

# WORKING PAPER

## **Different Hungarian Interpretations of the Chinese Economic Development**

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# Different Hungarian Interpretations of the Chinese Economic Development

## 1. Abstract

Finding an ‘all-size fits’ recipe to the economic problems of developing and middle-income countries is similar to squaring a circle, and maybe the biggest challenge to economists. Over the last decades, one of the very few countries that has managed to break out of the vicious cycle of poverty, has been China. (Japan, South Korea and Singapore broke the vicious cycle of poverty in the 1970s, 1980s.)

It is more than obvious that Chinese experiences cannot be copied and implemented in other countries without adjusting the Chinese economic policy conclusions to the local conditions. However, the speed of the Chinese economic growth and the modernization the country has undergone in the last three decades, captured the attention of Hungarian experts and media as well and the process has been debated on different academic platforms fiercely. This debate became very intense when the Global Financial Crisis hit the world economy. The positive effects of the Chinese economic stimulus programme and the resilience of the Chinese economy took analysts by surprise, but even at this stage, many pundits forecast the end of the Chinese economic miracle (Nagy, 2013; Gabay, 2012) Matura says f. ex. as for the Chinese population trends “If the current trend prevail, the number of Chinese will go below 1 billion people, which makes the currently functioning economic system unsustainable.”<sup>1</sup>

One can clearly see, that the interpretations are diverse, and the conclusions depend very much on the economic school followed by the economists. The representatives of liberal economic schools have often predicted the collapse of the Chinese model in the last two and three decades, while other schools underlined the resilience of the Chinese economy to major global shocks and its capability to deal with internal tensions (such as credit market, stock market bubbles, over-investment etc.)

In our opinion, the diving line lies at the very simple question, how scholars view the importance of institutions in the economic development. Analysts, who emphasize the importance of Western type institutions, mainly conclude that Chinese growth is not sustainable, it is about to decline, if not collapse in the medium term since the absence of feedback between political and economic governance leads to market failures and inefficient market structure, they argue usually. However, there are a growing number of analysts who stress the economic successes of Western European countries can be repeated under different institutional frameworks as well, because they see that feedbacks can be guaranteed by using different political institutions as well.

The paper will look at the main arguments of the two blocs while the paper seeks to analyze the coverage of the Chinese economic growth and evaluate academic papers on the

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<sup>1</sup> Original text: Ha marad a jelenlegi trend, 2050-re 1 milliárd fő alá csökkenhet a kínaiak száma, ami teljesen fenntarthatatlanná tenné a jelenleg működő gazdasági rendszert.” (quoted by Gabay, 2012)

very subject as well. This evaluation is carried out by relying on academic papers and how events, information and commentaries related to the topic are represented and at the same time. At the same time, the study makes attempts to organize and classify arguments and interpret the narratives of the Chinese economic miracle. The paper is organized in sections where various aspects (economic and political aspects) are debated relying on quotes from different sources, then these arguments and aspects are discussed by the author.

## **2. Overview of the literature**

One of the most known critics of the Chinese model is János Kornai who was a member of the World Bank team in 1985 that was formed by the World Bank at the request of Chinese officials and the experts were asked “for some guidance about the making the transition from a controlled economy to one where markets played a greater role. “ (Vogel, 2011). Kornai reflected in his essay – published in 2014 – on the words of the Hungarian Prime Minister who praised the Chinese model the same year. (Kornai, 2014). Kornai is fundamentally pessimistic about the future of the Chinese economic growth. While analyzing the main elements of the Chinese reforms process, he maintains that the bulk of the policy measures implemented by the Chinese are the same ones advised by the International Monetary Fund and the World Bank:

- Deep transformation of the agriculture;
- Private enterprises in the industry;
- A new legal form of corporations that forged the local public and private property;
- Opening to the world by liberalizing trade;
- Opening to the world by attracting foreign investments;
- Opening to the world by sending young Chinese to foreign universities;
- Inflow of modern technology.

He argues these elements do not constitute ‘unorthodox’ economic policy ideas, while constraining private consumption and decreasing the share of private households in GDP and at the same time investing in terms of GDP much more than the average of countries, are the two elements, special for the Chinese economic growth model.

