Debating China’s Economic Growth: The Beijing Consensus or The Washington Consensus

by Yasheng Huang

Executive Overview
This paper presents two competing views on China’s growth experience over the past three decades. For the sake of illustrative ease and brevity I label these two opposing views as the Beijing Consensus and the Washington Consensus. The Beijing Consensus interprets China’s economic growth as a function of innovations in the state sector, including close financial controls, state ownership of firms, and political controls in favor of economic growth. The Washington Consensus views China’s experience much the same as growth experiences elsewhere—that is, as a result of financial liberalization, private entrepreneurship, and political opening. Contrary to the established views among China scholars, this paper argues that the Washington Consensus view fits with the Chinese growth experience better.

In 2004, Joshua Cooper Ramo, a policy analyst based in Britain, published an influential position paper titled “The Beijing Consensus.” The central idea of Ramo’s paper is that China’s economic growth challenges every single principle in the Washington Consensus. The Washington Consensus, so named to underscore its American origin, espouses private property rights, economic opening, financial reforms, macroeconomic stability, and political liberalization to promote economic growth. The Beijing Consensus is ideologically neutral and flexible, in contrast to the doctrinal rigidity of the Washington Consensus, according to Ramo. It is committed to experimentation and innovation on the basis of existing conditions. This eclectic and pragmatic approach has served China extremely well over the past three decades. The country has grown rapidly and significantly reduced poverty.

Given the empirical evidence at hand, why should China or any other country adopt the recommendations of the Washington Consensus? If state ownership of firms promotes economic growth, why privatize? If the one-party system works well in generating growth in gross domestic product (GDP), why democratize? If state financial controls are effective in resource mobilization, why liberalize?

Throughout the 1980s and 1990s and at the turn of the 21st century, much of the developing world—Russia, Eastern Europe, Latin America, India, and Africa—was moving away from the commanding heights of economic statism (Yergin & Stanislaw, 1998). Free market principles succinctly enshrined in the Washington Consensus reigned triumphant, and almost hegemonic. Political scientist Francis Fukuyama even proclaimed the end of history—“the end point of mankind’s ideational evolution and the universalization of Western liberal democracy as the final form of human government” (Fukuyama, 1992). But by
2004—the year in which Chinese GDP broke a new record by incrementally contributing more to the world GDP growth than the United States did and by accelerating into a double-digit range, the Washington Consensus would be called into question.

Ramo stated in 2004, “What is happening in China at the moment is not only a model for China, but has begun to remake the whole landscape of international development, economics, society and, by extension, politics” (Ramo, 2004, p. 3). If that was the sentiment at a time when Lehman Brothers and AIG were still riding high, imagine the rhetoric after their fall. Many opinion leaders declared that the battle had been won, decidedly, by the Beijing Consensus. Washington Post columnist David Ignatius, invoking Richard Nixon’s famous backhanded tribute to John Maynard Keynes, declared, “We are all Chinese now” (2008, p. 1).

Serious scholars may dismiss these kinds of pronouncements as faddish hyperbole rather than something that deserves a sustained analytical treatment. But this conceptualization of the China model and the success of the country as fundamentally rooted in economic statism is having a real influence on business and policy discussions. Summarizing a widespread sentiment at the 2010 World Economic Forum, the annual gathering of business and policy elites, Thomas Friedman of the New York Times posed the following question: “Is the ‘Beijing Consensus’ replacing the ‘Washington Consensus’?” (He answered yes.) China itself can be said to be at the height of the Beijing Consensus moment. In the past two years, China has been in the midst of one of the most statist periods in its reform era, as evidenced by the massive stimulus package that has poured a huge portion of its GDP in financial resources into the state sector. Understanding accurately China’s developmental model has never been as important and as relevant. The language animating some of the Beijing versus Washington Consensus debates can be polemical, but the substance of the debate is not.

There are legitimate disagreements among academics about why and how China has succeeded (or why and how it may falter). The disagreements and debates cut across the normal discipline boundaries—economics, sociology, and political science. Academic debates aside, there are also real policy implications. Several policy and institutional innovations attributed to China by the Beijing Consensus hold normative implications for the world’s developing countries. For example, many have urged countries such as India to emulate the proactive and pro-business approaches of the Chinese government. Influential economists invoke China in their advocacy for a “heterodox” growth strategy and as an empirical counterweight to many of the policy prescriptions of the Washington Consensus. Given the influence of China and the Beijing Consensus model, it is extremely important for researchers and policy makers to get the facts right and identify the correct policy lessons about China’s growth. This is the central purpose of this paper.

This paper is organized as follows. The first part lays out the two policy models that characterized Chinese reforms during the two different reform periods. In the 1980s, China implemented many policies that would have been fully consistent with the Washington Consensus—private entrepreneurship, financial reforms, and some political opening. Starting in the 1990s, however, China moved away from this policy model and embraced the more statist Beijing Consensus policy model.2

The second section summarizes and clarifies the Chinese economic performance in the past three decades and matches the performance data with the policy models during the two reform periods. Personal income and consumption growth is singled out for emphasis because this measure, far more than GDP, is the appropriate benchmark for the actual living standards of the Chinese (Huang, 2008). I will also pay particular

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1 This is not an exhaustive survey article. The citations in the paper are meant to summarize the main views and not to be representative of all the scholarly works on this subject.

2 This paper does not discuss the details of Chinese politics, but it is important to note that the Chinese reform era experienced three different policy phases. The first policy period, from 1979 to 1988 (referred to as the “1980s” in this paper), is the era of Hu Yaobang and Zhao Ziyang in terms of economic policy, widely regarded as the most liberal Chinese leaders during the reform era. During the period from 1989 to 2002 (referred to as the “1990s” in this paper), Jiang Zemin and Zhu Rongji governed the country and managed the economy. The third policy period, since 2003, is the era of Hu Jintao and Wen Jiabao.
attention to private entrepreneurship and financial developments in rural China. Rural China, even in 2010, still represents a majority of the population (and the vast majority in the 1980s and 1990s). The welfare of the rural Chinese should thus be heavily weighted in any comparison of the Beijing and Washington Consensus. The final section concludes by drawing a number of broader implications from our analysis.

