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China as a Developmental State

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Abstract

The paper examines the notion of a 'developmental state' and shows that China possesses the characteristics of a developmental state. It explains the political economy which generated such a state in China and in some other economies. It analyses the methods and mechanisms that were introduced to create a developmental state, in particular the incentive structures that the leadership used to solve the principal-agent problem. These include personnel policies, fiscal decentralization, and patronage relationships. That leads to a review of its successes, limitations and adverse consequences, and to the question: can China's developmental state be sustained? Conclusions are drawn for both China and other developing countries.

Key Words: China; Developmental state; Economic growth; Incentives; Principal-agent problem; Virtuous circle

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1. Introduction

Over the 34 years of economic reform and marketization China's economy has grown at the remarkable rate of no less than 10% per annum. Economists tend to concentrate on the proximate determinants of the growth rate but it is arguable that the underlying political economy has played an important part (Knight and Ding 2012)¹. The overriding economic policy objective was the achievement of rapid economic growth, and the policies that were adopted managed to do this. China became a 'developmental state'.

There is no consensus on the definition of a developmental state. It is best defined as one in which the state gives overriding priority to the objective of rapid economic growth and adopts policies which are successful in achieving that objective. This broad definition is not universally used. The concept was initially put forward (by Johnson 1982) and taken forward (for instance, by Amsden 1989 and Wade 1990) in the context of the policies that were adopted in East Asia to generate rapid industrialization, and sometimes it is tied to a particular industrialization strategy. For instance, it has been used to denote the state's promotion of industries in which the economy has no comparative advantage, as opposed to reliance on more market-based industrialization in accordance with comparative advantage (Lin 2009: 40-1). However, the broader definition, untied to particular policies, is also in use (for instance, Chang 1999, Fritz and Menocal 2007, Beeson 2009), and it will be used throughout this paper.

In section 2 the reasons why China became a developmental state are examined, and this leads to a brief comparison with various other developmental states. Section 3 examines the institutions and incentive structures that China used to create and maintain its developmental state. In section 4 the successes, limitations and adverse consequences of the developmental state policies are discussed. Section 5 considers

¹ On which this paper builds.

whether China's developmental state can be sustained in the future, and section 6 concludes.

1. Origins

China's leadership under central planning gave high priority to rapid industrialization. Indeed, industrial production grew in real terms by 10.5% per annum over the period from 1952 to 1978. On the other hand, real GDP per capita increased annually by only 3.0%. Worse still, the real consumption per capita of rural households – representing over 80% of the population - rose on average by only 1.4% per annum between 1952 and 1978, and people had suffered from the traumas of the Great Famine and the Cultural Revolution during the intervening period.² China had neither the firmity of purpose nor the policies to be a developmental state under central planning. Politics, and not economics, was in command.

In 1976 there was a reordering of objectives from the political to the economic. The new leadership was intent on economic reform. There were three likely reasons. First and foremost, the loss of political legitimacy during the years of economic stagnation and political upheaval required an improvement in living standards to restore and solidify political support for the Chinese Communist Party (CCP). It was necessary to promote economic development in order to provide a new form of legitimacy: failure to do so would mean economic stagnation, social tension, and political decline. A second consideration was a greater awareness of the West's prosperity and of the economic success of some East Asian countries. If they could achieve rapid growth by harnessing the market and pursuing open economy policies, might not China also become more successful if it were to move towards similar policies? Third, the chaos of the Cultural Revolution had weakened the capacity for central planning.

² These figures are derived from National Bureau of Statistics (1999), *Comprehensive Statistical Data and Materials on 50 Years of New China*, Beijing: China Statistics Press,

The fact that the system concentrated discretionary power at the top provided the scope for at least gradual reform. The leadership embarked on two important reform programmes: not only economic reform but also political reform, that is, reform of state and party. The leadership system was modernised by introducing greater professionalism through the use of educational qualifications, cadre training, and an incentive system that rewarded the achievement of state objectives and involved performance evaluation in career promotion. Thus, the party and state bureaucrats including managers of state owned enterprises (SOEs) were moulded to meet CCP objectives, to which the achievement of rapid economic growth was central. China became a developmental state.

