Economy

Economy Today
An Interdisciplinary Approach to Contemporary Economic Challenges

edited by Piotr Urbanek

The book fits into a multidisciplinary research approach. The articles are the result of research conducted by eminent international economists, authors representing academic centres in different countries. The articles address current phenomena observed in the global economy. The authors do not aspire to comprehensively explain all the very complex and multi-dimensional economic developments, but illustrate many of these phenomena in an original way. The multi-threaded and multi-dimensional nature of the discussion in particular articles deserves attention. These include theoretical and methodological articles as well as the results of empirical research presented by the authors.

The book is addressed to those persons interested in issues of economics, finance, regional economy, and the management sciences. It can be valuable for economic practitioners, members of management and supervisory boards of companies, and financial analysts, and the articles may also be useful for academicians and students.

Piotr Urbanek, University of Łódź
2. Is China’s capitalism sustainable?

Krystian Karnia*

Abstract
During the last three decades China’s economic system has undergone a great transformation from communism to some form of state-led capitalism, in which ‘the state’ means actually ‘the Communist Party’. Looking at the average rates of growth and reduction in poverty indices, the Party’s evolutionary approach to reforms brought a successful catch-up process. However, the picture of the reforms is much more complex with the officials acting both as a developmental and inequality-enhancing force. The paper takes a closer look at the role of the state (and political actors) in economic development from socio-economical and macroeconomic perspective. It is argued that China’s system is hardly Nash-like equilibrium and correction in the growth distribution pattern is required (in fact, there have already been first signs of rebalancing).

* PhD student, Warsaw School of Economics.
Introduction

According to Polanyi ((1944) 2011), the market and the state constitute two inseparable pillars of modern capitalism. The former depends on incentives that are shaped by the state (and are encompassed in institutional framework), the latter relies on the market for the flows of revenues that finance its activity (Block and Evans, 2005, p. 505). Taking the role of the state as a major factor of differentiation, Schmidt (2002) distinguishes three types of capitalism: market capitalism in which the state provides economic actors with large autonomy and acts only as an arbiter; managed capitalism in which the state encourages associational governance and negotiations between different groups of economic actors, thus acts as a facilitator; state-enhanced capitalism in which the state strongly intervenes in private activity and takes the role of a leader. However, this classification focuses on already established structures, while China’s institutional framework can still be described as ‘work in progress’. Polanyi ((1944) 2011, p. 146) emphasised that even the systems considered as the models of liberal capitalism had established free market under ‘continuous, centrally organized and controlled interventionism’. The idea of state actively shaping the market is pushed even further in case of transition economies, as in the initial setup the institution of private ownership and the class of private proprietors were virtually non-existing (King and Szelenyi, 2005, p. 207).

During the last three decades China’s economic system went through the great transformation from communism to some form of state-led capitalism. If political monopoly of the Communist Party and the persistent importance of political ties (Shi, Markoczy and Stan, 2014) are taken into account, the term ‘state’ should actually be substituted with ‘Party’. Having abandoned fundamentals of communist ideology, the legitimacy of the Party has been tied to its ability to deliver improvement in peoples’ living standards. Economy-wide indices seem to support Party’s claims – real GDP per capita growth averaged 8.8% in 1979–2013 period and the share of population living with less than $1.25 a day (PPP) declined from 84.3% in 1981 to 6.3% in 2011 (World Bank, 2014). However, the picture of China’s gradual transformation is much more nuanced and the institutional outcome of the reforms is hardly on optimal one.

The next two sections describe briefly China’s evolutionary approach to transformation that resulted in emergence of the Party-led capitalism. The system’s main features are discussed in section four. Then, in the next two sections, a more detailed characteristic of the role of the state (and political actors) in China’s economic development is presented. As the analysis tries to introduce the relationship between state and economy in
a more universal way, some very unique features of China’s institutional evolution (e.g. Household Registration System) are overlooked\footnote{For analysis focused on transition and China-specific characteristics, see e.g. Karnia (2012).}.

Combining the standard macroeconomic approach with insights from new institutional economics, the paper argues that while the government’s actions were mostly growth-enhancing, the nature of this development was biased toward the Party-state and in the long-term unsustainable. According to the literature of comparative capitalism, there can be a ‘good’ form of régulation that allows for stable economic growth, low inequality and society-wide welfare, but also a ‘bad’ form that secures neither (Amable, 2003, p. 49–51). In order to continue its development, China’s institutional framework has to move closer to the former (and there are signs that the partial shift has already started).