**What Exactly Is the China Model?**

Proponents of the Beijing Consensus assume that those attributes touted as the essential elements of the Beijing Consensus—financial support for the state sector, restrictions on private-sector development, and tight political controls—have been constant features of China’s growth experience. One rule of thumb in researching the Chinese economy is that the devil is in the details. It is understandable why Ramo, writing in 2004, had this view of China because China’s policy model (as of 2004) did fit with the Beijing Consensus in a number of crucial dimensions. But the critical detail here is that China did not always have Beijing Consensus policies in place.

A careful review of empirical evidence—based on survey data and archival sources—shows the existence of two China models. One China model emphasized financial liberalization, support for private entrepreneurship, and some political liberalization. The other China model is more statist in orientation, putting the emphasis on financial and political controls and favoring the state-owned enterprises (SOEs) at the expense of private entrepreneurship. Roughly speaking, the first China model, which prevailed in the 1980s, was quite close to many of the prescriptions embodied in the Washington Consensus (at least in terms of the direction of the policy changes). The second China model, the Beijing Consensus, has prevailed since the early 1990s.

I focus on four building blocks of Chinese growth—private entrepreneurship, financial development, policy liberalization, and politics. I will leave out external opening and macroeconomic stability in my account, not because they are unimportant but because the consensus view among China scholars is that on these two dimensions China has done more or less what the Washington Consensus prescribes. Yingyi Qian (1999), a leading China economist, had this to say: “Although China has adopted many of the policies advocated by economists, such as being open to trade and foreign investment and macroeconomic stability, violations of the standard policy prescriptions are also striking.”³ This paper disputes the second part of Qian’s statement and shows that those violations are not as striking as he asserted.

Did private ownership—a vital component in the Washington Consensus view of growth—contribute to Chinese development? Many China scholars would argue no, at least not in a straightforward way. The consensus view among China economists is that private entrepreneurship was endogenous of growth rather than contributing to growth. What mattered more in the initial takeoff stage of Chinese growth was not private entrepreneurship as commonly understood in the West but a form of innovative state ownership at the local level. This characterization is questionable. A close reading of the original data and archival materials shows that pure private entrepreneurship played a vital role in the Chinese takeoff and the country’s impressive poverty reduction. Rural China holds the key to clarifying this question. The reason private entrepreneurship is often under-weighted in explaining Chinese growth is the confusion surrounding the identity of rural entrepreneurship. Many China scholars mistook rural private enterprises as government-sponsored entities. This mistake is not the fault of an evasive and opaque China (although there is some of that) but a failure to simply look into some crucial empirical details.

Recall that Ramo’s position paper was published in 2004. At that time, China’s policy model was statist. How does one reconcile the statist policy model as prescribed in the Beijing Consensus with evidence that private entrepreneurship contributed to China’s initial takeoff? The answer

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³ One can question this assertion that China has followed conventional policies on macroeconomics and external opening. Many of the macroeconomic tools used by the Chinese state are administrative in nature. China opened its doors to foreign investors but did so at the expense of domestic private entrepreneurship (Huang, 2003).
is that China reversed many of its policy developments after 1989. Three policy reversals are discussed here. I begin with financial policies, specifically financial policies in rural China. It is well-known that the Chinese financial system is inefficient—it supports the loss-making SOEs at the expense of the dynamic private sector, and it has a high level of nonperforming loans (Lardy, 1998). This overall assessment, while accurate, masks some crucial details about financial development in China. One detail is that in the 1980s China actually implemented many financial reforms in the rural areas, but almost all of these reforms were reversed in the 1990s. This interpretation is backed up by archival research based on volumes of bank documents (Huang, 2008). In this paper, I will use two waves of rural household surveys (1986–1991 and 1993–1998) to provide additional evidence on this development.

The second policy reversal has to do with private-sector development. In the 1980s, China’s development was characterized by a bottom-up process led by rural entrepreneurship. In the 1990s, the government began to favor the more statist urban development. Drawing on fixed-asset investment data, we will show this substantial policy reversal in the 1990s.

The third reversal has to do with politics. Compared with economics, China has never significantly liberalized its political system. This part of the Beijing Consensus is true. But what is also true is that to the extent that China has implemented some political reforms, every single political reform that it did undertake was undertaken in the 1980s. In the 1990s, many of these political reforms were reversed.

Private Entrepreneurship

According to mainstream economics, a hallmark of a market economy is the vibrancy of its private entrepreneurship (Baumol, Litan, & Shramm, 2007). But the standard perspective in research on the Chinese economy argues that growth happened in China despite the absence of sizable private ownership. Advocates of this view point to township and village enterprises (TVEs)—the growth engines in the 1980s and the first half of the 1990s in China—as an illustration.

The standard view on TVEs is summarized by Barry Naughton in his textbook on the Chinese economy (2007, p. 271): “TVEs had a special distinction during this period [1978–1996] because of their unusual ownership and corporate governance setup. Originating under the rural communes, most TVEs were collectively owned.” Many other scholars accepted this characterization of TVEs.4

Roland (2000) posed the following puzzle about TVEs: If TVEs are state-owned, why are they performing so well? Elaborate theories—some backed up by formal mathematical proofs—have been proposed to explain the performance of TVEs. One explanation holds that TVEs perform efficient functions in an inefficient environment.5 For example, in a country with weak rule of law, TVEs can prevent theft of public assets as happened in Russia’s early reform years (Stiglitz, 2006). Roland (2000, p. 282) hails this explanation of TVEs as an important application of the path-breaking work in the economics of incomplete contracting. This is high praise indeed. The TVE research not only enhances our understanding of China but represents an advance in economic theory.

All of these theoretical conceptualizations about TVEs are predicated on one empirical detail: that TVEs are state-owned. Let me step back and ask a question that economists should have asked before they began to model: Are TVEs really state firms?

The term TVE first appeared in a policy document issued by the State Council on March 1, 1984, titled “Report on Creating a New Situation for Commune and Brigade Enterprises.” This important document laid down the definitional and statistical coverage of TVEs. The second paragraph of the document—known famously in China as Document No. 4—defined TVEs this way: “TVEs include enterprises sponsored by

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4 Rodrik (2007, p. 87) has this to say about TVEs: “China did not simply liberalize and open up; it did so by grafting a market track on top of a plan track, by relying on TVEs rather than private enterprise.” Stiglitz (2006) explains: “Many of the new enterprises were created in the 1980s and early 1990s by township and village enterprises (TVEs). These were public enterprises and the standard ideology would have said that you cannot succeed with public enterprises; but they were enormously successful.”

