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THIRTY YEARS OF CHINESE REFORM AND ECONOMIC GROWTH: CHALLENGES AND HOW IT HAS CHANGED WORLD DEVELOPMENT

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On 22 December 1978, the Eleventh Central Committee of the Chinese Communist Party completed its third plenary meeting. There was no contemporary recognition in the West of the significance of the meeting.

Now we are recognising the thirtieth anniversary of the Third Plenum. In the intervening years, China, the lives of its people, its relations with the rest of the world, and to some extent the economic lives of people in the rest of the world have been transformed. China's output has increased proportionately more than ever before over three decades in a substantial economy. The consumption levels of what had been about half of the world's people in poverty have increased beyond the usual ambitions for development. The United Nations "millennium goals" for reduction of global poverty are being met in aggregate mainly through what has been happening in this one country. An isolated, autarchic economy thirty years ago, China since the early 1990s has absorbed around half of the direct foreign investment going to developing countries. In some years in the early twenty first century, China's exports or imports have accounted for around half of the growth in world trade and its output for around half the growth in world production. China has contributed the majority of growth in demand for some industrial raw materials in the century so far. China was the East Asian region's anchor of growth when financial crisis hit its neighbours in the late 1990s. Analysts everywhere, and nowhere more than in my own country, are waiting anxiously to see if China will be the anchor of global growth as the whole world is hit by a United States-centred financial crisis in 2008.

There is another side of the coin. The stress of economic growth without large efforts to reconcile it with environmental amenity have had negative effects on many aspects of Chinese life. Emissions of greenhouse gases have come to exceed those of any other country, and as a result the world is moving towards high risks of dangerous climate change faster than had been understood by the scientists and economists working within the Inter-governmental Panel on Climate Change (IPCC) only a few years ago. In the absence of new policies to break the established nexus between greenhouse gas emissions and economic growth, China will account for over one third of total emissions by 2030, three times as large as any other country (Garnaut, 2008, Chapter 3).

While the beginnings of Chinese reform doesn't seem so long ago for some of us, we are talking about a fairly long period in modern Chinese history. The reform era is now longer than the period of Communist Party rule within the paradigm of central planning that preceded it. The total span of Communist Party rule now covers more years than passed between the fracture of Imperial authority in the first Opium War and its humiliation in the invasion following the Boxer rebellion. It now covers more years than passed between the Boxer Rebellion through the formation of the Republic to the coming to power of the Chinese Communist Party. We are talking about a period that is long enough for historic transformations.

Through the reform period, there has been a transformation of the Chinese mind. Hundreds of millions of Chinese are now part of an international community of ideas and information. Many threads have been woven to produce this result. One was the audacious scale of the early promotion of study abroad. This was carried through in explicit recognition that many students would not return, and on the basis that enough would return or in other ways contribute to Chinese development for study abroad to provide a net gain for the country. Another was the unequivocal early commitment to opening the economy to foreign trade and investment, and its requirement of open movement of business and professional people in and out of China. A third was largely autonomous to Chinese reform decisions: the extraordinary increase in the power and reduction in cost of international information flows, with technological improvements including the internet.

Amongst much else, the transformation of the Chinese mind included the development of a modern economics profession, familiar with the theory and techniques of economics in the West, and increasingly confident in the exchange of economic ideas. Leading members of China's economics profession are now contributing to the critique and expansion of received wisdom about economic development, and to the distillation of lessons from the Chinese experience of development into the understanding of the global profession (Lin, 2007,2008; Fan, 2007). This has been an important and fascinating element of the reform process involving deliberate efforts of the Chinese state, external institutions (with the Ford Foundation's role being noteworthy) and Chinese intellectual entrepreneurs (with the establishment of the China Center for Economic Research building on contributions from each of these sources).

As important as any other element of the transformation of the Chinese mind was the acceptance of major roles for impersonal markets as important instruments for allocating resources and distributing incomes. This was a change not only from central planning since the revolution, but from patterns of imperial power extending far back into Chinese history.