### 2.1. The marginal revolution

In the late-1970s, Chinese economy faced giant inefficiencies that constrained production and improvement in people’s living standards. The legacy of institutional deterioration related to the Cultural Revolution resulted in China’s underperformance not only against advanced market economies, but also when compared to other command economies. It is striking that the average per capita consumption of grain was lower at the outset of the reforms in 1978 than just prior to Great Leap Forward in 1957 (Lardy, 2014, p. 60).

In 1978, the Communist Party launched a set of small adjustments targeted at the long suppressed rural sector. The goal was to decrease the effective tax rate without relaxing state monopoly on agricultural production. Instead, the reforms unleashed a series of interactions between peasants and the Party (both on local and country level) that ended up with creation of family farming under the so called Household Responsibility System. The spontaneous movement toward private farming was so widespread that in late 1981 (when Household Responsibility System was officially recognized) there were only 55% of collectives left, and the ratio dropped further to 2% in the next two years (Lin, Cai and Li, 1994, p. 21). Thanks to the new set of incentives, annual growth of agricultural production during 1979–1984 period was more than three times higher than in the early and mid-1970s (Huang, Otsuka and Rozelle, 2008, p. 478). At the same time, employment in the primary sector decreased from 69.3% (of total employment) in 1978 to 49.5% in 1984 (Brandt, Hsieh and Zhu, 2008, p. 690).
This structural change was supported by rapid development of another institutional novelty – Township and Village Enterprises (TVE). Actually, this form of rural industry – owned and operated by the local governments – existed in China since the early-1970s; however, it was significantly constrained by limited access to credit and resources. As estimated by Naughton (1995, p. 144), at the beginning of the reforms rural enterprises produced less than 9% of total industrial output. The sudden change in TVEs’ fortune came with the relaxation of state’s monopoly on purchase of agricultural materials. Rural enterprises started to manufacture basic goods for the primary sector, then entered into the long neglected light industry, became subcontractors to urban state-owned companies (SOE), and finally started to compete with them. At the heights of TVEs’ development in 1996, there were more than 23 millions of rural enterprises employing totally 135 millions of workers (OECD, 2002, p. 88).

Because the TVEs were excluded from the resource allocation scheme, they had to acquire all the input from the market and were allowed to sell their output at negotiated prices. In effect, they were operating under hard budget constraints and faced factor-price ratio that reflected China’s real factor endowment – abundance of labour and scarce of capital. During 1980s, total compensation of rural enterprise workers was much less than half that of state-owned enterprise workers (Naughton, 2007, p. 275). At the same time, when the economic situation deteriorated in 1989, about 3 million TVEs went bankrupt (or were taken over by the peers), while almost all of the loss-making SOEs were rescued (Qian and Xu, 1993, p. 37). Applying this to the macro level, the rise of rural industry introduced much needed price signals to the economy and reduced total misallocation of resources. In 1980–1996 period, collective enterprises (most of them TVEs) recorded average productivity growth of 4% annually – twice the ratio of SOEs (Jefferson et al., 2000).

Despite being registered as collectives and controlled by local governments, most of the TVEs were de facto private companies adopting this form of ownership in order to escape political discrimination (Huang, 2008). Small businesses employing less than seven nonfamily members have already been allowed to operate since 1978 in both rural and urban sector (Tsai, 2007, p. 50). However, the regulations were for sole proprietorship only (i.e. owners were responsible for their businesses with their personal wealth), and still leaved room for special government levies (Lardy, 2014, p. 90). Thus, as argued by Nee (1992), when the security of individual economic actors was concerned, TVEs were the second-best adaptation to the environment of underdeveloped formal institutions.
Reliable business norms and financing for this quasi-private sector were developed on the grounds of informal arrangements called guanxi (Peng and Quan, 2009). These included not only relationship between companies, but also alliances with local Party officials. Incentives for the latter came with fiscal decentralization introduced by the government in the early 1980’s. Under the new fiscal-contract system, local governments had to submit a fixed proportion of their revenues to the upper levels, but everything that exceeded this amount could be retained to finance their own expenditures. This scheme created interdependence between companies’ profits and local government’s disposable income and might be credited for higher permissiveness when new informal arrangements were concerned (Montinola, Qian and Weingast, 1995).

