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FOOTNOTES

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ECONOMIC INFLUENCE IN CHINA'S RELATIONS WITH THE WEST

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In the Cold War years, the literature on China's development focused on two themes. One was that trade and more generally participation in the international marketplace is unlikely to be helpful for poor countries in search of economic development. A second was the notion that China's culture and social structure were inimical to development, that you cannot have substantial economic development in China without sweeping and dramatic changes in social structure and individual behavior. Both of these ideas were mistaken. Let us take a closer look at China's economic history.

MING PERIOD

In the Ming period (1368-1644), China and India were the largest economies in the world. This was because they had the largest number of people; per capita incomes across Asia and Europe were not very different. China became a very important factor in the world economy with the discovery of the New World, the shipment of silver out of Mexico and Peru, and the price revolution in Europe. It played a crucial role in these episodes, which is perhaps not widely recognized.

The silver mines in Peru are at a high altitude. It took weeks to move the silver from the mines down to the ports. But people were willing to incur the very high costs of carting silver over mountain tracks because traders in China were willing to pay much higher prices for the silver than the Europeans. Most of the silver that was shipped from Mexico through Manila, like the silver that went to Europe, ended up in Asia. Most of that ended up in China, where it fueled economic expansion. We can call this horizontal expansion of the economy. The economy grew, but income levels didn't necessarily change a great deal.

Prior to the development of large-scale silver imports in the late 16th century, the Ming currency system was extraordinarily confused. This had important implications for the Song period, earlier in Chinese history. Some Song enthusiasts beat the drums for the notion that development in that period reached a peak that was never replicated throughout China's imperial history in terms of market development, and even now we hear about high per capita incomes during the Song. But this confuses economic improvement with high levels of economic achievement. There's no question that there was a process of marketization and development of industries such as the iron industry during the Song era. But it is doubtful that income levels in Song were higher than in the mid to late Ching period.

The currency confusion in Ming sheds some backward light on what was going on in Song. The Ming currency was a disaster. In *Fountain of Fortune*, Richard von Glahn describes year by year, decade by decade the total ineptness of the Ming monetary authorities. They tried to create fiat currencies, then they issued too much and the currency was devalued. They tried to escape the consequences by ordering that taxes be paid only in their currency, which simply created a dual currency system where, when people had to pay taxes, they would buy this currency that no one would accept in the marketplace and hand it over as tax payment.

Under the Chinese imperial system, each dynasty wrote its own history. This was a record keeping culture. In later periods, new dynasties trained people for public administration by having them study the accomplishments of the previous dynasty. So the Ming administrators knew what the Song had done. Therefore the Song currency system cannot have been as well run as some people think. If it were, the Ming would have known about it. The chaos and confusion depicted in von Glahn's book would not have happened.

The Ming also included the remarkable Zhenghe nautical expeditions, which sailed past India, around the Horn of Africa, and up the far side of Africa. Why did the Chinese abandon this? There were a series of expeditions and then they stopped. The reason tells us something important about the Chinese economy. These Zhenghe expeditions, it seems, were a project that was

carried out by a single emperor who was interested in the idea of maritime expedition. After he died, successive emperors weren't interested in this, because although China participated in maritime trade, the maritime sector simply wasn't that important to them. Yes, one emperor may say, "This is an interesting project, let's fund it." But comparing this behavior with the behavior of the European monarchs and their attitude toward maritime trade, and the importance that they attached to maritime issues, one sees a very large difference. China was to a substantial degree an interior, non-maritime polity. This reality persisted for a long time.

QING PERIOD

In the Qing period (1644-1912), the conventional history of the 19th century is of the Canton trade, with the balance of trade favoring the Chinese and with silver as a result flowing into China, as U.S. currency flows into China nowadays. Then the British discovered a good market for opium in China. They shipped opium from India and the trade balance reversed. This set off events that led to the Opium War. The Qing court discovered that currency outflow, which disturbed them, because just as currency inflow leading to upward pressure on prices lubricates economic expansion, currency outflow, leading to a reduction in money supply and a downward pressure on prices, creates economic problems. Therefore Commissioner Lin is sent to Canton to extirpate the opium trade, not because the court was concerned with the social evils surrounding opium, but because the court wanted to stop the outflow of silver.

Commissioner Lin did his job, the largely British traders complained to their government that their property had been confiscated and their businesses destroyed, their government responded with military pressure, leading to the Opium War and to the long history of unequal treaties.

On the political side, from the Chinese perspective, this history is unfortunate because the system of unequal treaties as we know infringed upon China's political sovereignty. But in *Opium, Empire and the Global Political Economy: A Study of the Asian Opium Trade (1999)*, Carl Trocki concludes that unfortunately, most of the literature on opium is written from the missionary perspective, emphasizing the moral horrors and moral turpitude associated with drug addiction.

