

The Federal Reserve and the People's Bank of China: Taiwan

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Abstract

Throughout time and history, civilizations have risen and fallen. Empires have cultivated massive amounts of land, only to be torn down by internal conflict. Nations have amassed armies to go to war, only for the tactics of war to switch. The extended history of international relations must be summed up into a single word: deception. Because of this, nations seek to grow their militaries, economies, and cultures in ways that rival others. The competition that the United States (US) will encounter over the next decade is through asymmetrical competition with China. However, the United States has historically been economically linked to the Chinese Communist Party (CCP). Through the latter's international deception, this has led to the rise of the CCP. Though their GDP is beginning to rival the United States, their economy has very little protection to foreign involvement as seen with the Evergrande bankruptcy. The United States must decouple its economy from China and begin to move its key industries stateside. This will mean that the US must bring the semiconductor industry to the stateside front. As Taiwan currently leads the world in semiconductor manufacturing, both hegemony seek to control the small island. If the central point of Taiwan disappears, then the prospect of war with China disappears.

Introduction

Throughout time and history, civilizations have risen and fallen. Empires have cultivated massive amounts of land, only to be torn down by internal conflict. Nations have amassed armies to go to war, only for the tactics of war to switch. The extended history of international relations must be summed up into a single word: deception. Because of this, nations seek to grow their militaries, economies, and cultures in ways that rival others. The competition that the United States (US) will encounter over the next decade is through asymmetrical competition with China. However, the United States has historically been economically linked to the Chinese Communist Party (CCP). Through the latter's international deception, this has led to the rise of the CCP. Though their GDP is beginning to rival the United States, their economy has very little protection to foreign involvement as seen with the Evergrande bankruptcy. The United States must decouple its economy from China and begin to move its key industries stateside.

The Market Economy

Classical Economics

Classical economics deals with the idea that price is king. When trading on the global scale, nations with various mineral deposits, work ethics, and skills may trade at a discount or a premium. This can result in wheat from the Balkans having a cheaper price than that of Kansas. The Balkans may not have a high wage per hour; thus, the wheat is not nearly as expensive as it would be from Kansas, a state with a high wage per hour (compared to the world stage). The only charge that would inherently increase the price would be the shipping from one country to the next. Classical economics is fueled by the concept of attempting to find a new or better way to accomplish a goal sought by many – better and easier ways to find money. In stocks, it is buying shares of a company at a low price and selling at a higher price. In business, it is finding a hole in the market and exploiting it. However, how does business proceed when the banks fail, ceasing the flow of cash? The business must close, even if the business is experiencing major growth in sales. The only way to stem the tide is by government intervention. Keynes thrived on this concept.

Keynesian Economics

Classical economics brought forth Keynesian economics. This was a shift entirely away from the price-based reforms that the classics brought forth. John Maynard Keynes founded Keynesian economics out of the Great Depression of the 1930's. The concept of Keynes was to allow the government to step into the private sector to encourage investment. During these economic downturns, consumer spending is always going to see a pullback. This will lead to lower earnings on Wall Street, which inevitably leads to larger selloffs. As consumer spending took a decline, government spending was ramped up tremendously to fill the discrepancy. To fill the discrepancy, the government must know who to help. Therefore, Keynes focused on two aspects of the economy: saving and investing based upon income. In Classic economics, saving and investing are intertwined in the pursuit of letting the market play out in the absence of governmental price regulation. In Keynesian economics, they are separate. Over time, as a person gains an income, they will save as much money as they can. Saving does wonders for the individual. When the economy takes a downturn, the lower and middle class are always the primary victims. As the downturn takes hold of the market, the lower and middle class must utilize their savings to minimize the effects of inflation on their incomes. However, in those rare

instances when the economy is booming, people's savings increases in connection with the rate of inflation. However, money is fungible. It may only move in one direction. It can be saved, or it can be spent.¹ When money is saved, it is usually due to the consumer perceiving a major event on the horizon. This event could be as "routine" as the birth of a child, buying a house, or starting a business.² However, this event could be the next Great Depression. Either way, in economics it signals that the consumer holds a viewpoint that is incongruent to the financial sector. Keynes believed that saving and investing are one in the same.³ This makes sense if one is intending to save to contribute later in society by buying a house, adding a child, or starting a business. To make the heavier movements in society, the debt-to-income ratio will always be a factor. It is this ratio that is driving many current decisions in the Fed. In his Preface to the German Edition of *The General Theory of Employment, Interest, and Money*, Keynes states,

Nevertheless, the theory of output as a whole, which is what the following book purports to provide, is much more easily adapted to the conditions of a totalitarian state, than is the theory of the production and distribution of a given output produced under conditions of free competition and a large measure of *laissez-faire*.”⁴

The Buyback Problem

A factor of Wall Street that consumers loathe are stock buybacks. Buybacks are when a company seeks to boost and stabilize its share price by buying tens of thousands of shares in their stock. Over the past two years, Lowe's has invested \$15 billion in its own company. These are usually hated by consumers because they perceive it as a method for the executives to have higher paychecks. However, in the stock market, it is a different story. Stock buybacks inflate the price of the stock to an unhealthy level. While it does not damage the stock nor the stock market, it creates a pseudo price. If a stock is worth \$10 at company *ABC*, then it is bought and sold on the stock market for \$10 with fluctuations in either direction based on market performance. In a week, *ABC* is planning a stock buyback of \$10 billion that will bring the stock to \$100 per share. Nothing in their business model has changed, products have yet to fly off the shelf, and social media has yet to make it a trend. Yet, this stock has popped \$90. This is the best-case scenario for the investor holding the stock, however it funnels money away from the business. *ABC* could have utilized that \$10 billion to break into other markets, give their employees a raise, or use it to pay off debt to leverage more.

