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The Chinese Developmental State?

Economic Reforms between Plan and Market

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List of Abbreviations

CCP	Chinese Communist Party
CEPD	Council for Economic Planning and Development (Taiwan)
CESR	Commission for Economic System Restructuring (China)
CPC	State Planning Commission (China)
CRS	Contract Responsibility System
EPB	Economic Planning Board
EI	Education Index
ETO	Economic and Trade Office (China)
FDI	Foreign Direct Investment
HDI	Human Development Index (United Nations)
HRS	Household Responsibility System
IDB	Industrial Development Bureau (Taiwan)
KDI	Korea Development Institute
KMT	Kuomintang
MFT	Ministry of Foreign Trade (China)
MITI	Ministry of International Trade and Industry (Japan)
MNC	Multinational Corporation
PLA	People's Liberation Army (China)
SEC	State Economic Commission (China)
SOE	State Owned Enterprise
TVE	Township and Village Enterprise
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNDP	United Nations Development Programme
WTO	World Trade Organization

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Introduction

In the past three decades the world has witnessed unprecedented economic growth in China. Following far-reaching reforms, Gross Domestic Product (GDP) increased at an average rate of 9.5% between 1978 and 2005, often reaching double digits during the past decade. The contribution of total factor productivity to this growth rose from 11% to over 40% during the Reform Era. Over 40% of rural population lived in poverty in 1980. That number declined within only ten years to 10% and again to 4.8% another decade later. China's participation in world trade, measured in the share of imports and exports of total GDP has jumped from under 10% pre-reform, to 64% in 2005.[1] These are just a few striking figures that illustrate the extent of transformation. In 2010 China replaced Japan as the world's second largest economy, even though its average income is still a fraction of that in the leading industrial nations.[2] This raises the important question, what level of development can China reach eventually?

Preceding China's rise were the remarkable success stories of South Korea and Taiwan.[3] In 1960 the two nations had a GDP per capita comparable to Mozambique or Jamaica and below any Latin American or Middle Eastern country.[4] Currently, both range among the 25 richest nations, again in GDP per capita, and among the 25 most developed according to the UN Human Development Index, which takes into account general indicators of well-being such as life expectancy and education. What is more, not a single country apart from the two city-states of Hong Kong and Singapore, have accomplished this level of 'catching-up growth' in the second half of the twentieth century.[5]

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1 Figures from: Rawski/Brandt 2008

2 One report by the BBC: http://www.bbc.co.uk/news/business-12427321 (Aug 2012)

3 Instead of „Republic of Korea" and „Republic of China" the familiar country terms of „South Korea" or even just „Korea" and „Taiwan" are used troughout the text to avoid confusion.

4 GDP data from Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm (June 2012)

5 Among the wealthiest twenty-five nations are of course the oil rich states of Qatar, Brunei, UAE and Kuwait but none of these made the top league of the HDI. Latest GDP figures from: IMF http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/index.aspx (Aug 2012); Human Development Index from: http://hdr.undp.org/en/ (Aug 2012)

The recent rise of China on the one hand and the preceding and exceptional development of two other nations from the region on the other, raise the issue whether the People's Republic has followed a similar path. The most widely purported explanation that takes the specific experience of South Korea and Taiwan into account is best subsumed as Developmental State model. The central task of this thesis is to apply this model to the Chinese case and ask: *Can China's economic growth be attributed to an emulation of the Developmental State?*

To this end a broad array of literature is reviewed to construct an answer. As the research task concerns a comparative aspect with historical precedents and the specific nature of political institutions to account for economic development, an interdisciplinary selection of literature was chosen: research of the economic history of South Korea, Taiwan and their precursor and role-model Japan are essential to build a general model or analytical template of the Developmental State. Research on China's economic performance and the structure and its political institutions provide the basis for application of the Developmental State model. With the exception of some limited evaluation of economic data, this thesis relies on the critical re-evaluation of secondary sources. Apart from concerns with limited scope, it is important to consider the ongoing nature of China's rapid economic development, including structural changes of state and economic institutions. Therefore, research will focus roughly on the initial two decades of economic modernization from 1978 to 2001. This timespan that starts with the onset of reforms fathered by Deng Xiaoping, covers two top leadership generations of Zhao Ziyang and Hu Yaobang during the first decade and Jiang Zemin and Zhu Rongji after 1989. It ends with the changeover to the third post-reform administration of Hu Jinato and Wen Jiabao, which coincides with China's accession to the World Trade Organization (WTO).

The addendum to the title, 'between plan and market' refers to two underlying themes of the research question: First, it reflects the main points of contestation concerning the East Asian Developmental States, namely the degree and effectiveness of a development plan that implies targeted intervention in the market. Second, it alludes to the fact that China is indeed transferring from an actual planned economy to a market-economy. This general point is so important that it is worth highlighting here: A Developmental State is based on a capitalist market economy in which it interferes to a certain degree.

Broadly, this thesis is split into two parts. Part I will examine the theoretical debate surrounding the main research task and examine the cases of initial East Asian success. Part II is dedicated to applying the foregoing findings to China.

To begin with, chapter 1 provides an overview of the broader historical debate on the nature of economic transformation or industrialization, which frames the issue of East Asian development. Chapters 2 through 4 each combine a discussion of one nation and a corresponding preeminent work of scholarship on the Developmental State. Chapter 5 concludes Part I and sets out to distill the previous results into a model of the Developmental State and discusses each attribute along with its significance when applied to another setting.

That model maps out the successive chapter configuration. The logic of comparison needs to briefly assess historical vantage points in order to grasp how and from what basis the Chinese state has evolved. Thus chapter 6 reviews the Maoist legacies of industrialization and political setup.

Subsequently, chapter 7 considers China's political economy during the Reform Era by first introducing the general organization of the Chinese Party-state and its main institutions, and second through a chronological discussion focusing on reforms of the state apparatus, formulation of a development strategy and actual involvement in the economy.

In chapter 8 the state structure is analyzed in light of properties of a Developmental State: A *meritocratic form of recruitment* of state officials and the degree of *embedded autonomy*, and *insulation* of state organizations.

Chapter 9 will round off Part II by briefly assessing the actual development achievements produced by the preceding institutions and offer some direct comparisons with South Korea and Taiwan. Finally, the conclusion will critically asses to what degree China followed the path of an Developmental State in two decades of economic transition and rapid growth.

PART I – Theories of the Developmental State

Introduction

There is not one single theory describing in general how East Asian states have successfully promoted development but rather a series of case studies identifying various factors usually pertaining to a certain country during its period of growth. What I shall define as a Developmental State may be regarded as combination of various studies in order to have a guiding model against which the Chinese case will be tested. Therefore, it is important to review the history of the concept and some of its most prominent exponents in turn.

Chapter 1 – The historical debate on economic modernization

A central issue of economic history is the transition from pre-modern agrarian to modern industrialized economies. Starting with England in the late 18th century, spreading over Europe, its settler colonies and Japan, this process spread to a number of smaller Asian countries after the Second World War and has engulfed China during the past thirty years as well. Numerous theories have tried to account for two phenomena: What was special about Europe? Did latecomers take a universal path of economic development or did they succeed following a different one?

A Eurocentric approach to the first question (e.g. Landes 1998) ascribes a dominant role to a culture, which has fostered an environment of liberal commercial and market forces since the Middle Ages and first bore fruit in 18th century England. The contending view is offered by the "California School" (e.g. Pomeranz 2000; Wong 1997) by maintaining that the core regions at both ends of Eurasia possessed similar preconditions for an emerging market economy, which were necessary but not sufficient for industrialization. Access to resources and fortunate technological innovation are examples offered for the critical condition separating the West from the Rest.

Transferred to the second question whether later industrializers followed the European path or not, one can find a similar divide. A Eurocentric approach focuses on the development of market forces in late industrializing countries or put differently: Economic development means adopting the relevant European institutions. Whether this happened voluntarily by opening home markets as the neo-classical theory of economics suggests (e.g. Williamson 2000) or forcefully as a neo-Marxist (e.g. Wallerstein 2004) view would have it, does not alter the lens of Eurocentrism. The World Bank's 1991 Development Report summarized its "market friendly" view, which was applied to its famous study of the "East Asian Miracle" two years later:

> "The appropriate role of government in a market-friendly strategy is to ensure adequate investments in people, provision of a competitive climate for enterprise, openness to international trade, and stable macroeconomic management. But beyond these roles, governments are likely to do more harm than good." (World Bank 1991; 1993: 84)

One of the report's authors, Joseph Stiglitz, later offered a criticism of the reductionist approach by the "market-friendly" view, namely that the neo-classical approach is the statistical measurements of inputs – human and physical capital and expenditure on technology – resulting in economic growth. While this provides valuable insights it also leaves unanswered what unique factors were responsible within a country to drastically augment these inputs (1996: 152). Here it is worth to interpret the huge differences of state action but also the similarities of those countries that were most successful:

> "Governments intervened actively in the market, but used, complemented, regulated, and indeed created markets, rather than supplanted them. Governments created an environment in which markets could thrive. Governments promoted exports, education, and technology; encouraged

> cooperation between government and industry and between firms and their workers; and at the same time encouraged competition." (Stiglitz 1996: 174)

Examining the potentially positive effects of more interventionist policies is central for the economic debate, but asking how and why they could be implemented in the first place requires a more general socio-political approach. Adding up state actions does not answer what kind of state lies behind them (Howell 2006: 275). This was the essential contribution of the theory of the Developmental State (e.g. Chang 2006; Amsden 2001; Johnson 1999; Woo-Cumings 1999 Wade 1990). This approach describes a kind of state that drove industrialization in a way that was prevalent in East-Asian countries, above all Japan, South Korea and Taiwan. As the subsequent discussion will reveal, the focus on East Asia does not necessarily imply another cultural explanation. Rather, at the core of the Developmental State model is an institutional explanation of growth in industrial late-comers based on the positive role of the state.

Before one can discuss various theories describing the East-Asian states' role in fostering their economy it is important to define what constitutes *development*. Compared to *economic growth* the term is rather fuzzy and different authors include varying criteria. Economic growth can simply be described and measured as the inflation-adjusted per capita value of goods and services. However, economic development is a normative term and can go beyond aggregate output by including for example such criteria as: Improvements in healthcare, education, welfare and the environment; greater social and/or political equality; a change in dominant sectors of production from agriculture to industry and services; (Perkins/Radelet/Lindauer 2006: 31). Analytically it is useful to set the bar higher and thus arrive at developmental criteria that only few economies have met historically. Howell (2006: 276) defines Developmental States in addition to their normative agendas and social, political and economic institutional setup, by their capacity to deliver not only rapid economic growth but also "general well-being, measured in terms of social indicators such as literacy, health status, life expectancy and per capita income." This approach to development will be taken into account after considering the main theories that focus on state institutions.

Chapter 2 – Japan: Chalmers Johnson's Developmental State

The Developmental States first appearance both historically and as a concept was the case of Japan.[6] In his seminal work about industrial policy in the mid 20th century Japan, Chalmers Johnson coined the term *Developmental State* (Johnson 1982). Writing during the Cold War, he emphasized a form of state-led capitalism that fell between the dichotomy of the western liberal model and the Soviet planned economy (Johnson 1990: 32). As the Japanese faced a world dominated by western powers, nationalism focused on economic strength and justified a powerful state, which could pursue this goal (Woo-Cummings 1999: 5–7). This has not changed before, during or after the Second World War. "Overcoming depression", "war preparation and war fighting", "postwar reconstruction" and "independence from U.S. aid" all required economic development (Johnson 1982: 380). The wartime period did not only spawn Japanese nationalism, but also Chinese communist nationalism and helps in understanding other prominent cases of the East Asian Developmental State such as Korea and Taiwan (Woo-Cummings 1999: 8). Thus, for Johnson, Japan becoming the second largest economy in the world is rooted in "consistent government policies, dating from at least the 1920s." (Johnson 1999: 37) His Developmental State model has the following characteristics:

The *state's highest and consistent priority is economic development* and potentially conflicting goals take a back seat (Maier 2009: 41). Intervention per se does not distinguish Developmental States, but rather its nature: When states in western liberal market economies perform regulatory intervention, they focus

[6] This is not to say that theories about state involvement in economic transformation go back to Johnson, but the term ‚Developmental State' and several specific features discussed here do.

on maintaining rules, but without following a particular developmental goal (Johnson 1982: 17–19).[7]

The development priority leads to the problem of how the bureaucracy interacts with private enterprise. Japan has experimented with three options:

1) Self-control: Private business may operate more freely but is required to report to the bureaucracy. The Zaibatsu[8] performs important economic functions by receiving a cartel granted by the state within an industry.
2) State control: Official direction of enterprise and industry especially during wartime in order to meet military needs.
3) Cooperation: The form of bureaucracy-civilian interaction accomplished by an institution such as the Ministry of International Trade and Industry (MITI).

The later forms emerged after World War II and during the American occupation, when the military ceased to play an important role and the Zaibatsu's economic functions became exclusively that of the state (Johnson 1999: 38).

State guidance of the economy is exercised through a meritocratic elite forming a small but efficient body of officials who identify prospective industries, select the instruments that lead to fast development and regulate competition in order to retain market forces (Johnson 1982: 315). In Japan's case MITI performed this function. Methods used include control of trade and capital controls. The first had been implemented already in 1949 through a law requiring all foreign exchange earned through exports to be sold to a central bank. This foreign exchange budget would be used for targeted industrial policy. The Foreign Capital Law of 1950 established a committee by which basically all foreign direct investment (FDI) had to be licensed by the State and thus conditions could easily

[7] This notion is highly debatable since Western states have historically intervened heavily and continue to do so, often on behalf of special interests (comp. Chang 2006). Nevertheless the point stands that intervention didn't serve a long-term development strategy.
[8] *Zaibatsu* is the Japanese term for the large business and financial conglomerates, which dominated the economy especially during the inter-war period.

be attached. These two instruments resulted in a trade policy geared towards import substitution of finished goods and acquisition of foreign technology (Johnson 1988: 194; 217).

A successful Developmental State further needs a political system that restricts legislative and judicial interference with the economy-guiding bureaucracy by acting only as “safety valves” (Johnson 1999: 38). This means, that the bureaucracy is effectively insulated from interest groups that would seek to lobby the state for individual rather than general benefits.

Finally Johnson underlines “the perfection of market-conforming methods of state intervention in the economy” (Johnson 1999: 39). This would include government financial institutions, the use of tax incentives and the setting of goals for the economy, public- and mixed public-private corporations and government licensing. The label “market-conforming” seems misleading as is best illustrated by the notion that:

> “Perhaps the most important market-conforming method of intervention is administrative guidance. … It is necessary to avoid overly detailed laws that … put a strait jacket on creative administration. … Highly detailed statutes serve the interests of lawyers, not of development.” (Johnson 1999:39)

What essentially conforms to the market is the freedom of a managerial and bureaucratic elite, consisting of public and private elements, to pursue a national development goal using the above-mentioned instruments at their own discretion. MITI supposedly realized these features to a degree hitherto not seen in any other industrialized state (Johnson 1999:39). The important question then becomes whether the Japanese Developmental State is a reproducible model or somehow unique. Johnson suggests something in between: In order to be effective, the Japanese model needs a society committed to industrial development. In effect, the economy was “mobilized for war but never demobilized during peacetime” (Johnson 1999: 41). This implies two sets of hurdles for potential emulators. For relatively more liberal societies such a departure from free markets would go hand in hand with high political costs. For relatively less liberal countries in most of the developing world, concentrating more economic power in state hands without the societal commitment to a common development goal is prone to corruption and monopolistic practices. It is therefore necessary to examine the only two countries that fit the label together with important studies of their successful economic development.

Chapter 3 – Taiwan: Robert Wade's theory of the Governed Market

Wade pointed out that Johnson had successfully characterized the Japanese Developmental State, but did not offer a proper theory of it. Wade's *governed market theory* builds on the basic ideas of Johnson, but is set in the context of the controversy of developmental economics between the neo-liberal or Washington Consensus view and the proponents of varying degrees of state intervention (Wade 1993: 26).

The main conclusion offered was that East-Asian success was based on:

1) Very high levels of productive investment, making for fast transfer of newer techniques into actual production
2) More investment in certain key industries than would have occurred in the absence of government intervention
3) Exposure of many industries to international competition, in foreign markets if not at home.
   (Wade 1993: 26; exact quotes)

The key point is that a governed market consciously strays from pareto-efficient resource allocation in the short run in order to accommodate a successful long-term growth strategy that would not have been the outcome of a completely free market. The East-Asian experience of Japan, South Korea and Taiwan have followed this strategy in various configurations and they have seen high economic growth rates in the second half of the 20th century. Wade's research tries to move beyond this correlation to find a causative structure.

It is further necessary to distinguish between a corpus of economic policy measures, which promise certain effects and the political economy capable of enacting them. It is helpful to consider the kinds of measures determined by Wade as underlying Taiwan's success before turning to the structure of the bureaucracy and the state in general:

Regulation of foreign trade and capital flows was used by the state to mediate between a need for national capacity building without curbing incentives by sheltering local producers from international competition. Therefore protectionist measures were neither erected uniformly nor under pressure of powerful interest groups. Rather an industry-bias emerged, consistent with a wider development goal. Selected export industries had no anti-export bias, as was the case with other developing countries, while the import-competing industry received ample incentive to sell domestically (Wade 1990: 116–117). FDI was channeled towards joint ventures and technology transfer. Local content requirements and restrictions on remittances were subject to negotiation, depending on the interest of the government in the respective foreign firm (Wade 1990: 148–157).

A policy of stable exchange-rate devaluation served as an export incentive together with concrete policies such as allowing exporters larger entitlements to foreign exchange or concessional export credits. In addition, tax alleviations for specific industrial goods were tied to export volume requirements (Wade 1990: 119).

The tariff regime was designed in a way not to hinder raw materials and components necessary for export goods, while duties on machinery were tied to the existence of local suppliers or whether they were used in specific industries wherein expansion was pushed strongest. The items permissible for duty exemption were specifically listed. Non-tariff barriers accompanied this regime, geared towards export promotion (Wade 1990: 127ff.)

Besides selective protection, the Taiwanese government has engaged in active export promotion, especially during the 1960s and 70s, which had been gradually scaled back since then. Export processing zones were established, wherein firms had been required to export all of their production in return for tariff exemptions, access to infrastructure and simplified administrative procedures. Furthermore, even if producers were required to favor local providers of inputs, their protection was conditional on converging their prices with the world market (Wade 1990: 139–41). The already mentioned export credits were provided with regard to firms export performance and future plans. Even export cartels were promoted by setting quotas for individual members. Wade concludes that:

> “The state has interfered in trade not less, but differently, than many other developing countries. As gatekeeper of the national economy, it has scrutinized inflows and outflows and affected the terms of transactions in line with national objectives.” (Wade 1990: 157)

Considering the evident incompatibility with neo-classical theory of trade distortions, it is important to remember that the governed-market theory focuses on the interplay of several components of state initiative, which have to work together in order to function. The Taiwanese government has pursued its development goal with other methods, complementing the policies on foreign trade and investment. Complimentary arrangements involved the banking system, national enterprises, a fiscal investment scheme and the national budget directly (Wade 1990: 159).

The Taiwanese financial system had not been diversified, but was dominated by state owned banks. While a curb market existed, mainly small businesses depended on it, while large and medium size firms received financing through the banks. All their transactions had to be reported to the central bank on a weekly basis. Bank loans were preferential since they came at a lower cost than the curb market; the government had set priority industries for them (Wade 1990: 161–8).

In the three decades from 1950–1980 public enterprises had an average share of 11.7% of GDP at factor cost.[9] They were concentrated in capital-intensive sectors with high linkages to downstream markets such as petroleum refining, petrochemicals, steel, shipbuilding etc. Historically these enterprises had been linked to strategic considerations and the military. But they also served the purpose of easing access for private firms to sectors with high entry barriers. During the 1970s public enterprises have accounted for 10% of the government's net revenue (Wade 1990: 180).

Another industry promoting tool were specialized funds out of the government budget. The Sino-American Fund for Economic and Social Development, established in 1965, was intended to foster innovation and increase productivity and trade. The Development Fund from 1973 targeted specific technology-intensive enterprises in accordance with economic planning (Wade 1990: 169). Tax incentives favor technology-intensive enterprises as well. Eligibility combined a strategic pre-selection of products with performance standards.

Together these measures amount to a high degree of interference in the free market, but as Wade points out:

> "Taiwan's industrial policies affect firms in the small scale sector very little, at least until those firms wish to deal with the international economy; and even then the *potential for discretionary intervention* is by no means generally used. For large parts of the economy, the policy strategy has been to structure the incentive environment in such a way that *autonomous profit-seeking will lead firms to behave in ways that aggregate up to national goals* — or at least not aggregate to something inconsistent with national goals."
> (Wade 1990: 192–3; emphasis mine)

[9] Calculated from three year averages provided in Wade 1990: 177; orig. in Short, R: The role of public enterprises: an international statistical comparison (Department Memorandum Series 83/84/International Monetary Fund/Washington D.C./ 1983); The calculation at factor cost rather than at market prices excludes subsidies and indirect taxes.

The two arguments emphasized here again point to the central feature of the governed market theory, namely the use of a general economic plan requiring resource allocations which differ from short-term oriented market forces, without stifling free enterprise. This seems like a walk on a tightrope. The second aspect of Wade's theory, and the one central to Johnson's study of Japan, is the institutional arrangements and the polity that upholds them. The specific policy mix is less important than the existence of a state with the capacity to implement, coordinate and adjust it in pursuit of national development. In practice, this requires the state to have a bureaucracy specialized for this purpose.

There was no single pilot agency in Taiwan such as MITI in Japan, but rather one informal and one formal body acted as the "economic general staff". The Council for Economic Planning and Development (CEPD) was advisory to the cabinet but employed a staff of over three hundred. It consisted of selected cabinet members and the governor of the central bank. Their job was to analyze the current economic situation, to evaluate large projects by state enterprises and to formulate macroeconomic development plans. Since the council had no official authority it acted as a bridge between different ministries (Wade 1990: 196).

The central institution for governing the market was the Industrial Development Bureau (IDB). It was responsible for drafting detailed plans with consideration of the CEPD's general plans. Its powers covered issues of trade and foreign investment as well as domestic industrial policy. It directed the above-mentioned tools and concessions for industrial promotion and had less to say on monetary matters of course, but was involved in tax policy and worked together with the Ministry of Finance (Wade 1990: 201–8).

The top decision makers of industrial policy usually had previously served in public enterprises or different government agencies and were integrated into an informal network of working relations across relevant institutions. The personnel was recruited from the top tier of graduates and consisted predominantly of engineers rather than economists (Wade 1990: 225).

Most importantly, these institutions were not marginalized in the executive branch but right at the center of power. Due to their mission as planners, both institutions promoted the long-term developmental strategies in their dealings with the individual ministries or the central bank. The latter two needed to devote their resources to the day-to-day business. Finally, this leading economic bureaucracy was largely insulated from special interests. This last point needs to be examined more closely within the context of Taiwan' political system.

Taiwan was characterized by Wade as an "authoritarian-corporatist" state, during its catching up phase prior to 1987 (Wade 1990: 228). In terms of policy setting capabilities, this political structure makes the rulers much less reliant on expressions of popular preferences. In addition they were insulated from interest groups that would have voluntarily formed outside the political elite.

Similarly to Johnson, Wade points to the situational as well as cultural aspects, which benefitted the formation of one-party states. As in the Japanese case, the Kuomintang (KMT) and their formation of the new State was shaped by World War II and in addition by the civil war. Moreover, the newly arrived KMT came across the remnants of the extremely authoritarian colonial structures from the sixty years of Japanese rule (Wade 1990: 229–231). According to Wade, the "Japanese colonial administration [of Taiwan and Korea] had carefully limited the growth of organizations in native hands. Distinct from other colonialisms, the Japanese administrators did not build dispersed strongmen as their agents of rule; and no Western entrepreneurs had independent access to the economies through which to make reinforcing deals with organizations outside the state." (Wade 1990: 338)

But there were two pronounced differences to Johnson's model of Japan: One was the role of politicians as safety valves and as separate from the bureaucratic elite. In a one-party state these functions are rather fused together. The second deviation only concerns the "cooperation stage" of Japan after the war, namely the role of the military. In Wade's words:

> "[Contrary to Japan], Taiwan, like Korea, is not merely a militarized regime, but a militarized society. The military has veto power over the selection of top-most political leaders; and beyond this, it inculcates military notions of discipline, authority, and vigilance throughout society." (Wade 1990: 253)

The Taiwanese state built on an authoritarian and centralized tradition. Coupled with the geo-political and historical potential of armed conflict it had the means and the incentives to pursue a long-term development strategy. Maybe the regime also required rising living standards to bolster its legitimacy. Probably the state's consistent involvement in the economy can be explained by a combination of internal and external factors. How about explaining their success?

As mentioned, the main argument of the governed market theory focuses on the deliberate deviation of short-term goals in order to reach sustained growth in the long run. The main point of criticism is the inability of the state to pick winners. Here Wade argued that by coordinating different tools, East Asian governments *made winners* (Wade 1990:334). This required a sustained government commitment, which could be undermined by corruption and abuse of power. Thus, Wade's characterization of the "authoritarian-corporatist" or more generally "hard" state is crucial (Wade 1990: 337). The insulation from popular preference and private interest groups limits corruption, but this cannot explain a lack of power abuse. Unfortunately this last issue remains somewhat open. The reason for the emergence of a "hard state" are summarized by Wade as follows:

> "Initial social disruption [losing the civil war], threats from other states [China], poor natural resource endowment, and the social basis for an independent bureaucracy all strengthened the governments hand and helped maintain the edge of their commitment to economic development." (Wade 1990: 341)

These issues were not the focus of Wade's study. It suffices to establish that the political structures were adequately described, without providing a detailed analysis of their origins. The existence of a "hard state" must be treated as a general precondition for a Developmental State, but the degree of "hardness" may obviously vary, considering Japan's very reduced version. It is important not to misinterpret that feature as an endorsement of authoritarianism for the sake of economic growth. After all, truly totalitarian states like North Korea are seldom role models for development. The essential features of a hard state are the capacity to pursue a development strategy independently. Furthermore, as Stiglitz has argued as well, adaptability of government policies was essential for continued growth: "Government policies adapted to changing economic circumstances, rather than remaining fixed. As the East Asian economies grew more complex, government had less need to assume an active role and found it more difficult to act effectively on a broad scale." (1996: 172) Thus, independence from special interests without being out of touch with society are the most important features for a Developmental State, otherwise a sensible development strategy might be captured or misdirected over time.