Through these changes, personal economic security is now provided significantly through the value of people's labour and produce in the market place, in the stead of an intrusive and overwhelming state. This personal security has been enhanced in recent years as labour has become scarce and valuable in a way that has no parallel in Chinese history, as coastal China unambiguously and inland China to a considerable extent experiences the rising wage rates that come with what Minami called the turning point of economic development (Minami, 1971, Garnaut, 2006, Cai Feng, 2007).

Reform in China has not and could never be a smooth or painless process. There have been challenges at every step, some bumps in the road, detours and dead ends.

As it happens, the three biggest challenges have coincided with the decennial anniversaries: the inflationary boom of 1988, which established the conditions for the one political crisis of the reform era in 1989; the East Asian financial crisis of 1998; and the global financial crisis of 2008. More of these later.

THE DISTANCE TRAVELLED IN THREE DECADES

Ideas and Policy

Thirty years ago, at the Third Plenum, Deng Xiaoping and his supporters took decisive control of the Chinese Communist Party. This ended what Deng once described in my presence as two years of indecisive policy after the death of Mao Zedong. During those two years, policies embodying pragmatic acceptance of a large role for domestic and international market exchange had been in continuing contest with Maoist commitments to local and national autarchy, central planning, state-owned enterprises in the cities and the People's Communes in the countryside.

During the time of indecisive policy, important steps were taken to lay a base for future growth. The awesome denial of formal education during the Cultural Revolution ended, with the return of competitive entry into the great universities in 1978. China's state enterprises experimented with the purchase of exotic technologies from abroad. But there were cross-currents and counter-currents, continued ideological contests over high policy, and uncertainty about continuity of policy as subordinate leaders watched for the emergence of a clear national direction.

Since December, 1978, there has been no turning back.

It is not that Deng and his supporters obtained endorsement at the Third Plenum for an elaborate, comprehensive new economic policy or plan. There was no blueprint for China's economic reform and internationalisation—even less than there had been in Taiwan and Korea at the beginnings of their sustained rapid economic growth in the early 1960s.

But after the 1978 Plenum, there was acceptance that domestic and international exchange through markets was a necessary and acceptable component of a national development strategy. There was pragmatic acceptance that institutions and policies that raised national economic output had a valid place in China, even if they were difficult to reconcile with established ideas about what was appropriate in old perceptions of socialist China. This was summed up in Deng's rehabilitation of an early Maoist exhortation to "seek truth from facts". These strands were drawn together in the 1987 Thirteenth Party Congress's acceptance of General Secretary Zhao Ziyang's definition of China as a backward country in the "primary stage of socialism" in which the first national objective was strengthening of the national economy.

The new political environment after 1978 saw foreign trade, direct foreign investment, and the utilisation of foreign technical assistance and capital in all forms become acceptable components of national policy. Local experiments with new forms of organisation of agricultural production were given legitimacy, leading within six years to the virtually complete replacement of the People's Communes with the immensely more productive household responsibility system. Markets became important for exchange for the rapidly increasing agricultural production.

The absence of a comprehensive reform strategy, the eclectic character of economic policy and the gradualism of change have been noted and often criticised by foreign observers from time to time over the past three decades. Over the first two decades, China was a “neither this nor that economy”, a “mixture of half-plan, half-market; pretend-socialism, pretend-capitalism” (Prybla, 1986) Raby (2001) noted the aptness of this description but also remarked upon the functional strengths of this approach to development strategy.

The absence of a comprehensive blueprint was inevitable in China’s circumstances, and the associated flexibility in response to changing circumstance and opportunity a virtue in practice.

It was inevitable because there was no conceptual basis for a market-oriented economy in China in the 1980s. A few leaders, and a few intellectuals involved in the policy process, Du Runsheng the most important amongst them, had understood the power of the market in economic development from experience in the liberated areas before 1949, from experience in socialist China before the push to state and collective ownership in the late fifties, and from the high-growth inter-regnum of the early 1960s between the Great Leap Forward and the Cultural Revolution. Some had drawn lessons from observation of the powerful experiences of other East Asian economies, including those of Chinese communities in Hong Kong and Taiwan. But the main understanding followed the commencement of reform, emerging from observation of the new pattern of Chinese development and increasing contact with foreign experience and ideas.

