

**The London School of Economics and Political Science**

**China as a Post-Socialist Developmental State:  
Explaining Chinese Development Trajectory**

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Philosophy

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## **Abstract**

This thesis is intended to contribute to the discussion on China's socio-economic development during the post-socialist period of reform and opening up. It is aimed at providing an explanation of the Chinese contemporary development trajectory, by establishing an institutional and policy model, which China is believed to have been following. This model is also believed to offer some general solutions to the underdeveloped countries in systemic transformation.

The thesis argues that China's post-socialist development trajectory has been determined by the provisions of the Developmental State (DS) model, as far as state development policies, state ideology, and state institutional arrangements are concerned, and to the extent, that China has become a genus of the Post-Socialist Developmental State (PSDS) model – this model being an alternative to the post-socialist neo-liberalism.

In the course of scholarly enquiry, China's development trajectory is analysed against the paths of historical developmental states, and against the general and developmental aspects of the process of post-socialist transformation. I start by analysing the features of the historical developmental states and by investigating whether the provisions of the DS model are viable contemporarily and how the model extends to the discussion on China's development. I then examine China's post-socialist transformation, partly in its DS context. Next, I analyse the features of China's development trajectory in comparison with the features of historical developmental states, as far as ideology and political and economic arrangements as well as state development policies are concerned. Finally, based on the previous analyses, I explain the DS-determined post-socialist development trajectory of China, address the causal relation between the DS institutionalisation and post-socialist transformation, and construct the PSDS model, as a general guideline for states in transition.

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## **Introduction**

### **1. China and the Relevant Models of Socio-Economic Development**

In the course of economic history, various civilisations have risen and fallen and the gravity of mankind's socio-economic development has shifted from one region to another. There is an abundance of often interconnected factors which constitute a successful developmental model, among which are institutional arrangements, systemic environment, state policies, societal capacity, as well as geo-political and geo-economic locality. This thesis concerns the contemporary developmental model China has been following during the post-Mao period of reforms and opening up (*gaige kaifang*).

Up until the nineteenth century, China was the largest economy in the world and Adam Smith (2003) would see it more appropriate to compare the Chinese economy with that of the entire Europe, rather than separate European states. Maddison (2007) claims that China owed its position to the intensive economic growth between the seventh and the thirteenth centuries and this was attributable to the development of an intensive and sophisticated agrarian production sector, to the creation of an internal market to trade goods, and to the well-organised and effective state<sup>1</sup> supported by a highly qualified state bureaucracy. At least until the end of the fifteenth century, China's civilisation was considered to be more advanced than European civilisation. Smith pointed out in 1776 that 'no other country has yet arrived at this degree of opulence [and that] China had probably long ago acquired that full complement of riches' (Smith 2003, p.132). Nevertheless, the overall progress of mankind in terms of socio-economic development in the first eighteen centuries A.D. was relatively slow as compared with the subsequent time periods. Kolodko (2008, pp.68,70) points out that it is estimated that the aggregated output of the world's economy between year 1 and 1000 did not increase and between 1000 and 1800 increased by a meagre 50%, with an average annual economic growth of 0.05%.

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<sup>1</sup> The state, defined by Max Weber as a compulsory association claiming control over a territory and the people therein (cited in Evans 1995, p.5), is considered here to be the structure of governance institutions (Wade 1990, p.8). In keeping with Wade (1990), the term state is often used interchangeably with the term government.

The consequences of the Industrial Revolution of the late eighteenth and early nineteenth centuries<sup>2</sup> allowed for a significant acceleration of socio-economic development and subsequently firmly established the representatives of the so-called Western world as the leaders of developmental advancements, first – the United Kingdom, then the United States, Germany and other European countries. The Industrial Revolution marks perhaps the establishment of the first effective developmental model of the modern era. This model was characterised by capital-driven economic expansion. The capital was generated through production increase, enabled by technological advancements. At the same time, economic expansion was facilitated by military means. China seemed not to be affected by the Industrial Revolution and, as a consequence, the developmental rift between Europe and the “Middle Kingdom” continued to increase. It is believed that the initial waves of Industrial Revolution failed to have an effect on China, otherwise a relatively well-developed state with well-educated elites and efficient bureaucracy, because of its 300-year policy of isolationism, which limited the diffusion of foreign technologies, domestic incentives for modernisation and the effective exchange of ideas related to economic policies. The militarist model of capitalist development of Western Europe was soon to affect the political stability of China, which as a result of several wars and domestic rebellions, became a semi-colonial state with 92 “treaty ports” with extraterritorial rights.<sup>3</sup>

The beginning of the Industrial Revolution prompted a critique of mercantilism, until then broadly considered to be world’s main economic doctrine, which advocated state-controlled foreign trade monopolies as paramount for developmental advancements (Skousen 2007). Adam Smith and then David Ricardo among others, supported the idea of trade liberalisation leading towards international production specialisation and utilisation of comparative advantage (Haakonssen 2006). However, their classical economy theory of “natural liberty” met opposition among the representatives of less developed countries. For example, a German economist Friedrich List believed that Smith’s ideas would bring benefits to more affluent countries and leave the less developed vulnerable. His perception was influenced by Alexander Hamilton’s (2008) American school, developed by the president of the United States, John Quincy Adams and senator Henry Clay into the American system – an economic plan to support the US

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<sup>2</sup> Preceded by 300 years of pre-capitalist development which had commenced with the Renaissance epoch in Europe.

<sup>3</sup> Subsequently, 19 foreign nationalities residing in the treaty ports were granted effective diplomatic immunity from the Chinese legal jurisdiction (Maddison 2007).

domestic industries development by providing the necessary physical and financial infrastructure, as well as by protecting them from foreign competitors through tariff barriers. Hamilton, the first US Secretary of Treasury, believed that those state interventions and protectionist measures are necessary for overall socio-economic development. As a result, List saw politics and economics as inseparable. He argued that 'economies need to be seen in their political context, if their relative successes and failures are to be understood. [...] It is only when a polity gains the status of a geographically substantial nation-state that it can become and remain a successful manufacturing and commercial entity' (Winch 1998, p.302).

The model of capitalist development brought enormous wealth to the industrial elite, whereas the labour force employed in the newly established factories and manufactories suffered the problems of low wages and difficult working conditions. Social marginalisation and exclusion as well as widespread industrial exploitation<sup>4</sup> became urgent issues, with the long-term potential capacity to politically destabilise many countries. This prompted considerations for a new economic model, based on Marxist critiques of capitalism, labelled as socialism or, due to the fact that the proposals for new systemic arrangements were presented in the document called *The Manifesto of the Communist Party* – communism. In its socio-economic form the model advocated the abolishing of private property and therefore eliminating the capitalist elite. It eventually evolved into advocating the abolishing of the market mechanisms in economic affairs and the establishing of a state-command mechanism in which the decision on the quantity and assortment of production, goods allocation and price would be met by the state (see: Schumpeter 1942). This model had a significant impact on China's development trajectory, since the state ideology of Mao Zedong – the founder of the People's Republic of China (PRC) – drew significantly from Marxism. Without subsequent extensive acceleration of socio-economic development, the implementation of the new model nevertheless reversed the trend of economic decline, as a result of which, the 'Chinese GDP per capita was lower in 1952 than in 1820 [and] China's share of world GDP fell from a third to one-twentieth' (Maddison 2007, p.43).

However, the second half of the nineteenth century was also marked by the enforcement of the Listian political economy into the systemic arrangements in continental Western Europe and thus by creation of what perhaps can be seen as initial institutional

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<sup>4</sup> As opposed to the earlier agrarian exploitation related to the feudal system.

fundamentals for what would later become a developmental state – a model believed to be largely responsible for the effective developmental catching up of some countries from the so-called group of late developers. This model denied the capitalist class the dominant role in development, entrusting the guiding of the process of socio-economic development to the state. Its origins can be traced from the institutional arrangements of Bismarck's Prussia and the nineteenth century period in Japanese history referred to as the Meiji restoration,<sup>5</sup> influenced by the ideas presented by List in his study entitled *The National System of Political Economy* (originally published in 1841) and by the “American system” of early nineteenth century. In this model the state elite, supported by effective state bureaucracy, would guide the process of the industrialisation of national economies. It was consistent, to some extent, with the perception prevalent after the Great Depression until the late 1970s and motivated by the Keynesian theory, that the role of the state or the public sector is crucial in the developmental endeavour, especially among underdeveloped countries.

In the mid twentieth century, when Western countries, comprising predominantly of Western Europe and North America, distanced the rest of the world in terms of the level of development and continued to rely on what evolved from the model of capitalist development and the Prussian interventionist state, and, at the same time, Eastern Europe was coerced into adopting the state-command economic system, the so-called developing countries, many of which were emerging from colonialism, were in desperate need for a developmental model to enable significantly better developmental dynamics in order to establish a sound trajectory of “catching up”.

By the end of the twentieth century, among the most successful late developers were those countries who became developmental states, i.e. South Korea, Taiwan and Singapore, as well as Japan – considered a prime example of the developmental state model, despite a rather “early” start to “late development”.

This however, did not secure its position as a feasible developmental option for less developed countries worldwide. In fact, the political competition between the Western world and the communist parties' controlled Eastern bloc, especially between the superpowers of both structures, i.e. the United States and the Soviet Union, affected

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<sup>5</sup> The Meiji restoration was the process of significant changes in Japan's political, social and economic structures, which accelerated the country's industrialisation.

extensively the popularity of developmental models and subsequently the readiness to draw conclusions from certain developmentally effective systemic and policy solutions. Through a simple comparison of the medium term effects of the two very different economic systems, that of the United States and that of the Soviet Union, without in-depth historical considerations, one arrived at an oversimplified conclusion that the liberal model is an adequate solution to developmental shortcomings. With support and pressure from influential financial centres in Washington, it was agreed among many policy makers that the extensive retreat of the state from the economy would unleash market forces and human entrepreneurship and would translate into better developmental dynamics. Although economic neo-liberalism, as the doctrine would come to be called, advocating extensive economic liberalisation and strict fiscal discipline, later proved not to be an effective developmental model, its rise to the position of an alleged global remedy for underdevelopment significantly affected the coinciding process of post-socialist transformation (PST) characterised by extensive systemic reformulation. The implementation of the provisions of the neo-liberal economic model into state policies is often blamed for economic decline, which most of the post-socialist countries have experienced during the process of systemic reformulation. More peculiar is the case of China which has been undergoing a similar institutional transformation from state-command economy to a market economy, but which has not experienced any economic contraction during the process. On the contrary, it has made significant developmental advancements, often described as spectacular. This thesis will examine the Chinese post-socialist development trajectory and will attempt to explain its causal mechanism.

## **2. Post-Socialist China and the Developmental State Model: Explaining Chinese Development Trajectory**

During the period of post-socialist transformation China has managed to avoid economic recession and has been growing rapidly at an almost two-digit speed for over thirty years, prompting a plethora of scholarly publications on its development trajectory and systemic reforms. This thesis is intended to contribute to the discussion on China's development trajectory. It does so by examining it in the context of the historical developmental state model and of the post-socialist transformation process, fusing those two intellectual streams. It is argued here that **China's development**

**trajectory during the process of post-socialist transformation has been determined by the provisions of the Developmental State (DS) model**, and more specifically:

- on the state development policy level as far as the three main DS policies are concerned; the policy of industrial development, the policy of export support and import discrimination, and the financial policy of support for industrial development and trade. This policy categorisation – a variation from the standard division presented usually in scholarly publications (see: Bernard and Ravenhill 1995; Haggard 1990; Jeon 1995; Stubbs 2009), is believed here to more accurately represent the types of DS policies;
- on the level of state paramount ideology to preside over socio-economic development, namely, the economic nationalism, which, on a sociological level mobilises the nation behind specific state activities and collective targets (see: Breslin 2007; Hughes 2006; Jiang 2010), however, in practical terms serves as a platform to develop regulations supporting domestic business and limiting market access (PP 2009, 2010; Breslin 2006);
- on the level of political and economic arrangements, related to the political and economic systems (see: Leftwich 2000; Fewsmith 2008a; Deng 1988; OECD 2009a), the positioning of the state within the systemic environment (see: Amsden 1989; Shirk 2007), and the interaction among actors of the development trajectory (see: Evans 1995; White 1999; Oi 1995; Gallagher 2005).

The thesis presents a detailed account of what choices of post-socialist China have been determined by the DS model and why. The causal relation between the DS-determined selection and the PST process is established.

However, China's certain degree of affinity to the historical developmental states such as Japan, Korea and Taiwan comes to many scholars hardly as a surprise (see: Baek 2005; Breslin 2007; Gallagher 2005; White 1988). Post-socialist China is believed to have adopted at least some DS solutions. However, it is often emphasised that only a handful of policy and institutional choices are consistent with DS solutions, as China is considerably different from the historical DS cases (see: Howell 1998, 2006). I argue here against this perception, as I claim that Chinese state development policies, state ideological background, and institutional solutions in terms of politics and economics draw extensively from DS experiences – this extension being explained later –, despite the fact that the process is taking place in a different international environment (i.e. more advanced globalisation) and China's institutional experiences (i.e. the systemic

transformation from socialism) are different from those of historical developmental states.

Moreover, I believe that the argument that it is not surprising that China's development trajectory has been determined by DS experiences is, to some extent, misplaced. This perception seems to ignore other experiences of post-socialist transitions. If we see China's development trajectory in a broader context of the PST process, then we notice how unordinary China's behaviour has been. Most of the post-socialist countries have chosen different modes of political and economic transformation to facilitate development. Naturally, one may claim that China is unique in its size and its capacity and that its transformation preceded similar processes in Central and Eastern Europe and the former Soviet Union (CEEFSU). However, once all the Eastern bloc countries were in transition, China's mode of reforms changed, but never emulated the paths of European and post-Soviet states.

Despite this, it is argued here that China's policy and institutional selections determined by the DS model is the natural choice in the process of post-socialist transformation, that is not merely preferred, but also more logical and obvious, even though it is rather a deviation from the standard behaviour of countries in systemic transition. Were it not for certain ideological pressure, it would be capable for other post-socialist countries to become types of the developmental state, in order to more effectively satisfy their post-socialist economic prerogative.

This is why this thesis goes further than the examination of China's post-socialist development trajectory in the context of the DS model and the PST process. It is argued here that due to the incorporation of the DS solutions into the Chinese post-socialist development trajectory, **China has become a genus of Post-Socialist Developmental State (PSDS) model** – PSDS being a viable post-socialist option. This model explains China's policy and institutional choices. Establishing the model also addresses the question as to the extent of DS-termination in China's post-socialist development trajectory. Being a type of PSDS, however, does not make China a separate model, which would be characterised by a set of distinctive, nevertheless, transferable and normative features. It would perhaps be difficult to see China as a model, due to its alleged uniqueness and thus unrepeatability of Chinese conditions. Nevertheless, this thesis aspires to establishing a set of conditions moulded into a normative framework,

offering – to quote Evans (1998) – transferable lessons. This model – the Post-Socialist Developmental State – would draw extensively from the Chinese experiences, as well as from the experiences of post-socialist and developmental states. Consequently, in addition to more accurately explaining China’s development trajectory, this thesis is also aimed at composing a pool of more general recommendations as far as developmental advancements of countries in transition are concerned.

In sum, this thesis seeks to answer the following questions:

- what are the specific features of China’s post-socialist development trajectory which are consistent with DS solutions and why have they been employed in post-socialist conditionality?
- what is the PSDS model, how does it explain China’s development trajectory and what transferable lessons does it offer beyond?

Naturally, the main hypotheses of the thesis generate additional claims, namely that China is undergoing a systemic process of post-socialist transformation and that a variation of the DS model is still a relevant developmental option. These are investigated in the course of research.

Taking into account the plethora of scholarly analyses available, there will always be the question whether China’s policy and institutional choices that are believed to be DS-related cannot be explained without framing them within a PSDS model. In other words, what brings us the conceptualisation of China as a PSDS? The thesis’ intended contribution to the scholarship on China’s development trajectory is by examining it in the context of two prominent and, in the case of China, intertwining processes: post-socialist transformation and the establishment of a genus of the developmental state model, which leads to the creation of the PSDS. This approach positions Chinese development trajectory in a broader analytical perspective, necessary for comprehending certain aspects of China’s development. The thesis compares the historical DS arrangements with those employed in post-Mao China. It also examines the Chinese post-socialist transformation and searches for the DS-characteristic elements in this process. It establishes a causal relation between the DS institutionalisation and post-socialist transformation. It is argued that some policy and institutional choices, such as for example, ownership reform, agrarian changes, industrial targeting, among others, can more accurately be explained by framing China’s development path within the PSDS model, due to this causal relation.

Although scholarly literature on China deals with the issue of systemic transformation, the scholarship on post-socialist transformation often ignores the biggest post-socialist economy, due to its Eastern Europe and post-Soviet bias. In doing so, perhaps intentionally, it omits an important account on the possible patterns of transition, systemic and institutional arrangements, and development paths, making the post-socialist debate largely incomplete. As far as the literature on the DS model is concerned, China is occasionally featured as a peculiar extension of some DS institutional and policy solutions. This thesis, however, attempts to present a comprehensive account of similarities and differences between China's development trajectory and the trajectories of DS historical cases. It also positions China as an indispensable subject-component of the post-socialist world.

Moreover, the thesis attempts to establish scaffoldings for a normative model of natural developmental choice for post-socialist states in transition, namely the Post-Socialist Developmental State. Establishing a model of Post-Socialist Developmental State is perhaps partly intended at gathering often scattered explanations of China's developmental and transformational variations under one general framework. More importantly, however, the PSDS model is offered as a preferable method of achieving the post-socialist economic objectives, not only because of the historical DS successes, but due to the certain transferability of systemic and other arrangements from socialism to the DS environment. The thesis offers "transferable lessons" for underdeveloped countries in transition, as the model effectively returns, in the contemporary conditions, to the proven developmental solutions abandoned during the period of economic hyper-liberalism (Nuti 2010). The thesis may also offer us a glimpse at a possible scenario of China's future development, as by adopting institutional and policy choices from the DS historical cases, it commits itself to certain actions in order to continue its developmental mode.

### **3. The Methodology and Chapter Composition**

The thesis is intended to be a contribution to the theory of political economy (see: Caporaso and Levine 1992) and more specifically to the discussions on economic-institutional arrangements and policies in the process of development. By extending the neo-Listian tradition of state-led development (see: Breslin 2011) to the contemporary

conditions of post-socialist transformation, I explain China's development trajectory. This leads to the establishment of the Post-Socialist Developmental State, which combines the elements of the PST process and DS institutionalisation. Although the thesis acknowledges the initial divisions created by the classical political economy, in terms of political systems, the dichotomy between state and market, and between structure and agency, it favours the new political economy integrated approach with an emphasis on comparative institutional analysis (see: Besley 2004; Breslin 2007). Institutions, North (1990, p.3) asserts, 'are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. [...] They structure incentives in human exchange, whether social, political, or economic.'

In analysing China's development trajectory I am partly guided by the comparative historical research methods (see: Mahoney and Rueschemeyer 2003). Historical policies and institutional arrangements of developmental states, in particular those of Japan and Korea, serve as an important part of the explanation for the current policies and institutionalisation in China. I utilise Schutt's (2006) methodology of four stages of qualitative comparative historical research. In chapter one and two I conduct an in-depth analysis of the main concepts related to the thesis – the developmental state model and post-socialist transformation. I also select the cases; China, as well as, for comparative purposes, Japan and Korea. In chapter three and four I examine the differences and similarities between the chosen cases. Finally, based on the analyses from the previous chapters, I identify the causal explanation for China's contemporary development trajectory and establish the features of the PSDS model. In chapter three and four I employ mostly the nominal comparison built around the idea of necessary and sufficient conditions across highly aggregated units, such as nation-states (Mahoney 2003). However, I also utilise the within-case analysis in chapter one and two, where the case examination is preceded by the general theory explanation. Moreover, I benefit from the causal narrative concept, in order to provide a more accurate description and to support the argument at a more disaggregated level (Mahoney 2003, p.365).

The research strategy involved a two-stage examination, firstly, of the secondary sources supported by primary statistical data, related to the concept of developmental states, to post-socialist transformation, including China's transition and development, as well as to institutional and social arrangements and state-level policies of the selected national cases. Secondly, the secondary sources research has been supported by field

research conducted in China, which resulted in intelligence from a number of official and unofficial sources. In the years 2007-2011 I interviewed three categories of people; ministerial officials, among others from the National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM) and People's Bank of China (PBC), and provincial policy makers; researches and scholars from academic institutions and governmental research centres; and business sector representatives. The set of questions would revolve around various aspects of China's development trajectory, its perception and explanation; China's systemic transformation; the interrelation of the actors of the development trajectory and the positioning of the state. In particular, the interviews would focus on policy and institutional solutions during the Hu-Wen administration.

In the case of China, the comparative political economy analysis generates an important concern. In comparing the PRC with other countries, we *de facto* assume China's homogeneity. In practice, it is extremely difficult to see the country as a monolith, not merely because of its size and capacity, but also due to the regional differentiation in the level of development and in the economic features. Extensive internal differences may produce different policy necessities, and the overall state-level policies can generate various effects. There are at least several Chinas in one China. From the perspective of policy-making, what constitutes a problem is the post-socialist institutional decentralisation of what is already the least centralised socialist economy. As a result, the centrally produced development policies are significantly reconfigured on the local level. It is, thus, often difficult to see a direct linkage between central policies and institutional arrangements and local outcomes. However, our disaggregating of China's development trajectory into the development policy level and economic and political institutional features, with the partial focus on the local level, serves precisely the purpose of avoiding the examination of China as a monolithic unit. In the sections, where China, for comparative purposes, is perceived as homogenous, the examination concerns a narrow selection of development policies and institutional arrangements created and administered into the economy, to a significant extent, on the state-level. At best, one may contemplate their variation of degree in implementation effectiveness on the ground, however, one cannot question their existence in the economic-institutional environment and their aggregate effect. The second concern is usually related to China's purported uniqueness. Uniqueness as such makes it more difficult to compare. However, this thesis does not support the claim of China's uniqueness. In fact, it is

argued that China's development trajectory is a natural consequence of extending the developmental state concept to the realm of post-socialist transformation, which was also expected by other post-socialist states, if it were not for international pressure.

As far as chapter composition is concerned, chapter one is concerned with the DS model's contemporary applicability and the extension of the DS debate to China. It starts with a descriptive analysis of the features of the developmental state concept, which involves its economic and political conditionality. It examines the model geographical and temporal limitations, the relations among the state's main actors, institutional and systemic arrangements, state ideology and state policies. Upon establishing a set of features and conditionalities, as presented in the scholarly literature, it is argued that the model's variation can still be contemporarily applicable. It is then explained how it extends to contemporary China.

Chapter two examines the process of post-socialist transformation. It begins with the analysis of the general theory and discusses the main threads of the debate on the modes of transformation in reference to the so-called Washington Consensus (Williamson 1990). This is followed by a detailed analysis of post-socialist transformation in China. It is argued that China is indeed a post-socialist state in the process of systemic reformulation. I analyse its political and economic features, its chronology and various perspectives. In the process, I search for DS-typical elements, as examined in chapter one, to evaluate, in very general terms, the DS-compliance of China's post-socialist development trajectory, before delving into institutional and policy details in chapters three and four.

The comparative research of China and the two largest historical DS economies in chapter three focuses on several groups of features, i.e. state ideology and institutional and systemic arrangements, including those of political, economic and social character, without insisting on a firm division among them. The stress is put firmly on the positioning of the state and its consequences rather than exhaustive categorisation of features of respective development trajectories. The chapter begins with the examination of economic nationalism. It then proceeds to the systemic arrangements and state capacity and legitimacy. It continues with the examination of the relations, among the main actors of development, including labour relations. It also tackles the

phenomenon of corruption. Finally, it discusses state interventionism through economic bureaucracy.

Chapter four continues the above comparative research. However, it focuses on the policy issues related to China's development trajectory, which are selected on the basis of their role in the historical DS cases. There are three sets of state policies which are examined in this chapter, the DS policy of industrial development, the DS policy of import discrimination and export support and the DS financial policy of support for industrial development and export. These sets of policies are among the most reflective of the main state activities of historical developmental states and are believed to have played a key role in their national development. The DS policy of industrial development is concerned with the targeting of certain branches of a national economy to be developed, due to their real or potential added value in general developmental efforts. The DS policy of import discrimination and export support illustrates the very mechanisms utilised in the directing of the inter-border flow of goods as well as the obstacles generated by international conditions in this respect. The DS financial policy of support for industrial development and export reveals the broad range of state instruments to additionally enhance the development trajectory in the market economic conditions via financial and fiscal incentives stimulating industrialisation and international trade. This analysis is preceded by the examination of general perceptions of the DS industrial policies, as portrayed in the scholarly literature, and by the analysis of the agrarian policies, as the pre-conditionality for industrial development.

Chapter five aims to answer the main questions of the thesis. It evaluates the Chinese development trajectory's affinity to the DS model in the conditionality of post-socialist transformation. It establishes the main features of the PSDS model and tries to identify the areas in which the PSDS explains China's policy and institutional selection. By offering the transferable lessons for underdeveloped countries in systemic transition, it attempts to explain the PSDS as the logical consequence of post-socialist transformation.

## **Chapter 1: The Developmental State: Its Conditionality and Its Future**

The concept of the developmental state is, among some scholars with interest in East Asia, widely believed to be the conceptual background of state policies and state institutional arrangements, leading to the unprecedented developmental achievements among the so-called late developers of the Asian continent. Nonetheless, the concept is often portrayed as only a historically justifiable phenomenon which cannot relate to contemporary conditions, mostly due to the accelerating pace of the process of globalisation, which, in effect, is believed to render the significance of state policies minimal.

Nevertheless, the “relatively fresh” significant developmental achievements of countries such as Japan, Korea and Taiwan, broadly considered to have been developmental states, oblige us to conduct a further examination of the applicability of the developmental state model contemporarily, especially in view of China’s recent developmental achievements and in view of the necessities of those countries, whose recent efforts at systemic changes are aimed at the acceleration of socio-economic development. Post-socialist countries may well constitute such a group, as the increase in developmental dynamics seemed to be one of the main reasons behind the commencement of their transformation.

The concept of the developmental state and its applicability is thus the starting point for the discussion on China’s development trajectory and, naturally, on the possibility of establishing a sound PSDS model. Therefore, in this chapter I evaluate the existing literature on the developmental state. I start by establishing the features of the DS model. I also analyse the conceptual discussion contained in the literature as to the political and economic conditionalities of the DS. I then evaluate the contemporary applicability of the provisions of the DS model. Finally, I explain how the discussion extends to China.

### **1.1. The Definitions**

The concept of the developmental state in the literature seems to be examined from various angles; addressed through its historical and ideological background and necessary pre-conditions, as well as through social, political and economic features,

state policies, external conditionality and institutional arrangements. For example, Weiss (2000) distinguishes three main criteria for developmental states; their priorities to eventually close the technological gap between themselves and highly industrialised nations, their organisational arrangements with an insulated state bureaucracy and a pilot state agency in charge of development, and their institutional links with organised economic actors as the locus of policy input, negotiations and implementation. Stubbs (2009, pp.5-6) distinguishes three key ingredients of the developmental state: first, one that is “essentially institutional” – ‘a cohesive set of institutions with a relatively autonomous capacity to implement a planned strategy for capitalist economic growth’, second, relational aspects which emphasise the interaction among the DS actors in political, economic and social dimensions as a “seamless web of influences”<sup>6</sup>, third, an ‘ideational aspect with particular attention being paid to nationalism, (neo)mercantilism, economic transformation, rapid industrialisation, performance legitimacy or some amalgam of a number of these ideas’. For, Howell (2006, p.275) ‘the ideal-typical developmental state has the following key features: first it has a political and policy elite committed to economic growth and transformation, with a power, authority and legitimacy to promote a developmental agenda. Often motivated by strong nationalist sentiments, such elites strive to modernise their countries, raise economic living standards and bridge the developmental gap. Second, complementing such a development-focused elite is a competent, authoritative state administration, particularly in the economic sphere, with the technical and managerial capacity to guide and steer economic and social development.’

Many of the DS analyses are country specific – see, for example, Johnson (1982) in reference to Japan; Amsden (1989) – in reference to Korea and Wade (1990a) – in reference to Taiwan, or comparative.<sup>7</sup> They also are often positioned within a broader theoretical discourse on various developmental trajectories. For example, Gereffi and Fonda (1992) examine the concept within the discussion on regional paths of development.

In order to illustrate the main components of the DS model, as portrayed in scholarly analyses and examinations, I address several points; firstly, the broad and narrow perception of developmental states; secondly, “the relational aspects”, i.e. state-society

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<sup>6</sup> See: Woo-Cumings 1999.

<sup>7</sup> See chapters three and four for more details.

relations and the concept of state-business alliance; thirdly, the general DS policies; fourthly, the main ideological background; and fifthly, the existence of quantitative definitions. I continue the analysis in the political and economic conditionality sections, with the comparative examination analysis followed in chapter three and chapter four.

### **1.1.1. The Geographical and Temporal Limitations**

It is believed that, historically, the roots of the developmental state can be traced not only to Bismarck's Prussia and to Japan's Meiji restoration, but also to Hamilton's American school and the American system, and the Listian political economy. Therefore, some scholars would like to see the definition of the developmental state being applied to a broad group of countries, who possess a historically proven track of fast development, in addition to certain institutional arrangements and policies examined later in this thesis. As a consequence, Woo-Cumings *et al.* (1999) analyse the applicability of the concept to European countries such as Austria and Finland. Furthermore, France and Germany, as well as Scandinavian countries are sometimes portrayed as genera of the developmental state. Schneider (1999) describes the *desarrollista* states of Mexico and Brazil as being examples of certain types of developmental states. South Africa is often tipped to become a developmental state, whereas Botswana was in the past seen as the African example of the DS model. In Asia, a number of countries are analysed in the context of the developmental state, namely, Japan, Korea, Taiwan, Singapore as well as Malaysia, on occasions, Thailand, Indonesia and the Philippines. This poses the question as to the geographical limits of the applicability of the developmental state concept.

The origins of the concept are believed to be connected with Chalmers Johnson's institutional analysis of Japan's industrialisation in the book entitled *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*. In his work Johnson shows the existence of a certain correlation between the institutional arrangements and developmental successes. Japan, a predominantly rural and relatively poor country becomes an affluent, developed nation in a shorter period of time than Western European and North American states. Johnson's analysis was followed by the examination of former developing nations – Korea and Taiwan (see: Wade 1990a; Amsden 1989; Cumings 1984) Consequently, the question of a DS transformation concerns “relatively poorer” countries, also called late developers, and their ability to

accelerate socio-economic development to achieve an effective catching up trajectory. This leads us to a somewhat geographically narrower applicability of the developmental state, upon the exclusion of European and North American countries.

A relatively extensive share of the development-related literature concerned with the concept of the developmental state deals with comparison between two regions; Latin America and East Asia, since Latin America, as pointed by Gereffi and Fonda (1992) and others, is often considered to be the first third world region to industrialise. Gereffi and Fonda (1992) argue that developmental experiences of Latin America, such as bureaucratic-authoritarian approaches and the dependency theory, have been used by experts on East Asia to frame the discussion on the region developmental changes (see also: Cumings 1984). Haggard (1990), focusing on their respective developmental strategies, examines, among others, society-related conditions, including the legacy of countryside, the position of labour force and the interest of capital, paying special attention to Mexico and Brazil. He underlines that the general DS development policies were, in their regional variation, very much an element of the Latin American developmental experience. For instance, import-substitution industrialisation was a characteristic feature of development of Mexico and Brazil, which eventually resulted in expansion of manufactured export, not, however, to the extent observed in East Asia. On a country-to-country comparative basis, Cummings (1984) considers Mexico the best analogy to Taiwan and Argentina to Korea in terms of political arrangements (authoritarian system, strength of the state) and industrialisation.

Unsurprisingly, the discussion eventually focuses mostly on the East Asia region. Akamatsu (1962), in his wild-geese-flying pattern, employs Western European and Asian states to illustrate the development of 'advanced and less advanced countries'. Cumings (1984) and Bernard and Ravenhill (1995) would later use the pattern to explain the interdependencies within the East Asia region. This, however, does not seem to solve the issue of the geographical limitation entirely, as Weiss (2000, p.23) complains that 'the term developmental state is [so] loosely applied that it has become virtually synonymous with the state in East Asia'. Indeed, some DS analyses venture outside of the Northeast Asia realm, as does, for example, Hayashi's (2010). He sees some of the Southeast Asian (SEA) countries as developmental states, which for Stubbs (2009) seems to create an important area of disagreement in terms of categorisation.

The DS model is often perceived as being limited to the Northeast Asian late-developer group of countries and Singapore, which in addition to having achieved impressive long-term developmental dynamics to allow for successfully catching up with the developed world, share, to some extent, similar cultural values. The scholarly literature sometimes focuses on the “Asian Three”, i.e. Japan, Korea and Taiwan and deals with their interdependencies (see: Bernard and Ravenhill 1995; Kohli 1994; Cumings 1984; and many others). Naturally, there are unavoidable differences among the successful Northeast Asian developmental states, in terms of their state policies and institutional arrangements. For example, Jeon (1995) divides the Northeast Asian (plus Singaporean) DS pattern of economic growth into three categories; South Korea’s ‘growth-obsessed’, Singapore’s ‘growth-with-stability’ and Taiwan’s ‘equity-and-stability-based growth’. Moreover, as a first developmental state, Japan is usually seen as an unordinary and peculiar example of the DS model.

The developmental achievements of developmental states are usually time-framed within the course of the twentieth century, as opposed to so-called Western countries, whose roots of developmental achievements can be traced as far back as the great geographical discoveries of the fifteenth century, or at least to the Industrial Revolution and its aftermaths. More accurately, the period between the 1950s and 1980s is considered the fast growth time of developmental states.

However, the narrow-broad discourse also applies to the timeframe in which states cease (or not) to be developmental states, firstly, due to their reorganisation of the DS-like institutional environment and termination of the DS-related state policies, secondly, due to their de-acceleration of developmental dynamics or, in extreme cases, due to their developmental regress (as was the case of Botswana in the 1990s<sup>8</sup>), and, thirdly, through achieving a developmental level comparable with Western nations (as was the case of Japan). Those three conditions refer to endogenous factors of the demise of developmental states, on the contrary to possible exogenous factors examined later in this chapter and usually more extensively featured in the scholarly literature. They relate to the changing external conditionality of the DS functioning.

It can be plausibly argued that the first endogenous condition effectively terminates the existence of a developmental state as such and Wade (2000) claims that it was indeed

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<sup>8</sup> Between 1990 and 2004 Botswana’s HDI (Human Development Index) fell by 0.11 points.

the case of Korea prior to the 1997 Asian financial crisis. The second condition seems also likely to do so. The third, however, is indeed an issue to be resolved in terms of whether a developmental state remains a developmental state after it reaches the developmental level of developed nations. This seems especially important in the comparative analysis of China with historically successful DS cases such as Japan and Korea, as it defines the time limits of the examination. The main purpose of the DS policies and institutional arrangements is believed to be the effective catching up with the highly developed nations in terms of standard of living and technological advancements. Weiss (2000) describes it as the “catch-up thesis”. In other words, the DS is often portrayed as the means to become a developed country. Once a state becomes a developed country it can be perceived as no longer being a DS case. However, Weiss (2000) believes that the purpose of the developmental state falls beyond this description. What she describes as a “transformative project aimed at maximising national goals” is a long-term DS-style tailored policy to create a transformative state capable of continuously upgrading its industrial economy to allow a gradual increase in wealth. Weiss (2000, p.29) thus believes that ‘catching-up does not bring automatic retirement for the developmental state’, as there is a new task of “keeping up”. She ushers a compromise by re-conceptualising the term as “the transformative state”. Moreover, Stubbs (2009, p.12) claims that the DS has never been entirely dismantled in the East Asian countries from the time when they became developed nations, despite the institutional changes worldwide, as it became deeply embedded in the formal institutions and informal governmental practices. It proved durable, as it became central to the East Asian political economy by bringing prosperity and stability to the region (Stubbs 2009).

Nevertheless, although some DS institutional features continue to be a part of the systemic arrangements after a developmental state becomes a developed country, it can be argued that the core activity of the developmental state is related to the period in which the country is pursuing the goal of becoming a developed nation. Lee and Mathews (2010) argue that the institutional arrangements need to be transformed once “imitation” becomes largely irrelevant in the process of elevating the economy’s level of sophistication and needs to be replaced by “innovation”, which happens when a state reaches a technological frontier associated with high level of development. If we disregard Weiss’ (2000) concept of a “transformative state” and accept that the purpose of the developmental state is a successful catching up, then the completion of this

process should imply a termination of the developmental state. On the other hand, this DS purpose seems only implicitly indicated in the literature, which is dominated by the perception of the developmental state as an overall state philosophy without limits defined by the extent of developmental achievements. Additionally, a developmental level indicating a completion of a successful catching up process seems, to some extent, arbitrary. Without fully resolving the issue of the alleged timeframe of the existence of the developmental state, for comparative purposes, the term “developmental state” will refer to the “DS core activity” period of the historically proven successful DS cases, during which the three sets of endogenous conditions described earlier did not occur extensively, i.e. there was no broad departure from DS institutional environment and policies, the pace of development continued to be relatively high, the states in question would retain a status of not being as developed as so-called Western countries. These somewhat elusive limitations are necessary for the comparative examination with China’s contemporary development trajectory, which possesses similar features to those characteristic of the states in “DS core activity” periods, namely; underdevelopment, high growth and, as it will be argued, limited economic liberalisation with the state at the centre of the process of socio-economic development.

### **1.1.2. The State-Society Relations: From “Embedded Autonomy” to “Subordinate Society”**

‘Developmental state is a shorthand for the seamless web of political, bureaucratic, and moneyed influences that structures economic life in capitalist Northeast Asia’ (Woo-Cumings 1999, p.). Therefore, one of the main elements characterising the concept of the developmental state is what Stubbs (2009) calls “relational aspects”. They are defined by the interrelation of effectively four actors of the developmental state, the state political elite, the state bureaucracy, the society and the business, as analysed in reference to particular examples in chapter three.

In his analysis on states and industrial transformation, Evans (1995) distinguished two ideal types characterising state structure and state-society relations, namely, predatory states and developmental states. ‘Predatory states extract at the expense of society, undercutting development even in the narrow sense of capital accumulation’ (Evans 1995, p.12). Pareto (1966, p.114) underlines that they are characterised by the process of ‘the appropriation of the goods of others by legal or illegal means’. Nozick (1974,

p.2, cited in Leftwich 2000, p.101) states that it is the political elite's 'degree of control over coercive, economic and political resources [which] determines the state predatory capacity'. Mobutu's Zaire is often seen as a prime example of a predatory state. Zimbabwe under the Mugabe regime, seems to be one of the most distinctive recent cases of a predatory state. 'There are clear structural differences between predatory and developmental states. Predatory states lack the ability to prevent individual incumbents from pursuing their own goals. Personal ties are the only source of cohesion; and individual maximization takes precedence over the pursuit of collective goals. Ties to society are ties to individual incumbents, not connections between constituencies and the state as an organisation' (Evans 1995, p.12).

Consequently, there seem to be two opposite patterns of interrelation between the state and the society, as reflected in the two models. In predatory states, the ruling elite thrive on the dwindling resources of the society, whereas in developmental states those resources are being multiplied partly by cohabitation and cooperation between the state and society for the benefit of both. This is what seems to initially constitute a concept of "embedded autonomy". According to Evans (1995), developmental states possess such "embedded autonomy", an autonomy of the state administration, which allows it to impartially fulfil its duties, as 'the elites and state institutions [...] [are] able to achieve relative independence (or insulation) from the demanding clamour of special interests (whether class, regional or sectoral, where they exist) and that [they] can and [do] override these interests in the putative national interest' (Nordlinger 1987 cited in Leftwich 2000, p.161), at the same time 'embedded in a concrete set of social ties that binds the state to society and provides institutionalised channels for the continual negotiation and renegotiation of goals and policies' (Evans 1995, p.12). This conceptual system seems to provide the autonomy necessary to rule the state effectively (which allows for composing and implementing unbiased long-term development policies), as well as to maintain the dialogue between the state and society, as the people are believed to participate in the policy formulation through established channels which connect the state and the society. These channels are necessary to form coalitions (see: Waldner 1999; Doner *et al.* 2005) of the state with various social groups, including the entrepreneurs, in order to minimise the opposition to the formulated developmental trajectories. Waldner (1999) and Doner *et al.* (2005) present somehow conflicting views as to the coalitions in developmental states. Waldner (1999, pp.137-138) gives the examples of the Taiwanese and the Korean DS as characterised by conservative or

narrow coalitions, as opposed to cross-class coalitions, which support collaboration between the state and large business and exclude significant sectors of the population to minimise so-called side-payments, (understood as concessions to certain social groups in order to gain their support for the overall development trajectory) extensively present in broad coalitions. In contrast to Waldner (1999), Doner *et al.* (2005) claim that broad coalitions contributed to the creation of developmental institutions, as the side-payments, necessary in the conditions of broad coalitions and unaffordable in the conditions of scarce resources and security threats (both; the scarcity of resources and the security threats characterised the economic and political environment of historical DS cases), would not be possible without the continuous “upgrading” of the economic structure. According to Doner *et al.* (2005) broad collations produce stronger institutions.

Leftwich (2000, p.160) seems to offer, to some extent, a different view from that of Evans (1995), on the existence of the interaction between the state and the society, as he sees several elements which define a developmental state, namely, a determined developmental elite; relative autonomy of the developmental state; a powerful, competent and insulated economic bureaucracy; a weak and subordinate civil society; the capacity for effective management of private economic interests; and an uneasy mix of repression, poor human rights (especially in the non-democratic developmental states), legitimacy and performance. Leftwich suggests the existence of a certain imbalance. On one hand, there is the powerful state with its powerful bureaucracy, powerful to the extent that it can manage the private economic interests effectively. On the other hand, there is a weak society, which in reality does not have any effective influence on the ruling elite, as it is subordinate to the latter. Stubbs (2009, p.6) supports the idea of an unbalanced relationship between the state and the society being critical for the DS, where a ‘weak society is unable to offer any concerted resistance to the rise of a relatively strong state’. Amsden (1989) validates, to some extent, Leftwich’s opinion on the imbalance, by providing an example in the form of the Korean case. She believes that the strength of the Korean state or its consolidation of power was possible to achieve partly due to “the weaknesses of social classes”. ‘Workers were a small percentage of the population, capitalists were dependent on state largesse, the aristocracy was dissolved by land reform, and the peasantry was atomised into smallholders’ (Amsden 1989, p.52).

The political weakening of the agricultural interests was conducted by the implementation of land reforms (see: Cumings 1984; Haggard 1990). It usually involved the dismantling of the influential landlord class and the fragmentation of the agrarian power centres. Haggard (1990, p.36) points out that rural changes were aimed at achieving two objectives; to eliminate rural elites as potential opposition towards state preference for industry and thus the country's industrialisation, and to gain the rural support for state policies by empowering the so far less privileged elements of the rural classes. He concludes that although there might not be a direct link between eliminating rural elites and the ability to industrialise, their absence gave the DS governments more freedom to manoeuvre.

As far as the DS working class is concerned, Cumings (1984, p.27) points out that 'labour was excluded [from participating in the political process of policy making] in the 1950s and remained excluded in the 1960s' in Korea and in Taiwan. Haggard (1990) underlines that all NICs were characterised by the political weakness of the industrial working class, due to inherent lack of empowerment (e.g. Taiwan) or repression (e.g. Korea). He points out that the DS governments would ensure that labour forces do not possess an extensive influence on policy making. However, at the same time, they would implement policies, which would enable them to gain natural support from the working class, such as the development of import-substitution production, which would generate additional employment. The control of labour would have its political reasons; the proximity of communist states, as discussed in the section on political conditionality, and therefore a somewhat increased possibility of leftist political movements outbursts within the labour force, and economic reasons; keeping the wages low, thus increasing the international competitiveness of a domestic production base.

It is important to reiterate the state's dual attitude towards working and rural classes. Waldner (1999) in his country-specific analyses of Korea and Taiwan reminds us that the DS rural and labour classes were repressed (a lack of political power to advance their postulates), but at the same time empowered (transfer of land, import substitution production). The DS governments' perception was that, on one hand the rural and working classes needed to be controlled, on the other, it was important to gain their support for the developmental endeavour.

Wade (1990a), White (1988) and Robinson *et al.* (1998) in their respective analyses pay more attention to the interconnectedness of state and domestic business as the main points defining the developmental state, often described as state-business alliance. Wade (1990a) focuses on the role of state as the power centre capable of nurturing development via certain policy incentives, realised through the “government big followership”. The “big followership” as opposed to “small followership” describes a situation in which business is ready to realise certain projects only with state assistance, as otherwise they would not be profitable or would be highly risky. Indeed, as Amsden (1989) states, the government also becomes the entrepreneur by ‘[usurping] the domain of the traditional private entrepreneur by making milestone decisions about what, when, and how much to produce’ (p.112). In this way, it creates the institutional arrangements close to what Hall and Soskice (2001) call a coordinated market economy, where ‘firms depend more heavily on non-market relationships to coordinate their endeavours with other actors’ (p.8). ‘They are market economies in the sense that initiative rests mainly with the enterprise, profit remains the enterprise’s main motive, and enterprises which do not make profits will in most cases go out of business. In general, but with many important exceptions, the state tries to get things done by influencing the market, by shifting the composition of what is profitable [by “getting prices wrong”<sup>9</sup>], rather than by direct regulation or direct production’ (White and Wade 1988, pp.5-6). According to Doner *et al.* (2005) this state-business relation is not clientelist, as is usually the case in many developing countries. The government-business cooperation takes place on functional industry-based criteria and the transparent environment according to consistent rules and norms.

From an economic perspective, the state-business alliance is a crucial element of the developmental state, ‘in which expert and coherent bureaucratic agencies [meaning a competent state] collaborate with organised private sectors [meaning the business] to spur national economic transformation’ (Doner *et al.* 2005, p.328), and in which the advantages of the state sector and the business sector are combined for the benefit of the developmental endeavour. The state secures an overall development plan, which is intended to provide improvements for the entire society, whereas the business sector realises the plan, making it in some respects rational, via the effective mechanism of product manufacturing as well as an effective organisational management of the development-related projects. Haggard (2004) warns, however, that there is no single

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<sup>9</sup> See: Amsden 1989.

model of business-government relations in the East Asia region. This is due to the varied extent of business opportunities created by political institutions and the different strengths of national businesses.

The DS state-business alliance is often blamed for extensive corruption, which is believed to be in a way incorporated into the institutional arrangements of the developmental state. The scholars are divided as to the extent and influence of corruption, as an inevitable element of the DS institutionalisation. 'Corruption is breaking legal and organisational rules to use public goods or power vested in one's public office for private ends. [...] It is an exchange of power for personal benefits' (Kwong 1997, p.ix). It is one of the manifestations of institution failure (Guo and Hu 2004). Undoubtedly, 'the developmental states have [...] not been immune from [corruption]. In rapidly growing economies, sudden wealth (and tidal flows of aid or investment) can generate huge temptations, especially so where [...] the role of the state in economic life is intense' (Leftwich 2000, p.161). However, Bramall (2009a, p.20) suggests that a certain type of corruption may have a positive influence on development.<sup>10</sup>

### **1.1.3. The State Development Policies: From Import Substitution Industrialisation to Export Oriented Industrialisation**

In an institutional environment where the state intervenes in the market to the extent it is believed to significantly influence the economic environment, as examined later, state policies are of a paramount importance as far as socio-economic development is concerned. The scholarly literature examines in detail the policies present in the DS historical cases and responsible for developmental advancements. Here I intend to summarise the general terms describing those policies in an attempt to create some sort of (overlapping) categorisation.

According to Evans (1998, p.67), there are at least three competing ways of characterising East Asian economic policies; the market friendly model as presented by the World Bank (1993), which argues that the state secures a stable macroeconomic environment and the rest is up to the market forces; the industrial policy model associated with Johnson's (1982), Amsden's (1989) and Wade's (1990a) studies of

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<sup>10</sup> The issue of corruption is examined in chapter three.

Japan, Korea and Taiwan, which underlines the policies' entrepreneurial function to nurture development of most promising industrial sectors; and the 'profit-investment nexus' model which acknowledges the state policies' role, however, does not demand from them to be heavily industry-specific. The latter model stresses the role of investment as the carrier of growth.

The developmental state is often defined as a theory of state-led industrialisation (Hayashi 2010). Indeed, the notion which dominates the economic aspects of the developmental state is the process of industrialisation. For example, Evans (1995) states that the embeddedness in the concept of embedded autonomy is believed to provide 'the underlying structural basis for successful state involvement in industrial transformation' (p.12) and that 'developmental states not only have presided over industrial transformation, but can be plausibly argued to have played a role in making it happen' (p.12). Woo-Cumings (1999, p.1) describes the developmental state as the explanation for the East Asian industrialisation. Johnson (1982), in his prominent analysis of Japan, focuses on the industrialisation. Industrial policy, examined in chapter four, is thus an important element of the DS environment.

This industrialisation starts with import-substitution industrialisation or ISI, where a state gradually replaces imported goods with domestically manufactured products. According to Haggard (1990, p.26), 'ISI may occur "naturally" as the result of balance-of-payments problems, supply interruptions associated with wars or growth of the domestic market. ISI is advanced, however, by policies to manage balance-of-payments crises, particularly trade and exchange controls, and by explicit industrial policies designed to raise the rate of return to manufacturing'. Haggard (1990) distinguishes three phases of ISI. 'In the first stage, the state earnings come from primary-product exports and the foreign borrowing finance the imports of selected producer goods. These imports provide the foundation for local manufacturing' (pp.25-26). In its second stage, the dependency on raw material and food exports as well as on foreign borrowing is maintained, 'since investment in new industrial capacity increases the demand for imported capital and intermediate goods' (p.26). The third phase is characterised by the supplementing of import substitution with the expansion of manufactured exports. Thus, ISI gradually moves towards export-oriented industrialisation or EOI (Stubbs 2009; Jeon 1995). EOI is historically believed to be the core state policy among the developmental states, as their economic growth and developmental advancements were

export-driven and would be difficult to achieve without the export-oriented policies.<sup>11</sup> The EOI would create a structural relation of a developmental state with the world economy (Haggard 1990), in which the world economy would become the market for the national production, excessive to the domestic consumption capacities. As compared to ISI, the EOI policy would be characterised by greater support for export and some trade liberalisation. It would be accompanied by a number of arrangements within the state trade and financial system policies related to the exchange rate and credit availability. Some scholars see in ISI and EOI the main difference between Latin American and East Asian industrialisations.

Another important DS policy aspect concerns industrial upgrading, i.e. a gradual and continuous change of the assortment of industrial production towards higher sophistication and technological advancement. According to Bernard and Ravenhill (1995) industrial upgrading was the key issue for East Asian developmental states. It would be the result of state support to selected industrial sectors.

#### **1.1.4. The State Ideology: Economic Nationalism**

The process of industrialisation is believed to have taken place in the conditions of a specific nationalist state. Woo-Cumings (1999), Leftwich (2000) and Johnson (1982, 1999) are all convinced that a developmental state is also a nationalist state, as Johnson (1982, p.24) claimed that ‘the very idea of the developmental state originated in the situational nationalism of the late industrialisers’. This perception does not seem to derive exclusively from the fact that East Asian societies seem more homogenous and less culturally diverse as compared with certain Western nations, but rather from the conditionality of the developmental state. A developmental state requires a certain level of societal mobilisation made possible by adherence to common values and determined by common goals, as exemplified in a somewhat elusive contract between the ruling elite, business elite and the society. By analysing East Asian nationalism and its role in the DS concept, one can plausibly argue that what matters is economic nationalism as the main philosophy behind development-related actions.

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<sup>11</sup> Japan is here a peculiar DS case, where export orientation was delayed compared to the institutionalisation of other DS features.

Economic nationalism is by no means a new phenomenon. Friedrich List is considered to be the founding father of economic nationalism. A fierce critic of Adam Smith, he argued for the extensive role of states in shaping international economic relations and guiding national developmental progress. Levi-Faur (1997, p.360) states that ‘national economic thought [...] is best characterised by following three assertions: a nation’s citizenry largely shares (or should share) a common economic fate; the state has a crucial positive role in guiding the national economy to better performance; and the imperatives of nationalism should guide the state’s economic policies’. He continues by saying that ‘nations matter [...] in the shaping of economic policies [and] that national imperatives should direct the course of a nation’s economic policy not only in regard to national security issues but also in regard to the welfare of the nation’s citizens’ (Levi-Faur 1997, p.370). He sees economic nationalism as one of three principal schools of political economy – in addition to economic liberalism and economic socialism. Cohen (1991) distinguishes benign and malign forms of nationalism. In the latter the government “seeks national goals relentlessly” whereas in the former it “is prepared to compromise national policy priorities where necessary to accommodate the interests of others”. Using List’s arguments, Reich (1991) and Levi-Faur (1997) advocate the positive or benign form of economic nationalism calling it “the benevolent version”.

All great economic powers used economic nationalism to advance the realisation of their own targets. This was the case of nineteenth century Britain as much as that of twentieth century United States. In fact, the apparent ‘consensus around [the] benign economic nationalism led American society to a prosperity never experienced before in the history of humankind’ (Levi-Faur 1997, p.368), by ‘nourishing American corporations and American products’ (p. 365). Consequently, economic nationalism does not need to be always in opposition to economic liberalism, though most of the time it is believed to be.

Akamatsu (1962) saw economic nationalism as an indispensable feature of the emerging East Asian capitalist economies. He believed that what gave birth to the economic nationalism in the region was “a conflicting relationship between imported consumer goods and native-produced goods”. As a result, the governments would raise import tariffs or directly limit importation. He saw economic nationalism in less developed countries as an effect of international economic environment shaped by colonialism. He considered it a defense mechanism in the developing economies’ conflict with advanced

countries in the process of homogenisation of industries of both groups of states. Naturally, this process would be particularly visible in East Asia. Therefore, economic nationalism would become an important, if not the leading ideology behind state economic policies in the region. However, especially in the East Asian context, ‘rather than [being] a coherent and systematic body of economic and political theory, economic nationalism [would] refer to certain measures of public policy and administration in such areas as trade and commerce, investment, finance and welfare that have historically been seen and characterised as nationalistic’ (Cai 2009, p.11), as examined in chapter three.

### **1.1.5. The Quantitative Definition**

The qualitative analyses of the concept of the developmental state are well known. Can, however, a quantitative examination prove the existence of a developmental state? In other words, can the phenomenon be measured? This is perhaps not the most important question for a political scientist. Nevertheless it would be academically cohesive to include a quantitative examination in the process of the developmental state determination. Even if, however, the quantitative analysis cannot prove the existence of a developmental state, then it is certainly able to show whether the developmental environment and developmental achievements can serve as a plausible initial argument that the concept has actually been implemented.

The question of how to measure the developmental state is inevitably connected with the issue of how to measure development. Bramall (2009a) divides the approach to measuring development into two groups; the opulence approach which estimates the material wealth, and the capability approach which refers, according to Amartya Sen, to ‘a person’s “capability” to the alternative combinations of functionings that are feasible [...] to achieve. [...] The capability set represents the freedom to achieve: the alternative functioning combinations from which this person can choose’ (Sen 1999, p.75, cited in: Bramall 2009a, p.8).

Leftwich (2000, p.173) believes that a developmental state would have an average annual economic growth of at least 4% for a period of 25 years, or preferably 30 years. Indeed, the quantitative examination would need to be conducted in a sufficiently long timeframe, as the phenomenon of developmental advancements is conditioned long-

term. Perhaps the timeframe proposed by Leftwich is empirically justifiable, as it applies to a long-term phenomenon. However, using economic growth as the most common and indeed most widely accepted indicator is convenient, but nonetheless, questionable. This is not to say that the dynamics of economic growth is insignificant in the analysis of developmental advancements. It is to stress that growth does not necessarily need to mean development. There are certain other indicators which determine development in its socio-economic form and should indeed be taken into consideration, such as Human Development Index (HDI), and Human Poverty Index, which also include the level of education and the health performance of a society. On a number of occasions the values of GDP resulting from economic growth have been misleading as to the level of development and the real standard of living enjoyed by a society. This is due to the fact that:

- economic growth does not always translate into developmental advancements (e.g. Turkmenistan);
- states sometimes realise more effective socially-oriented policies which contribute to the overall well-being of its citizens without high GDP “at its disposal” (e.g. Cuba);
- as a consequence and as mentioned earlier, GDP per capita as a pure economic indicator does not fully capture other indices crucial in determining the standard of living, such as HDI.

Bramall (2009a), however, rejects the idea of HDI, as the most suitable indicator, despite it being a synthesis of the opulence and capability approaches. He questions the assignment of arbitrary weights of one third to each of the HDI components, which are: life expectancy, knowledge and opulence. He believes that ‘HDI obscures more than reveals’ (p.13). Instead of HDI, he favours the change in life expectancy as the best measurement of progress.

The next question concerns the degree of egalitarianism within the developmental states. It is often believed that the existence of the developmental state phenomenon should also be measured by the change in social inequalities. Indeed an increase in disparities might suggest a drift towards a more predatory state. Evans’s (1995) analyses concentrate on the relation between the state (leadership, government, authorities) and the society. One perhaps should also pay more attention to the increase of Gini coefficient (a broadly used indicator measuring income disparities) as proof of the existence of a predatory society, in which the elites (not necessarily directly related to

the political power centres via a web of mutual interdependences, but economically influential) clearly abuse the vulnerable and less affluent parts of society. Consequently, the predatory state can perhaps be seen not only as an existence of predatory political elites who exploit the society, but also as an existence of predatory elements of the society who use their economic and/or political powers to abuse the rest of the society and tamper with its rights. Excessive value of the Gini coefficient might, then, suggest the presence of a predatory society, which is in opposition to a developmental environment. Moreover, Japan's decrease in levels of inequalities during the "core" developmental state period may suggest that disparities can be taken into account while examining the existence of the developmental state. Is the Gini coefficient a credible indicator which can be taken into account while determining the existence of the developmental state or lack thereof? Other developmental states, such as Korea and Singapore, experienced relatively large societal inequalities.<sup>12</sup> Consequently, the developmental state seems also to be present in countries of more significant disparities. This, not only seems to put into question the condition of embedded autonomy as an effective tool in channelling the societal needs into state policies, but also seems to render the inequality argument insignificant. On the other hand, however, it seems extremely difficult to make a valuable comparison between the city-economy of Singapore and the large economy of Japan. Nevertheless, although Japan's development path might suggest societal cohesion as an element of building a developmental state, Korea's example proves that the presence of more extensive inequalities may not be of such importance.<sup>13</sup> It is often believed that the introduction of the developmental state did not alter the relatively egalitarian, though differentiated in degree of disparities, societal composition in Northeast Asian fast growth countries (Perkins 1994). Their societies were more equal than the societies of other developing countries already at the beginning of the rapid growth period (World Bank 1993). Moreover, Bramall (2009a, p.18) shows that the alleged egalitarianism of the East Asian development model rests on questionable foundations. He points out that low income disparities are more the result of omitting a significant part of the society in the surveys rather than an illustration of the real situation. He also describes the Gini coefficient as too superficial to provide an informative judgement about the actual nature of inequalities (p.22).

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<sup>12</sup> In the case of Korea the overall income disparities remained relatively high throughout the period of DS core activity, i.e. over 0.30 and on occasion exceeding 0.40, whereas the income disparities between urban and rural areas after an initial hike, decreased significantly (see: Li and Luo 2008).

<sup>13</sup> It is important to note that the inequalities in the "post-developmental" state of Japan have been rapidly increasing (see: OECD 2006; Moriguchi and Saez 2005).

The developmental state practice does not seem to be concerned with maintaining a low level of inequalities in the way that continental Western European states are. Much more important is the relation between the state and domestic business, whose result of cohabitation must be the overall increase in the living standards of the society. As even the Japanese example proves, the increase in GDP per capita is clearly much more significant than the actual increase in the nation's living conditions in the DS model.

This is not to say that the existence of DS institutional arrangements and the implementation of DS policies do not eventually bring positive results in the form of narrowing disparities. Although not without controversies, the Kuznets hypothesis suggests that upon reaching a certain level of income (a continuous income increase featured developmental states as a result of rapid socio-economic development) the inequalities decrease (see: Acemoglu and Robinson 2002). This is only to emphasise that among DS cases the accent is on overall development rather than social cohesion, the latter being an anticipated outcome of the former. As Perkins (1994, p.660) suggests, 'egalitarianism [...] was thus more the result of historical accident than deliberate policy'.

Finally, the quality of human capital in the East Asian developmental states is often believed to play a crucial role in the overall regional socio-economic development. Therefore 'education that leads to the formation of human capital is recognised as an "engine of economic growth"' (Tilak 2002, p.5). The quality of human capital can be measured in various ways, i.e. by estimating the incidence of school attendance, the average length of education within the population, the literacy rate, etc. The analysis of the quality of human capital is implicitly contained in the examination of Human Development Index, as the former contributes to the value of the latter.

