



China's Industrial Revolution

—A New Perspective

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Definition

- Neoliberal economics is a term that describes a political and economic philosophy that advocates for free market capitalism, privatization, deregulation, globalization, and free trade.
- It also involves reducing government spending, subsidies, and interference in economic and social affairs.
- It is rooted in the principles of neoclassical economics that emphasize market efficiency based on the marginal analysis; e.g., equalization of MPK and MPL.

Introduction

- China's rapid rise does not fit into neoliberal recipe, thus has puzzled many people, including most Chinese themselves.
- Among the many conflicting views emerged to interpret China's rise, two stand out as most popular and provocative:

Introduction

- **The first** sees China's hyper-growth as a gigantic government-engineered bubble:
 - — thus un-sustainable and will collapse—because China has no democracy, no human rights, no freedom of speech, no rule of law, no Western-style legal system, no well-functioning markets, no private banking sector, no protection of intellectual properties, no ability to innovate (other than copying and stealing Western technologies and business secrets),
 - — nor a host of many other things that the West has possessed for centuries and have “proved” essential for Western prosperity and technological dominance.

Introduction

- **The second** sees China's dramatic rise simply as destiny:
 - — a return to its historical position: China had been one of the richest nations and greatest civilizations from at least 200 BC to 1800 AD.
 - — it was only a matter of time for China to reclaim its historical glory and dominate the world once again.
- As Napoleon once said, “China is a sleeping giant. Let her sleep; once she wakes up, she will shake the world.”

Introduction

- But neither view is correct.
- I will provide a different view on China's rise that can shed light not only on China's miracle, but also on the **British Industrial Revolution** itself.

Why Nations Fail?

- ✓ Poverty is rooted in the inability to engage in mass production.
- ✓ Such inability not due to the lack of technology per se, but rather the lack of a mass market to render mass production viable (profitable).
- ✓ Unfortunately, the market is not free, but a **public good** that is extremely costly to create.
- ✓ Creating mass market requires **state capacity & correct industrial policy.**

Why Is “Market” a Public Good?

- ✓ E.g., 3 pillars: (i) political stability, (ii) social trust, (iii) infrastructure.
- ✓ Infrastructure determines the time-space structure of the market — its physical shape, network structure, volume/direction/velocity of transactions.
- ✓ No single farmer or collection of sand-like farmers in fragmented country can create a unified mass market.

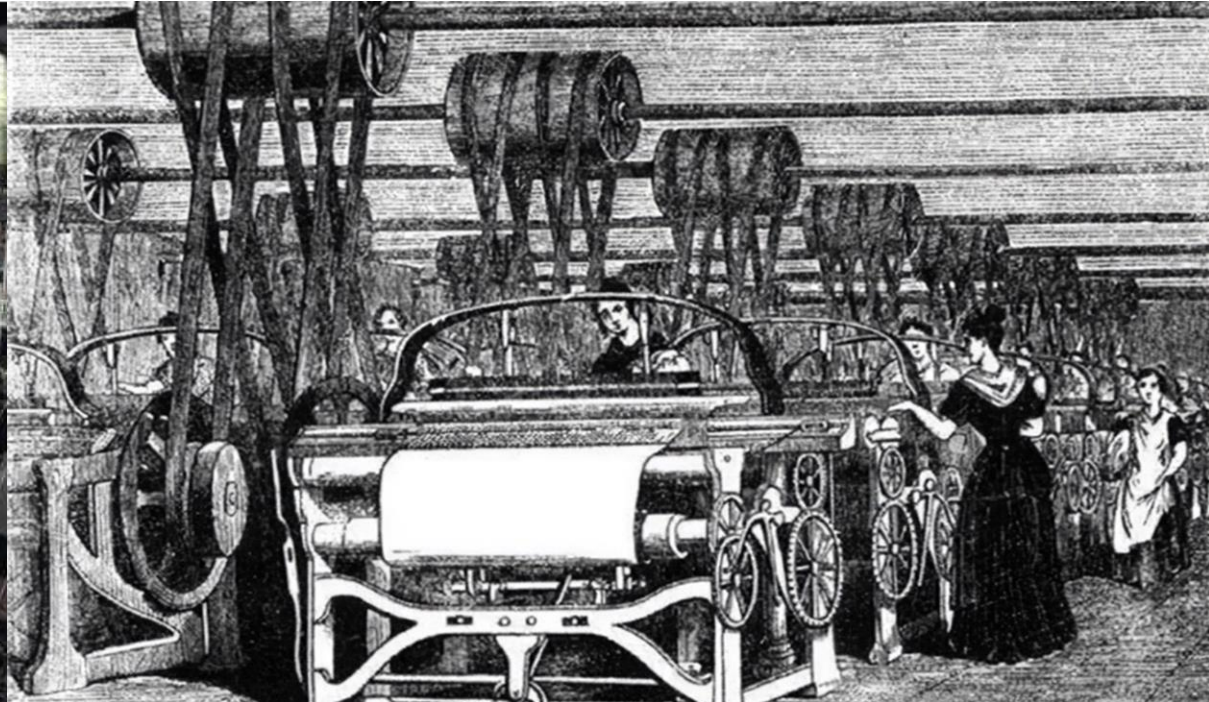
Why Is “Market” a Public Good?