Keynesian economics functions in the same manner. When markets hit volatile times, the investor finds unmitigated risk in his assets. Because of this, the markets will inevitably enter recessionary periods. To fight the recession, the government steps in to alleviate some of the pains brought on by the hard times. However, through this process, new money is introduced into

¹ Spending will be referred to as a type of investment. When someone spends \$10 on a burger, they are investing in their appetite. If someone spends \$1,000 on stocks, they are investing in their future.

² "Routine" in this instance is referring to major life events that most people can relate to on a basic level.

³ John Maynard Keynes. 2016. *The General Theory of Employment, Interest, and Money*. Pg, 37 Youcanprint.

⁴ Ibid. Pg 6

the system. This brings about inflation, thereby driving prices up to an unrealistic price point. This is the alternative route to investing in a \$10 stock and ending up at a \$100 stock.

Depoliticized Keynesianism⁵

As John Keynes mentioned in his Preface to the German Edition, Keynesian thought is positioned for the totalitarian state. Defined by Merriam Webster, totalitarianism is “the political concept that the citizen should be totally subject to an absolute state authority.”⁶ Totalitarianism usually is formed after a major crisis like the Great Depression, the Allies calling the debtor note on Germany in the 1930’s, and the housing crisis of 2008. During these times, citizens rely on governmental authority to ease the pain that the economy is unleashing. Out of one of these crises came the Fed. The Fed is an independent body that reports to Congress, but it is not under Congressional control. The Fed is the main body that manages monetary policy. The time when most people will hear of the Fed is when it goes into crisis management. During the COVID-19 pandemic, the Fed was active in maintaining and adjusting interest rates to accelerate the economy through what was one of the worst selloffs in recent history. Undoubtedly, without the Fed the US would certainly have uncontrollable inflation. However, the Fed has become the hot political topic of the past few years due to inflation. Calls from the Democrat Party state that the Fed is not putting its full weight into attempting to stymie inflation. Calls from the Republican Party state that the Fed is involving itself into matters that do not concern that bureaucracy. The Libertarians merely want the Fed to be dissolved no matter what happens.

However, the Fed was created to be an individual body to take the brunt of political attacks relating to inept currency management. A way that this is accomplished is by the depoliticization of what is known as a Minsky Moment. Minsky wrote that as a market is performing well, investors debt to income ratio is decreasing rapidly. As the investment profile is increasing in value and quality. The opportunity is available to take increasing amounts of credit out of the bank to invest back into the market. As the market becomes more profitable, it will attract more investors. As the institutional investors begin to evaluate their stock weight, they begin to sell so that they may capitalize on the bubble. Inevitably, panic ensues, and a crash will happen. This was seen during the Great Depression and the 2008 Housing Crash. After both crashes, Keynesian economics was the driving force. This is depicted in the following Figure 1.0.

⁵ Oliver Levinston (2021) Minsky’s moment? The rise of depoliticized Keynesianism and ideational change at the Federal Reserve after the financial crisis of 2007/08, *Review of International Political Economy*, 28:6, 1459-1486, DOI: [10.1080/09692290.2020.1772848](https://doi.org/10.1080/09692290.2020.1772848)

⁶ “Definition of TOTALITARIANISM.” 2019. Merriam-Webster.com. 2019. <https://www.merriam-webster.com/dictionary/totalitarianism>.

