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Reform in China

EXECUTIVE SUMMARY

This chapter examines whether political reform is necessary in China in order for the country to sustain economic growth into the future.

MAIN ARGUMENT:

Though the Chinese government so far has managed the rising tensions between economic modernization, on the one hand, and the many institutional flaws of authoritarian rule (e.g., lack of political accountability, weak rule of law, bureaucratic ossification, and endemic corruption), on the other, China will not likely continue this course of rapid growth without undertaking the necessary political reforms to make the Chinese political system more responsive and respectful of property and individual rights.

POLICY IMPLICATIONS:

- Western policymakers need to re-examine their assumptions about the sustainability of China's authoritarian developmental model.
- The U.S. government would benefit, in particular, from rebalancing and shifting U.S. policy toward China from the current focus on security issues to a new focus on non-traditional threats such as corruption, environmental degradation, and public-health disasters.
- A re-energized human rights approach to China by the West could emphasize domestic political change in China as the measurement of China's performance as a responsible global power.
- Given that China's political system is unfriendly to competitive markets, Western businesses have the same interests as Western governments in promoting democratic change in China. Western businesses would benefit from building a united front in their dealings with China.

China: Can Economic Growth Continue without Political Reform?

Minxin Pei

Though having become a great power, China faces a highly uncertain future. This uncertainty has now become one of the decisive factors influencing the policy of the West toward China. In the minds of key Western decisionmakers and strategic thinkers loom two questions: whether China will democratize and whether China can continue its rapid economic ascendance without democratic reforms. The strategic uncertainties facing these policymakers are illustrated by the matrix of potential outcomes based on the interplay between the two crucial variables: democratization and economic growth in China (**Table 1**). The most desirable outcome is Scenario I, which sees a China that has successfully democratized its political system, developed its economy, and become a strong partner of the West and Asian allies of the West. Each of the three other outcomes would create a different set of difficulties. Notably, sustained growth under authoritarian rule (Scenario II) would allow China to acquire military capabilities and economic influence with which to challenge and compete against the West. Yet an authoritarian China that falters economically (Scenario IV) is also likely both to experience political strife at home and to behave unpredictably abroad. If economic growth were to stagnate despite the democratization of the Chinese political system (Scenario III), China likely would pose a lesser traditional security threat but, due to its economic weakness, would generate many non-traditional threats, such as illegal immigration, environmental degradation, and epidemics. (These non-traditional threats are equally likely under Scenario IV.)

TABLE 1 Democracy and economic growth: four scenarios for China

	Democratic reform	Authoritarian rule
Sustained growth	Liberal Dream: A strong partner for the West (Scenario I)	Authoritarian Nightmare: A formidable competitor (Scenario II)
Faltering growth	Democratic Disappointment: A weak, peaceful power (Scenario III)	Frail Giant: A stagnant and insecure regime (Scenario IV)

The primary objective of this chapter is to address the question of whether China will continue to maintain rapid economic growth without undertaking democratic reforms. Although the most haunting specter for most Western strategic thinkers is Scenario II, this chapter argues that the country's economic rise is unlikely to continue if China fails to pursue the long-delayed political reforms. That the Chinese Communist Party (CCP) has consistently resisted democratic reforms in the last three decades while delivering impressive economic growth does not necessarily indicate that the party will be able to successfully do so in the future. On the contrary, the CCP's ability to delay introducing regime-changing political reforms has contributed to the accumulation of massive governance deficits and systemic risks; to the extent that these deficits and risks have real and substantial economic costs, China's economic prospects will suffer. In other words, without democratic reform the most likely outcome for China is Scenario IV—a faltering authoritarian giant beset by internal woes. Unfortunately, Western policymakers seem to be unprepared for this outcome.

This chapter first briefly reviews the history of rapid economic growth in post-Mao China, analyzes the main factors behind such growth, and then explains why massive socioeconomic modernization has not led to a democratic breakthrough in China. This is followed by a description of the economic and social consequences of lagging democratization. The next section explores the various mechanisms through which the absence of political reform would likely become a drag on China's economic performance in the next ten to fifteen years. The conclusion presents an analysis both of the prospects for political reform and of the policy implications of China's uncertain future.

The Chinese Economic Miracle

China's rapid economic growth—averaging about 9% a year since the late 1970s—has defied projections of not only pessimists skeptical of the capacity of China's authoritarian regime to deliver long-term superior

economic performance but also of optimists confident of the democratizing effects of sustained economic development. In less than three decades China has increased per capita income 1,000%, more than doubled the urbanization rate, and transformed itself from a negligible participant in the world economy to the third-largest global trading power. This process of fast-paced economic modernization and liberalization also has produced millions of professional workers and private entrepreneurs who have become a vital source of social dynamism and—potentially—political change. Indeed, judging by any measurement of economic development, the Chinese experience during the reform era has been nothing but a resounding success.

Such an assessment may fit well the theory of the developmental state derived from the historical experience of rapid industrialization in East Asia (Japan, South Korea, Taiwan, and Singapore).¹ In particular, the earlier literature on the developmental state implicitly credits authoritarian rule with the capacity to overcome the collective action problem of providing leadership in late-developing societies and to mobilize the financial and administrative resources in achieving rapid growth; to this extent the Chinese case provides yet another empirical confirmation, albeit on a gigantic scale. To advocates of the theory of the developmental state, the Chinese experience is thus hardly surprising. The linkage between democratic reform and superior economic growth performance is (if such a link exists at all) most likely to be negative: democratic reform may be not only unnecessary but also positively harmful for sustaining economic growth.²

Yet, the theory of the developmental state may be useful only in explaining *ex post facto* how some states managed to achieve rapid growth while others did not. The implicit linkage between authoritarianism and superior growth is tenuous because of the selection bias problem. A review of empirical evidence shows no systematic relationship between regime type and growth performance.³ At the same time, the theory of the developmental state must contend with the powerful insights of the institutionalist school

¹ Stephan Haggard, *Pathways from the Periphery* (Ithaca, NY: Cornell University Press, 1991); Thomas Gold, *State and Society in the Taiwan Miracle* (Armonk, NY: M. E. Sharpe, 1997); Robert Wade, *Governing the Market: Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990); and Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975* (Stanford, CA: Stanford University Press, 1983).

² Robert Wade, *Governing the Market: Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990).

