The Political Economy of the Rule of Law in China

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I. INTRODUCTION

The following pages briefly review the status of political economy as an interface of economics, of law, and of politics. Political economy presents a field informing the study of institutions, and of norms, which constitute the background to economic development. The rule of law contributes to economic development. In great degree, investor confidence is born under the shelter of law.

Engrossing is the saga of the People's Republic of China's long march toward market-oriented prosperity between 1978 and 2008. That march transpired in an atmosphere polluted by political tyranny. China's breathtaking achievements between 1978-2008 in a one-party system generate skepticism about the importance of the rule of law. Nevertheless, the Chinese experiment to disprove the supposed need for a rule of law remains inconclusive. In contrast, years-long, national booms in East Asia sputtered in the face of financial crisis. These countries aimed for landing on the shore of economically developed status never quite consummated. A 2008 stock market crash in China affords a fine test of autocratic China's capacity economically to thrive independently of the rule of law. Measuring that supposed capacity is the test scheduled for 2009. Beijing's ability to weather such a financial storm can be instructively compared, as of 2010, with the experiences of her neighbors over the decade past.

II. WHAT IS POLITICAL ECONOMY?

The term political economy can mark a sub-field of economics (intersecting law, and politics). It can refer otherwise to the whole realm of
economics (stretched to include intersection with law, and politics):

Political economy is the original name for economics, abandoned a hundred years ago for the simpler term “economics” because the content of the subject had narrowed. The word “economy” is derived from a Greek word meaning “the management of the household.” Political economy would be the management of the nation. In the nineteenth century, and frequently in the first half of the twentieth century as well, what we now call economics and what we now call political science would be studied under the heading of political economy in the same department of the university. Over the last fifty years or so, the unified departments split into individual departments of economics and political science, as each subject acquired a separate domain of investigation and a distinct style of analysis. The economy came to be studied entirely on its own, as a great machine that reacts to political decisions about such matters as tariffs and taxes but that runs entirely in accordance with its own laws of motion.

Just as the divorce seemed completed, there emerged on the horizon new problems that straddled the two disciplines. It became evident that voting could be usefully analyzed by methods that have more in common with economics than with political science as practiced at the time. The study of voting became the domain of scholars who may have started out as economists or as political scientists but who needed familiarity with both disciplines. It became evident that economic growth was as much a consequence of political organization as of conditions in the economy. It became evident that society’s choice of laws could be explained on the same economic principles used to explain society’s choice of roads, bridges, hospitals, and schools. It became evident that democratic government and civil liberties were intimately connected with the organization of the economy. ¹

Economics represents a social science.² It primarily focuses upon problems where the solutions entail cooperation.³ The roles of institutions and norms in economic development have been investigated.⁴ The history, politics, and theory of the rule of law have been probed.⁵ Edmund Phelps (recipient of the Alfred Nobel Memorial Prize in Economics in 2006) opined: “Britain’s property rights and rule of law enabled the rise of

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3. Id.
4. See, e.g., INSTITUTIONS AND NORMS IN ECONOMIC DEVELOPMENT (Mark Gradstein & Kai Konrad eds., 2007).
5. See, e.g., BRIAN Z. TAMANAH, ON THE RULE OF LAW: HISTORY, POLITICS, THEORY (2004); THE OXFORD HANDBOOK OF POLITICAL ECONOMY (Barry R. Weingast & Donald Wittman eds., 2008).
commercial society. Distinguishable from law is democracy. What are the links among democracy, governance, and economic results?

James M. Buchanan, recipient of the Alfred Nobel Memorial Prize in Economics in 1986, explains that personal liberty is workable solely under the rule of law. Buchanan envisions a state of nature wherein concurrence on general rules for behavior might be expected to enrich everyone’s lot. The requisite principle is one of generalization. That generality standard found institutional embodiment in a rule of law to delineate widely agreed upon criteria toward evaluation of legal structures. This generality forestalls many alternatives from majority option. Yet, within the choice squaring with the criterion, majorities can command. Differential treatment under law on the grounds of gender, age, race, or religion is violative of the central normative principle.

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7. To avoid ethical premises, we define democratic government descriptively, i.e., by enumerating certain characteristics which in practice distinguish this form of government from others. A government is democratic if it exists in a society where the following conditions prevail:
   1. A single party (or coalition of parties) is chosen by popular election to run the governing apparatus.
   2. Such elections are held within periodic intervals, the duration of which cannot be altered by the party in power acting alone.
   3. All adults who are permanent residents of the society, are sane, and abide by the laws of the land are eligible to vote in each such election.
   4. Each voter may cast one and only one vote in each election.
   5. Any party (or coalition) receiving the support of a majority of those voting is entitled to take over the powers of government until the next election.
   6. The losing parties in an election never try by force or any illegal means to prevent the winning party (or parties) from taking office.
   7. The party in power never attempts to restrict the political activities of any citizens or other parties as long as they make no attempt to overthrow the government by force.
   8. There are two or more parties competing for control of the governing apparatus in every election.


11. Id. at 175.


13. Id.


15. Id.

curbs overt departures from generality.\textsuperscript{17} Political discrimination cuts along broad swathes instead of among separate persons.\textsuperscript{18}

Respectfully received was the 2006 study, \textit{A Conceptual Framework for Interpreting Recorded Human History}, by Douglass C. North, John Joseph Wallis, and Barry R. Weingast.\textsuperscript{19} The issue in economic history is how countries sustained economic growth in the late eighteenth and early nineteenth centuries.\textsuperscript{20} The key is the leap from a limited to an open access society.\textsuperscript{21} Economic and political systems both tend to be of open, or else of limited, access. In a limited access order, rents squeezed from those exploited obtain because economic competition is occluded. Whereas in open access societies, rents reward competition.\textsuperscript{22} Transition to an open access order requires approximately fifty years.\textsuperscript{23} That suddenness marks the missing middle between developed and non-developing societies.\textsuperscript{24} One finds no continuum.\textsuperscript{25}

Limited access polities are incapable of supporting economic open access (inasmuch as political control over entry curbs economic competition),\textsuperscript{26} and limited access economies are incapable of supporting political open access (inasmuch as concentration of economic rents empowers elites to curb political competition): "The origin of property rights and legal systems is the definition of elite rights."\textsuperscript{27} How do open access orders bar political winners from expropriating the losers?\textsuperscript{28} Open access societies are filled with organized groups. These organizations provide focal points where government action can be evaluated and contested.\textsuperscript{29}

\begin{itemize}
  \item \textsuperscript{17} JAMES M. BUCHANAN, \textit{Generality and the Political Agenda}, in \textbf{THE COLLECTED WORKS OF JAMES BUCHANAN, POLITICS BY PRINCIPLE, NOT INTEREST: TOWARD NONDISCRIMINATORY DEMOCRACY}, supra note 12, at 66, 67.
  \item \textsuperscript{18} \textit{Id.}
  \item \textsuperscript{20} North, et al., \textit{supra} note 19, at 3.
  \item \textsuperscript{21} \textit{Id.} at 6.
  \item \textsuperscript{22} \textit{Id.} at 19.
  \item \textsuperscript{23} \textit{Id.} at 26.
  \item \textsuperscript{24} \textit{Id.}
  \item \textsuperscript{25} \textit{Id.}
  \item \textsuperscript{26} \textit{Id.} at 32, 34.
  \item \textsuperscript{27} \textit{Id.}
  \item \textsuperscript{28} \textit{Id.} at 39. Pulitzer Prize-winning historian Daniel Walker Howe reminds Americans of the indispensability of voluntary associations to civil society: "Evangelicals were the first Americans to set up the voluntary associations we consider indispensable to civil society." Daniel Walker Howe, \textit{Telegram From a Parallel Universe}, NEWSWEEK, June 30, 2008, at 46, 47.
  \item \textsuperscript{29} North, et al., \textit{supra} note 19, at 42. Hence Point Nine of the recent demands by over 2,000 Chinese citizens in their daring manifesto, CHARTER 08: \textit{Freedom to Form Groups}. The right of citizens to form groups must be guaranteed.
\end{itemize}
III. THE CHINESE ECONOMY EXPLODES: 1978-2008

Is there a politico-economic titan whose grand success evidences development devoid of the rule of law? In 2009, everyone in the world is alerted to the seemingly irresistible shift of global power to eastern Asia. The planet’s populace has been deeply impressed to see the exploding Chinese economy in transition. And North, Wallis, and Weingast propounded that the rule of law for elites is a doorstep condition of the major step into development. Yet, inside China, trust and commitments turn upon personal connections. They do not depend upon laws, contracts, or other legal instruments. North, Wallis, and Weingast showcased the

The current system for registering non-government groups, which requires a group to be “approved,” should be replaced by a system in which a group simply registers itself. The formation of political parties should be governed by the constitution and the laws, which means that we must abolish the special privilege of one party to monopolize power and must guarantee principles of free and fair competition among political parties.


China’s recovery from communism is one of the most inspiring stories in the history of economic development. The country went from being a suffering and impoverished land of catastrophe to being modernized in just 15 years. The state shrunk in scope nearly by default as the private sector grew and grew. This wasn’t the plan. It was the de facto result of the new tolerance of free economic activity. The state went into protective mode to keep its power, and did nothing to stop the swell of private enterprise. The result was glorious.

Keep in mind this critical point: China’s restoration as a civilized society came about not due to some central plan, but by its absence. The fact that the state did not intervene led to prosperity. Again, it wasn’t a policy or a constitution or a law that made the difference. There was no switch from a communist-style government to a night-watchman state. Because the state abandoned its posts under public opposition and contempt, society could flourish.


There is still the “old China” with the heavy hand of government, economic and investment challenges (corruption, banks with bad loans, murky accounting procedures and suspect numbers, lack of protection for intellectual property rights), social problems (poverty, joblessness, intolerance for dissent and challenges to the unilateral rule of the Communist Party), and major pollution problems.

Lewis J. Walker, No Illusion, the Rise of China, J. FIN. PLAN., Jan. 2006, at 32. Cannot China achieve
significance of open access to organizations. Yet, while China gradually is permitting nongovernmental organizations (e.g., advocacy groups and charities), Beijing constricts their ambit. There has been, for example, no legal framework to allow private charities. Parliament during 2006 shelved a charities law draft bill. China's Communist Party is legally untouchable. The 73-million strong Party dominates politics, and much business activity. It is deeply entrenched in the (theoretically) separate governmental administration. It stands above the law, with its own courts and disciplinary processes.

The twenty-first century has witnessed academic examination of, e.g., the new law and economic development, law and economics in developing countries, and the economic analysis of law in China. The notion that legal institutions prove crucial to the economic development process stands widely accepted both on the campuses and in financial

courts and disciplinary processes.

the rule of law for elites? See, e.g., Bo Zhiyue, China's Elite Politics: Political Transition and Power Balancing (2007).

