform the same services as skilled Americans but at a fraction of the cost. Job insecurity has gripped most working Americans, and their fear has spawned anti-China rhetoric and anti-immigration legislation.⁷

China has become a convenient scapegoat for American economic problems. American ethnic prejudice, as documented in Iris Chang's book, *The Chinese in America: A Narrative History*, combined with envy for China's recent successes—such as the resumption of strong economic growth shortly after the 2008 financial crisis—and a perceived lack of democracy make China an easy target. I use *perceived* because I explain in chapter 3 that the current set of Chinese leaders formulate policies with the greater public interest in mind. China bashing has become almost a contact sport on television with both left- and right-wing commentators trying to outbash each other with China aspersions. Even Michael Lewis, author of *The Big Short*, satirically noted this phenomenon in his opinion piece titled “All You Need to Know about Why Things Fell Apart.”⁸ Such negative rhetoric fuels more complaining and misunderstanding rather than productive problem solving.

Unlike foreign channels such as the British Broadcasting Corporation (BBC), American mainstream media mostly air American-centric views without devoting equal time to thoughtful discussions from foreign perspectives, perspectives that might shed light on subjects less familiar to Americans. But Americans are capable of inspired action that rises above media tirades. Throughout history, Americans have consistently united to meet challenges at the darkest hours—working collectively on the war effort during World War II and turning out in droves to volunteer aid after 9/11. More recently, the television show *60 Minutes* reported that in 2011 American families welcomed newly homeless neighbors into their homes, while foreclosures swept the country.

Today, Americans may face one of the most challenging tests of will. The challenge is not as simple and straightforward as facing an enemy like the Soviet Union during the Cold War. Rather, the challenge to America is how our nation will coexist in a world of rising powers and diminishing natural resources, both of which may threaten our chosen way of life. As developing nations around the world continue their unrelenting drive to improve their economic fortunes, can the United States blaze a trail that will lead to peaceful and sustainable outcomes? Some, myself included, worry that the West, particularly America, will fall behind in an increasingly competitive and unpredictable future. President Obama has called China's economic and technological rise the new Sputnik moment, and former Speaker of the House Newt Gingrich articulated that technological supremacy by China would amount to a "potentially catastrophic threat" to Americans.⁹ These worries have begun to generate some innovative policy proposals such as those announced by the Department of Energy to invest in clean energy research, but action has not been as forthcoming, and much more needs to be done. The problems will require practical solutions, metaphysical reflections on America's evolving identity, and national resolve for meeting these challenges.

At a minimum, America must become more competitive than in the recent past across the board. With more challengers, supremacy will be a more difficult position to defend. Though America's military is second to none, it would be unwise to unduly rely on it to maintain America's superpower status. Rather, America must strengthen its diverse portfolio of capabilities, because even with its military force, it is impossible to control everything everywhere all the time; nor should it try.

America is arguably at an inflection point in its role as a global empire.¹⁰ The financial crisis has uncovered weaknesses in our financial system and regulatory oversight that were formerly thought of as strengths, and its reputation internationally as a land of opportunity is being questioned more aggressively. At the same time, the consen-

sus for a march forward is hard to find. Although America remains the most powerful nation in the world, as of the start of the 21st century, America also risks losing its position through arrogance and inertia. It is in America's interest to be open and eager about learning new ways of doing things, if these new policies, methodologies, and frameworks can help our democracy function better in a world that is vastly different from the one when the Founding Fathers were alive. By borrowing ideas from the Chinese, America has the greatest chance of fulfilling its resolution to be the best it can be and of remaining a powerful and noble nation.

An enduring maxim throughout history is the wisdom of learning from the competition. The best U.S. corporations evolve and survive when competition forces them to win in a new environment. Similarly, governments also rise to prominence or fall from legitimacy depending on how leaders respond to the winds of change. The logical place to start then is to understand the strategies of the strongest competitor and then to customize those ideas to fit one's unique makeup and situation.

Like Olympians who must train long and hard for the gold medal, America must work on improving itself in the following ways:

- rebuild trust
- regain lost credibility
- restore integrity
- revive education
- rewrite poor legislation
- reinvest in infrastructure
- remove negativity
- remain focused on competitiveness
- realize the unlocked potential within many Americans

In short, America should be compelled to reinvent itself within the context of a quickly changing, globally competitive landscape. Such

advice may be difficult to hear, but the longer Americans remain complacent about their position in the world, their extravagant spending habits, and even their moral authority, the greater the chance that America will be caught by surprise in the defensive position.

