

THE WASHINGTON CONSENSUS INTERPRETATION OF CHINA: A CRITIQUE

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1. Introduction

There is an influential, neo-liberal proposition in the scholarly literature on China's economic transformation since the late 1970s. It states that China's reformed economic institutions are a mix of market-conforming and market-supplanting elements, that its developmental achievements so far have been ascribable to the conforming elements whereas the accumulated problems being ascribable to the supplanting elements, and that the problems have tended to outweigh the achievements as the country's economic transition moves on from the allegedly easy phase to the difficult phase. This proposition has been at the heart of the mainstream or orthodox interpretation – associated with major international decision-making institutions particularly the Washington institutions (the International Monetary Fund, the World Bank and the US government) – of China's economic transformation over the era of globalisation. It is no more than an extension of the notorious, market-fundamentalist Washington Consensus in the development-policy literature.

This essay offers a critique of the neo-liberal, Washington Consensus proposition summarised above. Placing the Chinese experience of economic transformation in the context of the worldwide developmental crisis in the era of globalisation, it is argued that the neo-liberal proposition is seriously flawed and unconvincing. In particular, pertaining to the proposition is the core argument that China's development achievements are mostly unrelated to the mainstay of its systemic reform. This argument presumes that development is “normal” or “natural” under the regulation of the market – which, however, does not fare well with the worldwide developmental crisis. Conversely, the efficiency attributes or developmental implications of China's market-conforming and market-supplanting elements should not be judged simply from a market-fundamentalist perspective. An alternative, development-oriented

perspective is thus needed.

This essay is organised in the following way. The next section contrasts China's developmental performance with the rest of the non-Western world over the era of globalisation, and highlights the paradoxical nature of the contrast for the Washington Consensus. Section three moves on to examine the tactics of the orthodox establishment in its attempt to explain the seemingly paradoxical contrast. Section four then criticise these tactics on the grounds that they are not consistent to the stylised facts both in China and worldwide. Section five gives some concluding remarks.

2. Globalisation Meets the 'China Paradox'

Viewed from the perspective of worldwide economic development in the era of globalisation, that is, over the past quarter-century, China's performance could be regarded as unique. The country has survived well the three waves of catastrophes that beset the non-Western world during this period. These catastrophes, namely, are: first, the 'lost decades of development' in most parts of the Third World since the early 1980s, second, the total crisis in countries of the former Soviet bloc since the mid-1980s, and, finally, the financial and economic crisis that engulfed most parts of East Asia in the closing years of the century.

What these catastrophes indicate is the transition of world economic development from the Golden Age of the 1950-70s to an era of prolonged stagnation since 1980. Along with the general stagnation, meanwhile, there has been a trend of growing disparity among major regions of the underdeveloped world – that is, a trend of uneven development.⁶⁰ As can be seen from Table 1, prior to the 1980s, the

⁶⁰ For an analytical overview of the worldwide developmental crisis and uneven development after the Golden Age, see Ajit Singh, 'The actual crisis of economic development in the 1980s: an alternative policy perspective for the future' (in A.K. Dutt and K. Jameson [eds.] *New Directions in Development Economics*, Aldershot: Edward Elgar, 1992). John Weeks ('The expansion of capital and uneven development on a world scale' *Capital and Class*, 2001, no.74, pp.9-30) gives a more theoretical and updated treatment. Dic Lo ('China after East Asian developmentalism', *Historical Materialism*, 2001, no.8, pp.253-264) notes several structural features of the world economy that have been highlighted in the relevant literature as possible main causes of the crisis. Williamson Easterly, 'The lost decades:

growth performance of most regions was rather satisfactory, while that of the newly industrialising economies (represented by South Korea and Taiwan in East Asia, and Brazil and Mexico in Latin America) could be considered as encouraging. And the record of countries of the former Soviet bloc was in no sense far behind the best performers.