5 This theory was first proposed by Che and Qian (1998) and reiterated by Roland (2000).
townships and villages, the alliance enterprises formed by peasants, other alliance enterprises and individual enterprises” (Ministry of Agriculture, 1985, p. 450). Collective TVEs are enterprises sponsored by townships and villages; on this point, the Beijing Consensus is correct. But not all TVEs are collective; indeed, the vast majority are not. Individual enterprises refer to household businesses that typically have fewer than seven employees. The alliance enterprises, or lianying, are a 1980s euphemism referring to larger private-sector enterprises with multiple private shareholders and with more than seven employees.6 Thus, the official Chinese definition and the official data include both TVEs controlled by townships and villages (collective TVEs or simply “collectives”) and TVEs controlled by private entrepreneurs. TVEs, as used by the Chinese, are a geographic concept—enterprises located in the townships and villages. Western economists, on the other hand, assume that the term refers to ownership—that TVEs are owned by townships and villages. This characterization is incorrect and leads to fundamental misunderstandings of that sector and the reforms themselves.

Data from the Ministry of Agriculture (MOA) provide detailed ownership breakdowns of the TVEs: (a) collective TVEs, (b) privately run TVEs (larger private firms), and (c) self-employment household businesses.7 A careful analysis of the MOA data reveals that private TVEs absolutely dominated the total pool of TVEs. The highest number of collective TVEs during that time stood at 1.73 million in 1986. In contrast, the lowest number of private household TVEs in 1985 was 10.1 million. To put it simply, all the institutional innovations in the state sector touted by the Beijing Consensus proponents turn out to be based on an erroneous understanding of TVEs.

However, as both Oi (1999) and Naughton (2007) rightly stressed, the private TVEs were individually smaller than the collective TVEs so their employment and output shares were smaller as well. Household businesses are sole proprietorships, with a very small number of employees. Although some privately run TVEs were large, they were fewer in number. Employment in the collective TVEs was larger than employment in the private TVEs. In 1985, the collective TVEs employed 41.5 million people, compared with 4.75 million in the privately run TVEs and 23.5 million in household businesses.

There is nothing unusual about the statically large collective sector. The collective TVEs were founded in the late 1950s and had more than 20 years of development, whereas private TVEs resulted from the rural reforms and began only in the early 1980s. Despite their initial small size, the dynamism was on their side, not on the side of the collective TVEs. In 1989, the private TVEs already claimed 58% of the after-tax profits and 45% of the total wage bill of all TVEs.8 Thus, in spite of a three-decade head start, after a mere decade of reform the collective TVEs found themselves being overtaken by the private TVEs across a range of performance measures, including employment. In dynamic terms, the “TVE miracle” referred to by economics and management scholars took place entirely in the private sector, not in the collective sector. The success of China’s economic reforms was (and is) emphatically not a story of innovation in the state sector, as some have argued, but one of the entrepreneurial development in the Chinese countryside.

The poorest provinces pioneered rural private entrepreneurship. The private TVEs were clustered in the poor, heavily rural provinces. In 1987, the highest output share by the private TVEs was 70.4%, in Hebei province, one of the poorest and most agrarian provinces in China. In the same year, the lowest share was in Shanghai (6%). This fact illustrates an important policy implication about private entrepreneurship and poverty reduction. As is well known, China was very successful in reducing poverty during the 1980s (Ravallion & Chen, 2007). An important mechanism of this

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6 The private TVEs discussed here are not “red-hat” firms—those private firms that are registered as public-sector firms in disguise. Red-hat firms are typically those very large private-sector firms that are registered falsely as collective firms. The private TVEs in our data were fully private, and their private ownership identity was known to the government.

7 The source of data on TVEs is from the Ministry of Agriculture (2003).

8 I have examined the TVE development in the 1980s in great detail and provided many sources of data (Huang, 2008).
poverty reduction was a reallocation of labor from low-value-added agriculture to higher value-added service and manufacturing industries. In the 1980s, that private TVEs played a critical role in this labor reallocation of farm labor and that private TVEs developed fastest in the poorest provinces suggests that private entrepreneurship contributed substantially to China’s poverty reduction. This insight turns the Beijing Consensus on its head by showing that not only did China have a vibrant and growing private sector but that it is the private-sector development that contributed to the country’s most stellar economic success: reducing poverty.

**Rural Financial Development**

Very early in the 1980s, as a part of the rural reforms, China also moved quite far in terms of financial liberalization in the countryside. Rural credit cooperatives (RCCs)—rural financial institutions closely controlled by local governments—were instructed to support start-up businesses and to experiment with interest-rate liberalization. The government also began to reform the governance of RCCs by introducing democratic elections to select branch managers and by assigning controls to RCCs’ true shareholders—villagers who were the members of RCCs. Widespread practices of informal financing, funds transfer, and gray markets were tolerated, and some were legalized. A rural financial institution known as rural credit foundations (RCFs) operated outside the purview of the Chinese financial regulators and had nationwide branches.

These RCFs are similar to the micro lending institutions that have become popular in recent years (e.g., Grameen Bank). Indeed, microfinance flourished in China long before the term became popular. Early research by the World Bank reported very high levels of credit availability to the private sector in the 1980s. Lin (1990, p. 188, footnote 3) reported on a survey of 56 private firms in Tianjin in 1985. Of those firms with a total investment of less than 50,000 yuan, bank loans accounted for 38.8% of their funds; of those with an investment between 50,000 and 100,000 yuan, bank loans accounted for 43.6%; and of those firms with investments more than 100,000 yuan, bank loans accounted for 69.9%. A World Bank researcher, William Byrd (1990, p. 209), thus observed, “Banking institutions already see well-established private enterprises as solid borrowers.” Byrd also reported that local banks that lent heavily to private-sector firms had lower non-performing loan (NPL) ratios.