## **1.2. The Political Conditionality**

There are certain controversies concerning the concept of the developmental state, as presented in the scholarly literature. One can address them by establishing certain political and economic conditionalities of the DS model. The first controversy concerns the question as to whether a developmental state can be both democratic and undemocratic, and how it can be applied in the two different systemic arrangements. The second main controversy surfaces when we take into account Johnson's statement

that ‘one of the main purposes in introducing the idea of the capitalist developmental state [...] was to go beyond the contrast between the American and Soviet economies’ (Johnson 1999, p.32), hence beyond state-command and liberal capitalism. This poses a question centring on the in-between options of economic systems, and where the developmental state should be situated on the map, as far as the genus of economic system is concerned. Political conditionality of the DS model goes beyond the issue of its applicability into various geneses of political regimes. It concerns the general perception of the state positioning. Therefore, the following analysis commences with the discussion on political systems, then continues with the institutional arrangements and the concept of strong state, and finally addresses the external political conditionality.

Although there does not seem to be a direct link between the concept of the developmental state and the genus of political system, the possibility of such a correlation should not be dismissed. As far as the interdependencies between the type of political system and the dynamics of socio-economic development are concerned, there are three basic theories: first, there is no correlation between authoritarianism/democracy and development; second, authoritarianism supports development more effectively than democracy and the latter may inhibit the pace of developmental advancements, democracy and development are mutually reinforcing.<sup>14</sup> Robinson and White (1998) underline that authoritarianism was seen as a favourable system for accelerating socio-economic development throughout the 1960s, 1970s, and until the early 1980s, based on the assumption that the process required a strong state, and a democratic state in poor societies lacked this strength. Indeed, Hayashi (2010, p.58) claims that ‘at least historically, authoritarianism [seemed] to be a shorter route to development’ partially because of democracy’s inability to restrain the labour class. Przworski and Limongi (1993) point out that authoritarianism’s developmental superiority would also be argued from the economic policy perspective. Democracy would undermine investment as it would “generate an explosion of demands for current consumption”, and thus inhibit the capital accumulation. ‘[Economic] growth [however] requires capital accumulation, which in turn demands that resources be diverted from consumption to investment’ (Haggard 2004, p.58). From the mid 1980s democracy and socio-economic development have been viewed as complementary. The argument has

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<sup>14</sup> The alleged interdependence between the developmental dynamics and the type of political system is a broad topic beyond the scope of this thesis.

been that ‘greater mass participation and popular pressure, and increased political representation by women and other disadvantaged groups, can help to make democratic regimes more sensitive to issues of poverty, social welfare, and forms of discrimination based on gender, ethnicity, and the like and impel them to take appropriate remedial action through policy commitments’ (Robinson and White 1998, p.5). Democratisation is seen ‘as opening spaces for socio-economically positive forms of popular mobilization’ (White 1998, p.21). This may partly translate into Evans’ “embedded autonomy”, in which popular opinions are taken into consideration by ruling elites. In fact, Evans’ requirement for embedded autonomy could be seen as a suggestion, not, however, as a requirement, for a fully functional democracy in developmental states. On the other hand, the “old perception” dubbed by White (1998) *the pessimistic view* still prevails to some extent, and is based on the belief of a certain incompatibility between democracy and development, as the former – to quote Leftwich (2000, p.174) – is a conservative system of power, whereas the latter – is a rather radical and turbulent process.

In the literature, there are examples of both democratic developmental states and authoritarian developmental states. Naturally, neither democracy nor authoritarianism guarantees extensive developmental achievements. The authoritarian developmental states, however, seem to be a given and little effort is made in terms of questioning their existence.<sup>15</sup> Perhaps the indisputable emergence of the authoritarian developmental states such as Korea and Taiwan, as well as developmental failures of democratic India prompted an ideologically motivated quest to prove that a democratic environment in the developing countries does not need to inhibit developmental efforts. Democratic developmental states are considered to be or to have been Botswana, Malaysia, Mauritius (Robinson and White 1998) and Japan. In particular, Amartya Sen (1997, 1999) is keen to advocate the positive developmental effects of democracy, based on the cases of Botswana and the Indian state of Kerala. White (1988, 1998) and Leftwich (2000) remain extremely sceptical about the possibility of the emergence of additional democratic developmental states. White (1998, p.42) sees several constraints: historical (historically all the “old” developmental states were authoritarian and the developmental breakthrough preceded democratisation), contextual (designing developmentally effective democratic institutions may be utopian because of the political and economic

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<sup>15</sup> It seems all the more odd that the prime example of the developmental state, Japan, is a liberal democracy and not an authoritarian state.

constraints, both domestic and international), systemic, (democracy is ill-equipped to generate a broader form of public interest that is necessary to provide basic collective goods, because it is characterised by regularised conflict between political forces and the policy outcomes are the result of competing pressures). Leftwich (2000) supports this view by underlining that a lack of a large number of democratic developmental states is a result of the very features characterising the above concept. Moreover, in democracies, the necessary developmental autonomy of the state seems greatly reduced. Again, on the economic policy level, this autonomy is needed to counteract various distributionist pressures. Haggard (1990) believes that authoritarianism can ensure this, however, he is far from assuming that it is exclusively possible in authoritarian conditions (Haggard and Moon 1986). Consequently, White attributes the existence of democratic developmental states to the fact that they are 'authoritarian forms of democratic regimes' (White 1998, p.42).

To further elaborate the issue of political regimes in the developmental states one needs to refer to the regional context, taking into consideration the cradle of the modern developmental state, namely, East Asia. It is true that a developmental state existed in authoritarian Korea and Taiwan as well as in reputedly democratic Japan. In fact, Japan was the first East Asian state to be considered a developmental state, one perhaps which bridges the "old historical" European and the "modern historical" Asian concepts of the developmental state. One should take into consideration that the fundamentals of the developmental state in Japan can be traced back to the Meiji era, an undemocratic period of time in the Japanese history, as well as the fact that until very recently the country was the prime example of what Leftwich (2000, p.177) calls dominant-party developmental democratic state, where development continuity is secured by a lack of political contestation of the ruling elite. Moreover, historically, the DS model was facilitated by Japan's bureaucratic structure which was believed to manage the country's affairs and the democratically elected politicians would have limited influence on the running of the state. As Johnson puts it, 'who governs Japan is Japan's elite state bureaucracy. It is recruited from the top ranks of the best law schools in the country; appointment is made on the basis of legally binding national examinations – the prime minister can appoint only about twenty ministers and agency chiefs – and is unaffected by election results' (Johnson 1982 cited in Woo-Cumings 1999, p.14). This is why Camilleri (2000, p.431) sees Japan as 'a hybrid political system given to recurring oscillations between authoritarian and democratic impulses'.

Consequently, it seems justifiable to claim that a developmental state would be difficult to sustain in a fully democratic system in which people enjoy extensive rights. Nevertheless, as historical examples prove, it is not entirely impossible, once the condition of a lack of political contestation is met. Unfortunately, as it seems, in order to follow a strict development path one needs to limit society's ability to counteract the state's efforts, in favour of particular goals dependent on one's affinity to a certain social group. In the macro perspective, societies, democratic or not, are mostly interested in increasing their own wealth in a relatively short period of time. The developmental state does enable developmental advancements. However, the process of improvements is by no means linear and steady and would probably involve interim recession and undoubtedly geographical and social differentiations in gains. It requires a set of policies motivated by an overall long-term target and not individualistic micro goals. In democracies, however, 'political-self-interest, that of both politicians and their parties, [not necessarily complacent with the overall developmental objective] is a dominant motivation behind the choice of institutional designs. And these politicians are not just self-interested thinkers but also short-term thinkers' (Lijphart and Waisman 1996, p.244, cited in White 1998, p.43).

Johnson, however, stresses the significant differences between traditionally authoritarian states and authoritarian or limited-democracy-type developmental states, by drawing from the concept of legitimacy of power. He stresses that 'the source of authority in the developmental state is not one of Weber's "holy trinity" of traditional, rational-legal, charismatic sources of authority. It is rather, revolutionary authority; the authority of a people committed to the transformation of the social, political or economic order. Legitimation occurs from the state achievements, not from the way it came to power' (Johnson 1999, p.53). 'In the true developmental state, [...] the bureaucratic rulers possess a particular kind of legitimacy that allows them to be much more experimental and *undoctrinaire* than in the typical authoritarian regime' (Johnson 1999, p.52). On the other hand, although Leftwich (2000, p.136) distinguishes geographical, constitutional and political legitimacy as the possible justifications for the societal acceptance of the ruling elites, he stresses that the concept is extremely elusive, hence difficult to measure and define, especially among the authoritarian states.

It is important to note that the discussion on the political regimes of developmental states is sometimes seen as unimportant. Leftwich (2000) claims that the debate about the applicability of the concept of the developmental state into various political regimes will not determine the favourable systemic environment for the former, as he seems to believe that, as White (1998, p.25) puts it, ‘the nature of the political regime is not a central issue’. According to Leftwich, primacy of politics (and not of a political system) in development is unquestionable. ‘Politics matters because politics shapes states, and states shape development’ (Leftwich 2000, p.191). Consequently, political institutions do matter, but thinking in terms of political regimes does not correctly address the conditionality of economic growth (Przeworski and Limongi 1993).

Indeed, although the DS political conditionality, as featured in the scholarly literature, is examined from the perspective of different political regimes, it is often believed that political systemic arrangements are secondary factors to the institutions, which shape the developmental states.<sup>16</sup> Institutions, understood as rules of the game and its constraints (North 1990) and organisational arrangements for the state to fulfil its development-guiding function are examined throughout this thesis. This chapter presents some general perceptions in this respect.

Waldner (1999) describes the DS institutions as institutional innovations, which feature several elements. Firstly, the arrangements of the political regime that are in opposition to what he calls precocious Keynesian regime of constituency clientelism, allow for relatively depoliticised economic policy making, partly because of a lack of influence of labour and the agrarian class. Secondly, because – to quote Johnson – “the politicians reign and the bureaucrats rule”, the formulation of a long-term development strategy is by competent technocrats. Thirdly, ‘fiscal policy is controlled by a state elite that is singularly devoted to economic development and thus uses state resources only for production and capital accumulation’. Fourthly, ‘state intervention is devoted largely to measures that will either guide the economy into targeted sectors or assist firms in given sectors to become internationally competitive’ (Waldner 1999, pp.143-144). For Doner *et al.* (2005) as for many other scholars, the main DS institutional features fall within the relational aspects and partly concern the existence of an autonomous and highly professional bureaucracy with a state “pilot” agency. This bureaucracy allies with

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<sup>16</sup> This is not to say that there is no relation between the genus of political regime and the DS institutions (see: Waldner 1999 and Haggard 2004).

private business sector and ideally with labour as well, to “govern the market” in order to achieve rapid development. This perception mirrors Haggard’s (2004) analysis in which he pays attention to the role of “big” institutions and in the case of East Asia concentrates on what he calls “partially representative” and “delegative” institutions. Partially representative institutions concern the linkage between public and private sectors; delegative institutions are bureaucratic agencies granted broad developmental mandates. For Haggard (2004) the big institutions of East Asian high growth countries such as strong property rights, allow for capital accumulation and subsequent investment. He also argues for small institutions or ‘micro-institutions’ who address the selective intervention and coordination problems and thus make the industrial policy effective and efficient. Haggard (2004) also believes that ‘some degree of centralisation in the allocation of rents, appropriate incentives within the bureaucracy, and limits on particularistic business-government networks seem plausible institutional requirements for a coherent industrial policy’ (p.70).

The institutional positioning of the state at the centre of developmental activities either via its pilot agency which is largely responsible for creating and implementing a national development strategy or as the main actor to form collations via its bureaucracy with other participants of the domestic economic life for the developmental endeavour, directly leads to the issue related to the strength and the capacity of the state. The historical DS cases were in opposition to what Myrdal (1968) labelled as a “soft state”, in his analysis of India’s developmental shortcomings. Myrdal’s soft state is described by Lankester (2004, p.291) as being ‘unable to enforce the discipline [that is] needed to implement [a] development plan’. A state is incapable of coercing other agents of state functioning, such as the society and domestic business, into supporting state developmental actions. In effect, it experiences meagre developmental results. The developmental state’s “politics” (as Leftwich puts it), is about the effective mobilisation of various actors behind the development trajectory guided by the state. A strong state (see: Migdal 1988, 2001; Deyo *et al.* 1987; Katzenstein *et al.* 1978) ‘can formulate policy goals independently of particular groups, [it] can change group or class behaviour, and [it] can change the structure of society’ (Krasner 1962, p.60, cited in: Cumings 1984, p.7). It ‘embodies three dimensions: coercive capacity, comparative independence from particular groups and classes, and an interventionism capable of restructuring society or substituting for other structures, such as the market’ (Woo 1991, p.2). This state does not need to be a hard state (this concept is often positioned against

the concept of a soft state), but a strong state capable of exercising its power. Its developmental competence derives partly not from being harsh towards its society, but from having the strength to effectively guide development. Haggard (1990) claims that this capability comes from the degree of insulation from societal pressures, cohesiveness of the decision-making structure and instruments' availability to pursue political and substantive goals. Stubbs (2009) reminds us, however, that a strong state needs to be accompanied by a relatively weak society. Nevertheless, the emergence of strong states is not possible 'unless sufficient resources, in the form of money, skilled manpower, and organisational and technical knowledge [within society] is available' (Stubbs 2009, p.5). He quotes Migdal whose conditions for strong states to emerge are remarkably close to external and internal conditions during which developmental states were formed, namely; exogenous political forces favour concentrated social control, existence of a military threat, presence of skilful top leaders to create the "grand design" and 'a social grouping with people sufficiently independent of existing bases of social control and skilful enough to execute the grand designs' (Migdal 1988, pp.271-5; cited in: Stubbs 2009, p.4). Moreover, Waldner (1999) sees developmental states drawing their strength from them becoming unmediated states with the central positioning of institutions (see: Barnett and Zurcher 2009). The central position of the institutions within the concept of the developmental state is therefore often underlined.

Finally, scholarly publications often present political factors other than domestic ones, which contributed to the developmental dynamics of developmental states. The developmental successes of Japan, Korea and Taiwan and a lack thereof to the comparable extent on the part of China and North Korea are sometimes partly attributed to external political factors associated with their geo-political location.

Capitalist developmental states of East Asia took their dominant institutional and policy form during the times of tense political situation in the midst of the Cold War. As much as in some other parts of the world, the military conflict between the socialist Eastern bloc and the capitalist states seemed a real possibility in the East Asian region. South Korea and Taiwan seemed in a particular predicament, as they faced military threats from North Korea and China respectively. Therefore developmental states were emerging within the political conditions of severe security threats (Stubbs 2009; Doner *et al.* 2005; Hayashi 2010). In view of insufficient military power, the circumstances enabled the governments to implement uncompromising development policies aimed at

increasing wealth and consequently military capacity, regardless of their interim social costs. The security threat served as an incentive for societal mobilisation behind the political elites.

Unsurprisingly, it was the United States who took the role of containing the Communist expansion (see: Camilleri 2000) by supporting the capitalist states of East Asia, especially Japan as a heavy weight economic power and initially a US semi-periphery, to balance the regional aspirations of China. American financial and technological assistance and the opening of its domestic market for consumer goods from capitalist East Asia created economic conditions for faster development, whereas American military involvement in the region guaranteed relatively stable political conditions for such development. To quote Cumings (1984, p.17) ‘security and economic considerations were inextricably mixed’. The capital and technological support by the US and other Western states enabled the effective DS policy of upgrading of the industrial bases, initially in Japan and later in Korea and Taiwan. It is important to note that Japan subsequently joined ranks with the US in technological and financial support to NICs.

All the Northeast Asian developmental states benefited from US assistance. It is estimated that the US’ post-world-war-two assistance to Japan was 2.2 bln USD (Serafino *et al.* 2006), the aid provided to Taiwan between 1951-1968 – 1.5 bln USD (Otero 1995) and help to Korea after the Korean war until 1975, excluding military assistance, – around 6 bln USD (Otero 1995). This assistance preceded the periods of high growth associated with the existence of the developmental state. The role of aid, although important in generating the initial impetus for growth, should not be overestimated. It is believed that although Japan and Taiwan spent 40% of the aid on infrastructure expansion, Korea consumed most of the obtained funds. Nevertheless, due to the political circumstances, it remained an important recipient of American funds. From the perspective of the concept of the developmental state, what seemed to matter more was the extensive transfer of technologies from the US, initially to Japan and then to Korea and Taiwan for the initial industrial upgrading, as well as the opening of the large American market to the products of newly established developmental states. In addition, the Cold War allowed the governments of Japan, Korea and Taiwan to be relatively free in implementing various types of economic policies, as long as they meant strengthening the capacity for containing the Communist bloc.

The external political factors, which shaped the developmental states of East Asia, cannot be limited to the Cold War. Cumings (1984), Kohli (1994), Bernard and Ravenhill (1995) point to the regional interdependencies that influenced the creation of North East Asian newly industrialised countries (NICs). These interdependencies go beyond the relationship defined by the wild-geese-flying pattern (Akamatsu 1962). They underline the historical linkage between Japan and Korea and Taiwan, which goes back to the end of the nineteenth century. 'Industrial development in Japan, Korea and Taiwan, cannot be considered as an individual country phenomenon; instead it is a regional phenomenon in which a tripartite hierarchy of core, semi-periphery, and periphery was created in the first part of the twentieth century and then slowly recreated after World War II' (Cumings 1984, p.38). Cumings (1984) argues that the 'region's economic dynamism [comes] with the advent of Japanese imperialism' (p.8) and colonialism, since 'in Korea and Taiwan the [Japanese] colonial power emphasised not only military and police forms of control but also development under strong state auspices' (p.10). Kohli (1994) establishes three state-society characteristics, which although seen as core elements of the Korean DS, originated from the Japanese colonial rule; namely, transformation of the state into a highly authoritarian, penetrating organisation, capable of controlling and transforming Korean society, evolution of the production-oriented alliance resulting in the increase in manufacturing and export, control of the lower classes.

### **1.3. The Economic Conditionality**

The developmental state is often conceptually positioned between a free market capitalist economic system and a centrally-planned economic system, and called a plan-rational capitalist system, 'conjoining private ownership with state guidance' (Woo-Cumings 1999, p.2), which suggests it being neither purely capitalist nor purely socialist.<sup>17</sup>

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<sup>17</sup> The process of post-socialist transformation in countries such as Poland witnessed calls for the establishment of neither capitalism nor socialism, but a system comprising market ability to fast socio-economic development and socialist welfare stability. Until now, certain political centres have expressed the wish to embark on transition to the third way, using the Catholic Church social doctrines as an ideological base. Moreover, especially in China, the state elites' aversion to the term "capitalism" results in a widespread receptiveness of the idea of a "unique" systemic economic arrangement, dubbed, socialism with Chinese characteristics. This issue is examined in the following chapter.

Johnson (1999), however, believes that the developmental state is in principle capitalist. He points to the important element of the developmental state from a microeconomic perspective, namely, the cooperation between private business and government or, broadly speaking, the private sector and the public sector. Private business becomes a partner for the government in the developmental endeavour. It is, then, private business – an important element of the landscape of the capitalist system – which is a crucial part of the developmental state. Indeed, although the format of capitalism in the Japanese and the Korean DS seems to be to some extent distinctive, in principle, the existence of a capitalist system in those two states has seldom been questioned.

Justin Yifu Lin, one of the most prominent contemporary Chinese economists and currently the chief economist of World Bank, is convinced, however, that the idea of a socialist state is firmly connected with the idea of the developmental state, hence socialist state is by definition a developmental state, at least as far as the paramount concept is concerned.<sup>18</sup> White and Wade (1988, p.4) insist, that ‘the developmental limitations of capitalism are well known, in particular its tendency to enrich propertied classes and privileged groups at the expense of the poor and socially marginalised’, hence, taking into account a historical record, socialist economies cannot be easily excluded from the developmental state group. Indeed, they emphasise that ‘historical experiences suggest [...] that in certain circumstances, for developmental purposes, direct planning along classical Soviet lines can play a positive role in the initial stages of industrialisation: in raising the rate of investment, generating and focusing scarce resources, defining and directing strategic changes in the industrial structure, regulating international ties, generating overall political support and establishing a social structure favourable to accumulation’ (White and Wade 1988, p.15). Thus, the idea of socialist developmental state does not need to be a utopian one. For example, Chun Lin (2006) points to significant developmental achievements in communist China during the Mao era, in spite of large setbacks and ill-formulated policies.

However, some researchers object to the usage of the terms capitalism or socialism, as they are often believed to be obscure, and prefer to position the debate against the concept of the market as an economic-institutional arrangement. The discussion on the market is an important part of the conceptualising of the DS model. It also extends to

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<sup>18</sup> Personal communication, Beijing, 10/09/07.

the analysis of China's development trajectory. In general, socialism is believed to be the synonym of central planning, whereas capitalism – of a market economy.

A market economy is believed to be a system in which the allocation of resources and products is decided according to supply and demand. This is the “mechanism” based definition. Moreover, it is an environment where the agents of economic activities can represent private, state and other forms of ownership. This is the “ownership” based definition. A market economy is often associated with the capitalist economic system. Capitalist system falls within the definition of market. However, the reverse relation is often seen as not necessarily irrefutable. This results in a growing perception that one must distinguish between market and capitalism. Arrighi (2007, p.24), following Fernand Braudel (1977), argues that there is a ‘world-historical difference between the process of market formation and the process of capitalist development’ and this distinction can be traced to Asian and European economic development in the times preceding and following the Industrial Revolution. As a result of the Industrial Revolution, Europe started the process of capitalist market development, whereas Asian states, and especially China, were for centuries characterised by a non-capitalist market-based development. Arrighi (2007) commences the formulation of the set of differences by citing Adam Smith, who considered the Chinese development model as a natural path and the European, as an unnatural path. Furthermore, Arrighi summarises the historical differences between capitalist development and non-capitalist market development as follows:

- The Asian non-capitalist model is labour-intensive and energy-saving, whereas the European capitalist model is capital- and energy-intensive (Siguhara cited in Arrighi 2007, p.39);
- The capitalist class are subordinate to the state's interests (non-capitalist); state is subordinate to the class interests of capitalists and the bourgeoisie (capitalist);
- Wealth comes from agriculture (non-capitalist); wealth comes from trade (capitalist);
- The main economic process is the accumulation of capital (capitalist); no such phenomenon exists in proliferation (non-capitalist);
- Militarist in nature (capitalist); non-militarist in nature (non-capitalist).

Arrighi's historical reference is an important source of information on market formation in Europe and Asia, however, his attempt to clearly detach market economy and capitalist development is problematic and difficult to be considered fully applicable

contemporarily. The capitalist mode of development has evolved and proliferated in genus, so did the institutional conditionality, as discussed later.

An additional question is posed by the interchangeable usage of the terms „market economy” and „free market economy”. “Free market economy” seems to some extent a pleonasm. The idea behind a market economy is that it is free or at least significantly freer than a non-market economy in the sphere of economic activities, though none of the market economies can be entirely free; and some are freer than others. “Market economy”, on the other hand, indicates that market forces are the paramount principles, without, however, discharging regulatory powers and interventionist policies of the state, as the degree of the alleged economic “freedom” is anticipated but not clearly defined.

Guo (2003a, p.555) reminds us that ‘there have been many mixed types of political economy [...] because states and markets have played various roles in the economy throughout the world’. In particular, they seem to apply to the conditions of East Asia. In his analysis of the ownership and state control, he points to the two most important hybrid types of economies; state capitalism – dominant at certain stages of South Korea’s and Taiwan’s development and distinctively different from a free market economy model; and a market socialism – a concept which differs from state command and is often believed to be crucial for understanding some tenets of China’s systemic transformation. He sees the general difference between state capitalism and market socialism in that in state capitalism the state is in control of the market and plays a vital role in economic processes, however the means of production are privately owned; in market socialism the situation is the opposite – there is a dominance of market mechanism, but the state owns the means of production. The term state capitalism is often used towards the systemic arrangement of the developmental state. Hence, White and Wade (1988) see developmental states as guided market economies or governed market economies (Wade 1990a). Wade (1990a) perceives developmental states as those who possess a mixture of free market (fm), simulated free market (sm) and governed market (gm). (For details see: Wade 1990a, p.297).

As far as market socialism is concern, one first needs to address the meaning of socialist economic system. A socialist economy is defined as lacking, to a considerable degree, the market mechanism of allocation and as limiting options for ownership. Means of

production are publicly owned by the state or the collectives. Indeed, for Kornai (1992) public ownership of means of production was the defining feature of socialism. Schumpeter (1942, p.415) saw it as an ‘organisation of society in which the means of production are controlled, and the decisions on how and what to produce and on who is to get what, are made by public authority instead of by privately-owned and privately-managed firms’. The term socialism is often replaced by the terms “central planning” and “state-command”. The phrase “central planning”, however, does not seem to fully capture the nature of a socialist economy. Central planning also played an extraordinarily important role among some market, non-socialist, economies. State-command, on the other hand, seems to be a broader concept, which implicitly points to the state not only as the central planner, but also as the paramount executor of those plans in an institutional environment where all the economic activities are subject to command and regulation. The state role as the paramount executor of the plans seems to be reserved for the non-market conditions, where hardly any other agents are in a position to participate in the economic activities.

The terms “socialism” and “market” are sometimes put together. The “socialist calculation debate” commenced by Barone and Pareto, and continued by Lange (mostly against von Mises), led to the conceptualisation of market socialism, in which a ‘rational economic calculation [characteristic for a market system] is equally feasible in the conditions of a centralised [socialist] economy without [extensive] freedom of consumption, freedom of labour force migration and freedom of resources allocation’ (Lange 1973, p.233). ‘The key idea [...] was that a market socialist system could through rational planning eliminate the abuse of monopoly power and the irrational production of capitalism, and yet ensure individual freedom by allowing a free market in consumer goods’ (Boettke 2004, p.8). Lange argued that a benevolent central planner can clear the markets by raising prices in response to shortages and by cutting prices in response to surpluses, as is done in the conditions of a free market. At the same time, the socialist state is able to distribute income more equitably, to solve the problems of externalities and to avoid monopolies from being created (Shleifer and Vishny 1994, p.166). The concept was heavily criticized by Hayek, who, like von Mises (1951), saw rational economic calculation under socialism impossible’ (Boettke 2004, p.4) and recently by Stiglitz (1993) who saw the failure of market socialism owing to its underestimating the significance of the incentive problem, the role of innovation of the economy, and the difficulty in allocating capital. Shleifer and Vishny (1994) point out

that despite this criticism the process of post-socialist transformation revived the debate on market socialism (see, for example, Roemer 1994).

Does it mean that there can be a case of a socialist developmental state? Unlike in most of the states of Central and Eastern Europe (CEE), where central planning was the consequence of totalitarian communist regime imposed by the Soviet Union after the Yalta Treaty and the developmental prerogative was not an element of the systemic arrangement, in the case of self-imposed socialism in China, the then new systemic doctrine was an interesting alternative for the developmental incompetence of the previous regimes. Hence, it is believed that developmentalism played an important role in moulding the frames for Chinese socialism. Nevertheless, the East Asian comparative studies seem to suggest that developmental achievements of what are believed to be capitalist states have been far greater than those of socialist countries. Moreover, the DS systemic arrangements suggest that the private sector, to a great extent absent in the socialist economies, plays a crucial role in the strategic business and state partnership. Consequently, socialism could have been about development, but the pace of development in socialist states would seldom match the pace of development in developmental states due to some systemic limitations. Therefore, it would be difficult to speak of the existence of a developmental state in China prior to the reform period, despite the fact that Chinese systemic arrangements at that time may have been aimed at the acceleration of development and indeed brought some positive results.

The historical developmental states, despite their guided and governed market status and thus various market distortive state interventions, were in essence capitalist countries. The degree and genus of capitalist state interventions is subject of the DS-related analysis below. What constitutes an economically liberal state perceived as having very little interventionism and what is the definition of an interventionist state, or rather what constitutes less interventionism as opposed to more interventionism? It is important to mention that from the perspective of political economy the interventionist state is understood as one which is characterised by the Keynesian economic model, where the arbitrary and inequitable distribution of wealth and income is being corrected by the government, to the extent that it is widely perceived to be interventionist. It is believed that the degree of interventionism can be measured by the size of governmental ownership, specific economic regulations and level of taxes.

As far as the relation between the developmental state and interventionism is concerned, Loriaux believes that, ‘the developmental state is an embodiment of a normative or moral ambition to use the interventionist power of the state to guide investment in a way that promotes a certain solidaristic vision of national economy’ (Loriaux 1999, p.24). Ha-Joon Chang, one of the most well known Korea-born scholars to contribute to the literature related to the developmental state, underlines that ‘economic development requires a state which can create and regulate the economic and political relationships that can support sustained industrialisation – or in short, a developmental state’ (Chang 1999a, p.183). Consequently, the introduction of the developmental state concept into the state ideology means in real terms a creation of a certain type of interventionist state. Cumings (1984) points out that a developmental state needs to consider the “Listian assumption” and, as a late developer, rather than to follow *laissez-faire* ideology, must create a strong state with protectionist barriers. The developmental state is a strong interventionist state, in the way which it shapes and reinforces the developmental directions, as opposed to a weak state, or Myrdal’s soft state. However, the broadly contested, nevertheless influential, World Bank’s report entitled *The East Asian Miracle: Economic Growth and Public Policy*, questions the relation between the performance of historical developmental states and state interventionism. ‘It is difficult to test whether interventions increased growth rates. [...] We know that intervention did not significantly inhibit growth’ (World Bank 1993, p.6). The report acknowledges that East Asian high growth countries are characterised by a certain level of state interventionism, however, claims that this intervention was “mild” and “careful” and in many cases, such as the Korean heavy and chemical industries, free market would play either equally effective or better allocative role (World Bank 1993).

Following the argument by the authors of the World Bank report, one needs to ask the question whether a developmental state can be created in an economy shaped by neo-liberal principles? In theory, it seems hardly possible to achieve extensive developmental goals in a relatively short period of time in an environment where authorities have very limited power in directing investment, regulating its intensity and influencing institutions, companies and communities so that they follow a certain overall development strategy and where the nation is not sufficiently rich to invest large financial assets for mutual benefits in its own country. By definition, the developmental states’ societies are, on average, in the process of accumulating wealth and are believed to be relatively poor. According to Chang (1999a), in this respect, a neo-liberal

economic model seems to have a number of shortcomings which hinder fast development in developing countries. He argues that this is due to the fact that the model does not take into consideration that for developmental purposes there has to be a limit in liberalisation and depoliticisation of an economy. He points out that ‘politicising certain “economic” decisions may not only be inevitable, but also desirable, because the world is full of assets with limited mobility and owners who are naturally determined to prevent changes that threaten their current positions’ (Chang 1999a, p.191). He also underlines that ‘the most important insight from early development economics was that systemic changes need coordination’ (Chang 1999a, p.192). Successful coordination requires a state which has the necessary tools to deal with the burden, and is not merely the guardian of certain freedoms.

Moreover, the issue of neo-liberal economy vs. interventionist state can be addressed, not necessarily taking into consideration domestic conditions, as has been the case so far, but taking into account the global environment. The so-called global economy is by no means liberal, hence liberalism cannot be held responsible for developmental achievements worldwide. Setting aside Joseph Stiglitz’s important argument about asymmetry of information, and Alexander Hamilton’s (cited in Woo-Cumings 1999, p.5) shyness of capital, one needs to remember that there are still many trade barriers, as well as powerful forces such as governments of large economies and international corporations, with a capacity to distort, for example, the international level of prices, by following certain policies.<sup>19</sup> Developmental states, as their economies are, to a large extent, export-driven (as examined later in this thesis), must comply with the international conditionality and work out their own position in the global economy. It cannot be achieved without a strong state, legally able to influence the directions of development. The international economic conditionality puts poorer countries who would like to accelerate their pace of development in an especially disadvantageous position, as they are forced not only to compete with stronger opponents on the global market, but also to follow the rules created by the developed states for the very benefit of developed states themselves. To navigate this, in a way, “hostile environment”, a relatively poor country must not only be “strong”<sup>20</sup>, but also the state needs to possess certain interventionist powers.

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<sup>19</sup> See more in: Ha-Joon Chang 1999, p.197.

<sup>20</sup> Understood as having strong and effective institutions.

Naturally, interventionism is by no means a remedy for shortages in developmental achievements. Evans (1995) rightly emphasises, that although ‘the state lies at the centre of solutions to the problem of order’, (p. 3), and ‘fervent calls for the dismantling of the state by late-twentieth-century capitalist free marketeers served to derail the state’s ability to act as an instrument of distributive justice’ (p. 4), taking clearly the side of some sort of interventionist ideology, ‘sterile debates about “how much” states intervene have to be replaced with arguments about different kinds of involvement and their effects’ (p. 10). He continues that ‘contrasts between “dirigiste” and “liberal” or “interventionist” and “noninterventionist” states focus attention on degrees of departure from ideal-typical competitive markets. They confuse the basic issue. In the contemporary world, withdrawal and involvement are not the alternatives. State involvement is a given. The appropriate question is not “how much” but “what kind”’ (p. 10).

How then, is DS interventionism different from the ordinary, somewhat classical, interventionism present in continental Western Europe? In general, the DS type of interventionism takes a task of guiding the development trajectory via a mix of regulations, policies and additional incentives. A more detailed description is presented below.

Firstly, the purpose of DS interventionism is different. The main objective of a developmental interventionist state is to realise the original purpose of the developmental state, namely the acceleration of socio-economic development in the long term, via certain instruments, to catch up with highly developed nations. A classical interventionist state does not require this conditionality. The contemporary Western European interventionist state’s target is to secure societal cohesion. In this type of interventionism the overall development is seen as important but a secondary issue. Consequently, an interventionist developmental state is not a social state, as usually is the classical model of interventionist state present in continental Western Europe. On the contrary, early developmental state in Japan and Korea resulted in suppressing and exploiting the less affluent rural part of the society, as well as the working class.

Secondly, ordinary interventionist states do not lack the extensive bureaucratic apparatus, but they do lack economic bureaucracy as the dominant power in the

governmental structure, responsible for the “guiding” of the economy by setting developmental goals and monitoring progress. For Evans (1998) this economic bureaucracy is a result of a “renovation” of classic bureaucracy, conditioned by the willingness of the state to invest political and economic resources in the construction of a capable state apparatus; the commitment to target the most critical parts of the bureaucracy from the perspective of economic policies; the ability to address the challenge of constructing a relationship between the government and the private business. This challenge is associated with the issue of bureaucracy’s autonomy. The economic bureaucracy is usually materialised in the form of a governmental institution, a pilot agency largely in charge of development, or, as Weiss (2000) puts it, of transformative goals. In the case of Japan, this role was assumed by the Ministry of International Trade and Industry (MITI), in Singapore – by the Economic Development Board, in Taiwan – by the Council on Economic Planning and Development, in Korea – by the Economic Planning Board (EPB). According to Waldner (1999), the pilot agency is needed due to the manner of DS-style industrial restructuring, which displaces market signals through various mechanisms such as subsidies, the socialisation of risk, and the administered pricing. These mechanisms are nothing less than the features of DS interventionism.

Thirdly, an important issue relates to the degree of interventionism present in classical interventionist states and developmental interventionist states. It is believed that despite being in opposition to the liberal economic model, developmental state interventionism is more limited in form than common interventionism. Sakoh (1984, p.523) insists that the Japanese DS model, in fact, featured very limited state involvement as demonstrated by the analyses of capital formation and lending sources. Although one can probably plausibly argue that DS interventionism is less extensive than classical interventionism, what matters more is Evans’ argument about the type and quality of engagement. DS interventionism is not about the strict regulation of economic processes, but rather about governmental leadership over the facilitation of the development trajectory. This trajectory can only be achieved once the business sector enjoys an adequate free market environment in which to perform.

Finally, the essence of DS interventionism as opposed to classical interventionism lies chiefly in the state-business alliance, where the state intervenes in the business sector in

a less (Korea) and more (Japan) subtle way, by distributing the incentives for the realisation of certain projects related to the overall developmental strategy.

Having analysed the overall features and the conditionalities of the developmental state one needs to address the following two issues; is the DS model still a viable option to follow and how does the debate extend to China's development trajectory? Let us here, however, summarise the very features of the "traditional" developmental state, as they have been agreed in the course of international research on the subject and presented above.

The developmental state is an institutional and policy arrangement, which is intended to enable some relatively poor economies to effectively catch up developmentally with highly developed nations. Sometimes the concept is believed to go beyond the catching up period and referred to as aiming at creating a transformative state focused on continuous upgrading of the economic structure. Indeed, this inability to exactly pinpoint the time limits of the DS existence seems to be a major weakness of the literature concerned with developmental states, as it contributes to the difficult task of accurately defining the DS features, not only due to different internal conditions of DS cases, but also because of the evolution of the global environment. For the purpose of this thesis, the comparative analysis of DS classical cases is conducted within the DS core activity period, which is limited by the process of developmental catching up.

The developmental state is largely defined by the interrelation of four actors, the political elite, the state economic bureaucracy or together "the state", the society and the business. Their interaction is defined within the concept of "embedded autonomy". The society, including the business is able to influence the state, however, the state remains extensively insulated and independent in the process of decision making concerning economic and development policies and institutional arrangements. In general, the society is perceived as subordinate to the strong and developmentally capable state. The state forms an alliance with the private business sector, in which the government designs the plans for industrial development and by means of various policy incentives and legal solutions supports the business expansion within the targeted areas and aids the export-related activities. The close interaction between the public and private sectors is often blamed for corruption of this institutional arrangement.

The state main ideology is nationalism – to gain societal support for the “transformative” project, and, within this category, economic nationalism, as the background of the state economic policy – to assist in developing the domestic business base. In the scholarly literature the state development policies are framed within the process of industrialisation, and more precisely, import-substitution industrialisation, which is followed by export-oriented industrialisation.

As far as political conditionality is concerned, the DS model is characterised by various degrees of authoritarianism or authoritarian mechanisms within a democratic system. What matters more for the DS model is a strong state supported by effective development-focused institutions rather than the genus of purely systemic arrangement. Moreover, the external conditionality of political insecurity and economic and political support also play an important role. As far as economic conditionality is concerned, the developmental state is a capitalist state or a market economy. It is, however, an interventionist state, with the central government having extensive planning capacities and market distortive instruments, it uses towards the realisation of its preferred development trajectory. The intervention is partly possible due to the existence of large economic bureaucracy, mostly concentrated in a state pilot agency to navigate socio-economic development.

#### **1.4. The Future of the Developmental State**

The concept of the developmental state is positioned by Gereffi and Fonda (1992) as one of five broad theoretical perspectives of regional development paths in the developing countries. The others are: neoclassical economics which advocates laissez-fair economic policies; the world systems theory which postulates hierarchy made up of core, semi-peripheral and peripheral nations together with the dependency theory which highlights the exploitive potential between the core and periphery; Marxism, which focuses on the exercise of power by dominant elites and the class conflict; and the institutional analysis which discusses issues such as culture and economic networks as developmental determinants and development mechanisms.

What is, however, the future of the developmental state in the contemporary world? Should one expect the final demise or a revival of the concept, which is believed to greatly influence the development trajectories of some states? Is the DS model destined

to head towards what Weiss (2000, p.25) calls “normalisation” (abandoning its priorities, dismantling its organisational architecture, and steadily disengaging from economic coordination) or does it still remain a viable option in an era of increased economic openness and capital mobility?

Initially described by Johnson (1982), the concept of the developmental state took into account the previous theoretical works on the role of the state in development and framed them into the conditions of late developers’ reforms and transformation. The plan-rational governmental ideology was realised by the involvement of the government in the process of development. State was believed to be at the centre of the solution to the problem of underdevelopment, which was in line with the common opinion that rapid development of poor countries cannot be sustained without the guiding role of the government. The rapid industrialisation of Japan, which became an affluent developed country by using extensively the carefully-designed development plan created and supported by the central government, was an important argument in defending the role of the state as a crucial factor in developmental transformation.

This perception was subsequently verified on the occasion of the emergence of a neo-liberal economic thought to be the superior economic ideology during the Ronald Reagan era. The developmental superiority of the US was obvious to the extent that alternative institutional scenarios aimed at accelerating development were mostly ignored. Without consideration for certain social, economic and historical factors, it was assumed that an extensively liberalised economy was the key solution to underdevelopment. This contradicted state involvement as the developmental remedy advocated in the concept of the developmental state.

Moreover, the positioning of the DS model within very specific geo-political conditions would produce a claim that once those conditions expired, the DS institutional and policy arrangements could not be sustained. Some would argue that developmental states could only have worked in the context of the Cold War (Hayashi 2010). The threat from the so-called communist bloc, especially to countries such as Korea and Taiwan, would generate domestic public support for government’s policies; the regional political situation would encourage the United States to assist by military, financial and technological means as well as to open its domestic market for goods from DS countries. At the same time, the protectionist national economic policies of

developmental states would not voice significant concerns in Washington, as long as the political commitment to the common cause of communism containment prevailed. However, once the political conditions changed due to the collapse of the Eastern bloc, US started ‘demanding that the East Asian countries open their economies and implement trade, investment and capital liberalisation’ (Hayashi 2010, p.46). The end of the Cold War meant on one hand ‘that the United States no longer felt it could ignore the neo-mercantilist protectionist economic policies of its regional allies’ (Stubbs 2009, p.10) on the other, a stop of ‘massive military and economic aid’ (p.11).

The financial crisis in East Asia (1997) was believed to be an additional blow to the perception of the DS applicability to underdeveloped countries. Allegedly strong, developmental states appeared to be weak and ineffective in dealing with dramatic regional turbulences in the financial markets. It was believed to be caused by the inability of the developmental states’ governments to counteract possible negative effects, due to a high level of corruption generated by the presence of special public-private partnership, in addition to the slow process of decision-making caused by an over-interventionist system. The East Asian economic system became for some synonymous with “crony capitalism” (Beeson 2004, p.5).

Finally, the phenomenon of increasing the interdependencies of economic processes worldwide, resulting in the creation of the scaffolding for a global economy, was believed to render the concept of the developmental state incompatible with contemporary economic conditions. It is often believed that, as a result of globalisation, the role of state in national economies is diminishing, as the governments are incapable of controlling the global economic processes because a situation in one part of the world influences the conditions in another. The gradual liberalisation of economic relations followed by the easing of regulatory regimes and by the process of the sophistication of exchange of information, including technologies and management techniques is believed to make the so-called global economy less receptive to incentives from national governments.

In view of globalisation processes, changes in geo-political situation, and certain purported shortcomings of the institutional arrangements in the East Asian countries as revealed during the 1997 financial crisis, it was concluded that the formula of the developmental state was eventually losing its significance. Beeson (2004) points out

that what was initially the strength of the Japanese economy and resulted in significant developmental successes, eventually became an obstacle in the reform process necessary as a response towards changes in the global market. Allegedly, Evans' embedded autonomy eventually transformed into intensive corruption-prone state-business relations. From the microeconomic perspective, extensive interventionism was believed to have hindered the innovative behaviour of Japanese companies, necessary for survival in the competitive global economy. *Keiretsu* and others, due to the maintaining of a prolonged conservative mechanism of management, were unable to effect an adequate response towards the needs generated by the international market.

It became a rather common perception that the DS model was a contemporarily not viable historical phenomenon, as it was not possible to duplicate the conditions during which historical developmental states achieved a rapid growth and thus 'the experiences of the East Asian high achievers [could not] be applied directly to today's developing world' (Hayashi 2010, p.46). 'Most would agree that the [contemporary] "post-WTO" global context [was] different from the one in which the East Asian countries succeeded in transforming themselves into industrial powers' (Evans 1998, p.69).

The above analysis leads us to the question of possible scenarios as far as the applicability of the concept of the developmental state is concerned. Is there space for it to be applied in the times of globalisation? Can any state benefit from it? These questions are the more significant, as the second largest economy in the world – China, is facing critical choices as to the direction it develops, which eventually will have a direct impact on global economic relations and most likely on the global economic situation. At the same time, a large number of underdeveloped countries struggle in their quest to accelerate socio-economic development in the long term and are indeed searching for an adequate developmental model.

The gradual disappearance of regulatory barriers in economic interactions between the states, the regions, the economic sectors, etc. seems to be aimed at the creation of one global economic organism without borders. Indeed, this may happen in the long term. Observing the contemporary international scene, both political and economic, with its interventionist forces, one must surely arrive at the conclusion of how elusive, at the current stage of mankind's history, this postulate is. Some barriers disappear, but in their place new mechanisms of protection are created. It is a popular opinion that the

new rules favour strong entities within the global economy and marginalise the weak ones, including developing countries. Consequently, the dismissal of a scenario in which the role of the state will still be crucial, upon the conviction that a one borderless global economy is rapidly emerging, seems premature. On the contrary, the role of the state will most likely remain extremely important to fend the national interests, as the 2008/2009 financial crisis clearly illustrates, allowing space for the possible utilisation of the provisions of the DS model. This can be argued in several points.

Firstly, the argument about the weaknesses of developmental states, as allegedly proved during the 1997 financial crisis, is in many ways misplaced. Certain East Asian countries were affected by the crisis not because they were developmental states, but because they abandoned the DS rules and followed certain liberalisation policies. At the time of the crisis, they were already liberal open economies. China, on the other hand, was barely affected, as it was not economically open enough, with its financial system's infrastructure being effectively guarded from the regional economic turmoil. The developmental state concept does not advocate the absolute necessity for opening up, as neo-liberal economic ideology, allegedly more receptive to the global market changes, does. Japan, Korea and Taiwan, at the time of the crisis, were no longer classical developmental states. In the Korean case, the 'government dismantled a previously effective developmental state during the 1990s' (Wade 2000, p.8). Due to economic liberalisation, global integration processes and changes in the features of the domestic social environment, certain instruments of the DS model were no longer at those countries' disposal (see: Chang *et al.* 1998). That is why Wade (2000) argues that the crisis affected Korea not because it was a developmental state, but because it was not. Weiss (2000) repeats Wade's argument and stresses that it would be more plausible to argue that the country's vulnerability to a financial shakedown was due to its neo-liberalism' motivated change in policies and economic liberalisation. She broadens her analysis addressing the situation in Southeast Asia and Japan. She claims that the affected Southeast Asian states were not developmental states, as they did not possess the "institutional strength" characteristic to Japan, whereas Japan was mostly affected by the self-induced banking crisis pre-dating the 1997 crisis rather than the regional financial crisis (Weiss 2000).

Secondly, even if the developmental state produces corruption, as described by Perkins (2001), White (1996), and many others in their examination of East Asian

industrialisation, and this corruption is believed to have inhibited innovation and contributed to an economic slowdown and recession in the Japanese economy, can a plausible alternative for the developing world be proposed? Are there any developmental successes in the developing world comparable with those in East Asia? Has the alleged corruption inhibited the process of socio-economic development in the DS cases to the extent they have not produced spectacular developmental results? Political corruption is a widespread phenomenon, which is believed to inhibit equal and equitable development. Nevertheless, it is present in all institutional arrangements and its reputed character of endemic East Asian crony capitalism is not a strong enough argument to dismiss what is indeed the remarkable developmental achievements of the DS model. Moreover, one can contemplate the thought that in certain circumstances corruption does not inhibit development. On the contrary, it can be growth promoting, if its result is a resource allocation to growth generating sectors (see: Bramall 2009a; White 1996).

Thirdly, the actual process of globalisation has left most of the nations and a plethora of social groups dissatisfied. The development-related disparities are increasing. Although some manage to accumulate significant wealth, the majority remains only marginally better off. This is because ‘a more aggressively enforced internationalisation of the global economy, [has been] built around rules that work primarily to the benefit of current holders of financial capital’ (Evans 1998, p.82). In this situation, only states are believed to offer adequate political resources to avert and redirect the process to make it more socially equitable, and the nations seem prone to turn towards interventionist practices to achieve better developmental dynamics.

Fourthly, globalisation may not be as demanding of state dismantling as might be believed. Weiss (2000) states that the argument that economic liberalisation caused by globalisation has prompted the DS dismantling is flawed. For example, according to her *proposition three*, there is empirical evidence that it was the DS dismantling which paved the way to liberalisation in the Korean developmental state and not the other way around (Weiss 2000, p.33) In other words, domestic politics might be considered a more important factor than the international conditionality in the process of states following the rules of the era of globalisation. ‘The new global regulatory environment and the more highly internationalised structure of business organisation do make some of the policies used by the East Asian NICs more difficult to implement, but what puts East

Asian practices out of reach is less likely to be external compulsion than anticipatory acquiescence by developing country governments to perceived constraints' (Evans 1998, p.81). Moreover, Weiss (2000) believes that financial liberalisation does not need to lead to state disengagement, i.e. the neo-liberal path is not the only route for regulatory reform (*proposition two*).

Fifthly, despite the official propaganda, developed nations intensively consider the implementation of protectionist policies via state intervention into the economy, in order to protect their own markets from various less or more illusionary threats. They will advocate it on the grounds of national security, as has often been the case in the US or on the grounds of unfair competition, as is usually the case in the European Union.<sup>21</sup> For example, Block (2008) illustrates the important examples of DS-style policies and DS-style interventionism in the US defence and high-tech sectors. He points out that 'governmental funding and infrastructure played a key role in [developing] such technologies as computers, jet planes, civilian nuclear energy, lasers and biotechnology' (Block 2008, pp.174-175). Many projects were pioneered by Pentagon's Advanced Research Projects Agency (ARPA), within the arrangements described by Block as Development Network State or DNS. He stresses the generally proactive role of ARPA, in particular in setting the technological goals, and of the National Institutes of Health (NIH) in funding the projects on biotechnology. Both ARPA and NIH can be seen as state pilot agencies contributing to the industrial policy by targeting certain sectors. This DS-style state-sponsored targeting has been, according to Block (2008), a common phenomenon in the US. The government has extensively contributed towards R&D projects via, for example, funds for early stage technology development. Moreover, the global economy is far from being free from protectionist attempts and interventionist economic forces of multinational corporations and governments of affluent states. What has changed are the mechanisms of intervention and protection. Therefore, as long as the above-mentioned practices prevail, there will be the space and the scope for government-motivated actions.

Sixthly, as the emergence of China as an economic superpower gives an important argument in the opposition to the recommendations motivated by the neo-liberal

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<sup>21</sup> As has often been the case when Chinese companies have expressed the desire to invest their assets into American firms and the American market. See, for example, 'Huawei rails at 3Com deal security concerns', *Financial Times*, 11.02.2008.

economic ideology, as far as economic development and economic transformation are concerned, the final and inevitable discrediting of this ideology, also as a result of the 2008/2009 financial crisis, seems to leave the pool of effective developmental models for underdeveloped states rather limited. The DS model resurfaces as a historically effective option, which elevates development to the ranks of the paramount ideology, above political and other considerations.

Globalisation, understood as a multilevel integration of national and regional economies and as a growth of interdependence of various socio-economic processes worldwide, will most likely continue in one form or another and the pressure of the external economic environment to influence the processes internally, will continue to take place. This is what constitutes the predicament of “late-late” development, as described by Beeson (2004). Therefore, state needs to play an important role in poor countries, who require better developmental dynamics, by attempting to benefit from international conditionality (e.g. from trade liberalisation, from easier technology diffusion) and by resisting external threats (such as attempts by foreign economic agents/actors<sup>22</sup> to overtake certain domestic industrial sectors in order to eliminate possible competition). Consequently, the concept of the developmental state has been buried prematurely. In view of recent East Asian economic achievements and the lack thereof in other regions, the necessity for creating developmental states cannot be easily dismissed.

In sum, it can be argued that the developmental state failures seem to be exaggerated and the corruption-proneness of the systemic arrangements does not need to dismiss the DS as a valuable option. Globalisation is far from being a socially equitable phenomenon and considering interventionist policies is common among all states, also among those who officially advocate the superiority of the liberal economic model. In turbulent times of the global economy and the rapidly increasing interconnectedness of national economies, developing nations have no choice but to rely on the state as a defender of their interests internationally, and as facilitator of the socio-economic progress internally. Wherever there is space for the developmental role of the state, there is space for implementation of the DS model in one form or another. In fact, this thesis attempts to construct a genus of a contemporary variant of the DS model, namely, the Post-Socialist Development State.

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<sup>22</sup> The phrases “economic agents” and “economic actors” are used in this thesis interchangeably and refer mostly, but not exclusively, to business entities.

The DS model cannot, however, be seen as a paramount remedy for underdevelopment in the various parts of the world and its provisions, applied to state policies and institutional arrangements, will not instantly solve the existing economic and social problems. Many conditions for East Asian developmental successes are historically specific and perhaps not repeatable. Therefore, each state needs to consider its own set of remedies, which depends on a number of factors.

Indeed, although I agree with the opinion that a number of countries from various parts of the world seem to share some political, institutional and social characteristics of the DS model, I also share the view that the realm of truly developmental states is probably limited to some examples of Northeast Asia. This rather conservative perception is not only based on the conviction that developmental states have certain important institutional and policy features in common, as well as share historical geo-political locality, but also considers the very effects of the long-term development trajectories of such countries like Japan, Korea and Taiwan. Those countries have indeed become highly developed economies, and the latter two could have been considered developing nations at the beginning of their DS-style transformation. In this respect I probably share the perception of those who accept the ‘consensus candidates’ (Stubbs 2009) or the “Asian Three” (Weiss 2000) as the DS cases. I also agree with Wade (2000) that the Asian Three ceased to be fully developmental states, despite Weiss (2000) and Stubbs (2009) correct assertions that the “DS residues” feature Japan’s, Korea’s and Taiwan’s contemporary institutions. Nevertheless, I find Evans’ (1998) argument about the “transferable lessons” from the DS concept and East Asian countries’ successes for a broader audience, indeed convincing. He is against a simple replication of policies and institutional arrangements. Instead, he believes that ‘trying to transfer [some] lessons from East Asia makes [...] sense. Constructing local counterparts to the proximate institutional prerequisites of East Asian success – bureaucracies with a capable economic core and government-business relations based on scepticism combined with communication and support in return for performance delivered – is not an impossible task’ (Evans 1998, p.83). Some institutional solutions and policy directions of historical developmental states may be employed in the contemporary conditions, as will be discussed in the following chapters in the case of China.

## 1.5. China and the Developmental State

The DS model in one form or another is still a valid developmental option, as the state needs to remain the main actor in the process of socio-economic progress in less developed countries. As developmentally most effective institutional and policy arrangements of the second half of the twentieth century it stands in sharp contrast with the neo-liberal economic doctrine not merely in systemic terms but most importantly in developmental results. The discussion on developmental state concept will probably continue as long as the state's role will be seen by some as being of paramount importance to developmental endeavour. This perception is very unlikely to change unless the process of growing disparities between the poor and the rich is effectively averted.

The recent developmental advancements by China, despite the overall trend of growing inequalities, prompt a question as to the sources of Chinese development trajectory and the role of its government. The country's geographical proximity and cultural affinity to Japan, Korea and Taiwan makes some scholars wonder about its relation to the historical DS cases. How does China fit into the discussion on the concept of developmental state? How does this debate extend to China? To quote Baek (2005, p.485), 'does China follow the East Asian development model?'

As illustrated in the following chapters, China's systemic arrangements and institutional environment are characterised by an active developmental role of the state. In this respect the Chinese contemporary development trajectory can perhaps be perceived as a continuation of a tradition of state-guided development, with its roots in the American system of the early nineteenth century, Listian political economy, and the experiences of developmental states in East Asia. Breslin (1996) believes that the Chinese path of development contains some similarities with capitalist developmental states of East Asia, but he is not convinced that China is actually a developmental state. This is because of what he calls a dysfunctional development, which Chinese reform period is characterised by. He argues that despite the fact that the DS' political-bureaucratic elite should not accede to political demands that would undermine economic growth, 'political demands have been a major factor in the Chinese economic decision-making process' (Breslin 1996, p.692). As a result of this and of decentralisation of fiscal and other powers, which provide the provinces with the ability to design their own

development-related activities, 'China's developmental trajectory owes at least as much to the dysfunctional agglomeration of numerous local initiatives, as it does to the plans and strategies of the national level decision-making elites' (Breslin 1996, p.689). Indeed, for Howell (2006) China's degree of decentralisation and, as a consequence, the lack of an effective central state as a prime actor, as she claims, undermines the case for China as a developmental state. She situates PRC together with India and Brazil somewhere between developmental and predatory states. Howell (2006) further examines the decentralisation issue, claiming that what partly drives the developmental advancements is local and sometime personal interests, which creates a sort of a "dual developmental state" as described by Ming (2000 cited in: Howell 2006, p.284), where central and local elites' ambitions influence the overall development trajectory. Therefore, as well as due to other factors, the central government is believed to 'have difficulties [...] in asserting its will on subordinate parts of the state and [thus] steering a coherent nationwide trajectory of economic development' (Howell 2006, p.285). In the environment of a plethora of quasi-developmental decision-making centres, their own survival takes precedence over national development (p.287). Therefore what is created in China is a polymorphous state rather than a developmental state. This results in unbalanced and uneven development. Breslin (1996) discusses several elements, which distinguish the developmental process in China from that in DS historical cases. In the case of China, the reforms were motivated by the ruling elite's desire to hold on to power and the reform policies were designed so that no group within the ruling elite and key social groups as well as geographical locations lose too much in the process. The reform process itself was characterised by a conflict within the ruling elite as to the specifics and destination of the reforms. The reformers had no previous experience and knowledge in utilising and controlling market mechanisms (pp.692-693). Howell (2006) continues her line of argument by questioning the existence of Evans' embedded autonomy in China. She believes that what characterises the ties between the government officials and business officials is far from embedded autonomy, due to the 'historically-rooted mutual suspicion between the Party and private entrepreneurship' (p.288).

There is a group of scholars, however, who has seen China as a developmental state during the period of state-command economy and/or during the time of market reforms. White (1988) called China a socialist developmental state, as the Chinese socialism has often been believed to be driven by developmental ideals (see: Lin 2006). 'The key

features of the socialist developmental state are the virtual elimination of private industrial capital, all-pervasive controls over the economy, and a state that, at least initially, represents the interests of a revolutionary coalition' (White 1984, p.103 cited in: Howell 2006, p.276). Baek (2005), partly contesting Howell's arguments, claims that the contemporary China of market reforms is a genus of the developmental state. 'Chinese aspects of this developmental state include: the high rate of domestic savings, the huge infrastructure of heavy industry, the promotion of industrial policy, the legacy of central planning, labour-intensive industry accompanied by import-substitutive capital-intensive industry, a strong central government with huge bureaucracy, and corporatist control over the society' (p.487). He claims that 'these characteristics seem to fit into Wade's (1990a) ten policy advice for "governed market" to promote government-guided development' (p.487). Moreover, Chinese government is believed to control the financial system and channel resources into specific targets and the national economy is highly dependent on export, as was the case of classical developmental states. He does, however, acknowledge that China's rapid development is taking place in a different international and domestic conditionality. He also admits that the main business actors of the Chinese developmental state are different from those of Japan and Korea, as far as the ownership control is concerned. Nevertheless, Lee and Mathews (2010) underline that China today draws on the entire Northeast Asian developmental experience, including Japan, Korea, Taiwan, as well as Singapore. In fact, the two scholars combine the developmental experiences of Japan, Korea and China describing them as "the BeST Consensus for development", where BeST stands for Beijing, Seoul and Tokyo.

China, as much as previously Japan, Korea and Taiwan, is often perceived as a corporatist state. According to Unger and Chan (1995, p.95) 'in the ideal-type corporatist system, at the national level the state recognises one and only one organisation as the sole representative of the sectoral interests of individuals, enterprises or institutions that comprise that organisation's assigned constituency. The state determines which organisations will be recognised as legitimate and forms an unequal partnership of sorts with such organisations.' All four countries erected strongly authoritarian corporatist structures during periods of intensive development (see also: Wade 1990a, p.27). Already in the period of state-command China possessed two "ingredients" of the Japanese corporate model; the cultural – a shared belief in the subordination of individual interests to the good of collective, and the one which also

lies within the institutional legacies of Maoist era and more precisely the role of enterprises, as multifaceted benefactor (Unger and Chan 1995, pp.126-127). Oi (1995) further explores the Chinese corporatism and links it more directly with the developmental state model. She considers China to be a local corporatist state, where the corporate-like ties characterise every level of state bureaucracy within the state structure as well as with business actors. She illustrates how, on one hand, the Maoist legacy provided the political capacity for the local corporatist state in China, on the other, the orientation towards economic growth and development resulted in the state bureaucracy taking a new role as local developmental agents, often in collision with state-level interests. This has created a decentralised developmental state in China, which adopted Maoist institutions for a transitional economy (Oi 1995, p.1139). Indeed, Howell (2006) reminds us that a number of 'new conceptualizations of the state in the reform period have emerged, such as the 'entrepreneurial state' (see: Duckett 1998), the 'corporatist state', 'the regulatory state', 'the dual developmental state', 'the market-facilitating state' [...] the 'rent-seeking state' (p.279), and China's arrangements may as well at least partly fall within their definitions.

Contemporary China shares some policy, institutional and social characteristics with the developmental states of Japan, Korea and Taiwan. Its affinity with the countries of the "East Asia miracle" is not without controversies. However, the pool of similarities is believed to be large, as examined later, to the extent that it is argued here that the Chinese development trajectory has been determined by provisions of the DS model and that China has become a genus of the Post-Socialist Developmental State. Consequently, the discussion on the DS model seems to extend to China, partly in the context of contemporary applicability of the DS model's variation and the expansion of its applicability to the states of post-socialist transformation.