The term 'developmental state', coined by Johnson (1982) to characterize Japan in the early post-war period, has been used to describe states which actively, resolutely, and successfully pursue economic growth. The growth of GDP in Japan averaged no less than 8% per annum from 1952 to 1980. Some other East Asian states have been placed in the same category, including South Korea and Taiwan (for instance, Vartiainen, 1999). For two or three decades in the post-war period the governments of South Korea and Taiwan single-mindedly pursued growth objectives and achieved rapid growth (Amsden 1989, Wade 1990). The South Korean economy grew by 9% per annum over the period 1965-90, and Taiwan's economy also by 9% per annum over the period 1960-90 (Knight and Ding 2012: 4).

There can be differences among developmental states and over time in the degree of democracy or dictatorship, the nature and extent of state intervention in the economy, and the strength of industrial policy. However, they all share an overriding policy objective to achieve rapid economic growth by means of active state policies, and success in meeting that objective.

Johnson (1982) explained the motivation for the Japanese developmental state as a response to a series of crises. For South Korea and Taiwan, external threats may have been the driving force – threat from North Korea in the former case and from

China in the latter. The threats to the state produced a firmity of purpose that is lacking in many developing countries: political survival required economic strength. In China's case, the developmental state arose from the need of the ruling party to restore and maintain the political legitimacy that it had lost.

The biased nature of the sample of countries identified as developmental states precludes hypothesis testing. There may be states which placed no less emphasis on growth objectives but failed to achieve rapid growth, for instance because the initial conditions were not favourable or their growth policies were not efficient. Other states may have experienced rapid growth - whether or not they emphasised growth objectives - without active state intervention, for instance because of favourable initial conditions and reliance on the market. Nevertheless it is worth identifying states which gave priority to growth objectives and adopted active policies that successfully achieved those objectives, and enquiring how they managed it. We do this for China.

2. The Evolution of Reform

China embarked on gradual, step-by-step economic reform, with one reform leading to another. It was governed by two criteria: it had to be efficiency enhancing and it had to be interest compatible (Qian 2003). This process can be illustrated by the early rural reforms. The new goal of economic growth effectively increased peasant power. This was not organised power but individual, atomized behaviour. Spontaneous experiments were permitted in a couple of provinces by reform-minded governors but in others the experiments initially involved secrecy and conflict. Peasants were attracted to household production because it offered higher incomes, security, and independence. The rural reforms were that rare economic event, a 'Pareto improvement', benefiting almost all rural people. The privatization and marketization of rural China was a process of cumulative causation. When one aspect of economic life was reformed, gains in efficiency were impeded unless other aspects of economic life were allowed to follow. Local markets for credit, labour, land use, and manufactured goods emerged.

One of the benefits of gradualism was that policy makers could learn from experiments and experience without incurring high risks. Another benefit was that economic agents had time to adapt to markets and to change their attitudes. For instance, SOE managers learned to cope with the new market competition and to find ways of benefiting from the new market opportunities. The early introduction of the dual-track pricing system had the virtue of avoiding opposition from planners and managers and yet harnessing the market for enterprise and improved resource allocation. The growth of the non-state sector drew resources away from SOEs. Not only did the non-state managers themselves have stronger profit incentives but also their competition strengthened the incentives of SOE managers.

Naughton (2008) distinguishes two distinct political periods. In the first (1978-93) power at the top was fragmented. There were too many veto players who could protect their constituencies, so making reform difficult. This was the period of 'reform without losers': policy had to follow a narrow and unopposed path. At the end of the first period, SOEs and urban workers remained protected and were largely untouched by economic reform. By the start of the second period (from 1993 onwards), many of the revolutionary elders had died off. The success of incremental reforms had enabled the reform leadership to consolidate their power. Policy making could become more decisive, and reform-related costs could be imposed on some of the losing groups. Moreover, the emerging mid-1990s crisis facing the SOEs and government revenue and threatening to stop rapid economic growth forced bolder action upon the leadership.