If there is a parallel in history for today's relationship between America and the rest of the world, it is found in the fate of the 15th-century Spaniards whose wealth and power were bankrolled by the Italian Medici bankers. Spain began building its empire with the New World and expanded to almost every continent through conquest. Unprecedented in its reach and power during its time, the Spanish Empire was known as "the empire on which the sun never set" hundreds of years before England made such a claim. However the empire met an untimely end due to inflation from debasing its currency, dependency on foreign sources for manufactured goods, and stretched military resources from multiple wars. During the 17th century, Spain became stagnant while other countries reformed their governments and ascended to power. By the 19th century, anticolonial uprisings put an end to Spanish territories. The similarities to the current U.S. empire are uncanny.

Though the United States does not engage in colonialism per se, the practice of foreign "aid" and arms sales to unpopular dictatorships that oppress the local population in the name of U.S. interests resembles colonialism in substance if not in form. U.S. inflation from currency debasement has been steady since the 1970s. A home that cost \$25,000 in 1970 now easily costs \$250,000 or more. The same is true of most commodities, ranging from gasoline to food. While official reports of inflation appear subdued, it is well known among many in the financial community that actual inflation rates are much higher. The items that make up the Consumer Price Index (CPI) are continuously modified with substitutions and alterations to calculations. These changes reduce the reported level of inflation in the economy. Had the items that make up the CPI remained the same, official inflation rates would actually be higher and perhaps more reflective of the

declining standard of living experienced by many Americans. If the United States fails to resolutely deal with its shortcomings, the world may watch us repeat Spain's history.

In this book, I hope to show that an answer to America's challenge may come from understanding the Chinese and borrowing some of their ideas for governance that can be reformulated to fit American democracy and culture. Obviously China has its own deficiencies, particularly in the area of human rights, which are almost inconceivable to condone. China will never become great if it also doesn't continually evolve its policies and improve its government regulations. But setting aside common Western concerns for a moment, since this book is not about human rights or China's other inadequacies, I believe that sharing some of China's best practices and principles could prove beneficial for sustainable economic growth and development around the world. Often, nations in the West have overlooked these practices because they assume that China stands for values that are polar opposites from their own. However, in many cases, that is not true.

Implementing some of the ideas presented in this book will largely depend on politicians and policymakers. But the way to reach those people running the country is through grassroots campaigns that spread awareness and get them to take these ideas seriously. Public pressure is predominantly the impetus for progressive change in everything from social justice and economic opportunity to environmental protection. It is a phenomenon that has happened throughout history and throughout the world. The end of slavery and the end of apartheid are testaments to the power of minority activists who raise the conscience of societies.

The bottom line is that the world needs global leadership to cooperate on the most serious worldwide issues now more than ever in recent history. That will be difficult to accomplish unless the world's powerful countries can see eye to eye and honor their commitments equally.

Throughout the book, I use the terms the *United States* and *America* interchangeably. When I use these terms, I am referring to the citizen-based style of government that I know my audience and nation want. Some progressives may argue that the current U.S. government is no longer the citizen-based style it was designed to be and that the current political system is a different animal. That distinction is not made here, but it's also not lost on me.

My book is certainly not a cure-all for the contemporary ills of America since there is far too much information to cover between these two large civilizations. But it will highlight some crucial points that the West ought to consider when discussing how we shape our collective future. My assertions about the United States are not meant as a comprehensive historical account but are based more on my contemporary observations that our country's original principles seem to have changed or gotten lost. America is undoubtedly still a great nation, but it needs to return to an older version of itself in some ways. In recent years, China has demonstrated things such as economic dynamism and a reform orientation that America once demonstrated in spades as an emerging nation. If Americans can critically appraise ourselves while objectively evaluating other nations, we can once again remind ourselves of what we once were and rediscover the course of where we must go.