He also contends that the Chinese economic results could be achieved because market-friendly reforms had established economic institutions, necessary to a functioning market economy. At the same time, he states that the reforms were never carried out completely, only the half or three-fourth of the necessary reforms were implemented. He also finds important the political institutions, he highlights the political monopoly of the Communist party was kept. In other words, he presumes that only the implementation of the Western type political institutions can secure the future and continuation of the Chinese economic successes. As for the future, he underlines the Chinese sooner or later will implement correctional measures that ‘let off the steam’ of the over-heated economy, in other words they will be forced to raise real

wages and step by step implement welfare measures and at the same time accept slow growth rates. (Kornai, 2014, p. 611)

There are some many aspects not discussed by Kornai, but the most important one is maybe the question of economics of scale. The size of the economy and the country allows such a scale of experimenting that cannot be done anywhere else. The size also allows for a more protectionist approach in the economic policy, because of the market size it makes sense to ‘foster’ enterprises and implement an infant industry (or ‘sunrise industry’) approach based on the original recipe of Friedrich List. (It must be also noted, that both the US and Germany successfully utilized the same market-protective approach the end of the 19<sup>th</sup> and the beginning of the 20<sup>th</sup> century. It is true though that since then many countries tried to pursue the same path unsuccessful – the Latin American countries and former socialist countries of Eastern Europe, but they lacked the needed scale, size.)

Gyula Jordán, one of the most known China-experts has a different and more nuanced view as to the sustainability of the Chinese economic model. Jordán starts his reasoning with a short history of ideas regarding the question whether the Chinese economic policy experiences could be summarized in a model. After short references to the Beijing consensus – the term was coined by Joshua Cooper Ramo, but it never became really popular among Chinese experts, politicians – he concludes that the Chinese model is rather an approach to solve problems, than a list of drafted points advising economic policy makers around the world. This approach builds on experiments that help us draw conclusions, implement them in the real economy gradually and slowly. He puts “In this sense, it is better not to view China as a model, but an alternative, either searching for development opportunities or looking for China as a partner.” (Jordán, 2012, p. 113)<sup>2</sup> As much as Jordán’s view on the Chinese model is appealing, it can be argued that the permissive nature of this drafting doesn’t help us understand deeper the nature of the Chinese economic policy.

The exceptionality of the Chinese economic model is also emphasized by Ferenc Gyuris (2017), who starts his reasoning with a historic overview of the reasons of China’s robust growth. He sees a fortunate coincidence between the drop of the investment rates worldwide in the 1970s and the opening up of the Chinese economy which provided ample investment opportunities for those looking for higher yields. The importance of regional economic development patterns is underlined by him, since he often refers to the flying geese model. (The term flying geese was coined by Akamatsu who tried to explain the catching-up process of late-comers. He stated the production of goods is moving from the more advanced countries to the less advanced ones due to the changes in the local comparative advantages.) As usually in the literature, he also underlines the importance of cheap labor, cultural reasons, and low prices, however, when it comes to the future, he is very pessimistic, he concludes: “It can be stated, that conditions upon the robust Chinese economic growth had been relying, have been exhausted. Along with a change in the favorable world economy conditions, the

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<sup>2</sup> Original text: “Ilyen értelemben tehát jobb, ha nem modellnek tekintik, hanem egy alternatívának – akár a fejlesztés, akár a Kínára partnerként tekintés szempontjából.”

model of the Chinese economic model built on export has been stalled.” (Gyuris, 2017, p. 285)<sup>3</sup> His view of the Chinese economy is rather static, his paper doesn’t explore question that the slow down of the Chinese growth is more or less predictable and it can be easily tied to need to industrial upgrade and structural adjustment. Comparing Kornai and Gyuris, it can be seen that Kornai criticized the low share of private consumption and viewed as hurdle in the way of fast growth while Gyuris saw the pick-up of the private consumption as a problem.

In the last years, one of the most comprehensive collection of papers on Chinese economic policy in the Hungarian literature was published by the journal *Financial and Economic Review*. The special edition of the journal published seven studies, and two essays on the topic. (The papers are available both in Hungarian and English.) Only three of the seven studies focused on macro-economic issues.

Miklós Losoncz tried to find an answer to the question whether China would be able to avoid the middle-income country trap. The paper raised three hypotheses, the first hypothesis of the paper was that a “radical transformation and even reforms of economic governance (the economic policy targets, the ways and means and institutions of achieving such targets, as well as the operational environment of the economy) is needed.” (Losoncz, 2017. p. 22). The second hypothesis is that the Chinese will solve this problem and avoid the middle-income trap (this is the third hypothesis of the paper.) The paper has a very positive approach to China’s future economic development, however it fails to offer the reader the why-s and how-s China will be able to solve the problems. Although Losoncz’s assessment of the future seems to be adequate to the reader, we think using the framework developmental state is the most sufficient one, when analyzing the different element of the future of the Chinese economy growth.

