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A concise history

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Chapter 20

UNSTABLE LEADERSHIP

SUMMARY: 20.1. Reagan's America: reviving the economy and reducing the role of the state. – 20.2. Japan's lost challenge. – 20.3. The dynamic recovery of the United States. – 20.4. China in the global economy: political repression and economic reform. – Bibliography.

20.1. Reagan's America: reviving the economy and reducing the role of the state

At the start of the 1980s, US society faced far-reaching problems. The end of dollar convertibility in 1971 and soaring petrol prices after the Yom Kippur War (1973) had created imbalances that were difficult to correct. The stagflation of the 1970s led to a rise in unemployment, falling profits and the stagnation of earned income, thus casting doubts on the traditional solutions used to overcoming this type of crisis. The degree of confusion and uncertainty afflicting US society provided the basis for the changes imposed by President Ronald Reagan, elected in November 1980.

In January 1981, the new president's inaugural address launched the key phrase that would mark a substantial proportion of his two mandates: less state intervention in the economy. With these words, Reagan launched what was essentially a set of measures to re-start the economy based on a *supply side* approach: tax cuts for medium to high incomes and companies in order to stimulate consumption and investments, reduced spending on social services, and less state intervention in the labour market. The cuts in social spending were used to increase military spending, in a move with obvious strategic implications (a more assertive containment strategy towards the expansionist ambitions of the USSR, engaged since 1979 in the Afghanistan War and also very active in Africa). This measure had also the purpose of obtaining typically Keynesian effects, both direct (maintaining or increasing employment in a strategic sector that provided jobs for tens of thousands) and indirect (through investments in research and development with positive effects on many sectors). Between 1980 and 1987 *welfare* spending fell from 25.5 to 18.3% of the federal budget, while military spending rose from 29.7 to 35.2%. However, the cuts were linear, because reduction in spending on certain areas (pensions and medical care for the elderly, tax deductions for mortgages) would have lost Reagan and his Republicans too many votes. Economic deregulation was simpler to implement, creating fewer social and economic problems, and even fewer political problems.[1]

However, the results did not live up to expectations, and in many cases were the opposite of what was intended by a president who based his political activity on containing public spending. The reduction in fiscal revenues drove the federal deficit to over 5%, which meant a substantial rise in the public debt, and this would influence many of the decisions made during subsequent administrations.

Nevertheless, the dollar appreciated, helped by the Federal Reserve's rigorous monetary policy. It had already raised interest rates in 1979, when they were around 11.5%, increased them gradually to 21.5% in December 1980 and then down to below 10%, which had been the 1978 level), allowing the US economy to take maximum advantage of the falling prices of raw materials in the first half of the 1980s. Unemployment reached 10% in 1982-83, and gradually decreased to below 6% by the end of the decade. Inflation was once again under control: it fell from 11 to 13% in 1979-80, 3.6% in 1985, and went below 5% in 1989-1990. This indicated the growing confidence of consumers and investors. From this perspective, Reagan's policy appeared successful, but other figures gave no cause for euphoria. Average GDP growth during the decade was below 3%, which was less than the 1970s, and old fears re-surfaced when Wall Street fell by 25% in October 1987. This was especially true for the middle classes, who had been more convinced than others by Reagan's promises of a new boom.[2]

It is no surprise that Reagan's presidency saw the first fears of a possible end to the "American century". This feeling intensified during the second half of the 1980s with the panic caused by the collapse of the stock exchange. Some observers talked of the relative decline of the USA,[3] although academics were unable to agree on this judgement.[4] Pentagon officials were concerned that defence production was falling in many base industries,

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[1] W.C. Berman, *America's Right Turn. From Nixon to Clinton*, Baltimore, 1998.

[2] F. Romero, *Il modello americano*, in V. Castronovo (ed.), *Storia dell'economia mondiale*, 6. *Nuovi equilibri in un mondo globale*, Rome-Bari, 2002, pp. 184-187.

[3] The best-known and most influential academic in this field at the time was British historian P. Kennedy, *The Rise and Fall of the Great Powers. Economic Change and Military Conflict from 1500 to 2000*, New York, 1987.