³ Adam Przeworski et al., *Democracy and Development: Political Institutions and Well-being in the World, 1950–1990* (New York: Cambridge University Press, 2000).

of economic development.⁴ According to the institutionalist school, superior long-run economic growth can only be sustained by political and legal institutions that protect property rights and restrain the predatory appetite of the state.⁵ To the extent that an authoritarian regime, unconstrained by the rule of law and political competition, is more likely to be a predator than a nurturer, an autocracy will be unlikely to maintain strong economic performance—unless it implements political reforms that would build and strengthen the institutions of the rule of law and expand political participation.⁶ From this perspective, pessimists are theoretically justified in questioning the durability of China's "authoritarian developmental state." Empirically, the spectacular collapse of Suharto's regime in Indonesia in 1998 also validates the view that, without political reform, even one of the most successful authoritarian developmental states could degenerate into a predatory one, with catastrophic consequences.⁷

For the moment, however, China's economic miracle appears to have clearly defied both orthodox theory and doomsayers. The economic locomotive is real and seems unstoppable. Unadjusted for quality (which will complicate matters a great deal since the social costs of environmental degradation, rising income inequality, and corruption would be included to offset the rise in income), the rate of growth China has achieved since 1978 is among the highest for a major economy. Between 1978 and 2003, China recorded an annual growth rate of 9.4%.⁸ A quarter-century of high growth has completely transformed the Chinese economy. The aggregate size of the Chinese economy in 2003 (adjusted for inflation) was more than eight times larger than in 1978.⁹ Structurally, the share of the modern sectors (manufacturing and service) rose from 72% to 85%, with manufacturing

⁴ Douglass North, *Institutions, Institutional Change, and Economic Performance* (New York: Cambridge University Press, 1990); and Thrainn Eggertsson, *Economic Behavior and Institutions* (New York: Cambridge University Press, 1990).

⁵ Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1989); and North, *Institutions, Institutional Change, and Economic Performance*.

⁶ In the institutionalist literature, the connection between strong protection of property rights provided by the rule of law and superior long-run economic performance is undisputed but the effects of democracy on growth remain unproven. In the contemporary world, however, the rule of law and democratization are politically interdependent. Authoritarian rulers are unlikely to subject themselves to the rule of law without the pressures of democratization. Therefore, political reform must include both legal and democratic reforms.

⁷ In East Asia, the two most successful developmental autocracies—Taiwan and South Korea—avoided such a catastrophe mainly because their ruling elites allowed political contestation to increase gradually. There were competitive elections and strong civic forces that helped check the state's predatory instincts. In Singapore, the rule of law and clean elections also acted as a self-enforcing mechanism against abuse of power by the ruling People's Action Party.

⁸ *Statistical Yearbook of China 2004* (Beijing: China Statistical Publishing Co., 2005), 25.

⁹ *Ibid.*, 56.

accounting for 52% of the economy.¹⁰ The material well-being for Chinese citizens has improved dramatically, as reflected in the increase of per capita income from \$150 in 1978 to roughly \$1,700 in 2005. The improvement of the standard of living can be seen clearly in the data in **Table 2** as well. Obviously, rapid growth has significantly reduced poverty. According to the World Bank, about 402 million people were lifted out of abject poverty (defined as living on \$1 a day) from 1981 to 2002, with the total population of the impoverished falling from 490 to 88 million in this period.¹¹

TABLE 2 Rising standards of living in China, selected indicators (1978–2000)

Selected indicators of standard of living	1978	1983	1990	1992	2000
Passenger cars (per 1,000 people)	–	–	1.43	–	6.74
Air transport, passengers carried (million)	1.54	–	–	–	61.89
Malnutrition prevalence, weight for age (% of children under 5)	–	–	–	17.40	10.00
Immunization, DPT (% of children ages 12–23 months)	–	58.00	–	–	89.00
Television sets (per 1,000 people)	2.62	–	–	–	304.16
Literacy rate, adult total (% of people ages 15 and above)	64.10	–	–	–	90.90

SOURCE: The World Bank, *World Development Indicators*, various years.

For the world economy, the most important aspect of China's economic modernization is the explosive growth of its foreign trade. The extensive linkages with the world economy have made China a critical component of the global supply chain. The participation of tens of millions of rural laborers in the export-oriented manufacturing sector has strengthened China's comparative advantage and contributed to low inflation around the world. China's enormous gains from international trade have given Beijing an unprecedented level of influence in the economic integration in East Asia (as seen from its leadership's role in helping establish free-trade zones in the region). With China's foreign currency reserves approaching \$1 trillion in 2006, China has become a pivotal player in international finance because its exchange rate and reserve policies can move both interest and exchange rates around the world.

¹⁰ *Statistical Yearbook of China 2004*, 54.

¹¹ The World Bank, "Shanghai Poverty Conference: Case Study Summary," <http://info.worldbank.org/etools/docs/reducingpoverty/case/33/summary/China-8-7PovertyReduction%20Summary.pdf>.

Many factors have contributed to China's rapid economic gains in the reform era. Compared with the more developed state-socialist economies in the former Soviet bloc, the pre-reform Chinese economy had more favorable structural and institutional conditions, such as a less extensive welfare state and less bureaucratic centralization.¹² These pre-conditions allowed China to avoid major economic disruptions since non-state firms could emerge and eventually replace state-owned firms as the main engine of growth and employment generation.¹³ One scholar aptly named this strategy "growing out of the plan."¹⁴ Additionally, China, by fortune of geography, is located in a "good neighborhood"—the fastest-growing region in the world economy. With proximity to the so-called "dragon economies" in general, and access to the business networks of ethnic-Chinese in East Asia in particular, China could not only benefit from the inflows of foreign direct investment from these economies, but also tap into the enormous pool of intangible wealth of entrepreneurial knowledge and connections accumulated by the Chinese diaspora. Indeed, China could not likely have built its competitive export-oriented industrial base without the contributions of direct investment and knowledge from the businesses in Hong Kong and Taiwan.¹⁵

To what extent should the Chinese government be given the credit for this economic miracle? In answering this question, one must disaggregate the effects of policy and strategy from those of authoritarian rule. The majority of mainstream economists, for example, firmly believe that China's gradualist reform strategy was responsible both for the massive expansion of output during the reform era and for the minimization of transition costs.¹⁶ In addition, the decision to launch economic reform first in the countryside ensured success in the early, and most difficult, stage of economic transition and later generated powerful momentum for extending the reform into urban areas.¹⁷ The policy of decentralization also appears to have offered enormous incentives for local elites to promote economic

growth.¹⁸ Conservative macroeconomic management, despite several episodes of high inflation, is another much-praised policy adopted by the Chinese government in maintaining a stable pro-growth environment.¹⁹ Lastly, by embracing globalization and aggressively courting foreign direct investment, China has managed to maximize its comparative advantage and significantly expand its foreign trade.²⁰

Much more problematic is the assessment of the extent to which China's authoritarian rule has contributed to the delivery of rapid growth for nearly three decades. Conceivably, one can make three arguments for the case that authoritarian rule has provided the political guarantee for superior economic performance in China since the late 1970s. First, compared to a democratic regime in a comparable developing country, China's authoritarian political system is more capable of mobilizing the resources for rapid development. Unconstrained by opposition parties, civil society groups, courts, and the press, an authoritarian regime has greater discretion and capacity to increase investment and build the physical infrastructure needed for economic take-off. This can be seen in China's very high investment rates and ability to develop its critical infrastructure with impressive speed, which stands in contrast to the low investment rates and slow infrastructural development in India. Second, China's authoritarian rule has suppressed labor costs and helped maintain the country's comparative advantage in the international economy. In particular, by prohibiting independent labor unions, China has made itself an attractive destiny for foreign direct investment in labor-intensive manufacturing. Third, as the disastrous experience of the former Soviet Union shows, adopting democratic reforms before economic reform bears fruit can unleash dangerous centrifugal forces and cause an anti-regime revolution. The subsequent political chaos and social unrest will cause an economic collapse with devastating consequences. The Chinese government, in particular, is fond of crediting the breathtaking economic take-off in the 1990s to the political stability that prevailed after the bloody suppression of the pro-democracy movement in June 1989.