A broad process of comprehensive reform was initiated. It was necessary to tackle several problems together, for instance the SOEs, urban workers, social security, migration, housing, government revenue, the foreign exchange rate, and trade. The absence of any one of these reforms had the potential to make some of the others ineffective. The reforms were assisted by a feedback loop: the more rapid growth of

output and government revenue made it easier for the state to compensate the losers.

3. Incentives

The groups that stood to gain from the reforms had to be motivated and the groups that stood to lose had to be made ineffective. The reform leaders needed to build up a reform coalition. They did so by developing a system of state appointments, by granting local fiscal powers of revenue retention, and by increasing their powers of patronage. These three sets of incentives are examined in this section.

Xu (2011) attributes China's growth success to the unusual nature of China's institutions, which he describes as 'regionally decentralised authoritarianism'. By this he means that political control is centralised but economic management is decentralised to the provinces, cities and counties. This system has evolved over the centuries: in a country as huge as China, it is inevitable many economic responsibilities and powers should be delegated to the, better informed, regions and localities. However, it creates a classic principal-agent problem. China does not have a federal system - in which there are more principals and fewer agents - but one in which there is one principal and many agents. For instance, Tsui and Wang (2004) show that, despite fiscal decentralisation, local governments are in many respects agents of the central government.

China's developmental state is based on a successful solution to the principal-agent problem. Central government solves the principal-agent problem by creating incentives for officials at all levels of government to pursue its own economic objectives. These objectives have primarily been the achievement of rapid economic growth.

The incentives are created partly by the system of state appointments, promotions and demotions at every level of government. This system is an important lever by which the leadership controls, coordinates and motivates officialdom at all rungs in

the hierarchical ladder. It determines every state official's career path. Each level of government controls personnel at the level immediately below: central, provincial, city, county and township governments.

Xu (2011) describes the system in detail. Evaluation is based on performance in achieving state objectives and targets. Each government negotiates with the subordinate government for performance targets. Officials sign target responsibility contracts with the superior government, and they are evaluated on the degree of fulfilment of their contracts. Performance criteria differ according to the level of government, being broader at the top. However, the most important criterion has been the achievement of economic growth in the relevant jurisdiction. Common ranking criteria are the growth rate of local GDP and the attraction of foreign direct investment.

There is competition among local government officials at the same level. For instance, leaders of the top three ranked townships are rewarded and those of the bottom three ranked townships are punished. Competition among provincial leaders determines the selection process into the national leadership. Performance rankings are regularly published. There is much rotation across localities or regions, often combined with promotion, which helps to diffuse good practices and strengthens allegiance to the centre. Officials in the bureaucratic hierarchy compete against each other.

The personnel system thus provides incentives for good performance. Because central government encourages regional experiments, as a way of overcoming resistance to reform and reducing the risks of reform, officials have an incentive to take reform initiatives. Thus, the performance criteria convert many bureaucrats into entrepreneurs, willing to take risks and experiment. In many other countries – more democratic or more federal – the spur to efficient governance comes from below, though 'exit' (mobility) and 'voice' (elections or protests) (Hirschman 1970).

In China the spur comes mainly from above, through competition among personnel, which has been referred to as a 'tournament' or as 'yardstick competition'.

There is considerable evidence that the personnel incentive system is effective. Maskin et al. (2000) find that provincial leaders from better performing provinces had a better chance of being promoted to the national leadership. Chen et al. (2005) report that the promotion or termination of provincial leaders hinged on the economic performance of the province during their tenure relative to that of their immediate predecessor. Li and Zhou (2005) find for the period 1979-95 that the promotion of top province leaders depended on the growth success of the province, relative to other provinces, over their period of tenure. Li (2011), using a data set for the 1990s, found evidence that the upgrading of counties to city status (with higher rank and greater autonomy) was based on county growth rates and was part of the incentive structure to promote economic growth.

Caldeira (2012) tested the yardstick competition hypothesis by estimating a spatial lag model for the period 1980-2004. Evidence of strategic interaction was found among provinces: public expenditure per capita in geographically or economically close provinces had a positive effect on a province's own expenditure. The strongest effects were for 'capital construction' and 'enterprise innovation'. The implication is that province leaders are most incentivised to raise their spending on activities that are important for local economic growth.

