

**Macro and Growth Policies in the Wake of
the Crisis**

**March 7-8, 2011,
IMF, Washington DC**

Is the Chinese Growth Model Replicable?

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How should Globalized Financial Crisis (GFC) affect our view of growth and growth policies?

- I. Income distribution and growth – issues of equity, efficiency and stability**
- II. Shift from catch-up, export-led growth?**
- III. Industrial Policy and Growth – How to deal with shift to Green economy and what technology frontier?**
- IV. Institutions and Growth – what is division between State and Market in new environment?**
- V. Financial Liberalization and Growth – tradeoff between liberalization and risk.**

Structural Growth Issues Going Forward – *Disciplined Marathon Runners, not Free Market Sprinters*

- **Twin crises – GFC + Global Warming, both due to excessive consumption of natural resources**
- **Current Financial-Free Market Complex has no hard budget constraint – *governments will always print money to bail out unrestrained TBTF financial sector***
- **This is Political issue, not Regulatory, requiring governance change, including at Global level**
- **Long-term sustainable consumption solution needs change to green lifestyle in both HDC and EME;**
- **Shift in export-led growth to domestic growth applicable only to few EMEs**
- **Key issue is still governance model of shared growth (lower inequality, long-term sustainability)**

Move from “Free/Best” to “What Works? And Can we Replicate?”

- **From “Best Practices” to “Best Fit”**
- **From Policies to Institutions/governance**
- **From “One size fits all – including mono-standards” to “How to adapt to changing world?”**
- **From Fragmented analysis to System-wide analysis.**
- **From politically “blind” to addressing inequality and capture**

Information Asymmetry and Principal-Agent Problem

- **Failure due to Fragmentation of Vision and Bureaucratic silos created fallacy of composition – no one had system-wide view of complex interactive global systemic risks**
- **Finance has grown 5 times or more larger than real sector, with Too Big Too Fail intellectual and political capture – collective action trap, since we need solution at national and global level**
- **Huge question of State-Market balance, at a time of massive fiscal constraint and role in addressing social inequality/structural growth changes**

Is Asian Miracle Growth Model outdated?

World Bank Study 1993

- **High growth with attention to equity;**
- **Export-oriented, high rates of investment**
- **Investment in human capital**
- **Government-led, but mimicked markets, promoting competition**
- **Flexible labour markets, aided by demographic endowment**
- **Stable political environment**
- **Feedback mechanisms through Deliberation Councils [especially industrial policy]**

Asian Crisis shifted thinking towards more Self-Insured, Adaptive Global Supply Growth Model

- **Japanese Flying Geese model extended to China and India, showing Global Supply Chain (GSC) adapting beyond national borders**
- **Institutional innovations in East Asia (including China) used Coasian “reduce transaction costs”, with State-Market/FDI cooperation to strengthening GSC [if GSC wins, we win]**
- **In resource/knowledge bounded constrained world, growth comes from selecting which GSC to “attach to”.**
- **Resilience of GSCs to crisis shocks illustrate that those who are connected to GSCs recover better and are more open to self-reinforcing global standards of performance.**

Concept of Supply Chains now widely established in Business and Policy thinking

- **East Asian Global Supply Chain and Indian IT Supply Chain well established**
- **China was late-comer but benefited from Global Supply Chain, by learning from Japan, Four Dragons and Four Tigers.**
- **Chinese institutional innovation improved upon Global Supply Chain by fitting supply chain into government policy and city design.**
- **Chinese success built on East Asian model of facilitating government, mimicking markets property rules and learning by doing.**

Synthesis of Macro-development economics and Micro-development economics is possible – Hausmman-Rodrik-Velasco approach

- 1. Do growth diagnostic with open-minded, open-ended pragmatic, experimental and contextual approach (Rodrik 2008, p.27)**
- 2. Monitor and evaluation, looking for selective and narrowly targeted reforms**
- 3. Suspicious of ‘best practices and universal remedies’**
- 4. Searches for policy innovations**