In the mid-1990s, when the legal and political environment for private entrepreneurs have significantly improved, the privatisation of TVEs took off. According to the survey of 670 enterprises from two coastal provinces by Li and Roselle (2003), the shares were sold almost exclusively to companies management rather than to outsiders. In 2003, collective TVEs wholly owned by local governments represented less than 10% of total rural industry’s employment (Naughton, 2007, p. 286).

2.2. Reforming state-owned enterprises

In contrast to the bottom-up transformation of rural sector, the reforms of the urban part of the economy followed much more centralized approach and proved to be less effective. That is hardly surprising – state-owned industry was the core of the command economy and the main area of both vested interests and pervasive control (Naughton, 2007, p. 287). Early initiatives tried to improve SOEs’ performance by expanding enterprises’ autonomy. This soon evolved into more controversial measures that gradually introduced basic market signals to SOEs’ economic calculations. Companies were not only allowed to retain part of the profits, but also to produce goods outside mandatory quotas. Until 1983, extra output has been swapped between companies on informal market, then government allowed SOEs to trade it at negotiated prices. Under the dual-track price system, the planners had their pre-reform flows secured, while managers had incentives to increase production. Because mandatory quotas were fixed in nominal terms, ‘plan’ was slowly giving ground to the ‘market’. By 1988, SOEs bought 60% of their inputs and sold similar share of output at the market prices (Lin, Cai and Li, 1994, p. 16).
The mandatory quotas had been completely dissolved by 1993. However, rigid labour market\(^2\) combined with ever increasing competition from TVEs have gradually undermined SOEs’ financial situation. By the mid-1990s their losses begun to spin out of control. Given the more decentralized nature of the economy, local governments were keen to engage radical measures (Naughton, 2007, p. 105–106). First, the authorities started to privatise small and medium SOEs. In most of the cases it took the form of managerial or employee buyouts; however, auctions with the participation of local entrepreneurs and joint-ventures also took place (Yusuf, Nabeshima and Perkins, 2006, p. 42). Second, by late 1997, a very aggressive restructuring of remaining enterprises was pushed through. Some SOEs were closed, other transformed into controlled by the state limited-liabilities or joint-stock companies. During the 1995–2002 period, more than 45 million urban workers (including 36 million from the state sector) have been laid off (Giles, Park and Zhang, 2005, p. 150). Most of the dislocated workers were absorbed by the rapidly expanding private sector; however, reemployment was neither smooth nor costless (Cai, Park and Zhao, 2008).

SOEs’ reforms marked the end of the first stage of China’s economic transformation and set the ground for some form of hybrid capitalism in which private ownership co-existed with a market-dependent state-owned sector. According to the report by OECD (2005a, p. 81–82), the share of private sector in GDP exceeded the one of public sector in 1998 for the first time (by 0.8 points); five years later the difference already amounted to 18.4 points. In 2004 private entrepreneurs finally received official legal protection ensuring equal status with state-owned companies, and in 2007 China’s first Property Rights Law has been adopted.

The Communist Party may have lost much of the ideological commitment to state-owned companies, but it did not withdraw from the economy. Kennedy (2005) suggests that despite the shift to market-based competition, the role of political ties – defined as managers’ personal connections with officials both on central and local level – has increased rather than declined. According to Fan, Morck and Yeung (2011, p. 1), China has developed a distinctive model of institutional framework that emulates market economy, but in its core remains deeply socialist. Former direct control over allocation of resources has been replaced by more discretionary measures including career rotation, Party affiliation and capital allocation. All of these features are analysed in the next section.

\(^2\) Despite introduction of work contracting in mid-1980s, in early-1990s SOEs still provided lifetime employment, housing, pensions and other social entitlements to majority of their workers.
2.3. Party-led capitalism

Looking at the official ownership figures, it seems that Chinese state has been gradually retreating from the economy. The share of public sector in the total number of industrial enterprises (with annual sales over 5mn RMB) fell from 39.2% to 4.5% over 1998–2012, and in total employment from 60.5% to 19.4% (World Bank, 2012, p. 110). However, the share in total industrial assets dropped modestly – from 68.8% to 42.4%. In effect, more than half of the seventy-three Chinese companies listed in the 2012 Fortune Global 500 are supervised by the state (Lin and Milhaupt, 2013, p. 699).