33. Ian Johnson, In China, Grass-Roots Groups Stretch Limits on Activism, WALL ST. J., Jan. 10, 2008, at 1, A12. Optimists point to some contrary indicators, such as outbreaks of environmental activism — organized over the internet or by mobile phone. It is true that the network of social activities not directly controlled by the state has expanded, as the Chinese economy has grown and become more complicated. This has created new pressures to which the Communist party needs to respond. But the overall trend seems to be towards less media freedom rather than more; and therefore less scope for political expression and activism not approved by the party.


34. Rosemary Righter, Book Review, TIMES LITERARY SUPPLEMENT, Feb. 1, 2008, at 22. Cf. David Shambaugh, China's Communist Party: Atrophy and Adaptation (2008). Juridical scientists are familiar with North's limited access order in varied eras and locales commanding a deployment of separate courts and disciplinary processes for elites. In the limited access order of nineteenth-century Mexico (for example) the young Antonio López de Santa-Anna Perez accepted such processes to be the natural state of affairs:

Despite growing convictions in Mexico that the fueros, the special privileges for the clergy and military, should be ended, he continued to believe that the welfare of Mexico depended upon continuance of special courts in which priests and army officers were tried with little chance of being found guilty; in simplest terms, clerics and military were above the civil law. These were the basic concepts on which he had been reared and he swore never to abandon them.


institutions’ research departments (such as that of the World Bank). Yet fully a decade ago the People’s Republic of China already seemed to have accomplished the impossible: After all, the premise previously had been that law must be antecedent to economy. Were proper laws not emplaced, productive economic activity probably was not to transpire. However, recall the warning of North, Wallis, and Weingast that attaining economically developed nation status is not incremental. It is not to be won through marginal improvement in the rule of law, in expanded schooling, or via increasing capital. How best is China’s development interpreted? It elsewhere has been suggested that autocratic China’s remains a trapped transition, encompassing problems which are an integral part of the gradualist approach to reform, and not incidental thereto.

The October 2007 report of the International Monetary Fund disclosed that China’s real GDP had grown 11.5 percent (year on year) during 2007’s first half. Chinese expansion throughout 2007 was 11.4 percent.

40. Since 1978, China has recorded an electrifying annual growth rate of 9 percent for at least 19 times. Japan’s recovery (1950-90) following its devastation in World War II showed the way for other Asian countries to rise. The four Asian Tigers followed. Deng Xiaoping launched China’s “open door” policy in December 1978, discarding Soviet-style central planning in favor of a free-market approach. Since then China has achieved a stunning 9 percent or higher yearly growth rate 19 times.

42. See, e.g., Minxin Pei, China’s Trapped Transition: The Limits of Developmental Autocracy (2006).

During the last two decades of the twentieth century the government policy of “Reform and Opening” gave the Chinese people relief from the pervasive poverty and totalitarianism of the Mao Zedong era, and brought substantial increases in the wealth and living standards of many Chinese as well as a partial restoration of economic freedom and economic rights. Civil society began to grow, and popular calls for more rights and more political freedom have grown apace. As the ruling elite itself moved toward private ownership and the market economy, it began to shift from an outright rejection of “rights” to a partial acknowledgment of them.

In 1998 the Chinese government signed two important international human rights conventions; in 2004 it amended its constitution to include the phrase “respect and protect human rights”; and this year, 2008, it has promised to promote a “national human rights action plan.” Unfortunately most of this political progress has extended no further than the paper on which it is written.

CHINA’S CHARTER 08, supra note 29, at 54.
percent. This thirteen year high marked the fifth year wherein output exceeded a double-digit rate. It was up from 11.1 percent growth in 2006. Economic growth peaked at 11.9 percent in the second quarter of 2007. According to Beijing, it was 11.5 percent in the third quarter. It was roughly 11.2 to 11.5 percent for the fourth quarter. Many analysts in late 2008 expected growth slowing to near 9 percent for 2008 and 7.9 percent for 2009, a slip from 2007. China's growth path broadly has followed the patterns of prior rapid expansions (e.g., those of Japan and Korea). However, China had sustained strong growth for the lengthiest span.

By 2007, China boasted 91 billionaires (in U.S. dollars). She had


44. The World Bank has just lowered its forecast for China in light of the deteriorating U.S. economy. It now expects growth for all of 2008 to slow to 9.4 percent, down two full percentage points from 2007. That still is extremely fast by the standards of any other economy, but it would be an adjustment for China after five straight years of 10 percent or more growth. Andrew Batson, Finally, Slower Growth for China?, WALL ST. J., April 2, 2008, at A6. In 2008, some speculated that the Chinese expansion was functioning at the safety limit of capacity. Samuel Brittan, High Time for All of Us to 'Buck Up', FIN. TIMES, Feb. 1, 2008, at 11. At least in an American-style developed economy, the growth ceiling of a majority of enterprises is 12 percent annually. Arne Alsin, Heed History's Lessons and the Gap Between Price and Value, FIN. TIMES, Feb. 2/3, 2008, at 4.

45. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK 179, 180, Figure 5.8 (October 2007). So-called spontaneous land reform was implemented (supposedly) in secret by a knot of peasants in the minuscule village of Xiaogang (in China's eastern Anhui Provence) during December 1978:

At that time the country was still recovering from the chaos of the cultural revolution. Most arable land was collectivized into communes, a system that had helped push much of the country to the brink of starvation. According to Communist party legend, after consulting the village elders on how they could avoid starvation, 18 hungry peasant farmers in Xiaogang signed a secret pact dividing their commune's land between them for each household to farm individually, a unilateral action that could easily have led to them all being executed as traitors. Instead, their example was championed by senior reform-minded officials, including paramount leader Deng Xiaoping, who ordered the "household responsibility system" be rolled out across the countryside. Peasant households were given 30-year contracts to use their land to grow what they wished and to keep or sell any surplus they produced. Capitalism had returned and the Chinese economic miracle had begun.

encompassed 345,000 persons owning minimum financial assets of $1 million during 2006. That was an increase of 7.8 percent from 2005.\textsuperscript{46} Sustained economic development has conjured a class called Xin Gui (New Nobility).\textsuperscript{47}

In November 2007, PetroChina became the globe’s most valuable company.\textsuperscript{48} The world’s largest airline, bank, insurer and telecom company—as well as the world’s biggest oil company—was then Chinese. During 2007 alone, China built new electrical generating capacity exceeding the entire capacity of the United Kingdom’s grid.\textsuperscript{49} In 2007, China outpaced South Africa to become the earth’s biggest producer of gold ore.\textsuperscript{50} Already was China the planet’s foremost producer of aluminum, lead, and zinc. China was the second largest tin producer, and she ranked among the top ten producers of silver, nickel, and copper.\textsuperscript{51}

China is the planet’s third largest trading entity. Her gross merchandise exports more than quintupled between the beginning of this century and August 2007. China is the world’s second biggest exporter of goods (behind Germany, but leading the U.S.).\textsuperscript{52} So swollen were Chinese trade surpluses that in 2007 the current account was to register a $400 billion surplus. That equaled approximately 12 percent of Gross Domestic Product. That was up from $21 billion—or 1.7 percent of Gross Domestic

\textsuperscript{46} In China, an income of $25,000 pays for an affluent lifestyle with a nice automobile or regular golf outings.

\textsuperscript{47} James T. Areddy, Robb Report Delivers Luxury to China, WALL ST. J., Jan. 9, 2008, at B3.


\textsuperscript{49} Mallet, supra note 48, at 9.

\textsuperscript{50} Since 1905 had South Africa been ensconced as number one gold producer.


\textsuperscript{52} Wolf, supra note 51, at 2.
Product—in 2000. In fact, in 2008 the aggregate current account surplus of emerging markets entirely concentrated in the oil exporting countries and China. As a proportion of Gross Domestic Product, the 2007 Chinese current account surplus totaled treble the Japanese level of the 1980s. It was over double the largest such surplus Japan ever generated. China’s 2008 current account surplus was predicted to equal those of Japan and Germany combined.

The U.S. Bureau of Labor Statistics price index of America’s imports from China steadily slipped from the end of 2003 (when the U.S. government began calculating the series) until February 2007. It hopped 2.4 percent between that February and November 2007. Then Chinese businesses enjoyed so potent a demand that they could command higher prices and still keep assembly lines humming. Anyway, China no longer depends upon exports to the United States.

Much of China’s growth derives from exporting elsewhere (China’s foremost trading partner is Europe), and from internal investment in infrastructure (China grows thanks to investment). In 2008, Beijing anticipated a backlash once China’s foreign exchange reserves touched $1.5 trillion. This would be treble that level of late 2004. For the first


62. In October 2007 China’s foreign exchange reserves were $1.455 billion. Wolf, supra note 51,
time was China spending more money purchasing overseas companies—such purchases including stakes in Wall Street titans Bear Stearns (now deceased) and Morgan Stanley—than was spent on takeovers of Chinese companies. The China Investment Corporation was established in 2007 to goose returns on Beijing’s fattening foreign exchange reserves. In 2008, that Corporation held $200 billion in funds. Perhaps $80 billion thereof was for investment externally. The yuan closed 2007 up 6.9 percent against the dollar. And on November 30, 2008, China, holding

at 2. China’s reserves today are over $500 billion greater than Japan’s. Id.

If gold and foreign currency reserves were the only prerequisite for harboring global ambitions in the monetary arena, China would make impressive claims of its own with $1.7 trillion as of December 2007, the world’s highest level. Japan comes in second at $973 billion. If you add together the gold and foreign currency reserves of EU member states that have adopted the euro, including those of the European Central Bank, the total amount in the EU is $511 billion.


63. Areddy, supra note 59, at C2.


Virtually every investment company in the world is trying to enter the Chinese market at the moment—there are currently around 60 fund companies approved by the regulators, half of which are joint ventures involving foreign groups such as JP Morgan, Deutsche Bank and Invesco. The industry has seen an explosion in assets under management from 40bn in 2005 to around $450bn by the end of 2007, the result of rising share prices and massive inflows of retail money.


68. Henry Sender, China Turns Risk Averse, Even as Capital Outflows Rise, FIN. TIMES (London), Jan. 18, 2008, at 21. And the China Banking Regulatory Commission announced that domestic banks may invest client funds into the Japanese stock market. So may they invest in mutual funds, should they obtain permission from the Japanese regulator. This expanded China’s Qualified Institutional Investor program, allowing investments in overseas investment products. (In December 2007 had that program’s permitted investment area stretched beyond Hong Kong to encompass the UK stock market.) Juan Chen, China to Allow Investments in Japan Stocks, WALL ST. J., Feb. 23/24, 2008, at B6. China is the earth’s largest capital exporter. Wolf, supra note 51, at 2.