Yet in the 1990s, many of these successful and productive policies were reversed. The authorities reassigned controls of RCCs to the county governments. Credit flows to the rural areas were reduced in order to mobilize financial resources to launch large-scale and highly visible infrastructure projects in urban areas such as Shanghai. The milestone event in this policy reversal was the 1994 tax reforms, which reassigned tax revenues massively in favor of the central government. Local governments, starved of resources but not reduced in size or political power, began to tax the peasants aggressively and increased surcharges on basic education and healthcare and other commercial fees (Ahlstrom, Bruton, & Lui, 2000). In 1993, the operations of RCFs were curtailed as well, and the Chinese central bank finally banned them altogether in 1998. Informal finance, widespread in the 1980s, was ultimately declared to be a criminal activity. Many rural entrepreneurs were arrested, and one even received a death sentence for “illegal raising of capital.”

I used the fixed-site rural household surveys (FSRHS) conducted by the MOA to illustrate this financial reversal story. FSRHS is one of the most detailed datasets on Chinese rural households with a long time series. FSRHS provides household-level information for many variables, including income, expenditures, household assets, financial assets, and credit patterns.

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9 The information in this section came from a chapter on rural finance in a 2008 book (Huang, 2008).

10 The FSRHS allows us to explore policy reversals over a long period of time. Other researchers have documented the lack of progress in financial reforms and some reversals but mostly for the 1990s. For example, Park and Shen (2001) noted that authority to issue new loans became highly centralized during the course of the 1990s, and a study by the International Finance Corporation, based on a survey in the late 1990s, showed that newer private firms faced greater financing constraints than older firms (Gregory, Tenev, & Wagle, 2000). Other studies have reported on the deteriorating rural finance in the 1990s (International Fund for Agricultural Development, 2002; Nyberg & Rozelle, 1999).
demographic information, and—importantly—bank loans and access to informal finance.11

Rural households are a proxy for private-sector development because the majority of the private businesses took the form of sole proprietorships organized as household businesses. Consider the trends of household loan access between the two waves of the FSRHS. Figure 1 shows the percentage shares of rural households that reported receiving either formal or informal loans in the survey. The pattern is very clear: Far fewer rural households reported receiving loans in the 1995 through 2002 time period as compared with the 1986 through 1991 time period. And the difference is substantial. The share of rural households that reported receiving formal loans declined from 37% to 13% between those two periods.

Are formal and informal loans substitutes? In other words, could the decline of formal loans in the 1990s have been partially or fully offset by the rise of informal loans? Since informal loans are less directly controlled by the state, an increase in informal loans can be said to be a sign of financial liberalization (Allen, Qian, & Qian, 2005). The evidence fails to support this assertion. The graph shows that formal and informal loans are actually complements; that is, when formal loan access decreased, so did informal loan access. Access to informal loans declined from close to 60% of the rural households in the 1980s to 30% in the 1990s.

Statistical analysis of the FSRHS data also reveals a change in the types of rural households receiving loans in the 1980s and the 1990s. In the 1980s those rural households engaged in nonfarm businesses were more likely to obtain loans. However, in the 1990s those loans instead went to village officials. This is a predictable outcome given the sharp decline in the availability of rural household loans. If a resource is made scarce

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11 The details of the analysis and of the dataset are contained in a background paper for the Organisation for Economic Co-operation and Development (OECD). See Huang (2009).
and its allocation is made less market-driven, the end result is that the politically connected households are able to lay priority claims on the scarce resources.

**Policy Liberalization**

Recall the debate between Beijing Consensus and Washington Consensus proponents on the best approaches to designing and implementing policy reforms. The Washington Consensus, as is well known, has a universal template of reforms—to grow the economy certain conditions have to be met regardless of the country-specific conditions. Beijing Consensus proponents put emphasis on trial-and-error experimentation. You experiment and adopt those policies that succeed and abandon those policies that fail. There is no need for a general theory of reform. One empirical implication of this line of reasoning is that Chinese policies should become more liberal over time. Reforms are an adaptive, cumulative, and self-reinforcing process. Yet this prediction is in direct contradiction to the main finding of this paper: that the Chinese economy has become increasingly statist over time and that there was a policy reversal in the early 1990s (Huang, 2008).

We need to understand this in order to show the existence of two policy models.

Chinese leaders, many of whom had no exposure to Western economics, did not design reforms according to free-market economic theory. This is not in dispute. The notion that countries should experiment rather than rigidly enforce a fixed ideology is indeed borne out by China’s growth experience. But, as the evidence on TVEs shows, China’s experimentation in the 1980s actually led to an explosion of private entrepreneurship in the form of TVEs and rural financial liberalization. What the China experience shows is that the emergence of market and of market order is somewhat spontaneous, conditional on policy liberalization.

My disagreement with the Beijing Consensus interpretation is not with its reasoning but with its characterization of facts. It boils down to an empirical question: Did Chinese private-sector policies become more liberal over time? The single best empirical support for the Beijing Consensus is the rising share of the private sector in the economy. An Organisation for Economic Cooperation and Development (OECD) study shows that the private share of the industrial value added increased from 27.9% in 1998 to 52.3% in 2003. There are some methodological problems with their approach, but their general conclusion about the direction of private-sector development is correct. There is no doubt that the size of the private sector in the 2000s is much larger than the size of the private sector in 1978 (when it was effectively zero).

The issue is whether a measure based on the output produced by private firms is the right measure of the policy environment. An output-based measure incorporates two very different effects. One is the “policy effect”: the increase in the private-sector share that results from policy liberalization. But this measure also incorporates what might be called an “efficiency effect.” The private firms are more efficient than the SOEs; therefore, even given a very narrow business space, they can outcompete the SOEs. This suggests, at least theoretically, that the ratio of the private to the state sector can rise without any improvement in the policy environment. Indeed, one can think of a situation in which the private output share rises because of policy constraints on the private sector. Credit-constrained private-sector firms have few options to grow other than to increase their operating efficiency. SOEs, lavished with resources, are not similarly motivated. Thus the efficiency differential can be very large precisely because of the policy discrimination.

Two examples are helpful in illustrating why an output-based measure is an inappropriate metric of the policy environment. The first example comes from China and from a period we know to be adverse for private-sector firms. That way we cannot attribute any increase in private-sector output to the organic growth of private entrepreneurship. Over time, the private sector would come to overshadow the state sector—to grow out of the plan, as it were (Naughton, 1996).

