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State and Market in China
The China Experience – A viable Model for the Development of other Developing Countries?

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Content

1 Introduction ......................................................................................................................................... 1
2 Models for Economic Development .................................................................................................. 1
3 The China Experience as a Model for Economic Development ....................................................... 2
   3.1 Historical Overview of the China Experience .............................................................................. 2
   3.2 Characteristics of a China Model .................................................................................................. 3
   3.3 Critical Evaluation ....................................................................................................................... 4
4 Developing Countries and the China Experience .............................................................................. 6
5 Conclusion .......................................................................................................................................... 6
References ............................................................................................................................................... 8
1 Introduction

In The Wealth of Nations, Adam Smith (1776) described China as stationary especially because of its laws and institutions which neglected foreign trade (pp. 1-6). Since the late 1970s, China’s rapid economic development has astonished the world. Within a relatively short time, China has internationally emerged to one of the largest economies. While the Chinese system proved its capabilities, the neoliberal economic system on the other hand found itself in a dead end after the 2008 financial crisis. In addition, the Western neoliberal approach of supporting developing countries to prosper has been proved unsuccessful (Ramo, 2004, p. 29). This calls into question if another model of development will become best practice now, considering that experiences from successfully developed countries, such as China, can be generalised and formed into models for development. This essay examines if the experience of China has offered a model for the development of other developing countries and aims to find out to what extent other developing countries can learn from the China experience. It focuses therefore on the course of China’s policymaking in the context of economic development.

2 Models for Economic Development

According to Schumpeter, economic development is the fundamental transformation of an economy (Feldman, Hadjimichael, Lanahan & Kemeny, 2016, pp. 6-8). It can be distinguished from the concept of sole economic growth, which is the quantified and aggregated increase in output. In short, developing a country means to mobilise and allocate resources, and to design institutions with the aim of transforming the national economy from a less developed to a more developed state (Gore, 2000, p. 789). Progress in development can be measured by different indicators. One common approach is the gross domestic product (GDP) which measures a country’s development based on the material wealth (Dang & Sui Pheng, 2015, p. 12). In another approach, derived from Sen’s work, the state of development is measured by the quality of life (Dang & Sui Pheng, 2015, p. 13). The Human Development Index (HDI) is a common indicator which is based on this approach and uses monetary as well as non-monetary measures.

Specific policymaking strategies for economic development can be generalised and formed into a model which puts policymakers of developing countries in the position of following a supposed path. The assumed path should lead to an increase in GDP or HDI and successfully transform the country. Models for development offer strategies to develop a country by either providing a set of policy descriptions which are to be adopted at the discretion of the policymaker or by requiring a fundamentalist adherence to a certain economic theory, such as neo-liberalism or Marxism (Hasmath, 2014, p. 5).

The probably most common yet controversial model, or consensus, is based on the neoliberal approach of Western states. The so-called Western Model, or (Post-) Washington Consensus, offers a set of liberal economic reforms which are regarded as a wise model for developing countries from the perspective of Western countries. The development strategies focus on privatisation, liberalisation, and macro-stability while predicated on a strong faith in free markets and minimising the role of government (Stiglitz, 2004, p. 1). The neoliberal model can be introduced using a shock therapy which dismantles
the centrally planned economy as fast as possible (So, 2009, p. 61). The shock therapy was often used in the downfall of the communist states in Eastern Europe. According to the neoliberal model, the state performs only regulatory functions and leaves economic development to the market forces and to the exploitation of comparative advantages (Stark, 2010, pp. 194-195). The state is described as market-rational (Stark, 2010, p. 195).

In contrast to the neoliberal model, in the East Asian Developmental State Model – which describes Japan’s, South Korea’s and Taiwan’s successful development strategy – the state plays an active role in fostering the country’s economic development. According to this model, the state actively plans and promotes economic development through planning and incentive-setting in order to achieve desired changes (Stark, 2010, pp. 194-195). The state undertakes import-substitution and export-oriented promotion of its domestic private industry and, most importantly in comparison to China’s case, prohibits foreign direct investments (Hsueh, 2011, p. 266). The state’s role is described as plan-rational (Stark, 2010, p. 195).