A second form of incentives is provided by the decentralization of fiscal responsibility and power. Early in the reform process local governments at all levels were granted rights to retain revenue, in particular 'extrabudgetary' revenue (falling outside the state budget), so encouraging them to promote economic development. They benefit from local economic development through the effect it has on their revenues and thus on their expenditures. Fiscal incentives and personnel incentives are separate but they overlap: fiscal success can help to speed local growth and thus improve promotion prospects.

Fiscal decentralisation grew in the reform period up to 1994, as the extrabudgetary revenue of local governments became increasingly important. There is evidence that fiscal decentralisation contributed to local economic growth, especially the growth of the non-state sector. Lin and Liu (2000) found that the growth of per capita GDP increased sharply in response to an increase in the marginal tax retention ratio. The marginal tax retention ratio at province level was low in the case of budgetary revenue but high in the case of extrabudgetary revenue (Knight and Li 1999: table 4). Jin et al. (2005) found that the marginal tax retention rate of provincial governments was positively associated with faster development of the non-state sector and greater reform of the state sector. However, these studies are based on data extending only up to 1993.

The major fiscal recentralisation that was carried out in 1994 – necessary to protect central government finances - blunted the fiscal incentives of local governments but did not eliminate them. Local officials retained much freedom over some sources of revenue and thus expenditure. Evidence that fiscal incentives have continued to operate since the fiscal recentralisation is provided by changes in development strategies pursued by county and township governments. From 1992 onwards local governments were given greater control rights over revenue generated by local land sales; local governments could also retain their revenues derived from local enterprises. As from 2002, however, central government appropriated 50% of the enterprise profit tax raised by local governments. The consequent switch in incentives redirected local government policies away from industrial development and the profits that this generated and towards urbanization through land sales and the capital gains that this generated (Kung et al. 2012).

A third incentive mechanism derived from powers of patronage (Naughton 2008: 109-11, 122-4). In the early years reform was assisted by the decentralization of decision making and a transfer of powers to local officials and SOE managers, so producing patronage relations within the hierarchical system via 'particularistic

contracting'. The web of patronage enabled officials to obtain loyalty and support from subordinates in exchange for advantageous contracts. As market opportunities were created, access to the new sources of income could be made available through patronage. The allocation of loans from the state-owned banks was an important means of creating political clients. Patronage extended beyond the state sector because private businesses had to maintain good relations with government and party officials.

The greater local autonomy which fiscal decentralization produced eventually threatened to weaken the top leadership. The fiscal recentralization of 1994, by transferring more revenue to central government for allocation to local governments, strengthened central powers of control. However, not only fiscal resources but also patronage resources were recentralized: the additional revenues could be directed to favoured clients. In general terms, the powers of patronage stem from hierarchical control – the right to grant permissions or refusals - over much of the economy. The same powers, however, can give rise to rent seeking and corruption.

4. Successes, Limitations and Adverse Consequences

The growth rate of GDP averaged a remarkable 10% per annum over three decades. The proximate causes of China's outstanding growth performance were examined in Knight and Ding (2012).³ Suffice to say here that rapid capital; accumulation, conditional convergence from a low base, and drastic sectoral change were found to be important. High physical capital investment (more than 40% of GDP in recent years) was crucial, both for its amount and its productivity. It could explain 31% of the difference in the growth rate between China and other developing countries, and conditional convergence (involving capital stock catch-up) another 47% (Knight and Ding 2012: 80). Deeper investigation showed that investment defined as

³ See chapters 4-7, estimating cross-country and cross-province growth regressions, and using sophisticated model selection methods and panel data GMM techniques.

'investment in innovation' and secondary and, especially, higher education enrolments were the most efficient types of investment. Three forms of structural change prompted efficiency and growth: the expansion of trade, the privatisation of production, and the transfer of labour out of agriculture.

The highlighted importance of capital accumulation for China's growth raises a deeper, underlying, question: why does China invest so much? The high rate of capital accumulation raises the danger that diminishing returns will set in and reduce its marginal product. However, the rate of return to capital stayed reasonably high, and profitability remained promising enough to maintain high investment. This was facilitated by rapid growth of total factor productivity (TFP), itself assisted by the economic reforms, and the ready supply of surplus labour that could be combined with the growing capital stock.