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12 This perspective is rooted in the gradualist framework on the Chinese economy. Accordingly, China did not actively privatize its SOEs, but it successfully created a hospitable business environment for the entry and the organic growth of private entrepreneurship. Over time, the private sector would come to overshadow the state sector—to grow out of the plan, as it were (Naughton, 1996).

13 Their paper is a background paper for the OECD report on China. See Dougherty and Herd (2005).
output during that period to policy improvements. This is the 1989–1990 period when the post-Tiananmen Square leadership launched a systematic and severe crackdown on the private sector. Private-sector employment fell during this period, and many private firms were shuttered. Credit was tightened. Yet, despite the crackdown, the private sector got proportionally larger. The gross output value of the urban industrial private sector, as a ratio to the SOEs, increased from 7.6% in 1988 to 8.6% in 1989 and to 9.9% in 1990.\footnote{The calculations are based on data on the value of gross industrial output broken down by ownership. Private sector here refers only to individual businesses. The data are provided in the National Bureau of Statistics (1997).}

The trend was the same in rural China. In 1988, private TVEs accounted for 48% of TVE employment; in 1989 it was 49%, and in 1990 it was 50%.\footnote{Based on data from the Ministry of Agriculture (2003).} The private sector became more important when the policy environment turned more restrictive.

A second example comes from the former Soviet Union. No one would accuse Leonid Brezhnev of being pro-private sector, but actually during his time in office, private plots contributed roughly half of the Soviet Union’s agricultural household income (Gregory & Stuart, 1981, p. 230), in spite of accounting for only 1.4% of the arable land (Hewett, 1988, p. 117). This was because private farming was so much more efficient than state farming.

The minuscule share of private plots in the Soviet Union suggests that a better measure of the changes in the policy environment should be based on an input allocated to the private sector rather than its share of the output. The appropriate input-based measure for China is fixed-asset investment (FAI) capital. These investments are equivalent to purchases of plant, property, and equipment in the Western accounting system. There are two reasons this is a better measure of policy. One is that FAIs remain substantially controlled by the state, and thus changes in the patterns of FAIs are a more accurate reflection of the Chinese state’s policy preferences. The second reason is that in a poor country, capital is scarce relative to labor. So capital allocation is more indicative than labor allocation of the fundamental orientation of the economic system.\footnote{Elsewhere I explain other reasons to focus on fixed-asset investments. They have to do with completeness of data coverage and consistency in data reporting. See Huang (2008).}

Table 1 presents a number of private-sector development indicators based on FAIs. It breaks the reform era down into four periods: (a) 1981–1989, (b) 1990–1992, (c) 1993–2001, and (d) 2002–2005. I singled out the 1990–1992 period here to show that the policy reversals were not due to the post-Tiananmen comeback of central plan-

\begin{table}
\centering
\caption{Fixed-Asset Investment (FAI) Measures of Private-Sector Development: Period Averages (%)}
\begin{tabular}{|l|c|c|c|c|}
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1) Fixed-asset investment (FAI): & & & & \\
\hspace{1em} a) All private & 19.9 & 2.6 & 12.4 & 26.0 \\
\hspace{1em} b) Rural private & 19.1 & 1.1 & 7.5 & 6.8 \\
\hspace{1em} c) SOEs & 8.1 & 23.8 & 9.1 & 13.4 \\
\hline
2) Equipment purchases: & & & & \\
\hspace{1em} a) Rural private & 25.4 & 1.4 & 20.8 & 15.3\textsuperscript{a} \\
\hspace{1em} b) Rural collective & 26.0 & 42.8 & 29.6 & 23.7\textsuperscript{a} \\
\hline
3) Nonresidential installations: & & & & \\
\hspace{1em} a) Rural private & 84.2 & 19.7 & \text{-}3.9 & \text{-}3.1 \\
\hspace{1em} b) Rural collective & 13.9 & 38.3 & 12.9 & 19.7\textsuperscript{b} \\
\hline
\end{tabular}
\end{table}

Note: In 1996 the government raised the reporting threshold from 50,000 yuan to 500,000 yuan for the state and collective sectors.

\textsuperscript{a}: 2002–2003 only.

\textsuperscript{b}: 2002–2004 only.

Sources: Based on various sources on fixed-asset investments compiled by the NBS.
ning. By our measure, the policy reversals on the private sector lasted well beyond the Tiananmen years.

The table presents statistics on FAIs in the registered private sector. In the 1980s, the annual growth rate of FAIs by the private sector (deflated to their 1978 prices) averaged around 19%. This came down to 2.6% between 1990 and 1992 and only 1.1% in the rural areas. Afterwards, the growth rate in the rural areas recovered to 7.5% (1993–2002) and 6.8% (2002–2005) but never to the level prevailing in the 1980s.

In sharp contrast, the SOEs’ FAIs grew rapidly after 1989. In fact, the growth rates in the state sector in the 1990s exceeded those of the 1980s, despite privatization. (This is due largely to the massive infrastructure investments undertaken by a numerically smaller number of SOEs in the 1990s.) Table 1 also provides data on equipment purchases and nonresidential installations that confirm the trends in the general FAI data.

The effect of the decelerations of the investment growth rate by the private sector is that the share of the private sector in the total FAI declined. During the 1981–1989 period, their share was 21.4%; this declined to 13.3% during the 1993–2001 period and 14.7% during the 2002–2005 period. The rural private sector declined even more, from 19.2% during the 1981–1989 period to 9.5% during the 1993–2001 period and 5.5% during the 2002–2005 period. By this input-based measure and consistent with our data on rural financial development, China became more statist during the 1990s. This is directly contrary to the postulations of the Beijing Consensus.

Politics

The Beijing and Washington Consensuses clashed not only on economics but also on politics. According to the Beijing Consensus, China’s rapid growth was enabled by its authoritarian political system. The Washington Consensus subscribes to the adage that “all good things go together”: Liberal economics is compatible with liberal politics and vice versa. In this section, we present evidence that Chinese politics also became more illiberal in the 1990s.

