# Summary and Conclusions

This study is mainly concerned with Chinese economic policy and performance in the second half of the twentieth century in which there was major institutional change and the trajectory of growth accelerated sharply. China now plays a much bigger role in the world economy and its importance is likely to increase further. I have tried to assess why and how this acceleration occurred and to throw light on future potential. I have also made a considerable effort to recast the estimates of Chinese GDP growth to make them conform to international norms.

## Reasons for Taking a Long View

In order to understand contemporary China it is useful to take a long comparative perspective. In many respects China is exceptional. It is and has been a larger political unit than any other. Already in the tenth century, it was the world's leading economy in terms of per capita income and this leadership lasted until the fifteenth century. It outperformed Europe in levels of technology, the intensity with which it used its natural resources and its capacity for administering a huge territorial empire. In the following three centuries, Europe gradually overtook China in real income, technological and scientific capacity. In the nineteenth and first half of the twentieth century, China's performance actually declined in a world where economic progress greatly accelerated.

A comparative analysis of Chinese performance can provide new perspectives on the nature and causes of economic growth. It can help illuminate developments in the West as well as in China. In the past, analysis of economic progress and its determinants has had a heavy Eurocentric emphasis. Assessment of the Chinese historical record has been highly Sinocentric. A more integrated view can illuminate both exceptionalism and normality and provide a better understanding of the reasons for the rise and decline of nations.

Adoption of more distant horizons can clarify causal processes. Growth analysis has concentrated on the past two centuries of capitalist development in which rapid technical change, structural transformation and rising per capita incomes were the norm. Earlier situations where per capita income was fairly static are usually neglected because it is assumed there was no technical change. But extensive growth — maintaining income levels whilst accommodating substantial rises in population — may also require major changes in the organisation of production. Technological progress needs to be interpreted broadly. It should not be restricted to advances in machinofacture, but should encompass innovations in administration, organisation and agricultural practice.

A long view can also help understand China's contemporary policies and institutions. Echoes from the past are still important.

China was a pioneer in bureaucratic modes of governance. In the tenth century, it was already recruiting professionally trained public servants on a meritocratic basis. The bureaucracy was the main instrument for imposing social and political order in a unitary state over a huge area.


ISBN: 978-92-64-03762-5 

The economic impact of the bureaucracy was very positive for agriculture. It was the key sector from which they could squeeze a surplus in the form of taxes and compulsory levies. They nurtured it with hydraulic works. Thanks to the precocious development of printing they were able to diffuse best practice techniques by widespread distribution of illustrated agricultural handbooks. They settled farmers in promising new regions. They developed a public granary system to mitigate famines. They fostered innovation by introducing early ripening seeds which eventually permitted double or triple cropping. They promoted the introduction of new crops — tea in the T'ang dynasty, cotton in the Sung, sorghum in the Yuan, and new world crops such as maize, potatoes, sweet potatoes, peanuts and tobacco in the Ming.

Agricultural practice compensated for land shortage by intensive use of labour, irrigation and natural fertilisers. Land was under continuous cultivation, without fallow. The need for fodder crops and grazing land was minimal. Livestock was concentrated on scavengers (pigs and poultry). Beef, milk and wool consumption were rare. The protein supply was augmented by widespread practice of small–scale aquaculture.

Agriculture operated in an institutional order, which was efficient in its allocation of resources and was able to respond to population pressure by raising land productivity. Landlords were largely non–managerial rentiers. Production and managerial decisions were made by tenants and peasant proprietors who could buy and sell land freely and sell their products in local markets.

## Chinese Performance from the Ninth to the Eighteenth Century

Between the ninth and the thirteenth centuries there was a major shift in the centre of gravity of the Chinese economy. In the eighth century three–quarters of the population lived in North China, where the main crops were wheat and millet. By the end of the thirteenth, three–quarters of the population lived and produced rice south of the Yangtse river. This had been a swampy lightly–settled area, but with irrigation and early ripening seeds, it provided an ideal opportunity for massive development of rice cultivation.