After the large-scale privatisation in the late 1990’s, the government consolidated its assets and focused on several key sectors to promote national champions. Industries deemed as strategic – these which involved land or natural resources and interfered with country’s safety – were monopolised by the state. Some other, deemed as ‘pillar’ – including automobiles, machinery, steel, chemicals, construction, electronics and IT – remained under strong bureaucratic influence that limited new entries from the private sector. Only downstream industries like factory-assembled exports, clothing and food became fully open to competition from private enterprises. At the same time, the state has become more sophisticated owner of its assets, as it transferred the authority of policy making and oversight to the central holding company known as the State-Owned Assets Supervision and Administration Commission (SASAC). After early experiments with different organisational frameworks, large vertically integrated business groups – in some aspects similar to Japanese keiretsu or Korean chaebol – have emerged. These groups (qiye jituan) typically include a dominant entity that is wholly owned by SASAC, a financial company, a research institute and at least one subsidiary that is listed on the stock exchange (Lin and Milhaupt, 2013, p. 711). Thanks to the hierarchical structure, state’s policy could be enforced efficiently using interrelated channels of corporate governance and political relations. One of the most powerful tools of bureaucratic coordination is career rotation.

The managers of SOEs are typically appointed by the Party basing both on skills and loyalty (Fan, Morck and Yeung, 2011, p. 4). They are transferred back and forth either to government positions or to other SOEs (Lin, 2010, p. 74). Thus, the scheme provides managers with incentives to promote Party’s rather than the company’s interest. As documented by

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3 State authorities exercised control over the listed companies by issuing only minority shares, and restricting purchases by foreign investors (so called A-shares).
McGregor (2010), the Party’s ability to reward or punish executives and bureaucrats has increased since late 1990s which made the centralised human resources policy an effective mechanism of control.

While career rotation is deeply rooted in SOEs corporate governance, other coordination channel – Party affiliation including also some less formal political ties – stretches much beyond the domain dictated by the ownership. Since the late-1980’s, many government officers quit their jobs to engage in private business, while those who stayed on the official position frequently hedged their bets by encouraging relatives. In a single year of 1992, when the government’s reformatory stance has been re-confirmed by Deng Xiaoping, more than 120 thousand Party members switched to private sector (Wu and Xie, 2002, p. 8, supra note 3). In the late-1990s, another big wave of officials going entrepreneurial was brought by privatisation of small and medium SOEs. In effect, as presented by the study of 790 Chinese companies that went public between 1993 and 2001, almost 27% of the initially appointed CEOs had strong political connections (Fan, Wong and Zhang, 2007, p. 331).

Formal and informal ties have also been established between the political elite and grass root entrepreneurs. The later – motivated by hostile institutional environment and government’s monopoly over land and natural resources – started to invite officials into firms’ consulting bodies, and to join the ranks of the Communist Party. According to survey by Dickson (2003, p. 111), in the late-1990s, about 40% of large- and medium-scale entrepreneurs held the Party’s membership, while this ratio for the whole population equalled only 5%. Facing the growth of private sector, the Party has also changed its approach toward the entrepreneurs. In the early-2000s, it started to court them with the new business-friendly ideology; however, one decade later it turned more heavy-handed by urging all private companies employing more than 50 people to establish party cells administrated by a highly powerful secretary (Shi, Markoczy and Stan, 2014, p. 63). In this way, the Party has created a ‘shadow commanding’ structure allowing to monitor private entity’s micromanagement.

The last important mechanism of bureaucratic coordination is the capital allocation. More than three decades from the start of the reform, the state still controls all major banks in the country and only recently started to relax restrictions on international capital flows. Not surprisingly, during the whole period of economic reforms, the banks tended to support SOEs as well as to finance investments in local and national infrastructure leaving the private sector significantly underserviced (Dobson and Kashyap, 2006). According to Fan, Morck and Yeung (2011, p. 10), almost 90% of the private entrepreneurs rely on own corporate savings, with informal debt making up much of the remaining part.
2.4. The disadvantages of Party-state rule

As presented by Schmidt (2002), the general idea of the state’s involvement in the economy refers to the existence of sectors that are essential for state’s functioning. The perception of what is ‘essential’ changes from one variety of capitalism to another; but still, in many developed countries the state holds the dominant position in a number of industries including not only defence and infrastructure, but also utilities, energy, transport and banking (OECD, 2005b). As discussed earlier, under the comparative economics framework, active role of the state does not automatically imply worse economic outcome (Amable, 2001). However, formal and informal control of the Party-state raises serious concerns about the efficiency of China’s system.

