



China as a Developmental State

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1. INTRODUCTION

WHY do some economies grow much faster than others? One possible contributory reason is that a country's government accords the highest policy priority to economic growth and that it adopts institutional arrangements and incentive structures which will promote that objective. Such a country can helpfully be referred to as a 'developmental state'. In this paper, it is argued that, by these two criteria, China is a developmental state. Moreover, its underlying political economy – represented by government objectives and the governance arrangements for their implementation – has contributed to China's growth.

There is no consensus on the definition of a developmental state. 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 economic policies that were adopted in East Asia to generate rapid industrialisation, and sometimes it is tied to a particular industrialisation strategy. Thus, much of the developmental state literature is about the precise policy measures that were put in place. However, there is a case for accepting a broader definition that is not tied to particular policies and instead stresses state objectives and the institutional arrangements by which the state goes about implementing them. That is the approach which is adopted in this paper.

There may be unsuccessful developmental states: states which have placed no less emphasis on growth objectives but have 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 without satisfying the developmental state criteria, for instance because of favourable initial conditions and reliance on the market. Thus, a developmental state need not grow rapidly nor need a rapidly growing country be classified as a developmental state.

This paper differs from a conventional research paper in economics in that there is no formal hypothesis testing. Being broad, the general argument is not amenable to precise empirical verification. Instead, several pieces of analysis and evidence are drawn together from a diverse literature. They are moulded into an argument within an analytical framework that concerns incentive structures and the solution to the principal-agent problem facing the Chinese government. That is the intended contribution of the paper. Within the confines of a journal paper, there is inevitably a trade-off between breadth and depth. The strength of the approach adopted in this paper is that it offers sight of the wood as well as the trees. The concomitant risk is that the constituent arguments might appear unconvincing. The strategy adopted is to minimise the risk by means of referencing.

A road map is required to show how such a broad paper hangs together. In Section 2, the reasons why China became a developmental state are examined. Section 3 explains how China made the transition from centrally planned economy to developmental state. Section 4 analyses the institutions and incentive structures that China used to create and maintain its developmental state. The successes, limitations and adverse consequences of these policies are discussed in Section 5. Section 6 considers whether China's developmental state can be

sustained in the future. The concluding Section 7 brings the different strands of evidence and argument together to form an integrated argument and considers the implications for other developing countries.

2. THE ORIGINS OF THE DEVELOPMENTAL STATE

China's leadership under central planning gave high priority to rapid industrialisation. Indeed, industrial production grew in real terms by 10.5 per cent per annum over the period from 1952 to 1978. On the other hand, real GDP *per capita* increased annually by only 3.0 per cent. Worse still, the real consumption *per capita* of rural households – representing over 80 per cent of the population – rose on average by only 1.4 per cent 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.¹ 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). Failure to promote rapid economic development would mean economic stagnation, social tension, and political decline. This interpretation of the motivation of the reform leadership is widely accepted (for instance, Kelliher, 1992; White, 1993; Naughton, 1995; Xu, 2011). Thus, according to White (1993, p. 11), 'the economic reforms were an attempt to re-establish the hegemonic authority of the Communist Party on a different basis: by abandoning the Maoist notion of development as a political struggle and attempting to accelerate economic development . . . Success, it was hoped, would provide a new form of legitimacy for the regime, based on its ability to deliver rapid improvements in welfare'.

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 (Naughton, 1995).

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 (Naughton, 1995).

Through their growth-oriented objectives and institutions, certain other countries at particular times have been referred to as developmental states, and indeed as successful developmental

¹ These figures are derived from National Bureau of Statistics (1999).

states (Johnson, 1982; Vartiainan, 1999). The growth of GDP in Japan averaged no less than 8 per cent per annum from 1952 to 1980). 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 cent per annum over the period 1965–90, and Taiwan's economy also by 9 per cent per annum over the period 1960–90.

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 growth promotion by the state.

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 sense of purpose that is lacking in many developing countries: political survival required economic strength. In China's case, it was argued above that the developmental state arose primarily from the need of the ruling party to restore and maintain the political legitimacy that it had lost.

