



Hans Hækkerup

中國

# The Return of CHINA Globalization and Economic Power

Royal Danish Defence College Publishing House

# THE RETURN OF CHINA

## GLOBALIZATION AND ECONOMIC POWER

Hans Hækkerup

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The Return of China - Globalization and Economic Power

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Mr. Hækkerup was appointed Chairman of the Danish Defence Commission of 2008. He was born on December 3, 1945 in Copenhagen, Denmark. He is married to Susanne, with whom he has two sons. He has three sons from a previous marriage.

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## **Contents**

Foreword .....	6
China is back.....	7
The economic miracle.....	7
Deng Xiaoping laid the foundations of the modern Chinese economy .....	12
An integrated part of the world economy .....	13
Is there a risk of a trade war between the US and China?.....	15
Where China's economic influence leads, its political might will follow.....	16
Two strong horses and a weak donkey .....	17
But can the high growth continue? .....	20
Is a revaluation of the Chinese yuan really the answer?.....	22
Can growth continue at its present rate? .....	23
Limits to growth? The reform process must continue .....	24
The demographic factor.....	25
Will the Chinese grow old before they grow rich? .....	26
Oil for the lamps of China .....	28
Energy efficiency .....	31
Coal is still ruling China's energy supply, but oil imports are growing fast .....	32
The CO <sub>2</sub> -breathing dragon .....	34
Social stability .....	36
A widening gap between rich and poor, east and west, and rural and urban areas .....	38
Civil unrest is growing.....	38
Conclusion: the return of China .....	39
List of literature .....	41
List of abbreviations .....	44

## **Foreword**

Over the course of the past 30 years we have witnessed the return of China as an economic superpower. The present global economic crisis has only underscored this point. Furthermore, it is important to note that the economic return of China would not have been possible without the globalization of world trade.

This study will discuss whether continued high growth in China is possible and what implications it will have for the world economy and for China's position in the world.

The basic factors – an abundance of migrant workers and the high savings ratio – are still in place, but there are also limits to growth.

Will the Chinese become old before they get rich? And will we see the Chinese in the cities in the East and on the coast live in relative prosperity while the big majority is still relatively poor?

And what will it mean for the stability of the political system in China?

Hans Hækkerup  
Copenhagen, November 2009

## China is back

As the Chinese are well aware, and Westerners astonishingly ignorant about, China has been a global economic power for eighteen of the past twenty centuries. From 1820 to 1976, the story has been about China's stagnation and fall. In the past thirty years it has been about China's revival.

Table 1

<b>The long view: Comparison between major countries share of world GDP from 1820 to 2005 (PPP)</b>				
	1820	1913	1950	2005
China	33%	9%	5%	15%
India	16%	7%	4%	6%
Japan	3%	3%	3%	7%
Europe	24%	34%	26%	21%
USA	2%	19%	27%	20%

*Note: In December 2007 the World Bank updated its survey of the World economics using the PPP method showing lower values for the Chinese and the Indian economy. This is not reflected in this table using the old PPP method.*

*Source: World Bank February 2008: 1*

*Source: Joseph Quinlan 2007; Angus Maddison in: Wutke (2006: 10).*

The aim of this paper is to examine to what extent China already is an economic superpower<sup>1</sup> and to identify where it still lags behind the USA, the EU and Japan.

## The economic miracle

Since 1979 China has experienced the most formidable economic growth in history.

China's GDP is now the third and will soon be the second largest in the world (after USA), accounting for 5.9% of global GDP in 2007 at market exchange rates. The US share of world output is 25.2%.<sup>2</sup>

1) We here define a superpower as one that has "broad-spectrum capabilities exercised across the whole of the international system" (Buzan and Wæver 2003: 34). An economic superpower has the economic capability of a superpower without taking military or other capabilities into account.

2) World Development Indicators Database.

**Box 1**

**PPP or market exchange rates?**

*Purchasing power parities (PPPs) compares the costs in different currencies of a fixed, wide-ranging basket of goods and services, including items that are traded and not traded on international markets. Adjusting GDP for PPP provides a more reliable measure of the physical economy, including the amount of infrastructure and industrial activity, and standards of living. It is also a better explanatory variable for energy demand than simple measures of income. However, the use of PPP is not without problems, one being that people and business consume different baskets of goods and services in different countries. For assessing the impact of economic developments in one country on another, actual market exchange rates provide a better basis. This is because international effects result from the international exchange of goods, services and assets – the price of which tend not to vary much across countries.*

*Source: IEA 2007*

Thus, 8.6% growth in China is equivalent to 2% of US growth at market exchange rates.<sup>3</sup>

Measured as purchasing power (PPP), China is number two, accounting for 9.4% of the global economy. The US is still the number one economy in the world with 17%. Japan is third with 5% and India is the 4<sup>th</sup> largest with 4% of the world total. If the EU is seen as one entity, it is the biggest in both market exchange rates and in PPP.<sup>4</sup>

**Box 2**

**Comparison of China with Japan and the small tigers**

*Per capita growth rates above 6 percent are very rare in economic history. Japan achieved them during 1955 to 1973, and Korea, Taiwan and Thailand did during 1982 to 1996, before they were stricken by the Asian financial crisis. But no country in world history has sustained such high rates of per capita growth for as long as China has.*

*Source: Shirk 2007: 20*

A forecast made by the American investment bank Goldman Sachs in 2003 showed that by 2040 China could surpass the US as the country with the largest GDP in the world (exchange rate).<sup>5</sup> Since

3) World Development Indicators Database.

4) CIA World Factbook.

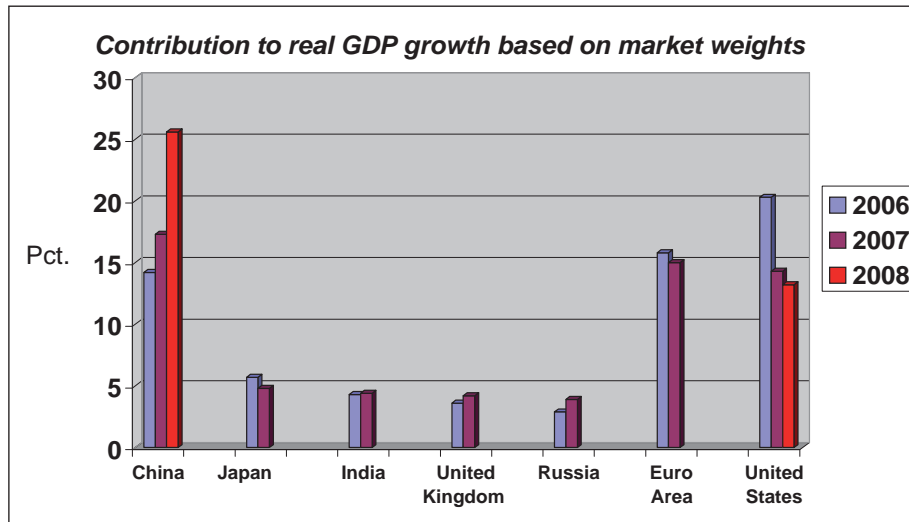
5) Goldman Sachs 2003: 3.

then, there have been several other forecasts. In 2008 PricewaterhouseCoopers estimated that China would surpass the US as early as 2025.<sup>6</sup>

Of course, 2025 is far away and one should be careful not to draw firm conclusions on the basis of such forecasts. And how important would it really be even if China did become the world's largest economy?

The overall size of a country's GDP gives an impression of its influence in the world economy, but it is equally important to look at its share of the growth in world GDP, and here China carries more weight than when considering total GDP.

Fig. 1



Source: IMF 2007: xi; World Development Indicators Database; IMF 2009a: 10

The US and the EU have traditionally accounted for much of the growth in world GDP, but this is gradually changing, and in 2007 China for the first time contributed more to world growth than the US.<sup>7</sup> In 2009, the EU and the US will both experience negative growth rates.<sup>8</sup> Thus, China and India are the two locomotives pulling the world economy forward in 2009. IMF forecasts that China's

6) PricewaterhouseCoopers 2006: 2.

7) IMF 2007: xi.