The China Miracle

Success usually comes to those who are too busy to be looking for it. —HENRY DAVID THOREAU

CHINA'S STEADY AND SPECTACULAR RISE in the last twenty years has perplexed many experts in Western circles. It has generated much intellectual debate as well as a wide range of emotions among Western academics, policymakers, politicians, and the public at large as people struggle to understand the manifold causes for the shift in international, economic, and political power.

Once isolated from the world and threatened by the West, China learned to change its fortunes dramatically in these last three decades. China burst onto the world stage a little while after the diplomatic breakthrough between it and the United States in 1972. Particularly in the last decade, since its accession to the World Trade Organization, China astounded observers around the world with its speed of urbanization, its modernization, its reduction of the number of people in poverty, and the sheer volume of foreign-exchange reserves it holds. China has accomplished much just in the last 15 years including the following:

- 118 megacities with over 1 million people each¹
- Over 6 million college students graduating per year²

- Over 420 million Internet users³
- Over 800 million cell phone users⁴
- 271 billionaires⁵
- High-tech exports reaching 20 percent of the total global market⁶
- Auto sales reaching 18 million units a year, making China the world's largest auto market⁷
- Largest number of Initial Public Offering (IPO) issuers in the world, making up 46 percent of global IPO value⁸

Though China is still considered an emerging market economy (EME), most experts would put it in a separate category from developed and developing nations because of its unique set of features. It can be described as simultaneously rich and poor, advanced and backward. With 56 ethnic groups and an even greater number of dialects, most experts agree that China is so vast, complex, and dynamic that discussing it as one entity gets tricky.

Nonetheless, I intend to select and explain a few key concepts about China's development that I believe have broader applications for the benefit of the United States and the world. By highlighting these specific practices and principles used by the Chinese that contributed much to their recent successes, I hope to export their model for economic accomplishment and gradual civil society reforms so that other countries can modify their systems of governance to match China's effectiveness. This is not to say that China's model is perfect or that it should be duplicated in every way. The suggestion, rather, is to set aside societal conditioning that could blind us from learning from a worthy competitor.

While certain personalities and other singular factors have no doubt influenced history, the overriding reasons for China's success lie in institutionalized values and methods that have worked for generations. Their way of governance has elicited the willing participation of over a billion people even post-Tiananmen Square,

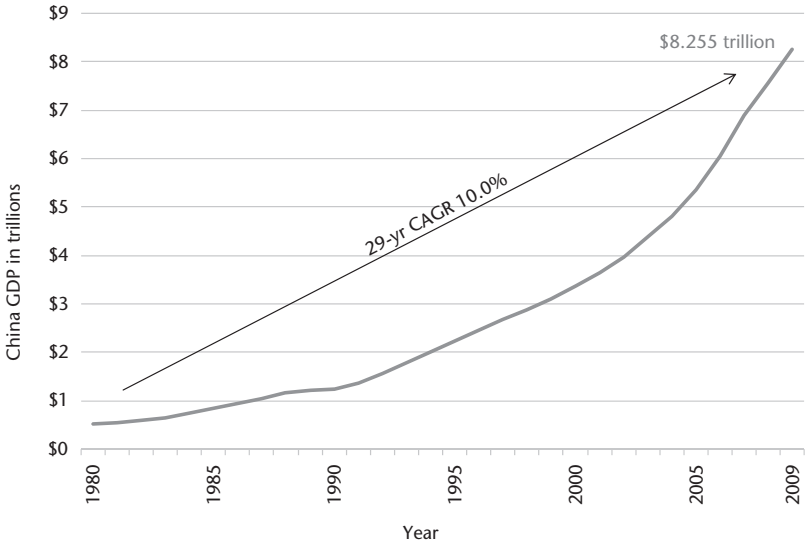


FIGURE 1 China GDP 1980–2009

Source: World Bank. Note: GDP is in 2005 purchasing power parity; CAGR = compound annual growth rate

despite what some Western media would have us believe. The Communists, though not seen as infallible by the Chinese, at least have been credited with freeing China from a century of foreign imperialism, a period in their history that they view as dark, shameful, and never to be repeated. To the extent that the Chinese can feel proud of their nation's accomplishments and confident that the government can steer their progress, they prefer the current government to alternatives.

Surely, some of the ways China competes now in global trade are not dissimilar to the mercantilist tendencies of the United States before World War I. The United States also used to compete with the Europeans by undercutting Europe's prices. Like the Chinese today, the United States collected a large current account surplus in the process.