[4] The best-known and most influential critic of the "decline" theory was political scientist Samuel P. Huntington, director of Harvard University's Center for International Affairs. His article contained the harshest attack on this theory (*The US – Decline or renewal?*, in *Foreign Affairs*, Winter 1988-1989).

utting the production capacity of the entire US industrial system at risk.[5]

During the 1980s, semiconductors became increasingly important worldwide due to their strategic role in the development of the electronics industry, seen in the USA as symbolizing the country's industrial competitiveness and its national security. The US had until then controlled the world market, although it encountered difficulties from the second half of the 1970s with competition from a powerful Japanese industry that was determined to penetrate the US industrial system. For example, Fujitsu attempted to take over Fairchild Semiconductor owned by the French Schlumberger group. Defense Secretary Caspar Weinberger's veto was decisive in preventing this, but perhaps even more so in allowing Fairchild's sale a few months later for $122 million to a US company, National Semiconductor.[6] This was just one of many aspects of a real trade war between the US and Japan. Tensions between the two countries grew alongside the increasing US trade deficit (it rose from below $7 billion to almost $40 billion between 1980 and 1985), blamed by American manufacturers and Washington on the yen, which they considered to be greatly undervalued.

20.2. Japan's lost challenge

The Reagan administration transformed these tensions into a kind of battle, initially for survival and then for US economic recovery from the serious difficulties it faced during the early 1980s. Washington won the contest by using every means it could – especially its political and strategic role – reminding Tokyo that Japan was sheltered under the US nuclear umbrella. The Plaza Accord (called after a famous Fifth Avenue hotel in the heart of Manhattan) was signed in September 1985 by the USA and Japan, and also by Great Britain, France and Germany, and allowed the US dollar to depreciate against the yen by 51% over two years (1985-1987), taking it down from about 262 to 130 yen.

The immediate effect was a slight contraction in Japanese exports. Japan's central bank attempted to contrast this by cutting interest rates and pursuing a strong expansive monetary policy, which had already been launched at the start of the decade. The Japanese central bank dropped its official interest rate from 9% in 1980 to 4.6% in 1986 and to 2.5% in 1987.

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[5] Department of Defense, *Bolstering Defense Industrial Competitiveness*, Washington, July 1988.

[6] D.K.H. Walters, *Deal to Sell Fairchild Semiconductor to Fujitsu Cancelled*, in *Los Angeles Times*, 17.3.1987; A.L. Friedberg, *The Strategic Implications of Relative Economic Decline*, in *Political Science Quarterly*, 104, 3, Fall 1989, pp. 401-431.

Japan's economic solidity allowed the country's investors to buy some of the historic symbols of American industry. In 1988, Bridgestone was able to buy Firestone, winning the contest with Pirelli. In September 1989, Sony bought one of the Hollywood giants, Columbia Pictures, for $4.4 billion from Coca Cola, its owner since 1982. One month later, the Mitsubishi group paid over $846 million for 51% of the company owning the Rockefeller Center, one of New York's most famous skyscrapers.[7]

Despite the gaps between US and Japanese GDPs and their per capita GDPs, many took it almost for granted that Japan would become the world's leading economic power in the 21st century. In the first half of the the 1980s, while the US economy struggled with a difficult recovery, Japanese GDP grew at an average of 4%, remaining over 3% despite slower growth in the second half of the decade. The liquidity injected into the system drove companies, especially manufacturers, to increase their fixed investments; these rose to around 20% of GDP, which was a similar level to the 1960s. These investments increased the competitiveness of Japanese industry and compensated for appreciation of the yen, while certain markets, especially the US market, were now "used" to products *made in Japan* and price elasticity was much lower.[8]

Liquidity meant that huge amounts of capital were directed towards foreign investments, whereas the influx of short-term capital was much lower (20-30 billion *vs.* 120-130 billion dollars). During this period, Tokyo became one of the world's most dynamic financial markets and rapidly gained a leading international position. The Tokyo stock exchange experienced a period of euphoria as the Nikkei index climbed from 12.598 in September 1985 to 38.915 in December 1989. At the same time, a huge property bubble formed. Land prices in urban residential areas soared, especially after 1985; in real terms, the national increase was 61.6%, but prices in the country's six biggest cities increased by 196.4%

The political authorities also appeared to have caught the growing mood of optimism, convinced that the property boom and rising stock exchange confirmed the solidity of the system. However, the first hints of concern were starting to circulate in the central bank, although it was unable to provide the government with concrete grounds for a change of direc-

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[7] C. Rappaport, *Japanese Tyre Maker Aims to Become World's Largest*, in *Financial Times*, 14.5.1988; P. Richter, *Sony to Pay $3.4 Billion for Columbia Pictures. Japanese Firm Willing to Offer High Price to Get Film, TV Software for Video Equipment It Makes*, in *Los Angeles Times*, 28.9.1989; R.J. Cole, *Japanese Buy New York Cachet With Deal for Rockefeller Center*, in *The New York Times*, 31.10 1989.