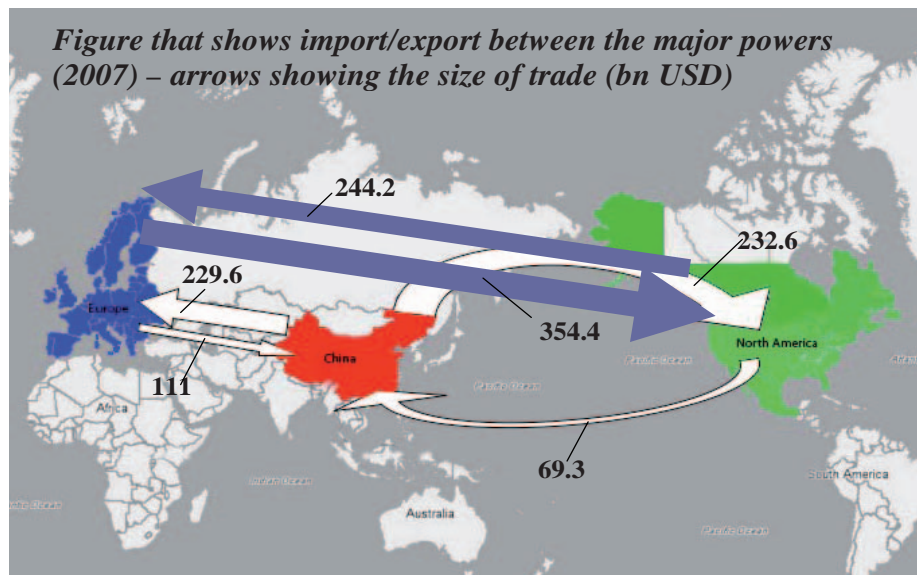
8) IMF 2009a: 10.

GDP in 2010 will grow with 9% and the US with 1.5%. Thus, China will also pull more than the US in 2010.<sup>9</sup>

Another measure of the economic influence of a country is its share of total world trade. China's imports and exports have increased 84-fold from only 20.6 billion USD in 1978 to 1.76 trillion in 2006, and China now accounts for close to 8% of world exports and about 6% of world imports.<sup>10</sup>

China's share of total world trade is thus 7.9%, still behind the US with 10.7% (WTO 2009: 15). China is the world's largest exporter, having recently overtaken Germany in June 2009 according to the World Trade Organization (WTO).<sup>11</sup>

Fig. 2



Source: US Census Bureau 2009; China Statistical Yearbook 2008: 717-720

To judge the impact of China properly as an economic locomotive, it is equally important to look at her share of growth in world trade, and here China clearly is ahead of the USA.

9) IMF 2009b: 2

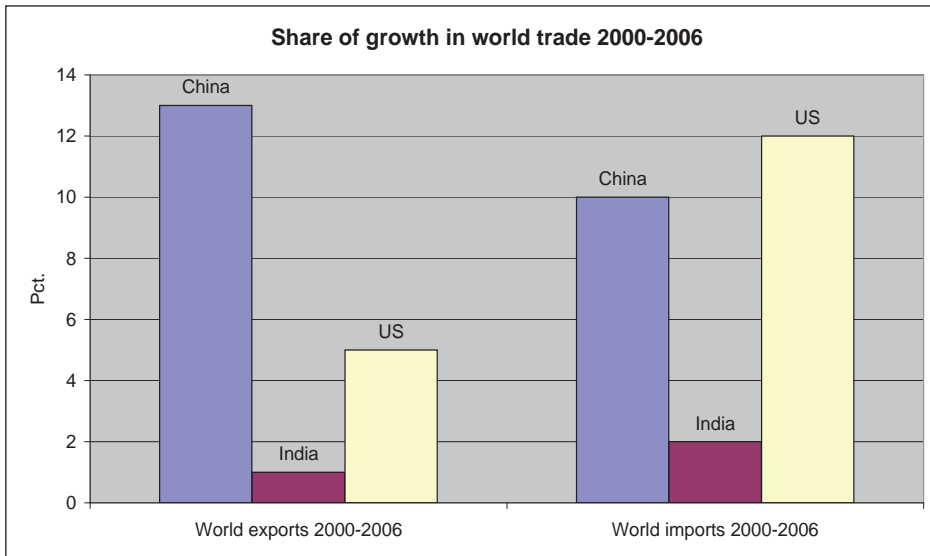
10) Ministry of Commerce in: China Daily (November 20, 2007).

11) People's Daily (August 26, 2009).

China accounted for 13% of the increase in world exports in goods and services and 10% of the increase in imports from 2000 to 2006, while the US contributed with 5% and 12% respectively.<sup>12</sup>

But even if China is speeding ahead when it comes to world trade and total GDP, it is still far behind the US, the EU and Japan when it comes to GDP per capita. In 2008 Chinese GDP per capita was 2,770 USD.<sup>13</sup> At the current growth rate it will be over 3,000 USD in 2010.

Fig. 3



Source: IEA 2007: 140-141

And as China moves up the value chain, it becomes more and more difficult to gain in productivity and achieve high growth rates.

Here technology comes in as the crucial factor. China has been very good at absorbing new technology and copying it – legally and illegally – and has overtaken the US as the world’s largest exporter of computers and other high-tech electronic products.<sup>14</sup>

12) IEA 2007: 140-1.

13) Xinhua (September 18, 2009).

14) Meri 2009: 1-2.

Foreign direct investment or FDI has been especially crucial in this respect, and the importance of these investments has been enormous for transfer of technology, even though it represents only a small share of total investments in China.

Also, a significant proportion of China's IT-exports comes from foreign invested companies or joint ventures.

Thus, China is able to compete with the US, Japan and Europe at the high-technology end but will still need transfer of technology.

### Box 3

#### ***China ahead of schedule***

*In 2002 the Communist Party Congress scheduled that China's GDP per capita would be 3,000 USD in 2020. That goal seems to be reached 10 years ahead of schedule, and the estimate for 2020 is now 6,000 USD per capita. But that would still be low compared with the GDP (2006) in the US (44,155 USD), Japan (34,023 USD) or the EU (33,493 USD)*

*Source: Xinhua (January 4, 2008)*

## **Deng Xiaoping laid the foundations of the modern Chinese economy**

If you ask the Chinese why the economic miracle happened, the quick answer is: Deng Xiaoping.

For the 28 years from 1978 until 2007 the average growth rate was 9.6%, and the growth rate was over 10% in the five years immediately preceding the global financial crisis.<sup>15</sup> And even if China's growth slowed down to 9% in 2008 and is estimated to be 8.4% in 2009, it has done better than any other major economy.<sup>16</sup>

This formidable growth has led some people to ask whether there is a special Chinese economic model and whether it is possible to export it to other parts of the world.

Of course not. Economic laws apply generally, but the special preconditions that have created this formidable economic growth in China at this time in history cannot be transferred to other countries in the world.

Officially China talks about 'a socialist economy with Chinese characteristics', but that is misleading. Rather, it could be characterized as 'a capitalist economy with socialist remnants and Chinese characteristics'.

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15) China Statistical Yearbook 2008: 37.

16) World Bank, Office Beijing (November 2009): 11.

Table 2

Main economic indicators							
	2004	2005	2006	2007	2008	2009	2010
Real GDP growth in %	10.1	10.4	11.6	11.9	9.8	9.2	8.7
Consumer prices in %	3.9	1.8	1.5	4.8	7.0	5.3	2.0
Current account balance (bn USD)	69	161	250	359	370	448	213
Foreign exchange reserves (bn USD)	610	819	1,066	1,528	1,998	2,476	...

*Note: The figures for 2009 and 2010 are projections.*

*Source: World Bank Office, Beijing, Quarterly Update, September 2009*

Nevertheless, it is reasonable to see Deng as the father of the economic miracle because he created the political framework that made it possible for market forces and the Chinese inclination for doing business to bloom.

Contrary to what Mao tried to convince the world of, the Chinese are not collectivists but individualists. It is the family that is the base of their society, and that builds upon a tradition of several thousand years of entrepreneurship, a tradition that also is recognizable among overseas Chinese.

## An integrated part of the world economy

China's economic rise would not have been possible without the globalization of world trade, which accelerated with China's accession to the WTO in 2001.

From China's perspective, globalization is a game it can win.<sup>17</sup>

China has become the workshop of the world, exporting manufactured goods and importing raw materials and fuel. Economic growth has been mainly driven by industry, which now accounts for nearly 50% of China's GDP.<sup>18</sup>

At the same time China has become a big consumer market in its own right.

Like Siamese twins, the Chinese and the US economies are dependent on each other: American companies produce cheap commodities in China for American consumers – often they don't have a choice. In this economic case it is out of area or out of business.