The absence of a blueprint was a virtue because any theoretical model of reform of the centrally planned economy in China would have been deeply flawed. The international economics profession knows much more clearly now, after the end of socialism in Eastern Europe more than a decade later, than it did at the beginning of Chinese reform, that the rapid unwinding of a centrally planned economy is fraught with risk of massive dislocation. A blueprint that won the plaudits of the international economics profession in 1978 would have been as ill-judged and as dangerous as the advice presented to Russia and Eastern Europe after the collapse of the former Soviet Union.

Some of the great sources of strength of the Chinese economy in the era of reform came as surprises to Chinese and foreign observers alike. These would have been given an inadequate place in a program of reform built upon received theory and the experience of others. First amongst the surprises was the ease and speed of successive ownership transformations: the emergence of the household responsibility system in agriculture in the early 1980s; the extraordinary dynamism and scale of activity within the township and village enterprises which grew from the remnants of the disintegrating people’s communes; and the growth to dominance of private ownership in the late 1990s and early twenty first century. Neither the business forms nor the sequence and timing of their adoption and eclipse would have been prescribed in a blueprint inspired by received wisdom.

Deng Xiaoping used to describe economic reform in China as crossing the river by feeling for stones at each step. General Secretary Hu Yaobang in late 1986 described reform in a letter to Australian Prime Minister Bob Hawke as an "experiment without precedent". In the uncertain months after the dismissal of Hu Yaobang from his office as General Secretary in January 1987, Deng Xiaoping alluded uncharacteristically to the Chinese classics. He compared the path of reform to the mission of Guan Yu, who had to cross five passes and cut down six generals to achieve his noble objective.

These metaphors contain important insights. Chinese reform required transformation in ideology, in ideas about policy, in law and regulatory systems and in economic institutions. Above all, it required the accumulation of new knowledge in Chinese minds, as the Chinese people learned to do new things, and old things in different ways, in an economic and social world that was fundamentally changed.

These transformations in ideology, ideas, knowledge, policy, institutions, law, and experience occurred alongside each other. They reinforced each other, until new ways of interpreting the world around had formed and been rendered coherent within Chinese minds.

At some time in the third decade of growth, China ceased to be a "neither this nor that economy". It had become a large market economy. Deep integration into international trade and investment had been reinforced by acceptance of far-reaching commitments on entry to the World Trade Organisation in November 2001. The considerable remaining limits on the use of markets were similar in extent and kind to those in many market economies across the world, shaped by the usual anxieties and realities of a market economy, and by political economy constraints with no public policy purpose. The East Asian financial crisis had made China cautious about the extent and speed of external financial liberalisation. This provided inoculation from contagion out of the United States-led financial crisis of 2007-08. While there was a genuflection to socialism—or reluctance to surrender major areas of patronage and control—in the reluctance to cut the final strands of state control from the large businesses in heavy industry and financial services, the growth in business ownership was increasingly and overwhelmingly private.

Three Crises

The first decennial crisis saw the largest departure from strong growth of the reform era so far and was the most threatening to continued reform and sustained growth. It began as the most virulent of the periodic inflationary episodes, with rapid monetary expansion driven by apparently insatiable investment demand from state-owned enterprises. There were no market-based mechanisms for constraining credit growth. Partial liberalisation of prices within the dual price system was creating opportunities for arbitrage between controlled and free markets, and opportunities for public officials to raise private incomes through the arbitrage. Within the dual price system, shortages of materials led to exaggerated price increases in the free markets.

Concerns about inflation and corruption through the early months of 1989 melded with expressions of wider political concerns. The major reconstruction of the senior personnel of Party and State in early June led to a period of political and economic retrenchment. The Western reaction to events in Tiananmen interacted with domestic political developments and contributed to the strongest doubts within the wider political leadership about reform of the three decades.

The economic retrenchment was secured through reimposition of direct central controls on investment by state enterprises and on other expenditures. This ended inflation, but at high cost to efficiency, growth and reform momentum.