[8] K. van Wolferen, *The Enigma of Japanese Power*, London, 1989; S. Tsuru, *Japan's Capitalism*, Cambridge, UK, 1993.

tion. Consequently, the banking system continued to pump money into the property sector above all, favouring big and small operators whose only collateral for their debts was the land they possessed or were in the process of buying, on the assumption that prices would either remain stable or rise even higher. The official interest rate was raised for the first time from 2.5 a 3.25% in May 1989, and three more times in the following 14 months until it stood at 6% in summer 1990, the highest level since 1981. However, the Bank of Japan's actions did not bring an immediate halt to the property bubble, which peaked in September 1990 when urban land prices were four times those of 1985.[9]

The stock exchange fell rapidly: at the end of 1990, the Nikkei index fell to 23,848, losing 15,000 points in a year, continuing to drop until it stood at 16,924 by the end of 1992. One year later, the property market also began to fall – as rapidly as it had risen. At the same time, some banks were already in a critical situation; bad debt amounted to around $1,000 billion at the end of 1991, and the figure would continue to grow in the following years. A series of bankruptcies began, hitting a banking system that just a few years earlier had seemed one of the world's most solid and vigorous (in 1987, US magazine *Fortune* reported that nine of the world's leading non-US banks were Japanese): six banks failed in 1992, and dozens more in 1993 and 1994.[10]

The consequences damaged the entire economic system. The banks made less credit available to business, creating difficulties mostly for small and medium companies, increasing numbers of which went bankrupt between 1991 and 1995. The big companies began a far-reaching reorganization process, which meant concentrating on their *core business*, reviewing their diversification strategies; in the case of the biggest *keiretsu* it meant eliminating entire sectors. This obviously involved a huge reduction in employment, restrictions on salaries, and gradual relocation of their activities; in the manufacturing industry, outsourcing rose from 4% to around 14% during the 1990s.[11]

This was the start of the *lost decade* of the 1990s. The Japanese economy fell into deep stagnation, with a GDP growth rate of around 0% and a level of inflation that also gradually dropped towards zero, and then became

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[9] *http://www.tradingeconomics.com/japan/interest-rate*; Y. Noguchi, *Land Prices and House Prices in Japan, in Housing Markets in the U.S. and Japan*, Chicago, 1994, pp. 11-28.

[10] T. Hoshi, A. Kashyap, *The Japanese Banking Crisis. Where Did it Come From and How Will it End*, Nber Working Paper, 7250.

[11] H. Miyoshi, Y. Nakata (eds.), *Have Japanese Firms Changed? The Lost Decade*, London, 2010.

negative from 1999 to 2003. The central bank gradually reduced the official interest rate down to 0.5% by 1995. Before this, the government had essentially used only fiscal leverage, increasing taxes on consumption and thus helping to depress internal demand even further. This was more of a political and social policy than an economic policy, aimed at obtaining resources to finance the growing cost of social welfare for Japan's rapidly ageing population. Only in the second half of the decade did the government launch expansive policies as it attempted to avert an increasingly dangerous economic trend. Public spending grew in the form of public investments financed with deficit spending, and the deficit rose from 3.4% of GDP in 1995 to 7.6% in 1999, while the public debt increased from 105% to 130% of GDP. However, as in many Western countries two decades previously, despite the abundant financial resures used, the results of this economic policy fell far short of expectations.[12]

