Lessons of China's Economic Growth: Comment

Martin Feldstein*

These are three very fine papers. I say that --not as an academic specialist on the Chinese economy -- but as someone who first visited China in 1982 and has been returning at least once a year for the past dozen years. So I have seen for myself the dramatic improvements in the Chinese economy that David Li documents in his presentation.

When I first went to China I saw a poor underdeveloped country in which goods were scarce and people were poor. This was true in Beijing and Shanghai as well as in other cities and in the rural countryside.

But growth rates that averaged nearly 10 percent a year during those past 25 years mean that China's GDP is about 8 times as great now as it was when I first visited there. This enormous rise in prosperity is visible not only in the major cities but also in the cross-road towns and smaller cities that I have visited. Goods are plentiful and hundreds of

* Professor of Economics and President Emeritus of the National Bureau of Economic Research. These comments were prepared for a session of the January 2009 meeting of the American Economic Association.

millions of people have been transferred from poverty to the middle class.

So it is natural to ask as Justin Lin , Yan Wang and Barry Naughton do: What can other developing countries learn from the experience in China?

Justin Lin and Yan Wang offer a number of very useful suggestions about approaches that have helped China and that can help even the poorest of countries today. But they stop short of offering any overall approach to development.

Barry Naughton concludes that there is no way that other countries can copy what China did. He notes that China was helped by decisive leaders at the top and by a high quality bureaucracy. We can wish that for every aspiring country but those are not easy things to attain.

Barry also notes that China managed to have what he calls "consultative, growth driven authoritarianism." That has worked well in recent years but those same words might be used to describe Mao's dictatorship which produced drastically bad economic results.

Perhaps the difference is in the "consultative" nature of the current leadership. But none of the authors tells us how that works. How are decisions reached in the State Council? How are lower level officials – governors and mayors – incented to do the right things? And what are the impediments to change? And how are those impediments overcome?

Those last two questions are very important to other large developing countries in which decisions are made by a more open democratic process that often impedes change. For example, it is easy to point to the virtue of foreign trade and foreign direct investment. Many of the economic leaders in India would agree. But the vested interests in the unions and in some parts of the business community do not want that competition and are able to block the progress toward openness that has helped China.

David Li notes the importance of the perceived sense of fairness in the system. Yet China manages to combine that sense of fairness with a system of education that selects the best students and gives them the best education. Many of us might call that fair. But many Indians might not. The Indians are burdened by major quotas for different minority

groups in every form of education. How does one shape the political definition of fairness so that it does not prevent an efficient allocation of resources and a system of incentive rewards to those who drive economic progress?

The Chinese are now facing the problem of increasing inequality in which the urban workers are getting ahead faster than the farmers and the more highly educated are seeing their relative incomes rise faster. So while poverty is falling rapidly, income inequality is also rising.

When I spoke at a meeting of the China Development Research Forum in Beijing a few years ago I screwed up my courage and said that I thought that China should not be worried about rising inequalty as long as poverty was falling and all groups were becoming better off. I worried that this was probably a politically incorrect statement to make to a group that included senior Chinese officials. But I was pleased when one of them replied that he agreed, adding that China had tried the opposite in the past and that it had failed.

So the slogan of Harmonious Growth that in principle guides China's development does not mean sacrificing growth.

Nevertheless, there is a problem in the fact that Chinese consumption is growing more slowly than Chinese GDP. This reflects both a rising saving rate and a falling share of wages in national income.

David Li notes that this has led to the imbalance in which --despite an investment to GDP ratio of more than 40 percent -- China has net exports of more than 7 percent of GDP. Indeed, because of China's large net holding of foreign assets, it has a current account surplus of more than 10 percent of GDP. That is an amount equal to 10 percent of China's output that could instead have been consumed at home – a consumption rise of roughly one-fifth.

Reducing export dependence and increasing consumption more rapidly have been important goals of the Chinese leadership for the past few years. I believe that the government expected that they would be able to reduce the magnitude of exports gradually while simultaneously raising domestic consumption.

But the sharp decline in global economic activity has caused China's exports to fall much more rapidly than they had expected. The result is rising unemployment in the export sector and a return of millions of workers from urban jobs to the rural area. With a population

of more than one billion and a very high percentage of young people going to university, China also faces the prospect of millions of university graduates who will not have the jobs that they had expected.

I believe that China must now increase the intensity of its program to raise domestic consumer spending, both private spending and government outlays on services for consumers. For example, there is much that the government can do to increase health and education services in the rural areas where the majority of the Chinese still live. This will involve giving funds to local governments and empowering them to provide those services.

The net wages of urban workers can be raised by a change in tax policies – reducing payroll taxes and providing the kind of income supplements that the US does in the form of a refundable earned income tax credit.

In addition to raising net income, the government can reduce the incentive to save that now causes Chinese earners to set aside more than a third of their earnings. A key step toward that end is changing the health care system so that individuals do not have to accumulate

funds to pay in cash for the high cost of care for serious illness. This could be as simple as a widespread development of health insurance.

The Chinese also save excessively because of the down-payment requirements for the purchase of housing and consumer durables. These could be changed.

I am an optimist about China's ability to weather the current storm and to continue on its path of Harmonious Growth. But the Chinese officials must now act in the decisive way that David Li mentions to change the pattern of government spending and of the institutional structure.

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