Introduction

"SURPASSING BRITAIN AND CATCHING UP TO AMERICA"

On November 6, 1957, thousands of delegates from sixty-four communist and workers' parties around the world gathered in the brand new Central Lenin Stadium (now Luzhniki Stadium) in Moscow to celebrate the fortieth anniversary of the October Revolution. In his long keynote speech, Soviet leader Nikita Khrushchev boasted that the Soviet Union would catch up to or even surpass the United States in fifteen years in terms of total output of major industrial products. At a follow-up meeting on November 18, Chairman Mao Zedong, inspired by Khrushchev's speech, made an impromptu speech and enthusiastically declared that China would follow the example of the Soviet Union and surpass Britain in fifteen years. What Mao had in mind was to surpass Britain mainly in terms of steel output, which he considered to be synonymous with industrialization.[1]

On New Year's Day in 1958, the *People's Daily*, the mouthpiece of the Chinese Communist Party (CCP), published an editorial officially declaring that China would overtake Britain in the output of steel and other heavy industrial products in fifteen years, and after that, China would take another twenty to thirty years to catch up to America in economic power. "Surpassing Britain and Catching Up to America" (*chaoying ganmei* in Chinese) thus became the goal and slogan of the Great Leap Forward. In the heady days of mid-1958, Mao even believed that China could overtake Britain in three years and America in ten in steel output.[2] But his dream of rapid industrialization was soon shattered by realities, and the Great Leap Forward

[1] See Mao (1999, pp. 325–326) and Qi and Wang (2002). [2] See Qi and Wang (2002).

ended up being the greatest self-inflicted disaster in Chinese history.[3] When Mao died in 1976, China was one of the poorest countries in the world.

In December 1978, China's new leader, Deng Xiaoping, explained to the visiting Japanese Prime Minister Masayoshi Ōhira that the medium-term goal of China's modernization drive was to become a "moderately prosperous society" (*xiaokang shehui* in Chinese) by the end of the twentieth century. Specifically, Deng said that China aimed to quadruple (*fan liangfan*) its gross national product (GNP) per capita in the next twenty years, implying an annual growth of 7 percent in per capita income.[4] At the time, this was an ambitious goal, but it was actually realized in less than twenty years. Clearly, Deng was not only a more pragmatic leader than Mao but also more informed in economics. Mao equated steel production and heavy industry with economic development and had no idea about realistic growth rates, whereas Deng already understood the concept of GNP and the fact that a growth rate of 7 percent per year was an admirable goal requiring great effort to achieve. On April 30, 1987, during a meeting with a Spanish delegation, Deng looked beyond the twentieth century and set a development goal for China in the first half of the twenty-first century: quadrupling its per capita income again from US$1,000 in 2000 to US$4,000 to become a middle-level developed country in thirty to fifty years.[5] By setting this long-term goal, he allowed per capita income to grow at a much slower rate of 3 to 5 percent per year. In reality, China realized a world-beating 8.5 percent average annual growth rate of per capita GDP between 1978 and 2018. Deng, an ultimate realist, never mentioned anything about China ever catching up to America.

In 1978, few people, not even a visionary leader like Deng, could have predicted that China would become by far the fastest growing economy in the world over the next forty years. In 2010, China became the second largest economy, having surpassed Britain in

[3] See Li and Yang (2005). [4] Deng (1994, p. 237). [5] Deng (2001, p. 226).

2006, then Japan four years later. It is still growing rapidly, albeit at a slower rate of 6 percent. Now that China is quickly catching up to the United States, many questions of paramount importance in economics and world affairs have arisen. What has led to China's rapid rise? Will China overtake the United States economically and technologically, and if so, when? Is there a Chinese model of development that can be emulated by other developing countries? Why is China's economy currently slowing down? Will the rapidly declining US–China relations slow it down even further? Will the United States, the incumbent superpower, and China, the emerging superpower, be able to coexist peacefully or fall into the so-called Thucydides Trap?[6] Opinions on these questions are sharply divided. The answers largely depend on how one understands China's rapid economic growth over more than three decades after the reform and opening-up policy of 1978 and its economic slowdown in recent years. Different interpretations of these two phenomena will lead to different answers to the aforementioned questions.