20.3. The dynamic recovery of the United States

At the end of the 1990s, Japan was no longer seen as challenging the United States. The Japanese economy was still the second in the world, but the gap with the United States was wider than in the previous decade. The US economy began to grow from the end of the Gulf War until 2001, much more than any other G7 member state. Once again, the United States proved the ideal environment to apply the Schumpeterian idea of "creative destruction"; in the last 20 years of the century, it lost around 44 million jobs during the reorganization of the economy but gained 73 million jobs in the private sector, meaning that there were actually 29 million new jobs. To give an idea of the scale of the phenomenon, 4 million jobs were created in Europe during the same period, but almost all were in the public sector. In the 1990s alone, the US economy created over 14 million new jobs, while Europe lost almost 5 million. US economic growth was relatively limited between 1990 and 1995 and remained on average below 2.5%, but between 1996 and 2001 it grew more than in any other period of history except the 1950s, and was permanently over 4%.[13]

Many factors made this decade the "roaring" 1990s. Slow growth in the late 1980s continued during George Bush's presidency and led to a psycho-

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[12] F. Hayashi, E.C. Prescott, *The 1990s in Japan. A Lost Decade*, in *Review of Economic Dynamics*, 5, 1, January 2002, pp. 206-235; W.R. Garside, *Japan's Great Stagnation. Forging Ahead, Falling Behind*, Chaltenham, 2012.

[13] J.A. Franke, P.R. Orszag, *American Economic Policy in the 1990s*, Cambridge, Mass., 2002.

logical crisis. Despite the rapid and – in some ways – spectacular victory in the first Gulf War, the US political system seemed unable to offer an outlet for the various demands generated by industry and society's most diverse groups. Bush's limits on public spending continued the policy implemented by Reagan (whose vice president Bush had been for 8 years), but now encountered both old and new social and political constraints. An ageing population (mostly Republican voters) was unwilling to forego any traditional welfare policies. The immigrant population, which had increased greatly during the 1980s, was bringing radical changes to the composition of the US working class. This involved the manufacturing sector, where the salary gap widened once more, overturning a key component of the *American dream*, in which *blue collar* workers were central to the growth of internal demand for consumer durables. It also involved the composite tertiary sector, where many of the new jobs were concentrated, and the middle class felt increasingly insecure. However, the country's economic and financial difficulties obliged Bush to abandon one of his solemn electoral promises in 1990, when he allowed the Democrat dominated Congress to increase taxes without using his power of veto.[14]

Together with the feelings of unease and frustration afflicting different social classes to varying degrees, this decision to increase taxes proved fatal to Bush's hopes of re-election in November 1992. The participation of a third candidate, businessman Ross Perot, was a rare event in US presidential elections, and Perot's success in obtaining 19% of the vote played a decisive role in the victory of Bill Clinton. However, the new presidency did not bring a return to the welfarism of previous Democrat administrations, partly because the trade unions no longer linked the Democrat Party to its traditional electoral base; the profound restructuring of the US economy during the 1980s had eroded much of the unions' influence, leading to a sharp fall in membership.

Clinton's programme was aimed at modernization of the US economy. Aged 46 when elected (Bush was 68), Clinton belonged to a culture that was more open to innovations, and he seemed more capable of accompanying the country into the new world that had begun to develop rapidly in the early 1990s: the world of electronics, with its countless aspects affecting the economy and the lives of millions of people. Clinton's programme also contained a reform of the health system, fiscal incentives in favour of education, and a reduction in the *welfare state* aimed at making certain protected categories return to work.

[14] R. Valletta, *Job Loss during the 1990s*, Frbsd Economic Letter, 97-05, February 21, 1997.

It was not simple to implement this programme. The public deficit inherited from the Reagan and Bush administrations prevented new expenditure. On the other hand, Federal Reserve head Alan Greenspan (nominated by Reagan in 1987) had introduced low interest rates to take the US economy out of recession. Clinton devoted a great deal of energy and some of his political capital to eliminating the deficit, an essential condition for general economic recovery, and his policy came to seem more Republican than "classically" Democrat. The same could also be said for Clinton's wholehearted support for the NAFTA free trade agreement, which eliminated many trade barriers between the United States, Canada and Mexico.[15]

However, US society continued to fear the changes taking place. This partly explains how the Republicans gained a majority in both Congress and the Senate, and they were also helped by Clinton's inability to implement many of the reforms promised in 1992. The following two years were much more successful for Clinton who returned to areas that were traditionally Democrat terrain, and his re-election in 1996 was helped by the substantial recovery now taking place, with unemployment down to around 5%.[16]