A similar positive attitude can be found in Eszterhai’s papers. Eszterhai explored the future of the Chinese economy briefly in his analysis, while assessing the economy policy goals of the Chinese Communist Party by 2050 (Eszterhai, 2017). He concluded that based on the very broad middle classes, China will succeed in transforming its economy structure. He also added the Chinese middle class is not only the largest in terms of numbers (around 109 million people in 2015, while that American middle class in only is only 92 million people), but the Chinese middle class will be able to set market trends and its special needs will influence and transform consumer markets. As for the innovation policy, key in being the number one world economy power, Eszterhai lists the goals of the “Made in China 2015” and highlights that these goals were drafted in the light of the German ‘Industry 4.0 recommendations’. He refers to the MERICS (Mercator Institute of China Studies) conclusions in the context. Based on these conclusions, Eszterhai concludes that by 2050 the average Chinese industry won’t catch up with the advanced economies but they will be competitors in some key industries targeted by the Chinese state. The third key area selected by Eszterhai involves challenges as for the population trends in China, that aging population

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<sup>3</sup> Original text: „Megállapítható az is, hogy a Kína rohamos gazdasági előretörését megalapozó tényezők idővel elapadtak, illetve a további növekedés akadályává váltak. A kedvező világgazdasági közeg átalakulásával az exportra alapozott kínai növekedési modell lendülete is megfogyatkozott.”

and the rising dependency ratio (the ratio of population not active in the labor market) will ultimately force China to implement welfare measures including pension system.

### **3. The most sufficient approach to understand the Chinese economic development**

The paradigm developmental state became popular in the 1980s, then along with stronger internationalization in the world economy, the model was more and more criticized, mainly because for a while it seemed to superficial observers that states' role in managing economy policy was on decline. However, the effects of the global crisis in 2008-2009 and the resilience of the Chinese economy to the crisis reignited the debate on the developmental state.

Chalmers Johnson was the first conceptualizing the term 'developmental state' in the 1980s. He emphasized the competent and far-sighted bureaucracy as the defining feature of the Japanese economic miracle. The purpose in making a distinction between capitalist and socialist economies, was to draw attention to differences, not to similarities in these economic systems. As he put it: "One of my purposes in introducing the "capitalist developmental state" into a history of modern Japanese industrial policy, was to go beyond the contrast between the American and Soviet economies" (Johnson, 1999, p. 32). What scholars failed to understand, that the term 'developmental state' not only goes beyond a difference between the capitalist and socialist economies and makes a new sub-group among the capitalist economies, but it can also include so-called socialist economies, such as the Chinese economy, into the group of 'developmental states'.

Later, the concept of 'developmental state' became popular, and major contributions were made by Alice Amsden (*Asia's Next Giant*), Robert Wade (*Governing the Market*), and others. However, the emphasis was shifted in some cases, some analysts highlighted infrastructure investment, and several policy tools (saving and credit giving schemes, foreign investments, export zones, government interventions to spread technology etc.), history, culture.

As we can see, none of these additional elements include Western type democratic institutions. But for sure, we can add strong state to the list, since – one of the often-recurring arguments – a strong state is needed to mobilize resources for public goods, since only a strong state is able to convince people and firms about the necessity of painful political adjustments. At the same time, politicians must be credible in the strategy to convince the private sector.

Macroeconomic and political stability are also crucial, let us say, they are preconditions of economic success. In each of the cases, the import-substituting policy was part of the history, however short-lived.

Another common element in the economic development of these countries was the modernization of agriculture, which was not heavily-taxed and agricultural workers were not impoverished. A strong social infrastructure of family, local communities supported by the

culture, as well as a modern physical infrastructure financed by governments and donors are to be found in Japan and South Korea. In each case, the ‘benevolent’ external supporter—the United States, pursuing its own political and economic interests—is also there to aid the countries and advise the elites of these societies.

When it comes to the peculiarities of the industrialization process; the structure of firms, the way how domestic firms are linked to the world economy and the role domestic firms have in the supply chains tends to differ in the ‘developmental states’ (the Korean chaebols and the Japanese keiretsu-s are very dissimilar in their way to function), but they do not matter, when it comes to success. In our understanding, these are the most important elements of the developmental state concept:

- economic development planning with far-sighted bureaucracy,
- huge reservoirs of cheap labor,
- foreign influence on economic policies,
- the link between long-term economic success and strong stable political institutions,
- and export-orientation.

In the 1990s, globalization and the opening up of national markets made the debate on the developmental state paradigm less heated, and Japan’s economic struggles and the ongoing internationalization of economic activities seemed to make the model obsolete and unattractive. However, China’s economic success, along with its interventionist approach to economy reignited the debate on the developmental state after 2008 and 2009.

