Volume Title: Capitalizing China

Volume Author/Editor: Joseph P. H. Fan and Randall Morck, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-23724-9; 978-0-226-23724-4 (cloth)

Volume URL: http://www.nber.org/books/morc10-1

Conference Date: December 15-16, 2009

Publication Date: November 2012

Chapter Title: Comment on "Financial Strategies for Nation Building"

Chapter Author(s): Jiahua Che

Chapter URL: http://www.nber.org/chapters/c12459

Chapter pages in book: (p. 333- 335)

References

Chen, Feng. 2000. "The Qing Dynasty's Expenditure Policy and Spending Structural Changes." *Jianghan Forum* 2000 (5): 60–70. 陈锋, 《清代财政支出政策与支出结构的变动》, 《江汉论坛》, 2000 年第 5 期.

Chen, Zhiwu. 2006. "On the Rise of the West." *Securities Market Weekly,* September 4. 陈志武, 《再谈西方的兴起》, 《证券市场周刊》, 2006年9月4日.

Liu, Guanglin. 2005. *Wrestling for Power: The State and the Economy in Later Imperial China, 1000–1770.* Cambridge, MA: Department of East Asian Languages and Civilizations, Harvard University.

Macdonald, James. 2003. *A Free Nation Deep in Debt: The Financial Roots of Democracy.* New York: Farrar, Straus and Giroux.

Peng, Zeyi. 1983. *China's Finances and Economy in the Second Half of the 19th Century.* Beijing: People's Publishing House. 彭泽益著 《十九世纪后半期的中国财政与经济》, 人民出版社 1983年版.

Poitras, Geoffrey. 2000. *The Early History of Financial Economics, 1478–1776: From Commercial Arithmetic to Life Annuities and Joint Stocks.* Cheltenham, UK: Edward Elgar Publishing.

Sheng, Xuefeng. 2002. "Review of the Level and Structural Changes of the Qing Dynasty's Fiscal Revenue." *Beijing Social Sciences* 2002 (1): 75–90. 申学锋, 《清代财政收入规模与结构变化述论》, 《北京社会科学》 2002年第1期.

Tang, Xianxing, Xiangguo Lu, and Jiwei Niu. 1998. "The Late Qing Dynasty's Decline and Setbacks in Early Stages of Modernization." *Literature and History* 1998 (2): 125–37. 唐贤兴, 卢向国和牛纪伟, 《晚清政府贫困化与中国早期现代化的受挫》,《文史哲》 1998年第2期.

Wang, Hao. 2001. "On Emperor Chongzhen of the Song Dynasty." *China Journal of Historical Studies* 2001 (4): 35–51. 王昊, 《论崇祯帝》, 《史学集刊》, 2001年第4期.

Wang, Shengduo. 2003. *Monetary History of the Song Dynasty.* Beijing: Social Science Publishing House. 汪圣铎著, 《两宋货币史》, 2003年, 社会科学文献出版社.

Zhang, Chunting. 2001. "A Brief History of China's Stock Market Development." *Stock Market Review,* 5th issue of 2001. 张春廷, "中国证券市场发展简史," 《证券市场导报》, 2001年第5期.

Zhang, Guohui. 2003. *Chinese Finance History, Volume 2.* Beijing: Chinese Finance Publishing House. 张国辉著, 《中国金融通史》 第二卷, 第二章, 2003年, 中国金融出版社.

Zhao, Xiangbiao, Songlin Liu, and Menggong Zhang. 2002. *A General History of China, Volume 2.* Urumuqi: Xinjiang People's Publishing House. 赵向标, 刘松岭, 张满弓主编, 《中国通史》 中卷, 2002年, 新疆人民出版.

Zheng, Beijun. 2004. *Modern China's Lijin Tax System.* Beijing: China Finance and Economics Publishing House. 郑备军著 《中国近代厘金制度研究》, 2004, 中国财政经济出版社.

Comment Jiahua Che

In "Financial Strategies for Nation Building," Professor Zhiwu Chen offers us two interesting observations and one brave thesis. The first observation

Jiahua Che is associate professor of economics at the Chinese University of Hong Kong.

