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The OECD on China's economy

# A model of reform

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## Some advice from the rich man's club

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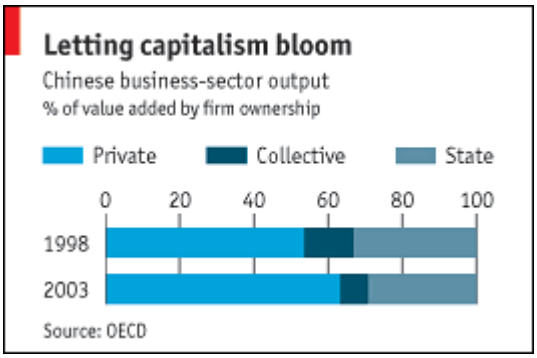
THE Organisation for Economic Co-operation and Development has long urged its mainly rich member countries to push ahead faster with structural reforms. Now, in its first full survey of China's economy, the Paris-based club has turned its attention to a non-member whose rapid pace of reform, along with its low levels of public spending and borrowing, would put many European countries to shame.

The report oozes praise for China's bold reforms over the past quarter-century, which have allowed market forces a much bigger role in the economy and opened it up to foreign competition and investment. No member of the OECD has embarked on reforms that have restructured or closed thousands of state-controlled firms every year, with millions of job losses. The number of state firms has tumbled from over 300,000 to 150,000 in the past decade.

This has been offset by rapid growth in the private sector. The OECD estimates that in 2003 private companies accounted for 63% of China's business-sector output (which in turn accounts for 94% of GDP). This compares with 54% in 1998 and virtually nothing in the 1970s. If you add in “collective” enterprises, which are officially controlled by local government but in practice operate more like private firms, the private sector's share was 71% in 2003 (see chart). By now it is probably close to three-quarters. Nevertheless, that still leaves state enterprises' share of output well above that in OECD countries.




In collaboration with China's National Bureau of Statistics, the OECD has analysed a new financial database covering around 160,000 firms. It finds that the average rate of return on capital for private-sector industrial firms rose from 8% in 1998 to 15% in 2003, thanks to rapid growth in total factor productivity (TFP: the efficiency with which both capital and labour are used). That was higher than the average return on capital in OECD countries of around 11%. Once state-controlled firms are included, however, China's average return drops below the OECD mark. State firms' return on capital rose from 5% to 10% between 1998 and 2003, but most of that improvement was accounted for by a minority: two-thirds of state firms make less than 5%, and 35% still make a loss.

Private-sector firms' TFP is double that of their state-controlled counterparts. As a result, the shift of resources from the public to the private sector boosts productivity. Over the 25 years to 2003, the annual growth in TFP averaged 3.7%. It slowed to 2.8% by the end of that period, but that was still much faster than in OECD countries. For instance, America's TFP growth has averaged about 1% over the past decade.

The OECD reckons that China can maintain its rapid pace for some years, as long as reforms continue. More aggressive restructuring in the public sector would help to boost economy-wide productivity growth. And to support the expansion of private business the OECD urges a reform of corporate law (to remove barriers to the entry and expansion of new firms), bankruptcy law and property rights. Measures to develop and deregulate China's financial markets would also help to improve the allocation of capital.

Although China is a poor country, it shares many of the problems of OECD countries. It needs labour-market reforms to increase mobility. It faces the burden of an ageing population. And its public sector is inefficient. The OECD should invite China to join its club—not just so that China can benefit from its experience, but also to ensure that the OECD itself does not become irrelevant by excluding the world's emerging economic giant.