According to Lardy (2014, p. 34), SOEs ‘corporatisation’ brought some improvement in financial results as the number of enterprises in the red and their total losses have declined. Nevertheless, in terms of profitability, they still lagged behind non-state firms. In 2009, the average return on equity of Chinese state-owned companies was almost 10 points lower than that of the remaining ownership forms (World Bank, 2012, p. 111), but the profitability within this group varied considerably. The biggest SOEs engaged in resource-extraction industries (and enjoying near monopoly on the market) recorded very high returns on assets, whereas small SOEs acting in a more competitive environment struggled to display satisfactory rates of return (OECD, 2010, p. 1).

In addition to weaker performance of the public sector, state-led allocation of capital is consequently blamed for systematic misallocation of resources (Boyreau-Debray and Wei, 2005). This, in turn, significantly lowers aggregate total factor productivity (TFP). Using microdata on manufacturing plants, Hsieh and Klenow (2009) estimate that if capital and labour were reallocated to equalize marginal product across manufacturers, TFP growth in 1998–2005 period would have increased by 2% per year.

Additionally, the importance of political ties led to emergence of unproductive rent-seeking. Fan, Wong and Zhang (2007) find that during the first three years after initial public offering, companies managed by politically connected CEOs recorded lower stock returns (by almost 18%) compared with firms not having such CEOs. As documented by Wederman (2004), along with growing economic opportunities, the corruption has not only intensified during the 1990s, but also spread into the senior cadres. That added to already strong political opportunism. The offsprings of the Party elite, known as ‘princelings’, have acquired vast amount of wealth while managing biggest Chinese transnational
corporations and financial institutions (Ding, 2000, p. 122; Barboza and La Franiere, 2012).

Public’s growing discontent over corruption has led the leaders to pursue large-scale anti-graft campaign. Since its beginning in 2012, some high-profile Party members including the country’s former security chief have been put into investigation. However, as much as directed at strengthening the Party’s legitimacy by tackling one of the most debated issues, the crackdown was designed to consolidate Xi Jinping’s political power. There is also more than a hint of hypocrisy in government’s action, as the recent investigation by Bloomberg (2012) exposed assets of $500 million in control of Xi’s extended family (though not the close relatives). After publishing story on current China’s leader, Bloomberg’s internet site has been blocked by censors.

Looking at the state-induced inefficiencies and widespread corruption, it seems that Party-led capitalism is very far from the ‘good’ form of régulation discussed broadly by Amable (2003). Nonetheless, the role of the political actors in China’s institutional development is slightly more nuanced than the imperfect outcome might suggest. Nee and Opper (2012) stress the importance of Party’s accommodative changes to formal rules that led to creation of vibrant private sector (so-called market-preserving policies). As can be drawn from Olson’s (1982) analysis of special interest groups, the Party had strong incentives to block the creation of new (formal and informal) institutions that challenged its privileged position. It can be argued that the persistence of political ties and political opportunism is the price to be paid when transformation unfolds without democratization.

The ambivalence toward the state-guided economy is shared by many other studies. Despite being critical to the Party’s political monopoly, Coase and Wang (2012) suggest that most of the top-down reforms that paved the way for the rise of common national market have been underestimated. Similarly, Naughton (2007) praises the government’s ability to implement decisive economic policies dealing with structural and economic problems. Next section completes the analysis of the role of the state in China’s development by adding some macroeconomic perspective.

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4 In 2014, China ranked 100th out of 175 countries in Transparency International’s Corruption Perceptions Index (CPI 2014, available at: http://www.transparency.org/cpi2014); however, the index is not a direct measure of corruption and may be subject to perceptual biases.

5 However, as the Russia’s example suggests, even with democratization there is no guarantee of a positive outcome.
2.5. The role of the state in economic development – macroeconomic policy