For acknowledgments, sources of research support, and disclosure of the author's material financial relationships, if any, please see http://www.nber.org/chapters/c12459.ack.

is that no government lasted for more than three hundred years in imperial China. What can be done to prevent such a cycle of regime change from happening again in modern day China? This is the question that Chen sets out to answer in the chapter. And the answer, according to Professor Chen, is public debt. To justify the answer, Chen offers his second observation: governments in imperial China resorted to either taxes or inflation, but not public debt, to finance government spending. Chen argues that, when a government faces a large negative fiscal shock, using tax or inflation to finance "were politically and socially dangerous," whereas using debt financing would have helped "spread the temporary high burden over a period of thirty to eighty years." To contrast with the experience of imperial China, Chen notes that, since 1982, China has a growing national debt on the one hand and an increasingly strong economy on the other. Borrowing from Macdonald (2003), Chen notes further that countries deep in debt back in 1600 tend to be developed economies today. Chen asserts that making use of public debt can "reduce the pressure for the national treasury to save so the country can invest more," and can allow the government to "convert future fiscal revenues into capital of today." Thus, the thesis from Professor Chen is that public debt helps the nation grow strong.

Chen's thesis offers a refreshing perspective to examine the aforementioned two seemingly unrelated phenomena. It was a pleasure and an inspiration for me to read his article and to contemplate the intriguing observations Professor Chen has brought forward.

Chen points out three advantages of debt over tax in meeting government spending: spreading the tax burden over time, capitalizing on future tax revenues, and reducing the precautionary need for saving for the government. According to Chen, the first one is crucial for a regime to survive a large spending shock; the latter two pave the way for the nation to succeed. Given these great advantages of debt over tax, there is a natural question of why generations after generations of governments in imperial China failed to recognize these advantages, but resorted to debt that ultimately led to their own downfall. While Professor Chen does not elaborate much on this question, two explanations are possible. The first possible explanation is that debt may not enjoy as a great advantage as described. After all, debt postpones tax, and there may be little difference between the two per Ricardian equivalence. Of course, many factors pertinent to imperial China may render the equivalence invalid. Professor Chen can make his thesis more convincing by pinpointing some of these factors.

The second possible explanation is that governments in imperial China did not rely on public debt because they were not able to. One factor Professor Chen may want to consider is the possibility of government default on public debt. If there exists a dynastic cycle, as Professor Chen noted in the case of imperial China, then private agents may not even want to lend money to the regime when a regime is coming to an end. If we add the default factor to Chen's thesis, multiple equilibria become possible. Private agents either lend to the government and, by saving the day, the debt is eventually repaid, or do not lend to the government, in which case the government will collapse, not able to repay any debt should it have borrowed any. In other words, the presence of the dynastic cycle may have prevented public debt from being adopted.

In this case of equilibrium multiplicity, it is natural to further ask which equilibrium is more likely to emerge in the context of imperial China. I think Professor Chen can enrich his thesis by discussing the existing literature related to the dynastic cycle in imperial China, which has attributed the cycle to factors other than the absence of public debt.

Of course, the discussion earlier assumes that the next regime will not recognize the public debt raised by the previous one. I suppose that this is indeed the case for imperial China. However, this is not true for public debt in a modern society. Why there is such a difference is another interesting issue to be addressed to supplement Professor Chen's thesis.

Leaving aside how spending should be financed, Professor Chen suggests that one possible strategy is to "spend as much as possible at the present in order to develop the economy and increase future wealth generating potential." I believe Professor Chen can make his statement more precise if he could elaborate on why, in his view, government spending is more preferable to private spending. These issues are in fact related to his reading of China's economic success during the last three decades, which he attributes to public debt raised by the Chinese government, whereas most students of China's economy would probably have attributed it to the withdrawal of the government's role in the economy.

Finally, I find the chapter to be more relevant for the survival of a dynastic regime than for the building of a nation. Although the two issues may be related, they are not the same. After all, for an extended period of human history, China remained a leading civilization and the largest economy in the world, with the dynastic cycle but without relying upon any public debt.

Reference

Macdonald, James. 2003. *A Free Nation Deep in Debt: The Financial Roots of Democracy*. New York: Farrar, Straus and Giroux.