## **Chapter 2: Post-Socialist Transformation in China**

Until the early nineteenth century China was the largest economy in the world (Maddison 2007) and this economy was characterised by a market system. The institutional departure from market towards state-command followed over a century of economic stagnation and was the result of the new state ideology introduced by Mao Zedong and the CCP after the establishing of the People's Republic in 1949. Over the last thirty years we have been observing the installation of a new market system and China is often believed to have been undergoing an extensive process of post-socialist transformation. This process will be the subject of the examination in this chapter. It is important to establish the features of China's post-socialist transformation, partly in order to determine whether and to what extent PST creates an institutional environment adequate for the implementation of a DS model variation.

### **2.1. Post-Socialist Transformation – The Overview**

As it embraces around 25 percent of the human population, post-socialist transformation is by all means a process of historical significance. It is hardly possible to imagine complex and extensive systemic changes that equal those taking place in parts of Europe and Asia. In simplistic terms, the process is twofold in nature; from the political perspective, authoritarian regimes are being replaced by democracies and, from the socio-economic perspective, the systems are being transformed 'from centrally-planned economies based on state ownership domination and bureaucratic control mechanisms into the free market economies based on private ownership and a deregulated market' (Kolodko 2004b, p.32). Some scholars also include a third process of the transformation, namely, nation building. Naturally, there are regional variations and indeed each country in transition would have its own personal set of characteristics.

The process of post-socialist transformation is often referred to, in scholarly literature, as post-communist transformation, since the term "communism" was broadly associated with the Eastern bloc's authoritarian political regimes of single-ruling parties propagating Communist principles. The scholarly discussion on what defines socialism and what defines communism is broad and seems to fall beyond the main scope of this thesis. Nevertheless, in order to establish what constitutes post-socialist and post-communist transformations in very general terms, one needs to attempt to present some

general perceptions as to the differences between socialism and communism. A communist country or a communist regime would commonly be defined as a state/regime in which a communist party rules and the political mechanisms do not allow for the contestation of its power. The regime would be perceived as severely limiting both political and economic freedoms. This is, however, the common perception from a political point of view of what constituted a communist state. Although Engels (1969) suggested that “Communism is the doctrine of the conditions of the liberation of the proletariat” indicating that it is a type of political system, the subsequently written *Manifesto of the Communist Party* (Marx and Engels 1969) describes also the socio-economic features of Communism and its postulates such as the abolition of private property and the reorganisation of labour relations. In fact, Schumpeter (1942) saw Marx not only as a philosopher, but also as an economist. Marx’s *Das Kapital*, as a critique of capitalism, was in its character an analysis of political economy. Indeed this “economic perception” was the very interpretation of Communism in most of the countries in the Eastern bloc, where the state ideology often propagated that socialism is an interim period between capitalism and communism, i.e. a process rather than a system (see: Brugger and Kelly 1990; Dirlik 2005), or a stage in human development, as the proponents of scientific socialism would claim, leading towards communism – Marx’s final social and systemic arrangement upon eliminating capitalism (see: Singer 1980). Consequently, communism was considered, in addition to its necessary political layer, to a great extent, a future socio-economic arrangement. The interpretation would be that communism was, thus, in its economic-institutional form, never achieved in the Eastern bloc. On the contrary to socialism, which was believed to have been firmly installed, with its distinctive economic features. It is important to note that what may seem to be an institutional monolith from the outside, would be a variety of micro systemic solutions inside, allowing various degrees of political and economic repression/freedom. In an attempt to reconcile both perceptions, i.e. the commonly accepted political one and the scholarly-related economic-institutional one, it could perhaps be argued that the Eastern bloc states were politically “communist” as they were ruled by communist parties, and economically “socialist”, as they could have been seen as being in the socialist transformation period towards communism. This is however, not to say that post-socialist transformation would refer exclusively to economic liberalisation and post-communist transformation – to political reforms.

This statement bears important consequences for our subsequent analysis. In many former members of the Eastern bloc the terms “post-communist” and “post-socialist” in reference to the systemic transformation can be used in a somewhat complementary way, as those countries witnessed the departure of communist parties from power or at least the change in the political mechanism which would earlier prevent an effective power contestation, and the departure of socialist economy. However, China, together with a handful of states, seems to be an exception, as the China Communist Party is still in firm control of the country, and the single party regime is still present. Socialism, as an economic-institutional system, on the other hand, is subject to reformulation. Following the above line of argument, one can conclude that the PRC might be undergoing post-socialist transformation but is not necessarily subject to post-communist transformation.

The economic transformation seems better reflected in the term “post-socialist transformation” than in the phrase “post-communist transformation”, not because the former does not apply to political arrangements, as it does, but because the latter, in its Western-originated common perception, to some extent, ignores the economic arrangements. More importantly, from the point of view of Marxist theory and of the political elites of the Eastern bloc, communism, as an economic-institutional arrangement had never been implemented, thus could not be in the process of transformation. In the analysis of the concept of the developmental state, the examination of a genus of the political system is rather a secondary issue and the economic-institutional arrangements take priority. Therefore, for the purpose of the examination of the “developmentalstateness”, one may wish to refer to the post-socialist transformation, as the process which without the exclusion of the political aspects, underlines the economic reforms.

As far as the political perspective is concerned, the last decades show that the need for democratisation – the desire to elect their citizens as representatives to the decision-making institutions – is in most nations, very powerful.<sup>23</sup> In particular, this desire can be observed in Central and Eastern European states, where the authoritarian regimes led by

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<sup>23</sup> Although seen by Plato as a form of degeneration of the order of the state (Sylwestrzak 1996), at the beginning of a new millennium, democracy is a dominant political system in the world. Throughout the last thirty years there have been significant advancements in this respect. ‘The 1980s and 1990s saw a huge increase in the global spread of democracy. Some 81 countries – 29 in Sub Saharan Africa, 23 in Europe, 14 in Latin America and 5 in the Arab States – took steps towards democratisation’ (HDR 2003, p.134).

communist parties have been replaced by multiparty democracies. In most of these cases the democratisation processes were indeed extremely fast, because of the following; firstly, after many years of authoritarian regimes people expected more political power, secondly, the introduction of democracy could take place in a decree-like fast track legislative procedure. Naturally one must take into consideration its interim failures, caused by the fact that a civic society has not been fully formed and that the new institutions fail to function correctly, however, the installation of the systemic legal frame can be almost immediate. Despite the democratic ambitions of many, some states of post-socialist transformation did not introduce democratic procedures. Consequently, the two main types of political systemic reform among the states of the former Eastern bloc are “political liberalisation” (e.g. Poland, Hungary Czech Republic, among others) and “political reformulation without liberalisation” (e.g. Kazakhstan, Uzbekistan, among others); the former resulting in the establishment of a democratic system, the latter – in the creation of another form of authoritarianism. In the DS context, it seems a convincing argument that the democratic post-socialist countries have had neither the time nor the desire to develop soft-authoritarian Japanese-style institutions aimed at shielding the development trajectory, as exemplified by a common lack of powerful economic bureaucracy and political penetration of state administration. Therefore, political reformulation without liberalisation would perhaps be a preferable process. However, DS authoritarianism is a specific case (Johnson 1982) and thus would require a number of other changes on the side of the post-socialist authoritarian power centre, as examined in chapter one.

As far as the economic perspective is concerned, years of experience allow for the assumption that at the current level of the development of our civilisation, market seems to prevail over any non-market system. Historically, this does not need to be a paramount truth, nevertheless, contemporarily – it seems to be a general rule. Therefore, the PST, in its economic-institutional form, constitutes a departure from state-command towards market economy. The process consists of several elements. According to Kolodko (2001a, p.22) they are: liberalisation and macroeconomic stabilisation; institution building; and microeconomic restructuring. In the Chinese context, Guo (2003a, pp.562-563) refers to the processes of ‘economic liberalisation – the loosening or elimination of government restrictions on economic transactions, including freeing prices, trade, delegating control rights or decision-making rights from the state to enterprise managers, and allowing the development of various types of new business

firms and enterprises, such as joint-ventured, individual-owned, private-owned, and foreign-owned; marketisation – the attempt to develop important elements of a market economy and create market institutions such as legal, financial, and social welfare systems; privatisation – a political process wherein the government, by the use of state power, administers a privatising programme and policy for the purpose of the dramatic and fundamental transformation of the existing public ownership, with the massive transfer of state-owned or collective-owned enterprises, land, and other public assets to private hands.’ Duckett (2003) adds that this marketisation is taking place along other important economic and social processes – industrialisation and urbanisation.

The divisions presented in scholarly literature essentially describe three mutually dependent, interrelated and often not clearly separable, processes: economic liberalisation, marketisation and microeconomic restructuring. Economic liberalisation is related to the process of the external and internal opening of closed economies for economic activities. Marketisation is, in real terms, an introduction of market mechanisms into the economic conduct by the implementation of certain laws and the creation of certain institutions, which supervise and define the limits of economic activities. Microeconomic restructuring involves sectoral changes into the structure of the national economy. It includes ownership reforms, redefining the central-local relations, as well as industrial restructuring. In the DS context, many post-socialist reforms, such as market institutionalisation, economic liberalisation and ownership changes among others, may contribute to the establishment of a DS-style institutional environment. However, they also may not, as discussed later in this chapter. It depends on the particular micro solutions within and the extent of the state reforms.

For the post-socialist transformation to commence, there were both political and economic factors which contributed to the mounting pressure for changes. Predominantly the economic factors, however, should be considered as catalysts to the collapse of state-command economies ruled by communist regimes. In post-second-world-war Europe, Western market economies have developed faster than socialist states and their societies have successfully maintained a more affluent position. A good example is illustrated by the case of Spain with its Franco-time capitalism and Poland with its state-command system. Shortly after world war two, Poland’s economy was marginally larger than that of Spain. After the collapse of the Eastern bloc, Spain’s economy was over twice as large as the Polish economy. In East Asia the story is indeed

similar. The market economies of Japan and Korea experienced better developmental dynamics than socialist China.<sup>24</sup> Consequently, the pressure to achieve better developmental results had to gradually increase in parts of Europe and Asia. State-command economies, in general, were eventually to collapse or to be transformed, in practice, due to their inherent low effectiveness, bureaucratic management inhibiting growth, and lack of sufficient development and modernisation mechanisms as compared with market economies.

There are a number of countries which have participated in the process of post-socialist transformation, however, there is some misunderstanding as to which states actually belong to the group. The confusion may derive from inaccuracy of the definition of socialist states or even more from a liberal appliance of the term “communist state”, hence those, with a few exceptions, which are now in transition. It is widely accepted that post-socialist transformation has been evident in Europe and Asia. A similar process might take place in America, in the case of Cuba, the only socialist country on the continent. The suggestion that there are any other socialist or post-socialist countries there, using the argument that the states were run by socialist ideologists/driving forces, as was the case of Salvador Allende’s Chile (1970-1973) or Daniel Ortega’s Nicaragua (1985-1990), is very questionable. It is just as questionable to assume that so-called African socialism, a term adopted as an ideology by African leaders after the colonial times (Kwame Nkrumah, Kenneth Kaunda, Samora Machel, Robert Mugabe and others), which was very much a reaction towards oppressive capitalist colonial powers and combined elements of traditional indigenous culture with socially orientated philosophy of state, have much to do with real socialism.

To clarify the matter, post-socialist transformation has taken place in Europe and Asia. Among the European states in transition there have been twenty countries of Central and Eastern Europe, of South-Eastern Europe and the former Soviet republics: Russia, Belarus, Ukraine, Moldova, Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Macedonia and Albania. Naturally, one may also include the former German Democratic Republic. It can plausibly be argued that many of the European countries have completed their PST process, upon creating systemic

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<sup>24</sup> A lack of market economic conditions is not the sole reason for communist China’s developmental dynamics not being as impressive as that of Korea, Japan as well as Taiwan in the 1960s and 1970s. Other factors include international conditions, as discussed in chapter one.

environment, legal conditions, economic mechanisms and institutions similar to that of their neighbours in Western Europe.

It is the inaccurate account of the Asian states in post-socialist transformation, which leads to misunderstanding. There seems to be some confusion with the term “Asian socialism” as has been the case with “African socialism”. Gyan Chand (1965), a close aid to India’s Prime Minister Jawaharlal Nehru (1947-1964) wrote in his book entitled *Socialist Transformation of Indian Economy*, about the necessity of continuing to build socialism in India. Chand is by no means the only author discussing India as a socialist economy (see: Jain 2000; Shah 2001). Moreover, the preamble of the 1949 constitution of India declares the state a sovereign, socialist, secular, democratic republic. Indeed, the state economic interventionism as well as good relations with the so-called Eastern bloc, could confuse some that India if not already, would soon be a socialist state. One should note, however, that Chand pitted “democratic socialism” in India against “communist totalitarianism” in the Soviet Union and China. Consequently his vision of “Indian socialism” was rather a vision of a state interventionist country with a market economy, closely associated with the ideas of European social democrats. Therefore, even in realising Chand’s ideas, India would not have become a socialist country and therefore could not be then classified as being in post-socialist transition.

In the post-socialist transformation group, former Asian Soviet republics such as Georgia, Armenia, Azerbaijan (the Caucasus region)<sup>25</sup> and Kazakhstan, Uzbekistan, Tajikistan, Kyrgyzstan, Turkmenistan (Central Asia) can undoubtedly be included. It is widely accepted that Mongolia, China and Vietnam are indeed undergoing transformation. North Korea is still a state-command economy with marginal reforms having been initiated in the late 1980s. Another country which is sometimes considered to be in post-socialist transformation is Laos. Although some analyses also include Cambodia and even Myanmar, it is highly questionable whether these countries can actually be considered to have been socialist and now to be in the process of post-socialist transformation.

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<sup>25</sup> It is a growing tendency to perceive the Caucasus’ states as European, due to their historical and political ties, culture and the ambiguity as far as the border between the European and Asian continents is concerned.

## 2.2. Post-Socialist Transformation – The Debate

The discussion on paths and methods of post-socialist transformation is chiefly held among scholars and most importantly among policy makers. One should remember that, as Kornai (2004) rightly points out, the analysis of transformation, even in the economic dimension, is about politics, as the politicisation of every decision is unavoidable (see also: Duckett 2003). As far as the large and extensive literature on this subject is concerned, most of the well-known experts such as Dornbush (1994) analyse only certain aspects of post-socialist transformation, focusing for example, as he did, on financial policy. Some dedicate their research partly to Central and Eastern Europe, like Sachs (1989, 1991, 1993) examining also Latin American economies, some focus predominantly on one individual country as Aslund (1991, 1995) does on Russia. The literature on post-socialist transformation seldom features the DS concept, as the PST process has taken place in the times of denial of the state's important role in economy and development. Moreover, the literature on post-socialist transformation seldom targets China, as it is Central and Eastern Europe and former Soviet Union biased. However, the literature on China is extensively engaged in the PST process, under various conceptualisations of reforms, transformation and transition.

Although most scholars tend to accept the superiority of the market system over the state-command system as far as the dynamics of socio-economic development is concerned, the very process of building a market economy in the post-socialist states – is controversial. China seems to be at the core of this discussion. On the one hand, there are supporters of rapid and aggressive economic liberalisation without any significant consideration for institutional reforms, so-called “shock therapy” doctrine followers, and, on the other hand, advocates of incremental changes who emphasise the need for building systemic institutions and for microeconomic restructuring and who stress the fact that these types of reforms require time. The very primal debate “gradualism vs. radicalism” – though not uncontested in its nature<sup>26</sup> – has been present since the beginning of the post-socialist transformation and both options have had influential proponents. Jeffrey Sachs, a central figure to the PST process at the beginning of transformation, although he subsequently eased his tone, spoke in favour of radical

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<sup>26</sup> This contestation arises partly from the analysis of China. The opponents of the conceptual gradual-radical discourse would argue that China, in some respect of its reforms, was indeed extremely radical, despite the fact that in the scholarly literature it is seen as the prime example of an incremental reform state.

changes, pointing to the fact that such reforms would allow faster adjustability to and integration with the increasingly globalised world. Stronger ties with the rest of the world would create conditions for faster development (Sachs 1994). Such changes were introduced – following Sachs’ advice – by Poland’s Minister of Finance Leszek Balcerowicz between 1989 and 1991, and were broadly known as *Plan Balcerowicza* (Balcerowicz’s Plan). Balcerowicz (1998) defends the radical reform path, as the only way to eliminate the hyperinflation as well as to unleash the human capital, and eventually allow for constant increase in productivity. He believes that gradualism enabled consolidation of certain groups of interests capable of sabotaging the course of pivotal economic changes in favour of their sectoral/personal gains. Murrell (1993) points out that the “shock therapy” in Russia was more intensive than in Poland under Yegor Gaidar – Russia’s Minister of Finance (1991-1993). However, Gaidar was forced to back down after, as he describes, populist pressure (Gaidar 2005). Nevertheless, until the beginning of the twenty-first century the radical path of reforms continued to have many supporters amongst Russian governing elites (Nekipelov 2005). Kolodko, who also held a position of Minister of Finance of Poland, seems to be the greatest opponent of the radical reforms path. He sees the gradualism vs. radicalism discourse in the economic liberalisation and stabilisation context, underlining that the imposition of drastic discipline in the economic policy resulted in the overshooting syndrome (see: Kolodko 1999a, 2001b, 2004a). In other words, the remedy was too strong for the problem, hence the economic depression was eventually extensively larger and longer-lasting than anticipated. In Russia, errors of the radical path as well as other elements of systemic transformation are analysed by Nekipelov (2005), who points to the fact that despite Balcerowicz’s argument, the interest groups in Russia insisted on radical changes, especially in the area of state assets privatisation, which contributed to the long-lasting economic depression. Most of the observers of the Chinese systemic transformation in comparison with other former socialist states, support the incremental transformation mode as the means to achieve a high developmental dynamics (see: McMillan *et al.* 1996; Naughton 1995, 1999; Jefferson and Rawski 1999a; Saich 2001). This is due to the overwhelmingly better developmental results of China than those of the other countries of the former Eastern bloc. This perception complies with Kornai’s (2004) statement that some reforms need time, if they are to be implemented correctly. Kornai himself seems to suffer from “Sachs syndrome”, where we observe a steady departure from the support for radical reforms in favour of gradual changes, due, as it seems, to the failure of the former, as far as the anticipated results are concerned.

Despite his previous opinions, Kornai currently advises against accepting any overall doctrine in pursuing transformation goals and warns against the assumption that “the faster the reform the faster the growth”. “There is no universal prescription [for successful transformation]. There are no specific, practical recommendations equally valid for every country’ (Kornai 2004, p.3). Gradual approach supporters also point to the well-constructed development policy as an element of post-socialist transformation, which, it is claimed, cannot be sustained during the rapid radical changes. The followers of the “shock therapy” doctrine are convinced that some changes had to be quick and drastic to avoid an economic catastrophe and to create a healthier environment for economic development. Hardly any of the PST countries, however, are believed to have followed exclusively either the gradual way or the shock therapy, if indeed such rather elusive concepts can be clearly defined, as far as systemic transformation policies are concerned.

It is often believed that it is the Washington Consensus which can be considered the starting point for the discussion on methodologies of post-socialist transformation, as exemplified in the gradual vs. radical discourse, as well as in the entire philosophy as far as the final target of the transition is concerned, namely, the imaginary future state system construction. The Washington Consensus, taking its name after the city where the world’s most important financial decisions were made, became in the 1980s the very element of a new reigning doctrine of economic policy. Coined by a famous British economist John Williamson (1990) the Consensus contains 10 points vital for stabilising the economy and public finances: introducing fiscal discipline; reordering public expenditure priorities by switching into better funding of basic health and education; constructing a tax system that would combine a broad tax base with moderate marginal tax rates; liberalising interest rates; allowing a competitive exchange rate; trade liberalisation; liberalisation of inward FDIs; privatisation; deregulation aimed at easing entry and exit barriers; securing property rights (Williamson 2002). It is important to note that in many points the Consensus stood in sharp contrast with the developmental state concept, as far as trade, interest rate, exchange rate liberalisation and economic deregulation are concerned.

The Consensus has had an enormous impact on the post-socialist transformation, despite the fact that its intentions have been questioned. In official propaganda the sets of economic policy recommendations were originally intended to guide Latin American

countries out of their economic and financial crisis. Indeed, only tough disciplinary measures seemed to be able to reverse the process of these otherwise deteriorating economies. In practice, although impossible to prove directly, the recommended policies served as a tool for mainly private and commercial financial organisations based in the developed world to recover the money they had previously lent to the countries of the region but because of the debt crisis, had been unable to retrieve. It was the debt crisis and not the economic crisis itself that seems to have prompted a reaction in Washington. In the late 1980s the total debt outstanding in Latin America approached 500 billion USD. Although other countries were affected, in the year 1983, 'sixteen of the nations were from Latin America, and the four largest – Mexico, Brazil, Venezuela and Argentina owed various commercial banks US\$ 176 billion, or approximately 74 percent of the total LDC debt outstanding' (FDIC 1997:191).

In the Latin American countries, the Washington Consensus' success was partial and limited. It brought some positive changes to their economies; 'healthier budgets, lower inflation, lower external debt ratios, and economic growth' (Clift 2003), to mention the most important advantages. However, there were no positive trends in poverty eradication and there was no decrease in social disparities. At the same time states became more vulnerable to external shocks. According to Lee and Mathews (2010), the inadequacy of the Consensus as a guide to development arose from its lack of recognition of economic development as a catch-up process, its failure to see development as a dynamic process of sequential stages and its silence on the fundamental role of capability building. Nevertheless, its partial and limited success allowed for the presumption that the model can be applicable to other regions. Indeed, a new stable economic environment was needed to be created especially in some countries of Central and Eastern Europe ravaged by stagflation – economic stagnation and inflation (Kolodko 1993), and in some cases, hyperinflation. Jeffrey Sachs (then a professor at Harvard University and a great proponent of the Washington Consensus) acting as an advisor to the Polish government was among the first to attempt to incorporate Consensus provisions to the packet of economic reforms in the PST world. Closer studies (Ahrens 1999; Kolodko 1999c), however, revealed that many countries adopting Consensus principles suffered tremendous losses in their economies. The infamous record holder was Moldova, whose economy decreased by 68 percent between the years 1989 and 2000 (EBRD 2001:16). The apparent failure in the countries of post-socialist transformation prompted furious attacks on the authors and executors of the

Consensus. Additional vehement criticism of the IMF's and World Bank's handling of the Asian financial crisis using the Consensus guidelines, in a book by Joseph Stiglitz (2002a) *Globalisation and Its Discontents*, resulted in a significant increase in Consensus opponents. The argument about the failure of the Washington Consensus in the case of states in post-socialist transformation seemed indeed valid if one takes into consideration the achievements of those countries which in full or partly rejected its provisions. The prime example is China, which has achieved high economic growth and instantly strongly opposed the Consensus' doctrine. This failure was due to the fact that the Consensus in its recommendations towards economic policies did not take into account the necessity of extensive institutional reforms needed for restructuring the state system in the process of post-socialist transformation, and that without such time-consuming reforms, the tough fiscal discipline and extensive economic liberalisation may harm the vulnerable socio-economic environment in transition. Moreover, regardless of the various arrays of post-socialist predicaments, perhaps the Consensus, inspired by neo-liberal economic thought, presented neither desirable nor feasible solutions to the former socialist states, positioned outside of the sphere of Western liberal capitalism. In other words, the assumption that the reform methodology and desired reform target would be universal was flawed.

The discussion about the wrongs and rights of the Washington Consensus and its applicability is not over, hence the genus of the best post-socialist transformation trajectory continues to be debated. In fact, Arrighi (2007) managed to engage Adam Smith in the debate, questioning the perception that the latter was a supporter of the liberal economic model and a potential proponent of shock therapy (see also: Kolodko 2011). 'The dogmatic belief in benefits of minimalist governments and self-regulating markets [...] or the equally dogmatic belief in the curative powers of "shock therapies" advocated by the Washington Consensus [...] were completely alien to Smith' (Arrighi 2007, p.43). Very influential policy makers such as Fischer (2003), Rubin or De Larosiere (2002) speak in favour of the Consensus, while Stiglitz (2001, 2002), Wolfensohn (World Bank President 1995-2005) and Kolodko (1999b, 1999c, 2001a, 2001b) all strongly oppose it. Stiglitz (2002) reveals the ill-advised policy recommendations based on the Consensus' principles, which contributed to the 1997 Southeast Asian financial crisis, in spite of being designed as remedies. Kolodko (2001a) illustrates the inadequacy of the provisions of the Consensus for the post-socialist environment, pointing to a certain lack of institutional background and fragility

of the systemic arrangements, citing North's (1997) argument about the importance of institution building. Williamson (2005) himself remains moderate, admitting the failures and successes of the Consensus, stressing, however, that the main ideas were deformed by economic neo-liberal orthodoxy. Perhaps as a result, Sachs and Woo (compare Sachs and Woo 1994 and Woo 2004) seem undecided about the final outcome, accepting the fact that the uniqueness of post-socialist transformation prohibits the liberal applicability of all the sets of policies created for a different occasion. Krugman (2007) is another influential economist, who having been a Washington Consensus' proponent, begins to question its neo-liberal provisions as remedies for underdevelopment.

The alleged developmental failures caused by the implementation of the Consensus provisions, as envisaged in post-socialist transformation, resulted in the formulations of alternative sets of recommendations. Those recommendations are usually conceptually closer to the DS model, as they reinstate the importance of the state in the developmental endeavour. The most commonly used term to describe them is the Post-Washington Consensus (Stiglitz 1998, Kolodko 2001b, Ahrens 1999; Jayasuriya 2001). Ramo (2004), however, decided to use the term "Beijing Consensus". There does not seem to be one widely accepted definition of what Beijing Consensus actually means. This is most likely due to the fact that by rehearsing some known concepts it brings little into the contemporary debate on the general guidelines for effective development. Ramo (2004) underlines the importance of an active role of the government in developmental efforts, which is a mere rediscovery of an already existing concept, abandoned, nevertheless, during, what Arrighi (2007) calls, the neo-liberal counterrevolution of the 1980s, which resulted in the adoption of "a hyper-liberal model" (Nuti 2010) in a number of countries. Moreover, acknowledging the positive developmental changes in China as well as in other states of the Northeast Asia region, Lee and Mathews (2010) coined the term BeST Consensus, as mentioned in chapter one. With the capability enhancement and development as the central feature, it is characterised by two principal agents; pilot agencies to guide industrialisation and domestic firms to advance economic development.

### **2.3. Post-Socialist Transformation in China**

The main question of this chapter concerns the process of post-socialist transformation in China, whether it takes place and, if it does, what its features are, also those, which

are related to DS-style institutionalisation. At no stage of the reforms, which already account for half of the time of the PRC's existence, would the Chinese authorities use the term post-socialist transformation. On the contrary, all efforts would be directed at improving socialism.

### **2.3.1. China during the State-Command Period**

During the cold war China was perceived as a member of the Eastern bloc. There were, however, always significant differences among the socialist states, not only as far as the level of development is concerned, but also in reference to political and economic arrangements. Khrushchev's Thaw, as the 1956 limited political liberalisation in the Soviet Union and the CEE was described, was met in China with Mao's articulate opposition. During the socialist times economic freedom was always greater in countries such as Poland than in China. Unlike in CEE where the system was in most cases imposed by the Soviet Union and was not related to socio-economic development, Chinese socialism was self-imposed and developmentalist. Its definition falls beyond the description of the production mode and refers to a certain positioning of the state as the guardian of what Lin (2006) calls "public good regime". The Chinese 'socialist development lay in both its historical origin of revolutionary modernity and its post-revolutionary mission of overcoming backwardness' (Lin 2006, p.70). The so-called central planning, however, was significantly less "central" in comparison with CEE and the Soviet Union. A large and underdeveloped country, whose authorities prior to the establishment of the PRC could not effectively control its territory for decades, lacked the sophistication necessary to maintain the type of system in which most economic and development-related decisions were met in the capital and most of the economic processes were regulated. Moreover, in Maoist China certain policies were deliberately designed to resist the Soviet Stalinist model. Nevertheless, a lack of market institutions as well as the presence of certain types of macroeconomic policies and regulations concerned with the mechanism of the allocation of production and goods, price control and origins of production means, clearly show that China was a socialist state. From the economic-institutional perspective China could have been seen as more "advanced" in building the futuristic communism than some of the CEE countries, where private means of production were partially allowed and price control not complete. Consequently, although lacking, to some extent, the executive machinery, state-

command was indeed exercised, by ordering the type and volume of production, its distribution and price. Moreover, the country was governed by a communist party.

At the time of the establishment of the People's Republic of China, the country was considered to be very poor by international standards, with large class- and geographical location-determined inequalities. The national economy was dominated by agricultural production. Politically, the state had emerged from the domestic civil war, preceded by the war against the Japanese, and the nineteenth century's period of semi-colonialism. The new, authorities, drawn from the CCP, with chairman Mao Zedong as the state leader, began the systemic reforms along the Marxist lines. The problems of the revolutionary government included, among others, establishing and consolidating administrative control and reviving and modernising the national economy (Riskin 1987, p.38). Maddison (2007, p.62) identified four economic reform objectives pursued during the Mao era:

- change in property rights; with three main targets: landlords, the national bourgeoisie (capitalists, merchants, bankers) and foreign interests (mostly in Manchuria and in the former treaty ports);
- a big increase in state revenue to finance expanded administrative mechanisms, maintain a high level of military preparedness and raise the rate of "accumulation";
- market forces were to be replaced by regulatory devices for allocating investment funds and physical inputs, controlling movement of labour, fixing prices and wages;
- foreign trade was to become a state monopoly.

The acceleration of socialist transformation in the mid 1950s resulted in the official elimination of privately-owned companies and in complete rural collectivisation. The State Planning Commission was established in 1952. The first five-year plan – the guidance for short-term state economic planning – was inaugurated in 1953. China became a fully institutionalised centrally planned economy by 1956 (OECD 2009a).

Despite following the Soviet model of heavy industry development aimed at building up the military capacity and at expanding the general infrastructure, Mao Zedong underlined in "On the Ten Major Relationship" that unlike in the Soviet Union, light industry and especially agriculture remained important sectors of China's development policy and cannot be neglected (see: Lardy 1983). By 1958 China's agricultural economy went through several phases of transformation; from land confiscation from privileged landowners, through pulling peasant resources together, creating "advanced

cooperatives”, to large people’s communes containing around 5000 households each (Maddison 2007, p.72). Lardy (1983, p.96) points out that the entire Mao period was characterised by informal experimentation as to the organisational structures determining the relative economic freedom of farmers. However, in the mid 1950s there was a diversion of productive forces from agriculture to producers’ goods production such as steel and iron in the heavy industry, in order to achieve a new policy objective, namely, the Great Leap Forward. This diversion resulted in an extensive famine, with starvation affecting millions of people.

The period between 1963, when the famine effectively ended and premier Zhou Enlai called for four modernisations, and 1978, when the systemic reforms were ordained, is often referred to as late Maoism. The main socio-economic objectives of that period were: creating self-reliance in the economy and improving the degree of egalitarianism in the society (Riskin 1987). It was characterised by the strategies of accelerating rural development, partly by the way of infrastructural investment, improving the education base and health care, and by defence-centred industrialisation. In 1964 the *dazhai* model was declared a national model of agricultural development, underlying the collective character of rural production, distribution and consumption (Riskin 1987, p.220). Nevertheless, as discussed by White (1987, p.413) ‘rural political economy [continued to be] dominated by two institutional systems; the state exercised [...] direct controls over the rural population, [...] the three-tiered system of rural collectives was a tightly knit framework for the comprehensive organisation of rural society and economy.’ Foremost, however, the period is associated with the Cultural Revolution, as the means to abruptly rearrange the governing structure of the country and to reformulate the social relations, in response to Mao’s weakening political position.

As far as managing of national industry is concerned, Brandt *et al.* (2008) point to the gradual decentralisation of companies’ control after the Great Leap Forward. Eventually, a large part ‘of industrial output came from smaller collective firms located in both urban and rural areas, most owned and directed by local governments’ (p.571). In neither large enterprises controlled by the central government nor in smaller firms in the hands of local authorities, was the role of the managerial staff more important than that of Party leadership. Simultaneously, the hidden private sector continued to operate (Haung 2008), for example, in such places as Zhejiang province, where especially in Wenzhou county people resisted rural collectivisation (Liu 1992). As far as the financial

system during the state command period is concerned, it consisted of a single bank, namely the People's Bank of China – 'a central government-owned and controlled bank under the Ministry of Finance, which served as both the central bank and a commercial bank, [in the late 1970s] controlling [as much as] 93 percent of the total financial assets of the country and handling almost all financial transactions. With its main role to finance the physical production plans, it used both a "cash plan" and a "credit plan" to control the cash flows in consumer markets and transfer flows between branches.' (Allen *et al.* 2008, p.509).

China's state-command economy worked out certain mechanisms as well as created institutional conditions for subsequent implementation of a genus of the developmental state model. These will be discussed in more detail further in this thesis. However, one can mention here the administrative centralisation despite business decentralisation, some aspects of the central-planning mechanism implementation and the expansion of state bureaucracy, the improvements in the human capital, and the banking system's subordination to the state agenda, as factors positively contributing towards the PSDS establishment. Moreover, the process of industrialisation, partly within the frames of four modernisations in terms of overall industry, national defence and science and technology can be seen as convergent with the historical DS pattern. On the other hand, elimination of private entrepreneurship as an important economic force effected a lack of a private sector partner for the state-business alliance, whereas the termination of market institutions abolished market mechanisms necessary for a DS model.

### **2.3.2. China in the Process of Post-Socialist Transformation**

As far as the subsequent post-socialist transformation is concerned, the main controversy concerns the issue, whether China has actually been dismantling the socialist regime, not merely in its political form, but also in being a socio-economic system characterised by state-command economy. During the reform period, in 1982 (at the 12<sup>th</sup> CCP Congress), China's leader Deng Xiaoping coined the term "socialism with Chinese characteristics", whereas in 1987 (at the 13<sup>th</sup> Congress) Party Secretary Zhao Ziyang declared that China was merely at "the initial stage of socialism" (Dirlik 2005, p.231, 232). The official propaganda continuously affirms that PRC is building a socialist society and a socialist market economy (the term officially used for the first time in the year 1992).

“Socialism” and “market” are, however, mostly seen as mutually exclusive, despite the concept of market socialism. This is our understanding from the previous analysis, backed by a mass of scholarly publications and, as it seems, the general perception. Nevertheless, the concept of market socialism is featured extensively in the analysis of the process of China’s transformation. It is sometimes believed that China’s reforms initiated in the late 1970s were geared in their first decade towards market socialism (Bramall 2009a; Lin 2006), as during that period the ownership of production means remained predominantly in the state or collective hands (despite economic restructuring and gradual removal of entry barriers for other economic agents), whereas prices became determined predominantly by market forces. For China’s political elites the model was considered sustainable and logical, as the economic liberalisation and opening up would be accompanied by maintaining public ownership and a drive to egalitarian prosperity. Guo (2003a, p.560) repeated Feng’s (1995) argument that de-collectivisation of China’s rural economy led in the 1980s to a new type of collective economy characterised by public ownership of land and individualised operations of production. Because of that Bowles and Dong (1994) saw China as a successful case of socialist state-led development. However, Greenfield and Leong (1997) argue that it was difficult to envisage China as an example of market socialism due to the state’s oppression of the working class, as discussed later in this thesis. They dub the systemic arrangements “communist capitalism” with the communist party in power and the marginalisation of the working class.

However, Justin Yifu Lin (2005) points to certain differences in perception of what constitutes a classical model of socialism and socialism with Chinese characteristics. He describes Chinese socialism as the creation of a harmonious society (the concept publicised by China’s fourth generation leader Hu Jintao) via extensive developmental efforts. Socialism is then closely associated with being a mechanism of development and modernisation, and in the process of systemic transformation – with a social element of the transformational endeavour and not merely with economic-institutional reform. In this respect, the terms “socialist regime” or “socialist state” do not need to refer exclusively to the economic-institutional construction of the country and may encompass certain political, historical and philosophical dimensions of the concept. Some Chinese scholars partly adopted Chand’s (1965) rhetoric on socialism, in addition to Lin’s (2006) historically-grounded motives of socialism and Lin’s (2005) socialism

incarnation in a harmonious society concept, and perceive socialism as sets of developmental ideals realised by state interventionist policies.<sup>27</sup> It is important to reiterate that many proponents and opponents of socialism alike, saw it as an overall state ideology not limited to economic-institutional arrangements, but encompassing various strata of societal existence (see, for example, Schumpeter 1942; von Mises 1951).

The replacement of the term “socialism” with “central planning” does not dismiss the argument that China is creating a socialist economy. On the contrary to common opinion, the inability to modernise and develop among the states of the Eastern bloc as efficiently as among market countries does not lie within the actual concept of central planning, but rather within the cross-sectoral extent to which central planning was applied. Among the developmentally successful DS countries, central planning in the form of “plan rational”, as described by Johnson (1982, 1999) and Woo-Cumings (1999), played a crucial role in the developmental endeavour. The shortcomings were in the rationality of planning, and, more importantly, agents which were designated to implement the plans. Therefore, in China, which is purportedly undergoing systemic reorganisation, central planning remains an important instrument in the formulation of general developmental objectives, though the actual policies implementation prerogatives have mostly been relegated from central authorities to provincial and other levels, in the process of post-Mao “administrative decentralisation” (see: Breslin 1999), and many processes are subject to market scrutiny. Thus, Howell (1998, p.57) probably rightly claims that China went from “command planning” to “guidance planning”. Moreover, the pallet of agents contributing to socio-economic development has been enlarged by entities from outside of the sphere controlled fully by the state bureaucracy.

However, to narrow the definition of socialism to its economic-institutional form, one is inclined to arrive at a conclusion that China has been building socialism without socialism, at least since the economic liberalisation of the 1990s. The uninterrupted governing of the Communist Party and the state’s official propaganda backed by some

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<sup>27</sup> From discussions with Professor Chang Xiuze, Institute of Macroeconomics, National Development and Reform Commission; Mr. Song Xiaowu, Member of the National Committee, Chinese People’s Political Consultative Conference (CPPCC) and Vice Chairman, Chinese Research Society for Economic System Reform; Mr. Zhang Shuguang, Research Fellow, Institute of Economics, Chinese Academy of Social Sciences; Professor Sun Liping, School of Humanities and Social Sciences, Tsinghua University; Professor Qin Hui, School of Humanities and Social Sciences, Tsinghua University; Mr. Zou Dongtao, Editor-in-Chief, China Social Science Documentation Press.

institutional experiments of an interim nature, cannot sufficiently blur the picture that, from the economic perspective, a market system with very little socialist type of institutionalisation is being created in the PRC, and that the departure from socialism was decided on and is being implemented, at least from the Eurocentric perspective. Naturally, it still leaves scope for philosophical debate about the distinctiveness in meaning and arrangements of the socialist state in China, hence the definitive abandonment of the system. An assumption that Deng Xiaoping's policies were intended at reforming socialism does not need to be dismissed, as 'the actual reform trajectory nevertheless followed its own logic, and given the tremendous pressures of ideological and institutional globalisation, it was not "allowed" to adjust until it would meet the "standards" of post-socialist transition set up within a framework of global capitalism' (Lin 2006, p.268). Indeed, China has been building a new institutional environment for economic activities and a new institutional platform for economic interaction and hence been creating a new economic order. This capitalist institutionalisation, which emanates from the conformity with the WTO guidelines, seems to have driven the systemic reforms in the long run.

The rhetoric of "building socialism" seems to be used for a certain justification for the Communist party, perhaps not to rule as the developmental legitimacy to power has rather firmly been established (as shown later), but to remain nominally a communist party, as the change in the official rhetoric could, nevertheless, prompt some questions related to power-holding. In addition to, as Lin (2006) points out, the ideological and historical baggage it brings in developing the country, "socialism with Chinese characteristics" can perhaps be used as a key to the gateway to some experimental policies, in the authorities' constant quest for various options. Such an experimentalism often guided the authorities of historical DS cases, as pointed out by Johnson (1999).

By emphasising "market" in the phrase "socialist market economy" and by accepting the philosophical perception of what socialism is supposed to constitute in the Chinese conditions, the idea of a "socialist market economy" does not need to be dismissed in its entirety. Perhaps an attempt at creating a harmonious society, to some level consistent with the continental European welfare state and Chand's option for India, can be seen as building a socialist market economy. Nevertheless, two arguments speak against this idea in the case of China.

Firstly, as a result of the reforms, the process of creating a harmonious society has so far been ineffective. The deterioration of societal ties is accelerating, where large parts of society are being marginalised. This is caused by economic conditions such as historical poverty which generates additional poverty, but also institutional shortcomings – e.g. legally-based exclusions of certain groups from free education, the healthcare service, the employment market, and social security, on an unparalleled scale (in European terms). Consequently, the number of citizens of a “second category”, drawn predominantly from the inhabitants of rural areas, who either still reside in villages or have become China’s migratory work force of 250 or so million people, is increasing. This marginalisation, unique in its scale, as it concerns a very large proportion of the country’s population, sharply contradicts the idea of a harmonious society. The government efforts to reverse the trend are, for the most part, insufficient. The growing disparities are reflected in the increasing Gini coefficient, which currently positions China among the countries where societal disintegration has for long been a significant problem.

Secondly, China seems to be characterised by an increasing number of features previously assigned by Arrighi (2007) to historical capitalist development. For example, foreign trade is believed to play a crucial role in China’s development. The nation with the largest foreign trade volume in the world, dominates certain sectors of world manufacturing. Although efforts are being made for a dramatic increase in domestic consumption, and some argue that, as opposed to common perception, international trade is not a driving force of economic growth in China (see: Anderson 2007), World Bank experts estimate that it will take decades for domestic consumption to replace trade as a dominant engine behind economic growth.<sup>28</sup> Foreign trade is believed to have been one of the main factors enabling the surge in developmental dynamics in the militarist model of capitalist development. Moreover, in contemporary China, capital is extremely important as an instrument of economic expansion and as a tool in stimulating certain sectors of the national economy. This has been the *rationale* behind the state’s accumulation of over 3 trillion USD worth of currency reserves, as a result of China’s export-orientated economy. Currently, China’s budgetary capacities allow for securing its economic presence in the most remote corners of the world, as a part of the strategy to strengthen its international position and to secure its long-term access to

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<sup>28</sup> Personal communication with one of the World Bank’s representatives to China, Paul Kriss, Beijing, 10/08/09.

natural resources necessary for further development. These capacities also enable the channelling of extensive financial assistance to favoured domestic sectors such as the energy sector, infrastructure building and others. Accumulation of capital and its subsequent utilisation in the developmental endeavour became something more than just an element of Chinese market reality. The abundance of capital now serves broad economic as well as political purposes. Naturally, the state seems to remain in control of the overall development trajectory to a significant degree and does not seem to be subject to capitalist class interests at large, as was the case in the historical European model of capitalist development. However, a lack of institutional transparency and – to borrow a phrase from Johnson (1999) – “seamless web” of connections between the state officials and business, makes it difficult to evaluate how influential the entrepreneurs are in their attempts to gear the institutional building, regulations and economic policies towards their self-interests.

Breslin (2007) argues that China is indeed a capitalist state, with, however, Chinese characteristics, in which ‘the state creates the space for the private sector to be increasingly important, and regulates the market to ensure that the new bourgeoisie [the emerging business elite] can appropriate surplus value thanks to the bourgeoisie’s close relationship with the party state’ (Breslin 2007, p.80). Nevertheless, Dirlik (2005) suggests that China’s departure from socialism should not be perceived as an inevitable drifting towards liberal capitalism. He argues that China’s state policies and reforms may be described as “postsocialism”, an arrangement which in a way is a continuation of socialism perceived as the desire to overcome capitalism’s deficiencies. ‘Postsocialism seeks to avoid a return of capitalism, no matter how much it may draw upon the latter to improve the performance of “actually existing socialism”. For this reason [...] it strives to keep alive a vague vision of future socialism as the common goal of humankind while denying to it any immanent role in the determination of present social policy’ (Dirlik 2005, p.231).

Putting aside the debates on the definitions of socialism and capitalism, one needs to reiterate that there seems to be a consensus that China was a country characterised by the socialist state-command economic system and is now building a type of market economy. This market economy seems far from adhering to socialist principles, even in their Chinese-philosophical form. In economic terms, China is undergoing a process of systemic reforms and its development trajectory exhibits features of capitalist

development. Both, the transformation from socialism to capitalism and the attempt to maintain the central state as the paramount power centre, are, from the DS perspective, desired processes, and contribute to the creation of the DS-style institutional environment.

China's systemic transformation is often described as a dual transition. Peculiarly, this refers to at least several different processes. Pei (2006) claims that China's dual track is about transition from state-socialist economic system and from a quasi-totalitarian political system. Indeed, Hamrin (1990) sees the dual strategy as bold economic reform combined with cautious political change. Focusing on economic affairs, Gallagher (2005) sees this dualism in the state withdrawal from the economy and its embracing of market principles. Lau *et al.* (2000) discuss China's dual-track approach to transition as containing simultaneous enforcement of the plan (the plan track) and market liberalisation (the market track). The dual transition can also be seen as economic-systemic reform transforming the state institutional arrangements, on one hand, and fast socio-economic development promoting the country into the group of more developed nations, on the other, as China is by all means characterised by these two processes.

### **2.3.3. Political Reforms and the Gradual Path**

As far as political reformulation is concerned, it is clear that, unlike Central and Eastern European countries and some former Soviet republics, Chinese political elites have not chosen to implement a democratic system. The systemic reforms commenced in 1978 had never been intended at introducing democracy, even less the one based on Western principles. As a consequence, the dynamics of Chinese political reforms have never caught up with the economic changes. The philosophy of economic liberalisation and the policy of opening up did not – according to Deng Xiaoping, the main ideologist of the reforms – contradict maintaining the ideological platform based on four cardinal principles: the CCP leading role, proletariat dictatorship, socialist way, and Marxist, Leninist and Maoist thought. Zhang (2000, p.154) believes that 'the excessive caution in political reform may be attributable to the following reasons:

- political reform is much more sensitive in the Chinese political system, and there has been no consensus yet on how to redefine the role of the Party in the Chinese political structure;

- it entails the reform of the Party cadre system or the nomenclature, which is deeply entrenched and involves many vested interests;
- it affects many people, as [at the end of the twentieth century] the state apparatus employed over 40 million people, and consisted of parallel institutions at all levels of bureaucratic hierarchy. China's citizen-official ratio [...] reached an alarming proportion of 30 to 1, unprecedented in China's entire history. Over 60 per cent of the state budget went to pay the wages of officials. Zhu Rongji [former prime minister] complained [...] that the state revenues had been 'eaten up' (*chifan caizheng*) by the country's huge bureaucracy;
- despite massive economic reforms, officials still retain considerable power.[...] It is not easy for them to give up this power and privileges;
- there is no other successful experience to refer to in 'decommunizing' a vast and populous country like China.'

Breslin (2004) indicates, however, that the economic reform generated an extensive political change redefining the relationships between state actors.<sup>29</sup> The core elements of the political reforms have been concerned with restructuring relations between the CCP, the government and the economy; institutionalising local-central relations; and democratising rural governance (Zheng 1999b). It seems symptomatic that the state has almost exclusively followed political reform to the extent necessary for the facilitation of economic changes, fast development and a more extensive international economic and political presence, as well as in response to social changes, with one main prerogative in mind – to retain and to strengthen the power over and the control of the society and the economy, in the dynamically changing circumstances. For example, Howell (1998, p.79) emphasises that 'the state has played a crucial role in refashioning the intermediary sphere so as to regain control over the society', as the systemic transformation resulted in an emergence of new socio-economic groups and in an increase of various social activities.

Many scholars discuss the CCP's ability to adapt to changing conditions and, at the same time, to influence the direction of changes in a way favoured by the Party's apparatus. Walder (2004) argues that China's communist party organisation neither collapsed and was dismantled as it was the case in CEE, nor did the apparatchiks become the beneficiaries of the massive state's assets appropriation as it was in FSU

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<sup>29</sup> The relations between various existing state actors are examined later in the thesis.

(see: Ding 2000b), nor did the communist party change its name and their top elites continued to rule as a nationalist dictatorship. 'China's Party hierarchy has survived unchanged, and despite extensive market reforms, has maintained its commitment to public ownership [...] coupled with effective political restrictions against the kind of spontaneous privatisation' (Walder 2004, p.194). Dickson (2001) points to the "inclusion" policies of cooptation and of creating links with other social organisations as the recipe for remaining affluent. The CCP has had a policy of attracting those who could contribute more effectively to the new role of the Party leadership defined as presiding over economic modernisation and rapid development – initially, technocrats, better educated and more competent than the old revolutionaries, and finally, economic practitioners, businessmen, also those in possession of very significant wealth, such as Liang Wengen.<sup>30</sup> By forging links with social non-party organisations, 'the state created a dense web [...] in order to channel interest articulation, regularise the flow of information between the state and key groups of society, replace direct state controls over the economy and society with at least partial social regulation, and screen out unwanted groups' (Dickson 2001, pp. 520-521). From the Party's perspective this was absolutely necessary, as the changes enabled by the economic transformation and institutional reforms had a strong impact on the society and societal activeness. As a result, the sphere between the Party and the masses has partly been filled with "social organisations", some of which are considered illegal (Howell 1998).

In the absence of democratisation, the political reformulation has taken the form of separation of powers and redefining of the links between the state and other entities, as well as within the state – between the Party and the government, and between the central and the local authorities. Goodman (1985) points out that China's leadership intended benign modernisation based on collective leadership and inner party democracy in decision making under the banner of socialist democracy. Decentralisation – a gradual process of transferring the powers and responsibilities to lower levels of China's state administration – was foremost aimed at increasing the effectiveness of economic policies. This resulted in the fragmentation of authoritarian power in the national space, as opposed to the political space occupied by the CCP (Breslin 2007, p.72). Nevertheless, by the 1990s the process of strengthening local political power centres was met with central government's efforts of re-centralisation.

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<sup>30</sup> Liang Wengen is considered to be China's richest man. He is the founder and main shareholder of Sany Group, a heavy industry manufacturer based in Changsha, Hunan Province.

According to Zheng (1999b), its main element was the “Party management of cadres” system, which seems to prevail until now, as exemplified by the rotation of officials among provinces and the centre on a regular basis. It coincided with the political power being passed from the revolutionary leadership – often participants of the *Changzheng* (the Long March), who were involved in creating the People’s Republic – to the generation of new leaders – the technocrats who were the products of Party bureaucracy (Fewsmith 2001).

Although, as Zheng (1999b, p.1161) points out, the political reform in China has not been about the opening of the political process to the general public and should be seen as a process of institutional adjustment, some political liberalisation is believed to be taking place and is visible in media broadcasting, in the increasingly more openly expressed opinions of policy makers and in a growing number of socially motivated protests and demonstrations.<sup>31</sup> The most important example of limited political liberalisation is often considered to be the quasi democratisation of rural governance, where members of local communities gained the power to influence who would be seated in the villagers’ committees. Initially self-established in two counties in Guangxi province in the early 1980s, rural elections became institutionalised through a course of laws and regulations (O’Brien and Li 2000). However, despite it being an obvious gain on the front of political liberalisation, resulting in greater accountability, social acceptance, and, usually, competence of local leaderships, Lewis and Xue (2003) argue that rural democracy does not work properly, as it is insufficiently supported by the state. Moreover, due to various local political factors, the system has developed unevenly throughout the country.

A lack of extensive political liberalisation is not uncommon among other PST states, especially former Asian Soviet republics, which makes China, in this respect, hardly an exceptional case. Gallagher (2002) believes that what delayed democratisation in China was the economic reform pattern, as the changes redirected the popular attention and weakened social resistance to a lack of political transformation. For Pei (2006, pp.8-9) a lagging behind of the political reforms risks getting trapped in a “partial reform equilibrium”, where partially reformed economic and political institutions support a

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<sup>31</sup> The debate on democratisation of the political scene is persistently present during the conferences of the influential China Reform Forum. It is believed that the Special Administrative Region (SAR) of Hong Kong will serve as a laboratory for the wider introduction of democratic practices in China. Some media, especially the Guangzhou-based Nanfang group, have not been complacent with the authorities for quite some time in respect to economic debates, but also recently, in political themes.

hybrid neo-authoritarian order that caters mostly to the needs of a small ruling elite. This is indeed a valid claim clearly observed on the ground. However, China's political reformulation and the maintaining of an authoritarian system seems to be complacent with the East Asian model and White's *pessimistic view* as to the political necessities for effective developmental advancements, if only the Japanese style soft-authoritarianism is not available, due to historical factors. In fact, the post-socialist separation of powers between the Party and the government, even if to a large extent elusive, but nevertheless empowering certain dualism in decision making mechanism, may be perceived as an obstacle in creating a PSDS. So is the administrative decentralisation.

It is a prevailing opinion that China's mode of transformation is a gradual one, thus positions China among the grand opponents of the Washington Consensus and among proponents of the incremental reform path (see: CIRD 2008). Zheng (1999b, p.1161) states that 'China's political reform can be defined as political incrementalism aimed at continuously adjusting its institutional framework to guarantee economic reforms and political stability on one hand, and [to] accommodate drastic changes resulting from socio-economic development, on the other.' Indeed, gradualism is often named in reference to economic transformation, as China's 'approach to economic reform was experimental and evolutionary' (Nolan 2004b, p.7).

Naturally, it would be a mistake not to consider some of the reforms in the PRC to be radical, as the cases of socially costly widespread redundancies motivated by economic restructuring show or as the economically motivated demolition of the cooperative health care system in rural areas proves. Some drastic restructuring efforts, however, cannot disguise the fact that the overall philosophy of step-by-step reforms, inspired by Chen Yun's<sup>32</sup> phrase "crossing the river by touching the stones" (and partly caused by the indecisiveness of the political elite), is being followed, often with careful evaluation of the reforms' necessity for and influence on the Chinese economy. The "radical" is conceptually positioned against the "gradual", meaning "fast" against "slow". What was often a matter of months in the CEE states upon embarking on the transformation, seems to take years in the PRC; the examples being – price liberalisation, banking system institutionalisation and private property and private means of production

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<sup>32</sup> Chen Yun is considered to have been one of PRC's top Communist leaders and an influential economic and development policy maker.

legalisation. Even if we accept Huang's (2008) arguments, who advocates against the perception of China being gradualist, giving the alleged reversal in economic liberalisation of the rural areas in the 1990s as an example, or even if we acknowledge the ad-hoc reformism of China's elite market by swings in policy, focused on occasions on short-term gains and being reactive rather than anticipatory, as described by Harmin (1990), which creates conditions for rapid radical changes in policies, the paramount idea of gradual approach to the systemic reforms in China does not need to be dismissed, as both, small retrenchments discussed by Breslin (1992) and the apparent gross reversal illustrated by Huang (2008) may be perceived as the very features of the landscape of gradual change, with its accelerations, slow downs, standstills and reversals. There are various important reasons why the Chinese leadership prefers the gradual reform path, namely; the developmental failure of radical paths, a necessity to maintain social stability, and last but not least – the cautiousness to be able to maintain power, by controlling the economy and the development trajectory. This is why economic liberalisation is accompanied by plan-determined compensation activities to create “reform without losers”<sup>33</sup> (Lau *et al.* 2000).

Chinese gradualism is praised by some and criticised by others. Many scholars support the idea of gradual post-socialist transformation (as indicated earlier). However, many see the disadvantages of this model. Young (2000, p.1092) believes that the ‘incremental reform releases segments of the economy from centralised control, while maintaining, for a prolonged period, many of the distortions of the central plan’. As a result, ‘the freed segments of the economy find it profitable to exploit the rent seeking opportunities implicit in the remaining distortions of the economy. Their attempts to capture and then protect these rents leads to the creation of new distortions’ (Young 2000, p.1092), which inhibit the process of creating a market economy. Lardy (1998) claims that the Chinese strategy of gradualism has been far from optimal, as it distorted resources allocation, did not relieve SOEs from social burdens and effectively contributed to the non-performable loans (NPL) crisis, among others, making China's reforms an “unfinished economic revolution”. Again, China risks getting trapped in a “partial reform equilibrium” (Pei 2006).

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<sup>33</sup> See: Shirk (1993) and Lautard (1999).

#### 2.3.4. Economic Reforms

To reiterate, the process of post-socialist transformation in its economic-institutional dimension consists of economic liberalisation and opening up, market institutionalisation and microeconomic restructuring. It is extremely difficult, if not impossible, to make clear divisions among these PST's components. For example, liberalisation of domestic economic activities in initially semi-closed, state-command economies concerns, among others, the liberalisation of ownership of means of production and the introduction of market mechanisms and market institutions. The latter is analysed in reference to the entire process of marketisation. The former is a main element of microeconomic restructuring, namely the ownership rights reform.

As far as economic liberalisation is concerned, the government has introduced a number of policies which gradually allowed an increasingly large pallet of various types of companies to participate in business activities. Those policies were believed to be often reactive and not anticipatory (Harmin 1990), as the authorities would sanction type of firms and forms of economic activities already existing in different parts of the country. Initially, the economic liberalisation was concerned with rural de-collectivisation. In 1984, some controls on establishing private companies were lifted (Bramall 2009a, p.411). Following the 13<sup>th</sup> CCP Congress' acceptance for further deviation from state command, the year 1988 saw legal reform, which established private enterprises as a formal business category (Breslin 2007). After the reforms were stalled in the late 1980s, the internal economic liberalisation picked up after Deng Xiaoping's southern trip (*nanxun*), and effectively accelerated in the mid 1990s, in view of an approaching perspective for China to join WTO. Not only have various forms of ownership and economic activities been sanctioned, but also, Jiang Zemin invited private entrepreneurs to join CCP.

Deng Xiaoping's decision to end the period of Mao's isolationist is believed to be a clear mark of the beginning of China's opening up process. Naturally neither China's re-engagement with the global economy was as abrupt as one may think, nor was the Mao regime isolationist to the extent that many perceived. During the state command period, China was involved in international trade. Its international economic cooperation was often related to projects in other developing countries, however, on a scale unparalleled to that of today. Taking into account China's gradual re-engagement

with the global economy, Breslin (2007) identified four phases of PRC's opening up to the outside world. Phase one (1978-1986) was characterised by the creation of special economic zones for foreign investment. The state's attitude changed from permissive to facilitative during phase two (1986-1992), when, as a result of 22 regulations, the regulatory environment became more beneficial for foreign investors, for example, via lower fees and freer capital transfer. The acceleration of opening up took place during phase three (1992-1999), resulting in the creation of a dualistic economy with the liberalised internationalised export regime and protected domestic trading regime. Investment in export-processing zones became easier, whereas certain industrial sectors, contained in "the Catalogue", were prohibited for foreign investors. Phase four is related to the period of joining the WTO, when effective international pressure to liberalise the economy grew, due to the ongoing access negotiations. It is often claimed that the state leadership became genuinely more inclined to believe that further economic liberalisation would bring more positive developmental effects. However, it seems to be an increasingly common opinion that the economic liberalisation during the Hu-Wen regime (named after president Hu Jintao and premier Wen Jiabao) has lost in its dynamics or even has been put on hold. Some foreign investors believe that in fact the process is in regression (PP 2009, 2010), though this may partly reflect the disappointment with the pace of change previously hoped for.

It is believed that the opening up had an enormous effect on China's developmental dynamics. Rightly so, perhaps many policies could not have been implemented, were it not for the technical and managerial knowledge and the capital from outside. It is important to note, however, that some scholars question the extent of the positive effects of opening up. Bramall (2009a, pp.389-390), for example, argues that the foreign sector contribution to development has been small and technological diffusion and other spillover effects rather weak. From the perspective of the DS model, this selective liberalisation was important in creating a DS-style economic environment for subsequent extensive engagement in international trade.

Market institutionalisation is about 'creating market institutions and legal norms and mechanisms, as well as market organisations, to enable market based allocation of resources' (Kolodko 2001a, p.31). In the DS context, it is a desired process, as the DS institutional environment is characterised by a market economy. Naturally, it is impossible to examine in this thesis the entire process of law changes and

institutionalisation, which concern the rules of engagement in China's domestic economy. It can be noted, however, that some of the most important regulations were passed in the mid 1990s, i.e. the company law, the labour law and the new commercial banking law (OECD 2009a, p.41). Those regulations were followed by bankruptcy law, pension and social regulations, and property rights. For the OECD experts, the new competition regulations – a set of regulations dealing with monopoly behaviour and abuse of position, which laid the regulatory framework for competition in the national economy – are the most important sign of effective marketisation. The core of it constitutes a new antimonopoly law adopted in 2008 (OECD 2009a).

Moreover, it is important to note that post-socialist administrative reforms can be seen as an element of market institutionalisation, despite the fact that they also clearly fall within the microeconomic restructuring category. There have been six rounds of administrative reforms (1982, 1988, 1993, 1998, 2003 and 2008), which Yang (2008) divided into two stages. The first stage (1978-2002) was aimed at fostering the market and removing planned economy by decentralisation; the second phase (from 2002) – to accelerate governance transition by promoting law-based administration. According to Breslin (2007) the 1998 governmental restructuring was 'designed to make a final move from government control over the economy to macroeconomic supervision and regulation' (p.70) and included a reduction in state bureaucracy and alternations to the People's Bank of China (PBC). The 2003 changes put in place further necessary institutions for market development (OECD 2009a, p.154) partly by de-regulating the state-owned enterprises' environment (Yang 2008), and introducing new state bodies to supervise economic activities and the development process (e.g. NDRC, MOFCOM, SASAC). The 2008 reform established five super-ministries and consolidated a number of state agencies to make the supervisory of macroeconomic processes more effective.