Ten years after Japanese economic euphoria, US society now appeared in a similar psychological state, and the difficulties of the 1980s seemed distant. Since the USSR no longer existed, the USA was now the only great power, and it seemed set on a course towards the "American century". Company restructuring in the 1980s involved not only the composition of the workforce, but touched on all aspects of organization from technology to shop floor layout. The US industrial system entered the 1990s with renewed efficiency, and no other developed country could rival its competitiveness. Massive investments in the high-tech and computing sector opened up a new divide between US companies and their European and Japanese competitors. US company spending accounted for around 40% of total world spending in this field, i.e. roughly double the amount European companies invested in information technology, and eight times the world average.[17] However, the 1990s were also the period when new names appeared on the world scene (Bill Gates, Paul Allen, Ted Turner, Craig McGraw, Larry Ellison, Andrew Grove, Jeff Bezos and others), inheriting and continuing the limitless capacity of US society to produce absolute excellence in the different economic sectors.

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[15] A. Grenspan, *The Age of Turbulence. Adventures in a New World*, New York, 2007.

[16] J.A. Franke, P.R. Orszag, *American Economic Policy in the 1990s*, cit.

[17] R.J. Gordon, *Technology and Economic Performance in the American Economy*, Nber Working Paper, 8771, February 2002.

Some operated in high-tech and information technology; together with biotechnology, these were the cutting edge of technology and were also the sectors that attracted most interest from private and institutional investors (e.g. *mutual funds* or pension funds) as the economic situation gradually consolidated. With regard to the state, the federal deficit gradually disappeared and actually became a surplus in 1997. Wall Street appeared unstoppable; between December 1991 and January 1992, the Dow Jones index recovered to the level preceding the October 1987 crash, soaring to 16,302 in December 1999.

The boom of this *new economy* was short-lived, and the Dow Jones index dropped around 3,000 points in August 2001. The first signs of economic difficulty were already felt in early 2000. New investments fell sharply. The economic growth rate dropped from 6.44% at the end of 1999 to 5.50% at the end of 2000, and then declined during the first eight months of 2001. Greenspan had just raised the interest rate from 5% to 6.25%, but hurriedly dropped it again, fearing a new phase of economic decline.[18]

20.4. China in the global economy: political repression and economic reform

Neither Greenspan nor others could foresee the events of September 11th. The terrorist attack was a severe psychological blow to the United States. The government and Federal Reserve responded immediately with economic and monetary interventions, in addition to the political and military interventions in Afghanistan and Iraq. Wall Street had climbed back to its September levels by December 2001. Many people wondered if – and to what extent – Al Qaeda might be the USA's real challenger. The immediate consequences of the attack meant that public opinion was less interested when China joined the WTO in December 2001 following years of difficult negotiations.[19] On the other hand, as Larry Summers said in 1995, when he was Undersecretary at the Treasury during Clinton's presidency, the United States could not afford to repeat the mistakes made a century before by the international political and economic system still centred on Great Brit-

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[18] *http://www.macrotrends.net/1319/dow-jones-100-year-historical-chart*; *https://www.federalreserve.gov/datadownload/Review.aspx?rel=H15&series=bf17364827e38702b42a58cf8eaa3f78&lastobs=&from=&to=&filetype=csv&label=include&layout=seriescolumn&type=package.*

[19] *China's Economy and the Wto. All Change*, in *The Economist*, 10.12.2001.

ain, which had underestimated the importance of German and Japanese achievements.[20]

At a G20 summit in 2010, the international press reported the existence of an informal but immensely powerful G2, although this was immediately denied by the two parties concerned, the USA and China. Less than two years later, when China became the world's leading export nation in 2012, reducing the ten-point gap with the United States, Japan and Germany in under ten years, the situation was very different. In 2012, many people wondered if the 21st century would be the Chinese century, and a sinologist suggested that China was "buying the world". This shows just how much China had achieved since the start of the reforms introduced by Deng Xiaoping (1978), and since the sanctions imposed by the international community in reaction to Tienanmen Square (1989), or even since it had joined the WTO (2001). During the 1990s, China's GDP grew at an average annual rate of over 10%, and GDP growth rates never fell below 8% during the following decade, despite the 2007-2008 crisis.[21]

