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The Chinese Developmental State: Threats, Challenges, and Prospects

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Over the last 40 years, China's development has been breath-taking. Its poor, centrally planned economy has been transformed into a middle-income capitalist one with a strong resemblance to highly successful East Asian economies like Taiwan and South Korea. It is argued here that China had become a developmental state by the mid-1990s, showing most features of its predecessors. At the same time, differences such as its huge size, socialist past, and structural problems have made it increasingly clear that China's rapid growth rate is unsustainable. Instead of a strong and confident great power, one can only see a vulnerable giant with an inevitably decelerating economy.

KEYWORDS: **China; political economy; developmental state; economic development; East Asia.**

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論 The East Asian economic miracle in the second half of the 20th century impressed journalists, politicians, and economists. The remarkable development of Japan and later Taiwan, South Korea, and the city-states of Singapore and Hong Kong soon led to the birth of a new concept: the developmental state. An increasing number of authors began to question conventional wisdom and the suggestions of mainstream economics for developing countries in regard to how to achieve rapid economic growth and break out of poverty. The successful example of these East Asian economies has made it evident that state intervention into the economy, the protection of certain markets, and systematic subsidies of exporting

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industries and enterprises might be important tools in the catching-up process, and it is clearly unsatisfactory to rely exclusively on market forces. The development paths and institutional solutions of these economies have shown so many similarities that the East Asian developmental state soon became the general model of economic catching-up. The works of Johnson (1982), White (1988), Amsden (1989), Wade (1990), Haggard (1990), and Evans (1995) have proven that successful strategies require sophisticated tools and a multidisciplinary approach. Inspired by these experiences, many developing countries began to implement features of the developmental state. After the slowdown of the late 1980s and the emergence of some structural problems, however, the credibility of the developmental state slowly began to erode, and its former glory was ultimately wiped out by the severe consequences of the Southeast Asian financial crisis in 1998.

The decline, fall, or inevitable end of the developmental state (Beeson, 2004; Pang, 2000; Pirie, 2017; Williams, 2014) has become the central theme in the literature since the turn of the century. While pro-market reforms have been urged, the success of the East Asian economies has been downplayed. A majority of the works were inspired by several influential and critical writings (Balassa, 1988, 1991; Krueger, 1990; Krugman, 1994; The World Bank, 1993) that emphasized the market-oriented solutions of these economies, understated the economic role of the state, and suggested well-known neoliberal receipts to fight against the crisis. While state intervention in the economy was indeed transformed in these economies, it was far from eliminated. On the contrary, according to many scholars (Amsden & Chu, 2003; Fields, 2012; Haggard, 2018; Wade, 2018a, 2018b; J. Wong, 2004), the main elements of developmental state have successfully tackled the new challenges and ultimately remained in place. As evidence, they point to the rapid economic growth of Taiwan and South Korea after the Millennium that eventually led to their emergence into the elite club of most developed economies.

Though some countries hit hard times during the years of the Southeast Asian financial crisis, there were others in the region that needed only a short time to overcome their difficulties and regain rapid economic growth. The most interesting example was China, which became the most dynamic economy in the world after the implementation of its Reform and Opening-up Strategy in 1978. By downsizing the planning system, promoting market reforms, and allowing both domestic private entrepreneurs and foreign enterprises to contribute to the revitalization of the economy, China was gradually reintegrating into the world economy. Its breath-taking growth rate and extremely successful export-oriented development strategy led many authors (Boltho & Weber, 2009; Knight, 2014) to compare its path, ideas, institutions, and policies to those of other East Asian economies (especially Taiwan and South Korea) and to argue that China had successfully adapted the features of the East Asian developmental state to its specific endowments.

In this paper, we will show that despite the differences between China and other East Asian economies, the concept of developmental state can easily be applied to the case of China. It will be argued that following its transition from socialism to capitalism (or from a planned economy to a market economy[1]), China by the mid-1990s had become a developmental state showing most of the features of other successful East Asian economies. At the same time, it is also clear that fundamental differences including the size of the country, its socialist past, and certain structural problems have made it impossible for China to fully copy the institutions and policies of South Korea and Taiwan and led to a somewhat different type of developmental state. What is more, these differences are responsible for the serious threats and challenges that may undermine China's long-term growth prospects, though the country is only in the middle of its catching-up process. While there have been similar problems in South Korea and Taiwan, difficulties like environmental degradation, corruption, and social unrest appeared in much later phases of their respective development paths.

First, the East Asian developmental state will be examined. After a short historical overview, the most important elements of the concept will be outlined. The following section highlights the growth performance of several East Asian economies and puts China's development in comparative perspective. We will also examine the birth process of the Chinese developmental state and argue that its main features were developed only after the comprehensive reforms of the mid-1990s. Then, problems and threats will be analyzed which distinguish China from other East Asian developmental states and which may undermine China's long-term growth prospects. We will see that the challenge to keep growth rates as high as in the previous decades is practically unsurmountable, and the Chinese developmental state will have to suffer a premature decline.

The Concept of the Developmental State

Japan's post-war economic success opened a new chapter in both economic history and development economics. Following Johnson's (1982) path-breaking work

[1]Throughout the text, we will simultaneously use the concepts of socialism, the socialist system, and the planned economy, on the one hand, and capitalism, the capitalist system, and the market economy, on the other.

the concept of the developmental state was born, originally to highlight the institutional background of the Japanese miracle. Elements of the Japanese model were later applied by other East Asian economies (South Korea, Taiwan, Singapore, and Hong Kong[2]) as well, proving that economic catching-up alongside rapid modernization is a real possibility. Often referred to as members of the heterodox or structuralist school, scholars like Wade (1988, 1990, 2018a, 2018b), Amsden (1989, 2001), Haggard (1990, 2018), Evans (1995), Woo-Cumings (1999), and Knight (2014) studied the conditions and possibilities of economic development from a point of view which was clearly different from that of the neoclassical approach. They made use of results from various fields including economics, historical institutionalism, sociology, and political science, and tried to explain East Asian changes by combining relevant findings of these disciplines. Although the general definitions or descriptions of the East Asian developmental state differed from one author to another, the most important features showed remarkable similarities. In this section we collect these features to examine how well these peculiarities fit to the changes having occurred in China in the past few decades.