A totally different picture emerged in the stagnation era, however. The real growth rate of per capita income for all low-income and middle-income economies was a mere 1.3% per annum in the 1980s, and 1.8% in the 1990s. The same rate for all low-income economies excluding China and India actually fell sharply, from the already low level of 2.0% per annum in the 1960-80s to 1.2% in the 1990s. And the growth performance of middle-income economies meanwhile has not been any better. Thus, especially when the growing disparity across regions is taken into account, it is no exaggeration to call the 1980-90s the ‘lost decades of development’. This is even more so for countries of the former Soviet bloc, where the average annual growth rate of per capita income in the 1990s was -1.7%.

[Table 1]

In this context, China’s rapid and sustained economic growth since 1980, over and above its respectable record in the previous decades, is indeed unique. As also can be seen from Table 1, the country’s per capita income grew at an average rate of 8.8% per annum in the 1980s and 9.3% in the 1990s, far exceeding the average of the Asia-Pacific region which is the best performer of the world during this period. The growth performance is paradoxical as well, given that China’s economic institutions and policies have long been dismissed by the world orthodox establishment – that is, the Washington establishment and its associated free market doctrines – as by nature seriously deviating from the canonical free market economy, and being akin to the crisis-causing factors of the three groups of economies indicated in the opening

developing countries’ stagnation in spite of policy reform 1980-1998’ (Working Paper no.27272, The World Bank 2001, www.worldbank.org), notes the almost total ignorance of the worldwide developmental crisis in the mainstream literature.

paragraph of this article. How, then, has this ‘China paradox’ come about? Does there really exist a distinctive, discernible ‘Chinese model of economic transformation’ that has underpinned the spectacular developmental performance?

3. China in the Transition Orthodoxy

Talking about ‘the China paradox’, of course, would imply a challenge to the free market doctrines, and the orthodox establishment has been outspoken in rejecting it. A recurring claim has it that, given a longer time span, an economic collapse of comparable (to the East Asian crisis, if not the Russian depression) scale is bound to occur in China, as a punishment for its deviation from the established, universal doctrines.

What the orthodox establishment considers as anomalous, indeed objectionable, in China’s reformed economic institutions concerns, ultimately, the widespread violation of the principles of individualistic property rights. Easily observable phenomena such as discrete government intervention in economic affairs (the state-business relationship), soft budget constraints (the finance-industry relationship) and rigid employment and compensation systems (the worker-enterprise relationship) are deemed symptoms of this ultimate disease.

Thus, in the scholarly circles associated with the orthodox establishment, there has long been a proposition stating that China’s reformed economic institutions are a mix of market-conforming and market-supplanting elements, that its developmental achievements so far have been ascribable to the conforming elements whereas the accumulated problems being ascribable to the supplanting elements, and that the problems have tended to outweigh the achievements as the country’s economic transition proceeding from the allegedly easy phase to the difficult phase. The future prospects for the Chinese economy, the proposition maintains, is at best uncertain and more likely crisis-prone. And the only way to avoid this looming crisis is to embrace the orthodox doctrines *in toto*, particularly via mass privatisation of state firms and liberalisation of external economic transactions.⁶¹

⁶¹ Examples of this claim abound, see, e.g., *The Economist* 24th-30th October 1998, pp.15-16

To put the above proposition in context, it should be noted that China's experience of economic development and systemic reform has posed a serious challenge to the orthodox doctrines – known variously as 'market fundamentalism in transition' (IMF 2000) or 'the transition doctrine of the Washington consensus' (Stiglitz 1999) – in the so-called transition debate. Back in the early 1990s, Martin Weitzman, an influential economist, apparently being puzzled, spelt out the following: 'According to almost any version of standard mainstream property rights theory, what has been described as the "East European model" basically represents the correct approach to transformation, while what we are calling the "Chinese model" should represent a far-out recipe for economic disaster... The central paradox is the enormous success of the Chinese model in practice, contrasted with the sputtering, tentative, comparatively unsuccessful experience with the East European model.'⁶²

The Chinese experience appears to indicate that adherence to principles of individualistic property rights is neither necessary nor sufficient for generating sustained rapid economic growth – indeed for avoiding economic stagnation. The credibility of the orthodox doctrines is thus at risk if not having an adequate explanation of the seemingly anomalous Chinese experience.