- ✓ Division of labor is limited by the extent of the market:
“In the lone houses and very small villages scattered about in the highlands of Scotland, every farmer must be butcher, baker, and brewer, for his own family. In such situations we can scarce expect to find even a smith, a carpenter, or a mason, within less than twenty miles.”
- ✓ “[S]o it is upon the sea-coast, and along the banks of navigable rivers, that industry of every kind naturally begins to subdivide and improve itself, and it is frequently not till a long time after that those improvements extend themselves to the inland parts of the country.....” (Adam Smith, *The Wealth of Nations*, 1776, Chapter III)

How to Create Mass Market?

- ✓ Early European powers relied on mercantilist state government, powerful navy, and militarized merchants to create monopolistic global markets — through colonialism, imperialism, slavery, bloody wars and gunboat diplomacy.
- ✓ Dutch merchant and warrior , CEO of VOC, Jan P. Coen): **“Your Honors should know by experience that trade in Asia must be driven and maintained under the protection and favor of Your own weapons, and that the weapons must be paid for by the profits from the trade; so that we cannot carry on trade without war, nor war without trade.”**
- ✓ **Why the Industrial Revolution happened in UK first?** Generations of British monarchs and militarized merchants helped create for England the world’s largest textile market, cotton supply chains, and trading networks that made mechanized mass production profitable, thus kicking-started the **First Industrial Revolution**.

First Industrial Revolution



Creation of Mass Market by State Capacity

- ✓ Economic historian Sven Beckert: *“The first industrial nation, Great Britain, was hardly a liberal, lean state with dependable but impartial institutions as it is often portrayed. Instead it was an imperial nation characterized by enormous military expenditures, a nearly constant state of war, a powerful and interventionist bureaucracy, high taxes, skyrocketing government debt, and protectionist tariffs—and it was certainly not democratic.”* (Sven Beckert, 2014, p. xv)

How to Create Mass Market?



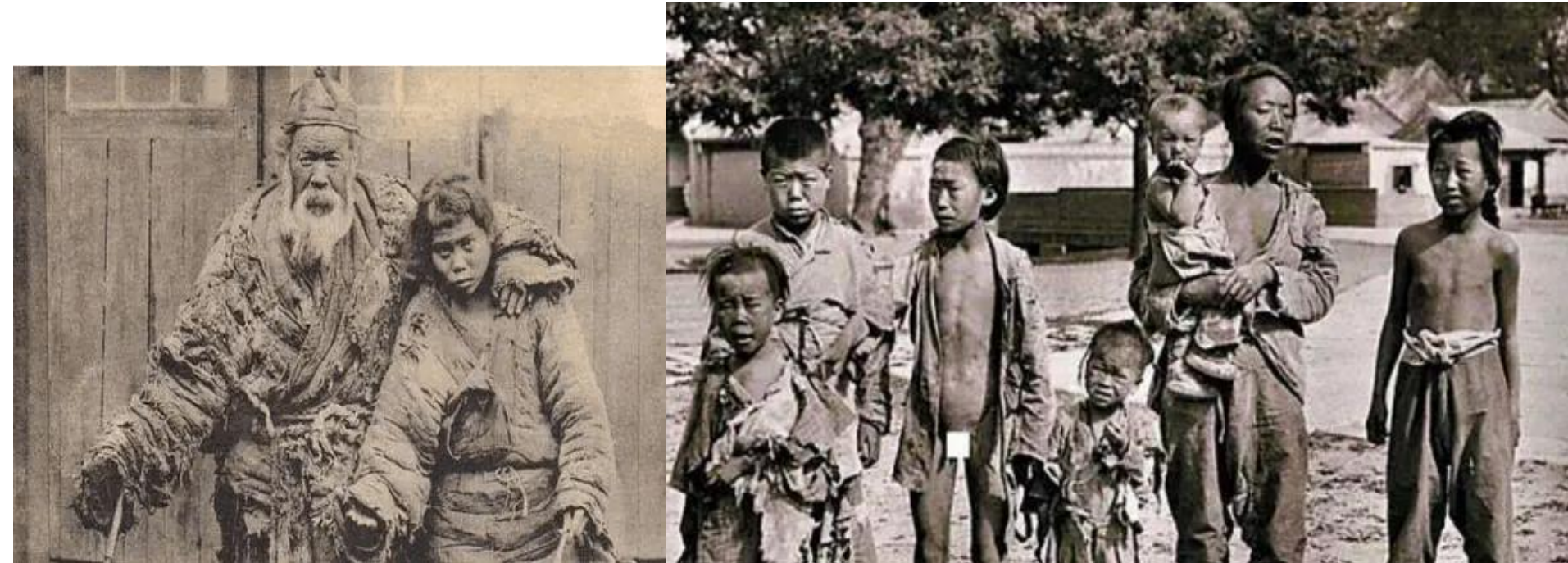
How to Create Mass Market?

