

Asian Tiger or Fragile Dragon?: Understanding China's Development Model

By Tao Ran

School of Economics

Remin University of China

China's Growth Model

- China has become a source of excitement and contention. Its dramatic growth and sustained development have fascinated scholars from different disciplines and inspired creative works on economic growth.
- Market institutions (Guthrie, 1997; Wank, 1999; Whyte, 1995), federalism (Montinola, Qian and Weingast, 1995), transition (Naughton, 1996; Yang, 1997), and capitalism (Hung 2008).
- These studies not only brought to light the underlying currents that carried the tide of China, but also facilitated critical reflections on the mainstream theories deeply rooted in western experiences.

China's Growth Model

- The Beijing Consensus, in Ramo's word, endorsed a more active role of the state in orchestrating national development and setting the terms for global engagement. This new development approach challenged the founding principles and policy prescriptions of the Washington Consensus (Williamson, 1989).
- A 2005 World Bank report reached a similar conclusion (World Bank, 2005a). With "discomfort" and "humility", the report acknowledged the ending of Washington Consensus. Instead of conventional best practices and allocation efficiency, it discussed approvingly growth strategies, i.e. industrial policies, and made reference to China and other high performing East Asian countries. With the 2008 financial crisis, the tide seems to turn decidedly to the East..

China's Growth Model

- Ramo is simplistic, if not naïve. But he posed some very timely questions:
- Can China's past experiences be understood in one coherent model? If so, what are its main pillars? Is government intervention part of the story? What implications does China's development have on the rest of the world, especially developing countries?
- **China specialists** need to think beyond the national experience and reflect on the worldwide implications of China's growth.
- **Development experts** should refrain from projecting their idealized realities onto China and ground analysis in empirical facts and existing studies mentioned above. It is in this spirit that we propose some answers to these questions in this paper, hoping to bridge these two fields and facilitate a constructive dialogue.

East Asian Model

- China's development in the past two decades has followed a path that resembled the East Asian developmental state model.
- The state was authoritarian but, instead of abusing power solely for personal wealth, its leaders prioritized national economic growth.
- By suppressing labor, the state managed to divert resources from consumption to investment. To make up for the weak demand in domestic markets, it aggressively promoted its products to the international market.
- Throughout the high growth periods, the state utilized an array of policy tools to shape market conditions, such as industrial targeting, tax rebates and tariff exemptions for exports, subsidies for technological innovations, and market entry restrictions for foreign firms.

China's Growth Model

- This aggregate level analysis, however, offers only a partial picture of China's rise. What truly distinguishes the China Model from other East Asian economies is the strong dynamism at local levels.
- Chinese local governments exhibited an insatiable appetite for growth and investment, especially export-oriented manufactures. This local developmentalism has intensified since the mid 1990s after the central government recentralized the fiscal system and after local SOEs and TVEs privatized.---**Counter-intuitive!!!**

China's Growth Model

- In their drive to secure revenues, local governments competed fiercely with each other for manufacturing capital because of its value-added taxes (VATs) and the spillovers to services (i.e. business taxes).
- Government policy tools were applied to construct extremely pro-business conditions with over-investments as well as disastrous consequences for land, labor and environment. In this race to the bottom, the ugly side of local developmentalism reared its head.

