

## Land policy

# How Asia works

by Joe Studwell

Most people assume the world will continue to speed up. Yet the chances of seeing another developmental story like China's are rather low. The era of transitions from poverty to wealth in only two generations, or 50 years, is probably over. The reason is that China—like Japan, South Korea and Taiwan before it, and Vietnam along with it—built its extraordinary developmental performance on land reform that enabled a transition to high-yield farming. Today land reform, which only occurred in east Asia in the wake of war or revolution, is off the development agenda. Without it, however, there is no way to create the large initial productive surplus that primes sustainable economic growth of 8-10% a year.

The evidence of what occurred in successful east Asian states is powerful: good land policy, centered on egalitarian household farming, set up the world's most impressive post-war development stories. In the first 10-15 years following the shift to small-scale household agriculture in Japan, South Korea, Taiwan and China, gross output of foodstuffs increased by somewhere between half (in Japan, which was already the most productive country) and three-quarters (Taiwan). Increases in agricultural output facilitated the increased savings that paid for industrial investment. It is for this reason that land reform is the first rung on the ladder to accelerated economic development.

### It's land policy, stupid

In a country in the early stages of development, typically three-quarters of the population is employed in agriculture and lives off the land. The problem with agriculture in pre-industrial states with rising populations, however, is that when market forces are left to themselves agricultural yields tend to stagnate or even fall. This happens because demand for land increases faster than supply, and so landlords lease out land at increasing rents. Tenants, facing stiff rents with little security of tenure, are unable to make the investments—for instance, in improving irrigation or buying fertilizer—that will increase yields on the land they farm. Landlords could make the investments to increase yields, but they make money more easily by exacting the highest possible rents.

This problem has plagued agriculture in poor countries around the world. In east Asia, however, a series of radical land reform programs undertaken in China, Japan, South Korea and Taiwan after World War II structured a different kind of agricultural market. Although the first land reform was orchestrated by communists, and the second, third and fourth by anti-communists, the objective was the same in all cases:

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For Asia, land reform was the foundation of economic success

Market forces alone are likely to cause farm yields to stagnate or fall in developing countries

Increased agricultural output in East Asia can be attributed to radical land reforms undertaken after World War II

to take available agricultural land and to divide it up on an equal basis among the farming population. It was a market in which owners of small household farms were incentivized to invest their labor and the surplus they generated towards maximizing production. The result was hugely increased yields in all four countries. Sadly, there has been no equivalent policy change of such magnitude and effect anywhere else.

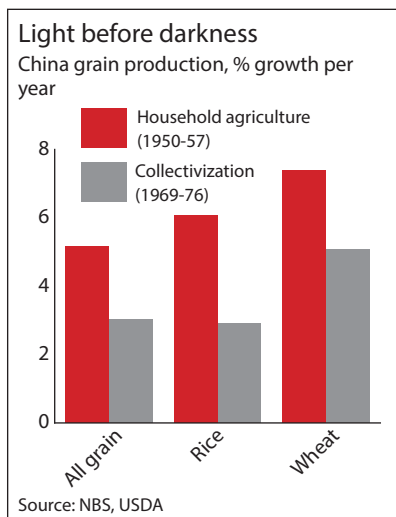
Klaus Deininger, one of the world’s leading authorities on land policy and development, has spent decades assembling data that show how the nature of land distribution in poor countries predicts future economic performance. Using global land surveys done by the United Nations’ Food and Agriculture Organization, he has worked out that only one significant developing country has managed a long-term growth rate of over 2.5% with a very unequal distribution of land. That country is Brazil, the false prophet of fast growth which collapsed in a debt crisis in the 1980s in large part because of its failure to increase agricultural output. Deininger’s two big conclusions are that land inequality leads to low long-term growth and that low growth reduces income for the poor but not for the rich.

**Collective murder**

China’s land reforms show how important it is to get policy right. The first widespread redistribution of land occurred during the war against Japan (1937-45) and the Chinese civil war (1946-49). Landlords were expropriated and farmland was redistributed to rural households as a core policy for rallying Communist Party support. After the Communist victory over the nationalist government in 1949, the “land to the tiller” program was completed. For a handful of golden years, agricultural output jumped and the Communist Party lived up to its propaganda about creating a “peasant revolution.” From 1956, however, China’s leaders began their murderous experiment with collective farming. As farms scaled up, yields fell and, when Mao pressed for a concurrent industrial Great Leap Forward, millions of people died (see “Bigger is not always better”). China had to wait until the revolutionary son of a landlord, Deng Xiaoping, rose to power in 1978 to rediscover what household farming could do for a developing country.

The revelation was simple enough. Grain production was 305m tons in 1978 under collective farming, and 407m tons in 1984, by which time almost all land had been converted to household agriculture, with average plots of just over one-third of a hectare. China’s grain output went on to exceed 500m tons from the late 1990s. This was despite the conversion of large amounts of agricultural land to commercial and residential use, and despite the conversion of an increasing share of farmland to non-grain crops and animal-rearing. Today, Chinese rice yields are in line with those of the northeast Asian states and are among the highest in the world.