America's once-polluted cities and poor labor conditions, as evi-

denced by the Triangle Shirtwaist Factory Fire of 1911, also have contemporary parallels in China. The poor working conditions in some of China's big cities have led some to believe—particularly Americans who currently live in China—that China is simply following America's trajectory in history. China's modern development undeniably will exhibit some of the same characteristics of early 20th-century America. China, for instance, has even started to redistribute income with minimum wage laws and transfer payments through higher taxes.⁹ But misunderstanding or overlooking some of the differences between U.S. development and China's development can cause Americans to miss opportunities to learn from the Chinese. Historical study can offer only a partial guide for developing future policy initiatives. Understanding China's strategies and appreciating the implications of those differences, on the other hand, can lay the groundwork for potentially more advanced civilizations than what exists today.

While I have no doubt that some will disagree with sections of my analyses and/or conclusions for how they might be applicable to the United States, their very disagreements will hopefully propagate more reasonable opinions and ideas because in-depth discussions can beget real progress. There will always be critics who will remain unconvinced no matter what facts, figures, or reasons are presented. One such critic is my own father, who has admitted to me that he will be biased against China's leadership no matter what evidence I cite because the Chinese Communist Party (CCP) ruined his family, stole their wealth, and condemned them to a life of hardship and misery when it came to power under Mao Tse Tung. However, my intention in writing this book is not to stir emotional outbursts but to arouse reasonable debate and out-of-the-box thinking. The book, I hope, will promote more deliberative discussion about the appropriate role of governments, the extent of their powers, the conditions and circumstances of when those powers should be granted, and which elements are worth keeping and which ones should be tossed. Worlds

are beginning to collide, so we will be forced to think about these issues sooner or later.

Global problems will require new global leadership to address with courage the serious issues of unsustainable natural-resource depletion and pollution that have been allowed to fester for decades. Business as usual could eventually lead to a worldwide crisis that surpasses everyone's worst fears. The fundamental thesis of this book is that all nations can and need to work together to avoid an eventual Malthusian crisis, a catastrophe in which the planet can no longer support the human population, as predicted by Thomas Malthus. The key to cooperating may be found in some examples of China's governance. China is not a totalitarian regime like Russia during the Cold War. Unlike those in most authoritarian regimes, China's leaders have earned their authority through a lifetime of meritocratic service that is far from arbitrary. Their system of earned authority actually resonates strongly with Western values, is surprisingly popular with its population, and may even be used to strengthen today's democratic institutions.

A country must choose its allies and enemies carefully. Like the Roman Empire whose seeds of its own destruction resulted from its miscalculated relationship with the Germanic world due to its perceived Persian threats, the United States risks destroying itself if it attempts to fight imagined enemies like China and bestows misplaced trust in dubious allies such as the Pakistan government or Afghanistan's president Hamid Karzai who are arguably more corrupt, bigger violators of human rights, and potentially more dangerous than China. By diverting precious time, energy, and talent toward fighting endless wars rather than funneling them for more constructive uses, the United States may unwittingly create its own downfall. Overextended military aggression abroad and unrestrained military buildup at the expense of other investments can ultimately backfire. Fighting for a larger share of a shrinking pie could yield far less than working cooperatively with nations like China to grow the pie so that all par-

ties can enjoy bigger pieces. The United States needs the wisdom not to let hubris get in the way and the courage to root out its own corrupting elements. Both of these will be discussed in detail in the following chapters. Borrowing some of China's best practices may help the United States close the gap between our current reality and our professed democratic ideal.

Another Japan?

Skeptics simply say that Americans should ignore China because they've heard the same hysteria before when Japan was on the rise in the 1980s. The fear that the Japanese were going to take over the world was laid to rest after the Plaza Accord. In this agreement, the developed nations requested that Japan more than double the value of its currency in relation to the U.S. dollar between 1985 and 1987. When the Japanese exports all doubled in price in a timeframe spanning less than two years, naturally the country was unable to export the same volume to the world. Japanese companies suffered severe financial losses. Layoffs and massive reductions in labor wages followed for the next two decades, now referred to as Japan's Lost Decades. Even if some argue that Japan's problems were homegrown, the timing of this agreement no doubt precipitated and exacerbated the subsequent fall. Foreign exchange plays an integral role in all cross-border commerce. In the case of Japan, where the lion's share of its economy was dependent on exports, the forced appreciation of its exchange rate caused many of its businesses to become less profitable. When loans to these less profitable businesses soured, Japan's banking sector was thus harmed, causing a dramatic fall in its stock market as a domino effect.