Scholars debate the extent of economic reforms in China, but few would dispute the characterization that Chinese politics is authoritarian. This apparent strength of the Chinese system—its ability to make quick and otherwise difficult decisions—is often held as a facilitating condition for Chinese growth. By contrast, the slow, messy, and indecisive workings of a democracy—such as the one embraced by India—are viewed as a hindrance to growth.18

Just as in the case of TVEs, empirical details matter. One crucial detail is that China undertook substantial and meaningful political reforms in the 1980s. One of the best treatments on political reforms is by Pei (2006, p. 11), who showed that every one of China’s important political reforms, such as the mandatory retirement of government officials, the strengthening of the National People’s Congress (NPC, China’s national legislature), legal reforms, experiments in rural self-government, and loosening control of civil society groups, was instituted in the 1980s.

Studying Chinese politics is far more difficult than studying the Chinese economy, in part because we do not have very good political data and in part because Chinese politics, by its very design, is opaque. For this reason accounts by insiders are particularly valuable. In one widely circulated article, Wu Min, a professor at the Shanxi Party School—a training ground for government officials—revealed both the depth of political reforms in the 1980s and their subsequent reversals in the 1990s.19 According to Professor Wu, in the 1980s there were significant efforts to redefine and reduce the functions of the Chinese Communist Party (CCP). The CCP committees were abolished in many government agencies, and some explicit and transparent limits were placed

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17 This is admittedly a narrow definition of the private sector. Elsewhere I have addressed various definitional and measurement complications of this measure and found that they did not change the qualitative conclusions reported here (Huang, 2008).

18 It is often argued that India would be able to build more infrastructure and attract more foreign direct investment (FDI) if it were more like China politically. This proposition rests on thin empirical evidence and false reasoning, as I have shown elsewhere (Huang 2008).

on the power of the Party. China did not introduce free media and open elections, but it was moving in the direction of a limited state.

The political reforms of the 1980s were to enhance the accountability of the government by creating some checks and balances over the power of the CCP and by fostering intraparty democracy. Professor Wu cited one specific measure taken in the 1990s to derail the reforms of the 1980s. In the 1990s, China instituted explicit provisions prohibiting the NPC from conducting evaluations of officials from the executive branch, the courts, and the procuratorate, a power that was given to the NPC in the 1980s. In the 1990s, the CCP branches were reestablished in all government agencies, and the modest efforts to reduce the power of the state were completely abandoned (Pei, 2006).

Are there more systematic indicators of the political reversal than these anecdotal accounts? One possible metric is the size of the state measured in terms of government headcounts. According to one account, the number of officials on the government payroll was 46 million in 2004 (or one out of every 28 Chinese), a doubling from 20 million in the early 1990s (Zhao, 2004). Another measure, which I calculated in great detail elsewhere (Huang 2008), is the FAIs in buildings, properties, and other asset bases controlled by the government. (This does not include investments in SOEs.) The amount more than tripled, from 2.3% of the total FAIs in 1990 to 7.1% in 2002. In brief, the statism of the 1990s extended well beyond finance and economics to encompass Chinese politics. At least in this sense the Washington Consensus has a point: Good (or bad) things do go together.

Why the Policy Model Matters

Does it really matter which policy model China adopted? On the surface, the answer seems to be no. Chinese growth has been consistently rapid for the last 30 years, and since this is the case, the switch from the Washington Consensus policies of the 1980s to the Beijing Consensus policies of the 1990s may be an interesting historical episode, but does it really have any policy or analytical significance?

To answer this question one must know another detail about the Chinese growth experience—the view that Chinese growth has been consistently rapid depends heavily on what economic metrics we use. If we use GDP data, the established view is right—the Chinese economy grew at a consistently robust rate for the last 30 years and the statist policy changes of the 1990s did not matter. If, however, we use a different set of metrics—those that measure the actual monetary and material gains accruing to the Chinese population—there is a huge discrepancy in performance between the 1980s and the 1990s. Roughly speaking, personal income and consumption grew between two and three times as fast during the Washington Consensus decade of the 1980s as during the Beijing Consensus decade of the 1990s. This is not a case of a distinction without a difference. The difference between the two decades is huge and very significant in terms of welfare gains accruing to the population.

The above data raise the question as to why one should put more stock in the personal income/consumption data than in the GDP data. There is one technical and one substantive response to this question. In technical terms, Chinese GDP data are plagued with problems, such as inconsistencies across years and regions, lack of definitional clarity, and inadequate explanations of and disclosures on reporting norms and procedures. Indeed, in 2009, the local governments reported a GDP figure that is between 10% and 15% larger than what the national government reported. Also, Chinese GDP purportedly grew at a rapid rate despite a sharp slowdown in electricity usage—a combination of these two unlikely events that has happened multiple times over the past two decades. In contrast, the personal income data were obtained through painstaking household surveys. Such household surveys, although problematic, are widely believed by independent analysts to be well designed and informative (Kraay, 2000).

The substantive reason is that personal income represents a better measure of the welfare of the Chinese population than national income accounting data such as GDP. Economics, John Stuart Mill famously stated, is the study of “the sources and conditions of wealth and material
Mill reminds us that the ultimate purpose of economic growth is to improve the welfare of the majority of the population. The normative justifications of the China model are also offered on welfare grounds. One famous formulation in the economics literature is that the Chinese reform has been “Pareto optimal” in that it has created winners without creating losers (Lau, Qian, & Roland, 2000). As a welfare measure, GDP data, especially Chinese GDP data, are quite deficient. At best, GDP growth is a proxy and often an imperfect measure of welfare improvement. It is not an end in and of itself.20

We do not have an exact measure of “welfare,” but we have something closer to the concept than GDP: personal income and consumption data. For this reason we assign more weight in our evaluation of Chinese growth experience to the income and consumption measures than to the GDP measure. We will also pay particular attention to China’s rural population. As of 2008, 720 million Chinese resided in rural areas on a long-term basis (defined as more than six months), and 230 million rural migrant workers resided in cities but without the legal benefits of urban citizenship (such as free basic education and healthcare). China’s rural population is the Chinese equivalent of “the aggregate bodies of human beings” Mill emphasized in his justification for economic growth. For this reason this paper focuses more on rural data than on urban data.

Figure 2 presents Chinese economic performance along two dimensions. One is the familiar GDP

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dimension; the other is the less familiar dimension—the growth of the household income. Both types of growth statistics are in per capita terms calculated on the basis of their values expressed in 1978 prices and refer to their period averages.