In the face of this 'China challenge', the orthodox establishment has responded by means of relying on the proposition indicated above that focuses on the

and pp.23-28. For a scholarly version of this view, see N.R. Lardy, *China's Unfinished Economic Revolution* (Washington, D.C.: Brookings Institution Press, 1998). See also IMF, *World Economic Outlook* (Washington, D.C.: The International Monetary Fund, October 2000) and the World Bank, *Transition – The First Ten Years: Analysis and Lessons for Eastern Europe and the Former Soviet Union* (Washington, D.C.: The World Bank, 2002), for more recent accounts from the orthodox establishment.

⁶² Martin Weitzman, 'Economic transition: can theory help?' (*European Economic Review*, 1993, vol.37, pp.549-555), p.549. Weitzman did not provide a general answer to this question. Nevertheless, in a subsequent paper with Chenggang Xu on the acclaimed development of China's collective township and village enterprises ('Chinese township-village enterprises as vaguely defined cooperatives', *Journal of Comparative Economics*, 1994, vol.18, pp.121-145), Weitzman raises a proposition – in the spirit of the theories of idiosyncratic exchange and incomplete information – which states that vaguely-defined property rights do have distinctive competitive advantage under certain structural and institutional conditions.

institutional aspect, as well as a second, related proposition on economic development. The World Bank, in its 1996 *World Development Report*, which is devoted to the ‘economics of transition’, frames such a question for itself to answer: ‘Do differences in transition policies and outcomes reflect different reform strategies, or do they reflect primarily country-specific factors such as history, the level of development, or, just as important, the impact of political changes taking place at the same time?’⁶³ The answer, unsurprisingly, is that differences in country-specific factors, particularly the different levels of industrialisation, have largely explained the disparity in actual economic performance. Both in China and in countries of the former Soviet bloc, the development experiences – sustained rapid growth in the former case, depression in the latter case – are largely unrelated to their respective strategies of systemic transformation and development policies. Unlike countries of the former Soviet bloc, China was fortunate to be with a low level of industrialisation in the beginning of its reform. It has thus been able to generate economic growth via labour transfer from the rural-agricultural sector to industry, whilst postponing the needed, unavoidably painful reforms.⁶⁴

4. A Critique and Pointers for Further Investigation

It should be clear that what underpins both of the two orthodox propositions is the notion that economic development is somehow easy or normal – the notion of the so-called ‘natural path of development’. This does not fare well with the dismal picture of late development on the world scale, as depicted above with reference to Table 1. After all, it should be noted that China’s growth performance in the era of systemic transformation stands in sharp contrast to not only countries of the former Soviet bloc but also most of the non-Western countries.⁶⁵ And it is also noted that the

⁶³ World Bank, *World Development Report* (New York, Oxford University Press, 1996, p.5).

⁶⁴ This view was pioneered by Jeffrey Sachs, a leading figure in the army of Western advisers to countries of the former Soviet bloc in designing their systemic transformation strategies. See Jeffrey Sachs and Wing-Thye Woo, ‘Reform in China and Russia’ (*Economic Policy*, 1994, no.18, pp.101-145).

⁶⁵ Joseph Stiglitz (‘Whither reform? Ten years of the transition’, keynote address at the

initial condition of China's economic transformation is not simply one of under-industrialisation. As can be seen from the figures in Table 2, in 1980, industrial value-added accounted for an astonishingly high proportion of 49% of China's GDP. This is lower than the Soviet Union (54%), but higher than South Korea (40%), Brazil (44%) and India (24%) in the same year. The fact that, despite starting with one of the highest industry-to-GDP ratios in the world, China has been able to maintain very rapid industrial growth throughout the reform era, and with it to absorb labour transfer from the rural-agricultural sector, clearly should not be taken for granted.

