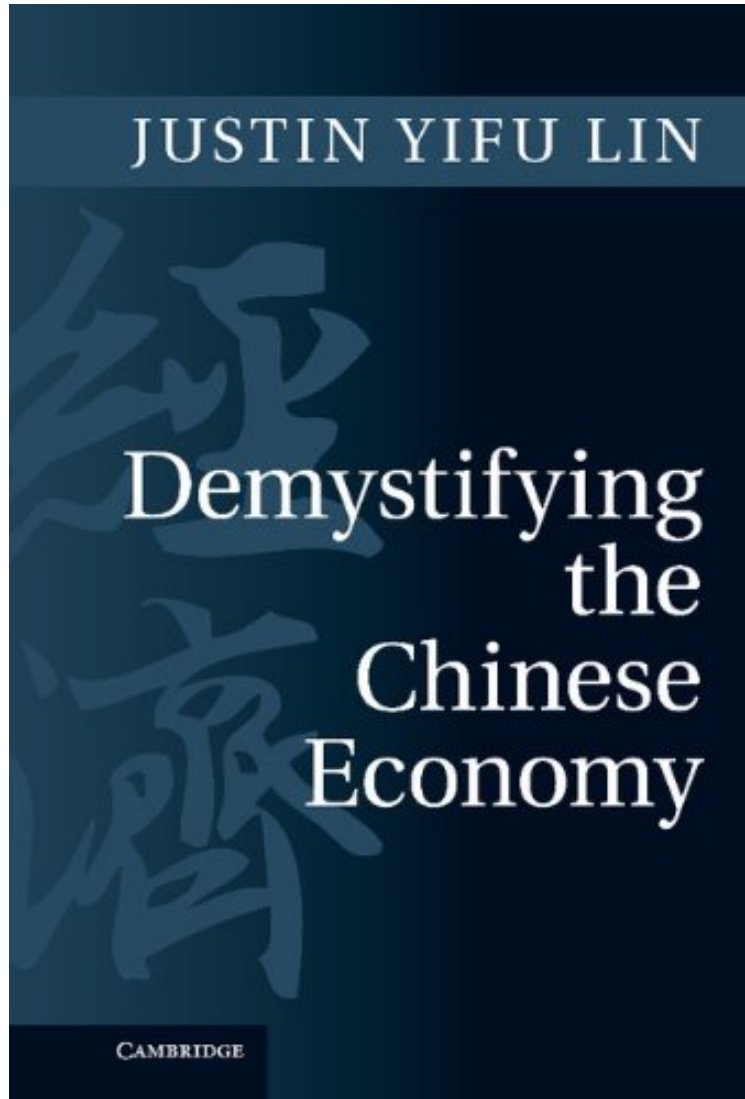


(Free pdf) Demystifying the Chinese Economy

Demystifying the Chinese Economy

Justin Yifu Lin

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Author Justin Yifu Lin is the founder of the China Center for Economic Research and former professor of economics at Peking University. He has a PdD in economics from the University of Chicago, and until recently was

the chief economist at the World Bank. China was the world's largest and most advanced economies before the 18th century (accounting for an estimated 1/3 of global GDP in 1820), then degenerated into one of the world's poorest by the late 19th century (about 5% prior to 1979 reforms). It did not reverse its fate until introducing market-oriented reforms in 1979; since then it has been the world's most dynamic economy and is forecast to regain its #1 position before 2020. The book is based on Justin Lin's lecture notes for Peking University classes. He contends that in premodern times, technological inventions were came mostly from farmers and craftsmen, the rate of innovation was slow, and most lived on subsistence agriculture. China's advantage at the time derived from having a large number of farmers and craftsmen, a relatively advanced market system, Confucian philosophy, and a civil service examination system with improved resource allocation and facilitated unity. When scientific experiment became the basis of invention, technological development in western countries accelerated, as did their economic development. China's civil service examination system, based on Confucian classics, repressed incentives to learn mathematics and how to conduct controlled experiments. China soon was no longer a leader. Outside economists criticized Asia's export-oriented development strategy right from its 1950s beginnings. China received the same criticisms when it initiated reforms in 1979. Deng Xiaoping, the architect of China's initial reform efforts proposed in early 1980 that China accept a target of quadrupling China's GDP by the end of the 20th century. Author Justin Lin admits doubting the viability of that goal; in fact, it was exceeded. Undeterred by Western criticisms, Chinese leaders focused on taking advantage of its comparative advantage - plenty low-cost labor. Adam Smith's theories were based on interpreting and resolving the problems of developed countries; because the conditions and problems in developed countries constantly evolve, theories changed as well (for some). Regardless, theories tailored for developed nations are not necessarily applicable to developing ones. The author rejects 'shock therapy' because policymakers too often simply do not know what is going to work. The book contains many examples of experiments that failed because the incentives involved were not understood by policymakers; these failures also justify Deng's emphasis on using limited experiments to guide the way and avoid major setbacks that would have played into the hands of those opposing change. China decided to also focus on catching-up in technology, allowing it to utilize existing or used machinery and improve per capita income much faster than in Europe and the U.S. It was able to import what the world knew and export what the world wanted. Previously, Mao had pursued a wrong strategy for his time. Lack of industrialization, especially large heavy industries that supported military strength, were seen as the root cause of China's then backwardness. Previously, leaders in France, Germany, the U.S. and other Western nations pursued the same strategy, motivated by the contrast between Britain's rising industrial power and the backwardness of their own industry. China, however, attempted to do so prior to attaining basic industrial competencies. Nonetheless, China's government gave firms in those sectors a monopoly, and subsidized them with lower-priced inputs, often creating shortages. This allowed China to establish modern industries, test nuclear bombs in the 1960s, and launch satellites in the 1970s. But its labor-intensive sectors were repressed - and that was where it held a comparative advantage. Thus, efficiency was low and growth prior to 1979 was driven mainly by increased inputs. GDP did increase an average of 6.1% from 1952-78, but the populace did not fare so well. And without protection, those new industry firms would not have been viable. China then embarked on a dual-track system, introducing reforms in some areas while maintaining the status-quo in others - aimed at controlling the shock delivered at one time. Farmers were one of the first beneficiaries - they were allowed to own their land again (collective farms were broken up) and could set prices for selling their production that exceeded quota obligations sold to the state at fixed prices. Meanwhile, entry of private enterprises, joint ventures, and foreign investment in labor-intensive sectors were liberalized. Poland, Slovenia, and Vietnam adopted similar strategies. The costs, so far, have been rising income inequality and negative environmental impact. The state's proactive role included guidance as to where to focus efforts, encouraging foreign investment and technology transfer, protecting nascent industries, providing capital for infrastructure and new industries.