Entrepreneurial expectations of rapid economic growth were necessary for high investment. The developmental state was crucial, both to high investment and to high saving. Incentives were provided at all levels and in all parts of the state sector: bureaucrats were rewarded for promoting investment and businessmen could take investment decisions with confidence that growth policies would be pursued. Neither funds nor saving held back investment. Enterprises that were owned or controlled by government had access to a ready supply of bank loans at low rates of interest, and the non-state enterprises that were not linked to government were sufficiently profitable to be able to rely on their own retained profits. Government took a long term, dynastic, view of the distribution of inter-temporal consumption. The fact that investment – much of it in relatively high-technology sectors and embodying new technologies – was so high in turn accelerated the growth of TFP. In these ways, the developmental state policies generated a virtuous circle of rapid growth – high confidence, high investment, high growth, high confidence,... - and kept it going.

Caution is required lest it be thought that all forms of local policy intervention have promoted growth. Nee et al. (2007), analysing the performance of a sample of China's listed firms, found that firm performance (measured by economic returns) is adversely affected by direct local government interventions in the firm (measured by the extent of involvement in firm decision making). They concluded that local governments contribute indirectly to growth of their economies by providing the institutional (policy and infrastructure) environment that offers favourable conditions for firms.

Rapid economic growth brought about remarkable changes in China's economy and society, giving rise to new socioeconomic problems. These were compounded by the narrow focus of state personnel responsibility contracts on the primary objective of economic growth. Thus, for many years of economic reform officials were little concerned with such issues as income inequality, procedural injustice, or environmental pollution.

An indication that economic growth in itself is not a sufficient objective is provided by the growing evidence on subjective well-being in China. Easterlin et al. (2012) showed that measured life satisfaction was on average no higher in 2010 than it had been in 1990, despite the fact that real household income per capita in 2010 was more than 5 times its 1990 value. Knight and Gunatilaka (2011) and Knight (2012) attempted to explain this stagnation in terms of relative income and its widening, changing and broadening reference groups, and rising economic insecurity. Whyte (2010) produced survey evidence that people dislike the many forms of procedural injustice that they encounter, for instance, the unequal treatment of people according to *hukou* (rural or urban residence registration) status, the sale of village land by local officials without adequate compensation, and the failure to pay wages as contracted.

Recognition of emerging problems led in the mid-2000s to the leadership's introduction of new objectives in addition to the growth objective. The harmonious

society policies of recent years have been pursued in various ways. One way was to modify the targets laid down in the responsibility contracts negotiated with officials at different levels. Some incentives for local government cadres now operate in relation to non-growth objectives. These include, for instance, rewarding city officials who achieve redistributive objectives, such as the introduction and raising of city minimum wages, rewarding local officials who achieve targets for reducing environmental pollution, and punishing officials held responsible for causing local social discontent.

5. Sustainability?

There are various reasons why we might expect China's growth rate to decline gradually as the economy matures. These include the growing scarcity of relatively unskilled labour as China reaches the 'Lewis turning point' and enters the second stage of the Lewis model. This process may have started and will become important over the coming decade (Knight and Ding 2012: ch. 9).

It is difficult confidently to forecast China's evolving political economy over the long term. Much will depend on the power of the top leadership and the strength of bureaucratic, business and military vested interests. One scenario, espoused for instance by Pei (2006), is that interest groups will grow more powerful as the economy develops and that the balance of competition among them will determine future economic policy. In these circumstances it is possible that the developmental state will gradually wither away - and give way to the predatory state. Another scenario is that China will gradually become a more democratic country with a fully marketized economy. Again, the developmental state might wither away as people's expressed concerns receive more attention - and evolve into the neoliberal state. In this case the decline of the developmental state would reflect social preferences.