As the first to introduce this concept, Johnson (1982) wrote about the rise of Japan. He labeled the Japanese developmental state as plan rational system as opposed to plan ideological (communist command economies) and market rational (Western-type market economies) systems. According to Johnson (1982, p. 18), in plan ideological systems the "ownership of the means of production, state planning, and bureaucratic goal-setting are not rational means to a developmental goal (even if they may once have been); they are fundamental values in themselves, not to be challenged by evidence of either inefficiency or ineffectiveness." Kornai also drew a sharp dividing line between growth-oriented market economies and communist planned economies, pointing to the fact that "the economic tasks under the classical socialist system form only one factor in the policy of the Communist Party; economic considerations are often subordinated to other domestic and foreign policy objectives" (Kornai, 1993, p. 125). Thus, when assessing whether a former communist country like China became a developmental state, the critical point is the completion of the change of systems from socialism to capitalism.[3] It is a necessary condition because

[2]Due to their small size and very specific endowments, we will consider here Hong Kong and Singapore only for illustrative purposes.

[3]Following Kornai (1993, 2008), we will characterize the socialist system by the dominance of state property, the dominant role of bureaucratic coordination, and the monopoly of power of the Marxist-Leninist communist party. Meanwhile, the three criteria of capitalism are: the dominance of private ownership, the dominance of market coordination, and the political elite's at least "benevolent" stance toward private ownership and the market. Once the dominance of state ownership is replaced by that of private ownership, market processes overshadow bureaucratic planning, the elite's hostility toward the market comes to an end, and the change of systems from socialism to capitalism happens.

political and social goals can be subordinated to economic growth only in a system that is "freed" from the ideological ballasts of Marxism–Leninism.

To describe the different factors in Japan's development path behind the country's breath-taking growth rate, Johnson emphasized a small, inexpensive but very efficient bureaucracy that functioned in a framework of politics and allowed bureaucrats enough room to take initiatives and implement the most efficient policies: "the most striking structural characteristic of the capitalist developmental state is an implicit political division of labour between the tasks of ruling and the tasks of reigning. The politicians reign and the bureaucrats rule" (Johnson, 1982, p. 154). Bureaucratic autonomy, however, is not enough. To be efficient, bureaucrats also need strong linkages both to the politicians and to the businesses, i.e., the bureaucracy must show the characteristics of "embedded autonomy" (Evans, 1995).[4] Moreover, Johnson (1982) also stressed that the state (the government) always intervened in the economy in a market-conforming way and always tried to perfect its tools. Finally, he singled out the MITI (the Ministry of International Trade and Industry), which provided coordination (Johnson, 1982, pp. 315–319) and a strategic framework for the processes.

Following Johnson, Wade (1990) analyzed the Taiwanese developmental state, which explicitly declared economic growth as its top priority. While it was committed to private property and market coordination and subordinated its interventions to these principles, the developmental state was not at all passive. On the contrary, it actively guided the market while consulting and cooperating with the private sector. The South Korean developmental state was interpreted by Amsden (1989) as a special case of late-industrializing countries. Like in almost all late-industrializing countries, the state here too used subsidies as its primary tool and stimulated investments through distorted prices while also simultaneously disciplining the subsidized by setting and enforcing performance standards. Businesses with good performance (especially with good export performance) were rewarded by the further issuing of licenses, while bad performance entailed punishments like withdrawing licenses or reducing subsidies. Most subsidies went to huge enterprise groups (Chaebol) in privileged positions which had to cooperate with state-owned banks and were guided by industrial licensing policies and rationing capital flows. The state used selective seclusion (some markets were open to foreign competition, while others were not), and helped national champions to grow rapidly.

[4] Such bureaucratic autonomy in communist countries has never existed: bureaucrats have always depended on higher ranking party bosses, severely limiting their own initiatives.

More recently, Haggard (2018) wrote an excellent summary of the origins, emergence, and history of the developmental state, arguing that this "philosophy" is far from dead. He approached the subject by comparing different views and using both historical and economic reasoning to bring them together under the umbrella of a single concept. In two papers, Wade (2018a, 2018b) offered a general view of the subject and used a multilevel approach to the theory of the developmental states: "The theory focuses on the syndrome of politics, ideas, institutional arrangements and policies of the three main cases[5] during their decades of super-fast industrialization after World War II" (Wade, 2018b, p. 8). Thus, according to Wade, developmental states (defined as capitalist economies) showed specific characteristics at three different levels: (1) ideas and politics, (2) institutions, and (3) policies.

At the level of *ideas and politics* one can always find a "developmental mindset"[6] which governs these states. It means a strong agreement among the elite on the following: high and sustained economic growth rates, high rates of investment into GDP, selective industrial policies designed and implemented by the state, export-promotion, the importance of education, and large public research and development (R&D) expenditures. This high-level commitment provides the basis of the formation of a successful developmental state. The second level is about *institutional arrangements*, including highly centralized bureaucratic power, the state-controlled financial system, embedded autonomy,[7] the array of industrial steerage instruments, and the repression of labor to keep down wages.[8] Finally, at *the policy level*, developmental states perform an active industrial policy by channeling funds to selected sectors with increasing returns and external economies, keeping strategically important productive capacities in national hands, searching for opportunities to replace sophisticated imports with domestic production, and trying to maintain a low level of inequality to share the costs of high growth. Among the instruments used, one can find directed credit, fiscal investment incentives, trade protection, and bargaining practices with

[5]He meant Japan, Taiwan, and South Korea.

[6]He borrowed the concept from Thurbon (2016).