In China, many pundits, economists, and, of course, policymakers are understandably proud of the country's rapid rise and are confident about its future, crediting it to China's unique institutions and good policies. Many commentators outside China have also been impressed by its rapid growth and have made bold predictions about China's rise to the top position in the global economy.[7] However, there are many others, both within and outside of China, who see more of the challenges and headwinds facing the Chinese economy, including a rapidly aging population; debt-ridden corporations and local governments; excess production capacity; insufficient consumption; export dependence; inability to innovate; rigid exam-oriented education system; delay or even reversal of market reforms; renewed statism; and distortionary industrial policy. They are less worried

6 See Allison (2017).

7 See, e.g., Jacques (2009), Fogel (2010), Subramanian (2011), Lin (2019), and Mahbubani (2020).

about the consequences of China's rise and more about whether China can sustain its economic growth and avoid a deep recession or financial crisis in the short term and escape the so-called middle-income trap in the longer term.[8] The COVID-19 pandemic and the tensely antagonistic US–China relationship have added further uncertainties to China's economic prospects.

THE CHINESE GROWTH PUZZLE

If someone told you that China's economy has grown rapidly over the past four decades or so, you would find it a trite statement. But if they told you that China's economic growth has been the fastest in the world, and not by a slight margin, but several times faster than the global average, you might be a little more surprised. In fact, if you are an average reader rather than an economic expert, this might even be the first time you hear such a statement. The truth is that China's relatively more modest growth rate of 6–7 percent in recent years is by far one of the fastest in the world.

With more time to contemplate, you might venture that China's growth is no reason to brag, as China had a very low income base to start with, so it is no surprise that its growth is faster than that of other countries. After all, China has been growing rapidly for many years, but is it not still relatively poor compared with more developed countries like the United States? Indeed, based on data from the World Bank, China's per capita income is just above 15 percent of the US level, and even on a more generous purchasing power parity (PPP) basis, which takes into account the price differences between the two countries, it is still just over 25 percent of the US level.

But do low-income countries naturally tend to grow faster? Alas, this is not generally the case! Since 1980, the growth rate of gross domestic product (GDP) per capita in low-income countries has generally been lower than that of high-income countries. China's growth rate is not only much higher than that of developed countries

[8] See, e.g., Pettis (2013), Shambaugh (2016), and Magnus (2018).

like the United States, Britain, and Japan but also much higher than that of other developing countries – be they middle-income countries like Brazil, Mexico, Turkey, or the Philippines, or low-income countries like Haiti, Kenya, or Bangladesh. After forty years of rapid economic growth, China has grown from one of the poorest countries in the world to one of the richest poor countries in the world. Measured by the total size of its economy (i.e., GDP), China has gone from eleventh place behind the Netherlands in 1978 to the second largest economy in the world today. Moreover, if the current trend continues, China will overtake the United States to become the largest economy in the world by 2030.

So, the puzzle here is not why China has grown so much faster than developed countries to become an economic superpower, but why it has also grown so much faster than other developing countries. I call this the Chinese growth puzzle.

Today, we all attribute this achievement to the reform and opening-up policy that began in 1978. This is of course correct. However, China's reform and opening up can only explain its faster growth after 1978, not why it has grown faster than other countries – and not just a little, but much faster.[9] Most developing countries have implemented policies of market reform and openness to varying degrees over the past three to four decades, and many of them have freer markets than China, but no country has grown faster.

Some commentators, either approvingly or begrudgingly, have attributed China's rapid rise to its state-led economic model that favors state-owned enterprises (SOEs) and pursues an active industrial policy, to its protectionist and mercantilist trade and investment policies, and to its technology transfer policy without regard for

[9] The small African country of Equatorial Guinea can be considered an exception. Equatorial Guinea quickly grew rich thanks to its oil discovery in the 1990s, and its average growth rate of GDP per capita between 1981 and 2018 was 9.9 percent, faster than that of China. However, its oil-based growth occurred mainly during the 1992–2008 period, while its growth rate was negative in most other years.