More immediately, there can be various sorts of adverse shock to the Chinese economy that might dislodge it from its current virtuous circle of economic growth. The hypothesis being advanced is that an adverse shock can start a cumulative

process that ends the virtuous circle of growth and might even transform it into a vicious circle of stagnation. One danger comes from the possibility of financial collapse, associated either with China's macroeconomic imbalances or with its immature financial system. The spectre to avoid is the experience of Japan, which moved from rapid growth up to the 1980s to slow growth since the 1980s. Several factors may have contributed to this reversal but an important one was the financial bubble of the late 1980s and its subsequent collapse. Expectations of economic growth receded, investment confidence was lost, and Japan's developmental state came to an end.

The underlying hypothesis is that a developing country is characterised by two growth equilibria, one involving high investment and high growth and the other low investment and low growth. This perspective is different from that provided by neoclassical growth theory. A role is given to externalities. For instance, assume that the expected profitability, and thus investment, of each firm is raised by high investment in the economy as a whole. Moreover, if individual investment bears a non-linear relationship to the economy-wide anticipated investment rate – being insensitive at high and low anticipated rates – there is the possibility of more than one self-fulfilling outcome. There can be one stable equilibrium in which investment is generally high and another stable equilibrium in which it is generally low (illustrated by Ray 1998: 114-6).

Another form of adverse shock could be the growth of social instability. This might result from the emerging socioeconomic problems that are associated with the developmental state, and which help to explain the failure of reported life satisfaction to have risen over two decades. Localised and uncoordinated cases of socioeconomic instability do not pose a threat to expectations of continued rapid economic growth. However, they are reported to be rising in number. Should they become more widespread and coordinated, investor confidence could be shaken and aggregate investment could fall. This might set in motion a cumulative train of events.

For instance, the external imbalances of the Chinese economy make it prone to asset bubbles through their effect on liquidity. A loss of investor confidence might cause an asset bubble to burst, in turn threatening the solvency of the banking system and the supply of funds for investment. The actual slower rate of growth of the economy might itself deter investment, and it might also have a harmful effect on social instability. Thus, there can be aggravating interaction among adverse shocks, and interaction between such shocks and economic growth.

China's changing socioeconomic situation is liable to require a dilution of the developmental state objectives as outcomes other than economic growth become more important for promoting life satisfaction and preserving social stability. China may have to become a 'human developmental state' (Riskin, 2009), that is, with objectives normally considered to be aspects of human development (as suggested by the Human Development Reports of the UNDP) being added to the economic growth objective. These might include greater policy attention to issues of poverty, inequality of income and public services, social security, the environment, various personal freedoms, and procedural injustices. Such policies might well help to maintain rapid growth by reducing the risk of adverse shocks.

Human development policies might, however, also weaken the incentive structures that help to sustain the developmental state. It is arguable that incentives created through tournament competition can be harmful when agents are responsible for multiple tasks: agents concentrate on the measured target and neglect the unmeasured tasks (Holmstrom and Milgrom 1991). In principle, it is possible for the national leadership to establish a set of weights for its various objectives, and to apply these in performance evaluation. However, there are difficulties of making evaluation trade-offs and of measurement arising from perverse reporting incentives and technical problems. It is arguable that even local GDP growth has at times been exaggerated by ambitious officials; the chances of misreporting are greater in the case of less measurable targets. The system of incentivising officials

through personnel policies may thus become less effective in the future if objectives other than economic growth loom larger. The alternative is that it remains biased in favour of growth objectives and so weakens the harmonious society policies.

6. Conclusions

It was the need to restore and maintain political legitimacy and avoid social instability that led China's authoritarian government throughout the period of economic reform to accord the highest policy priority to the achievement of rapid economic growth. Moreover, it was successful both in finding ways to achieve that objective and in actually achieving that objective. China in this period has been a very successful developmental state.

Authoritarian states are prone to general conservatism, so making economic reform difficult. The Chinese leadership has overcome this obstacle and solved the agency problem by means of the incentive structures for officialdom that were put in place, and which helped to turn bureaucrats into entrepreneurial reformers. The incentives were created partly by means of personnel policy: the cadres were put into a tournament based on forms of yardstick competition. Fiscal decentralization policy and patronage relationships also helped to provide incentives for promoting economic growth.