Figure 1. Gross Fixed Capital Formation / GDP

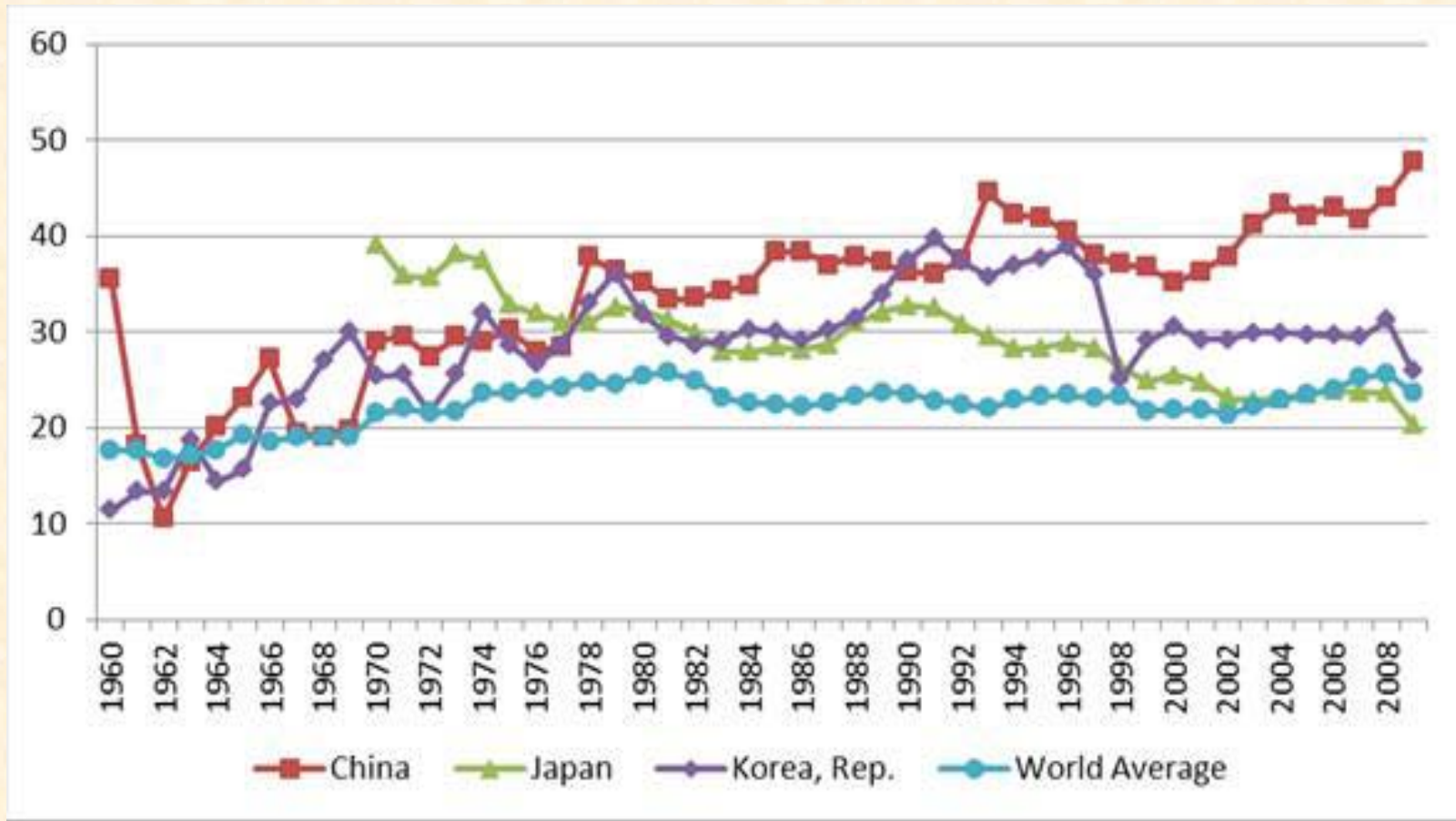
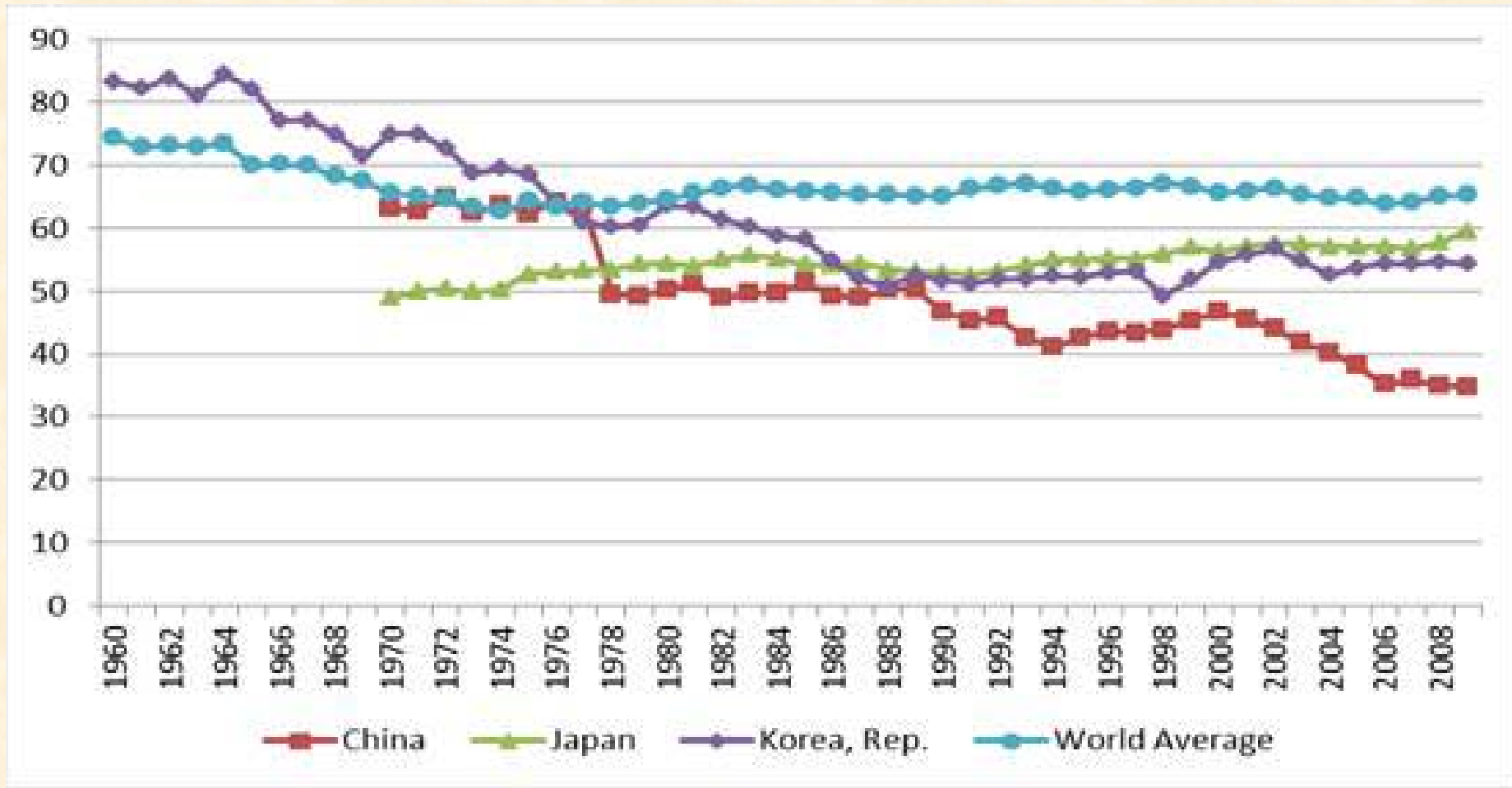