Based on Johnson's description of Japan, Wade has sought to create a more comprehensive theory of how East Asian states have successfully "governed the market". The focus lies on state institutions, namely a bureaucracy selected by merit that is insulated from special interest but connected with the private sector, allowing the formulation, coordination and adjustment of a long-term development policy. The other successful case for industrial catching up, Korea, has similar attributes and will be discussed on the basis of Alice Amsden's theory of growth through the *independent asset approach*.

Chapter 4 – Korea: Amsden and the most successful "riser of the rest"

Amsden's work on the "rise of the rest" is not a case study on South Korea, but rather a broad comparative study of those states, which have successfully accomplished fairly continuous growth of manufacturing output during the second half of the 20th century, that she collectively calls the "Rest" in contrast to the "West". The group comprises China, India, Indonesia, Thailand, Malaysia, South Korea and Taiwan in Asia, Turkey in Europe and finally Brazil, Mexico, Argentina and Chile in Latin America. These countries had already to a degree acquired manufacturing experience before World War II and were capable of moving into mid-technology industrial production (Amsden 2001, p. 1). This analysis builds on her earlier work, focusing on "Asia's Next Giant" South Korea (Amsden 1989).

At the outset is the historical sequencing of industrialization that separates pioneers and innovators from learners. The means for agrarian societies in the twentieth century to catch up meant "using processes conceived by unallied economic and political units." (Amsden 1989: 3). The crucial barrier remained the acquisition of sufficient "knowledge-based assets" in the sense of "proprietary concepts". They include managerial skills as well as technical know-how. Three technological requirements are distinguished:

> "*production capabilities* (the skills necessary to transform inputs into outputs); *project execution capabilities* (the skills necessary to expand capacity); and *innovation* capabilities (the skills necessary to design entirely new products and processes)." (Amsden 2001: 3)

Even though the "Rest" possessed that record of industrial production, the skill deficit in all three categories relative to the first and second wave industrializers was considerable. Thus, all those countries, except for Argentina, met this backlog demand by building an institutional control mechanism through state institutions. Following the infant industry argument, local producers who were not competitive enough for the free world market needed state assistance. The downside of moral hazard and disincentives to gain productivity are evident. However, by applying the "principle of reciprocity" meant that the state would institute performance standards for selected industrial producers in exchange for protective measures and subsidies. The goal was to get firms to gain the necessary knowledge-based assets needed to eventually compete without protection or subsidies (Amsden 2001: 8). More precisely, investment was needed in large-scale production units, skilled labor in the managerial and technological fields and distribution networks (Amsden 2001: 70–98).[10]Or put a different way, the three sets of capabilities quoted above needed to be realized in fixed capital and human resources in addition to gaining market share.

All countries in the "Rest" approached this strategy at first by subsidizing their import substitution industries. What eventually divided the group was the export quota extracted from the targeted sectors (Amsden 2001: 161). Where exporting was made part of performance standards, export shares in GDP skyrocketed. The causes for this division lie with the historically prevalent nature of manufacturing experience and also with the degree of income inequality.

Three distinctive but not exclusive kinds of manufacturing experience prevailed among the "Rest": Pre-modern – stemming from pre-industrial artisan production as for example in India, China or the Ottoman Empire. Émigré – the experience brought in by immigrant traders and artisans such as the Chinese communities all over South-East Asia, foremost in Singapore. Colonial – depending on the nature of the colonial ties, knowledge was transferred and in many cases fixed capital in industry brought in. The colonial ties were either European or Japanese. Considering the success of Korea and Taiwan, the latter is considered by Amsden to have been the most valuable (Amsden 2001: 15; 161).

The reason for this is not the extent of actual fixed capital that was inherited from the Japanese. Indeed, measured in manufacturing value added per capita, Korea ($5) and Taiwan ($6) in 1948 compare poorly with most Latin American countries at the time, which exhibit values between $17 in Peru up to $137 for

[10] Amsden follows the classic principle of „three-pronged investment" as presented by Chandler Jr.: Scale and Scope: The Dynamics of Industrial Capitalism, Cambridge Mass. 1990

Argentina (Chang 2006: 169).[11] Rather, as mentioned above, the organizational structure of firms and industrial sectors was decisive.

The other dividing factor was the level of income distribution. After World War II, countries in Latin America had higher inequalities in land and income distribution, while Japan, Korea and Taiwan were among the most equal societies in this regard (Amsden 2001: 18). These disparities result in a distinction of two developmental models. On the one hand, the *Integrationist* group includes those countries without a strong colonial manufacturing experience and which exhibit a high income-inequality. On the other hand are the *Independent* group; those countries with extensive colonial manufacturing experience and equal societies. The labels do not refer to the original differences but rather to the diverging path of industrialization taken. The Integrationists featured a smaller average firm size, a policy that targeted exports less and a preference for the "buy" decision when acquiring new technology. The Independents had the opposite features of large national firm leaders, a policy targeting exports and preferring the "make" decision for technological innovation (Amsden 2001: 205–6).

Unequal income distribution is a source of social and political uncertainty and thus limits the time horizon under which firms and officials operate. It favors the "buy" decision instead of the long-term approach of the "make" decision. In addition it pushes states towards a diffusion of assets in order to prevent further unequal distribution. This aspect corresponds to Wade's emphasis on the capabilities of hard states to extract and pool social resources. In addition, where income inequality is based on rents outside the manufacturing sector, e.g. large land holdings, it tends to draw or keep a countries elite form engaging in industrial capacity building (Amsden 2001: 205–6). In the opposite case according to Amsden:

[11] Values are given in 1958 Dollars; Original source: United Nations, The Growth oft he Word Industry, 1938–1961, 1965

> “[A]n existing equal income distribution may be hypothesized to favor long-termism and, paradoxically, a greater tolerance for rising concentration. To offset the social costs of rising concentration, targeted firms are subject to performance standards. Over time the most important standard involves heavy expenditure on R&D and other forms of learning.” (Amsden 2001: 206)

This point is reinforced on a more general level by Stiglitz, who argues that government policies that supported income equality are an integral part of overall political stability, which in turn nurtures cooperative behavior of the private sector in form of an improved business climate and ultimately promoted economic growth (1996: 172).

Taiwan and Korea are the foremost examples of the independent path to development. This approach is fundamental for the model of the Developmental State, since it corresponds to the preceding research of Johnson and Wade. Because the Taiwanese case has been elaborated above, I will solely present Amsden’s findings for South Korea’s industrialization, but it should be noted that they correspond strongly to Wade’s study.

South Korea

Under the treaty of Shimonoseki, which ended the Sino-Japanese War of 1894–5, the Qing dynasty had to relinquish its influence over the Korean peninsula. Subsequently, soon after proving victorious in the Russo-Japanese war, the Japanese occupied Korea in 1910. Since that time, Japan began to invest in industrial production there. The result was the creation of a proletariat, used to wage labor. By 1940 industrial output, almost non-existent before, was almost equal to agricultural production (Amsden 2001: 102). The inclusion of native Koreans in salaried management gradually increased, even if most firms remained foreign-owned (Amsden 2001:105). The Japanese *Zaibatsu* served as the role model for the Korean *Chaebols* and thus transferred knowledge of production techniques as well as “project execution skills (in both private *and* public sectors)" (Amsden 2001:103–5). The manufacturing experience falls clearly in the colonial category.[12]

What distinguishes the *independent* industrializers, such as Korea, was a sudden disruption of firm ownership after decolonization. Japan's unconditional surrender in August 1945 and the subsequent division of the Korean peninsula created the most abrupt decolonization and transfer of ownership in industry, paving the way for repatriating firms under state guidance towards a concentration of assets (Amsden 2001: 121).

Postwar reforms in Korea created a relatively equal distribution of land following redistributive reforms; other measures of economic equality draw a similar picture. "Over half a century after World War II, Korean income distribution supposedly did not become substantially more unequal. […] In fact, regional income inequalities in Korea were very low compared with those in Argentina, Brazil, China, Mexico and India." (Amsden 2001: 18).[13] Korea, having not only a highly equal distribution of income, but also the least division by class, race or ethnicity could establish the most national firm leaders and largest business groups (Amsden 2001: 237).

By 1985 Korea had twenty-one firms among the top fifty of the "Rest" measured by sales (Amsden 2001: 202). All shared the fact, that they had been targeted as recipients of intermediate assets in return for maintaining performance standards by the government (Amsden 2001: 193). In 1993 the largest enterprises were Hyundai, Samsung, LG, Daewoo, Samsung Co. Ltd. and Sunkyung. Among the top fifty were twenty-seven from Korea (Amsden 2001:

[12] „Taiwan's manufacturing experience before *the 1960s* was possibly as extensive as Korea's, although with different timing and weights attached to different elements, given the crucial fact that Taiwan benefited not only from Japanese mentoring but also from an influx in the 1950s of large numbers of experienced workers, managers, and entrepreneurs from the Chinese mainland." Amsden 2001: 105

[13] According to a UN-study in 2008 of income distribution, Japan ranks number one, Korea comes in fourth and Taiwan ninth. Source: Davies, James B.; Sandström, Susanna; Shorrocks, Anthony and Wolff, Edward N. : The World Distribution of Household Wealth (WIDER Discussion Paper/ Vol. 2008/03) online at: http://www.wider.unu.edu/publications/working-papers/discussion-papers/2008/en_GB/dp2008-03/; For more detailed information see Chapter 9.

198). Since the state had induced these firms to invest in R&D, its share of GNP had reached “western levels” by 1990 (Amsden 2001: 241).

What is more, the Korean state had followed the Japanese model of export promotion. In the period from 1950–1992 the average growth rate for exports in Korea was 26.3% (20.3% for Taiwan), compared with 10.2% in Brazil or 7.9% for India. (Amsden 2001: 162). Korea thus fulfills all of Amsden’s criteria that distinguish “the Rest”. Furthermore it spearheaded the more successful independent state-led approach to industrialization.

Colonial manufacturing experience and a relatively equal distribution of wealth can be seen as historically adjuvant sources to catch-up industrialization. The goal is developing export-oriented large-scale companies that achieve “learning” in production, execution and innovation capabilities. The tools for achieving this were capable state institutions: “*Where Korea differs from most other late industrializing countries is the discipline its state exercises over private firms*.” (Amsden 1989: 14; e.a.)

Korea’s pilot agency was the Economic Planning Board (EPB), established in 1961. It was responsible for formulating the longer-term strategy and guidelines by analyzing both the international economic environment and national capacities. Individual ministries then dealt with their respective sector. Similar to the informal CEPD of Taiwan, the Korea Development Institute (KDI) was added a decade later to provide technical analysis and assistance (Kwack 1990:70). These institutions exhibit the two key features of operating beyond the influence of special interest groups while being connected to the private sector. Certainly, personal relations and favoritism cannot be completely excluded when government is so strongly involved in guiding economic efforts, but Korea has retained the key policy of rewarding good and penalizing bad performers. Amsden concedes that:

> “The bail-out process has been highly politicized insofar as the government has typically chosen close friends to do the taking over of troubled enterprises (the

> production facilities of troubled enterprises are never allowed to rot). This corruption notwithstanding, when the victim of bankruptcy has appeared to be poorly managed, the government has deserted it." (Amsden 1989: 15)

Aside from government rescue, discipline requirements were especially strict for meeting export targets. As way of support the state in Korea actually controlled commercial banking, used subsidies and limited entry into target industries, yet it countered monopolistic behavior by limiting a number of commodity prices as well as capital controls – much like in Taiwan (Amsden 1989).

At the heart the argument lays the fact that latecomers to industrialization have always faced different obstacles and for those of "the Rest", developing after World War II, the major hindrance was a lack of knowledge backed assets, necessary to compete in an oligopolistic world market with established firms, which already possessed them. Catching up meant having a Developmental State induce investment in production capabilities, project execution capabilities and innovation capabilities by sheltering domestic producers from global competition while pushing them to develop these skills and assets. Too little government support would prevent national firms to acquire the necessary skills to be more competitive, while the same would be true if the state offered unconditional protection, generating firms that are dependent on continued subsidies and protection from international competition as was often the case in Latin America.

The most successful states achieved this balance thanks to a colonial manufacturing experience and a transfer of ownership through abrupt decolonization. This granted the economy a foundation to build on, while granting the state easy access to productive assets. Additionally a relatively balanced income distribution provided the social and political stability for implementing a long-term strategy without having to deal with organized opposition of would-be losers who benefit from a given unbalanced distribution of wealth, such as vast landholders.

For the acquisition of knowledge-based assets it was crucial to support large-scale national private firms that focused on exporting and thus international competitiveness. An industry's growth was assisted by subsidies, while its development of knowledge-based assets was induced by attaching performance standards as a condition to receive intermediate assets by the state. Though a vast range of policies were available and different mixes were applied by the three countries discussed, the common denominator was a state with the institutional capacity to help the private sector strive internationally. In the next part the theories presented thus far are integrated into a model of the Developmental State, against which the Chinese experience can be compared.

Chapter 5 – The Developmental State Model

As has become clear, the Developmental State cannot easily be described as a general model for industrialization because several essential factors are very specific to the three East Asian states discussed. Japan even has to be set apart, as it had already undergone industrialization during the 19th century; only its developmental regime after World War II had all the essential characteristics that served as a role model for Taiwan and Korea. The latter two countries then are the only two that fulfill all requirements of a Developmental State, which can be grouped into three themes: *Historical vantage points*, *institutional structure*, and *development strategy*.

The historical conditions offer some indication why specific institutions evolved assuming a degree of path dependency. However, the main research question is whether China has followed the Developmental State model and therefore the focus lies on the nature and effectiveness of political and economic institutions. The development strategy and policy mix that are actually implemented can be seen as second tier explanations, since no matter what they encompass, only sufficiently capable institutions can design, coordinate and adjust them.

The Developmental State model derived from the reviewed scholarship is summarized in Table 1. The attributes of a Developmental State and their significance for economic growth are in separate columns. This is highly important when one departs from the well-established case studies, since too many variables separate each polity and complicate any effort at comparison. However, by keeping in mind what significance a certain historical event or institution has for economic development it is possible to identify the existence of different attributes that may render the same outcome. On the other hand the same attribute may lead to a different outcome due to an interfering variable. In addition, a fourth point is added, to take account for the actual development achievements that define a functioning Developmental State. As indicated above, this includes GDP growth as well as other social indicators of well-being.

Table 1 – Developmental State Model

	Attribute	Significance
1.	**Historical vantage points**	
1.a	Colonial manufacturing experience with centralized organization and exclusion of Western influence[14]	Existing base of industrial structures and know-how from an already industrialized nation
1.b	Complete disruption of ownership structures after decolonization	Blank slate for state and/or indigenous ownership
1.c	Initial equal income distribution	Better social cohesion and thus more scope for state action
1.d	Other nations perceived as rivals or threats	Urgency on developing economic and military strength
2.	**Institutional setup of the State**	
2.a	Long term development strategy	Consistency; allows for investments that only pay off in the long run
2.b	Centralized "pilot" agency	A locus of competencies for coordination and adjustment of policy; conception could derive from multiple sources
2.c	Insulation of the state bureaucracy	Reduces private interests and public pressures that run counter to the long term development strategy
2.d	Embedded autonomy	Access to and influence over civil society in order to pursue the common development goal and to receive accurate feedback
2.e	Meritocratic bureaucracy	Induces a nations top graduates to develop and to administer the development strategy; counters corruption
3.	**Development outcomes**	
3.a	GDP growth	Standard measure of economic success
3.b	Income distribution, Education, Health	Broader measure of societies well-being

[14] Atul Kohli also examines the Japanese lineages of industrialization of colonial times. He concludes that „the roots of economic dynamism in the critical case of South Korea are located, at least in part, in the state-society relations created under the auspices of Japanese colonialism. This finding, in turn, directs attention to unique aspects of Japanese colonialism: as a late developer, who had perfected a state-led model for catching up in the world economy, Japan in its colonies constructed a political economy that also turned out to be well suited at catching up." (Kohli 1999: 136)

The attributes and their significance listed in Table 1. vary qualitatively. Under the seemingly broad heading of ”historical vantage points” four features were chosen.[15] The first two are *colonial manufacturing experience* and a *disruption of ownership*, transferring the preexisting industrial structures to private nationals or the state. These are not general preconditions but historical facts that characterized important starting points for the South Korean and Taiwanese Developmental States. If their model is to be emulated by China or any other economy, the existence or lack of these circumstances needs to be considered. Furthermore, *relative income equali*ty improves social cohesion and lowers resistance by social groups that benefit from an unequal distribution of assets. Finally, a *perception of outside threat*[16] serves as an incentive to prioritize national development over other strategies, for example maximizing asset extraction in the short run by elites (Pei 2006). This aspect is not merely important as a historical vantage point but stays relevant throughout the development process.

Chapter 6, starting off Part II, will examine the Maoist legacy and the dawn of the Reform Era in these terms. Taken together, the set of attributes provides for conducive conditions and the incentives for the evolution of a Developmental State. Their inclusion points to the rejection of culturally motivated explanations of East Asian economic development and shifts the focus to the nature of institutions.[17]

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[15] The historical conditions chosen here were derived in Part I from the main proponents of the Developmental State theory. There are, however, a long list of „initial conditions“ that were at one point or another used to explain the „East Asian Miracle“ such as initially high human capital endowment in the North-East Asian economies (World Bank 2003: 15). It is worth considering a critical analysis by Chang (2006:143f.) of several initial conditions as applied to Japan, Korea and Taiwan: In terms of human resource endowments, including literacy rates and school enrollment, East Asia was slightly better endowed than Sub Saharan Africa (SSA) before 1950 and clearly worse off than Latin American countries (153). Concerning natural resources, and the argument that an abundance of them actually acts as a curse, Chang points to the vast differences of well-endowed developed regions, such as Australia, Canada or Scandinavia. Furthermore, the variance for developing SSA countries is so vast, that it contradicts a strong causality of a resource curse (157).

[16] The impact of the international political environment is rather scarcely considered by Amsden and Wade, their focus lies on imbalances of world trade. T.J. Pempel offers a compelling analysis of the international economic conditions for the Developmental State (See: Pempel 1999)

[17] For a critique of cultural explanations of differences in economic development in East Asia in particular see: Jones 2002, p. 98–114; A criticism of the idea that Confucianism had fostered East Asia’s high savings rate is offered in: Chang 2006: 19; Lin (2007: 10–11) also makes the excellent

Point 2a and 2b of Table 1 encompass the institutional setup of a Developmental State, which must conform to a *long-term development strategy* coordinated and adjusted by *centralized agencies*. Chapter 7 considers this point, while offering a chronological and detailed discussion of China's political economy during the Reform Era. As points 2c and 2e indicate, the Developmental State requires an *insulated bureaucracy* that is free from special interests to design and pursue this strategy and it needs to have a form of *embedded autonomy*[18] in order to implement and coordinate with actual producers and businesses of the private sector. To this end, the recruitment of officials and bureaucrats needs to be based on *merit* in order to optimize outcomes. Evidently, these attributes are highly idealized, yet their existence only needs to be established to a significant degree. Chapter 8 will examine whether the Chinese state has evolved comparable institutions and thus had complied to the Developmental State model.

The actual developmental strategy and policy are the outcome that functioning institutions of a Developmental State aim for. As mentioned, they constitute second tier explanations for the present research agenda. The case studies have indicated some commonalities: A focus on exports - by itself, this is uncontested by neo-classical authors, but the issue is whether the state could enhance export performance by diverging from a free market strategy. At any rate, the Developmental States have implemented several policies that targeted exports:

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point that culture is "a given or slowly changing factor. The difficulty of taking culture as the fundamental detriment of economic development is that it cannot explain why a country suddenly takes off after a period of long stagnation—such as the NIEs in East Asia in the 1960s and China and India after the 1980s. Neither can it explain why countries with the same culture—such as South Korea and North Korea, as well as West and East Germany—have dramatic differences in economic performance. Moreover, culture can change as a result of economic development—rather than being a cause of it."

[18] This term was coined by Peter Evans (1995: 59): "It is an autonomy embedded in a concrete set of social ties that bind the state to society and provide institutionalized channels for the continual negotiation and renegotiation of goals and policies" (1995:12) I use it here to encompass the feature discussed above under the designation of „state-civilian cooperation" (Johnson), and the „authoritarian-corporatist state" (Wade) as well as Amsden's „principle of reciprocity". I have separated points 2c and 2d to underline the distinction of being independent when planning from coordinating with civil society and adapting the strategy in accordance with feedback of the private sector. For further discussion of State-Autonomy and its role for development see Polidano 2001

On the macro level, currencies were undervalued in order to make indigenous products more attractive on the world market.[19] This serves the underlying goal of acquiring foreign exchange that is needed for importing advanced technology. In addition, protection of infant industries allows native firms to enhance productivity until they can compete internationally.[20] To this end a certain industry and firm size is needed to gain from economies of scale and to receive a profitable return on R&D costs. Developmental States have targeted national champions by inducing mergers and providing the already mentioned conducive policies towards specific sectors. Again, the goal is to enable competition with the established MNCs. Finally, a preference for indigenous production is essential where increased know-how is involved. This usually pertains to reaching higher value-added stages of a production chain, which is the ultimate mark of a developed economy.

The actual mix may differ and apparently similar policies can lead to different outcomes. For example, import substitution was soon abandoned or scaled back in East Asia, while it led to overly dependent firms in other countries. Neo-classical economic modeling often points out the inefficiencies of state interventionism, while other approaches point to the lack of practical applicability of such assumptions. It is beyond the scope of the present study to evaluate a large set of policies in detail from different theoretical perspectives. The range of current scholarship has become narrower though, a point the conclusion will pick up with respect to China.

[19] Additional export promotion tools were discussed above in Chapter 3 and include subsidized loans, export rebates, special exporting zones with preferential tax breaks etc. Lin (2007) emphasizes this point by underlining that a successful development strategy needs to suit a country's comparative advantage. Having viable exports is a good indicator of a comparative advantage. Chang 2006 disagrees by pointing to an aggressive strategy of pursuing more technologically advanced products.

[20] Chang (2006:33–34) reiterates the point that the two strategies reinforce each other. But the one-sided policy of import-substitution to protect local industry without an export promotion program hinders the advancement of competitiveness, as experienced by Latin America. Summing up he states: "the point about infant-industry protection is not to ignore the principle of comparative advantage altogether, but to *strategically* violate it, knowing that this will result in a loss in current income but will make it possible, if properly done, to develop new industries which can put the country on a higher growth trajectory in the medium to long run" (34)

In Chapter 9 the findings for the People's Republic are put into context with actual development achievements not only in GDP growth but other standards of society's well-being: A *healthier population* that *is better educated* are hallmarks of a successful development strategy as defined above. Finally, levels of *income distribution* show whether the state has spread or redistributed the fruits of development across society.

The logic of the division of Part II is derived from the central research question whether China's economic growth can be traced back to the workings of a Developmental State. Therefore, before asking what kind of institutions have emerged in China, it is critical to consider what kind existed before. This allows one to judge the reform period and its impact properly.

PART II – Is China a Developmental State?

Introduction

Comparing China's economic transition to other East Asian countries poses some obvious difficulties. First of all, with a population of currently over 1.3 billion, it is more than ten times larger than Japan, twenty-seven times South Korea and fifty-seven times Taiwan. In that respect the city of Shanghai, with its twenty-three million inhabitants, could be compared to the two smaller states. The vast size also makes it more difficult to coordinate and manage economic activity according to a centrally devised strategy, without preventing competition and free market forces to develop.

Furthermore, at the beginning of the reform period, whether the aim was a transition towards a Developmental State or completely free market economy, the outset was an entirely state-controlled planned economy, dominated by relatively inefficient large-scale heavy industry and a rural workforce employed in the collectivized agricultural sector (Nolan/Wang 1998: 152). In some respect this offers the opposite task. Namely, dismantling state control and leaving enough in place to establish a working Developmental State instead of creating state institutions to increase central strategy coordination. This can be an additional hurdle since existing institutions might resist transformation.

Part II will follow the guiding structure of the Developmental State Model composed in Chapter 5. The logic of inquiry is thus: What were the initial historical conditions? Did China then develop the institutional framework of a Developmental State? Was this reflected in the development outcome when measured against South Korea and Taiwan?

Chapter 6 – Historical vantage points: The Maoist legacy

Industrial base, ownership and income distribution

Contrary to South Korea and Taiwan the link to colonial manufacturing experience has been severed or at least drastically transformed after Chinese Communist rule began in 1949. In any case, Japanese industrialization efforts had centered only on the North East, where the Japanese Kwantung Army had acted as a quasi government of the puppet state Manchukuo since the inter-war period, following a program of resource extraction and development of heavy industry, necessary to fuel the military. As Duara (2006) notes: "By 1945, Japanese investment in Manchukuo exceeded the combined total of its investment in Korea, Taiwan, and the rest of China. Industrial production tripled between 1933 and 1942, and producer goods output grew the fastest." Including Manchuria then, Chinese industry grew at an average rate of 9.7% per year between 1912 and 1936 (Perkins 2011: 51).

After the Japanese had been defeated in 1945, the Chinese civil war for control over the newly freed nation raged on another three years. With the Communist victory the remainder of indigenous entrepreneurs chose exile or faced dispossession. After the CCP had consolidated its power and overcame the crisis of the Korean War a complete reorganization of the economy began. Indeed, the first Five-Year Plan, initiated in 1953, had the official aim to fulfill "Transition to Socialism". Agriculture was collectivized, industry nationalized and private enterprise almost completely suppressed (Guo 2006: 13; Perkins 2011).

