CHINA'S HUBRIS

The 'Beijing Consensus' could have a serious downside, says DEEPAK LAL

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I WAS in China recently after two years and found that hubris had set in about the country's rise. At the Shanghai Forum I attended, it was argued that not only was China set to become the world's dominant economy within a decade, but a national assertiveness to challenge the US super-power was evident, so was a marked reversal in the gradual increase (since 1989) in personal liberty. The source of this hubris was China's successful navigation of the global financial crisis, which had undermined US hegemony, justifying China's distinctive economic policies of state capitalism, termed the "Beijing Consensus".

Joshua Cooper Ramo, a young analyst at the Foreign Policy Centre, has coined this term. He rightly claims that China's 30-year growth spurt has been based on an eclectic mix of institutional forms. He asserts that the dominant form has been state capitalism. This has been rigorously questioned by Yasheng Huang of the Massachusetts Institute of Technology, first in the book *Capitalism with Chinese Characteristics* and most recently in a paper titled "Rethinking the Beijing Consensus" ("Asia Policy 11").

Professor Huang differentiates between two periods of Chinese growth since its opening-up: the more liberal entrepreneurial capitalist model followed in the eighties and the more statist model since the nineties. He argues that many Western students studying China have been misled into not distinguishing between these two periods, having taken the first period in which growth was based on town and village enterprises (TVEs) as being led by collective firms. This is based on a statistical misunderstanding. The term used by official Chinese statisticians includes "both [collective] TVEs controlled by townships and villages and TVEs controlled by private entrepreneurs… [It] is a geographic concept referring to enterprises located in townships and villages…Western economists, on the other hand, understand the term from an ownership perspective as referring to an enterprise owned by townships and villages" ("Rethinking the Beijing Consensus"). Disaggregating this data by ownership type, Professor Huang found that "private TVEs absolutely dominated the total pool of TVEs".

This statistical misunderstanding has led many Western economists to describe the Chinese growth miracle as being based on a unique form of collective enterprise, when it clearly wasn't, at least in the early reform period. As usual, the "new dirigiste" is at hand to provide "elaborate theories – some backed up by formal mathematical proofs – ... to explain the performance of TVEs ... as an efficient substitute in a weak [institutional] environment". Dani Rodrik and Joseph Stiglitz have argued that "the rise of the TVEs challenges the standard claims of economics that private ownership rights motivate entrepreneurs to invest and take risks" (ibid, p16). Some more theoretical curiosa based on empirical sand!

Professor Huang then distinguishes between per capita gross domestic product (GDP) growth and per capita personal income (the income accruing to Chinese households). There was a large divergence between the two in the nineties. While real per capita income grew at 8.1 per cent between 1989 and 2002, per capita personal income grew by only 5.4 per cent a year. Given the ongoing financial repression, the difference was appropriated by the State. As it is, per capita consumption, which is the source of economic welfare, despite similar GDP growth rates in the two periods, "Chinese personal income grew fastest during the 1980s and then slowed dramatically during the 1990s, whereas GDP growth remained unaffected. These trends correlate closely with the different economic policies" (p 5). China followed the more market-oriented development in the first and the more statist one in the second.

The difference between GDP growth and personal income has provided the financing of a massive increase in public investment – not least on infrastructure in the recent stimulus during the global financial crisis – as well as a massive build-up of foreign exchange reserves. This investment, Yao Yang of Peking University has argued recently, has very low rates of return. The accumulated foreign exchange reserves of $3 trillion, held in large part in the US and Eurozone public debt instruments, are beginning to look more like the unprofitable deployment of Japanese surpluses by its private sector in the 1980s. For, with the ongoing sovereign debt crisis in the Eurozone and an incipient one in the US, these massive Chinese holdings are beginning to look like the subprime mortgages held by US banks before the Great Crash, with dire consequences for the returns on this deployment of the massive savings of the Chinese people by the State. Finally, the large monetary easing during the global financial crisis has led to a bubble in the property market, again echoing pre-bust Japan.

So, is the latest adherent to the "Asian" model likely to meet the same fate as its parent? I do not think so. This is because China, unlike Japan in the eighties, is still in the "catch-up" phase of economic growth. And with savings rates remaining high, until the "demographic dividend" ends in 2025, with an elastic labour supply in relatively free labour markets, and abundant industrialisation opportunities for expansion beyond the coast, China should be able to maintain high growth rates in the next decade.

The dangers are longer term, once the catch-up phase ends. Professor Huang argues that the State-led capitalist model that China has followed since the nineties is inferior to the Indian model (which is closer to the "Washington Consensus"), because of the stunted size of the Chinese indigenous private sector and the continuing reliance on financial repression.

There has been a marked decline in Chinese total factor productivity since the late nineties. India's private sector-led development model has fostered indigenous entrepreneurship, whereas China is still dominated by state monopolies. Thus, India has generated growth rates close to China's in the noughties with much lower investment. On the presumed failure of the Indian state to provide infrastructure to match China's, Professor Huang notes that in 1980 China started with an infrastructure disadvantage compared with India, and yet had spectacular growth rates. So like India today, "FDI and infrastructural investment played a minor role in China's initial economic take-off". He concludes that India has a better chance of maintaining high, sustainable growth rates than China. So much for the "Beijing Consensus" replacing the "Washington Consensus"!