

# The Economics of China

## China and the East Asian Development Model



Fall 2020

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- Before the Chinese economic growth miracle, other growth miracles happened in East Asian. We will focus on Japan, South Korea, and Taiwan.

TABLE 9.4. *GDP Per Capita Growth in Selected Developing Countries (Average Annual Percentage Changes)*

	East Asia		Others
Japan (1950–75)	7.4	Turkey (1950–75)	3.6
Taiwan (1960–85)	7.0	Brazil (1955–80)	4.1
Korea (1965–90)	7.5	Mexico (1955–80)	3.4
China (1980–2005)	7.0	India (1980–2005)	3.9

Sources: Groningen Growth and Development Centre Database; Maddison (2003).

<sup>1</sup>These slides are based in part on chapters in Naughton, B., & Tsai, K. S. (Eds.). (2015). *State capitalism, institutional adaptation, and the Chinese miracle*. Cambridge University Press.

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- Four major features of "the East Asian Development Model":
  - 1. "An almost constant emphasis on the **importance of rapid growth of investment**, the manufacturing sector, and external competitiveness, an emphasis that was translated into **interventionist industrial, trade, financial, and other policies**".
  - 2. "**firms**, while **often protected at home from foreign companies and in downturns**, would be expected to be able to fend for themselves against domestic rivals and on the world market".
  - 3. "**macroeconomic policies**, usually aiming at budgetary balance, or even surplus, and trying to prevent high and variable rates of inflation".
  - 4. "A number of **favorable pre-conditions of a broader socioeconomic and political nature**, such as homogenous populations, high levels of human capital formation, relatively equal patterns of income distribution (thanks partly to prior agricultural reforms), competent bureaucracies, and fairly authoritarian governments through much of the periods here considered".

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- "Washington Consensus"<sup>2</sup> vs. the East Asian Development Model.
- What is the "Washington Consensus"? (Serra and Stiglitz, 2008, p.3)
  - It refers to "the set of views about effective development strategies that have come to be associated with the Washington-based institutions: the IMF, the World Bank, and the US Treasury".
  - Three keywords: privatization, liberalization, and macro stability.
  - "Washington Consensus has come to be associated with **'market fundamentalism,' the view that markets solve most, if not all, economic problems by themselves**".
  - However, in contrast to the Washington Consensus view, "advances in economic theory in the 1970s showed that market failures are pervasive."

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<sup>2</sup> Refer to Serra, N., & Stiglitz, J. E. (Eds.). (2008). The Washington consensus reconsidered: Towards a new global governance. OUP Oxford.

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- "Washington Consensus" vs. the East Asian Development Model (Serra and Stiglitz, 2008, p.4)
  - "In the countries that followed Washington Consensus policies, economic growth was limited at best, and disproportionately benefited those at the top."
  - "Meanwhile, the countries of East Asia followed a quite different set of policies, and had enormous successes."
  - "For instance, governments played an important role in promoting particular industries."
  - "In some cases, government enterprises (such as Korea's national steel company) became global leaders in efficiency."
  - "In short, both theory and evidence weigh heavily against what has come to be called Washington Consensus policies."

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- "Did China Follow the East Asian Model?"<sup>3</sup>
- **Similarities between economic policies** in China and East Asian "miracles" during the growth miracle phase in each country include:
  - market-oriented policies.
  - government control/intervention in credit provision.
  - export-promoting strategies (for example, undervaluing exchange rates at times to boost exports).
  - Stable price levels (with some exceptions).
  - Positive real interest rates "in most years".
  - Maintaining government budget surpluses, in general.

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<sup>3</sup>This is the title of Chapter 9 on pages 240 to 262 in Naughton, B., & Tsai, K. S. (Eds.). (2015). State capitalism, institutional adaptation, and the Chinese miracle. Cambridge University Press

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- The last point was part of the relatively high saving rates which were used to fund the relatively **high levels of investment which each of these countries had during their miracle growth years.**
- **Other similarities** between China and East Asian "miracles" during the growth miracle phase in each country include:
  - Authoritarian governments.
  - "investment in human capital had already been substantial before rapid growth began."
  - "All four countries, thanks partly to early agricultural reforms, began their high growth years with relatively equal distribution patterns".

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- What about differences?
- Couple of differences are noteworthy.
  - "East Asian developmental states relied on informal coordination between a small group of elite bureaucrats and a relatively small number of corporate leaders".
  - "China's economy is larger by an order of magnitude, in terms of geographic expanse and number of actors".
  - "Not surprisingly, different institutions have evolved to manage this more complex physical, economic, and administrative space."
  - Hence, **"the association between China's state capitalism and rapid economic growth is strong"**.
  - **"The second unambiguous difference is China's openness to foreign direct investment (FDI) relative to its East Asian neighbors during comparable stages of development."**



# China and the East Asian Development Model

- Did China abide by "The Decalogue of Washington Consensus Policies"<sup>4</sup>? **No, it did not.**
  - On one hand, China has implemented tax reforms, ended the dual exchange rate regime, , and overall maintained fiscal discipline and positive real interest rates. This is generally in line with the Washington Consensus.
  - On another hand, China has diverted away from Washington Consensus Policies when it comes to privatization and the details of economic openness and deregulation.
  - According to the Washington Consensus: "State enterprises should be privatized". In contrast, China has maintained "large and important government-owned corporations".
  - In addition, while allowing for market competition and opening its economy, China has maintained significant barriers to entry in some sectors.

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<sup>4</sup><http://documents1.worldbank.org/curated/en/848411468156560921/pdf/WPS5316.pdf>