The development of heavy industry became paramount even though the lack of a genuine "proletariat", sufficient fixed and investment capital, and know-how gave China a comparative disadvantage. In order to artificially reduce costs, the market-mechanism was replaced with a fixed price regime, exploiting mostly the abundance of cheap labor (Zhang 2009: 13). By setting very low prices for agricultural raw materials, industrial manufactures benefited from cheap inputs and could garner swollen profits. These, in turn, fueled the government's revenue either through direct remittances of profits or through indirect taxes, which the central government in turn used to develop heavy industry (Young 200: 5).

As in the Soviet Union, central planners reinvested a high proportion of output, averaging roughly 30% since the 1950s. More than a third of industrial investment was allocated towards iron, steel and manufacturing of heavy machinery. Consequently the value of heavy industrial output multiplied over ninety times during the entire pre-Reform Era, compared with a twenty times increase for light industry and merely a two-fold growth of agricultural output. However, total factor productivity decreased steadily, forcing ever-larger shares of industrial output to be reinvested in order to keep up growth figures (Shirk 1993: 25–26).

By 1980, China's industrial sector was larger than those of most other developing nations and even greater or on par with middle- and high-income countries (Heston/Sicular 2008: 39). Yet, this inefficient and one-sided investment strategy prevented sufficient production of consumer goods, while a negligence of infrastructure inhibited their distribution (Xiaolin 2011; Shirk 1993: 27). This explains the tragedy of double-digit industrial growth, while general welfare decreased — although not in all aspects of life (see: Chapter 9). Before one can get a sense on what basis a potential Chinese Developmental State could operate, it is necessary to consider the other historical vantage points identified above: prevalent income distribution and ownership structures.

From 1957 to 1960 the notorious industrialization effort termed 'The Great Leap Forward' fundamentally rearranged society. It was during that period that collectivization was extended to the entire rural population. Organized in Communes under local government supervision, all land and other productive resources were placed under collective, in essence state, ownership. Organized as brigades and subdivided as teams the peasantry worked and was bound to their commune, which also encompassed their own schooling, security and even small-scale industry (Guo 2006:15). Approximately 750.000 back-yard furnaces were set up to smelt ore or existing iron goods, but largely produced worthless pig iron from formerly useful utensils (Fenby 2009: 400). Nearly 80 percent of China's population lived and worked under this rural organization scheme. Income from collective farming was divided at the level of teams, consisting of 25-30 families and on the basis of perceived need and to a lesser degree on work points. In effect this created a relatively equal distribution of income. Differences were due to a rural/urban divide and natural resource endowments of specific regions (Benjamin et al. 2008: 735).

Urban population worked in SOEs, was allocated housing and only had limited access to consumer goods due to rationing. The fixed price regime and strictly enforced prohibitions to migrate from rural to urban areas resulted in an income gap of 5:1. But this was somewhat mitigated by the rationed commodities and rather boosted savings instead of being manifested in a living standard that was five-fold higher in cities (Benjamin et al. 2008: 736). By 1980 China's GINI coefficient was 0.28, even slightly below that of Japan (0.31 in 1956), South Korea (0.34 in 1965) and Taiwan (0.32 in 1964) during the respective starting phases of growth (Bramall 2000: 451).[21]

None are as able to identify positive aspects of the notoriously dismal Mao-era economy as Chris Bramall: "The absence of significant concentrations of economic and financial power in late Maoist China thus made it much easier to introduce growth-promoting institutional structures." (Bramall 2000: 451) Relative equality was an important boon as reformers faced two potential pitfalls: For one, dismantling the system of government purchase and reselling of agricultural output at fixed prices would deprive the state of its arbitrage income. Two, reducing the implicit subsidies for urban food consumption would raise demands for wage increases or result in unrest and deprivation as urban real incomes fall. The eventual outcome saw a compromise between the two, but

[21] The GINI coefficient is used to measure statistical divergence of values on a percentile scale with 1.0 meaning complete inequality and 0.0 indicating that all measured values are the same. Current values applying the GINI coefficient to income by the Word Bank rank Namibia (0.74) as the country with the most unequal distribution and Japan (0.25), among others, with the most equality; See: http://data.worldbank.org/indicator/SI.POV.GINI/ More details and data are presented in Chapter 9 and in the Appendix.

even so the reforms had an inescapable redistributive outcome that was mitigated by the initial conditions (Comp. Rodrik 2007: 91).

While the manufacturing experience of Maoist industrial policy suggested a less than ideal precondition for a Developmental State to profit from, the two advantages of indigenous ownership of productive assets and an equal income distribution are clear legacies of the Mao era. These three attributes make up a more or less fertile ground for the Developmental State but they do not explain what motivation lies behind adopting such a model. As noted above, the fourth historical vantage point zooms out to international factors and their influence.

External and internal reform pressures

Maoist thought applied Marxism and Leninism to specific Chinese circumstances. According to that, imperialism, both Western and Japanese, had controlled China's economy via dominion over trading ports and had infringed upon the financial system, both fiscal and monetary. By supporting select warlords and by proselytizing via media control, schools and other social institutions, the Western powers at least were seen to have "conducted a policy of cultural aggression" (Zheng 2004: 45). Domestically, the institution of feudalism kept the peasants oppressed. Since the overwhelming majority of the population lived in rural areas, a revolution needed to be built on the peasantry instead of a proletariat. Massive industrialization within an autarkic economy would restore Chinas greatness and offer protection from outside forces. The Ministry of Foreign Trade (MFT) controlled specialized corporations in charge of importing and exporting what little resources and goods were required from the outside (Guo 2006: 29).

Nevertheless, in the beginning the ideological partnership with the Soviet Union induced an inflow of advisers, technology and fixed capital (Brandt/Rawski 2008: 4; Guo 2006: 13). The first five-year-plan included 156 major plants to be provided by the USSR while 28.000 Chinese went to their northern neighbor for training. Following the second Taiwan Strait crisis, the Soviet Union agreed to assist the People's Republic with its own nuclear weapons program, which would culminate in a first test in 1964 (Fenby 2009: 377). Mounting disagreements between the two socialist countries eventually led to a break off and consequent withdrawal of all Soviet assistance in 1961, leaving China completely isolated. At that time, the "Third Front" initiative aimed at creating secure industrial bases across China and in far flung provinces in case of foreign attack. This had the unfortunate effect of duplicating industries and losing the advantages of economies of scale and shared infrastructure at specialized clusters (Young 2000: 7). Factories were moved from the coastal to inland regions. Brandt and Rawski note that: "Although China's leaders valued material progress, considerations of national defense and ideology frequently trumped economics during the plan era, with predictably negative effects on output and productivity." (2008:7)

Perceived outside threats did little to convince the Chinese leadership to change course and try and imitate institutions of successful Developmental States. China's economic isolation, its vast territory, the world's largest population and standing army, and a nuclear arsenal presented its leadership with very different options when faced with an external threat compared to South Korea and Taiwan. Rather, the decision for economic reforms resulted from the internal crisis of the Cultural Revolution, the death of chairman Mao and the ensuing struggle for succession.

The planned economy was administered by the highly centralized Party state. All productive assets were under at least indirect control of Party cadres. Top officials garnered support by the distribution of assets and positions to their clients. Limited accountability was only given through acts of individual leaders to keep a power balance within Party and state organs, reinforcing a strict hierarchical structure and chain of command (Naughton 2008: 93). This system was undermined during the final decade of Mao's life and the launch of the Cultural Revolution from 1966–76. In essence, the movement was a pretext to radicalize supporters and stage violent clashes and weigh in on power struggles between various Party factions, which depended on the tacit guidance by the

Chairman. Old leaders, who had fought alongside Mao for over forty years, suddenly faced persecution. Most notably the former military leader Peng Dehuai and the vice chairman and head of state Liu Shaoqi. Both died under incarceration. Deng Xiaoping was even purged twice but placed under house arrest instead of prison. Mao's presumed successor and leader of the PLA faction, Lin Biao, rose to power by allying himself with the group that instigated the Cultural Revolution. This in turn made him too powerful in Mao's view, leading to Lin's untimely death.[22]

These top tier power struggles were carried out through mass mobilization campaigns, edging on youths to become "Red Guards" and to go on witch-hunts for supposed counterrevolutionaries. Three quarters of top economic officials and almost a third of all Party officials were purged (Guo 2006: 43). Thus the virtues of being "red" trumped the qualifications of being an "expert" — an anti-intellectualism that crippled economic governance. The state failed to provide political order and economically it failed to provide goods. According to Xu (2011: 1079) that amounted to a "change of the legitimacy base of the Chinese Communist Party[.]" After Mao's death in 1976 the question became, how to restore that legitimacy? Different answers delineated the frontlines of the ensuing struggle for succession (Zheng 2004: 52).

The need to enhance the economic situation in 1976 was even more evident, as previous ignorance was stripped away. Shirk notes:

> "The Chinese leaders also may have believed the Chinese economy to be in even worse shape than it actually was. A greatly improved system for compiling economic statistics revealed declining factor productivity and made other deficiencies of the system more obvious than they had been in the past. When in the mid-1970s Chinese officials began to venture outside China to visit foreign countries, many of them for the first time, they were shocked and demoralized by

[22] After Lin and his family had realized that the political winds had shifted against them, they actually considered a coup d'état but instead opted to flee the country. Their plane presumably ran out of fuel over Mongolia on the way to Soviet Territory (Fenby 2009). This and similar episodes highlight the arbitrariness and interplay of political fortune that by itself prevented a well-functioning government.

> what they saw. They had anticipated the technological and economic gap between China and the West, but they were surprised and humiliated to see that China lagged far behind even Japan and the newly industrialized countries of East Asia." (1993: 35)

Hua Guofeng, Mao's official successor, brought the Cultural Revolution to an end and purged its main instigators, the so called Gang of Four led by Mao's widow Jiang Qing. Nevertheless, Hua remained a staunch supporter of Maoist policies with certain updates: Announcing to uphold whatever policies the Chairman had designed and to follow whatever instructions he had given, he initiated another massive heavy industrialization program, but this time with inclusion of outside markets.[23]In what was later derisively termed the "foreign leap forward", about 120 new projects were launched, all of which relied heavily on technology imports. Increased investment spending created a record budget deficit of 15.5% of revenue (Fenby 2009: 537). Subsequently, after 1977 the value of imports rose from \$72m to \$200m (Bramall 2000: 231). The intention to pay for these imports by developing and exporting oil reserves was proven unfeasible, when estimates of reserves had to be scaled back and the collapse of an oil rig in the Bohai Gulf, killing seventy-two, demonstrated the industry's inadequacy (Fenby 2009: 537). After the already critical situation, created by the Cultural Revolution, had been exasperated, Deng could use his policy of economic reform as an attractive alternative to wrest leadership away from Hua at the third Plenum of the Eleventh Communist Party Central Committee in December 1978 (Shirk 1993: 35-6).

Conclusion

The Mao era had drastically expanded the industrial base but not by virtue of integrating the entrepreneurial elite that had gained manufacturing experience during and before the Japanese occupation. Any link to traditional forms of entrepreneurship had been severed as well. Thus any advantage in knowledge-

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[23] This „Two Whatevers" policy was later criticised by the Dengist faction who instead favored the approach of „seeking the truth from practice/facts; Fenby 2009: 536, Huang 2008: 88

backed assets had been largely lost. The continued isolation from the Western world and subsequently even from the Soviet Union prevented an effective build up of an efficient and modern industrial base. But in terms of output at least, an overcapacity in heavy industry was attained.

The complete disruption of ownership and control over productive assets by foreigners had been achieved to a much higher degree than was the case after Decolonization in South Korea and Taiwan. In addition, ownership was also monopolized. As a beneficial historical vantage point for a Developmental State, ownership disruption serves a specific purpose: to allow the state to coordinate these industries, rather than to nationalize them entirely.

Income distribution was relatively equal under the planned economy, with the biggest divide between rural and urban areas. A low income-inequality suggests limited resistance to a change in the status quo as well as better social cohesion to bear any redistributive outcomes of reforms. In that respect, late Maoist China resembles the East Asian Developmental States rather well.

Finally, a driving force to maintain a Developmental State has been a perceived external threat. To recap the argument: The South Korean and Taiwanese leadership perceived the need for continued modernization and wealth accumulation as a foundation for economic and political clout. China by virtue of its size and nuclear arsenal could reinforce its national security despite a lack of per capita development. For a long time, even internal legitimacy of the Party did not suffer from the negative outcomes of its development policies. Only when the Cultural Revolution eroded not just what limited popular security had been maintained, but also the functioning of the power allocation within the Party-state, pressures for reform won out. However, this does not mean that a transformation into a Developmental State was on the horizon. The following chapters will explore what political and economic institutions emerged in China post-1978 and to what extent they resemble the Developmental State model.

Chapter 7 – The Institutional Setup of China's Political Economy

Introduction

The Developmental State model presented above has emphasized the formulation and implementation of a long-term development strategy that goes beyond a basic state-led drive towards economic growth. Rather, it should encompass concrete steps towards building a homegrown internationally competitive industry that is capable of reaching ever-higher steps along the value-added chain of production. The success of such a strategy depends on central state institutions that are powerful enough to coordinate and adjust economic policy. These ought to be staffed on a meritocratic basis. Those in charge of directing policy need to be insulated from special interests or political factions while being simultaneously embedded in civil society. This section introduces the Chinese political institutions and their transformation throughout the Reform Era in order to understand how economic policy decisions were made and to what extent they resemble the institutional setup of a Developmental State.

Deng Xiaoping had consolidated power by embodying a departure from the Cultural Revolution and the attempted continuation of Maoist policies by Hua Guofeng. A Party Resolution condemned Mao's policies of the last decade of his life, with the official position remaining that 70 percent of his decisions were correct and only 30 percent were wrong (Fenby 2009: 560). The new leadership was thus identified in the negative, or by virtue of what it wasn't rather than for what concrete path it represented. This accounted for the backing of diverse factions but also meant that there was no clear path of reform. What became so distinctively associated with a new era under Deng was the result of experimentation and gradual policy innovation, best summarized by the leader's own description of "crossing the river by feeling the stones."[24]

[24] Fenby 2008: 533

The evolution of political institutions in general and specifically those in charge of economic policy between 1978 and 2001 is usually divided into two periods, before and after the Tiananmen revolt of 1989 (e.g. Naughton 2008; Hunag 2008). This approach is sensible, as the years around 1990 mark not only social turmoil but also an economic crisis and a leadership transition accompanied by a policy shift. Both periods can be further subdivided by major reform initiatives that focus on specific sectors of the economy and on internal power redistribution: First, between 1978–1983, the new leadership had to consolidate power and implement ad hoc measures to deal with the legacy of Mao and his designated successor Hua, while already experimenting with first reforms.

Initial success allowed for a second, deeper reform drive from 1984–1989 ending in political and economic crisis. A three-year period of consolidation and retrenchment set in until in 1992 the reform drive was re-launched, albeit with a slight shift of focus from rural to urban sectors. The attention throughout these chronologically discussed sections lies with the major reforms that transformed the state as an economic player, foremost through reforms of state industry and the fiscal system. Subsequently the main attributes of a Developmental State's institution are examined in light of China's experience over more than two decades. However, first a basic account of the Party-State's main political and economic institutions during the Reform Era is required in order to explain how economic policy was made.

Policy formulation and institutions of the Chinese Party-State

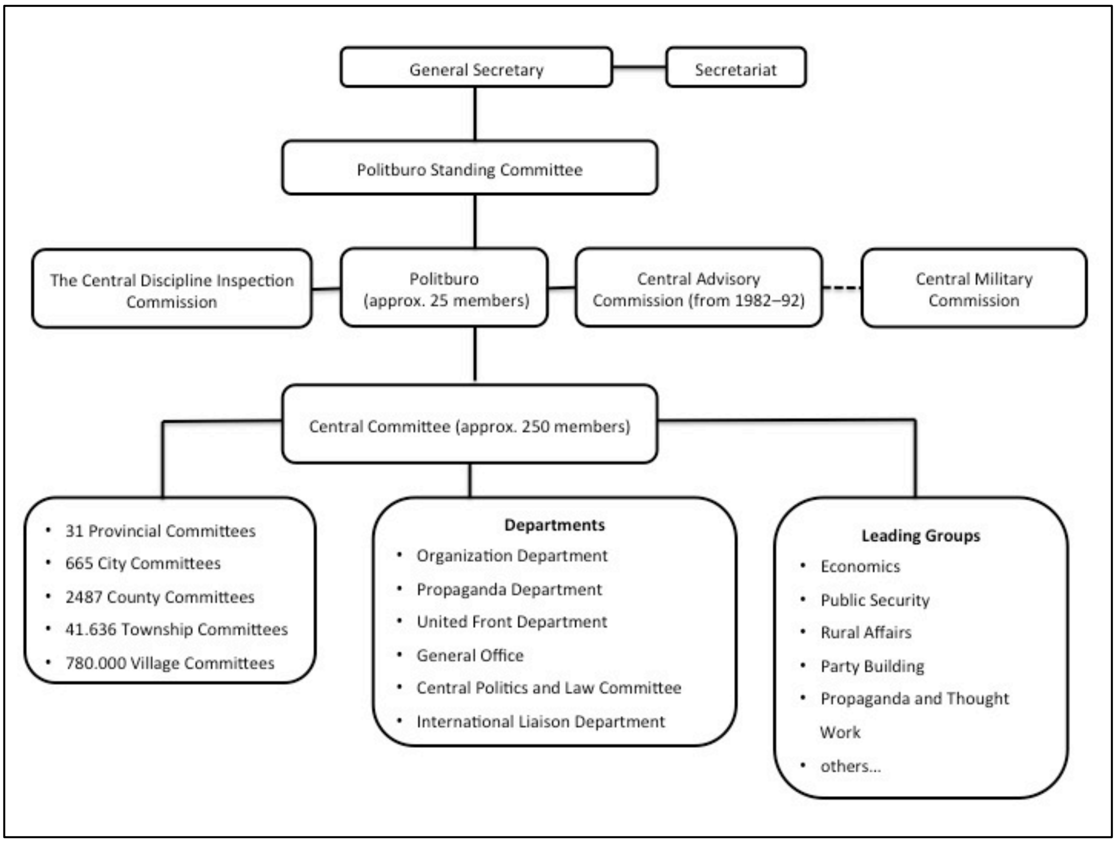
Deng's reformist agenda was foremost a means to reinstate the CCPs mechanism of power allocation and internal checks by allowing the different factions to operate again. While the once purged, old revolutionary leaders thankfully supported him, the economic experiments of reform created lucrative opportunities to be doled out to a network of clients (Shirk 1993: 37). While these actions served to further consolidate power, Hua Guofeng and his group were not radically purged. In fact, Hua officially remained Premier – the head of government – until 1980 and Party Chairman as well as heading the Central Military Commission until 1981.[25]

This constellation conveyed stability and thus legitimacy for the Party, while it also serves as a reminder, how much politics was based on personality of leaders even if they did not hold the highest offices. The allocation of power is spread through networks that run parallel in both Party and state institutions. Understanding their function is paramount for considering how they can foster or inhibit attributes of a Developmental State.

Figures 1 and 2 respectively chart the organization of both the CCP and the Chinese government. The Party, rather than the state as such, is considered to represent the combined will of society and it is the locus of political power. While the government and its bureaucracy are closely linked through membership with the CCP, their organization is distinct. Both Government and Party are structured hierarchically, with the top two offices usually held by different leaders. The Party General Secretary usually reinforces his position by heading the third pillar of power within China, the People's Liberation Army. Power struggles for top leadership play out over the composition of three connected institutions: The Central Committee, the Politburo and the Secretariat.

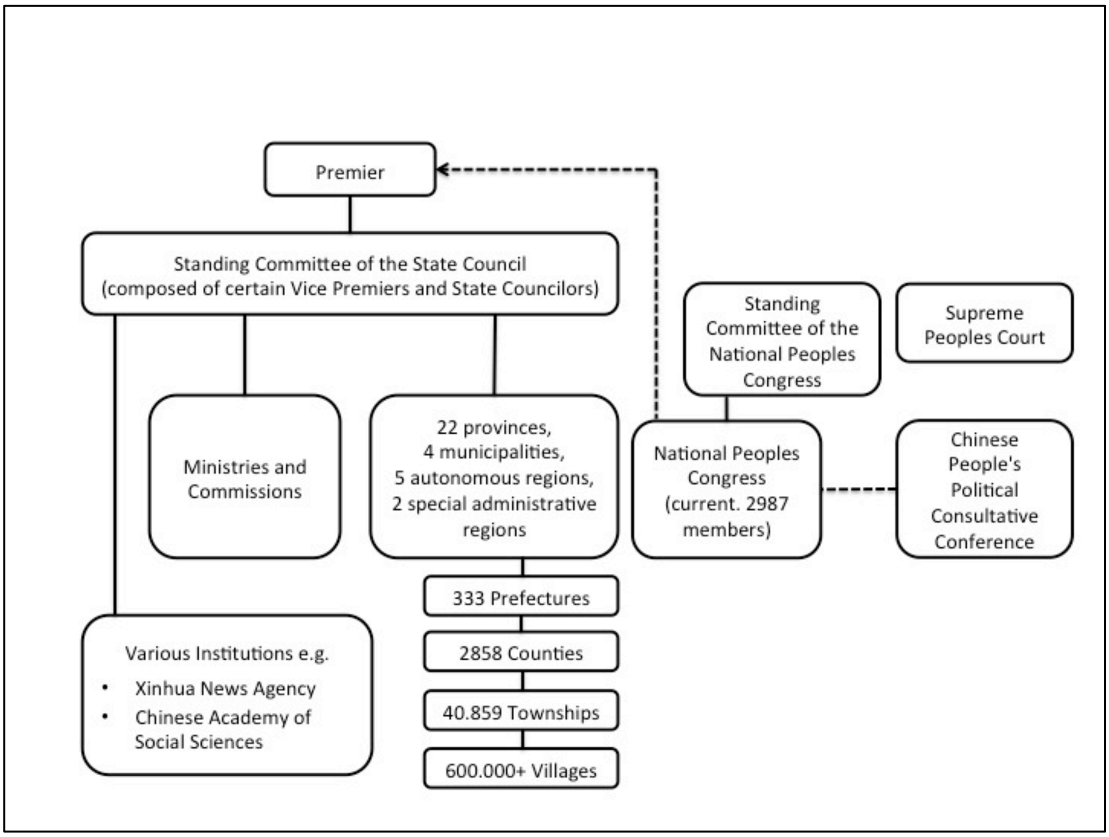
[25] These are the top three offices in the People's Republic. Even Mao had not held all of them at once, having made Zhu Enlai the premier. Currently Hu Jintao holds the office of President of the People's Republic of China, but that is a largely ceremonial office for the head of state. His true power stemmed from his positions as Party Chairman (now held by Xi Jinping) and Chairman of the Central Military Commission. Wen Jiabao, the Premier, is head of government.

Figure 1 – Organization of the Chinese Communist Party



Source: Author

Figure 2 – Organization of the Chinese government



Source: Author

The Central Committee formally elects the Secretary and the Politburo. In practice, informal channels decisively influence these appointments. Party elders, such as the famous eight immortals, the PLA command and above all the retiring leadership decides the succession at the top.[26] Dittmer and Wu (2006: 52f.) transfer the Weberian concepts of value-rational and purpose-rational to political relationships in modern China. Value-rational relationships are an end in itself and apply to the informal networking (*guanxi*). Purpose-rational relationships usually are an instrument towards a specific shared goal and encompass formal and officially conferred power relationships. Empirically the two are not always clearly distinct. Chinese politics is very much characterized by informal relationships, which are embodied by factions. Their three main purposes in descending order of importance are: security, material interest, and a certain policy interest by its members. The composition of the Central Committee often gives a clue to faction rivalries with a useful division of blocks into central Party officials, the military and local and provincial officials.

The Party organization mirrors that of the state by relying on departments and groups with specific functions, corresponding to the ministries, as well as federal offices on all levels of local administration. The two exhibit a "delegation relationship" with the Party as the "principal" and the government as the "agent" (Shirk 1993: 55). While bureaucrats are in charge of the daily administration, the ministries or commissions they work for receive directives from Party organs. The chief instrument of power is the Party's ability to fill any position in government. Aside from the most senor positions, which are determined by the politburo, all personnel decisions within the state, the Party and even many seemingly private institutions are made by the CCP's Central Organization

[26] The eight immortals is a reference to a mythical group in Taoism used to describe CCP Elders in the 1980s and 1990s who had revolutionary experience; many participants of the famous Long March. These veterans often relinquished formal power positions but still played a decisive role in policy-making. Foremost among them were Deng himself and the economic planner Chen Yun.

Department (McGregor 2010: 73).[27] Formally, the National People's Congress, the legislative branch of government, elects top positions. But this body's decisions are frequently characterized as mere rubber-stamping.[28]

Within the administration, those civil servants who are CCP members form "Party groups". Each of these controls the corresponding agency from within but the group's members are simultaneously answerable to the Central Committee or its subunits. While in the Soviet Union, the Committee had served to supervise Party members, the Chinese communists switched from controlling to substituting government (Shirk 1993: 61).

At the top level, Party leading groups are formed by a handful of key officials and organized according to policy area. The Finance and Economy Leading Group was established after the fifth CCP plenum in 1980 and is still in existence. It formed the top body for economic decision-making through which the Politburo directed both State and Party in economic matters. In general, these leading groups are very informal and tend to shift between the Party and government, depending to who is in charge of them. Their membership is not made public and needs to be painstakingly inferred from various sources and reports (Miller 2008).

The general policy decisions are made in the politburo and in the leading groups. Their members are leaders of political factions, which spread throughout the government bodies, including those in charge of applying economic policy. The three most important formal institutions for economic policy during the 1980s were: The State Planning Commission (SPC), the Ministry of Finance (MoF) and the State Economic Commission (SEC).