- ✓ Any European state that mimicked the British method of mercantilist market creation also successfully kick-started their own industrial revolution (including the US & imperial Japan)
- ✓ But in the 20th century especially after WWII, agrarian nations no longer have the same “**privilege**” of creating their own global market through colonialism, imperialism, slavery, wars and gunboat diplomacy.
- ✓ US contribution: WTO; but still require state capacity. E.g., India and Russia all joined WTO but with little effect.

Destruction of China's proto textile industry by British machine

- Marx: "... a machine was invented in England which took away the jobs of millions of workers in India and China and caused a change in the whole form of existence in these countries. ...These countries bought cheaper English goods and put their own artisanal workers to death."
- "Ever since the British dominated world trade by navy power and developed manufacturing to a level where they could supply almost the entire world with their own products, ... the Indians have been deprived of their means of earning a living, China turned upside down. ...Chinese industry, based on manual labor, could not stand the competition of the machines."

Destruction of China's proto textile industry by British machine



Indian Experience



China's Experience

- Qing dynasty: market without state → no mass market to support mass production.
- 1949-1978: state without market → mass production without market support, thus non-profitable.
- After 1978: state + market → Industrial Revolution.
- Government (especially local) must play critical roles in market creation by acting as “public merchants”.

China compressed centuries of Western development into a few decades



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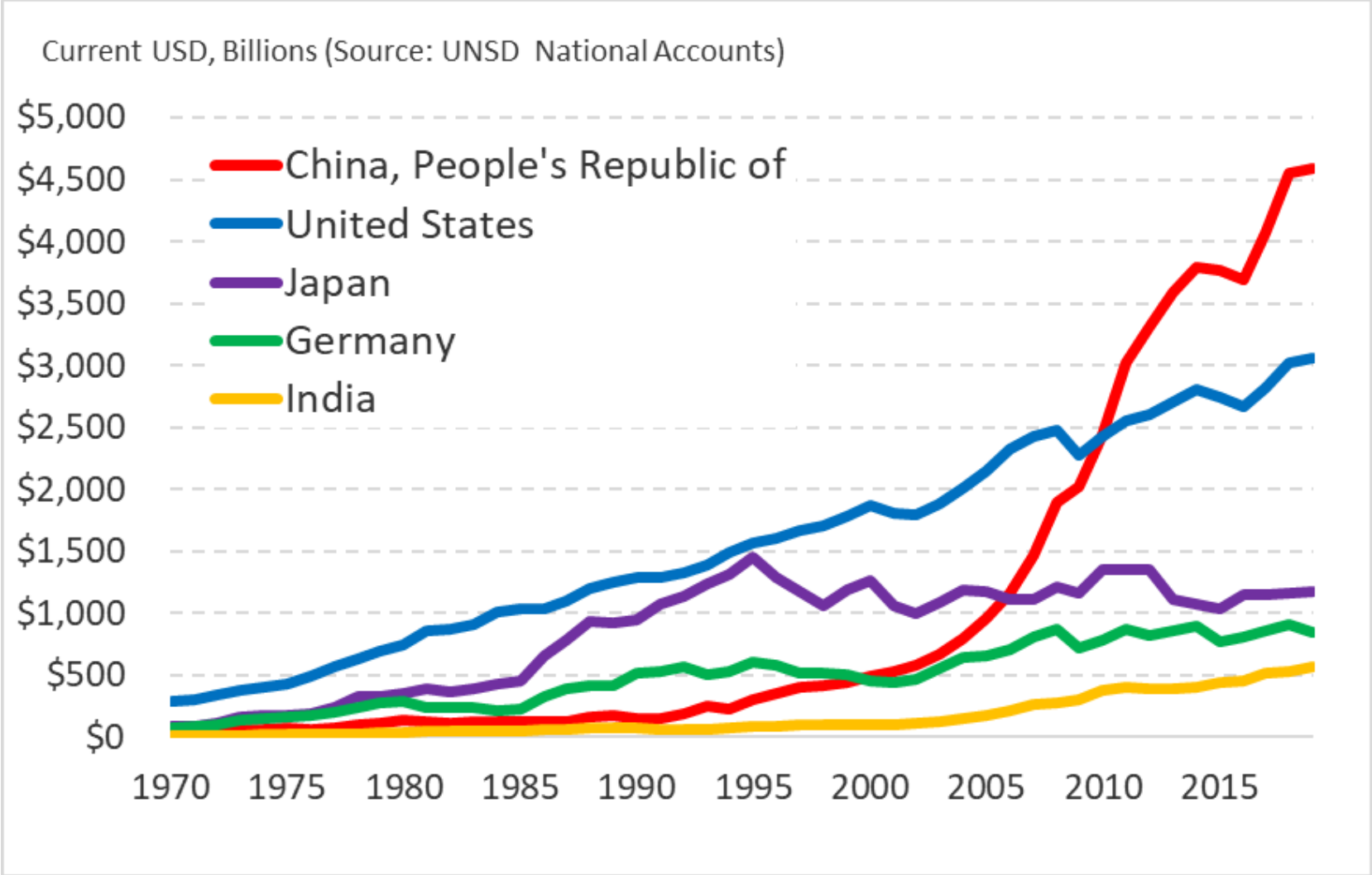