An obvious element of marketisation is the establishment of the market-based financial system. In China, the commercialisation of the banking system commenced in the mid 1980s, with the first private banks allowed to operate in 1987 and first foreign banks – in 2006. In 1990, two stock exchanges were established in Shanghai and Shenzhen. Currently, the financial system is supervised by Western-style institutions such as the China Banking Regulatory Commission, China Securities Regulatory Commission and

others, and the allocation of credit is increasingly determined by market conditions.<sup>34</sup> As far as the market-based price determination mechanism is concerned, the dual price system was introduced in the first half of the 1980s, when the enterprises were allowed to sell a proportion of their output outside of plan, from 1984 on using effectively market prices. Moreover, the government was gradually reducing the number of commodities, whose prices were state-controlled. 'By the end of 1988, only 25 percent of commodities were subject to full scale control, leaving around 25 percent subject to floating prices (i.e. prices were allowed to vary within a specified band) and the remaining 50 percent being market determined' (World Bank 1990, p.59 cited in Bramall 2009a, p.351). The OECD study shows that by the mid 2000s '87% of producer prices and 96% of retail prices were determined by market supply and demand, compared to 46% and 69% [respectively] in 1991' (OECD 2009a, p.48). In the opinions of OECD experts, although challenges remain, the marketisation process has been vastly advanced. 'Market and the legal and regulatory framework for business developed are well established. [...] The basic regulatory frameworks and institutions have been put in place for [...] the financial sector. Monetary and fiscal policy instruments are fairly well developed.' (OECD 2009a, p.80).

There is a number of various reforms which are classified as microeconomic restructuring in the process of post-socialist transformation. The scholarly literature on China usually discusses: the ownership reform; separation of various economic and institutional agents in the process of the economic decentralisation of a centrally-planned economy; and restructuring of the socialist industry.

The policy concerning ownership rights of production means is often considered the defining feature of systemic arrangements. In capitalism or in a market economy those means can be owned privately, collectively, or by the state. In socialism or in a state-command economy it is the state or the public who are believed to be the owners. Thus, the process of privatisation is seen as a crucial element of transformation from state-command to market. Moreover, for the purpose of this thesis, this reform is important from the perspective of establishing the economic actors of China's variation of the developmental state. Privatisation is seen as the main element of the post-socialist ownership rights reform. However, it is especially visible in China that privatisation is

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<sup>34</sup> A more detailed analysis of the financial system is conducted in chapter four, as the financial system related policies have been identified among the main DS-style policies.

only one of the processes which is taking place in the sphere of ownership. For example, as described by Guo (2003a, pp.556-557), during the first period of ownership reform (1979-1987), the reformers focused on decentralisation of management and thus on the expansion of managerial autonomy of SOEs; in the second stage (1987-1992) – on separation of ownership and management by introducing a system of “contracted managerial responsibility”; and only in the third period (from 1992) – on transformation to a mixed structure of ownership with the public sector dominant and various types of ownership coexistent. In general, however, the ownership rights have been defined obscurely, despite the perception of them being a vital element of constructing of a market economy.

The ownership reform began in the rural areas. According to Walder (2002) China’s rural economy was “privatised” in three distinctive though overlapping phases, namely; the abandonment of the rural agriculture and the division of land into family plots; the emergence of private household production and marketing of non-agricultural goods and services; and the formal transfer of public enterprise assets accumulated over the reform period into the hands of private owners. Although individual user rights were established through the household responsibility system (HRS), the collective ownership rights remained the prime focus in the 1980s. In fact, Bowles and Dong (1994, pp.73-74) see the initial reform process as enforcing the social nature of ownership, via, for example, the creation of collectively owned township-and-village enterprises (TVEs), who rapidly appropriated a significant share of national output at the expense of state-owned firms. TVEs are often considered to be an outcome of “vaguely defined ownership rights” (Weitzman and Xu 1994) and of limitations in private property rights, and are referred to as ‘(typically industrial) business unit[s] that belong to all residents of a rural community where [they are] usually located’ (Che and Qian 1998, p.2). They have played an extraordinary role in rural development in terms of generating both, growth and employment. They are seen as collectively owned enterprises located in villages (Weitzman and Xu 1994) or community enterprises as opposed to SOEs and European style cooperatives (Che and Qian 1998). Although their nominal owners are local residents who established them, the real control rests in town and village governments (Chang and Wang 1994).

A lack of clearly defined property rights and the ideologically rooted anxiety towards the term “private” did not stop private businesses from being established. During the

initial reform periods, companies usually existed as individual firms (*geti*) rather than private (*siying*). A “red hat” practice, where privately owned companies or hang-on households (*guahu*) were registered as cooperatives with local governments, popular in the Wenzhou model of development (Parris 1993), was a good example. Despite the economic reforms, the restrictions on private means of production were being lifted gradually and the Wenzhou model was a good example of adapting traditional institutions [of central planning and a lack of private property rights] to modern conditions (Liu 1992, p.699) even prior to the reform period, and of engaging privately-owned firms under disguise in activities regulated by market forces.

As a result of Deng Xiaoping’s *nanxun* of 1992, privatisation accelerated. The 15<sup>th</sup> Party Congress (1997) gave it an additional stimulus. Although it is often believed that the Congress, to some extent, only sanctioned the ongoing process (Gallagher 2005, p.46), its provisions were seen by local governments as an encouragement to develop a private business based economy, thus they began a widespread privatisation (Cai 2002). Many of the TVEs and other firms owned by local governments changed their status, mostly as a result of insider privatisation (Li and Rozelle 2003). By the end of the millennium more than 90% of rural enterprises were privatised. In addition to informal privatisation in the rural areas, informal privatisation was conducted via companies’ internationalisation, where the international expansion of PRC’s firms in 1980s and 1990s was often accompanied by the illicit privatisation conducted by the members of *nomenklatura* and their associates who would appropriate assets of state firms using offshore legal environments (Ding 2000a). However, despite the privatisation drive, land has remained in state hands and ‘land ownership rights [cannot be sold]. The transfer of land use rights can [exclusively] be achieved through negotiations’ (Guo 2003a, p.561). This policy’s proponents often argue that privatisation would cause waste of land and human resources; undermine the access of the Chinese agricultural sector to the credit; discourage investment; and inhibit the ability to provide public goods (Bowles and Dong 1994).

The mid 1990s drive to privatisation took place under the slogan *zhuada fangxiao* “keep the larger and let the smaller go” and was meant to address the issue of some SOEs deteriorating performance. Naturally, the government started to privatise SOEs earlier (Yao 2004), however the general policy emphasis was on managerial and organisational changes to improve performance rather than on changes in ownership. Yao (2004)

describes the privatisation policy of the mid 1990s as *gaizhi*, that is “the change of the system”, preferred by the Chinese narration, due to the ideologically-derived long-term reluctance to the term privatisation. ‘*Gaizhi* included contracting and leasing [...], selling to private owners, employee-holding, incorporation, listing on the stock market, restructuring of internal and external governance, and bankruptcy’ (Yao 2004, p.254).

Guo (2003a), however, rightly points out that the government’s intention has never been to rely extensively on the private sector. Even during the Jiang Zemin’s era of rapid privatisation the state intended to tie its industrial policy with SOEs. One form of retaining control, at the same time strengthening the position of companies by increasing their assets, was creating large conglomerates (*qiye jituan*). The preference for large companies was very much a model of some developmental states, as examined in the following chapters. Many well-known Chinese companies operating on the international market are the products of domestic mergers and acquisitions, propelled by the late 1990s policies to create large business entities capable of competing with multinational corporations (MNCs). Despite the ongoing privatisation, the Hu-Wen regime only reinforced the policy of preference for SOEs as the main actors of certain developmental activities, gradually adding new industrial sectors to Guo’s (2003a) list of state “commanding heights” of the national economy. This list, composed of preferential sectors for state owned firms, included infrastructure industries (energy, raw materials, and transportation); pillar industries (mechanical, metallurgical, electrical, chemical, building, machinery, petroleum, natural gas); high tech industries (information, telecommunication, biological technology); financial and banking systems; foreign trade and international economic cooperation; new material technology (Guo 2003a, p.558). In order to make SOEs more competitive, other reform activities focused on commercialisation of companies via management system changes (for example, introduction of management responsibility system), via marketisation of the business environment – introduction of modern accounting, partial replacement of subsidies through bank loan and encouragement to use consulting companies, and via separation of powers – more competences were transferred to firms’ management, via reduction in allocative policy from above and in government coordination (see: Jefferson and Rawski 1999b; Zhang 2000; You 1998).

The separation of economic powers and the decentralisation of the decision-making process, sometimes also categorised as economic liberalisation, have been important

elements of post-socialist microeconomic restructuring in China. One should remember that the PRC under Mao was perhaps one of the least centralised centrally-planned economies. A large, populous and underdeveloped country lacked, to some extent, the necessary capacity and machinery for effective central planning. The systemic reforms saw even an increase in decentralisation and economic power delegation into the lower levels of state administration and into the business entities, as ‘the reformist leadership of China identified the decentralisation of economic decision-making power as a major strategy for reforming the economic system and achieving economic growth’ (Zheng 1999b, p.1166). As a consequence, China’s ‘central control is limited by local autonomy’ (Breslin 2007, p.61). Inevitably the delegation of decision-making powers loosened central government control and allowed the local authorities to strengthen in various spheres such as investment, trade and privatisation. In response, the policy of selective political and economic re-centralisation was implemented by the central government in the 1990s. Premier Zhu Rongji implemented fiscal re-centralisation to consolidate the tax base and to reroute some financial resources to the central authorities. Nevertheless, the idea of decentralisation continued to be influential within China’s leadership. Jiang Zemin claimed that ‘conferring needed powers on local authorities, giving them more flexibility to adapt measures to local conditions, and unleashing their initiative and creativity in developing their local economies are beneficial to strengthening the vitality of the whole economy’ (Jiang 2010, p.460). However, it is also believed to be in opposition to the centralist model of the developmental state.

The transformation of socialist industry is another important feature of the post-socialist microeconomic restructuring. The overall industrial policy, however, is also crucial for the understanding of the DS model. It is therefore discussed in chapter four. It is important to note here that China has been undergoing a dual industrial process during the reform period. The first is associated with the restructuring of the heavy socialist industry and is characteristic for most post-socialist states. The second is related to industrialisation, as China, being considered a developing country, has been under-industrialised compared to CEE and FSU countries.

Some of China’s economic reforms are indeed consistent with the DS-style institutionalisation. The economic liberalisation of the state-command economy, with its selective character to maintain a type of political control by the state, is a prime

example. The controlled loosening of limitations to international trade is a clear sign of a post-socialist economy drifting towards re-engagement with the global economy, a necessary policy from the perspective of the DS model. At the same time, post-socialist market institutionalisation is an indispensable process, if we were to think about constructing a genus of the DS model. However, some microeconomic restructuring can be seen as clearly not complying with classical DS-requirements. A lack of properly defined property rights and the general weakness of the private business sectors, partly caused by some state-sponsored discriminative practices, as examined later in this thesis, create perhaps obstacles in an effective state-business alliance. Moreover, the process of administrative decentralisation weakens the central government's influence, as compared to the centralist historical DS cases.

### **2.3.5. The Chronology**

Let us here present the chronology of China's post-socialist transformation. According to Guo (1999, p.41), post-socialist China went through five transformation phases: economy regulated mainly by planning and supplementally by market (1978-84); commodity economy with a plan (1985-87); socialist commodity economy (1988-89); a combination of planned and market economy (1989-91); socialist market economy (since 1992). According to Ma Kai – the then chairman of the National Development and Reform Commission (NDRC) – the establishment of the socialist market economy was completed in 2005 (People's Daily 2005). Breslin (2004) distinguishes between the stages of reforms and the phases of economic opening up. He divides the reforms into the period of policy formulation (1978-1984), the period of abandoning the old system (1984-1994) and the period of an 'attempt to build a new system of macro economic control based on law and regulation rather than [sustained] through state planning control' (since 1994) (Breslin 2004, p.1). Bramall (2009a) sees the initial eighteen years of reforms as a specific, Dengist type of market socialism, whereas the subsequent years as transition to capitalism. For him, the ideological turn is believed to be Deng Xiaoping's death.

The year 1978 is considered to be the starting point of the transformation. The political decision authored by Deng Xiaoping was reached during the 3<sup>rd</sup> plenum of the 11<sup>th</sup> CCP Central Committee. It was recognised that only reforms and putting an end to the PRC's isolationism would allow China to achieve dynamic socio-economic development, and

consequently in the long run to catch up with the developed states. Economic modernisation, as much as in historical DS cases, became the main state agenda. Deng, the author of the general idea and not unambiguous target of the new policy, entrusted the plan's realisation to Zhao Ziyang, a proponent of the market, who until 1989 as initially the premier and then the CCP's Secretary General was responsible for implementing systemic reforms and development policy. It was Chen Yun, however, who in the first years of the reforms, namely during the readjustment period, was considered to be the most influential in economic policy making (Zhao 2009). Some scholars question, Deng's reformist intentions, suggesting that the Politburo only sanctioned the reforms initiated by farmers and indeed the provincial leadership of the CCP in Sichuan (Zhao Ziyang) and Anhui (Wan Li) provinces, and later adopted a more lenient attitude towards systemic deviations such as the Wenzhou model.<sup>35</sup>

The entire process of reforms was characterised by a conflict of visions within the state leadership. According to Solinger (1982, p.68, cited in Breslin 2007, p.46) five areas of conflict would involve the extent of market regulations, the degree of decentralisation, the pace of growth vs. stability, the position of heavy industry, the extent of promotion of foreign trade. Needless to say, these areas of conflict seemed to have been solved to a large degree in historical developmental states; the extent of market regulations would allow guided interventionism, the state would remain centralist, the pace of growth would be paramount though neo-authoritarianism would secure stability, heavy industry would belong to the targeted sector and trade would extensively be promoted by various means.

China's post-socialist transformation commenced in rural areas, where the partial introduction of market mechanisms allowed for the creation of a commodity market for agricultural products; and where the ownership reforms transformed the commune-based production into individual-based production. Moreover, 'a host of restrictions were lifted on non-agricultural activities' (Wong 1988, p.3). These reforms 'drastically altered the organisation of production and the distribution of output in the countryside' (Perry and Wong 1985, p.10). By 1983 de-collectivisation was almost complete and by 1984 the commune system abolished. It prompted a dynamic development of the rural economy (Wong 1988). The reforms gained support from the majority of peasants, as

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<sup>35</sup> Huang (2008) presents an important account of pre-reform economic activities of the "informal sector" as illustrative examples of bottom-up changes.

did the agrarian reforms in the developmental states of Japan, Korea and Taiwan, implemented for the political benefit of the state elites, as discussed in chapter four.

The period between 1978 and 1982 is often referred to as the “readjustment” (Solinger 1982). It was characterised by market reforms in rural areas, as well as by slow opening up of the economy to the outside world (establishment of SEZs) and by shifting the priorities in industrial production. By diverting the investment from heavy to light industries, the government hoped for the acceleration of socio-economic development (Zhao 2009). It was aimed at putting the national economy on the track of steady development by correcting the economic imbalances. Chen Yun argued that “three balances” related to budget, bank loans and demand-supply, had to be achieved if the economy was to be run well (Bachman 1986, p.298).

In 1984 the reforms were more directly extended to the urban areas and were intended to expand the productive forces. They involved the continuation of the ownership rights liberalisation and price marketisation, as well as further opening up by establishing new special zones (open coastal cities, open zones – including two river deltas, two provinces, two peninsulas, open cities on Yangtze river and open border cities) and by allowing foreign companies to establish their presence. Economic liberalisation and opening up was reinforced by Zhao Ziyang’s strategy to develop coastal provinces, as the most suitable for international trade and foreign investment due to their location and a higher overall level of development. Reforms continued to be implemented until 1989, however, their opponents consolidated in the mid 1980s (the so-called Anti-Bourgeois Liberalisation Campaign started in 1987), reaching momentum during the Tiananmen Square events (1989). As a consequence, the market reforms were brought to an interim standstill and some advocates of far reaching economic liberalisation were removed from power. The “Tiananmen interlude” (Naughton 2007), serving as an interim period for the consequent state ideology reformulation, lasted until the *nanxun*.

The reforms proceeded after the Deng Xiaoping propaganda trip around the country’s southern provinces, where, as an icon of the Chinese political scene, he continued to lobby in favour of further systemic changes. He emphasised that the Chinese people ‘should be bolder than before in conducting reform and opening up to the outside and have the courage to experiment’ (Deng 1994, p.360). Deng’s insistence on reform acceleration effected the most significant state policy reformulation during China’s

PST. Ideologically, 'rather than viewing the national interest as being served by protecting key sectors from the market, the national interest was now viewed as being best served by forcing market competition and creating a more efficient market economy' (Breslin 2007, p.52). In 1995, Jiang Zemin declared: 'To invigorate the economy, we need to further loosen control over all economic activities that should be regulated by market forces' (Jiang 2010, p.456). Consequently, socialist modernisation ideals present in the reforms course of the 1980s were mostly lost during the uncontrolled drive towards the market in the 1990s (Lin 2006) and China turned away from the possible path of market socialism towards capitalist development (Bramall 2009a). Thus, "embedded socialist compromise" where market reforms were accompanied by the political task of protecting those who might suffer (Breslin 2007, p.45), was compromised and abandoned. Indeed, the second half of the 1990s marked the increasingly intensive PRC authorities' compliance with the market capitalist doctrine, where at its culmination, China joined WTO (December 2001).

The taking over of power by the so-called Hu-Wen regime in 2002, however, is believed to mark a point at which another ideological reformulation commenced. Hu's scientific concept of development (examined later), for example, was aimed at addressing the negative side effects of the alleged Jiang Zemin's drive towards capitalism (see: Fewsmith 2008b). The subsequent 17<sup>th</sup> CCP National Congress (2007) reinstated social priorities of the systemic transformation, in view of the increasing inequalities and marginalisation of parts of society, often resulting in social unrests. As the priorities can mostly be achieved through strengthening the abilities of the indigenous population for socio-economic development, by some sort of preferential treatment, the Western-centred perspective is that by doing this, the state administration drifts away from the systemic arrangements implemented due to China's accession to WTO, which is perceived as a sign of desisting market-orientated reforms. Indeed, in policy terms, during the Hu-Wen period, the external economic liberalisation has been put on hold or even reversed in some aspects such as industrial sectors accessibility, as discussed in chapter four, whereas internal economic liberalisation seemed to continue at a slower pace, as seen in the regulatory reforms of domestic economic environment (OECD 2009a, 2010). This attempt to return to more explicit state interventionism could be perceived as resorting to the means preferred by some historical developmental states. In social terms this change has apparently had positive results, as claimed by

Fock and Wong (2008), as more resources have been channelled to rural areas education and health care services, and as certain unofficial tax practices have been curbed.

### **2.3.6. The Chinese Perspective**

How are *gaige kaifang* perceived in China and by the Chinese policy makers? We have mentioned some terms, which were coined during the reform process to explain and/or justify certain policies. We have briefly discussed some perceptions prevailing among the Chinese academics and the political elite. As China is abandoning socialism and aggressively deviating from Marxism (Morgan 2004), the ideology-based explanations on the part of the Communist Party often seem to require more and more terminological equilibristics. From the economic perspective, this is partly concentrated on the justification of the nominal communist organisation to preside over a process of an effective drifting away from socialism.

As far as political reformulation is concerned, Chinese authoritarianism is sometimes referred to by the Chinese as collective democracy or Chinese democracy. The concept of collective democracy has been based on a negation of Western-style democracy. Neo-Marxists – a strong group among PRC scholars – believe that Western democracy is ‘a mechanism of competition which allows the *bourgeoisie* to abuse the working class’ (Shih 1999: 24). Thus, Western democracy is nothing more than a dictatorship of the *bourgeoisie*. Stressing individual rights – visible especially in the American system – is a result of the middle class being actively involved in the forming of capitalism, the middle class being orientated towards protecting its own interests. In China, the government was considered to be, to a large extent, the driving force behind the systemic transition and it was the state which had been building a system based on a collective ownership. As a consequence, collective democracy corresponds to the economic system. The social structures in China have a collective character, which lays the foundation for a „collective culture”, whereas in the West, this culture is individualistic. According to some analysts associated with the CCP, there is no contradiction between pluralism and collectivism, and the ecstatic acceptance of democracy by CEE countries and the use of all its privileges was a collective act, because even in a Western-style democracy, any decision must be supported by a group. As a result, there is no functional difference between both system variants (Shih 1999). The Chinese authorities represent an opinion that a non-democratic system (in the

Western sense of the word) does not necessarily have to be worse than Western democracy and they sometimes try to argue that when it comes to conducting stringent economic reforms it is better. Another argument is that even if one recognises that the final product of political reforms should be Western-style democracy, it has still not been proved that the political transition must be a linear process.

As far as economic reforms are concerned, there is plethora of domestic analyses, which explain China's development trajectory. The three mainstream theories include: Deng Xiaoping's theory of socialism with Chinese characteristics, Jiang Zemin's – on three represents and Hu Jintao's – on scientific concept of development (Rong 2009; Hu 2011). These are all perceived as the continuation of the Mao Zedong thought on Marxism-Leninism (Hu 2011). In the domestic ideological debate, the systemic changes are usually referenced against Marxism. It is important to stress again, that the reforms process, in the official propaganda, has never been about abandoning socialism. On the contrary, it has been about various paths and methods to build a socialist society and a socialist state, leading eventually to communism. Neither was there any official contemplation of releasing the CCP from the burden of being the primary and, in practice, the only political power centre. Deng (1994, p.248) claimed that 'without the Communist Party there would be chaos, or at least instability'. The Deputy Director of the Economics Institute of the Chinese Academy of Social Sciences (CASS), Liu Shucheng distinguished four periods of ideological formulation of the reforms: socialist modernisation and economic development (1978-1984), restructuring of the economic system via change in the relationship between plan and market (1984-1992), establishment of the socialist market economy (1992-2002), completing of the establishing of socialist market economy regime (since 2002).<sup>36</sup>

In 1978, the economic modernisation and economic opening up to the outside world became the CCP's policy objective. In 1980 and 1981, Mao Zedong's "left tendencies" were criticised, nevertheless, the Party reaffirmed its dedication towards Marxist ideological, political and organisational foundations (Ding 2010) and its adherence to four cardinal principles (1979). Deng brought back Zhou Enlai's idea of four modernisations of agriculture, industry, national defence and science/technology. In 1982, he declared the necessity to build "socialism with Chinese characteristics" (Rong

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<sup>36</sup> A presentation during the "International Seminar on 30<sup>th</sup> Anniversary of China's Reforms and Opening Up", Beijing, CASS, December 2008.

2009), which would become his paramount theory. It is important to mention that for Deng there was no contradiction between market and socialism, as the former, together with planning, were means and the latter an institutional arrangement. Later on, in 1992, as a result of *nanxun*, he would reiterate that ‘a planned economy is not equivalent to socialism, because there is planning under capitalism too; a market economy is not capitalism, because there are markets under socialism too. Planning and market forces are both means of controlling economic activity. The essence of socialism is liberation and development of the productive forces, elimination of exploitation and polarisation, and the ultimate achievement of prosperity for all’ (Deng 1994, p.361). Nevertheless, in the early 1980s, planning was assigned a major role, whereas market became the supplementary force. Chen Yun in his theory of a “bird in a cage” explained that the cage (the plan) should not be too tight, as it would suffocate the bird (the market), but a lack of a cage would allow the bird to fly away (Bachman 1986, p.298). In 1984, the socialist economy was identified as a “commodity economy” to prevent, as claimed by Zhao Ziyang (2009), an ideological conflict with the opponents of the market. On the ideological front, a CCP’s Central Committee Resolution on Reform of the Economic System addressed political economy combining Marxist basic principles with China’s socialist practices (Ding 2010).

In 1987, Zhao Ziyang used the term “primary/initial stage of socialism”. Incorporated into the theoretical foundation of the 13<sup>th</sup> CCP Congress, it served as an ideological justification for more reforms deviating from Marxist theory. As China was at the initial stage of socialism (and it would take around 100 years to complete, as counted from the moment of the establishing of the PRC) it could use a variety of means, thus those market related too, to advance the development of socialism. It was similar to what Dirlik (2005) called post-socialism – a departure from socialist path in order to achieve it in the long term. Jiang Zemin claimed that ‘because China is in the primary stage of socialism, it must allow economic entities under diverse ownership forms to develop side by side’ (Jiang 2010, p.598). After the *nanxun*, during the 14<sup>th</sup> Party Congress, the term “socialist market economy” was officially recognised as the socio-economic system of China. The 15<sup>th</sup> CCP Congress called the theory of constructing socialism with Chinese characteristics the Deng Xiaoping theory, and inscribed it into the Party’s constitution as its guiding ideology. It stated that the CCP took Marxism-Leninism, Mao Zedong thought and Deng Xiaoping theory as the guidelines for its actions (Ding 2010).

The biggest ideological contribution of Deng Xiaoping's successor, Jiang Zemin was to include into the Party constitution the three represents (*sange daibiao*) during the 16<sup>th</sup> Party Congress in 2002. As a result, the CCP now formally represents not just the Chinese proletariat, but also China's advanced productive forces, China's advanced culture, and 'the fundamental interests of the overwhelming majority of the Chinese people' (Breslin 2007, p.71). This moment could be perceived as implicitly marking an official ideological transformation from communism to nationalism as the state ideology. Despite Jiang's insistence on adherence to four cardinal principles, three represents (announced already in 2000) intensified the scholarly debate on the reform path China may take in the future (Jia 2004). Three represents illustrate the evolution of the Party's position prompted by changes of economic, social and political conditions, and a more vocal assertion of its role as the state party. Jiang attempted to balance the politically-liberal, or at least Marxist-remote, three represents not only with the more dynamic assertion of power by the CCP and curbing political activity, but also by bringing back Deng Xiaoping's concept of a *xiaokang* society (initially mentioned in 1979) or a moderately well off society, where all the Chinese citizens will achieve a relatively "comfortable" standard of living. Later on, in its policy objective of refocusing on social development rather than economic growth, the Hu-Wen regime would emphasise the *xiaokang* society concept.

Gradually, the rhetoric of the new Hu-Wen administration would gear towards its own new concepts. In further interpreting Marxism's applicability to Chinese circumstances, president Hu Jintao introduced a scientific concept of development or a scientific outlook on development (*kexue fazhan guan*) supported by the idea of "harmonious society" (*hexie shehui*) (Fewsmith 2008a). Premier Wen Jiabao added "five balances" – balancing urban and rural development, development among regions, economic and social development, man and nature, domestic development and opening up to the outside world (Wen 2004 cited in: Fock and Wong 2008, p.2). Announced by Hu in 2003 and incorporated into the Party constitution during the 17<sup>th</sup> CCP Congress in 2007, the scientific concept of development is supposed to provide 'an elementary answer to the significant theoretical and practical problems of "realising what kind of development and how to develop"' (Ding 2010). It calls upon the scientific reasoning in defining the development trajectory, thus, in practice, leaves a gateway for deviating from economic ideologies. It claims to "put people first" and "take people interests",

thus focusing more on human development in various well-being related dimensions, rather than on pure economic indicators, who often seem to disguise the real developmental picture. Consequently, in theory, it emphasises the quality of growth over its dynamics (Chen 2011). According to some Chinese scholars, the concept directly relates to sustainable and balanced development with an energy-saving and environment-friendly society and aims at creating an innovation-oriented country (see: China Daily 2007c). It is a response to the challenges China faces not only in the process of climbing the ladder of development, but also as a result of its growth model so far. In 2007, Hu Jintao declared that Deng Xiaoping theory's, three represents and the scientific concept of development constituted the sinicisation of Marxism.

Sustainable and balanced development based on scientific principles shall result in the creating of a socialist harmonious society, as discussed during the sixth plenary session of the 16<sup>th</sup> CCP Congress in 2006 and during the 17<sup>th</sup> CCP Congress. A harmonious society is a vision of a modern, educated and affluent society guided by principles of 'honest, friendly and harmonious relationships and just, fair and open competition between social members' (People's Daily 2007), functioning in an institutional environment of rule of law and developed legal system and institutions. From an economic perspective, in the harmonious society 'competition will optimise the distribution of resources, foster technological progress, develop social productivity and raise overall national [economic] strength. [...] Labour, knowledge, technology and capital [will be] all factors of wealth creation, which can make profits and should be respected so long as they [make] contributions to society.' (People's Daily 2007).

Although the majority of Chinese citizens have benefited from the reforms and there seems to be an overwhelming support for the changes, more and more Chinese see the CCP as a remote structure which despite controlling the country is not a factor in everyday life. The ideological justification for the CCP to run the country is seen indifferently and as a natural strategy to hold on to power. As long as the state policy brings economic benefits, most justifications would, in the mid term, be usually socially accepted. This is not to say that the government does not get its share of criticism of its social and economic policies, as the social spaces for societal interaction are opening up (Howell 1998), especially via internet, where anonymity is easier to maintain. Even some open sources and scholars would criticise the direction of China's policies, usually

in reference to inadequate social effects or sometimes in respect to inadequate marketisation (see: Yu 1999, 2006).<sup>37</sup>

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Having analysed the DS contemporary applicability and the process of post-socialist transformation in China, we now turn towards a comparative analysis of institutional features and the policy solutions of the PRC and the historical developmental states.

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<sup>37</sup> See footnote thirty one.

### **Chapter 3: China's Development Trajectory and the Developmental State Model: Ideology, Political and Economic Arrangements**

In chapter one I conclude that the concept of the developmental state, despite its alleged shortcomings, may still be considered a useful tool in addressing inadequate developmental dynamics in some poor countries. The concept itself will still be applicable as long as the globalisation process requires significant corrections in order to achieve more equitable development and as long as disguised interventionist forces shape the global economy. Moreover, when the neo-liberal economic ideology has been discredited, the guiding role of the state in development as embedded in the concept of the developmental state resurfaces as indeed an interesting option. Having analysed the process of post-socialist transformation in China in chapter two one needs to address the question as to the similarities and differences between China's development trajectory and the historical DS cases.

The analysis needs to be conducted in two sets of dimensions, the policy dimension addressed in chapter four, as the policies do shape the developmental states and impact directly the DS results, and the ideological background together with political and economic arrangements, discussed in this chapter, as drawn predominantly from specific DS features presented in the scholarly literature.

The differences among countries considered in scholarly literature to be types of developmental states are as vast as among developing countries, as well as among post-socialist states, as far as economic capacity, geo-political locality and social structure are concerned. In order to comparatively analyse the Chinese case, one needs to refer to the countries whose economic, geo-political and cultural proximity are the closest. Needless to say, these constitute the 'consensus candidates' (Stubbs 2009) or the "Asian Three" (Weiss 2000), namely, Japan, Korea and Taiwan. In order to focus on the largest DS economies, as China itself is a large economy, I will focus my comparative analysis mostly on Japan and Korea. Naturally, there are significant differences between China, Japan and Korea. The relatively close geo-political locality, a history of interactions resulting in a comparable culturally determined social structure and membership of the group of large economies creates, however, a more suitable platform for a mutual comparative analysis.

### 3.1. Economic Nationalism in China

It is believed that a developmental state can be introduced in the social conditions of a nationalist state. Indeed, Johnson (1982) and others suggest a direct link between nationalism and the DS model. He points out that in the Japanese and Korean cases, the creation of the DS model was seen ‘as the means to combat Western imperialism and ensure national survival’ (cited in Woo-Cumings 1999, p.6). Stubbs (2009) argues that this nationalism was related to the tense political situation in the region and the constant threat of war. Rowen (1998) emphasises that a particular type of nationalism was among Kuznets’ three main requisites for successful development and that it is ‘found in greater abundance in East Asia than in other developing regions’ (p.9). The sociological analysis of a nationalist state in East Asia is beyond the scope of this dissertation and may as well constitute a separate thesis. In fact, it may be difficult to compare the Chinese and Korean post-colonial nationalism with the imperialist nationalism of Japan, with both nationalisms having their roots in the historical path of all three countries. In the case of Japan, this nationalism can perhaps be divided into the period until the end of world war two (aggressive) and the period afterwards (benevolent and of economic character) (Nish 2000). In all cases, from the perspective of their impact on the social environment of the developmental state, these nationalisms seem to translate into a collective consciousness, not merely in the form of personal identity, but also in the broad acceptance of the fact that development trajectory concerns everybody and that the collective effort must take place in order to realise it. China, Japan and Korea are well known for their collectiveness as an element of societal interaction. It is believed that in the case of China the collectivist philosophy serves as the basis for the justification for the political regime and the nature of the economic changes (see: Shih 1999).

Nationalist attitudes, in a distractive and aggressive form, such as hostility towards cultural diversity, have been present in most post-socialist countries, including the two largest economies of the CEEFSU group, namely Russia and Poland. The root causes of this phenomenon are not easy to establish. A limited interaction with the outside world as a result of the “Communist era”, as well as historical *pathos* of certain ill-defined and mis-perceived superiority, may play a role. Although one can talk about Russian nationalism during the Soviet era (see: Brudny 2000; Carter 1990; Hosking 2006), its more aggressive, heavily xenophobic form emerged during the transformation period.

Naturally, there are tremendous differences in the form of nationalism between Poland and Russia due to their various historical experiences. In both cases as it seems, societal mobilisation behind the overall objectives has, however, always been limited to some political events threatening the existence of the nation. It is probably due to the promotion of individualism, as an element of culturally motivated behaviour, unlike in East Asian countries, where collectivism in many different forms, plays an important role.

Does a developmental state require a nationalist society, as is broadly believed? If indeed this is the case, then this very nationalism ‘based on the claim of a community of feeling grounded in the past which overrides particularist attitudes and ideologies’ (Kuznets 1966, p.13 cited in Rowen 1998, p.9), must translate into societal mobilisation behind state-level developmental targets. Japan and Korea seem to have managed to achieve an adequate level of societal mobilisation, which, however, should not be seen as a display of unconditional compliance with the actions of governments. In the case of Korea this process was directly related to the coercive authoritarianism of Park Chung Hee, which was based on the experiences from the abusive Japanese colonial regime. As far as Japan is concerned, it is associated with the effective policy of industrialisation initiated by the Meiji administration, during which economic development became a means to nationalist purposes (Raphael and Rohlen 1998). In the case of China, the societal acceptance of systemic transformation seems to derive from actual development trajectory and developmental results. The initial societal support for economic changes is, however, believed to be attributed to several features, namely, a lack of adequate developmental achievements prior to the reform period, a coercive communist regime, but also, as some would claim, a certain nationalistic perception by the Chinese society of its superiority. The rapid development and growing importance of China seems to keep the society in conviction of this superiority and to enforce nationalism.

Chinese nationalism is a topic well researched (see: Fewsmith 1995; 2008a; Hughes 2006; Unger *et al.* 1996; Wei and Liu 2001; Gries 2004; Friedman 1995; He and Guo 2000; Zhao 2004; Zheng 1999a; Liew and Wang 2004). ‘Nationalism is hardly a new force in China; indeed it is a leitmotif underlying twentieth-century Chinese politics’ (Fewsmith 2008a, p.103). The notion of “saving the Chinese nation” had been present at least since the defeat in the first Opium War (Yang and Lim 2010). The post-imperial

nationalism rose during the May Fourth Movement (Wu 2008), as ‘after the fall of culturalism in the late nineteenth century [and the period considered to be one of national humiliation], the Chinese political elite deemed necessary to promote nationalism as a new force for unity’ (Zhao 2000, p.28). Townsend (1992, p.98) reminds us that this is the common perception, which he does not necessarily agree with, that a “rise of nationalism” distinguishes modern China from its imperial past. Undoubtedly, the Japanese invasion of China in 1937 contributed further to nationalism becoming an important state ideology (Wei and Liu 2001). Indeed, the modern history of China has had elements of nationalism, also during the state command period. In the analysis of China’s socialism Lin (2006) underlines that Chinese socialism was nationalist in nature. It was considered to be a means in overcoming poverty and backwardness. The cosmopolitan idea of creating a unified socialist world of equal citizens regardless of their initial state affiliation was always a secondary issue. This nationalism, deeply rooted in the tradition traced back to long before the socialist era, enforced during the republican times and strengthened during the cold war rivalries,<sup>38</sup> has been preserved in the Chinese society and is present while new developmental directions of the nation are being designed.

In his study, Hughes (2006) presents the changing landscape of Chinese nationalism during the reform period, illustrating its main linkages, namely, to the economic policy, to the foreign policy and to the security issues. He discusses Deng Xiaoping’s employing the concept of patriotism ‘to establish a linkage between certain areas of policy making’ (Hughes 2006, p.87), in order to frame subsequent strategy formulations. He underlines that the emergence of nationalism during the reform period signifies a creation of a more important ideological policy instrument than before, while China is becoming internationally more affluent. Nationalism is used to legitimise CCP’s claim to power, its reforms track and chosen development path (Hughes 2006; Breslin 2007). Therefore, as Shirk (2007, p.11) pointed out, ‘the Communist Party embraced nationalism as its new ideology in an age when almost nobody believes in communism anymore’, to the extent, however, that the state leadership became fearful that the unfolding ideology may enable society to escape the close state-sponsored surveillance (see also: Fewsmith 1995; Breslin 2007).

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<sup>38</sup> When China had to deal with the US-led blockade and Soviet Union’s expansion of influence.

Hughes' (2006) study examines nationalism's external conditionality which is globalisation and external security, as well as internal factors which is internal security and a continuous ideological struggle within the state apparatus as to the directions of reforms. This internal struggle (see: Fewsmith 2008a; Shirk 2007) is an important feature of China's transformation and its pronounced character distinguishes it from historical developmental states. Unsurprisingly, in the allegedly capitalist country with the allegedly communist regime, this results in multi-layered, though often implicit, ideological debate. Consequently, nationalism, surfaces as at least a partial remedy to the ideological chaos featuring China's transformation and development. The internal ideological debate, with its extensive ambiguities, would distinguish the contemporary nationalists or a "New Left" (Hughes 2006, p.75) (those who advocate strengthening of the state role) from liberals. Hughes (2006, p.70) acknowledges that the picture is more complex and it includes 'various schools of thought, such as the "Right" and the "Left", and more recently "neo-authoritarianism", "liberalism" and the "New Left"'. Fewsmith (2008a, p.xvii) positions the New Left as comprising the new nationalists, post-modernists and neostatists.

Chinese nationalism is often analysed in reference to the three policy areas mentioned above; economic policy, foreign policy and security policy. All of the types seem to fall within the general DS nationalist agenda and its purpose – to mobilise the nation to a collective endeavour. For example, Deng's rhetoric of "national unification policy" (Hughes 2006), continued by Jiang's appeals to national unity (see: Jiang 2010), is nothing less than an attempt at societal mobilisation behind state policies. Internal and external security issues have often been used for steering nationalism and for mobilising the nation against alleged threats. The external enemies posing threat to the territorial integrity would usually comprise of the US and Japan (Gries 2004, Gries *et al.* 2011; Li 2001; Yu 1996), but also of the Taiwanese government, as well as those who question, for example, the One-China policy. Nationalistic displays related to security issues have been common and ranged from dubious naval activities around the Spratly and Diaoyu islands to "spontaneous" protests at Ritan Lu – the location of the Japanese embassy in Beijing.<sup>39</sup> The nationalistic rhetoric was especially visible around important dates of China's recent history. Events, such as disturbances in the Olympic torch relay in the European states prior to the 2008 Beijing Olympic Games and support for the Dalai Lama during his visits to third countries, were often portrayed as a plot by the outside

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<sup>39</sup> In the years 2007-2011 I witnessed at least 21 such protests.

world against China and the Chinese people. The 60<sup>th</sup> anniversary of the establishment of the PRC was featured with to date the most grandiose display of military power. To describe this type of nationalism, Zhao (2000) used Shambaugh's phrase "defensive nationalism", assertive in form, reactive in essence, but not particularly aggressive. Indeed, foreign policy has always been subject to "assertive nationalism" when China's economic interests or territorial possessions were questioned (Whiting 1995).

It is often believed that in the early 1990s Chinese nationalism radicalised, as it aimed at '[defending] the Chinese model of development, [endorsing] political authoritarianism, and [seeking] sources of legitimacy and identity in traditional Chinese culture' (Wu 2008, p.467). An element of it was the emergence of cultural nationalism, as a negation of Western values as remedies to China's and the world's problems' (Fewsmith 2008a, p.121). However, the main feature of what Gries (2004) called a "new nationalism" was its pragmatism – pragmatic in nature advancements of national interests domestically and internationally, with a specific self-contentedness or pride of the reforms' successes, described by Whiting (1995) as affirmative nationalism. It is an increasingly common perception that China's nationalism became indeed a pragmatic nationalism (Zhao 2000; Hughes 2006), especially in the way it navigates China's foreign trade policy, as presented in the following chapter, and it justifies economic activities within the borders of the People's Republic. Fewsmith (2008a) underlines, however, that at the same time there was a rise in what he calls a "popular nationalism" – a mixture of populism and nationalism, whose supporters would, nevertheless, criticise the government for insufficient defence of Chinese interests and, in economic terms, compliance with the wishes of international corporations. Fewsmith (2008a) also points out that since the 1990s more attention has been paid towards the issue of nationalism being the ideological background for the mode of China's socio-economic development.

Indeed, as far as economic nationalism is concerned, especially in the last two decades, but also throughout the modern era, it has been an important part of Chinese nationalism, as was the Japanese and the Korean nationalism during their DS core activity period, and, at the beginning of the twenty-first century, China became the prime example of a state, whose economic nationalism contributed to extensive developmental achievements. China's economic nationalism is the result of its "East Asian heritage" rather than "post-socialist heritage", as for many post-socialist states this concept remained estranged, when they embraced neo-liberal economic doctrine.

Pei (1998) claims that in the East Asian conditionality, political nationalism would need to be replaced by economic nationalism to maintain political legitimacy of authoritarian regimes. In the case of Japan, ‘a transformed version of Meiji economic nationalism [was] evident throughout society in the post-war years, and leaders defended and reinforced it’ (Raphael and Rohlen 1998, p.291). This economic nationalism is not exclusively related to the mobilisation of the nation, but is exemplified in the economic policy of the subordination of all economic activities to the overall developmental strategy and clear preference for domestic economic agents in the realisation of developmental endeavours. Its essence can be defined as ‘[pursuing] national economic interests through shielding the national economy against outside influences and [implementing] aggressive and discriminatory policies against foreigners’ (Cai 2009, p.11). In the case of China, this has been especially visible in the categorisation of industrial sectors according to the access regulations for foreign entities, commonly referred to as the Catalogue (Breslin 2006) and examined later in this chapter.

In the 1980s, economic nationalism was realised partly by the gradual process of economic liberalisation, where the incremental and closely monitored opening up would, on the one hand, give time for domestic economic agents to consolidate and strengthen their position, on the other, would not allow foreign agents to immediately penetrate the domestic market. In the 1990s, despite the increase in political nationalism, economic nationalism had to be relegated to being a secondary state doctrine, as far as its instruments are concerned, at least in the interim period, in view of the imperative to comply with the wishes of the international power centres, when China was at the final stages of negotiating its accession to WTO. However, Hughes (2006) points out that ‘by the end of the 1990s, the particular form of Chinese techno-nationalism had become quite explicit in Jiang Zemin’s elevation of scientific and technological personnel to the status of a revolutionary vanguard leading the nation to wealth and power under his ideology of the “three represents”’ (Hughes 2006, p.26). Moreover, economic nationalism motivated at that time the consolidation of the state-owned business sector.

The change in the leadership in 2002 is broadly believed to signal a reorientation of the overall policy. The Hu-Wen regime is often perceived as the one which reinstalled the principles of China’s economic nationalism through increased state interventionism and reversal of economic liberalisation. Although economic nationalism and economic

liberalisation do not need to contradict each other, taking into consideration the current degree of interconnectedness of national economies and their mutual interdependence, China's authorities most likely consider this reversal as the means to advance economic nationalism, as Scissors (2009) points out, necessary, in their opinion, for the realisation of developmental targets.

As a result, the American administration chose to publicise "the evils" of China's economic nationalism, namely, 'mercantilist tactics, including: the aggressive [and, as it is presumed, unjustified] use of antidumping and safeguard measures, manipulation of its exchange rate, provision of subsidies to SOEs, condoning violation of intellectual property rights, explicit and implicit demands of technology transfer in exchange for market access, blocking foreign industry from government procurement, adaptation of unique technical standards, and discriminatory implementation of health and safety standards' (Kennedy 2008). However, the mounting criticism of China's economic nationalism is predominantly brought about by the fact that PRC is increasingly considered to be a threat to the traditional hegemonies of the global economy, as exemplified by the growing international importance of large Chinese enterprises. This criticism is only partly related to actual practices within the state economic policy.

China's economic nationalism as much as the Korean and Japanese DS-related nationalisms is characterised by maintaining an environment of absolute dominance of domestic economic agents where foreign agents play merely additional supporting roles. The features of contemporary China's economic nationalism can be observed from various perspectives: as laws and regulations including ad hoc quasi-regulatory actions, as policies, and as a sectoral approach. As a result of WTO accession, the Chinese government was obliged to eliminate certain trade/market access barriers. This, however, did not change the state's overall conviction of a necessity to protect the internal market while advocating liberalisation worldwide. Consequently, other, non-WTO related, often implicit, constraints have since been applied to favour domestic economic agents by either blocking or deterring foreign competitors.

From the perspective of "the laws and regulations", procurement practices and recently enacted laws concerning socio-economic affairs seem to be the most vivid examples of China's economic nationalism. The public procurement practices involve prohibition of wholly foreign-owned companies and joint ventures registered in China from bidding in

certain sectors such as the energy sector, which is increasingly reserved for products and goods made by Chinese domestic companies. Even when the wholly foreign-owned companies and joint ventures are accepted for a bid, they do not seem to have a chance of winning the tender, usually due to “technical reasons”. As a result, since 2005 not a single bid has been won by a foreign company in tenders related to wind energy, despite the fact that European companies possess far greater technological expertise than Chinese firms and the quality of products often seem to guarantee lower overall costs in the long term. Authors of the *2009 Position Paper (PP)*, a yearly publication by the EU Chamber of Commerce in China concerned with the market barriers, admit that current regulations openly favour wholly Chinese-owned companies not only in the energy sector, but in a number of economic sectors (PP 2009, p.112). For example, in the environmental protection sector, all the Clean Development Mechanism (CDM) projects, introduced worldwide as a global tool in combating climate change,<sup>40</sup> are awarded exclusively to Chinese domestic companies, despite the fact that they are financed by foreign entities. In this case, economic nationalism takes priority over environmental considerations. By opening the sector to foreign companies, the number of CDM projects would increase in the country, which is considered to be one of the biggest emitters of greenhouse gases in the world. In the financial sector, foreign banks as well as domestically incorporated foreign banks are usually forbidden or deterred from participating in lucrative governmental bids for pilot projects concerning new financial services. Similar and indeed more open discrimination takes place on the provincial and local level, where foreign and joint venture firms are deterred or barred from participation in tenders because of the “local content” condition and obligatory transfer of technology.

Moreover, there is a legitimate fear that the new antimonopoly law (introduced in August 2008) and the new labour law (introduced in January 2008) are used to discriminate foreign economic agents. Anecdotic evidence suggests that it is indeed the case. Although Chinese SOEs are mostly exempt from the investigations regardless of whether the new labour law is enforced, many foreign companies are subject to notorious interrogations in this respect.<sup>41</sup> Calling on the new anti-monopoly law, the

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<sup>40</sup> The Clean Development Mechanism (CDM) is an arrangement under the Kyoto Protocol allowing industrialised countries with a greenhouse gas reduction commitment (called Annex 1 countries) to invest in projects that reduce emissions in developing countries, as an alternative to more expensive emissions reductions in their own countries.

<sup>41</sup> Personal communication with representatives of the European Union Chamber of Commerce in China, Beijing, July and August 2009.

Ministry of Commerce (MOFCOM) prevented the Coca-Cola Company from acquiring China's biggest juices producer – Huiyuan, without, as it seems, providing sufficient reasoning for the decision. The interpretations and implementation guidelines of the new antimonopoly law lack adequate clarity, as several agencies are equally engaged in their creation, i.e. NDRC, MOFCOM, SAIC (State Administration for Industry and Commerce) and the Anti-Monopoly Commission. This allows for arbitrary usage of the new law, based on political motives generated by economic nationalism.

China's economic nationalism can sometimes be seen through ad hoc governmental decisions and the behaviour of its authorities. In June 2009, the circular of NDRC and other eight ministers was distributed among various levels of decision-making authorities, which contained a "strong advice" to purchase Chinese products while spending the 4 trillion RMB stimulus aimed at reviving the economy during the global financial crisis. It suggested 'priority must be given to domestic products for all government-invested projects' (PP 2009, p.111), and warned against engaging 'in any discrimination against domestic products' (NDRC 2009).

The Chinese government adopted a very much sectoral approach in its strategy of favouring domestic economic agents, in which certain branches of the national economy are considered to have strategic importance. This results in prohibition of the penetration by foreign economic agents, or in significantly limiting their scope of possible activities. 'From 1995, this differential approach to foreign investment was formalised in "The Catalogue Guiding Investment in Industry", which, on an industry-by-industry basis, shows where investment is prohibited, restricted, encouraged or permitted' (Breslin 2006, p.21). Breslin (2006) analysed the different sectors, which are prohibited from foreign investment (e.g. essential services, defence sector, heavy pollutant product industries and those illegal under Chinese law), encouraged (export-orientated, high-tech and *pro-forma* those who cannot be restricted under the WTO regulations), and restricted (those deemed to be central to national economic development such as certain foods, medical products, raw materials, power plants, chemical, etc.). These branches, where the penetration is most severely limited are sometimes referred to as "absolute control" industries and include armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, civil aviation, and shipping (see: CTI 2009). The Catalogue is on occasion amended. Although a sectoral opening up trend could be observed before and after WTO

accession, the common perception has been that the second half of the 2000s was marked by tightening of control and an increase in the number of industries with limited foreign access (PP 2009, 2010).

For example, the energy sector is almost fully controlled by the state and state-controlled enterprises. This includes oil and gas exploration, refinery, wholesale and retail business, new and renewable energies. ‘Growing limitations are [even] imposed on foreign companies that wish to offer energy equipment and services to support large projects. [...] [The government is] tightly reserving domestic energy sector opportunities to domestic companies’ (PP 2009, p.207). The banking sector is also affected to a distinctive degree. Foreign banks, including domestically incorporated foreign banks, do not enjoy the same rights as domestic banks as far as opening new branches, introducing new services and obligatory deposits are concerned, to name a few. The same applies to foreign insurance companies and related services. Moreover, in the building and construction sector, with a plethora of administrative regulations and additional requirements imposed exclusively on foreign contractors such as permissions from MOFCOM (Circular 50), the debt-equity ratio for foreign real estate investors (1:1 instead of 2:1) (Circular 171), the absolute requirement for a local partner (Decree 78), international companies are effectively deterred from entering the market (PP 2009, p.354).

The most effective institutions in barring foreign economic agents from participating in the Chinese domestic market using the standardisation practices, discussed in the following chapter, are the AQSIQ (the General Administration of Quality Supervision, Inspection and Quarantine) and the CNCA (the Certification and Accreditation Administration) in the sector of agricultural and food products. The most well known case is the on-going procedure for European meat, especially pork, to be allowed to access the Chinese market. Despite evident shortages of this product in China, caused not, as some tend to believe, by the interim conditions such as natural disasters, etc., but by long-term structural shortcomings and environmental conditions, and despite the fact that in the long term the situation will deteriorate, Chinese authorities are very reluctant to finalise agreements with most of the EU member states. Multi-layered and multi-

staged procedures take years and are subject to indiscriminate delays on the Chinese side, often implicitly motivated by political reasons.<sup>42</sup>

The above analysis of China's economic nationalism should not be perceived as a list of complaints which foreign governments and companies address to the Chinese authorities. This is merely an indication of the current policy without, so to speak, taking sides. Although the Chinese government practices may cause outrage among some members of the international community and are subject to notorious criticism from many developed countries, they are not unique in their form. Chinese companies often face certain constraints in the European market, for example, in the construction market.<sup>43</sup> Moreover, "buy Chinese" is not a unique idea. Americans would often openly propagate "buy American", or discourage purchasing goods "made in China". The British food industry notoriously labels its products with the British flag and notes such as "British beef", etc., implicitly encouraging their purchasing.

In sum, it can be plausibly argued that China's economic policy, which will be subject to additional examination in the following chapter, is extensively characterised by economic nationalism. In the political elite's quest to control the pace and directions of development as well as to strengthen the domestic economic agents, certain sectors of the national economy are protected and access to some is limited, regardless of the economic *rationale*. The authorities use various incentives and deterrence techniques to achieve their goals. On theoretical grounds, Chinese leadership simply believed not in Smith's rhetoric but in List's argument that 'free competition between advanced factories in England and relatively backward factories of other manufacturing countries would [...] simply lead to the destruction of the industries of the weaker states' (List 1837, p.48, cited in Levi-Faur 1997, p.366). China is in this equation perceived by the Chinese elite as the weaker state, which needs economic nationalism in the form of favouring/discriminating and constraining/encouraging or rather, the regulating and the guiding of various economic agents for the overall benefit of national development.

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<sup>42</sup> E.g. a Dalai Lama visit significantly delays the negotiations for the host country of that visit.

<sup>43</sup> The companies who participate in the bids in the construction market are often required to have some experience in the EU market. Many Chinese companies, despite significant achievements in China and outside, lack this type of experience.

### 3.2. The Political Arrangements of the State

Economic nationalism might sometimes be associated with the genus of political system. However, the significance of the political regimes was examined in chapter one. The DS model in Korea during its core period and contemporary China share the characteristic of the political system, namely its authoritarian form of a rather strongly coercive character. In the case of Japan, the democratic system is accompanied by the mechanism of shielding the development trajectory. Indeed, Japan, during its DS-proper period, managed ‘to retain many “soft authoritarian” features in its governmental institutions, and extremely strong and comparatively unsupervised state administration, single party rule [...], and a set of economic priorities that seems unattainable under true political pluralism during such a long period’ (Johnson 1987, p.137). In the post-socialist world some countries became democratic and some did not. As far as China is concerned, the late 1980s economic reforms contributed to the emergence of the concept of new or neo-authoritarianism, sometimes believed to be an interim period leading eventually towards political freedom (Fewsmith 2008a, Hughes 2006). The concept advocated an establishment of a strong authoritarian state with a clear target to preside over economic modernisation and the catching up trajectory. To a large extent, it was modelled on the experiences of South Korea and Taiwan, and by the early 1990s gained support of the central leadership. This is not to say that there was no political liberalisation intended. Some limited progress towards wider popular participation in constructing policy recommendations has been made, as discussed in chapter two. This suggests a deeper commitment towards Evans’ embeddedness, and perhaps a long-term gradual liberalisation of the political sphere, in terms of some civil rights.<sup>44</sup> It should not, however, be mistaken for a process of full democratisation, as was eventually the case of Korea and Taiwan. China remains fully, so to speak, an authoritarian state, where the role of electorate is played by, what Shirk (2007, p.40) and others call, a selectorate – ‘a group of people within the Party who have effective power to choose the leader’.

An authoritarian state, however, does not guarantee a strong, “capable” state, a somehow crucial condition for a developmental state and indeed embedded in the concept of neo-authoritarianism. In the post-socialist world the threat of Myrdal’s soft state is indeed great, as even the case of Russia illustrates (Rutland 2009). Deficiencies

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<sup>44</sup> The issue of embeddedness is elaborated later in this chapter.

in legislation have been a common feature, as the systemic transformation has been a complicated and multilayered endeavour, encompassing various strata of societal existence, including reformulation of the legal system and laws. This process has been taking place in a relatively short period of time. A lack of obedience towards rules and law enforcement has been distinctively visible in the former Soviet republics, where due to the inadequate sequence and/or sectoral intensity of reforms, the states have found themselves in complete disarray. Powerful groups pursuing their own goals, in collision with the overall interest of the country, have been the constant feature of the former Soviet republics as well as some Central and Eastern European states. In general, the resistance of public control has always been present in Central and Eastern Europe and derives from the aversion towards the political elites, inherited from the communist times.

Japan and Korea are considered not to have been soft states during their DS periods. In Korea, the re-imposition of the developmentally uncompromising state took place during the general Park Chung Hee era and was related to the form of the military regime (see: Kim 1997, Woo 1991). According to Amsden (1989, p.142), the process of transformation from a weak state, unable to defend itself against foreign aggression, towards a strong state, capable of mediating market forces, took over a century. The strong state in Japan seemed to derive more from certain structural arrangements serving the development trajectory, and from institutional transparency. A well prepared and educated bureaucracy, which traces its roots back to the Meiji administration, largely independent from both the society and the political elites, would have the institutional and intellectual capacity to run the state in such a way as to achieve extensive developmental goals, via creating an adequate environment for domestic business to thrive in the designated economic sectors (see: Johnson 1987).

China has never been seen as a soft state, as opposed to India, another large Asian developing economy with extensive potential for growth, and to Russia, the second largest post-socialist economy. In fact, the neo-authoritarianism enforced the perception of China as a strong state. The toughness of the regime in Beijing towards its citizens contributed towards the somewhat distorted picture of China as a very strong state, in addition to being a harsh state. The PRC fulfils, however, some requirements to become Myrdal's soft state and is characterised by certain important weaknesses, which may affect the overall development trajectory. These weaknesses are presented below.

Firstly, there are undoubtedly, certain influential groups originating from the PLA (People's Liberation Army) leadership, local government officials and business circles who contribute towards the mafianisation of economic relations (i.e. the creation of corruption-prone, non-transparent ties between business and state administration). Especially during the period of accelerated privatisation present on the provincial level, the temptation of the illegal acquiring of large amounts of state assets results in increasing "grey-zone" economic activities. Moreover, the process of administrative decentralisation has eroded the state capacity in a number of sectors, including the fiscal extraction (Wang and Hu 2001), necessary for the process of industrialisation. It created 'weak centre and strong localities' (Hu and Wang 1995 cited in: Fewsmith 2008a, p.143) and weakened the state's ability to control the business sector (Wang 1997). This erosion of state capacity may have a profound negative impact on the genus of systemic economic and political changes (Breslin 2007).

Secondly, a lack of obedience towards legal regulations and policies adopted at the centre, and an overall crisis in law enforcement, especially at a local level, has been endemic throughout the transformational period. Although the broad discretion of ministries and other state executive bodies allow for flexibility and the rapid adjustment of the National People's Congress' general laws, it also leaves significant space for overinterpretation, abuse and distortion of initial ideas behind the laws. Moreover, too many agencies produce regulations and supporting guidelines, which results in a regulatory chaos of conflicting and unclear rules (OECD 2009a, pp.70-71), as has been the case of the antimonopoly law, for example. Law implementation and interpretation has become one of the biggest issues as far as state management is concerned and is often debated publicly. It is widely considered that China's legal regulations, for example, those referring to natural environment protection, intellectual property rights and others, have complied with international standards; however, their reinforcement has been disastrously ineffective, as seen by the amount of illegally-produced goods available on the market and by the appearance now and then of scandals related to environmental pollution. The analysis of effectiveness of law implementation in China, especially in such a sensitive and crucial area as environmental protection, suggests a certain inability of the state to govern.

Finally, Shirk (2007) points out that due to the systemic arrangements, despite the overall appearance, China has been, politically, a very fragile state, especially during the Hu-Wen regime. This is because neither president Hu nor premier Wen are uncontested totalitarian dictators and, therefore, could be effectively challenged by the selectorate if the internal economic and/or political situation deteriorated or if China's international position weakened. She argues that the state leaders must follow three basic rules in order to maintain the grip on power, namely; avoiding public leadership splits, preventing large-scale social unrest and keeping the military on the side of the Party. Any of the occurrences mentioned above have the potential to politically destabilise China. An open split in the leadership may even effect a military confrontation. Large-scale social unrest, a possible side effect of the state-sponsored nurturing of nationalism and unbalanced development, may turn against the political elite and trigger protests around the country, if large parts of the society conclude, using currently available information technology, that the leadership is unfit to govern. The military has always complied with the wishes of the Party. However, the generals seem to possess the ability to stage an effective *coup d'état* if they profoundly disagree with the state policy, for example, in reference to national security.

Indeed, China may exhibit some signs of becoming a soft state and indeed being a weak state, whilst maintaining the status of a politically harsh or hard state. Limiting societal and political entrepreneurship, as a means to enforcing a harsh state, cannot be seen as the prevention of the formation of a soft state.<sup>45</sup> Additionally, China's political structure produces a number of possible triggers of conflict, as determined by Shirk (2007). From the developmental perspective, this may lead to the distortion of the development path and to the further polarisation of the society or indeed to a political situation in which a developmental reversal takes place.

