“China’s Coming Revolution.” Asia, Inc. (Hong Kong) 2, no. 12 (December 1993): 64-65. Condensed version of remarks made during a fundraising event for the Hong Kong Centre for Economic Research, October 1993.

A new economic order is being ushered in worldwide as a result of two revolutions:

- A technological revolution, which has greatly improved the possibility of communications, transportation and the like;
- A political revolution, which really dates from the fall of the Berlin Wall. It’s a much younger revolution, but it has a very close and complex relationship with the technological revolution. The technological revolution makes it possible for relatively low-wage labor to cooperate efficiently with advanced technology, advice and capital. The political revolution has greatly increased the scale at which low-cost labor is available.

It’s hard to know where to put China into this picture because China has not yet really had a political revolution. It’s been participating in the economic revolution and technological revolution, and the politics have changed. But the true political revolution in China is yet to come.

In Russia the order has been reversed. The political revolution has come first, and economic reform is coming later than China’s. I believe a strong case can be made that the Chinese order is better from the point of view of short-run growth, but that the Russian order may will be better from the point of view of long-term growth. But that’s something still to be determined. Remember, we’re watching an experiment unfold in the world for which there is no prior precedent. Never in the history of the world has a totalitarian state successfully converted itself into a free-market economy. That hasn’t happened. And that experiment is under way in China, in Russia and in the former satellites of Russia.
Russia starts out at a higher technological and industrial level than China. But at the moment, it’s in a state of turmoil, particularly and primarily because of the failure to control inflation. There’s nothing that’s more dangerous than to let inflation run, nothing that can do more harm to a country. Indeed, the communists were able to take over China, in considerable measure, because of the hyperinflation that occurred under Chiang Kai-shek.

We’ll see in the next 10 to 20 years which of these countries does better. But we’re not involved in a race we’re involved in people trying to better their condition. And the more effective the people of Russia can be in bettering their own condition, the more effective the people of China can be in bettering their own condition, the better for the world.

There is no question that during the period since we were first here in 1980, China has maintained an extraordinarily impressive rate of growth — owing a great deal to the overseas Chinese in Hong Kong Taiwan and elsewhere, and the example that they set. In the case of Hong Kong, equally important has been the capital that has flowed into China. Because with capital comes technology, management and all sorts of other things.

After our recent visit, however, I’ve come away with very mixed feelings. On the one hand there clearly is continued great progress. Wherever we went that progress was evident. Whether in Chengdu, where there was a marvelous downtown shopping mall that had been completed in less than a year, or in Chongqing at the newly opened futures market. The very fact that there would be a futures market in Chongqing, that a country like China would now have stock markets in several places, shows the kind of change that has been occurring.

The changes in Shanghai also have been dramatic. The skyline has all sorts of new, tall buildings emerging. The hotels are vastly more impressive than the one we stayed in in 1988. The shopping district, especially at night, glitters like the Ginza in Tokyo. Those are the positive changes.

On the other hand, and this is where my mixed feelings come, some of the visual progress is deceptive. When we drove through Pudong, a new district being developed across the river
from Shanghai, we were told that a year ago Deng Xiaoping visited and he expressed
disappointment at how slowly it was developing. They promised that if he came back in a
year, he would see something truly impressive. And surely he will. You drive along that street
now and it glitters like one of the main shopping streets in Shanghai proper. But what you
really have there is a Potemkin village for a reigning emperor. That is not progress. That is a
subsidized monument.

A great deal of China’s progress has been produced through joint ventures and foreign
investment. But there’s good foreign investment and bad foreign investment. A foreign
investment is good if it comes in at roughly the same terms as domestic investment and
generates good returns both for the investors and for the Chinese. But you know, very few
foreign investors come to China to benefit China. They come in to make money. And one
way they make money is by taking advantage of the special privileges the government has
been conferring on foreign investors. Foreign investment that is attracted primarily by those
privileges is good for the investor, but not for China. There really is no free lunch. Somebody
has to pay for this.

If there’s a lot of money to be made, people try to make it. And indeed, let me say a quick
word in favor of corruption. In many cases much of what’s called corruption is simply
introduction a black market that undoes the harm which is being done by the attempt by
government to interfere with market practices. What’s a black market? It’s a market, a free
market. And so what’s called corruption is sometimes, not always, an introduction of market
forces into a controlled economy. In China, for example, you have a wrong exchange rate. Do
you think it would be good for China for all exchanges to be made at the official exchange
rate? You can’t do it. The only way you can do that is by having authorities go over every
transaction.

The most disappointing feature I observed in China was that there is absolutely no sign of
any lessening of central bureaucracy and control, whether you are in Sichuan, in Shanghai or
in Beijing. There’s one thing of which there is no shortage whatsoever in China, and that’s
bureaucrats. Yet I believe that until there is a real curtailment of that central bureaucracy, and the attempt by the central bureaucracy to control the development of China, it will be very difficult for China to achieve what it is capable of. And it’s capable of a great deal. The potential is enormous.

The bureaucrats say they want to have a socialist market economy. And what they mean by that is controlling reforms from the center. There’s a feeling that decentralization has gone too far and needs to be corrected. And I may say to some extent that feeling is correct. There are some things that need to be decentralized, and some that do not. One thing that cannot effectively be decentralized is the control of money supply.

The original reforms that were so successful in China, were in the agricultural area. That didn’t involve the same kind of problems as reform does in industrial areas, where state-owned enterprises play such a very large role. There, it’s much harder to introduce market mechanisms without producing a conflict with central controls.

The market is a system organized from the bottom up. The centralized bureaucracy is organized from the top down. Those are incompatible. They cannot both last. Tiananmen Square was the first sign, the first manifestation of that conflict. But sooner or later a clash is inevitable. And the long-run future of South China depends on how that comes out. I do not think there is any way to know how it will come out. But one thing you can be sure of: if the bottom-up markets can win that clash, there is no limit to the future prosperity and progress of China.