Higher land productivity permitted denser settlement, reduced the cost of transport, raised the proportion of farm output which could be marketed and released labour for expanded handicraft production, particularly the spinning and weaving of cotton, which provided more comfortable, more easily washable and healthier clothing.

While there is widespread agreement that this change in the locus of production and product–mix increased Chinese living standards, there has hitherto been no quantification of how big a rise occurred. My assessment is that it was relatively modest — a rise in per capita income of about a third. The rise in income was accompanied by a more intensive use of labour, so labour productivity did not rise as much as per capita income.

China's economic advance in the Sung dynasty relied heavily on exploitation of once–for–all opportunities for switching to intensive rice agriculture and there is little convincing evidence for believing that China was on the brink of developing a mechanised industry.

From the thirteenth to the eighteenth century, China was able to accommodate a four–fold increase in population whilst maintaining the average level of per capita income more or less stable over the long run. However, the pace of growth was far from smooth. In the fourteenth and seventeenth centuries, population dropped by more than 30 million. These crises were due largely to devastation that accompanied changes in regime and to epidemic disease (bubonic plague and smallpox). In the eighteenth century the demographic expansion was particularly large. It was in this century that China's extensive growth was most impressive.

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## Institutional Differences between Europe and China

Outside agriculture, China's bureaucratic system hindered the emergence of an independent commercial and industrial bourgeoisie on the European pattern. The bureaucracy and gentry of imperial China were quintessential rent–seekers. Their legal and customary privileges defined their status, lifestyle and attitudes. They were the group that dominated urban life. They had a strong regulatory bias. Entrepreneurial activity was insecure in a framework where legal protection for private activity was exiguous. Any activity which promised to be lucrative was subject to bureaucratic squeeze. Larger undertakings were limited to state or publicly licensed monopolies. China's merchants, bankers and traders did not have the city charters and legal protection which merchants had in European cities. International trade and intellectual contacts were severely restricted. This self–imposed isolation was also a barrier to growth.

Between the fifteenth and eighteenth centuries economic leadership passed from China to Western Europe. This was not due to specially unfavourable conditions in China but to Western exceptionalism. There were several reasons why Europe was better placed to promote the emergence of modern capitalism.

The most fundamental was the recognition of human capacity to transform the forces of nature by rational investigation and experiment. Thanks to the Renaissance and the Enlightenment, Western elites gradually abandoned superstition, magic and submission to religious authority. The Western scientific tradition that underlies the modern approach to technical change and innovation had clearly emerged by the seventeenth century and begun to impregnate the educational system. China's education system was steeped in the ancient classics and bureaucratic orthodoxy. It was not able to develop the fundamental bases of modern science.

Europe had a system of nation–states in close propinquity. They were outward looking, had significant trading relations and relatively easy intellectual interchange. This stimulated competition and innovation.

## The Adverse Impact of Internal Disorder and Imperialist Intrusions

Between 1820 and 1952, the world economy made enormous progress by any previous yardstick. World product rose more than eight–fold and world per capita income three–fold. US per capita income rose nearly nine-fold, European income four–fold and Japanese more than three–fold. In other Asian countries except Japan, economic progress was very modest but in China per capita product actually fell. China's share of world GDP fell from a third to one twentieth. Its real per capita income fell from 90 per cent to less than a quarter of the world average. Most Asian countries had problems similar to those of China, i.e. indigenous institutions which hindered modernisation and foreign colonial intrusion. But these problems were worse in China and help to explain why its performance was exceptionally disappointing.

China was plagued by internal disorder which took a heavy toll on population and economic welfare. The Taiping rebellion (1850–64) affected more than half of China's provinces and did extensive damage to its richest areas. There were Muslim rebellions in Shensi, Kansu and Sinkiang. In the Republican era there were three decades of civil war.