Certainly it is within the realm of possibility that the United States will attempt to do the same thing to China to neutralize it as a potential economic threat. The *Financial Times* reported on February 8, 2011, that the United States had attempted to enlist Brazil in a united front against China's pegged currency policy ahead of a G-20 meeting. This move is just one of the ways that the United States attempted

to hobble China's economic growth. It follows years of Western media and policymakers calling China a manipulator of currency in attempts to pressure China to appreciate its currency, the yuan, faster or to loosen its peg so that the yuan would free float. "Deregulation of China's currency" is merely another way of saying "Let the foreign exchange traders have the power to manipulate the value of the currency to their ends."

Many differences between Japan and China, however, lessen the likelihood the United States will pursue this route, starting with the fact that China has welcomed significant direct investment from the United States and other countries while Japan was a more closed society. Japan's exports were largely high-end electronic products, designed and produced entirely by Japanese companies. Japan did not experience a flood of foreign direct investment. Its success came as Dr. W. Edwards Deming helped Japanese companies become the most competitive in the world with his theories of Total Quality Management (later modified and elaborated upon by other management experts so that now these ideas are collectively referred to as *Six Sigma* by manufacturing concerns). Dr. Deming had first approached American manufacturing companies with his theories of benchmarking and other ideas for improving production quality, but he was rejected by all of them because he was considered too radical by top American executives back in the 1940s and 50s. As it turned out, Dr. Deming discovered that the Japanese openly embraced his ideas, so he worked with them instead and helped them rebuild their manufacturing capabilities after World War II to become the best in the world.

Fast-forward to China, and we see a different story. Unlike Japan, China threw open its doors to the world and received significant foreign investment from every corner of the earth. China offered the dual allure of a giant consumer market and a seemingly infinite supply of cheap labor, attractions that foreign companies found irresistible despite the innumerable risks of doing business in a Communist country. Additionally, the explosion of Internet services, which didn't exist during Japan's rise, made it possible to coordinate offshor-

ing and outsourcing with greater ease and at lower cost. With costs of communication and shipping coming down, multinational companies and entrepreneurs from around the world were able to rely on the Chinese to turn their ideas and dreams into reality.

So unlike Japan, exports out of China are not Chinese exports per se but instead belong to American companies, German companies, Dutch companies, and a long list of others who have vertically integrated China into their supply-chain processes. The goods leaving China and arriving in the United States mostly originated from American businesses and are sold to American consumers; the Chinese merely assisted in putting the products together and account for no more than a quarter of the value added. In 2009 Behzad Kianian and Kei-Mu Yi at the Federal Reserve Bank of Philadelphia reported that of the \$644 billion the U.S. consumer spent on goods made in China in 2007, roughly \$322 billion was attributed to wholesale markup, retail markup, domestic shipping, and profit margin for U.S. companies. Of the remaining balance, an estimated \$161 billion was attributed to imported inputs, and only \$161 billion went to the Chinese for assembly or other labor intensive work.

The evidence is clear; the aisles of a typical store in America are filled with U.S. branded products made in China but virtually no Chinese brands. These American brands range from well-known companies like Nike and Apple to the millions of small, unknown business owners running businesses out of their own homes. Just because the goods crossed national borders doesn't mean that the Chinese owned them or made the lion's share of profits. Rather, when foreign companies chose to assemble their widgets in China rather than in their home markets, they were making a decision on what would make their business operations most profitable.