Opium probably had no large effect on the Chinese economy. Most Chinese couldn't afford to become addicted to opium. Opium addition was the province of rich people, who had either a lot of wealth they could dissipate or relatives who could pay for their opium. Most of the opium sold in China was heavily adulterated. Opium in small quantities has the effect of coffee--it's a stimulant. In many cases, working men used opium the way our society uses coffee or liquor. Indeed, the overall economic impact of opium is probably not dissimilar from the impact of alcohol on the American economy. In many American cities one can go downtown on Sunday morning and see people lying in the gutter because of alcohol, just as Chinese addicts did because of opium. But if one was writing a 50-page paper on the American economy, very little space would be devoted to alcohol. The same with opium in 19th century China's economy.

Other effects of the unequal treaty system included essentially imposing a free trade regime on China. China was required to allow more or less unlimited trade in all kinds of commodities, then later on as the treaty provisions expanded, it was obliged to allow foreign investment as well as foreign trade. The result was not enormous--foreign trade was not a large component of the Chinese economy at this time, which was large and mainly away from the coast. But new technologies arrived in China--the railroad, the telegraph--along with new administrative technologies and new forms of organizing financial institutions. The Chinese were very quick to take advantage of these opportunities. For example, the first commercial steamship in inland waters in China was partly owned by Chinese. The Chinese were quick to adopt both new commodities and organizational innovations.

One consequence of China's opening in the 19th century was price integration. By the end of the 1880s, the price of rice, for example, in Shanghai was linked to the price of rice all up and down the Yangtze River Valley and to the international price. This represents a substantial impact on the economy because it means that throughout in the Yangtze River area, a large fraction of the Chinese population, people who grew, ate, or traded in rice, or conducted business with anyone who did any of those things, was tied into the international economy. Shifts in the price of rice outside China would reverberate inside China and vice versa.

There was also an impact on income distribution, which is difficult to see. We don't have a firm quantitative grasp of growth or income level trends in the Chinese economy in the 19th century, but we can confidently predict an impact on income distribution something like this: What kind of commodities was China able to sell into the international market under this forced free trade regime? Commodities that were low in price from the outside perspective. These tended to require a great deal of labor—e.g., tea and silk, when one thinks of the manufacture and collection of these products and their shipment to the port cities. So this trade represented an increased demand for labor on the Chinese side. This must have been beneficial to China, whose main asset is labor--people at the lower end of the income scale. The effect was likely to shift the production structure of the economy in a modest way in the labor-using direction.

Although we don't know exactly what did happen in China's economy in the second half of the 19th century, we know some things that didn't. There was no groundswell of change in the direction of modernization or industrial revolution. If China had a long history of scientific and technological accomplishment, why didn't the first Industrial Revolution take place there? Because the Industrial Revolution was an epochal event that took place under special circumstances. It happened in Great Britain, and once it happened there, everything changed for the rest of the world.

Once there was an Industrial Revolution, why did it take so long to get to China? And why did it take longer to get to China than it took to get to Japan, where historians equipped with hindsight claim to detect a fundamental shift before the end of the 19th century? Pretty strong magnification is needed to say that Japan had begun modern economic growth by 1895, which is what the leading authorities on the subject say. But still, there's no question that the Industrial Revolution and dynamic push toward "modernization" took place in Japan earlier than in China.

This is problematic, but I believe China's culture and social structure are not antithetical but are actually conducive to growth. Its recent experience of hyper-rapid growth is probably not transferable. One reason for this is that there are elements in traditional Chinese culture and society that generate levels of entrepreneurship that don't exist in other poor countries. But if Chinese society is so conducive to growth, if the Chinese economy was in the starting block in 1978 and it only took a little bit of reform to initiate explosive growth, why not in the 19th century?

Economists are enthusiastic about institutional explanations of growth and stagnation just now, and I've been considering ideas about property rights and the difference between the structure of property rights in China, in China in the 19th century, and in Europe around the time of the Industrial Revolution. But there are much simpler possible explanations. One is the matter of size.

The Toyota Automotive Company had its origins when a man named Toyoda, a village craftsman, made silk looms for village women to weave silk cloth. He happened to wander into an industrial exhibition in one of the Japanese treaty ports. Japan had unequal treaties, the same regime that was imposed on China. He saw the latest French and German textile machinery and thought "I can make this." He proceeded to do so. His equipment initially found no market. However, once he was widowed or divorced and then remarried, the second Mrs. Toyoda turned out to be a business type. With him doing the engineering and her doing the business, they prospered. The Toyoda Automatic Loom became well known as Japan's first big invention. Toyoda sent his son to study engineering in Germany. Toyoda Sr. had a clear plan: "I made the Automatic Loom, you will move into the automotive industry." And we all know what happened.