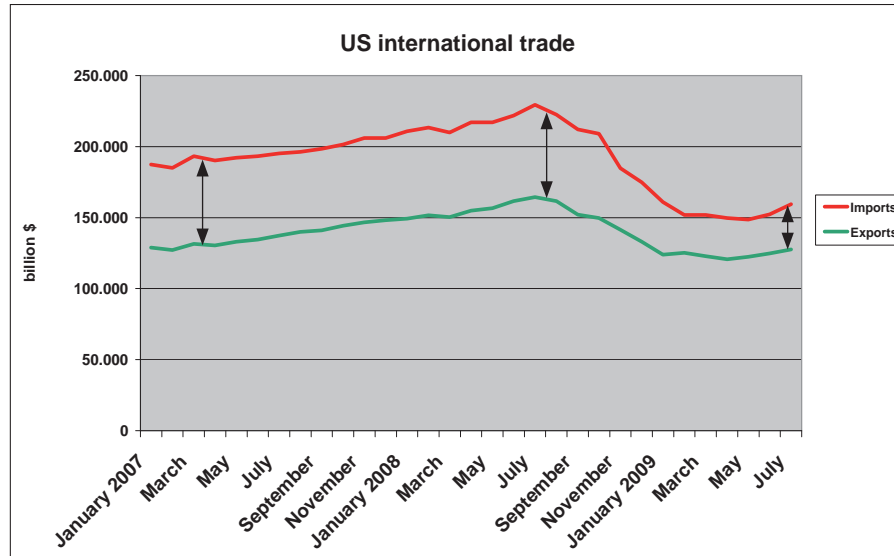
If the capital intensity of a form of production is less than 80-90% (or the labour intensity is greater than 10-20%), companies will move production to China.

17) Shirk 2007: 19.

18) Rosen and Houser 2007: 9.

The result of this economic interdependence has been a huge deficit in the US balance of payments in relation to China (268 billion USD in 2008 according to the US Commerce Department).<sup>19</sup>

Fig. 4



Source: US Census Bureau and US Bureau of Economic Analysis 2009: 1

This is part of a bigger picture: the US runs a deficit on its balance of payments with all its major trading partners. The overall US deficit was 677 billion USD in 2008.<sup>20</sup> This is only possible because the US dollar is the world's 'reserve currency'.

The economic crisis has led to an overall reduction in the US balance of payments deficit,<sup>21</sup> but its deficit with China has only been slightly reduced.<sup>22</sup>

China's foreign currency reserves are the biggest in the world (2.022 trillion USD by the end of June 2009).<sup>23</sup> China, Japan, South Korea and Taiwan finance the US deficit by buying American government

19) US Census Bureau 2009.

20) US Census Bureau 2009.

21) US Census Bureau and US Bureau of Economic Analysis 2009: 1.

22) US Census Bureau 2009.

23) Bloomberg News (July 10, 2009).

bonds. This is no problem as long as these countries are ready to finance the US debt. The day they won't, the US would be in big trouble – but so would they.

China has an interest in speaking up the security of the US economy because of the massive Chinese investments in US government bonds.

## **Is there a risk of a trade war between the US and China?**

In the US – and especially in the US Congress – it is common to blame China for the deficit in the balance of payments, the loss of blue collar jobs etc.

This line of reasoning ignores the fact that the real culprit is the US itself in consuming more than it can afford in the long run. Under a law of 1988, economic sanctions can be imposed on countries that manipulate their currencies.<sup>24</sup>

Even though the Chinese yuan is undervalued, in its half-yearly report in 2006 the US Treasury concluded that neither China nor any other major trading partner of the US met the requirements for designation as a manipulator of the US currency.<sup>25</sup>

Nevertheless, the Bush administration had a hard time trying to fend off legislation like the Schumer-Graham China Currency Bill, which aimed to place a surcharge of 27.5% on imports from China to neutralize the advantage of an undervalued currency. Such a surcharge would make Chinese exports to the US more expensive for American consumers and create new jobs, but contrary to the lawmaker's intentions, it would be very unlikely to do this in the US and more likely to do so elsewhere in Asia, thus cutting the US deficit with China, though the positive effect on the overall US deficit might be limited.

But this would only be the case if China did not take any countermeasures such as surcharges on American goods. If they were to, the impact on the US economy would be negative.

Another problem has emerged because China has started using part of its foreign currency surplus to buy US assets. There was some reaction when in 2005 Lenovo bought IBM's personal computing division,<sup>26</sup> but when, later that year, the Chinese oil company CNOOC made a bid to buy Unocal (the 9th biggest oil company in the US), the deal was stopped by Congress for 'national security reasons'.<sup>27</sup>

The Chinese government has set up a sovereign wealth fund, the China Investment Corp, with an initial 200 billion USD to manage. Two-thirds of the money is earmarked for domestic investment, but that still leaves a sizeable amount for outside investments.

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24) China Daily (December 20, 2007).

25) US Treasury Department 2006: 1-2.

26) People's Daily (March 10, 2005).

27) Congressional Research Service (September 15, 2005).

Another important area of contention between China on the one hand and the US and EU on the other is the protection of intellectual property rights or IPRs. If the US and Europe are to keep their position on top of the value chain, this is a decisive battle they have to fight. One can only stay on top if one has the edge in technology, design and organization.

### Where China's economic influence leads, its political might will follow

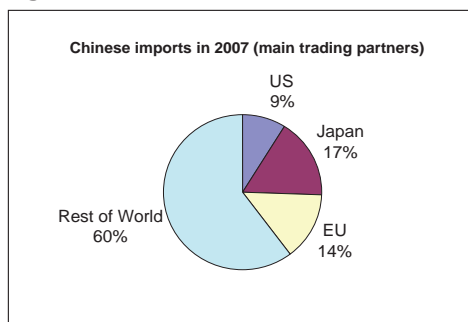
China's main trading partners are EU-25, the USA and Japan, who account for 60% of China's exports and 40% of its imports.

Nevertheless, China's booming economy has had big influence on economies in the rest of Asia as a locomotive, pulling the other countries behind it. The trade pattern is also very positive for the

Fig. 5



Fig. 6



Source: China Statistical Yearbook 2008: 717-720

Fig. 7



Source: CIA World Factbook

smaller Asian countries. China has been called 'the Robin Hood of Asia' because it runs big surpluses on its balance of payments with the US and the EU and a deficit with the rest of Asia.

For China membership of the WTO has been crucial for its integration into the world economy, but unfortunately negotiations on a further liberalization of world trade, commenced at Doha, Qatar, in November 2001, are stalled because of differences between the developed nations led by the EU, the US and Japan and the major developing countries led by India, Brazil, China and South Africa over subsidies for agriculture etc.

This has led to a surge in Free Trade Agreements (FTAs). China today has FTAs with ASEAN, Chile, Pakistan, New Zealand, Singapore and Peru, and is negotiating new FTAs with Australia, Iceland, Norway, Costa Rica, the Gulf Cooperation Council and the Southern African Customs Union. Under consideration are FTAs with India and South Korea.<sup>28</sup>

On the one hand the Chinese leadership is concerned about the halt in the general liberalization of world trade, while on the other hand bilateral FTAs fit well into traditional Chinese foreign policy thinking (divide-and-rule).

For the US it is crucial to integrate China into the US-designed economic system (Bretton Woods) of WTO, the International Monetary Fund (IMF) and the World Bank, rather than risk a parallel structure developing. The global financial crisis has made it even more evident, and many problems will be handled directly by the US and China.

## **Two strong horses and a weak donkey**

Investments, exports and consumption are the troika that pull along any economy.

In the case of China, investment and exports – the two strong horses – have been driving the economy, while consumption has been the weak donkey.

The main factor stimulating the economy has been investments in fixed assets. This high level of investments has been made possible by an extremely high savings ratio and a high level of foreign direct investments (FDI).

The other main factor has been exports. In many developing economies the balance of payments has been the obstacle to high growth rates, but China's formidable economic growth has been export-driven. With an annual increase of 49% in the period 2002-2007, the export sector has been pulling the rest of the economy behind it.<sup>29</sup>

Patents, scientific publications and funds for research and development have contributed to fast growth.

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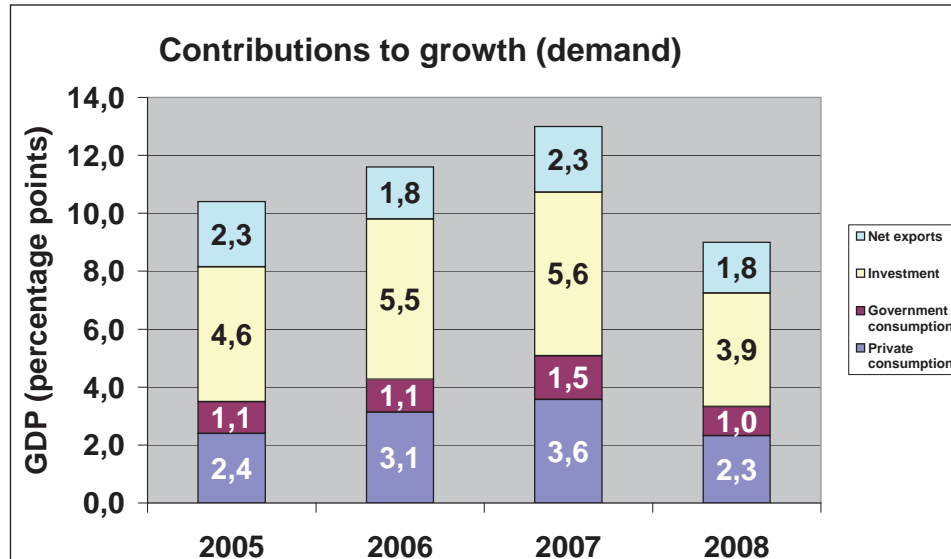
28) Ministry of Commerce 2009.

