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# Is the Chinese Growth Model Replicable?

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Although I refer to the Chinese growth model in this chapter, I am really talking about the Asian growth model more generally. The real issue is that the global financial crisis that began in 2008 has challenged our thinking about growth, equity distribution, industrial policy, and the role of the markets. Going forward, we are facing both a financial crisis and a global climate-change crisis. One is immediate, the other one is longer term, but both have the same origin—excess consumption financed by excess leverage.

Crises seem to occur every ten years. Twenty years ago, it was the failure of the Soviet system, which had no hard budget constraint. My contention is that the present financial capital market has no hard budget constraint. The banking system can leverage itself to whatever size possible, and when banks fail, the losses are underwritten by the state. So there are similarities regarding this problem.

Regarding the problem of institutions that are too big to fail: when does finance leverage itself in a way that moves it into a predatory algorithm? We do not have academic answers for this question. We do not even have a practical answer to this hard-budget-constraint issue. This is not a regulatory issue. Regulatory reforms cannot deal with this problem. This is a political problem that we have not solved.

We are facing a global climate-change problem, and the real issue is that if people in the developing countries live the lifestyle of those in the advanced countries, then there will be no natural resources left. The average Chinese and Indian cannot live the average American way of life without destroying the world's natural resources. If all five billion people in the emerging markets start living the life of the average American and consume the same amount of natural resources per capita, then we will have a global crisis on our hands.

Changing lifestyles is a major problem that needs to be addressed. Emerging markets also need to shift from an export-driven model of growth to domestic consumption–led growth. These are the critical issues.

Growth models have moved from ideal policies (what is good and what is bad) to a more practical standard—namely, what works. We have also seen the mistakes of monoculture. If we have one standard for the whole world and if that standard is wrong, then the whole world pays for it. Diversity is important, and differences of view are important.

The crucial problems are information asymmetry and agency problems. Fragmented academic disciplines and fragmented bureaucratic structures are preventing us from seeing a systemic problem, and this crisis is a systemic problem. If we see only part of the problem and the part we see is somebody else's problem, then we have global markets but national regulations, and national policies do not add up at the global level. Everybody says it is everybody else's problem, but it is actually a systemic issue.

Another problem is that if finance—the agent of growth and development, the agent of fiduciary trust—becomes five times larger (in assets) than global gross domestic product, then it is no longer an agent. It is a principal. Proprietary trading is about finance acting on its own behalf, not on behalf of the real sector.

Was the Asian growth model wrong? There was an Asian crisis, and the model needed to be modified. But the Asian model appears to be successful, although it is less elegant in its ability to explain itself. After the Asian crisis, Asia moved to become a self-insured, adaptive-growth, supply-chain model. This was essentially invented by the Japanese when they adopted Henry Ford's assembly line, added just-in-time inventory management, expanded the supply chain to include clusters of suppliers, and then extended that supply chain to the Four Dragons and then the Four Tigers. Today that supply chain is in China, India, and Vietnam and has become global.

Supply chains are networks, and financial markets are networks. In this global network system, there are fragmented national laws and national thinking. Growth is about adapting global experience and practices to local conditions. That is innovation. The concept of the global supply chain now is accepted in the business community, but it is rarely used by economists. The World Bank, however, is thinking about cities and geographical space and the Coasian reduction of transactions costs. All of these are essentially about networks and supply chains.

Some have asked whether the Chinese model can be replicated. Barry Naughton, who looks closely at Chinese state enterprises and growth, has written about this singularity versus replicability issue. He claims that China has so many unique features that its successes are not replicable but that some process innovations in China can provide lessons about the nature of institutions and interactions between institutions in the development process.

I think that his intuition is right but that the Chinese growth model is actually about the process of growth. The problem with the Washington Consensus was that it confused an ideal with the journey of reaching that ideal. That journey has huge information asymmetry. How can you form rules, as Paul Romer says, when nobody knows what that rule is? If we have gone to a path where nobody understands what this unknown unknown is all about, can you have rules? Can you formulate the proper rules if you do not understand what is going on? The only way you can proceed is to move pragmatically on a search-and-experiment basis. It is all about networks, markets, and adaptive systems. The Western theory of complex adaptive systems is a good way of explaining Chinese and Asian growth. Policies such as capital adequacy, capital models, and export models are not being used, but the growth model is seen as an adaptive system within a global system. And the Chinese actually work on this on a pragmatic basis.