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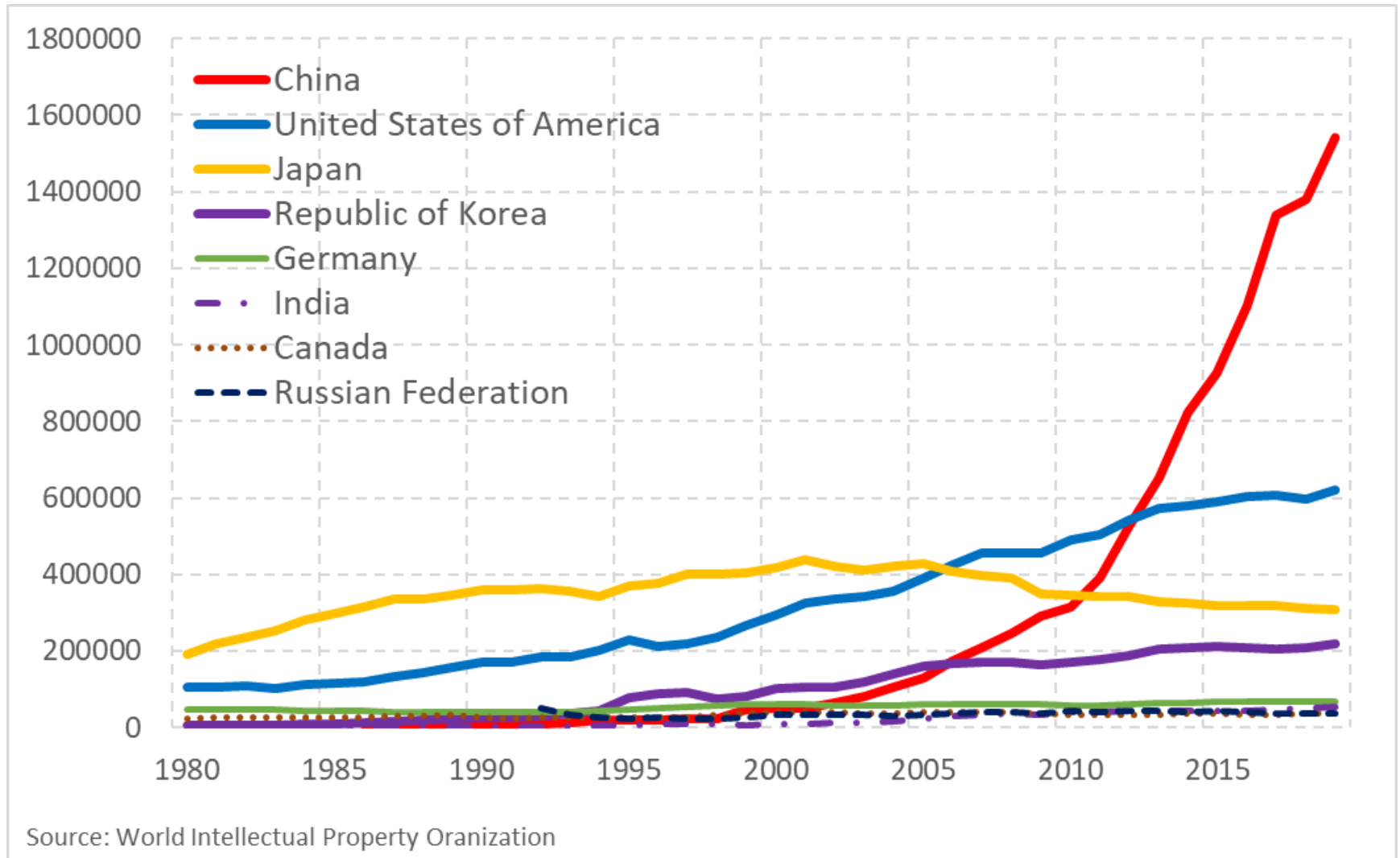