Of these three arguments, the most serious and plausible is the second one. Authoritarian rule is most likely an ally of international capital in search of cheap labor. The enormous advantage of cheap labor has definitely been the most important factor in the explosive growth of China's labor-intensive export sector. The linkage between authoritarian rule and resource

¹² Yingyi Qian and Chenggang Xu, "Why China's Economic Reforms Differ: The M-form Hierarchy and Entry/Expansion of the Non-state Sector," *Economics of Transition* 1, no. 2 (1993): 135–70.

¹³ Jeffrey Sachs and Wing Thye Woo, "Structural Factors in the Economic Reforms of China, Eastern Europe, and the Former Soviet Union," *Economic Policy* 18 (1994): 102–45.

¹⁴ Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978–1993* (New York: Cambridge University Press, 1995).

¹⁵ Hongying Wang, *Weak State, Strong Networks* (New York: Oxford University Press, 2002).

¹⁶ Lawrence Lau, Yingyi Qian, and Gerard Roland, "Reform without Losers: An Interpretation of China's Dual-Track Approach to Transition," *Journal of Political Economy* 108, no. 1 (2000): 120–43; and Gerard Roland, *Transition and Economics: Politics, Markets, and Firms* (Cambridge: MIT Press, 2000).

¹⁷ Jean Oi, *Rural China Takes Off: Institutional Foundations of Economic Reform* (Berkeley: University of California Press 1999).

¹⁸ Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993); and Yasheng Huang, *Investment and Inflation Control in China: The Political Economy of Central-Local Relations during the Reform Era* (New York: Cambridge University Press, 1996).

¹⁹ The World Bank, *China, 2020* (Washington, D.C.: The World Bank, 1997).

²⁰ Shang-jin Wei, ed., *The Globalization of the Chinese Economy* (London: Edward Elgar, 2002).

mobilization capacity may appear obvious and intuitive. Yet—given the ease with which authoritarian regimes can mobilize resources and the enormous discretion with which such regimes use them—waste and corruption is likely to be endemic under authoritarian rule, resulting in inefficient use of resources. One telltale example of systemic waste in China is the huge stockpile of non-performing loans in the financial system (about \$700 billion in 2005), despite rapid growth (normally, banks thrive in fast-growing economies, but not in China).²¹ The so-called Chinese model compares well only with Russia but not with many of the East European countries, which achieved the democratic breakthrough and successfully adopted radical economic reforms. Today, these countries rank higher in governance indicators, have much lower level of corruption, and enjoy greater economic freedom than China.²² Of course, if we factor in the personal welfare loss from living under authoritarian rule (lack of political choices, fear of the secret police, and denied access to information) then gains in the material standards of living must be discounted, and China's achievement would lose a great deal of luster.

Regardless of the degree to which authoritarian rule contributes to or undermines China's growth performance, the most important question is whether Chinese economic growth will continue to surge ahead at high speed *without* political reform. For the next decade, many of the economic fundamentals remain positive and China's strong growth momentum will most likely continue. The most important favorable economic factors include:

High savings rate. The national savings rate (combining household, corporate, and government savings) will remain well above 30% for at least a decade, providing the funds needed to sustain high rates of investment, the most powerful and proven engine of growth. Some optimists even claim that, based on the experience of East Asia's newly industrialized countries (NIC), high savings rates, not the health of political and economic institutions, determine long-run growth performance.²³ The connection between high savings and high growth is, however, not a certain one. Aside from the issue of whether savings are efficiently invested in China, changing demographics, especially the rapid growth of an elderly population in the mid-2010s, is likely to reduce savings rate. High savings in China are

maintained, at present, by households' uncertainty about their pensions, healthcare, and educational expenditures. Ironically, successful reforms that would increase confidence in the government's ability to pay for these social services in the future could reduce public uncertainty, increase consumption, and reduce savings. The net result is not necessarily slower growth but a different—and perhaps more healthy—type of growth that is driven by consumption, not investment.

Migration of rural labor. The massive migration of rural labor that is of marginal productivity to the modern sectors in urban areas has been a principal contributor to the increase in productivity and economic growth in the reform period. In the past quarter-century, an estimated 150 million rural migrants have been absorbed into the manufacturing, construction, and service sectors in China. In the next two decades, more than 200 million rural residents are expected to move to more productive employment in the cities.²⁴ The participation of this huge labor pool in the modern sectors will not only maintain China's low-wage cost advantage but also generate its own growth momentum.

Growing and dynamic private sector. Despite the Chinese government's discrimination against the private sector, private Chinese firms have become the main engine of economic growth and employment generation. As indigenous private Chinese firms continue to gain market share, talent, and financial clout, they will provide a key source of momentum for the Chinese economy.²⁵

Spreading growth clusters. As a continental economy, China will gain additional advantage from the spread of growth clusters from the more prosperous coastal areas to the agrarian hinterland. To date, growth has concentrated mostly along the east coast. Although this concentration has greatly exacerbated regional economic disparities, the migration of growth clusters, driven by manufacturing companies' search for cheaper locations to relocate, will provide a powerful stimulus to economic growth in the agrarian provinces located in the central part of the country.

Globalization. By embracing globalization, China has maximized its comparative advantage of abundant low-cost labor.²⁶ The outsourcing of manufacturing activities to China by firms with higher labor costs has been a main driver of export growth and improvement in quality for products

²¹ *The Financial Times*, May 3, 2006, 1.

²² See the World Bank Institute, "Governance Indicators," <http://www.worldbank.org/wbi/governance/data.html>; Transparency International, *Corruption Perception Index*, <http://www.transparency.org/>; and the Fraser Institute, "Economic Freedom in the World," <http://www.fraserinstitute.ca/economicfreedom/index.asp?snav=ef>.

²³ Jonathan Anderson, "How to Think about China," (UBS Securities, 2005).

²⁴ *The 2005 China Development Report* says that the "cumulative number" of rural migrants to the cities will be "well over 200 million" over the next approximately fifteen years, http://www.undp.org.cn/downloads/nhdr2005/NHDR2005_complete.pdf, 102.

²⁵ See OECD, *Economic Survey: China* (Paris: OECD, 2005).