The colonial intrusions led to cession of extraterritorial rights and privileges to nineteen foreign powers in a welter of colonial enclaves. There were three wars with Japan and two with France and the United Kingdom. The Boxer rebellion involved a simultaneous armed struggle with all the foreign powers. Russia took 10 per cent of Chinese territory in the 1850s in what is now Eastern Siberia and in the first years of the Chinese republic, it helped detach Outer Mongolia. After all these foreign wars, the victorious powers added to China's humiliation by exacting large financial indemnities.


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The Imperial regime and the Kuomintang were both incapable of creative response to these problems. They did not react positively or effectively to the Western technical challenge. The Ch'ing authorities were incapable of reactive nationalism because they themselves were Manchus not Chinese. After the imperial collapse the warlord regimes pursued regional rather than national objectives. The KMT was not effective in asserting China's national interests. It achieved very little in regaining Chinese territorial integrity and did not respond effectively to Japanese aggression. The Ch'ing and the KMT were fiscally weak and failed to mobilise resources for effective defence and development.

## The Maoist Transformation and its Impact

The establishment of the People's Republic in 1949 marked a sharp break with the past. It provided a new mode of governance, a new kind of elite and a marked improvement on past economic performance. It was the Chinese equivalent to the 1868 Meiji revolution in Japan. However, China set out to create a socialist command economy inspired in substantial degree by the Soviet model, whereas Japan embraced a dirigiste variant of capitalist institutions. Both countries executed their development strategy without intending to provide any role for foreign capitalist interests.

The new Chinese regime was successful in the areas in which the Ch'ing and the KMT had failed. It was able to impose internal order, its ideology was a brand of reactive nationalism and it was able to mobilise resources for defence and development. The commitment to communist ideology and techniques of governance was strongly influenced by China's peculiar history. The colonial intrusion in China had involved all the major capitalist countries and the failure to end it after the Treaty of Versailles in 1919 gave an anti–Western bias to Chinese nationalism. In the 1920s the USSR provided military and organisational support to the KMT and in the aftermath of the Second World War helped the Communist forces to take military and political control in Manchuria. The outbreak of the Korean war in 1950 created an unusual degree of international economic and political isolation for China and meant that the USSR was its only source of technical and financial assistance.

Although the ideological commitment to a socialist economy and rejection of capitalism was very strong in China, the alliance with the USSR was in substantial degree opportunistic. Russia had been one of the major colonial intruders in the past. The USSR had at times supported the KMT against the interests of the Chinese communist party. After the Second World War it treated East European countries as puppet states. The Chinese situation was very different. The new government was not created as a Soviet dependency. It had developed substantial intellectual and political autonomy in two decades of armed struggle.

The new regime had three major objectives: *a)* to change the sociopolitical order; *b)* to accelerate economic growth; *c)* to improve China's geopolitical standing and restore its national dignity.

There have been two very distinct phases of policy and performance since the creation of the People's Republic. The first of these, the Maoist phase lasted until 1978 and the Reform period from 1978 onwards.

From 1952 to 1978 there was a major acceleration in the pace of growth, with GDP rising three–fold and per capita income by 80 per cent. The economic structure was transformed. The industrial share of GDP rose from 8 to 30 per cent. The acceleration in performance was due to a massive increase in inputs of physical and human capital. The capital stock grew by 7.7 per cent a year, labour input rose faster than population. Human capital was improved by significant advances in education and health. However, the productivity picture was dismal. This was a boom period in many parts of the world economy, particularly in Europe and Japan. In spite of its growth acceleration, China grew somewhat less than the world economy as a whole (per capita growth was 2.3 per cent a year compared with a world average of 2.6 per cent). There were several reasons for these disappointing results.

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Economic development was interrupted by major political upheavals. There were changes in property rights, the Korean war, the disruption caused by the Sino–Soviet split, the self–inflicted wounds of the Great Leap Forward and the Cultural Revolution. All these had adverse effects on efficiency and productivity by making the growth path unstable.

