Discussion of Alwyn Young’s

“The Razor’s Edge: Distortions and Incremental Reform

in the People’s Republic of China”

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I must apologize for not being here in person but I hope to see most of you tomorrow.

This is an entertaining, informative and useful paper. As with so much of Alwyn’s work, it is a careful compilation of relatively new data, imaginatively organized to make a big point. I must say the title is a little misleading. The path to economic development, if not salvation, is hardly narrow. We have the experience of Capitalist North America, Bismarckian Germany, Meiji Japan, Dengist China, and Czarist Russia to convince us that there are many roads to development.

Alwyn wants to tell the following story. Maoist China was very much a Stalinist state, with rigid controls, detailed plans, and pervasive centralization. The reforms of the late seventies decentralized the economy to a great deal, laid emphasis on incentives, and entrusted power to local and provincial authorities. These authorities, for a variety of reasons, erected barriers to interregional trade. These barriers made the authorities better off (this we must take as an article of faith in economic theorizing) but made the nation as a whole worse off than it would have been had the barriers not been erected while the other reforms continued to be made.

Alwyn provides three kinds of evidence to support the view that local authorities erected barriers to trade. One consists of the observations of shrewd observers of the contemporary scene. Extensive use is made of the insightful observations of the Far Eastern Economic Review. I do not wish to malign this kind of evidence. Just because this kind of evidence does not come in numbers does not mean it is not valuable data. In any event, the Far Eastern Economic Review is fun
reading. The problem, as Alwyn takes pain to point out, is that we have no way of knowing how selective this evidence is.

The second kind of evidence is more formal. It essentially consists of constructing measures of the extent of specialization in the production of different types of goods across regions. Alwyn shows that these measures show a decline in the level of specialization during the seventies and eighties and a modest stabilization since then. The first measure of specialization is the mean absolute deviation (from countrywide mean) of sector shares in national income. One problem is that this measure does not have an obvious metric, that is, one does not know what a large number is. In any event, this measure does show a large change over time. The second measure is the extent of dispersion within manufacturing. In this measure, manufacturing is divided into light and heavy manufacturing. This measure shows essentially no change in the reform period. The third measure is the coefficient of variation of output of 12 very disaggregated commodities. Many of these (but not all) show a fall in specialization. I must confess that to my naked eye there is no obvious evidence of a break in trend at the time of reform. Alwyn also reports on trends for a broader array of products in the post-reform period and finds that roughly three quarters of the products show a decrease in specialization.

Alwyn then turns to the question of whether this decrease in specialization could be due to provinces becoming more similar. From statistics Alwyn reports I computed that in 1978, the ratio of the income of a province one standard deviation above the mean to that one standard deviation below the mean in 1978 was 3.15. This statistic in 1992 was 2.6. This hardly seems like a big change to me. Alwyn shows that the rich and poor regions have structures of production which are systematically different from the typical region and also concludes that changes in the dispersion of income cannot account for reduced specialization.

My main problem with the view that the fall in specialization is evidence of rising barriers
to trade is the evidence for the U. S. presented by Sukkoo Kim (Quarterly Journal of Economics November 1995). Kim, using somewhat different measures, finds a rise in specialization from 1860 to 1930 and a substantial fall since then in the United States I find it hard to imagine that transport costs have risen since then. There are a whole bunch of stories including Krugman and Venables’ work which are consistent with these findings. One of the key issues here is the cost of transporting intermediate goods relative to the costs of transporting final goods and the other key issue is the size of scale economies. For example, under autarky, we might expect to find all regions looking very similar, if tastes and resource endowments are similar. With small transportation costs, if scale economies are small, we expect to see all regions looking similar. We might see lots of specialization if intermediate goods are costly to ship and final goods are cheap to ship. That is, I have good reasons to expect nonmonotonicity in specialization with respect to changes in trade barriers.

An important issue that arises here is whether trade theory leads us to expect a fall in specialization. China became much more open to trade in the eighties. That is, Chinese prices got closer to world prices. The provinces of China are similar to each other when compared to the rest of the world. I would therefore expect trade to lead to the provinces looking more like each other.

The third kind of evidence is the most intriguing. Alwyn decomposes the variance of output shares across regions into the variance of labor productivities, the variance of labor inputs, and the covariance between the last two variables. He shows that the variance of outputs seems to be unchanged or falls, the variance of productivities is roughly unchanged, the variance of labor inputs rises and the covariance falls. He interprets this as a rise in trade barriers. Here my problem is that I have no way of knowing whether these changes are large or small. I think the paper has to take a stand on the theory especially quantitative theory. Without such a stand, we have numbers but absolutely no way of interpreting the numbers. By the way, we now have the technological capabilities to set up and solve such models.
Finally, the whole point of the Chinese reform process was to decentralize allocation mechanisms. I don't see how we get to pick and choose about the decentralization process. The local officials clearly had strong links with manufacturers and potential entrepreneurs. The cooperation of the local officials was essential to decentralization. They were bought off by giving them some ability to hinder trade and thus create and capture rents. My guess is that the creation of barriers to trade which Alwyn Young bemoans were essential to the progress in China. The distortions and the reforms go together. Furthermore, it is not obvious to me that an interstate commerce clause would have been a good idea in China. Consider the silk cocoon war. Another interpretation is that a cartel in Shanghai held cocoon prices artificially low. In retaliation, Zhejiang province set up factories. Was this necessarily an inefficient outcome?