3. THE EVOLUTION OF THE DEVELOPMENTAL STATE

The road from central planning to developmental state had to overcome three initial obstacles: weakness of leadership, bureaucratic inertia, and vested interests. 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: peasant cooperation was now necessary (Kelliher, 1992). This was not organised power but individual, atomised behaviour. Spontaneous experiments were permitted in a couple of provinces by reform-minded governors, and the reforms were permitted, and later encouraged, to spread. 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 privatisation and marketisation 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. New institutions – local markets for credit, labour, land use, and manufactured goods – emerged.

One of the benefits of gradualism was that policymakers could learn from experiments and experience and could find ways of overcoming vested interests. For instance, 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. Policymaking 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 (Naughton, 2008). 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.

Underlying, and driving, this process of economic reform was a strengthening commitment of the leadership to the pursuit of economic growth. Rapid growth was achieved partly because the initial conditions were favourable: huge economic inefficiencies could be eliminated through market reform. In addition, it was achieved partly because of the powerful incentives that were built into the system of governance.

4. INCENTIVES FOR THE DEVELOPMENTAL STATE

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 that 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 in a county 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. Such experiments include the initiation or promotion or financing of local investment projects and the overcoming of local institutional or resource bottlenecks.

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 corresponds to economists’ notions of ‘tournaments’ or ‘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.

In contrast to these researches, a study by Shih et al. (2012) failed to confirm the promotion hypothesis. The determinants of party rank and its change over five party congresses were analysed. The authors found that the economic growth of a province had no effect on rank level or change. However, their inclusion in the promotion equation of both province growth of GDP and province growth of revenue (the latter is found to have a positive effect) might well bias downwards the effect of GDP growth.

There is need for qualification arising from the difficulty of ensuring accountability when the principal is less well informed than the agents. Promotion criteria are liable to be distorted. Jin et al. (2005) provided evidence that factional connections enter into promotion decisions. It is also possible that some personnel decisions are subject to political influence and position buying (Yang, 2009). In a detailed study of particular local governments, Landry (2008) found that, whereas the good performance of city mayors raises the odds of promotion, poor performance is not punished.

Performance measures, also, are liable to be inaccurate. Landry (2008) argued that high mobility from one post to another within the bureaucracy blunts cadre accountability. Zhou (2010) analysed collusion among local governments at different levels in the bureaucratic hierarchy in response to directives from above. Such collusion might permit helpful flexibility in implementing policy according to local conditions. However, it might instead produce goal displacement, in which local governments or officials pursue their own objectives. Despite these imperfections, there is nevertheless general agreement in the literature that China's personnel policies do provide effective incentives for promoting central government's growth objectives.

A second form of incentives is provided by the decentralisation 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 province *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). 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 per cent 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 urbanisation through land sales and the capital gains that this generated (Kung et al., 2013).

A third incentive mechanism derived from powers of patronage (Naughton, 2008). In the early years, reform was assisted by the decentralisation 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 decentralisation produced eventually threatened to weaken the power of the centre. The fiscal recentralisation 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 recentralised: the additional revenues could be directed to favoured clients (Naughton, 2008). In general terms, the powers of patronage stem from hierarchical control – the right to grant permissions or refusals – over much of the economy.

Again, there is need for qualification which weakens, but does not negate, the argument. The same powers of patronage can give rise also to rent seeking and corruption. Preferential access to funds, resources and opportunities mainly affects how the growth of income and wealth is distributed. However, it also affects the rate of economic growth insofar as less efficient opportunities and investments are chosen. For instance, the banking system has favoured state investment projects at the expense of the private sector (Allen et al., 2005; Haggard and Huang, 2008), despite the evidence that the rate of return on investment in privately controlled industrial firms has been higher than in state-controlled industrial firms and that marginal private investment has contributed more to growth (Knight and Ding, 2012).

5. SUCCESSES, LIMITATIONS AND ADVERSE CONSEQUENCES OF THE DEVELOPMENTAL STATE

The growth rate of China's GDP averaged a remarkable ten per cent per annum over three decades. The proximate causes of China's outstanding growth performance have been intensively researched (for instance, Yao, 2006; Riedel et al., 2007; Knight and Ding, 2012). Suf-
fice to say here that rapid capital accumulation, conditional convergence from a low base, and drastic sectoral change have been found to be important. High physical capital investment (more than 40 per cent of GDP in recent years) was crucial, both for its amount and its productivity. It could explain 31 per cent of the difference in the growth rate between China and other developing countries, and conditional convergence (involving capital stock catch-up) another 47 per cent. Three forms of structural change were found to promote efficiency and growth: the transfer of labour out of agriculture, the expansion of trade, and the privatisation of production (Brandt et al., 2008; Knight and Ding, 2012). Thus, over the experienced range, the share of state ownership in investment and production was not important for the developmental state policies; indeed, the declining state sector share was good for growth. However, a perception that state ownership of the 'commanding heights' of the economy is necessary to implement the developmental state policies or to protect vested interests may create an obstacle to further privatisation.