However, before the final judgement as to the strength of the Chinese state, one needs to establish, how much of the alleged legal chaos and economic "grey-zone" activities are the state's failures and how much they take place simply because the state tolerates them or indeed supports them. The legal chaos prevents some unwanted foreign economic agents from acquiring a powerful position on the Chinese market, and thus,

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<sup>45</sup> It is important to reiterate that the concept of a soft state is not related to the level of political repression present in a given state, as the Chinese example illustrates, neither to the idea of an economic liberal or economic interventionist state. It relates to a state's ability to exercise effectively certain powers in order to secure the realisation of policies. In the context of this thesis, these powers relate to development policies.

can perversely be seen as the means to realise Wang's (1997) and Hu's neo-authoritarian postulates of promoting certain domestic economic agents. A lack of enforcement of environmental regulation does not inhibit the nominal value of economic growth and allows for the realisation of the "growth at all costs" doctrine. A lack of effective IPR (intellectual property rights) allows for better diffusion of innovative technology. Naturally, those benefits might be short-lived and counterproductive in the long term, when China becomes an important source of technology, when the quality of economic growth deteriorates due to lack of environmental considerations, and when ineffective privileged companies, borne out of an initial lack of competition, will be unable to provide competitive products. Nevertheless, in the short term it seems to be a successful strategy. Moreover, although undoubtedly there are certain power centres in China, which, following Myrdal's logic, could contribute to the weakening of the state despite the fact that they are often associated with the ruling elites, and, as Breslin (1992) and Shirk (1993) point out, there is a constant struggle among the PRC leadership, the overall states' priorities are being implemented and the state is by far the strongest power centre able to exercise enormous influence on the other alleged power centres. Since the Tiananmen events in 1989 the state leadership has successfully managed to continue a "peaceful rise" and to avoid creating circumstances which could generate state-wide conflict.

The existence of authoritarianism in China prompts the question of the legitimacy of power, partly as the means to alleviate a potential state vs. society conflict. Among the majority of post-socialist states the legitimacy is derived from the democratic elections, in which it is the nation which votes political parties into power. The leaders are accountable to their nations and can be replaced in the process of popular voting. In authoritarian states such mechanism does not exist, hence political/democratic legitimacy is not enjoyed by the ruling elite. Consequently, the state leadership needs to search for other types of legitimacy, such as, for example, developmental legitimacy. On the other hand, however, it does not mean that in democratic states the developmental legitimacy of the ruling elite to power cannot exist. Nevertheless, most of the democratic post-socialist governments do not seem to effectively seek this type of legitimacy, as their "promotion" to power is the result of the democratic vote.<sup>46</sup> In fact,

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<sup>46</sup> "Promotion" often does not depend on how well you do, only on how well/badly your opponents do. Poland in the year 1997 seems to be a good example of this. After a period of fast economic growth, the governing social-democratic party lost the elections despite gaining more votes than in the previous

hardly any post-socialist state from Central and Eastern Europe and, especially, from the former Soviet Union achieved developmental dynamics comparable to those of developmental states, and thus their respective political elites cannot aspire to the possessing of a developmental legitimacy.

In the case of both Korea and Japan, the developmental legitimacy seemed important in power being maintained by the respective ruling elites. In Japan, developmental efforts were met with the cyclic approval during the democratic elections, although an important argument of a lack of political contestation should not be discounted in the analysis of factors determining the election victories of the Japanese Liberal Party. In Korea, developmental legitimacy partly served as a replacement for political rights, which the Korean society extensively lacked, and was seen as an important justification for the continuation of the military regime. Camilleri (2000) claims that in the case of China, 'the [Communist] regime [believed that its] claim to legitimacy depended on restoring to China its dignity and sense of importance, expunging the humiliation suffered at Western hands, and satisfactorily managing the unfinished business of China's civil war, not to mention the Cold War' (p.434). In the post-socialist period this seems to hold true and is partly realised by elevating China to the ranks of economic superpower through rapid development. This is why the consequent governments have aimed at retaining the developmental legitimacy, as they have empirically proven their commitment to the transformation of the economic environment and to improving people's well-being, as illustrated by the dynamics of economic growth and significant positive change in HDI. The legitimacy comes precisely from those achievements. It seems to be connected with the concept of a *xiaokang* society, advocating the necessity to achieve a certain degree of wealth in the population, and with the concept of a harmonious society – to establish balanced and orderly societal relations. Ruling elites' developmental legitimacy is enjoyed for the time during which positive results in the developmental sphere are experienced, unlike political democratic legitimacy which is usually awarded for a fixed term. Consequently, the current legitimacy enjoyed by the Chinese political elite may not be there once the government's policies are no longer effective in fulfilling the prime objective, which is fast and steady development. Naturally, developmental reversal and the subsequent loss of developmental legitimacy would not mean an automatic departure of the Communist party from power.

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elections which promoted it to power. This was due to the consolidation of the opposition into one main political bloc.

Nevertheless, in such a situation, to maintain the supreme political position, it could mean for the CCP a slow drift towards policies of a predatory state. In fact, it is often claimed that societal polarisation, continuous marginalisation of parts of the society and dramatic increase in income disparities, already called the legitimacy of the China party-state into question (Wedeman 1997; Guo and Hu 2004).

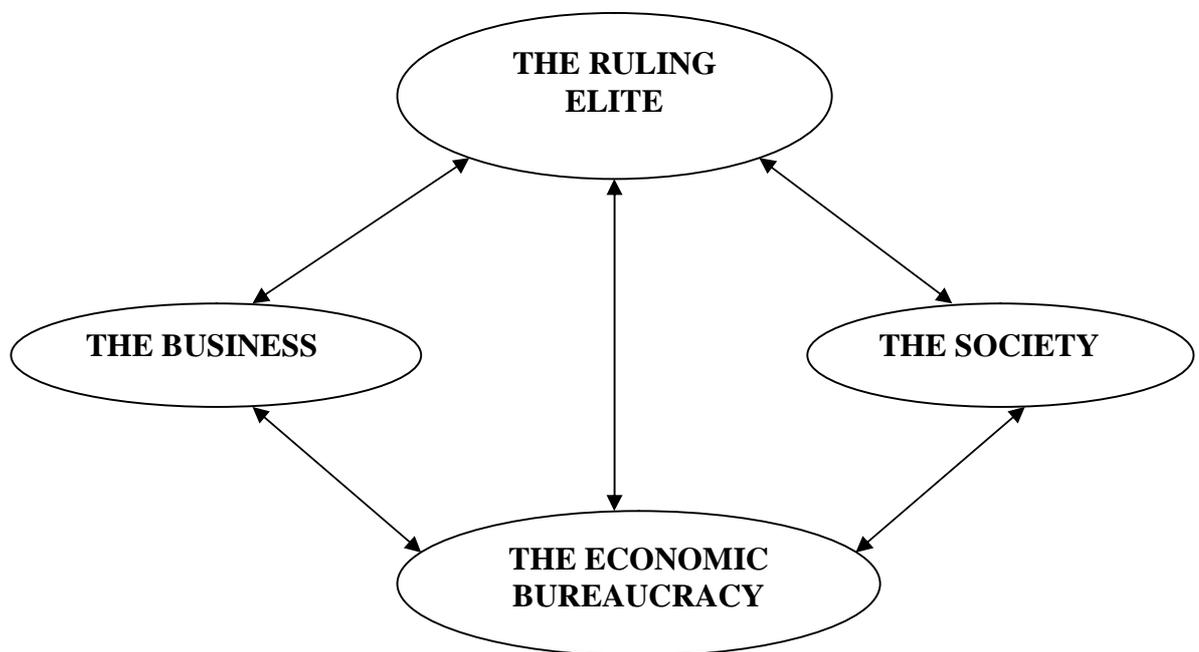
Continuing the issue of derivatives of the genus of the political system, one must acknowledge that the existence of an authoritarian state inevitably results in limiting the freedoms available for the society in liberal democracies. Moreover, Leftwich (2000, p.160) believes that a developmental state is characterised by “an uneasy mix of repression and poor human rights” record. Most of the democratic post-socialist states have maintained good records of respect for political freedoms, human rights and at the beginning of the systemic transformation eliminated repressions. Naturally, the picture has not always been positive. On occasion, liberal democracies of Central and Eastern Europe would lose their Freedom House status as “free” countries and become “partly free”, as opposed to former Soviet republics, who would witness human rights violations in most cases during the entire period of transformation. One should note, however, that Leftwich (2000) does not advocate political repression as an element of the developmental state. He merely notes that in a developmental state some rights, widely present in Western democracies, are withheld. As far as political freedoms are concerned, as opposed to certain social, economic and development-related rights, China does not seem a mere “tamperer” of rights, but a gross violator. Naturally, political persecution was present to a great extent in the authoritarian Korean DS and, to some extent, in the pre-DS Meiji Japan. Nevertheless, China is probably a much more significant case, where political imprisonment, intimidation of the political opposition and widespread censorship of politically-related matters are practised on a large scale. The repressions, as well as Confucian values deeply rooted in the society such as the respect for hierarchy and order, create, as it is believed, a type of subordinate society, another condition listed by Leftwich (2000). However, although East Asian nations are in general seen as subordinate societies and in the case of China this perception is reinforced by the harshness of the political regime, it is also a fact that the number of socially-related protests, as well as socially-related debates in the media, conferences and gatherings, suggests a certain misperception as to the real level of the societal subordination of the Chinese people. The Chinese society is increasingly vocal about

defending its social rights, which is acknowledged by the state leadership and translated into a gradual process of the broadening of social dialogue.

### **3.3. The Interaction of the Four Actors of the Developmental State – “The Relational Aspects”**

In DS cases, development trajectories have partly been facilitated by a certain type of internal relationship. It is believed that implementation of the developmental state concept into mainstream policies requires institutional arrangements such as relative autonomy of the state and a competent economic bureaucracy. The DS model possesses a rather difficult requirement which, in effect, defines the interrelation between four actors of the developmental state scene – the political elite, the state (economic) bureaucracy, the business and the society – namely, the requirement of insulation and the requirement of embeddedness, hence Evans’ embedded autonomy.

Figure 1: Four Actors of the Developmental State



State bureaucracy and the political ruling elite are often seen as one actor, namely the state. However, the DS model is also characterised by a specific relation of these two. Japan showed a great deal of insulation of the bureaucracy from the political elite, whereas Korea – dependency of the former on the latter. China is closer to the Korean

case. However, the case of China brings into the scope another aspect of state-bureaucracy relations, not featured in the significantly smaller countries of Japan and Korea, namely the issue of centralism. The Japanese and Korean developmental states were centralised structures with one central authority to impose policies and regulations. China, due to its communist legacy, that of economic and political centralism and that of political harshness, is often seen as a centralised state, where policies articulated in Beijing are effectively executed throughout the country. Their sum shapes China's overall development trajectory's directions. However, post-socialist China's development and reform paths cannot be evaluated without taking into consideration the local/provincial dynamics (White 1999; Breslin 2007), with provinces' effectively autonomous power centres distorting the state policy implementation and reorganising developmental priorities. White (1999) sees a clear difference between centralised China during the state command times and the gradually decentralised China during the market reform period. However, even in the state command period China's economy was to a lesser degree centralised than more developed states of Eastern bloc, thus Chinese central authorities were more constrained in implementing socialist-time state-level policies. 'Unlike the Soviet Union, where the strong ministerial system by-passed local governments and transmitted plans directly to their enterprises, the Maoist system decentralised economic and administrative power to the localities' (Oi 1995, pp.1133-1134).

Central-local relations in post-socialist China attracted significant scholarly attention. The post-socialist decentralisation, a process common among most of the former state-command economies, is believed, in the case of China, to have gone far enough for discussing federalist scenarios (Cai *et al.* 1999; Chung 2006). However, Chung (1995) argues that although 'there is no doubt that during the period of economic reform overall provincial autonomy has indeed expanded as a result of various measures of decentralisation, [...] it seems wrong to infer that the centre is completely helpless in restricting provincial autonomy as some "split China" scenarios project' (p.502). He points out that 'the post-Mao reforms seem to have produced complex effects on central-local dynamics. While the decline of ideological control and the decentralisation of economic policy making have generally expanded local autonomy, the reforms have also significantly enhanced the centre's ability to acquire key information on local policy behaviour' (p.503). In reality, the centre still remains the paramount decision maker, as far as general policies and key cadre nominations are concerned. The rotation

mechanism, where high-ranking officials change positions and move to other provinces upon the decisions met in Beijing, allows the Capital to retain control, despite the internal political fighting within various factions.<sup>47</sup> The fact that this control is perhaps less effective than in the cases of Japan and Korea, should not preclude China from the potential membership of some type of developmental states group, partly because it did not affect the general developmental dynamics to the extent that it is not comparable to the historical DS cases.

The administrative machinery in the form of economic bureaucracy together with the ruling elite require insulation from both the society and the business, in order to fulfil its duties in managing the state's overall development trajectory. In the case of business, this state autonomy seems to be achieved to a significant degree in all three countries, China being, in this respect the weakest case, where corruption greatly sabotages the insulation at lower administrative levels. Japan, seems to be the finest example of this autonomy. On the other hand, this insulation shall not prevent the creation of the state-business alliance – a mechanism necessary for facilitation of the development trajectory. This alliance had a different form in Japan than in Korea. In Japan this relationship seemed indeed “embedded” and characterised by the conciliatory cooperation, in Korea – coercive dependency. It is difficult to speak of a full formulation of state-business alliance in the case of China. A certain type of alliance, however, exists in two forms: first, by definition, Chinese state-owned enterprises are the tools of implementation of the state developmental strategy. This is not to say that they all serve the purpose of development. On the contrary, some are a heavy burden on the state budget and on tax payers and function due to some “short-termist” political reasons. Only half of all the SOEs were actually bringing revenue at the turn of the century (Mako and Zhang 2002) and probably only a handful of them would be able to compete with a non-state sector, without the support of state regulations and without state interference into the market.<sup>48</sup> This is indeed an awkward type of alliance, if an alliance at all, as the dependence of one partner on the other is absolute. The energy sector seems to be the most vivid example of this relationship, where the state directly engages SOEs in the realisation of its strategy. Second, the state creates certain incentives for development of designated

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<sup>47</sup> Based on the discussion with the head of Dragonomics, Beijing, 21/10/11.

<sup>48</sup> A potential inability to compete in the conditions of a “free” market environment can partly be illustrated by the extent of government subsidies received by some large Chinese companies. The issue is presented later in this thesis.

sectors. These incentives are then utilised by state and non-state enterprises.<sup>49</sup> This DS-style policy largely defines the state-private business alliance in China.

As far as state-society relations are concerned, all three countries managed to maintain a relatively high level of insulation, in China and Korea, due to, it appears, the lack of democratic procedures, in Japan – due to the lack of democratic procedures towards the state bureaucracy and the lack of political contestation. The level of embeddedness seemed the highest in Japan. However, the Chinese state's embeddedness in the society seems to be increasing, partly as a result of the 17<sup>th</sup> CCP National Congress. It takes the form of broadening the consultation channels. Although 'public consultation procedure is not a legally guaranteed right at present' (OECD 2009a, p.102), symposia, panel discussions and hearings have become an ever more frequent instrument of public participation in the creation of laws and regulations. In certain circumstances the hearings are obligatory and their results must be made public. This involves a number of procedural consequences such as 'that opinions from concerned parties shall be recorded and listed during the drafting of administrative and local rules. Experts shall be called upon to expound on professional or technical issues related to the drafting of regulations. During the period of examination, the investigating organ shall examine whether the drafting organ has correctly handled opinions on the draft regulation from different organisations, institutions and individuals' (OECD 2009a, p.103). Moreover, 'the Standing Committee of the 11<sup>th</sup> National Peoples Congress in April 2008 announced that it would solicit for public comments on the majority of draft and amendments coming under its review' (PP 2009, p.91). Although the public consultation procedure constitutes only one example of increasing embeddedness, a society's influence on the laws and regulations seems extremely important in a country such as China, which is undergoing institutional transformation, even if this influence is indeed limited and often illusory, as it allows the nation's broader participation in systemic institutionalisation.

In many democratic post-socialist countries, state autonomy from the society seems, to a great extent, illusory, in both respects; that of political elites and that of state bureaucracy. Politicians often define their support for policies and for legal regulations in relation to certain groups (the electorate) they believe they represent. Those groups

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<sup>49</sup> This policy of incentive creation, examined in chapter four, is indeed also characteristic for the classical developmental state.

eventually vote them in or out. State institutions are often penetrated by political agents as far as the administration is concerned. Embeddedness of the ruling elite within the society is defined by the short-term accountability for the policies implemented. In the case of state-business relations, the level and nature of interconnectedness differs, in some cases resembling Latin American political capitalism.

In sum, it can plausibly be argued that China is in the process of achieving Evans' embedded autonomy. The ruling elite enjoys extensive autonomy from the society and on the state level, also from the certain groups of particular economic interests. As Shirk (2007) points out, however, this autonomy has some limitations. The embeddedness in the form of social dialogue continuously increases its importance in defining the societal interrelations with the power centre. The CCP sees the expansion of dialogue as a crucial element of political reform enforced by the 17<sup>th</sup> Party National Congress (China Daily 2007a) and some subsequent laws.

However, despite the expansion of state-society consultations channels, the picture is not that positive. While discussing the state-society relations one also needs to focus on one important feature of the DS architecture, namely, the underprivileged position of the labour force, in particular, the working class. 'The exclusion of labour from [the] corporatist-style of politics of developmental Japan is [...] well noted in the literature, as are the repressive labour politics of pre-democratic Korea and Taiwan' (Gallagher 2005, p.153). This was due to the fact that labour force was paramount for the nationalist development project (Gallagher 2005, p.156) in the East Asian states, and thus it was believed that it needed to be effectively controlled. China, as much as Korea with its most antagonistic labour relations among the East Asian NICs (Gallagher 2005, p.156), has been characterised by a high degree of repression towards the labour force during the reform period. Gallagher (2005) points out that 'the ideology and policies of state-led capitalist development adopted in China since the 1990s have brought this mark of developmentalism home' (p.153). This clear departure from Communist ideals has, indeed, been a gradual process, which accelerated in the 1990s, with a number of new laws taking away many socialist benefits such as prevention from being fired or life time employment (Solinger 2006, p.181), and with the introduction of Jiang Zemin's three represents, which are sometimes believed to have depreciated the importance of workers (Solinger 2003, p.948). This is the result of the CCP forming an alliance with the business sector rather than with the labour sector (Chen 2003) and 'a

radical shift in the state's relationship to the urban working class' (Gallagher 2005, p.153). Consequently, the working class has been effectively marginalised (He 2000) and a large underclass has been created (Solinger 2006), whose standard of living is perhaps lower than it was during the state-command economy period. Effective institutionalised channels for articulating and advancing class interest do not exist (Chen 2003). Uncoordinated workers are unable to effectively channel their agenda in the conditions of market hegemony (Blecher 2002), as they are unprepared for the onslaught of global capitalism (Gallagher 2005, p.96).

Indeed, eliminating rights and privileges of the working class has been a distinctive feature of post-socialist transformation. Extensive socialist benefits were difficult to sustain in new market conditions. However, in CEE, this temporal privilege vacuum was soon replaced by the European continental model of extensive social rights. This has not happened in FSU and is not taking place in China. Post-socialist China remains very much the Korean case of extensive repression of the labour force. In 2000 He wrote, 'regression in capital-labour relations is a stark phenomenon in China today. What we are witnessing is a return to conditions common during the Industrial Revolution of the nineteenth century, of which Marx wrote the classic critique in his monumental work *Capital*. In the PRC today, workers employed in firms financed [especially] by Asian capital are typically forced to toil continuously for ten or twelve hours everyday, with [...] no weekend off. Workers in such firms earn very low wages, in poor and dangerous conditions. Accidents occur frequently. [...] Many firms producing toxicants take no protective steps of any kind' (He 2000, p.85). It seems difficult to see effective improvements since.

A developmental state requires a strong and competent, developmentally-orientated bureaucracy. Korea and Japan did possess such a bureaucracy during their DS core periods. Cheng *et al.* (1998) point out that in the case of Korea, the economic bureaucracy, based on the Indian model, started to emerge in the late 1950s. However, it was the centralisation process of the 1960s, under the military regime, concerned predominantly with economic-decision powers and the establishment of the Economic Planning Board, which shaped the Korean development-focused state administration. The agencies promoting industry development obtained a strong standing, whereas foreign trade was closely integrated within industrial policy functions. Does China

possess a competent state economic bureaucracy?<sup>50</sup> As a result of administrative reforms in the early 1990s, which seem to have put an accent on constant improvements of the bureaucracy, the professionalisation of the cadres is growing (Brodsgaard and Chen 2009). Civil servants are relatively well paid. However, the process of bureaucracy becoming autonomous is rather slow. Nevertheless, the ruling elite is to a great extent free from societal pressure. In time, one should expect an evolution of the public administration towards greater independence and higher professionalism in governing the country and provinces, as has been the trend for the last 20 years. Moreover, the fact that the power is centred in the hands of one political structure contributes towards the stability of the administrative cadres. The developmental logic and the will to hold on to developmental legitimacy result in the selection of those who would be best equipped, intellectually and practically, to facilitate the long-term policies.<sup>51</sup> It is clearly visible on the level of interaction with various state officials.<sup>52</sup> The situation in many other post-socialist states seems relatively worse. The political infiltration of the state administration situates many post-socialist countries among Latin American states where “appointive bureaucracy” is prevalent and dominant.

The analysis of autonomy and bureaucracy inevitably leads towards the question of corruption. Despite the fact that the relation between the level of corruption and the dynamics of developmental change in the DS model has not been firmly established, much of scholarly literature features the discussion on corruption, as endemic corruption is often considered one of the most important features of the DS relational aspects, hence the necessity to address the issue at this point.

Although none of the political and economic systems are operated free from corruption, the special partnership between business and the state present in historical developmental states can be seen as offering a fertile ground for corruption and the forming of crony capitalism. Indeed, in Japan, Korea and other countries corruption is on occasion a serious issue (and politicians have been tried on corruption charges in a

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<sup>50</sup> The pilot developmental agencies characteristic for the DS model are examined in the following section.

<sup>51</sup> In line with improving professionalism among the senior cadres, CCP has introduced extensive trainings for their candidates for higher posts in the state administration. The system is based on the functioning of several Party schools; namely, Party School of the CCP Central Committee (Beijing), China National School of Administration (Beijing), China Pudong Executive Leadership Academy (Shanghai), China Jingtangshan Executive Leadership Academy (Jingtangshan), China Yan'an Executive Leadership Academy (Yan'an) and China Business Executive Academy (Dalian).

<sup>52</sup> Personal observations.

number of instances), never to the extent, however, of that in the *desarrollista* states of Latin America. The Korean DS case is the more interesting, as there are different opinions on the level of corruption. On one hand, it is claimed that the agreed industrial policies (determining the overall industrial development and the economic actors to participate in the process) were the result of political consideration motivated by the exchange of bribes (see: Kang 2002; Sindzingre 2006). On the other hand, some believe that the so-called targeted industries, examined in chapter four, enjoyed to some extent a corruption free environment under the political umbrella of president Park Chung Hee, and the decisions concerning those industries were met using developmental and technical criteria (see, for example, Perkins 2001). Those two statements do not need to be contradictory. Perhaps, once a company joins the privileged group due to an “exchange of bribes”, it then enjoys a corruption free inner environment to operate in. Another group of countries vulnerable to corruption are those undergoing a systemic transition such as post-socialist transformation. At a certain stage of the reforms the economy in transition is characterised by a dual track of plan and market, and this is ‘the major cause of corruption in the reform context because it is not a true market, but a plethora of networks protected by cards and bureaucrats’ (Meaney 1989, p.210 cited in: Gong 1997, p.277). As a result, White (1996) argued that ‘political and bureaucratic corruption [...] remains a consistent aspect of the developmentally successful East Asian NICs (with the exception of Singapore) and has reared its hydra-head in the post-communist “transitional” societies of Central and Eastern Europe’ (p.149).

Consequently, China, undergoing post-socialist transformation and attempting to shape many of its “relational aspects” of economic and administrative actors in the DS manner, has been the subject of extensive examinations in the context of corruption. Historically, the socialist China was prone to corruption, as were all Eastern bloc members. It was the “socialist mode of corruption” shaped by the very features of state-command economy, namely, the monopoly of power held by the Communist Party, state-ownership of property, and central planning of production (Kwong 1997). In the conditions of the high degree of regulatory and distributive powers of the state administration, where almost all economic decisions were met by the monopolistic bureaucracy, socialist corruption (Gong 1997) would always be a natural problem. However, what has been stressed by many scholars is that the level of corruption increased dramatically during the reform period (see: Kwong 1997; White 1996), especially in the mid 1990s, after the *nanxun* (Gong 1997; Wedeman 1997). Despite

some neo-liberal explanations of the supposedly negative correlation between economic liberalisation and the intensity of corruption, the increase in corruption during the market reform period is hardly a surprise and in the Chinese mode of incremental transformation would be difficult, if not impossible, to avoid. “The cake” (i.e. the national economy) became bigger due to economic growth, the control over it less tight due to marketisation, and the supervision roles of the state more ambiguous due to transitional chaos. Moreover, ‘the void of moral authority was filled [...] with growing materialism and hedonism’ (Kwong 1997, p.119). Therefore, ‘market reforms in the 1990s did not reduce corruption so much as they merely altered its characteristics’ (Gong 1997, p.277). In his analysis of post-socialist corruption in China, White (1996) named several explanations of the phenomenon, as presented by scholars; “spiritual corruption” – due to the contamination by the capitalist thoughts and practices, transitional corruption – ‘inevitable accompaniment of the transition from central planning to a market economy, “a half-way house”, in which market relations are developing, yet state agencies still retain a great deal of power and the unreformed political system pervades the economy’ (p.154), and finally, corruption caused by rent seeking.

There is an agreement among the scholars and policy makers, including those representing Chinese political power centres, that in the post-socialist China, corruption is a significant problem in both rural (Oi 1991) and urban areas (Meaney 1991) and that it is indeed to a great extent related to the process of post-socialist transformation. For example, Guo and Hu (2004) discuss the administrative monopoly in the transformational period as the main source of corruption in China, as opposed to state capture-based corruption dominant in CEEFSU. This monopoly ensures that in many sectors the interests of state monopolies are well safeguarded and result in active rent seeking by the government because of the intermingling of its functions of governing and enterprise management. Gong (1997) admits that the formation of cadre entrepreneurs and their role in the economy is highly problematic. ‘The rent accumulated by the sector monopoly [...] is the loss of social welfare reflected in the monopoly price. [It also] includes various illegal fees collected by monopolistic sectors under various pretexts’ (Guo and Hu 2004, p.275). However, White (1996) questions rent seeking theory as the leading explanation for rampant corruption in China. He argues that it does not explain the differentiation in corrupt practices in various places despite similar conditions, and does not address its increase during the reform period.

He distinguishes three main corrupt practices in China; class A (clearly illegal in formal terms), class B (pervasive entrepreneurial practices by various state agents) and class C (pervasive networks of personal ties commonly known as *guanxi*).

One of the main types of corruption is the institutional corruption (Wedeman 1997) or organisational corruption (Lu 2000), characterised by the exploitation of public authority by an organisation for its material gain. ‘Institutional corruption involves the pursuit of gain by institutions acting collectively and relying on the authority or resources of the organisation to generate or extract income improperly’ (Wedeman 1997, p.806). Wedeman (1997) identifies a variety of forms of institutional corruption in contemporary China. ‘These include the improper levying of fees, arbitrary fines and forced apportionment of funds – known colloquially as the “three disorders” (*san luan*); unauthorised, and often coerced, fund raising; the siphoning of money out of budgetary and extra-budgetary accounts into off-the-books slush funds or “small treasuries” [or “small coffers”] (*xiao jinku*); the erection of illegal export and import barriers in support of local protectionism; and the systematic misappropriation of funds by local governments and bureaus. Lu (2000) identifies several patterns of this type of corruption; namely, exacting revenues without clear legal mandates through *san luan*, unaccounted for, unreported, and underreported funds, partly in the form of *xiao jinku*, irregular use of regulatory power for predatory purposes, generation of profit through the spin-off “economic entities”, the disposal of impounded revenues.

The corruption in China is to a great extent a provincial and local phenomenon, where lucrative privatisation and public procurement contracts are brokered. Indeed, for Ding (2000b, p.2) ownership changes comprise the major source of corruption in China. This does not only include the process of privatisation, which in itself is highly corruption-prone. Chen (2002) points out that corruption is prevalent in the new forms of SOEs managements (e.g. in the factory director responsibility system) and ‘takes place in various links of the whole process of SOEs’ production and business’ (Chen 2002, p.61), such as procurement (inferior product for superior price) and sale (hiding income to evade taxation). Naturally, rampant corruption accompanies privatisation and shareholding transformation, as a result of ‘organisational corruption and predation committed by government-appointed SOE directors and their collaborators in the party-state apparatus’ (Chen 2002, p.69).

Despite repeated anti-corruption campaigns and the official propaganda that the government pays close attention towards the problem, supported by the examples of trials of high ranking dignitaries such as the former CCP Shanghai chief Chen Liangyu or the leaders of the Food and Drug Administration, Zheng Xiaoyu and Cao Wenzhuang, the Chinese authorities have failed to break extensive business-political connections as well as to stop building new relationships. Those connections and relationships have little in common with the DS concept of state-business alliance defined as a type of cooperation agreement to facilitate the long-term development trajectory, and, to some extent, exhibit elements of the appropriation of the state, characteristic for predatory states.

The corruption in China has both a political and economic impact. For example, according to Lu (2000, p.285), ‘organisational corruption bears counter-developmental effects at least in three aspects. It disrupts and distorts the market, hurts investment, and reduces competitiveness. It harms state capacity in steering a healthy course of economic transition. It weakens the integrity of the bureaucracy and has an adverse effect on the institutionalisation of government structure and procedures’. Not only does it erode economic achievements by siphoning off economic benefits, it also endangers social stability and development long term (Guo and Hu 2004). It generates poverty (Chen 2002). Nevertheless, DS-style corruption can actually have the opposite effect. Bramall (2009a) points out that some studies prove that corruption can be growth-promoting. He argues that ‘corruption does lead to a deadweight loss. [...] However, if it has the effect of transferring resources to a growth-promoting class – as it seems to have done in South Korea – the net effect will be strongly positive. [...] Everything depends on the use to which the rents from corruption are put’ (Bramall 2009a, p.20). This use is determined by the conduct of public officials which White (1996, p.155) described as “unorthodox”, as it may bring clear corporate and public benefits and contribute to stimulating economic development. Bramall (2009a, p.20) concludes that although ‘it is certainly arguable that corruption in China is not growth-promoting, [this] possibility cannot be dismissed *a priori*’.

Politically, however, corruption in China can lead to a crisis of legitimacy (Wedeman 1997; Guo and Hu 2004), partly due to the corruption-promoted rise in inequalities, which can generate social unrest (Chen 2002). With no democratic mechanism of siphoning off the popular pressure, the state stability can be significantly affected.

Therefore, it is the political rather than economic consequences of corruption, which may affect the Chinese developmental model, by destabilising party-state and inhibiting its abilities to preside over effective catching-up trajectory. Naturally, East Asia has witnessed high long-term economic growth in politically unstable countries such as Thailand. The relationship between political stability and dynamics of economic growth is more complex and by all means not straightforward. Nevertheless, due to various social and political factors, stability remains of vital importance in the PRC.

Corruption in China, however, seems to differ from that in many FSU states. It is prevalent especially in the undemocratic former Soviet republics. Kazakhstan (CPI rank = 150), Kyrgyzstan (150), Tajikistan (150) and Turkmenistan (162) are rated among the most corrupt states in the world, according to Transparency International. China with the CPI of 3.5 (rank 72) is situated in the middle of the ranking of post-socialist states (Transparency International 2007). It is a significant fact that only former Eastern bloc EU members have experienced lower levels of corruption than China. All the remaining former Soviet republics and the remaining Balkan states seem more corrupt. For example, Ding (2000b) argues that as far as corruption related to privatisation is concerned, the situation was much worse in Russia, where the state was stripped from its assets as part of spontaneous and often illegal appropriation. In China, due to a lack of official mass privatisation campaigns, 'the [Chinese] managers and officials have had to design more subtle schemes to transform public assets into private property' (Ding 2000b, p.26). On the other hand, China's ownership reform cannot be compared to this relatively corruption-free process in CEE (Walder 2004; Breslin 2007).

#### **3.4. The Economic Arrangements of the State**

In the case of China, it seems beyond any doubt that the systemic transformation has been aimed at the significant acceleration of socio-economic development. This is repeatedly communicated in official documents, media and scholarly reports, as well as via the state leadership (see: Deng 1988). The developmental objective was also seen as the target of China's institutional arrangement prior to the reform era. Johnson (1999) argues that in order to accelerate development, China and North Korea chose communist modernisation, whereas Japan and South Korea, a capitalist developmental state model. In this respect the objective has not changed. However, the communist

modernisation did not fully achieve expected results, hence the authorities chose to adjust the model of development.

The pursuit of the improved welfare of the society has remained the priority and is being achieved more effectively than prior to the reform period. One can, at most, question the imbalances of the Chinese achievements in the social strata of development. On the other hand, however, 'Japanese people's standard of living did not change anywhere near as much as the change in the Japanese gross national product' (Johnson 1999, p.5). The initial pre-DS industrialisation in Korea involved little quality change for impoverished rural and urban residents. In fact, the social disparities featured the entire period of the Korean DS model. Nevertheless, the development trajectory was successfully maintained during the DS core activity period in both countries. In the case of Japan it resulted in becoming the second largest economy<sup>53</sup> and a developed nation. In the case of Korea it meant an overcoming of backwardness comparable to that of early post-colonial African states and becoming eventually a developed state. China's example seems to a great extent similar, where socio-economic development has been conceptually detached from social welfare, i.e. the overall developmental objective from social policies. In China, where the social elements of economic transformation have been neglected, the entire process of accelerating development is focused on the overall target and not on the benefits for certain social groups. This leads to the situation in which developmental advancements are accompanied by mounting social-related failures. On one side, there is an impressive economic growth and change in the overall value of HDI, on the other – the income disparities are among the highest in the former Eastern bloc. While a moneyed Chinese middle class is growing, some people are only marginally better off. In fact, due to the dismantling of the cooperative healthcare system in the rural areas and the deteriorating educational base therein, some groups are experiencing decrease in their standard of living. A geographical diversity in transformational gains has prompted economic migration. Economic migrants, however, stumble on various obstacles while pursuing new employment opportunities outside their areas of residence, in the form of discriminatory practices based on the provisions of the *hukou* system, a practice which requires that each individual is registered within a particular geographical area, usually his/her place of birth, and limits his/her rights outside of this area. This leads to the marginalisation of a large part of the society, which is unable to benefit from the state's developmental achievements. Societal

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<sup>53</sup> Only recently Japan was overtaken by China as the second largest economy.

marginalisation is an increasingly important issue and, as a side effect of systemic transformation, one of the greatest concerns of the authorities, as it is responsible for a number of social unrests (see: Chen 2003; Gallagher 2005; He 2000), which, as claimed by Shirk (2007) and many others, threaten the position of the political elite.

In general, however, the overall development trajectory has been effectively maintained, bringing extensive developmental achievements in China. These achievements are far greater than in other post-socialist countries. However, despite the fact that in both Japan and Korea the pace of economic growth during the DS core activity period was faster than the change in people's welfare, none of the two countries experienced societal disintegration and marginalisation, characteristic of that taking place in China. On the contrary, it is believed that in Japan and Korea, the developmental state eventually contributed to social cohesion.

As far as the economic aspects of the process of post-socialist transformation is concerned, there seems to be a common agreement that the PST is about abandoning socialism and creating capitalism. The Chinese economy is becoming a market economy. The rights to private means of production are extremely unlikely to be abolished, regardless of the ideological and institutional direction the PRC decides to follow. Despite the heavy and extensive presence of the state sector in the economy, the private sector is expanding at a significant pace. Although many developed countries deny the recognition of China's market economy status (MES), the features of China's economy are essentially of a market character and certain alternative systemic and policy solutions, such as, extensive state interventionism as exemplified by close control and tight regulations regarding the energy sector, should merely be seen as the market economy variation. In fact, some of the steps taken by the leadership even suggest that China's development resembles, to some extent, Smith's capitalist development. As pointed out in chapter two, the process of capital accumulation is a significant part of the overall economic activities and a vital instrument in strengthening the state ability to guide the development trajectory. The wealth comes from trade and not from agriculture.

Among the post-socialist states there have been periods of following what was seen as liberal economic ideologies and more interventionist doctrines; hence each state's

policy would represent a mix of those two.<sup>54</sup> It is noteworthy, however, that, contrary to common opinion, critics to the allegedly inevitable transitional trajectory of post-socialist states guided by the neo-liberal principles, were indeed present at the beginning of the post-socialist transformation, mostly among political scientists, but also among some economists. This was exemplified in the statement made at the beginning of systemic transformation by the president Lech Walesa, who, knowingly or not, called upon creating a second Japan in Poland. Consequently, there was an alternative, unlike some would want to believe. White and Wade (1988, p.1) underlined that “late development”, which the states in post-socialist transformation have experienced, should have been seen ‘primarily in terms of Listian “political economy”, concretely as a process in which states have played a strategic role in taming domestic and international market forces and harnessing them to a national economic interest’. Particularly in the era of globalisation and the increasing interconnectedness of the economic processes “taming” and then “harnessing” seem of great importance.

The Korean and the Japanese DS cases were examples of an interventionist state – a DS-type interventionism in which the states would guide the developmental process, more directly in Korea than in Japan, where in the former certain business entities would be ordered to do certain things and prohibited from doing others (see: Wade 1990a; Graham 2003). This type of interventionism would, in general, be seen as less intrusive than classical interventionism or indeed socialist interventionism. Nevertheless, neither Korea nor Japan could be described as “low intervention countries”.<sup>55</sup>

What kind of interventionism is, however, the contemporary Chinese interventionism? Is the Chinese state a DS-type interventionist state? By the partial introduction of market mechanisms, initially in the rural part of the national economy, the degree of state interventionism was bound to diminish. Moreover, in the 1990s, China’s government accelerated the pace of economic liberalisation. During the negotiations concerning PRC’s accession to the WTO, the state’s withdrawal from some parts of economic life was forced by the necessity to comply with the broadly accepted WTO

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<sup>54</sup> The discussion on state interventionism has indeed a long history with important consequences in the post-socialist world. It is important to note, however, that the dispute in the post-socialist countries concerns internal economic ideologies which impact the type of domestic policies implemented, and should not be associated with the ambiguous global debate about the norms and rules of the global economy. Naturally, those subjects are prone to be mixed and confused in the course of debate.

<sup>55</sup> A term used by Wade (1992, p. 284) in his analysis of Korea and Taiwan.

rules. ‘The agricultural sector was partly opened. [...] China committed to extensive changes in laws and regulations governing entry [to its domestic market]’ (OECD 2009a, p.54). Additionally, as much as throughout the state-command period, effective central planning remained an unaccomplished issue. At the beginning of the reforms, the degree of effective interventionism would be limited by the fact that China, a predominantly underdeveloped and poor country, but foremost a very large entity, would have some difficulties in enforcing the centrally generated policy guidelines into the actual local policies. This often seems to be proved by the disparities between provincial level actions and state-level policy recommendations.

On the other hand, the communist legacy and a lack of democratic norms and procedures would suggest that the state has all the means to intervene in every aspect of political, social and economic life. Despite the process of economic liberalisation, China since the beginning of the systemic reforms has been perceived as an interventionist state. Deep into the transformation process partly characterised by this economic liberalisation, the 17<sup>th</sup> CCP National Congress (2007) implicitly reiterated the Chinese authorities’ commitment to extensive interventionism into the national economy and economic relations for supposed developmental benefits. The authorities rightly saw the previous waves of economic liberalisation as the means to achieve better developmental dynamics. Once, in their opinions, these means were exhausted, they did not hesitate to resort to extensive interventionist policies. The opportunity arose during the global financial crisis (2008/2009), when most of the large economies resorted to financial stimulation to combat the negative effects of the crisis. In the case of China, where socio-economic development largely depends on international trade, at a time of a dramatic decrease in world consumption, the necessity for a direct control of certain economic activities seemed obvious. The most important long-term incentive for increasing state interventionism, however, despite various market mechanisms in this field, has proven to be the global climate change. It is often believed that the current mode of economic development needs to be dramatically altered if we are to avoid a long-term developmental catastrophe caused by global warming. In addition to inter-state cooperation, this requires extensive state intervention, especially in a country responsible for a significant share of the world’s environmental pollution and greenhouse gas emissions.

Consequently, the Hu-Wen regime has had favourable conditions both internal and external to reverse the economic liberalisation course and to increase state interventionism. Without doubt, growing internal inequalities, the recent financial crisis and the issues concerned with climate change internationally and extensive environmental pollution domestically, gave the Chinese elite reasons for a more broad intervention in economic affairs, as can be seen by the general shift in the content of economic policy (see: PP 2009). This has been happening despite some improvements in the market regulatory environment (see: OECD 2009a).

In sum, it can be argued that from an economic systemic perspective, China has been very much an interventionist state. This interventionism is clearly seen in the earlier analysis of Chinese economic nationalism. The country has transformed from a state-command economy into market, but has maintained strong interventionism throughout the period of transformation. It is believed that the Chinese state is very much involved in what White and Wade (1988) seem to discourage; namely, direct production and direct regulation, and falls beyond guided interventionism.

The DS interventionism is characterised by the presence of a powerful economic bureaucracy. This prompts the question who “intervenes” on behalf of the government as far as maintaining, securing, and also designing and redesigning development trajectory is concerned. Upon close examination of the state-level administrative relations, institutional prerogatives and policy competences, it can be concluded that the role of the paramount government institution supervising the developmental directions and modernisation efforts in China is the descendant of the State Planning Commission – The National Development and Reform Commission (NDRC). NDRC finally took its present shape after the State Planning Commission had been renamed as the State Development Planning Commission (SDPC) (1998) and had merged with the State Council Office for Restructuring the Economic System (SCORES) and with a part of the State Economic and Trade Commission (SETC) in 2003. According to the official documents, NDRC ‘is a macroeconomic management agency under the State Council, which studies and formulates policies for economic and social development, maintains a balance of economic aggregates and guides the overall economic system restructuring’ (NDRC 2007). Its principles are:

1. To formulate and implement strategies for national economic and social development, long-term plans, annual plans, industrial policies and price policies;

2. To monitor and adjust the performance of the national economy, maintain the balance of economic aggregates and optimise major economic structures;
3. To examine and approve major construction projects;
4. To guide and promote economic system restructuring;
5. To carry out the strategic readjustment and upgrading of industrial structure, coordinate the development of agriculture and rural economy and guide the development of industry;
6. To formulate plans for the development of the energy sector and manage national oil reserves;
7. To promote the sustainable development strategy, social development and coordinated development of the regional economy and implement the Western Region Development Programme;
8. To submit the plan for national economic and social development to the National People's Congress on behalf of the State Council in accordance with the Constitution (NDRC 2007).<sup>56</sup>

As the agency responsible for the development of the country and therefore an organisation which contributes greatly towards the formulation of the Five-Year (Development) Plans (which serve as main guidelines for the short-term developmental and reform agenda), NDRC must be firmly positioned within the governmental structure to be capable of enforcing its recommendations and of effectively supervising the activities of other agents. The chairman of the Commission, selected from the members of the Central Committee of the CCP, is an extremely influential person (in the rank of the deputy premier), whereas some of his deputies are ranked at ministerial level. NDRC is often labelled as a “super ministry”, from the pre-2008 administrative reform,<sup>57</sup> reflecting its influential position among other ministries.

Another important institution concerned to a great extent with the country's development is the Ministry of Commerce (MOFCOM), whose main mandate is to

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<sup>56</sup> The details of NDRC's functions are presented in the appendix.

<sup>57</sup> As a result of the 2008 administrative reforms, five so-called super-ministries were established; namely, the Ministry of Industry and Information, the Ministry of Human Resources and Social Security, the Ministry of Environmental Protection, the Ministry of Housing and Urban-Rural Construction, and the Ministry of Transport. A ministerial level energy commission was also created. Initial observations suggest that the super-ministries are only now in the process of installing themselves as more important institutions within the governmental structure and are far less important than the old super-ministry – the NDRC. This reflects the philosophy of gradual reform, greatly preferred by the Chinese authorities over sudden changes. Their eventual strong position within the government seems guaranteed, as a result of the extent of their competences.

formulate development strategies, guidelines and policies of domestic and foreign trade and international economic cooperation (MOFCOM 2007).<sup>58</sup> This is because China's development is fuelled by international trade, similar to the historical developmental states.<sup>59</sup> MOFCOM, although often considered a "normal" ministry, enjoys a very influential position in the governmental structure, as opposed to some so-called "super ministries" created as a result of the 2008 administrative reforms.

It is worth investigating the competences and functions of the NDRC and the institutions largely believed to have constituted the core of the economic bureaucracy in the DS of Japan and Korea. The differences among them seem to reflect the overall state role during the Japanese and the Korean DS core periods, as well as contemporary China. The Japanese MITI acquired more of a guiding role, especially for the leaders in targeted industries and export activities. The Korean EPB and the Chinese NDRC seemed more in direct control of certain developmental aspects as far as the strategy formulation and policy implementation are concerned. Although MITI would play some role in other sectors of the Japanese national economy such as investment in plants and equipment, pollution control and the energy sector, it would focus mostly on the strategy of the industrial development. Although it would coordinate the general policies concerning international trade, its role in export facilitation would be limited to export competitiveness issues, whereas the overall export strategy would be developed with extensive participation of the Ministry of Finance and the Ministry of Foreign Affairs. As far as the general developmental planning is concerned, it was not a main concern of MITI, as the Japanese Economic Planning Agency would be the paramount agency in this respect. Johnson (1982) accurately described the role of MITI as compared to other state institutions in his examination of so-called deliberate councils – advisory bodies drawn from independent experts, who would advise the Japanese authorities on accepting or dropping certain policy proposals. Among 246 deliberate councils (as of 1975) only 36 were attached to MITI. The most important MITI-affiliated council would be the Industrial Structure Council, whereas the Economic Council would be attached to the Economic Planning Agency (see: Johnson 1982). Nevertheless, if we accept that the main component of the classical DS development was the industrialisation, then MITI would play a major role in this particular process. This is, however, the main difference between the Korean EPB, the Chinese NDRC and

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<sup>58</sup> MOFCOM's mandate is described in the appendix.

<sup>59</sup> The issue is elaborated in the following chapter.

the Japanese MITI. The Korean and the Chinese paramount economic bureaucracy agencies would play an important role in the overall developmental strategy formulation, not only within the industrial policy. The EPB would be, however, more economically intrusive than the NDRC. 'From its initiation, EPB came to have a powerful say over ministries through the budget' (Cheng *et al.* 1998, p.102), as it effectively controlled the amount of financial resources obtained by ministries. Amsden (1989, p.82) points out that the Korean agency would even determine micro economic projects to a great extent. This role in the Chinese administration system is rather reserved for specific ministries, and most commonly, local, provincial or county-level authorities. The EPB seemed also to possess a stronger political position than the NDRC enjoys currently, as it would be accountable directly to the Office of the President and the President himself. The leader of the EPB would be guaranteed a position equal to that of a vice premier and the Board would be in charge of the budget allocation to other ministries, as mentioned above. NDRC is accountable to the leadership of the State Council and has no budgetary allocative powers. Its strength derives from the fact that the NDRC recommendations become the governmental policies to be implemented by the ministries. It seems not embedded, however, in the Communist Party structure, although it seems hardly possible that the NDRC leader is not a member of the CCP Central Committee. Moreover, EPB infiltrated directly other ministers, unlike NDRC, by having its agents officially placed in the ministries' departments, who would monitor the sectoral progress. Nevertheless, NDRC does possess the privilege to monitor the implementation of recommended policies. The EPB and NDRC would be similar, as far as their analytical role is concerned. The important "intellectual arm" of the EPB would be the Korea Development Institute (KDI), whereas one of the main tasks awarded to the NDRC would be to analyse and examine the macroeconomic processes and the socio-economic development in all of the sectors of the national economy.

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In conclusion, it is important to make the final comparison of certain ideological, political and economic arrangements of China's development trajectory with those in the historically proven DS cases of Japan and Korea. All three countries are characterised by a type of nationalism which results in societal mobilisation behind developmental targets. Economic nationalism is a prevalent feature of the state

ideology, which impacts the policies and regulations. The political systems differ, as the Japanese DS enjoyed a democratic environment, with the institutional functions structured to facilitate the long-term developmental strategies, whereas in Korea, authoritarianism featured throughout the DS “core activity” period, with the state institutions subordinate to the overall development plan. China’s political environment remains authoritarian and in view of the developmental successes, a possible societal movement towards a political liberalisation seems rather a distant alternative. All three states can be considered strong states, however, contemporary China exhibits some potential for fragility. From the DS perspective, the degree of China’s institutional decentralisation can be perceived as a weakness, as it inhibits the state’s ability to implement policies.

In all three cases, including democratic Japan, the legitimacy of the ruling elite to power is drawn from developmental achievements along with nationalist promises. Undoubtedly, a fast pace of long-term development to enable effective catching up has been the paramount target of the economic restructuring and industrialisation in all cases. This developmental objective was achieved in Korea and Japan and is being achieved in China in a market economic environment. The market system of the DS model is characterised by a certain type of interventionism, which translates into a guided market economy. China’s economy is characterised by a presence of extensive interventionism to regulate the market.

The economic bureaucracy, necessary for a DS-type interventionist state, was extensive and well organised in the Korean and Japanese DS cases. It is also an important part of the Chinese administrative structure. In all three cases the economic bureaucracy was dominated by one paramount agency. Nevertheless, in Japan, this agency had the least broad area of competence.

State autonomy is present in all three cases. Evans’ embedded autonomy is most clearly visible in the Japanese case. The frames for the state-business alliance are yet to be fully formulated in China. Currently they are seen as extremely corruption-prone. Although in the case of Korea, the civic freedoms were greatly repressed during the DS period, China has the most coercive regime in the group with the worst record of respecting human rights. At the same time, the repression of the labour force is a distinctive DS feature of contemporary China.

## **Chapter 4: China's Development Trajectory and the Developmental State Model: Comparative Policy Analysis**

Strategically designed state-level long-term development policies aimed at state transformation so that it can become a developed country within a relatively short period of time are a crucial part of the DS characteristics. This chapter focuses on the main group of DS-related policies and establishes to what extent they are also the part of China's developmental efforts during the transformation period. The policy selection has been decided upon the policies' conformity with and importance for the DS model, as featured in the scholarly literature.

### **4.1. The Perceptions on Industrial Policies and the Developmental State Model**

Developmental states' economic modernisation efforts have often been referred to as a process of state-led industrialisation. Indeed, the process of industrialisation and thus the industrial policy seem to be the central elements of the DS, as the industrialisation, also seen as a part of the process of the departure from an economic system dominated by rural activities, i.e. urbanisation, is the core of the historical DS transformation. The literature on industrial policies is rather extensive and detailed.

Ha-Joon Chang (1999a) points out that there is no unambiguous definition of the industrial policy (IP) and that the term is often used in reference to too narrow a spectrum of economic activity, namely, the state subsidies policy, or too broad a spectrum, namely, any economic activity related to industry. Indeed, Cimoli, Dosi and Stiglitz (2009, pp.1-2) claim that industrial policy 'comprises policies affecting "infant industry" support of various kinds, but also trade policies, science and technology policies, public procurement, policies affecting foreign direct investments, intellectual property rights, and the allocation of financial resources. [They conclude that] industrial policies, in this broad sense, come together with processes of "institutional engineering" shaping the very nature of the economic actors, the market mechanisms and rules under which they operate, and the boundaries between what is governed by market interactions, and what is not'. Rodrik (2007, p.3) sees industrial policies as 'policies that stimulate specific economic activities and promote structural change, thus, are not [exclusively] about industry *per se*'. However, for Lindbeck (1981) those policies do not involve monetary and fiscal measures. For Haggard (2004, p.64) industrial policies

comprise ‘selective interventions designed to influence the allocation of resources among different activities’. This selectiveness seems to be at the core of the discussion on definitions of industrial policies. ‘When we talk about “industrial policy”, the majority of us do not mean any policy that affects industry [but] “selective industrial policy” or “targeting” – namely, a policy that deliberately favours particular industries over others, against market signals, usually to enhance efficiency and promote productivity growth’ (Chang 2009, p.2). “Against market signals” is the cause of the debate between proponents and opponents of the applicability of industrial policy as a developmental tool, in other words, whether industrial policy actually matters (Haggard 1990). ‘The traditional *rationale* for selective industrial policy (i.e. policies intended to promote specific industries as against general policies to promote industrialisation) has been made in terms of “market failures” that arise when competitive markets either do not exist or are incomplete, in situations, for example, when there are information asymmetries, scale economies, or externalities’ (Haque 2007, p.3). Its opponents question the correlation between the policies and the dynamics of economic growth (see: Krueger 1978; Krugman 1983; Pack and Saggi 2006; Page 1994; Quinn and Jacobson 1989; World Bank 1993; Woo 2011). Their objections concern the effectiveness of governments addressing the market imperfections and constructing adequate counter policies, and the governments’ ability to eliminate rent seeking and corruption associated with industrial policy (see: Rodrik 2007). Its proponents claim that ‘industrial policies [are] intrinsic fundamental ingredients of all development processes’ (Cimoli *et al.* 2009, p.2) (see: Amsden 1989; Chang 2002; Rodrik 2008; Wade 1990a; Zysman 1983, 1998), despite their shortcomings (Stiglitz 2002c). Graham (1992) claims that industrial policy opponents misread the history and that industrial policy has always been present in some forms, even in the United States during Reagan’s deregulation period.

There is a plethora of literature on industrial policy, its features, history and applicability. Shapiro (2007, p.12) claims that ‘in many ways, theories of industrialisation have come full circle’. Initially, the justification for industrial policy would come from the perception that market forces are incapable of structural change of the economy necessary in the process of socio-economic development. ‘Development is fundamentally about the structural change: it involves producing new goods with new technologies and transferring resources from traditional activities to new ones. [...] Poor countries remain poor because markets do not work as well as they could to foster

the structural transformation that is needed' (Rodrik 2007, pp.6-7). Therefore 'there was broad consensus around the basic assumption that development required [a] non-marginal change that market forces alone could not generate' (Shapiro 2007, p.2). Chang (2009) points out that the history of rapid development of currently affluent states is dotted with interventionist practices framed within the industrial policy, since the eighteenth century. Indeed, Alexander Hamilton – the first US Treasury Secretary – and Friedrich List are considered main historical proponents of industrial policy (see: Hamilton 2008). Thanks to Gerschenkron (1962) and others it became a conceptual tool in fighting underdevelopment. However, a “neoclassical backlash” resulted in the industrial policy being questioned as to its developmental role, as its application was allegedly linked to poor economic performance (Shapiro 2007). Although neo-liberal economic doctrine is in retreat, 'the context for the design of industrial policy has profoundly changed as a result of new rules governing international trade, the rise of global value chains and marketing networks, and other aspects of globalisation' (Haque 2007, p.1).

Most of the recent scholarly literature on industrial policy is associated with the rapid development of East Asian states. Socio-economic regional advancements have been closely linked among the main DS historical cases of Japan, Korea and Taiwan, not merely in the context of wild-geese-flying pattern (Akamatsu 1962), but also due to the long-term political and economic interaction, particularly intense during the Japanese colonialism (Cumings 1984; Doner *et al.* 2005; Kohli 1994; Wade 1990a). As far as industrialisation is concerned, the East Asian states are often portrayed against Latin American countries, the latter believed to be the first developing nations to industrialise. The main difference between the two regions is usually framed within the debate on outward (i.e. export driven) and inward (i.e. domestic consumption driven) industrialisation in East Asia and Latin America, respectively. However, according to Chang (2009, p.3), the East Asian type of industrial policy involves 'a lot more than handing out subsidies and providing trade protectionism (e.g., tariffs, import bans, quotas, domestic regulations at least partially intended to curb imports). According to him, industrial policy measures in East Asia included:

- coordination of complementary investments (the so-called Big Push) and competing investments through entry regulation, “investment cartels”, and (in declining industries) negotiated capacity cuts;

- policies to ensure scale economies (e.g., licensing conditional upon production scale, emphasis on the infant industries starting to export from early on, state-mediated mergers and acquisitions);
- regulation on technology imports (e.g., screening for overly obsolete technologies, cap on technology licensing royalties), when the state acts as a venture capitalist and an incubator for high-tech firms;
- regulation on foreign direct investment (e.g., entry and ownership restrictions, local contents requirement, technology transfer requirements, export requirements);
- export promotion (e.g., export subsidies, export loan guarantees, marketing help from the state trading agency);
- government allocation of foreign exchanges, with top priority going to capital goods imports (especially for export industries) and the bottom priority to luxury consumption good imports (Chang 2009, p.3).

In this large group, he pays special attention to the coordination of complementary and competing investments, the advantages of the economy of scale and the imperative of structural change, which is encouraged via the policies mentioned above (Chang 1999b).

In his “classic” work on Japanese industrialisation, Johnson (1982) distinguished two basic components of the industrial policy in Japan, corresponding to micro and macro aspects of the economy; the first – industrial rationalisation policy, and the second – industrial structure policy. ‘Industrial rationalisation means: (1) the rationalisation of enterprises, that is, the adoption of new techniques of production, investment in new equipment and facilities, quality control, cost reduction, adoption of new management techniques, and the perfection of managerial control; (2) the rationalisation of the environment of enterprises, including land and water transportation and industrial location; (3) the rationalisation of whole industries, meaning the creation of a framework for all enterprises in an industry in which each can compete fairly or in which they can cooperate in a cartel-like arrangement of mutual assistance; and (4) the rationalisation of the industrial structure itself in order to meet international competitive standards’ (Johnson 1982, p.27). Industrial structure policy ‘concerns the proportions of agriculture, mining, manufacturing, and services in the nation’s total production; and within manufacturing it concerns the percentages of light and heavy and of labour-intensive and knowledge-intensive industries. The application of the policy comes in the

government's attempts to change these proportions in ways it deems advantageous to the nation. [...] The heart of the policy is the selection of the strategic industries to be developed or converted to other lines of work' (p.28). Kagami (1995) underlines that throughout the period of Japan's rapid growth there were many IP definitions, which appeared in the scholarly literature, ranging from all MITI activities, via most policies intervening into the national industry, to selective actions within certain industries. He focuses his IP analysis on market limitations as the main reason to implement industrial policies, and following Goto and Idre he divides them into: traditional and recently added market failures, and market imperfections. He pays special attention to the economy of scale concept (internal and external), as Chang does, and to Marshallian externalities and start-up costs. The "internal" economies of scale concern the decreasing cost of production per unit with the increasing volume of production and with the accumulated knowledge of workers (so-called dynamic economies of scale). 'The "external" economies of scale mean that the average production cost in related industries declines in proportion to a production expansion in the main industry' (Kagami 1995, p.121), for example, in the case of "network effects" or "Marshallian externalities", when improvements in the main industry trigger improvements in related industries thanks to knowledge dissemination. Kim (1985, p.16), in his analysis of Korea, considers industrial policy to be 'all government policy measures that are aimed at promoting the development of [national] industry.' However, he distinguishes between those industrial promotional measures, which exert an economy-wide impact and those – industry-specific. In his analysis of Taiwan, Wade (1990a, p.30) sees industrial policies as functional and sectoral. Baek (2005, p.492) divides Chinese industrial policy into industrial organisation policy and industrial readjustment policy. According to him, the latter is the legacy of the socialist past and the existence of socialist heavy industry, as examined later in this chapter. For Bramall (2009a, p.397) industrial policy, as a selective assistance to some enterprises (as also understood by Brandt *et al.* 2008), has, in various ways, featured modern China during central planning and market economy periods.

It is symptomatic, how the content of industrial policy changes in different analyses of East Asia. For example, Cimoli *et al.* (2009) exclude financial system-related policies from industrial policies, calling them *compatible macro policies*. For Wade (1990a, p.30) 'macroeconomic policies affect aggregate demand, but they also affect different industries differently, although [are] not intended to produce such differential effects,

[whereas] industrial policies [...] are intended to affect production and investment decisions of decentralised producers'. Moreover, Page (1994), in his attempt to discredit industrial policy, attributes the East Asian developmental achievements to trade policy, setting those two apart. For clarity, one may appreciate the distinction between trade policy and industrial policy, as interrelated, nevertheless, different sets of state activities. Due to the complexity of the East Asian industrial and trade policies, it is perhaps also advisable to separate the financial sector-related activities. Much of scholarly attention has been directed at the financial sector, which has played an extraordinary role in DS industrialisation (see, for example, Lee 1992; Woo 1991, among others).

It is also important to note the post-socialist context of industrial policy. The socialist heritage and the pre-second world war tradition meant that a large part of CEE states was rather extensively industrialised prior to the PST process (Baka 2004). Zysman *et al.* (1998) claim, that during post-socialist transformation, the CEEFSU industrial policy had, to a large extent, a “back door” character. Due to a broad acceptance of the Washington Consensus provisions, the states initially did not design any explicit industrial policies, and the authorities often questioned their applicability (see: Balcerowicz 2003). Moreover, the term had an implicitly pejorative meaning, often associated with a state command economic system and the communist past. As a result, in the case of Poland the 1989-1991 “shock therapy” threatened to trigger de-industrialisation rather than industrial transformation, as industrial production fell by 30% (Klein 2007, p.191). Nevertheless, during the realisation of the economic policy called *Strategy for Poland* (1993-1997), the state authorities “reconciled” with the idea of industrial policy (see: Kolodko 1999a). It focused on the consolidation and restructuring of domestic companies (Comisso 1998). In Russia, industrial policy has been neglected during most of the PST period (Kolodko 2004a; Nekipelov 2005). Contemporarily, some scholars call for it to be reinstated (see: Lovert 2005), some claim it is indeed happening in some industries such as high tech (Fushita 2009). The question, however, is how post-socialist transformation affected industrial policy in China. The issue will be examined later.