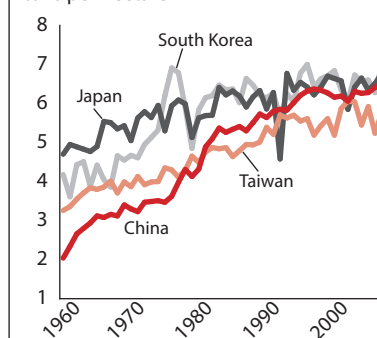
Under the terms of its accession to the World Trade Organization in 2001, China cut tariffs and quota restrictions on agricultural imports



to levels far below those of Japan, South Korea and Taiwan at similar stages of development. Yet only one agricultural commodity has seen a boom in imports. It is soybeans, whose imports by value increased from US\$3 bn in 2001 to US\$25 bn in 2010. Interestingly, Chinese soybean production, concentrated in its northernmost province of Heilongjiang, depends for a substantial chunk of its output on large farms, often state-run ones—not on household production. It was decided to retain some collectives in the province as large state units after 1978. As a result, China tries with soybeans to compete at scale with international scale producers (especially US ones) and comes off second best.

In 2010, China's 55m tons of soybean imports accounted for 90% of all its overseas grain purchases. With rice and wheat, where the household farming structure is almost ubiquitous, imports were just 400,000 tons and 1.2 million tons respectively—less than half a percent of China's annual grain consumption. In 2012, China's grain imports (rice, maize, wheat and soybean) surged 24% to 70m tons, but still only accounted for 13% of annual consumption (see "Feeding the hungry hordes," on p42). At China's present level of development and incomes, global scale producers of rice and wheat cannot compete with Chinese families gardening their plots.

The proof is in the yields  
Increases in rice paddy yields by country,  
tons per hectare



Source: FAO STAT; Council of Agriculture, ROC

### Bigger is not always better

In farming, as in many other things, we are told that bigger is better. Free marketers and Marxists are united in insisting that scale is fundamental to efficiency. Yet for millions of people in China, North Korea and Vietnam, switching from household farming to large collectives meant one thing: starvation.

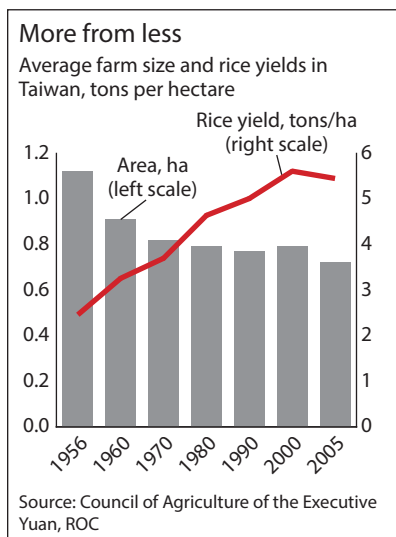
The Communist Party of China won its revolution by promising "land to the tiller" to millions of impoverished tenant farmers. It initially delivered on its promise and, under household farming, there was a very substantial increase in agricultural output in China in the second half of the 1940s and the first half of the 1950s. The available data are of poor quality, but the increase is widely agreed to have been in the range of 40–70%, taking grain output from a pre-World War II peak of less than 140m tons to close to 200m tons. For a brief moment, Chinese farmers experienced an unprecedented holiday from want, not to mention a boom in rural textile, handicraft and manufacturing output. There is no reason this state of affairs should not have lasted. No reason, that is, except Marxist dogma, and the obsession with large scale.

In 1956, following the Russian and North Korean examples, Mao Zedong led a drive to create agricultural collectives in which hundreds of families pooled their land, tools and labor in each unit of production. These changes,

together with an industrialization drive, were presented as China's Great Leap Forward. In reality, the disruption to agricultural output was such that a famine occurred in 1959-61 in which an estimated 30-40m people (nearly 10% of the population) died.

The question of efficiency in agriculture depends on what outcome you are looking for. Big capitalist farms may produce the highest return on cash invested. But that is not the agricultural "efficiency" that is appropriate to a developing state. At an early stage, a poor country with a surfeit of labor is better served by maximizing its crop production until the return on any more labor falls to zero. Put another way, you might as well use the labor you have—even if the return per man hour looks terribly low on paper—because that is the only use you have for your workers.

The experience of east Asia bears this out. Small-scale household farming brought healthy harvests; large-scale collective farming brought only agricultural stagnation. In Japan, Taiwan, South Korea and China, economic take-off was underpinned by families of five, six or seven people tending plots of not more than one hectare, frequently much less. A gardening approach delivers the maximum crop output, as any home fruit and vegetable gardener knows.