3 The China Experience as a Model for Economic Development

3.1 Historical Overview of the China Experience

In 1956, Mao described the Chinese people as “both poor and blank” (Riskin, 1987, p. 33). Riskin (1987) interprets this saying as an “indictment of the past and a source of hope for the future” and uses this image of the Chinese people to characterise China’s economy at that time (p. 33). War and civil war had destroyed the economy and most of the industries had moved to Taiwan and Hong Kong. At the same time, the economy suffered a deep depression and was in a great chaos with corruption and hyperinflation. This situation created an openness within China’s population for new initiatives by new authorities, like a blank page offers room for new content to be written on.

From 1949 to 1976, China experienced a radical change under Mao’s political economy. However, neither the Great Leap Forward nor the Cultural Revolution transformed China’s economy successfully without drawbacks. Around year 1978, a shift in the party’s focus from an ideological adherence to personality cult to the reality of economic development took place when Deng Xiaoping countered the prevailing ideology with his mind-emancipating pragmatic saying:1 “It doesn’t matter whether a cat is white or black so long as it catches mice” (Qian, 1999, p. 4). Following this shift in strategy, five major initial reforms were introduced between 1979 and 1983: agricultural reform, opening up the economy, fiscal decentralization, state-owned enterprise reform, and support for commune-brigade enterprises (Qian, 1999, pp. 4-5). Numerous other reforms followed, such as the dual-track approach gradually allowing market prices along with planned prices, the contract responsibility system increasing profit incentives as well as expanding the autonomy of state-owned enterprises (SOE), and the expansion of private and collective, non-state enterprises which were now incentivised through decentralisation (Qian, 1999, pp. 9-12). The reformation continued with privatisation, among others. While the privatisation of SOEs first began by experiments of local governments, it soon got promoted by the

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1 However, the saying is dating back to earlier times.
central government with the aim of keeping the large enterprises but letting go the small ones (Qian, 1999, p. 21). Different than many states of Eastern Europe and former Soviet Union, China avoided a fast-going mass privatisation of SOEs but focused on deregulating prices and creating competitive markets where it was pragmatically found reasonable (Kroeber, 2011, p. 51).

3.2 Characteristics of a China Model

China’s experience showed a unique development path which differs significantly from the path of countries which followed the neoliberal model. China’s path differs also from East Asian countries which followed the East Asian Developmental State Model, despite sharing characteristics. Several approaches tried to derive a general China Model from China’s development. Such, inconsistently called, China Model or Beijing Consensus was often created as a contrasting response to the Washington Consensus without deliberately avoiding the popularising effects which came along. However, the perceptions of these attempts remained controversial and none of the models or descriptions of consensus experienced a wide acceptance in the scientific community. According to Williamson (2012), who coined the Washington Consensus, the Beijing Consensus “has never been codified in the form of a series of propositions similar to those that [were] originally termed the Washington Consensus” (p. 3). Yet, four fundamental characteristics distinguish China’s experience.

First, one of China’s key elements of its development is characterised by the opening of its economy to international trade and foreign direct investment. Foreign direct investment is highly encouraged by the state and plays an important role in forming an export industry (Kroeber, 2011, p. 47). It is strategically utilised to transfer knowledge into the domestic economy while it exposes the domestic economy to technology. In exchange for knowledge and technology, foreign investors get market access. China’s cheap labour was especially attractive as a production base for foreign investors to import capital base in such a form of factory building and know-how providing. Different than the neoclassical theory suggests, the state focuses not on absolute strength but on high-value added products. The liberalisation of market entry and the strategic utilising of foreign direct investments modernise domestic infrastructure, maximise the domestic technology base, and promote the competitiveness of the domestic industry at the same time (Hsueh, 2011, p. 259).

Second, sectoral regulation and market liberalisation is applied selectively. According to Hsueh’s (2011) findings, the state’s role in strategic areas is enhanced while its role in non-strategic areas is relinquished (p. 254). Strategic sectors consist of industries which are either important to national security, which contribute to the national technology base, or where domestic enterprises are less competitive. Next to the telecommunication and the energy industries, the financial system is one vital industry for the state to keep control of. After ensuring governmental authority in these sectors, the government pursues industrial development that achieves security and economic goals. In contrast to strategic sectors, nonstrategic sectors are industries which are less important to national security, that make less contribution to the national technology base, and where the domestic industry is competitive. The state’s role in this sector is lowered and decentralised by introducing market competition and by leaving decisions to local authorities. In this point, a China model would diverge from the East Asian Developmental State Model which never relinquished control by liberalising and decentralising to such an extent. The strategic and nonstrategic sector are combined in an effective way. The example of the
financial industry illustrates an effective interaction between the strategic and nonstrategic sector. The financial industry is being used by the state as an instrument to allocate credits in a way that governmental development goals are being achieved (Kroeber, 2011, p. 47). At the same time, the recipients of the credits which belong to the nonstrategic sector are being kept efficient by using mechanisms of market pricing and competition.