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[27] McGregor (2010) emphasizes the Department's power by making a striking comparison: "A similar department in the US would oversee the appointment of the entire US cabinet, state governors and their deputies, the mayors of major cities, the heads of all federal regulatory agencies, the chief executives of GE, ExxonMobil, Wal-Mart and about fifty of the remaining largest US companies, the justices of the Supreme Court, the editors of the New York Times, The Wall Street Journal and the Washington Post, the bosses of the TV networks and cable stations, the presidents of Yale and Harvard and other big universities, and the heads of think-tanks like Brookings Institution and the Heritage Foundation." (72)

[28] See: The Economist: The National People's Congress. What makes a rubber stamp? (Mar. 5th, 2012)

The Planning Commission is in charge of drafting the five-year plans, formerly covering almost all economic activities. Thereby, it allocates funds and sets targets for the ministries and provinces, which in turn direct the state controlled sectors to fulfill these. The reform process has often worked by laying out an additional track to the existing plan, rather than transforming the methods used by the Planning Commission. Its power waxed and waned, depending on whether radical reformers or conservative planners dominated politics (Shirk 1993). The Ministry of Finance is in charge of state revenue and thus focuses on saving rather than spending measures. During the Reform Era it represented the interest of the central state vis-a-vis the provinces especially concerning reforms of the tax system (Zheng 2004). The State Economic Commission was established in 1982 and represented the chief rival of the Planning Commission. In fact, it took over administering the plan by monitoring its implementation in shorter time intervals. In addition it was in charge of many of the new policy experiments, making it the power base of the radical reformers (Zheng 2004).

To understand how institutions of a Developmental State could emerge it is essential to focus on the CCPs role and see China as a Party-State. The crisis that had led to the reform process foremost concerned the Party. Of course the chaos and misdirected mass-mobilizations of the Cultural Revolution had had a negative economic impact but to a totalitarian one-Party regime, the welfare of the masses is not the primary factor for maintaining power. As Perkins (2011: 61) notes:

> "The biggest political legacy of the 1960s and early 1970s from the point of view of the economy, however, was derived directly from the politics of that period. The Great Proletarian Cultural Revolution was so extreme along so many dimensions that it led to reaction equally strong. The Great Leap Forward [1958–1961] did more direct damage to the economy, but it was the Cultural Revolution that fundamentally undermined political support for the kinds of utopian social change goals and political mobilization policies pursued during the last half of the 1960s and into the early 1970s"

The poor condition of the nation was a recurring phenomenon, but the loss of political support from all but few radical left-wing cadres, opened the way for change. Thus the process of economic reform was a means to find new legitimacy for the Party-State foremost internally and to a lesser degree externally. The direction of economic policy therefore, was neither provided by circumstances, nor by international financial institutions, nor by a clear theoretical model or ideology to be applied. Rather, the policies coalesced from the interaction of different factions within the CCP, with Deng Xiaoping acting to balance them out (Garnaut 2011:84). The general agreement among elites was that economic reform should bring development and raise living standards, thereby replacing the Party's role of ideological standard-bearer with provider of actual tangible wealth (Guo 2006: 45).

Commencing the reforms 1978–1983

Deng reintroduced the grand scheme of the 'Four Modernizations' in agriculture, industry, defense and science and technology at the 3rd Plenum of the eleventh Congress of the CCP in December 1978. Zhu Enlai had already proclaimed such an initiative over a decade earlier. Back then, Deng had been briefly in charge of it between his first and second purge by Mao (Fenby 2008: 514). The sequence of reforms was determined by how much political resistance needed to be overcome instead of following any coherent strategy. Deng used the momentary reform oriented consensus to ensure that the next generation of leaders would continue in this vein. The two younger cadres that would take on the top positions during the 1980s were Zhao Ziyang and Hu Yaobang.

Zhao has copied the pioneer Wan Li's agricultural reform success in Anhui province to Sichuan, where he had been made Party Secretary in 1975. By letting farmers sell produce that exceeded their quota requirements on the free market, he substantially increased the provinces output. In 1980 he replaced Hua Guofeng as head of government, becoming the new Premier. Hu was also a staunch supporter of reforms but his political career shadowed Deng's with its ups and downs and concentrated on the central Party leadership. After Mao's death he lead the powerful Organization Department. In 1980 he too replaced Hua, but as General Secretary. The remaining position as Chairman of the Central Military Commission held by Hua was taken by Deng for himself the following year (Fenby 2008). While not always on the same page, this new generation of leaders would head the "radical reform faction", often clashing with the "conservative faction" leaders of the old guard such as Chen Yun and Peng Zhen, who favored a slower pace of transition and preferred giving the planning system a central role, since they feared political destabilization if economic reform got out of control (Guo 2006: 43). The struggle between these factions would determine the pace, scope and sequence of reforms.

Agricultural reform posed an ideal starting point since it lay outside the entrenched interests of economic planners who had focused on industry. The central institutions concerned, such as the Ministry of Agriculture, The Ministry of Grain or the All China Federation of Supply and Marketing Cooperatives all had little political clout (Shirk 1993: 133). Before real structural reform could be tackled however, the dire situation of state finances inherited by Hua Guofeng's ill conceived Great Leap Outwards had to be rectified.

The first actual new policies had also been initiated in 1978 by rising the state purchasing prices of agricultural output by 22.1% and subsequently by another 7.1% and 5.9%. Meanwhile, the urban consumer prices were kept stable (Pei 2011: 61). The goal was to relieve the burden of the rural population and to complement decollectivization in order to raise productivity. The decreased gap between rural sellers and urban consumers, formerly a lucrative arbitrage for the state, had to come out of the central budget. The legacy of the Great Leap Outwards however also piled on investment commitments and put a huge strain on state finances and foreign exchange reserves through a mounting trade deficit. Inflation rose from 2% to 6% in 1980 and the budget deficit increased dramatically. This prompted further efforts to cool down the economy by cutting state enterprise capital investment and by actually renouncing approximately a thousand joint venture contracts. Consequently, GDP growth declined from 7.8 to 5.2% in 1981 (Dittmer/Wu 2006: 57). But in consolidating state finances, even at the price of more sluggish growth, Deng and Chen saw eye to eye. While there was no agreement on urban-industrial reforms, Zhao was allowed to continue with extending agricultural reforms after the precedent had been set in Anhui and Sichuan (Huang et al. 2008: 488).

The Household Responsibility System (HRS) replaced communes but without privatizing any land. The collectively owned plots were contracted out to farming households based on family units. Farmers still had to fulfill a set quota and sell it at the plan-price but what was produced beyond that could be sold at the higher market price.[29] Between 1979 and 1984 agricultural output grew by an annual average of 7.5% (Liu et al. 1998: 135)[30]. As Yasheng Huang notes, contrary to the institutional economist's insistence on absolutely secure property rights, the credibility offered by Deng and an initially united leadership, was a marginal shift towards a belief in more autonomous land use and thus sufficient to boost productive incentives even in the absence of legally protected ownership rights (Huang 2008).

How is the early success of agricultural reform related to assessing central economic institutions and bureaucratic restructuring? The main argument here is that the new orientation of the Party towards economic development provided the respective leader with legitimacy to rearrange central institutions and redistribute power toward his faction. Since rural reform driven by Zhao went ahead relatively unopposed and had proven successful early on, the premier could do just that. His aim was complementing the central institutions of a planned economy with those of a market economy under his aegis. The State

[29] After decollectivization from 1979 onwards, the unified grain collection system was switched to a "contract procurement system" following the dual-track pricing system. Peasants sold a fixed quota at a predetermined price and negotiated the price for the rest of the grain on the market, even though most of it was purchased by the state as well. Between 1985 and 1991 the state procured around 80% of marketed grain which in turn accounted for a third up to one half of the total amount (Pei 2006: 98).

[30] According to Huang et. al. Agricultural GDP between 1978–84 even increased on average by 8.8% compared with 4.9% between 1970–1978. What is most striking is the boom in cash-crops. Cotton production for example slightly declined during the late Mao era, while it grew by almost 20% annually during the first half decade of the Reform Period, suggesting the market oriented shift of production choices. Data from: Huang/ Otsuka/ Rozelle 2011: 479; A good analysis of the change of the incentive structure that compares the HRS with the previous working method is provided by: Lin 1988

Economic Commission (SEC) was restructured in 1982, integrating five former commissions among them the ones in charge of agriculture and energy, the Finance and Trade Group of the State Council, and several State Bureaus. Zhao also recreated and personally headed the Commission for Economic System Restructuring (CESR), using it as his “think tank and power base”. Overall, State Council staff was reduced by 17.000 officials (Zheng 2004: 89).

The composition of the administration always reveals the CCP’s preference for which groups should take part in policy formulation. The reformist faction had thus managed to open up the least contested sector for reform and reshuffled the responsibilities of the top bureaucracy towards market economics. The first years of the Reform Period did not exhibit a concentration of economic policy-making but merely a shift from one faction to another. Several agencies claim responsibility for essential sectors of the economy, resulting in competition between ‘savers’ (MOF), ‘spenders’ (Ministries, Provinces) as well as between Planners (SPC) and market reformers (SEC). Reforms lack a clear blueprint and instead are carried out where there is least resistance.

Similarly to agricultural reform, which had spread from local implementation to include more and more of the country, other reform measures were “tested” first. This form of particularistic policies allowed the reformers to garner support, since the prize of becoming an “experiment” was lavish central funding. Most famously, four Special Economic Zones were established in Shenzhen, Zhuhai and Shantou in Guangdong province, located strategically near Hong Kong and Xiamen in Fujian province on the Taiwan Strait. They enjoyed lower tax rates and more autonomy over investment decisions, most importantly involving foreign funds. Opening the economy meant opening these zones, which soon became responsible for most of exports and FDI (Xu 2011: 1113).

On the enterprise level, profit-retention schemes were granted to specific SOEs. As with the HRS the idea to create such incentives was first implemented in the provinces, this time by Zhao Ziyang during his time in Sichuan. Each enterprise was entitled to negotiate a proportion of the profits that would not be remitted to the state, but could instead be used for worker's welfare, bonus payments or investment (Qian 2006: 235). The SEC and local politicians also favored the first experimental firms to adopt the system in order to ensure their success and thus legitimize expanding the reforms. As Susan Shirk reveals from interviews she had conducted: "Even SEC officials admitted that reform experiments were not true tests of changes in the rules of the game but served primarily political and propaganda functions." She concludes that: "the experiments were an effective way to tie the interests of local officials to the fate of the industrial reform drive." (Shirk 1993: 201) The most dramatic change of China's political economy was the similarly motivated decentralization, especially in fiscal matters.

Under the old fiscal system dating back to the 1950s, all revenues went to the center and were distributed among provincial governments as seen fit to accomplish set targets. The main source of revenue was the remitted profits of SOEs operating in heavy industry (Wong/Bird 2008: 430). This was a function of a national economy that extracted rural surplus and reinvested it in heavy industry. Since the reformers had allied with provincial governments, the revenue mechanism changed. The increase in rural income through price reform in addition to the growing non-state industrial sector, budget revenues declined.[31] In 1978 direct taxes made up 60% of state revenue and 93% came from SOEs. In 1989 direct taxes accounted for only 19% with a mere 8% coming from SOEs profit remittances (Zheng 2004: 111). Relative government revenue declined from 31.2% of GDP in 1978 to 23% in 1983. The MoF, usually a staunch supporter of central power and fiscal conservatism, now welcomed further decentralization as it wanted to transfer the budget draining responsibilities along with the resources that the provinces had gained.

In 1980 a fiscal reform started under the heading of "eating in separate kitchens" or fiscal contracting. As with other measures, the new system introduced a particularistic element. Each province could negotiate a proportion of revenue to be retained locally. The deals varied: for example Guangdong had to deliver a

[31] The non-state industrial sector includes private business, foreign-invested business but mainly township and village enterprises (TVEs) that focused on light industry.

fixed amount to Beijing, while Fujian would receive predetermined subsidies (Qian 2006: 233). The central government still decided on all tax rates and between 1980 and 1984 about 80% of revenue that was collected locally was remitted to the central state (Shen/Jin/Zou 2012: 6). But compared to the old system, the provinces had gained significant autonomy and were able to develop their local economy by allocating new funds for investment. Furthermore, this system was implemented down the line, with contracts being negotiated between the provinces and the prefectures, which continue the deals with the counties, which eventually sign contracts with the townships and villages (Oi 1992: 103).

Spanning industrial enterprise reform and fiscal reform was the matter of how homogeneously to extract profits from SOEs, since curiously they were required to pay income taxes and remit a share of after-tax profits (Young 2000: 9). A conflict arose that split up the reformer's camp between Hu, who favored maintaining particularistic profit-contracting and Zhao, who now accommodated Chen Yun's conservative centrists by supporting the implementation of a tax-for-profit scheme, that would rely more on a synchronized income tax. This division reflects the competition over who would eventually succeed Deng (Shirk 1993: 222). The struggle was only resolved during the next period of reforms.[32]

To conclude, the early reform measures did not conform to any long-term strategy. Deng's faction enlisted the support of the provinces with attractive possibilities to pioneer reform experiments and by expanding local autonomy in agricultural, industrial and fiscal matters. This went against the established economic power bases of the MoF and the SPC. Throughout the first years the conservative faction pointed to the precarious state of the budget, trade deficits and the slump in GDP growth in order to maintain the central control of a planned economy as much as possible. But the marketization measures showed

[32] When Zhao went on several state visits in Africa, Hu campaigned for profit-contracting in China, venturing into the economic policy domain that had been under Zhao's purview. Apparently Deng privately reprimanded Hu and in effect also accommodated the conservatives. In 1983 a tax-for-profit system was introduced that augmented the MoF's central control. Since it did not endure, this small victory is confined to a footnote. See Shirk (1993:245–279) for a detailed account.

enough positive result, albeit with some time lag, to empower the reformers to continue.

From extended reforms to crisis 1984–1989

The HRS had quickly spread throughout the countryside, with 80% of households in 1982 and two years later almost all of them taking part (Qian 2006: 232). GDP growth accelerated after the fiscal and macro imbalances had been overcome. A new wave of reforms was decided at the 3rd Plenary Session of the 12th Central Committee in October 1984. This time the industrial urban sector was the main target. The market economy was formally placed on equal footing alongside the planned economy. Fourteen coastal cities were opened to foreign investment with other regions following suit the following year. The dual-track marketization was extended to industrial goods, allowing enterprises to sell their above-quota output. The market price was usually higher than the plan price, reflecting the long legacy of scarcity in China. This generated opportunities for patronage by the planners setting the initial quota, since that determined the profits that could be made from the surplus (Naughton 2008: 112). By the mid 1980s, the industrial ministries had switched from opposition to conditional support, seeking a higher share of benefits. For example, these could take the form of special "departmental contracts" that can essentially be reduced to handouts by the SPC (Shirk 1993: 139). In return they would increasingly relinquish control over SOEs.

The gradual retreat of the planned economy needs to be seen in perspective: While in 1978 no producer goods were sold on the open market, the share rose to 13% in 1985 but by 1991 it was still less than half (Brandt/Rawski/Sutton 2008: 572). The major structural shift was related to the emergence of a non-state sector with the rise of Township and Village Enterprises (TVEs). Mostly owned by the respective local governments, it would be misleading to label them either public or private enterprise. The important feature is, that they are not centrally directed SOEs, but the main beneficiaries of the expanding market economy.[33]Their predecessors, Commune and Brigade Enterprises, were only allowed to produce goods necessary for agriculture, to use local inputs, and to only sell locally. All three restrictions were lifted for TVEs, allowing them to compete with established SOEs.

In 1984 the tax for profit system for SOEs was implemented. The enterprises were divided into two groups: large and small. Large firms had to pay a 55% tax on profits, while the rate was reduced progressively for those in the small category (Zheng 2004: 110). In principle, a fixed tax rate on profits without any further remittances would function as an incentive to be profitable and provide managers with a better ability to project future expenses. However, the fierce resistance had resulted in a number of exemptions. Since the enterprises were owned by the state, unprofitable ones would not only fail to contribute to the tax revenue but needed to be subsidized. In a move that ran counter to the logic of market competition an additional “adjustment tax” was introduced to be paid by specifically profitable enterprises, mostly located in the coastal provinces. Opposition from industry and the most affected provinces remained strong throughout the years until finally in 1987 the measure was scrapped.

Earlier in the year, Hu had called for political reform, encouraging modest democratic positions. His lenient stance towards ensuing student protests, initially backed by Deng, united the old guard in opposition. Exhibiting their political clout despite the mass retirements from state offices, seventeen members of the Central Advisory Commission successfully pressured Deng to remove Hu as General Secretary (Dittmer/ Wu 2006:58). But instead of vice premier Li Peng, their favored candidate to take up the post, Deng gave the office to Zhao.

With the internal rivalry between the reformers resolved, the new General Secretary proceeded to back a return to the particularistic policy of extracting

[33] The literature on the nature and importance of TVEs during the Reform Era is vast. It rightly points to their essential role for China’s modernization, but since they fall outside the main focus of the political economy of an Developmental State, they cannot be considered in more detail at this point. For a good overview see: Xu/ Zhang 2011

SOE profits now termed "Contract Responsibility System". Managers increased their autonomy and each enterprise negotiated three-year contracts over the amount of profit they had to remit. By the end of the year, 80% of large and middle SOEs adopted the new system and the rest soon followed (Qian 2006: 235). Already an agency problem emerged that provided managers with a soft budget constraint, since any attempts to introduce negative consequences for loss making had been in vain. As the share of profits retained increased, central government revenue declined, leading to further fiscal decentralization.

The 1980 "eating in separate kitchens" program of negotiated revenue sharing between the provinces and the center had led to considerable divergence. Guangdong and Fujian, where the initial SEZs were located, received the best deal by having fixed obligations for five years and could direct any surplus however they saw fit. While the poorest provinces, mostly further inland and the autonomous regions, remained reliant on central subsidies, the rich metropolitan areas like Beijing, Shanghai or Tianjin were forced to relinquish the lion's share of taxes (Shen/Jin/Zou 2012: 6). The negotiated sharing of funds did not help offset the loss to the budget from decreased enterprise remittances. As in the early 1980s, the MoF reacted with further devolution of responsibilities.

In 1988 the Contract Responsibility System was introduced for the provinces as well. Revenue sharing was effectively decoupled from expenditure needs, charging local governments with partly financing themselves. Overall, central government revenue still declined, reaching a trough of 20% of total revenue collected, amounting to only 3% of GDP in 1993 (Wong/Bird 2008: 432).[34] Zheng (2004: 115) sums up Beijing's dilemma: "Fiscal reform provided a strong incentive to act like entrepreneurs, using various ways to increase provincial revenues, and the resulting behavior was not always in line with central government's expectation. Instead it became an effective tool for local

[34] As the numbers provided by Zheng (2004: 116) demonstrate, when the proportions are measured in collections, then the central government share actually increased from 20.6% in 1981 to 41.3% in 1990, but once grants and other forms of revenue are included the bleaker picture for the central budget emerges. Wong and Bird (2008: 432) explain this with the unanticipated effects of high inflation, which outpaced the negotiated growth of remittances.

governments to seek greater power in relation to the central government." Indeed, this is reflected in the composition of the Central Committee, where provincial leaders formed the largest bloc, holding 43% in 1987.[35]Like SOE managers, provincial governments had a soft budget constraint and the power to negotiate favorable deals, increasing their tax base and demanding huge investment sums for various projects even if on aggregate their action put pressure on the national economy.

Leading up to 1986 the macro indicators made the conservative faction nervous about an overheating economy and they demanded restrictive monetary and fiscal measures. Further price reforms were delayed. Inflation dropped from 8.8% to 6%, industrial growth went down to 8.8% from 18% and import growth almost halted at 1.6% compared to the 54% increase the year before (Dittmer/ Wu 2006: 58).

Zhao, seemingly backed by Deng, tentatively announced another attempt to liberalize prices in 1988. He faced stiff opposition, now embodied by the conservative's hopeful Li Peng. After Deng suddenly withdrew his initial support, Zhao's faction was forced onto the defensive. In 1988 price reform was abandoned and Li Peng advanced to the Premiership (Shirk 1993:326). He proceeded to have the Planning Commission take over the Economic Commission, cementing his factions grasp on central economic policy making (Zheng 2004: 90). The infamous protest at Tiananmen Square was the final turning point for the Party. Zhao was deemed to have reacted to leniently and was removed, even put under house arrest, but Deng protected him from further prosecution at Li's hands (Fenby 2009: 633). Political turmoil was accompanied by economic crisis and it took three years until any new reform efforts could be re-launched.

[35] Including seats of local military leaders puts the share above 50%, See: Shirk 1993: 150.

From crisis to recommitting to the market 1989–1993

Along with Zhao, other leaders of the reform faction lost their top positions. The political unrest and its danger to the Party was seen as resulting form the economic imbalance, which in turn were attributed to the reforms. Jiang Zemin, who had shown strength in dealing with protests as mayor and Party leader of Shanghai, was chosen as Zhao's successor. Deng even stepped down and allowed Jiang to head the Central Military Commission. Nevertheless, Jiang moved closer to Chen Yun's conservative camp (Fenby 2008: 646).

In mid 1989 a period of "retrenchment and austerity" set in. Inflation reached 17.8% and foreign debt stood at over $40 billion at the end of the year (Dittmer/Wu 2006:60). GDP growth collapsed from 11.3% the previous year, to 4.1% and further to 3.8% in 1990. Reestablishment of central control over investment and imports countered inflation and in 1990, for the first time since 1983, China registered a trade surplus. At the same time growth and the reform momentum were arrested (Garnaut 2011: 87). But ever declining SOE profits and budgetary revenue since 1978 limited the capacity of central Party-State cadres to fuel their patronage support network through doling out investment projects or generating and allocating jobs (Naughton 2008: 114).

Dissatisfied with sluggish growth and a halt to the reforms, Deng allied with Zhu Rongji, Jiang's successor as Mayor of Shanghai. Early in 1992, Deng embarked on his famous "southern tour", visiting the SEZs of Shenzen and Zhuhai and as well as Shanghai. It was a massive mobilization campaign of the wealthy provinces and cities to continue economic modernization. He proclaimed that: "we should be bolder in carrying out reforms and opening up to the outside word and in making experimentation."[36]The power of the elder faction was naturally waning with their physical demise. Chen Yun conceded the inappropriateness of formerly reliable policies for the new situation. By the end of the year, the

[36] Cited in Fenby 2008: 647. Deng compared the current approach to women with bound feet, a phrase that Mao had often used to mock adversaries.

Central Advisory Commission was abolished, marking the end of the Old Guard's power (Naughton 2008: 114).

Zhu Rongji was given a newly created agency, the Economic and Trade Office (ETO). After he became Vice-Premier in 1993 his agency was upgraded to the State Economic and Trade Commission (SETC), which would serve as his main power base and policy formulation tool, taking on the tradition of the reformist faction under Zhao. Jiang Zemin, head of the Party, acted as balancer between the factions, with the conservatives still led by Li Peng.

At the Third Plenum of the fourteenth Party Congress the aim was proclaimed to establish a "socialist market economy", finally substituting any mention of a planned economy. A document was drafted listing major reform goals for all sectors. The major shift is described by Huang:

> "In the 1990s, Chinese policy makers favored the cities in terms of investment and credit allocations and taxed the rural sector heavily in order to finance the state-led urban boom. The policy changes in the 1990s were not experimental; rather they were rooted in a technocratic industrial policy blueprint and a heavy urban bias." (Huang 2008: xv)

The provinces led the way in pushing forward with reform, increasing the number of open cities and special development zones without formal central authorization.[37]FDI barriers were lifted in several sectors, while more regions became accessible. Most importantly, approval authority for FDI was transferred to the local governments (Huang 2003:247). SOE autonomy was increased in many areas including investment, wage, and labor decisions (Qian 2006: 238). Economic modernization entered into a new phase under a new generation of leaders, but was still determined by the power allocation between the factions

[37] One rather extreme example was the village of Daqiu near Tianjin. With almost 300 enterprises, many foreign-invested, it was lauded in the media as an example for the new market approach. The local Party Chief took on the air of a western CEO, wearing expensive suits and driving a fine German car. However, it turned out that he had suppressed the entire village to enrich himself. Finally, a paramilitary unit had to remove and arrest him. See: Fenby 2008: 655

within the Party-State elite and the tension between center and provincial governments.

The new reform drive 1994–2001

During the 1990s a consensus emerged to commit to economic reform and stability. Curbing inflation accounted for “soft landings” after the boom phases. Figures 3 and 4 illustrate a gradual cooling down of growth without any radical collapses, even throughout the Asian Financial Crisis 1997–8, and inflation following the trend with a slight lag. The new leadership thus remained secure from being made responsible for either sluggish development or precarious instability that could foster social unrest, especially since all forays into political liberalization had been shelved.

The factional competition focused on internal political power, the separating line between them often derived from local backgrounds such as Jiang’s Shanghai gang that triumphed over his Beijing centered rival Chen Xitong (Dittmer/Wu 2006: 68). The other cleavage, between center and provinces, saw a decisive change through two important reform initiatives concerning SOEs and fiscal matters.

Industrial reform centered on making SOEs more profitable and divesting the state from loss-making enterprises. The share of total industrial output of small scale SOEs fell from 36% in 1980 to 10% in the early 1990s while large scale SOEs raised their share from 25% to over 28% (Nolan/Wang 1998: 156). Overall though, the share of SOE’s output declined sharply, reaching 44% in 2001 (Pei 2004: 124). SOE profits declined more drastically from 14% to 0.6% of GDP between 1978 and 1996 but slowly gained ground again since (Naughton 2008: 108). The particularistic policymaking and building of patronage has allowed urban workers and their bosses to increase wages. Since the beginning of the Reform Era until 1996 the SOE wage fund grew on average by 16% annually (Lin 1998: 425). By 1993 one third of SOEs reported losses (Zhang 2004: 131). The same year, small and medium sized enterprises employed the majority of workers but accounted for less than half of output (Qian 2006: 246). In the early 1990s the central state had to use 17% of the budget to cover SOE losses, which were concentrated in these small firms (Nolan/Wang 1998: 156).

To counter the dire situation of state industry and to alleviate the fiscal burden a reform was started to implement a "modern enterprise system", including an increase in corporatization and even shared stock options, where a minority stake was traded publicly. By 1997 most of the companies listed on the Shanghai and Shenzen stock exchanges (both opened in 1990) were majority state-owned (Guo 2006: 106). The remaining stake was controlled by individual organizations such as relevant Ministries, TVE partners, in some cases even the PLA or foreign investors (Nolan/Wang 1998: 165).