$682 billion in Treasury notes, bills and bonds, proved the major holder of America's public debt.70

A number of China's largest banks (including Bank of Communications and Industrial and Commercial Bank of China) declared that their earnings increased 60 percent in 2007 (year over year). Analysts said that net profits in that industry waxed correspondingly. Domestic media guesstimates put pretax profits for all banks at $85.4 billion. This marked an 83 percent increase from the year previous.71

The China case72—one of steroidal economic growth over the three decades 1978-2008—continues pointedly to challenge understanding in 2009 of the law-development nexus. Question: Does this precedent squarely disprove the proposition that the rule of law must precede development?73 Answer: Alternatively, the Chinese development spurt (to what remains an absolutely modest level74) might suffice to beget the resources (and public constituency) supportive of additional growth into a genuinely developed country status.75 For key to the issue is that China now lies at a far lower level of per capita Gross Domestic Product than, e.g., Japan, South Korea, and Taiwan.76

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Chinese officials may privately complain about the US government's profligacy, but they also recognize that being one of the largest holders of Treasury bonds does not bring as much leverage as might appear at first sight. China has little choice but to keep buying more US securities because a collapse in bond prices and the dollar would also have a huge impact on China's dollar holdings and its own economy—a situation Lawrence Summers, former US Treasury Secretary, called "the financial balance of terror."


73. DAM, supra note 38, at 231.

74. Define middle income as a family with at least $26,000 a year in the U.S. or $5,000 in China. By that definition 80 percent of Americans are in the middle or upper classes, but only 8 percent of Chinese and 5 percent of Indians. A. Gary Shilling, Chinese Chance, FORBES, May 19, 2008, at 150; A. Gary Schilling, Sell Commodities, FORBES, Mar. 10, 2008, at 110.

Drive the highway from Shanghai to Suzhou, and the entire distance takes you through one developing industrial district after another—new, modern facilities, with high-rise apartment villages for employees, families, and young people who consider a 900-square foot, two-bedroom apartment (one room for the "one child") the lap of luxury.


75. DAM, supra note 38, at 232.

76. Id. at 239.
IV. THE CHINESE ECONOMY IMPLODES: DECEMBER 17, 2007

Prior to December 2007, it had been doubted that China's economy lived up to its reputation.\(^7\) Sure enough, on December 17 the World Bank released fresh data relating to the global economy's production of goods and services. Its 2005 International Comparison Program estimated Purchasing Power Parities ("PPPs") benchmarked to 2005.\(^7\) For China and India, less reliable previous estimation methods had engendered their estimated GDPs at a level 40 percent larger than were the new and improved techniques of 2007.\(^9\) The University of Glasgow's Adam Smith Professor of Political Economy Ronald MacDonald advises that it now is accepted widely by such institutions as the International Monetary Fund (as well as the World Bank) that in cross-country GDP-level comparisons market exchange rates ought to be avoided since these can be diverted from equilibrium—or fair—values for protracted intervals. PPP rates valuing GDPs in common prices should be utilized. Numerous studies signal that PPP rates elicit the more satisfactory cross-country GDP comparisons.\(^8\) A variety of elements can impact equilibrium currency prices:

A factor that may affect equilibrium currency prices is the interest rate of a country. If the U.S. interest rate, corrected for people's expectations of inflation, abruptly increased relative to interest rates in the rest of the world, international investors elsewhere would increase their demand for dollar-denominated assets, thereby increasing the demand for dollars in foreign-exchange markets. An increased demand in foreign-exchange markets, other things held constant, would cause the dollar to appreciate and other currencies to depreciate.

Another factor affecting equilibrium is a change in relative productivity. If one country's productivity increased relative to another's, the former country would become more competitive in world markets. The demand for its exports would increase, and so would the demand for its currency. Changes in consumers' tastes also affect the equilibrium prices of currencies. If Japan's citizens suddenly developed a taste for a U.S. product, such as video games, this would increase the demand for U.S. dollars in foreign-exchange markets. Finally, economic and political stability affect the supply of and demand for a currency, and therefore the equilibrium price of that

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\(^9\) Id. at 1-2.

currency. If the United States looked economically and politically more stable than other countries, more foreigners would want to put their savings into U.S. assets than in assets of another country. This would increase the demand for dollars.\textsuperscript{81}

PPP, instead of market exchange rates, is the preferable metric of the relative cost of living, because the former is premised upon goods and services which households can purchase with their domestic currency.\textsuperscript{82} For example, 2008 opened with the American dollar well beneath its PPP (as metric of the greenback’s purchasing power).\textsuperscript{83} Should one care concerning a country’s position in the world economy, then exchange rate measures are the tool of choice. China’s economy might have expanded at approximately 11 percent during 2007 in terms of yuan, but its growth in U.S. dollars exceeded 17 percent. That dollar growth rate is the rate relevant to China’s ascent in the global economic hierarchy.\textsuperscript{84} Yet to have a feel for living standards, PPP (cautiously utilized) can prove a helpful device.\textsuperscript{85}

This 2007 recalculation affected China particularly, because it marked the initial instance wherein China stringently had been surveyed for price data.\textsuperscript{86} These new estimates imply that there languish hundreds of millions more Chinese (than previously supposed) subsisting at the World Bank’s poverty line of one dollar per diem.\textsuperscript{87} The absolute total of persons living beneath this poverty line in 2008 approximates 300 million. That figure is treble the pre-December 2007 estimate.\textsuperscript{88} China’s toilers endure even more
impoverishment and despair than many spectators had comprehended. Rampant corruption ensuing upon burgeoning growth, in combination with tension between the rural poor and the urban wealthy, is producing terrific stress.

The International Comparison Program ("ICP") constitutes a global statistical initiative to amass comparative price data, and to estimate the PPPs of the planet's foremost economies. Utilizing PPPs (rather than market exchange rates to convert currencies) renders it possible to compare the outputs of economies—and the welfare of their respective participants—in real time (i.e., controlling for real price-level differences). The 2005 ICP elicited estimates of the relative price-levels of GDP and its principal aggregates for 146 economies. These PPPs express the value of local currencies in terms of a common currency (the US dollar). The 2005 ICP represents the most thorough, and extensive, endeavor ever to measure PPP across countries.

In these new tabulations, the US remained the world's biggest economy with 23 percent of global GDP, trailed by China with 10 percent (and then by Japan with 7 percent). Invoking the PPP metric produces a world GDP larger than GDP converted to US dollars keyed to market exchange rates. Many lands—including China—were for their first time included in 2005:

The power and energy on display in emerging Chinese cities can be so impressive it is easy to forget that China's per capita output is less than Albania's. In purchasing power parity terms, at $5,325, China comes in 100th place, four slots behind Albania. Of course China, with its 1.3bn people, has an economy vastly bigger—roughly 350 times


90. See, e.g., GUIDI & CHUNTAO, supra note 74. To be sure, a challenge presented in estimating poverty resides, ultimately, in the failure to identify an international poverty level—or even a national poverty line—corresponding to the genuine cost of attaining fundamental human requirements. According to Sanjay G. Reddy, of the Barnard College Economics Department and the Columbia U. School of International and Public Affairs. Sanjay G. Reddy, Letter to the Editor, FIN. TIMES (London), Nov. 19, 2007, at 12.


92. Id. at 12.

93. Id.

94. Id. at 13.

95. Id. at 14. Diverse are the estimates of the size of the global capital market. The average emerging from figures compiled by Goldman Sachs, by Merrill Lynch & Co., and by the McKinsey Global Institute place the total stock of world equities at approximately $33 billion. George Hoguet, Sovereign Funds Should Lend Support to Equities, FIN. TIMES (London), Dec. 13, 2007, at 26.

96. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT/ THE WORLD BANK, supra note 91, at 11.
bigger, in fact—than its east European cousin. Scale does matter. But, until China chooses to act like the sum of its parts, it might be more useful to think of it as 350 Albanias than as one America.  

Prior estimates of China’s PPPs had resulted from a 1986 research study. China submitted prices for eleven administrative areas (plus the urban and rural components). These eleven city prices were extrapolated to the national level by the Asian Development Bank, and by the World Bank.  

What does the Chinese GDP level signify, more broadly?  

V. THE CHINA SYNDROME  

When their own per capita GDP levels lay at the contemporary Chinese level, Japan, South Korea and Taiwan (plus several additional neighbors of China) grew at least as quickly as has the People’s Republic. True, China’s per capita GDP (at purchasing power parity) swelled by 370 percent between 1978 and 2004, a 6.1 percent trend rate. However, between 1950 and 1973 the per capita GDP of Japan waxed by 460 percent, an 8.2 percent trend rate. Between 1962 and 1990 the per

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98. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT/ THE WORLD BANK, supra note 91, at 11.  
99. Id. at 19.  
100. Id.  
102. DAM, supra note 38, at 239 (citing Martin Wolf, China Has Further to Grow to Catch Up with the World, FIN. TIMES (London), April 13, 2005). The Chinese Communist Party in 1978, under Deng Xiaoping’s new captaincy, announced that its focus would shift to economic development. Id. at 240.  
103. DAM, supra note 38, at 239 (citing Martin Wolf, China Has Further to Grow to Catch Up with the World, FIN. TIMES (London), April 13, 2005). The Chinese Communist Party in 1978, under Deng Xiaoping’s new captaincy, announced that its focus would shift to economic development. Id. at 240.  

capita GDP of South Korea skyrocketed by 680 percent, a trend rate of 7.6 percent. And between 1958 and 1987 the per capita GDP of Taiwan mounted by 680 percent, a trend rate of 7.1 percent. These stretches of boomtimes ranging from 23 years (Japan) to 29 years (Taiwan) compare to the Chinese history of 1978 to date.