[7]Using the concept of Evans (1995), Wade argued that "the developmental state gains high 'capacity' from institutional arrangements of 'embedded autonomy'. . . [which] means that the state and its officials have a close working relationship with capitalists, but also the capacity to discipline capitalists and capital. They have the autonomy needed to formulate and implement a strategic vision for the economy's future growth and to discipline the owners and managers of capital in line with that vision; while they also maintain close enough relationships with these owners and managers of capital to get information feedback and corporate buy-in to the national project" (Wade, 2018b, p. 9).

[8]It also restricted consumption allowing high savings to contribute to "upgrade the production structure quickly, raise mass living conditions, inhibit domestic revolt, and support a strong military, coupled with knowledge that many domestic firms could not compete 'on a level playing field' with firms in developed countries" (Wade, 2018a, p. 18).

multinational companies (Wade, 2018b, pp. 10–11). Perhaps, the most important policy, however, has been the implementation of performance standards which have linked performance (mostly export performance) with the possibility of future subsidies (Amsden, 1989, 2001).

This structured view of political, institutional, and policy features of the developmental states allows us to discuss the applicability of the concept to China. Many scholars have studied the developmental state in this regard. Boltho and Weber (2009) argued that the concept of the East Asian developmental state is well suited to contemporary China. As fundamental characteristics, they listed the constant demand for rapid growth in investment, the manufacturing sector and external competitiveness, the strong belief in the virtues of the competitive market economy, the creation of a stable macroeconomic environment, and the provision of social preconditions of rapid growth like public education, relative income equality, competent bureaucracy, and a strong (authoritarian) government. Knight (2014) defined a much more general framework of the developmental state. He set up only two criteria: economic growth as a top priority and an institutional framework providing an adequate incentive structure that might help the government to achieve its main goal. By deliberately omitting the analysis of differences in national strategies of industrialization and industrial policies, he was able to concentrate on the most important features of the developmental state in a broader sense. Based on these principles, it is clear that Knight regarded China as a good example of the developmental state. Many scholars were however not convinced that China could be classified as such. Howell (2006) for instance argued that it is not possible to regard China as a developmental state and that it was rather a "polymorphous state" with some similarities to East Asian developmental states but also some striking differences. His concerns included China's socialist past as a different point of departure, its relatively decentralized political and economic nature, and pathologies like corruption, environmental degradation, and rising inequality. We will consider all of these features later. We will argue that these "anomalies" have indeed detrimental effects on future growth prospects, but in general they do not challenge the view that China is a developmental state.

In the remaining parts of the paper, we will first look at the numbers by comparing China's growth path with those of other East Asian economies. We will then assess how well China fits into the framework of the developmental state, and what kind of tensions and challenges China must face during its development efforts. We will use Wade's (2018a, 2018b) multilevel approach, showing that China started to display most of the features of a developmental state after its transition from socialism to capitalism in the mid-1990s. We will however not study the problems of the transformation, crisis, or sustainability of the developmental state after a successful catching-up process (like in the recent literature on Japan, Taiwan, or South Korea). Finally, as our focus is on the East Asian region (especially on China), only the East Asian variant of the developmental state will be studied here, keeping this variant in mind wherever the term "developmental state" is mentioned.

China's Growth Path from a Comparative Perspective

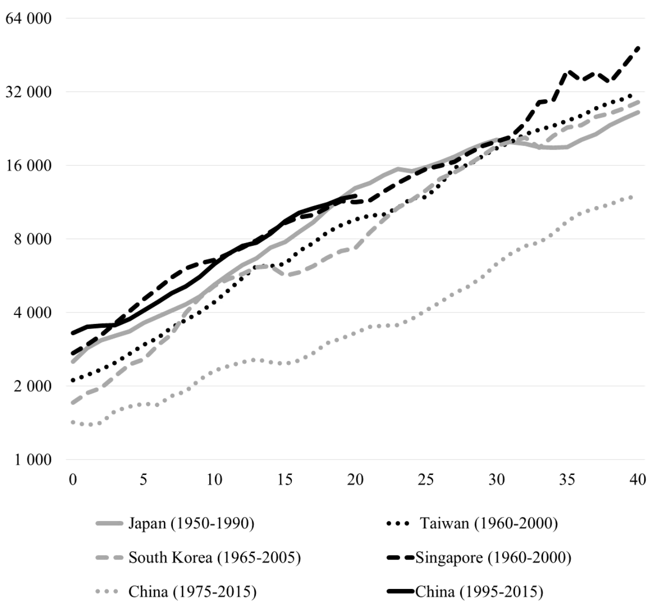
While the contributions of the developmental state to economic growth in East Asia is an undeniable fact, it is very difficult to measure exactly. While rapid growth periods can be identified quite easily, it is almost impossible to assess the hidden potential accumulated in previous periods. Economic development generally depends not only on current institutions and policies, but on past institutions and history as well. Path dependence (North, 1990) is particularly important in the sense that institutional and historical legacies may have at least as big an influence on a country's future performance as the activities of the current government. Consequently, it is not possible to directly infer success of the applied policies from good economic performance alone.

The more aspects we consider and the farther we go into the past, the more difficult it is to assess results. It is equally problematic to define the period to be examined. How is it possible, for example, to determine the exact period of the birth of the Chinese developmental state? The same questions — naturally for different periods — can be asked regarding Japan, South Korea, and Taiwan as well. Can we say that the Japanese regime in the late 19th century was a developmental state? How can we assess the rapid development in Korea and Taiwan between the two world wars as Japanese colonies? These questions are not merely academic; answers to them may strongly influence how a given development strategy can be assessed and to what extent the performance of an economy reflects the accumulated potential of the past.