Perception rather than reality is dictating U.S. policy when it comes to jobs. It's not necessarily the case that China took jobs away from American workers. Those jobs may have never existed in the first place if China hadn't provided the inexpensive labor. The wages in devel-

oped countries are much higher, a factor that could have deterred entrepreneurs from even launching a business. But with China in the picture, more companies were willing to take the risk because the profit potential was more attractive. China's cheap labor and manufacturing capabilities enticed Western entrepreneurs to pursue projects that in turn required support at home in other areas, for example, sales, marketing, branding, retailing, accounting, legal services, and finance. Thus China indirectly contributed to the United States moving up the food chain toward what is now referred to as a *knowledge economy*. In contrast to an industrial economy, the critical drivers of job creation and economic growth in a knowledge economy are entrepreneurial ideas, intellectual property, and the reliance on expertise such as research and development (R&D) professionals.¹⁰

Since the profitability and even viability of many U.S. companies both large and small are directly tied to the cost of their operations in China, it is not in their interest to see the Chinese currency appreciate rapidly. A rapid rise would immediately impact the profits of U.S. companies since they cannot quickly move their operations to Vietnam or India where production costs are low, but the physical infrastructures are significantly poorer than in China. In addition, a rise in the value of Chinese currency would decrease the relative value of the dollar, reducing American consumer spending power and resulting in a loss of sales for American businesses.

A rapidly rising yuan would also be bad for the United States because the Chinese could use its stronger currency to buy up even more natural resources around the world or snap up U.S. assets at fire-sale prices. Moreover, an American company with overseas profits will not want to repatriate its profits back home if it will be more profitable to keep the money in a rapidly appreciating currency. If American companies were to keep their money in China, then they would invest less at home, spelling even higher unemployment in the United States.

Finally, if the yuan were to appreciate too rapidly, precipitating

a Japanese-style Lost Decade, most Chinese export companies that operate on razor-thin margins would go bankrupt and lay off millions of Chinese workers; this happened during the financial crisis of 2008.¹¹ Without a growing middle class in China, the world will have no immediate replacement market to sell its wares, given that citizens of developed economies are still hamstrung with enormous debt loads and many developing nations rely overwhelmingly on China to continue their economic growth.¹² Global trade would again come to a screeching halt, and the United States would probably be blamed for crafting such an agreement. So for all the above reasons, it is unlikely that the United States would push for another deal like the Plaza Accord, despite the vituperative threats from Senator Charles Schumer or other American politicians who regularly engage in bashing China because they think the yuan should be artificially appreciated.

Another Bubble?

Others, such as hedge fund manager Jim Chanos, believe that China will eventually implode due to its inefficient allocation of resources to infrastructure investment. They believe that China's high growth rate due to its building frenzy is unsustainable. Some see this as Russia redux in which too much central planning from a powerful government will ultimately bankrupt its economy.

While the Chinese investment in infrastructure is indeed high compared to other nations, it is actually not so out of line when compared to the United States during its Industrial Revolution over a century ago. For example, the United States had four times the number of railroad miles during that time period than exist today, but such "overinvestment" did not derail the young nation. Similarly, China will undoubtedly create wasteful infrastructure from less-than-optimal allocation of resources. Stories of empty office and apartment buildings abound. But a closer look reveals that most infrastruc-

ture investment since the 2008 crisis has gone to retail housing where demand shows no sign of relenting. Construction and real estate have stayed steady at roughly 10 percent of the gross domestic product (GDP) since the mid 1990s. Total property investment as a share of total fixed asset investment was roughly 20 percent in 2008, and residential property made up approximately half of that number.¹³

The migrant workers that flow into China's coastal cities from Western China are akin to the waves of immigrants in the tens of millions that arrived on American shores throughout the Industrial Revolution. The share of the urban population in China went from less than 30 percent in 1990 to almost 50 percent by 2009, while the share of agricultural employment has dropped from 60 percent to 40 percent during the same time period.¹⁴ We can expect China's urban population to rise another 20 percent if it is to reach comparable urbanization rates of other developed countries like Japan and Korea.