What proportion of the Japanese population lived within one day's walk of a treaty port, say, in 1910? What proportion of the Chinese population did? There's an enormous difference. If Toyoda had wandered into some other place rather than this industrial exhibition, today's popularization of Toyota management systems might never have occurred. Most Chinese never had much chance to find out about foreign innovations because they lived in places where they never encountered such things, simply because China is big and the maritime dimension is not very large.

Second, there is an institutional explanation for China's delayed progress. The late economic historian Alexander Gershenkron wrote an important book on *Economic Backwardness in Historical Perspective*. His idea was that once the Industrial Revolution existed and Great Britain was powering ahead dynamically, in order to get the follower countries moving required some extraordinary measure. He said it takes more than a string of stagecoaches to make a railroad. In most circumstances, these extraordinary measures come from government.

In China, the government simply didn't have many resources. The contrast with Japan is enormous. At the end of the Tokugawa period, the feudal dues--the revenue paid to the Japanese *han*--was calculated at approximately 25 percent of GDP. In China around 1900, the central government's revenue was calculated at approximately 2 percent of GDP. This did not change until the establishment of the PRC. Through the Nanjing period in the 1920s-30s, government revenue as a proportion of GDP was way under 10 percent. In Japan, the Meiji inherited an economy in which 25 percent of GDP was concentrated in a small number of locations--the headquarters of the former Tokugawa *han.* They used some of these revenues to pay off the samurai, some for administration, and ended up spending about 5 percent of GDP on development projects, many of which failed as they always do. The Japanese government was able to expend more specifically on economic development projects than China's government could for all purposes--public administration, defense, etc.

So neither in the 19th century nor in the first half of the 20th was the Chinese government ever in a position to create the sort of effort that the Meiji did in Japan to considerable effect. Therefore we can understand why China's economy was not able to respond as rapidly as Japan's without getting into cultural explanations.

REPUBLICAN PERIOD

In China's republican period, there was modest but definite growth both of total output and of output per person. It's a period of considerable foreign investment, both direct and through portfolio acquisitions (for instance, via railroad bonds). The biggest changes in the Chinese economy came in unexpected places in this period. One was transportation, where you had extension of the telegraph and railroads, which made a huge difference. Before the railroad, it took 40 days to travel from Beijing in north to Wuhan, the big river port in the central Yangtze area. If a Wuhan-based merchant received a message, "Price of rice high in Beijing," that information was already 40 days old. By the time the merchant could deliver rice to Beijing, it was already day 80 after the initial episode of high Beijing rice prices. By the time the message returned to Wuhan, "rice shipment sold for 2000 yuan," 120 days had passed. Once the railroad is built, with the telegraph, the "high price" message arrives on day 1, and by day 3-4 the rice shipment can arrive in Beijing. It's easy to imagine the stimulative impact of that kind of reduction in communication costs on trade.

The other sector in which there's dramatic change in China's economy prior to WWII is the monetary sector, where you have private Chinese banks, operating under a system of "free banking" with no government regulation, issuing bank notes with no

official support (a similar system operated in colonial Hong Kong). Amazingly, these banks persuaded the public to use their notes rather than silver currency, even though the only backing for them was the "faith and credit" of the banks themselves. Under this arrangement, if I was holding Bank of China banknotes and Bank of China went bankrupt, those banknotes were good only as wallpaper. But nonetheless, during the 1920s-30s, there was a big shift from metallic to paper currency, and this again has hugely beneficial effects on trade because it cuts transaction costs.

If you think about the weight of silver and the need to carry trunks full of silver dollars, the benefits become evident. I once asked my Chinese history professor, the late Knight Biggerstaff, who was a student in China in the 1920s, how he managed money. He said that when he traveled--and he was a poor student--he had a chest full of silver dollars and a servant whose job it was to carry and guard this chest. Talk about advertisements for burglars and thieves! Think about a business operator trying to conduct large-scale trade with cart loads of silver dollars and then employing gangs of thugs to protect the silver dollars. What if the thugs decide that their wages aren't sufficient and turn on their employer rather than on the would-be robbers?

During the Depression, President Roosevelt raised the price of silver as a sop to the western U.S. mining states. This contributed to a huge outflow of silver from China for two reasons. First was to take advantage of the high prices offered in the U.S. (note that Roosevelt had no thought of wrecking the Chinese monetary system, only of domestic politics, just as when our current and potential leaders today talk about forcing changes in the Chinese monetary system they are playing domestic politics with no thought or understanding of the international consequences that such policies might unleash).

Second, the Japanese were conducting economic warfare against China by smuggling silver out of the country in the hope of destabilizing the Chinese economy. But these Chinese banks were so successful in persuading people to hold and do business with banknotes rather than silver that the Chinese money supply did not decline, despite massive outflows of silver. Furthermore, because there was no monetary contraction, the impact of the world Depression on China was very shallow.