It is alas not possible to incorporate a variable representing governance incentives into either cross-country or the cross-province growth equations. However, some of their effect might have been picked up by other explanatory variables such as capital accumulation. 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 to the high investment. Incentives were provided at all levels and in all parts of the state sector. Bureaucrats were rewarded for promoting investment, and businesses 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 intertemporal 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 five times its 1990 value. Knight and Gunatilaka (2011) 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.

6. IS THE DEVELOPMENTAL STATE SUSTAINABLE?

Two issues are discussed in turn: the sustainability of China's high growth rate even despite its developmental state, and the sustainability of the developmental state itself. 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.

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, and investment confidence was lost. Although the developmental state apparatus was apparently maintained, Japan's developmental state ceased to be successful.

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, the number of officially recorded 'mass incidents' is reported to be rising.² 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, social instability might cause a loss of investor confidence. An asset bubble might then burst, so threatening the solvency of the banking system and the demand for and supply of funds for investment. The consequent slowdown in economic growth might in turn have a harmful effect on social instability. Thus, there can be aggravating interaction among adverse shocks and aggravating interaction also between such shocks and faltering growth. Through the socioeconomic changes that they have entailed, the success of China's single-minded developmental state policies might contribute to social instability and so threaten the continuation of that success.

These are reasons why China's developmental state might cease to be successful in achieving rapid economic growth. The more fundamental question is as follows: can the developmental state itself be maintained? 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.

² From 9,000 in 1993 to 180,000 in 2010.

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.

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 marketised, rule-based 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. Some combination of elements of these scenarios is no less plausible.

7. CONCLUSION

It has been the basic argument of this paper that two main conditions are required for a country helpfully to be called a developmental state. One is that the government accords top priority to economic growth, and the other is that governance should be incentivised to achieve that objective. Favourable initial conditions and the choice of specific economic policies are of course relevant to the success of a developmental state, that is whether it achieves its growth objective. However, if economic growth is the policy priority and if appropriate governance incentives are in place, it is more likely that efficient growth policies will be pursued.

It was the need to restore and maintain political legitimacy and avoid social instability that led China's 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 methods designed to achieve that objective and in actually achieving that objective. China in this period has been a successful developmental state. It is not possible to estimate

precisely how much of China's growth is due to its developmental state characteristics, but they are likely to have made a significant contribution.

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 incentive structures helped to overcome bureaucratic inertia, and the emerging success of the reform policies helped to overcome vested interests and to enlarge the reform coalition.

The incentives were created partly by means of personnel policy: the cadres were put into a tournament based on forms of yardstick competition. Promotion and demotion depended on success in meeting performance targets, which were normally framed in terms of economic growth objectives. Local fiscal powers provided incentives for officials to pursue economic growth in their jurisdictions. Through patronage relationships within the hierarchical system – stemming from rights to grant permissions and refusals – higher tiers of government could ensure systemic adherence to economic growth objectives. Early fiscal decentralisation strengthened the former incentive and later fiscal recentralisation the latter.

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 widely held perception that rent seeking and corruption are rife in the Chinese economy. For instance, President Hu Jintao was said to have described corruption as 'rampant' (Shirk, 2008, p. 32). The *Worldwide Governance Indicators* of the World Bank placed China 148th of 235 countries on 'control of corruption' in 2009, and 220th on 'voice and accountability'.³ 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. However, the principal may not be able to deal with the informational advantages that its agents possess in this regard. More pressures from below would no doubt help to provide voice and improve accountability.

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 are less measurable – than it was when economic growth was the only preoccupation.

What lessons does China's experience provide for other developing countries? The two criteria mentioned above 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 electors' interests might require a shorter time horizon and broader policy objectives than is the case in China.

³ Governance Indicators of the World Bank Group, country data report on China <info.worldbank.org/governance/wgi/sc_country.asp>.

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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