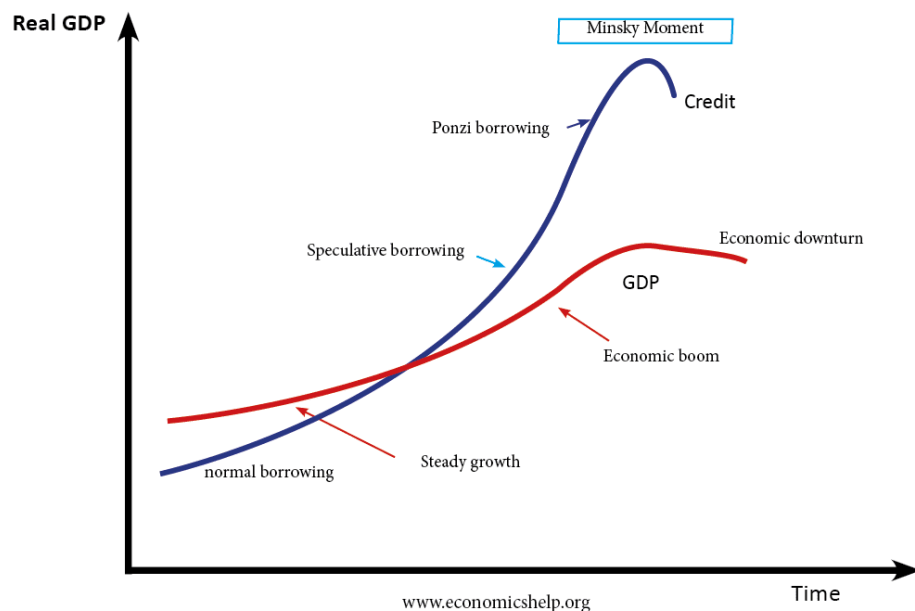


Figure 1.0

Even though the Fed may be removed from politics, they are still impacted by politics. People desire stability through efficient markets. However, the Fed has failed on this in the past. In the 1970's, they found that the Fed allowed the Federal government to stabilize variables like unemployment and inflation without anchoring the general price points. As a result, inflation was “permanently inflated”.⁷ This ushered in the concept of Post-Keynesian economics of the 2008 period. This is the concept that macro-governmental regulation should take place in the financial sector. In her paper regarding the reaction to the 2008-2009 market crash was one describing how useful Post-Keynesian economics is to the modern market. However, she did consider the fact of inherent risk in capitalism. She mentioned in her report to the Federal Open Market Committee (FOMC) in 2009, “Regardless of how well micro-prudential supervision is executed, on its own it will never be adequate to safeguard the economy from the destructive boom and bust cycles that Minsky considered endemic in capitalistic systems.”⁸

Because the market is naturally experiencing the “boom and bust cycles”, the Fed can and does mostly focus on inflation from the monetary standpoint. From Oliver Levingston’s perspective, the concept of neoclassical economics enables the Fed to stay removed from the politics of life while still impacting the way politics is handled. Therefore, the Fed utilizes two models of economics depending on how the economy is situated. Because they are removed from politics, the Fed has next to no authority over how unemployment insurance (among other programs) is handled. This opens the door for Post-Keynesian economics. Because the government has started these programs, neoclassical economics is imperative due to the

⁷ Levingston, Oliver. 2020. “Minsky’s Moment? The Rise of Depoliticised Keynesianism and Ideational Change at the Federal Reserve after the Financial Crisis of 2007/08.” *Review of International Political Economy*, June (June), 1–28. <https://doi.org/10.1080/09692290.20201772848>.

⁸ Yellen, J. L. (2009, April 16). A Minsky Meltdown: Lessons for Central Bankers [Paper presentation]. Paper Presented at the 18th Annual Hyman P. Minsky Conference on the State of the U.S. and World Economies—Meeting the Challenges of the Financial Crisis, New York City: Levy Economics Institute of Bard College.

necessity of knowing where the money is flowing to. Figure 2.0 below illustrates the frequency of the terms “Keynes” or “Post-Keynes” at each FOMC meeting since 1981 to 2014. A notable mention for this graph is the frequency Keynes is brought up during times of financial trouble.⁹ The United States is now in a system of Post-Keynes thought combined with the neoclassical economics of Milton Friedman.

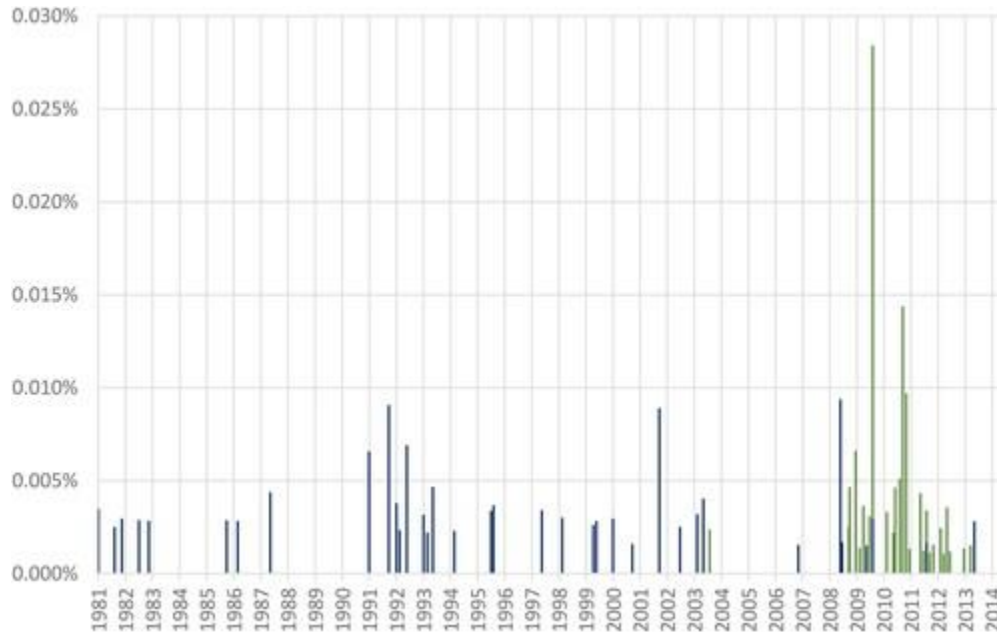


Figure 2.0

Changing the (Chinese) Culture, Shaping the Minds

As development methods and standards have changed over time, many international bodies consider foreign help to be of immense value. Not only do countries enjoy the prospect of loyalty through a perceived “ownership”, but the people inside the country come to enjoy a higher standard of living. Usually, during a crisis, foreign aid is welcomed by both the federal government and people. This is not so in China. Between 1959-1961, The Great Leap Forward caused many significant structural changes to the young Chinese nation. Under the new government the CCP would take over the means of production. In doing so, they cut off all foreign aid. This could be due to cultural ideas of the Westerner being inferior, harkening back to the days of the Boxer Rebellion. Or it could be due to conspiracies that the CIA used biological weapons on the Chinese during the Korean war. Or it could be fear of mere foreign domination. Whatever the case may be, foreign aid was strictly cut off. This is a major norm that continues to this day.