First, we consider Japan. Although there is some continuity between pre-war and post-war developments, it is quite evident that the typical characteristics of the developmental state became dominant only after 1950. It is not surprising that the very concept appeared only much later in the literature (referring to the 1960s and 1970s). Similar arguments can be said about South Korea and Taiwan as well, with the addition that the end of colonialism, the devastation of the civil wars, and the regaining of sovereignty meant a radical break with the past, promising a new beginning for both economies, even if their development paths were fundamentally influenced by past institutions and legacies (Kohli, 1994; Wade, 1988). Based on these considerations, and following Boltho and Weber (2009) and Fields (2012), we date the emergence of the Japanese developmental state to the early 1950s, the Taiwanese one to the beginning of the 1960s, and the South Korean one to the mid-1960s.

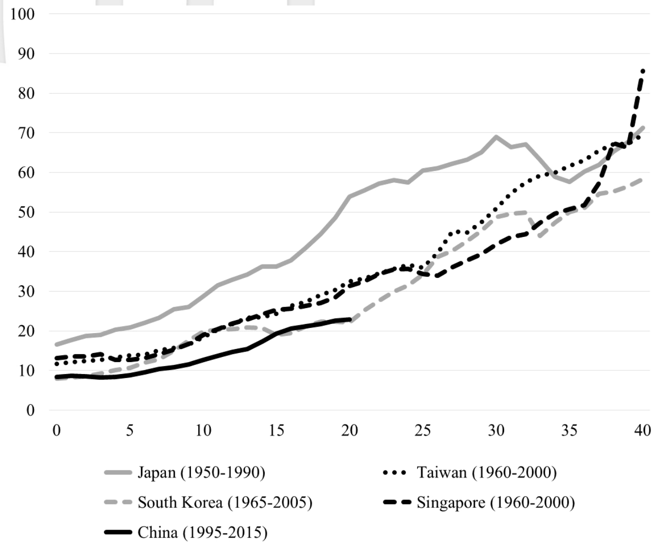
Along with Boltho and Weber (2009, p. 282), we first examine the per capita GDP at purchasing power parity (PPP). According to Figure 1, growth rates of the different economies in the first three decades of their development were almost identical (which is shown by the approximately parallel lines), but original levels of development were somewhat different. In order to make the series more comparable, we relate the per capita GDP data of these economies to that of the United States. In the beginning of the 1950s, Japan's per capita GDP level was 20% of the US GDP, reached 50% after less than 20 years, and rose to 70% by 1980. South Korea, Taiwan, and Singapore started their development paths from a lower level (close to 10%) and reached remarkable results. South Korea stood at almost 60% and Taiwan close to 70%, while Singapore stood at more than 80% after 40 years of sustained rapid growth.

Though it is not evident when the catching-up process becomes "successful," World Bank categorization (The World Bank, 2017) may provide a hint. Estimates



Source: Maddison Project Database (Bolt, Inklaar, de Jong, & van Zanden, 2018).

Fig. 1. Per capita GDPs of different economies in the indicated time periods (PPP, GK$, logarithmic scale).



Source: Maddison Project Database (Bolt et al., 2018).

Fig. 2. Per capita GDPs (PPP) of different economies in the indicated time periods as a percentage of US GDP.

(having been made since 1987) have always grouped Japan and Taiwan into the category of "high-income countries." South Korea first reached this status in 1995, while China began as a low-income country, became a lower-middle-income one in 1997, and reached upper-middle-income status in 2010. Using 1995 as a starting date of the Chinese take-off process (reasons behind this choice will be further examined later), its development path shows remarkable similarities to those of Taiwan and South Korea. Figure 2 shows comparable data from the Maddison Database (Bolt et al., 2018). China reached 22% of US per capita income after 20 years of rapid growth, a development level comparable to that of South Korea in 1985. Taiwan, Singapore, and Japan performed better, reaching this level much earlier during their catching-up process. The comparison indicates a lag of 30 years in the case of South Korea and even more compared to the other economies. Assuming that the future growth path of China remains similar to those of Taiwan and South Korea in the 1980s and 1990s, China should attain 50% of US per capita income (PPP) by around 2030. One of the most disturbing features in the Chinese economy is its unusually high investment rate, which is unparalleled in East Asia. Gross Fixed Capital Formation (GFCF) relative to GDP has never reached 40% in any of the countries examined and remained most of the time at around 30% everywhere except China, where the GFCF rate has been about 10–15 percentage points higher on average, exceeding 44% of the GDP in every year since 2009 (The World Bank, 2017).

Finally, we compare China's long-term growth prospects with the growth performance of other East Asian developmental states in similar phases of their development processes. The Maddison dataset (Bolt et al., 2018) reveals that after 20 years of rapid growth, Taiwan achieved a 6.6% annual per capita growth rate between 1980 and 1995, while South Korea had 7% between 1985 and 2000. As a result, Taiwan had reached 51% of US per capita income after 35 years of catching up, South Korea had reached 47%, and both economies had become developed ones. For China to achieve similar success and reach this 50% threshold by 2030, it should continue its per capita annual growth at a rate of at least 6.5%.[9] Projections however fail to estimate such a high growth rate, rather putting China's future performance at around 4.5%. A recent study of the Organisation for Economic Co-operation and Development (OECD) for instance counts with a 4.2% annual per capita potential growth rate between 2018 and 2030 and only 2.2% between 2030 and 2060 (OECD, 2018). At such a rate, the desired 50% of US per capita income will not be achieved even by 2060.[10] The numbers and projections of China's growth path strongly indicate both similarities and differences with other East Asian economies. The subsequent sections seek to answer the following two broad questions: To what extent can we say that China is a developmental state? What kind of endogenous and exogenous threats and challenges endanger the country's future growth prospects?