Production units were too large. This was particularly evident in agriculture. The 130 million family farms of 1957 were transformed into 26 000 people's communes in 1958 with an average size of 6 700 workers. This was a disastrous move. Within three years, farm management reverted to 6 million production teams with an average size of 30 workers. In industry and services there was also an overemphasis on bigness. By 1978 the average industrial firm in China had eleven times as many workers as in Japan.

China was isolated from the booming world economy. Its share of world trade fell and it was cut off from foreign investment. Resources were allocated by government directives and regulation. Market forces played a negligible role. Hence there were inefficiencies in the production process (as witnessed by the massive investment in inventories) and neglect of consumer welfare.

In the reform period from 1978 onwards major changes in policy were successful in generating substantially higher growth in per capita income. There was a rapid increase in the capital stock, but the major reason for the improvement was better use of resources and substantial growth of total factor productivity.

## Reformist Policies since 1978 Produced Three Decades of Dynamic Growth

There were several forces which contributed to the greater efficiency and faster productivity growth after 1978.

Peasants regained control and management of their land. The average production unit became the farm household employing 1.4 persons on less than half a hectare. There were better prices for farmers and greater access to markets. The result was a big improvement in incentives and productivity.

There was a huge expansion of small–scale industry, particularly in rural areas. The average size of state enterprise did not change, but in the non-state sector it fell from an average of 112 to 8 employees per firm by 1995. Productivity growth was much faster in the non–state sector, which had lower labour costs, virtually no social charges, much smaller and more efficient use of capital.

China made massive strides to integrate into the world economy. The state monopoly of foreign trade and the policy of autarkic self–reliance were abandoned after 1978. Foreign trade decisions were decentralised. Between 1980 and 1997 there was a five–fold devaluation of the yuan. Special enterprise zones were created as free trade areas. In response to the greater role for market forces, competition emerged, resource allocation was improved and consumer satisfaction increased. The volume of exports rose by 15 per cent a year from 1978 to 2006 and China's share of world exports rose from 0.8 to 8 per cent. If Hong Kong exports are included, China was the world's biggest exporter ($1 286 billion, 10.7 per cent of the total) in 2006, Germany was second with $1 126 billion, the United States third with $1 036 billion, Japan fourth with $650 billion and Russia seventh with $305 billion. Its integration in the world economy has been furthered by reduction of its own trade barriers and the greater security of its access to foreign markets thanks to its membership in the World Trade Organization.

In 1978 China had no foreign debt and received virtually no foreign investment. The annual inflow of direct foreign investment rose slowly to $3.5 billion in 1990, but by 2005. it had risen to $60 billion. The total inflow from 1979 to 2005 was more than $620 billion. Chinese foreign borrowing has been relatively modest, a total of $147 billion between 1979 and 2005, most of it long or medium term. The debt structure presents negligible exposure to sudden changes in foreign confidence, the


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Peoples' Republic has never been in arrears on foreign debt and had accumulated huge foreign exchange reserves of $1.2 trillion early in 2007. It has become a significant investor and supplier of foreign aid to countries which supply it with oil and raw materials. China's opening to the world economy has been remarkably trouble free by comparison with the situation in some other Asian and Latin American countries and the successor states of the USSR.

As a consequence of successful policy in the reform period, Chinese per capita income rose by 6.6 per cent a year from 1978 to 2003, faster than any other Asian country, very much better than the 1.8 per cent a year in western Europe and the United States and four times as fast as the world average. Per capita GDP rose from 22 to 74 per cent of the world level. Its share of world GDP rose from 5 to 15 per cent and it became the world's second biggest economy, after the United States. The big question is how long this catch–up process can last and how far it can go?

## The Outlook for the Next Quarter Century

China is still a relatively poor country. In 2003 its per capita income was only 17 per cent of that in the United States, 23 per cent of that in Japan, 28 per cent of that in Taiwan and 31 per cent of that in Korea. Countries in this situation of relative backwardness and distance from the technological frontier have a capacity for fast growth if they mobilise and allocate physical and human capital effectively, adapt foreign technology to their factor proportions and utilise the opportunities for specialisation which come from integration into the world economy. China demonstrated a capacity to do this in the reform period and there is no good reason to suppose that this capacity will evaporate.

