

tionalized in missions designated to safeguard Global South nations so as to claim their sovereignty and territorial integrity. Along their disputed land borders and in the maritime and airspace domain, we have to design a “New Russia, China and New Non-Aligned

Movement Joint Doctrine for Military Operations Other than War.”

I think that is my point that I can share at this opportunity. And so, I’m waiting for the discussion period. Thank you.

Prof. Wen Yi

The Secret of China’s Economic Success

This is the edited transcript of the presentation of Wen Yi to Panel I, “The Growing Danger of World War III Underlines the Necessity for a New Security Architecture,” of the Schiller Institute’s April 15-16 Conference, “Without the Development of All Nations, There Can Be No Lasting Peace for the Planet.” Professor Wen is a macroeconomist and former senior researcher at the Federal Reserve Bank of the United States.

Subheads have been added.



Schiller Institute

Professor Wen Yi

Thank you very much for inviting me to this wonderful conference. First of all, I was called upon with very short notice, so I do not have a power point to share with you. But I would like to say something with respect to the essence or the secret of China’s rapid development. Because I think China’s experience is very important to be shared with other developing nations. But so far unfortunately, all the conventional, Western-style economic theory has not been able to provide any coherent explanation for the rapid rise of China, and also not able to provide a good explanation of the origin of the British industrial revolution.

I think the two phenomena are intrinsically related. If we cannot explain China’s economic development, then there’s no hope we could also explain the industrial revolution which happened about 250 years ago in the UK. And vice versa, there’s no good theory to explain the industrial revolution, and that’s why people still cannot understand the development of China very well.

So here, I’m going to be offering something which is quite different from the conventional economic theory. First of all, let me mention three sort of superficial differences in terms of the China model and the Western capitalistic kind of development model. After that,

I’m going to try to get into some more fundamental logic behind that.

First of all, if you compare the rise of China, or the development of China, with the development of Europe or the West, the big difference, of course, is the scale. So far, after almost 250 years of industrial revolution, started by the UK, we only have less than 15% of the global population living in industrialized societies. More than 85% of the global population is still unindustrialized. That’s a very unfortunate situation. If China could manage to finish its

industrialization process, that alone would add another 20% of the global population into this group of people living in industrialized society. So that’s the first.

Secondly, the industrialization process in China, despite many struggles, has been very rapid, very fast. So, if we count Deng Xiaoping’s economic reform as a starting point, and actually to be more reasonable we should start with the establishment of the People’s Republic of China—so that’s still a mere 70 years. And yet, it took the Western powers several hundred years to develop, and eventually led to industrialization. Even after the UK kick-started the industrial revolution, it still took the West 250 years to finish that phase. So, in terms of speed, this is also very dramatic.

And lastly, but not least, the Chinese way of industrialization is very different from the Western way of industrialization. It’s very peaceful, at least so far. And we know the West’s way of industrialization has been very painful and is full of wars. That’s why we call the Western capitalism, war capitalism.

So, those are three, we can say, superficial features. But the underlying economic logic however is very similar. That’s what I want to point out, and therefore shed light on this Chinese experience, as well as the

British industrial revolution; and therefore draw some lessons for developing countries. Because as the title of this conference says, without the development or industrialization of all nations, we cannot have lasting peace. I think that's a very profound message.

China's 'Secret Recipe' of Industrialization

So, in retrospect, let's look at China's experience. Or, what I call the "secret recipe" of industrial revolution, which has the following features: Number one, poverty is actually rooted in the inability to be able to mass produce commodities; anything you name, from clothing to shelters or to automobiles, to everything. So, this kind of lack of ability to mass produce, to have mass production, is the fundamental reason for poverty. But yet, in order to mass-produce things, normally we tend to think about technology.

But today, technology actually is not really the issue. Something which we have forgotten is that in order for mass-production technology to be profitable, to be adopted by any nation—especially by the private sector—we must have a mass or unified market to make it profitable.

Without a mass market, anything you produce massively cannot be sold. Therefore, you cannot make a profit. We have come through this experience of social planning, so that was trying to push through mass production without relying on a market. But yet that kind of method essentially was not able to compete with capitalism, because it ran losses.

So therefore, mass production must be supported by a mass market. In this regard, we have not gone beyond the traditional economic theory, because Adam Smith himself pointed out that industrialization or division of labor is limited by the size of the market. Without a market you cannot hope to adopt a division of labor, because that's going to make losses. So, this part we know.

But what we don't know, which Adam Smith never pointed out, and the conventional economic theory never teaches us, is the following: The market itself is the fundamental public good. No individual peasant is able to produce it, so this kind of public good can only be created with the help of the state.

And the market has three pillars. Without them, there is no market. The first pillar is political stability; the second pillar is social trust; the third pillar is infrastructure. Without them, there is no market. So, a market is a public good, which has to be created, and

collectively, especially by the government.