This was the one period during which reform was suspended and in doubt. That it was followed by recommitment to acceleration of reform and internationalisation of the economy, alongside the maintenance of political stability through the coercive powers of the state, was determined by Deng Xiaoping himself. The outcome was not endogenous to the process of reform and growth.

This first decennial crisis was overwhelmingly domestic in origin, although its political manifestations developed foreign dimensions. The second and third were apparently entirely foreign in origin, although we will need to examine whether China contributed to the current crisis.

The Asian financial crisis began with speculative pressure against the Thai baht in May and June 1997. By July there was irresistible capital outflow, and there was massive baht devaluation within a new floating exchange rate regime. Over the next six months, the contagion forced reversals of immense capital inflows into immense outflows. The consequence was a collapse of values in all financial asset markets, currency depreciation, and shrinkage of domestic investment and then economic activity in one after another of the market economies of East Asia.

China's fixed exchange rate against the United States dollar meant that the falls in other East Asian currencies generated large real appreciation of the renminbi. This coincided with reduced domestic demand in China's major trading partners. Exports fell to East Asia and stopped growing to the world as a whole. Direct foreign investment fell in China. Speculative capital outflow became important in both Hong Kong and the mainland of China, despite the inhibiting influence of controls on the capital account of the balance of payments. The Chinese currency came under strong pressure for devaluation.

China adopted a bold response to the crisis all around it. The Chinese authorities took two risky decisions. They decided to defend the value of the yuan against the United States dollar. And they decided to seek to maintain rapid economic growth—depressed by the cessation of export growth and the decline in direct foreign investment—through strong fiscal expansion.

The decisions were risky in relation to the exchange rate for two reasons. First, no-one could be sure that the authorities could indefinitely resist the pressures for currency depreciation. It would depend on how long the crisis remained and how deep it became elsewhere in East Asia. Second, the large real appreciation that was occurring against all other East Asian currencies except the US-pegged Hong Kong dollar were increasing the recessionary pressure on Chinese economic activity, and this could not be sustained indefinitely if domestic sources of demand growth continued to decline.

The holding of the dollar peg seemed to contradict a lesson of crisis elsewhere in East Asia, that rigid exchange rates increased the risks of crisis because sooner or later they would need to be abandoned, and late abandonment increased the inevitable eventual adjustment costs. The financial collapses elsewhere in East Asia were partly a reflection of structural weakness in financial institutions and governance, and Chinese banks and their governance seemed to be as weak as any.

The fiscal expansion exacerbated pressures on the exchange rate and brought forward the day when the authorities might have to yield on the currency peg. The whole strategy depended on the judgement that financial stabilisation and growth would return to East Asia before China was forced by external financial pressures and decline in domestic growth to abandon either fiscal expansion or the fixed exchange rate.

The Chinese "Keynesian" strategy through the East Asian financial crisis had a chance of working because China entered the crisis in a strong macro-economic position, with low inflation, high growth momentum in exports, investment and output, and reasonably large external reserves. That it worked in reality owed much to good judgement and to the steadiness of policy and its articulation. That in turn depended on what in retrospect was a remarkable period of leadership stability, built around Jiang Zemin as General Secretary and Zhu Rongji as Premier.

China avoided becoming part of the East Asian crisis, and its strategy helped to shorten the crisis elsewhere.

The East Asian financial crisis left a legacy of Chinese confidence in the country's capacity to maintain growth through adverse external circumstances that is important in 2008. It also entrenched the role of state-owned businesses in heavy industry, including mining, minerals and energy processing, transport and communications, and the financial sector, and indirectly to the huge surplus savings of the early twenty first century.

Like the second, the third crisis of the reform period had external origins. Or mainly external: near its heart are all of the causes of the massive current payments imbalances between the United States and East Asia in which Chinese patterns of savings have played a part.

At first sight, the current financial crisis looks like a global version of the East Asian financial crisis. China has entered this crisis in a much stronger external payments and reserves position than it had in 1998, so can implement a massive fiscal expansion with a firm exchange rate with greater confidence than in 1998.