That summarizes the essence of Develop (Cross the River) by Feeling the Stones, the “Most Important Development Experience of our Generation - China

Barry Naughton: 5 Paradoxical Propositions on China's Development Experience (2009)

1. China is important model with important lessons
2. There is no consensus about what these lessons are, and many supposed lessons are inconsistent, incompatible or just plain wrong.
3. Despite remarkable institutional creativity, there is **no specific institution which one can responsibly recommend should be replicated in other developing economies.**
4. Institutional innovation in China involved modifying and strengthening, as well as abandoning, existing hierarchies.
5. Since no country has an institutional endowment similar to that of China, no country should adapt China's specific experiences. However, the ***process innovation in China can provide many lessons about the nature of institutions and the interactions between institutions and the development process. Developing countries may be able to strengthen their capacity for institutional innovation by examining China's experience.***

Networks, Markets and Adaptive Systems

- Increasing understanding that economy can be depicted as network that links economic actors together in flow of exchange (Zukerman, 2003)
- Markets can be seen as social and economic networks that are adaptive (McQuade and Butos (2009).
- Network theory now increasingly used in economics and sociology, but its explanative power still limited (Rauch, JEL2010).

Chinese Growth Model is Replicable

Complex Adaptive Model

- **Chinese bureaucracy is oldest surviving bureaucracy in world – through wars, chaos and adaptation to new environment, even though decay may take centuries;**
- **Modern system is still incomplete, as China transits into globalization via integration through Global Supply Chain that backward integrates into rural areas.**
- **Underlying this is fairly rigid hierarchical administration structure of ministerial/department divided into geographical areas of centre/province/city/county, interlaced with flexible cadre/official decision-making that allows experimentation with contextual change.**

Common Law vs Administrative Rule by Norms

- Magistrate/judge/supreme court level common law decisions
- Accumulate to Common Law “Principles”
- Amended in crises or special circumstances by legislation

Feedback via voting process and media

- County/City/Provincial/Central administrative decisions
- Accumulate to State Council/Politburo decisions
- Endorsed/amended by legislature

Feedback via media and internal processes.