Influential books about growth in China—such as Angeline G. Chen's *Taiwan's International Personality: Crossing the River by Feeling the Stones* (1998) and Robert Weil's *Red Cat, White Cat: China and the Contradictions of "Market Socialism"* (1996)—treat the Chinese model as if it were idiosyncratic and not replicable. The real issue is that in a common law system, microrules are decided by magistrates and judges until an issue develops into a common law principle. China is very much administrative, but it also accumulates small rules into major policy decisions (at the highest level). What matters is orchestration—building the national supply chain and the linkages with the global supply chain.

According to Thomas J. Peters, tight policies are followed by organizations that have a clear vision of where they want to go. One of China's tight policies was Deng Xiaoping's 1979 Four Modernizations—modernize agriculture, modernize industry, modernize defense, and modernize science and technology. But because workers had never before tried to accomplish these modernizations, they needed very tight decision rules. What decision rules? As early as 1962, Deng was quoting a Sichuan proverb: "No matter if it is a black cat or a white cat; as long as it can catch mice, it is a good cat." As long as it works, do it. So it is about practice, not theory. It is about experimentation and open-mindedness.

The middle stage is more complex. It requires looseness. The supply chain can be foreign owned, locally owned, or state owned. As long as it works, you follow that supply chain. This approach was not invented in China. The Chinese and Koreans copied it from the Japanese, and the Japanese copied the idea from the Americans. Everybody is learning and adapting. The competition within China is between cities, and it is about adapting these supply chains.

The Chinese innovation in this process is that the government can assist a private-sector supply chain by implementing rules, infrastructure, and telecommunications—rather than adding transaction costs that increase supply-chain inefficiencies. China integrated its small and medium-sized enterprises (SMEs) and multinational corporations into the global supply chain. The growth strategy becomes one of picking a supply chain—abandon a dead or closed supply chain and invest in a successful supply chain.

This approach has resulted in a pragmatic, adaptive system. Partly because of the advantages of scale, China has evolved special market cities where the state reduces the transactions costs of SMEs and enables them to join the multinational supply chain. Competition today is no longer one of company versus company or nation versus nation. It is about supply chain versus supply chain, and that supply chain is cross-national, not just Chinese.

In China, a large part of that supply chain is actually owned by foreigners. The challenge for this multinational supply chain is that it requires orchestration to bridge the differences between the old authoritarian model and the current free-market model. In an orchestra, the players cannot be free to play whatever they wish to play, and the conductor cannot overwhelm the musical score with idiosyncratic interpretations of the notes. Feedback mechanisms are needed between the conductor and the players.

The current regulatory system of free markets assumes that if every single player is safe or if every single player is a very good player, then they will produce good music. But this is not inevitable or preordained. A good musical outcome requires a productive relationship between the conductor and the orchestra and a context in which the orchestra can move to make good music. The resulting music depends partly on the musicians and partly on the conductor. Likewise, in the relationship between the supply chain and the state, the state learns how to play with good feedback mechanisms to gauge whether the system is working and to create that growth model.

The model requires an interactive feedback mechanism between the conductor/state and the players/market. This is not an either/or situation in which either the state controls everything or the free market requires everything to be market-based, with minimal government involvement. It is about encouraging the proper feedback mechanisms between the state and the market, including the global market, to ensure that the overall supply chain operates smoothly.

In conclusion, growth as a process is replicable. There are no ideal policies that are optimal. As we all cross rivers by feeling the stones, we are finding that the stones in each river are different and that the distance between one river and the shore is also different from the distance between another river and the shore. Complex adaptive systems are needed, and often there is no difference between macro and micro. The macro depends on the micro, the micro depends on the macro, and the aggregate micro does not necessarily add up to a macro. We need to understand the interactive actions between them.

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