²⁶ See Peter Nolan, *Transforming China: Globalization, Transition, and Development* (New York: Cambridge University Press, 2004).

made in China. Although China's explosive growth in exports has met with increasing protectionism in its main markets (the United States and Europe), China's extensive ties with the global economy will allow China to tap into the huge pool of foreign technology, management know-how, and—to a decreasing extent—capital in maintaining its growth momentum.²⁷

Political Reform: A Critical Assessment

If China's success in achieving three decades of high growth has confounded skeptics, the dearth of evidence that the three decades of unprecedented economic modernization have made the Chinese political system more democratic has equally challenged the theoretical validity of the school of "democratic evolution," which asserts that economic development has liberalizing effects on authoritarian political systems. Of course, it would be false to claim that Chinese politics has not changed. Compared to the era of mass terror under the rule of the late leader Mao Zedong, Chinese society today is much more free, diverse, and autonomous. Despite an overall poor human rights record and a history of repression, Chinese politics has also become much less brutal and more constrained by rules and norms.²⁸ The Chinese Communist Party (CCP) even has undertaken limited administrative and institutional reforms, including strengthening the legislative branch, building a modern legal system, and even experimenting with grassroots democracy in villages.²⁹ Nevertheless, judging by the most basic criteria of democratization (such as the emergence of an organized opposition, autonomous civil society, and civil liberties) the Chinese political system remains unmistakably authoritarian, not democratic.

More disturbingly, the Chinese experience, especially since the 1990s, seems to have stood on its head the liberal modernization theory predicting democratization as a result of economic development. The reality in China is the reverse: while China's economic take-off was barely beginning, Beijing was more tolerant of experiments with democratic reforms, but as the country has grown richer, China's political system has failed to grow

more democratic.³⁰ In some respects, the Chinese political system today has become even less democratic than in the 1980s. For example, the Communist Party has discontinued the experiment with so-called inner-party democracy, which allowed limited competitive elections within the Central Committee. The discussion of political reform has similarly been banned in public discourse; in contrast, the top leadership seriously explored various options of political reform in the late 1980s.³¹

The reverse relationship between economic development and democratic change in China can be seen more clearly in the limits of the three most important institutional reforms endorsed and implemented by the Chinese Communist Party since the late 1970s: strengthening the legislative branch, building a modern legal system, and instituting semi-competitive elections in villages.

Strengthening the Legislative Branch

China's efforts to strengthen the role of the legislative branch—mainly the National People's Congress (NPC) and, to a lesser extent, local people's congresses (LPC)—in decisionmaking is generally considered one of the most important steps of political institutionalization.³² If successful, this reform measure would introduce institutional pluralism into an authoritarian political system. While the importance of strengthening the legislative branch is widely recognized, research on the actual achievement of this reform has yielded different assessments. Kevin O'Brien's study of the NPC in the 1980s finds no evidence that this key legislative institution became more competitive or responsive. Instead, the reform merely strengthened the CCP's hold on the legislative branch.³³ Murray Scot Tanner's research, however, offers a more upbeat assessment of China's legislative reforms. Tanner argues that these reforms have considerably reduced the control of the CCP in policymaking by enhancing the political standing of the NPC and making the NPC an influential player in China's decisionmaking process. This does not mean that the legislative process in China has been democratized. The NPC is merely another bureaucratic player in a

²⁷ See Nicholas Lardy, *Integrating China into the Global Economy* (Washington, D.C.: Brookings Institution Press, 2001).

²⁸ Andrew Nathan, "Authoritarian Resilience," *Journal of Democracy* 14, no. 1 (2003): 6–17.

²⁹ Randall Peerenboom, *China's Long March Toward Rule of Law* (New York: Cambridge University Press, 2002); and Murray Scot Tanner, *The Politics of Lawmaking in Post-Mao China: Institutions, Processes, and Democratic Prospects* (New York: Oxford University Press, 1999).

³⁰ In the 1980s, senior leaders, including Deng Xiaoping and Peng Zeng, pushed for legal reforms, village elections, and the strengthening of the National People's Congress. Deng himself called for democratic reform in the mid-1980s as a means of overcoming bureaucratic resistance to economic reform. Regarding Peng's role in reforming the NPC, see Michael Dowdle, "The Constitutional Development and Operations of the National People's Congress," *Columbia Journal of Asian Law*, 11 (1997): 1–123.

³¹ Wu Guoguang, *Political Reform Under Zhao Ziyang* (Taipei: Yuanjing Publishing Co., 1997).

³² Tanner, *The Politics of Lawmaking in Post-Mao China*.

³³ Kevin O'Brien, *Reform Without Liberalization* (New York: Cambridge University Press, 1990).

decidedly authoritarian policymaking process.³⁴ Evidence shows that the NPC is, at best, a secondary bureaucratic player that routinely endorses the bills drafted by the executive branch. For example, the Standing Committee of the NPC rejected the bills proposed by the government only three times in 28 years.³⁵ Official figures also indicate that individual legislators play an insignificant role in law-making. For example, from 1983 to 1995 more than five thousand bills were proposed by delegates, but only 933 (18%) of them were referred to committees. There was no record that any of the proposed bills ever became law.³⁶

In practical terms, the most visible progress in China's legislative reform is the hundreds of laws and resolutions issued by the NPC since the late 1970s. These laws have provided the legal framework for China's economic reform (about a third of all the laws passed since 1978 are classified as "economic laws" that govern commercial activities), as well as codified administrative rules and procedures (about half of the new laws are considered administrative laws). Compared with the Maoist era—during which Mao's personal edicts and the CCP's documents served as the supreme laws of the land—the new laws passed by the NPC were certainly a huge improvement, especially since they adopted many Western legal concepts. Yet Stanley Lubman, an authority on Chinese law, finds shortcomings in the laws and rules passed by the NPC. He believes that the language of these laws often is too vague and is intentionally designed to maximize the flexibility and discretion of the government rather than to constrain the power of the state.³⁷

Legal Reform

The rule of law is the institutional foundation for sustainable long-run growth. As such, China's effort since 1976 to build a modern legal system is key to the success of Chinese economic reform.³⁸ Though the Chinese government likes to showcase its achievements in legal reform, any impact on protecting property and individual rights or on constraining the power of the ruling party and the state has been mixed. China has undeniably passed

³⁴ Tanner, *The Politics of Lawmaking in Post-Mao China*.

³⁵ These bills were the law on residents' committees in 1989, the highway law in 1999, and the draft law on the bankruptcy of state-owned enterprises in 1987.

³⁶ *Shidai zhuren* [Master of the Times], 7 (1999): 23.

³⁷ Stanley Lubman, "Bird in a Cage: Chinese Law Reform after Twenty Years," *Northwestern Journal of International Law and Business*, 20 (2000): 383–423.