The most important part of reform was termed "grasping the large and letting go of the small" (Ngo 2011: xxxviii). Within two years over 20 million workers were laid off and more than half of small and medium sized SOEs were privatized or merged with larger ones (Qian 2006: 243). For the first time since 1978, industrial SOE profits began to rise, albeit slowly (Naughton 2008:108). One-thousand SOEs were targeted to form large conglomerates in key industries and under continued state control. A Vice-Premier announced in 1998 that China's standing in the economic order "will be to a large extent determined by the position of our nation's large industrial groups."[38] After joining the WTO in 2001 policymakers intended to create fifty even larger conglomerates, modeled after the Japanese and Korean example complete with favorable financial support (Brandt/Rawski/Sutton 2008: 614). But contrary to Japan and Korea (and to a lesser degree Taiwan), the focus was not on *private* national champions. The main point to be made here is the success that was achieved in halting the drain on the state budget by consolidation of SOEs and the concentration of efforts on fewer firms. This meant extensive investment projects in urban industry, financed by the state. But private sector share in fixed-assed investment actually

[38] Vice Premier Wu Bangguo quoted in Brand/Rawski/Sutton 2008: 614; originally in Nolan/ Zhang 2004

declined from 21.4% between 1981 and 1989 to 13.3% between 1993 and 2001 (Huang 2008: 113).

The second major step in 1994 was a new tax reform with the aim to recentralize financial administration. The former complex system of turnover taxes, including multiple tiers, was simplified by introducing a value added tax at the single rate of 17%. Excise taxes were levied for specific products such as tobacco, alcohol and luxury items such as jewelry. A modest 5% tax for business, trade and other services and transactions was introduced as well. The corporate income tax was unitized to 33%. Overall, the simplification and harmonization was an easy way to eliminate distortions through loopholes or inconsistencies that had provided incentives to duplicate certain industries, where local government would extract more revenue (Wong/ Bird 2008: 434).

At the heart of the reform was a new way of tax sharing, that distinguished between three groups: A central fixed revenue base, including continued remittances by centrally owned SOEs, tariffs and others. A second group made up a purely local revenue base, consisting of, among others, business taxes of local enterprises, state and land sales revenues and personal income tax. Most importantly, a third revue base was shared at fixed ratios between the central and local governments, including the new value-added-tax of which three quarters of revenue flowed to the center (Zheng 2004: 119).

New agencies were created for actual collecting both the central and shared taxes, with a separate entity having autonomy to collect the local taxes. Previously, local tax offices had been in charge of assessing, collecting and then delivering almost all taxes, which had provided opportunities to withhold some revenue. In fact, Wong and Bird (2008: 437) go as far in making this fact alone responsible for a significant recovery of the central budget, improving from 22% in 1993 to 56% of total revenue in one year. The value-added-tax made up 42% of total revenue (Shen/Jin/Zou 2012: 12).

The new system had two important effects: First, while the central government has regained a higher ratio of revenues it did not reassume more responsibilities for spending the funds. In descending order of magnitude the central governments three main expenditures were: military, servicing interest on national debt and capital construction. Since three quarters of spending still fall under local obligation, the provinces and in turn the counties, villages and towns rely heavily on transfers along the chain from the central government.[39]These transfers consists mostly of tax rebates, except for the poorest, mostly inland and minority regions. The reason for this lies in the nature of the tax rebate that is based on the previous year's tax income and delivers 30 percent of any increase back to the province. Thus, rich regions like Shanghai, Beijing or Tianjin are vastly favored. This comes on top of the fact that the previous particularistic contracts, which served to redistribute funds between provinces, have been abandoned in favor of equal tax rates (Wong/Bird 2008: 438).

The second effect was a shift to extra-budgetary and off-budgetary resources of revenue. The former denote "all resources managed directly or indirectly by administrative branches of the government outside the normal budgetary process." (Wong/Bird 2008: 443) The latter are simply collected without *any* formal authorization from the central or even the provincial government by the subunits (Shen/Jin/Zou 2012: 37). Due to several reclassifications and the opaque nature of these funds it is very difficult to provide an exact estimate, but they rival the actual budget in size. They are almost entirely spent by the local government. The function of these extra and off-budgetary revenues is to fill the gap left by the responsibility to finance infrastructure, social services or education but their opaque nature makes them extremely prone to misallocation (Pei 2008: 124). The new tax system did manage to dampen the long trend of fiscal decentralization but could not reverse the absolute positions. Measured in spending, central government allocated 47.4% of total revenue in 1978, which declined to 34.7% in 2000 (Pei 2004: 142). Considering the vast amount of funds

[39] The order of spending volume was calculated for 2005 but they still fall under the same fiscal sharing system of 1996, See: Shen/Jin/Zou 2012: 16

outside the official budget concentrated in the local units the imbalance becomes all the more severe.

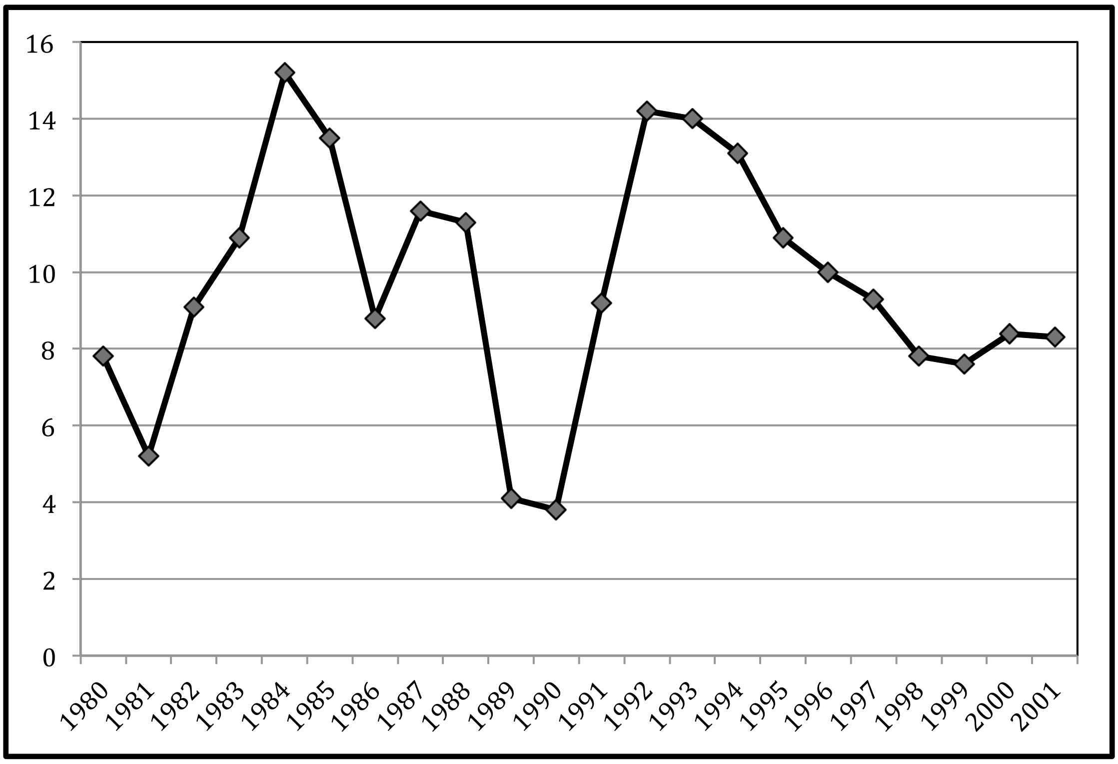
Conclusion – The Political Economy of the Reform Era

Over twenty-three years of reforms a continuous shift from plan to market had occurred in China. Modernization was the new legitimacy for the Party-State, both internal and external since the last years under Mao had undermined the entire social structure, including the implicit rules how elite power was allocated. Deng Xiaoping offered a return to the factional competition of patronage networks and a promise of wealth generation that promised lucrative returns while increasing overall prosperity.

For the first decade the reformist faction initiated a successful transition towards more marketization through increased autonomy for agriculture and rural industry at the same time accumulating political power towards a younger and more change oriented faction. Subsequent opposition by conservatives, preferring to preserve the planned economy and seeing their political power bases diminished, succeeded whenever the rapid reforms could be blamed for instability, both economic and social. Eventually the crisis of 1989 halted further reform and tightened the Party's resolve to hold on to political power through authoritarian means.

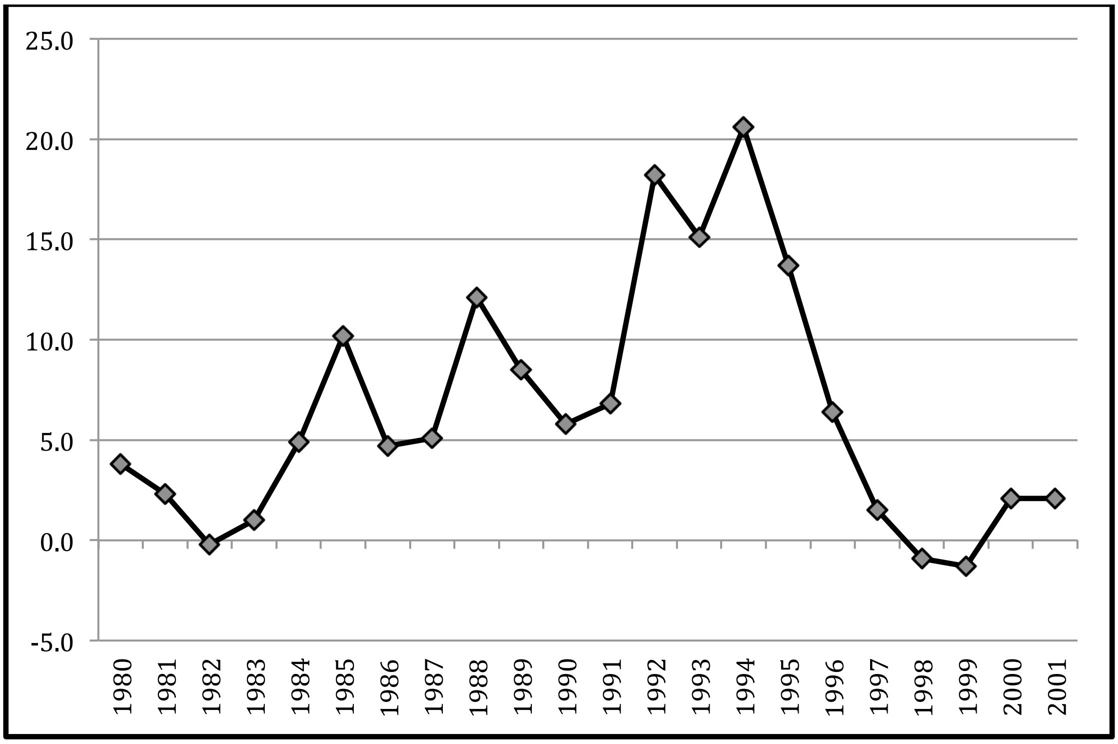
As the reform drive was achieved through a play to the provinces, their increased influence on the center re-launched the reforms, now focusing more on the urban bastions of state industry and a consolidation of state finances that favored the already richer coastal parts of the nation. Throughout the second decade of the Reform Era a consensus of growth with stability was achieved and reflected in more macroeconomic stability. The primary division no longer drove the factional disputes between reformers and conservatives, as a new generation of like-minded technocrats could agree on the general direction of economic reforms. The central state has countered the gradual loss of power and responsibilities to the provinces by repositioning itself from administrating the vast residue of the economic plan to dominating big business. Factional policy-making and imbalanced decentralization are the two main forces that influence the degree to which institutions of a Developmental State could have emerged in China. The following section examines the main attributes in light of the two-decade transformation discussed.

Figure 3 – Annual GDP Growth in %



Source: World Bank data

Figure 4 – China Inflation (GDP deflator annual %)



Source: World Bank data

Chapter 8 – China’s Bureaucracy: Meritocratic, Embedded and Insulated?

The discussion of China’s political economy has demonstrated how the state managed a gradual transition from plan to market that was far from complete at the turn of the millennium and more than a decade later is going on still. The outcome of economic policy was the result of negotiations between different power factions and saw the rise of provincial influence vis-à-vis the central state. Considering the almost complete control over productive assets during the plan-era, theoretically this leaves plenty of room for a capable Developmental State. What was already demonstrated however, is the lack of a long-term development strategy, especially for the first fifteen years, besides the general direction of market liberalization. This chapter then, will consider the evolution of organizational features of the state apparatus and how they compare to those of the Developmental State Model. The discussion above already provides a basis for judging the extent of insulation and embedded autonomy of the bureaucracy. Therefore, to complement the picture, the reform of China’s civil service towards increased meritocracy and efficiency is reviewed first.

Meritocracy and efficiency

Although meritocracy has increased relative to the Mao Era it remains contentious what forces lay behind it (Cao 2004: 436). The politics of the first Reform Era years have demonstrated how informal power was preserved at the highest level and therefore even a recruitment initiative could not escape the client-patronage forces that were still attached to the topmost power brokers. But several attempts at reforming the system have produced some qualified results.

Early on, in the 1980s Deng pushed for rejuvenation of the CCP and the state hierarchy. He declared his goal to "abolish the de facto lifetime tenure system of government officials" and to "modernize the contingent of government officials".[40] Fast-tracking younger and better-educated cadres into top leadership positions was one such effort. Another one was setting an implicit age limit for politburo members. As compensation the Central Advisory Commission was created where powerful elders took seats after they had resigned from formal state and Party offices (Naughton 2008: 102). Their continued power during the 1980s and early 1990s meant the preservation of the respective patronage networks, now promoting younger clients to fill vacancies. Overall, within less than a decade ninety percent of officials, not counting those on county level and below, had been replaced (Li 1998: 394).

The 1980s and the 1990s both saw a rise in meritocratic principles applied to staffing official government post, albeit with reduced applicability for provincial and local subunits. Rationalizing state structures had the adverse effect of preoccupying Party officials with maintaining their department or jurisdiction rather than pursuing a coordinated goal (Howell 2006: 287). Besides evoking resistance the reforms bore another liability. Civil servants charged with implementing a shift toward a market economy could find opportunity for corruption. Having the adverse experience of the Soviet Union in mind, Naughton argues that:

> "As the option of personal enrichment becomes more feasible along with the growth of the market economy, there must be some increase in the overall level of incentives inside the hierarchy in order to sustain the same level of commitment as before. Those incentives can either be career incentives or rewards for specific performance." (Naughton 2004: 3)

Both positive and negative *incentives* and *specific rewards* were part of reforms attempting to introduce meritocratic principles, but they achieved different outcomes between groups working within the state apparatus: professionals, administrators and the top level leadership. The two main efforts at restructuring the bureaucracy were Deng and Zhao's initiative starting in 1980 and then again the limited attempt by Li Peng in 1993 and by Zhu Rongji in 1998.

[40] Cited by Li 1(998: 393); originally in: Deng, Xiaoping: Deng Xiaoping Wenxuan. Selected Works of Deng Xiaoping, Beijing 1983.

The rejuvenation effort of the early 1980s had provided the Party-State with a boost of fresh talent. The intent was to refit the entire administration to be able to carry out the envisioned modernization process. As Burns (1983) has discussed, the civil service reforms under Zhao encompassed several measures, including: education, cracking down on corruption, departmental streamlining and most importantly, efforts to introduce meritocratic elements in recruitment and advancement of state employees.

Educating officials to pursue the "Mass Line" was based on standard efficiency criteria, including such general virtues as trust, openness and honesty. The basic principles have not been significantly altered since Mao's time and are aimed at both Party cadres and civil servants (Burns 1983: 701). The organizational reform's relevant aspects lie in actual institutional changes and a new incentive structure, both positive and negative.

At the macro level institutional reform started with the State Council by trimming the number of commissions, ministries and bureaus. As discussed above, a reduction was initially accomplished but bore the mark of Zhao's concentration of competencies for the SEC. The overall trend of departmental streamlining had been slightly reversed and reshuffled under the premiership of Li Peng after 1988 until the cuts made by Zhu Rongji in 1998 (Zheng 2004). The cutting of departments masks an actual extension of personnel. The goal had been set to reduce government staff by 25% until 1993 and 50% by 1998 (Chou 2004: 231). Official data, referenced by Pei (2006: 136), indicate that during the first decade of the Reform Era, the number of government employees actually grew at a rate of 6.7% annually, compared with 1.8% from 1953–1978.[41] In 2002 the total count had more than doubled to 10.75 million cadres.[42] However it is

[41] This far surpasses China's slow annual population growth, which approximately reached 1.5% between 1980 and 1990 and declined to 0.7% until 2001. See: World Bank data online at: http://data.worldbank.org/indicator/SP.POP.GROW?page=2

[42] According to Pei, this figure includes all employees of government agencies and other state-affiliated social organizations but excludes teachers and medical professionals (Pei 2006: 138). According to Burns (2007: 3) the total number of public sector employees in 2002 was approximately 70 million, half of whom worked in SOEs.

likely that the true number of officials is even higher, as overstaffing is being concealed especially at the lower levels of government. The cost of administration rose by 11% more than budget revenues increased between 1978 and 2002, consequently crowding out other investments (Pei 2006: 138).

The prominence given to a somewhat powerful bureaucracy in the Developmental State model does not lead to the conclusion that a growth in its size is in any way a positive sign. While recruitment of new and better-educated talent is essential, it should be accompanied by an overall streamlining especially through concentration of long term economic planning within central agencies. Instead, China's expansion points to a fragmentation and replication of administrative units on the provincial level and below. Some changes did occur in the composition of the civil service but the increase of meritocratic principles hit several walls.

The introduction of a performance based evaluation system within the state bureaucracy clashed with the Central Organization Department's power to control official posts. As Burns wrote commenting on the first reform drive:

> "China has adopted parts of [an appraisal process based on objective criteria], relying at least in theory on 'democratic assessment' of cadre performance by peers. Authorities have not, however, given high priority to standardizing performance appraisal criteria nor to developing objective measurable goals. The Party assumes the prerogative of determining these criteria, which may explain why so little has been done in this area." (Burns 1983: 717)

Zhao had intended to curb the Party's influence by two measures: First, by empowering the Ministry of Personnel allowing it to manage all positions up to vice-ministers. Two, by dismantling the Party groups within state agencies where all decisions where aligned with Party directives, including individual promotions (Wang 2012: 4; Chou 2004: 216). After some initial success the attempt to reduce Party influence failed. As discussed above, the crisis and political demise of Zhao and the pro-democratic reformers in 1989 reestablished the CCP's hold on the state and especially empowered the Central Organization Department in questions of personnel. The new civil service reform effort initiated under Li Peng and Zhu Rongji in 1993 focused more on continuing with technical aspects.

For one, the number of institutions under the State Council was again slightly reduced, from 45 ministries and commissions to 41 but this reflected mostly the reshuffling of power bases instead of an effort to streamline government (Zheng 2004: 93). Nonetheless, the new civil service system was intended to separate those agencies with regulatory function from the general administration, which could then focus on performance evaluation and staffing, albeit under the Party's oversight. The former, 'political civil servants' would be appointed by the CCP while the latter, 'professional civil servants' would undergo an open examination process. Such a transparent distinction remained unimplemented, as the conservatives led by Li Peng continued to prevent any attempt at political reform detrimental to Party authority (Wang 2012: 4).

The CCP Committees thus reassumed their control over the nomenklatura, selecting candidates that had been shortlisted but also determining whether an open recruitment was necessary at all to fill a post (Chou 2004: 217). Still an overall tendency emerged that saw more rigorous selection criteria for civil servants *in addition* to political requirements. Especially at the central government meritocratic principles for recruiting have taken hold by the late 1990s; farther down the level of government the selection process becomes nontransparent and more corrupt (Burns 2007: 10).[43] By 1998 open recruitment occurred in 30 provincial governments, but only 18 of them made use of it at the township level, where less than half of new employees were chosen this way

[43] Burns gives the example of how bureau chiefs at the Ministry of Personnel were selected in one instance. In 2004, four vacancies were publicly advertised for which one hundred candidates applied. Sixty of whom were given examinations. The results were added to the usual appraisal, leaving 31. These had to answer two essay-based questions, followed by an interview with a board that included the Minister.

(Chou 2004: 221).[44] For judging the potential of an efficient bureaucracy on the national level, this tendency undermines a Developmental State in combination with the decentralization of economic policy making. Still, since these recruiting data include a vast apparatus it is necessary to consider whether different groups of government employees face distinct recruiting preconditions.

Setting aside the career requirements of the top leadership for the moment, one must ask how important professional ability was compared to political conformity for the elite staff. Following the research by Walder et. al. (2000), there is little ground to suggest that the state had forsaken the principles of loyalty to the Party as a prerequisite to career advancement. What emerged is a double career path, distinguishing "high professionals" such as engineers, academic faculty *or economic planners* from "elite cadres", which include "managerial positions in public agencies or enterprises and their subunits". Based on empirical data on urban adults across China, the studies show that CCP membership — not surprisingly — is immensely important for becoming an elite cadre, but it bears little influence on becoming an elite professional. In contrast, attainment of higher education does little for advancement to elite cadres, while it is necessary almost per definition for becoming an elite professional.[45]

The distinction of career paths suggests that the shortage of college educated candidates, exacerbated by Mao's anti-intellectual campaigns, has led the state to channel them towards professional positions rather than including higher education requirements for the administrative cadres (Walder et. al. 2000: 205). Irrespective of one's career, a higher education has dramatically increased the odds of becoming a Party member. Since 1988 a college degree became the best predictor for CCP membership, displacing factors such as parent's membership

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[44] Chou quotes township data for 2003, when only 43.3% of positions were filled through open recruitment. He compares this with the 62.7% national average for 2001–2002. There is no reason to believe that the shares had been better the years before.

[45] The exact scale of the respective impacts, according to Walder et al. (2000: 199) were: „[...] Party members are 5.3 times more likely to become cadres than are non-members, while they are not more likely to become elite professionals [...] Those who attended college are 6 times more likely to become professionals than are high school graduates, who in turn enjoy a 9-fold advantage over those without a high school diploma. However, college education does not significantly improve the odds of becoming an elite cadre above the 2.4-fold advantage conferred by a high school education."

(Walder 2004: 199). Thus, while the overall Party-State apparatus includes an increasing number of higher educated members, entry to administrative careers can be based on political merits alone. This is neither surprising nor completely undesirable. The question remains whether the promotion system works to motivate and select ideal candidates.

In the early 1980s appraisal of state employees was introduced that ought to include the evaluation of performance by peers. The Party decides on the criteria for such assessment, making the entire process rather arbitrary (Burns 1989: 717). Only in 1989 were these appraisals made mandatory, but in effect only leading officials were vetted. The aim was not so much to identify merit and qualification but rather the absence of political loyalty and to uncover corruption. A seemingly standard procedure was introduced only in 1994, directing heads of departments to set up commissions to score their subordinates annually. Based on its member's judgment and a candidate's self-report one of three grades was issued: "excellent", "satisfactory" or "unsatisfactory". Those not rated "unsatisfactory" were entitled to a year-end bonus. The entire system then exhibited more structure, but was still undermined by the high discretionary influence by the Party and the weight of personal opinion. In effect more than 99% of civil servants were deemed satisfactory or excellent and thus entitled to a minor bonus (Chou 2004).

While performance based incentives failed within the bureaucracy, the continuing economic liberalization had exposed some organizations staffed by the state to market forces and even allowed the emergence of a modest private sector. Cao (2003) finds a correlation between effective performance-based standards and the extent of exposure to competitive market forces. Conversely, higher levels of state control have a relatively negative impact on the emergence of meritocracy.

Finally, concerning the top leaders the process has already been discussed above. The Party selectorate negotiates internally along factional lines over top promotions. The main qualification is political capability in building a patronage system. In addition a successful track-record in one's political career is required, especially since the modern Party line focuses on economic success. Huang (2001) uses an argument of institutional economics to account for the outcome of top leadership succession. Over the Reform Era the majority of leaders had a strong background in provincial or urban management where they have presided over successful economic expansion. Provincial leaders are, what he terms "multi-task-bureaucrats", while their ministerial peers are "single-task-bureaucrats". The former are favored for two reasons:

> "First, governing a country is more akin to governing a province than to governing a ministry because both involve multidimensional tasks. Thus the performance of a bureaucrat in a provincial post provides more information about his suitability as national leader than the similar performance of a ministerial bureaucrat. Second, to include a similar level of effort, promotion is a more important incentive mechanism for provincial bureaucrats than for ministerial bureaucrats because the output of the latter is more easily measured." (Huang 2001: 74)

This analysis fits neatly with the ongoing provincial bias discussed throughout the previous chapter. It was reflected in the State Council's composition and the fact that the post-Tiananmen factions have shifted from proponents of certain policies to regionally delineated ones.

In conclusion, the Chinese civil service had limited success in developing a truly meritocratic system of recruitment and promotion if measured by the level of transparent selection criteria based on skill rather than political adherence. Proclamations to streamline the state apparatus have also proven unfulfilled. However, for top professionals including economic planners, a quality education is a necessary criterion, if not a sufficient one. While these professionals do staff the administration of top policy bodies, their leaders undergo the more politically determined career path of rotating governing positions. Since they operate under the pressure of factional competition and the requirement to build their own patronage network, any long-term national economic policy planning is prone to take a back seat.

Embedded Autonomy and Insulation of China's bureaucracy

To successfully support the economy, state officials need a counterparty that is not only the passive beneficiary of policy but also actively engaged in formulating goals and providing feedback. The main theories discussed in Part I take the existence of such a counterparty for granted, but in this respect above all, China was different, for it lacked a strong private sector. Thus it is useful to reconsider the concept briefly, before applying it to the People's Republic.

