

Interview – CAIJING (Chinese newspaper)

with János Kornai

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Question 1

You hold the view that the systematic reforms during transitions consist of many parts, some parts with low costs, some with high costs. China chose the low-cost reforms to break through so it has had a relatively stable transition. In your view, has the Chinese approach of steady reform been successful? Do you think there is some kind of “Chinese model” in a country’s reforms and transitions? If so, what is your comment on this model?

You ask a difficult and complex question, to which I would like to give as accurate an answer as I can. This entails breaking the overall question up into smaller ones and seeking to clarify some ambiguous concepts.

What in your vocabulary does “model” mean? We economists normally term a “model” a theoretical construct that maps certain relations in the real economy—usually with the help of mathematical formulae. You clearly use the word in another sense, to mean a real course of historical events that can serve as a *pattern* or *example* to other countries. Well, China is unique and defies imitation! It is the world’s most populous country with incomparable cultural traditions. The idea of a “Chinese model” is not one that I can interpret.

I would suggest instead analyzing the main attributes of China’s development in recent decades, singly and in relation to each other, and then trying to decide whether there were favorable or detrimental—and if favorable, whether they could only have occurred in China, or whether they can be accomplished elsewhere as well.

There are two other words in your question that I feel are ambiguous and call for explanation and a clear definition.

One troublesome expression is “stability”. What do you understand by it? That China’s production has grown continuously since the death of Mao, with accelerations and decelerations at most, but no absolute declines? This is one fascinating feature of China’s development, which has made a deep impression all over the world.

The comparisons are obvious. The economic transition that followed the political change of 1989–90 in the new democratic countries of the former Soviet Union and other East European communist countries was followed by deep transformation-associated recession. Not for some years were pre-change production levels reached again.

As for the developed capitalist countries, they have undergone deep, painful recession in the last year or two, and their economies can still not be said to have started growing again.

China’s showing, in the light of those comparisons, is imposing indeed.

What do you mean in your question by “low-cost”? Who pays a low price? American and European consumers certainly incur “low costs” if they buy cheaper Chinese goods. There are several factors behind the fact that Chinese goods can be sold cheaply in rich countries’ markets. One is the exchange rate, but I do not want to cover that now. Perhaps the most important factor is the low pay of Chinese workers. Labor costs cover not only the monies employers hand to employees, but the pay-related, pay-proportionate taxes and social contributions, including the financing of pensions and health care. The cost of North American and European labor is raised, among other things, by the cost of a welfare state providing broad social care. This undermines competitiveness in many industries competing with Chinese products.

What we have reached here is not a narrowly economic question, but some basic ethical ones. The lightning speed of Chinese growth has been enabled, among other factors, by a very high proportion of investment and low proportion of consumption in utilization of GDP. Today’s generation is making a sacrifice—a big sacrifice—for tomorrow’s. This is one possible, historically applicable solution to the problem of intergenerational distribution, apportionment between present and future, but I would like to remind you that other courses are possible as well. Thinking of the history of the world economy in terms of centuries, there appear before us the lines followed by the United States, the Scandinavian countries, or Australia. They never grow so fast as China does today, yet they reached the peak of economic development. And during their development, the growth of consumption grew in step with the growth of production.

“Low-cost”—an expression widespread in Chinese discourse today—tends to distract attention from the truly essential strategic dilemmas.

Question 2.

China’s economy has been rapidly expanding for many years. How do you view this phenomenon? What are the main forces behind China’s rapid economic growth? Is it sustainable?

I have partly answered this question already. China has a proportion of savings and investment that is unique in world historical terms. It is difficult if not impossible to establish to what extent this is voluntary and to what extent forced saving.

Think of the history of the Scandinavian countries. Their annual average rate of GDP growth over the last century is far, far lower than what China attains today. But over that century, Swedish social democracy repeatedly won parliamentary elections and kept the backing of the trade unions and the majority of society. It fought continually and successfully for higher wages, job security, health-care development, and a pension system to ensure a decent old age.

Or look back on American history, where the spirit of enterprise was especially strong. Most of the great innovations and world technical developments of the last 60–80 years were introduced by American entrepreneurs. The Americans were also ahead in basing their country on the rule of law, developing forms of competition between political forces, and producing a Constitution.