[Table 2]

In terms of the immediate causes of economic growth, it might well be true that China's growth pattern in the 1980s and 1990s is not really unusual compared with the wider, underdeveloped world as a whole in the second half of the twentieth century. Three general observations pertaining to the worldwide experience of late development are of note. These, namely, are: first, late development is often associated with the process of industrialisation, in the form of an increasing share of employment of resources and production of output by industry in the economy; second, there exists a positive relationship between output and productivity growth within the industrial sector; and, third, there also exists a positive relationship between industrial growth on the one hand, and the output or productivity growth of the rest of the economy on the other hand.⁶⁶

Annual Bank Conference on Development Economics, Washington D.C.: The World Bank, April 1999), then chief economist of the World Bank, was outspoken in criticising this notion of the transition orthodoxy. He maintains that China has faced a task of economic transformation that must be more difficult than that faced by countries of the former Soviet bloc – because China's task encompasses simultaneously both systemic reform and economic development, rather than systemic reform alone. Clearly, this statement suggests that economic development is by no means a natural or easy process. This message is a basic tenet of what has been termed, somewhat grandiosely, 'the post-Washington consensus'.

⁶⁶ These observations are known in the literature as the 'Kaldorian stylised facts', while the interpretation attached to them by Nicholas Kaldor is known as 'the Kaldor-Verdoorn Laws' (N. Kaldor, *Causes of the Slow Rate of Economic Growth in the United Kingdom*, Cambridge: Cambridge University Press, 1966. See also J.S.L. McCombie and A.P.

China's real growth rate of industrial value-added reached 11.1% per annum in the 1980s, and increased further to the rate of 13.7% per annum in the 1990s. These rates are much higher than the average of all low-income economies meanwhile, 5.5% and 2.7%, respectively for the two periods, as well as that of all middle-income economies, 3.6% and 3.9%, respectively. They are also substantially higher than the average of the East Asian high-growing economies (including China itself), the star performers of the underdeveloped world, where the average annual growth rates during these two periods are both 9.3%. No wonder, therefore, China's overall economic growth in the 1980-90s has far outstripped most parts of the underdeveloped world.

Figure 1 charts out the evolution of labour productivity of Chinese industry relative to the rest of the economy, both in nominal and real terms. It can be seen that the curve representing relative labour productivity at constant prices has been persistently above that representing relative labour productivity at current prices. This indicates the transfer of productivity gains in the industrial sector to the rest of the economy via changes in relative prices, thereby propelling overall economic growth. Moreover, the fact that the gap between the two curves has tended to widen over time implies that the pace of productivity transfer has tended to accelerate. It is thus clear that, regarding the immediate dynamics of economic growth, the Chinese experience over the reform era is industry-led growth.

[Figure 1]

It is necessary to go beyond the immediate dynamics of economic growth (which is common to experiences of late development) to investigate the underlying, structural-institutional causes of the dynamics (which could be China-specific). In view of the relevant literature on industry-led growth, and on the 'Kaldor-Verdoorn

Thirlwall, *Economic Growth and the Balance-of-Payment Constraint*, London: Macmillan, 1994.) It is noted that, whilst the interpretation has been a matter of debate, the observations themselves have been largely a consensus in the literature. See M. Syrquin, 'Structural transformation and the new growth theory' (in L.L. Pasinetti and R.M. Solow [eds.] *Economic Growth and the Structure of Long-Term Development*, London: Macmillan, 1994).

Laws' indicated above, it is often posited that productivity growth in an economy is typically generated by the interaction between particular structural-institutional arrangements and the demand environment – the two aspects combine to form a particular path of economic growth.⁶⁷ Hence, further investigation into the dynamics of China's economic growth needs to take as its point of departure the following two questions. First, what are the sources of demand that have underpinned Chinese industrialisation over the reform era? Second, what are the attributes embodied in China's reformed economic institutions that have made them capable of utilising the favourable demand condition to generate productivity growth?

For the first question, it is noted that, on the world scale during this period, a main factor that has impeded late industrialisation comes precisely from demand-side constraints.⁶⁸ Also recall that China's rapid industrial growth has been achieved in the context of starting in the late 1970s with one of the highest industry-to-GDP ratios in the world. There must exist some peculiarities with China's economic growth path in the reform era such that the accelerating pace of industrialisation has found its necessary demand conditions.