Household income measures personal income or take-home pay in the form of wages, benefits, transfer payments, property income (rental income, interest payments on bank deposits, or stock dividends), and profits from operating small businesses. Because the National Bureau of Statistics (NBS) conducted rural and urban household surveys separately, we need to pool the rural and urban household income to calculate the household income growth for the entire country. In my calculation I weighted the rural and urban income by the shares of rural and urban population based on their legal residence status (a system known as the hukou system). In the graph, we show household income developments in three ways: urban, rural, and weighted rural-urban income growth.

From 1979 to 1988, GDP per capita grew at an annual average rate of 8.5% in China versus 8.1% during the 1989–2002 period. On the basis of GDP data alone, one would naturally draw the conclusion that the Chinese economic performance has been consistently robust. Yet one comes to a very different conclusion when looking at the important household income. In the 1980s, the weighted rural-urban per capita household income growth exceeded GDP per capita growth by 2.6 percentage points (11.1% minus 8.5%). In the 1990s, the pattern reversed itself. Per capita GDP growth averaged 8.1% annually between 1989 and 2002, but weighted rural-urban per capita household income growth slowed down sharply, from 11.1% in the previous decade to only 5.4%. The difference between household income growth and GDP growth is now negative, at nearly -3 percentage points.23

Rural household income in the 1980s grew at an extraordinarily robust rate, averaging 12% for the 1979–1988 period (after inflation is excluded). In the 1990s, the rural income growth slowed sharply to only 3.9%. In comparison, urban per capita income grew at 7.1% annually over the same time, as compared with 6.3% in the 1980s. However, the increase in the growth rate of the urban income was not enough to offset the decrease in the growth rate of rural income, both because the acceleration of the urban income growth was relatively modest and because of the large number of rural residents.

Naughton (2007) pointed out that the rural consumer price index for the early 1980s understates rural inflation (and thus the income growth is overstated for the early 1980s). One exercise to get around this objection is to assume that the performance in the second half of the 1980s—for which we have better data on inflation—prevailed throughout the entire 1980s. Between 1984 and 1989, rural household income per capita averaged 7.2%. This is surely an extremely conservative estimate for the 1980s. The rural economy put out its strongest performance in the first half of the 1980s. But even this estimate shows a far stronger performance than the growth in the 1990s (3.9%).25

It should be noted that the annual difference between 7.2%, the conservative estimate assumed for the 1980s, and the actual growth rate of 3.9% of the 1990s is not an abstract matter. It entails real and substantial income and welfare implications.

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21 The source of household income data is the annual survey conducted by the National Bureau of Statistics. (For details, see Huang, 2008).

22 An alternative is to weight the household income by resident population shares. Because of the way the household surveys are designed, some of the income from the rural migration is reflected in the rural income, and therefore it is more accurate to classify that part of the income as rural income. Using residency as the population weight would substantially overstate the rural migrant income because it assumes that rural migrants earn the same income as legally registered urban residents. In any case, using the resident population shares yields qualitatively similar conclusions.

23 It should be noted that 5.4% might have understated slightly the true growth rate. The reason is that the calculation implicitly assumed the rural migrant income to be the same as rural income. However, when we adjusted the calculation by using resident population shares, the growth rate would be raised to only 5.7%. This is an overestimate of the true growth rate because it had the opposite bias. The true growth rate is between 5.4% and 5.7%.

24 According to a rural survey, rural per capita income more than doubled between 1978 and 1984, and real rural per capita consumption increased by 51% between 1978 and 1983 (Riskin, 1987, p. 292).

25 In previous work (Huang, 2008), two other objections were dealt with on data grounds. One has to do with rural labor migration; the other has to do with the higher base of household income in the 1990s. Neither of these two objections would fundamentally alter the qualitative conclusion reached here.
tions for hundreds of millions of Chinese rural residents. This is not only because of the difference in the two growth rates, but also because of the extraordinary length of the second policy period, lasting some 13 years. Assuming that Chinese rural households had grown in the 1990s at 7.2% instead of the actual 3.9%, by 2002 an average Chinese rural resident would have been 52% richer than he was actually. Here is a plausible counterfactual: All the hot-button policy issues today such as declining domestic consumption to GDP, exchange rate valuation, and lack of education and healthcare in the Chinese countryside would have been far more manageable had rural China been 50% richer than it is actually. The large and growing gap between personal income and GDP is at the very root of many problems in the Chinese economy and society today.

Consumption in Rural China

One feature of the Chinese growth, which the Beijing Consensus proponents have not highlighted but which has now come to the fore in the current discussions on global imbalances, is the unusually low and declining household consumption as a share of GDP. This problem is linked to the significant slowing of per capita income growth and is particularly severe in rural China. Studying consumption has another purpose, which is to understand the degree to which the Chinese GDP translates into welfare improvement. Personal consumption is a better indicator of the well-being of a population than GDP data.

First, it is helpful to compare China with other countries in order to appreciate the depth of the problem of underconsumption in China. In 2000, the ratio of household consumption to GDP stood at 47%, compared with 68% in the United States. Over time, the two countries grew further apart. In 2007, Chinese household consumption had declined to one-third of GDP, while for the United States, the percentage ratio held steady at around 70%. (By the way, this growing divergence lies at the root of the trade imbalances and the policy tensions between China and the United States.) But China is not just underconsuming compared to the United States. India’s consumption is 20 percentage points higher than China’s 2007 ratio, Brazil’s 25 percentage points higher. And there is nothing East Asian about China’s low consumption level. Korea and Japan, two other quintessentially East Asian countries, consume more than 55% of their GDP.

The low and declining consumption is related to the development discussed previously—low income growth.26 This is the thesis of a recent International Monetary Fund (IMF) paper by Aziz and Cui (2007), borne out by the rural household income and consumption data. Figure 3 presents the real growth rates of per capita rural household consumption between 1982 and 2002. The deflators used in the calculation are the rural income deflators with 1978 as the base year. This was to make the comparison with the income side easier. Using other deflators, such as the rural retail price indexes, produces qualitatively similar results.