Embeddedness, as coined by Peter Evans, relates to the extent of networks crossing the public-private divide and producing a synergy beneficial for development (Evans 1995). The concept may apply to such networks on different levels. Evans notes: "Embeddedness is not just a feature of developmentally effective relations between public agencies and the powerless. It is even more pervasive in successful projects that join the state with elite actors." (Evans 1996: 1122). The evident drawback of close ties between officials and civilian actors is the potential for rent-seeking. "Unless such opportunities are constrained by powerful internal norms and a dependably rewarding system of longterm career benefits, corruption is indeed likely to become the prime consequence of embeddedness" (Evans 1996: 1126).[46] Therefore, "autonomy" from "social entanglements" is required as well (Kohli 1999: 132). The notion of *insulation* of state bureaucracy applies to both private attempts of interference as well as political ones.[47]

Despite the positive trend, the relative absence of meritocratic recruitment of China's state employees demonstrated at the beginning of this chapter suggests a lack of insulation. Indeed, levels of rent-seeking increased significantly during the Reform Era. Gong (1997) documents how market reforms opened up vast

[46] Evans refers to East Asia's success, confirming the Developmental State model arrived at in Part I: „attention has been paid to the traditional Weberian requisites of bureaucratic organization. Public institutions are characterized by traditional Weberian features such as meritocratic recruitment, good salaries, sharp sanctions against violations of organizational norms and solid rewards for career-long performance. Corruption is still common, but it has not been allowed to overwhelm the joint public-private project of industrialization." (Ibid.)

[47] Again Evans bears the Devleopmental State model out: „The technocrats in Japan's MITI or Taiwan's Industrial Development Bureau [...] share a relative disinterest in contributing to the political advantage of particular political factions. (Ibid.: 1127)

new opportunities for officials to generate corruption income. For example, since land is state owned, property development contracted out, and the completed properties are sold on the market, bribery of those officials who allocate real estate became very lucrative. An observed expansion of enterprise tax-evasion often falls under the same category, as many businesses concerned are state-administered or enjoy the protection of local officials through personal ties (Gong 1997: 281).[48]While the rise of the market economy has primarily shifted rent-seeking behavior, the concurrent decentralization of economic policy making has locked it in, because local officials, who have benefitted from the reform process initially, are wary of letting privatization continue (Liu et al. 1998: 147). This popular line of argument sees China as an entity of "economically separate fiefdoms" (Williams 2005: 143) or as a "decentralized predation state" (Pei 2008: 36). At the core of this phenomenon, that undermines embeddedness and insulation of the state, is the underdeveloped private sector.

The many hybrid forms of enterprise have made it difficult to determine the size of the private sector. In 1997 the non-state sector, determined by excluding all SOEs, produced roughly 70% of industrial output. However, that includes collectively owned enterprises, shareholding enterprises or foreign-invested enterprises, all of which are to some degree controlled by government agencies or the localities. By counting only registered private businesses and those firms with only a minority stake held by the central government, the share decreases to only 21.2% (Haggard/Huang 2008: 340–341). A conservative approach to measuring the "de jure private sector" is useful as it encompasses the counterparty from which a Developmental State ought to be insulated, while enjoying the embedded autonomy of a shared network and feedback mechanism. All other enterprise forms have institutionally built-in agency problems when it comes to public-private interaction.

[48] Gong provides telling figures: „In 1992 alone, more than 150 big and mid-sized enterprises were caught for tax fraud; among them, three big cases implicated 71 government officials. Based on a sampling investigation of different types of enterprises, the national statistical bureau estimated that about 80% of private businesses, 50% of collective enterprises, and 40% of state-owned ones evaded taxes."

Over the first two decades of the Reform Era, China's private sector has grown by any definition, since it was virtually non-existent before 1978. Opening up the rural economy has freed a vast labor pool that fueled the industrial drive in the countryside. By 1985 over 12 million TVEs were registered, most of them beneficiaries of credits channeled through the government controlled banking system (Huang 2008: xiv).

The positive flip-side of decentralizing economic capabilities, especially the fiscal contracting reforms, is the incentive generated for lower levels of government that retain revenue beyond the negotiated amounts and thus seek to run or support profitable TVEs (Oi 1992: 104). However those TVEs that were collectively owned (meaning directly by local government) enjoyed a comparative advantage since they face a harder budget constraint than SOEs and are more reliant on the market forces, giving them incentives to be more efficient; In contrast to private firms they enjoy even better access to credits controlled by the provinces (Nee 1992: 197). Despite this seeming institutional advantage, private firms outperformed their collective counterparts (Haggard/Huang 2008: 343). Even though, during the second decade of the Reform Era, government policy actually turned from ambivalent to restrictive towards the indigenous private sector. This is illustrated by a fall of private sector share in fixed-asset investment from 21% in the late 1980s to 13.2% by the mid 1990s (Haggard/Huang 2008: 353).[49]

The missing indigenous private sector is especially underdeveloped at the commanding heights of the economy. Personalized ties that connect policy-makers with leading entrepreneurs could not emerge after three decades of staunch opposition to the private sector before 1978 and only a limited embrace during the Reform Era. Not before 2001, at the very end of the period under discussion, Jiang Zemin held his famous speech, endorsing private businessmen

[49] Measured in percentage of total industrial output, the share of the domestic private sector paints a similar picture as it increased during the 1980s from 0% to 5.39% and then contracted to 3.4% by 1995 and slightly improved by the end of the century (Perkins/Rawski 2008: 862). As Haggard and Huang (2008) argue though this measure is not indicative of policy support by the government, since higher private sector productivity might partly counter the contraction of state-controlled investment funds.

joining the Party. Chinese entrepreneurs and state officials have never formed ties through social background or education. The relationships they do form are clientelistic and tend to aim at the rent-seeking behavior described. Furthermore, being inimical to all forms of autonomous interest formulation, private business lacks a comprehensive organization that could serve as a feedback-loop to the state (Howell 2006: 288–289).[50] Almost 90% of private firms in 2000 did not have a single active CCP member (Pei 2006: 185). What does happen however, is cadres leaving state offices to form or join private firms after having used their power and influence to prepare lucrative business ventures (Pei 2006: 154). These ties may eventually lead to increased embeddedness between the public and private sectors but further undermine the bureaucracy's insulation. Moreover, using business ventures as an exit option results from the "wrong" kind of personal networking instead of the institutionalized relationship, that is the attribute of a Developmental State.

Conclusion – Limits of a Developmental State Bureaucracy

A well functioning Developmental State requires an elite bureaucracy that includes a capable staff of economic planners, who can formulate a long-term development strategy, requiring meritocratic recruitment and appraisal. Their policies need to be coordinated through a network with the private sector in order to receive feedback on what works and what doesn't, meaning embedded autonomy. These ties must exclude favoritism on an individual level, preventing opportunities of rent-seeking on both sides. Rather, they refer to aggregate interest formulation on an institutional level. Finally, the bureaucracy must be insulated from political pressures as well.

Despite moderate progress, China failed to create a Developmental State bureaucracy during the first two decades of the Reform Era. The main

[50] Howell (2006: 290) also makes the general point that: „The constant tension within the Party/state between retaining a controlling hand over more independent organizing and stimulating its growth for purposes such as welfare reform and market regulation, continues to inhibit the development of predictable, institutionalized arrangements for the aggregation and articulation of interests."

undermining forces were the decentralization of governance capabilities and the underdevelopment of private enterprise.

Meritocratic recruitment and appraisal had been gradually introduced, but mostly at the central level with decreasing applicability down the line of federal government. The Party's dominance over government personnel decisions has prevented the introduction of transparent criteria. This effectively negates any insulation of public employees. Client networks within the Party are the dominant factors for career advancement and due to decentralization of economic policy making, the provision of patronage has shifted to the provinces as well. That opens up opportunities for rent-seeking that undermine civil servant's insulation from business interests.

The lack of embeddedness is mainly a result form a nonexistent private sector counterparty to state economic policy agencies. Even though increasingly important for economic growth, the private sector remained unconsolidated and small compared with the state-involved sector. Decentralization has led to the emergence of a TVE collective sector with its private counterparts reliant on local government controlled investment funding. The commanding heights of the economy were still dominated by SOEs.

In effect China faced a major challenge for evolving a capable Developmental State bureaucracy. Reorienting a planned economy towards the market required dismantling the strong central state, where an insulated and powerful guiding agency would be located. This was a function of the political logic of decentralization. Meanwhile, the continued dominance of industry by all levels of government prevented the emergence of a large-scale private sector. The two factors represent prominent differences to the South Korean and Taiwanese Developmental States. While China's growth performance has evidently been spectacular, it is useful to conduct a closer examination of development achievements in a direct country comparison.

Chapter 9 – Development outcomes in comparison

The Developmental State model assembled in Part I was motivated by the unique distinction held by South Korea and Taiwan. They are the only two nations with large and diverse economies that joined the range of industrialized and wealthy countries in the second half of the twentieth century outside Europe and its offshoots.[51]This chapter will first compare this achievement with China's, taking into account relative levels of initial wealth. Subsequently, improvements in health and education are studied. Finally, the social distribution of income and its change are discussed. Together these indicators provide a well-rounded yardstick to measure a Developmental State's success, since economic growth figures alone can be distorted.[52]

Economic growth

The standard yardstick of an economy's size and progress is the Gross Domestic Product, which tries to capture the value of all goods and services originating from the territory of a certain economy, rather than their national ownership (GNP or GNI) for a given year. Nevertheless, this section will use general terms such as Income", "living standard" or "wealth" in reference to GDP. In order to achieve useful comparisons, only per capita GDP at purchasing power parity is sed. [53]

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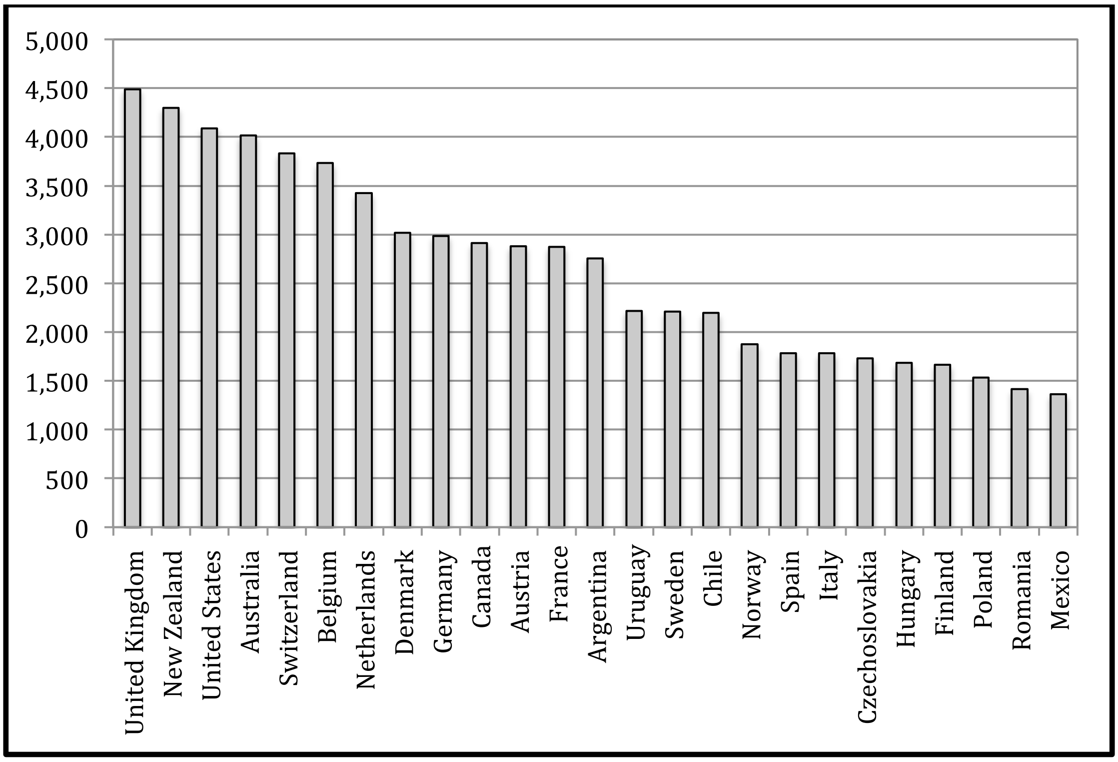
[51] The usual caveat applies that two city-states of Hong Kong and Singapore as well as small resource rich states are excluded.

[52] A crass example like Equatorial Guinea illustrates this well. With a GDP per capita between the UK's and Finland's it is well placed within the wealthiest quarter of the globe, but the dismal state of education, health and inequality dispel any illusions of high development. Of course vast oil resources account for it's nominal riches. A different example reveals some shortcomings that even the extended use of inputs fail to capture. The Islamic monarchy of Brunei would fare as well as the UK based on these indices while widely lacking political freedom.

[53] The main database in use for historical comparison is that of the late Angus Maddison's Groningen Growth and Development Centre. As explanation from the homepage: "Gross domestic product (GDP) at market prices is an aggregate measure of production equal to the sum of the gross values added of all resident institutional units engaged in production (plus any taxes and minus any subsidies on products not included in the value of their outputs). The sum of the final uses of goods and services (all uses except intermediate consumption) is measured in purchasers' prices less the value of imports of goods and services, or the sum of primary incomes distributed by resident producer units. […] The GDPGK series is expressed in 1990 U.S. dollars, and it is available for all of the 123 countries in the database. It is converted at "Geary-Khamis" purchasing power parities (PPPs)."

Figures 5 and 6 offer an interesting comparison of the twenty-five wealthiest nations at the beginning and end of the 20th century. In 1900 only European countries and its offshoots dominated the top positions, with Japan being the only exception. By the year 2000, Taiwan and South Korea take the ranks 20 and 24 respectively measured in GDP per capita. In 1965 both ranked around the 100th place and had 56% and 44% of the world average GDP per capita, similar to Angola or Morocco at the time. By the year 2000 the ratio has increased to 280% and 240%.

Figure 5 - 25 wealthiest countries in 1900 (GDP per capita; fixed USD 1990)



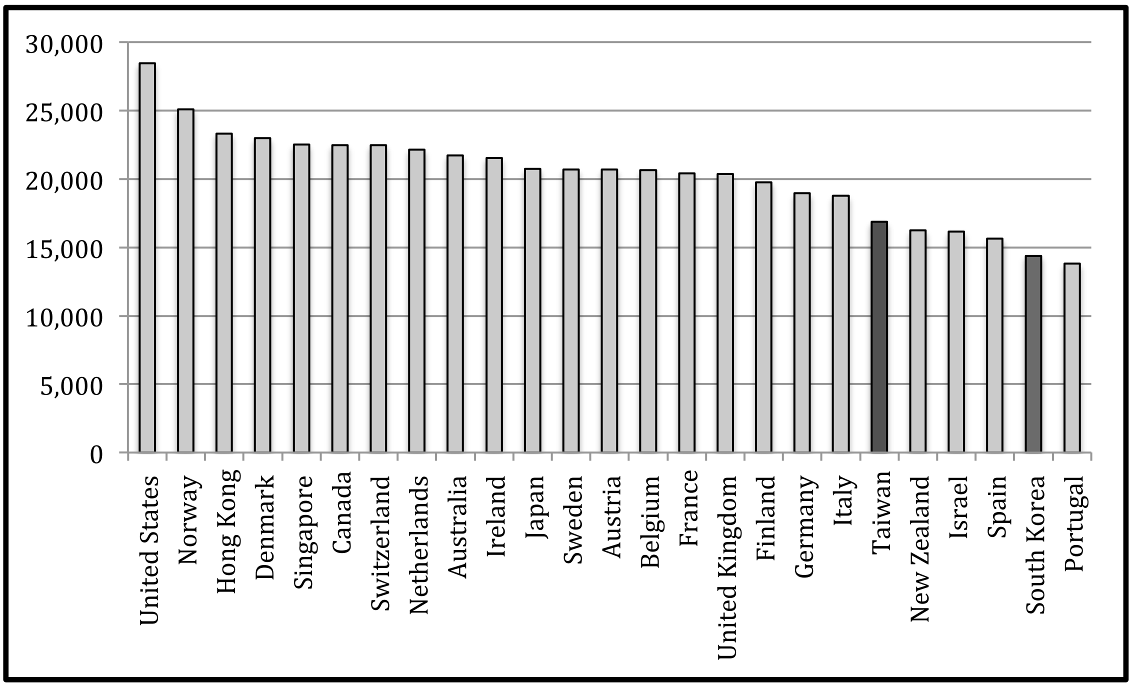
Source: Maddison[54]

The scarcity of individual country data and the incomparability of the colonial territories with modern units renders the composition of a bottom ranking for 1900 impractical. The earliest data available concerning the three countries under observation are from the year 1913 and indicate that even then Taiwan

[54] Small countries like Liechtenstein or Luxemburg are excluded. The ranks are applied to territories of modern states, even if at the time they formed different political units. Note: Japan holds rank 30 but would advance to the top 25 if the Austro-Hungarian Empire were calculated as a unit as well as the Commonwealth states.

and South Korea, both already under Japanese control, had a lead on China in average living standard by 32% and 57%.

Figure 6 - 25 wealthiest countries in 2000 (GDP per capita; fixed USD 1990)

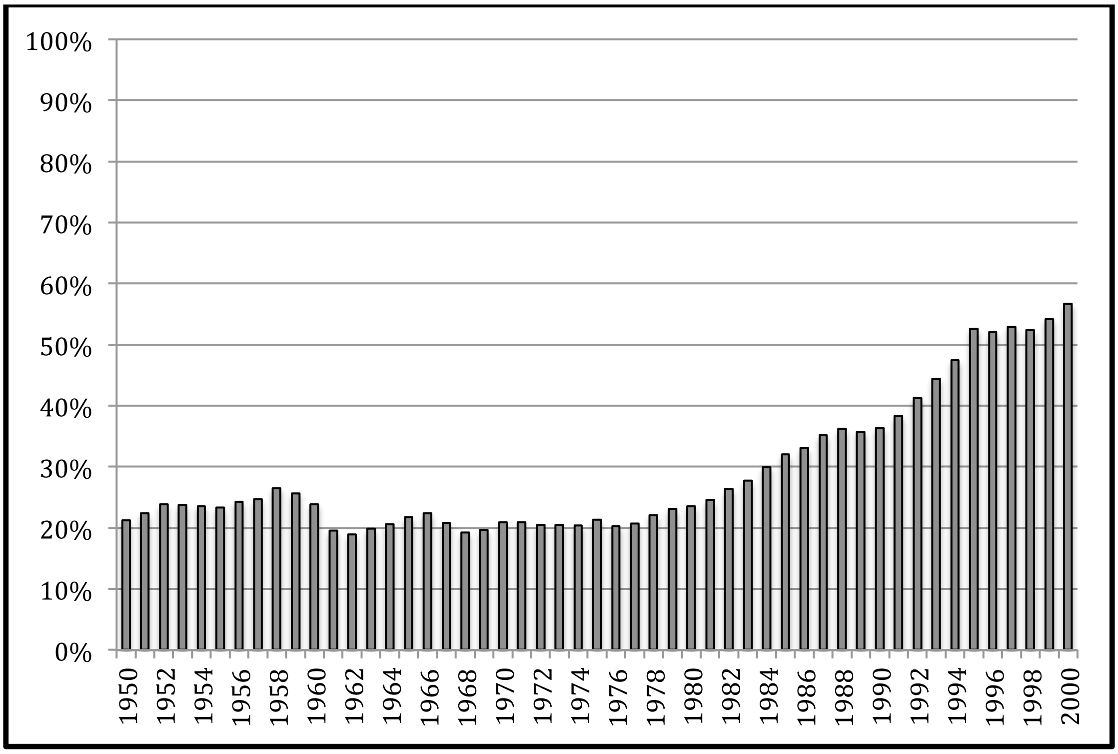


Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm[55]

Figure 7 shows China's share of average World GDP per capita for the second half of the 20th century. It clearly reveals the dent following the Great Leap Forward in 1958, reducing the share from 26% to 19% and remaining around that level until a rather steady growth sets in with the Reform Era. Comparable relative levels of income shares that South Korea and Taiwan had in 1965 were reached in China by the mid 1990s only. This clearly illustrates the People's Republic's relative backwardness even at the outset of the growth spurt. A direct comparison of GDP per capita levels of the three countries illustrates this point even better (Figure 8).

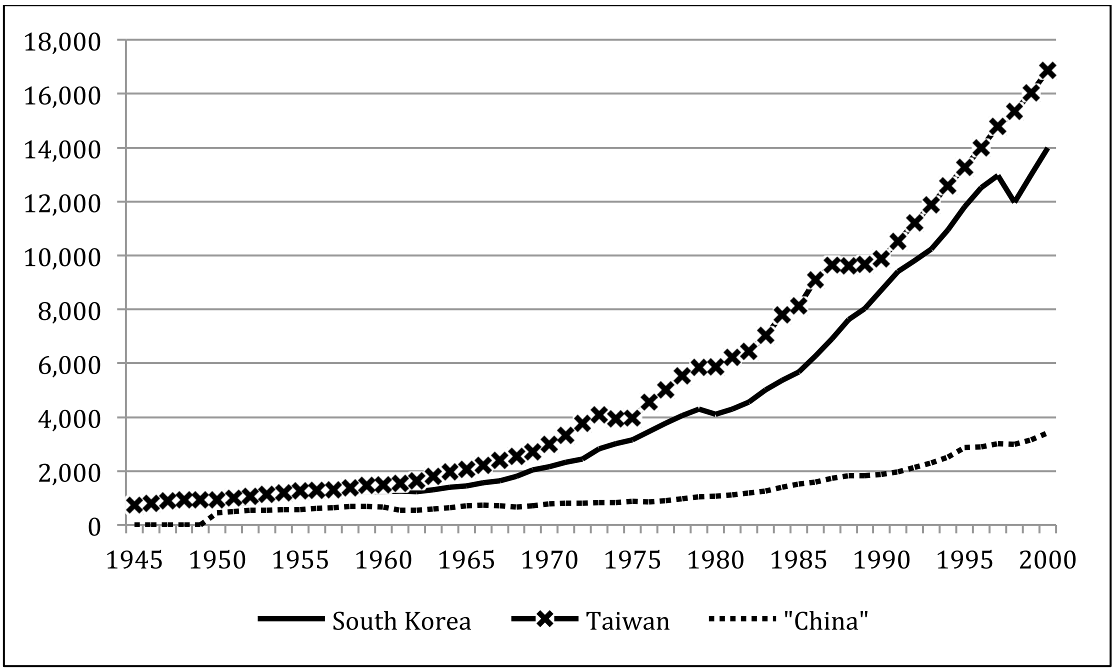
[55] Small countries like Liechtenstein, Luxemburg or Brunei are excluded; Note: The large oil-rich countries are included in the data but do not make the cut in the year 2000 with the United Arab Emirates holding rank 26 and Kuwait coming in at rank 30 for example.

Figure 7 – China’s share of average World GDP per capita



Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm

Figure 8 – GDP per capita Country comparison (fixed USD 1990)

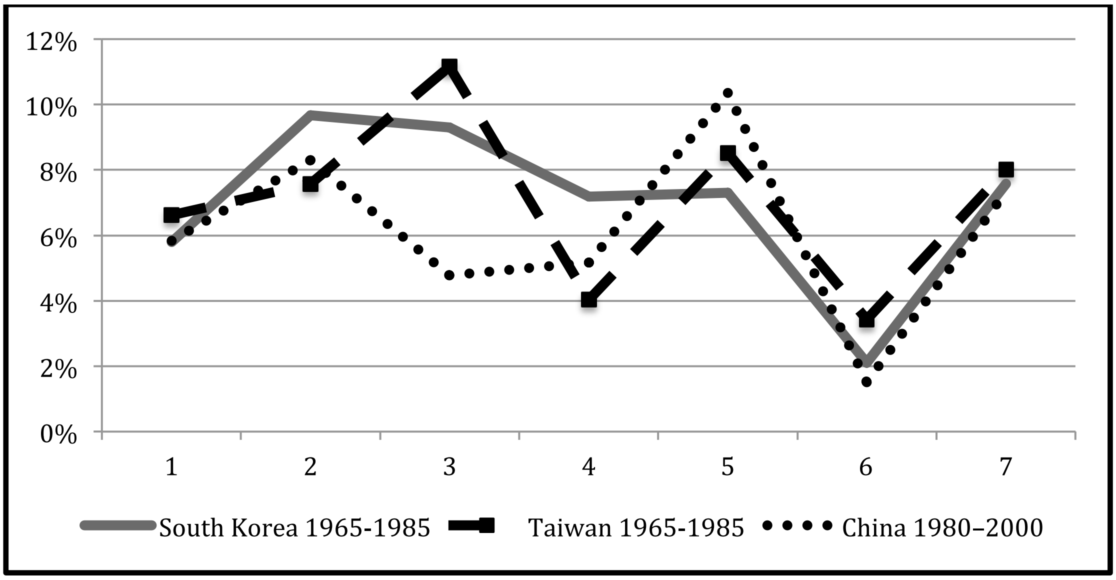


Source: Data in Appendix (Tables: 7,8,9)

Following the mid-sixties, South Korea and even more so Taiwan saw per capita GDP taking off. In comparison China's performance seems almost stagnant, since the initial levels and the significant time lag of growth spurts require a larger scale of income levels for depiction. Figure 15 in the appendix plots China's performance in isolation to better indicate the results of policy eras. Therefore, performance should be assessed by comparing the period of Chinese transformation under consideration with the same time spans of Taiwan's and South Korea's growth acceleration. Figure 9 shows annual GDP per capita growth rates between 1980 and 2000 for China and the same two-decade long period of 1965 to 1985, roughly capturing the spurts of Taiwan and Korea.

The two East Asian developmental states outperformed China significantly during their first decade of transformation while all three performances in the second decade were remarkably similar, given that different periods are under consideration. Overall these rates indicate a superior performance of the earlier two countries, which is illustrated in Figure 10, superimposing absolute per capita growth of the two periods.