So many books have been written about the transformations to China's economy and society between the late 1970s and the present. However, perhaps the well-known Chinese writer Yu Hua best summarizes the dramatic and epic developments of just a few decades: "The last forty years have been for China what the last four hundred years have been for Europeans".[22]

The changes launched in 1978 have profoundly reformed the Chinese economy. From agriculture to industry and banking, all sectors have been thoroughly changed: the foundations were laid first in the primary sector, with new land management and the creation of *township and village enterprises*, the closure of the collective farms (abolished in 1983), and partial liberalization of prices of agricultural products to create internal demand in rural areas. Immediately after this came changes to the banking system with the creation of four state banks: the Bank of China (BOC), the People's Bank of China for Industry and Commerce (PBOC), the China Construction Bank (CCOB) and the Agricultural Bank of China (SBC).

In 1979 China introduced laws to attract foreign investments in designated "special economic zones" (SEZ)[23] and launched its "one-child poli-

[20] L.H. Summers, *An Assessment of American Economic Thinking and Policy Towards China*, in *United States-China Relations*, 2, 23, 1995, pp. 1-8.

[21] Z. Brzezinski, *The Group of Two That Could Change the World*, in *Financial Times*, 13.1.2009; A. Kroeber, *Vast Gulf Ensures a G2-Dominated World Order is Kept at Bay*, *ibid.*, 2.6.2009; P. Nolan, *Is China Buying the World?*, Cambridge, 2012.

[22] Yu Hua, *La Cina in dieci parole*, Milan, 2012.

[23] R. Coase, N. Wang, *How China Became Capitalist*, New York, 2012, pp. 59-64.

cy" to control population growth. In 1980, China joined the World Bank, and state-owned companies were allowed to keep a share of their profits to finance investments and productivity bonuses. The BOC became the central bank in fact and in law. In 1985, the number of SEZs rose to 14, and internal migrants flocked to these areas along the Chinese coast where foreign companies paid much higher wages. In 1986 China applied to join GATT, the first step towards its subsequent entry of the WTO.

Concerns in the Chinese Communist Party (CCP) and in society in general became more acute among those worried about the changes taking place and those who wanted to accelerate change. These tensions culminated dramatically in government repression of the Tienanmen Square protests, when around a thousand protesters were killed and about 30,000 arrested.

Deng, the architect of the reforms, ordered the shift to repression out of concern for social stability. The CCP General Secretary, riformist Zhao Zyiang (a supporter of President Hu Yaobang, who was disgraced in 1987 and replaced by the more conservative Li Peng, then died suddenly in April 1989), was discharged and replaced by Jiang Zemin, the Mayor of Shanghai. In 1993, Jiang also became President of the People's Republic of China and remained in office for ten years. He was actually in power for a total of fourteen or even sixteen years (since he continued to serve as Chairman of the Party's powerful Central Military Commission for two more years).

The collapse of the USSR and the transition beginning in Eastern Europe dealt a hard blow to the conservative wing of the CCP, which remained hostile to the economic changes taking in place in China during the last fifteen years or so. Consequently, after just over two years of stagnation, Deng was finally able to relaunch his reforms in 1992 during his southern tour of China. In the following autumn the CCP Congress defined the course outlined by Deng as aiming to develop a "socialist market economy".

State-owned companies were the first to experience the new situation; 1993 saw the start of a radical restructuring policy that reduced the number of jobs in these companies from 76 to 50 million by 2000. At the same time, business legislation introduced different forms of ownership; in this way, the *state owned enterprises* (SOE) became public limited companies. The following year saw the first privatizations of the smaller SOE, which were sold firstly to employees and managers, but also to foreign investors. In the year Deng died, 1997, the CCP Congress decided to limit state intervention in the economy to certain strategic sectors (defence, communications, elettricity, petrol, aviation and railways).