Having severed the rigid link between the yuan and the United States dollar in July 2005, and appreciated from 8.3 to less than 6.8 yuan to the dollar over two years or so, the Chinese authorities no longer have an established peg to defend. The yuan value in US dollars is now slightly below the peak. China is in a better position to sustain a growth-oriented strategy based on fiscal expansion of any dimension through the current crisis than it was at an equivalent stage of the financial crisis. The focus on expanded public expenditure on development of rural and inland regions in recent official policy statements, including by General Secretary Hu Jintao and Premier Wen Jiabao, suggest a better developed base for productive fiscal expansion than was present in 1998.

At first sight, the global financial crisis of 2008 calls for a larger version of the strategic response of 1998. At first sight, China is in a position to follow that approach with less risk than a decade earlier.

Deeper down, this global crisis has some more difficult dimensions affecting China's policy. The 2008 global financial crisis may end up having a much larger impact on the Chinese economy, sustained for longer, than the Asian financial crisis.

While it is early days, and the early, vigorous and concerted policy action by many countries will have beneficial effects, it is likely that the weighted average downturn in China's export markets will be even greater than the decline of export growth to zero in the late 1990s. It may be much greater.

The export share of the Chinese economy is now much larger: a downturn in exports has greater leverage over Chinese growth.

China is now a much more market-oriented economy. It is subject to greater fluctuations through the ebb and flow of private business sentiment. Many of its enterprises and state investment vehicles, even those which are majority-owned by the state, have lost large amounts of capital in the collapse of United States and other financial institutions and asset values. Their behaviour will be affected more than the loss of financial capacity alone would suggest.

For all of these reasons, China will have to sustain larger fiscal expansion for longer through the current crisis than it did through the Asian financial crisis, if it is to maintain strong growth in output. It will need all of the increase in capacity that is provided by a degree of exchange rate flexibility, huge foreign exchange reserves and current account surplus at the starting point, and the policy confidence that comes from having done something like it successfully once before.

There is one other issue, arising from China's much larger role in the global economy in 2008. China represents now a high proportion of global savings, and a higher proportion still of the pool of surplus savings over domestic investment that is available for international investment. There is a sense in which the huge flow of surplus savings from China to the United States has funded the near-zero interest rates, the household and public budget deficits and more generally the financial imbalances that have been the source of the contemporary crisis.

The correction of the domestic recessionary pressures in China through massive domestic demand expansion will reduce the amount of surplus savings available for international investment. Something similar will be happening in other East Asian surplus economies. This will coincide with the reductions in surpluses in oil exporting countries deriving from large falls in the oil price.

The total pool of global savings could diminish to an extent that has material effects on global real interest rates. This would be offset for a while by lower investment rates in recession or lower growth in many countries. It would become more important as recovery gets under way and investment rises. In these circumstances, permanently lower Chinese surplus savings could, in the absence of corresponding structural change in America behaviour to raise the rate of savings and reduce the current account deficit, contribute to early increases in the real global interest rate. The subsequent recovery could be weaker and shorter than might be anticipated from historical experience. We all have a strong interest in the changes in United States official and household savings behaviour that could avoid this outcome.

The Crises That Didn't Happen

The crises that didn't happen through the reform period are just as important and just as interesting.

The scale and the unusual institutional setting of Chinese reform and growth have stretched Chinese and foreign capacities for comprehension. The unfamiliar settings have always seemed to threaten the continuation of market-oriented reform and growth. The perceptions of threat have sometimes related to challenges of ideology and policy, sometimes of political resistance to change, and sometimes prosaic problems of economic management in a rapidly growing and changing economy.

In the first decade after 1978, there was widespread incredulity about the continuation of market-oriented reform beyond each step as it was revealed. Often the successful steps were revealed after they had been successfully implemented in many places. Sometimes the successful steps evolved independently of policy, so that their absorption into development strategy took the form of pragmatic acceptance of fait accomplii.