Industrial Output top 5 countries

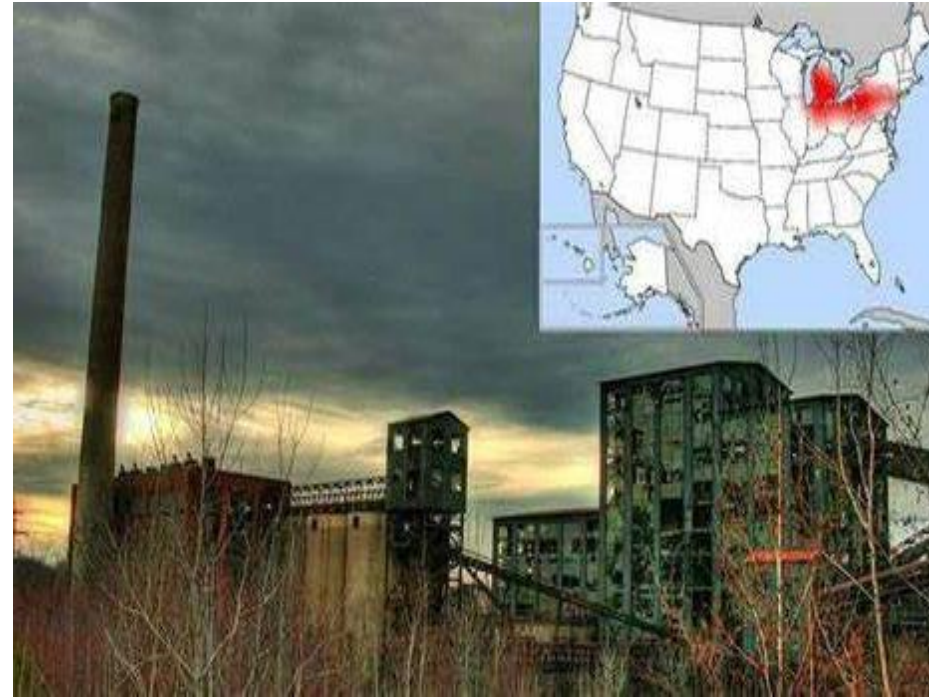


Patent Applications

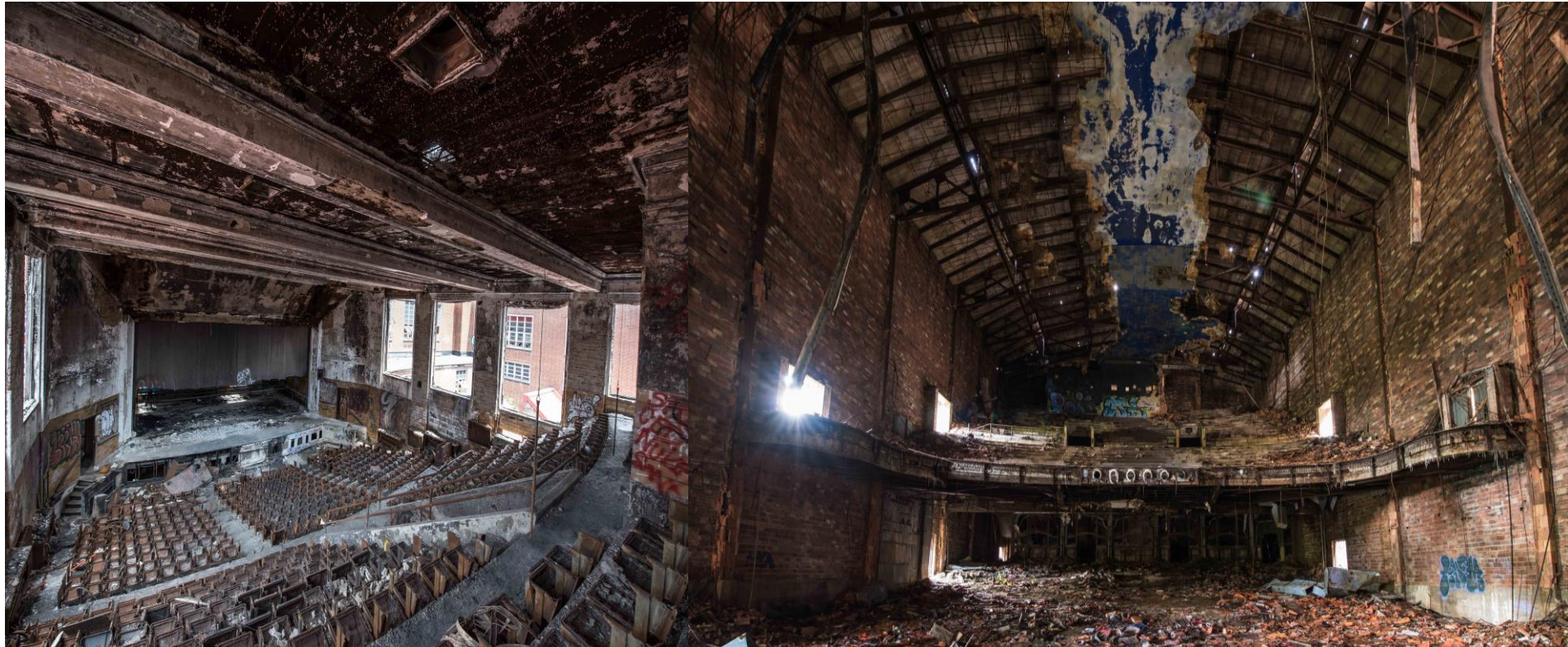
top 10 countries



Revenge from Developing World?



Revenge from Developing World



Revenge from Developing World?



The Triumph of “Marketism”? Yes and No.

- “Yes” for obvious reasons. Market imposes:
 1. economic incentives to compete
 2. discipline on management and technology adoption
 3. Darwinian “creative destruction” to eliminate losers
- “No” for overlooked reasons. It’s extremely costly:
 1. for anarchic, uneducated peasants to form cooperatives unless political stability and social trust exist
 2. to create mass market to support the division of labor and mass production
 3. especially to create market regulatory institutions to prevent cheating and fraud
 4. — — Hence, it is the lack of state-led market creation & regulations that destroyed East Europe under Shock Therapy, and trapped Africa and Latin America despite democracy.

Why Neoliberalism Doomed to Fail?