In 2002, the year after China entered the WTO, the CCP recognized the role of the private sector in China's economy and allowed businessmen to join the Party. This involved changing the CCP statute, amending an article to state that the CCP represented "the vanguard of Chinese society" instead of "the vanguard of the working class", as in the previous text, which had remained unaltered since the Party's foundation in 1921. The new generation of leaders who rose to power in 2003, President Hu Jintao and Premier Wen Jiabao, completed reform of the SOEs, and concentrated on the 196 most important companies with the aim of creating around thirty internationally important groups. For this purpose, state owned companies were placed under the control of a new organization, the State Owned Assett Supervision and Administration Commission (SASAC).[24]

China appeared almost unaffected by the 2008-2009 crisis, and actually turned itself into one of the emerging economies driving world economic growth, also helped by the package of measures implemented by the Chinese government (worth 4 trillion RMB, i.e. over $586 billion). While developed economies saw their GDP fall, and the overall growth of the world economy remained extremely limited, China's GDP still grew at an impressive rate: 9.0% in 2008, 8.7 % in 2009, 9.9% in 2010, 8.8% in 2011 and 7.3% in 2012.[25]

On 30th April 2014 the first page of the *Financial Times* quoted a source close to the World Bank, which said that China would become the world's leading economy by the end of the year, ahead of even the most optimistic forecasts made just a couple of years before. China's official statistics agency expressed its reserves about the methodology used to draw these conclusions and commented – with a remarkable degree of understatement – that it "could not confirm these data as official statistics".[26] Nevertheless, world public opinion swung between highlighting concerns over the world economy's growing reliance on the Chinese economy and focussing on the old and new weaknesses of China's social and economic system. In the first case, it was pointed out that China had become the "workshop of the world", the same expression used to describe mid-18th century England, although a largershare of Chinese manufacturing output was produced for foreign companies and much was exported, providing a

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[24] B. Naughton, *The Transformation of the State Sector: Sasac, the Market Economy, and the New National Champions*, in B. Naughton, K.S. Tsai (eds.), *State Capitalism, Institutional Adaption, and the Chinese Miracle*, Cambridge, 2015, pp. 46-71.

[25] *http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN.*

[26] C. Gilles, *China Overtakes US as the Top Economic Power This Year*, in *Financial Times*, 30.4.2014; M. Wolf, *On the Top of the World*, *ibid.*, 3-4.5.2014.

growing trade surplus that was in part used by China's monetary authorities to buy US Treasury bonds; this was said to represent a kind of security investment for the Chinese, or to indicate a new element in US dependence. In the second case, attention was focused on China's excessive investments in fixed assets as opposed to consumption, its booming property investments that would sooner or later become a bubble, a higher public debt than was officially declared (due to the difficulties of estimating provincial and local government debt), higher unemployment than indicated by official figures, a largely incomplete liberalization process that penalized foreign investors, a financial system concealing dangerous weaknesses, and the growing level of debt among Chinese businesses.

China's economic growth rate began to fall; between late 2014 and early 2015 it dropped firstly below 8% and then below 7%. Despite government reassurances that these figures agreed with its forecasts, there were increasing concerns in the developed countries about the effects this slower growth might have on their own economies. At the same time, the slipping growth rate confirmed the opinions of those who saw a Chinese return to "normality", with a future of much lower growth rates, closer to the best performances of the developed countries led by the USA.

The country is still in the midst of extremely important and difficult changes. At the end of 2013 there was a new impulse towards the liberalization of China's economic system (the market no longer has a "fundamental" role, but has "a "decisive" role in the allocation of resources). Moreover, despite recognizing the SOEs guiding role, the Chinese government intends to strip them of the privileges they have enjoyed and of their access to economic and financial resources at fixed prices. The situation is not without its difficulties. During an annual session of the National People's Congress in March 2015, premier Li admitted that "deep problems with the country's economy are becoming increasingly evident".[27] The measures concerning the SOE were accompanied in summer 2015 by a considerable move towards convertibility of China's currency, the renminbi, allowing it to fluctuate in relation to market pressures and the actual state of the economy. This decision was applauded by the International Monetary Fund, but the consequent depreciation of the renminbi gave rise to worldwide concern. When the Shanghai stock exchange began to fall – and then to plummet – in July and August 2015, the effects on the world's other stock exchanges were immediate. Besides demonstrating increasingly deep-seated world integration – at least at the financial level – this also highlights the

[27] T. Branigan, *China Lowers Growth Target to 7% as It Fights 'Deep-seated' Economic Problems*, in *The Guardian*, 8.3.2015.

weakness of a stock exchange system buoyed up by the chronic insufficiency of supply in comparison with the demand for shares. At first the Chinese government preferred to let the market forces act, but was then compelled to intervene decisively to support the stock exchange by buying up shares worth $200 billion.[28] The question cannot evidently be limited just to the stock exchange. Stating a half-truth, "The stock market sell-off is not the problem," says Chinese economist, David Daukoi Lee, who continues, "The problem – not a huge one, but a problem nonetheless – is the Chinese economy itself. It requires corrective action from Chinese authorities – not surgery, but acupuncture".[29] The issue involves not only the reforms already implemented but even the credibility of a power that once seemed absolutely unassailable. At the same time, the severe battle against corruption that was launched several years ago is perhaps achieving some results at the political level, but has also partly slowed private enterprise.