The Emergence of the Chinese Developmental State

Following Kornai's (1993) characterization, it is clear that China at the beginning of its reform process was a communist planned economy, or in Johnson's (1982) words, a plan ideological system. Therefore, as a precondition for determining the possible birth date of the Chinese developmental state, one must first assess when the change of systems from socialism to capitalism took place. The most important general characteristics of the Chinese transformation process show that China in the 1980s was still far from a capitalist market economy. Instead, this period marked the reform of the socialist system (Kornai, 1993; Wu & Ma, 2016). The essence of the changes in the first phase of the reforms between 1978 and 1992 can be captured by

[9]Assuming a 1.1% per capita growth rate of the US between 2018 and 2030 (OECD, 2018).
[10]Actually, it would stand at 46% in 2060.

the slogan: "reform without losers,"[11] or using an economic concept, by their Pareto improvements (Knight, 2014). The CCP only adopted reforms that did not interfere with the fundamental structures of the socialist planned economy and contributed to the improvement of economic performance. Many of the most important initial reform steps, including the introduction of the Household Responsibility System and the emergence of the Township and Village Enterprises (TVEs), can be considered as spontaneous changes which were sanctioned only after fierce debates inside the party (Naughton, 2007). Since private property of the means of production and market coordination were regarded only as complementary institutions to public property and central planning, we cannot speak of a capitalist China at that time. Though rapid economic growth as an important goal for the CCP became gradually evident in this phase, the country still lacked strong central control, a relatively autonomous and competent bureaucracy, and a commitment to market processes. By the end of the 1980s, macroeconomic stability had been undermined, corruption had become commonplace, and tensions had increased in society, leading to the bloody events of June 1989.

By that time, disintegrating socialist structures forced the elite to find new directions to further the reforms. Especially serious was the state of highly inefficient and rigid state-owned enterprises (SOEs), which were gradually losing space to the emerging private sector (including TVEs). Equally problematic was the deteriorating balance of the central budget due to decreasing incomes while local and provincial leaders made fortunes by exploiting the opportunities that stemmed from partial reforms (Hellman, 1998). To change the course of events, the CCP implemented a comprehensive budgetary and tax reform in 1994 aimed at re-centralizing the most important resources.[12] The central bureaucracy gradually gained strength, and it became much easier for the leaders to carry out their plans. Centralization was accompanied by thorough enterprise reforms. According to the slogan "grasping the large, letting go of the small,"[13] the state kept strategically important and profitable enterprises under its control while others were either sold or left to their own resources (Naughton, 2007). Simultaneously, some SOEs with bright prospects were selected to be national flagship companies of the future. By 1995, the Chinese economy had

[11]This phrase was introduced by Lau, Qian, and Roland (2000).

[12]Revenues of the central government had amounted to only 2.7% of GDP in 1993. Revenues had grown to 7% by the year 2000, and to 10.1% by 2015. Revenues of local governments during the same period had first fallen from 7% to 6.4% and then grew once again to 12%. Revenues of all levels of government had risen from 9.7% to 22% of GDP between 1993 and 2015 (National Bureau of Statistics of China [NBSC], 2016).

[13]*Zhua da fang xiao* (抓大放小).

Table 1.
Applying the Original Concept of the Developmental State to the Chinese Case

Dimensions of the developmental states	Main characteristics	The Chinese developmental state
Ideas and politics, elite agreement on the "developmental mindset"	High and sustained economic growth	+
	High rates of investment into GDP	+
	Selective industrial policies by the state	+
	Export-promotion	+
	The importance of education	+
	Large public R&D expenditures	+
Institutional arrangements	Highly centralized bureaucratic power	In part
	State-controlled financial system	+
	Embedded autonomy	In part
	Array of industrial steerage instruments	+
	Repression of labor	+
Policies	Active industrial policy	+
	Strategically important capacities in national hands	+
	Import substitution	+
	Low level of inequality	No
	Directed credit and fiscal investment incentives	+
	Trade protection	+
	Bargaining practices with multinational companies	+
	Implementation of performance standards	In part

undergone a deep change: economic planning was abolished, private property and market coordination became dominant, and the CCP adopted a pro-market stance. As a result, China became a capitalist country.

The transformation of the economic system as a precondition was an important step toward a developmental state. In line with this transformation, other important changes including new political commitments, new institutions, and new policies began to emerge. Table 1 summarizes how the different features of the three levels have appeared in China. Most importantly, the CCP gradually raised rapid economic growth to the top of its priorities in keeping with its political interests. The leading role of the party would not be challenged as long as it maintained a certain level of economic growth and achieved favorable results. Political interests contributed to the commitment to rapid economic growth in other East Asian developmental states as well (Kim, 2011): Taiwan's authoritarian political system maintained its legitimacy in self-defense against the People's Republic of China, and South Korea's in its defense against the Democratic People's Republic of Korea. By the mid-1990s, other elements of the "developmental mindset" had also gradually gained strength in China, marking the birth date of the Chinese developmental state presupposed in Figures 1 and 2. In addition to the commitment to rapid economic growth, a *political consensus* had emerged among elites regarding new priorities like large investment projects to fuel the economy, a centrally designed industrial policy, and the need for export-promotion, education, and large public R&D expenditures.

Equally important were *institutional changes* that transformed the economy. While similarities between China and other East Asian developmental states are evident at the level of ideas and politics, one can find some differences at this level. One institutional element that is missing in China but was prevalent in other East Asian developmental states is a high-level centralization of the bureaucracy. Being a huge country with a long tradition of strong regional centers and relatively decentralized decision-making processes,[14] this requirement has clearly not been met. The CCP and most countries with Leninist parties possess mechanisms and institutional arrangements like the well-functioning nomenklatura system or the bureaucracy's expertise and ability in rule-making and rule implementation, significantly reducing both the agency problem and deficiencies in regulation (Zang, 2012), making decision-making and hierarchical procedures surprisingly efficient.

As economic growth became the top priority in China, professionalism was gradually increasing among bureaucrats. The rewards and punishments inside the party were increasingly linked to contributions to growth brought by the units under their control, while it became commonplace to use market mechanisms and competition as catalysts for more rapid growth (Knight, 2014), or as So (2016, p. 180) puts it: "[F]or example, once the party leaders set up a target GNP growth rate of 10 percent, the recruitment, promotion, and merit increase of national, provincial, city, township, and county officials are judged on whether their regions could attain this targeted 10 percent growth rate." The autonomy of bureaucrats was further increased by the relatively decentralized character of decision-making mechanisms which allowed the officials to try out and use new methods and initiatives at different levels.[15] The distinction between bureaucrats and managers[16] has however remained blurred during

[14]Compared to other communist countries.