³⁸ For two excellent studies of China's legal reform, see Pitman Potter, ed., *Domestic Law Reforms in Post-Mao China* (Armonk: M. E. Sharpe, 1994); and Stanley Lubman, ed., *China's Legal Reforms* (Oxford: Oxford University Press, 1996).

several hundred laws, made huge investments in raising the professional qualifications of its judges and lawyers, and improved judicial procedures, but the Chinese legal system—operating as it does under the strict controls imposed by the CCP—lacks the independence necessary to function as the guarantor of the rule of law.³⁹ Several key indicators suggest that legal reform began to lose momentum in the late 1990s. The growth of civil and administrative litigation has registered a net decline in recent years. The total number of civil and commercial cases fell from more than 5 million in 1999 to about 4.4 million in 2002 (a 12% decline over three years). The decrease in the number of administrative litigation cases (lawsuits filed against the government) was especially notable. The number of such lawsuits fell in 2002 to about 80,000, back to the level of 1996 (when court data indicated that plaintiffs could win or gain favorable settlements in two out of five cases).⁴⁰ Falling litigation may indicate the erosion of the public's confidence in the impartiality of the Chinese courts. One measurement is the rapid fall of plaintiffs' "win rate" in lawsuits filed against the government. In 1996, plaintiffs suing the government could expect to gain favorable court rulings and settlements in 41% of the cases. This rate fell, however, to 32% in 1999 and it plunged to 20.6% by 2002.⁴¹ If anything, the courts have become less willing to rule against the government or to force it to settle with plaintiffs.

China's legal reform has lost momentum for one main reason: despite nearly three decades of institutional experiments, the Chinese legal system has not freed itself from the political dominance of the ruling CCP and, consequently, is deprived of the institutional independence and authority needed to perform its functions effectively. The CCP's political dominance can be seen throughout the organizational structure and routine operations of the courts. The CCP has a special political and legal committee (*zhengfa weiyuanhui*) headed by a senior party official who oversees the courts and law enforcement. The committee often determines the outcomes of major court cases. Candidates for the presidents and vice presidents of courts are nominated by the CCP. Local governments also have substantial control over the courts because the presidents and vice presidents of local courts are appointed by the local governments, which also control the budgets and personnel appointments of the courts. If the CCP's dominance has deeply politicized the judicial system, the significant influence of local governments

³⁹ Peerenboom gives a relatively upbeat assessment of China's legal reform in his book: Randall Peerenboom, *China's Long March toward Rule of Law* (New York: Cambridge University Press, 2002).

⁴⁰ *Law Yearbook of China, 2003*, (Beijing: *Zhongguo tongji chubanshe*, 2004), 149.

⁴¹ Calculated from data supplied by *Zhongguo falü nianjian* [Law Yearbook of China], various years (Beijing: *Zhongguo falü nianjian chubanshe*).

over the courts has fragmented the authority of the judiciary and greatly limited its effectiveness. Of note is that these two institutional flaws of the Chinese legal system are well-known, yet none of the legal reform measures implemented to date address these two defining features of the Chinese judiciary.

In retrospect, one should not be surprised by this outcome. The CCP's desire to maintain political monopoly is fundamentally incompatible with the nature of the rule of law. The party's primary objective for legal reform is to make the legal system more effective in serving the CCP's overall strategy of maintaining power through economic reform; therefore, legal reform will not be allowed to undermine party authority.

Village Elections

Of all the limited political reform initiatives, instituting village elections has been heralded as the most promising step toward genuine democratization (despite the fact that the elected villager are, legally, only civic groups empowered with self-government). Promoters of village elections, both in and outside China, argue that village elections make local governments more accountable, help protect the individual rights of villagers, improve local governance, and empower the peasantry.⁴² Yet, seventeen years after village elections, significant controversy remains as to whether village elections have delivered their promises or substantively democratized politics at the grassroots level. Researchers have found that village elections have failed to empower the peasantry and to end the dominance of the CCP's cells in the villages. For example, local CCP bosses continued to control key levers of power, especially village finance and personnel appointments.⁴³

To be sure, important progress has been made in advancing village-level democratization. This progress has resulted from both the political entrepreneurship of reformers within the government and the political pressure and innovation of villagers. For example, the draft law on village elections passed in 1988 had few useful provisions on how elections should be held. After rural voters experimented with and on their own adopted many important procedural innovations, the government eventually

revised many of these innovations into the law in 1998. Another important measure of progress in this regard is that—nearly two decades after the experiment was launched—village elections have become an established political institution in China, with most provinces having held more than three rounds of such elections by 2000. A survey conducted in 2002 shows that 83% of the villagers polled reported elections in their villages in 2002, compared with 76% in 1993, with voter turnout rising from 63% in 1993 to 69% in the 2002 poll.⁴⁴

That village elections are now regularly held throughout China does not mean that these contests are genuinely competitive. In fact, many studies show a very mixed picture. If the baseline for measuring progress is whether multiple candidates compete in these elections, much improvement has been made. The percentage of villages having multi-candidate elections rose from 53 in 1993 to 70 in 2002. Yet this measurement does not fully reflect the competitiveness of village elections, since the local authorities can manipulate the nomination process to ensure that their choices get on the ballots. As a result, only 43% of the villages used the free primary method of nomination and 35% of villages adopted nomination procedures that violate the legal provisions on village elections. If the electoral provisions in the Organic Law on Village Committees are strictly applied, only 31% of the villages in China are in compliance.⁴⁵

Since most village elections are manipulated by local officials, these elections have little effect on local governance.⁴⁶ Worse still, unelected local authorities and CCP party organizations also routinely usurp the power of financial control of villager committees and illegally dismiss elected village committee members. In one jurisdiction in Hubei province, 187 of the 329 village committee chairmen elected in September 1999 were illegally removed by township governments before their terms expired. Replacements were not elected but appointed—illegally—by local authorities. Similar incidents were reported in many other parts of China.⁴⁷ The most serious failure of village elections is that they have failed to counter the power of the CCP in rural China. Although having allowed village elections, the CCP is unwilling to cede power at the grassroots level. Consequently, elected villager committees are constantly engaged in a power struggle (mostly over the village's budgets and personnel decisions) with the village

⁴² Kevin O'Brien and Lianjiang Li, "Accommodating Democracy in a One-Party State: Introducing Village Elections in China," *The China Quarterly*, 162 (2000): 465–89; Robert Pastor and Qingshan Tan, "The Meaning of China's Village Elections," *The China Quarterly*, 162 (2000): 490–512; and Allen Choate, "Local Governance in China: An Assessment of Villagers Committees," (Working Paper no. 1, The Asia Foundation, 1997).

⁴³ Oi and Rozelle, "Elections and Power: The Locus of Decision Making in Chinese Villages," *The China Quarterly*, 162 (2000): 513–39; and Björn Alpermann, "The Post-Election Administration of Chinese Villages," *The China Journal*, 46 (2001): 45–67.

⁴⁴ Tianjian Shi, "Election Reform in China" (unpublished manuscript, Department of Political Science, Duke University, 2004).

⁴⁵ Ibid.

⁴⁶ John James Kennedy, "The Face of 'Grassroots Democracy' in Rural China," *Asian Survey* 42, no. 3 (2002): 456–82.

⁴⁷ *Nanfang Zhoumo* [Southern Weekend], September 12, 2002.