In that first decade of reform, I recall the confidence with which commentators announced that the residual role of ideology would block the emergence of a labour market in China. That barrier to the emergence of a market economy melted away when the melting served an essential development purpose. There was confident expectation that the limits to ownership reform of enterprises would eventually constrain growth. Rural Chinese ingenuity flowed around the blockage, and a new form of collective ownership, the township and village enterprise, was observed to be playing a crucial role in the industrialisation of the countryside. It was not long before flaws in the institutional structures of township and village enterprises were being held up as a reason why the rapid growth to which they were contributing exceptionally would come to an end. Before that end came, the large-scale removal of "red hats" revealed a transformation in favour of private ownership.

I recall the confident pronouncements that it would be politically impossible to unwind the cradle-to-grave protections associated with employment in state enterprises, or to substantially liberalise foreign trade in agricultural products, or to rely mainly on international markets for important industrial raw materials. Here the confidence was based on the experience of other countries, supported by knowledge of a Chinese reality. As it turned out, the constraints were removed when the economic value of doing so became large enough.

The more prosaic barriers to continued economic growth had been daunting in the first decade of reform. There were long debates about whether it was better first to change the basis of price formation, or to change enterprise ownership and control. Successful urban reform required both, but there were many barriers to doing them together, and to start with either one raised many difficult issues of economic stability. The outcome was inelegant, pragmatic and for a while destabilising.

The problem of macro-economic stabilisation policy in a partially reformed economy was especially difficult. How to control monetary expansion when major enterprises still had state-like command over financial resources, but were less and less under the control of the central monetary authorities? The increasing amplitude of successive business cycles through the reform period raised doubts about the longevity of strong growth.

All of these ideological and policy, political and economic management challenges to reform and growth came together in the inflationary and then political crisis of 1998-89.

The crises that didn't end reform and growth over the second decade 1988-98, were increasingly of conventional economic and political kinds, familiar from development experience in many contexts. The slump in economic growth in 1989 and 1990 ended the raging inflation that had emerged in 1988. It did this partly by slowing greatly for a while domestic and foreign interest in Chinese investment. To the extent that the deflation was engineered by the authorities, it was through the application of crude controls on expenditure and especially investment by state-owned enterprises. These controls had all of the costs to growth of resource allocation within the planned economy. Deng's declaration in 1991 that reform and opening to the outside world were to accelerate and expand unleashed a new and virulent inflationary episode. The Deng boom coincided at first with the developed country recession of 1991-92. The China boom of the early 1990s eased the impact of OECD recession on growth in smaller East Asian economies—the first of several episodes in which Chinese expansion offset the East Asian growth impacts of downturns in economic activity elsewhere.

This was the decade in which the ownership issues were resolved in favour of widespread private roles, with state-owned enterprises remaining prominent in heavy industry and the financial sector. It was the decade in which critical decisions were taken on deepening Chinese integration into the international economy, with commitments being made to secure membership of the World Trade Organisation. It was the decade in which the increasing amplitude of the business cycle was tamed, with more effective discipline on bank lending and the development of more sophisticated instruments for financial management.

The second reform decade ended with the uncertainty of the East Asian financial crisis.

At the time of the twentieth anniversary of the Third Plenum, the risks that China would become a victim of the crisis were high.

The downturn during the financial crisis left a heavy shadow. Growth, while remaining high by the standards of the rest of the world, around 7 percent, was lower than in any other part of the reform period except 1989-90. Huge and sustained fiscal expansion left the state much larger than the leaders of reform had judged to be desirable. Much expenditure was allocated poorly for growth. Part of the growth in output found its way into huge stocks of unwanted goods, leading to cynicism about the reality of growth performance.

This macro-economic episode and the strategic response to it left lingering concerns about the quality of the financial system, and questions about whether its evident weaknesses would one day generate China's own financial crisis. Now, with the global financial system in crisis, China is vulnerable from the weaknesses of Western financial institutions that have invested in its own institutions.

Throughout the reform era, there has been a persistent question about whether the Chinese political system would change enough and sufficiently fast to accommodate the immense changes in the society and economy that inevitably accompany economic expansion and structural change. There has been a persistent question about whether the Chinese political system would change enough and fast enough to maintain political stability.