Authoritarian states, lacking the discipline that comes from 'exit and voice', are also prone to the rent seeking behaviour and corruption that stems from lack of accountability. There is indeed a general perception that rent seeking and corruption are rife in the Chinese economy. For instance, President Hu Jintao is said to have described corruption as 'rampant' (Shirk 2008: 32). The Worldwide Governance Indicators of the World Bank placed China 148th out of 235 countries on 'control of corruption' in 2009, and 220th on 'voice and accountability'. It might be countered that the normal view of voice and accountability is to measure the pressures that come from below, whereas in China it is the pressures that come

from above that provide accountability. Even if some officials are more motivated by rent seeking than by promotion prospects, good relative achievement of contracted targets helps officials to keep their positions and thus to retain rents, whereas poor performance threatens loss of rents.

Despite this check, the general perception of endemic rent seeking and corruption in China remains, especially in local governments. The principal is not able to deal with the informational advantages that its agents possess in this regard. Nor is the principal's interest entirely clear: the patronage that comes with creating opportunities for acquiring rents helps to maintain allegiance to the CCP. More pressures from below would no doubt help to provide voice and improve accountability.

A virtuous circle with positive feedback effects has helped to maintain China's developmental state. There has been a process of cumulative causation in which high confidence produces high investment, which in turn generates high growth, thus maintaining high confidence, and so on. There is a danger that an adverse shock might break the virtuous circle, so bringing the developmental state to an end. However, to protect against this danger might require a further broadening of objectives beyond economic growth.

China's rapid socioeconomic changes mean that rapid economic growth remains a necessary condition but is no longer a sufficient condition for maintaining political legitimacy and social stability. Indeed, the emphasis placed on growth targets in personnel policy may have contributed to the neglect of adverse developments such as rising inequality, environmental pollution, and unfair treatment. The leadership recognises this danger and has responded to it by recently introducing additional policies that are designed to achieve a more harmonious society. It remains to be seen whether the system of yardstick competition can be as successful in promoting policy objectives, now that they are broader and their outcomes less measurable, than it was when economic growth was the only preoccupation.

What lessons does China's experience provide for other developing countries? The creation of a developmental state is not unique to China but it is not common. We have mentioned Japan, South Korea and Taiwan in particular periods of the twentieth century as fulfilling the criteria, and there may be others. A comparative study of developmental states - to discover what characteristics they have in common and how they differ - could be illuminating. For instance, Rodrik (1995) attributed the rapid growth of both South Korea and Taiwan to good initial conditions and the ability of the state to remain insulated from pressure groups and to solve the problem of coordination failure. In considering the same two countries, Lau (1990) stressed good economic policies, external threat, and strong commitment to economic development. Vartiainen (1999) mentioned also the competence and strength of their bureaucracies, which was partly a legacy of former Japanese rule. If development states share some of the institutional characteristics that have promoted growth in China, these cannot be well captured by the proxies for good institutions that are normally employed in cross-country growth regressions, and it may prove difficult to find good alternative proxies (Xu 2011).

Several conditions are required for a country to be a developmental state. As just indicated, these might include favourable initial conditions and the choice of appropriate economic policies. However, one condition for a developmental state is that the government accords high priority to economic growth and another is that governance should be incentivised to achieve that objective. These two criteria might prove difficult in a democracy, in which the electorate is the principal and government the agent, or in a federal state, in which there are several principals. For instance, India with its democracy has had objectives broader than just economic growth, and with its federal structure has lacked political articulation (Herring 1999). The representation of people's interests might require a shorter time horizon and broader policy objectives than is the case in China.

Many governments of developing countries, whether democratic or authoritarian, appear from their deeds if not their words to place low priority on the pursuit of economic growth. Rent seeking by elite groups often diverts attention from growth objectives. The 'helping hand' observable at different levels of government in China becomes a 'grabbing hand' elsewhere (Frye and Schleifer 1997). In fact, China's governance is two-handed, having both a helping and a grabbing hand. The lack of voice and accountability is one of the disadvantages of the governance arrangements that have helped to produce China's developmental state. If leaders in other developing countries do attempt to emulate China's incentive structures for achieving rapid growth, they must also address the voice and accountability problems that are inherent in China's developmental state.

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