CCP branches. In a study of 500 villages in Hunan, the elected villager committees were totally powerless in 40% of the villages surveyed because the CCP cells monopolized key decisionmaking power.⁴⁸ Another survey of 2,600 rural residents in 1999 found that local government officials and party organizations were perceived as more powerful than the newly elected villager committees.⁴⁹

The results of China's political reform since the late 1970s have been disappointing but not unexpected. Except for the small group of liberals who lost power in the late 1980s, the CCP leadership has been dominated by political conservatives who steadfastly have resisted substantive political reforms that would have undermined the party's political supremacy. Since leadership choices determine the timing of democratic transition, the extremely limited progress toward a more democratic political system in China is predicted by the regime transition theory.⁵⁰ If the leadership had any incentive to open up the political system in the 1980s because of the strategic necessity of generating the needed momentum for economic reform, such incentives completely vanished in the 1990s when the economy began to take-off explosively. Instead of producing the desired democratizing effects, rapid economic transformation has enabled the CCP to strengthen hold on power.

Autocracy and Development: Why Politics Matter

Given the breathtaking economic growth China has attained under authoritarian rule during the reform era, the very question of whether the lack of political reform has been a drag on economic performance may seem odd, if not ludicrous. The record of nearly three decades of high growth is in itself testimony to many that China does not need democratizing reform to improve economic performance. If anything, this record proves the superiority of the authoritarian developmental state.

Economic growth is not, however, the only measure of the progress of a society. A political regime that is credited with achieving rapid economic growth can, nevertheless, conceivably perform poorly on many indicators of governance or have paid enormous social costs for high rates of growth. More important, the quality of growth must also be taken into account when

evaluating any country's economic performance.⁵¹ Obviously, a society that has achieved high rates of growth at the expense of massive environmental decay, rising inequality, rampant corruption, and underinvestment in public goods cannot be judged to have delivered superior performance. When this yardstick—quality-adjusted growth—is applied, China's record begins to lose luster.⁵² Although establishing rigorous relationships between a certain regime type and quality-adjusted growth performance may be methodologically difficult, it is possible, at least in the Chinese case, to trace many societal ills to the strategies and policies adopted by the CCP to maximize its chances of political survival. This section explores, mostly at the theoretical level, why and how autocracy impedes sustainable economic growth.

A post-communist authoritarian developmental state, such as the post-Mao Chinese state, is constrained by the overriding objective of delivering and maintaining rapid economic growth on the one hand (because economic performance is critical to political survival) and by the inherent institutional flaws of autocracy that undermine efficiency, distort incentives, and exacerbate the principal-agent problem on the other. Economic growth may provide the authoritarian developmental state the fiscal and technocratic resources to offset the effects of the pathologies of an authoritarian regime.⁵³ It is doubtful, however, that an authoritarian developmental state can grow out of these flaws without undertaking the necessary political reforms that will remove these underlying growth-limiting institutional obstacles.

Constituency Maintenance, Inequity, and Inefficiency

Contrary to conventional wisdom, an authoritarian developmental state is not immune to capture by interest groups. The differences between state capture under autocracy and state capture under democracy lie mainly in the rules under which politically powerful interest groups influence the policies of the state and the degree of transparency of the political process in which state capture takes place.⁵⁴ Maintaining the support of key political constituencies is a particularly tough challenge for post-communist

⁴⁸ *Zhongguo gaige (nongcunban)* [China Reform, rural edition], 2 (2003): 15.

⁴⁹ David Zweig, "Democratic Values, Political Structures, and Alternative Politics in Greater China," *Peaceworks*, no. 44, July 2002, 45.

⁵⁰ Guillermo O'Donnell and Philippe Schmitter, *Transitions from Authoritarian Rule: Tentative Conclusions about Uncertain Democracies* (Baltimore: Johns Hopkins University Press, 1986).

⁵¹ High-quality growth is that which is achieved with relatively less environmental degradation, socioeconomic inequality, neglect of basic needs, and corruption.

⁵² The quality of economic growth can be measured by social costs (inequality and corruption) and environmental costs. High growth accompanied by high social and environmental costs is low quality growth. See Minxin Pei, "The Dark Side of China's Rise," *Foreign Policy* (March/April 2006): 32–40.

⁵³ The rise of technocracy in China is viewed by most scholars as a positive development. See Cheng Li, *China's Leaders* (New York: Rowman and Littlefield, 2001).

⁵⁴ Joel Hellman and Daniel Kaufmann, "Confronting the Challenge of State Capture in Transition Economies: Oligarchy and Economic Reform," *Finance and Development* 38, no. 3 (2001): 31–42.

autocracies. Lacking charismatic leadership and ideological appeal, a post-communist authoritarian regime has few instruments to motivate its supporters and retain their loyalty—other than to provide them with costly economic privileges and patronage. The imperative of regime survival thus necessitates policies favoring the key constituencies of the authoritarian developmental state, such as the security apparatus, the state bureaucracy, the ruling party's core membership, and selected social elites. These policies, designed to secure the support of the elite, have serious effects on both social equity and economic efficiency.

In an elitist authoritarian regime, public policies unavoidably favor the politically powerful and discriminate against the weak.⁵⁵ Unless motivated by enlightened self-interest for its long-term survival (rarely seen among authoritarian regimes), an elitist autocracy faces insurmountable obstacles to taking effective measures (such as fiscal redistribution or human capital investment targeting the underprivileged groups) to mitigate the effects of their policies on social injustice. In elitist autocracies in which the state controls valuable economic resources (such as land, credit, and under-priced state-owned assets) and access to commercial opportunities (permission to enter restricted markets or establish new businesses), politically privileged groups can readily turn their access to power into easy acquisition of private wealth, a practice commonly known as crony-capitalism.⁵⁶ Needless to say, the redistribution of assets under crony-capitalism further entrenches the underlying socioeconomic structures that produce inequality and injustice. Based on available data from China, pro-elite policies are among the contributing factors for rising inequality in the last three decades. Estimates from various sources suggest that the Gini coefficient of income has increased from 0.28 to around 0.45 during this period.⁵⁷

Economically, pro-elite policies could harm growth because rising public frustrations with social injustice breed political instability.⁵⁸ Politically, pro-elite policies tend to perpetuate a vicious cycle: the more dependent an authoritarian regime is on elitist constituencies, the more privileges the regime tends to provide to these favored groups to maintain

their support, and the more fearful of democratization the ruling elites grow because liberalizing politics would threaten not only their political power but also their deeply entrenched economic privileges. As a result, elitist authoritarian regimes typically apply more repression, not pro-poor redistributive policies, to deal with rising social discontent.