For the second question, it is well-known that China's reformed economic institutions have exhibited a strong character of long-term orientation, in terms of the state-business, finance-industry and workers-firms relationships. This is true not only

⁶⁷ Masahiko Aoki, 'Toward an economic model of the Japanese firm' (*Journal of Economic Literature*, 1990, vol.28, pp.1-27), provides a schematic, theoretical exposition on the relative efficiency attributes of different enterprise systems in the context of different demand environments. Dic Lo and Russell Smyth, 'Towards a re-interpretation of the economics of feasible socialism', (*Cambridge Journal of Economics*, 2004, vol.28, no.6, pp.791-808), in a similar vein, synthesise a range of theories on technological paradigms, growth paths and economic institutions to investigate the relative efficiency attributes of different economic systems.

⁶⁸ Ajit Singh ('The actual crisis of economic development') analyses the slowdown in late industrialisation with an emphasis on the worsened demand conditions after the Golden Age. Lance Taylor and C. Rada ('Can the poor countries catch up? Sources of growth accounting give weak convergence for the early 21st Century', The Schwartz Working Papers no.2003-4, <http://www.newschool.edu/cepa/publications/workingpapers/index.htm>, CEPA, New School University, 2003) provides a more recent analysis along the same line of arguments.

for state-owned enterprises but also for the main part of the non-state sector, that is, collectively-owned enterprises – these two types of enterprises still account for around two-third of the output of Chinese industry as a whole, despite a quarter-century of market reform and privatisation. Hence, the second question coined above could be reformulated in the following way: what kind of advantage can be generated by the systemic feature of state-owned enterprises, which appears to have more than compensated for the (allocative) efficiency loss that is deemed unavoidable from the standpoint of orthodox economic theory? Further investigation into this question will be of fundamental importance for making sense of the seemingly paradoxical experience of China's economic transformation.

5. Concluding Remarks.

From the analysis and discussion in the preceding sections, it can be seen that China's experience of economic transformation is far too complex to be subsumed under the neo-liberal, market-fundamentalist doctrines of the Washington Consensus. In particular, it is unconvincing to first presume that development is "normal" or "natural", and then, on that basis, to argue that China's developmental achievements have been largely unrelated to the mainstay of its systemic change. Any convincing account of the experience need to explicitly analyse – from a more positive and constructive perspective – the attributes of China's reformed economic institutions in terms of their ability in generating productivity growth and economic development.

Table 1. China's Economic Growth in International Comparison

	1960	1970	1980	1990	2001	2002	2003	2004
	-70	-80	-90	-200	0			
China	2.9	3.7	8.8	9.3	6.8	7.6	8.7	8.9
India	1.1	2.3	3.6	4.2	3.5	2.6	7.1	5.5
South Korea	6.0	8.4	7.7	4.7	3.1	6.3	2.5	4.2
Brazil	2.6	6.5	0.7	1.3	0.0	0.7	-0.7	4.0
USSR/Russia	4.0	4.7	1.3	-4.7	5.6	5.2	7.8	7.6
Low-income economies (excluding China and India)	2.0	1.8	2.2	1.2	2.6	2.4	5.4	4.5
Middle-income economies	3.5	2.1	1.2	2.2	1.6	2.3	4.2	6.1
Low- and middle-income economies			1.3	1.8	1.5	2.0	4.1	5.6
East Asia and Pacific			5.9	5.7	5.1	6.3	7.3	7.7
Europe and Central Asia			1.2	-1.7	2.0	5.3	5.8	7.0
Latin America and Caribbean			-0.3	1.7	-1.3	-2.3	0.5	4.6
Middle East and North Africa			-1.1	0.7	0.8	0.8	3.4	3.4
South Asia			3.4	3.7	2.8	2.7	6.1	5.1
Sub-Saharan Africa			-1.3	-0.1	0.9	1.1	2.0	2.4
High-income economies			2.7	2.2	0.4	0.8	1.7	2.8

s: World Bank, *World Development Report* and *World Development Indicators*, various years.