Constant review of policies/implementation obstacles

Economic Feedback easier via market process

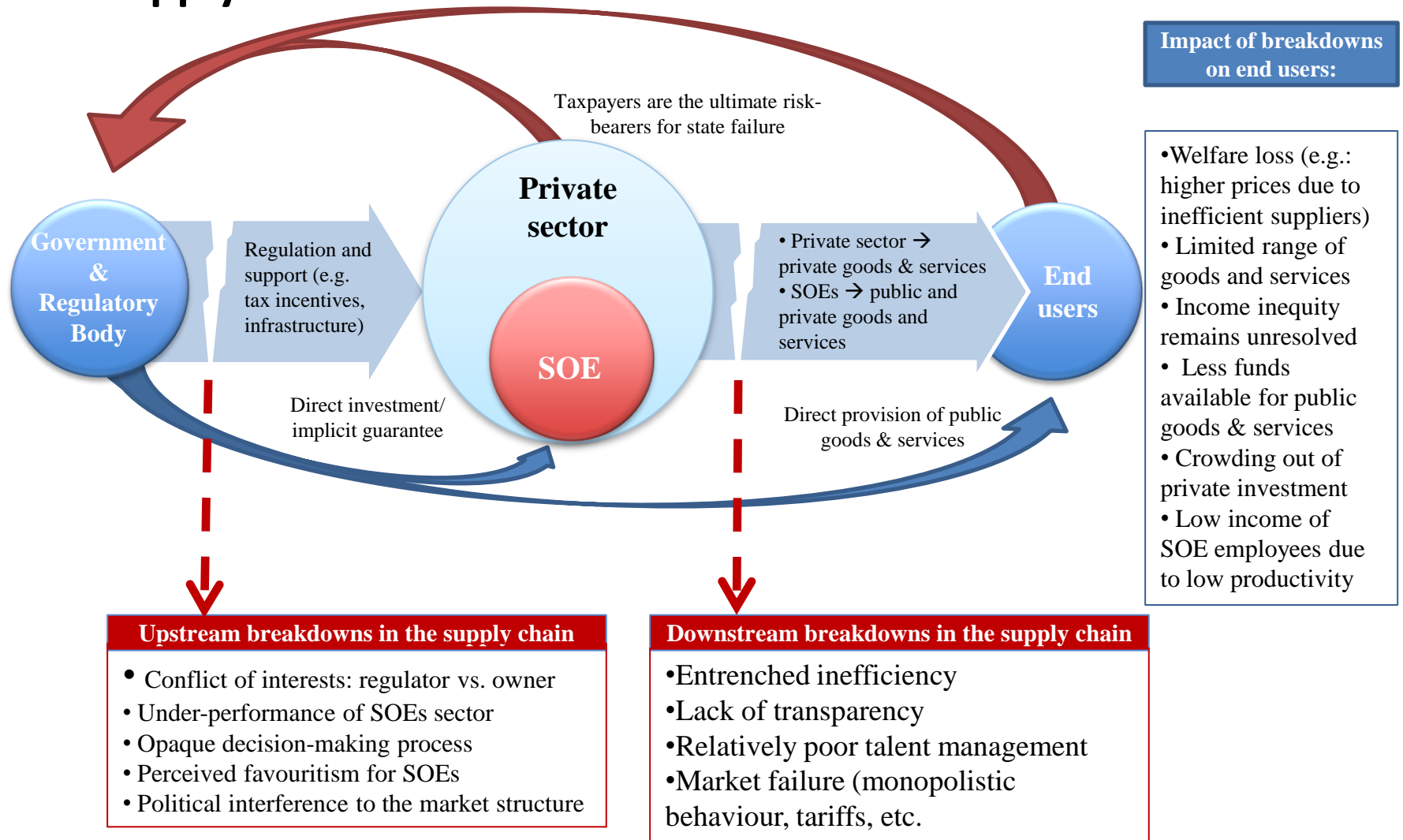
Chinese Officials focused Delivery/Economic Performance as Ultimate Accountability

- Four Modernizations [Agriculture, Industry, Defense & Science/Technology] were Prioritizing Key Growth Problems.
- Slogans such as “Scientific Development Approach, Seek Truth from Facts and Black Cat/White Cat” were Norms that remind officials to ignore theory and concentrate on what works pragmatically and learnt so far.
- Historically, Chinese officials are known as Parent/Official 父母官, assuming paternalistic responsibility for citizens.
- Modern approach is relentless Feedback mechanism on what works.

Chinese learned to copy, adapt and extend Global Supply Chain

- Organizations must simultaneously be “tight” in executing and “loose” in adapting ... Peters and Waterman (1982), p.355
- Chinese bureaucracy and SOE learn to be “tight” in implementing projects + infrastructure, but “loose” in allowing FDI and imports of skills, technology and resource inputs.
- County/City governments provided infrastructure, utilities, and guidance for SMEs/MNCs to connect to GSC or local supply chains
- HR policies – education + migrant labour provided learning capacity for skilled labour and management to emerge.