**Keep your banks under state control—one of the key secrets for economic success**

Agriculture, which is rarely even mentioned in today's discussions about economic development, was the making of the Asian miracles in Japan, South Korea, Taiwan and China. The second stage of the miracles occurred when governments directed investment and entrepreneurs towards manufacturing. This was important because manufacturing industry makes the most effective use of the limited productive skills of the workforce of a developing economy, when workers begin to migrate out of agriculture. Relatively unskilled laborers create value in factories by working with machines that can be easily purchased on the world market. In addition, in east Asia successful governments pioneered new ways to promote accelerated technological upgrading in manufacturing through subsidies that were conditioned on export performance. This subsidy and what I call "export discipline" combination produced the sort of Asian industrialization on steroids the world has become familiar with.

### **Climbing the development ladder**

In addition, policy interventions in the financial sector to focus capital on intensive, small-scale agriculture and on manufacturing development provided the third key to accelerated economic transformation. China's rural credit cooperatives played an important early role as did bank credit for large irrigation and other agricultural infrastructure projects. More recently, the banking system has paid lousy interest rates to retail depositors and used the profits to cover the costs of supporting state industrial policy. The state's role has been to keep money targeted at a development strategy that produced the fastest possible technological learning, and hence the promise of high future profits, rather than on short-term returns and individual consumption.

Three strategies—household farming, acute concentration on manufacturing, and financial repression—determined success and failure around east Asia. In southeast Asian states including Thailand, Malaysia, Indonesia and the Philippines, the actual implemented effects of land-reform programs were a fraction of what they were in China and the northeast of the region. The quality of entrepreneurs in southeast Asia was no less in northeast Asia, but southeast Asian governments failed to constrain entrepreneurs to manufacture and did not subject them to export discipline. Instead, there were state-sector manufacturing projects, but with little competition between firms and no requirement to export. As a result, governments obtained a very low return on all forms of industrial policy investment.

Finally, where Japan, South Korea, Taiwan and China focused their financial systems on the objectives of high-yield, small-scale agriculture and the acquisition of manufacturing skills, keeping financial institutions under close state supervision and maintaining controls on international capital flows, other countries did not. Southeast Asian states were blessed with high levels of savings just like China or Japan. But governments directed the hefty investments this made possible to the wrong ends—to lower-yield, large-scale agriculture, and to companies

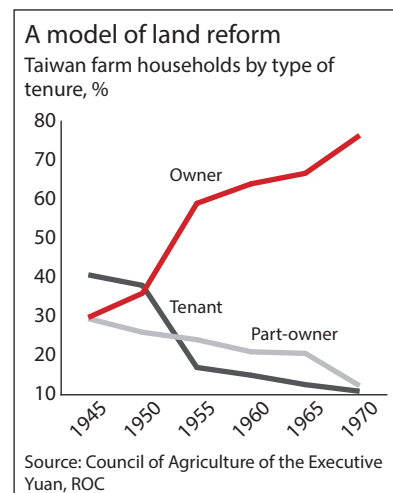
that were either not focused on manufacturing or only on manufacturing for protected domestic markets. Southeast Asian states then made their developmental prospects even worse by following rich-country advice to deregulate banking, to open up other financial markets and to lift capital controls. The same advice had been proffered to Japan, South Korea, Taiwan and China at an early stage in their development; it was sensibly resisted for as long as possible.

### Agriculture: the magic ingredient

The recipe for developmental success in east Asia has been as simple as one, two, three: household farming, export-oriented manufacturing, and closely-controlled finance that supports these two sectors. The least recognized ingredient has been the agricultural one. The reason the recipe worked is that it enabled poor countries to get much more out of their economies than the low-productive skills of their populations would otherwise have allowed at an early stage of development. Governments manipulated economies which thereby forged ahead and created wealth that paid for people—who cannot be neatly transformed by government policy—to catch up.

Neoclassical economists do not like political intervention in markets. They claim that markets are inherently efficient. But history shows that markets are created—which is to say that, in a functioning society, markets are shaped and re-shaped by political power. Without the dispossession of landlords in Japan, South Korea, Taiwan and China, there would have been no increased agricultural surplus to prime industrialization. Without the focus on manufacturing for export, there would have been no way to engage tens of millions of former farmers in the modern economy. And without financial repression, it would not have been possible to pay for an accelerated economic learning process. In all of the above, markets and competition were made to serve development.

The message that east Asia—and indeed a historical understanding of development around the world—sends to economists is that there is no one economics. At a minimum, there are two. There is the economics of development, which is akin to an education process. This is where the people—and preferably all the people—who comprise an economy acquire the skills needed to compete with their peers around the world. The economics of development requires nurture, protection and competition. Then there is the economics of efficiency, applicable to a later stage of development. This requires less state intervention, more deregulation, freer markets, and a closer focus on near-term profits. The issue is not whether there are two kinds of economics that exist at different stages of development. The question is where these two stages meet. This is the difficult and interesting subject to which economists could more productively apply themselves.



The one, two, three of the east Asian miracle:  
household farming,  
export-oriented manufacturing,  
state-controlled finance