

Book Review: China's Remarkable Economic Growth

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*This book examines the causal processes at work in the evolution of China's institutions and policies. It explores important consequences of China's growth, posing a series of key questions, such as: is the economy running out of unskilled labour and why and how has inequality risen? **Erik Tollefson** thinks this book is a profitable read for anyone concerned with the complex details behind China's growth story.*

China's Remarkable Economic Growth. John Knight and Sai Ding. Oxford University Press.

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China's strong economic performance over the past 30 years has attracted notable attention. Indeed, since Deng Xiaoping's path-breaking reforms to open the economy in 1979, China has registered an average annual GDP growth rate of nearly 10%; as a result, roughly 500 million people rose out of poverty. While China's economic story is understood in broad contours, controversies regarding the details still abound. Economists have spilt copious ink hypothesizing whether China's current growth strategy is sustainable over the long-term, whether other developing countries can learn anything from China's meteoric economic rise, and even whether the purported story itself is true: intense skepticism of government statistics remains pervasive. [John Knight](#), a renowned economist at Oxford, and [Sai Ding](#), a research fellow at Oxford, step into these highly contested waters with a robust approach: an evidence-based, empirically-driven analysis of China's past economic performance and its implications.

Although the book is laden with statistical analysis, the determined reader will not only be rewarded with a deeper understanding of China's economy, but perhaps more importantly, an understanding of where lacunae in the evidence and controversy still remain.



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After a brief review of prevailing macroeconomic models, the authors begin their analysis in an interesting place: tracing the arc of the political economy of reform in China. While for many countries an economic analysis might only tangentially cover reforms, this is not the case for China. Indeed, the authors make the point that since government reform measures and economic growth are inextricably woven, an understanding of the former is necessary for the latter. Deng Xiaoping undertook a herculean task in the economic and political “demaofication” of China in 1979; he adopted a gradual, iterative approach towards reform described in the famous maxim “crossing the river by feeling for the stones”. The reform economic model emphasized export-led growth through attracting foreign investment into the country to leverage its most underutilized asset: labour. The Chinese government introduced numerous reforms to meet this goal including decollectivizing farms, reforming state owned enterprises, and allowing rural residents to enter urban areas.

Two of the most interesting chapters in the book examine economic controversies that arose as a result of the reform model. In chapter eight, Knight and Ding explore the highly disputed question: “Why does China invest so much?” Since 1979, China has maintained a comparatively high level of investment (gross fixed capital formation) around 40% of GDP; this is twice as large as other developing economies, and thought to be one of the main reasons China has grown so fast. According to the neoclassical growth model, however, chronically high investment levels may signal an economy out-of-equilibrium; other countries with unsustainable investment levels have suffered devastating banking and foreign exchange crises as a result.

The authors take a measured view of the issue. On the demand side, high investment levels may be partially explained by high expected returns on capital: while upper estimates for return on capital are 20% (from 1979-1993), more conservative estimates range from 10-14%; returns from private enterprises outstripped those from state-owned enterprises. The ethos of reform played a key role in maintaining expectations: The Chinese government’s singular focus on driving economic growth molded investors’ expectations for future returns. At the same time, structural reforms such as privatizing state-owned enterprises and allowing (underemployed) rural workers to work in factories drove productivity gains in a capital abundant environment.

On the supply side, China boasted a high savings rate (roughly 40% throughout the reform period) making funds available for domestic investment: households, firms, and the government provided a majority of available funds at different points in time. Firms in China, however, did not have equal access to capital: state-owned firms had access to low-interest loans from state-owned banks that paid depositors little for their use. More efficient private firms were starved for capital. Thus, while China’s investment level may not be indeed be too “high” it certainly did not allocate capital in the most efficient manner.

Overall, the authors posit that China’s high rate of investment may be profitably understood via different models (and their assumptions): while the neoclassical growth model predicts current investment levels may not be, the endogenous model, which features aspects of technological change and resource reallocation, may better explain what the authors call China’s “virtuous circle” of high investment levels sustaining robust economic growth.

In chapter 10, Knight and Ding explore one of the most controversial issues in economic policy today: income inequality. The authors start the chapter with the riddle of conflicting economic evidence. According to official Chinese government statistics, the Gini coefficient (a measure of income inequality) rose steadily until 1995 and then stayed roughly flat. On the other hand, analyses by the World Bank and other scholars have found a steadily increasing Gini coefficient over time. Who is right? The difference does not necessarily lie in statistical sleight of hand, but in the inclusion (or exclusion) of subsidies given to urban residents. The debate is not merely academic: if the Gini coefficient has stopped growing, the government may have room to adopt more aggressive growth policies; if not, current economic policy may be unsustainable.

While conflicting evidence exists for rising income inequality, the authors find a clear case for an increasing disparity of wealth and a substantial decrease in poverty. While poverty substantially declined after decollectivization reforms (1978-1985), the continued fall after that may indicate that a rising economic tide lifted all (or at least a majority) of boats in China. The authors conclude the chapter with an interesting point: how the initial reform model embedded inequality. Initial reform efforts promoted inequality through favoring development of coastal provinces, an urban populace, and layoffs in the SOE sector. As China looks to the future, many of the policies now under consideration look to smooth out these inequalities.

The authors end their analysis with a circumspect look at China's economic past and future. Besides the fact that economies tend to experience lower potential growth rates as they mature, the authors examine numerous shocks that may derail China's future economic prospects: internal imbalances (high investment), external imbalances (reliance on exports), bank vulnerability (excessive non-performing loans) and social unrest. Although seemingly different in kind, these factors are interconnected and have the same origin: the Chinese government's economic reform model. The remaining (open) question is what the government will do (if anything) to promote future growth prospects.

Overall, *China's Remarkable Economic Growth* is a profitable read for anyone concerned with the complex details behind China's growth story. Although the authors do an excellent job of offering lucid explanations based on extant evidence, any potential reader should be aware: this book does have advanced statistical analysis (particularly in chapters 4-8). With the rich expertise of the authors and robust descriptive analysis, however, readers from a variety of backgrounds will benefit from this volume.

Erik Tollefson currently works as a policy analyst in the area of economics and health policy. He spent numerous years working abroad in Asia in corporate finance (M&A) and economic analysis. [Read more reviews by Erik.](#)