Also, between 1990 and 1996 Thailand grew at rates ranging from 6.8 percent to 11.2 percent. Malaysia between 1990-1996 expanded economically at rates ranging from 8.9 to 10.0 percent. Indonesia between 1990-1996 grew at rates ranging from 7.2 to 9.0 percent. Unfortunately, after these muscular surges, between 2000 and 2004 Thailand managed an average growth rate of 5.4 percent; Malaysia eked out an average growth rate of 4.4 percent; and Indonesia squeezed out an average growth rate of 4.6 percent. As a national economy earns a per capita GDP level nearer that in the developed world, the prospects for a catch-up with first world business methods and technology become more expensive and...
difficult.\textsuperscript{110}

The predicament of South Korea today illuminates the difficulties that even a rapidly developing nation confronts in bidding to complete its mutation into a fully developed economy.\textsuperscript{111} Its years-long economic surge rendered her the planet’s number eleven economy—a top exporter of cars, electronics, ships, and steel. Her robust growth over 2002-2007 kept at a pace of approximately 4.5 percent per annum.\textsuperscript{112} However, this paled beside the 6 to 7 percent growth rate of the prior half-decade, and the still-headier figures of earlier decades. In 2006, South Korea slipped behind both Brazil and India, demoting her to the thirteenth rank.\textsuperscript{113} By 2008, the verdict in the international business media was that South Korea might continue to expand economically at a pace faster than those of many western countries (or of her longtime rival, Japan). Yet Seoul’s halcyon days of eleven percent annual growth were long gone.\textsuperscript{114} Whereas the recent expansion of South Korea—anticipated at approximately 4 percent for 2008—is excellent by most rich nations’ standards, it is only 50 percent of the average pace of the 1970s and 1980s.\textsuperscript{115}

In the third quarter of 2008, South Korea slipped into debtor-nation status for its initial time in over eight years. Then, preliminary data signified that her industrial output had shrunk 2.4 percent from October 2007 to October 2008. This was the first such annual contraction for South Korea in 13 months.\textsuperscript{116} South Korea’s exports were down 18.3 percent in

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\textsuperscript{110} DAM, supra note 38, at 239. And the reverse is true as well. Columbia U. Prof. Stephen Sestanovich grasps of the Russian economy’s extraordinary expansion: “The low base from which it is growing means that strong increases can continue for a long time before petering out.” Sestanovich, supra note 85, at A21.
\textsuperscript{112} Id. at A1.
\textsuperscript{113} Id. at A1. Cambridge University economist Ha-joon Chang avers that his native South Korea prospered through going contrary to many economic prescriptions demanded by rich countries (as through the International Monetary Fund, World Bank, and World Trade Organization) as conditions for aid (e.g., largescale and swift trade liberalization). \textit{See}, e.g., \textit{HA-JOON CHANG, BAD SAMARITANS: THE MYTH OF FREE TRADE AND THE SECRET HISTORY OF CAPITALISM} (2007). Somewhat by contrast, meanwhile, the People's Republic of China had cooperated with international institutions, even if detrimentally to its own interests. \textit{See}, e.g., \textit{ALASTAIR IAN JOHNSTON, SOCIAL STATES: CHINA IN INTERNATIONAL INSTITUTIONS} (2008). In all events, the rise of global financial markets (premised upon the minimally-constrained international flow of capital) derives from an old economic orthodoxy only reembraced widely \textit{circum 1994}. \textit{See}, e.g., \textit{RAWI ABDEAL, CAPITAL RULES: THE CONSTRUCTION OF GLOBAL FINANCE} (2007).
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November 2008 from a year earlier. This transpired notwithstanding the Korean won’s staggering devaluation (shedding some 25 percent of its value against the dollar and the Chinese yuan, and 46 percent against the Japanese yen). Small wonder was it that the recipient of the Alfred Nobel Memorial Prize in 2008 for his analysis of trade patterns and location of economic activity, Paul Krugman, then announced that South Korea must have been undergoing a nightmare: The Asian financial crisis of the 1990s once more.

The region in question herein indeed was impacted by that 1997-1998 Asian financial crisis. Inferior macroeconomic management might have ignited that Asian financial crisis. Nevertheless, the extent of stock market declines and of exchange rate depreciation among the crisis lands related snugly with their respective debilities in legal institutions respecting corporate governance (notably, regarding the dearth of any protection of minority shareholders). Familiar, of course, to scholars of law and economics is the prominent issue of corporate governance in context of the 1998 East Asia/Russia/Brazil crisis:

The East Asia crisis has highlighted the flimsy protections investors in emerging markets have and put the spotlight on the weak corporate governance practices in these markets. The crisis has also led to a reassessment of the Asian model of industrial organization and finance around highly centralized and hierarchical industrial groups controlled by management and large investors. There has been a similar reassessment of mass insider privatization and its concomitant weak protection of small investors in Russia and other transition economies. The crisis has led international policy makers to conclude that macro-management is not sufficient to prevent crises and their contagion in an integrated global economy. Thus, in South Korea, the International Monetary Fund has imposed detailed structural conditions that go far beyond the usual Fund policy. It is no coincidence that corporate governance reform in Russia, Asia and Brazil has been a top priority

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for the OECD, the World Bank and institutional investor activists.  

The 1997-1998 Asian debacle heralded output and employment losses genuinely appalling.  

To be sure, in some degree an increase in wealth facilitates institution building. Developing countries impeded by initially weak institutions, which enjoyed an acceleration in growth (usually via a surge in manufactures exports) could maintain such growth for fifteen years or more. One interpretation of the Asian Tigers' lightning growth followed by crisis is, concisely, that the Tigers attained growth with celerity despite weak institutions while still at a comparatively humble level of development. Their failure to invest in institutional improvements invited the Asian financial crisis.

The year 2009 proves premature to stipulate that China constitutes a counterexample to the need to focus upon institutions in the developing

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124. **DAM, supra** note 38, at 276.


126. In the view of one source virtually deemed an oracle, see, e.g., E. Ray Canterbery, *Alan Greenspan: The Oracle Behind the Curtain* (2006):

A large segment of the erstwhile Third World, especially China, replicated the successful economic export-oriented model of the so-called Asian Tigers: Fairly well educated, low-cost workforces were joined with developed-world technology and protected by an increasing rule of law, to unleash explosive economic growth. Since 2000, the real GDP growth of the developing world has been more than double that of the developed world.


nations, nor to the necessity of the rule of law in China herself. Possible interim development (short of attaining developed nation status) absent strong legal institutions. Indeed, Chinese GDP growth peaked at more than 14 percent, but back in the early 1990s. Nonetheless, maintainable growth into more exalted per capita levels demands a considerable development of legal institutions.

In medicine, a syndrome is a set of concurrent symptoms distinguishing a disease. Is China vulnerable to the agonizing symptoms which broke out over 1997-1998 in the cases of, e.g., Thailand, Malaysia and Indonesia? Specifically, the query for 2009 is whether China’s institutional weaknesses, particularly of her financial sector, endanger her growth rate (even as similar debilities diminished the growth rates of her Asian neighbors). Lengthy is Beijing’s history of dictating policy to

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128. DAM, supra note 38, at 276. "The country has one official union, the All-China Federation of Trade Unions, but it is government-run and has little independence. Efforts at setting up true unions have always been crushed." Shai Oster, China Faces Unrest As Economy Falts, WALL ST. J., Dec. 22, 2008, at A8.

129. DAM, supra note 38, at 277.

The pattern is that as countries go from low to middling incomes people work much longer hours—and also record big gains in productivity or in other words how much output each of them can produce per hour worked—so the economy grows rapidly and average standards of living rise. But when they grow richer still, hours of work decline and further improvements in living standards have to come from higher productivity alone. If they are not working longer, they can only get richer only by working better. This is more difficult to do: the economy’s growth rate is typically far slower in rich economies than in the middle-income but catching-up ones, where hours of work are rising as well as effort.

DIANE COYLE, SEX, DRUGS, AND ECONOMICS: AN UNCONVENTIONAL INTRODUCTION TO ECONOMICS 190 (2004).


The 2007 growth of 11.4 percent, although robust, is not as high as the peak of the 1980s and ’90s, when GDP growth in some years surpassed 15 percent. Jonathan Anderson of the investment bank UBS says China’s boom-bust cycles of those two decades are being wound back into a more sustainable pattern.


132. WEBSTER’S COLLEGIATE DICTIONARY 1012 (2nd ed. 1948).

133. DAM, supra note 38, at 242.

Although lower wages among the tigers are keeping them competitive for now, they are concerned about the future, because competition for foreign investment is particularly intense. China’s 2001 entry into the World Trade Organization promoted a surge in foreign investment there, even as China’s rivals in the region saw their foreign investment shrink. Without fresh outside capital, the economies of Malaysia, Singapore, and Thailand may all start looking like Japan’s, where
Regulators pressed bankers to address bad loans left over from governmentally ordained "policy" lending during the 1990s. Further, since 2000 have authorities pushed banks to curtail loans to specific industries deemed squandering investment. A weak and ineffectual financial sector could lead either to a crisis resembling the Asian financial crisis, or to a more slowly expanding Chinese economy. Along either fork in that road, a shaky financial sector is liable to hinder growth. But what might unleash financial devastation?

VI. THE POLITICAL ECONOMY TEST SCHEDULED FOR 2010

A. CHINA PARTIES LIKE IT'S 1929: 2007

In February 2008, the government of China announced that during January 2008 China had attracted $11.2 billion in foreign investment, up 109.8 percent from January 2007. Mesmerized by China's economic boom, an ambitious or avaricious readership perused titles like: Billions of Entrepreneurs: How China and India Are Reshaping their Futures and Yours; Managing the Dragon: How I'm Building a Billion Dollar Business in China; A Bull in China: Investing Profitably in the World's Greatest Market; From Wall Street to the Great Wall: How Investors Can Profit from China's Booming Economy; Adam Smith in Beijing: Lineages of the Twenty-First Century; and The Little Red Book of China.
In autumn 2007, three of the half-dozen largest companies on earth (by market capitalization) were Chinese. The market capitalization of Chinese companies (listed both in China and abroad) totaled over double China’s GDP. By comparison, U.S. stocks at their early 2000 crest were capitalized at 183 percent of GDP. So intense was demand for Initial Public Offerings that their first day “pop” averaged over 200 percent. In early 2008, Beijing stood poised to relax its two-year ban against foreign investment in China’s booming domestic securities industry.

The Shanghai Composite Index reportedly spurted over 300 percent between January 2007 and November 2007. In the two years preceding late 2007, the Shanghai Composite Index had quintupled. Through

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China’s stock market remains dysfunctional because it started as a no-cost source of money for state-owned enterprises. Allowing the market to become a viable source of capital for entrepreneurs would hurt these companies and those who own their overpriced shares.


146. “An initial public offering (IPO) is a company’s first sale of stock to the public. Securities offered in an IPO are often but not always those of young, small companies seeking outside equity capital and a public market for their stock. Investors purchasing stock in IPOs generally assume very large risks for the possibility of large gains.” DAVID L. SCOTT, WALL STREET WORDS 176 (1988).

147. Chancellor, supra note 145, at 20. There is debate over underpricing of Chinese IPOs:

PetroChina raised a record $9bn from its Shanghai listing, but if the shares had been priced at today’s level, even after the collapse since the first day of trading, the company would have raised $4bn more. And, given that most of the large IPOs have involved state-owned companies, it is the state leaving money on the table. The World Bank calculated that in just the first five months of last year, the government could have raised $9.5bn more if the flotations had been priced at the first-day closing levels – a figure that is $1.5bn more than the central government spent all last year on free education programs.


149. “The Shanghai stock market has climbed by around a third since early August and more than 300 percent since January.” Chancellor, supra note 145, at 20. “Between October 2005 and October 2007, the Shanghai Composite Index rose more than 400 percent, before coming back down in recent months.” Dugan & Cui, supra note 148, at B2.

