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