Third, the strategy of decentralisation incentivises local entities by fostering competition among them. A shift from state-owned enterprises to local-government-owned enterprises leads to more individual responsibility and subsequently to an increase in productivity (Stiglitz, 2004, p. 4).

Fourth, the same party steadily rules a one-party system. The ruling party must have and maintain a firm grip on government, the courts, the army, the internal security apparatus, and the free flow of information (Callick, 2007, para. 1). The authoritarian policies decreed from the government disciplines labour, suppress labour protests and interrupt civil society in order to keep the labour cost low which attracts foreign investment and facilitates capital accumulation (So, 2009, pp. 58-59). Although the government’s role in China’s economy might seem to become less important due to the use of liberal market mechanisms, its authority remains relatively unchanged as the government relinquished its control only in nonstrategic areas but enhanced its control in strategic areas (Hsueh, 2011, p. 254).

3.3 Critical Evaluation

The China experience has shown a unique path of a developing country’s transformation. By pursuing the characteristic approach, China was able to successfully obtain technological know-how, to promote relatively large domestic companies, and still to retain control over foreign forces even in a more liberal environment (Hsueh, 2011, p. 259).

Regarding the outcome of the China experience, its success is undoubted in terms of sole economic growth defined as the quantified aggregated increase in output. Nevertheless, its current situation and its potential for future growth cannot be left without further examination. If China’s success is measured by its comprehensive national power, the picture is different than what the quantified economic growth suggests at first (Kroeber, 2011, p. 62). Comprehensive national power requires brand names and intellectual property rights from which price premiums, royalties and license fees can be collected and it requires the control of the distribution channels in foreign markets (Kroeber, 2011, p. 62). The examples of Sony and Toyota show that the development according to the East Asian Development State Model brought up such global firms and increased the country’s comprehensive national power. However, at least in some industries, China’s strategy of importing foreign capital and knowledge by attracting foreign direct investment with low-cost labour in order to export production capacity did not create valuable indigenous intellectual property rights. As a result, China is threatened to be “locked into low-value assembly production” and to be obliged to pay rather than to collect royalties and license fees, according to Kroeber (2011, p. 63). China’s attempts to incentivise the creation of comprehensive national power in the form of intellectual property rights failed. As a result of China’s door-opening policy strategy its economy has been integrated in global trade and thus, China must ensure the conformity of its economic policies with international trade rules. Especially after China’s entry into the World Trade Organisation (WTO), it must reduce trade barriers and increasingly treat foreign and domestic
companies equally. The example of the State Council Document 18 in 2000, which was an attempt of China to promote domestic information technology companies, shows the difficulties the interventionist China Model is facing. Accused by U.S. competitors as illegal subsidies, the incentives were qualified as discriminating and thus not in conformity with global trade rules and had to be rescinded (Kroeber, 2011, p. 63). China’s interventionist power largely degrades as industrial policies are converting into trade issues. To sum up, the strategy of importing foreign capital and knowledge by attracting foreign direct investment with low-cost labour in order to export production capacity led to a fast-growing economy. However successful in terms of development pace this experience might be, the question of a sustainable enhancement of comprehensive national power remains. The recent rise of companies like Alibaba and Tencent might bring hope for China’s future.

Regarding the question if China’s experience can be replicated, the answer is more obvious. China’s development path shows a pragmatic process of gradual and adaptive development without a clear blueprint (So, 2009, p. 61). The approach of planning the economy with changing plans every few years as well as the frequent adjustments and reversals of reforms and policies shows an experimental course of learning from failures and a gradual adaption based on experience. Thus, China’s development does not offer a particular economic model or policy principles to follow which would lead to the same experience.