The Chinese have built a government that stems from the top down. Based on previous Presidents Mao Zedong, Deng Xiaoping, and current President Xi Jinping, rule has branched out into several varying powers. The CCP is the ruling and reigning political party with no known rival at this point in time. In this system of governance, military rule is the most powerful rule. Due to this policy, generals create policies for the citizens. The People’s Liberation Army is the main army of the CCP. The Chinese civilization is dominated by Mao Zedong, Deng Xiaoping,

⁹ Levingston, Oliver. 2020

and Xi Jinping thought¹⁰. Mao Zedong focused on a Cultural Revolution that took the “Four Olds” out of the custom. Deng Xiaoping opened the economy in the mid-1980s to include Exclusive Economic Zones. These zones helped create intense revenue streams into the Communist coffers. This was the beginning of the China that is known today. Xi Jinping was the third reformer. He is currently seeking to bring China back to the social stages of Mao with the economic elements of Deng Xiaoping via “socialism with Chinese characteristics”¹¹. This “socialism with Chinese characteristics,” has been and continuously are antithetical to the United States foreign policy.

Chinese Economics

Like the Fed, the People’s Bank of China (PBC) relies on regulating interest rates to stabilize an inefficient economy. However, they enjoy an alternate theory of economics called Fordist Economics. Stemming from Henry Ford of the Ford Motor Company. The lead economists of that era were focused on wage-led growth based on the concept of higher productivity and profits.¹² However, China utilizes a type of Fordist economics that is derived from State-led growth combined with an intense form of socialism. The concept is that from a top-down approach, the government determines what gets produced, who produces it, and how many they need to produce. This type of economy is also called the Coordinated Market. A coordinated market often the most effective way to govern a people. It gives a rigid protocol on certain events and when they should be executed. All matters relating to governance came from the top down. The advantages are scenario-specific to achieving a common goal. For example, if a nation desires to become excellent in one industry, then the nation can unilaterally fund and incentivize development in that industry. If the nation desires war, then the people are quickly mobilized towards one goal. In theory, the command economy is extremely efficient at completing a task in a unilateral approach on a smaller scale whether it be wartime production of tanks, international competition of semiconductor chips, or developing world-class cybersecurity officers. However, the command economy is so rigid that a flex in the market can break the system. This results in a quota system that, left unchecked and followed to its furthest logical conclusion, ends in a massive famine or natural disaster. As shown in *The Great Famine*, it is easy for the government to ordain a system that produces a desired outcome. The PRC developed barracks, mess halls, and even workplaces to fuel a greater desire to become the leading producer of steel. This was the main issue and the first sign of a crack in the edifice of the CCP. The rigidity of the structure of governance caused vast misallocations of food and water throughout the provinces. Because people were pulled off of their family farms and forced into the mines to labor for iron, wages fell, GDP per capita fell, and the population fell.

A Quick Cultural Backstory

Coined by Chairman Mao, under The Great Leap Forward, the ways of the past must be forsaken. The Four Olds of Mao’s Cultural Revolution sparked change within Chinese society. Enforced by the Red Guard, the Revolution abolished anything that hinted at the old ways of the

¹⁰ In *The Constitution of the People's Republic of China: Adopted on December 4, 1982 by the Fifth National People's Congress of the People's Republic of China at Its Fifth Session*. Beijing: Foreign Languages Pr., 1983.

¹¹ Marquis, Christopher, and Kunyuan Qiao. *Mao and Markets : the Communist Roots of Chinese Enterprise*. Chapter 1, Page 33. New Haven, Connecticut: Yale University Press, 2022.

¹² Valli, Vittorio. 2018. Chapter 2. *The American Economy from Roosevelt to Trump*. Springer.

old culture, customs, habits, or ideas. It can be likened to how a cult removes the identity of a person to replace it with a renovated thought process. In doing so, Mao cultivated a culture that sees the government as the supreme ruler. All ideas of family, religion, and property were eradicated under the idea of the greater state. Under the new identity, people were to regard the supreme power, and it worked. People regarded Mao under the most respectful terms imaginable. To this day, scholarly criticism of Mao is difficult to find from a Chinese native. It becomes even more striking when learning about The Great Famine.