150. Gady A. Epstein, Shanghaied: How Do You Say "Irrational Exuberance" in Chinese?, FORBES, Dec. 10, 2007, at 95, 96. China’s stock exchange largely had traded in isolation and obscurity for most of its 17-year history. Id. “China’s stock market has roared back to life over the past two years after spending years as one of the world’s worst performers.” Rick Carew, Citi Expands Sights in China, WALL ST. J., Jan. 29, 2008, at C5. Governmental action—a sweeping change in the share
2007, that Composite shot up 97 percent.\(^{151}\) And at that it closed the year 14 percent beneath its October 2007 peak,\(^ {152}\) when it had notched a 128 percent gain for 2007. The Shanghai Composite Index had batted a heftier 130 percent during 2006.\(^ {153}\)

The price-earnings ratio ("p/e") for the Composite closed 2007 at 59 times the prior year's earnings. At that the p/e ratio actually closed down from its multiple of 71 at the October peak.\(^ {154}\) And the composite closed 2007 at a trailing p/e average of 26.98.\(^ {155}\) The Chinese domestically listed equities, in mid-February 2008 trading at 37 times trailing earnings, numbered among the globe's most costly.\(^ {156}\)

By comparison, recall America's post-World War II trailing p/e average approximating 14.5. Historical p/e ratios of the entire market premised upon the last 12 months of reported earnings, from 1871 through December 2006, fluctuated between its 1917 low of 5.31 and its 2002 46.71 high.\(^ {157}\) The p/e ratio in March 2008 for the Standard and Poor's 500—looking ahead to 2008 earnings—was 13.2.\(^ {158}\)

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\(^{151}\) [Areddy, For Investors, the Games Have Begun, WALL ST. J., Feb. 5, 2008, at C1, C5.]


\(^{153}\) [Chang, supra note 151, at R4.]

\(^{154}\) [Areddy, supra note 150, at C2. "The Shanghai Composite now trades at 14.4 times, versus 74 times at the peak, according to Credit Suisse." Leslie P. Norton, China's Stocks Rattle Investors, Barron's, Nov. 10, 2008, at M8. Even on February 4, 2008, the p/e ratio of Shanghai shares measured 53 times 2007 profits. Areddy, supra note 150, at C5.]


\(^{156}\) [To work out the quality of Chinese earnings turns upon the set of stocks examined, and whether additional income—such as that of affiliates—is factored in. Anyway, Shanghai's exalted p/e ratios minimized how dear China's stocks really were. Shanghai's Paper Tigers, FIN. TIMES (London), Feb. 14, 2008, at 14.]

\(^{157}\) [In the accounting of the Wharton School of the U. of Pennsylvania Russell E. Palmer Prof. of Finance Jeremy J. Siegel. JEREMY J. SIEGEL, STOCKS FOR THE LONG RUN: THE DEFINITIVE GUIDE TO FINANCIAL MARKET RETURNS AND LONG-TERM INVESTMENT STRATEGIES 110-11 (4th ed., 2008). "The very high number recorded for 2002 is due to very special circumstances." Id. at 110.]

\(^{158}\) [Tom Lauricella, Are Low P/Es a Valid Reason to Buy Stocks?, WALL ST. J., Mar. 10, 2008, at C1.]

One complication is that earnings pogo around quite a bit. In calculating our p/e ratios, and reciprocally our earnings yields, do we use trailing 12-month earnings? Do we use next year's expected earnings? Do we use next year's expected operating earnings? Each of these leads to distortions and a different "normal" p/e ratio. Today for instance, the trailing 12-month earnings for the S&P 500 is $67, while Wall Street's estimate for 2008 operating earnings is $97, leading to current p/e ratios of 20 and 14 respectively. Robert Shiller, of Yale, came up with the elegant expedient of averaging real earnings over a 10-year span. This takes out the effects of economic peaks and troughs and leads to a much cleaner measure of whether the market is expensive or cheap.
The Shanghai Composite Index tracks yuan denominated Class A shares, and foreign currency denominated Class B shares.\textsuperscript{159} Short-selling\textsuperscript{160} A shares is illegal in the Chinese markets. Therefore some investors have shorted exchange-traded funds which track domestic Chinese markets.\textsuperscript{161} In China by late 2007, some five million new brokerage accounts were opening monthly. Over 60 million trading accounts (encompassing stocks and mutual funds) were opened during 2007 in China——over ten times the 2006 pace.\textsuperscript{162} Shanghai’s was the fastest growing exchange of 2007, with trading volume up 428 percent (by value). That gave it more trading than the Deutsche Börse, and established it as number six globally (by value traded).\textsuperscript{163} In December 2007 David Roche predicted: “The big shock of 2008 will be that the China bubble

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\textsuperscript{159} *Shanghai Stumbles 1.4% as Snowfall Hurts Outlook*, WALL ST. J., Feb. 2/3, 2008 at B3.

On Chinese exchanges, the majority of stock is Class A shares traded in Yuan, the Chinese currency, and the government limits how much of that can be owned by non-Chinese investors. A smaller market of Class B shares, denominated in U.S. dollars and Hong Kong dollars, is open to non-Chinese investors.


\textsuperscript{160} A “short sale” is “the sale of a security that must be borrowed to make delivery. Short sales normally, but not always, entail the sale of securities that are not owned by the seller in anticipation of profiting from a decline in the price of the securities . . . .” SCOTT, *supra* note 146, at 324. Repugnant to Beijing was anticipation of a stock decline.


The Chinese stock market—the so-called A-share market—is not efficient. One anomaly is that the prices for a Chinese share in Hong Kong and New York tend to be the same, but the same shares trade at premiums up to 100 percent in the A-share market. These inefficiencies do not present an opportunity to foreign investors unless one has one of the limited number of qualified foreign institutional investor quotas. The market is essentially restricted to Chinese nationals living on the mainland. Local Chinese institutions do take advantage of unsophisticated investors and that is why managed funds in China tend to outperform the market indices.


B. THE THUNDER OUT OF CHINA: 2008

Regulators had called for commercial banks to freeze lending through 2007. A China Banking Regulatory Commission official confirmed "guidance aimed at supporting the macro control measures being implemented." While the freeze did not appear connected directly to the stock bubble, it could leave the less cash to be plowed into stocks. Curbing lending through hiking interest rates would more have comported with a market oriented approach to business. Indeed, Chinese officials during 2007 increased lending rates a half-dozen times, and raised banking-reserve requirements ten times. To avert overheating, the People's Bank of China in 2007 tightened policy rates from 6.12 to 7.47 percent.

Even pre-2008, the Chinese stock market bubble resulting from excess liquidity in the Chinese financial system was recognized internationally. This excessive liquidity had stemmed from Beijing's bid to peg the yuan to the U.S. dollar. In July 2005, Beijing ended the yuan's informal peg to the dollar. However, Beijing continued tightly to control the value of the yuan. Critics assert that Beijing artificially...
suppressed that currency’s value to make Chinese exports cheaper and more competitive.174 This artificially suppressed interest rates. Said suppression led to misallocating capital, i.e., overinvestment.175 That tale is an ancient one.

For the so-called business cycle process always is born of credit expansion. Vital is that an expansion of credit lifts prices above their true market level. Too, it lowers the interest rate beneath its true market level, conjuring malinvestment.176 Now borrowing firms are misled into supposing that wealth is at hand, rendering (supposedly) profitable long term projects previously dismissed (accurately) as unprofitable.177 Therefore, the business cycle’s recurrent features include the boom phase, during which prices and production activity expand.178

Capital goods are produced goods, which must combine yet further...


China is still unwilling to let the renminbi float freely, because it does not want to cede control of its economy to market forces. Since depegging the currency from the dollar in July 2005, the Chinese authorities have closely managed its exchange rate.

The renminbi has been allowed to appreciate only gradually so as to boost the Chinese manufacturing sector, on which an increasing proportion of the country’s population depends. Before October it was allowed to rise at a steady annual rate of about 5 percent a year. This policy has not only seen China build up a significant trade surplus, but also, at $1,528bn, the largest stockpile of foreign exchange reserves in the world.


Of course, the integration of China’s surging economy, see, e.g., _China’s Surging Economy: Adjusting for More Balanced Development_ (John Wong & Wei Lu eds., 2007), into the world economy has implications for Beijing’s economic practices (including its exchange rate regime). See e.g., _Globalisation and Economic Growth in China_ (Yang Yeo & Linda Yueh eds., 2006). China’s current account surplus for 2007 approximated 10.5 percent of GDP. That was unprecedented for a China-sized economy. McGregor & Guha, _supra_ note 59, at 2.

China’s currency, the renminbi, which has appreciated by about 12 percent since Beijing officially broke its peg with the US dollar in mid-2005, has helped limit the surplus by making imports cheaper. But the appreciation to date does not yet appear to have had any material impact on China’s exports, which remain hyper-competitive.

_Id._


177. _Id._ at 856.

178. _Id._ at 745
with additional factors to satisfy consumer appetites. Within the boom phase nestles a more profligate boom in the heavy capital goods and higher order industries. These include industrial raw materials, construction, machine goods, and the markets in titles thereto, e.g., the stock market and real estate markets. (Remember those misdirected borrowing firms?) Sure enough, industrial output and infrastructure investments have outstripped even China's officially posted nationwide growth rates. For January-June 2007 they respectively swelled by 18.5 and (perhaps more tellingly) 21 percent. As trumpeted during 2007 of China: "People speculate in stocks in Shanghai and real estate in Shenzhen because money is cheap."

The cyclical terminus is the slump, unmasking the boomtime's easy credit conjured malinvestment (in higher order investments, unprofitable in an honest interest rate market). Once money has diffused economy-wide, an honest market's actual consumer sovereignty resurrects itself. Consumers evidence which boomtime investments were unprofitable, as those consumers reassert their actual preferences (as expressed at the market interest rate, once relieved of its immediately preceding credit distortion). Consequently, the China of 2008. Therein the overcapacity

180. ROTHBARD, supra note 176, at 745.
181. Righter, supra note 37, at 22.
182. Chancellor, supra note 149, at 20.
183. ROTHBARD, supra note 179, at 745.
184. Id. at 860.
185. Id. at 857.
186. Id. at 860.
187. Id. at 858. In real life, pain and inefficiency can accompany the reassertion of true consumer preferences:

It is the return of confidence, to speak in ordinary language, which is so insusceptible to control in an economy of individualistic capitalism. This is the aspect of the slump which bankers and business men have been right in emphasising, and which the economists who have put their faith in a "purely monetary" remedy have underestimated.

John Maynard Keynes, The General Theory of Employment, Interest, and Money 317 (1964). Keynes' reference to "purely monetary" economists reminds one that markets can be shaped by financial models
of 2005-2007 was being squeezed from the Chinese economy. (Remember that misallocated capital, i.e., overinvestment?)

Asset price bubbles build (and pop) in 2009 as they have since the early eighteenth century, when modern competitive markets evolved. For here is the verdict from former Treasury Department Undersecretary for Finance Peter Fisher on America’s 2006-2008 housing bubble burst and 2007-2009 stock market collapse:

In the middle years of this decade, we had negative real short-term interest rates. And that really means free money, which really distorts the system. Capitalism is premised on the idea that capital is a scarce commodity rationed with a price mechanism. It wasn’t just a handful of clever guys on Wall Street who figured out what to do with the free money. People all over the housing and financial services industries figured out ways to lever themselves up way too far. That’s the engine that led us this far astray.