Furthermore, the risk of China imploding from overinvestment seems highly unlikely because credit expansion is small compared to the West even after the financial crisis of 2008. According to Fitch Ratings, China's government debt-to-GDP ratio is 21.5 percent. The U.S. federal debt-to-GDP ratio, on the other hand, was just shy of 100 percent in 2010. American household debt-to-GDP reached 100 percent in 2007, while the Chinese household debt-to-GDP was a mere 12 percent in 2008. Union Bank of Switzerland (UBS) and Goldman Sachs estimated that in China, household debt as a share of disposable income was under 60 percent in 2009 and will likely remain so for some time to come given the government's proactive tightening of credit. Household debt in the United States, by contrast, is estimated at over 120 percent of disposable income in 2009. Excess leverage that defaults or causes fear of defaults is usually the trigger of financial crises. Based on conventional measures of debt levels compared to the amount of equity and bank reserves borrowed against them, that condition is far from reaching a tipping point in China. Besides, housing is the only financial asset for many Chinese. Excess

housing units that sit empty won't get abandoned because they were secured with substantial down payments of 50 percent or more and so function as a store of wealth. Some have been paid for in full in the same way some investors hold gold bullion in vaults as a hedge against inflation.¹⁵

Finally, Westerners must also not overlook that private market forces can be enormously inefficient and won't necessarily do a better job than government-induced investments. After all, private markets were responsible for the speculative manias that funded everything from Dutch tulips to profitless Internet companies. By now, volumes of research, coming from such organizations as the Bank for International Settlements (BIS), indicates that market failures happen regularly, so China's political economy should be no more likely to suffer an economic setback than more self-proclaimed market-oriented economies.

Economic bumps on the road in China obviously cannot be ruled out as property prices and stock market prices fluctuate. However, I would argue that fluctuations in valuation must not be confused with the bigger fundamental picture of steadily growing development needs. But regardless of what China's fate will be in the coming decade, the Chinese leaders have already proven in the last few decades that they have created a compelling recipe for running a country with a population more than four times the size of the population in the United States. Francis Fukuyama, the author best known for writing the book *The End of History*, stated in the *Financial Times* on January 18th, 2011, that "its [China's] specific mode of governance is difficult to describe, much less emulate, which is why it is not up for export." I have to politely disagree. Even if China and the West seem worlds apart in history, culture, and governance, it is possible that the United States can learn from China just as China has learned and continues to learn from the West. Let me just cite a few examples of what China has already learned from the West:

- China has learned to adopt capitalist market principles (within a Communist framework).

- China has learned to manufacture many types of products it never used to have, from laptops to high-speed trains.
- China has learned to conduct business according to international rules created by Western countries, like the United States.
- China has learned to incorporate religion in a way that doesn't pose a threat to the State.
- China has learned to appreciate Western fashion, fast food, rock music, and reality shows that were completely foreign to their culture.
- China has learned to create social safety nets like pension plans and health insurance for its population.

No doubt there is still plenty for China to learn from the West. The last chapter of this book highlights some of the things that the United States does particularly well that China should adopt. There are obviously many areas that China needs to address or improve, but the main thrust of this book is to talk about what works in China, so that Americans can seize an opportunity to learn and improve in areas that the United States has been lacking in our recent past. Some of our weaknesses are some of China's strengths. No country, including China and the United States, has a monopoly on superior morality or knowledge, but the nations who understand their weaknesses and strengths, and can evolve accordingly, will have time on their side.

China's leaders still face significant problems in the years ahead, and the governance of the Peoples Republic of China (PRC) is not guaranteed to succeed in the coming decades. Among some of the serious challenges facing Chinese leaders are their ability to continue growing without inflation getting out of control, their ability to manage the large wealth inequalities, and their ability to smoothly transition from a heavy industrial economy to a more service-oriented economy while cleaning up the vast environmental pollution.

However, China's principles for governance provide a powerfully viable framework for economic progress that has thus far enabled it

to dodge the bullets that would have taken down a weaker government. Instead of wallowing in negativity and despair over their misfortunes, the Chinese turned perceived threats—such as the global financial crisis of 2008—into opportunities and advantages around the world. When a government appears credible by maintaining stability and benign conditions for people to thrive, people are motivated to work and achieve because their faith in the institutions and its leaders makes them believe they have a future. They endure significant hardships through the belief that the fruits of their labor will someday be rewarded even if the rewards are not immediate. So as long as the Chinese believe in their government's ability to lead, it is reasonable to expect that the citizens of China will continue to find ways to prosper despite the multitude of obstacles.