Balcerowicz (1997, p. 201–202) argued that much of China’s success can be attributed to its initial backwardness. As much as it is true, it also misses the point. Cross-country studies of Barro and Sala-i-Martin (2003) clearly show that convergence in levels of per capita income is everything but unconditional. All the mechanisms that allow poor economy to grow faster than the rich one – higher marginal returns to capital (Solow, 1956), structural change accompanied by factor reallocation (Lewis, 1954), and transfer of technology (Gerschenkron, 1962) – are only potential and work unless broad socio-economic institutions constrain them. Examining growth experiences over the past several decades, Johnson, Ostry and Subramanian (2006) distinguish some patterns that allowed countries with initially low level of GDP per capita and weak institutions to kick-start growth and then sustain it along with upgrading the quality of their institutions. They find that higher levels of educational attainment and lower levels of inequality helped; however, the key was to promote manufacturing export. Rodrik (2010, p. 89–90) goes into more details by providing specific policy prescription for successful export-led growth. First, sound fundamentals including stable macroeconomic environment, price signals and contract enforcement (sometimes achieved de facto, but not de iure). Second, industrial policies enhancing the capacity of tradables sector including tax incentives, undervalued currency, some trade protection, and even financial repression. This set of policy measures resembles Gerschenkron’s (1962) notion of late development, according to which the state not only needs to construct the markets, but should also help to overcome low private capital and coordination failure.

Until the mid-1990s China has been trying to get its fundamentals right. The most direct consequence of marginal revolution and dual-price track system was the emergence of effective price mechanisms. The share of producer goods transacted at market prices increased from zero in 1978 to 46% in 1991 and 78% in 1995, while for the retail trade it amounted to 3%, 69% and 89% respectively (OECD, 2005a, p. 29). Deregulation has also embraced the exchange rate. Before the reforms started, the planners maintained fixed and overvalued exchange rate to subsidize the import of capital goods. In 1980s, the authorities gradually devalued the official rate and simultaneously introduced market quotations. In 1994, the official and market rates were unified, and two years later, the current account convertibility was announced (nevertheless, control over capital flows was still binding) (Lin and Schramm, 2003, p. 260–261). According to IMF estimates cited by Branstetter and Lardy (2008, p. 639), the Chinese currency
lost about 70% of its value (in real terms) against the dollar over 1980–1995 period. This significantly improved the competitiveness of China-based manufacturing export and encouraged some further manipulations (Coudert and Couharde, 2007). Additionally, being de facto pegged to the dollar, the exchange rate become central not only to export-promoting strategy, but also to monetary policy. When the economy was ‘growing out of the plan’ from the mid-1980s to the mid-1990s, its output gap and inflation were highly volatile; however, since 1996 the economy has avoided significant slowdown (even during Asian and later global financial crisis), and inflation never exceeded 6.0% per year.

Along with building the fundamentals, the authorities started opening the country to foreign trade and investment; however, in highly selective fashion. Policies adopted by the government consequently aimed at promotion of export, while trying to maintain some protection for local market. First, in the early-1980s, two distinct trade regimes have been introduced – one that offered reduced tariffs for imports designed for companies engaged in export processing; the other that combined high tariffs with import quotas designed for remaining firms (Branstetter and Lardy, 2008, p. 634–637). The discrepancy between the two has been gradually lessened – in 2001, China joined World Trade Organization (WTO) having weighted average tariff amounting to 14%; five years later it was only 4% (World Bank, 2014). Second, several measures courting FDI in manufacturing export were approved. In 1979, the authorities passed the Law on Joint Ventures that provided basic framework for foreign companies investing in China. In the same year, four Special Economic Zones (SEZ) offering preferential taxes and simplified administrative rules were established. During the next decades more economic zones and more concessions followed; however, up to this day the system has been quite restrictive when it comes to investments in strategic sectors. The result of state’s industrial policy was striking – in 1995, FDI firms accounted for 8.9% of manufacturing employment and 31.5% of China’s export; by 2008, the shares increased to 33.0% and 55.2% respectively (Chen, 2011, p. 15).

Following the East Asian export-led growth strategies, China has managed to set all three catch-up mechanisms in motion. Higher investment resulting from FDI inflow and financial repression allowed for Solow-style convergence. Labour-intensive manufacturing export relied heavily on rural migrant workers (Chan, 2010, p. 359), and thus sped up the pace of structural transformation. At the same time, FDI made positive contribution to labour productivity both directly (as joint venture framework required transferring of technology to local partners) and indirectly (spillover effects – especially strong in the early phase of opening up).
By establishing sound fundamentals and promoting export, the state was acting like a developmental force. However, as reforms evolved, policy’s center of gravity has been gradually shifting from ‘opening-up’ to ‘financial repression’. Owing to controls on both interest rates and capital flows, dominance of state-owned banks, and strong state interventions, the government was able to mobilize savings and use these funds to develop strategic sectors. In some cases it may have succeeded in overcoming coordination failures, but generally, the result was an unsustainable pattern of growth. Zheng, Bigsten and Hu (2008) find that since the mid-1990s China’s economic strategy relied too much on capital formation which has led to inefficient allocation of resources and a slowdown in TFP growth. Similarly, using a sample of more than 12 thousand firms, Dollar and Wei (2007) estimate that China could achieve the same growth by reducing its investment intensity by 5% and allowing for unbiased allocation of capital.