There are only a handful Hungarian economists who use this paradigm as take-off for their analysis, although it captures the features of the successful East Asian economies, that made the breakthrough and left the so-called middle income country trap.<sup>4</sup> In his paper, András Székely-Doby utilizes the developmental state paradigm, as he attempts to draw appropriate conclusions as to the Chinese economic model. After a short literature overview, he analyzes the Chinese economic growth patterns, the rise of the Chinese developmental state and its future possibilities. He concludes, that “In this study we argued, that model of the East-Asian developmental state, that first in Japan, later in Taiwan and South-Korea emerged, could be applied to the developmental features of China of the past decades, ...” (Székely-Doby, 2017. p. 645)<sup>5</sup> He lists the following elements of the Chinese model: political elite focusing on economic growth, the emergence of professional bureaucracy that gradually gaining upper-hand and enjoying proper autonomy, the prevalence of market forces in the

<sup>4</sup> The term refers to the economic policy problems of fast growing countries that initially base their development on cheap labor, however as they rise economically, the societies become more wealthy societies, and the average salaries and wages start to rise, the engines of growth are being stalled. In this development phase, these countries need new sources of economic growth, they have to find new competitive advantages over the other countries. This is not an easy process. not every country can manage it, Portugal is often mentioned as an exemplar, the country is not cheap enough to rely on investments utilizing low wages levels, however the added value produced by the manufacturing is not high.

<sup>5</sup> Original text: ”Tanulmányunkban amellet érveltünk, hogy a Japánban, majd később Tajvanon és Dél-Koreában kialakuló kelet-ázsiai fejlesztő állam modellje jól alkalmazható Kína elmúlt évtizedekben tapasztalható fejlődési jellegzetességeire.”

economy, rewards based on market performance etc. etc. He highlights that the Chinese developmental state struggles with issues threatening the dynamic growth of the Chinese economy. He refers, in particular, to

- the political support of state-owned enterprises regardless whether their market performance was sufficient or not;
- unsustainably high investment rates;
- the unbalanced and weak financial system;
- corruption and environmental pollution as elements of concern.

Judit Ritz also utilizing the developmental state approach, finds the model obsolete and she rejects its usage. In her paper, she writes of the decline of the developmental state paradigm. (Ritz, 2017). In the conclusions, she provides us with a list which contains the general conclusion and causes of why the developmental state approach is not appropriate anymore. In the next part, we only focus on the hypothesized causes of the decline.

She highlights, that good governance, and efficient bureaucracy are the basic conditions upon which the developmental state can rely, however, she adds, there is a threat that this interpretation of the developmental state contributes to the emerge of authoritative regimes (illiberal) and the decline of democratic institutions. She also argues that the definition and interpretation of economic development has changed over the last decades. She maintains, the term ‘development’ is being interpreted as freedom nowadays, which stand in very sharp contrast with the authoritative political regimes of the East Asian development states, she contends. (Ritz, 2017, pp. 83-84).

There are two reasons why this approach might be misleading when analyzing East Asian developmental states:

- Firstly, we can easily find episodes in the economic history of the East Asian developmental states, when political regimes could be featured democratic (i.e. Western type democratic institutions). Japan f. ex. has had very strong democratic institutions after WWII. South Korea became democratic in 1988, however, former started economic policies were kept and contributed to the fast economic growth of the Korean economy in the 90s as well. Thus, there is no evidence that ‘developmental states’ are necessarily authoritative or suppressive regimes, at the same time it can added that there is no evidence that suppressive regimes are good at managing the economy. The key to success must be found somewhere else.

- Moreover, it can be added that there is no historic evidence that only Western-type democratic institutions can maintain growth-generating economic policies that might induce inclusive growth. Different historical and cultural backgrounds require different solutions, moreover, the size of the country and its economic and political development state can definitely influence the choice of institutions.



It might be surprising but even Ley and Fukuyama are also keen to point out that democracy was not a necessary element of the catch-up process of the Asian developmental states. They argue that the success of a political order can be measured by different indicators. However, theoretically, there are five important elements which matter in the long run: the rule of law; rapid economic growth; inclusive political institutions; a competent and efficient state bureaucracy; and a vibrant, strong civil society.