[15]As long as they were in line with the CCP's most important goal of high economic growth.

[16]Even in the case of private enterprises.

the whole period, rendering the decision-making process less clear-cut and less efficient. Yet, despite its somewhat weaker character, embedded autonomy became an important institutional feature in China by the mid-1990s. Other institutional elements at the same time have shown a strong resemblance to those in Taiwan or South Korea. The transformation and modernization of the financial system preserved state-ownership in the banking system and along with it control over financial flows, providing excellent steerage instruments for the party-state to implement its priorities in industrial development. It was also ensured that wages remained competitive while the organization of labor was kept as a monopoly of the party.

At the *policy level*, one can find both similarities and differences between China and other East Asian development states. In China, the large role of the state in economic affairs stems from the country's socialist past, and until the early 1990s, the most important sector was the state sector. Contrary to other East Asian developmental states where state intervention was actually increased to achieve sufficient results, in China the most pressing concern was how to make SOEs more efficient by reducing the state's involvement. Enterprise reform in the mid-1990s created a structure similar to that of other developmental states, with a substantial number of large SOEs and an even greater number of private ones. This new structure made the implementation of industrial policy easier than before since the state was no longer assumed to instruct almost *all* industrial enterprises. Instead, decisions in most cases have been left to the market while the state has kept its control in strategically important sectors. The state has governed the market as it has in other East Asian developmental states (Wade, 1990). At the same time, financial reform (however partial it was) transformed the socialist-type financial system to a more market-conforming one and replaced ministries with state-owned banks as the main sources of financing enterprises. These changes made it possible for the government to implement policies aimed at rapid industrial upgrading in selected sectors through the financing of privileged SOEs in the first place. Moreover, whole new clusters have emerged that specialize in either the production of specific products or in their production processes (Breznitz & Murphree, 2011).

As far as the differences are concerned, perhaps the most crucial one has been the relative weakness of performance standards in subvention decisions. Due to its large size, foreign trade plays a much smaller role in China[17] than it does in other East Asian

[17]The export to GDP ratio in China was 19.8% in 2017 (see World Bank Databank at <https://databank.worldbank.org/home.aspx>). In contrast, it was 43.1% in South Korea (see World Bank Databank at <https://databank.worldbank.org/home.aspx>), and 55.4% in Taiwan (Government of Taiwan, n.d.) at the same time.

developmental states. Moreover, many exporting companies are foreign-invested ones, and export performance as a general standard can only be assessed in a limited number of cases. Instead, both local and provincial governments as well as enterprises are evaluated by their contribution to economic growth (Knight, 2014), which depends mainly on investment. Investment performance however has nothing to do with competitiveness or efficiency but is rather a means for the elite to maintain or increase their political and economic power. Even worse, in some instances the obsession toward growth has resulted in overcapacity and overinvestment, severely hurting long-term prospects and sustainability issues. Another big difference between China and other East Asian developmental states can be found in social policy. While Taiwanese and South Korean leaders have always paid special attention to keeping inequality at a low level, similar efforts in the People's Republic of China have not taken place. Consequently, while East Asian developmental states have successfully shared the costs of modernization and rapid industrialization across different social groups and avoided the escalation of income-related tensions, China since the beginning of its reforms has always been forced to face growing public discontent due to increasing inequality.

In sum, it became evident by the mid-1990s that China had gone through substantial changes. Its planned economy was transformed into a market one, and the party adopted a pro-market stance. These changes did not mean that China had accepted the "Washington consensus," however. Instead, Chinese leaders not only adopted the features of the "developmental mindset," but also implemented most of the institutional elements listed by Wade (2018a, 2018b) and several of the policy ones, having learned from the experiences of successful East Asian economies. As a result, China by the mid-1990s had become a developmental state, showing the most important features of the concept while also maintaining some differences. If it were necessary to find a unique label, we might call it a "developmental state with Chinese characteristics."

Threats, Challenges, and Prospects

Along with the similarities, there are also some important factors that differentiate China from other East Asian developmental states. We will argue here that these differences are predominantly responsible for the unsustainability of China's current rapid growth rate. Due to its huge size, China's performance has not been as influenced by a strong export orientation, an efficient, autonomous, and centralized bureaucracy, and strong incentives based on efficiency, characteristics that have been of great importance in the case of other developmental states. Second, legacies of the socialist era made it difficult for China to copy all the institutions and policies of other East Asian developmental states and ultimately led to an unfinished transformation process which entailed increasing rent-seeking practices and corruption, while the prospects of wide-scale innovations and constant upgrading in industries have been reduced. Third, conditions of rapid economic growth have been weakened in the past two decades. Especially, demographic trends, environmental degradation, and increasing income and regional inequalities have all had a detrimental effect on China's future development.

As far as the first factor is concerned, it is very difficult for a huge country like China to rely mainly on exports as the primary engine of growth. Therefore, China has increasingly relied on investment to maintain its economic momentum, financed mostly by central, provincial, or local governments. In contrast with the examples of Taiwan and South Korea where investments were performance-based and aimed at improving efficiency and international competitiveness (Amsden, 1989, 2001), the most serious problem with the huge Chinese investments has been the apparent lack of market selection mechanisms. These projects have been motivated mainly by political considerations: to gain political advantages by making a greater contribution to economic growth, to increase the profits of large SOEs (Ho, 2013; Lu, 2000), and to extend the power and resources of the CCP. The unprecedented amount of large-scale overseas projects like the One Belt One Road Initiative and other investments is definitely not sustainable in the long run. What is more, loss-making investments may create a huge burden for future generations and undermine growth prospects by extracting scarce resources from the economy for unjustified purposes like unused motorways or uninhabited "zombie" cities. Consequently, while other East Asian developmental states achieved economies of scale and scope by creating national champions amidst the hard realities of international competition, the subsidization of huge Chinese SOEs (the new national champions implementing the huge investment projects) has taken place mostly by ignoring their actual performance and by responding to political needs. To tackle these obvious problems, the CCP has openly pushed households to consume more in order to replace investment with consumption as the primary engine of growth (Shambaugh, 2016). This is an arduous task, however, as Chinese households are forced to save a considerable amount due to underdeveloped healthcare and pension systems in the country.[18]

[18]Household saving rate as a percentage of disposable income stood at 37% in 2015 (OECD, 2019).