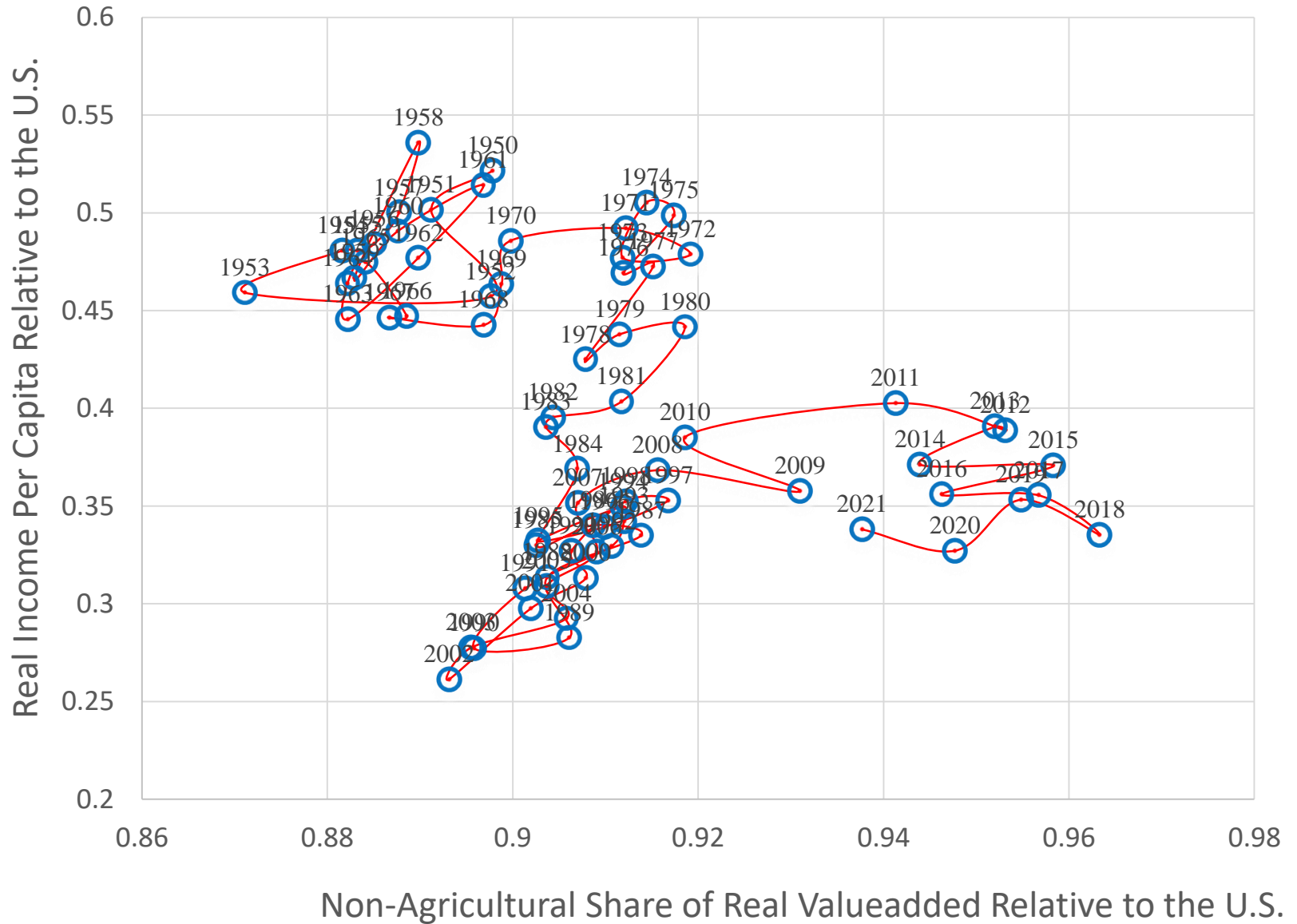
- ✓ Neoliberalism fails to understand **3** economic principles: **(i)** division of labor is limited by the extent of the market; **(ii)** the market is a public good that can only be created with the help of the state; **(iii)** market creation is a sequential process.
- ✓ Mass market has three pillars: political stability, social trust, infrastructure.
- ✓ Neoliberalism destroys a nation's state capacity, thus undermining the political foundation of the mass market and government's capacity to design industrial policy.
- ✓ Without political stability and correct industrial policies, market reform creates mafias and oligarchies instead of entrepreneurs.

A Tale of Two Countries:

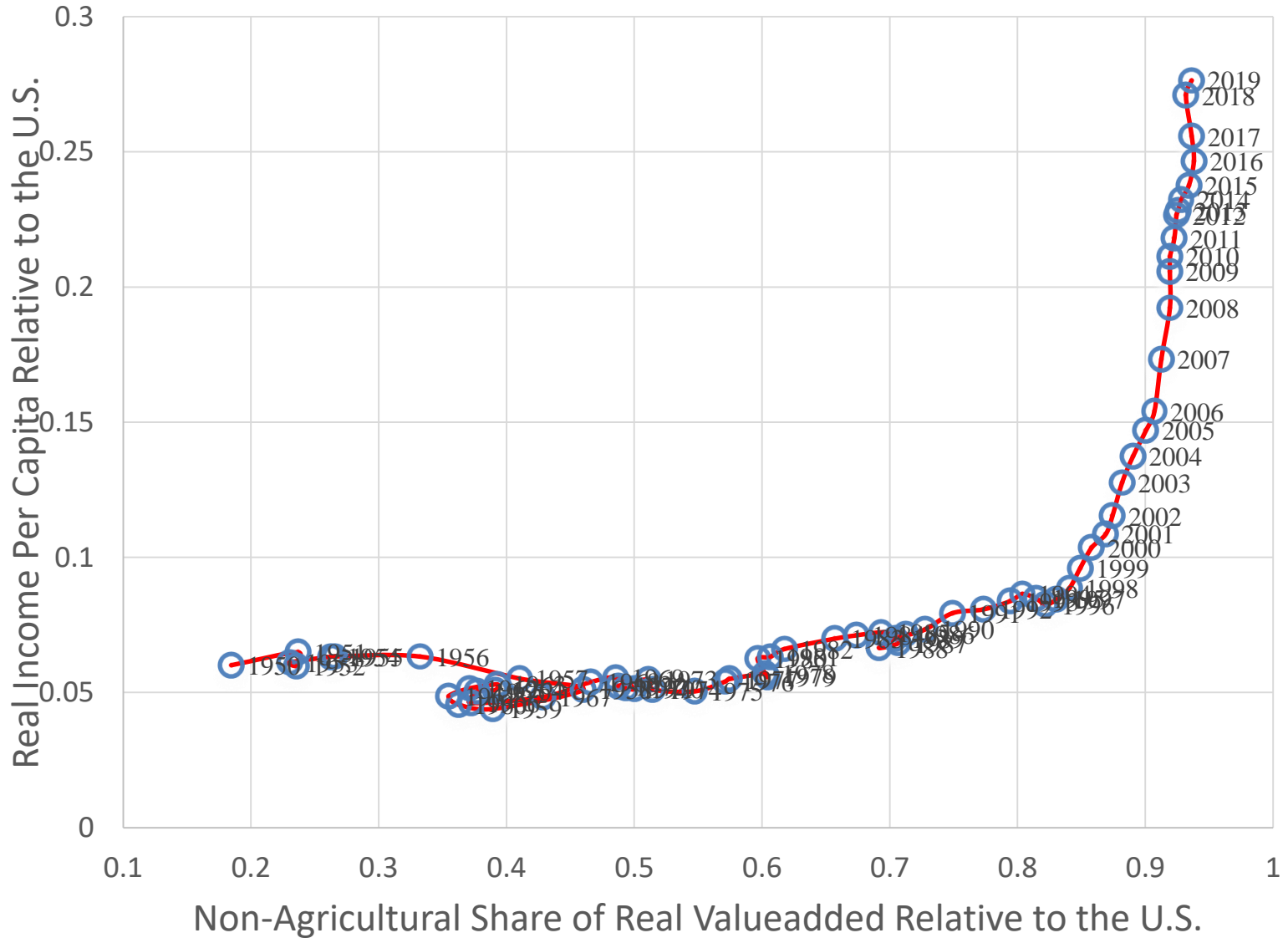
Argentina vs. China

- ✓ Argentina has everything that neoliberalism and New Institutional Theory prescribe:
- ✓ Free market, mobility of land/people/capital, democracy, rule of law, Western-style legal system, private banking, intellectual property rights, freedom of speech, and a host of other things that neoliberalism and New Institutional Theory considered essential for Western prosperity and technological dominance.
- ✓ China is portrayed as the opposite.....

Argentina's Path of Industrialization



China's Path of Industrialization



A Tale of Two Countries: Argentina vs. China

- ✓ What is the exact role of infrastructure and how can it be built?
- ✓ Why is the exact role of the State in industrialization and development? Why is it ignored in the neoclassical framework?
- ✓ Neoclassical marginal analysis is misleading: Can the marginal product of any chemical compound be equalized in different organs of the human body? Should the marginal product of firm-specific capital be equalized across different industries/supply chains?

Conclusion:

Laws of Economic Development

- ✓ Poverty is rooted in the inability to mass produce consumer goods & the means of mass production.
- ✓ But mass production requires a **mass market** to render it profitable.
- ✓ Yet the market is a public good that can only be created and nurtured with the help of the state.
- ✓ Also, market creation is a sequential process that requires correct industrial policies and even state violence.

Conclusion:

Transition to a New Global Order

- ✓ Without the development of all nations, there can be no lasting world peace. 250 yr passed since the British IR, more than 85% of the world's population still unable to IR.