China was the largest and one of the most advanced economies in the world before the eighteenth century, yet declined precipitately thereafter and degenerated into one of the world's poorest economies by the late nineteenth century. Despite generations' efforts for national rejuvenation, China did not reverse its fate until it introduced market-oriented reforms in 1979. Since then it has been the most dynamic economy in the world and is likely to regain its position as the world's largest economy before 2030. Based on economic analysis and personal reflection on policy debates, Justin Yifu Lin provides insightful answers to why China was so advanced in pre-modern times, what caused it to become so poor for almost two centuries, how it grew into a market economy, where its potential is for continuing dynamic growth and what further reforms are needed to complete the transition to a well-functioning, advanced market economy.

"No one knows the Chinese economy better than Justin Lin, and there's no one better placed to describe its essential workings. A unique perspective on the Chinese miracle from a unique perch." - Barry Eichengreen, George C. Pardee and Helen N. Pardee Professor of Economics and Political Science, University of California, Berkeley "Justin Lin's Demystifying the Chinese Economy is a tour de force. The book succeeds at many levels. It presents a broad historical

perspective over two millennia of the rise, fall, and the dramatic resurgence of Chinese economic power. It presents an analytically informative study of the sources of Chinese economic growth and the prospects of growth for the future. Lin formalizes the successful pragmatic Chinese approach to economic development using his insightful notion of 'Comparative Advantage Following (CAF)' strategies. The book challenges many tenets of conventional neoclassical theory and shows how naive application of many of its principles had catastrophic consequences for many transition economies." - James J Heckman, Henry Schultz Distinguished Service Professor of Economics, 2000 Nobel Prize in Economics, University of Chicago "This book considers fundamental questions about the great transformation of China from a poor underdeveloped country to a global leader in modern economic growth. These are among the most important questions of our time, and Justin Lin has the best credentials to help us understand them. In this book, he offers a new and important perspective on the conditions for modern economic development in China and the world." - Roger Myerson, Glen A. Lloyd Distinguished Service Professor of Economics, 2007 Nobel Prize in Economics, University of Chicago "This clear and insightful study of the origins of China's failures and, finally, its extraordinary success will be must-reading for anyone who wants to understand Chinese development. An important book and much overdue." - Edmund S. Phelps, McVickar Professor of Political Economy, 2006 Nobel Prize in Economics, Columbia University "This is the best book on China's economy that I've read..." - James Pressley, Bloomberg "...[one of] five recent titles from the Letter from China bookshelf that are surprising or entertaining or useful...when the history of China's economic boom is written, Lin's will be one of the clearest cases in defense of the Chinese way." - Evan Osnos, New Yorker.com

About the Author Justin Yifu Lin is Senior Vice President and Chief Economist of the World Bank. He obtained his PhD in economics from the University of Chicago in 1986 and returned to China in 1987, the first PhD in social sciences to return from abroad after China started economic reform in 1979. He was the founding director of China Center for Economic Research at Peking University from 1994 to 2008 and is the author of seventeen books, including *The China Miracle* (1996), *State-Owned Enterprise Reform in China* (2001) and *Economic Development and Transition* (Cambridge, 2009).