It is likely that the catch-up process will continue in the next quarter century, but it would be unrealistic to assume that the future growth trajectory will be as fast as in 1978-2003. In that period there were large, once-for-all, gains in efficiency of resource allocation in agriculture, an explosive expansion of foreign trade and accelerated absorption of foreign technology through large-scale foreign direct investment. The pace of Chinese progress will slacken as it gets nearer to the technological frontier. I have assumed that per capita income will grow at an average rate of 4.5 per cent a year between 2003 and 2030, but that the rate of advance will taper off over the period. Specifically, I assume a rate of 5.6 per cent a year to 2010, 4.6 per cent between 2010 and 2020 and a little more than 3.6 per cent a year from 2020 to 2030. By then, in our scenario, it will have reached the same per capita level as western Europe and Japan around 1990, when their catch-up process had ceased. As it approaches this level, technical advance will be more costly as imitation is replaced by innovation. However, by 2030 the technical frontier will have moved forward, so there will still be some scope for catch-up thereafter.

With such a performance, China should overtake the United States as the world's biggest economy before 2015 and by 2030 account for about a quarter of world GDP. It would have a per capita income like that of western Europe in 1990. Its per capita income would be only one third of that in the United States, but its role in the world economy and its geopolitical leverage would certainly be much greater.

## The Policy Problems of Rapid Growth are Changing

In the projections I made in 1998, I cited three major problems, which might impede China's prospects of high economic growth. One was the difficulty in reducing the role of inefficient state enterprises. A large proportion were making substantial losses. They were kept in operation by government subsidies and failure to service loans which the state banks were constrained to give them.

ISBN: 978-92-64-03762-5  

Their importance has fallen very significantly. In 1993, state employment in manufacturing was more than 35 million; by 2005 it was less than 6 million. In the economy as a whole, state employment fell from 19 to 9 per cent of the occupied population. Hence this problem is no longer likely to be a significant obstacle to rapid economic growth.

A related problem was the weakness of the financial system. In the reform period there was an explosive growth of household savings and rapid monetisation of the economy. Savings were captured by the state banking system and the government had large seigniorage gains from the monetisation process. These new funds offset the disappearance of the operational surplus of state enterprise and the decline in tax revenue.

Although these developments were helpful to the authorities in maintaining financial stability, there were clear dangers in a banking system which operated with a large proportion of non-performing assets due to diversion of private saving to prop up state enterprises which by any normal standard would be regarded as bankrupt. Here again there has been considerable progress. There have been major improvements in the solvability and efficiency of the banking system. Most of the bad debts have been written off and China has attracted foreign participation in state banks by the sale of shares on the Hong Kong and Shanghai stock markets. In the two years since June 2005, more than $60 billion was raised this way and some foreign banks have been allowed to operate in China.

The third related problem was the weak fiscal position of central government. Total government revenue fell from 31 per cent of GDP in 1978 to 10 per cent in 1995. The tax base was seriously eroded by the large range of tax concessions granted by provincial and local governments, as well as by the dramatic fall in revenue from state enterprise. Tax revenue rose to 17 per cent of GDP by 2005, but needs to rise further to extend social protection and strengthen health and education facilities. These social benefits have been eroded by the decline in benefits formerly provided by state enterprises.

***Energy supply and the Environment*:** The problem of energy supply and the environment has emerged as a significant new challenge to China's future development. Electricity supply rose ten–fold between 1978 and 2005 and its availability at rather low prices transformed living conditions in many urban households. Car ownership has also risen and is likely to become the most dynamic element in private consumption. In 2006 there were about 19 million passenger cars in circulation, (one for every 70 persons). This compared with 140 million and one for every 2 persons in the United States. Judging by the average west European relationship of car ownership to per capita income, it seems likely there will be 300 million passenger cars in China (one for every 5 persons) in 2030.