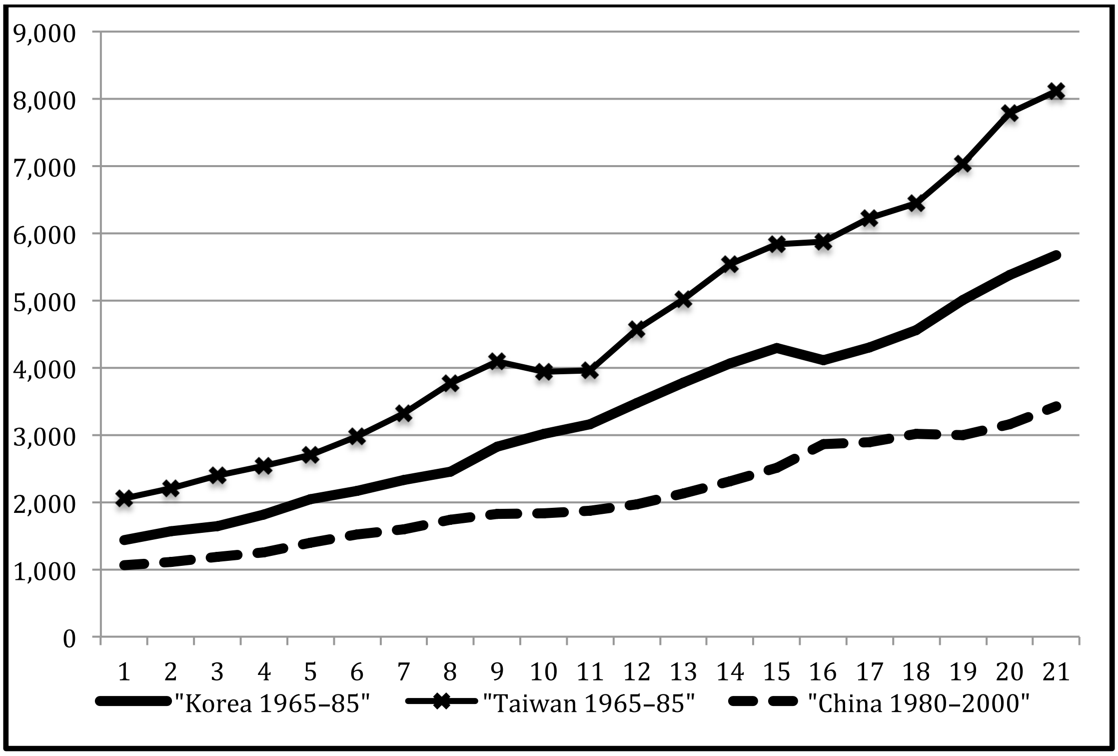
Figure 9 – GDP per capita growth during spurts[56] (three-year averages)



Source: Data Table 7, 8, 9

[56] The growth rates were calculated also based on fixed USD 1990 used by: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm; thus they do not conform to the standard measure of GDP growth used e.g. above in Chapter 8 by the World Bank. They are useful for inter-temporal comparisons and their absolute values should not be over interpreted. Note: In order to allow for a better visualization, three-year averages were used.

Figure 10 – Growth spurts of GDP per capita (over 20 years; fixed USD 1990)



Source: Data Table 7, 8, 9

Figure 9 and 10 illustrate the important point that all three economies achieved considerable growth. Over twenty years GDP per capita grew in Taiwan by 3.7 in Korea by 3.9 and in China by 3.2 times.[57] At the end of 1985, both Taiwan and South Korea ranked among the thirty richest countries of the World.[58]Even today, China still has a very long path ahead to achieve this feat, even if current growth continues. This is mostly due to the high level of relative backwardness that has historically built up over almost two centuries of stagnation. China only reached Taiwan's and South Korea's initial 1965 per capita levels between 1984 and 1988. Nevertheless, looking at the two decade time-spans of closing the gap, China's record was slightly inferior to the two Developmental States.[59] However, the speed and level of economic output is not the sole standard to evaluate a State's level of development. Average GDP does a poor job of capturing actual

[57] The Y-axis still uses the absolute values of fixed USD 1990 in order to indicate actual growth levels of income. The nominal levels reached rather than the stark divergence and slope caused by the exponential nature of growth, are indicative. For a different visualization see Figure 16 in the Appendix, which uses a Log scale.
[58] As usual, without including small states and solely natural resource based income.

average standards of living. The next section examines further development indicators.

Measuring development beyond wealth

Since 1990 the United Nations Development Programme (UNDP) compiles the Human Development Index (HDI).[60] The aim is to account for a nation's level of development by including measures of health and education in addition to living standards and express the results in one figure between zero and one with higher values indicating more development. By 1982, South Korea held the 31th rank (24th if small and resource based economies are excluded) and the 15th place in the report released in 2011. Since Taiwan is not a recognized UN member its HDI is not included, but by its governments own calculations it would currently hold rank 18. Since the methodology of weighing and calculating the index has changed over time it is not that useful for inter-temporal comparison and plotting. Table 2 lists the results published by the UNDP for China[61] and South Korea.

Table 2 – HDI, China and South Korea

Year	China	South Korea
1980	0.404	0.634
1985	0.448	**0.69**
1990	0.49	0.742
1995	0.541	0.793
2000	**0.588**	0.83
2011	*0.687*	*0.897*

Source: UNDP

[60] The complete data set and background information can be accessed at: http://hdr.undp.org/en/ (Jan. 2013) From the homepage: „The first Human Development Report introduced a new way of measuring development by combining indicators of life expectancy, educational attainment and income into a composite human development index, the HDI. The breakthrough for the HDI was the creation of a single statistic which was to serve as a frame of reference for both social and economic development. The HDI sets a minimum and a maximum for each dimension, called goalposts, and then shows where each country stands in relation to these goalposts, expressed as a value between 0 and 1."

[61] Note that given Taiwan's unrecognized international status it was either not included in the calculation or even included in China's figures. Since its population is only 1/55 that of China's it hardly dilutes the values though.

The calculations do not go back to the 1960s and 70s but the bold figures mark the end years of the two-decade growth spurts used in above comparisons. By 1985 South Korea had reached an HDI value of 0.69, while China exhibited a value of 0.588 by the year 2000. Taking into account that Korea's income in 1965 was only caught up to by China in 1985 it is reasonable to attribute a five year lead, but Korea's HDI for 1980 of 0.63 still lay above China's result. Since income has already been evaluated, the evolution of health and education need to be considered next.

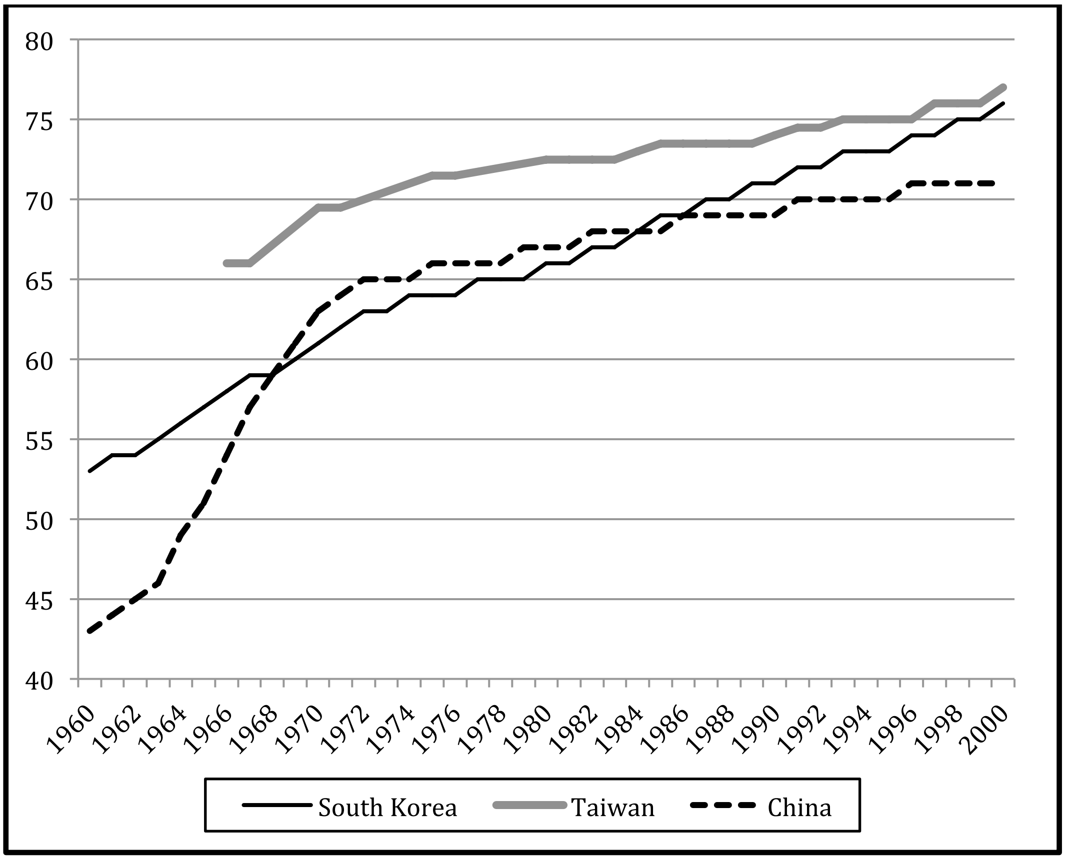
To assess a populations health the HDI uses life expectancy at birth. Figure 11 shows the rather surprising development. While all countries experienced steady increases, Chinese averages life expectancy increased dramatically after the Great Leap (1958–61) and leveled off during the Cultural Revolution. During Korea's growth spurt between 1968 and 1984, the People's Republic actually surpassed its fast developing neighbor's levels. Taiwan on the other hand started out with a considerably higher life expectancy of 66 years in 1966, the year the first data was available, and exhibited steady growth.[62] Figure 12 again isolates the growth spurt periods. Even more so than with GDP per capita growth, both Korea and Taiwan experienced better improvements.

The nature of old age certainly makes marginal improvements more difficult and a certain leveling off is to be expected once the global frontier of general health factors and medical provision are reached. The curious case of China's rapid improvement during the mid-Mao Era is pointed to by Bramall (2009: 296) for example, when arguing that to some degree the vast programs of irrigation and food supply have indeed reduced poverty successfully even before the Reform Era. Similarly the spread of school enrollment has been positively noted by Brand and Rawski (2008: 5): "School enrollments [during the Mao era] increased at all levels; the spread of education reduced the proportion of Chinese aged 16–65, who had not completed primary school from 74 to 40 percent between 1952

[62] Korea caught up with Taiwan around 2010 when both countries had an average life expectancy of 80, putting them among the global top.

and 1978." Different measures of educational attainment have also been the third input in composing the HDI.

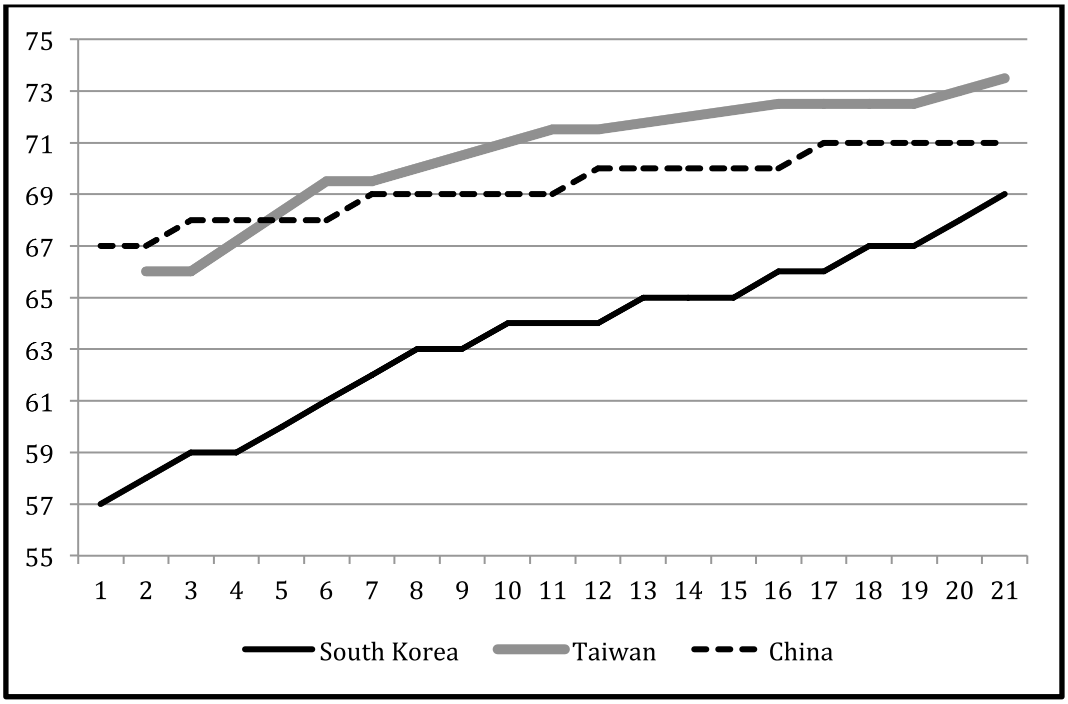
Figure 11 – Life Expectancy at Birth in South Korea, Taiwan and China (years)[63]



Source: Table 11 in the appendix

[63] Data for Taiwan only from 1966 onwards.

Figure 12 – Average Life Expectancy during growth spurts (21 years)



Source: Table 11 in the appendix

Data for valid direct comparison in educational matters is a little patchy for the 1960s and 70s, especially for Taiwan since it is not included in United Nations surveys and the national statistical office uses diverging indices. Similarly, literacy rates are difficult to appraise for Taiwan and South Korea. Table 3 presents literacy rates for China for selected years.

Table 3 – Adult Literacy Rate as Percentage of Population in China (Ages 15+)

Year	%	Year	%	Year	%
1982:	65.5	1990:	77.8	2000:	90.9

Source: UNESCO

This impressive 25% increase in adult literacy is corroborated by the Education Index, which combines expected and mean years of schooling. Table 4 shows this index for selected years in China and South Korea as well as corresponding public expenditure on education. The bold figures allow a direct comparison according to the two-decade growth spurts. At the end of the time spans, Korea exhibits an Education Index of 0.69 out of a perfect score of 1 while China's figure for the year 2000 lies somewhat lower at 0.53. Indeed, five years into the growth period, Korea spent 3.5 percent of GDP on education, while China expended 2.5 percent only.

Table 4 – Education Index and Public Expenditure on Education

	Education index		Public expenditure on education (% of GDP)		
Year	South Korea	China	Year	South Korea	China
1970	-	-	1970	**3.5**	1.3
1980	0.612	0.372	1980	3.5	2.5
1985	**0.692**	0.396	1985	4.2	**2.5**
1990	0.738	0.437	1990	-	-
1995	0.81	0.482	1995	-	-
2000	0.862	**0.535**	2000	-	-

Source: UNDP

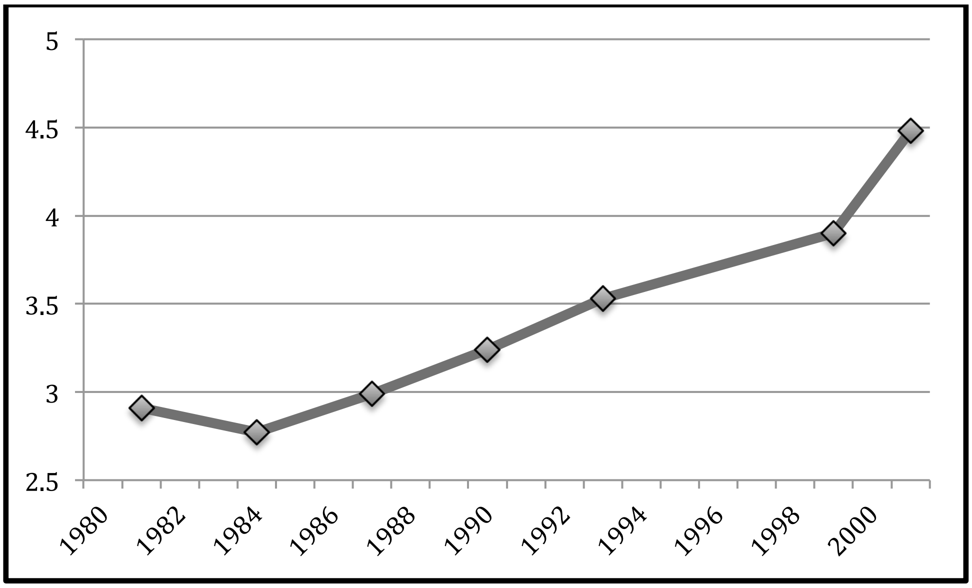
Having looked at the recent historical measures of development according to the priorities set by the Human Development Index a clear picture emerged. GDP growth, Health and Education during each two-decade transformative period grew consistently in China but at a slower rate than in the two Developmental States. Since 2011 the UNDP also calculates an inequality adjusted HDI by taking vast gaps in wealth, health and education across societies into account. Such considerations are essential when assessing a Developmental State, since it truly measures how much of the population is actually participating and gaining from economic growth.

Compared to all previous measures, China's record truly departs with respect to income inequality. The standard value, already employed in foregoing chapters, is the GINI coefficient. It is a statistical tool to determine how widely values differ of a given sample yielding a co-efficient between zero and one. Transferred to income inequality, a result of zero indicates that everybody earns exactly the same, irrespective of the actual amount. In contrast, a value of one would imply, that a single person or household earns everything, while all others have nothing at all. The realistic values for modern economies currently range from under 0.25 for countries like Japan and Denmark espousing the highest equality levels to values over 0.6 for the most unequal nations such as Botswana, South Africa or Haiti.[64]

Figure 13 shows China's income GINI over the Reform Era in isolation. The national trend over two decades is a stark rise in inequality. To some degree this is to be expected when shifting from a collectivized and price controlled, planned economy to one extending market forces. With regard to structural properties of inequality, Benjamin et al. (2008: 773) have found several trends: Both urban and rural population's income inequality has increased. The former is related to the decrease of subsidies and other entitlements and the divergence of wages earned due to the diversifications of enterprise. Rural households income has diverged due to a different levels of involvement in non-farming income as well a general stagnation of returns on traditional farming.

[64] Data from the World Bank at: http://data.worldbank.org/indicator/SI.POV.GINI/ (Jan 2012); The year of surveys differs between nations and for several there is no data available.

Figure 13 – Income Inequality in China (1980–2001; GINI) [65]



Source: Table 12 in the appendix

These effects were anticipated in public thinking though as evidenced by Deng's famous pronouncement in 1986 that: "We permit some people and some regions to become prosperous first, for the purpose of achieving common prosperity faster." [66] Interestingly before that time, income inequality after 1978 had actually declined until 1984–5, since reforms in the beginning disproportionately favored the poor, mostly rural Chinese (Naughton 2009: 109). In addition, the food price controls shielding the urban population had been maintained until the strain on the budget had become too overwhelming. With the opening of SEZ in coastal regions and reduction expansion of the dual-track price system the trend reversed. Deng countered that in a socialist society wealth, in the end, belonged to the entire people: "That is why our policy will not lead to polarization, to a situation where the rich get richer while the poor get poorer."[67]That, however, is

[65] In order to homogenize sources, the figures use values increased by one decimal step making the range 0–10. The GINI definition by the World Bank: „Gini index measures the extent to which the distribution of income or consumption expenditure among individuals or households within an economy deviates from a perfectly equal distribution. A Lorenz curve plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The Gini index measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line. Thus a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality." Online at: http://data.worldbank.org/indicator/SI.POV.GINI?page=6 (Jan 2013)

[66] Quoted in Fenby 2008: 567

[67] Ibid.

exactly what happened until 2001 and has even increased in pace since then. How did the Developmental States fare in the past?

Figure 14 maps the development of the income GINI for China, South Korea and Taiwan from 1965 to 2001, smoothing the disparity of available annual data by calculating five-year averages; Figure 15 again compares the growth spurts. The overall difference in trend between China and the Developmental States is immediately apparent. Taiwan's income inequality has remained relatively stable after inequality dropped following comprehensive land reforms in the 1950s and early 60s (Bourguignon et al. 2001: 139).

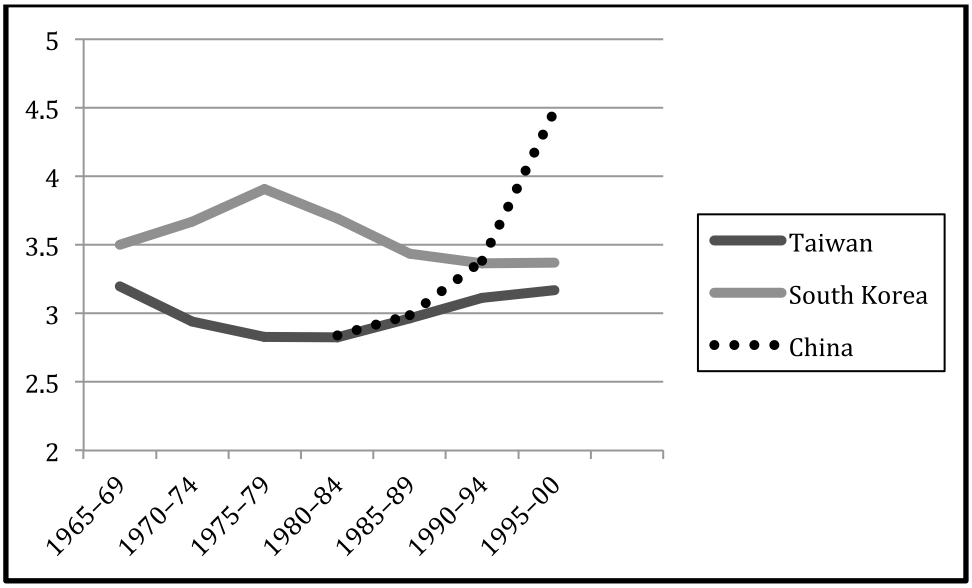
South Korea's land reforms did not contribute to comparable income equalization. Inequality peaked dramatically during the recession of 1979, a fact that is insufficiently captured by the lack of annual data. Since then, the GINI has steadily dropped, a fact that was even more prominent for employment income (Fields/Yoo 2000). Latest data available show that the trend has continued at least until 2010, when Korea's income GINI was 0.31.[68]

Studies explain the decline in both countries by weighing the influence of various factors, with education and broader participation in the labor market playing an important role among others.[69]What statistical studies naturally omit is what didn't happen in the Developmental States that occurred in China and caused such rapid income disparity.

[68] CIA World Factbook: www.cia.gov/library/publications/the-world-factbook/fields/2172.html (Jan 2013)

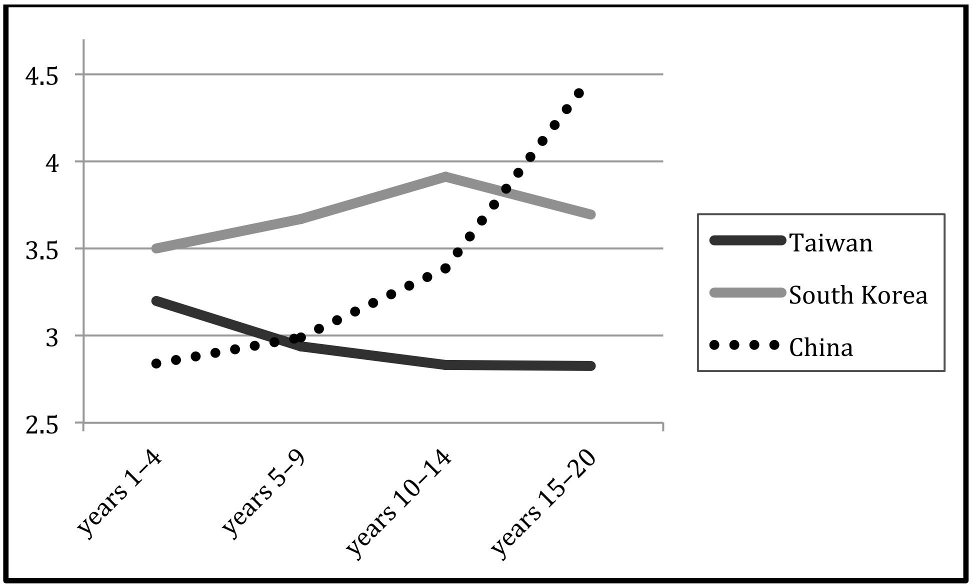
[69] For Taiwan see: Bourguignon 2001, concentrating on the period 1979–94; For South Korea see: Fields/Yoo 2000

Figure 13 – Income Distribution (GINI 5-year averages)



Source: Table 12 in appendix

Figure 14 – Income Distribution for 20-year growth spurts (GINI 5-year averages)



Source: Table 12 in appendix

Growing imbalances in China are ascribed to the general erosion of state capacity. As Pei points to the "[…] excessive provision of private goods that benefit favored jurisdictions and sectors" at the expense of "provision of education, public health, research and development." (Pei 2008: 14).[70] Especially the importance of better

[70] Teresa Wright's (2010: 163) study on the acceptance of authoritarianism across China's social strata even suggests that the relative divergence of wealth has motivated the ‚winners' to preserve the current rule in order to continue their rent-seeking behavior.

education has been noted as a key factor to curb inequality, not only via comparison with Taiwan and South Korea but also by the study of China's experience thus far by Benjamin et al. (2008: 773).

In conclusion, the country comparison has illustrated the performance gap between the two Developmental States and China. While GDP growth was formidable in all three and beyond what most developing countries have achieved by the end of the twentieth century, China's progress was slightly lagging. When it comes to the essential development indicators in health and education the gap is still wider with the noteworthy exception of relatively early improvements in average life expectancy. Finally, the main deficit of China's development has been and continues to be a rapid increase in income inequality. This relative gap is mitigated by an overall improvement in living standards, but the ability of the East Asian neighbors to better reconcile growth with equity contributes to negating the central research question whether China has followed the Developmental State model.

Conclusion

The impressive growth of China over the past three decades has spurred a range of scholarship trying to explain which "path" to development was responsible. The uniqueness of historical circumstance often repels attempts at generalization. Yet, interpreting past experiences helps narrow down the range of causal relationships. Hence, nobody is advising a developing country today to adopt a socialist planned economy. There is often a trade-off in scholarly endeavors between certainty and modesty. Depending on the format a different balance is called for. The present study tries to contribute to the topic of development paths by assembling one model and asking to what degree the Chinese experience conforms to it. Before summarizing the findings and offering some conclusions it is vital to delineate clearly what this research has attempted in relation to the larger debate.

