

Reform: How Did China Succeed

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China's success over past 40 years is unprecedented in world history

- Enormous increase in **GDP** (\$244.985 bn in 1976 vs. \$9.504 tn in 2016) and **GDP per capita** in 40 years (\$263.231 in 1976 vs. \$6,893.77 in 2016)
- Now largest **economy** in world in PPP (China is 15% larger than the US as of 2016; 3.6% of global total in 1990 vs. 17.7% in 2016)
- Largest source of global **savings** (32.4% of GDP in 1978 (global average 23.8%) vs. 45.4% of GDP in 2017 (global average 25.8%))
- Largest **manufacturing** economy (share of global manufacturing as of end-2017: China 27%, Indonesia 22%, Japan 19% and India 16%)
- 740 million people moved out of **poverty** (770mn in 1978 vs. 30mn in 2017)
- Successful transformation in many dimensions—towards a social market economy with Chinese characteristics
 - Education
 - Innovation
 - Both physical and “soft” infrastructure
 - Institutional transformation

Still much to be done

- Per capita income still about one-sixth of US
- Many areas of institutional development needed
- Many aspects of quality of life
 - Environmental problems
 - Health—though trends are positive
- Inequality
 - Including access to education, especially for migrants
- Some critical aspects of economic structure
 - Excessive reliance on debt
 - Developing sustainable basis of support for local government

Key question: How was China so successful

Multiple problems

- Change in system of organizing production to a market economy
- Shift from rural to urban
- Shift from agriculture to industry
- Transformation from a developing country to an emerging market
 - To an innovation economy and learning society

Marked contrast with Russia

- Russia had a more educated population
- More resources
- More industrialized
- More urbanized
- Higher GDP

Yet Russia saw income and living standards (even life expectancy) decline

Key ingredients to China's success

- Pragmatism—non-ideological
 - Recognition that transition was a new problem that had never been solved
 - But there were lessons to be learned from the experiences of others
 - Crossing the river by feeling the stones
- Gradualism—no shock therapy
 - Still, there may be threshold effects that require decisive, critical minimum efforts.
 - Mixture of speediness and gradualism
- Recognizing that each stage of development requires new institutional arrangements, new policies
 - Marked shift in policies in each decade, within a context of continuity

Recognition of importance of learning

What separates developed and developing countries is as much a gap in knowledge as a gap in resources

- Institutional innovation and learning
 - Dual pricing regime
 - Township and Village Enterprises (TVEs)
 - Joint ventures
- Heavy investments in education
 - Sending many students abroad
- Learning from others: Opening to world was crucial
 - Engagement in trade
 - But recognized early on that China had to go from just being low cost center of production/assembly for others to having its own firms
 - Listening to experiences of other countries

Learning and innovation

- Recognizing that what was learned in one part of country had to be transmitted to rest
 - Gaps in knowledge within a country are as important as gaps in knowledge between countries
 - Successes in Eastern China had to be replicated in rest of country
- Focus on becoming an innovation economy
 - Recognizing that one couldn't just borrow from others

Specific institutional innovations that contributed to China's success

Individual responsibility system in agriculture

- Provided strong incentives, without having to engage in contentious political debate over full privatization
- Got 95% of benefits, without large distributive costs that would have come from full privatization
- China still hasn't come to terms with rising inequality associated with property
 - Need for capital gains and property taxes

Marked contrast with countries that ideologically insisted on quick privatizations

- Agriculture production declined
- Institutional frameworks associated with production chains eroded
- Poverty and inequality increased

Dual price regime

- Facilitated transition to market prices
- Again, the ideologically pure said it couldn't be done

Township and Village Enterprises (TVEs)

- Decentralized competition
- China emphasized competition
- Russia emphasized privatization—largely failed
 - Deindustrialization—largely a natural resource economy with high levels of inequality
 - Monopolization
 - Corruption—even Americans in charge of privatization process were corrupted in process
 - Wrong theory of reform
 - Shouldn't expect Rockefeller or Gates to be enthusiasts of competition law
 - With poor corporate governance, could “loot” companies
 - Failures undermine confidence in reform process

TVEs

- Washington Consensus policies said TVEs couldn't work
 - Ambiguous property rights
- But they did work
 - Partly by using existing institutional infrastructure, developing new institutions, and through competition
- Scale limitations
 - Played a less important role in more recent growth

Balanced industrial policies

- Identifying priority sectors, but not exclusive focus on them
- Use of exchange rate to promote exports
 - China may have been lucky—West open to manufacturing imports
 - China also affected domestic political economy in West—large profit opportunities sustained opening, without regard to effects on workers or overall economy
 - Backlash growing
 - Africa won't be able to follow manufacturing export led growth model
 - Global jobs in manufacturing declining

Reform is a never ending process

- China entering into a new stage of development
 - Critical problems of inequality, health, environment, livable cities
 - Market can't solve these problems
- Further questions posed by changing globalization, recognition of the risks of excessive financialization
 - West hasn't succeeded in adequately taming financial markets
 - Problem partly a political one—excessive influence of financial markets
 - As China grows, vested interests may also grow in influence
- Principles that guided China in first forty years likely to continued to be relevant
 - Pragmatism—crossing the river by feeling the stones
 - New problems, not fully foreseen, will appear
 - Will have to address these problems, using insights from theory and past experiences
 - Openness—there is much to be learned from experiences of others and from the insights of non-ideological economic analysis