There has been a surprisingly large improvement in the efficiency with which energy is used. In 1973, 0.64 tons of oil equivalent were used per thousand dollars of GDP, by 2003, this had fallen to 0.22 tons. The International Energy Agency (IEA) projects a further fall to 0.11 tons in 2030 in a scenario which takes account of energy efficiency policies the government can reasonably be expected to adopt. Energy efficiency was better in China than in the United States in 2003 and the IEA expects this to be true in 2030.

However, the environmental impact of energy use in China is particularly adverse because its dependence on coal is unusually large and carbon emissions are proportionately much bigger from coal than those from oil or gas. In 2003, 60 per cent of energy consumption came from coal, compared to 23 per cent in the United States, 17 per cent in Russia and 5 per cent in France. Eighty per cent of its electricity is generated by coal powered plants. This means that the ratio of carbon emissions to energy consumption is higher in China than in most countries. In the IEA "A" scenario, China is expected to emit 0.8 tons of carbon per ton of energy used in 2030, compared with 0.63 in the United States and a world average of 0.60.


ISBN: 978-92-64-03762-5 

Chinese coal is particularly dirty, sulfur dioxide and sooty particles released by coal combustion have polluted the air in its major cities and created acid rain which falls on 30 per cent of its land mass. There are more than 20 000 coal mines and nearly six million miners with low productivity and dangerous working conditions. Several thousand are killed every year in mining accidents. In north China there are some coal seams near the surface which burn continuously in unstoppable fires. These environmental problems are likely to be bigger in China than in the rest of the world, as it is more difficult and more costly to reduce the proportionate role of coal.

The other major problems facing China are social rather than economic.

***The Legal System and Private Property Rights*:** China has made giant strides in moving towards a market economy and its legal system allows private enterprise to flourish. Property rights have recently been strengthened, but are a good deal weaker and more ambiguous than they would be in a capitalist economy. Land is still state or "collective" property. Peasants can get 30–year leases for their farms and urban householders can get 70–year leases on their houses; thereafter, their property reverts to the state. It is difficult to sell such properties or use them as collateral for loans. Paradoxically for a socialist country, property rights are weaker for ordinary citizens than they are for domestic or foreign capitalists. Urban developers find it easier than would be the case in a capitalist country to expropriate land of peasants or poor urban residents and demolish their homes without adequate compensation. Influential party officials are able to enrich themselves by conniving in such transactions. These problems have led to increased public protests and punishment of party officials for corruption. The equity and efficiency of the economy would benefit considerably if property rights were strengthened and the judiciary were less subject to official pressure.

***Regional and Urban Rural Inequality:*** Regional inequality is extreme. There is a ten-to-one spread of average per capita income between persons living in China's 31 administrative regions and the gap has hardly changed since 1978. Shanghai has always been top and Guizhou bottom. The divergence could be narrowed by major investment in transport and other infrastructure, improved education opportunity in the low income areas, removal of barriers to migration between different areas and elimination of the tax advantages enjoyed by special enterprise zones in eastern China. However, the mitigation of inter-regional income divergence is likely to be a slow process.

Rural-urban inequality is bigger than in other Asian countries. The gap is biggest in the western provinces and lowest in the east. An important reason is the household registration system (*hukou*) established in the Maoist period to control population movement. It is reinforced by legislation to penalise immigrant workers who seek unregistered employment in urban areas. Despite some easing in the system, they are still denied public services such as health and education, they have difficulty in getting housing and employers who hire them may suffer financial penalties. Hence they are in a weak bargaining position and get low wages for long hours. Their wages are often in arrears and sometimes fail to be paid. These unregistered households are about a sixth of the urban population and their average income is 60 per cent lower than that of registered urban households. It is clear that this discriminatory registration system is a major source of social discontent which is in need of remedy. Removal of the system would certainly increase the urban inflow, but this is in any case inevitable in the long term.

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**ISBN 978-92-64-03762-5**
**41 2007 09 1 P**