Policies favoring a small group of elites that constitute the core supporters of an authoritarian regime also harm economic efficiency for two reasons. First, the state must devote enormous fiscal resources to provide the material privileges expected by these elites. For example, in China, administrative expenditures accounted for 19% of the total government spending in 2003, exceeding the combined government spending on education, health, and scientific research.⁵⁹ Second, the authoritarian regime must also protect the economic interests of these elites both by preserving their rent-seeking opportunities and by supplying them with various subsidies to maintain the viability of their businesses. In the Chinese case, evidence of this tendency can be seen in both the size of the political patronage of the CCP and the financial performance of the state-owned enterprises (SOE). According to official data, the CCP appoints 81% of the managers of SOEs and 56% of all enterprise managers. In 2003, 5.3 million CCP officials—about 8% of the CCP's total membership and 16% of its urban members—held executive positions in SOEs.⁶⁰ The flawed property rights and political patronage result in enormous waste and inefficiency, as reflected in the miserable financial performance of SOEs. For example, the median rate of return on assets was a only 1.5% for SOEs in 2003. As a group, more than 35% of SOEs lose money and one in six has negative equity.⁶¹

Incentive Structure and Social Deficits

Without question, the incentive structure of any political system motivates its ruling elites and determines their responsiveness to public needs. In a democratic system in which the ruling elites are periodically held to account for their performance by the electoral system, these elites have the incentive to respond to the needs of the voters or the interest groups that can influence electoral outcomes. In an authoritarian system, on the other hand, the ruling elites are held accountable by their superiors in a bureaucratic hierarchy. As a result, authoritarian ruling elites are conditioned to respond not to public needs but to the top policy priorities

⁵⁵ The CCP under Jiang Zemin became an elitist regime. See Cheng Li, "One Party, Two Systems: Bipartisanship in the Making?" paper presented at the Carnegie Endowment for International Peace, November 2, 2005.

⁵⁶ For a discussion on crony-capitalism see David Kang, *Crony Capitalism: Corruption and Development in South Korea and the Philippines* (New York: Cambridge University Press, 2002).

⁵⁷ One study by the Ministry of Finance in 2003 shows that the Gini index was 0.28 in 1991 and 0.458 in 2000. See Lian Yuming ed., *China by the Numbers* (Beijing: Zhongguo shidai jingji chubanshe 2004), 354. Also see OECD, "China in the Global Economy: Income Disparities in China: An OECD Perspective," (Paris: OECD, 2004).

⁵⁸ Alberto Alesina and Roberto Perotti "Income Distribution, Political Instability, and Investment." *European Economic Review* 40, no. 6 (1996).

⁵⁹ *Statistical Yearbook of China 2004*, 293.

⁶⁰ *China News*, <http://www.chinanews.com.cn>, October 20, 2003 and June 3, 2004; and *Dangzheng ganbu wenzhai* [Digest for Party and Government Officials] 6 (2002): 48.

⁶¹ See OECD, *Economic Survey: China* (Paris: OECD 2005), 40.

valued by their bureaucratic superiors, who determine their job security and political careers. In pre-reform communist systems, as in Castro's Cuba and Maoist China, the regimes' preferences for providing public goods (health and education in particular) over ensuring economic growth can result in higher levels of human development attainment relative to income.⁶² Once the top priorities of the regime change from favoring social investment to emphasizing rapid economic growth, however, the ruling elites at all levels of the system rationally alter their behavior and concentrate their efforts on tasks that will meet the growth targets expected of them by their superiors. In the Chinese case, such a shift of priorities has resulted in an excessive increase in investments in fixed assets (needed both for growth and for establishing a tangible record of managerial competence of the local elites), but at the expense of a significant reduction in social investments.

The extent of the massive shift can be seen from data on government expenditures. In the 1990s—the decade following the Tiananmen crackdown in 1989 and the collapse of communist regimes in the former Soviet bloc—maintaining high rates of growth was the centerpiece of the CCP's survival strategy. In this decade of China's awe-inspiring economic take-off, however, the state's social investments plunged. Under the pretext of "marketization," the government systematically reduced its role even in areas (such as public health and primary education) where market forces simply did not exist. The government's spending on education fell nearly twenty percentage points as a share of total education spending in the 1990s. Social policy became highly regressive as well. For instance, China's rural residents, the country's most disadvantaged and poorest group, have to pay out of their meager income 78% of all the education funding (the central government provides only 1% of the funding for rural education).⁶³ Investment in public health has also suffered. In the 1980s, the Chinese government funded 36% of all health-care costs. By 2000, however, the share of government spending in total health-care expenditures had fallen to less than 15%. As in the case of education, China's health-care policy is regressive to the extreme, providing the ruling elites with high-quality medical services for free and forcing the poorest to pay for their own health-care needs. In terms of financial equity, a report by the World Health Organization rates China's health-care system higher than only two countries—Brazil and Myanmar.⁶⁴ A majority of the population are denied access to the health-care system for financial reasons. The Chinese Ministry of Health disclosed in late 2005 that two-thirds of the

population do not have any type of health insurance and that about half of the people who become ill do not seek professional medical attention or treatment.⁶⁵ Education and public health are not the only areas in which the shift in regime priorities has led to sustained underinvestment and neglect. Potentially far more dangerous is the massive environmental degradation that has ensued as the elites have pursued high economic growth at all cost.⁶⁶

Since the Chinese leadership headed by Hu Jintao came to power in early 2003, the issue of China's social deficits has become a highly contentious topic. Sensing potential political gains from this debate, the new leadership has announced a series of measures to reduce rural taxation and increase spending on health care, education, and infrastructure in the countryside. Judging, however, by the relatively small amounts of new spending on social investment, this step, although welcome, will make only a small difference in reducing the accumulated social deficits.⁶⁷

Most notable is that in the raging debate on social deficits in China the most sensitive political topic—how to reform the political incentive structure so that the local elites would behave more responsively to public needs—is studiously avoided. The modest spending increases are accompanied neither by administrative reforms to streamline a bloated and parasitic rural bureaucracy nor by new measures to empower rural residents politically so that they can hold local elites accountable for inadequate delivery of social services. The omission of these political reforms makes reorientation of the priorities of local governments more difficult, thereby ensuring the continuing accumulation of social deficits. Blaming local elites—the proverbial scapegoats—for their failure to make the necessary social investments would, however, be unfair because they are merely responding at the local level to the incentive structure embedded in China's developmental autocracy. In other words, as long as the ruling elites in Beijing deem continued high economic growth more important to regime survival than increased social investments—and continue to evaluate local elites accordingly—local officials will behave rationally by focusing on growth despite ballooning social deficits.

⁶⁵ *China News*, January 6, 2006 and Dec. 22, 2005, <http://www.chinanews.com.cn>; and *China Newsweek*, August 22, 2005, 24. For the latest review of China's health-care system, see the World Health Organization, *A Health Situation Assessment of the People's Republic of China*, http://www.wpro.who.int/NR/rdonlyres/0267DCE8-07AB-437A-8B01-03D474D922CD/0/hsa_en.pdf.

⁶⁶ See Elizabeth Economy, *The River Runs Black: The Environmental Challenge to China's Future* (Ithaca: Cornell University Press, 2003); and Vaclav Smil, *China's Past, China's Future* (London: RoutledgeCurzon, 2003).

⁶⁷ The new leadership announced a 13% increase, or \$5.6 billion, for rural spending in 2006. See Edward Cody, "China Plans to Boost Spending in Rural Areas," *The Washington Post*, March 5, 2006, A19.

⁶² This can be seen in the ranking of human development for China, Vietnam, and Cuba in the United Nations Development Program's *Human Development Report*.

