

The background of the cover features a photograph of a person, likely a farmer, carrying a large, heavy bundle of harvested crops, possibly rice or wheat, on their back. The person is wearing a dark jacket and a purple cloth is visible at the bottom right. The background is a vast, green field, possibly a rice paddy, under a bright sky. The overall color palette is dominated by greens and yellows, with a dark overlay on the left side where the text is placed.

BEIJING CONSENSUS OR WASHINGTON CONSENSUS

**What
Explains
China's
Economic
Success?**

BY YANG YAO



China's remarkable economic growth is often attributed to strong government intervention that can mobilize large amounts of resources to clear any bottleneck to growth or institutional change. This approach is often referred to as the *Beijing Consensus* (BC) as compared to the *Washington Consensus* (WC): the former being a model of authoritarianism and heavy state involvement in the economy, the latter a model of neoliberal and market-oriented doctrines. But these characterizations are inaccurate.

VARIATIONS ON A THEME

IN JOSHUA RAMO'S original formulation published in 2004 by the U.K.'s Foreign Policy Centre, the BC is defined by three principles, none of which necessarily requires strong government intervention:

- institutional innovation,
- equitable and sustainable development, and
- self-determination.

Over the last 30 years, the Chinese economy has moved progressively toward the market doctrines of neoclassical economics as summarized by John Williamson in his formulation of the WC. These include:

- prudent fiscal policy,
- economic openness,
- privatization,
- market liberalization, and
- the protection of private property.

China has been extremely cautious in maintaining a balanced budget and keeping inflation in check. Programs aimed purely at redistributing economic resources have been few, and transfers from the central government to the provinces have generally been dominated by infrastructure investment. The country is the world's second largest recipient of foreign direct investment after the United States; and more than 80 percent of China's state-owned enterprises have been privatized or transformed into publicly listed companies.

BIG BANG OR EVOLUTION?

WHAT'S UNIQUE is the way China has applied the WC. Implementing the WC requires substantial institutional

change and policy reform, whereas developing countries are usually characterized by rigid institutions that impede the function of the market. A big-bang approach to reforms is usually politically impractical or prohibitively costly. China's gradual one-step-at-a-time approach has been more successful. So if there is a Beijing Consensus it refers to the way China shaped its institutional and policy reforms to make the Washington Consensus work in the Chinese context.

THE BEST MAY BE THE ENEMY OF THE GOOD

THE CHINESE EXPERIENCE has yielded a number of lessons for other developing countries.

FIRST, institutional efficacy is more important than institutional purity.

The recent development economics literature points to the importance of institutions for economic growth. But institutions are effective only if they provide the right incentives to align the personal interests of economic and social agents with the interests of society at large.

In this case, first-best institutions may be ineffective because they often require drastic changes in the incentive structure which may be detrimental to and alienate the major stakeholders. Admittedly, adaptation which implies compromises with political and social realities, can result in lower efficiency. This may simply be the cost of success. Adaptation properly applied can motivate the stakeholders to buy into the reform, which is a key success factor.



Workers assemble solar-powered vehicles in Weifang. Designed and manufactured by a Chinese company, the vehicle can run 120 to 150 kilometers under normal driving conditions on a full charge with speeds of up to 48 kilometers per hour. It has attracted its first batch of export orders from countries including Germany, the United States, and Norway.

WHAT'S IN IT FOR ME?

BUT CHINA ALSO OFFERS many examples of institutional adaptation that improved efficiency.

The township and village enterprise (TVE) played a key role in China's industrialization in the 1980s. TVEs were nominally owned by local governments but in effect managed by private entrepreneurs. So although their ownership structures were unclear, they did offer strong incentives to both entrepreneurs and local officials to improve economic efficiency. They helped entrepreneurs circumvent the adverse political constraints at the time and generated local government tax revenues and economic growth.

The dual-track price system implemented between 1985 and 1994 is another example. This system assigned two prices to a single good, one for planned quotas and the other for market transactions. In this case the efficiency

losses came in the form of corruption: because the planned prices were much lower than the market prices, the officials who controlled the quotas could take advantage of the price differential to make money (arbitrage). However, the system provided powerful incentives for state-owned enterprise (SOE) managers to produce more output for the market while protecting weak SOEs from failing in the face of market competition. This was important to win support for reform from the larger part of the society. In addition, the system prevented hyperinflation which was plaguing other transition economies.

THE CARROT OR THE STICK

SECOND, government officials need to be motivated.

The role of government in economic development was highlighted in the World Bank's influential 1993 report *The East Asian Miracle* and echoed in its

recent 2008 *Growth Report*. Although both explored how government can usefully take action to remove bottlenecks to economic growth, they spent little time on how to motivate government officials to take those actions.

In China, government officials are motivated in two ways.

First, promotion of government officials is strongly based on merit, especially their contributions to economic growth. This is quite different from performance evaluation based on accountability, which requires government officials to follow preset rules or be punished. Although this kind of negative incentive exists in China, positive incentives for innovation and performance leading to economic growth are more prevalent. So far, the positive effects of this system have outweighed the negatives.

Second, public servants benefit directly from economic growth:

■ those in more prosperous regions enjoy much higher salaries than

- those in less developed regions,
- different government departments can offer different levels of income and welfare, with departments that are directly involved in managing economic activities enjoying better treatment, and
 - some provinces provide bonuses to officials in subnational governments for generating more tax revenue.

Politically, many of those practices are regarded as extra-legal. In China they are considered practical ways of harnessing the inevitable forces of human nature.

Fiscal decentralization, too, has helped motivate subnational government officials. As one of the most fiscally decentralized countries in the world, China's subnational government revenue accounts for 45 percent of total government revenue and subnational spending accounts for 77 percent of total government spending. Decentralization turns local government officials into strong stakeholders in local economic growth. In addition, fiscal decentralization has created a constructive competition for resources among local governments, inducing them to improve services, local infrastructure, and other aspects of the business environment.

REDUCING ELITE CAPTURE

THIRD, insulation from special interests.

Government officials should be immune to conflicts of interests and pressure from special interest groups which in many developing countries often derail institutional and policy reforms.

Because Chinese society has been relatively equal, the government faces

less pressure from powerful interest groups. The primary interest is in promoting long-run economic growth which helps ensure better incomes for society as a whole.

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Another strategy has been to search for so-called Pareto-improving reforms: when no one is made worse off and at least one person is made better off. When reforms drastically change the distribution of wealth or power in

society, the government must take a stand and address challenges from the less favored. Pareto-improving reforms make it easier to mobilize broad public support.

A HOPEFUL FUTURE

IN DESCRIBING EAST ASIA'S growth experience, political scientists have proposed the concepts of *autonomous states* or *developmental states*, where the state plays a role in macroeconomic planning. But they are strong concepts because they require that the state have certain intrinsic qualities. Ultimately, they lay the burden on having visionary and committed leaders. The Chinese experience has taken a different approach. It treats the government as made up of rational individuals who need to be motivated to work for the common good of society. Based on this belief, a wide range of institutional arrangements have been established to incentivize government officials to behave as if they were disinterested when they face conflicts of interests in society.

Although China's application of the Washington Consensus may be country specific, it contains a key principle that others can learn from: namely, a volitional pragmatism featuring constant experimentation with a defined objective to improve on the status quo. Nothing is taken as permanent or perfect: the future is always envisioned as better than today and incentives are crafted to make that vision a reality. □

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