Figure 2. Household Consumption /GDP



China as a Fragile Dragon

- A stimulating debate ensued and researchers on both sides battled over the causes of East Asian miracle. All agreed that these countries adopted an unconventional approach to development, even though they differed as to whether its effect was positive or negative, i.e. growth “because of” or “despite of” state intervention
- *Growth-targeting authoritarianism.*
- *Pro-business and anti-labor regime.*
- *“Helping hand” government*

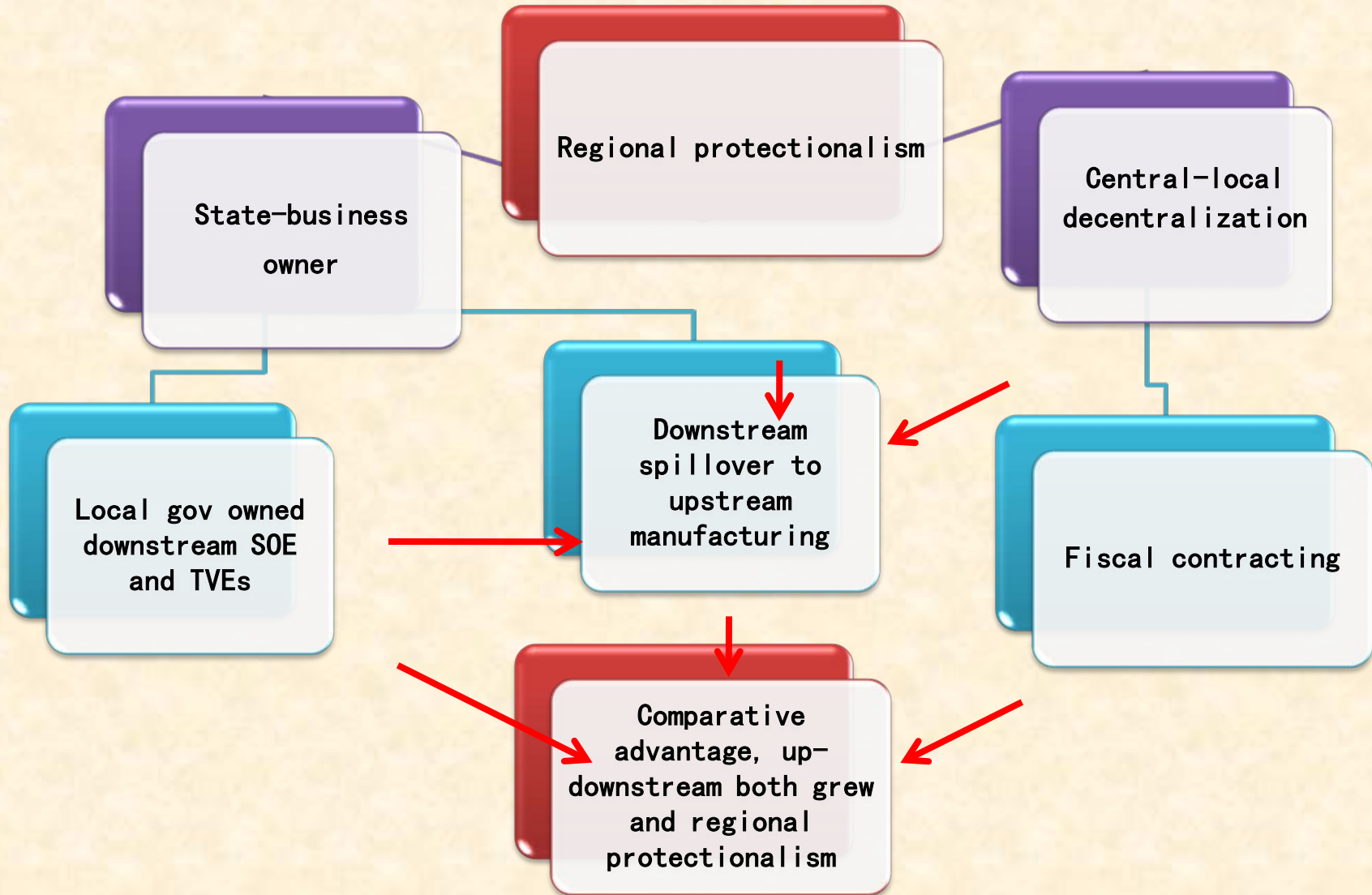
China as a Fragile Dragon

- China's growth in the last two decades did bear the birthmarks of a typical East Asian developmental state. A growth-oriented autocrat reinforced a pro-business regime through labor suppression, financial repression, and industrial policies. These measures also made its products competitive in the international market, a necessity to compensate for domestic frugality.
- China, however, is not just another super-sized Taiwan. As shown in earlier figure, China's reliance on investment and suppression of consumption since the mid-1990s were **extreme even by East Asian standards**. This aggressive developmentalism was a result of fierce competition for investments, especially for manufacturing businesses, among Chinese local governments