TAIWAN

After 1949 the ROC moved to Taiwan and established its headquarters there. Taiwan, like everyone else in the post-WWII period, thought that in order to build the economy, it should not rely on international trade because that wouldn't work. They looked at the experience of the Soviet Union prior to WWII and also at the Depression, when all the big trading countries closed their doors to trade, which promptly collapsed. So Taiwan started upon the path of self-reliant development everyone else was doing at the time. India and China did it--this was not just socialists or communists. Everybody had this mistaken idea.

But then in the late 1950s a group of academics, professors of economics, persuaded the Taiwan government to try a new development path. Let the exporters export; don't manipulate the currency exchange rate against them. Let's see if participation in the international economy can help us grow. One of the perpetrators was a man named Ta-chung Liu, who happened to be one of my undergraduate teachers. This initiative was an enormous success. As a result of Taiwan's rapid growth starting in the late 1950s, this idea of taking advantage of rather than resisting globalization spread across Asia, most recently to China, with enormously beneficial results for hundreds of millions of people.

REFORM ERA

The economic boom in China over the last thirty years is a major event in global economic history. It is not just that China has grown a lot over these years, or that it has grown faster over those years than even Japan grew in its high-growth period. This is a major event in global economic history. For example, if we think in terms of poverty alleviation, taking the World Bank's dollar-a-day absolute poverty standard as a norm, more people have escaped poverty faster during China's reform era than on any other occasion in human history. This is true whether we're talking about headcount, the numbers of people, or if we're counting a portion of the population. If we think about the factors that various historians have adduced as the main driving force in the Industrial Revolution in Great Britain--culture, technology, nutrition, institutional change, international trade growth--every one of those factors is present in China over the last thirty years and on an enormous scale.

To conclude by considering the impact of China's growth on global power shifts and on the potential future of U.S. foreign policy, the result of China's great boom is an enormous shift in the relative power of China in the economic, technological, diplomatic and security areas. The Chinese are well aware of this. Think of the 19th-century Japanese slogan *fukoku kyohei* (enrich the country and strengthen the army); the same idea undergirds the Chinese "self-strengthening" movement in the late 19th century as well as the PRC's "Four Modernizations" slogan around 1980 (the four elements included industry, agriculture, science and defense). If we ask, "does China's economic growth mean that Beijing will expand its military?" the obvious answer is an unqualified yes. It's part of the plan and has been for at least 125 years.

We know historically that when one nation experiences a rapid increase in its relative strength, other nations adjust. These adjustments can be peaceful, as occurred in the case of Japan during the second half of the 20th century and the U.S. in the 19th-20th centuries, or they can be anything but peaceful. Think about the circumstances surrounding the rise of Germany and Japan in the century ending in 1945. So a very important question for our political leaders among others to consider is how this is going to work out in the case of China. Will the inevitable adjustment be a smooth or violent? Because China's polity depends on economic growth for stability and legitimacy, and because its economic growth is deeply linked to the global economy and will be even more so going forward, the inclination of Chinese policymakers should be to cooperate

internationally, even if they are building a strong military, and clearly under some circumstances they will be willing to use it.

Faced with frictions and difficulties, it's been true in the recent past and is likely to continue to be true going forward that their first thought will be of cooperation rather than conflict as a means to resolve difficulties. This creates opportunities for leaders of China's trade and diplomatic partners, especially the U.S., of which I do not believe we have taken full advantage to date. Both the Clinton and Bush administrations have lacked an identifiable Asia policy. They react to developments in Asia like a fire department. If a bell goes off in the Far East, they slide down the pole and drive out and do something about it. When tension subsides, they return to business as usual--i.e. focusing mainly on events in Europe and the Middle East. I see no framework, no clear sense of long-term priorities and objectives. We can hope that whoever assumes elective office in the White House next year will decide that it's a good idea to change this dangerous state of affairs.

Thomas Rawski, professor of economics and history at University of Pittsburgh, is co-editor of two recent books:* China's Rise and the Balance of Influence in Asia *(University of Pittsburgh Press, 2007) and* China's Great Economic Transformation *(Cambridge University Press, 2008). ***This essay is based on his presentation at the FPRI Wachman Center's March 1-2, 2008 history institute on China's Encounter with the West, held at and co-sponsored by the University of Tennessee at Chattanooga Asia Program. See www.fpri.org for videocasts and texts of lectures. Core history institute support is provided by The Annenberg Foundation; additional support for specific programs is provided by W.W. Keen Butcher, Bruce H. Hooper, John M. Templeton, Jr., the Lynde and Harry Bradley Foundation and the Ewing Marion Kauffman Foundation. The next history weekend is Teaching the History of Innovation (Kansas City, MO, October 18-19).***

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