Coming back to the DS-style industrial policies, the general approach to industrialisation in developmental states is concerned, firstly, with import substitution industrialisation (ISI) and then, with export-orientated industrialisation (EOI), as

discussed in chapter one. These processes are accompanied by gradual technological and, thus, value-added, upgrading of the content of industrial production. Historical experiences prove that the scope and the intensity of DS industrialisation allows for a significant expansion of production and the subsequent reorientation of the economy towards export, as the initial domestic capacities of absorbing the production volume come to exhaustion. This exhaustion is, nevertheless, an expected effect of industrialisation, as firstly, a relatively poor society of an early developmental state consumes less than the societies in developed nations and, secondly, it is international trade, which is expected to bring about rapid development. Export-led growth is seen as an important engine behind the DS developmental achievements. To sustain the developmental dynamics a developmental state seems to be forced to continue some manner of grand export dynamics. Consequently, the trade policy is a vital element of the DS architecture, in addition to a general industrialisation policy. Moreover, DS economic reorganisation, as much as PST systemic reformulation, takes place in a relatively short period of time. Thus, the state needs to possess additional tools for the creation of certain incentives to stimulate the development of industries, production and export. In the systemic conditions of market economy, characteristic for the developmental state, these incentives can be partly materialised through specific financial policies. The financial system is perceived as the bloodstream of the market economy, enabling economic activities to take place. Consequently, the usage of financial system-related instruments is also of great significance. It is important to note, however, that the interconnectedness of a state financial policy, state-led industrialisation and state-encouraged trade, results in rather bleak barriers as to which policy instruments should be attributed to a particular set of policies mentioned above. Moreover, state industrialisation policy, trade policy and state financial policy are together and separately a broad spectrum for examination. A thorough analysis of each would need to constitute a separate thesis. Theoretical considerations in chapter one, deliver, however, some important conclusions as to which elements of these state policies should be perceived as being at the core of the DS model. The DS-type state interventionism is a “guiding” type of interventionism. This means that the state manages the development trajectory via a certain pool of incentives. Those incentives encourage the business, partly via Wade’s “big followership” to certain activities in certain economic sectors. Consequently, industrialisation, international trade-related and financial policies should be examined from the point of view of encouraging commerce and industrial development.

There is empirical evidence, as illustrated later in this chapter, that, in general, the DS trade policy includes the erecting of certain barriers for imports and the establishing of incentives for export. In fact, export seems in the classical DS case a more important component of DS-related economic activities, as the import policy selectively deters foreign products from the market, at the same time attracting desirable commodities, and enables the domestic production to thrive without foreign competition, whereas export policy fuels the entire process of national development by delivering financial assets to the economy. In the DS model it is a strict selectivity of import and an extensive support for the export of certain products which matter. Therefore, the essence of the DS trade policy is the policy of (selective) import discrimination and (selective) export support, which, to a great extent, determines the volume and the genus of export and thus, to a considerable degree, domestic production. Consequently, in the process of the economic expansion of historical DS cases, domestic production was absolutely crucial. The assortment of production is a derivative of the industrial structure of a country, a result of the policy of industrialisation. Therefore, the export offer of a developmental state is the effect of the policy of industrial development, i.e. the policy of selecting and developing certain industries. The policies of import discrimination and export support and of industrial development are supported by certain activities within the financial sector of the economy. The state utilises financial system-related policies to encourage industrial production and international trade.

The comparative analysis of DS relevant policies is affected by the time distortion factor. In the case of Japan, the DS proper is believed to have taken place from the 1950s, until early 1980s. In the case of Korea, the DS is counted roughly from the mid 1960s until early 1990s. In the case of China's development trajectory during the period of systemic transformation, as a contemporary phenomenon, its commencement should probably be traced to the late 1970s. Different time frames mean that the respective processes have taken place in a different global institutional environment (i.e. different international conditionality) and at different stages of human social and technological development. This significant fact influences the reforms implemented and the policies followed by a state.<sup>60</sup>

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<sup>60</sup> Naturally, the differences in political and institutional background between China and the other two states have also had an impact on the reforms and policies implemented.

In the Japanese industrialisation policy the first half of the twentieth century was crucial in establishing Japan as a production base as well as the state which worked out the initial mechanisms of support for the preferential industrial sectors. The institutional formation commenced as early as in the 1870s during the “Meiji restoration”. In Korea, the industrialisation policy can be traced back to the early 1930s, and the state institutional reorganisation to the beginning of the twentieth century and the Japanese colonial rule. In China, the transformation period was preceded by the state-command economy (fully institutionally formalised in 1956 and lasting until 1978) and the communist political regime (since 1949).

The issues concerned with the policy of industrial development, the policy of import discrimination and export support and the state financial policy of support for industrial development and international trade, in the cases of Japan and Korea, are well researched. There is an increasing number of analyses, which attempt to examine the Chinese financial, industrial and trade policies in comparison with those of Japan, Korea and other Asian or developing countries due to the increasing role of China on the international economic scene and significant developmental achievements during the last three decades. Most of those analyses do not seem to address the similarities and differences from the perspective of the existence of certain features of the DS model. This is probably because the notion of the developmental state lost its attractiveness, due to the factors mentioned earlier in this thesis. As stated in chapter one, however, the DS model may still remain an interesting developmental option. Therefore, the following sections of this chapter will examine the above-mentioned, three most evident DS sets of policies in the case of China, with references to the historical developmental states of Japan and Korea.

Broadly speaking, the DS model is believed to be an institutional and policy option/alternative for some relatively poor countries in their quest of accelerating the socio-economic development and eventually catching up with the developed states. Consequently, the initial conditions of a DS must be similar to those in many developing countries, that is, the agricultural sector constitutes a major component of the overall national economy. The significant share of rural, agrarian-production-focused, economy is often seen as the predicament in overcoming underdevelopment. Consequently, the necessary background for the establishment of the DS is to commence the reorganisation of the agrarian sector and agrarian relations. Indeed, the

DS-related, as well as China-related, literature is concerned with rural development and agrarian reforms, necessary for subsequent effective industrialisation. Therefore, those processes will also be presented here in a comparative perspective.

#### **4.2. Agrarian Reforms and Rural Industrialisation**

Rural area reforms are usually not considered an element of the developmental state's architecture. However, considering the starting point of the DS transformation (i.e.) the relative backwardness of the DS economies and thus a domination of agrarian sector within the national economy, it is plausible to claim that rural changes are more than implicitly involved in the making of a DS. This is due to the fact that industrialisation of underdeveloped countries is linked to "de-ruralisation" or urbanisation, and includes a shift from the dominance of primary industry to secondary and tertiary, which is accompanied by a transfer of labour force from agrarian and agrarian-related jobs to industrial ones. It is symptomatic that land reforms have featured early or pre-developmental state periods, predominantly, to create political conditions for industrialisation and to increase the effectiveness of food supply. Interestingly, with all their differences, the land reforms of the late 1940s were, to some extent, similar in Japan, Korea, Taiwan and China, and involved the distribution of the land from the wealthiest, nevertheless often unproductive, elements of the rural society. Their political aim was to weaken the landlord class – usually a rich and influential, conservative caste – a factor to consider when implementing extensive modernisation efforts in the form of state-led industrialisation, and to gain the support of the less affluent parts of the society, at the same time, in the non-communist countries, to avoid a possible peasant rebellion leading to a change of the political system. In the case of PRC, landlords were natural enemies of the new regime. In Japan, the reforms were initially carried out by the American administration, in Taiwan – by newly arrived and not locally affiliated Nationalist government. There was much more to rural transformation than just a land reform. The economic, and thus developmental, aim was to increase the productivity and accelerate rural development (see: Alesina and Rodrik 1994; Cumings 1984; Donner *et al.* 2005; Jeon 1995, Wade 1990a), in the case of Taiwan and Korea, partly in the preparation for possible military conflict with communist China and communist North Korea, respectively. For example, the rural development policies in South Korea 'involved the creation of a corporatist network of public-private and parastatal organisations that gave subsidised loans to improve farmers' housing, provided

technical training, expanded irrigation and access to fertiliser, and disseminated seeds for higher yield varieties of rice' (Wade 1982, cited in: Donner *et al.* 2005, p.342). Improving rural infrastructure was also an element of rural development in China during the state-command period and rural industrialisation, 'primarily as a way of modernising agriculture (by supplying farm machinery, chemical fertiliser and the steel and concrete needed for irrigation systems' (Bramall 2009a, p.119). Bramall (2009a, p.94) argues that the land reforms in the CCP-controlled territories prior to 1947 were radical and aimed at an egalitarian distribution of land, whereas those implemented between 1947 and 1953 focused on an interim phase of the rich peasant economy (characteristic for Japan and Korea) – to increase production. However, eventually, by mid 1950s, the rural economy was fully collectivised, creating a very different structure from that in Japan and Korea. Therefore, in terms of rural economy, the initial conditions of the historical DS cases and in post-Mao China were dramatically different. However, a common denominator was that despite all these changes, agriculture was in all cases considered to have a merely supporting role for industrialisation and remained a rather neglected sector of the national economies. In China, this applies to both; the state-command and the market economy periods.

The developmental states of Japan and Korea began their period of rapid industrialisation with agriculture being in the hands of private small-scale owners (Kim and Lee 2003; OECD 2009c). China's post-socialist fast development started with the reforms of non-private large-scale unit agriculture. Typically for most socialist states, China's rural economy featured mostly collective ownership. Naturally, there were exceptions to collectivism within the Eastern bloc. For example, in Yugoslavia and Poland a bulk of agricultural production was from small-scale private farms (see: Johanssen 2001). Therefore, the post-socialist land reform in Poland was limited to the privatisation of large state-owned agriculture production units (PGR) of marginal meaning to the rural economy. However, other countries, as much as China, embarked on the de-collectivisation path. Johanssen (2001, p.12) points out that 'most of the countries have chosen to reform the communist agricultural system and most have chosen to adopt the principle of private ownership' despite the poorly defined property rights or a lack of legal sanctioning of private land. 'Furthermore, in general the restitution policy has been the dominant method in Central Europe, whereas distribution

to farm workers [has] dominated among the CIS<sup>61</sup> countries' (p.12). In this respect, China, with its land distribution to farmers without legal ownership entitlements, seems hardly an exception, and exhibits a one of the post-socialist patterns.

The ineffectiveness of the collective farming, especially visible in the Soviet Union, prompted Chinese authorities to resort to the systemic solution, imitating the rural conditions in Japan and Korea, if the country was to embark on a similar type of rapid industrialisation – hence, the distribution of land to smallholders. Naturally, the ideological constraints prevented the Communist government from transferring the land ownership rights, nevertheless the household responsibility system brought extensive positive results in terms of food production. Moreover, the DS rural environment was by no means optimal and hardly the most effective solution. Japan and Korea relied heavily on grain supply from the US in 1960s and 1970s (Cumings 1984), as the growth of agricultural output was rather slow (Bramall 2004). Nevertheless, it was created as a political conditionality for DS industrialisation and was partly determined by geographical conditions, rather than was chosen as the best option for rural development. Despite this, it proved more effective in food supplying than the socialist collective system.

In China – a large country with a number of historical incidences of malnutrition, the change in agricultural production mode was paramount. Agrarian reforms had also their political motives – by creating better conditions for development in rural areas, the CCP gained social support for the modernisation efforts. By creating small farming units rather than large *latifundia* the authorities made sure the rural power centres are fragmented and weak. The process of rural industrialisation accelerated during the reform period, despite it being also a visible element of late Maoism. As restrictions were lifted on non-agricultural activities, many peasants turned away from farming, commencing a period of dynamic transfer of labour force from agriculture to industry and services – a phenomenon observed in developmental states. As a result, in the mid 1980s, over 100 million rural peasants were working in non-farm activities (Wong 1988, p.3). Sanctioning private enterprise in rural areas effected a mushrooming of rural enterprises, among them TVEs, who rapidly increased their share in the national market and continue to engage a large part of the national workforce. The transfer of labour force is also visible through the increase in the number of migrant workers from rural to

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<sup>61</sup> The Commonwealth of Independent States.

urban areas (OECD 2009b). A dynamic transfer of labour force from agricultural to non-agricultural industrial jobs also featured the periods of high growth in Japan and Korea (see: OECD 2009c).

Land reform and rural industrialisation during the post-socialist transformation brought positive developmental results in the non-urbanised territories of the PRC. Naturally, one may question their extent. The dissolving of cooperative healthcare services and the deterioration of accessibility to the educational base may suggest a socio-economic regress in some aspects. There seems to be, nevertheless, an agreement that as much as during the state-command period, in the PST period, the rural areas, as compared to urban territories, have been neglected by the authorities. As a result, the urban-rural income gap continues to grow. A lack of adequate attention seems in some ways odd in the country which hosts over 20% of mankind and only 7% of the Earth's arable and husbandry land, which is rapidly decreasing due to environmental pollution and climate change. The explanation seems to lie within the model of China's development. As much as in DS historical cases, the agriculture plays an auxiliary role in the process of economic modernisation and the sector is aimed at supporting industrialisation. Therefore, in economic terms, the preoccupation is with securing a steady supply of food and labour. This is evident in most countries undergoing rapid industrialisation, also outside of the East Asia realm. Nevertheless, East Asia is a very explicit example of the disadvantageous position of the rural economy.

### **4.3. The DS Policy of Industrial Development**

In our analysis, a DS policy of industrial development can probably be summarised as a policy which determines which industries are targeted for development and why, and, what assortment will be produced as a result and by what sort of economic agents. This policy defines the change in the national industrial structure enabled by “sequencing and targeting” and thus can be seen as Johnson's macroeconomic industrial structure policy. It also relates to his microeconomic industrial rationalisation policy, as it involves, among others, rationalisation activities within industries and the institutional environment to effect a gradual technological upgrade of selected industries and, as it impacts directly the companies' capabilities. It decides in which sectors the “big push” takes place. In short, the DS policy of industrial development is about the philosophy of upgrading by learning and then by innovating, sustained via the mechanism of targeting

industries for industrial change, by using certain types of economic agents, as discussed below.

#### **4.3.1. Industrialising by Learning and by Innovating**

The developmental states' initial phase of industrialisation 'has come about as a process of learning rather than of generation of inventions and innovations' (Amsden 1989, p.4), as the late developers were in the position to "borrow" existing technologies (see: Gerschenkron 1962). Therefore, the DS industrial targeting, examined later in this chapter, would need to be primarily focused on those industries, who would contribute to the broad strategy of the overall catching up, rather than single out exclusively sectors associated with advanced technologies. In the DS conditionality, these industries would usually possess the potential of their products becoming widely desirable on the international market in the foreseeable future, as the DS growth would be export-led. For a developmental state to be able to maintain a certain competitive advantage and sometimes also domination on the international scene in production of certain goods in the long term, would not only require the utilisation of geo-economic superiority as reflected in the tradition of the manufacturing of particular goods and favourable locality for transportation and retail (selling) of its industrial products, but also constant upgrading, which would allow the production to be international market receptive. In other words, the changes in global international trade relations and consumption patterns would have to be met with adequate reaction on the supply side, for the industrial production to be sufficiently profitable. Eventually, this demand would be generated by supply, as a developmental state would move from copying existing technologies and, subsequently, products, to inventing technologies and, subsequently, products.

In practice, preferential treatment of what would be technologically-advanced production became an important feature of the developmental state and indigenous innovation has been a vital element of the East Asian developmental model (Evans 1998). Adequate levels of innovation would be achieved via investment in R&D and/or import of technologies. The quality of R&D could be achieved through the attraction of foreign specialists and experts, as well as foreign technologies, in the short term, whereas long-term effects would be achieved via the creation of a local intellectual base

composed of scientists and engineers. This would necessitate a constant nurturing of human capital formation via the expansion of the training base/facilities.

Although Japan is considered to belong to the “late developers” group, hence the initial process of innovation would suggest an importation and duplication of technologies, Japan’s rather early developmental start in the late developers group, as well as a general lack of a generic Asian policy of major FDI attraction, suggest that throughout the DS core period Japan, to some important extent, relied on its own R&D. Indeed, already at the beginning of the twentieth century, Japan’s expansion in cotton textile production was attributed to the utilisation of new technologies and adequate managerial coordination based on indigenous experiences and patterns. Mass and Miyajima (1993) point to the establishment of experimental industrial laboratories aimed initially at developing new technologies in the textile industries, as far as dyeing of material is concerned, as an example of R&D orientation. This policy resulted in a very high position of Japan in ranking of the Human Capital Index even among developed nations. The subsequent “targeting” of industries for development during the DS core period took into consideration the advantages of becoming innovative; hence offering technologically more advanced products. This is not to say that Japan refrained itself from importing necessary technologies during the DS-proper. On the contrary, the American companies were especially targeted for the transfer of technology. Initially, ‘Japan imported [...] technology for its basic and high-growth industries, and imported the greater proportion of this technology from the United States’ (Johnson 1982, p.16). The government was in charge of technology transfers and no technology would enter the country without MITI’s approval (Johnson 1982). Based on Foreign Capital and Foreign Exchange Control Law, ‘the Japanese government allocated its scarce foreign currency selectively to those firms capable of adapting and improving import technology, in order to encourage the importation of advanced technology and to promote a domestic technology base’ (Sakakibara and Cho 2002, p.678). Subsequently, ‘technological development was supported by direct and indirect production and R&D subsidies, the encouragement of multifirm research consortia, the discouragement of foreign direct investment in sectors in which it was technologically feasible for Japan to enter’ (Noland 2007, p.255). The proof of a strong R&D base was delivered during the early 1970s when Japan commenced reorganisation of its industrial sector towards future promising branches such as computer industry and electronics. As a result, by late 1970s, Japan became the world leader in semiconductor technology, following the

MITI's vision of "technology-based nation". Nevertheless, the R&D expenditure remained relatively low as compared with advanced economies and increased significantly only by the mid 1980s. Despite the fact that direct support for private R&D was introduced already in early 1950s 'the size of the incentives provided through tax breaks, subsidies, and low-interest loans was modest. [So was the] budgetary contributions to research conducted in universities and national research institutions' (Sakakibara and Cho 2002, p.678).

Korea found itself in favourable conditions as far as the process of learning and innovating is concerned, already prior to the establishment of the DS model. The state was seen by its coloniser – Japan as an important supply base for further Japanese expansion in Asia, hence the development of the country was viewed by the Japanese as crucial. This is why Korea's rapid and extensive industrialisation commenced under the Japanese rule. The first Korean companies<sup>62</sup> derived their innovation from imitating the Japanese firms and from heavily relying on transfer of technology from Japan. During the DS core period, Korea continued to rely on foreign technologies for its industries, partly benefiting from the US overall assistance. Nevertheless, in the early 1980s the government commenced the reorganisation of development trajectory into knowledge- and information-intensive industries, in which local R&D would play a crucial role. By Cho *et al.* (1996) this period is called "creative knowledge intensive era". The alleged initial low position in rankings on the Human Capital Index (see: Noland 2007) resulted in Korea's government paying more attention to the education of scientists and engineers. Chun (2002) points out that science-profiled high schools were for that reason supervised by the Ministry of Commerce, Industry and Energy and not by the Ministry of Education.<sup>63</sup> As early as in the 1960s, the government established the Korea Institute of Science and Technology responsible for developing industrial technology and the Korea Development Institute for conducting research on development policy. Foreign specialists were continuously attracted via income and career-development incentives. Korea became a good example of effective human capital accumulation (Kim *et al.* 1995; Lee 1997). Sakakibara and Cho (2002) claim, however, that the Korean government did not play an important role in a direct R&D promotion until the 1981 amendment of the 1971 Technology Development Promotion Law. Instead, R&D was mostly promoted indirectly through general policies of broad objectives. For

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<sup>62</sup> The companies set up in Korea were initially the Japanese *zaibatsu* such as Mitsui and Mitsubishi. Both companies became *keiretsu* after world war two (Morck and Nakamura 2003).

<sup>63</sup> For the analysis of the importance of the R&D during Korea's industrialisation see: Amsden 1989.

example, state support for certain companies would create conditions for the targeted firms to develop their own R&D base. ‘The new policy [as a result of the amendment] was geared toward both direct and indirect promotion of technology-intensive industries’ (p.679).

China’s tactics in developing innovative industrial branches seems similar to that present in the initial stages of the DS in Korea, as well as partly in Japan; namely, through the import of technologies. Its domestic market, large in terms of potential consumers and proven capacity to grow rapidly, made it easier for the Chinese government and Chinese firms to attract the inward transfer of foreign technology. The authorities ‘have been able to demand and entice technology transfers on a large scale from eager investors vying for the opportunity to market and manufacture their goods there’ (Linden 2004, p.4). According to Linden (2004, p.5) the absorptive capacity for technology is a distinctive feature of contemporary China, as compared to other East Asian countries. The technology transfer on a large scale took place also during the state-command period from the Soviet Union, prior to the Khrushchev’s thaw. However, during the times of economic opening up, the process accelerated significantly, especially in the special zones created for export production.

This is not to say that China has been entirely unsuccessful in nurturing the domestic research base. During the state-command it had a relatively well articulated innovation system (Linden 2004). It managed, for example, to develop a nuclear weapon programme. It recorded a number of innovations in food production (Bramall 2009a). During the systemic transformation period, the government efforts were initially focused on improving the research base. ‘The research institutes were corporatised and encouraged to obtain funds by competing for state-funded grants, performing contract research for enterprises or by licensing their technology for a fee (Liu and White 2001, cited in: Linden 2004, p.6). According to Lee *et al.* (2006) the PRC can be perceived as a good example of relatively effective strategy of “forward engineering”, in which the initiative rests in research centres and other academic institutions with intellectual potential who in order to implement the results of their research are engaged in the establishment of the manufacturing base. ‘Forward engineering is a top-down mode of technological development where the creators of scientific knowledge themselves further process the new or nascent knowledge until it could be applied to commercial uses’ (Lee *et al.* 2006, p.20). Three important computer equipment manufacturers, i.e.

Lenovo, Founder and Tsinghua Tongfang were all established by and affiliated with academic institutions (Lee *et al.* 2006).

The imported technologies serve as the basis for the development of local technologies and consequently local industries. This happens in a number of industrial sectors. The two most vivid examples are in the areas of renewable energy and of transportation. In 2007 China overtook Japan and Germany as the biggest producer of solar panels in the world. China's based Suntech company became the biggest manufacturer. In 2009, China became the biggest wind turbines manufacturer in the world. Currently, there is a number of Chinese companies whose position on the global solar energy-related market is increasing; Yingli Solar (originating from Hebei province) being, in addition to Suntech, another prime example. Moreover, the recent project of Solar Valley (in the city of Dezhou, Shandong province) is indicative of China's engagement in the development of the solar energy sector. The project, whose cost has been estimated at 740 mln USD, is aimed at establishing world's largest research and manufacture centre. As far as wind energy is concerned, the two largest companies, Sinovel and Goldwind, who account for 43% of China's production (CCM 2010), also became global players. However, although China has become the biggest producer of solar panels and wind turbines, the technology utilised in the production is predominantly from foreign sources. Representatives of the PRC's Ministry of Environmental Protection openly admit that China does not possess advanced technologies in this respect and is forced to import them.<sup>64</sup> However, as Chinese companies such as Suntech and Yingli Solar are becoming world leaders within their sector, they are being forced to increasingly rely on their own R&D, to maintain their affluent position on the international market.

The second example is the construction of China's high-speed railway system.<sup>65</sup> For this purpose CNR – the leading Chinese producer of trains – purchased German technology from Siemens and has since been modifying it for domestic purposes.<sup>66</sup> As a result of this cooperation the Beijing-Tianjin high speed railway line was opened in 2008. In 2009 the 1054 km railway line, which connects the southern city of Guangzhou with the Central China city of Wuhan, became operative. The third line connecting Beijing with Shanghai was opened in 2011.

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<sup>64</sup> Personal communication at the Ministry of Environmental Protection of the People's Republic of China, Beijing, 11/08/09.

<sup>65</sup> High-speed railways are considered those capable of 330km/h.

<sup>66</sup> With the assistance of Siemens' engineers based in the headquarters of the CNR branch for high-speed trains, in the city of Tangshan.

China's dynamic inward transfer of technologies is conducted partly without the consideration and respect for intellectual property rights, as has been the recent cases with the automobile industry, the food processing industry, computer software and others, involving, for example, German carmakers and a French food production chain. In 2007, the Chinese car manufacturer Shuanghuan was accused of copying one of the BMW and Mercedes models. The dispute between a French company Danone and a Chinese company Wahaha was related to the latter copying the products of the former. As a result of the Chinese court ruling in favour of Wahaha, Danone lost a large part of the Chinese market. Although IPR are well incorporated into the Chinese legal system and the National IPR Strategy<sup>67</sup> of the People's Republic of China has recently been launched, the enforcement of the regulations on the ground is very limited. This seems to be a deliberate policy of the authorities aimed at short terms benefits. In the long term, however, this policy may prove counterproductive, by discouraging international cooperation and by exposing Chinese companies to their own IPR infringement.

The insufficient development of domestic technological capacity and the existence of a relatively poor R&D base has implicitly been emphasised in the 2006-2020 Programme for Science and Technology Development prepared by the PRC's Ministry of Science and Technology. The Programme outlines the key industries which will enjoy preferential treatment from the state due to their innovative character, namely, biotechnology, information technology, new materials technology, advanced manufacturing technology, new energy technology, marine technology, advanced agricultural technology, and in particular biomedicine, nanotechnology and ICT technology, commercial aircraft technology and satellite technologies. It is intended that the expenditure for the R&D will reach 2.5% of GDP by 2020. There are currently over 4000 official research centres registered throughout the country, with estimated 250,000 full-time scientists (NBS 2008), and 54 high-tech industrial zones. The Programme states that the authorities intend to establish an additional 50 state research centres, 100 state-owned laboratories and 300 industrial technological centres. The Programme for Science and Technology Development and national level projects are complemented by regional activities and initiatives by various organisations. Many provincial governments create additional special entities, in which foreign investors who bring know-how can enjoy extensive assistance from the local authorities. China

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<sup>67</sup> Issued by the State Council on 5<sup>th</sup> June 2008.

Development Bank established a special fund for the Chinese graduates who return home from studying abroad and set up companies in the area of advanced technologies. Those initiatives are aimed at averting the situation in which, despite China maintaining a high third position in the world ranking according to the number of patents, these patents do not contribute significantly towards the innovativeness of the national economy.

The limited development of the domestic research base and a lack of efficiency in utilising existing research establishments for economic innovativeness, is why foreign partners remain the key for the further innovation of China's national economy. The European Union is the main source of innovative technologies for China, with German industrial companies such as Siemens (seen as the absolute leader in technology transfer to the PRC) at the forefront. The Chinese government does appreciate the technological cooperation, as expressed by premier Wen Jiabao during the EU-China Economic Summit in 2007.

There are, however, various barriers and obstacles in the effective delivery of new technologies into the Chinese market; firstly – a persistent lack of respect for IPR, as previously mentioned. The *2007/2008 Position Paper* published by the EU Chamber of Commerce in China enlists the lack of enforcement of the IPR regulations, as one of the most significant barriers for European companies to access and to operate on the Chinese market, which consequently would lead to enhancing the level of innovativeness of the Chinese economy (PP 2007).<sup>68</sup> Secondly – the regulations, which force foreign firms to disclose sensitive technological information when gaining access to the Chinese market. 'In various circumstances, companies are required to apply for technical and/or regulatory approval of a product (e.g. medical or cosmetic product) or for the authorisation to build a plant. Such enterprises are required to disclose to Chinese governmental agencies highly confidential information, information that goes beyond the scope necessary for the approval concerned' (PP 2009, p.77). Moreover, the regulations concerning the requirement of the majority share of Chinese companies in joint ventures in various industrial sectors are perceived as additionally affecting the willingness of foreign firms to cooperate and to deliver their know-how.

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<sup>68</sup> It is believed that the European small and medium enterprises (SME) possess the largest innovative capacity on the EU market. However, especially, SMEs are anxious to cooperate with Chinese partners or establish their base in China due to the relatively high possibility of their technology being illegally transferred to other local actors of the market. The IPR is usually one of the most important topics in discussion of the EU Commissioner of Trade and the representatives of the PRC government.

Despite numerous IPR violations, foreign companies are keen to be part of the strategy of “trading market for technology”. China opens its lucrative domestic market for those companies who bring in innovative technologies. With its population of 1.3 billion people, the country constitutes a great consumer market and thus represents incomparable opportunities for foreign commercial entities to conduct business activities. Many foreign firms are ready to benefit from access to this market in exchange for their know-how. Establishment of the Shanghai Bell joint venture in 1984 was perhaps the first effective implementation of this strategy (Lee *et al.* 2006).

In sum, it can be stated that all three countries, China, Japan and Korea have considered imitation and then innovation important elements of the policy of industrial development. The sources of innovation varied. Japan relied mostly on its own resources, China relies predominantly on the import of technologies, whereas Korea seems to have been an in-between model, in which technology-copying was gradually replaced by its own R&D. Undoubtedly, China intends to achieve the same position in this respect. ‘The indigenous development of intellectual property is a point of national pride’ (Linden 2004, p.2).

All three countries were characterised by inward technology transfer, with Japan being perhaps the least dependent case. During its rapid growth period, China has acquired technology by all means available, with and without consideration for IPR. Due to the attractiveness of its domestic market capacity as the main factor creating international supply, and the chosen DS-style development path of technological upgrading creating the demand, the technology transfer to China has indeed been impressive, to the extent that a number of Chinese companies, initially using imported know-how, managed to become world leaders in certain sections of knowledge-intensive industries in a very short time. Huawei is perhaps the prime example. In the case of Japan, the source of technology was the US, in the case of Korea – Japan and the US. In the contemporary China, it is the EU and, to some extent, Japan, Korea and the US.

In the context of the PSDS model, it is important, however, to return to the initial conditions for technological advancements of developmental states’ and China’s economies. Bramall (2009a, p.385) claims that without certain developments during the socialist period, China’s inwards technology transfer, even less its own R&D

development, would not be possible. He specifically points to the education expansion and defence industrialisation in the late Maoist period, which created “technological inheritance” crucial for developing the capacities for the subsequent economic modernisation during the systemic transformation. Perhaps China’s socialist period can be seen as Japanese colonial period in Korea and Taiwan and Meiji restoration in Japan, in terms of performing initial industrialisation. In the 1930s Japan-led industrialisation of Taiwan involved development of food processing, plywood, textiles, pulp and paper, cement, chemical fertiliser, aluminium and copper refining, petroleum refining and shipbuilding industries (Wade 1990a, p.74). In Korea, it involved textiles, processing of raw materials, mining, iron, steel, hydroelectric power and shipbuilding (Kohli 1994, p.1280). Industrial development in socialist China focused on heavy industry, including defence and machinery. Defence industrialisation is often believed to be a driving force for economic growth in developing countries (Benoit 1973, 1978; Ross 1991) as well as a catalyser of industrial upgrading.

The earlier-mentioned initial high ranking in human capital gave Japan an advantage in commencing a process of economic modernisation in the 1950s. Korea’s lack, to some extent, of the same human capital power, despite Japanese industrialisation, forced the government to rapidly intensify the efforts to improve the educational base (Chun 2002; Lee 1997). The societies of socialist states were on average better educated than the level of GDP per capita would suggest (see: Cereseto and Waitzkin 1986) – the case of Cuba being a distinctive contemporary example (Gasperini 2000). There is empirical evidence of improvements in China’s educational base in the 1960s and 1970s, especially at primary and secondary level (see: Bramall 2009a, Huang 2008, Gao n.a.). From the 1960s China began to converge with Korea and Taiwan. As a result, its human capital stock at the beginning of *gaige kaifang* was of a better quality than in Korea and Taiwan in the 1960s (see: Godo and Hayami 1999). It is, thus, legitimate to claim that the relative readiness for transformation, in terms of society’s skills and education, is attributable to its socialist past. The “socialist inheritance” put China in a better position to embark on DS-style industrialisation than would be the case of many non-socialist developing nations. The same could theoretically apply to FSU states, as those who during the state-command period dramatically increased the level of their societies’ education.

### 4.3.2. The Targeting

The anticipated degree of the innovativeness of particular industrial sectors have had an influence on the selection of branches for preferential treatment in the DS environment, as they would eventually partially determine the quality of the performance of the DS model. As mentioned earlier, a characteristic feature of the DS model was that certain sectors were deliberately targeted by the authorities for development as they were considered the most promising for the overall economic catching-up process with the developed nations.

It is important to note that “the targeting” of certain sectors does not need to mean that a given industry actually has a great significance for the overall development of a national economy. It means that the authorities consider this given industry to be promising in the long term. At the same time, some industrial sectors would not be targeted, but their importance for a national economy would be great.<sup>69</sup>

During the DS core period, Japanese government’s targeting encompassed various sectors. In the early days of the “DS-proper”, the priority was given to production of coal, iron and steel, as a part of the “priority production programme” (Kuchiki 2007, p.7). It should be seen as the continuation of the pre-war heavy industry development focused then on the military equipment, which would accompany the expansion of textile production from the late nineteenth century. Later, the focus also included electric power building and shipbuilding, as well as petrochemicals to produce synthetic fibre and chemical fertiliser, among others. According to Cumings (1984, p.2), this assortment of targeting represented the second phase of Japan’s industrialisation, which commenced in the 1930s and was completed by the mid 1960s. The late 1940s efforts were mainly focused on reconstruction of pre-war industrial sectors, whereas the theme of the 1950s industrialisation became the industrial catching-up (Kagami 1995). In a way, Japan followed the traditional development path of the early second half of the twentieth century, also present among socialist countries, where heavy industry was seen as the development’s engine in the 1950s, as part of the reconstruction efforts, after world war two. A similar recovery after the Korean war determined the initial targeting policies of the South Korean government during its pre-DS proper period, which

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<sup>69</sup> Moreover, some other industrial sectors would be targeted not because they constitute a future of the DS related economic expansion, but because they are indeed necessary in supporting DS targeting of other industries.

included cement and glass as well as refined oil products. Nevertheless, attention was directed shortly afterwards towards light industry (Mah 2010). During the 1950s communist China embarked on the development path by preferential treatment for heavy industry, including iron and steel production, as did the communist North Korea, with rather different final results, due to some ill-designed policies.<sup>70</sup>

In the 1960s, the Japanese government continued promoting heavy as well as chemical industries (HCI). Heavy industry remained strategic at least until 1970 (Kobayashi 1993, p.81). However, more focus was directed towards machinery and automobile industry. Although the Korean government also started paying more attention to heavy and chemical industries, as a potential export orientated production, nevertheless, the production was dominated by the light industry, including textiles (Kim 1985, p.6).

In the 1970s the Japanese targeting focused on machine productions and electronic industries, including computer industry. Undoubtedly, it was partly caused by the 1973 oil shock, as a result of which a number of energy-intensive industries such as aluminium, chemicals, and steel, found themselves in decline. Despite that, in 1973 Park Chun Hee announced its strategy of heavy-chemical industrialisation in Korea (Jeon 1995, p.74). HCI became a priority sector (Amsden 1989; Haggard and Moon 1986). As much as in Japan during the 1950s, the production of iron, steel, petrochemicals and non-ferrous metals became strategically important. The government also promoted the construction of shipyards (Kim 1985, pp.8-9).

From the late 1970s, high-tech products became the main target for the Japanese government's preferential treatment and the governmental support for R&D increased. In the late 1970s the Koreans accelerated the development of heavy and chemical industries, with the emphasis on industrial machinery, steel and electric equipment, whereas in the 1980s, similar to Japan, redirected its attention to knowledge- and information-intensive industries (see: Cho *et al.* 1996; Mah 2010). The change from labour intensive to knowledge intensive industries in both cases was also dictated by the rapidly increasing cost of labour (Kimura 2009; Cho *et al.* 1996). Needless to say, the targeting of industries was consequently reflected in the assortments of export goods.

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<sup>70</sup> In the case of China, the "great leap forward" was a very illustrative example of an ill-designed policy. Moreover, it is important to note that during the first decade after the Korean war, it was North Korea which developed significantly faster than South Korea.

The policy of targeting in China shows certain similarities with and differences from Japan and Korea. As mentioned above, the 1950s were characterised by heavy industry development. This strategy was only marginally adjusted during the late state-command period, when the machinery sector for rural industrialisation became a more visible element of industrial targeting. As a result ‘between 1953 and 1978 per capita production of coal quintupled, that of steel increased by 11 times, and that of electricity increased by 16 times’ (Naughton 2007, p.329).

‘After 1978, China diversified into a range of relatively low-technology, labour-intensive consumer goods that had been neglected under the planned economy’ (Naughton 2007, p.330). As early as in April 1979, the *Executive Intelligence Unit* reported that China turned away from heavy industry and shifted towards light industry (EIR 1979). China’s industrial development took a reverse direction from the classical mode, where labour intensive light industry development preceded more capital intensive HCI and machinery. This was precisely due to the fact that PRC commenced the process of post-socialist transformation. During the socialist period it followed the Soviet style HCI development, creating an illusion, as put by Naughton (2007), that it already passed the developmental period of early, labour-intensive phase of manufacturing development. Due to developmental necessities, however, heavy industry was not abandoned as a whole and the significant transformation of this industrial sector commenced. Already in 1981, the industry resumed the growth (Tidrick and Chen 1987).

To some extent, the simultaneous development of HCI and light, especially textile, industries characterised pre-DS Japan and Korea. However, Japan abandoned textile industry as a targeted sector early on, followed by a similar decision in Korea in the late 1960s. In China, light industry, especially textile production, still seems an important branch of the national economy, at least in terms of job creation. Within the manufacturing sector, textile production still engages the largest number of workers. In the year 2008 the total employment exceeded 20 mln people. However, by no means can it be currently considered a targeted industry, as governmental support seems limited to some provisions related to export. The state has withdrawn from textile production, which is now in the hands of private Chinese producers, joint ventures and foreign companies with their production bases located in China.

The HCI reorganisation and development in the 1980s included the increase in production of steel, iron, coal and oil. The targeting of steel and iron should be associated with both, international demand and Chinese domestic demand, related particularly to infrastructural expansion. The process of socio-economic development had to be accompanied by adequate infrastructure building. Indeed, it was often claimed that a lack of infrastructure development was one of the factors which hindered the developmental advancements in China prior to the systemic reforms. This is why the Chinese authorities decided to heavily invest in the sector during the reform period. Between 1982 and 1989 around 293 bln RMB was spent on 261 projects (Ke *et al.* 2009). A good indicative of infrastructural development is the length of motorways built. The first motorway Jingjintang highway was constructed in 1993. By the end of 2008, the total length reached 60,300 km. Moreover, the acceleration of economic growth would require intensification of the domestic production of energy. In fact, the targeting of development of energy industry was entirely motivated by domestic necessities, with the exception of the recent development of the renewable energy sector, aimed, to some extent, at the international market as a response to growing international demand.

In addition to construction and petrochemical, Kuchiki (2007) named two other industrial sectors, which became enlisted as targeted in the mid 1990s – the automobile industry and the electronics and machinery industries. Indeed, both sectors resemble the priority sectors in the middle stages of the Japanese and Korean DS. In general, the petrochemical industry featured in the early-to-mid DS core periods for both Japan and Korea, followed by automobile and machinery, and electronics – mid-to-late. In fact, the results of the middle DS period targeting are still part of the world's production assortments, where especially Japanese cars and Korean AGD products maintain dominant positions in certain layers of the international market. Naughton (2007, p.332) underlines that 'since 1995 new patterns of structural change have emerged in Chinese industry. [...] First, the overall shift toward light, diversified manufactures clearly came to an end after 1995. Traditional light industry products typical of the early stage of industrialisation declined dramatically as a share of China's industrial output. [...] Food products, textiles, garments, and leather goods dropped from 24% to 17% of total industrial sales. Instead, newly emerging industries with higher technological content grew robustly. Electronics and telecommunications equipment increased its share from 4.6% to 10.5% of total industrial sales.' The mid 1990s targeting in China is currently

also increasingly visible on the world stage. China became a main supplier to the outside world of a number of goods manufactured within the electronics and machinery industries. Among others, it manufactures 80% of world's digital cameras and DVD players, 70% of air conditioners and microwave ovens, 60% of electric cookers, refrigerators and notebooks, 50% of phones, electronic fans and colour TV sets, and 25% of cars. It is also the number one producer of washing machines.<sup>71</sup> According to China Machinery Industry Federation, the four major machinery-related industries became: automobile, power equipment, machine tools and construction machinery.<sup>72</sup>

The increase of technologically advanced products in the share of production volume and gradual turning towards knowledge-intensive industries became a feature of China's industrial development at the beginning of the twenty first century. For example, establishing semiconductor joint ventures with leading foreign semiconductor firms has been one of China's key industrial development strategies (Hu and Jefferson 2008). It was also a distinctive feature of Japan and Korea at their late stages of DS-proper. However, China's contemporary policy of industrial targeting cannot be simply summarised as a return to the labour-intensive production after the period of socialist development, and then gradual increase of capital-intensive industries, with clear focus on technological upgrading. The populous and underdeveloped country's industrial development strategy seems to have no choice but to adhere to the diversification mentioned by Naughton (2007), perhaps in the broadest manner possible. Indeed, currently in China, the areas of targeting are extensive and go beyond the classical industrial sectors. This is due to the fact that it could be extremely difficult for such a vast and populous country to focus entirely on a handful of industries in order to nurture national development.

Firstly, it is sometimes claimed that the agricultural sector enjoys "guiding" interventionism, where reorganisation, modernisation and technological innovations are aimed at enhancing the capacity in food production (see OECD 2009b), despite the common perception of inadequacy of government measures. The most populous nation in the world plagued by a plethora of famines, gears its policies towards the rather difficult task of securing food self-reliance. Indeed, diverting attention from the agricultural sector would have severe consequences for China. This is why China's

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<sup>71</sup> Compiled data from: National Bureau of Statistics of China and Ministry of Industry and Information Technology of China.

<sup>72</sup> Personal communication, Beijing, 10/07/09.

government currently tries to put a stronger emphasis on rural development (see: Fock and Wong 2008).

Secondly, HCI, controlled to a great extent by state-owned enterprises, is still being targeted, partly to secure the international position using the comparative advantage, as is in the case of the shipbuilding industry (characteristic for the early Japanese and mid Korean DS), and partly to satisfy the local market in need of infrastructure expansion. Many special enclaves still attract investment in heavy and chemical industries. For example, Nantong Economic and Technological Development Area (NETDA) specialises in chemical industries and this is the profile, which the local authorities intend to maintain.<sup>73</sup> As a result of this targeting, China's infrastructure, including roads, railways, bridges, buildings, has been growing rapidly. The country is currently host to the biggest number of skyscrapers, the fastest train in the world and the only maglev technology-based train for public usage connecting Shanghai city with Pudong airport, the longest bridge over the sea (the Donghai bridge), and the highest positioned railway (Qinghai-Tibet railway – the Tanggula pass).

Thirdly, the targeting involves the machinery and electronics industries, due to their labour-intensive character, in addition to being capital intensive, and possibility for a long-term competitive advantage. As a result, China has become an important producer of automatic data processing equipment (e.g. notebook computers), telecommunication equipment and components (e.g. mobile phones), household electrical appliances (e.g. refrigerators, air conditioners), electronic products (e.g. digital cameras, TV sets), as well as motor vehicles and their components, vessels (e.g. ships), construction machinery (e.g. cranes, excavators, etc.), among others.

Despite the policy of combining labour- with technology-intensive production, certain traditional industrial sectors such as light industry remain extremely important for sustainable development, although they can hardly be described as targeted. Regardless of the innovativeness element of the policy of industrial development, and indeed of China's entire economy, as the recent activities indicate, including those in the international financial markets<sup>74</sup>, the further development of labour-intensive traditional

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<sup>73</sup> Personal communication with the representatives of NETDA, Nantong, 29/11/09.

<sup>74</sup> The establishment of the China Investment Corporation (CIC), which attracted substantial attention from the international community, as the new governmentally-controlled institution and the largest hedge-like fund in the world, can be seen as innovative behaviour. The CIC, with its budget of around USD 250

branches of the national industry remains very important, as the labour transfer from rural economy into industrial economy must continue.<sup>75</sup> Although some scholars predict a slow but firm departure from labour-intensive production in places such as the Pearl River Delta due to the increasing labour costs, the overall status of China's economy still require the extensive development of labour-intensive industries. In order to proceed with the de-ruralisation process, one needs to continue a steady increase of the absorption capacities of the urban parts of the national economy.

Fourthly, the energy production and environmental protection-related industries gain their importance in the process of China's fast socio-economic development (see: Chatham House 2007, 2008). Indeed, China's international expansion partly aimed at securing imports of oil and natural gas from all corners of the world (see: Downs 2006; Rosen and Houser 2007), as well as the reorganisation and the modernisation of domestic mines in order to achieve greater efficiency, with the grand support of and the decisive role of the state, are clear examples not only of the level of demand for energy, but also of the intensity of targeting efforts. This is caused by the fact that energy shortages have been a real obstacle in economic development and China's energy efficiency is at the disastrously low level (Naughton 2007) (the GDP unit produced in China requires seven times more energy than that produced in Japan and four times more than that produced in the USA), making it an important environmental factor, since 67% of electric power is produced from coal, over 90% from fossil fuels, and 70% energy is used in industrial production. Moreover, the situation becomes increasingly difficult as in order to maintain the current pace of development, by 2030 China will need an additional 1300 GW of energy production capacity, more than the current overall US capacity.

Consequently, since the late 1990s, the industry development is compelled to take into account the necessity of limiting the usage of energy in industrial production as well as curbing the pollution emitted, which accompanies the process.<sup>76</sup> Thus, the energy

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bln drawn from large Chinese foreign exchange reserves, is believed to plan strategic investments in a number of projects domestically and internationally, to acquire a strong international position.

<sup>75</sup> Anecdotic data suggests that out of the over 700 million rural population, there were 293 million people employed in rural areas in 2007.

<sup>76</sup> It can plausibly be argued that until the summit in Rio De Janeiro in June 1992, which produced the UNFCCC or the United Nations Framework Convention on Climate Changes (an international treaty, whose objective is to stabilise greenhouse gas concentrations in the atmosphere at a level which would prevent dangerous changes to the climate) little attention was paid to environmental and climate issues in constructing developmental models.

production associated industries, such as coal mining, oil exploitation and transportation, nuclear plant building, as well as the renewable energy sector, are increasingly important. Due to the deteriorating environmental conditions and to climate change which impact on the entire planet, industrial development must involve the activities aimed at limiting air, soil and water pollution, including CO<sub>2</sub> emissions,<sup>77</sup> as much as the increasing of energy efficiency. A lack of a certain quality of water and energy supply interruption is an often-occurring predicament, which affects the Chinese industrial output. Due to environmental crises the standard of living is decreasing in the coal-intensive production provinces of Central China, with Lifeng (the Shanxi province) selected one of the five most polluted cities in the world.

Despite the fact that China has become the biggest polluter on the planet and that its energy efficiency is at an extremely low level, it must be acknowledged that those issues remain of a concern to the Chinese authorities and that certain sectoral policies in this respect are being introduced. The Ministry of Environmental Protection (MEP) has launched a number of initiatives, which became state policies, such as green credit, green insurance, green security and green trade.<sup>78</sup> ‘The Circular Economy Promotion Law came into effect on 1<sup>st</sup> January 2009. It establishes a legal framework for developing the economy, raising energy efficiency [and] protecting the environment. [...] China has also implemented various tax incentives and subsidies to support sustainable development’ (PP 2009, p.38). 38% of the November 2008 economic stimulus<sup>79</sup> was designated for green and eco-friendly projects. The Chinese government has repeatedly pledged to reduce the energy intensity and began to focus on reducing the carbon intensity in the process of industrial production, as indicated by premier Wen Jiabao during his speech in New York prior to the G20 summit in Pittsburgh.<sup>80</sup> Moreover, China participates in the NZEC (Near Zero Emission Coal) Initiative, which examines ‘the merits of various options for carbon (CO<sub>2</sub>) capture, transport and

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<sup>77</sup> China accounts for a quarter of global CO<sub>2</sub> emissions and 57% of the global increase in carbon emissions within this decade (Hallding *et al.* 2009, p.12). The European Commission estimates that by the year 2020 the per capita greenhouse gas emissions in China will exceed that of Europe.

<sup>78</sup> The policy of “green credit” ensures that good environmental performance is a criteria for companies to obtain bank loans. As far as “green insurance” is concerned, companies will be required to buy insurance from insurance companies, based on their environmental risk assessment. For heavy industries, “green security” means that companies within this sector will need to reach specific environmental standards in order to be listed on the stock exchange. According to the policy of “green trade”, products that are highly polluting and environmentally dangerous shall enjoy no trade privileges (see: PP 2009, p.38).

<sup>79</sup> The November 2008 economic stimulus was the package of financial assistance for a number of sectors of China’s national economy to avert the negative effects of the global financial crisis.

<sup>80</sup> 24<sup>th</sup>-25<sup>th</sup> September 2009.

geological storage (CCS) (NZEC Summary Report 2009).<sup>81</sup> At the same time, provincial and local authorities attempt to implement policies aimed at supporting green development, often in collaboration with the Ministry of Science and Technology – Shanghai’s fund to encourage energy conservation and emission reduction projects being a good example.

Naturally, from the perspective of the DS historical experiences, the energy sector targeting seems nothing more than a supporting activity for the DS core targeting, whereas environmental protection was hardly an issue in the DS cases. Contemporarily, the necessity for energy security makes the energy sector by all means a targeted industry, not merely in its supporting role of other industries. Moreover, the environmental protection-related industries constitute an integral element of any long-term feasible developmental model.

Fifthly, the sectors, which are currently subject to extensive targeting, were indeed the final DS targeting objectives in Japan and Korea, namely the new innovative technologies in knowledge- and information-intensive industries. This policy of targeting is aimed at replacing the “made in China” philosophy with the “made by China” doctrine, to use the words of a CCTV commentator during the national parade commemorating the 60<sup>th</sup> anniversary of the establishment of the PRC. Chinese authorities create fiscal and administrative incentives for companies bringing innovative technologies, often attempting to discriminate against these firms who are not in the possession of know-how. The law is constructed in such a way that the transfer of technology to Chinese companies is almost inevitable. At the same time, it is advocated on the international scene that a transfer of innovative technologies to China, preferably on a non-remunerable basis, is a necessary condition for alleviating the effects of climate change and environmental pollution.<sup>82</sup>

To reiterate, there are certain similarities and differences between China’s targeting and the targeting of the two other states. Japan and Korea went from pre-DS-proper

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<sup>81</sup> CCS technology is at an experimental stage. It is aimed at eliminating CO<sub>2</sub> from the atmosphere by capturing it at its source and then depositing it among geological formations underground. Twelve initial installations are expected to be built in the European Union.

<sup>82</sup> In the years 2007-2011 I visited a number of special zones, situated in such diverse places as the historical industrial bases of Liaoning province, the opening up policy’s off-springs in Zhejiang, and the underdeveloped Western China development hubs in Sichuan. In the overwhelming majority of cases, the local authorities would stress that the pool of incentives to establish business presence was linked to high-tech investments.

favouring of light industries, through labour intensive HCI and machinery industries, to capital-intensive electronics. Eventually, both countries focused on new-technology-, knowledge- and information-based industries, without, however, the hindering of their supremacy in some electronics and machinery sectors that they had achieved. China's process of industrial development during the post-socialist period has been to a large extent consistent with Japan's and Korea's – light, including textile, industry, then the HCI, subsequently machinery and electronics, eventually knowledge-intensive technologies. In this respect it is fashioned on the DS model, with two significant differences, however. Firstly, due to China's capacity, a number of industrial sectors are targeted simultaneously, with, as it seems, similar intensity. This is not to say that the Japanese and Korean governments adhered to a policy of single industry support, however, the shift in support seemed indeed more pronounced. Secondly, there are some types of industries, which did not constitute main targets in developmental states, such as agriculture, environment and energy, but do feature China's policy of targeting. Although Japan included environmental policies as part of its industrial upgrading and transformation (Kagami 1995), the importance of those three sectoral policies within the general state policies has increased only contemporarily, due to climate change, rapidly increasing environmental pollution and dwindling natural resources.

China's industrial targeting needs also to be seen in the post-socialist context. As a result of state-command industrial planning, 'at the start of reform, Chinese industry had already attained a substantial size. Chinese factories and mines employed more workers in 1978 than the combined total of all other third-world nations' (Brandt, Rawski, Sutton 2008, p.569). The dominance of heavy and defence industry resulted in two processes; firstly – the unusual character (Naughton 2007) of developing light industries, having had experience in developing HCI industry, against the common developmental pattern; secondly – a part of industrialisation policy has been focused on industrial restructuring rather than industrial development. Both phenomena are explained by post-socialist transformation. The reasons for resorting to light industry development strategy are well known; necessity to create a large amount of industrial jobs in a relatively short period of time, if the country was to abandon its underdeveloped pattern of rural economy dominance; short supply of light industry products as a result of HCI domination<sup>83</sup>; a lack of financial resources to develop

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<sup>83</sup> In the 1970s 'China's industries were still able to produce to only a level that supplied the population with severely rationed cloth and non-grain food commodities' (Huang *et al.* 2008, p.469).

exclusively capital-intensive industries at the beginning of transformation; necessity to embark on rapid development trajectory while performing a costly and long restructure of heavy industry; and finally, the desire to partly reorient the national economy to export production. Indeed, initially the labour intensive products of the light industry became the main export goods. As far as heavy industry restructuring is concerned, the reform took primarily the form of liberalisation of allocation mechanisms to allow more market-based incentives, ownership changes leading to partial autonomy, price deregulation, and changes in labour relations. At the same time, technological upgrade, usually by means of foreign technology, and changes in managerial practices, allowed for the modernisation of the sector. These modernisation efforts have allowed the industry to increase the quality and diversify production, catering predominantly for domestic infrastructure development. As a result, some large Chinese companies such as LiuGong<sup>84</sup> began even to operate on the international market, including the European Union.<sup>85</sup>

Throughout the DS core period in Japan and Korea and the transformation period in China, all the above-mentioned sectors would enjoy a preferential treatment additionally described in the sections concerned with the financial- and trade-related policies. This preferential treatment would be the direct consequence of the strategy of targeting. The mechanism of targeting would be sustained in a similar way in all three cases, that is, by a certain degree of control over production, distribution and consumption. This very control was more stringent in Korea than in Japan. Again, due to the time distortion factor, the economic environment seems more liberal in contemporary China than it was in Korea and Japan during their DS “core activity” periods. Despite what has been seen as a return to interventionist practices by the Hu-Wen administration and the attempts at strengthening the status of the national economy as a “regulated market economy” (China Daily 2007a), production, distribution and consumption is decided mostly by market demand and not by state administration.

Historically, after world war two, the Japanese government supervised production and product distribution, via the state policy of direct allocation of goods and rationing measures (Kagami 1995, p.125). This continued during the “priority production programme”, via the technology import approval mechanism and close monitoring of

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<sup>84</sup> LiuGong is believed to be world’s 20<sup>th</sup> and China’s largest construction equipment manufacturer.

<sup>85</sup> In 2011, LiuGong acquired HSW – the leading Polish steel producer.

developmentally-related spending on infrastructure (roads, harbours, hydroelectric powers). However, subsequently, the Japanese DS model was characterised by certain policy elasticity, thus a more liberal economic environment than in other DS cases. On the contrary to Korea, Japanese industrial policy was flexibly revised (Cho *et al.* 1996). “Deliberation councils” consisting of representatives of state administration, business and other knowledgeable circles, were good examples of dynamic adjustment in state policy (see: Johnson 1982). The loosening of state control was connected with the mid 1960s partial liberalisation drive and then with the late 1970s government’s promotion of further economic liberalisation. In Korea, the first attempts to relinquish the direct targeting in favour of more prominence for market forces were initiated in late 1970s (Haggard and Moon 1986). The real liberalisation policies, however, were implemented starting from the early 1990s (Chang *et al.* 1998). In the initial period of systemic reforms in China, the government directly controlled all production, distribution and consumption, except for the partly liberalised agricultural market. This was the legacy of the socialist period. The loosening of state control took place in the 1990s on the path to WTO accession, as discussed earlier. Although the gradual economic liberalisation has witnessed some retrenchments since, as some policy-makers call for closer monitoring and regulating of production and export, the extent of control in contemporary China, as Perkins (2001) points out, cannot reach the level equal to that in the Korean DS model, especially in the most developmentally successful years of Park Chun Hee’s rule, during which the decision on the nature and volume of both production and exportation was to a great extent reached in the presidential office, and then forcefully negotiated with Korean firms. Direct targeting of specific industries and specific companies was an integral part of the policy of industrial development (Kim 1985). Perkins (2001) also underlines that in Korea the effective control was not too difficult, in terms of achieving the desired manufactured volumes, as half of the value added production was in the hands of 200 or so companies. As far as Chinese companies are concerned, this big country hosts a vast number of economic agents, and despite the fact that some industrial sectors are controlled by a handful of privileged companies, national development cannot be facilitated by a small group of large enterprises, as was the case of Korea.

### 4.3.3. The Business Actors

This leaves us with the issue of the economic actors/agents facilitating the DS strategies as well as China's current development, and more specifically, with the question, what group of companies would become "national champions", to use the DS-related terminology. 'Below the level of the state, the agent of expansion in all late-industrialising countries is modern industrial enterprise, a type of enterprise that Chandler (1977) described as large in scale, multidivisional in scope, and administered by hierarchies of salaried managers' (Amsden 1989, p.9). In Japan, the initial facilitation of pre-DS textile as well as military production expansion was conducted by family-controlled conglomerates – *zaibatsu*, which significantly increased their role in industrial production during the governmentally motivated cartelisation efforts in the 1920s. Most of them, however, were dissolved in the late 1940s, as a result of the introduction of the antimonopoly law. In view of a certain economic liberalisation forced upon Japan, when it became an IMF Article VIII country (1964) and a OECD member (1966), the *keiretsu* conglomerates came into play as the only organisations capable of maintaining the Japanese firms' competitive advantage on the international market via the economy of scale. A number of internationally well-known companies have been either vertical or horizontal *keiretsu*, namely, Mitsubishi Group, Honda Group, Toyota Group, Nissan Group, Daihatsu Motors. At the same time, fully or partially (under various arrangements) government-owned companies have been present in the Japanese developmental state (Johnson 1982; Nielsen 1982) and played an important role until the mid 1980s reform (Nakamura 1996). In the case of the Korean DS, the main enterprises were privately-owned *chaebols* (Kim 1985), whose origins can be traced back to the Japan-led industrialisation of Korea and the presence of the *zaibatsu* on the Korean market. Kyongbang, Kongsin, Paeksan, Hwasin, Mokpo belong to the oldest *chaebols* (Kohli 1999, p.118), and among the most famous are Samsung, Hyundai and LG. In the early 1970s, 46 *chaebols* controlled 37% of value added in manufacturing (Perkins 2001, p.5).