In addition, the bottom-up construction of informal economic institutions played an important role in the development of China. According to Nee (2010), entrepreneurs were central agents who pushed institutional innovations (p. 13). The example of the private enterprises in the Yangtse-Delta demonstrates this process. Through a bottom-up process, new private firms constructed autonomous supplier and distributor networks which allowed to decouple from government-owned companies and thus to avoid the often-experienced long delays and poor qualities (Nee, 2010, p. 12). At that time, the government had not initiated reforms to incentivise such a development and had not provided rules for property rights, company registrations and liabilities. But, informal arrangements among groups of people provided the required business norms and funding (Nee, 2010, p. 13). This example in which the transformation was not driven top-down by institutional changes from the government but from bottom-up informal agreements, contradicts the state-centred theory. The state-centred theory proposes that institutional innovations come from rulers and that economic success will follow (Nee, 2010, pp. 12-13). However, the bottom-up process, which was unintended by the state, is difficult to integrate into a model for development. Such a process cannot be replicated by other developing countries through policies because it relies on the innovation spirit of a state’s constituents rather than on a state’s policy reforms.

The China model therefore neither offers a complete set of policy descriptions for policymakers nor does it show a fundamentalist adherence to a certain economic theory. In short, the case of China does not fit into the initially stated definition of a model for the development of other developing countries.
4 Developing Countries and the China Experience

The previous chapter showed the difficulties of creating and following a China model. Still, developing countries might replicate policies of China. In order to adopt at least part of China’s policymaking strategies and so to emulate China’s successful economic growth experience, developing countries must meet certain basic preconditions which China had when it started its successful development.

First, a one-party system with strong institutions must exist. In the case of China, the historical circumstances such as civil wars and economic depression facilitated the establishment of a one-party system. During the following era of Mao, the necessary institutions were built. The Communist Party and the strong institutions are a legacy of that time and, however with single exceptions such as Vietnam and North Korea, might not be found in any developing country. It is also unlikely that these conditions can be created in today’s globalised geopolitical environment with a well-established protection of human rights. Second, an educated and relatively large population is required in order to attract foreign investments with relatively cheap labour when opening the economy for foreign trade and investment. As one of world’s largest countries, China had the geographical and population size required for this strategy which other developing countries do not have by nature. Third, China does not have an abundance of valuable resources like some developing countries have. These resources, for example found in a number of African countries, might play an important role in the development of the country allowing a more suitable way of development than the China model would.

As pointed out in the previous chapter, China’s experience is based on an experimental approach. For example, not all utilisations of liberal market mechanisms, regulatory measures or combinations thereof were successful (Hsueh, 2011, p. 269). Some had to be reversed, others were adjusted. This experimental approach led to a unique policymaking design which only fits China and would cause difficulties to emulating developing countries.

Summing up, the China experience cannot be emulated by developing countries because of two main reasons: First, because of large differences in basic conditions between China at the start of its development on the one side and developing countries today on the other side; second, because of the experimental, selective, and pragmatic approach of the China model which tailored the policies to fit only China’s circumstances.

5 Conclusion

Within a surprisingly short time, China has internationally emerged to one of the largest economies. However, the overview of China’s experience has also unveiled a difficult situation. The strategy of importing foreign capital and knowledge by attracting foreign direct investment with cheap labour in order to export production capacity resulted in a thread of being “locked into low-value assembly production” (Kroeber, 2011, p. 63). Nevertheless, the recent rise of Chinese internet companies give hope to a positive answer to the question whether China’s success is sustainable and whether it should be praised by developing countries. Yet, developing countries will face difficulties when trying to emulate China’s experience because of the differences in basic conditions between China and developing
countries. Therefore, it is not feasible to emulate China’s experience. However, specific principles of China’s development might still offer potential for adapted imitation.

In particular, developing countries can learn that through an elaborated combination of liberal market instruments and state-interventionistic instruments limited resources can be mobilised and administrative capacity can be enhanced if these instruments are selectively applied across industrial sectors.

In the beginning, the question was asked whether the China experience has offered a viable model for development for other developing countries. To answer it finally, I would say that China’s experience has not offered an abstract and applicable model which per definition provides a complete set of policy descriptions that can be adopted by the policymakers of developing countries. Rather, the experimental experience of China has unveiled a pragmatic view of policymaking and showed that this approach can successfully advance a developing country. As Hasmath (2014) puts it aptly, the Chinese way of doing things is more a “philosophical movement towards an ultra-pragmatic view of conducting policy deliberation” (p. 5).

Concluding, China’s experimental approach of selectively utilising Adam Smith’s theories of liberal market and combining them with interventionistic laws and institutions which attract foreign trade exemplifies a unique development path. This example of a visible hand might help other developing countries in finding their own unique growth experience.
References