Chinese reform governments have not responded to pressures for political change along lines suggested by conventional Western analysis. There have nevertheless been responses. In the third decade of reform, they have included changes in governance arrangements at a local level , and more overt concern for development in poor regions and for incomes and living standards amongst people who were not early beneficiaries of the growth process. Through the third decade of reform, disruption of growth as a result of political unrest is another crisis that has not happened. At least, not yet.

WHERE IS GROWTH GOING AND WHERE WILL IT END

China's reform and development have a long way to go, but the directions are clearer to Chinese and to foreigners than ever before. At the beginning of reform, few spoke of the end point being an economy with living standards in the range of the countries that were then developed. The numbers were too large to contemplate. That would mean the addition to global output of an amount well in excess of the sum of production in all of the developed and transitional economies together. This would place great strain on every world market, producing the goods and services in which Chinese resources were deficient, and in which China had or would develop international comparative advantage. It would place great strain on the Chinese and global physical environments.

In 1986 I asked Deng Xiaoping where growth would have taken China by the middle of the twenty first century. He said that by the middle of what was then the next century, the Chinese people would enjoy average living standards comparable with those of the newly industrialised economies of Asia at the time of our conversation. He added that he hoped that the Chinese people would be satisfied by that.

It is now clear that the only resting place for rapid growth is Chinese living standards and per capita output and consumption that are close to the global frontiers. At that place, China's people will have demanded and received the quantum of security against poverty and in other ways that is usual in advanced industrial societies. At that resting place, China will be contributing more or less its proportionate population share of the developed world's ideas and productive innovation—which itself requires considerable political liberalisation. It will be generating more or less its proportionate share of the developed world's environment hazards, including greenhouse gases. At that time, there is no prospect of there being a successful international community unless China is producing more or less its proportionate share of global public goods, including leadership of economic and environmental stabilisation, and peace and good order.

Increasingly, the new agenda of Chinese government under the twenty first century leadership of Hu Jintao and Wen Jiabao has involved the spreading of Chinese growth into areas and amongst people that been only slightly touched by its beneficent processes.

Increasingly, the new agenda has involved China playing a larger role in leadership of the global economic and political systems. There is an inevitable lag between the reality of the expansion of China's weight in the global community, and domestic and international recognition of that weight. Successful management of all of the international challenges of the early twenty first century requires us all to shorten that lag, because there will be no provision of the international public goods that are necessary for sustainable growth, peace and environmental amenity without Chinese leadership playing a major role.

HOW CHINA HAS CHANGED PERCEPTIONS OF GLOBAL DEVELOPMENT

There is one overarching lesson for global development from the success of thirty years of Chinese reform. The beneficent processes of modern economic growth that began in Western Europe, its offshore settlements and Japan in the nineteenth century, and which spread to small East Asian economies in the third quarter of the twentieth century, are available for much of humanity. They are not restricted to a small proportion of people, with narrowly particular histories and cultural backgrounds. Chinese success more than doubled the beneficiaries of sustained, rapid, internationally-oriented modern economic growth. It has since been followed by success in other populous countries, whose experience together with that of China suggests that the necessary conditions for growth can be met in many economies in many cultural and historical circumstances.

The Chinese experience confirms old knowledge about the necessary conditions for sustained modern economic growth. Sustained rapid growth requires widespread acceptance in the community that economic growth and the associated rise in living standards has primacy amongst policy objectives. Economic growth is disruptive. It changes the distribution of income and wealth, transforms basic institutions and churns elites. All of this generates resistance, and no government will want to confront resistance unless there is broadly based support for change within society. Even where there is sufficiently widespread political support, there must be an effective state, capable of applying growth-oriented policies against the inevitable resistance from the many interests that believe that they are damaged by them.

Sustained rapid growth requires a large role for markets in the allocation of resources and the distribution of incomes. This is necessary for efficiency in resource allocation and also for flexibility in resource use in response to changes in the economic value of various activities, including in response to economic growth itself. The demands on flexibility increase as incomes rise and economic activity becomes more complex.