And also, infrastructure we know is important, but we still do not know how importantly it shapes the market. For example, it directly determines the shape—the space-time form of the market—and it determines the flow, the direction, the volume and speed of the flow of goods. Yet infrastructure itself we know is a public good, and it's one of the pillars to support a market besides political stability and social trust.

So, the new imperialism completely ignores political stability as a pillar of the market; completely ignores social trust as a pillar of the market. And of course, the new imperialists also do not know how to build infrastructure, because that requires money.

So, therefore, we have to go beyond Adam Smith to realize that the market is fundamental to support mass production, but the market is a public good, which can only be created with the help of the state.

So, during the economic reform in the 1980s and '90s, the Washington Consensus told the developing countries, the government simply has to go back, just go back, and let the state collapse, and hopefully the market will emerge by itself. It is false. If you think of the history of Europe: The British government, the Dutch government, the German government, the French government, the U.S. government, the Japanese government, they all helped to carry the market for their own enterprises.

The 'Step by Step' Economic Method

Also, another principle is that the market to support industries cannot be created by one single big push, or shock therapy. It can only be created sequentially, step by step, because the market has structures. And the most preliminary, or primitive type of market to start with, in any agricultural society, is the so-called proto-industrial market, which supports craftsmen and small tiny firms. That stage is critical, especially for countries in Africa and for China in the 1980s.

Normally, countries try to skip over rather essential stages, to rush into industrialization, and therefore they skip earlier stages to develop the market, jumping to heavy industries. Eventually, they run into a financial crisis. This is vividly illustrated by the Latin American experience, either by Brazil, by Argentina, by Chile, and many others. So, this is the wrong way to go to create a market. You have to be humble, to create a market from the bottom, and step by step.

You look at the Chinese experience in the 1980s,

when Deng Xiaoping started economic reform. First of all, he maintained the political stability, because he fully understood that without political stability you could not attract foreign capital; you could not have an economy. At the same time, he also wanted all the governments, not just the central government, but also local governments to help with the economy; essentially create a market.

But Deng Xiaoping was very humble. His goal was just to achieve per-capita income at the level of \$200 or \$500 per person by the year 2000. This humble goal turned out to be correct. Otherwise, you rush into industrialization, trying to build heavy industries, which will fail, because heavy industry requires light industry to create its market demand. The light industry, if we want to use a mass production technology, requires a proto-industry to create the market.

So therefore, China's experience started in the rural areas, by the so-called village-township firms. They were very primitive, very small scale, but very important. Millions, even billions of people participated in that process that eventually created the market. So therefore, if I want to give a more detailed characterization of the evolution of the market—how to create a market in a sequential process—I divide that into three stages.

The first stage, especially for poor nations like African nations, you create a market to support proto-industries, which are very primitive but very important. They draw all the peasant people into manufacturing, but that's very primitive. Then, once the market is fermented very well, especially with a delivery network—mom-and-pop shops—then you can support mass production of light industries, such as textiles. Textile production is very important as a stage for countries to move up.

The Transition to Heavy Industry

Once you go through the industrialization of light industries, that creates a huge demand for transportation; for machinery. So that's going to help you to kick-start the heavy industrial revolution; heavy industries. So that's the third stage. And only after you finish the heavy industrialization, you use capital to produce capital; you use machines to produce machines. Now your productivity will be so high, such that you can make the agricultural machinery very

cheap, and farmers will be able to purchase it. Only at that stage, modernization of agriculture becomes possible.

Many nations have begun in the wrong order. They start with heavy industrialization; start with financial reform. That's completely wrong. You've got the order wrong. That's not the way to create markets, especially for the industrial market.

So only after that, the working population's productivity becomes so high, the wage rate is so high, such that labor becomes scarce and capital becomes so cheap and abundant, that the society is able to move into a welfare state. So, you can support welfare. Welfare has two aspects: Number one is economic welfare, like pensions, unemployment insurance, free education, free Medicare. And another aspect is political welfare: human rights and other things. But without the economic foundation, if you jump into the welfare state too early, you are going to fail. Your economy is not able to support it.

So, I think that summarizes this Chinese experience, and this experience actually shares the same economic logic with the British industrial revolution; with the American industrial revolution; with the Japanese industrial revolution. Therefore, today when we try to help developing countries to develop their economy, we need to draw lessons from this, rather than just helping them with modern industries, because their economies are not able to support it. A market is not created that way. It can only be created sequentially. I think that is essentially my point.

But of course, you look at European history, their governments played a very important role to help them create a market, especially a global market. Without the creation of the global market through colonization, through the great voyage, the industrial revolution could never happen.

But of course, China's experience told us that we can also create markets peacefully, without repeating the Western style of war capitalism. That's one of the most important lessons China is able to offer to other developing countries. The state, the government—central and local—needs to play a very important role to help your economy to create a market for your own economy.

I think that's the end of my talk. Thank you very much for listening.