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foreign intellectual property (IP) rights.[10] China hawks in the United States seem to subscribe to this view.[11] However, if a statist economic model can produce a growth miracle, why has no other country achieved or tried to achieve similar success by adopting this model? In fact, for many academics, statism is not China's strength but its weakness.[12]

Why, then, has China been able to sustain its rapid growth in the past four decades, when most developing countries have grown slowly during the same period? In other words, what are the distinctive strengths that have enabled China, but no other developing country, to catch up to the developed countries so quickly?

Explaining the Chinese growth puzzle will not only help to understand the reasons for the rapid growth of the Chinese economy in the past but also predict its prospects for the future. Indeed, China's economic growth has fallen sharply in recent years, causing many to worry about its future. What are China's strengths (if any) going forward? Will a deteriorating US–China relationship in a post–COVID-19 world derail or at least significantly slow down China's rise? What are the chances that the Chinese economy will collapse under the weight of the superpower conflict with the United States, a debt-ridden corporate sector, and increasing state control of the economy, as some pundits have predicted or even hoped? To answer these questions, it is necessary to first understand the driving forces behind China's rapid rise. I focus especially on the thirty-year period between 1982 and 2012 preceding the recent downturn, during which China experienced an average annual growth rate of 10 percent. I then address the issue of growth slowdown after 2012.

China is a big country, and its population size is an important factor to consider in matters such as national defense, international trade, e-commerce, and social media. However, when studying economic development and growth, it is often more meaningful to use

[10] See, e.g., Wen (2016) and Bremmer (2017). [11] See, e.g., Navarro and Autry (2011).
[12] See, e.g., Naughton (2011), Huang (2011), and Lardy (2019).

per capita statistics. Therefore, in this book, I use GDP per capita to represent the level of a country's economic development and the growth rate of GDP per capita to represent the speed of economic development or simply economic growth.[13]

CONTENT AND STRUCTURE

Some may argue that the Chinese growth miracle has been exaggerated because it is based on official figures from the National Bureau of Statistics (NBS) of China. There is a widely held suspicion that China's GDP statistics are manipulated by the government. Even if this is true, the conclusion to be drawn is far from simple. An inflated GDP growth rate is not the same as an inflated GDP level, and vice versa. The key question is then: How inaccurate are these figures? I investigate this question in Chapter 1. The short answer is that China's economic growth may have been overstated in official data and that the level and growth rate of GDP in any given year may not be accurate. Nevertheless, after taking these factors into account, the facts are still very clear: China's economic growth has been the fastest in the world. In this chapter, I also place China's growth performance in a historical and global comparative perspective.

There are many popular explanations for China's rapid economic rise besides the aforementioned initial low-income level and the reform and opening-up policy, including, for example, the abundance of cheap labor, the demographic dividend, and its export orientation in the age of globalization. I evaluate these explanations in Chapter 2. For now, suffice it to say that if these explanations are correct, at least some, if not all, developing countries should have been able to achieve rapid growth similar to that of China. Compared with developed countries, all developing countries have low income and cheap labor, and most have declining fertility rates, leading to

[13] My view of economic development as per capita GDP growth is relatively narrow, unlike that of Nobel laureate Amartya Sen who defined development as the enhancement of various types of freedoms or the removal of various types of unfreedoms. See Sen (1999).

potential demographic dividends. They could all have also relied on exports for growth. Indeed, it is much easier for a small developing country to pursue export-led growth, as it is less likely to become the target of foreign protectionist policies than a big country like China.

Economists have distinguished between two levels of causes of economic growth.[14] The first level is called proximate causes, including investment (i.e., accumulation of physical capital); education (i.e., accumulation of human capital); and technological progress (or increased productivity). An economy grows as it accumulates physical capital through investment and human capital through education and as it makes technological progress or improves its productivity. But what are the factors that cause physical and human capital to accumulate and technology to advance faster in some countries than in others? These factors constitute the second level of causes of economic growth. They are called the fundamental or ultimate causes of growth, including institutional, geographic, and cultural factors.