This is good news for America and the world. For decades, America and Washington DC-based institutions such as the World Bank and the International Monetary Fund (IMF) dictated their market-friendly, economic reform policies known as the Washington Consensus to weaker developing countries.¹⁶ There is now overwhelming evidence that this set of policies contributed to the downfall of those economies.¹⁷ After the financial crisis, the World Bank and IMF began rethinking those policy recommendations when the Seoul Development Consensus was endorsed by the G-20 in 2010.¹⁸ Had China listened to Western policymakers, it is highly probable that its continuous growth in the last two decades would not have been achieved. China might have looked more like Argentina or many other countries that adopted the Washington Consensus to modernize their economies after suffering from a colonial past. But China has been one of the few countries wise enough to resist Washington's economic demands to open its financial markets prematurely, choosing instead to pursue its own policies, which have served it well thus far.¹⁹ It is one of the few industrialized nations of the world that has not allowed its economy to be crippled by *financialization*, a phenomenon that I explain in chapter 6. Without China's growth,

America and the rest of the world most likely would have hit bottom almost a decade earlier when the Internet bubble burst. But because of China's steady and rapid development, U.S. corporations were able to continue achieving record profits. These corporations grew their profits by increasingly selling to overseas markets, lowering their labor costs through outsourcing and offshoring jobs, and accessing low borrowing costs as an indirect result of China's reinvestment in U.S. Treasuries.²⁰ China's large purchases of U.S. Treasuries (over \$1 trillion) helped keep interest rates low in the United States. By providing a steady demand for U.S. bonds, bond prices did not fall and thus interest rates remained low.²¹ In other words, China's well-managed political economy gave the rest of the world a new lease on life the same way America was a powerful economic growth engine for the world during the 20th century.

Game Changer

In the following chapters, I explain in greater detail the institutional as well as cultural elements that I believe have catapulted China from a backward agrarian nation into a leading economic power. The significance of China is not that it may overtake the United States in traditional measures of power, but that it will take on an important role in changing the game being played. With the benefit of hindsight, historians can look back and see how the Industrial Revolution in Britain changed the world. Had someone recognized the economic, technological, and political trends back then, one might have predicted the extensive reach and duration of the British Empire. More importantly, I discuss how China turns its aspirations into reality, and I point out how these methods could apply to Western democracies. China can play an integral part of the solution in the coming decades with its rapidly modernizing economy and incipient innovations in process manufacturing and product development. Americans ought to resist the temptation to fight the inevitable rise of China's impor-

tance and its contributions to the world economy. By treating China as a critical partner in solving global problems, America and the rest of the world may avert the frictions that could lead to Armageddon and instead pave the way for the next Renaissance.

As part of my discussion about why China succeeded, I also provide context as to how China has interacted with the nations of the world based on their institutions, their thought processes, their values, and their history. I also cover how China will likely address the major long-term issues facing the world today. Make no mistake, this is not a book about China, but rather about the enduring principles China has reliably followed for approaching global problems, the way America brought Western democratic capitalism to the world. In order to unleash much pent-up talent and increase the natural rate of innovation, a new ideology must replace old belief systems and ways of doing things. Integrating China's methodologies into Western practices could be a promising way of getting there.

Research for this book comes from years of discussions and interviews with countless individuals in both the private and public sectors in the United States and China. My work as a professor at both Peking University and at New York University as well as my position as a senior fellow at Demos, a nonpartisan think tank, give me the benefit of exchanging ideas and information with people around the world, who include CEOs, academics, investors, ambassadors, journalists, students, inventors, entrepreneurs, media executives, policymakers, lawyers, engineers, and bankers. Sifting through all this information for my classes, speeches, and other engagements, certain trends became increasingly obvious to me. By describing these trends and providing a framework through this book, I seek to introduce a distinct perspective for interpreting today's world and offer solutions that have rarely been discussed in mainstream media.



ABOUT THE AUTHOR

ANN LEE is a Senior Fellow at Demos, a non-partisan think tank. She has written for the *Financial Times*, the *Wall Street Journal*, *Newsweek*, *Businessweek*, *Forbes*, *Worth*, and the *Hong Kong Economic Journal* and other trade publications. She has provided political and economic commentary on ABC, CBS, CNBC, CNN, Fox Business, Bloomberg TV and radio, NPR, and many foreign news channels. A former investment banker and fixed income trader, she now teaches at New York University. Currently a resident of New York City, Lee is a Woodrow Wilson National Fellow and a graduate of Harvard Business School.

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