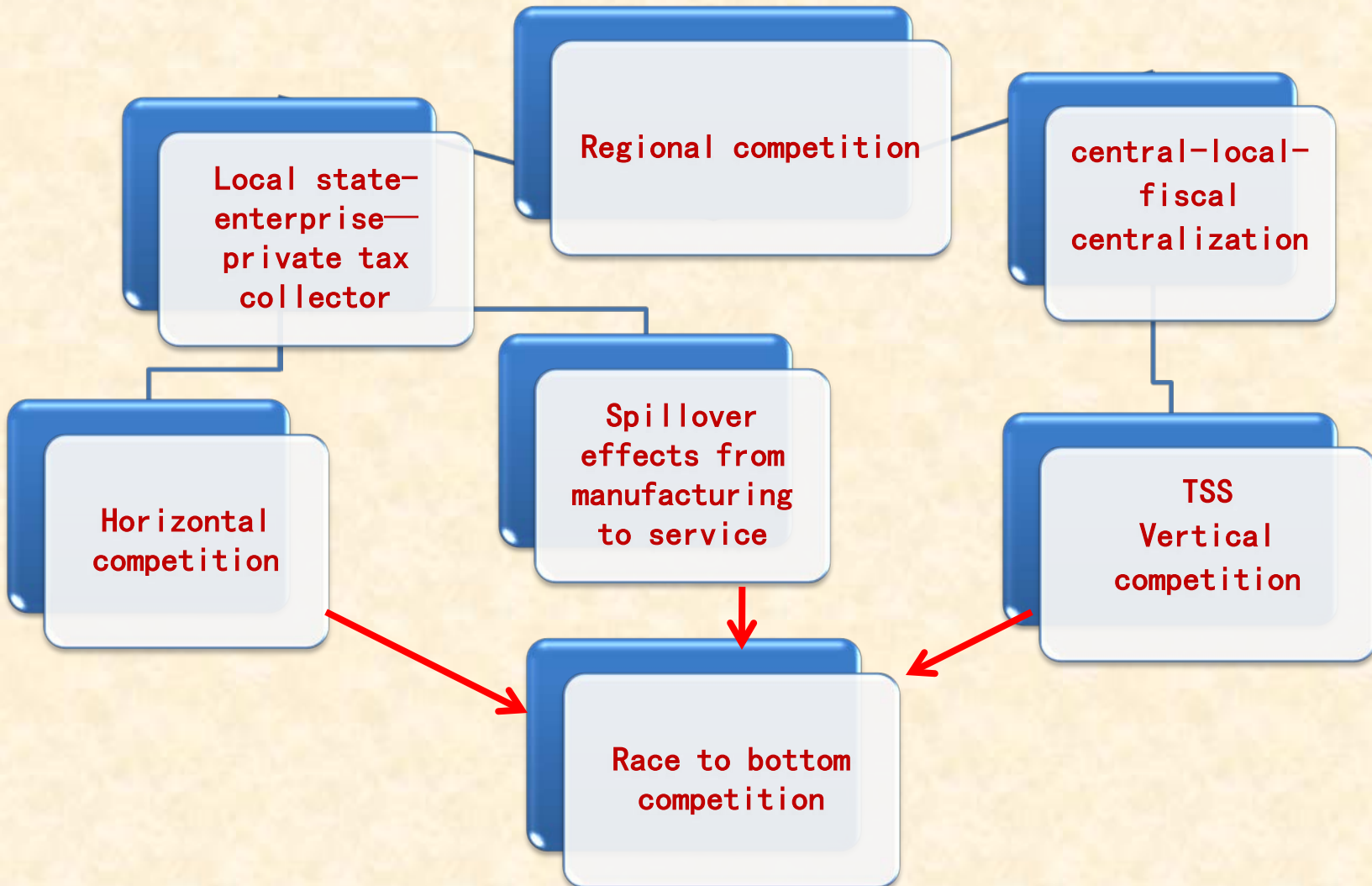
China as a Fragile Dragon

- Three sets of institutional factors that contributed to the rise of local developmentalism.
- *Fiscal reform and revenue imperative.*
- *Factor mobility and regional competition.*
- *Industrial linkage and spillover.*
- In sum, fiscal recentralization, factor mobility and industrial linkage worked together to generate a powerful local developmentalism in China. The economy did grow rapidly, especially in the 2000s, but the furious drive for growth also pushed the East Asian developmental model to a breaking point.

China's Growth Model period I



China's Growth Model period II



Negative Consequences of China Model

- Economic imbalances aside, this developmentalism also left a devastating trail on the nature and society. In order to win over manufacturing capital, local governments raced to the bottom to construct extremely pro-business conditions.
- Environmental standards were relaxed so polluting enterprises could continue production. In some cases, local enforcement agencies openly colluded with factories to evade central inspections (Economy, 2004; Tilt, 2006). Pollution not only destroyed air, water, natural habitat, wild lives, but also damaged human health. Labor was another victim.
- In general, labor did not enjoy a lot of rights, but, in order to support local businesses, local officials refused to enforce already low labor standards. Workers, especially migrants from the countryside, had to work long hours for meager wages, sometimes under dangerous conditions.