Today, many wonder about the future of China, no longer seen as the new challenger to the USA; some even suggest the Chinese model may be nearing its end. They underline that China's present rulers have an even more difficult task than Deng, who had to deal with a poor and still partly preindustrial society, with no middle class, and extremely variegated media, which, although strictly controlled by the authorities, represented a new form of expression for Chinese society. Power was not concentrated in one single person, but in an articulated and complex structure that required efforts to achieve agreement. Perhaps the time is approaching when Chinese political power and society will have to find a new balance between more modest economic growth and the growing pressures from the relatively wealthier classes and also from those who are still relatively poor. As a McKinsey analyst wrote in 2016, the reality is that the Chinese economy now consists of "multiple subeconomies, each more than a trillion dollars in size. Some are booming, some declining. Some are globally competitive, others fit for the scrap heap".[30] This is perfectly consistent with the words of Justin Yifu Lin, ex-chief economist and former vice-president of the World Bank, who issued an invitation to "demystify the Chinese economy".[31]

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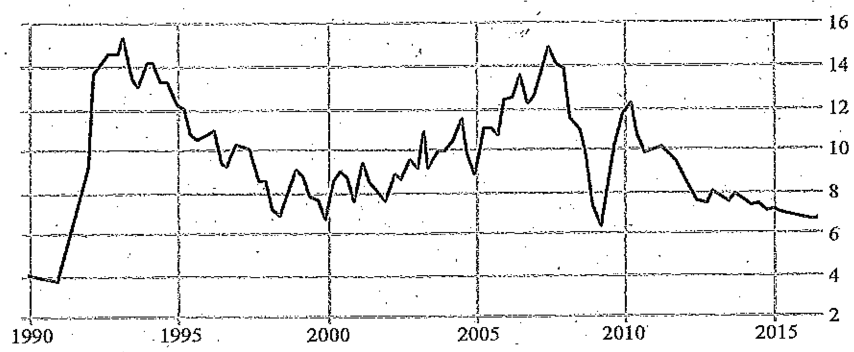
[28] *Stock Sell-off Highlights Beijing's Dilemma*, in *Financial Times*, 25.8.2015; J. Anderlini, *Credibility on the Line, ibid.*, 30.8.2015.

[29] D. Daokui Li, *China's Problem Is the Economy Itself, Not the Market sell-off*, in *Financial Times*, 31.8.2015.

[30] G. Orr, *What Might Happen in China in 2016?*, in *http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/what-might-happen-in-china-in-2016.*

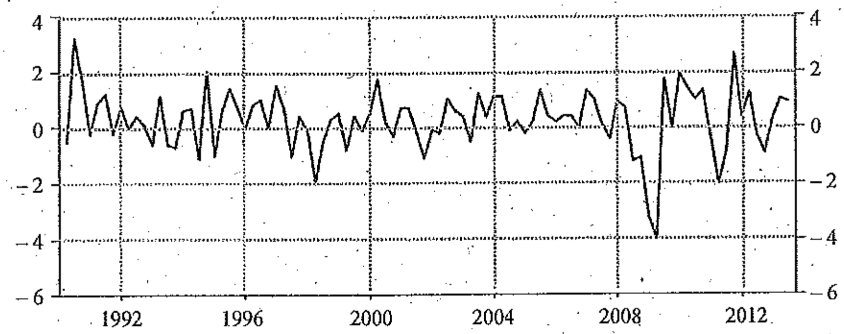
[31] J. Yifu Lin, *Demistifying the Chinese Economy*, Cambridge, Mass., 2012.

Figure 20.1. China GDP growth rate (1990-2016, %)



Source: www.tradingeconomics.com.

Figure 20.2. Japan GDP growth rate (1991-2013, %)



Source: *www.tradingeconomics.com.*

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