In the Chinese model, the formation of more or less efficient state/bureaucracy was the first element in the 1980s, which was followed by robust economic growth in the early 1990 and later on, and the emerge of wealthy middle-classes. However, the rule of law is weak. There is a clear modernization process, since the Chinese model is more democratic than it had ever been. (Goralczyk refers to Zheng Yongnian's works in Chinese, who maintains that China is in a phase of strengthening its society. And as in the case of Taiwan and South Korea, after this phase, he argues, the country will be ready to conclude the democratization process – Goralczyk, 2017, p. 45.) However, there is the example of Singapore, where in addition to the former element, the rule of law is firmly implemented, and there are also inclusive economic policies; albeit the country lacks the institutions of the Westminster model of democracy. The question, which cannot be answered at this stage, is whether the Chinese elite can find ways to use some elements of the Singaporean experience and thus make the Chinese economic growth rate sustainable and self-supporting.

### **3. Conclusions**

For the time being, most of the Hungarian literature focuses on the Belt and Road Initiative, which is certainly the most important trade and investment initiative in this decade, however, it is still only one element of the Chinese economy policy. Besides these papers, another type of academic writings rather emphasizes the development of the Hungarian and Chinese trade and investment ties which is again important, however, it misses the overview as for the Chinese economy. Of course, the third type of classic writing either focus in politics and cultural issues of the imperial China or political and economic developments of China after 1949. Despite the academic relevance of these papers, we cannot learn about the current Chinese economy policy and its possible future.

In my opinion, the developmental state paradigm can be applied to a correct and appropriate description of the Chinese economic development, however, it is worth classifying the divergent and common features of the Chinese economy and other developmental states of East Asia and contrast them.

— At this stage, economic planning tools are stronger in China than it had been in the original development states. This is no surprise given the historical background. Not only the state-owned enterprises have larger role in the Chinese economy, but China still has a multi-track price setting system, which modifies market prices, and helps guiding the enterprises into new sectors. It must be added very

similar systems could be found in the 1950s and 1960s in Japan, South Korea and Taiwan.

— Currently, the role of developmental banks is much stronger in China than in Japan and South Korea. It only suffices to look at the total assets/GDP ratios, where China ranks first with 45 percent, while the assets of the South Korean development bank reach 15.41 percent of the country's GDP (Based on 2016 data). However, it is clear that the relevance of the development banks was higher in Japan, South Korea in the former decades, so the difference in a historical comparison is not fundamental.

— Cheap labor still characterizes the Chinese economy; as it had characterized the Japanese, Korean and Taiwanese economy in earlier development stages. Although it is true that wages have been rising in the Chinese economy, there are still backups of cheap labor in the rural sector of China. As a result, inequality is on the rise in China. In our understanding, growing inequality is a key feature of the Chinese development for the moment, but it was not typical for development states. However, only a few analysts realize that the new normalcy in the Chinese economy, which on the one hand means slower, but on the other hand also a more equal distribution of economic wealth within the society.

— Land reform was crucial in each case: Japan, Taiwan and South Korea started their industrialization process with the land reforms that were finished in the 1950s, and 1960s. Although the Chinese have taken steps to modernize the agricultural sector over the course of the last years, that process is not finished yet.

— The link between Western type political institutions and economic growth rate is absent in the case of China, however, in our understanding, this is not a crucial element of the developmental state model. The rule of law and the relative independence of state bureaucracy, and the merit-based selection of bureaucrats are more important and inherent elements of the developmental state model, however, China's performance is weaker in these features than other advanced Asian economies, in particular corruption is a widespread problem. According to the corruption perceptions index 2017, compiled by Transparency International, China had 41 points and was ranked the 77<sup>th</sup> in the world, while Japan ranked the 20<sup>th</sup> (73 points) the Island of Taiwan the 29<sup>th</sup> (63 points) and South Korea the 51<sup>st</sup> place (54 points) in 2017. As we can see, there are differences between these countries, but they are not crucial.

— Export-orientation has been a permanent and inherent feature of this economic model strong in each case, however, the Chinese market is still more closed than other Asian markets. Given the size and the different historical development path of China, this is not too much of a surprise. That is probably one of the reasons why China did not share the feature of strong foreign influence on economic policies in the initial years. And learning from the bad experiences of the 1930s, China was cautious not to open its economy too fast to the foreign capital, while implementing the first

special economic zones in Guangdong and Fujian and, later, while expanding this model to other areas of China.

To sum up, it can be argued that the Chinese economic model is unique because of its size, the country's historical development, however, it does bear strong resemblance to the original developmental states model of the advanced Asian economies. The model can be efficiently utilized, when depicting the Chinese economy, and the resemblance is more striking, when we consider how much the world economy has changed over the decades. Therefore, in our understanding, the Chinese economy can be considered as a special case of the developmental state in the 21<sup>st</sup> century. The differences between China and the three analyzed Asian economies would not be outstanding if one wouldn't consider the unexemplary freedom of maneuvering room for economic policy in the Chinese case, which follows from the size of the economy and the relatively protective economy policy.

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