People speculate in stocks and real estate because money is cheap. By no means are the populace, nor the rulers, of China to be singled out for castigation over financial mismanagement in view of China’s recent bubbles in stocks and real estate.

If this is so often told a tale, why does risk management, premised upon state of the art statistical models, so poorly perform? Because the underlying data exploited to estimate a model’s structure draw, generally, from both intervals of euphoria and of fear. Spans of euphoria (e.g., in China during 2007) are extremely hard to suppress. The speculative fever must break on its own (e.g., in China during 2008). These contraction phases of credit/business cycles, fear driven, historically have been far more abrupt (and fleeting) than the expansion phase, fueled by a slow yet cumulative euphoria build up.
In August 2008, property sales in China fell 15 percent over the preceding year. The National Bureau of Statistics reported sales falling over 39 percent in Shanghai and 55 percent in Beijing. Real estate accounts for a quarter of all investment on the mainland (approximately twice the American level). Too, that August prices nationwide registered a downtick, the initial instance in years when they had not grown.\(^{193}\)

And that stupendous thunderthud that you hear from China is the nosedive of the Shanghai Composite Index, and of the smaller\(^{194}\) Shenzhen market. This was the picture drawn as early as March 2008:

As the year turned, the world’s fears were invested in the US. All its hopes were turned to China. That has changed. Anxiety about China has suddenly spiked. This was partly because the bubble in its domestic equity market has burst. The Shanghai Composite is down 31.6 per cent from its October peak—more than the NASDAQ Composite had dropped at the same state after the tech bubble burst. Hong Kong-quoted H-shares and New York-quoted ADRs are down a bit less, but still by more than 20 per cent. PetroChina, the biggest Chinese company, has fallen by half since its November peak.\(^{195}\)

In 2008, the Shanghai Composite Index had fallen 72 percent from its October 2007 record\(^{196}\). At that, its p/e ratio stood about 23 percent above the p/e ratio of the All Country-World Index.\(^{197}\)

How profoundly can an emerging market plunge? The worst capitulation in emerging market history opened in 1997. Over 1997-1998, the Indonesian, Russian, and Thai markets retreated over 90 percent (in U.S. dollars). Those in the Philippines and South Korea gave up over 80 percent. And stocks in Hong Kong and Singapore fell by 70 percent.\(^{198}\) Moreover, history instructs that extremely sharp increases in stock prices seldom are followed by the gradual return to comparative price stability.\(^{199}\)

\(^{193}\) Frederik Balfour & Chi-Chu Tschang, A Housing Sinkhole Starts to Spread, BUS. WK., Nov. 3, 2008, at 84.

\(^{194}\) Andrew Wood, Chinese Shares Tumble in Fresh Sign of Deflating Market Bubble, FIN. TIMES (London), Nov. 3, 2008, at 84.


\(^{199}\) BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: A TIME-TESTED STRATEGY FOR SUCCESSFUL INVESTING 50 (rev. and updated, 2007).
C. THE RULE OF LAW IN CHINA: 2009

Colossal bubbles have typified early capitalism. Once bubbles burst, bad debts surface, invariably. The financial system goes through the wringer. It was grasped that once China’s excess extra liquidity were mopped up, not only would the stock market tumble and profits contract, but the banking system could suffer as well. So must be set the stage for Beijing’s test of 2009: Can China flourish all the way to developed nation status without the rule of law?

What precisely might Beijing do to advance the rule of law during 2009, in the wake of the pricking of the stupendous Shanghai Composite Index bubble? China’s official data disclose that in excess of 100 million people had invested in equities (mostly during the pre-October 16, 2007, bull market). Angered retail investors, following their bubble’s burst, plausibly will demand investigations into corporate monkey business. Even largescale public protest looms as a possibility. Thousands of irate investors demonstrated at Ministry of Finance headquarters the day following that Ministry’s increase by .2 percent of the trading tax during May 2007.

Beijing should react to public pressure by punishing individuals and companies which engaged in illegal dealings during the heady bubble years climaxing in 2007. The China Securities Regulatory Commission (the watchdog over the market) ought to open its investigative proceedings to the populace. Beijing should make a virtue of necessity by rendering its China Securities Regulatory Commission genuinely independent. That Commission’s institutional autonomy crucially could indicate Beijing’s post-crisis commitment to reform.

In 2008, the Commission was a bureaucracy staffed with political appointees. They wielded limited power to enforce regulation. To de-link the China Securities Regulatory Commission from the Communist Party’s patronage network, and to appoint genuinely respected persons (including foreigners) experienced in financial regulation to the truly


201. Chancellor, supra note 145, at 20.

independent new Commission should become a priority. This would constitute a timely step along the lengthy road to the rule of law. Only slowly, through sometimes painful trial and error, will elites accept that it is in their self interest to submit to the rule of law.

At least in principle, in agriculture it is not landownership which matters. A government is not necessarily a farmer's more incompetent landlord than is a private landowner. What counts is whether the agriculturist enjoys property rights in her produce. The typical anemic agricultural productivity in socialist economies stems from conditions of those economies overall, and from agriculture's relationships respectively to markets for inputs and outputs, and to the nonagricultural sectors. In China, per capita grain production was identical in 1936, 1957, and 1977.

Already one discerns impressive evidence of the payoff in China from secure property rights. Explained economist Craig Richardson, of China:

Its economic growth has depended upon a property-rights system with varying degrees of security. There appears to be a three-tier system of property rights, depending on where the property is located and who owns it. Peasant farmers have the least protection, city residents have better protection, and foreign investors have the most secure property rights.

There hasn't been a single case of a foreigner investor losing property during the past 50 years. Foreigners have developed a high level of trust with the Chinese. Foreigners often build in rural areas, but they don't negotiate with individual farmers over the purchase of land, since farmers work under the auspices of so-called Town Village Enterprises.

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206. Craig Richardson, China's New Landed Gentry: Foreigners, BARRON'S, Oct. 27, 2008, at 55. A TVE is a land collective that lets farmers receive the fruit of their labors, but decides from year to year how land will be allocated. The mayors or managers of the TVEs are directed by China's central government to be self-supporting; no one expects government bailouts from Beijing. TVEs act as if they were for-profit corporations, with peasants in the role of de facto employees, rather than property owners. TVEs compete with each other in wooing foreign investors, promising them tax breaks and land. A foreign company can generate far more tax revenue
This property rights system, unthwarted by special interests, resolves around the interrelationship of foreign investors and the TVE. The TVE enforces foreign land rights; foreign companies reciprocally deliver tax revenues. According to a 2006 analysis by the National Bureau of Economic Research, workers in foreign-owned companies number just 3 percent of the Chinese labor force, but their productivity is eight times the greater, accounting for approximately 40 percent of GDP growth overall.\textsuperscript{207}

Excruaciately protracted remains the road to the rule of law in Communist China. Chinese courts are not independent of the Communist Party. Courts decline, often, to hear politically sensitive cases. As many as 300 attorneys have been jailed, some for speaking out concerning human rights. Amnesty International (plus other groups) have raised voices over a crackdown on attorneys (and other rights defenders) who embrace causes carrying a political charge.\textsuperscript{208} As declaimed on December 10, 2008, by the bold signatories of Charter 08, a public summons for China to become an open society:

\begin{quote}
The political reality, which is plain for anyone to see, is that China has many laws but no rule of law; it has a constitution but no constitutional government. The ruling elite continues to cling to its authoritarian power and fights off any move toward political change. The stultifying results are endemic official corruption, an undermining of the rule of law, weak human rights, decay in public ethics, crony capitalism, growing inequality between the wealthy and the poor, pillage of the natural environment as well as of the human and historical environments, and the exacerbation of a long list of social conflicts, especially, in recent times, a sharpening animosity between officials and ordinary people. As these conflicts and crises grow ever more intense, and as the ruling elite continues with impunity to crush and to strip away the rights of citizens to freedom, to property, and to the pursuit of happiness, we see the powerless in our society—the vulnerable groups, the people who have been suppressed and monitored, who have suffered cruelty and even torture, who have had no adequate avenues for their protests, no courts to hear their pleas—becoming more militant and raising the possibility of a violent conflict of disastrous proportions. The decline of the current system has reached the point where change is no longer optional.\textsuperscript{209}
\end{quote}

and many more jobs than a rice-paddy farmer.

\textit{Id.}

\textsuperscript{207} Id.


\textsuperscript{209} \textit{CHINA'S CHARTER 08}, \textit{supra} note 29, at 54. Predictable was Beijing's response: "Currently, the security forces are cracking down on intellectuals associated with Charter 08, an appeal for democracy and human rights that many see as the most significant such document since 1989 and
What is at stake in all of this?

VII. THE GLOBAL STAKE IN CHINA: 2010

A. THE IMMEDIATE YANK STAKE

The Chinese performance in 2010 must be of more than theoretical interest to American analysts. The United States dictates the international monetary affairs agenda even following the colossal financial tumult of 2008. The macroeconomic role of a modern financial market is to pool risk, to share information, and to deliver liquidity. Sans a smoothly running financial market entailing appropriate informational flow, and risk pooling, there would prove less finance for venture capital, and private equity. Given that efficient financial systems allocate capital to businesses with the highest growth potential, financial development is a cause of (not just a consequence of) economic growth. That has been established firmly by economic research of the past two decades. And the American finance industry offers more support for emerging companies than does its European counterpart. The trend within U.S. capitalism is

which has, defying Beijing’s net censorship, been collecting signatories over the web.” Kathrin Hille, China Steps Up Internet Censors’ Scrutiny, FIN. TIMES (London), Jan. 5, 2009, at 4. “The country’s efficient repression apparatus has swung into action, with at least 70 of the 303 people who initially signed the charter summoned or interrogated.” Jamil Anderlini & Kathrin Hille, Crackdown Lays Bare China’s Harsher Stance, FIN. TIMES (London), Jan. 3/4, 2009, at 3.

All mention in the charter of Chinese is blocked from websites, search engines and even e-mails. Propaganda officials have banned domestic media from interviewing any signatories or publishing any of their work. According to Amnesty International, the authorities now consider the charter a “counter-revolutionary platform”, a likely sign that signatories will be dealt with more harshly.

Id.


212. According to N.Y.U. Stern School of Business Prof. Thomas Phillipon, and Nicholas Véron, research fellow at Bruegel:

[T]he American finance industry offers more support for the growth of emerging companies than its European counterpart. Economic research in the past 20 years has firmly established that financial development is not only a consequence, but also a cause of economic growth. Efficient financial systems enable the allocation of capital to businesses and entrepreneurs with the highest growth potential. Europe’s recent financial development has been impressive but remains unbalanced. The continent’s large companies can now rely on deep, liquid and efficient capital markets. But every available indicator suggests that emerging enterprises benefit from a wider range of appropriate financing solutions in the US than in Europe.