- ✓ The neoliberal approach to development has failed because it is economically wrong and politically counterproductive.
- ✓ The core of neo-liberalism is de-nationalization and thus de-industrialization.
- ✓ A new world order is emerging, and we need new approaches to economic analysis.

Ideas in this PPT are based on my book (2016):

**THE MAKING
OF AN
ECONOMIC
SUPERPOWER**
**Unlocking
China's Secret
of Rapid Industrialization**

The rise of China is no doubt one of the most important events in world economic history since the Industrial Revolution. Mainstream economics, especially the institutional theory of economic development based on a dichotomy of extractive vs. inclusive political institutions, is highly inadequate in explaining China's rise. This book argues that only a radical reinterpretation of the history of the Industrial Revolution and the rise of the West (as incorrectly portrayed by the institutional theory) can fully explain China's growth miracle and why the determined rise of China is unstoppable despite its current "backward" financial system and political institutions. Conversely, China's spectacular and rapid transformation from an impoverished agrarian society to a formidable industrial superpower sheds considerable light on the fundamental shortcomings of the institutional theory and mainstream "blackboard" economic models, and provides more-accurate reevaluations of historical episodes such as Africa's enduring poverty trap despite radical political and economic reforms, Latin America's lost decades and frequent debt crises, 19th century Europe's great escape from the Malthusian trap, and the Industrial Revolution itself.

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THE MAKING OF AN ECONOMIC SUPERPOWER



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