The Great Famine

The Great Famine was the first national crisis the CCP handled. Beginning in 1957, the second five-year plan had the main goal to overtake Britain in national output of steel within 15 years. To do this, the CCP organized villages into various mess halls where they were expected to eat their meals. From there, the CCP organized these villages to the fields to farm or to the mine. By 1958, the CCP amended their goals to overtake Britain and the United States in steel within seven and fifteen years respectively. Within the year, the CCP shortened the goal to within a year. As a result, the mismanagement of farms and mines caused a severe famine.¹³ Because the rural population largely ate in communal mess halls, the lack of food caused a communal problem. The data provides a major correlation between the mess halls, the excess mortality rate within a province, and the mortality rate in 1960. The province of Anhui took the brunt of the famine, the mess hall participation rate was slightly over 90%. The excess mortality rate of the same province was 474% with a mortality rate of 68%. The death toll was as high as 30 million people, or it could be as low as 2.6 million people.¹⁴ Because of this death toll, the measure of norms, social trust, and capital were all negatively affected in the short and long terms. To this day, the Great Famine is relatively unheard of. When it is heard of, it is cast in a warmer light than it should be. This is due to what's considered in China's Constitution as Maoist Thought. Maoist Thought lives and dies on three main principles: nationalism, frugality, and the "mass line".¹⁵ Mao believed that the people of China must have the mindset of strength if they were to survive in the international realm. He was right. International politics is one of push and pull relationships. Blood will be shed to declare true independence. Even once independence is gained, there is still the subtle push and pull of diplomacy. However, these principles cost the lives of tens of millions of people.

The Great Famine did not result in a major reform as people may have hoped it would. Instead, the solution was to create several major bureaucracies to cover a range of industries. Mao created the People's Bank of China (PBC) so that there was a singular source from which monetary policy originated from. In the political sense, it created a scapegoat. However, this scapegoat created what is now known to be the State-led model of growth. This growth arises

¹³ He, Q. and Sun, M. (2016), CENTRAL PLANNING LEGACIES: THE LINGERING EFFECTS OF THE GREAT LEAP FORWARD IN CHINA. *Bulletin of Economic Research*, 68: 182-203. <https://doi.org/10.1111/boer.12034>

¹⁴ It depends on the source. Most scholars agree on the 30 million death toll. However, China-sponsored researchers estimate a death toll of 2.6-4 million.

¹⁵ MARQUIS, CHRISTOPHER, and KUNYUAN QIAO. *Mao and Markets: The Communist Roots of Chinese Enterprise*. Page 43. Yale University Press, 2022. <https://doi.org/10.2307/j.ctv3006z6k>.

from consumption financed by credit, investments by the State both domestically and abroad, and by exports.

PBC in Action

As brought about by Michal Kalecki, “low-income households have a higher propensity to consume than high-income households.”¹⁶ Due to low wages combined with high cost of living, the average Chinese citizen prefers to have much higher savings than the average American. The Chinese health administration was successful at achieving a 95% insurance rate for Chinese citizens and expatriates. This insurance is funded mostly by payroll taxes. The employer typically pays 6% and the employee pays 2%¹⁷. While this tax is low, the average wage in 2022 for a citizen in China was 114,029 CNY/year – or USD \$15,660¹⁸. Over the course of the year this is well over \$300, which is 25% of a month’s wage. On top of this, if a citizen in China must be hospitalized the average reported copay is \$1,110-1380; this is with no maximum out-of-pocket expense. If a Chinese citizen would like to initially see a doctor, there is usually a minimum fee of 1,800 RMB. On top of this, long-term health care, disability, and hospice are almost entirely out-of-pocket expenses. These out-of-pocket expenses are inextricably combined with the reality that a family member has to care for these individuals, thereby weakening the labor market. While this increases GDP and wages per capita, it lessens the amount of cash that is flowing into the home.¹⁹ At the same time, savings per household stay close to 51.7% as of 2010²⁰. Therefore, because many people cannot work, this wage is a pittance compared to other countries. They must save to survive.

While the Chinese must save to survive, they may not have to. The PBC, a State-Owned Bank (SOB) conducts a form of financial repression on its citizens so that it may have the ability to provide low interest loans to the State-Owned Enterprises (SOE). To compound this effect, the PBC has established a system of negative direct deposit rates. Typically, when a person applies for a checking account in the US, there is a growth rate of 0.001%-0.005%. It is a minimal growth rate but it grows, nonetheless. US savings accounts usually hover close to the 5% interest rates. However, the PBC has a negative demand deposit rate for checking accounts that hovers around 2.75%.²¹ This means that for every 100 Yuan that a Chinese citizen places into the bank, Y2.75 of the deposit is taken by the bank year over year. China has reported that they are

¹⁶ Baccaro, Lucio, and Jonas Pontusson. 2016. “Rethinking Comparative Political Economy.” *Politics & Society* 44, no. 2 (April): 175–207. <https://doi.org/10.1177/0032329216638053>.

¹⁷ Pattinson, Tom. 2020. “How Does China’s Healthcare System Actually Work?” Focus - China Britain Business Council. August 27, 2020. <https://focus.cbbc.org/how-chinas-healthcare-system-actually-works/>.

¹⁸ Trading Economics. 2019. “China Average Yearly Wages.” Tradingeconomics.com. TRADING ECONOMICS. April 14, 2019. <https://tradingeconomics.com/china/wages>.

¹⁹ Pattinson, Tom. 2020.

²⁰ Bell, Stephen, and Hui Feng. *Banking on Growth Models: China’s Troubled Pursuit of Financial Reform and Economic Rebalancing*. Page 30. Cornell University Press, 2022. <http://www.jstor.org/stable/10.7591/j.ctv1s04wgv>.