Thomas Phillipon & Nicholas Véron, Europe’s Saplings Need Financial Fertiliser, FIN. TIMES
the gathering subordination of operations and the preeminence of finance. Finance has trumped industry.

Financial services—prior, at least, to the 2007-2009 financial tempest—represented almost the last thing wherein the United States yet excelled worldwide. The finance industry’s contribution to the economy increased from 2.3 percent of GDP during 1947 to 4.4 percent in 1977. It reached 7.7 percent of GDP by 2005. Students studying toward the M.B.A. at topranked American schools favored employment with financial services institutions. Of Harvard’s M.B.A. class of 2008, 41 percent selected market-sensitive careers, actually topping the 40 percent of her class of 2007. General Electric reaped from financial services 34 percent of its pretax earnings. Caterpillar (earthmoving equipment), Deere & Co. (tractors), and Pitney Bowes (postage meters) each pockets a minimum of 12 percent of its earnings via financing things. A report on the top fifty


If one must get permission from a wide variety of agencies, and file a long series of complex environmental impact statements, and worry that after building a plant and hiring workers, the plant cannot be closed and the workers let go if conditions require, and on and on and on, then potential entrepreneurs will be less likely to take big risks in putting a satellite in space, or mining the sea, or building a nuclear fusion plant. Instead, individuals and entrepreneurial firms will turn to financial adventuring such as selling tax shelters and fighting to take over existing firms.

SIMON, supra note 205, at 162-63. But some complained that America’s politicians err in gambling the country’s future on finance. See, e.g., KEVIN PHILLIPS, BAD MONEY (2008).


centers of commerce found London leaving New York in the second place slot (but with third ranked Tokyo followed by Chicago).  

Earlier had North explained that the main reason for modern economies’ services sector growth is that resources become devoted to transacting. Transaction costs are entailed by exchange. As specialization and its concomitant division of labor have waxed, so has the sum of exchanges. External to a firm, banking, insurance, finance, wholesale and retail trade (atop a goodly chunk of governmental functions) all are a portion of the transaction sector. Internal to a firm, bloating numbers of accountants and attorneys facilitate exchanges and a complex environment of impersonal exchange. The progress from personal to impersonal exchange magnifies the sum of transaction costs, invariably. Yet the consequence marks a drastic cut in production expenses. This more than counterweighs the heavier resources allocated into transacting. This made for the dramatic expansion of the modern economies.

It is plain that the United States (and the United Kingdom) felt less Chinese competition in the business cycle now just concluded than had the percent of a finance company (Sony Financial). Id. at 48. In 2006, 82 percent of Sony’s $1.1 billion in pretax earnings derived from its financial unit. This was double the sum raked in by its pictures division through producing films like CASINO ROYALE and THE DA VINCI CODE. Id. 


Or as Dr. Garry Wills anticipated North:

One long-recognized use of capital is to give leisure for planning, inventing, tinkering, teaching new workmen, etc. In that sense, capital has always flowed in to a “knowledge industry.” Furthermore, the production of wealth is incomplete without its distribution and protection. It does no good to produce thousands of shoes if you cannot find people who want them, or if the people who want them just come and grab them for free. By considering problems of distribution and protection, the knowledge industry completes the production process.


A critical role for public coordinating institutions in furnishing the prerequisites for market stability and economic recovery has been suggested relative to postwar European capitalism. See, e.g., Barry Eichengreen, The European Economy Since 1945: Coordinated Capitalism and Beyond (2005). James Tobin, awarded the Alfred Nobel Memorial Prize in Economics in 1981, BANNOCK, ET AL., supra note 9, at 410, declared: “It was a bunch of planners—Truman, Churchill, Keynes, Marshall, Acheson, Monnet, Schumann, MacArthur in Japan—whose vision made possible the prosperous postwar world.” JAMES TOBIN, WORLD FINANCE AND ECONOMIC STABILITY: SELECTED ESSAYS OF JAMES TOBIN 210 (2003). (It is thanks to General of the Army Douglas MacArthur that Japanese corporate law is based on the law of Illinois. DAM, supra note 38, at 174.)

It has been supposed that the ideal of an atomistic and anonymous market remains potent, but is probably to endure as an ideal. See, e.g., CAITLIN ZALOOM, OUT OF THE PITS: TRADERS AND TECHNOLOGY FROM CHICAGO TO LONDON (2006).
large economies of central Europe.\textsuperscript{226} As well, with their disproportionately outsized financial sectors, those two countries likewise had reaped a financial windfall from the rise of China (and of other emerging markets).\textsuperscript{227} Still, the United States and United Kingdom would do well to beware of a 2008 Chinese stock market collapse, and 2010 emergence in Beijing of the China Syndrome previously evident in the 1997-1998 Asian financial crisis. An ebbing tide strands every boat.

B. THE LONG-TERM STAKE INTERNATIONALLY

Furthermore, the whole world inevitably is invested in a China of 2010 approaching developed nation status (in the contemporary international order) via opting for the rule of law. Princeton University Professor G. John Ikenberry propounds that the American led, post-Second World War international order has been historically unique.\textsuperscript{228} The institutions and rules thereof are rooted in (and reinforced by) capitalism and democracy.\textsuperscript{229}

Particularly has a triad of specific features of this Western order proved critical to its success, and to its durability:\textsuperscript{230} “First, unlike the imperial systems of the past, the Western order is built around rules and norms of nondiscrimination and market openness, creating conditions for rising states to advance their expanding economic and political goals within it.”\textsuperscript{231} In Ikenberry’s account of this Western order nondiscrimination is reflected, somewhat, Buchanan’s principle of generality (as a key to the rule of law). Second is the coalition based nature of the Western order’s leadership.\textsuperscript{232} Moreover: “Third, the postwar Western order has an unusually dense, encompassing, and broadly endorsed system of rules and institutions. Whatever its shortcomings, it is more open and rule based than any previous order.”\textsuperscript{233} Ikenberry’s account of this Western order’s predilection for rules echoes, somewhat, the North, Wallis, and Weingast accent upon the rule of law for elites (as a key to an open access order). New York University Professor of Economics William J. Baumol sometimes asserts that there is no profession the total economic product of

\begin{footnotes}
\item[227] Id.
\item[229] Id.
\item[230] Id.
\item[231] Id.
\item[232] Id.
\item[233] Id.
\end{footnotes}
which exceeds that of attorneys. But there exists no profession the marginal contribution of which proves slighter!

Given the first of these features (market openness) and the third (system of rules and institutions) be advised that—as few westerners are aware—China and the Association of South East Asian Nations have agreed to create the world’s largest free trade area. This will encompass 1.7 billion people. Their project contrasts with the American (and European) publics’ loss of faith in free trade. The China of 2010 must feel two propensities: “China not only needs continued access to the global capitalist system; it also wants the protections that the system’s rules and institutions provide.” The mounting interdependence of Pacific economies could make a pillar of global economic growth and stability.

It might be possible for China economically to overtake America, alone. Yet it is unlikely that China ever could overshadow the wider Western order.

But when the economic capacity of the Western system as a whole is considered, China’s economic advances look much less significant; the Chinese economy will be much smaller than the combined economies of the Organization for Economic Cooperation and Development far into the future. This is even truer of military might: China cannot hope to come anywhere close to total OECD military expenditures anytime soon. The capitalist democratic world is a powerful constituency for the preservation—and, indeed, extension—of the existing international order. If China intends to rise up and challenge the existing order, it has a much more daunting task than simply confronting the United


Capitalism requires markets in which the participants can have confidence in any agreements arrived at. It is driven by the pursuit of accumulated and retainable wealth and opportunities to expand that wealth by devoting it to the production process. Sanctity of property and contract, and institutions that can be relied upon to enforce them both, are necessary conditions for the creation of capitalists and for effective execution of their role. That is why, without the contribution of the lawyers, the free-market economies might never have evolved. And even if they had, it is unlikely that their unprecedented growth could have occurred. It is on these grounds that I base my evaluation of the enormous total contribution of lawyers to the performance of the industrial economies.

Id. at 69.

235. Id. at 68. “Alas, no successful civilization in history—Greece, Rome, England, France, the list goes on—ever found prosperity through its bureaucrats and lawyers.” Victor Davis Hanson, 'Post-Industrial’ America Needs Can-Do Leaders, INVESTORS BUS. DAILY., July 22, 2008, at A13.


237. Id.

238. Id. “Japan and India have similar FTAs with Asean.” Id.

239. Ikenberry, supra note 228, at 32.

240. Mahbubani, supra note 236, at 11.

241. Ikenberry, supra note 228, at 36.
And, perhaps, economic development can help midwife democracy ("capitalist democratic world").

**VIII. THE SPECTER OF 1997-1998**

Unfortunately, evidence suggested that China’s output alarmingly shrank in October 2008. Economic conditions appeared to be deteriorating speedily. Remember the cyclical terminus? In the 70 largest cities, house prices downticked .3 percent between September 2008 and October 2008. They downticked another .5 percent between October 2008 and November 2008. In Shenzhen, housing prices by late November had eroded by 14.8 percent since November 2007 alone. China’s economy relies upon real estate investment for 9.2 percent of G.D.P.