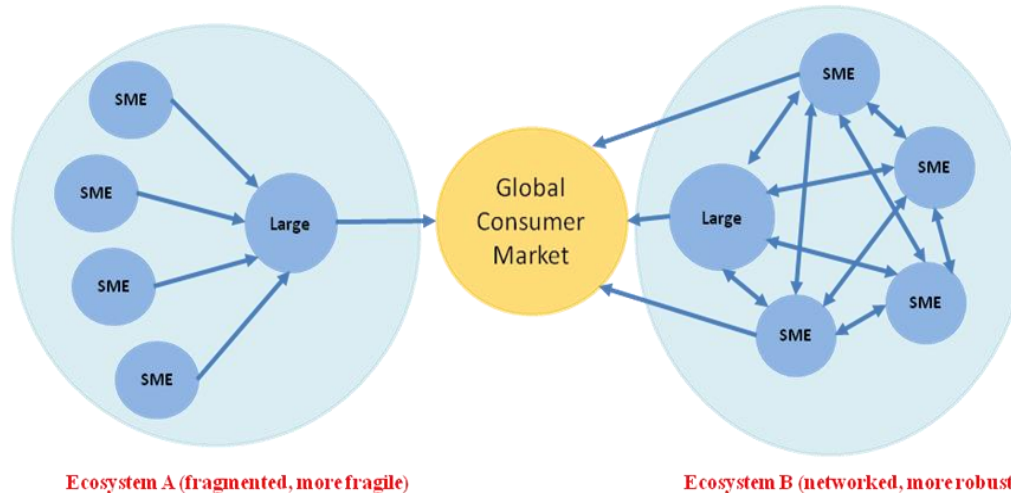
Government/SOEs sit in middle of Key Supply Chains



Integrate SMEs into the global supply chain:

Need to create conducive ecosystem for SMEs to connect to the global supply chain:

Comparing Ecosystems



Characteristics of the ideal ecosystem for SMEs → clear property rights, low transactions costs and avoidance of information asymmetry

- State to reduce uncertainty (hence, transaction costs) and make property more accessible; also tackle market and coordination failures.
- Improve transparency by establishing a database of SMEs that is accessible by all entities

Example: Chinese Specialized Market Cities

- In conditions when SMEs had difficulty competing against MNCs and SOEs, smaller cities “attach” to MNC/SOE Supply Chain by creating “Specialized Market Cities”, specializing in specific product/product components, e.g. batteries, lamps,
- SMEs were given space and market platforms to cluster, interact with global buyers, and achieve economies of scale, by “branding”.
- E.g. Wuyi Specialized Market became regional hub for SMEs that now has global brand to source consumer products.
- Local Governments innovated through local comparative advantages [proximity to larger Industrial Zones in Shanghai] but went SME route due to lack of access to finance and critical mass of SOE/MNCs.

**Competition is no longer company against company,
but rather supply chain against supply chain – Fung,
Fung and Wind (2007)**

- **Companies with access to best networks not only can outperform competitors today, but also have the capacity to flexibly outperform them tomorrow. p.48**
- **Networks can work “smarter” than the individuals or firms that are part of them. **Orchestration is what makes smart networks smart.** p.50**
- **Networks can also be designed to increase flexibility and resilience (e.g. against SARS attacks) .**
- **In a flat world, the challenge is to balance the benefits of being part of a single cluster with the benefits of being part of multiple clusters. p.60**

Systems “Orchestration” – interactive feedback between state and market

- **Systems evolution is path-dependent, time irreversible and requires interactive “orchestration” between state objectives and market evolution within global competitive/cooperation context.**
- **Free market/minimal government may lead to huge inequalities and system capture by elite. State authoritarianism have corruption and system fragility/collapse risks. No ideal paradigm.**
- **Further study needed to understand how checks and balances needed to be built into system to prevent capture, corruption and inefficiencies.**

Tentative Conclusions

- **Development Thinking moving away from Grand ideas or Micro-theory towards Complex Adaptive systems of path dependent Societal Evolution.**
- **Focus on Systemic Stability/Resilience/Growth through reducing transaction costs, protecting property rights and strategic selection of cooperation/competition strategies by “attaching” to Global Supply Chains, using comparative advantages.**
- **Contextual Experimentation/Adaptation/Feedback and continual institutional innovation [process, structure, standards, values and norms] is more realistic approach in New Norm of higher global competition, volatility, unknown unknowns.**