29) China Statistical Yearbook 2008: 708.

The weak link has been consumption. The share that final consumption contributed to GDP shrank from 65% in 2000 to 39% in 2007 (compared with an average of 70% across the world).<sup>30</sup>

In 2008, the 9.0% real growth in China's gross domestic product or GDP broke down into 3.3 percentage points driven by consumer spending (private and public), 3.9 from investments and 1.8 contributed by net exports.<sup>31</sup>

Fig. 8



Source: Asian Development Bank (March 2009): 162

The global economic crisis dramatically changed this. Exports fell to under 0% in the last quarter of 2008 and have not contributed much to growth in 2009. The stimulus plan (586 billion USD) and increased lending from banks has stimulated investments enough to offset the fall in exports, and the lazy donkey, namely consumption, has done reasonably well.

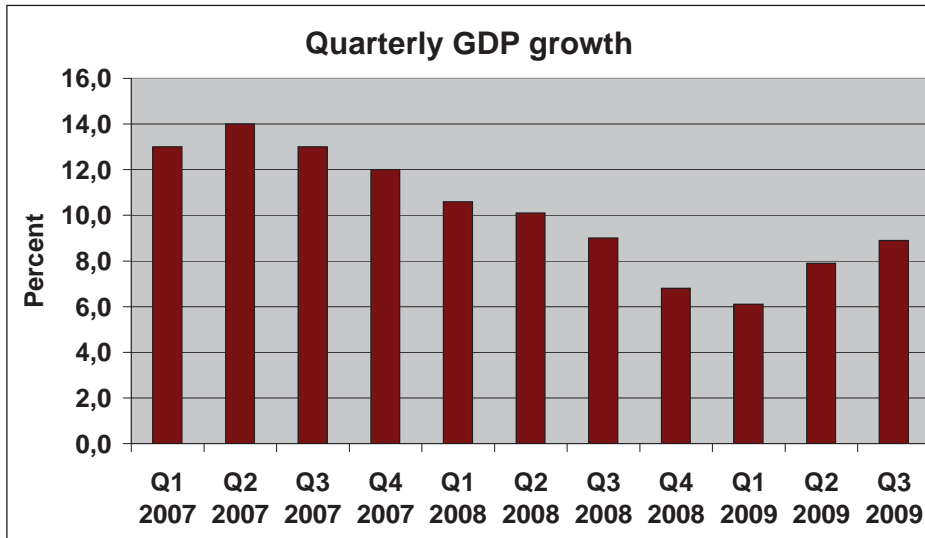
Thus Chinese GDP reached the bottom in the first quarter of 2009 with 6% growth from a year earlier and has picked up in the second and third quarter. Growth expanded 8.9% in the third quarter of this year.

30) China Statistical Yearbook 2008: 57.

31) Asian Development Bank (March 2009): 161.

In the international economy, the discussion is over whether the crisis will be V-shaped (quick recovery) or U-shaped (slow recovery) or possibly even W-shaped. In the case of China it looks more like a square root,  $\sqrt{\quad}$  (quick recovery to high, stable level).

Fig. 9



Source: Asian Development Bank (September 2009): 123; Asian Development Bank (March 2009): 161

Box 4

**Migrant workers and the hukou system**

The hukou system was set up in 1958 in order to control mass urbanization. It effectively divides the population in two – urban households and rural households.

As a migrant worker from the countryside you can work in the cities, but you – and your family members – have little access to social welfare in cities and are restricted from receiving public services such as education, medical care, housing, employment and from buying private property, regardless of how long you have lived and worked in the city.

Source: Rong Jiaojiao, China Daily, May 21, 2007.

## **But can the high growth continue?**

The basis for the high level of exports has been a huge supply of cheap labour. 150 million migrant workers have moved from the countryside to the cities, and in the coming years more will come. The planners are talking about 14 million per year, which is the biggest migration in history,<sup>32</sup> equivalent to 40,000 people every day.

They will ensure downward pressure on the wage levels of manual labour, and thus keep the price of goods manufactured in China very cheap.

But the household registration system, or *hukou*, has become an obstacle to the market economy.

While immigration from the countryside ensures an abundant supply of manual labour, this is not the case for more qualified employment. Although the universities will turn out 6.1 million graduates in 2009,<sup>33</sup> manpower that masters the English language, computer skills etc. is in scarce supply, and here competition drives up wages.

As China moves up the value chain, the wage-price spiral will also apply to the Chinese economy, but as long as the growth in productivity is greater than the rise in real wages, there will be downward pressure on wage levels in the global economy.

The other factor driving the economy is fixed asset investments in housing, infrastructure and factories. The share of fixed asset investment rose 28.8% year-on-year in the first quarter of 2009 after the stimulus package had made its impact.<sup>34</sup>

Especially important is foreign direct investment (FDI), which has grown from USD 63 billion in 2006 to 75 billion in 2007, and the figure for 2008 was 108.3 billion.<sup>35</sup> After the crisis, FDI fell to a lower level, but it has now again been rising for the first time since the crisis.<sup>36</sup>

Even if FDI only accounts for a small part of total investments, it is closely linked to the transfer of new technology. Half of FDI comes from overseas Chinese (Hong Kong, Taiwan, Singapore), one fifth from Japan and South Korea, and only one tenth each from the US and the EU. The high investment level in China is made possible by an extremely high savings ratio (50% in 2007).<sup>37</sup>

This is due to several factors, the most important being that state-owned enterprises and private companies reinvest all or nearly all of their profits, and only a minor part goes to the owners.

Another factor is that there is no social safety net in China. With the dismantling of the old economic system (called 'the iron rice bowl'), where one's workplace provided one's basic needs, very few people are now insured, and they must themselves pay for education, health services etc. Most

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32) IEA 2007: 243.

33) Chinese Academy of Social Sciences in New York Times (December 16, 2008)

34) Xinhua (April 16, 2009).

35) China Statistical Yearbook 2008: 707; China Daily (February 17, 2009)

36) China Daily (September 16, 2009).

37) People's Bank of china (March 24, 2009)



simply cannot pay. During the 1990s the savings ratio of personal disposable income has increased to 25% (compared with 1% in the US).

This is reinforced because China's booming economy is not creating enough new jobs, putting a downward pressure on wages and thus resulting in a falling wage ratio as a percentage of GNP. The other side of the high level of savings is that domestic consumption is still weak, even though more and more people are moving up into the middle class.

As long as the state-owned enterprises (SOEs) plough the surplus back in the enterprise as investments, it will be difficult to stimulate consumption in a sufficient manner. Nevertheless, Chinese consumption has been holding up very well during the crisis. A good example is that car sales in China went up by 90% year-on-year, which is remarkable during a crisis.<sup>38</sup>

If this development is to be continued a new stimulus package should include an improvement of the social security system, thus freeing money for consumption.

## **Is a revaluation of the Chinese yuan really the answer?**

A revaluation of the Chinese yuan (CNY) is one measure that has been widely discussed, and the US has taken it up again and again with the Chinese leadership. In Congress there has been considerable pressure for a tougher US policy.

But the truth is that a revaluation will only help reduce the US trade deficit with China to a limited extent. Exports to China will become less expensive and imports from China more expensive, but there is not much excess capacity in American manufacturing, and American companies long ago shifted to less labour-intensive production, so the effect will be limited.

Actually, the CNY was revalued by 2.1%<sup>39</sup> on 21 July 2005 and has since then appreciated by a further 15.5%. One USD is now worth 6.83 CNY (23 October 2009).<sup>40</sup>

Since the outbreak of the economic crisis, the CNY has been stable in relation to the USD. But the effect of this revaluation has not prevented the US deficit with China from sky-rocketing. Nevertheless, the Chinese leadership is very firm: they will not make a major revaluation of the yuan but rather let it appreciate gradually. It is a precondition for internal stability that China has high economic growth – at least 7% – which does not leave much room for daring experiments.

On the other hand, no revaluation will create a problem for China in the long run because it will create an imbalance in the world economy and will stimulate inflation.

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38) Financial Times (September 8, 2009).

39) 20/7-05: 8,289 CNY for a USD.

40) South China Morning Post (December 12, 2007).

## Can growth continue at its present rate?

There are no signs that the basic structures behind the high growth – cheap manual labour and the high savings ratio – will change over the next ten-fifteen years. But there might be other obstacles or limitations to growth that will slow down the Chinese economy.