In 2009 two economists led a written argument over what strategies developing countries should adopt in order to catch up with the global industrial leaders. Their discussion revolved around the question, what role the state should and could play in promoting sustainable growth. On one side of the argument was Justin Yifu Lin, one of the foremost Chinese economists and former Senior Vice President of the World Bank. His scholarly opponent was Ha-Joon Chang, a South Korean economist from the University of Cambridge.[71] While the former derived his line of argument from neo-classical economic theory, the latter is a proponent of heterodox and institutional economics. Nevertheless, even at the lowest common denominator, the state is seen as an essential component for achieving economic growth. This is in contrast to the often reductionist complaint by opponents of the Washington Consensus, used as a short-hand to encompass a neo-liberal set of remedies, prescribing a vast range of free-market policies to ailing developing countries. But the debate has diversified, influenced in no small part by the transformation of China, growing rapidly while relying on

[71] Lin/Chang 2009

some general form of state-capitalism.[72] What the argument came down to then, was whether successful involvement meant:

- A "facilitating state" that uses policies in accordance with a nation's comparative advantage
  OR…
- Deeper government intervention, that actively fosters production capabilities beyond what current factor endowments would suggest.

The scholarship used here to construct the Developmental State Model was based on work that focused on Japan, South Korea and Taiwan and argued for adopting the strategy advocated by Chang that calls for defying ones comparative advantage through a range of policies.

The present study has not tried to weigh in heavily on this argument but instead focused on the institutional setup of the state that makes coordinated development feasible in the first place, be it more modest or far-reaching. The three East Asian states have adopted relatively high levels of state intervention and generated institutions in accordance while achieving high levels of development. Though the entire argument made by the studies in Part I were presented, the input extracted for the Developmental State Model focused on institutions of state capacity, not specific policy.

Summing up, the attributes of a Developmental State are as follows:

- A long-term development strategy
- A centralized setup of government agency in charge of coordination and adjustment of policy

[72] Emphasizing this view is the popularity oft he term „Beijing Consensus" coined by Joshua Cooper Ramo in a paper offering a very optimistic account of China's economic success, based on innovation (transcending comparative advantage), broader development goals than GDP and „self-determination" in both economic and political matters. (Ramo 2004). A recent article by Acemoglu and Robinson succinctly frame the issue of state-capitalism (Acemoglu/Robinson 2012).

- The insulation of the respective bureaucracy from private and public special interest
- Embedded autonomy, allowing influence over and feedback from civil society in pursuit of national development
- The implementation of meritocratic selection criteria

In addition, a set of historical vantage points was identified, beneficial to the emergence of a Developmental State. They are:

- Colonial manufacturing experience
- Disruption of ownership structures after decolonization
- Relatively equal income distribution

The central research question then is: *To what degree do these attributes apply to the Chinese experience of the Reform Era between 1978 and 2001*? In Part II this was answered the following way:

Historically, the colonial manufacturing experience has been strongly diluted by the effects of the civil war and the ensuing three decades of Maoist enforcement of a planned economy. Its main feature was an extraction of capital from the collectivized agricultural sector and reinvesting it in heavy industry, while extending isolation from the world economy. Under state control the disruption of colonial ownership structures was total. The all-encompassing plan led to a relatively equal distribution of income. Generally though, China's economy stagnated and the nations relative backwardness continued to increase. China's economic isolation, geographical extent including diversified resources, the world's largest population, a vast army and last but not least the possession of nuclear arms allowed the regime to feel capable of resisting outside threats. In order to understand the changes that set in, the political dynamics of the People's Republic were subsequently examined.

The economic transformation and ensuing institutional set-up of the state were influenced by an eventual disintegration of the social and political structure of governance that escalated in the Cultural Revolution. The turning point is significant, as it did not only concern the population at large, but the ruling elite. The Communist Party had lost internal legitimacy when seeming capriciousness undermined the mechanism of power brokerage negotiated between factions and relational networks.

The new leadership under Deng owed its success to gradually replacing the single focus on ideology with an agenda of reforms that promised to alleviate the dire state of the economy and offered the elite broad opportunities for political and material gains in addition to increased general living standards. Since this encompassed negotiating between shifting interest groups no definitive blueprint was followed except gradually extending successful reforms that had proven to be beneficial implementations of marketization.

The absence of a long-term development strategy was a result of political pragmatism. In addition, competition between leading factions was reflected in the institutional setup of the Party-State, precluding the formation of a pilot agency in charge of policy coordination and adjustment. The insulation of the state bureaucracy from public special interest was undermined by the logic of party factionalism in charge of selecting officials. Meritocratic principles for choosing government employees were extended but without supplanting politically motivated selection.

Perhaps the most significant deviance from the Developmental State Model in China was something not initially emphasized by the theories discussed in Part I. Namely, the nonexistence of a strong private industrial sector. Despite an irregular expansion of private business, sizeable parts of the Chinese economy at the turn of the century were still owned by various levels and institutions of government, especially when it comes to large industrial enterprise. This makes the point of a bureaucracy's insulation from private interest at the macro level moot. Furthermore, embedded autonomy, the public-private feedback mechanism of a Developmental State, must remain equally underdeveloped.

A general trend emerged that devolved power from the center to the provinces in fiscal and economic matters. The multi-tiered progression of reform, favoring the coastal provinces had led to an imbalance. While the competition between regions had the positive effect of local governments creating favorable environments to attract business it also fostered a situation of duplicating sectors that received preferential treatment as well as inter-jurisdictional trade wars. Most leaders rise to the top after proving themselves in governing a province or large metropolitan area. The provincial faction in the highest state- and Party organs has gained a lot of ground vis-à-vis representatives of the central government and military representatives.

Though China has seen remarkable GDP growth and poverty alleviation, its record compares unfavorably with the accomplishments of South Korea and Taiwan during their first two decades of industrial catching-up. This is evidenced by higher living standards, even when compensating for a head start, life expectancy and levels of education. The primary difference was China's rapid increase in income-inequality, a trend that continues to this day.

The evidence amounts to the fact that China does not have the institutional setup proposed in the Developmental State Model. The two primary reasons for this are:

1. The lack of a long-term development strategy, centrally coordinated and adjusted by a capable and insulated agency.
   AND…
2. The underdevelopment of a large-scale industrial private sector.

The present research has pointed to some underlying reasons I deem reasonable to have acted as obstacles to evolving such institutions. The historical legacy of a planned economy is felt in the public-private imbalance. After all, neither Japan, nor South Korea nor Taiwan had started their industrialization under comparable circumstances. In addition, China did not face an imminent external threat perceived as a "sink or swim scenario" the likes of: Perry's forceful economic intrusion and the loss of a World War in Japan; a nearly lost civil war splitting the nation down the middle and leaving it surrounded by powerful ideological enemies like South Korea; and losing control over the largest nation to be left exiled on its doorstep like the Taiwanese government. Arguing on the basis of such historical contingencies should be done with care. The theories of Part I do not address the historical and external origins of the Developmental State sufficiently. More research in this direction would be welcome.[73]

Still, the present analysis has emphasized the contrasting case of an internal crisis of legitimacy and system of power allocation. The nature of China's reforms has seen gradual experimentation: An outcome of competing factions, seeking to restore internal legitimacy while rebuilding lucrative client networks. Substantial efficiency gains early on, derived from simple market reforms like the Household Responsibility System and the opening up of light rural industry have quickly sprouted opportunities for productive gain but also for rent-seeking behavior. It makes sense then that those in charge seek to continuously control productive assets. On a macro level this concerns the Party and its hold via the state over large swathes of big business. On the micro level it reflects the provincial and local power brokers, channeling investment funds to their regions. Both undermine a functioning Developmental State.[74]

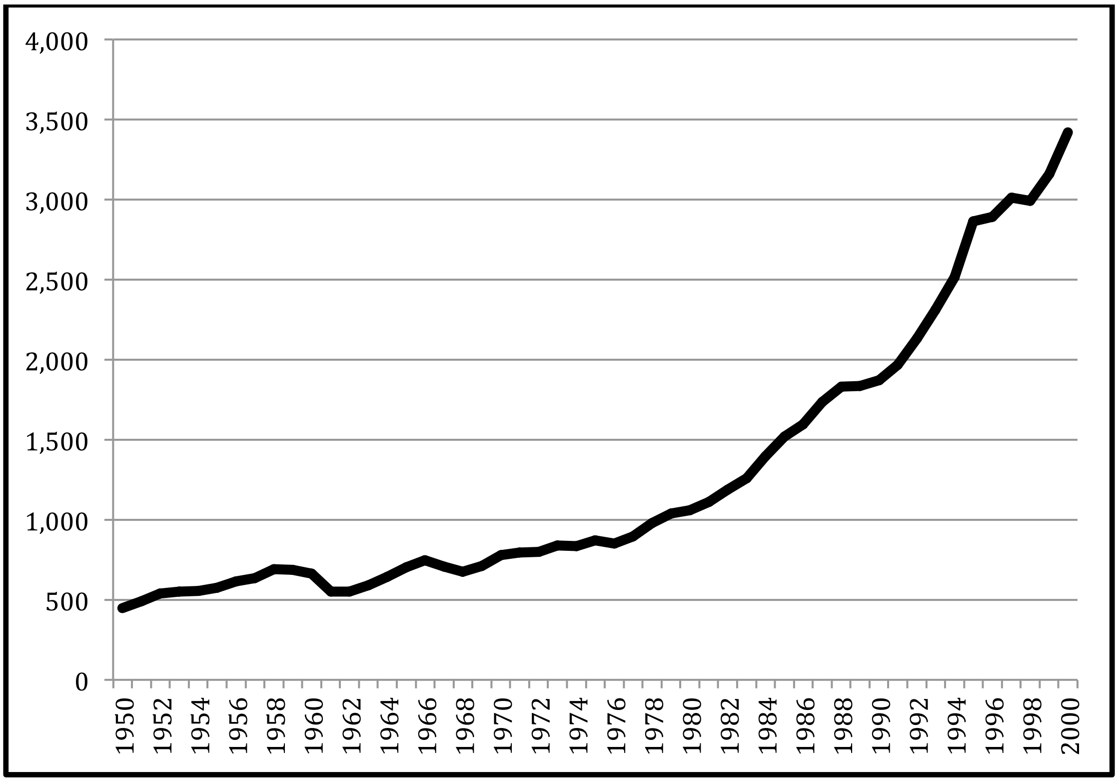
Over the last dozen years, which haven't been addressed here, China's economy has continued to grow while facing still wider gaps in average income and increasing environmental backlash. A debate has gained prominence between two camps of thought: The "New Left", critical of the pace and supposed excessive market-orientation of the reforms instead favoring more state involvement in areas of social security promoting more equitable growth. On the other hand the "New Right" represents a more market-liberal approach while also relegating issues of increased political participation.[75] The former school of thought demands the kind of more equitable development seen in South Korea

[73] See: Cerny 2007 for a discussion of periodization and the influence of changing political globalization on state-capitalism
[74] The problem of different sector requirements is discussed in: Segal/Thin 2011
[75] See: Leonard (2008) for an overview of current Chinese thinking on economic and political issues.

and Taiwan. Considering the rapid pace of continuing growth it is difficult to tell, where China is headed in terms of sustainability, equality and even political system, but up to today it has not adopted the Developmental State Model.

Appendix

Figure 15 – China GDP per capita (1945–2000)



Source: Data Table 7

Table 5 - China annual GDP growth rates

Year	% change	Year	% change
1980	7.8	1991	9.2
1981	5.2	1992	14.2
1982	9.1	1993	14
1983	10.9	1994	13.1
1984	15.2	1995	10.9
1985	13.5	1996	10
1986	8.8	1997	9.3
1987	11.6	1998	7.8
1988	11.3	1999	7.6
1989	4.1	2000	8.4
1990	3.8	2001	8.3

Source: World Bank (http://data.worldbank.org/

Table 6 – China Inflation (GDP deflator annual change in %)

Year	% change	Year	% change
1980	3.8	1991	6.8
1981	2.3	1992	18.2
1982	-0.2	1993	15.1
1983	1.0	1994	20.6
1984	4.9	1995	13.7
1985	10.2	1996	6.4
1986	4.7	1997	1.5
1987	5.1	1998	-0.9
1988	12.1	1999	-1.3
1989	8.5	2000	2.1
1990	5.8	2001	2.1

Source: World Bank (http://data.worldbank.org/)

Table 7 – China GDP/ capita (constant 1990 USD)

Year	GDP per capita	% change	Year	GDP per capita	% change
1950	448		1976	853	-2%
1951	491	10%	1977	894	5%
1952	538	9%	1978	978	9%
1953	552	3%	1979	1,039	6%
1954	557	1%	1980	1,061	2%
1955	577	4%	1981	1,110	5%
1956	616	7%	1982	1,186	7%
1957	636	3%	1983	1,258	6%
1958	690	9%	1984	1,396	11%
1959	686	-1%	1985	1,519	9%
1960	662	-4%	1986	1,597	5%
1961	553	-16%	1987	1,737	9%
1962	550	0%	1988	1,830	5%
1963	590	7%	1989	1,834	0%
1964	645	9%	1990	1,871	2%
1965	702	9%	1991	1,967	5%
1966	746	6%	1992	2,132	8%
1967	707	-5%	1993	2,312	8%
1968	675	-5%	1994	2,515	9%
1969	713	6%	1995	2,863	14%
1970	778	9%	1996	2,892	1%
1971	795	2%	1997	3,013	4%
1972	798	0%	1998	2,993	-1%
1973	838	5%	1999	3,162	6%
1974	835	0%	2000	3,421	8%
1975	871	4%			

Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm

Table 8 - Taiwan GDP/ capita (constant 1990 USD)

Year	GDP	% change	Year	GDP	% change	Year	GDP	% change
1945	742		1965	2,056	4%	1985	8,113	4%
1946	806	9%	1966	2,205	7%	1986	9,088	12%
1947	904	12%	1967	2,395	9%	1987	9,641	6%
1948	931	3%	1968	2,539	6%	1988	9,623	0%
1949	932	0%	1969	2,706	7%	1989	9,665	0%
1950	924	-1%	1970	2,980	10%	1990	9,886	2%
1951	991	7%	1971	3,324	12%	1991	10,522	6%
1952	1,063	7%	1972	3,767	13%	1992	11,204	6%
1953	1,140	7%	1973	4,091	9%	1993	11,877	6%
1954	1,193	5%	1974	3,942	-4%	1994	12,597	6%
1955	1,250	5%	1975	3,958	0%	1995	13,284	5%
1956	1,270	2%	1976	4,566	15%	1996	13,985	5%
1957	1,314	3%	1977	5,020	10%	1997	14,795	6%
1958	1,382	5%	1978	5,542	10%	1998	15,333	4%
1959	1,462	6%	1979	5,831	5%	1999	16,040	5%
1960	1,492	2%	1980	5,869	1%	2000	16,859	5%
1961	1,551	4%	1981	6,229	6%			
1962	1,632	5%	1982	6,446	3%			
1963	1,804	11%	1983	7,036	9%			
1964	1,977	10%	1984	7,790	11%			

Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm

Table 9 – Republic of Korea GDP/ capita (constant 1990 USD)

Year	GDP	% change	Year	GDP	% change	Year	GDP	% change
1945	683		1965	1,436	3%	1985	5,670	6%
1946	686	1%	1966	1,569	5%	1986	6,263	10%
1947	719	5%	1967	1,645	10%	1987	6,916	10%
1948	768	7%	1968	1,812	13%	1988	7,621	10%
1949	819	7%	1969	2,040	6%	1989	8,027	5%
1950	854	4%	1970	2,167	8%	1990	8,704	8%
1951	787	-8%	1971	2,332	5%	1991	9,409	8%
1952	835	6%	1972	2,456	15%	1992	9,810	4%
1953	1,072	28%	1973	2,824	7%	1993	10,234	4%
1954	1,124	5%	1974	3,015	5%	1994	10,959	7%
1955	1,169	4%	1975	3,162	10%	1995	11,809	8%
1956	1,149	-2%	1976	3,476	9%	1996	12,507	6%
1957	1,206	5%	1977	3,775	8%	1997	12,962	4%
1958	1,234	2%	1978	4,064	6%	1998	11,966	-8%
1959	1,243	1%	1979	4,294	-4%	1999	12,994	9%
1960	1,226	-1%	1980	4,114	5%	2000	13,985	8%
1961	1,247	2%	1981	4,302	6%			
1962	1,245	0%	1982	4,557	10%			
1963	1,316	6%	1983	5,007	7%			
1964	1,390	6%	1984	5,375	7%			

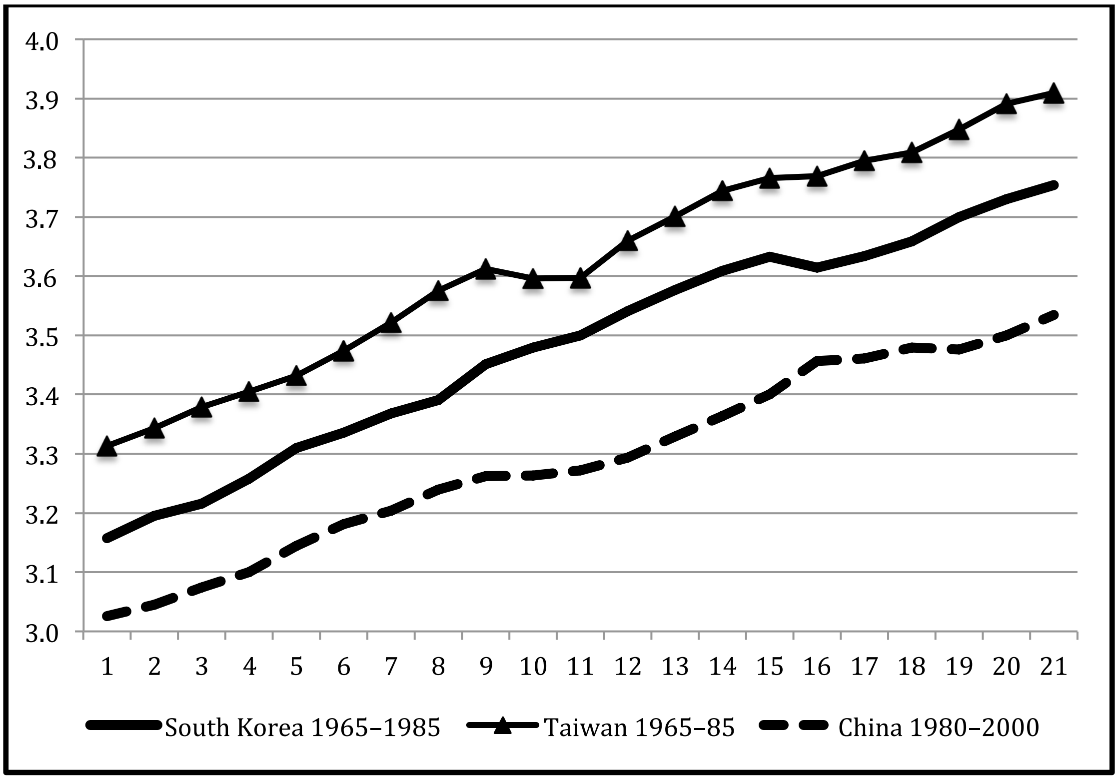
Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm

Table 10 – China's share of average World GDP

Year	World average GDP per capita	China	%	Year	World Average GDP per capita	China	%
1950	**2,111**	448	21%	1975	**4,087**	871	21%
1951	**2,197**	491	22%	1976	**4,213**	853	20%
1952	**2,258**	538	24%	1977	**4,309**	894	21%
1953	**2,329**	552	24%	1978	**4,422**	978	22%
1954	**2,363**	557	24%	1979	**4,500**	1,039	23%
1955	**2,467**	577	23%	1980	**4,512**	1,061	24%
1956	**2,534**	616	24%	1981	**4,523**	1,110	25%
1957	**2,578**	636	25%	1982	**4,501**	1,186	26%
1958	**2,607**	690	26%	1983	**4,541**	1,258	28%
1959	**2,675**	686	26%	1984	**4,668**	1,396	30%
1960	**2,773**	662	24%	1985	**4,748**	1,519	32%
1961	**2,831**	553	20%	1986	**4,833**	1,597	33%
1962	**2,914**	550	19%	1987	**4,932**	1,737	35%
1963	**2,978**	590	20%	1988	**5,056**	1,830	36%
1964	**3,130**	645	21%	1989	**5,130**	1,834	36%
1965	**3,228**	702	22%	1990	**5,150**	1,871	36%
1966	**3,335**	746	22%	1991	**5,137**	1,967	38%
1967	**3,390**	707	21%	1992	**5,165**	2,132	41%
1968	**3,505**	675	19%	1993	**5,200**	2,312	44%
1969	**3,624**	713	20%	1994	**5,304**	2,515	47%
1970	**3,729**	778	21%	1995	**5,446**	2,863	53%
1971	**3,803**	795	21%	1996	**5,552**	2,892	52%
1972	**3,904**	798	20%	1997	**5,690**	3,013	53%
1973	**4,083**	838	21%	1998	**5,709**	2,993	52%
1974	**4,099**	835	20%	1999	**5,833**	3,162	54%
				2000	**6,038**	3,421	57%

Source: Maddison, Angus: http://www.ggdc.net/maddison/Maddison.htm

Figure 16 – Growth spurts of GDP per capita (over 20 years; Log scale)



Source: Tables 7, 8, 9

Table 11 – Average Life Expectancy at Birth in South Korea, China and Taiwan

Year	South Korea	China	Taiwan	Year	South Korea	China	Taiwan
1960	53	43		1985	69	68	74
1961	54	44		1986	69	69	74
1962	54	45		1987	70	69	74
1963	55	46		1988	70	69	74
1964	56	49		1989	71	69	74
1965	57	51		1990	71	69	74
1966	58	54	66	1991	72	70	75
1967	59	57	66	1992	72	70	75
1968	59	59		1993	73	70	75
1969	60	61		1994	73	70	75
1970	61	63	70	1995	73	70	75
1971	62	64	70	1996	74	71	75
1972	63	65		1997	74	71	76
1973	63	65		1998	75	71	76
1974	64	65		1999	75	71	76
1975	64	66	72	2000	76	71	77
1976	64	66	72	2001	76	71	77
1977	65	66		2002	77	72	78
1978	65	66		2003	77	72	78
1979	65	67		2004	78	72	78
1980	66	67	73	2005	78	72	78
1981	66	67	73	2006	79	72	78
1982	67	68	73	2007	79	73	79
1983	67	68	73	2008	80	73	79
1984	68	68	73	2009	80	73	79

Source: World Bank; Taiwan before 1982 - ROC Ministry of the Interior

Table 12 – Income Distribution (GINI) Taiwan, South Korea, China

Year	Taiwan	South Korea	China	Year	Taiwan	South Korea	China
1965	3.20	3.50		1985	0.29	3.67	
1966				1986	2.95		
1967				1987	2.96		2.99
1968				1988	3.01	3.2	
1969				1989	3.01		
1970	2.94	3.32		1990	3.09		3.24
1971	2.95			1991	3.06		
1972		4.02		1992	3.11	3.49	
1973				1993	3.14	3.24	3.53
1974	2.93			1994	3.17		
1975				1995	3.15	3.34	
1976	2.8	3.91		1996	3.15	3.26	
1977	2.85			1997	3.17	3.16	
1978	2.81			1998	3.20	3.72	
1979	2.86			1999	3.19		3.9
1980	2.77	3.89		2000	3.20		
1981	2.80		2.91	2001			4.48
1982	2.83						
1983	2.87						
1984	2.86	3.5	2.77				

Source: Taiwan - Directorate-General of Budget, Accounting and Statistics 1974 (1965), 1974), UNU WIDER World Income Inequality Database (other years); South Korea- Jomo K.S.: Growth with Equity in East Asia? (DESA Working Paper No. 33 ST/ESA/2006/DWP/33/ September 2006) – (1965, 1970, 1976, 1980); World Bank (1998), UNU WIDER World Income Inequality Database (other years); China – World Bank

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Zusammenfassung (Abstract)

Mit Beginn umfangreicher Reformen in der Volksrepublik China vor gut dreißig Jahren setzte eine bislang anhaltende Periode starken Wirtschaftswachstums ein. Eine Reihe von Autoren begründete vorangehende Entwicklungserfolge ostasiatischer Nationen mit dem Vorhandensein einer charakteristischen Form eines interventionistischen Staates. Ziel der vorliegenden Arbeit ist es anhand dieser Literatur und den Fallbeispielen Japan, Südkorea und der Republik China (Taiwan), ein institutionelles Modell eines „Developmental State“ zu erstellen und des Weiteren zu prüfen inwiefern es auf die Volksrepublik China während der Reformperiode zwischen 1978 und 2001 zutrifft.

Das Hauptaugenmerk liegt auf einer langfristig orientierten Entwicklungsstrategie und zentralen, fachlich besetzten und ausreichend ausgestatteten Institutionen, um diese zu koordinieren. Dabei sollte Unabhängigkeit von politischen wie auch privaten Sonderinteressen vorliegen, jedoch gleichzeitig Rückinformation aus dem zivilen Sektor zur Anpassung der Wirtschaftspolitik herangezogen werden können.

Die Analyse nach diesen Maßstäben hat ergeben, dass die chinesische institutionelle Struktur nicht dem „Developmental State“ Modell entspricht. Die zwei Hauptargumente dafür sind: Einerseits keine langfristige Strategie für strukturelle Reformen, hingegen ein Trend zur Dezentralisierung wirtschaftspolitischer Kompetenzen der die Koordination von Peking aus erschwerte. Andererseits blieb die Entwicklung eines starken privatwirtschaftlichen Sektors aus, insbesondere im Bereich der Schwerindustrie und führender Großkonzerne. Eine abschließende Analyse entwicklungsökonomischer Kennzahlen zu Lebensstandard, Gesundheit, Ausbildung und Einkommensverteilung veranschaulichen relative Defizite Chinas gegenüber Südkorea und Taiwan.

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Sonstige Kenntnisse und Interessen

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EDV	Microsoft Office, Adobe Photoshop
Interessen	Literatur, Malen, Klassische Musik, Tennis, Wandern