Or consider India. It is exceeded in population only by China, and like

China, it was among the poor, stagnating countries until recently. But there has been an admirable increase in its pace of development since the bureaucratic barriers to development were dismantled and a free hand given to entrepreneurial capitalism. What is more, India's system of parliamentary government has persisted throughout these changes.

"Sustainability" has a narrower and a broader meaning. It is probable that even in a narrower, economic sense this criterion will place constraints on growth, for instance greater congestion in big cities and environmental damage caused by rapid growth of industry and motorized transport. But it is even more important, perhaps, to consider the political conditions. How long will it be possible to sustain, without change or reforms, the political system that guarantees the present macroeconomic situation and present ratio of consumption to investment? These I think are questions best addressed by researchers into political science and contemporary history.

I think an emphatic warning is called for after the questions and responses so far. I would not advise China to follow the "Scandinavian Model" or "North American Model" or "Indian Model", any more than I would suggest Sweden or the United States or India follow the "Chinese Model". Having outlined the various courses taken historically, I would like to put forward the following thought:

It is not possible to do any simple cost-benefit analysis to calculate the optimal development course arithmetically. In reality, the joys and sufferings, achievements and sacrifices can be distributed among the social strata, regions and generations in many different ways. And that applies not just to material welfare, but to the joys and sufferings connected with individual freedoms or curbs on freedom rights. I am not trying to provide a recipe for resolving these underlying problems of distribution, simply to draw attention to the dilemmas of choice.

Question 3.

During systemic economic transitions, how to properly design different functions of the market and functions of the government? In China, there is too much marketization in some areas but in other areas there is too little. This is a very difficult question faced by China. In light of Hungary's practices, what are your suggestions?

You ask about Hungary's experience, but there is no consensus in Hungary on this. It is one of the questions sharply debated in the political forums of democracy, in the press, and in discussion among the intelligentsia. And it is a subject of discussion all over the world, of course, not just in Hungary, as one of the fundamental questions of our time, placed on the agenda of history in all regions of the world at almost the same juncture. Wherever the socialist system reigned with its characteristic extreme predominance of the state before 1989-1990, continuing attempts have been made to reduce the role of the state. However, the financial and economic crisis that struck the developed capitalist countries recently has awakened them to the need for more effective state regulation.

To me, one of the most attractive, exemplary features of Chinese development is its experimentation. Hotheaded reformers in many countries, including Hungary, devise notions that they want introduce at a blow, universally

over the whole country. I see that the customary course of events in China has been different. Any big change usually begins with the appearance of a local initiative. This is noticed by leaders higher up, supported, and if it really works, treated as an example for other parts of the country to follow. So if the initiative is viable it spreads, and the spread may even accelerate in the meantime.

There is no comprehensive, uniformly valid ratio to apply between state bureaucratic coordination and market coordination, such as 30:70, 50:50 or 70:30. Different proportions are desirable in banking or education than in health care or policing. There are spheres where the state must play the main role and others where the market must dominate.

Above all it is important to be sober and clear-sighted in setting the ratios and forms of division of labor between state and market. The market is not a magic machine that works without fail, but nor is it an impenetrable jungle hunting ground for beasts of prey. The state is not a machine that works with perfect, omniscient objectivity and fairness, operated by incorruptible civil servants, but nor is it one in which the decisions depend solely on corrupt people hungry for power. Both mechanisms are far from being perfect. It is not even certain that the joint effect of the two will eliminate the imperfections of both. In fact the opposite may pertain: the interaction of the two mechanisms may destroy what under one or the other would have been advantageous.

There is no need for empty generalized slogans: “We need a stronger state to curb market excesses!” or “Away with bureaucratic interference—the market will solve the problems.” Instead let there be responsible, disinterested, unprejudiced analysis of specific areas of the problem, and a careful design of the necessary scale and limits of state influence.

Question 4.

Some people think that China’s rapid economic growth will automatically lead us to systemic reforms. What do you think of this view? Will systemic reforms necessarily be a byproduct of economic growth?

Study of several decades of the history of many countries leads to the conclusion that there is no automatic, deterministic link between economic development levels and political forms. Still less can any simple causal relation be seen between growth rate and level of political development. Production in the Soviet Union grew fastest under Stalin’s First Five-Year Plan, accompanied as it was by a wave of terror and appalling oppression. Germany was among the richest and most developed industrial countries when Hitler and the Nazi Party came to power and then the growth rate accelerated rapidly. And in reverse, the constitutional state and parliamentary democracy began to develop in a number of European countries while they were at a much lower level of development than they are now.