Sustained rapid growth requires a high degree of international orientation in markets for goods, services, capital, technology and ideas. Again, this requirement expands with the complexity of the economy as incomes grow.

Sustained economic growth requires high levels of investment. For this to provide a stable basis for long-term growth, it needs to be supported by high rates of domestic savings. The experience of many countries, now including China and India, is that high savings rates are to a considerable extent endogenous to sustained rapid growth, so that this becomes an easier condition to meet once strong growth has been established.

Education—investment in human knowledge and skills—is a necessary component in the high levels of investment. This becomes a more and more critical condition as incomes rise in the process of growth.

One piece of good news from the Chinese and other experience, is that rapid growth is reasonably tolerant of imperfect provision of its necessary conditions. If the conditions are present in reasonable degree, strong results can be achieved.

These are the general lessons of the Chinese experience with reform and growth, when Chinese reality is read alongside the successful development outcomes of others, earlier and later. There are some more specific lessons.

One specific lesson from Chinese experience is that there are advantages in starting reform and growth from agriculture and more generally from the countryside. The wide dispersion of the benefits of growth that came with the early success of agriculture galvanised political support for market-oriented reform. Here the outstanding contrast is with India, where the apparent exclusion of agricultural communities from the benefits of accelerated growth has been an important focus of political resistance. The large early gains in agriculture also laid the basis for the industrialisation of the countryside of coastal China, which itself had many advantages for sustained rapid growth in the country as a whole.

A second specific lesson is a corollary to the general lesson confirming the importance of free trade. Chinese experience reveals that rapid, internationally-oriented growth is possible in a big country. The General Secretary of the Chinese Communist Party, Zhao Ziyang, began to articulate the “coastal strategy” in 1987, based on growth in exports of labour-intensive products from the coastal provinces. One reaction of some Western economists was to say that China cannot be an export-oriented economy on the pattern of Taiwan, South Korea. Hong Kong and

Singapore. China was too big. It would turn the terms of trade against itself. The requirements of structural change in importing countries would generate unmanageable protectionist reactions.

We now know that China was not too big for export expansion, and the associated opportunities associated with specialisation according to comparative advantage, to play major roles in development. To be sure, Chinese export prices fell relative to imports—to the great advantage of countries, like many developing countries and like my own, whose comparative advantage in foreign trade was complementary to that of China's. But the loss in the terms of trade was small compared with increased gains from more efficient resource allocation and related dynamic advantages. To be sure, there were protectionist reactions—but not so large as to block rapid expansion of total Chinese exports over the next twenty years. To be sure, to sustain rapid export growth, China had to diversify exports into more capital-intensive and technologically more sophisticated products at an earlier stage of development than had been the case in the smaller East Asian countries which had followed strategies of export-oriented growth.

But China was not too big. The lesson here is a strong one. If China is not too big for an internationally-oriented growth strategy with strong initial specialisation in line with comparative advantage on exports of labour-intensive products, neither is India, nor Indonesia, nor any other developing country.

A third specific lesson is that there are advantages in gradual change. This is an important insight from the analysis of Lin and his colleagues at the China Center for Economic Research (Lin, 2007, 2008). This is an important antidote to mistaken views of influential parts of the Western economics profession. Many foreign analysts have underestimated the importance of institutions in economic development, and the inevitably gradual nature of successful institutional change. The development of the institutional basis of a market economy in particular, with its requirements of education, accretion of new cultural norms, and the development of regulatory frameworks and the people to manage them, takes time. Chinese reform gradualism gave them time.

There are two closely related lessons related to reform culture. One is to give a major role to experiment. There are many inevitable risks in reform. These can be reduced by proceeding in moderate steps, expanding on reform measures that have been successful. This helps to build confidence in the reform process, and avoids periodic setbacks when large steps have surprising and adverse consequences. A second is to take steps towards greater use of markets and deeper integration into international markets when you can, and not to wait until ideal circumstances have emerged. It is a lesson of Chinese development experience that you can get a long way on the good. There is no need to make the best the enemy of the good.