In the case of China, the question of which companies could be the main actors/facilitators of the process of development, whether as was in the case of Japan – private as well as some state companies, or closely monitored private companies as was the case of Korea, continues to be perceived as an open question. Huchet and Richet (2002, p.173) name several groups of companies, which dominated the early stage of

China's systemic reforms; 'large state-owned enterprises run from the central government; small to medium-sized businesses in the state and collective sector set up in urban areas and run by local governments; [...] small firms in rural zones registered as collective enterprises and run by local governments; [and] private firms on the fringe of the centrally planned system; especially in trade and services.' The subsequent economic liberalisation and deepening of the ownership reform resulted in an increase of privately-owned companies. 'Since the mid-1990s, [...] new categories of Chinese groups with more complex control structures [emerged]: major financial holding companies in the public sector specialising in services, [...] commonly called "red chips" (CITIC, COSCO, China Resources, Beijing Enterprise); major state groups controlled by the central government and operating in protected sectors; state sector and collective groups that are leaders in competitive fields and have earned greater autonomy from their overseeing [mainly local] administration; joint ventures a majority of whose capital is controlled by a foreign company and firms 100% controlled by foreign multinationals; small groups in the state and collective sector controlled by local governments; private groups in competitive sectors that increasingly operate under the control of the main owner; small private and family collective commercial firms in the service sectors in urban and rural areas' (Huchet and Richet 2002, pp.173-174). Despite the ongoing reforms, in the mid 1990s, the authorities reaffirmed their dedication to supporting state-owned enterprises. 'Five hundred and twelve large SOEs were designated as priority companies by government industrial policy' (Baek 2005, p.489) and 'the medium and large-scale high-technology industry as well as the security-related sector[s] were selected among SOEs as strategic sectors of vital importance' (p.488). At the end of 1990s, the 'hundred largest [SOEs operated] in areas that [were] still strongly regulated and largely protected from both internal and international competition' (Huchet and Richet 2002, pp.175-176). Currently, state-owned enterprises dominate some of the targeted industries. The largest companies, such as Sinopec (petroleum), Shenhua Group (coal mining) (both in the energy-related sector), China Telecom (telecommunications), Baoshan Iron & Steel (heavy industry), CCCC (construction), as well as reportedly the biggest company in the world – PetroChina (the estimated market value in the year 2007 was 1100 bln USD), to mention but a few, are all state owned. It is the overall state policy to entrust the development of targeted industries and subsequently, the realisation of the developmental objectives in the hands of Chinese state-owned enterprises. Those enterprises are, by definition, easier to control and influence, to the extent that 'Beijing [is able to set] non-profit orientated

goals for state-owned enterprises to accomplish, and thereby [can use] the SOEs to further its industrial policies. These goals may require that SOEs make suboptimal decisions for political [...] purposes' (Haley 2007, p.2). Moreover, Huang (2008) suggests that the favouring of large SOEs has taken place at the expense of other companies, especially private Chinese SMEs (small and medium enterprises), as an element of building a "state-led capitalism" where private indigenous entrepreneurship is repressed and the dominance of state firms ensured by extensive support. Consequently, the current policy suggests that the central government has indeed chosen the actors for the implementation of the developmental strategies. Therefore, some insight into the ability of the main economic actors to facilitate China's development trajectory may be provided by the analysis of the reforms of SOEs, which in itself is a topic well researched (see: Jefferson and Rawski 1999b; You 1998; Zhang 2000). On the other hand, the emergence of private enterprises as well as the increasing importance of private Hong Kong and Taiwan based firms may result in them taking over the targeting policy implementation in, at least some less politically sensitive sectors, once they have gained the authorities' consent. The policy of building the national economy's innovation capacities, very important for the successful contemporary development, can be realised (under state guidance) via private companies. The European example shows that a significant part of know-how is generated in small and medium-sized private enterprises. The last two decades of lack of significant developmental achievements in Japan is often attributed to the fact that large state-owned enterprises and *keiretsu* multi-conglomerates with complicated and conservative managerial structures, which impact, among others, the decision-making processes, failed to secure an adequate innovativeness of the Japanese economy, which in turn, slowed down, reaching recession point at a certain stage. The clear case study is Sony, a long-time innovator in the electronic industry, which has failed to manufacture a breakthrough innovative product comparable to the invention of the walkman.

#### **4.4. The DS Policy of Import Discrimination and Export Support**

Despite the Japanese DS rather late development of export-oriented regime, all the East Asian DS examples prove that export was an important drive behind the fast socio-economic development. The trade policy would involve the establishment of barriers for import and incentives for export. The import substitution industrialisation (ISI) would include import barriers. Export orientated industrialisation (EOI) would involve export

promotion. Nevertheless, it is very difficult to categorise the plethora of policy instruments used by the developmental states. In this section we deal with general trade policies, custom duties and quantitative measures rather than incentives which are broadly referred to as subsidies. Those are analysed in the next section.

According to Prebisch (1950) developing countries should introduce import substitution strategies in their developmental quest, as due to the dominance of their primary commodities export and industrial products import, they suffer unfavourable terms of trade. Consequently, the general DS trade policy was characterised by “import substitution” and then by “export orientation”. Those concepts, however, should in no way be seen as opposite. On the contrary, in the DS model, the natural consequence of the successful policy of import substitution was the gradual introduction of export orientation policies. In Japan, the dual strategy was already present in the years 1914-1938 (Mass and Miyajima 1993, p.153), when the state became a world leading textile exporter. The earlier mentioned cartelisation process was accompanied by increased import tariffs and anti-dumping laws. After world war two, Japan followed a similar path. Up until 1975 it was domestic consumption, and thus ISI, which drove its economic growth (Johnson 1982, p.16). All international trade was under government’s direct control (until the early 1950s) (Kimura 2009). Later, two factors caused the steady climb of average trade tariffs rate, namely; gradual reduction of tariff exemption for machinery and the increase in tariffs on food imports. For example, sugar customs duties hiked from 15% in 1951 to 100% in 1959 (Yamazawa 1975, p.386). Import substitution production was additionally enhanced in the DS-proper period via the exercising of strict control over import, mostly via quota systems, where in the 1960s almost 500 types of goods were under the import quota system (Sakoh 1984, p.531), including steel products (as early as in 1950). Economic liberalisation moved Japan closer to an EOI pattern. However, this liberalisation focused on eliminating quota-style quantitative restrictions, whereas tariffs continued to be important tools in restraining imports. The agreements brokered during the GATT’s Kennedy Round (1964-1967) effected a gradual decrease in Japanese tariffs from the late 1960s. In the early 1970s, the government implemented a number of effective tariff reductions on mining and manufacturing products, as well as on agricultural goods (Yamazawa 1975). In the late 1970s, the measures to prevent import and promote export were gradually eliminated, whereas in the early 1980s the policy of import promotion took place, in order to balance the Japanese trade surplus.

‘Until the late 1950s, Korea was a typical inward-orientated economy’ (Nam 1995, p.154). The early DS period was characterised by import substitution production. Soon after the Park Chung Hee regime took over power, the EOI became the dominant focus (Jeon 1995). The government introduced various export incentives. Nevertheless, export, was closely monitored, to the extent that the decisions on the product type, the exporter and the targeted market were greatly influenced by the state administration. Moreover, the ‘Ministry of Commerce and Industry set annual export targets for officials connected with export administration’ (Kim 1985, p.30). At the same time, protection of the domestic market played an important role. The government tightened import control, while the general import tariffs rose to 40%. The tariffs diversification and tariffs exemptions allowed the government to steer the inflow of goods and capital. For example, intermediate goods for export production and some capital goods for special uses or specific industries were imported duty free (Nam 1995). Imposed import quotas were awarded to companies proportionally, according to their export volume (the export-import link). Although the first attempts at import liberalisation took place already in the late 1960s, the effective policy took shape in the early 1980s. In both cases, Japan and Korea, the export incentives took predominantly the form of various financial system-related policies, thus the topic is examined in the following section.

Tariffs and quotas were extensively used by developmental states to manage international trade. Selective discrimination of imports and selective support for exports, the latter especially via various financial incentives, were important features of historical DS cases. However, those policies have been, in particular, affected by the time distortion factor due to the evolution of the international economic order and international economic rules. Due to globalisation, which ‘adds more actors to the policy process in developing states and [...] increases the power of “external” actors over state policy’ (Breslin 2003, p.228), the degree of openness of national economies worldwide, during the time of China’s systemic transformation, has been significantly greater than during the DS core periods of Japan and Korea. As a result, ‘compared to the growth takeoffs of Japan and Korea, China’s opening occurred at an earlier stage and went further’ (OECD 2009a, p.35). One must, thus, take into consideration that the process of state guidance of China’s development trajectory is affected by the fact that the Chinese authorities are unable to use certain mechanisms of import/export limits, barrier, quotas, readily available during the times of the Japanese DS and the Korean

DS. This situation is exacerbated by the fact that China became a member of the World Trade Organisation. Its path to WTO (1986-2001), as well as its accession's consequences, are well documented (see: Breslin 2003, 2007; Lardy 2002; Zweig 2002). Domestically, there has always been opposition to joining WTO, however both – president Jiang Zemin and premier Zhu Rongji eventually supported the idea. Internationally, the negotiation process was aimed at ensuring that China would not obtain benefits derived from the status of a developing economy, despite its persistent claim to be a developing country. As a result, 'China's accession protocol entailed significant concessions far exceeding the obligations of previous "developing country" members' (Breslin 2003, p.221). During the first five years of membership it was obliged to effect a significant reduction in trans-border barriers, as 'the agreement mandated a further reduction in tariffs in a wide range of sectors along with the conversion of quotas into tariff equivalents' (OECD 2009a, p.54).<sup>86</sup> The average tariffs fell from 15.88% to 9.82% (OECD 2009a, pp.152-153).<sup>87</sup> Further liberalisation in the field is expected and required and any protectionist behaviour is usually met with reaction from the EU and the US, as expressed during the High Level Economic Dialogue meetings between the EU and the PRC, and as proved by the US engaging the Chinese on occasions in the WTO dispute settlement mechanism. Moreover, China's participation in the OECD's "enhanced engagement" programme, during which several large developing economies, including India, Brazil, Indonesia and South Africa aim to improve their economic, as well as political transparency and adhere to market economy rules in their economic-related conducts, will put additional pressure on the Chinese government to refrain from using protectionist policies. Thus, it is difficult to argue with Zweig (2002) and Lardy (2002) that China's trade policy is, to a large extent, determined by foreign factors and international pressures.

Consequently, Chinese authorities had to find the means and mechanisms to cope with this international conditionality characterised by a high degree of intrusiveness into domestic economic affairs and to benefit from the distinctively different institutional arrangements of the global economic order than that during the Japanese and Korean DS core periods. It is believed that to a large extent China has been successful in achieving this, as the contemporary Chinese economic expansion illustrates. China's

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<sup>86</sup> One should not confuse the obligation of tariffs reduction, imposed by international agreements China chose to be a part of, with the general change in the state ideology to increase state interventionism, especially visible after the 17<sup>th</sup> CCP National Congress.

<sup>87</sup> Not to mention that in the year 1992 the average tariff level was around 42% (see: Ianchovichina and Martin 2004 and OECD 2009a, pp.152-153).

interventionist attitude and economic nationalism resulted in the broad usage of non-tariff means to hinder import (e.g. standardisation) and promote export (e.g. political and developmental cooperation with other developing countries), as the way to circumvent the effects of economic liberalisation.

Some means of import discrimination have been examined in the previous chapter in the section on economic nationalism, where access to the market is limited by laws, regulations, policies, sectoral activities and ad-hoc actions, in place of customs duties. One of the main policies in this respect involves China's standardisation practices. According to PP (2009, p.140), with 22,900 national standards, 40,000 industry standards, 14,000 local (provincial, municipal) standards, China has more standards than all the European states combined and no systematic structure to govern them. Moreover, 'the Chinese standardisation infrastructure is growing extremely fast, and with this growth inevitably comes growing complexity' (PP 2009, p.140). There are conflicting regulations on various levels, especially as far as industry standards are concerned, and access to the information regarding procedures is limited. The country seems to remain behind its WTO commitments to adjust national standards to international norms. Indeed, unwilling to accept and adopt international standards and certification procedures, the Chinese authorities effectively utilise standardisation procedures to constrain the market access and to discriminate against foreign products. One case clearly demonstrates the level of determination to use this tool. In October 2008 during the EU-China trade negotiations concerning the free flow of certain groups of goods, in response to Peter Mandelson's (then the EU Commissioner for Trade) questions as to why China would not allow access of European medicines to its market, knowing that in order for them to be sold in the EU they had to go through very detailed and exhaustive scrutiny, Chen Deming, the PRC's Minister of Commerce, replied that "we Asians are different. That's why we need to employ our own procedure and our own standards". Although one can understand that, in general, China is often unwilling to accept international standards to allow market advantage for domestic producers, the response of Chen Deming was not only racist but also sub-intellectual.<sup>88</sup>

Coming back to the issue of ISI, in the case of China, the import substitution has always been an important component of the overall developmental strategy, during the socialist and post-socialist periods. In the conditions of state command without appropriate

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<sup>88</sup> I personally witnessed this exchange of opinions at the MOFCOM headquarters.

market mechanisms of financial intermediation, the persistent lack of so-called hard currency funds, ISI was perhaps the only way to industrialise and indeed it was vigorously implemented by Zhou Enlai in the 1970s (Bramall 2009a). In terms of instruments, ‘by the mid 1980s, China had moved from a planned trading system to a system of high tariffs, multiple nontariff barriers, and abundant administrative discretion, a system that was in many ways typical of developing country ISI strategies’ (Naughton 2007, p.385). Because of the socialist heritage, trade barriers had to be redefined rather than erected. Thus socialist style trade barriers were replaced by custom tariffs for subsequent WTO negotiations (Naughton 2007).

It is export, and thus EOI, however that became an increasingly visible element of China’s developmental advancements. In 2009, the country became the biggest exporter in the world, which was the result of the long-term state-level export support policy, as from the early 1980s China’s authorities were creating a wide pallet of incentives for export production. The policy was clearly visible in the creation of special zones, in which manufacturing would be export-orientated. As opposed to Japan, where the DS model was not characterised by the existence of some special designated geographical structure to play a significant role in export expansion, in this regard, China resembled some Southeast Asian countries with their special zones to attract FDI and with their export processing zones (e.g. in the Philippines and Malaysia) (see: Ishida 2009 and Ge 1999) and indeed Taiwan, who established the first Asian export-processing zone in Kaoshiung, and Korea – in Masan city. Indeed, the special zones, where a relaxed taxation policy as well as other indirect incentives are applied to attract foreign capital, have been a pillar feature of the Chinese development trajectory. The special arrangements were created for special economic zones (SEZ) in Shenzhen, Zhuhai, Shantou and Xiamen (1979-80), as well as Hainan (1988), open coastal cities of Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai (1984), open zones in the Yangze river delta and the Zhujiang (Pearl) river delta, the triangle of the South Fujian, the Liaodong and Shandong peninsulas, the Hebei and Guangxi provinces (1985), the Shanghai-Pudong zone (1990), open ports of the Yangtze river – Chongqing, Yueyang, Wuhan, Huangshi, Jiujiang and Wuhu, as well as the thirteen open border cities – Yining, Bole, Tacheng, Erenhot, Manzhouli, Heihe, Suifenhe, Hunchun, Ruili, Wanding, Hekou, Pingxiang and Dongxing. In addition, fifty-four economic and technological development zones (ETDZ) have been created in various parts of the

country. The goal of all special zones has been the support for the grand development plan of the country, via export-oriented production, as well as via attracting capital, new technologies and managerial skills to improve the effectiveness of the entire Chinese economy.

Currently, although some fiscal incentives are still in place, special zones do not enjoy the same privileged position as previously, due to economic liberalisation throughout China and the process of the unification of business tax rates. Moreover, Chinese “classical” export products have already achieved a satisfactory international position, and the conditionality of international trade relations should secure their long-term participation in the global market. Thus, extensive governmental support does not seem to be necessary. Naturally, both the EU and the US are on occasions threatening to impose tariffs and other barriers on Chinese products, using a vast range of arguments, from politically-motivated to economically-related antidumping measures<sup>89</sup> and this may, in theory, affect the position of Chinese products on the global market. Nevertheless, the Chinese authorities learned to negotiate those threats, by skilfully adopting the Western rhetoric advocating the necessity of the liberalisation of the international market and the abolishing of trade barriers.

The PRC government has utilised certain tools in order to promote Chinese export expansion. There is a special state-level, and indeed greatly influential agency, which promotes international trade, namely the China Council for the Promotion of International Trade (CCPIT)<sup>90</sup> and its quasi-commercial wing, as opposed to the CCPIT governmental character – China Chamber of International Commerce (CCIC). CCPIT does not only focus on export promotion, but generally on international trade cooperation, including the promotion of the importation of new technologies. In many ways it is similar to the Japan External Trade Organisation (JETRO), created in 1958, and the Korea Trade Promotion Corporation (KOTRA), which was established in 1962

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<sup>89</sup> As has been the widely publicised case of China-made shoes for the European market.

<sup>90</sup> According to the official website, China Council for the Promotion of International Trade (CCPIT) (established in May 1952) comprises VIPs, enterprises and organizations representing the economic and trade sectors in China. It is the most important and the largest institution for the promotion of foreign trade in China. The aims of the CCPIT are to operate and promote foreign trade, to use foreign investment, to introduce advanced foreign technologies, to conduct activities of Sino-foreign economic and technological cooperation in various forms, to promote the development of economic and trade relations between China and other countries and regions around the world, and to promote the mutual understanding and friendship between China and people and economic and trade circles of all nations around the world, in line with the law and government policies of the People's Republic of China (CCPIT 2008).

as the governmental agency to promote export-related activities and to assist the companies involved in export as well as to conduct overseas marketing.<sup>91</sup>

Other export-incentive tools can be described as being part of the process of China's overall international economic expansion. Negotiations of trade barrier elimination (as was the case of establishing a free trade agreement between China and ASEAN<sup>92</sup>) and realisation of development projects in exchange for access to natural resources (as is the case of cooperation with African countries, periodically reviewed during the FOCAC<sup>93</sup> meetings) are aimed at promoting Chinese products and at opening additional markets for Chinese goods. For example, CAFTA (China-ASEAN Free Trade Agreement), which took effect in January 2010, creates more opportunities for Chinese exporters in one of the most dynamically growing regional markets, as the custom tariffs have been reduced from an average of 12.8% to 0.6% (Chinese export to ASEAN) and from 9.8% to 0.1% (Chinese import from ASEAN), at the same time, enables closer economic ties with countries which serve as an important base for raw materials and energy resources for the Chinese economy. China's economic expansion is particularly visible in smaller ASEAN economies, namely Myanmar, Laos and Cambodia.<sup>94</sup> The policy of economic expansion in the developing world is sustained via developmental assistance through financial instruments and direct investments, as reiterated by premier Wen Jiabao, in his speech during the 2009 FOCAC summit, in which he emphasised that China would provide African states with 10 bln USD worth of credit on preferential terms, forgive debts of the poorest African countries, liberalise trade barriers, invest in 100 energy production projects, send 50 teams of agriculture and food experts and donate 500 mln RMB for medical supplies, among others. It is estimated that between 2004 and 2009 the value of China's development-related projects in Africa was around 14 bln USD and they included reconstructing Angola's roads, railways, hospitals, schools and water systems, building a gas-powered electricity plant in Nigeria and a hydropower plant in Congo, among others. Closer cooperation between China and Africa not only allowed China access to untapped energy resources and raw materials, but also opened new markets for its goods. As a result, only between the years 2007 and 2009, Chinese export to Africa grew from 37.3 to 47.7 bln USD (a growth of 27.9%). A similar policy

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<sup>91</sup> The Korean government also developed a system of trade companies specialising in export – *chonghap sangsa* (Kim 1985).

<sup>92</sup> Association of Southeast Asian Nations.

<sup>93</sup> Forum on China-Africa Cooperation

<sup>94</sup> Personal observation from visits to ASEAN states, January-April 2012.

towards Latin America increased China's export from 51.5 to 57.1 bln USD (a growth of 10.9%) (CCS 2007, 2009).

The recent political rhetoric backed by some scholars' opinions suggests that the policy of export support will in the long term be relegated to a category of less importance. Indeed, the actions on the part of the government may indicate a significant turn in its politics. In 2007 and 2008 tax deductions for exporters were significantly reduced. In January 2008, an extra customs tax was imposed on the export of agricultural products. The official propaganda stresses the importance of more extensive import of goods, in order to decrease the foreign trade imbalance. This seems to be in line with Japanese policies of the early 1980s. Moreover, the authorities realise that export dependency might negatively influence the economy, as its status depends greatly on the international economic situation. In fact, the Chinese model of export dependency has often been criticised, as making the national economy excessively vulnerable to external shocks and foreign economic agents. Therefore, the policy of boosting domestic consumption is vigorously implemented, so that domestic consumption becomes the main pillar of economic growth. What has to be stressed, however, is that regardless of whether China's GDP growth will be fuelled by domestic consumption, which nevertheless is a remote perspective, export will remain important for the national economy. There are structural long-term factors, which determine the position of export within Chinese economic activities. The most populous country in the world, with scarce arable land and the continuous diminishing size of what is available for cultivation, will be forced to accelerate the volume of agricultural importation in order to feed its increasingly affluent and expected-to-be-well-fed population. Despite the official propaganda, it will not be achievable exclusively with domestic resources. The consequent import of goods will have to be met by maintaining a certain level of export dynamics, in order to shape the necessary balance. Moreover, development of labour-intensive industries, necessary in the process of shifting the rural populations to non-agrarian employment, will continue to put pressure on export expansion, as a large volume of manufacturing will not be absorbed domestically. In addition, the globalisation process, in a way, already requires national economies to maintain a high volume of exchange, as trade contributes to economic innovation by pushing towards greater competitiveness. Consequently, the policy of export support will have to be maintained in one way or another. In fact, the 2008/2009 global financial crisis forced the Chinese authorities to temporarily reverse the policy trend of a slow departure from

the support for export activities, due to a dramatic fall in export volume. At a time of a rapid decrease in consumption around the world, China has attempted to maintain a high level of international retail of its products by various actions in the sphere of the policy of export support together with the policy of financial support, including fiscal means such as the reintroduction of tax preferential treatment for certain export sectors, for example, the textile and toy industries.

#### **4.5. The DS Financial Policy of Support for Industrial Development and Export**

As far as the DS financial policy of support for industrial development and export is concerned, I will focus my analysis on those main financial policies and financial reforms, which facilitated the development of industrial production and the development of export. Some of them had to be mentioned in previous sections of this chapter in reference to trade and industrial development policies.

Woo-Cumings (1999, p.10) sees finance as the nerves of the developmental state. Sindzingre claims that ‘financing the developmental state could be achieved at the external level via foreign direct investment, debt, and aid, and at the internal level via taxation – public revenues and spending –, domestic private savings and investment’ (Sindzingre 2006, p.6). East Asian countries are believed to be in a way privileged, as far as the potential availability of domestic financial assets is concerned, since their nations are characterised by widespread preference for a high rate of savings. It is worth mentioning, however, that high savings featured in Korea only in the late 1970s, and the industrial policy was initially financed primarily from foreign loans. Moreover, Shen Minggao from the China Citi Group believes that the high saving rate within Chinese society is not culturally motivated, as some would like to believe, but is forced both by the relatively low purchasing power of the population, leading to long periods of saving before goods such as cars, property, etc. can be purchased, and by a poorly developed financial sector, which results in limited options for private credit, hence making it impossible to obtain loans for such purchases.<sup>95</sup> Our interest here, however, does not lie in the broad issue of financing the developmental state, but rather in the question of how the financial policies support the developmental state’s activities in terms of industrial production and export.

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<sup>95</sup> Personal communication, Beijing, 17/09/07.

It is important to note here that the effects of the financial policies have often been questioned as to their real influence on the actual industrialisation and socio-economic development, especially in the case of Japan (see: Sakoh 1984, Noland and Pack 2003). The criticism usually comes from the opponents of the industrial policy. Indeed, it is often difficult to find a correlation between the specific policies and the increasing dynamics of the development of certain industries and sectors of the national economy. Nevertheless, the lack of a proven positive correlation does not mean that there is no negative correlation in the absence of certain policies. In other words, to give an example, the fact that the direct link between financial subsidies for heavy and chemical industries (HCI) and the pace of development of the HCI may be difficult to establish, does not mean that in the case of a lack of those financial subsidies, the HCI would develop at a similar pace. One also should take into consideration that the usage of financial and fiscal instruments towards specific industries, are most likely to produce some effects in other sectors of the economy, not necessarily, as it sometimes may be argued, in a negative sense.

To nurture the development of certain industries, as well as to boost export, the DS financial policy of support would involve the direct and indirect channelling of financial assistance via banks or state institutions in the form of credit subsidies and other subsidies, regulatory actions such as domestic tax policies and price control mechanisms, as well as monetary policies such as the manipulation of interest rates and exchange rates. All those policies are sometimes classified as subsidies related (see: Magnus 2006; CTI 2009). The entire history of DS model in Japan and Korea is featured with extensive interventionism in the financial sector. The same applies to China throughout the period of systemic transformation.

#### **4.5.1. The Monetary Policy and the Banking Sector**

Unlike in many post-socialist countries, including Poland, where the monetary policy of the central bank has focused on maintaining a low level of inflation, and, to a considerable degree, ignored the developmental necessities in favour of financial stability, the monetary policy in developmental states was always subordinate to the developmental targets, and was often realised via maintaining an artificial rate of exchange in order to boost export (China throughout the reform period, Korea in early 1960s), or, via multiple exchange rates, which would allow for the market adjustments

necessary in order for the exporters to maintain an adequate level of international competitiveness (Japan and Korea in some years of the DS model functioning, as well as China). In fact, in the case of Korea it was the Economic Planning Board, which during the Park Chung Hee times realised to a great extent, the monetary policy, due to its proximity to the state leader. A similar situation applies in the case of China, where the People's Bank of China (PBC) does not enjoy any freedom, and is merely a tool in the overall development policy, as has been seen in the policy of the foreign exchange rate (see: Lardy 2005; Yu 2010; Morrison and Labonte 2011). The flexible management of the exchange rate regime has been a part of China's strategy of export development (OECD 2009a). To enhance international competitiveness, the exchange rate was devalued on three occasions in the 1980s and the dual exchange rate system was introduced in 1981.<sup>96</sup> In order to further enhance the level of the competitiveness of Chinese exports, the PRC maintained an undervalued RMB pegged to the US dollar. Under international pressure, as well as because of certain internal conditions, in June 2005, the RMB was revaluated at 2.1%, and the daily allowable rate fluctuation was set at 0.03%, which was subsequently extended in 2007 to 0.05%. The case of the controlled gradual de/revaluation of the RMB proves that monetary policy is entirely subordinate to the developmental objectives. The undervalued RMB increases the international competitiveness of the Chinese export, as indicated above. A liberalisation of this course, insisted on by the Western world, would have, at least in the short term, a negative impact on developmental dynamics, despite the arguments about creating a healthier financial environment and cheapening the import, which is important for the PRC as far as the trade imbalance and the cost of supply of energy resources and raw materials are concerned. This policy of maintaining an undervalued currency was a common practice among the developmental states. In the case of Japan from the 1950s until 1971 the Yen was pegged to the dollar at the value of 360, as was the Korean Won in the 1970s. Due to rapid development of the Japanese economy which would have led to currency appreciation, at the end of the 1960s, the Yen was significantly undervalued (Yamazawa 1975), hence, a series of revaluations in the 1970s.

The lack of policy-freedom of central banks was similar to the lack of freedom (to various degrees) in the entire banking sector. In Korea, especially during the fast development of the Park Chung Hee era, the banking sector was closely controlled by the state and fulfilled the developmental objectives. In 1962, 'the structure of the

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<sup>96</sup> The exchange rate regime was subsequently reunified in the year 1994.

Monetary Board, the supreme authority overseeing monetary policies, and the management and administration of the Bank of Korea and the management and operation of the banking system as a whole, were altered drastically' (Lee 1992, p.190). Banks were nationalised. The central bank became an arm of the Ministry of Finance, as the powers of Finance Minister as a chair of the Monetary Board were expanded. Its budget would be overseen by the EPB and the export and policy loans flow would be influenced by the Ministry of Commerce (Woo 1991, p.159). The Bank of Korea enjoyed significant supervisory powers towards commercial banks (Euh and Baker 1990, p.10). This control was even tightened in 1972 as a result of an Emergency decree which was intended to 'dramatically improve the financial structure of businesses, primarily by relieving them from the burden of private money market loans' (Chun 2002, p.24). As a result, 'the role of banks, both commercial and specialised, became that of credit-rationing outlets for the government as the allocation of credit was tightly controlled by the Ministry of Finance' (Lee 1992, p.190). At the same time, this policy became a tool to influence businesses, as 'by controlling their access to credit the government controlled their decisions on resource allocation and thus the pattern of industrial development' (Lee 1992, p.189). Financial liberalisation came in the early 1980s, 'as part and parcel of stabilisation' (Woo 1991, p.189), together with the general trend of opening up and phasing out the industrial policy. Major commercial banks were privatised (Nam 1995).

In Japan, the environment looked more relaxed, where, although the post-world-war-two reconstruction-related investments were financed by the state's Reconstruction Finance Corporation, in the 1960s the dominant lending/investment was done by private banking (Sakoh 1984, p.523). Nevertheless, such governmental institutions as the Export-Import (ExIm) Bank and Development Bank of Japan played an important role in the process of financing development (Suzuki 1987) and also in encouraging other banks to finance specific projects. Moreover, in the Japanese DS arrangements under the "main bank system", each enterprise would be informally bound to one particular bank, which it would, among other activities, draw its financial assets from (see: Aoki and Patrick 1994). This would create a certain degree of safety associated with the fact that the financial assets would be entrusted to an institution often partly controlled by the enterprise or that this institution would hold considerable equity holdings in the enterprise. In both cases, that of DS in Japan and that of DS in Korea, the banking

sector was a semi- or non-independent component of the financial sector, an infrastructure to provide services to the economic actors of the DS model.

In the case of China, despite Xu's (1998) claims that the political elite saw it as an important part of transformation, the financial sector has been worse developed than even in the early years of the DS model in Korea and Japan. Initially, the banking sector was dominated by four state-owned, so-called, policy banks, each with its division of competence, i.e. to which sectors the financial resources should be channelled. For example, the Agricultural Bank of China would facilitate the transactions in rural areas, whereas the Industrial and Commercial Bank of China would do the same in the urban territories. The Bank of China would be engaged in foreign transactions. Nevertheless, the underdeveloped financial sector is believed to have played an important role in development of rural areas in the 1980s. Huang (2008) points out that, due to the relaxation of state policies and support from government officials, the Agricultural Bank of China began broader crediting of non-state businesses, by expanding the range of businesses eligible for loans (e.g. private rural enterprises in addition to household businesses) and by eliminating certain regulatory obstacles (e.g. it waved the loan-guarantee requirement for some costumers). Its limited capacities, in view of the rapid development of the rural economy, were supported by rural credit cooperatives (RCC) – structures enjoying relative autonomy, who became the main source of funds for rural businesses; by rural cooperative foundations (RCF), which accumulated capital from certain activities related to the privatisation process; and by informal finance – private business entities tolerated by the officials (Huang 2008). At the same time, however, in urban areas ‘most credit continued to be allocated on the basis of the plan [as opposed to market allocation] at interest rates fixed by the authorities’ (OECD 2009a, p.36).

Huang (2008) underlines that the rural financial liberalisation came to an end, and the subsequent “financing repression” of the 1990s reversed the process. Banks were ordered to change their lending priorities from private to other businesses and within the rural economy were encouraged to support agricultural activities rather than non-agricultural enterprises. Bureaucratic control over RCC was tightened to the extent it affected significantly their lending abilities. There was a crackdown on informal financing. All the banks began to realise the governmental policy of investment according to the leadership's wishes (central and local), mainly into the state-owned enterprises. In particular, the China Construction Bank (one of the four big state-owned

banks) would focus its activities on assisting the SOEs in the process of additional capitalisation.

The policies were subsequently relaxed and the limits of activities abolished after the 1994 reform, as a result of which the PBC acquired the formal role of a central bank.<sup>97</sup> Nevertheless, the preference for a state-owned sector prevailed. The arbitrary channelling of funds into politically motivated projects without proper economic justification, present also in the DS model of Korea, in the case of China, resulted in extensive NPL (non-performable loans) problems, so called “bad loans”, which until today remain unsolved and are likely to continue to contribute to the level of fragility of the Chinese financial sector.<sup>98</sup> Currently, when private banks are free to operate and, due to the WTO regulations, foreign banks have the right to operate their businesses in the PRC, the large state-owned banks are still the ones awarded the programmes related to the development plans of the state, especially in the area of infrastructural activities as well as financial services pilot projects. Naturally, this is met with significant opposition from several foreign banks, such as Standard Chartered, who upon fulfilling the high capitalisation requirement to enter the Chinese market, would like to participate in the lucrative financial services projects.<sup>99</sup> In sum, one may argue that the Chinese state-owned policy banks can be perceived as the financial sector’s state agents for supporting the developmental strategy.<sup>100</sup> This approach is consistent with the Korean DS model.

#### **4.5.2. Indirect and Direct Subsidies**

In all the above countries, the banks have realised a policy of indirect subsidies offering preferential rate loans for designated sectors and designated enterprises. These were usually described as policy loans or subsidised general loans (Woo 1991, p.163). The mechanism was based on subsidised interest rates (Kim 1985, pp.36-37), and the market distortion in Korea became so significant that export loans had negative real interest

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<sup>97</sup> The informal role as a central bank the PBC acquired in 1983 (OECD 2009a, p.36).

<sup>98</sup> According to the OECD the situation is improving. The ratio of NPLs to the overall volume of loans from the banking system fell from 18% in 2003 to 6.2% in 2007 (OECD 2009a, p.47).

<sup>99</sup> Information obtained during a personal communication with a representative of the Standard Chartered in Beijing, 06/12/07.

<sup>100</sup> It does not mean that they are the most efficient supporters of this strategy. In fact, they enjoy their status because, firstly, the government feels more confident in relying on financial support from the institutions it fully controls and, secondly, the effectiveness of other banks, especially the large foreign banks, is compromised by the fact that they face a large amount of discriminatory treatment on the Chinese market.

rates (Woo 1991, p.164). Woo (1991) distinguished three ways of generating policy loans in Korea – from the banking system, the fiscal-type taken out of the state budget, and from the National Investment Fund (since 1973). In the 1970s policy loans accounted for over 40% of domestic credit. Preferential loans were initially granted for the textile industries and later – for export and all the HCI sectors, including transport infrastructure, energy and defence. In Japan, ‘capital channelling to preferred sectors was implemented through direct subsidies, indirect subsidies through state-owned or dominated banks, and preferential tax brakes such as accelerated depreciation on investment’ (Noland 2007, p.255). Policy loans mostly benefited the targeted industries – iron and steel production, electric power and shipbuilding. A direct credit allocation to selected industries on concessional terms was supplemented by governmental direct subsidies. However, Kimura (2009) claims that the government needed to exercise significant pressure on banks, especially Japan Development Bank, to provide policy loans, as on the contrary to Korean authorities, its involvement in providing direct subsidies was much smaller. Gradually, the policy loans were phased out in both Japan and Korea – during the process of economic liberalisation.

Direct subsidies featured already pre-DS Japan for the designated textile production industry. The Japanese government used the Fiscal Investment and Loan Programme in the endeavour of selective investment in targeted sectors and enterprises, whereas in Korea this role was fulfilled by the National Investment Fund. In Japan, the initial purpose of the direct allocation of foreign reserves was to purchase foreign technologies. It is important to reiterate that the preferential policy of direct and indirect subsidies was not only directed at targeted industries, but also – at particular enterprises. In Korea, especially during the HCI targeting, the subsidies were given to certain enterprises, who managed to gain favour from Park Chung Hee.

In China, direct and indirect subsidies have been seen as a favourable tool and the Park Chung Hee policy of designated enterprise targeting have been used towards large state-owned enterprises active within the so-called pillar industries, namely automobile, machinery, electronics, petrochemical, construction. They include governmental grants and governmental interest subsidies, debt forgiveness and loan guarantees at no cost, as well as preferential lending rates for companies investing in western China, and for high-tech companies (see: Wong *et al.* 1995). Although the official propaganda of the 15<sup>th</sup> CCP National Congress insisted on privileged financial treatment for small and

medium enterprises, the large SOEs have been the major beneficiaries of the main four state-owned banks' loans, guaranteed through, for example, "specific project financing". The most vivid examples of subsidies provided in various forms to a handful of companies were presented in *An Assessment of China's Subsidies to Strategic and Heavyweights Industries*, submitted in 2009 to the U.S.-China Economic and Security Review Commission of the United States Congress. The report named several companies which exceeded the value of 1 bln RMB in subsidies received, namely; Huaneng Power International Inc. (HPI), one of the leading power producers engaged in developing, constructing, operating and managing large-scale power plants throughout China – the total value of subsidies has been estimated at over 1.9 bln RMB in various forms, including governmental grants (423 mln RMB) for e.g. construction of desulphurisation equipment; China Blue Chemical Ltd. – a company producing mineral fertilizers and chemical products – 1.7 bln RMB worth of subsidies; China Telecom Co. Ltd. – 5.3 bln RMB; China Shenhua Energy Ltd – a major coal producer which also operates railway, port and power businesses – 4.9 bln RMB; Air China Ltd. – 2.5 bln RMB; Cosco – one of the world's largest companies in the shipping industry – 2.8 bln RMB; Dongfeng Motor Group Co. Ltd. – 1.6 bln RMB; Chalco (Aluminium Corporation of China Ltd.) – 3.4 bln RMB; and finally, PetroChina with a staggering 37.5 bln RMB. The assessment report divided China's subsidies into two groups; practical subsidies which 'reward companies for accomplishing a social policy goal, such as investing in disadvantaged regions to alleviate unemployment' and strategic subsidies 'that seek to advance the overall economic well-being of the country by earning foreign exchange, promoting technological development, developing an industry that the government views as being important, or otherwise enhancing China's industrial competitiveness' (CTI 2009, p.vi). The subsidies are also awarded to foreign firms which operate in the targeted industries and are considered important from the perspective of China's sectoral development. The report does not include the estimates related to subsidies associated with the November 2008 economic stimulus. A significant part of the stimulus is believed to have been spent on direct subsidies to a handful of favoured enterprises in the designated sectors concerned with, among others, energy and automobile production.

These subsidies also take the form of various tax subsidies. In general, tax policies, meaning favourable treatment for certain activities, i.e. lower taxes, tax deductions, tax exemptions and special depreciation for tax purposes, were all used towards targeted

sectors and enterprises in the case of Japan and Korea. In Japan the overall level of taxes was relatively low. In the 1950s the Japanese government introduced various tax incentive policies for industrial development, as well as export development, namely, special depreciation (1951), import tax exemption for import of machinery (1952), export-import link tax reduction (1953). The fiscal policies served to attract modern technology (Kagami 1995). “Inclined taxation system” provided generous corporate tax exemption arrangements in purchasing specific types of machinery and equipment, and accelerated the introduction of foreign technologies (Kimura 2009). In Korea, ‘the 1961 Tax Exemption and Reduction Control Law began to provide export firms with tax deduction measures’ (Mah 2010, p.8). The subsequent policies focused on tax exemptions and tax deductions, as well as accelerated tax depreciation on profits from export activities, in targeted HCI such as steel, chemical, shipbuilding and machinery, and eventually in 1982 – on R&D related activities (see: Haggard *et al.* 1994; Nam 1995).

The scholarly literature has paid significant attention to the fiscal subsidies as well as fiscal reforms in China (see: Lin and Liu 2000; Oi 1992; Tsui and Wang 2004; Wong 1991) in the process of redefining central-local relations industrialisation (Wong 1992) or state capacity (Wang and Hu 2001). During the state command period, China’s ‘fiscal system [had] two salient features: an overwhelming dependence on industry and a reliance on profits of state-owned enterprises, along with taxes, for government revenue’ (Wong 1992, p.200). Therefore, the initial fiscal reform was to ‘gradually [...] replace enterprise profit remittances with a series of taxes’ (p.215) (see also: Naito 2010). Fiscal decentralisation – the process commenced in the mid 1980s – was aimed at transferring the powers to lower administrative levels in order to increase the effectiveness of tax collection and of tax utilisation and was conducive with the general characteristics of post-socialist reforms after central planning. According to Tsui and Wang (2004, p.73) it had two important features; it introduced fiscal contracts between successive levels of governments to share locally generated revenues as well as subsidies from and remittances to the next level of government; secondly, it gave freer reign to local governments in tapping off-budget resources. Lin and Liu (2000) believe that fiscal decentralisation significantly contributed to economic growth, mainly by improving the efficiency of resource allocation. However, Wong (1991) and Tsui and Wang (2004) are not convinced about the extent of actual decentralisation and alleged benefits of local governments. Wong (1991) claims that by the early 1990s, the fiscal

system in China fell into serious disarray, as the central-local and local-local relations deteriorated. Indeed, Wang and Hu (2001) state that since the early 1980s the state's financial extractive capacity has declined rapidly. The decreasing capacity in tax collection and tax revenues transfer from local to central authorities, as well as macroeconomic imbalances, prompted premier Zhu Rongji to implement in 1994 the policy of fiscal re-centralisation. It can be argued that this process had a lot in common with a DS practice, as the centralism was an important feature of the DS model. The initial aim of the new tax policy was (as was also in the case of Korea) an improvement of tax transfer to the central authorities. Despite the mid 1980s reforms, the tax system changes lagged behind the dynamics of the national economy's development and only the 1994 tax reform succeeded in significantly boosting the tax revenue of the central government, necessary for the continuation of the developmental endeavour. Fiscal policies remained relatively effective and rather conservative during the first years of the new millennium, as illustrated by the low fiscal deficit (Naito 2010). On the institutional side, the reforms accelerated in 2007. According to OECD (2009a), the years 2007-2009 were 'remarkable in China's taxation history [...] following the promulgation of the enterprise income tax law [and] the issuance of the revised value-added tax provisional rules' (PP 2009, p.50), to name a few reforms. However, the 2008/2009 global financial crisis prompted a wave of financial policy adjustments. The government used some fiscal measures to alleviate the effects of the slowdown in economic growth and the increase in unemployment. Yu (2010) grouped the government's responses into two categories: expansionary fiscal policy, which included relaxation of tax policies and the fiscal stimulus package of 4 bln RMB; and expansionary monetary policy, which dramatically increased the money supply through the additional bank credits.

The Chinese taxation system remains barely transparent, which inhibits the ability to fully comprehend tax preferential policies. Tax preferential treatment has largely been associated with the industrial production in special zones and, consequently, the exporting of goods "made in China". Indeed, Ernst and Young's (2006) report indicates that manufacturing companies in SEZs and ETDZs would normally be granted a reduced 15% tax rate (as compared to the standard tax rate of 33%) with the full exemption for the first two years of operation and 50% reduction for the following three years. In HTIDZ (High-Tech Industrial Development Zones), the tax could even be 7.5% for the second five-year period of operation (after the first 5 years of "tax

holidays”) for Sino-foreign joint ventures. The spectrum of industrial sectors, which would enjoy preferential tax treatment, would be broad and would include: engineering, electronics, partly energy, metallurgy, chemical and manufacturing of construction materials industries, light, including textile, industry, manufacturing materials, medical and pharmaceutical industry, agriculture and forestry, construction, communications and transport industries, as well as industries associated with scientific and technical development, geological studies, consulting services aimed at production improvements and precision instruments (Ernst and Young 2006). The three main options used in China’s fiscal policy to control the genus of industrial production and the genus of export have been tax exemptions, tax deduction (the VAT on materials would be offset against the VAT on the final product), and various tax rebates, the latter introduced already in 1985; all three determined by the location of manufacturer, type of production and other issues related to the degree of innovativeness and of the technological advancement of the product.

However, the tax preferential treatment benefited predominantly foreign companies and joint ventures, and in this respect, Chinese companies operating in geographical parts of China other than special zones were discriminated against. This subsequently changed with the introduction of the unified corporate tax rate in January 2008, as a result of which the general tax of 33% was lowered to 25%, whereas companies who paid preferential 15% tax rate were subjected to a transition period with gradual increase of tax to reach 25% in 2011 (naturally, with some exceptions related to location, length of operation on the Chinese market, etc.). Currently, tax preferential treatment is still awarded to R&D-related investments, as was in the case of Korea and Japan. Foreign investors can benefit from tax breaks if they establish companies in the government (including local government)- determined industries and areas. Those industries are usually recruited from the last group of targeted industries, namely, knowledge- and information- intensive. Another element of the current policy is that the tax-related preferential treatment is applied to pillar companies in designated sectors. A part of the subsidies awarded to the large Chinese companies mentioned above has been in the form of tax subsidies, such as refunds of value added tax, preferential and concessionary tax rates, exemption from certain tax surcharges and other tax exemptions and tax credits for purchases of domestic equipment.

It is important to note that the Chinese government proved to be flexible in the use of tax policies to encourage or discourage international trade, depending on the internal and external economic situation. Despite the general long-term policy of withdrawing tax preferential treatment for export, associated with the strategy of boosting domestic consumption, during the global financial crisis certain tax privileges were temporarily restored. In October 2008 China raised tax rebates for 3,486 items from various labour-intensive industries and high added value sectors (China Daily 2008) and continued to do so until June 2009, to alleviate the effects of worldwide decreasing consumption resulting from the global financial crisis. However, in order to fulfil its international obligations to limit the dynamics of growth in greenhouse gas emissions, it eliminated tax rebates for 406 items to discourage export manufacturing of highly polluting, highly resource dependent and highly energy consuming products (People's Daily Online 2010). Additionally, in order to boost business activities, the government announced an intention to lower the corporate tax in China's underdeveloped Western regions to 15% (Straits Times 2010).

#### **4.5.3. Price Control, Investment Policy and Foreign Direct Investments**

Price control has been another common tool among the developmental states. In Japan, state-regulated pricing was aimed at achieving the desired allocation of resources. In the early stages of the DS core period over 60,000 goods had their prices controlled. This number was subsequently reduced after the "Dodge Line" reforms (1949-52).

China's reform period has been characterised by a dual price system, where certain sensitive goods, such as some grains, petrol, electricity, pharmaceuticals, etc. have had their prices controlled by the government. The intention of the dual system was to encourage industrial production via guarantees of state purchase of certain goods at the pre-set price. At the initial stage of reforms, however, there was almost a full price control. In the mid 1980s the price reform was aimed at partial price marketisation (Gao 1987). By the end of the 1980s, half of the prices were market prices, whereas the other half – controlled state-set prices. The price control mechanism is still an attractive instrument, as presented in the recovery package put forward by the Chinese authorities after significant shortcomings in energy caused by the strong snowfall in central and southern provinces during the winter of 2007/2008. Nevertheless, the price liberalisation process, imposed by the WTO rules, is extremely advanced, and the

temporary attempts to administer the price level cannot be seen as a long-term element of the development policy.

Some of the financial system-related incentives presented above are aimed at navigating the financial resources flow into targeted industries, and can perhaps be seen as elements of the overall investment policy. Naturally, investment policy can be categorised as trade related or market access policies – in the case of China this would make sense in the context of SEZ and investment restrictions in certain industrial sectors. However, in the DS context, investment policy effectively channels funds to designated sectors and areas, therefore can be seen as DS financial policy of support for industrial development.

China in this respect went further than DS historical cases and, especially in the 2000s, large investments have also been directed to rural areas, as agriculture seems to have become a targeted industry. Naturally, as pointed by Noland and Pack (2003), Japan also channelled large financial means to the agricultural sector, however, in the form of European-style subsidies. In China, the policy of targeting of agriculture is visible in the amount of focus directed in the 11<sup>th</sup> and 12<sup>th</sup> Five-Year Plans towards development of the countryside's infrastructure and public services (Fock and Wong 2008). The Hu-Wen regime has channelled large financial resources to reconstruct education and healthcare bases, whereas agricultural tax has been eliminated to limit the fiscal burden on the farmers.

However, as far as the investment policy is concerned, what is an important feature of China's development model is the foreign direct investments (FDI). In fact, 'in establishing an investment policy in post-Mao China, the policy was designed to gain the benefits of foreign direct investment (capital flow, job creation, export growth and the upgrading of technology and skills)' (Breslin 2006, p.9). 'China's early and continued opening up to FDI [...] stands in stark contrast to the experiences of other East Asian states, in particular Japan, Korea and Taiwan' (Gallagher 2002, pp.366-367). Indeed, FDI did not seem to play a vital role in DS historical cases. Japan eventually became an important FDI source in other countries (Yamazawa 1975), in addition to its historical colonial investment-related activities in Korea and Taiwan (see: Cumings 1984; Kohli 1994; Wade 1990a). Its presence is particularly visible in China and in Southeast Asian countries such as Thailand (ASEAN second largest economy) and

Laos. In Korea, FDI seemed to play a marginal role. Nevertheless, Kim (1985) claims that the authorities were eager to attract foreign investment, especially into the special zones such as Masan or Iri EPZ (see: Amirahmadi and Wu 1995; Oh 1993) as it played an important role in promoting the development of indigenous industries. 'Foreign capital was welcomed as long as it could contribute to the development of priority sectors, the transfer of technologies, and the enlargement of marketing contracts' (Kim 1985, p.39). Nevertheless, 'the Korean and Taiwanese governments chose to keep their domestic economies closed and protected while taking the outward orientation [while] China's leadership opted instead for much greater integration with the global economy' (Gallagher 2002, p.367).

In China, the FDIs have been an important part of investment policy and secured steady capital, technology, and organisational skill flows into the country. This happened despite the prevailing "communist" regime (Gallagher 2002). According to Tseng and Zebregs (2002, pp.5-6), 'equity joint venture companies, cooperative joint venture companies, and wholly foreign-owned enterprises have been the main forms of absorbing of FDI into China'. Initially they were allowed only in SEZs, but already in 1986, this limitation was lifted. Although contemporarily investment is encouraged in most parts of the country, various special zones named earlier continue to have a legal and infrastructural edge in terms of attracting foreign investors. Despite the Catalogue, mentioned in the previous chapter, China remains one of the largest FDI destinations. Tseng and Zebregs (2002) name three groups of FDI determinants; economic structure (market size, abundant supply of cheap labour, infrastructure, scale effects), reduced barriers and preferential policies, as well as cultural and legal environment.

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The above policy comparative analysis illustrates certain distinctive features as well as similarities of China's development policies with the policies of the Japanese and Korean developmental states. The case studies and examples presented here show that China's authorities seem determined to closely supervise industrial development and international trade, through various industrial, trade-related and financial policies. As compared to Japan and Korea, China's industrial development, especially the targeting component of it, is characterised by a broader scope and faster pace, due to the significant differences in the initial internal and external conditions. The targeting

involves a variety of industries and the nature of targeting is partly determined by the socialist past.

Having analysed the specific features of China's development trajectory in terms of ideological, political and economic arrangements, and state-level policies, as compared to the historical DS cases, and having established the distinctive elements of China's post-socialist transformation, we now turn to the final exercise of this thesis. The final chapter will attempt to explain the Chinese post-socialist development trajectory and to construct the model that China is believed to be following, namely, the post-socialist developmental state model. This model is also intended to provide a broader understanding of developmental issues in the post-socialist world.

## **Chapter 5: China – The Post-Socialist Developmental State**

### **5.1. The Unordinary Character of China's Post-Socialist Development Trajectory**

China's mode of post-socialist development has a number of similarities with the historical developmental states, as examined in this thesis, and may be perceived as an attempt to apply the provisions of neo-Listian political economy into the contemporary conditionality of systemic reformulation and into a new set of internal and external institutional features and processes. Although many aspects of China's development trajectory seem hardly a surprise, as it would be expected that the Chinese authorities would draw some lessons from the neighbouring patterns of indeed very successful development, if we consider that China is undergoing a process of post-socialist transformation, which the historical developmental states did not, then its reform path and thus the development trajectory seems highly unordinary when compared with other post-socialist cases.

In much of the scholarly literature the exceptionality of China's transformation is usually claimed as such on the basis of distinctive initial conditions. Indeed, the differences in post-socialist transformations depended on a number of reasons, such as the initial conditions (political, economic, geo-political, geographical, social) and the choices made by the authorities throughout the period of post-socialist transformation. The importance of choice of policy mix derives from the fact that the differences among the states were not limited to the development level of the countries as a whole, but also to the development level of certain sectors of their economies. Moreover, particular sectors had different importance for different economies. In deciding the direction of the reforms, one had to take into consideration all the above elements. Undertaking the same sectoral reforms in different states would bring about different results and would have a different impact on the development of the economy.

Although initially the political institutions in the socialist world seemed similar, the regional differences in development were significant.<sup>101</sup> It is hardly acceptable to claim that states such as Poland, Czech Republic, Slovakia, Hungary and especially Slovenia, commencing the post-socialist transformation belonged to the category of developing

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<sup>101</sup> The developmental differences may partly be attributed to the fact that some CEE countries tried to reform their centrally planned economies before the year 1989, as was the case of Poland and Hungary in the 1980s and Yugoslavia already in the 1960s and some, such as Romania and Bulgaria, did not.

countries. China and Vietnam, on the contrary, are still considered a part of the developing world, though do not belong to the group of the least developed countries (LDCs) (LDCR 2004). At the beginning of systemic changes the level of development in CEE was much higher than in the East Asian socialist states. In the year 1989, GDP per capita in China was US\$ 391, in Vietnam – US\$ 97, as compared with the Soviet Union – US\$ 5204, Poland – US\$ 2139 and Hungary – US\$ 3043 (UNStats 2005)<sup>102</sup>. The developmental situation of countries would also be characterised by various factors, for example, the level of industrialisation and the position of each industry within the economy, the degree of urbanisation with its consequences for societal composition, and populations' socio-economic conditions such as income disparities, educational base, accessibility to health care, etc. Predominantly rural and poorer China stood in clear contrast to the more industrialised and more extensively urbanised Soviet Union and Eastern Europe, where societies were better educated, in general, healthier and better fed.

Secondly, geo-political or rather geo-economic location has been another initial condition determining development trajectory. Due to the economic contraction in the Soviet Union, as well as the entire CEE region, states recorded heavy losses in international trade, which then subsequently worsened the socio-economic situation.<sup>103</sup> The European Economic Community (EEC) states were not a sufficient alternative. An unimpressive economic growth of 2.4 percent (EU-15 in the years 1980-89; UNCTAD HS 2005) and the protectionist access barriers to the EEC market, did not initially allow for the adequate dynamics of trade relations. At the same time China was a part of the region which was consistently showing pro-growth tendencies (since 1960s) and at the beginning of the twenty-first century became, as it seems, the driving force of the global economy. Asian Tigers – Korea, Taiwan, Hong Kong, Singapore, as well as Japan offered excellent trade and economic cooperation opportunities, together with other Southeast Asian fast developers. Moreover, China had the advantage of easy access to private capital and consequently investment stimulating economic growth. China's government could count on foreign investments from Chinese diasporas living in Southeast Asia and partly North America. Prosperous *Huaqiao* inhabiting Taiwan, Singapore, Hong Kong, Macao and also Indonesia, Thailand, Malaysia and other

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<sup>102</sup> It is another issue, however, as to how reliable the data is that refers to the socialist period of these countries. Nevertheless, it can be assumed that the developmental disparities within the Eastern bloc were indeed significant.

<sup>103</sup> During the state-command period most of the trade took place among the COMECON (The Council for Mutual Economic Assistance) states.

countries of the region have been a leading economic force with great financial potential and the first and prime group to invest in China upon the opening of Special Economic Zones (SEZ).

Thirdly, the internal political conditions also influenced the scope of systemic changes. Although Deng Xiaoping's reforms in rural areas were met with nation-wide appreciation, as the need for change in the socio-economic conditions was indeed great, the CEEFSU leaders so much discredited their reforms before 1989 by failing to deliver adequate growth and improvement in the standard of living, that there was no national agreement on sole economic changes without reforming the political system (see: McCormick 1995). Partly because of the pre-second-world-war tradition, but mostly because of the proximity of the Western democratic states, the pressure on the CEE countries' authorities to introduce political reforms was growing. China did not witness such strong revisionist movements – the drive for democratic changes was not as strong as in the CEE. Moreover, the early agrarian reforms gave the Chinese authorities a better position for the continuation of self-designed changes.

The differences in the initial reform design and initial local conditions are clearly seen in a comparative analysis of USSR<sup>104</sup> and PRC (see: Gill 1995). Embarking on a transformation path the Soviet Union was extensively urbanised with a dominant, though highly ineffective, industrial sector of mostly state-owned enterprises. Agriculture had been collectivised. The social security system did function in both cities and villages. Introducing reforms in rural areas of the same nature as in China based on a de-collectivisation could have met some resistance. At the same time, the urban workforce was relatively well educated. Industrial reforms would mean extensive structural changes, imperative to increasing efficiency, and socially costly redundancies. Moreover, central planning had been a dominant economic model for over 50 years and the reforms would break the state's monopoly and could weaken the authorities. In PRC, the rural areas suffered from extensive poverty. The state's industrialisation had been less extensive, potential "industrial" opposition less influential, and the level of society's education lower than in USSR. Paradoxically, more extensive poverty in China than in the Soviet Union allowed CCP to introduce reforms, which CPSU<sup>105</sup> could not politically afford to implement.

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<sup>104</sup> The Union of Soviet Socialist Republics.

<sup>105</sup> The Communist Party of the Soviet Union.

It is often assumed that as a result of initial conditions, China's development path during the period of transformation has brought relatively more positive effects. Chinese authorities are believed to have benefited from certain advantages to intensify the country's development; namely, societal support for change, inexpensive labour, access to foreign investment, proximity of potential export markets and a higher incidence of poverty. It is important to note, however, that those advantages, were not entirely independent phenomena, but, to some degree, the effects of the state activities. Consequently, it was the state which partly created those advantages as much as neutralised any possible negative conditions for the benefit of the country's development. Indeed, Nolan (2004b) argues that the very different interim outcomes of the reforms in China and in Russia are not the results of initial conditions, but of policies chosen by the states' leaderships. This is due to the fact that 'despite the differences, [both respective national economies] possessed large possibilities for accelerated growth with the introduction of market forces in an incremental fashion, in a stable political environment with an effective state apparatus' (Nolan 2004b, p.8).

Indeed, China chose a selective economic liberalisation and gradual and cautious institutional and administrative adjustment, as its 'approach to economic reform was experimental and evolutionary' (Nolan 2004b, p.7). In Russia, after the *glasnost* and *perestroika* period, authorities began the fast liberalisation and privatisation, as after following 'transition orthodoxy of revolutionary political change' the authorities implemented an economic shock therapy (p.7). Consequently, there seems to be a distinctive difference between the Russian and the Chinese state in dealing with the endeavour of reform, namely – the passive role of the Russian state and the active role of the Chinese state. The ability of the Chinese state to intervene is at the core of Unger and Cui's (1994) argument that the main difference between the Russian and Chinese processes of transformation lies in the philosophy of the reforms aspired to in the case of China and disregarded in Russia by three historical events: firstly, the American interventionism towards its agricultural sector in the nineteenth century, which is considered to have laid the fundamentals for the further development of the country; secondly, the subordination of foreign capital to the national development strategies and pioneering a successful partnership between government and business in the East Asian tigers; thirdly, the emergence of the regimes of cooperative competition in most developed parts of continental Europe, in particular, in Northern Italy, Catalonia,

Denmark and Southwest Germany, where companies would compete, but nevertheless pull together their financial, commercial and technological resources.

The most unordinary feature of China's post-socialist development trajectory is related to the fact that development policies rather than systemic reforms have been the most important part of China's transformational endeavour.<sup>106</sup> This is not as much a novelty as it is unfortunately rather an unorthodox mode of behaviour among the post-socialist states. Although a good system cannot replace development policy and development policy cannot be an antidote for the lack of systemic reforms (Kolodko 1999a), many policy makers in Central and Eastern Europe, at least in the initial stages of transformation, forgot about this simple truth, focusing exclusively on the reforms of the system. Their short-sightedness was motivated by neo-liberal economic doctrine reaching its peak popularity in the late 1980s and early 1990s.

As a result, China has been by far the fastest growing economy among post-socialist countries and the only country with a double digit figure on average annually in the years 1990-2005 (WEO 2008), hence in the period when most socialist countries were either in the process of post-socialist transformation or were on the verge of committing to it. In the years 1979 -2011, China's growth was also the most impressive. However, the problem with economic growth is not only that it does not accurately reflect the changes in standard of living, but also in the post-socialist world, it often misrepresents the entire developmental change. The *casus* of Bosnia and Herzegovina is the most evident. Despite very impressive economic growth during most of the PST period, Bosnia and Herzegovina struggles to regain its pre-transition size of the national economy. This is because of extensive losses generated at the beginning of

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<sup>106</sup> On the contrary to development strategies, I consider development policies not to be development plans, but rather the implementation of developmental strategies into the mainstream policy activities. Their target is to accelerate socio-economic development or in certain extreme situations counteract the possible deterioration of social conditions. They can be twofold in nature; firstly, as an integral set of policies which are implemented simultaneously with the systemic changes; secondly, they can be incorporated into the mainstream reforms as their elements. They may be perceived as social policies, as '[under Mao] social policy was closely tied to development strategy' (Saich 2001, p.242). Conceptually, however, development policies are semi-institutional incentives for long-term advancements in the social sphere and in the economic dimension supporting a country in its maintaining of the development path, whereas social policies have more of a focused character targeting specifically certain parts of societal existence. Development is an overall process of the socio-economic improvement of an exclusive macro character. Social policies are aimed at securing societal cohesion and the availability of public services, thus determining welfare from the micro perspective. It is necessary to draw this distinction, as there seems to be a very different level of satisfaction in those two areas in China. Socio-economic development has been steady and rather dynamic. Social policies are believed to suffer significant deterioration during the transformational period, especially as far as health services and education are concerned.

transformation (an economic decline of 80%) and thus a very large reduction in the base for subsequent calculations. As a result, subsequent large increases in the size of the economy did not allow for a full recovery.

Therefore, the change in size of a national economy is perhaps a better indicator of wealth accumulation. Indeed it seems to be, as it deals with the issue of initial post-socialist depressions. According to EBRD data, by 2006 (as compared with 1989) the leaders in this respect were Poland (in CEE) and Turkmenistan (in FSU), reaching a 158 and 177 percent of their sizes of 1989 respectively (EBRD 2007). Needless to say, in this time period China increased its economy several times over. However, in addition to the earlier discussed flimsiness of economic growth as a development indicator, the change in size of the economy does not tell us what the average wealth increases per capita are, as we do not know the dynamics of change of the population size. In developing countries, the growth is often consumed by the population expansion.

It is, thus, necessary to consider the HDI (Human Development Index) change. Here, too, China is exceptional. Between the years 1990-2005 China experienced the largest positive change in the Human Development Index. Most of the countries recorded a change of between 0.02 and 0.07, whereas the social situation of some deteriorated. China's change was 0.143. Among the Central and Eastern European states the best dynamics have been experienced by relatively poor Albania (0.097) and the richest Slovenia (0.066) (HDR 2002, 2005, 2007/2008). Anecdotal evidence suggests that China achieved the best results for the 1980-2005 period, more adequately reflecting the Chinese reforms timeframe.<sup>107</sup> As far as the comparison with historical developmental states is concerned, China, indeed, by far, exceeded Leftwich's requirement in terms of GDP growth and the pace of the Korean and the Japanese growth during their DS-proper (see: Maddison 2007) and recorded better HDI dynamics than historical developmental states (HDR 2002, 2005, 2007/2008).