The spread of private ownership, free enterprise and market coordination provides favorable conditions for political reform, but it does not guarantee automatically that the reform will be accomplished.

Question 5.

You went to China in 1986 to attend a conference about macroeconomic management. In that conference, you suggested four target models for economic reforms and you preferred market coordination with macro-management. Now 20 years have passed and China has gone a long way in market-oriented reforms, but its market reform goals have not been realized: the market system and private property have not been properly established; the government is still meddling with private enterprises' affairs; administrative monopolies have not been crushed. Ironically, at the same time, macro-control by the government has been strengthened. In your view, what efforts should China make to achieve its market reform goals?

I would like to refrain if I may from giving economic-policy advice to China from this distance, in Budapest. Your country has first-rate economists with a thorough knowledge of the conditions and the economic and social situation. They are far better qualified than me to say what should be done. At most I can offer my observations on a few questions.

- I have the impression there are big problems in the banking sector. Though many US and European banks are in a tough, even critical position at present, while China's banks seem firm, this does not mean all is in order. Chinese experts should analyze monetary policy, exchange-rate policy, loan structure, and especially treatment of poorly performing loans.
- The danger with such a rapid rate of development is of disproportions and deficits arising in the economy, which can cause big problems later. Forty years ago, I wrote a book entitled *Rush versus Harmonic Growth*, and it was also translated into Chinese at the time, but I am afraid it will have disappeared from the bookstores long ago. I spoke in the book against the "fetish of the growth rate," drawing on experience in the Soviet Union and Eastern Europe. Economic politicians, in pressing for the fastest possible growth in GDP, were neglecting other important development tasks such as housing, environmental protection, urban transport, and so on. The book included a simile to illustrate this disharmony: a man in a smart new jacket, worn but still wearable trousers, and no shoes. Perhaps it would be worth reissuing this book in China.
- The figures I have seen point to a marked widening of income differentials in China. This is economically detrimental, but in addition, it rightly offends people's sense of justice and may bring sooner or later some serious social tensions.
- China should be prepared to see its export market decline. The more individual and social consumption grows in China, the narrower will be the difference in wage costs between China and the developed countries. Hitherto China has followed an economic policy of export and investment-led growth. Is it preparing for an alteration in this strategy?
- A state governed by the rule of law is essential to the operation of a modern market economy. Major steps have already been taken to modernize the legal system, but I believe much remains to be done to protect private property and public property, and to ensure compliance with contracts.

This list of problems, concerns and tasks is far from complete. I sincerely hope that Chinese economic policy-makers will find appropriate ways to address these difficult questions.

Question 6.

Chinese economists think that if China wants to carry on its reform, it will meet heavier costs. How do you view the prospects for China's reform? What lessons could we learn from the Eastern Europe?

I would prefer to refrain from drawing universally valid conclusions from the transformation in Eastern Europe. The whole region has a population no bigger than a single Chinese province, yet how varied the experiences of these small and medium-sized countries have been! In any single year, one will be found to have produced great results while problems mounted for another. Successes and failures alternated in all of them. It is especially important for other countries to learn by the less-than-successful measures.

- Populism does not pay in the longer term. The public eventually calls for fulfillment of popular, irresponsible promises and sweeps aside those who offered an easy-going economic policy.
- Imposing reforms forcibly on the public does not pay. The reforms that prove lasting are preceded by thorough debate and enjoy widespread support.
- It does not pay to throttle opposition criticism of government policy. This was attempted in several East European countries, where protests were beaten down and those voicing independent opinions were intimidated. The silencing worked for a short while, but sooner or later, scope had to be made for competing views and free expression.
- Nationalist arrogance or boastfulness about success does not pay. The outside world shows more sympathy for countries that declare willingness to learn from others' political and economic experiences, proving receptive to them and adapting them to local conditions.

The successor states that arose from the demise of the Soviet Union and the ex-communist-led countries of Eastern Europe as a whole form a vast laboratory, where a wide variety of political and economic institutions are being tested. I would advise my Chinese friends to seize this exceptional opportunity, look over this vast laboratory carefully, learn from the mistakes, and put the successful experiences to good use.