Before the recent crisis, the world economy had two powerhouses: the USA and China. But the US has run out of steam and in 2007 it accounted for 14% of the growth in world GDP at market exchange rates, while China, with a GDP one fifth of America's, contributed more to global GDP growth at 17%.<sup>41</sup>

Table 3

Share of world growth (billion current USD, market prices)						
	2007	2008	Difference 2007-2008	Growth from 2007-2008	Difference 2008-2009 (projected)	Difference 2009-2010 (projected)
China	3,260	3,553	293	25.6%	231	284
U.S.	13,751	13,920	170	13.2%	-389	0
World	54,584	55,730	1,146	100%	-1,393	1,032

*Note: The figures for 2009 are projections.  
Real GDP growth in % for 2008 and 2009 are from IMF 2009b*

*Source: World Bank Office, Beijing, Quarterly Update, September 2009*

If we compare GDP growth based on PPP weights, China contributed even more, with 34% compared to a US contribution at 7% of world economic growth in 2007.<sup>42</sup>

The effect of the crisis on the Chinese economy has been limited, and China stands out as the strongest economic powerhouse, whether at market prices or PPP.

50% of world economic growth in 2007 at PPP came from the three emerging market economies of China, India and Russia.<sup>43</sup>

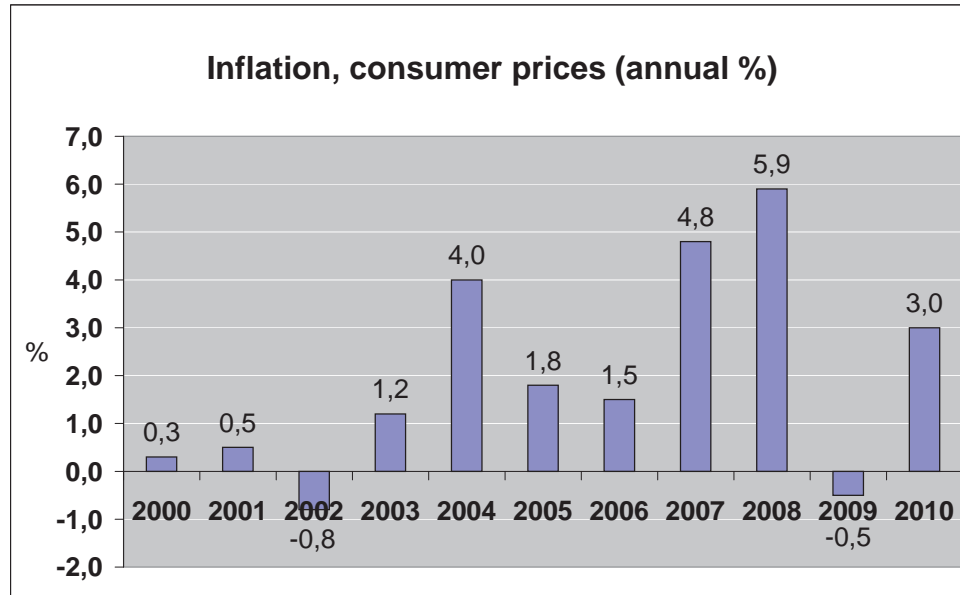
There was speculation that we could see a repetition of the Asian bubble in 1997 if the Chinese boom ended with a hard landing, followed by a collapse of the stock market and the banking system based on bad loans and inflated property prices.

41) IMF 2007: xi.

42) IMF 2007: xi.

43) IMF 2007: xi.

Fig. 10



Source: World Development Indicators Database. Projected figures from 2009 and 2010 are from Asian Development Bank (September 2009): 126

It seems that the Chinese leadership had learned from 1997. They have tried to consolidate the banking sector by reducing the burden of bad loans, and they have put forward the most ambitious stimulus package, worth 4 trillion CNY (385 billion USD) over two years.<sup>44</sup>

One of the major concerns for the Chinese leadership is the revival of inflation, but consumer prices are still falling. CPI fell 1.2% in August 2009 from a year earlier.<sup>45</sup>

### Limits to growth? The reform process must continue

One of the preconditions for continued high growth is that economic reforms are speeded up.

The banking sector and the housing market are still in need of institutional reform.

44) China Daily (September 11, 2009a).

45) China Daily (September 11, 2009b).

Many SOEs have been financed by the state bank sector but in recent years the government has been putting great amounts of money into the banking sector to get rid of these bad loans.

But the fact that the Chinese banking sector has been handling the financial crisis so well and that it has been an advantage to have a big state sector may halt necessary reforms. There are 119,000 state-owned enterprises in China with total sales revenues of 18 trillion CNY in 2007 and profits of 1.62 trillion yuan (222 billion USD).<sup>46</sup>

Almost all the top domestic corporations in China are owned by the state, from automobiles, power generation, aviation and telecommunications to oil and gas. The 152 most important SOEs are directly under the State Council watchdog, the Asset Supervision and Administration Commission. The government is also the ultimate controlling shareholder of such offshore-listed companies as PetroChina, China Mobile and China Southern Airlines. These SOEs employ 75 million people. CNPC alone has 1½ million employees and Sinopec 1 million. This direct control naturally gives the Chinese government a lot of leverage in negotiations with other countries.

Extremely important also is the protection of private property. In 1998, China amended the constitution to fully recognize private ownership and private enterprise, while insisting that state ownership would remain the dominant form of ownership: 'Individual, private and other non-public economies are major components of the socialist market economy, and the State protect the lawful rights and interests of individual and private economies'. In March 2007 the country's first private property law was passed after long discussions and factional infighting in the Communist Party. It offers urban property-owners protection against arbitrary seizure. This will lead to a reform of the judiciary.

China has adopted a new law on arbitration in rural land disputes but as long as farmers are not allowed to sell their land, productivity will remain low in the agricultural sector.<sup>47</sup>

Technology is also the key to continued economic growth. 60% of China's exports are made by foreign invested firms that want their IPRs (intellectual property rights) protected. As China moves up the value chain, the demand for better protection will grow also from Chinese producers as seen during the Olympics where the national protection of trademarks worked pretty well.

## **The demographic factor**

With 1.338 billion people in July 2009, China has the largest population in the world, accounting for one-fifth of the global population. This compares with 307 million US citizens (factor 4.4) and 5.5 billion Danes (factor 243).<sup>48</sup>

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46) Xinhua (January 23, 2008).

47) Xinhua (June 27, 2009); Guardian (July 4, 2009).

48) CIA World Factbook.

Every four seconds a new Chinese person is born (and every nine seconds one dies).

The authorities claim that the one-child policy has resulted in 400 million fewer Chinese than there would otherwise have been, and the policy is expected to continue being enforced although with more flexibility. The explanation for this is simple: China has 7% of the world's arable land and 20% of the world's population, and the Chinese leadership wants to have self-sufficiency when it comes to agricultural products, and especially grain (traditionally the grain surplus was the Emperors' most important tool in controlling China).

Actually, a Chinese woman has on average 1.8 children (almost the same as in Denmark), well below the replacement rate.<sup>49</sup>

In 2030 China's population is expected to peak at 1.500 million inhabitants.<sup>50</sup> India is expected to overtake China as the World's most populous country soon after 2030.<sup>51</sup>

A serious problem for China is the sex-ratio, with 117 newborn boys for 100 girls. This means that 17% of men will not be able to find a wife in the future (unless they import a wife from a neighbouring country). Three hundred million Chinese will move from rural to urban areas in the next fifteen to thirty years. That is the same as the entire current population of the US.<sup>52</sup>

## **Will the Chinese grow old before they grow rich?**

It is generally assumed that a fast growing work force with a rate of high labour market participation is essential for rapid economic growth. While this is still the case for China, it will gradually change in the years until 2030.

### **Box 5**

#### ***Age dependency Ratio***

*The age dependency is the ratio of dependents – people younger than 15 or older than 64 – to the working age population – those aged 15-64. For example 0.7 means there are 7 dependents for every 10 working-age people.*

*Note: The Chinese dependency ratio in fig. 12 does not equal the regular one because the retirement age in China is 60 years.*

49) CIA World Factbook.

50) IEA 2007: 243.

51) IEA 2007: 425.

52) China Daily (August 27, 2009).