Naturally, one has to take into consideration that the HDI reflects the overall achievements of the entire country. In the case of China, where inequalities are rapidly increasing, it would mean that in some areas (territorial and sectoral) there have indeed been significant improvements, whereas in other areas the social situation has

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<sup>107</sup> In the years 1980-2005 China's HDI increased by 0.218, Albania's by 0.126, Hungary's by 0.073, Latvia's by 0.058, Bulgaria's by 0.053, Estonia's 0,049 and Romania's by 0,027. (Author's calculations based on HDR 2007/2008).

deteriorated. Indeed, China's developmental achievements attract a large amount of criticism. This usually focuses on the supposed unsustainability of China's growth, due to its environmental costs connected partly to China's economy's high energy consumption; and because of its social consequences – growing disparities and thus societal polarisation and the marginalisation of some social groups. Moreover, many scholars find the quantitative analyses to be distorting in terms of presenting the real developmental picture. Bramall (2009, p.537) claims that especially during the period of intensification of the building of capitalism, human development has not been impressive and many changes led to a deterioration in social conditions in areas such as education and/or rural income. Lin (2006) points to the imminent slow down of the HDI dynamics, due to the neglect of social sphere. Nevertheless, China's post-socialist transformation has brought some spectacular developmental improvements (OECD 2010) and re-established China as an economic superpower in the international arena. Its high long-term developmental dynamics, its location, some cultural features, and some state policy choices, allow it to claim its place among the group of East Asia's fast developers.

## **5.2. China's Post-Socialist Development and the Developmental State Model**

This section argues that many directions of China's development trajectory have been determined by the fact that China is following a type of DS model. This model can be described as a Post-socialist Developmental State (PSDS), as it is based on the classical institutional and policy solutions of the DS model in the conditionality of post-socialist transformation. As has been analysed in chapters three and four and indicated in chapter two, there is a plethora of policy and institutional choices that one may classify as determined by the DS provisions. This section will analyse their application to the Chinese development trajectory.

As far as political systemic reforms are concerned, China, as opposed to most CEE and some FSU countries, did not undergo a process of democratisation. Instead, it chose to maintain a type of authoritarianism. This choice was motivated, among others, by the CCP desire to retain political control of the state. A legal prohibition of political contestation seemed to be the easiest solution. In the DS context, this was closer to the Taiwanese and the Korean cases rather than the Japanese case. The Japanese pattern would perhaps be difficult to establish in post-socialist China. From the Japanese soft

authoritarian institutions it was required not only to preside over economic modernisation and development, but also to shield the development trajectory from the democratically-elected political elite's potential short-termist populism (see: White 1998), this populism being so prevalent in the newly established post-socialist democracies.

Naturally, political reformulation without liberalisation is hardly exceptional among post-socialist states. Many former Soviet republics have continued undemocratic practices. However, China's authoritarianism exhibits features of neo-authoritarianism or, as described by Woo-Cumings (1999) and Fewsmith (2008a), new authoritarianism, which advocates a strong, undemocratic state to guide developmental advancements of a country. On the contrary to many FSU countries, Chinese authorities effectively sought the developmental legitimacy to stay in power. This seems indeed a rarity in the post-socialist world, but is nevertheless a rule among DS cases. The developmental and modernisation obsession among China's ruling elite during the process of systemic transformation has been clearly visible (for data see the Appendix). Whereas in CEE the motive of gaining political freedoms and establishing democracy prevailed, in the PRC it was the acceleration of socio-economic development, which justified reforms and opening up (see: Deng 1994; Jiang 2010).

Retaining an authoritarian state was also aimed at creating a strong and capable state, following what White (1998) called a pessimistic view that authoritarianism is better suited for fast development in a developing country. Despite the purported erosion of state capacity (see: Wang and Hu 2001; Wang 1997; Shirk 2007), the authorities have attempted to strengthen their power and control (Howell 1998) over the society and the business sector. It is visible in their practice of forging links and relations with and influencing newly emerging social structures (Dickson 2001), which are the result of systemic changes. In the DS context, these links are intended to maintain an uneven relationship with other state actors (Leftwich 2000), for example, through the policy of suppressing the labour force (Solinger 2006), common in the DS historical cases (Gallagher 2005). Indeed, the working class position is believed to have deteriorated during the PST process (He 2000), partly due to ideological reformulation (see: Solinger 2003). At the same time, although the authoritarian regime is believed to be relatively autonomous and insulated despite a clamour of pressure, empirical studies show that it strives for embeddedness through a social dialogue (PP 2009, 2010) to create some

form of Evans' (1995) DS-style embedded autonomy, as examined in chapter three. This "keeping at bay" various societal structures emerging during post-socialist transformation and attempting to effectively control societal interaction, in a way expected from the nominally communist regime, is accompanied by a gradual extension of negotiation and consultation channels to the society and business, via experiments with rural democracy (O'Brien and Li 2000), public soliciting of new laws (PP 2009), and an increased consideration of public opinion (for example, communicated through the internet). This is because Chinese authorities are searching for their own pattern of embedded autonomy (Evans 1995) with a subordinate society (Leftwich 2000).

As far as the economic aspects of the process of transformation are concerned, China's lack of approval for the Washington Consensus contrasted with many CEE and FSU countries who at different stages of their transitions followed its provisions. The Consensus was in dramatic opposition to the regulations prevailing and policies followed in the East Asian development model. Chinese authorities chose a proven regional option rather than a theoretical framework with little evidence of success, despite the fact that it was often argued that the acceleration of economic growth required radical changes and rapid liberalisation (Summers 1992) and China was believed to be implementing the policy of "growth at all costs". Naturally, the political *rationale* for incremental changes was to maintain stability and control. Nevertheless, this is hardly a gradual pace of reforms, which indicates the affinity of the Chinese development trajectory with the DS model. Rather, it is the reform selectivity, focused on maintaining a tight grip over economic freedom in certain sectors of the national economy, partly via access barriers and investment limitations (see: the Catalogue) and on establishing a strong domestic business base through market distortive mechanisms. From a theoretical perspective, a strong domestic sector does not have to be an indispensable element of successful development (Balcerowicz 1997). In fact, to enhance the competitiveness of their national economies, many post-socialist countries chose to partly liquidate their inefficient domestic industrial sectors or hand them over to foreign, so-called strategic, investors (Poznanski 2001), who would provide know-how and raise the level of capitalisation. This policy was in line with many neo-liberal recommendations (Sachs 1993, 1994). Despite suffering from common socialist countries' maladies of ineffective industries, China opted for a different variant of improvements and focused on state-supervised strengthening of its domestic business base and state-controlled restructuring of companies. The process required time,

resources and selective opening up, rather than broad and swift economic liberalisation, as it would be largely against the so-called market forces. Theoretically, it was a more difficult and lengthier road to follow. However, it was a choice dictated by the DS logic, as it would allow for the business sector to be retained in domestic hands.

China's post-socialist marketisation has also featured DS institutionalisation. In addition to establishing institutions characteristic for capitalist economies (OECD 2009a), the reform focused on creating economic bureaucracy with an influential pilot agency to preside over economic modernisation. The powers of NDRC equal almost those of the Korean EPB and far exceed those of the Japanese MITI. None of the CEEFSU countries structured their administrations so that they include such a prominent developmental agency; either due to the perception that economic planning is a relic of the past, or because authorities would not search for developmental legitimacy and would secure their claim to power with other means. The two largest post-socialist economies of CEEFSU, Russia and Poland, lacked what could be described as a powerful economic bureaucracy and, suffice it to say, they did not seem to make any effort to create one. In the case of Poland, there was a ministry responsible for the privatisation of state assets known as the Ministry for Ownership Transformation (*Ministerstwo Przekształcen Własnościowych*), but there was no Ministry for Development. As far as central planning is concerned, the Chinese political elite saw it not only as compensating for economic liberalisation (Lau *et al.* 2000), but also as the DS-style "plan-rational" to guide development (see: Woo-Cumings 1999). China did not relinquish extensive state interventionism, and the state withdrawal from the economy was rather limited, compared to many CEE states. In fact, during the PST period, it searched for new means and instruments of intervention to control various entities and processes. In the case of post-socialist Poland, state intervention and therefore also central planning was rapidly replaced by market forces (Kolodko 1999a, 2001a); in the case of Russia – even without basic market institutionalisation at first (Nekipelov 2005).

State interventionism is common within the Continental Western Europe capitalist model. The differences between classical European interventionism and DS interventionism were discussed in chapter one – to developmentally catch up with developed nations (the DS model), to secure/maintain societal cohesion in the process of development (the Western European model). Chinese interventionism is much closer to the DS type in terms of the general ideology. Despite usual official propaganda, it is

not about social cohesion and elevation of the less affluent parts of the society, as proven by rapidly growing income disparities and the institutional discrimination of the less affluent rural part of the society and the industrial working class. It is to guide the general process of socio-economic development.

Extensive state involvement into the economic affairs, in the case of China has resulted in rampant corruption. Its intensity increased during the PST process (Kwong 1997; White 1996). Corruption is often rightly blamed for the developmental incapacity of ruling elites. More odd is that China's authorities pay little, if any attention to the problem. The reason being that in the DS model corruption did not affect extensively the developmental trajectory, due to it being often growth-promoting, as it would divert the resources to more effective economic entities (Bramall 2009a). Although this does not need to be the current case in China, its real impact is to some extent questionable. Moreover, corruption serves some DS purposes, such as deterrence of unwanted foreign economic agents and activities.

As far as the paramount state economic ideology is concerned, Levi-Faur (1997) distinguished three principal schools of political economy, namely, economic socialism, economic liberalism and economic nationalism. By employing this simplistic division we can observe the difference between China and most of the other post-socialist countries. As a result of post-socialist transformation, China has replaced economic socialism with economic nationalism, as opposed to economic liberalism preferred by most post-socialist states. Although a lack of full marketisation in a number of CEEFSU countries, as presented by EBRD (2001, 2005, 2008), may suggest that some countries still have not fully embraced economic liberalism as their main state ideology, and after twenty years of transformation may see it as unnecessary, hinting towards economic nationalism as a preferred philosophy in an increasingly interdependent and volatile world, China's economic nationalism has shown distinctive features of the DS model, not merely in the state ability to mobilise the nation behind the common developmental goals, but also in protecting its domestic market. It is visible, as presented in chapter three, in prohibitive procurement practices demanding, among others, local content, in discriminatory use of new labour and competition laws aimed at targeting foreign entities, in arbitrary decisions related to economic activities, guided by ambiguous regulations of local and state authorities. Economic socialism was replaced as the state and CCP's main ideology by economic nationalism (Shirk 2007). Moreover, China's

DS-style nationalism has been prominent not only in the economic sphere. It concerns a broader policy area of national economy, foreign affairs and security (Hughes 2006). Security issues, in perhaps a more pronounced manner, were especially important in the context of East Asian nationalism (Camilleri 2000; Cumings 1984).

As far as China's development policies are concerned, it can be plausibly argued that they are to a great extent similar to the DS classical development policies and deviate from ordinary post-socialist policies, as discussed below.

Rural policies in post-socialist China included a distribution of land to farmers rather than its restitution, as was the case in most CEE countries (Johanssen 2001). Naturally, restitution would probably mean a partial return to the feudal relations or at least to the rich peasant economy of the early 1950s (Bramall 2009a). However, the Communist Party-controlled regime could have abandoned this policy and maintained large commune units established in the late 1950s. It would be economically justifiable, if only appropriate managerial changes and market institutionalisation took place in rural areas in the process of abandoning the state command. For example, Poland's fragmented agrarian production structure continuously dominated by smallholders is rightly blamed for its ineffectiveness and the generating of social problems (see: Borzutzky and Kranidis 2005) and contrasts with states such as Czech Republic, where large units remained mostly in tact. At the same time, the revisionist pressure present in most CEE countries which led to restitution, in China, was not present. Moreover, empowering the farmers through land distribution could theoretically weaken the CCP position, whose persistent inadequate attention throughout the state-command period and prioritising urban development resulted in rather limited support in the rural areas. However, by creating family units and a household responsibility system, Deng Xiaoping addressed two important issues: firstly enabled a rapid rise of the volume of production, as China was experiencing food shortages. Secondly, by nevertheless empowering the farmers and creating conditions for more effective wealth generation, bolstered rural support for its new economic policies. Increasing the volume of production and gaining support for further policies were very much the targets of South Korean and Taiwanese land reforms (see: Alesina and Rodrik 1994; Cumings 1984; Wade 1990; Donner *et al.* 2005; Jeon 1995). By arable land fragmentation, Chinese authorities perhaps did not choose the optimal strategy for rural development. However, the rural development was not of paramount importance, despite the official

propaganda. The rural policies served the purpose defined within the frames of the DS model and were to play an auxiliary role in industrial development.

The policy of industrial development was a permanent feature of socialist states (Brada 1984). However, this policy was extensively neglected in the CEEFSU region during post-socialist transformation, at least at the beginning of transition, as it was believed that the best industrial policy is no industrial policy (Husan 1997; Klein 2007). The subsequent attempts to revive industrial policies after the dismantling of the planning bureaucracy and extensive external economic liberalisation, were not effective. In Poland, as in other countries, it took the form of industrial restructuring (Olszewski *et al.* n.a.), aimed at gradual advancements in the level of sophistication of the industrial product. In China, the policy of industrial development has not been abandoned during the post-socialist transformation. On the contrary, it has been characterised by all the features presented by Chang (1999b, 2009) in his analysis of East Asian industrial policy (see: chapter four), a natural for socialist states tendency for import-substitution industrialisation (ISI) (despite the existence of COMECON<sup>108</sup>), has been supplemented by export-orientated industrialisation (EOI) in the post-socialist era, and industrial development was tuned into the DS pattern of gradual change in the industrial targeting from labour-intensive to capital- and technology-intensive sectors. However, in order to follow what is often considered to be a classical developmental path, post-socialist China initially reversed its targeting and went from capital-intensive HCI to labour-intensive light industry development. This is not to say that it did not begin a HCI restructuring, as it did. It is to stress that at the beginning of transformation, light industry development became the focus, despite the socialist heritage of having a more developed HCI sector. Naughton (2007) argues that it was due to the fact that the socialist development of HCI created an illusion of skipping the light industry development period. Nevertheless, China could have focused its efforts on the industrial restructuring of existing HCI, broadly considered to be more advanced, where it must have gained expertise and experience, and then continue to climb the developmental ladder. The reasons for light industry development are clear and convincing, as discussed in chapter four. Among them was also the desire to increase China's participation in international trade. The fastest way was perhaps by the rapid expansion of technologically-not-intensive branches, which required a large number of workers with limited skills. As much as in other DS countries, China's industrial selection, the

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<sup>108</sup> Whose China was not a member of.

(supposedly developmentally-reversed) choice of light industry, the (time-consuming) industrial restructuring of HCI, and, gradual focusing on those industries with advanced technological content, was determined by the PRC's willingness to more extensively engage in international trade, as China's growth was intended to be export-led (Woo 1998). Empirical evidence from the analyses of developmental states suggests that mostly export could have secured dynamic economic growth in an underdeveloped country whose domestic purchasing power would not allow for internal consumption to be initially the driving force for socio-economic development. Naturally, other post-socialist states also considered international trade an important developmental factor, however, they never utilised the East Asian experiences to the extent China chose to (Kokko 2002). Export-led economic growth is an exception among post-socialist countries and the rule in developmental states.

Indeed, in its industrial targeting China was guided not merely by gradual technological improvements in its production content, which is a common developmental pattern, but also by the content's international market receptiveness, which is more affiliated with the DS-style export-driven pattern of growth. However, Chinese authorities chose to develop industrial sectors previously not associated with China. In order to achieve this, they created an ambitious national R&D programme accompanied by intensive inward technology transfer (Linden 2004) characterised by ambiguous attitude towards IPR (PP 2007).

The plethora of instruments used by the state in order to channel capital, technological and skill resources to the targeted sectors, partly illustrated in the closely monitored foreign investment policy, is overwhelming. Foreign technologies and expertise have been attracted, on one hand, by potential business opportunities, and, on the other, special investment conditions. Moreover, various aspects of the monetary policy have not been aimed at macroeconomic stabilisation, but have focused on developmental issues. As in other DS cases and as opposed to most post-socialist CEE countries, the banking sector has not become an independent element of the market economy. PBC and the state-owned policy banks are developmental tools and their decisions are based on the government's necessities to advance its agenda. China utilises DS-style indirect (rate manipulations, rebates and exemptions) and direct subsidies (direct payments) to targeted sectors and enterprises. Fiscal (tax) subsidies are also important instruments (see: Wong *et al.* 1995).

It is often believed that in the contemporary international conditionality characterised by the process of globalisation, engagement in international trade is usually necessary for developmental advancements. Therefore, export promotion became a natural element of external economic activities. Most post-socialist countries have specialised agencies to assist exporters to gain access to new markets. In this respect DS-style export promotion is perhaps not unusual. What is distinctive, however, is the domestic machinery to make export more competitive, by navigating financial system-related incentives. Chinese authorities not only resorted to political means of development cooperation with less developed countries and negotiated trade agreements with potentially important partners, but also employed a comprehensive state regulatory machinery. An artificial exchange rate of the undervalued RMB is maintained to make export more internationally competitive (Mehrotra and Sanchez-Fung 2010; Yao *et al.* 2011). Export-oriented production is supported by various pallets of subsidies, as examined earlier. Moreover, what has been a distinctive feature in DS trade policy is the import discrimination. China has used a number of tariff (e.g. import custom taxes) and non-tariff, including bureaucratic, barriers to prevent import. In order to comply with WTO regulations, it developed a range of additional instruments to prevent its domestic market's penetration by foreign products and economic entities, via, for example, very strict and ambiguous standardisation procedures (PP 2009), or deliberate ignoring of its own IPR regulations. It constructed a Catalogue of industries where foreign presence is either limited or entirely forbidden due to ambiguous national security reasons.

However, not all post-socialist China's solutions are perceived to be in line with DS arrangements and not all DS recipes are believed to have been implemented. For example, the authorities chose to rely on state-owned enterprises as the partners for the state in state-led industrialisation. It contradicts the idea of the DS state-business alliance, which is based on public-private partnership. In both, Japan and Korea, private companies were crucial in the development of various industries. China apparently chose to ignore this fact, at least as far as targeted capital-intensive industries are concerned.

Indeed, a developmental state would choose the most effective agents for implementation of its development strategy. In many aspects, it would be private companies. On average, they are more efficient in delivering the results, as they have

more clearly defined targets, i.e. maximisation of profit, and more clearly defined beneficiaries – the stakeholders. The state-owned enterprises are usually implicated in ambiguous “extracurricular” activities and social targets, which may inhibit their effectiveness. Naturally, private companies in the DS environment are not free from these kinds of pressures. This was the case in both Japan and Korea.<sup>109</sup> Nevertheless, the logical choice for post-socialist states would be to make sure that there is a supply of private companies. In the post-socialist conditionality it could be achieved in two ways; firstly, via privatisation of state companies. Socialist economies were characterised by hosting a number of relatively large SOEs. The second method would be to create an institutional environment for growth of the private sector. The second option is, however, a time consuming process, with ambiguous and often unpredictable results. Therefore, privatisation would be an easier and, thus perhaps, preferable option.

Let us here, however, present the main features of the privatisation outcomes of the two largest CEEFSU economies, namely Russia and Poland. In the post-socialist world, privatisation was considered to be an important element of transformation (Dehesa 1991; Kornai 1992) and indeed encouraged to be implemented as fast as possible (Sachs 1993; Williamson cited in: Kolodko 1999a). In both cases, this process was rapid and extensive (Baka 2004; Jermakowicz *et al.* 1994), gained some support in their respective societies, but ended up with dubious results (Klein 2007; Poznanski 2001). The post-socialist privatisation process had in the two countries two distinguished features leading to the same conclusion in the context of our DS-related analysis. In Poland it resulted in most of the sizable companies being transferred to foreign owners (Poznanski 2001), usually in the same sector, as seen in a number of industries, from alcoholic beverages (Pernod-Ricard bought the biggest Polish vodka trademark Wyborowa) to defence (PZL Swidnik and PZL Mielec – world leaders in helicopter manufacturing were sold to the Italian-British company AgustaWestland and the American firm Sikorsky Aircraft Corporation, respectively), with all the possible sectors in-between. In Russia, the privatisation process did not result in the handover to foreign stakeholders. Instead, it created a caste of oligarchs, who, in anticipation of the instability of the country’s political system and, as a consequence, the insecurity in terms of their economic status and wealth possession, commenced large transfers of their financial assets to more secure locations abroad. To avoid the repossession of their wealth acquired in dubious conditions, they chose to invest much of their assets in other

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<sup>109</sup> In Japan the companies would enjoy a greater power in influencing the industrial policy than in Korea.

countries and not in Russia. The process of privatisation in both countries resulted in the effective elimination of potential economic agents for DS-style state-led developmental efforts. In the case of Poland, the picture is clear – the companies are usually foreign owned, and the handful of those that are domestic owned would not be able to carry on the task, as their number fell short even of the relatively limited number of the Korean *chaebols*. In Russia, the appropriation of state assets, often illicit in form, was not accompanied by regulations, which would prevent the flight of capital and other assets, and the state until very recently was not able to effectively coerce the business sector into supporting the developmental endeavour.<sup>110</sup>

The outcomes of the Polish and Russian ownership reforms illustrate the rationality of China's choice to keep state-owned enterprises and to nominate them to be among the main economic agents, if it was to follow the DS-patterned development trajectory during post-socialist transformation. The Polish failure to create a domestically-controlled large business sector, in addition to the SOEs being, for obvious reasons, easier to manoeuvre into the state's policies, suggests that PRC's reliance on the state sector may not have been a choice to regret. Naturally, the Chinese authorities commencing transformation in the late 1970s could not have known Poland's and Russia's experiences of the 1990s. Initially due to ideological constraints, and later perhaps having observed the developmental logic of East Asian states and rather ambiguous results of early privatisation efforts in CEEFSU, Chinese authorities chose to keep some important companies within the state's proximity and influence. The easiest way was to maintain state ownership. The history of the Rheinisch capitalism of Western continental Europe (Hall and Sockice 2001; Bramall 2009b) was dotted with SOEs effectively operating as vital economic agents. Chang (2009) points to the Korean POSCO and the Brazilian Emraer as not only successful state-owned companies, but also as those who enabled the state to enter new sectors of world production and to become an important player. Keeping 150 or so large state-owned enterprises to be the actors of the developmental endeavour meant that the Chinese authorities followed rather than ignored DS recommendations. Priority was given to the stability of state-business alliance and to the effectiveness of control over the supposed effectiveness of performance.

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<sup>110</sup> By no means am I trying to say that today's Russian government has a clear development strategy, which it imposes on its business sector. I merely state the fact that, it has perhaps created conditions for an effective state-business relationship.

The fact, however, that in the case of China the main companies in the targeted industries are state owned, does not mean that China has not followed more directly certain Japanese and Korean patterns. On the contrary, in the 1990s and during the first decade of the twenty-first century, there was a certain level of intensification of mergers among the SOEs, as discussed in chapter two. After the 15<sup>th</sup> CCP National Congress (1997), the Chinese authorities, using the economy of scale argument, started implementing a policy of grouping companies and creating large conglomerates, similar in size to *chaebols* and *keiretsu*, as the continuation of *zhuada fangxiao* (Breslin 2007; Gallagher 2005). The earlier-mentioned Shenhua, Baoshan, Sinopec and PetroChina are examples of the policy of creating a range of very large companies, with asset capacity, which would allow them to pull sufficient resources to compete on the international scene dominated by MNCs. In the case of Japan and Korea it was the large companies who were predominantly responsible for implementing the state's industrial production plans.<sup>111</sup> This is currently also the case in China.

The reliance on state firms does not need to be a permanent feature. Initially, it seemed to be the logical choice, even from the DS perspective. The state needed to secure a business partner for the state business alliance who was most reliable and easy to manoeuvre into the developmental agenda. Japan and Korea had strong private business sectors prior to DS-proper; China possessed large state-owned firms prior to systemic transformation. However, perhaps China will eventually rely on private companies in its DS-style development process. Accepting the business sector to the CCP (as a result of the concept of “three represents”), and its most prominent member, the business tycoon Liang Wengen to the CCP Central Committee (GT 2011), is a sign of creating a Korean model-inspired close relationship between private business and the state. The mechanism of DS-style state-business alliance based on public-private partnership is thus under construction.

Another issue concerns growing disparities, as a result of which China is already positioned among the most unequal societies. It is a common opinion that developmental state policies eventually led to a higher degree of social cohesion. However, this issue has been addressed earlier. The DS model has never been about social cohesion. In fact, Korea experienced relatively large income disparities during the

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<sup>111</sup> As opposed to Taiwan, where the development trajectory was mostly facilitated by small and medium enterprises and MNC's subcontractors.

DS-proper. Perkins (1994) rightly argues that some positive effects in this respect were side effects rather than deliberate targets. With that in mind, Chinese authorities chose to ignore social necessities and focus, as developmental states did, on overall development. This was despite the initial strategies of “not leaving any social group behind”.

What has clearly failed to form within the post-socialist Chinese state is the DS-style centralist character. Naturally, China is not a federalist state; despite some claims that it might be eventually becoming one (see: Cai *et al.* 1999; Chung 2006), and the central party-state is still the most influential power centre. The government has been keen on tightening its grip on provinces by Zhu Rongji’s fiscal re-centralisation and the mechanism of rotating the leading state cadres. However, China is a very large, populous, diverse and underdeveloped country. Therefore the centralism present in small Korea and Taiwan, or in medium-sized Japan, is perhaps unattainable. This directly affects China’s ability to be a strong capable state. From the DS perspective, this can be seen as one of the main weaknesses in the PRC following some kind of DS development pattern. However, China is not a Myrdal’s soft state as India was. Neither is it a developmentally incapable state, despite the shortcomings in its development trajectory.

In sum, the choices of the Chinese authorities as far as institutionalisation and policies during post-socialist transformation are concerned are, to a significant degree, determined by the concept of the developmental state. This is why China has maintained a type of authoritarian political system, but nevertheless sought developmental legitimacy and is seeking to create some sort of embedded autonomy; in the process of reforms, implemented selective liberalisation; development policies, guided by economic nationalism, took priority over systemic changes; its state interventionism has been economically rather than socially orientated and would be partly sustained by influential central economic bureaucracy, its authorities were growth-obsessed and this growth was to be driven by export; in micro solutions it focused on building a strong domestic business sector and a weak labour class, developed a large pallet of policy mechanisms to support export and discriminate import, and chose a strategy of industrial targeting with gradual technological upgrades and international market opportunities in mind. This is why it ignored corruption and growing disparities. This is also why in search of business partners for the DS state-

business alliance it prioritised the effectiveness of control over type of ownership. Naturally, due to various internal and external factors some policies and institutional arrangements differ from those in historical developmental states. For example, international trade related policies, as well as market access regulations had to be redefined due to the changes in international conditions. In this respect, China has managed to adapt to a new environment, as did Japan in the late 1960s after partial liberalisation, without abandoning the paramount philosophy of state developmental intervention.

In the case of China, DS institutionalisation and post-socialist transformation, the two processes which extensively reshape state institutions and state functioning, have indeed been intertwining. The above explanation of the DS-determined features of China's post-socialist development trajectory establishes the main threads of the causal relation between the DS model and the PST process, and more specifically addresses the issue of how DS principles reshape post-socialist transformation and how post-socialist transformation affects the change in DS principles. Their causal relation has not only moulded the framework for Chinese development trajectory, but also delivers important general insight into DS applicability in the post-socialist conditionality. The causal relation between DS institutionalisation and post-socialist transformation is mostly characterised by the rejection of economic liberalism with its broad institutional and policy consequences, and a strong emphasis on a policy of export-orientated industrial development. More attention will be focused on this in the processes of constructing of the PSDS.

### **5.3. Post-Socialist Developmental State Model:**

#### **The Natural Choice of Systemic Transformation?**

The PSDS model is a type of DS model within the frames of contemporary post-socialist transformation. It fuses the two intellectual streams of the developmental state concept and post-socialist transformation. Its basic features are similar to those in the DS model adjusted by the PST process and different international conditions, as compared to historical DS cases. It is assumed here that there can be various genera of the PSDS model, as each country would have its own variation of institutional features and policy solutions and that China's development trajectory represents one of those genera. The PSDS model brings into the discussion on the DS model two important

elements. Firstly, it debates its broader than usual applicability, extending it to a very particular group of countries in systemic transformation. Secondly, it confronts the model with the different international conditionality than that experienced during the high growth period of historical developmental states.

In addition to guiding development trajectory by many means characteristic for the classical DS model as examined earlier, the Post-Socialist Development State has a task of systemic transformation. Consequently, the role of the state, in addition to following an effective development trajectory (which has somewhat been lost in the process of post-socialist transformation due to political and economic-doctrinarian reasons), also includes presiding over economic liberalisation, market institutionalisation and microeconomic restructuring. The PSDS should be characterised by selective, and perhaps cautious economic liberalisation, as the so-called “shock therapy” has produced extensive economic contraction in the post-socialist world and subsequently significantly impaired the developmental dynamics. The economic-systemic reorganisation creates two unfavourable conditions; firstly, the state’s attention is captured by systemic transformation and development policies are usually neglected, as was the case in the majority of post-socialist states. Secondly, the process leaves the economy in interim vulnerability, due to the dissolving of old institutions and the creating of new ones. This “transformational vulnerability” negatively affects the state’s ability to maintain a stable, favourable environment for development. Within the process of systemic reformulation, the mechanism of state-command or central planning needs to be replaced by indicative, guiding planning rather than be dismantled. The old economic bureaucracy needs to be restructured along the DS lines. The paramount developmental agency not only takes up the task of coordinating the overall development-related efforts, but also is responsible for designing and implementing systemic reforms and preventing the developmental dynamics from being affected by transformational vulnerability. In the process of industrial development, a post-socialist developmental state should partly use the advantages of historical experiences of HCI development. The PSDS initially employs the state-owned enterprises as the state’s partner for the state-business alliance, as neither indigenous development of the private sector nor post-socialist privatisation offer at first adequate privately owned resources.

In short, the PSDS model is presented with the additional tasks as compared with the historical DS model, as follows:

- An additional macro task of transformation of the systemic arrangements and of state interventionist mechanisms. The new institutions and laws allow a broader scope of economic activities by non state-owned actors and facilitate the partial withdrawal of the state from directly controlling those economic activities. They redefine state's role in guiding development;
- An additional macro task of counteracting "transformational vulnerability", connected to a systemic reformulation and a lack of institutions, which creates an institutional and legal vacuum (Blanchard and Kremer 1997). The DS model could be focused on development, whereas the PSDS model needs to address the issue of the systemically unstable economic environment. This can be achieved via maintaining a firm control over the reforms (a "strong in capacity", interventionist state), by gradual mode of transformation (as the shock therapy would weaken the state's ability to act) and by protectionist measures motivated by economic nationalism;
- An additional micro task of ensuring a capable partner for the state in the state-business alliance. The DS experiences suggest that this partner ought to represent a private sector. However, what seems to be more important in the DS context, is that it is a partner who can be effectively influenced. The post-socialist experiences suggest that it is difficult to extract such a partner from the private sector;
- An additional micro task of reorganisation of the industrial sector. Unlike pre-DS countries, socialist states were extensively industrialised and at the point of transformation possessed a large industrial sector, dominated by heavy industry. The PSDS policy of industrial development would, thus, need to involve the restructuring of socialist industry to remain important for national development and to fit the frames of the post-socialist developmental state.

As far as the contemporary conditionality is concerned, the PSDS task in nurturing development is both easier and more difficult. There are essentially two groups of factors, which need to be considered currently, and could have been ignored in the past; firstly, a more intrusive global economic order. Consequently, a sophistication of trade and financial sector-related policies is necessary, as custom tariffs, quotas, arbitrary export-import link mechanisms, which were readily available for historical DS cases, may not be at the state's disposal contemporarily due to the globalisation processes. A

post-socialist developmental state needs to use its remaining domestic policies such as fiscal policies, entry procedures and others to encourage and to deter economic activities; and is required to increasingly negotiate its obligations and privileges on international forums. The second group of factors encompasses broad issues related to environmental pollution, climate change and the scarcity of energy and other resources. They have not been examined earlier, as they do not relate directly to the process of post-socialist transformation. Nevertheless, they constitute an integral part of any contemporary developmental model, and are believed to have an increasingly negative impact on the Chinese development trajectory. Environmental issues and climate change need to be taken into consideration as they affect the quality and pace of developmental changes. In the PSDS model, the imperative to consider environmental degradation as a threat to the development trajectory, could specifically result in: development of environment protection-related policies, regulations and mechanisms as well as effective policies of adaptation and mitigation; incorporation of environmental considerations into the strategy of sectoral development; development of a low carbon economy in general, by the reorganisation of the energy sector, transportation sector and industrial production, in order to gradually increase the share of low carbon growth; internationally committing to the path of carbon emission reduction, as was the case among the states in the Annex I<sup>112</sup> of the UNFCCC, and the gradual decrease in carbon intensity per GDP unit produced, as indicated by some countries in Autumn 2009.<sup>113</sup>

However, the positive effects of globalisation are that a contemporary post-socialist developmental state has easier access to knowledge, i.e. information and technologies. It seems therefore much easier to increase the quality of human capital as compared with the historical DS cases.

The constraints of the PSDS model are similar to those of the DS model, as discussed in chapter one, meaning, in order to retain the PSDS status, three sets of endogenous conditions must not occur extensively, i.e. there is no broad departure from DS institutional environment and policies, the pace of development continues to be relatively high, the states in question are not as developed as so-called Western countries. Naturally, the PSDS countries must be recruited from formerly socialist

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<sup>112</sup> Annex I of the UNFCCC contains a list of developed economies and the so-called economies in transition, which are obliged to reduce greenhouse gas emissions under the Convention.

<sup>113</sup> The negative environmental and climate changes may also result in the necessity to include the agricultural policies within the contemporary developmental models. In the case of China, the agrarian reform, aimed at increasing food production, gave a very significant impetus for further development.

states. Consequently, they must be effectively undergoing the process of systemic transformation from a state-command economy to a market economy. However, the completion of this process does not need to mean termination of the PSDS model. A post-socialist economy remains post-socialist after the PST process has been completed. Perhaps a highly developed post-socialist state can still be a PSDS, if it became a transformative state (see: Weiss 2000).

The PSDS model is largely in opposition to some general guidelines of the economic conduct, broadly advocated by affluent members of the so-called international community, such as a limiting of the role of the state and extensively liberalising national economies. Despite the failure of this neo-liberal economic doctrine, as illustrated not only by the growing disparities in Latin American countries in the 1990s and meagre developmental results of post-socialist states, but finally by the 2008/2009 global financial crisis, the terms associated with the DS and thus PSDS model such as economic nationalism, interventionism and especially protectionism (an instrument of economic nationalism), in relation to state economic policies, still seem to have a pejorative meaning. This is not due to the evident superiority of one set of policies and regulations over another, but due to the intense propaganda worldwide which poorly disguises the economic interests of most affluent participants of international economic relations.

Despite the neo-liberal propaganda it can be argued that the PSDS was perhaps more desired and a more natural choice for the post-socialist states than was the neo-liberal economic model guided by the Washington Consensus' provisions. This is visible in the analysis of China's development trajectory during the systemic transformation throughout this thesis. The argument can be summarised in three points.

Firstly, due to the insufficient developmental results in the socialist times, the post-socialist states of CEEFSU hoped for the acceleration of economic growth, as a result of systemic transformation. In fact, it is often claimed that in Central and Eastern Europe and in the Soviet Union socialism collapsed rather than was dismantled (Kolodko 1999a) due to limited developmental achievements. The DS model, which PSDS has been built on, was the most successful developmental option in the history of the second half of the twentieth century, whereas the neo-liberal model did not bring any recognisable acceleration of development in countries it was applied.

Secondly, socialist states prior to the transformation already possessed a number of institutional features necessary for the implementation of a genus of the DS model. State-command system positioned the state as the paramount power centre to design and implement developmental plans. Socialist countries were usually unitary, centralised states. They had experience in and institutional mechanisms for central planning. Naturally, the DS plan-rational varies significantly from the socialist state command. Nevertheless, the socialist experiences would have been invaluable in creating a new central planning mechanism. Socialist states possessed an extensive planning bureaucracy, which could have been transformed into the economic bureaucracy of the DS model. The bureaucrats lacked the knowledge on market and market mechanisms, however, possessed essential knowledge on designing centralist developmental strategies. By definition socialist countries were interventionist and their elites decided which industries to develop and what and how much to produce. As mentioned earlier, the difference between the DS model and socialism was in the agents of developmental endeavour and the institutional mechanisms used for industrial development. However, the concepts of state guiding industrial development via some sort of planning, were closely related. The alternative to the PSDS was the neo-liberal model, where central planning and state interventionism were abandoned, centralised state decentralised, and state bureaucracy effectively dismantled. As a result, the central state was weakened and retracted from the economy. The shock therapy recommended by the proponents of the Washington Consensus would favour building new institutions “from scratch” and ignore the positive institutional legacy of socialism. As empirical experiences illustrate, this pattern of development was initially counterproductive, whereas in the long-term it brought limited positive effects, if any.

Thirdly, socialist legacy would create some favourable conditions for the process of DS industrial development. Socialist states were relatively well industrialised and the societies were well educated. Industrialisation was a key to DS-style development and human capital quality was paramount for Japanese post-second-world-war advancements, whereas a lack of an adequate level of qualified cadres forced Korea to pay much more attention to nurturing a local educational base. Japan and Korea were also characterised by large enterprises as the agents for industrial development. Socialist states possessed a number of large state-owned enterprises, who upon adequate restructuring could become important *keiretsu-* and *chaebol-* style partners for PSDS

state-business alliance. Finally, socialist states had a domestically-owned banking sector, considered a necessary condition for the DS financial policy of support for industrial development and international trade, as this banking sector role would go beyond that reserved in traditional Western capitalism. The neo-liberal model offered open market competition to the socialist companies, who never operated in the market conditionality and would have to compete against experienced MNCs, leading at best to the shifting of industrial decision-making abroad, and at worst, dismantling of the industrial base. It also offered privatisation of the banking sector as the necessary restructuring activities, which would inevitably lead to eliminating banks as DS-style developmental agents.

Consequently, Chinese authorities selected a more “natural” institutional and policy choice of systemic transformation to facilitate the post-socialist development trajectory, despite it being unordinary. There seems to be a plethora of scholarly literature on virtually all elements of China’s development and transformation, providing analyses on why and how the state leadership chose particular ways to retain power and to develop the country. Naturally, there has been a number of ways of doing this, and although today China’s choice is often considered to have been developmentally a better option than that taken by many other post-socialist states, China could have followed a very different route than it did in its systemic transformation and thus post-socialist development trajectory; namely, fast democratisation, extensive liberalisation and opening up. At the beginning of transformation it was not clear that post-socialist economies would plummet into extensive recession. On the contrary, it was believed that they would thrive after perhaps a short period of depression. China’s policy and institutional selection, as well as the mode of transformation, was the result of embracing the PSDS model. Following the analysis of DS-determined choices in China’s post-socialist development trajectory, which in effect explains the PSDS’s influence on Chinese development, one may argue that in general the PSDS addresses some aspects of China’s political reformulation, its focus on economic growth, its genus of market economy and its pattern of international engagement, and more specifically:

- the method of retaining the power by a nominal communist party. CCP could follow other autocratic regimes, i.e. increase or reformulate political repression, enrich itself and ignore the economy. In the short term, it would be easier than implementing reforms of an ambiguous target and gradually empowering the nation with economic and other means;

- prioritisation of long-term economic growth and economic modernisation for China to become a developed and modern economy, rather than focusing on systemic reforms to become a liberal market economy;
- extensive state involvement in the economy to preside over economic modernisation and industrial development, despite proceeding with post-socialist economic liberalisation;
- the method of interaction with the global economy by incremental and selective opening up aimed at strengthening the domestic business sector and by developing an export-orientated regime, by nurturing new, international-market receptive industries, in addition to relying on historical advantages related to socialist industrial development.

The Prussian and the Japanese-Meiji development models eventually led to military confrontation. What could it mean for China, if it follows similar, to some extent, state-led capitalist development pattern framed within the PSDS model? This thesis is perhaps not the place to contest China's doctrine of a peaceful rise (see: Guo 2006). However, because it examines China's development's affinity to the DS pattern, then one may be tempted to forecast Chinese development trajectory, based on this pattern. This trajectory will most likely be characterised by the continuity and then by gradual change in a number of elements. Chinese authorities will continue favouring market distortive mechanisms, especially visible in state development policies. They will search for new mechanisms for the state to preside over development, in order to adapt to the global changes in the international economic order. The policy of industrial development will push for more technological advancements, whereas the policy for export support may gradually be weakened during the attempt to divert the focus towards domestic consumption. It is likely that eventually the Chinese elite will change its attitude towards certain aspects of economic liberalisation and more effectively adopt certain norms believed to be the domain of developed, Western, nations. For example, domestic market penetration in various sensitive sectors might be permitted once they are fully controlled by Chinese companies and those companies reach the capital, technological and managerial level, which will enable them to effectively deter MNCs. Intellectual property rights will be embraced once Chinese companies begin to lose more than gain without their protection. Finally, political liberalisation will lead to a liberal democracy. It is sometimes claimed that contrary to the official propaganda, Chinese authorities accepted the inevitability of political liberalisation and are believed

to be preparing themselves and the nation. However, one of the biggest sets of factors to influence the Chinese development trajectory has already emerged. It is environmental pollution, climate change and scarcity of resources (see: Chatham House 2007; 2008; Smil 2004; Song and Woo 2008), as mentioned earlier. It influences Chinese development trajectory and will continue to do so in the foreseeable future.

As a result of China's industrialisation during the socialist and post-socialist period, as well as due to the prioritisation of growth over sustainable development in the contemporary conditions of environmental degradation, the pace, but most importantly, the quality of economic growth is likely to diminish in the near future. The developmental losses will be in the form of a slow-down in economic growth either due to lost opportunities or decreased returns, as well as in the form of a decrease in the quality of economic growth, that is to say, the lack of the growth's translation into socio-economic development. As far as lost opportunities are concerned, environmental degradation and climate change will prevent the farming of certain lands which could have been or indeed were farmed in the past, due to soil, air and water pollution as well as due to weather-related anomalies altering natural conditions. Certain types of industries, which rely on pure water, pure air, etc., will not be developed in specific areas, despite, for example, growing local necessity for additional employment. The same applies to certain services, which could have been established and provided, but due to environmental and environmentally-related social and economic reasons, will not. Lost opportunities to develop industries, agriculture and services will have a direct negative impact on the GDP growth, labour market and additional consumption opportunities.<sup>114</sup> Environmental degradation and climate change will diminish the returns from various economic activities. This process is related to the decreasing productivity of land as well as of people's labour. Pollution will affect the population's health, which will impact the effectiveness and the amount of work they can provide. Radical environmental anomalies will most likely shorten and only on occasion expand the farming periods. The new weather conditions will prompt outbreaks of diseases and soil pollution will decrease the quality of farming and husbandry lands. Those phenomena are already extensively affecting China's development and the authorities are paying increasingly more attention to the problems, as presented in chapter four.

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<sup>114</sup> In a way prompting a spiral of events, as such additional consumption could facilitate the development of more industries and services.

However, PSDS does not only serve the purpose of explaining China's post-socialist development trajectory. In general, it offers "transferable lessons" – to borrow the phrase from Evans (1998) –, how to maintain an effective development trajectory during the post-socialist transformation and contemporary international conditionality. Institutional arrangements enabling state-guided development, policy solutions focusing on industrial development and a selective engagement with the global economy and state ideology defending national economic interests, as analysed in this thesis, can all, in one way or another, be considered for a broader audience. The main message, however, is that the role of the state (i.e. the ruling political elite and the administrative bureaucracy) in the process of socio-economic development of underdeveloped countries and countries in systemic reformulation, is of paramount importance, and no imaginary market forces are able to effectively preside over developmental advancements.

However, which group of post-socialist countries could currently benefit from the PSDS model's provisions, while systemic transformation in many cases has been significantly advanced? Undoubtedly, the new member states of the EU and the countries in the process of accession negotiations, have already selected the mode they would like to follow in terms of development. On the one hand, these states are limited in their competences by the imposition of EU regulations and, in the case of accession negotiations, by EU guidelines. On the other hand, the inevitable consequence of the multi-layered convergence with the entire relatively wealthy bloc of the EU, partly via the cohesion policy, immensely contributes to their developmental dynamics, to the extent that it is increasingly believed that the state policies of the post-socialist EU member states can no longer either help or damage their development trajectory.

Some provisions of the PSDS model might be useful, however, for those states whose development trajectory depends predominantly on the institutional and policy choices made by their political elite, as they are not part of or in proximity to the European Union. Undoubtedly countries which still seem to be in the process of post-socialist transformation and in need of long-term acceleration of socio-economic development lie in the Caucasus region and in Central Asia. Russia is also a good candidate, where some PSDS-style efforts have recently taken place. Moreover, for Cuba and North Korea, who did not commit to the process of systemic transformation, some PSDS provisions

might be indeed useful to prevent extensive economic contraction and to build fundamentals for long-term sustainable development, if the respective leaderships decide to reform the state-command system. Vietnam and Laos are already successfully implementing PSDS provisions. Mongolia can still become a PSDS, in view of its recent policy reformulation and more intense state involvement in some elements of the national economy.<sup>115</sup>

Finally, most of the PSDS features, those related to the DS model, can perhaps serve as guidelines of conduct to be considered by any developing country who would like to embark on an effective developmental catching up trajectory and is committed to withstanding the pressure of the affluent entities within the contemporary international economic and political order.

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<sup>115</sup> Personal observations from consultations with the governmental officials in Ulan Bator, 21-29/08/11.

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## Appendix

### **National Development and Reform Commission's (NDRC) Main Duties**

The detailed main functions of NDRC are as follows:

To formulate and implement strategies of national economic and social development, annual plans and medium and long-term development plans; to put forward targets and policies concerning the development of the national economy and the optimisation of major economic structures, and make recommendations on the employment of various economic tools and policies; to submit the plan for national economic and social development to the National People's Congress on behalf of the State Council.

To study and analyse the economic situation and its development both at home and abroad and provide macroeconomic forecast and early warning; to study important issues concerning national economic security, put forward policy recommendations on macroeconomic management, and coordinate economic and social development; to adjust the daily performance of the national economy and coordinate and solve major problems in the operation of the national economy.

To summarize and analyse the fiscal and financial situation, participate in the formulation of fiscal and monetary policies, and formulate and implement industrial and price policies; to analyse the effects of implementing fiscal, financial, industrial and price policies, and supervise and inspect the implementation of industrial and price policies; to set and adjust the prices of important commodities that are regulated by the state and important tariffs and fees; to control and monitor the total size of China's foreign debts, optimise its mix, and maintain the balance of international payments.

To study major issues concerning the restructuring of economic systems and opening up to the outside world, formulate plans for the comprehensive restructuring of economic systems, and coordinate plans for dedicated economic restructuring; to put forward recommendations on improving the socialist market economy system and promoting development with reform and opening up, and guide and promote the overall economic system restructuring.

To recommend the total size of fixed assets investment and plan the layout of key projects and productivity; to arrange fiscal expenditure for economic construction, guide and supervise the utilization of foreign loans in construction projects and policy-oriented loans; to guide private investment in fixed assets, study and put forward strategies for foreign capital utilization and overseas investment, and targets and policies concerning aggregate balance and structural optimisation; to arrange construction projects funded by central government appropriation, key construction projects, foreign-funded key projects, overseas resource development projects and overseas investment projects utilizing large amounts of foreign exchange; to organize and manage the work of special inspectors for key projects.

To carry out the strategic readjustment and upgrading of industrial structure; to put forward development strategies and plans for important sectors in the national economy; to study and coordinate the solution of major problems associated with agriculture and rural economic and social development, and coordinate dedicated plans and policies; to guide industrial development and promote industrialization and informatisation; to formulate sector-specific plans in industry, and guide the drafting of technical regulations and standards for different sectors; to formulate development plans for oil, natural gas, coal, power and other parts of the energy sector; to promote the development of high-tech industries, carry out technological upgrading and guide industrial modernization; to guide and regulate the assimilation and innovation of imported technologies and key outfits.

To study and analyse the development of the regional economy and urbanization, put forward plans for the coordinated development of the regional economy and the implementation of the Western Region Development Program, and bring forward strategies and important policy measures concerning urbanization; to guide and coordinate regional economic cooperation.

To study and analyse both domestic and international markets and maintain the aggregate balance and overall control of important commodities; to formulate plans for the overall volume of import and export of important agricultural products, industrial products and raw materials, supervise the implementation of these plans and adjust them in accordance with the performance of the national economy; to manage the state

reserve of important materials and commodities; to put forward strategies and plans for the development of modern logistics.

To coordinate social undertakings such as population and family planning, science and technology, education, culture, health, etc. and national defence, and synchronize their development with the development of the national economy; to bring forward policies concerning coordinated economic and social development and coordinate the solution of major issues of social development.

To carry out the strategy of sustainable development, study and formulate plans for resource conservation and comprehensive utilization, participate in the formulation of ecological\_improvement plans, put forward policies of resource conservation and comprehensive utilization, and coordinate the solution of major issues of ecological improvement and resource conservation and comprehensive utilization; to coordinate environmental protection.

To study the situation of a multi-ownership economy, make recommendations on the optimisation of ownership mix and organizational set-up of enterprises, and promote fair competition and common development among enterprises of various ownerships; to study and put forward policy measures that promote the development of small and medium-sized enterprises (SMEs) and a non-state-owned economy, strengthen overall guidance and coordinate the development of SMEs and the non-state sector.

To study and put forward policies that increase employment, adjust income distribution, improve the policy of coordinated development of social security and economy, and coordinate the solution of major issues related to employment, income distribution and social security.

To study and formulate administrative laws and regulations concerning national economic and social development, economic systems restructuring and opening up to the outside world, and participate in the drafting and implementation of relevant laws and administrative regulations.

To undertake other tasks assigned by the State Council.

In accordance with relevant regulations of the State Council, the NDRC is also responsible for the administration of the State Grain Administration and State Tobacco Monopoly Administration.

Source: NDRC 2007

### **Ministry of Commerce's (MOFCOM) Main Duties**

MOFCOM's mandate entails:

1. To formulate development strategies, guidelines and policies of domestic and foreign trade and international economic cooperation, draft laws and regulations governing domestic and foreign trade, economic cooperation and foreign investment, devise implementation rules and regulations. To study and put forward proposals on harmonizing domestic legislations on trade and economic affairs as well as bringing Chinese economic and trade laws into conformity with multilateral and bilateral treaties and agreements.
2. To formulate development plans for domestic trade, study on and put forth proposals on reforming the commercial distribution system, foster and develop urban and rural markets, promote the restructuring of the commercial distribution sector and the improvement of such modern distribution modalities as chain store operation, modern logistics and e-commerce.
3. To research into and formulate policies for regulating the market operation and distribution order, breaking up market monopoly and regional blockage, to set up and improve an integrated, open, competitive and orderly market system. To monitor and analyze market activities and commodity supply and demand, organize the adjustment of market supply of main consumer goods and regulation of the distribution of major means of production.
4. To study on and work out measures for the regulation of import and export commodities and compile a catalogue thereof, organize the implementation of import

and export quota plan, decide on quota quantity and issue licenses; to draft and implement import and export commodity quota tendering policies.

5. To formulate and execute policies concerning trade in technology, state import and export control, and policies encouraging the export of technology and complete set of equipment; to push forward the establishment of foreign trade standardization system; to supervise technology import, equipment import, export of domestic technologies subject to state export restriction and re-export of imported technologies, and to issue export licenses pertaining to nuclear non-proliferation.

6. To study on, put forth and implement multilateral and bilateral trade and economic cooperation policies, be responsible for multilateral and bilateral negotiations on trade and economic issues, coordinate domestic positions in negotiating with foreign parties, and to sign the relevant documents and monitor their implementation. To establish multilateral and bilateral intergovernmental liaison mechanisms for economic and trade affairs and organize the related work. To handle major issues in country-specific economic and trade relationships, regulate trade and economic activities with countries without diplomatic relationship with China. In line with the mandate, to handle the relationship with the World Trade Organization on behalf of the Chinese government, undertake such responsibilities under the framework of the WTO as multilateral and bilateral negotiations, trade policy reviews, dispute settlement, and notifications and inquires.

7. To steer the work of the commercial branches of China's Permanent Mission to the WTO, to the UN and other relevant international organizations, as well as Chinese embassies in foreign countries. To keep in touch with the representative offices of multilateral and international economic and trade organizations in China and the commercial functions of foreign diplomatic missions in China.

8. To organize and coordinate the work pertaining to antidumping, countervailing, safeguard measures and other issues related to fair trade for import and export. To institute a fair trade early warning mechanism for import and export, and organize industry injury investigations. To guide and coordinate domestic efforts in responding to foreign antidumping, countervailing, and safeguard investigations and other issues concerned.

9. To give general guidance to nationwide efforts in foreign investment. To analyse and look into China's foreign investment developments and submit information concerning the developments and the corresponding proposals to the State Council on a regular basis. To draw up and enforce foreign investment policies and reform schemes, participate in the formulation of mid-term and long-term planning and development strategies for foreign investment utilization. To examine and approve, according to relevant laws, the establishment and changes thereafter of foreign-invested enterprises with foreign input exceeding the state fixed amount, or engaged in restricted business areas, or in businesses subject to quota and license administration. To verify the contracts and statutes of large-scale projects with foreign investment and their major subsequent changes particularly stipulated in relevant legislations. To supervise the enforcement of laws, regulations, contracts and statutes by foreign-invested enterprises. To guide and oversee nationwide efforts in attracting foreign investment and other business opportunities, as well as the establishment and trade performance of foreign-invested enterprises in China. Comprehensively guide and coordinate the specific work of state-level economic and technological development zones.

10. To be responsible for China's foreign economic cooperation efforts. To formulate and implement policies and regulations on foreign economic cooperation, guide and monitor the regulation of overseas contract projects, labour cooperation and designing and consulting businesses. To work out administrative measures and specific policies guiding China's overseas investment. To approve Chinese companies to invest in and set up overseas establishments (excluding financial companies) and supervise their operation.

11. To be in charge of China's efforts in providing aid to foreign countries and regions. To formulate and implement China's foreign aid policies and plans, and sign the relevant agreements. To compile and execute annual foreign aid programs. To supervise and inspect the implementation of China's foreign aid projects. To manage China's foreign aid fund, concessional loans, special funds and other foreign aid funds of the Chinese government. To facilitate the reform on foreign aid provision modalities.

12. To formulate and implement economic and trade policies as well as mid-term and long-term trade planning for the Hong Kong Special Administrative Region (HK SAR),

Macao Special Administrative Region (Macao SAR) and Taiwan region. To hold economic and trade talks with the competent authorities in charge of trade and economic affairs of HK SAR and Macao SAR as well as authorized non-governmental organizations of Taiwan and sign the relevant documents. To be in charge of the commercial and trade liaison mechanism between the mainland and the HK SAR and Macao SAR. To organize the direct trading activities with Taiwan, and to be responsible for bilateral and multilateral trade issues involving Taiwan.

13. To be responsible for the training, selection and management of Chinese professionals working in the Permanent Mission of the People's Republic of China To the World Trade Organization, the Economic and Commercial Counsellor's Offices of the Chinese Embassies and missions to other international organizations. To guide the work of the chambers of commerce for import and export and other relevant associations and societies.

14. To undertake other assignments entrusted by the State Council.

Source: MOFCOM 2007

## Socio-Economic Indicators

**Table 1:** Development-related Indexes of Post-Socialist States (1990-2005)

	Average Annual GDP Growth (1990-2005)	HDI Change (1990-2005)	Year of Economic Depression Maximum	Average Annual GDP Growth since the Depression Maximum
Albania	3.4	0.097	1992	6.5
Armenia	2.4	0.038	1993	9.0
Azerbaijan	1.8	N/A	1995	13.3
Belarus	1.9	0.014	1995	7.3
Bosnia and Herzegovina	5.0	N/A	1993 and 1994	16.2
Bulgaria	0.5	0.030	1997	5.1
Croatia	0.9	0.038	1993	4.6
Czech Republic	1.5	0.046	1991 and 1992	3.2
Estonia	2.4	0.047	1994	7.0
FYR Macedonia	-0.1	N/A	1995	2.6
Georgia	-2.3	N/A	1994	6.9
Hungary	2.0	0.061	1993	3.6
Kazakhstan	1.2	0.023	1995	7.0
Kyrgyzstan	-1.0	N/A	1995	4.9
Latvia	0.6	0.051	1993	6.6
Lithuania	0.7	0.035	1994	6.2
Moldova	-3.8	-0.032	1999	5.7
Mongolia	2.0	0.046	1993	5.0
Poland	3.6	0.064	1991	4.6
Romania	0.9	0.036	1992	3.3
Russia	-0.4	-0.013	1998	6.9
Serbia	-1.8	N/A	1993	4.0
Slovakia	1.9	0.043	1993	5.3
Slovenia	2.6	0.066	1992	4.4
Tajikistan	-1.3	-0.030	1996	7.3
Turkmenistan	4.0	N/A	1997	14.6
Ukraine	-2.7	-0.021	1999	7.5
Uzbekistan	1.6	-0.002	1995	5.0
China	10.2	0.143	1979*	10.3
Vietnam	7.6	0.113	1986*	7.2
Laos	6.3	0.123	1989*	6.7

Source: Author's calculations based on the data from EBRD 2007; HDR 2002, 2007/2008; WEO 2008.

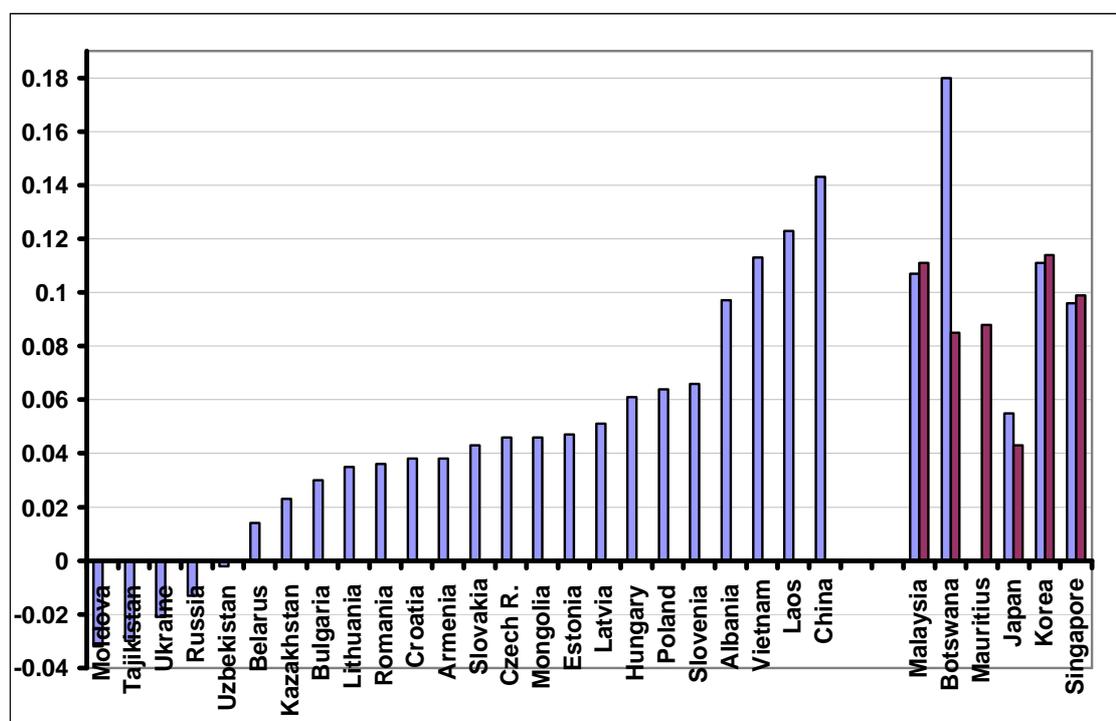
\* Base year for the calculations as there was no economic contraction.

**Table 2:** HDI Change in Historical Developmental States

	HDI change (1975-1990)	HDI change (1980-1995)
Japan	0.055	0.043
Korea	0.111	0.114
Singapore	0.096	0.099
Malaysia	0.107	0.111
Botswana	0.180	0.085
Mauritius	N/A	0.088

Source: Author's calculations based on the data from EBRD 2007; HDR 2002, 2007/2008; WEO 2008.

**Figure 2:** HDI Change among Post-Socialist and Developmental States



\*In the case of PST states, the surveyed period is 1990-2005. In the case of developmental states, the surveyed period is 1975-1990 (bright) and 1980-1995 (dark).

Source: Author's calculations based on HDR 2002, 2005, 2007/2008.

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