²¹ 杨洋. n.d. “PBOC Tightens Regulations on Banks’ Interest Rates on Structured Deposits.” Accessed December 5, 2023. <http://www.chinadaily.com.cn/a/202003/18/WS5e717464a31012821727feba.html>.

intending to raise that rate to 3% by the end of the 2023-2024 fiscal year.²² To incentivize loans, the interest rate for loans is typically lower than the depreciation rate for deposits. The financial repression also shows its form via the wages. According to Bell and Feng (2022), before the Global Financial Crisis, household income declined from 67% of national income to 58%. This was due to massive amounts of unskilled surplus labor flooding the market combined with inadequate development into the skilled businesses. This resulted in the extreme poverty level to low-income brackets encountering massive competition for a job that should necessitate massive competition.

Combine a poorly skilled labor force with a centrally owned bank and this will result in what is to follow. *The Law of the People's Bank of China* clearly stipulates that the PBC is an independent body. That is, the PBC is separate from the halls of government power, but it is directly involved in maintaining the interest rates, foreign exchange rates, and managing the national treasury²³. In 2012, the Governor of the PBC spoke at the International Monetary Fund (IMF) and the World Bank's Per Jacobsson Lecture in Tokyo. In this speech he outlined China's monetary policy, and it has four main objectives in mind. The first is to manage inflation. Because China has a central economy with market characteristics, inflation can veer out of control quicker than that of the USD inflation. The second goal of the PBC is to "promote reasonable growth in the economy." The third goal is to "maintain relatively full employment and maintain a relatively low unemployment rate." The final goal is to keep a balanced Balance of Payment (BoP).²⁴ One of the ways that the PBC has kept these goals is buying USD in bulk. The PBC owns nearly \$3.2 trillion USD in their own reserves.²⁵ One of the main reasons for this is the PBC utilizes USD for capital injection. Because USD holds more value than CNY, less is more in their situation.

The monetary policy to spur economic growth thrives on consumer spending combined with financial repression. Because of this, one of the critical shortfalls of the PBC is the nonperforming loans (NPL). NPLs are as bad as they sound. Typically, in commercial banking, a loan is considered nonperforming once payment is overdue for 90 days.²⁶ During the dot com boom of the 2000s, China had reported that 40% of State-Owned Enterprises (SOEs) had taken out nonperforming loans. The PBC has established 6 sector banks. The six banks are the Industrial and Commercial Bank of China, the China Construction Bank, the Agricultural Bank of China, the Bank of China, The Bank of Communications, and the Postal Savings Bank of China. In 2020, these six banks held 40% of all banking assets in China. There are several other state-owned joint stock commercial banks that hold 18% of total banking assets, and a few banks known as "policy banks". These policy banks are the Export-Import Bank of China, the China Development Bank, and the Agriculture Development Bank of China. These banks institute

²² Tang, Frank. "China Reforms Bank Deposit Rate Regime to Unleash Liquidity for Businesses." 2021. South China Morning Post. June 21, 2021. <https://www.scmp.com/economy/china-economy/article/3138171/china-reforms-bank-deposit-rate-system-unleash-liquidity>.

²³ *The Law of the People's Bank of China*. March 18, 1995

²⁴ Bijian, Zheng. Chapter 4: Pg 66-67 *China Under Xi Jinping : Its Economic Challenges and Foreign Policy Initiatives*. Edited by Binhong Shao. Leiden, Netherlands ;: Brill, 2015.

²⁵ "China Foreign Exchange Reserves August 2023 Data - 1980-2022 Historical." *China Foreign Exchange Reserves - August 2023 Data - 1980-2022 Historical*. Accessed September 24, 2023. <https://tradingeconomics.com/china/foreign-exchange-reserves>.

²⁶ As terms in contracts vary, this is not a hard and fast rule. It is a general norm.

policies set forth by the CCP in conjunction with the PBC²⁷. The SOEs consist of the majority of Chinese business. A report in 2018 stated that SOEs in China consist of 194% GDP in nearly every sector of the economy²⁸. The main reason for this is merely political. A CCP official is reported as saying, “Why are SOEs so important? The answer to this question lies in the question of what happens if there were no SOEs. Would that be called socialism? Can you imagine the Communist party surrounded by private entrepreneurs and capitalists?” As a result of this, SOEs reign in every facet of Chinese business. There are several “strategic industries” such as: defense, electricity, telecommunications, oil, aviation, and ship building. Then there are “pillar industries” such as: equipment manufacturing, auto, information technology, construction, iron and steel, nonferrous metals, chemicals, and surveying and design. Over the strategic industries the PBC must maintain complete and total control, and over the pillar industries the PBC must maintain a “strong influence”²⁹.