Professional economists and political scientists have tended to explain the Chinese growth puzzle from an institutional perspective. I refer to them collectively as institutionalists. Among them, there are two contrasting schools of thought: the free market school and the active government school. Both schools acknowledge that the reform and opening-up policy has been a key factor in China's rapid economic growth, but the free market school believes that China's economy is still not free or open enough. This school of thought argues that if China does not further accelerate its pace of reform and opening up, its economic growth will be difficult to sustain and could even suffer a total collapse. In contrast, the active government school attributes China's rapid growth to its strong government and active economic intervention (e.g., effective industrial policies), and tend to give high marks to China's political system. These two contrasting institutionalist views are evaluated in Chapter 3. The short conclusion is that

[14] See, e.g., Acemoglu (2009).

neither view can properly explain the Chinese growth puzzle. The free market view cannot, because China's market is not much freer than that of most developing countries. The active government view cannot either, because China is not particularly well ranked in terms of government effectiveness, even among developing countries, and because it is highly unlikely that out of some 150 developing economies in the world, only China has been lucky enough to have discovered or stumbled upon the right industrial policies for economic development over the past forty years. There are, of course, many other institutionalists who hold different or more fine-grained views than the aforementioned two schools. I also evaluate some of these views in Chapter 3. I conclude that institutional and policy factors may be important contributors to China's economic growth, but they do not appear to be the differentiating factors that have made China grow faster than all other countries.

As other factors such as geography, climate, and ethnic homogeneity are unlikely to offer good explanations for China's growth, culture remains the only major factor to consider. The cultural view is not new. Confucian culture, especially its emphasis on hard work, thrift, and education, has been used by sociologists to explain the growth miracle of the East Asian economies of Japan and the four Asian Tigers (Hong Kong, South Korea, Singapore, and Taiwan) from the 1950s to the 1990s. But how exactly (i.e., through what channels) has Confucian culture promoted economic growth? How do we prove that China and other East Asian economies value thrift and education more than other developing economies? If Confucian culture is so conducive to economic development, why has China's rapid growth only occurred in the past four decades and not earlier? Is Confucian culture a substitute or complement for effective institutions and government policies? I try to answer these questions throughout Chapters 4–7. In particular, I argue for the role of a thrifty culture in China's investment-led growth in Chapter 4 and the role of Confucian culture's emphasis on education in China's high-quality schooling in Chapter 5.

One may very well agree that China's economic growth over the past four decades has indeed been remarkable, if not miraculous. However, this does not necessarily allay a prevalent concern about China's macroeconomic structure. China's growth is often described as seriously imbalanced with lackluster domestic demand, especially consumption. It has been mainly driven by investment and exports, which seems unsustainable. According to this view, as the Chinese economy continues to grow, export demand will not be enough to compensate for the shortage of domestic demand; moreover, investment-driven growth has led to overcapacity and a rapid accumulation of corporate debt, which will ultimately lead to an economic crisis. In Chapter 4 (and also later in Chapter 8), I show why these popular views are misplaced. Much of the misunderstanding is caused by the failure to distinguish between long-term growth and short-term growth. Long-term growth is determined by investment, education, and technological progress, not by consumption or exports, which only affect short-term growth.

China's economic growth over much of the past forty years has indeed been driven by investment and cheap labor, although cheap labor is not specific to China. Now that China's high investment may have run into the law of diminishing returns and its labor is no longer cheap compared with other developing countries, it seems that China needs to switch to a growth model driven by innovation. Yet is China's ability to innovate up to scratch? There are tendencies either to exaggerate China's innovative capacity and its threat to Western competitors, or to dismiss it and attribute its technological progress to imitation, or worse, to the theft of foreign technologies. I address the role of technological progress and innovation in China's rapid economic growth and evaluate the country's ability to innovate in Chapter 6.

In 2012, the Chinese economy entered a phase of declining growth. Its GDP growth rate of 6.1 percent in 2019 was the lowest in nearly thirty years. What are the causes of this severe slowdown? Is the Chinese growth miracle finally coming to an end? After all, China