
Preface

It is widely known that China's economic growth over the past three and a half decades has been without historical precedent. The reason for this phenomenal and sustained growth is more controversial. There is a widespread view that China's government has succeeded through "state capitalism." Adherents of that view believe that China largely eschewed reliance on market forces in favor of retaining direct ownership of the commanding heights of the economy. Despite China's undeniably growing private sector, it was assumed the government exercised substantial indirect control of the rest of the economy by allocating credit via the state-owned banking system.

Nicholas Lardy compellingly overturns this view. He argues that China has maintained extraordinarily rapid growth since 1978 primarily because of the freeing of the private sector and the shrinking of the state—that is, markets over Mao, as he memorably characterizes it. Market forces came to play an ever larger role in resource allocation, and private firms emerged as the most dynamic element in China's economy. In fact, Lardy shows that private firms became the major source of economic growth, virtually the sole source of job creation, and the major contributor to China's still growing role as a global trader. China has grown because it has grown more capitalist. Thus it does not represent an alternative model to capitalism, at least in terms of what parts work.

In addition, the evidence marshaled in this book disproves the often asserted view that the decade of leadership of former President Hu Jintao and Premier Wen Jiabao (2003–13) increased the role and importance of state-owned firms. Yes, the Hu-Wen government promoted industrial policies that appeared to advantage state-owned companies at the expense of private as well as foreign firms. But Lardy's comprehensive analysis shows that these efforts were largely unsuccessful. The financial performance of state-owned compa-

nies improved only briefly and temporarily relative to that of private firms but then declined so sharply for most of the decade that by 2012 the efficiency of state-owned industrial firms had fallen to only one-third that of private firms. By 2013, China's growth was even more dependent on private companies than when Hu-Wen took over.

For Lardy, the critical test of the new Chinese leadership on economics will come in services, where inefficient state firms remain completely dominant. Lardy's major contention is that freeing private business in this area can contribute significantly to Chinese economic growth, even as the economy moves away from the credit- and investment-driven growth path of recent years. Lardy argues that China's current leadership of President Xi Jinping and Premier Li Keqiang seeks to further transform the role of the government, ceding even greater space to the market; their statements to date, notably in the Third Party Plenum released in November 2013, support this view. The Xi-Li government seems likely to focus its efforts on less distortionary government priorities, such as meeting increasingly urgent popular demands for cleaner air and water and safer food supplies, providing a stronger social safety net, and making economic growth more inclusive. Lardy documents their public commitments to further enhance the role of the market by eliminating the few remaining price controls—including bank deposit interest rates, which continue to distort the allocation of resources—and by reducing the regulatory barriers that impede the entry of private firms into services.

The Institute has a long history of studies on the Chinese economy. Nicholas Lardy, Anthony M. Solomon Senior Fellow at the Institute, has led our work in this area, beginning with his 1994 book *China in the World Economy*. More recently, as China has become even more important to the global economy, the Institute has increased its research and outreach on China. We have published eight policy briefs and working papers on China-related issues in the last two years, created a dedicated blog "China Economic Watch" on Chinese economic policy, and now publish a regular "China Rebalancing Watch." Other books include these multiauthor studies: *China: The Balance Sheet—What the World Needs to Know Now about the Emerging Superpower* (2006), *China's Rise: Challenges and Opportunities* (2008), and Arvind Subramanian's *Eclipse: Living in the Shadow of China's Economic Dominance* (2011). Later this year, we will publish *Bridging the Pacific: Toward Free Trade and Investment between China and the United States* by C. Fred Bergsten, Gary Hufbauer, and coauthors.

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ADAM S. POSEN
President
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