In 2004, 143 million Chinese were 60 and over, which corresponds to 11% of the population. This development is expected to continue, and in 2030 23.8% will be 60 and over.<sup>53</sup> China currently has the optimal composition of its work force, with few old people and few children. The number of dependant elderly or children per person in the workforce – China’s age dependency ratio – is expected to grow from 0.5 at present to 0.7 by 2030.<sup>54</sup>

This demographic timetable helps explain why, in 2000, China’s leaders declared that the two decades until 2020 were a ‘period of strategic opportunity’. Twenty more years of rapid growth will quadruple the size of the economy once again, creating a ‘well-off society’ with per capita income over 3,000 USD (based on exchange rates).<sup>55</sup>

Fig. 11

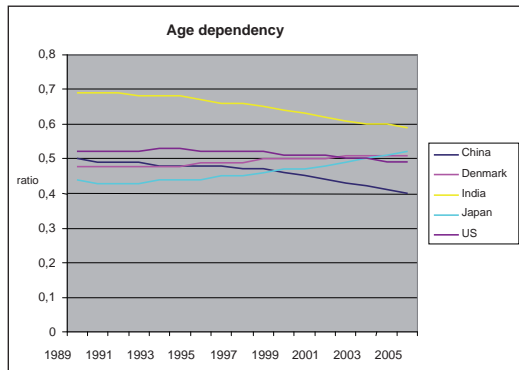
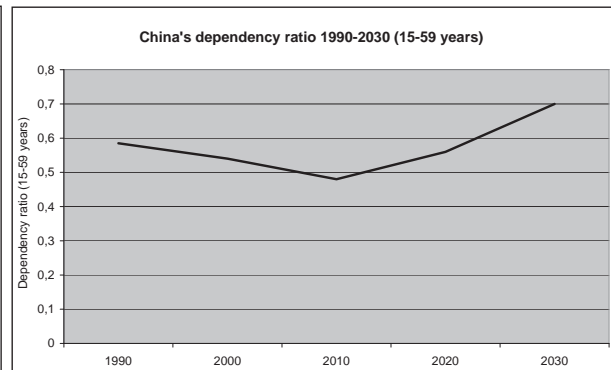


Fig. 12



Source: China Statistical Yearbook 2007: 261; World Development Indicators Database

## Oil for the lamps of China

Another important factor in China’s continued high economic growth is access to energy.

The world energy market has been boiling over with oil prices that have been hovering at around 140 USD a barrel. Even if prices are lower now, that could easily change. It is first and foremost China’s fast growing economy that demands more energy.

The USA is the world’s biggest energy consumer and claims 21% of world consumption in 2007,

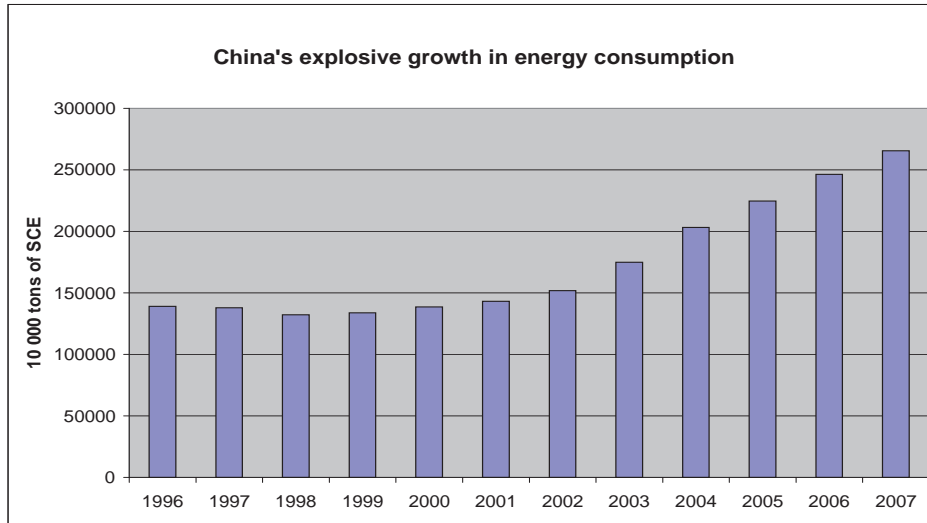
53) IEA 2007: 258-9.

54) IEA 2007: 258-9.

55) Shirk 2007: 21.

while China comes second with 16% (and the curve is rising fast compared with the rest of the world).<sup>56</sup>

Fig. 13



Source: China Statistical Yearbook 2008: 243 Note: SCE is Standard Coal Equivalent

The International Energy Agency (IEA) estimates that shortly after 2010 China will overtake the US as the world's leading energy consumer and that by 2030 it will be responsible for 22% of the world's energy consumption, which by that date will be 50% greater than today.<sup>57</sup>

Competition over scarce energy resources has been going on for some time between the well-established customers in the US, Japan and Europe and the newcomers headed by China and India.

But why is the growth in China's energy consumption so extreme?

The answer is simple – globalization.

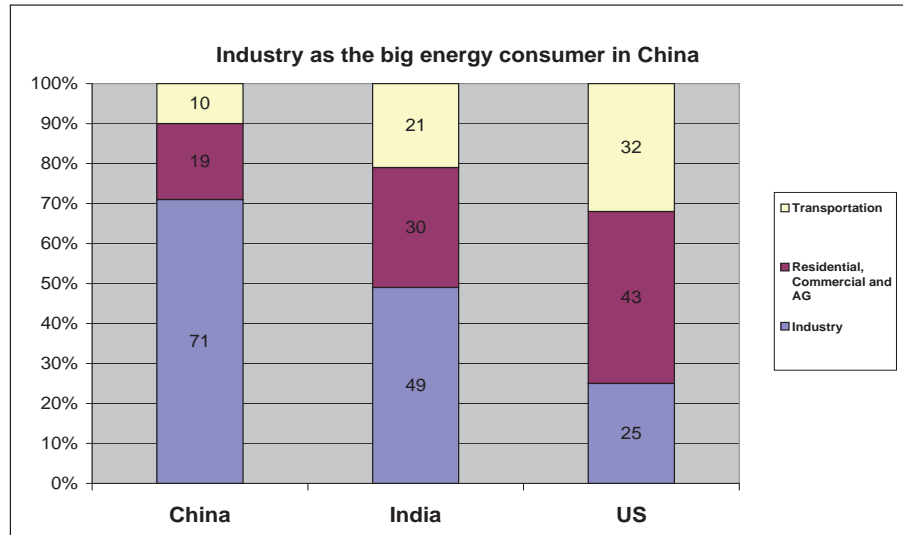
One of the effects of the international division of labour is that China has become the workshop of the world. A disproportional part of the world's heavy industry – and some of the most polluting factories – are located in China, while the Chinese import raw materials from the less developed countries and export consumer products to the USA and the EU. Thus, the developed world is avoid-

56) IEA 2007: 44; 74; 119.

57) IEA 2007: 44; 74; 119.

ing the most polluting production. Industry is responsible for 70% of energy consumption in China compared with 50% in India and 25% in the US.<sup>58</sup>

Fig. 14



Source: Rosen and Houser 2007: 9

China is seeking to move up the global value chain and produce more technologically sophisticated goods with lower energy use. That might in the long run reduce China's problems, but it will not solve the global problem because the most polluting production will be pushed down to the least developed countries.

At present it is not air-conditioners or cars that are driving up Chinese energy consumption, but heavy industry. But that will change. The number of cars grew from 5½ million in 1990 to 37 million in 2006 and is expected to grow to 270 million in 2030.<sup>59</sup>

Continued high economic growth will transform China and increase its demand for energy for transport and home consumption dramatically.<sup>60</sup>

58) Rosen and Houser 2007: 9. The figure includes housing and institutions in the industrial sector.

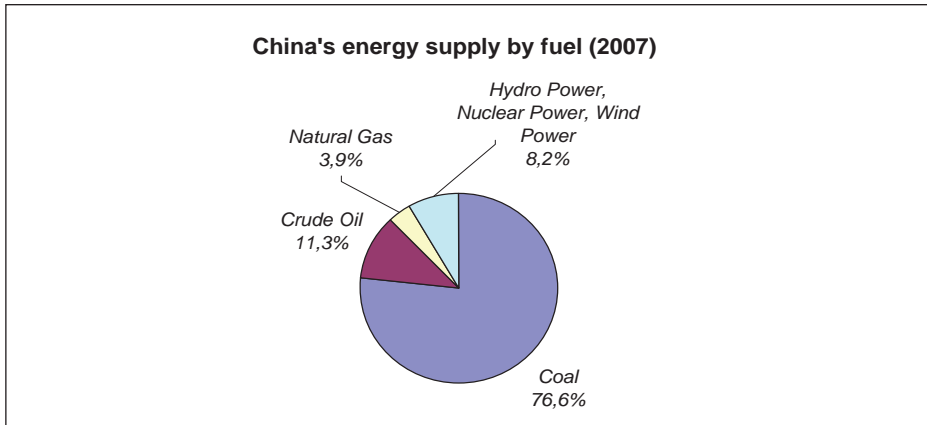
59) IEA 2007: 298.

60) IEA 2007: 7-8.

Energy consumption per inhabitant in the USA is double that in Europe, seven times that in China and twenty times India's. China is expected to reach a level close to the European, but still, there is a long way to the American level.<sup>61</sup>

Thus, it would be naïve to assume that the Chinese leadership will accept limits to its energy consumption or a level of CO2 emissions that could limit the country's economic growth.