Due to the vast size and diverse nature of the country, the relatively decentralized character of economic control is another problem China has had to face (Breslin, 2012, p. 45). Despite the efforts of the 1994 reforms, the country is simply too big to be governed in a centralized manner. As Xu (2011, p. 1076) puts it, China is a regionally decentralized authoritarian system that has allowed too much room for corruption, rent-seeking practices, and the spread of questionable financial solutions that may lead to unmanageable levels of debt. Decentralization *per se* is not necessarily detrimental to growth: well-functioning markets and the rule of law can assure efficient functioning. In a country, where these features are missing, however, too much autonomy results in excessive rent-seeking and corruption. Strong links and interdependence between the political elite and the top management of the Chaebol had made rapid economic development a common goal in South Korea: until the 1990s they were "each other's hostages" (Kang, 2004, p. 7). At the lower levels, by contrast, corruption was avoided by strong authoritarian measures while oligopolistic competition between big enterprise groups encouraged development and the improvement of productivity (Kim, 2011, p. 11). At the same time in Taiwan, the state controlled heavy industry while small and medium-sized local private enterprises that were predominantly family-owned were successful in international markets. The interdependence or "alliance" between the two prevented the proliferation of rent-seeking behavior (Fields, 2012, p. 56).

The situation has been quite different in China. "Partial reform equilibrium" (Hellman, 1998) and ill-defined property rights have enabled a collusion of political and economic elites that has led to the emergence of an extensive corruption network. This has caused much more damage than there would have been if corruption had existed only in independent and separate cases (Pei, 2016). This is a severe problem even if there are mechanisms and procedures inside the party (like the nomenklatura system) which may significantly reduce its impact. Threats have been serious in the state-controlled financial system as well. The system has suffered from the exponential rise of the shadow banking system and the increase of the total debt to GDP ratio to over 200% (C. M. Wong, 2013, p. 10) due to a constant hunger for investment to achieve targeted growth rates at both the local and provincial levels. This may create systemic risks that threaten the future growth prospects (Woo, 2012).

The second main problem of the Chinese developmental state stems from its socialist past. Path dependency and the relatively slow changes in cultural patterns (Roland, 2004) have made it difficult for China (and other former communist countries in general) to transform its planned economy to a market one. More importantly, however, it was the speed of the transformation that determined the advantages and disadvantages. In the case of China, the gradual approach proved successful in the first phase of reforms (1978–1992) since possible setbacks from the downsizing of the state-owned sector could be avoided until the private sector was strengthened. This was an important reason behind China's rapid growth rate during this period. Still, there have been problems. Thorough reforms of several crucial sectors like the financial system or large state monopolies have not taken place. This phenomenon known as the "transition trap" (Pei, 2006) or partial reform equilibrium (Hellman, 1998) occurs mainly during gradual transformations, and stems from the preferences and power of the winners. Since reforms are uneven and more advanced in some sectors than in others, vast sums of rent are accumulating due to the incoherence of the system. Rent usually goes to the winners of the processes who are not interested in furthering reforms to keep their positions intact. Consequently, further reforms are halted and the entire transition process remains half-baked. In the early phases of the reforms, rent-seeking does not create significant problems since the benefits of opening up new possibilities outweigh the costs of rent extraction. In later phases when development reaches a higher stage, however, there is increased pressure to make the country efficient and competitive. At this stage, rent-seeking and corruption become increasingly harmful and begin to impede further innovation and development.

Since Taiwan and South Korea had no comparable communist legacies, the emergence of the developmental state in these economies was much more straightforward. Moreover, both colonial experiences (Kohli, 1994) and the presence of American forces pushed these states to build their systems on a market economy base. Profit orientation, entrepreneurship, and business practices had all been present well before the emergence of the developmental states, while Japanese-style governing methods and strategies also made it easier for these economies to fully adopt a developmental mindset. These differences between China and other East Asian developmental states are of great importance from the point of view of future development prospects. While China has managed to reach an upper-middle-income status from which the way forward leads to greater innovation and the continuous upgrading of industrial structures and methods, this can only be achieved in a business-friendly environment where political considerations cannot dominate economic realities. Upgrading requirements in both Taiwan and South Korea ultimately pressed these developmental states to be more open and more market-friendly, forcing Taiwanese and Korean enterprises to compete with global industry leaders on a more or less level playing field. By contrast, the large Chinese SOEs have faced no real pressure due to their privileged positions, and without further reforms it is hard to imagine how these state monopolies can catch up with global leaders on all fronts. As Howell (2006) puts it, it is much more probable that China's competitiveness will deteriorate, and that the country will become stuck in a middle-income trap.

Finally, the third group of problems which may endanger sustained rapid growth has been the deterioration of both internal and external conditions for the developmental state. These problems are exogenous; they do not stem from the developmental state itself but pose serious threats to its existence. The first of these stems from China's changing demographics. The developments considered here are the consequences of the one child policy of the 1980s and have had a huge structural impact on China's economy. China's labor force is estimated to be shrinking at an annual rate of 0.2% from 1,020 million people in 2015 to 990 million in 2030 while its dependency ratio is expected to rise from 37.7% to 48.6% during the same period. By 2050, it will reach an unprecedented height of 67%. By comparison, the dependency ratio of other East Asian developmental states fell after their first 20 years of rapid growth, from 57.6% to 46.4% in Taiwan between 1980 and 1995 and from 52.7% to 38.5% in South Korea between 1985 and 2000. It is also worth noting that between 1980 and 1995, the dependency ratio in China fell from 68.4% to 49.6% and fell further to 37.7% by 2015, showing a rapid increase in the labor force and an inexhaustible source of economic growth in turn.[19] This was one of the most important causes of China's meteoric rise during the 1980s despite the evident shortcomings of its economic system. But with a sharp change in the early 2010s, the trend was reversed and future demographic developments will inevitably put enormous economic and social pressure on China and will significantly reduce its growth prospects.