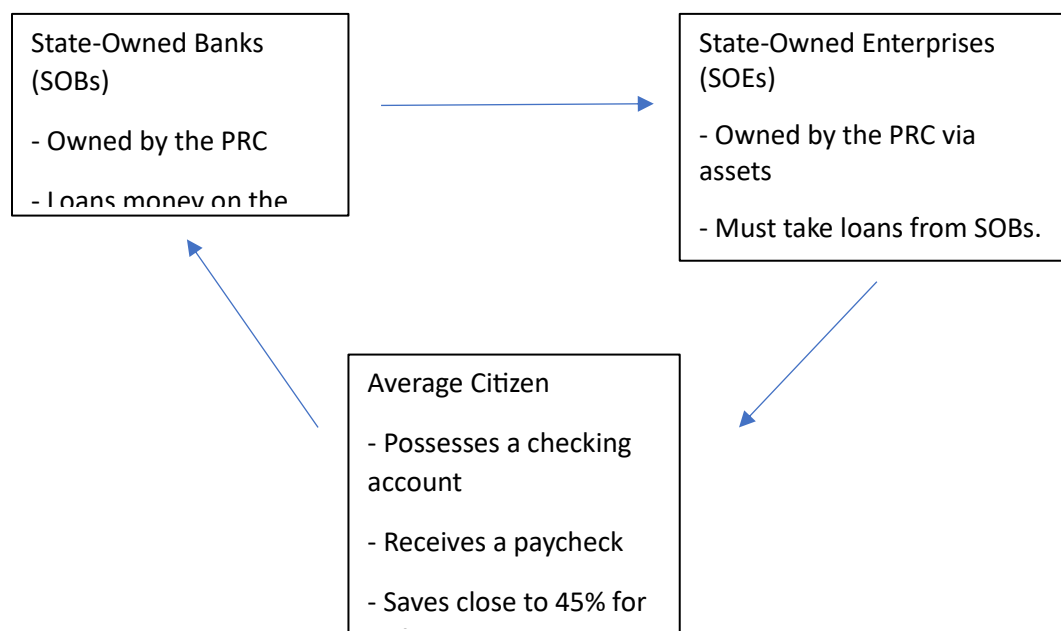


Figure 3.0

The Trident Growth Model

It is the State-led growth over these 15 industries that create problems for the Chinese economy. As stated above, the PBC has over \$3 trillion held in assets. They publicly own nearly \$1 trillion of the US government debt. Over time, China has shown that it is attempting to switch to the Trident Growth Model. This model is the synthesis of the State-led growth model, the export-led growth model, and an investment-led growth model. So far in this paper, the focus has been on the State-led model. This is due in part to the fact that it is the backbone of their

²⁷ Bell, Feng; Pages 35-36

²⁸ Emilia M Jurzyk, “Resource Misallocation among Listed Firms in China: The Evolving Role of State-Owned Enterprises.” n.d. IMF. Accessed November 13, 2023. <https://www.imf.org/en/Publications/WP/Issues/2021/03/12/Resource-Misallocation-Among-Listed-Firms-in-China-The-Evolving-Role-of-State-Owned-50167>.

²⁹ Bell, Feng; Page 36

economy. Because of the high personal savings rate in their country, they must rely upon production rather than consumption to drive growth. Without this production, export and investment-led growth will disappear. Moody's drives this point home by downgrading China's credit rating from "stable" to "negative".³⁰ No cash input, a poorer debt to income ratio. This results in less credit. China closed its factories in major cities across its nation multiple times over the COVID-19 pandemic. As a result, Apple, a company valued at more than \$3 trillion, moved its factories from Shanghai to India.³¹ Due to this, inflation will inevitably increase within its own country. This will happen due to the cheap credit provided by the PBC. A Minsky's Moment will inevitably happen.

The Minsky Moment will happen due to the decrease in productivity in the domestic market. If the Chinese are not making exports, people both internally and externally will not see the incentive to invest in its economy. This is a fact in the US and in China. Because of this, China is known more broadly speaking as a coordinated market. Coordinated markets are known for a higher export-GDP ratio and for their net trade surpluses that lead to higher investment that drives the former. Because the ratio and the surplus have declined in recent years, a collapse is inevitable. Bell and Feng (2022) point out three basic problems with how the PBC handles its monetary policy: "Credit is still being allocated to inefficient SOEs, too much credit is being allocated to inefficient local government investment, and too little credit is being allocated to the private business and household sector."

The United States Dilemma

The United States has put itself in a unique position that has never been seen before. As the world's foremost superpower, the US has placed itself in the middle of an international conflict in Southeast Asia, i.e. China. Because of the volatile, changing nature of the federal government, there has yet to be a linear position on China. In the late 1940's, a major uprising came to a head in China. The Republic of China (ROC) leader Chaing Kai-Shek fought a civil war against the People's Republic of China (PRC). Backed by the United States, Chaing Kai-shek fought a valiant fight, but he was forced to retreat to the island of Taiwan. From there, formal relations ceased with the PRC and relations with the ROC were developed to fruition. However, 30 years later former President Nixon began formal relations with China in 1972. This was the beginning of a rocky relationship between the two nations because of the contentious issue of the ROC. Following Nixon, former President Carter severed relations with the ROC in favor of the PRC. He went as far as severing a mutual defense pact with the ROC merely to bolster a development plan with the PRC. In response to this, Congress drafted a piece of legislation that solidified a neutral stance between the three entities in question. The legislation that was passed was the Taiwan Relations Act (TRA) of 1979. Because of the flashpoint of Taiwan's history with the US, the Act was an attempt to have stability in the region. Following the Korean and Vietnam wars, there was a heavy United States presence in the South China Sea at the time the TRA was passed. Following the Taiwan Relations Act (TRA), the Six Assurances were released by the Reagan administration. To quote the former Sec. of State Rex Tillerson, the

³⁰ "Moody's Downgrades Outlook on China Credit Rating over Debt Fears." 2023. Yahoo News. December 5, 2023. <https://news.yahoo.com/moodys-downgrades-outlook-china-credit-083535795.html>.

³¹ "Apple Tells Suppliers to Plan for Shift of Manufacturing out of China." n.d. AppleInsider. <https://appleinsider.com/articles/22/12/03/apple-tells-suppliers-to-plan-for-shift-of-manufacturing-out-of-china>.