*Fig. 15*



*Source: China Statistical Yearbook 2008: 243*

## **Energy efficiency**

China uses more energy to produce a unit of GDP than the US.

In the 11th Five-Year Plan (2006-2010) the government aims to cut energy use per unit of GDP by 20% (and pollution by 10%) by 2010.<sup>62</sup>

At a UN summit in September 2009, Hu Jintao said that China would reduce the amount of carbon dioxide it emits to produce each dollar of GDP by a notable margin by 2020 compared with 2005 levels.<sup>63</sup>

The aim is to increase energy efficiency, but the precondition for that is huge investments in new

61) IEA 2007: 206.

62) IEA 2007: 248.

63) Reuters (September 23, 2009).

housing, insulation, energy-saving equipment, cars that consume less fuel and energy-saving technology. What is needed is a decoupling of energy from growth in GDP.

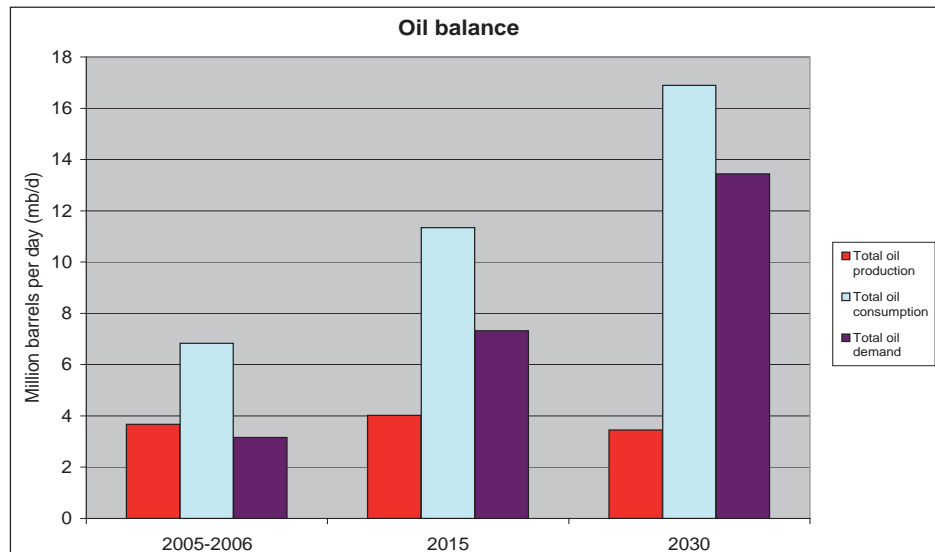
In the 1980s and 1990s, energy demand grew more slowly than GDP. Between 1980 and 2000, primary energy demand rose by a factor of two, while GDP increased six-fold. As a result, energy intensity improved by nearly 6% per year during this period.<sup>64</sup>

But between 2002 and 2004, energy demand grew much faster relative to GDP, causing energy intensity to rise. Since 2005, intensity has once again begun to fall, thanks in part to strong government action to rein in energy-demand growth.<sup>65</sup>

## Coal is still ruling China's energy supply, but oil imports are growing fast

But how will China get all the energy it needs?

Fig. 16



Source: World Energy Outlook 2007: 326

64) IEA 2007: 262-3.

65) IEA 2007: 262-3.

Coal is still king and delivers 63% of China's energy supply, and there are no plans to change that, even though coal pollutes more than other energy sources.

China produced 35% of the world's coal last year but reported 80% of the total deaths in coal mine accidents. Accidents in China's coal mines killed 3,786 miners in 2007.<sup>66</sup>

Presently, oil accounts for 19% of China's energy supply, and China is the world's second largest oil consumer. In 2006 China produced 3.7 million barrels a day (mb/d) from its oilfields, which are mostly concentrated in Daqing and Xinjiang, and China is eager to start production from the East China Sea, despite a disagreement between China and Japan about the demarcation of the sea border in the area.<sup>67</sup>

Even though China was the fifth largest oil producer in the world in 2007,<sup>68</sup> its own production is not enough to satisfy its demand, and since 1993 it has been a net importer of oil. In 2006 China imported 3.7 mb/d, equal to 50% of its total oil consumption.<sup>69</sup>

And in 2007, China for the first time overtook Japan as having the world's second largest oil demand.<sup>70</sup>

Natural gas and the country's many hydropower projects contributed just 2% each to energy consumption,<sup>71</sup> and even though China is increasing its hydropower capacity at great human and environmental cost, like the building of the Three Gorges Dam, it is expected to account for only 2% of China's total energy demand.<sup>72</sup>

## Box 6

### **Three Gorges Dam**

*The Three Gorges Dam spans the Yangtze River and is the largest hydro-electric power station in the world with an annual electric power generating capacity of over 100 megawatts when it becomes fully operational in 2011. But the price has been high. The Three Gorges was one of China's main tourist attractions. 13 towns, 140 small towns and 1,352 villages are now under the water surface and 1.4 million people have been displaced.*

66) State Administration of Work Safety in AFP (January 27, 2009).

67) IEA 2007: 319-21.

68) IEA 2008: 267, 272.

69) IEA 2007: 325-6.

70) IEA 2008: 93.

71) IEA 2007: 287.

72) Rosen and Houser 2007: 17.

Nuclear power provides less than 1% of primary energy. China is planning to build thirty reactors by 2020 at a cost of 61 billion USD. The first contracts have been signed with Japanese-owned, US-based Westinghouse Electric.

Box 7

***Petrol prices in China***

*Although crude oil prices have bounced back since the start of this year (they are still only half what they were at their peak in July 2008), Chinese drivers are paying more for petrol than they did a year ago. While Americans are only paying 69 cents a liter, Chinese pay over 90 cents (and Germans 1.85 USD) a liter because of the high fuel taxes.*

*Source: The Economist (September 17, 2009)*

Because of the continued use by so many rural households of firewood and crop wastes for cooking and heating, biomass remains an important source of energy. Still, its share of primary demand is only half what it was two decades ago.

Other renewables, like wind-power, while growing very rapidly, only delivered 0.2% of China's energy supply in 2007.

In 2008 China's renewable energy accounted for 9% of the total Chinese energy consumption.<sup>73</sup>

## **The CO<sub>2</sub>-breathing dragon**

The IEA expects CO<sub>2</sub> emissions to be 57% higher in 2030 than today.<sup>74</sup> If this is not stopped, we will face severe consequences.

China passed the US as the world's biggest CO<sub>2</sub> emitter in 2006, though its per capita emissions are far lower.<sup>75</sup>

In 2005 China was responsible for 19% of the world's CO<sub>2</sub> emissions, and according to EIA's forecast it will be responsible for 29% in 2030.<sup>76</sup> And even worse, CO<sub>2</sub> emissions per inhabitant in China already is equal to the world average and is expected to rise to the same level as in Europe today by 2030 (which is less than half of the American level).<sup>77</sup>

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73) People's Daily (September 27, 2009).

74) IEA 2007: 191.

75) EIA 2009: 131.

76) EIA 2009: 131.

77) IEA 2007: 202.



In the negotiations leading up to the new treaty that will come into force after Kyoto expires in 2012, China has consistently objected to accepting a fixed level for CO<sub>2</sub> emissions.

In order to achieve a compromise between the leading CO<sub>2</sub> emitters, an asymmetrical solution has to be adopted in which countries like the US and Australia and to some extent Europe, Russia and Japan have to accept reductions, while countries like China and India will be allowed to increase their consumption, but within defined limits. This means substantial deviations from business-as-usual.

If agreement can be reached on this overarching principle and the countries actually live up to that signature, it will be possible actually to reduce global CO<sub>2</sub> emissions. According to a World Bank study, eleven of the twenty most polluted cities in the world are in China.

For the Chinese leadership things are not so easy.

On the one hand they want to be seen as a responsible partner in the world community. On the other hand the Chinese leadership will never accept restrictions that might hamper economic growth because growth is the internal legitimacy for ruling.

Up to now they have manoeuvred in a way so that the ball remains in America's court. As long as the US administration fails to accept binding restrictions, China can get off scot free.

In the 11th Five-Year Plan (2006-2010), it was decided that China will cut pollution by 10% by 2010.<sup>78</sup> Results have been small so far but in the coming years China will build new power stations with a more advanced technology thus reducing CO<sub>2</sub>-emissions. And CO<sub>2</sub> is just one of the sources of pollution. SO<sub>x</sub>, NO<sub>x</sub>, carbon monoxide and particulates contribute to acid rain and air pollution.

Not to mention the most important problem for China's population: the shortage of clean water.

## **Social stability**

The importance of economic growth for China's internal stability is paramount.