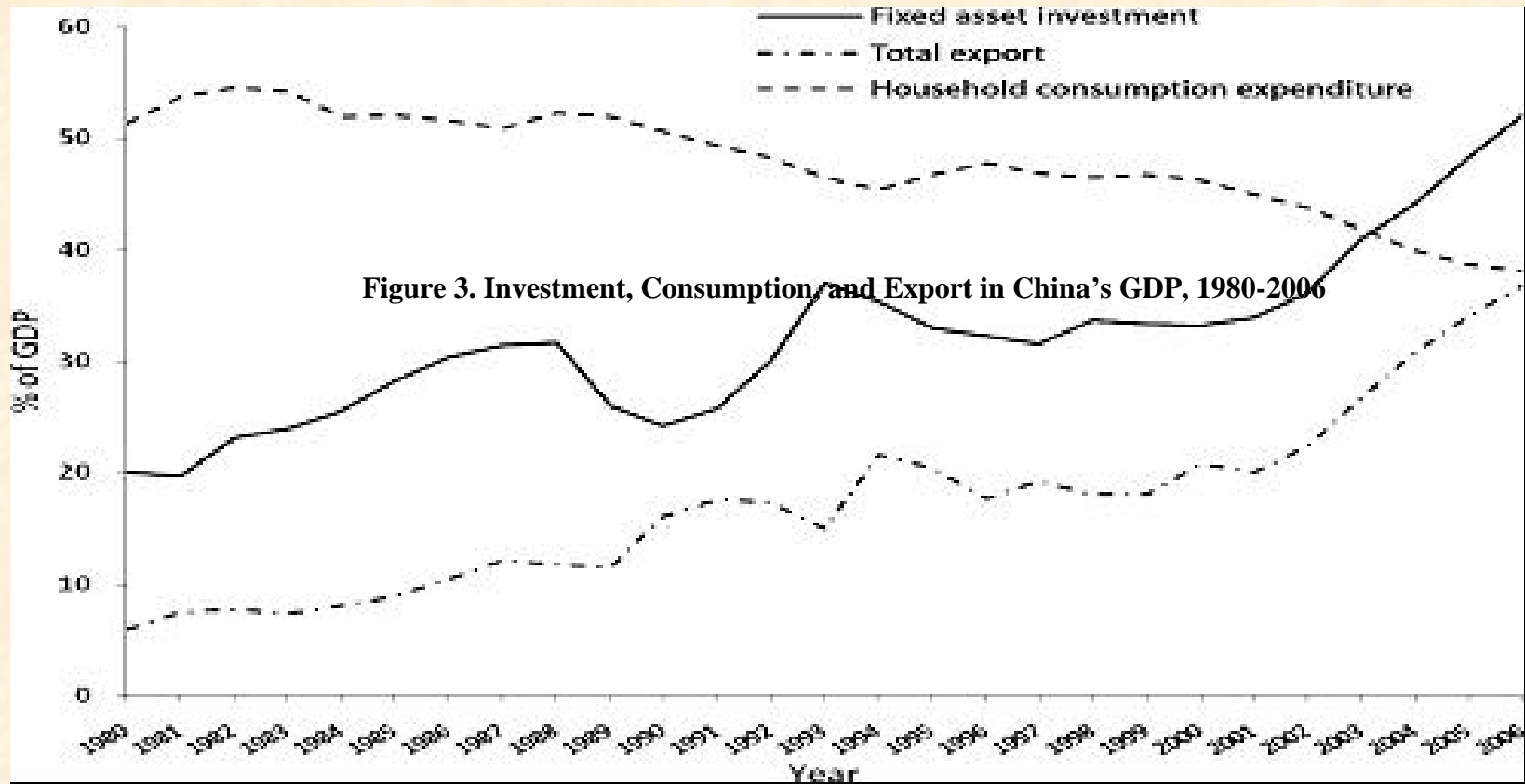
Negative Consequences of China Model

- Finally, (over)leveraging land for development also caused social problems. The need to generate revenues and subsidize manufacturing enterprises led to the twin problems of excessive requisition of farmland and under-compensation for land owners, resulting in millions of disgruntled farmers in the countryside (Zhu and Prosterman, 2007; Tao et al, 2010) .
- In the urban areas, residents were overburdened with skyrocketing housing prices. The red-hot housing market not only drained people's financial resources for consumption but also carried the huge risk of a bubble (Su and Tao, 2011).

China's Manipulated Advantages in Intl Competition

- Cheap labor , and also low labor protection
- Cheap capital
- Cheap land and subsidized infrastructure
- Cheap environment
- Weak domestic demand and manipulated exchange rate
- Housing bubbles and large scale public housing scheme—the **worst of worse—China's subprime mortgage crisis**

Figure 3. Investment, Consumption, and Export in China's GDP, 1980-2006



Implications of China Model for Other Developing Countries

- Analyzing China's developmentalism on both national and local levels gives us **a much sobering picture**. Neck-breaking speed has allowed the government to stay ahead of troubles for the past three decades, but the continuation of this model will be called into question when domestic consumption is slow to catch up and when social crises trigger major upheavals.
- Given the size of the Chinese economy, that would have huge ramifications on the rest of the world. In fact, China's past development has already reshaped the landscape of the world economy, particularly through its deep involvement in world trade.

Implications for Other Developing Countries

- Government is essential in bringing about growth, in particular in the early stage;
- Regional competition helps to create a helping hand to business development;
- However, an over-active government may result in short or even mid-term growth at the costs of long term development.

Implications for Other Developing Countries

- China is an emerging great power, but still a fragile power in the sense that its growth model is not sustainable.
- Serious economic crisis may follow soon without serious and comprehensive reform
- The catch phrases of **“Harmonious Society”** and **“Peaceful Rising”** in fact reflect China’s serious domestic challenges and international challenges;

An County level Industrial Park In North China



A District Level Industrial Park in East China



High-density Residential Building



High-Density Commercial Building



Migrants living in Jiangsu urban villages



Urban Villages in Beijing





Shenzhen Chengzhongcun

Remaining challenges: Urban Villages in Shenzhen