Six Assurances are as follows: (1) “Had not agreed to set a date for ending arms sales to the Republic of China. (2) Had not agreed to hold prior consultations with the PRC regarding arms sales to the Republic of China. (3) Would not play a mediation role between the PRC and the Republic of China. (4) Would not revise the Taiwan Relations Act. (5) Had not altered its position regarding sovereignty over Taiwan; and (6) Would not exert pressure on the Republic of China to enter negotiations with the PRC.”³² The Taiwan Relations Act combined with the Six Assurances have created a “strategic ambiguity” about the US-Taipei relationship. Strategic ambiguity can be understood to be a policy that remains unbiased towards one or more parties. This policy refuses to take a definitive, and thus, predictable response towards any particular goal. To this day, it is a well-kept philosophy when looking at Southeast Asian foreign policy. Per a Congressional Research Service paper titled *President Reagan’s Six Assurances to Taiwan*, “on September 17, 2020, then-Assistant Secretary of State for East Asian and Pacific Affairs David R. Stilwell stated that the United States ‘will not take a position on [Taiwan’s] sovereignty.’”³³

The Red Line

The US has a critical interest in Taiwan, its semiconductors. As stated above, the US has become increasingly murky about its relationship with Taiwan. Many executives in the government have expressed both doubt and support on behalf of US involvement should kinetic action take place. The United States should and must decouple a majority of its economic ties with China. With a 20% tariff on common goods, China is no friend to the US in the current climate. The majority of generic pharmaceuticals now originate from China. In 2004, the last penicillin made its migration to China.³⁴ The US must begin to enact strong counter tariffs on Chinese goods coming into the US. Their manufacturing is on the decline, investors are fleeing the nation, and very few major nations care to partner with China to dig them out of the financial hole they have dug. Simultaneously, the US must create and bolster other FTAs in the region, as well as creating an iron-like economic bond with Taiwan. Many neoclassical economists have a disdain for FTAs because it lowers the economic prowess of major nations in lieu of smaller nations. However, this move is not to strengthen the US. It is to make other nations dependent upon the US and strengthen the dollar overseas. In the international relations realm, China begins to feel encircled. This will create a situation where China must act. The economic bond with Taiwan now comes to the forefront. As economics precedes a nation, it can serve as a warning for politicians. If a nation has a strong economic tie, then it is not likely to go to war.³⁵ If China seeks to subvert the political fray of Taiwan, then the tie to the US will certainly begin to break. If China pursues kinetic action, trade via the Taiwan Strait will be halted due to a blockade. This intel is only available if a strong economic bond is created. Alternatively, the US already has

³² Green, Michael. 2017. “What Is the U.S. ‘One China’ Policy, and Why Does It Matter?” Csis.org. January 13, 2017. <https://www.csis.org/analysis/what-us-one-china-policy-and-why-does-it-matter>.

³³ Lawrence, Susan. 2023. *President Reagan’s Six Assurances to Taiwan*. Congressional Research Service

³⁴ “Made in China: How U.S. Dependence on Chinese Medicines and Components Could Pose a Security Threat.” 2019. Wwww.moaa.org. January 25, 2019. <https://www.moaa.org/Content/Publications-and-Media/News-Articles/2019-News-Articles/Made-in-China--How-U-S--Dependence-on-Chinese-Medicines-and-Components-Could-Pose-a-Security-Threat>.

³⁵ This is different than the McDonald’s Theory. The theory I speak of is more general. A nation will not trade food or water with the nation it seeks to conquer or destroy.

defense pacts with most major nations in this region. This will strengthen these relationships should a conflict arise. This will cripple the Chinese economy. Exports and investment are already down overall this year. If exports are decimated internationally, China's GDP will crash. This will result in the catastrophic failure of the Chinese market and the CCP.

Economic Priorities

While many military analysts would sing songs of praise if the threat of China suddenly faded away, the US must also reevaluate its economic priorities. The US already has a strong player in Nvidia for semiconductors. Nvidia stock has soared amid a strong uptick in e-vehicles and increased electronic consumption. Among stockbrokers, Nvidia is a more valuable company. The US must provide incentives to bring the factories to the US in a greater scale. I think that a main way that this must be accomplished is by a prioritization of citizenship or work visas for those seeking to migrate to the US for electronic production. If a person from Taiwan, South Korea, or Japan seeks to immigrate to the US, then the US must establish a program to fast-track employment and citizenship for these immigrants. Sponsored by the home country, they would bring skilled labor into the country. This would elevate the domestic economy by creating higher competition. On the international stage, the United States would increase its self-sufficiency. As the United States grows in its semiconductor capacity, the need for a relationship with Taiwan decreases. In turn, this creates a better relationship with China, avoiding war and potential bloodshed on the United States' behalf.

Conclusion

If war were to break out tomorrow over the sovereignty of Taiwan, it will be a sure thing that both nations will collapse. Inflation is rampant in both nations. The Fed and the PBC are so integrated into industries that seek to invest internationally rather than domestically that if war were to break out, both markets would experience such a catastrophic shock that the nations will collapse. The best way to avoid war is to move key industries stateside. If the US moves key industries stateside, then the banking system will strengthen, the economy will become healthier, and inflation should decrease.

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