The paradox is that economic growth in China has created greater inequality, even though it has lifted millions of Chinese out of poverty.

China's Gini-coefficient rose from 0.31 in 1978 to 0.47 in 2007, one of the fastest to rise in the world and the highest in Asia, catching up with Nepal (the US has a coefficient of 0.45 and India one of 0.37).<sup>79</sup>

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78) IEA 2007: 248.

79) CIA World Factbook.

Box 8

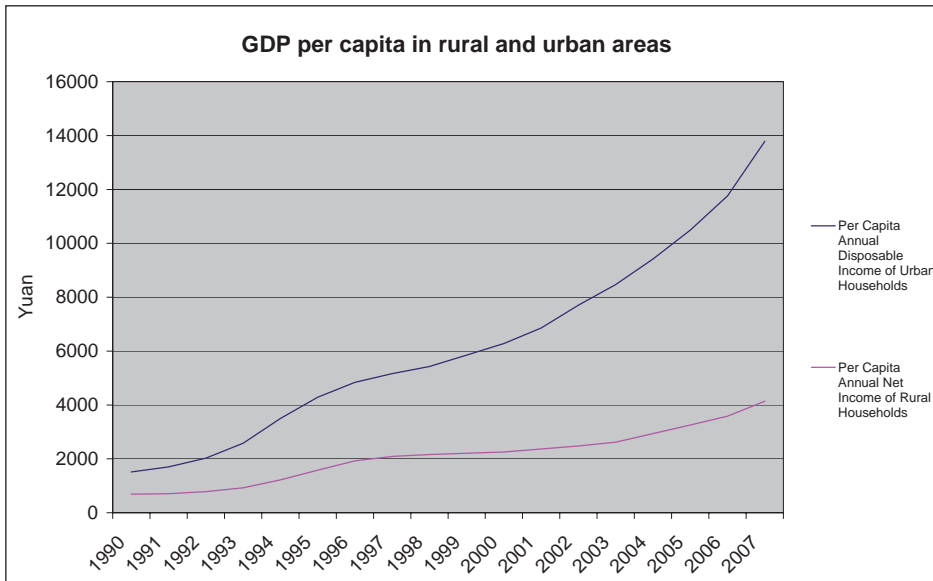
**The Gini-coefficient**

The Gini-coefficient is a statistical measure of inequality of income distribution. It is defined as a ratio between 0 and 1. 0 corresponds to perfect equality (everyone having the same income) and 1 corresponds to perfect inequality (one person having all the income and the rest having no income). Thus, a low Gini-coefficient indicates a more even income distribution and a high Gini-coefficient indicates more unequal distribution.

Source: IMF 2007: 144

The leadership recognises this as a serious problem but the policy of “harmonious society” has had limited results up to now.

Fig. 17



Source: China Statistical Yearbook 2008: 317

Nevertheless, China saw a fall in the proportion of the population living on less than 1 USD a day (The World Bank's international poverty standard in PPP terms). Between 1981 and 2007 the fraction of the population consuming below this poverty line fell from 65% to 4%.<sup>80</sup> This is truly a striking achievement.

Thus, over half a billion Chinese have been lifted out of poverty, and there were only 50 million poor people in China by the end of 2007.

## **A widening gap between rich and poor, east and west, and rural and urban areas**

In 2007 China's urban income was 3.33 times higher than the income in rural areas, and the difference is rising (it was 3.23 in 2005), despite the government's declared intention of reducing the gap.

The difference between rich and poor in the towns is also growing, and there is an eight-fold gap between the richest 10% of urban residents and the poorest 10%. Among rural residents the gap is 7.3 times, much bigger than the gap between rural and urban residents.

In 2005, GDP per person in coastal areas was 2.787 USD, while that of inland areas was 1.229 USD. The difference is actually not as big as the other differences in income, reflecting the fact that there is a sizable urban population in the western regions and many migrant workers in the eastern regions.

In the first half of 2009, there has been a year-on-year increase of 8.1 percent in rural households' income.<sup>81</sup> Urban households have risen even more, at 9.8 percent.<sup>82</sup> This is a remarkable development in a world suffering from a financial crisis.

The 'Go West' strategy has not been able to offset the growing income disparity created by market forces, the main reason being that most of the investments in the west are not profitable compared with investments in eastern China. Similarly, the attempts to close the gap between rich and poor and urban and rural residents have not been very successful.

## **Civil unrest is growing**

As long as China's economy is booming and nearly all Chinese get something more in their rice bowls every year, they can live with the fact that some get more than others. But if the economy grinds to a halt or slows down considerably, tensions will escalate.

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80) World Bank East Asia and Pacific Region 2009: iii.

81) National Bureau of Statistics of China (24 July 2009).

82) Global Times (27 July 2009).

In 2006 there were, according to official statistics, 94,000 demonstrations (with over 100 participants). In 2005 there were 87,000, in 2004 74,000, in 2003 58,000 and 10,000 demonstrations ten years ago. Comparable figures have not been published since then.

This growing number of incidents reflects the growing dissatisfaction with the existing regime, which is often associated with corruption and political abuse, whether environmental disasters, the sale of land without proper compensation etc.

But as long as these are only isolated events, they can be handled. If they become part of a countrywide network that the Communist Party cannot control, the authorities clamp down hard, as in the case of Falun Gong.

There are still dissidents, lawyers and others who try to stand up for the most basic human rights, but most of the Chinese in the generation who were young during the Cultural Revolution want stability before anything else. For them, the most important human right is the right to earn money.

The biggest problem for the communist leadership is corruption within the party's own ranks. The leadership has tried to take on corrupt party functionaries – including high ranking ones like Shanghai party secretary Chen Liangyu – but there is a suspicion that corruption cases are also an instrument to get rid of party members who oppose the party line.

The CPC Central Committee for Discipline Inspection has announced new anti-graft measures to curb corruption. High-ranking members will be ordered to disclose all housing and business details, along with the jobs of their spouses and children.<sup>83</sup>

This is a step in the right direction but if the leadership were really serious about holding corrupt officials responsible, there should be accountability. This can only be achieved by holding free elections. But that would mean saying farewell to the party's monopoly of power.

## **Conclusion: the return of China**

China's economic rise would not have been possible without an open economy and skilful use of the globalization of the world trade, accelerated by China's accession to the WTO in 2001, and China today is integrated into the global economy to a great extent.

China is not yet a full-blown superpower, but it is already an economic superpower when it comes to total GDP, foreign trade, imports and exports, and it has the biggest currency reserves in the world.

China's GDP growth places it comfortably among the big economic powers as the second most important economic powerhouse, driving the world economy the next couple of years.

While the US economy has slowed down in 2008, China has taken over during the crisis as the

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83) China Daily (September 21, 2009).

most important locomotive for global growth, and even if the US is expected to pick up growth next year, China will contribute more to world growth in 2010 than the US.<sup>84</sup>

And the basic factors – an abundance of migrant workers and the high savings rate – are still in place.

But there are also limits to growth: the growing income differences between rich and poor, east and west, and the rural and urban population, low energy efficiency, extreme pollution, corruption within the communist party, an ageing population and instability in Chinese society all threaten the prospect of continued high economic growth.

China's GDP per capita and productivity are still very low, and even though it is acquiring new technology at a rapid rate, the prospect of catching up with the USA, Europe and Japan in GDP per capita is beyond visual range.

Nevertheless, there will in ten to twenty years time be several hundred million Chinese living in relative prosperity.

Economic ties are no guarantee that nations won't fight – for one thing, trade can introduce new bones of contention – but they do give them a stake in trying to resolve their differences peacefully.<sup>85</sup>

China's economic rise gives the country political power and makes it possible to increase its military power – and thus to resume its natural place in the world. There are not many examples in history books of a rising power being integrated peacefully into the existing international system.

The challenge is that we have to do it better this time.

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84) IMF 2009b: 2.

85) Shirk 2007: 17.

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## **List of abbreviations**

CNY	Chinese yuan
CPI	Consumer Price Index
EIA	Energy Information Agency
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
IEA	International Energy Agency
IMF	International Monetary Fund
IPR	Intellectual Property Rights
PPP	Purchasing Power Parity
SOE	State Owned Assets
USD	US dollar
WTO	World Trade Organization

*The Return of China – Globalization and Economic Power* is part of a broader research programme on China. It is conducted by China Studies located at the Institute for Strategy, Royal Danish Defence College. The aim of the project is to investigate how China's growing economic and military power will lead to a new security and defense balance in the Asia-Pacific region and globally, among these being to explain the consequences for China's neighbours and the sole superpower, the US.

The research programme consists of five main topics:

- China's role as an economic superpower
- China as a military power
- China's relationship with the US
- China's role as a global actor
- China's role as a regional actor

In the light of the research programme it will be described how the West can best develop a policy that makes room for a rising China within the framework of a changed international system.