China admitted to a 9.6 percent decline in electricity generation in November 2008 from a year earlier. There was a 12.4 percent plunge in crude steel production over November 2007-November 2008. Finished steel was down 11 percent. China’s November 2008 passenger auto sales marked a 12 percent year-over-year drop. The Purchasing Manager’s Index (which is prepared by the China Federation of Logistics and Purchasing) in October 2008 fell to a seasonally adjusted 44.6. This marked the lowest reading since the July 2005 inauguration of that gauge. According to preliminary data from China’s General Administration of Customs, her October 2008 diesel fuel imports of 80,000 metric tons proved well beneath the 338,838 tons imported during September 2008. This October 2008 total was down 46.4 percent from the October 2007 figure, and diesel fuel imports had dropped to their lowest

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242. *Id.*


On November 26, 2008, Shenzhen’s mayor confessed that factory closings had eliminated 50,000 jobs therein during 2008. Closed, or ceasing production, were 682 factories. Between January 2008 and January 2009 foreign direct investment in China shranked 33 percent. By late 2008, widespread factory closures in southern China had ignited a series of protests. Director of the Central Rural Work Leading Group Office Chen Xiwen in February 2009 conceded that approximately 20

255. Jason Leow, China President Warns Hurdles Ahead, WALL ST. J., Dec. 1, 2008, at A16. Localised disturbances are a common occurrence and these are only likely to multiply in the months ahead. But Chinese workers focus their anger first on the factories and bosses that fire them, with local government officials quick to adopt an empathetic and supportive pose when disputes flare up. Equally important, the Chinese state’s ability to sniff out and suppress the stirring of a more ambitious labour movement remains formidable.
million migrant workers—nearly a sixth of the 130 million such—had lost their jobs over recent months.\textsuperscript{258} This total (derived from a survey of 150 villages, extrapolated nationwide) doubled that calculated by the human resources ministry at close of 2008.\textsuperscript{257} And those 20 million unemployed excluded those lingering in cities after suffering redundancy or yet obtaining some kind of stipend after becoming redundant.\textsuperscript{258} The ranks of the unemployed were expected to hit 25 million.\textsuperscript{259}

Cobalt is viewed as a crude proxy for industrial activity, so varied are its applications. The cobalt market's poles are China and the Congo. Katanga province attracts foreign mining companies by the score. In 2007, some 64 percent was processed in China. Yet Chinese industrial ferment so precipitously slowed that cobalt demand ground to a halt in 2008. Between March 2008 and November 2008, the cobalt import price in eastern China fell 50 percent.\textsuperscript{260}

China's 2009 exports could decline by 20 percent.\textsuperscript{261} For China's customs agency shocked economists by revealing that Chinese exports fell 2.2 percent between November 2007 and November 2008 (their worst collapse since 1999, and initial decline since June 2001). Meanwhile, imports dropped 17.9 percent through the identical span (their grandest drop since the early 1990s). Imports had risen over 20 percent during 2007. Exports during January 2009 recorded their worst setback in over a decade, receding 17.5 percent from January 2008. This decline pace accelerated from the December 2.8 percent drop. China's imports plummeted 43.1 percent, versus only a 21.3 percent December contraction.\textsuperscript{262} Preliminary customs data disclosed that China's importation of crude oil slipped 17.3 percent between October and November 2008 (notwithstanding a slump in the price of crude oil).\textsuperscript{263}

\begin{footnotesize}
\begin{itemize}
  \item 257. Mitchell & Waldmeir, \textit{supra} note 255, at 3.
  \item 259. Out of Work in China, BUS. WK., Feb. 16, 2009, at 12.
  \item 261. And each one percent retreat elicits a domestic GDP contraction of .6 percent in domestic GDP, thanks to China's structural overexposure to exports. Frank Roche, \textit{Blight of Capital Protectionism Will Give Rise to Dollar Crisis}, FIN. TIMES (London), Jan. 30, 2009, at 22.
\end{itemize}
\end{footnotesize}
China’s abrupt deceleration derived from decisions of 2007 to remove the froth from the booming property market.²⁶⁴ Remember those interest rate revisions²⁶⁵ of 2007?²⁶⁶ The slowdown started in the housing market and spread to such related industries as cement and steel.²⁶⁷ So by November 2008, the collapse of China’s housing market had sliced demand for steel. According to the China Iron & Steel Association, the industry’s average profit margin by autumn 2008 had evaporated from 7.6 percent in the opening half of 2008 to 1.4 percent. The steel industry’s 2008 downturn proved both the deepest and sharpest since, at least, the 1997-1998 Asian financial crisis period.²⁶⁸ Inasmuch as China represents 50 percent of world steelmaking capacity, her steel firms will face a rough patch in financing idle capacity.²⁶⁹ In November 2008, iron ore imports dropped 7.9 percent.²⁷⁰ And a large fall in orders from sectors like construction (and automobiles, and appliance) resulted in a December 1, 2008, announcement that China would spend some $3 billion buying base metals to cushion its mining and smelting industry from plummeting demand.²⁷¹ In February 2009, new car sales for 2009 were expected to level or decline.²⁷²

Beijing claimed a fourth-quarter 2008 economic expansion over the fourth quarter of 2007. But after stripping away seasonal adjustments, some economists tentatively estimated the economy actually could have shrunk.²⁷³ Few economists credited China’s official unemployment rate of 4 percent. Economist at the Central Party School (a Communist Party institute, in Beijing) Zhou Tianyong estimated the true jobless rate at about

²⁶⁵. Authers, supra note 169, at 17.
²⁶⁶. In 2008, China reversed that 2007 interest rate course:
The Chinese central bank reduced its key one-year lending rate to 6.66 percent from 6.93 percent on Oct. 29. China cut borrowing costs for the first time in six years on Sept. 15, the day U.S. investment bank Lehman Brothers Holdings Inc. filed for bankruptcy. It followed up with another reduction on Oct. 8 as the Fed and five other central banks made emergency coordinated reductions to counter the financial crisis.
Dwyer, supra note 247, at 7.
²⁷³. Geoff Dyer, Economists Treat Statistics from Beijing with Caution, FIN. TIMES (London), Jan. 23, 2009, at 3. “The official figures for house prices are believed by some to understate both past increases and current decreases in prices.” Id.
12 percent, rising to 14 percent in 2009.\textsuperscript{274} Of China’s 5.6 million 2008 university graduates, 1.5 million had not been able to find jobs by early 2009.\textsuperscript{275}

Australia’s central bank Governor Glenn Stevens in December 2008 opined: “The most striking real economic fact of the past several months is not continued US economic weakness, but that China’s economy has slowed much more quickly than anyone had forecast.”\textsuperscript{276} In January 2009, the price of goods departing factories dropped 3.3 percent, probably to depress corporate profits (a crucial investment source in China).\textsuperscript{277} The retreat of China’s manufacturing output put a quietus to the theory of economic global decoupling. Finance professor at Guanghua School, Peking University, Michael Pettis explained that developing nations’ dependence on American demand was obvious from world balance of payments data: U.S. trade deficits and the developing lands’ trade surpluses rose as proportion of global G.D.P. in a nearly unbroken line between 1997 and 2007. The world balance of payments could be restored via sharp decline in global production: ending overcapacity via stupefying factory bankruptcies.\textsuperscript{278} Given political realities, the Asian trade surplus countries’ production looked destined to contract, painfully.\textsuperscript{279}

However, in the winter of 2009, there appeared but little Beijing policymakers might attempt short-term without evoking an export sector collapse, and an unemployment hike threatening social stability. China must take years to adjust, demanding substantial change in her financial system.\textsuperscript{280} Citibank economist Ken Peng perceived that the People’s Republic’s 2008 production growth slowdown proved even more abrupt than that of the fateful Asian financial crisis of the 1990s.\textsuperscript{281} And a behemoth Chinese stock market clifftop leap prepares a 2010 test of Beijing’s ability to finally achieve what her twentieth-century neighbors could not achieve: Developed nation status devoid of the rule of law.

\textsuperscript{274} Batson, supra note 268, at A13.
\textsuperscript{276} Batson, supra note 268, at A13.
\textsuperscript{279} Pettis, supra note 278, at 11.
\textsuperscript{280} Michael Pettis, \textit{This Is Not the Time to Attack China}, FIN. TIMES (London), Feb. 18, 2009, at 11.
IX. CONCLUSION

The preceding discussion briefly has reviewed the field of political economy as overlapping economics, politics, and law. Debate over political reforms in the People's Republic of China must distinguish the rule of law from democracy. To a large extent, it is the shield of the law (as distinct from democracy) which elicits investor confidence because investor rights are respected. Soros Fund Management Chairman George Soros made plain as much in a 2008 interview with Judy Woodruff:

Woodruff: So while people are thinking that goods are cheaper from China, you're saying the prices go up. It affects so many things that we buy in this country. What of Russia and how its economy is doing?
Soros: Basically, the country is benefiting from the high price of oil, but, at the same time, it is reestablishing a very authoritarian regime where the rights of investors are not respected. Now it is British Petroleum that is being chased out. So you invest at your own risk. I've done it and I'm not going to do it again.
Woodruff: So what you see in Russia tells us that political freedom and economic freedom are separable after all?
Soros: Well, the lack of political freedom also impinges on the rights of shareholders. So it's not a suitable area for investing exactly because you don't have the rule of law. China is improving a great deal. The rule of law is getting stronger in China, even though you don't have democracy.

Political economy helps to instill the lesson that the rule of law (Soros: "even though you don't have democracy") enriches the environment for countrywide economic development.

Police state Commnunist China's mindboggling boom of 1978-2008

282. See, e.g., DEBATING POLITICAL REFORM IN CHINA: RULE OF LAW VS. DEMOCRATIZATION (Suisheng Zhao ed., 2006).
seemed to prove the rule of law to be optional to national development. The Asian economies since 1960 have outpaced in growth those of the west. First emerged Japan, Singapore and Taiwan. Erupting thereafter were the People's Republic of China and, less effervescently, India. However, Beijing has yet to snatch the trophy of developed nation status. Similar longer term booms in East Asia of over a decade ago foundered on the shoals of financial crisis. It was speculated whether the Wall Street Crash climaxing in March 2009 would prove the catalyst for a Chinese meltdown devastating China's economy. China's 2008-2009 downturn definitely marked her most serious one since 1989. It was speculated whether the 2008-2009 downturn could light the fuse for the blowup of the Chinese Communist tyranny.

The year 2009 marked a juncture wherein China had the chance to enhance the rule of law internally, and so to advance to developed nation status along that thoroughfare. Too, in 2010 China will have the chance to prove itself a fit partner of neighbor lands globally, above all, of her valiant little sister Taiwan. Beijing can do so by embracing the rules and norms of nondiscrimination and market openness, and a system of rules and institutions. The latter endeavor could redound to the profit, and enhanced military security, of the human race. Even so much is in play.

286. Id.
287. Id.
290. “China's fiscal bailout contains lots of smoke and mirrors, and social unrest is mounting. We may be seeing the final days of the Mao dynasty.” A. Gary Schilling, Field Day for Short-Sellers, FORBES, Feb. 16, 2009, at 106.

China is best viewed as a paradox. Seen from western capitals, it often appears bathed in a glow of enviable destiny—the future superpower with supercharged growth. But from within Zhongnanhai, the forbidden compound in central Beijing where its leaders live and work, the country feels besieged by a perennial employment crisis, the social injustice of a vast wealth gap, restive ethnic minorities and a deep imbalance between the rigidity of Communist rule and the flexibility required by a capitalist economy.

The west may be looking to China as a source of growth, but Beijing is feeling defensive: concerned above all else to ensure that a sharp slump in growth does not trigger regime-threatening unrest. All Chinese policies can almost always be traced back to this primal fear.

291. See, e.g., Patrick Smith, Taiwan and China Dance Ever Closer: To Further Economic Integration, Beijing and Taipei May Table the Issue of the Island's Sovereignty, BUS. WK., Nov. 10, 2008, at 58. Meanwhile, official data discloses that Taiwan's GDP shrank 8.86 percent between the final quarter of 2007 and the final quarter of 2008. Taiwan's economy contracting for two consecutive quarters, it glided into recession. This especially spelled gloom for China, wherein Taiwanese manufacturers have relocated much of their output. Robin Kwong, Tumbling GDP Pushes Taiwan into Recession, FIN. TIMES (London), Feb. 19, 2009, at 2.