The consumption data are presented in two ways. Broad consumption refers to consumption of all goods and services; narrow consumption excludes consumption of education, healthcare, and telecommunication services. The reason to make this distinction between the broad and the narrow measures is that in the 1990s the Chinese state increased substantially the surcharges on education, healthcare, and telecommunications, three areas of the economy monopolized by the government. The narrow consumption measure is meant to minimize this monopoly pricing effect.

Two patterns stand out in the data: a consumption boom in the 1980s and a bust in the 1990s. Rural China consumed massively in the 1980s. On average, between 1982 and 1988, the broad rural consumption averaged 13% per year (roughly comparable to their income growth during this period). This was the decade associated with financial liberalization, private entrepreneurship, and political liberalization. During the Beijing Consensus era after 1989, rural consumption collapsed. Between 1989 and 2002, the annual growth rates averaged only 3.8%. About one third of this consumption growth

26 An alternative theory is known as "precautionary savings hypothesis." The idea is that Chinese households saved more over time and reduced their consumption (Chamon & Eswar, 2008). One difficulty with this theory is that the Chinese household savings rate has not risen over time (while the government and corporate savings rates have). The other problem is that it explains only a small portion of the consumption change, as pointed out by Aziz and Cui (2007).
was actually attributed to the state’s monopoly pricing and was arguably involuntary. Once the consumption of education, healthcare, and telecommunication services is netted out of the data, the rural consumption slowed even further, to just above 2%. (Notice that for the 1980s, the broad and narrow consumption measures are identical, meaning that the state did not increase monopoly surcharges in that decade.)

**Conclusion**

The proponents of the Beijing Consensus assume, often implicitly, the existence of a single model that purportedly explains the performance record of the entire reform era. But the real question is “Which performance record are we trying to explain?” Is it the one that shows rapid GDP growth along with equally impressive gains in personal income and consumption, particularly in the poorest (rural) parts of the country? Or is it the one that produces rapid GDP growth with heavy capital investment but much smaller gains in personal income and consumption? As emphasized throughout this essay, it really matters which metrics one focuses on to assess Chinese performance. The GDP performance implies one model, but the Chinese record on personal income and consumption growth implies the existence of two models: one that is conducive to our measures of welfare improvement and the other anathema to it (holding GDP growth constant).

This factual—bordering on a technical—point entails some very important analytical and policy implications for China and, given the importance of China in the world economy, for other developing countries. We show that the Washington Consensus explanation in fact fits with the Chinese growth experience better. While both eco-

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**Figure 3**

Real Annual Growth of Per Capita Rural Household Consumption in Three Policy Periods (%)


Notes: The deflators are rural household income deflators (in 1978 prices) published by NBS. Broad consumption encompasses consumption of all goods and services. Narrow consumption is defined as broad consumption minus service consumption of education, medical care, and telecommunication.

Source: Based on rural household surveys by NBS.
nomic liberalism and statism have been associated with rapid GDP growth, the liberal policies are found to be substantially more efficient in improving Chinese welfare. Our political analysis illustrates the same correspondence principle as our economic analysis; that is, when China was trending in a politically liberal direction (in the 1980s), its GDP growth was more welfare enhancing. When the politics of the country were trending in the opposite direction (in the 1990s), its GDP growth became less welfare enhancing.

This interpretation of the Chinese growth experience should not be interpreted as a validation of market fundamentalism (i.e., laissez faire economics) or “shock therapy” (i.e., the idea that reforms have to be simultaneously and rapidly adopted). The emphasis in this paper is on the direction and the dynamic movement of the reforms rather than on a static match between policies and the Washington Consensus. For China, as I argued in my 2008 book, the policy model of the 1980s is that of “directional liberalism” and the dynamic changes mattered most for economic growth. On reform tactics, many of the Beijing Consensus proponents emphasize gradualism and experimentalism, which are eminently sensible. Chinese reforms were experimental, but contrary to the claim made by the Beijing Consensus proponents those experiments resulted in financial liberalization and private entrepreneurship.

The debate about the Beijing Consensus is eventually about theory—what are the right economic principles that promote growth? The meaningful lesson from China for other developing countries is whether China implemented the right economic principles for itself. Other than the adage that policy tactics should be grounded on local conditions, the Beijing Consensus’s emphasis on experimentalism has limited normative value for other countries wishing to grow. Local conditions, by definition, are country-specific, and we cannot specify in advance what they are. A number of economists who view China’s success from the perspective of the Beijing Consensus are actively advising poor countries on development policies. One country’s experiment is another country’s theory. So we’d better get the general principles right.

Does this analysis yield insights on China’s own future? Yes, it does. In the past two years the Chinese government has become more economically statist and has moved substantially in the direction of the Beijing Consensus. The subprime crisis originating from Wall Street has provided both the ideological confirmation and an economic rationale for the Beijing Consensus. But the irony is extreme. Many of the Beijing Consensus policies were instrumental in contributing to the slowdown of rural personal income and possibly to the lowering of China’s domestic consumption. The Beijing Consensus might have exposed China to the economic consequences of the subprime crisis in the United States in the first place.

In order to compensate for the declining domestic consumption and the collapse in external demand, the Chinese state has increasingly resorted to investments to drive GDP growth, and, to the extent that investments are more state-controlled, the Chinese economy has become more statist as a result. The Beijing Consensus period has coincided with a massive increase in the investment share of GDP. One victim of the fixed-asset investment boom is productivity growth. I have conducted an exhaustive review of several papers on total factor productivity (TFP) in China. Beginning in the late 1990s TFP growth either slowed down compared with the earlier period or completely disappeared (Huang, 2008). The growth during the Beijing Consensus period is primarily driven by factor accumulation, especially by investments, not by productivity gains.

This is a very worrisome development. We know from research on East Asia that productivity slowdowns presaged the general economic contractions or even financial crises (Krugman, 1994; Young, 1995). The situation may very well have gotten worse as a result of the massive and statist stimulus program the Chinese government has undertaken. In 2009 the investment/GDP ratio is probably well over 50% of the GDP. One estimate is that over 90% of the GDP growth in 2009 is explained by investments. There is a nontrivial prospect that the Chinese economy may stumble, and if and when it does, we at least know to whom to credit this development: the economic statism so enthusiastically endorsed by the Beijing Consensus.
References