As financial repression acts as an implicit tax on labour (to subsidize capital), the costs of over-investment are borne by households – Lee, Syed and Liu (2012) estimate them at 4% of GDP per year in the last decade. This raises the question whether China’s growth maximizes economy-wide social welfare or allows to profit politically-connected ones only. With patchy social safety net, suppressed consumption and growing environmental problems it started to look more like the latter. At the same time, heavy reliance on state-led investments led to SOE’s overcapacity and surge in (official and hidden) public debt. According to estimates by Standard Chartered it rose from near 150% of GDP in 2008 to 250% in mid-2014 (Anderlini, 2014).

The last once-a-decade leadership transition that took place at the end of 2012 brought changes to the Party’s economic strategy. New government is prone to accept a slowdown in economic growth as the cost of rebalancing the economy (Bloomberg, 2013). First, measures to limit the scope of financial repression have been gradually introduced – the ceiling on deposit rates was lifted, real effective exchange rate has been allowed to appreciate and the capital control partially scrapped. Second, the government is experimenting with new policy plans that focus more on quality rather than quantity of growth. The Economist (2015) reports that Shanghai municipality is the first to withdraw from GDP targeting, other provinces are expected to follow (however, not immediately). All these measures are welcomed, but it seems that diverting the benefits of economic growth from SOEs to households is going to take some time. Despite the reforms, China’s financial system is still heavily biased toward the state and protected from foreign competition by subtle regulations. At the same time, there is no sign that the government is ready to give up promoting SOEs or to liberalize ‘strategic’ and ‘pillar’ sectors.
Conclusion

Thanks to the combination of market-oriented reforms and successful macroeconomic policy, China has recorded unprecedented economic growth since 1979. The market economy has emerged ‘from below’ forcing the state to take more accommodative rather than active approach. Nonetheless, the Party has been holding the reins all the time – it delayed introduction of hard budget constrains to SOEs and launched brutal crackdown on Tiananmen protests in 1989. The accounts for the export-led growth strategy are different. The institutional experiments were crafted by the state and adjusted to changing macroeconomic conditions. Thus, the state was acting like a developmental force and the goal – integration into the global value chains – was appealing to the international community.

However, after more than three decades of reforms, the Party-state still holds the dominant position in the China’s economy. Former direct control over the resources has been replaced by more discretionary measures, entrepreneurs established strong political ties with the officials and the boundary between the market and the state has blurred. As presented by the paper, this institutional outcome is hardly an optimal one, especially when system’s intrinsic deficiencies are reinforced by financial repression leading to investment-biased growth. China has established state-controlled economy, but certainly no welfare state.

The measures taken by the new leadership to rebalance the economy are welcomed, but as many pointed out, the reforms should also tackle Party’s political monopoly. Since the authoritarian system does not allow for free flow of ideas, Coase and Wang (2012) see the Party as the biggest obstacle to China’s long-term growth. Similarly, Acemoglu and Robinson (2012) suggest that the ‘extractive’ institutions that put the interests of the elite over the interests of the society will hamper China’s further development. Even those who propose more pragmatic approach toward the Party, argue for smaller economic role for the state, further privatization of industrial SOEs and healthier relationship between the state and business firms (Yusuf, Nabeshima and Perkins, 2006, p. 238).

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The book fits into a multidisciplinary research approach. The articles are the result of research conducted by eminent international economists, authors representing academic centres in different countries. The articles address current phenomena observed in the global economy. The authors do not aspire to comprehensively explain all the very complex and multi-dimensional economic developments, but illustrate many of these phenomena in an original way. The multi-threaded and multi-dimensional nature of the discussion in particular articles deserves attention. These include theoretical and methodological articles as well as the results of empirical research presented by the authors.

The book is addressed to those persons interested in issues of economics, finance, regional economy, and the management sciences. It can be valuable for economic practitioners, members of management and supervisory boards of companies, and financial analysts, and the articles may also be useful for academicians and students.

Piotr Urbanek, University of Łódź