Another problem which China must face is environmental degradation. Side by side with rapid industrialization, the environmental pollution which has been hurting China since at least the mid-1980s has reached an unprecedented scale and presents serious political, social, and economic challenges for the country. These developments are especially disturbing as the rapid spread of protests and demonstrations[20] has been largely the result of a deterioration of the environment and living conditions. Although severe pollution could indirectly lead to gradual democratization through increasing discontent, the resilience and strong social embeddedness of the CCP may allow it to maintain a delicate balance between economic goals and the need to alleviate the effects of environmental pollution. In so doing, however, increased spending on

[19] Sources of data: United Nations (n.d.).

[20] The number of pollution-related mass protests rose by 29% between 1996 and 2014, reaching an incidence rate of several hundred in 2014, with pollution being the most frequent cause of mass protests (Congressional-Executive Commission on China [CCEC], 2015, p. 209).

environmental protection and rehabilitation will inevitably cause a decline in China's economic growth.

The final issue under consideration is an increasing inequality that is social-, regional-, and income-based. There is a clear difference between China and other East Asian economies in this regard. While inequalities have been kept at a low level in other East Asian societies and the costs of rapid development have been distributed evenly across different social groups, inequalities are growing rapidly in China[21] and have led to increasing tensions and the worsening situation of disadvantaged groups. Without trying to estimate the overall effect of increasing inequalities on future growth prospects, it will suffice to refer to some prominent works in economics that have demonstrated how detrimental inequalities can be for sustained economic growth. Despite some efforts to legitimize increasing inequalities in China (Li & Zou, 1998), there is a near consensus in economics that inequality is harmful for growth. Alesina and Rodrik (1994) for instance showed that inequality in income and land distribution is negatively associated with growth, while Acemoglu and Robinson (2000, 2012) argued in several works that prosperity and sustained growth are more achievable in an equal society. Stiglitz (2012) also warned against excessive inequality, quoting an International Monetary Fund (IMF) paper on the issue which said that "longer growth spells are robustly associated with more equality in the income distribution . . . Over longer horizons, reduced inequality and sustained growth may thus be two sides of the same coin" (Berg & Ostry, 2011, p. 3).

Conclusion

In this paper, we argued that the model of the developmental state has been well suited to China's development characteristics over the past two decades, and that China in fact became a developmental state by the second half of the 1990s. This period witnessed the transformation of the reform — socialist system to a capitalist one by completing several crucial reform steps, including the comprehensive budgetary and tax reform of 1994. Re-centralization opened an opportunity to lay the foundation for a new development strategy based on a more explicit "developmental

[21]In 2011, the Japanese Gini-index stood at 37.9 (in 1993, it was only 24.9). In South Korea it was 30.2 (2014), in Taiwan 33.6, while the Chinese Gini-index had risen to 46.9 by 2014 (Central Intelligence Agency [CIA], 2017).

mindset" and on institutions like the systematic economic involvement of the state (and SOEs),[22] a firm grip on the financial system, and control over strategic sectors.

Two decades after its birth, however, the Chinese developmental state is facing numerous problems which are threatening the sustainability of rapid economic growth. As China is still in the middle phase of its catching-up process, threats like the unsustainability of huge investment projects financed by the state, politically motivated subsidies of SOEs without relying on the selection mechanisms of market competition, imbalances in the weak and state-controlled financial system, widespread and organized corruption, adverse demographic trends, increasing inequalities, and unprecedented environmental degradation[23] make it evident that the rapid growth rate of the previous decades is not sustainable.

Although there has always been the promise of change (including much-needed reforms in the financial system and the network of state-owned monopolies), nothing fundamental has happened. Due to the resilience and stability of the political system, a strong commitment on the part of the CCP to maintaining its political monopoly, and a set of efficient tools and institutions it has developed to keep the status quo intact, it is very unlikely that these much-needed reforms will be implemented. Due to the aforementioned problems, however, the efficiency of the developmental state will inevitably decrease without further reforms, hopes of catching up with the most developed countries will gradually fade away, and serious difficulties stemming from the malfunctioning of the current system will put future economic successes in question. Prospects are not good in this regard, and the obvious hardening of the political system (Shambaugh, 2016) points to an even darker future.

Yet, China's development since the beginning of the reforms has been breathtaking. After four decades of dynamic growth, it has become a middle-income country exceeding the size of US GDP in PPP terms and pulling hundreds of millions of people out of poverty. By taking steps to transform its inefficient socialist planned economy to a modernized capitalist one based on private property and market mechanisms, China has laid the foundations of a strong, East Asian-type developmental state. Beyond the apparent successes, however, several factors like its huge size, the legacy of its socialist past, structural weaknesses, demographic problems, increasing inequality, and widespread corruption pose serious threats to the sustainability of its high economic growth rate. To tackle these problems and to avoid

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[22]This is reflected by the new slogan: "the state advances, the private sector retreats" (*guo jin min tui*; 國進民退).

[23]A good summary of these developments can be found in The World Bank and State Environmental Protection Administration of the People's Republic of China (2007).

the middle-income trap, China will need fundamental reforms in all of these areas. Yet, even if China were committed enough to accomplish most of the needed reforms in the foreseeable future (which is, unfortunately, not the case), some structural problems are irreversible. Consequently, all these factors point to the inevitable decline of the Chinese developmental state.

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