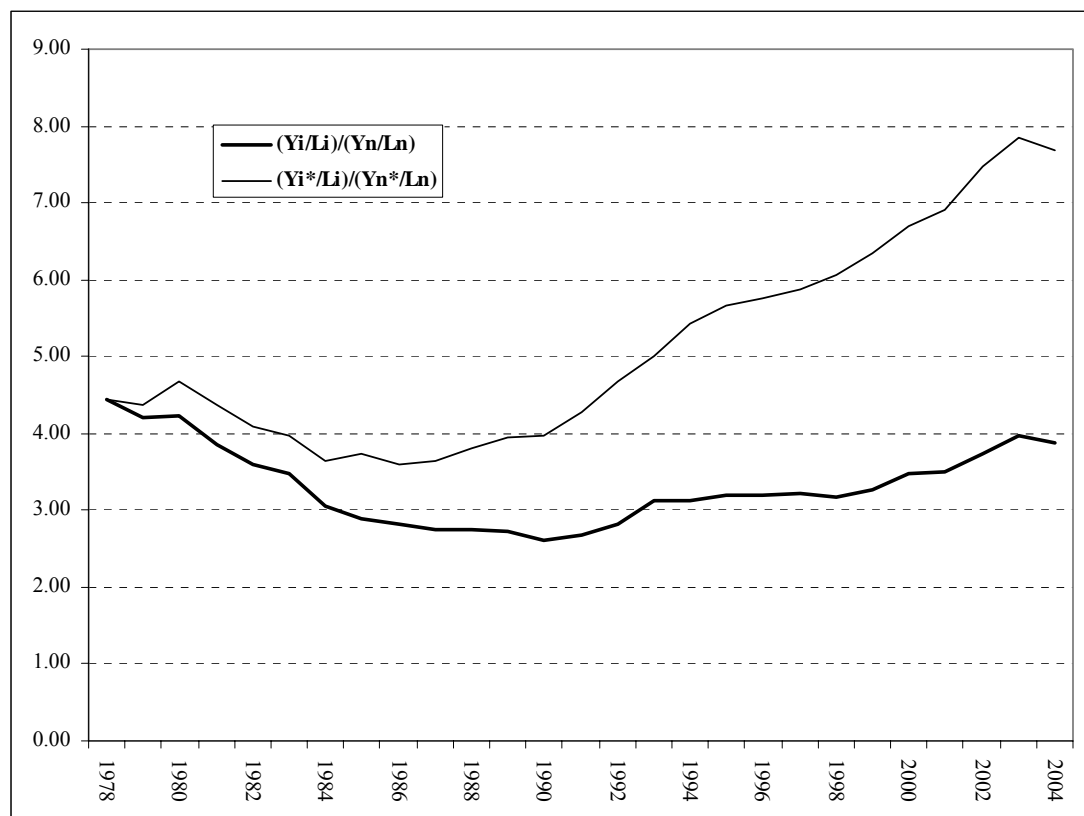
Figures are average annual real growth rate of per capita GDP (%).

Table 2. China's Level of Industrialisation in International Comparison

	Share of industrial value-added in GDP (%)			Share of manufactures in total exports (%)	Share of high-tech products in total manufacturing exports (%)	
	1980	2000	2003		2001	2000
China	49	50	52	89	19	27
India	24	27	27	77	5	5
South Korea	40	36	35	91	35	32
Brazil	44	28	19	54	19	12
USSR/Russia	54	38	34	22	14	19
Low-income economies (excluding China and India)	32	27	27	52	4	4
Middle-income economies	41	36	...	61	18	20
Low- and middle-income economies	...	36	35	...	17	19
East Asia and Pacific	42	48	49	80	31	33
Europe and Central Asia	...	33	31	56	10	12
Latin America and Caribbean	40	29	27	49	15	14
Middle East and North Africa	53	35	37	14	2	3
South Asia	24	26	26	78	4	4
Sub-Saharan Africa	39	30	31	33	4	...
High-income economies	37	28	...	82	25	18

Sources: World Bank, *World Development Report* and *World Development Indicators*, various years.

Figure 1. Relative Labour Productivity of Industry



Notes: Y = GDP and its components at current prices, with *denoting data at 1978 constant prices. L = total labour employment. The subscripts i and n denotes the secondary sector (i.e., industry plus construction) and the rest of the Chinese economy, respectively.

Sources: China State Statistical Bureau, *China Statistical Yearbook*, various issues.