⁶³ Lian, *China by the Numbers*, 385–86.

⁶⁴ The World Health Organization, *World Health Report*, 2000.

Information Asymmetry, Monitoring of Agents, and Corruption

The apparent strength of an authoritarian developmental state is its capacity to mobilize the resources (mainly fiscal revenue) needed to increase investment in the economic sectors targeted by the government as engines of growth. The literature on the developmental state focuses on the state's capacity to overcome the collective action problem and market failure as the key to generating above-trend growth in late-developers. Unfortunately, the theory of the developmental state overlooks or assumes away another issue—the principal-agent problem. Like all large organizations, an autocratic developmental state relies on individual bureaucratic agents to implement its policies. Given the inherent problems of information asymmetry, an authoritarian state has great difficulty in monitoring and policing its own agents. Theoretically, authoritarian regimes should have greater problems of information asymmetry and difficulties in policing their agents because of the absence of a free press, opposition parties, and a strong civil society. In practical terms, an authoritarian developmental state with a serious problem of information asymmetry and a weak capacity to monitor and police its agents unavoidably will lose the ability to control the corruption by the same agents.⁶⁸ In other words, corruption by the insiders of the regime is the Achilles' heel of an authoritarian developmental state.

Post-Mao China is no exception to this rule. As a key part of reforms, China decentralized the control rights of the state's property (land, factories, and natural resources) and transferred significant administrative power to the lower echelons of the government. Such decentralization was meant to encourage local elites to take greater initiatives and increase economic efficiency. Whereas decentralization may have improved the incentive structure for local elites, it was not, however, accompanied by institutional reforms that would have increased the state's capacity to monitor and police these agents as well. To make matters worse, the failure to introduce democratic reforms in general and the suppression of the freedom of the press and civil society in particular have allowed newly empowered local elites to form rent-seeking collusive alliances among themselves (the most egregious manifestation of which is the local mafia states). Authoritarian developmental states are, therefore, always at risk of degenerating into authoritarian predatory states.⁶⁹

Academic studies indicate that such a degenerative process is quite advanced in China.⁷⁰ Official data and countless anecdotes in the Chinese press also provide several disturbing clues to the extent of official corruption. First, the amount of wealth looted by corrupt officials has increased dramatically, as indicated by the “large-sum cases” prosecuted by the court, which doubled in number from 1992 to 2002. Second, corruption is reaching the higher levels of the ruling elites. For example, the number of officials at the county-level and above prosecuted each year by the government rose from 1,386 in 1992 to 2,925 in 2002.⁷¹ Third, collusive corruption involving a group of officials now has become widespread. Select regional data suggests that these cases account for 30–60% of all corruption cases.⁷² In an authoritarian developmental state, collusive corruption is inevitable, being the optimal survival strategy for local elites who face no democratic constraints from below and know how to use the advantage of information asymmetry to deceive their superiors. In such an environment, denunciation by other local elites poses the most dangerous threat. The optimal strategy for eliminating this threat is to cooperate—indeed collude—with these elites.

The more that an authoritarian regime must depend on the same agents, whose corruption is endangering the long-term survival of the regime, to maintain the regime's security and power, the more the autocracy is ill-positioned to fight corruption; a serious anti-corruption drive will likely turn many of the regime's most loyal agents into its fierce foes and put the survival of the regime at great risk. This enforcement dilemma is clearly reflected in the Chinese government's half-hearted approach to combating corruption: as shown by official data, most corrupt officials face no serious punishment.

On average, each year in the 1990s 140,000 Communist Party officials and members were caught in corruption scandals, but 82% received no punishment and only 5.6% were criminally prosecuted. Despite the new leadership's vow to eradicate corruption, in 2004, of the 170,850 CCP

⁶⁸ For studies on how the Chinese government evaluates its officials, see Barry Naughton and Dali Yang, eds., *Holding China Together: Diversity and National Integration in the Post-Deng Era* (New York: Cambridge University Press, 2004); and Susan Whiting, *Power and Wealth in Rural China* (New York: Cambridge University Press, 2000).

⁶⁹ For a discussion on state degeneration, see Minxin Pei, *China's Trapped Transition: The Limits of Developmental Autocracy* (Cambridge: Harvard University Press, 2006).

⁷⁰ Yan Sun, *Corruption and Market in Contemporary China* (Ithaca: Cornell University Press, 2004); Xiaobo Lu, “From Rank-Seeking to Rent-Seeking: Changing Administrative Ethos and Corruption in Reform China,” *Crime, Law and Social Change* 32, no. 4 (1999): 347–70; and Xiaobo Lu, “Booty Socialism, Bureaupreneurs, and the State in Transition: Organizational Corruption in China,” *Comparative Politics* 32, no. 3 (2000): 273–94.

⁷¹ *Zhongguo falü nianjian*, various years.

⁷² <http://www.jcrb.com.cn>, Feb. 27, 2002; *China News*, Feb. 25, 2002, <http://www.chinanews.com.cn>; and <http://www.jcrb.com>, Nov. 5, 2002.

members whom government investigators found to have engaged in wrongdoing, only 4,915 were prosecuted.⁷³

Conclusion: Risk Factors for Future Growth

As discussed in the preceding section, certain growth-inhibiting characteristics are embedded in an authoritarian developmental state. Economic growth will be difficult to sustain unless these intrinsic characteristics of authoritarianism are removed or their ill effects mitigated through political reform. Undertaking political reform—especially democratizing reform—would, however, at the same time endanger the survival of the authoritarian regime itself, though such reform may improve the prospects of long-run economic growth. Understandably, few authoritarian regimes willingly reform themselves out of existence unless the alternative is imminent demise. Based on this perspective, the current Chinese leadership's uncompromising stance *against* political reform is completely rational, and the CCP will unlikely initiate political reform without first experiencing a powerful political or economic shock.

Yet the institutional flaws of autocracy materially affect economic performance and social stability. Maintaining the status quo for another ten to fifteen years in China will most likely result in faltering growth due to persistent economic inefficiency, rising systemic risks, and accelerated political decay.

Persistent Economic Inefficiency

To the extent that the CCP must maintain a huge political patronage as its base of support, systemic economic waste and inefficiency will be a significant drag on economic performance. The most obvious symptoms of such waste and inefficiency will be chronic financial hemorrhaging in SOEs, massive overcapacity, and misguided investment projects built more to burnish the record of local elites than to generate real economic returns. At the aggregate level, China's banking system, through which the CCP allocates investment capital, will bear the brunt of systemic inefficiency.⁷⁴ The system will continue to use cheap or free credit to sustain politically favored sectors and firms, while at the same time discriminating against the private

sector. Given the logic of political patronage and crony-capitalism, the state will keep protecting its monopolies in the most important economic sectors (such as finance, energy, natural resources, transportation, and telecom services). The allocation of factor inputs, most importantly land, will be determined not by market forces but by government fiat. The consequences of these systemic inefficiencies will be low returns on invested capital and an extremely fragile financial system saddled with impaired assets. Inefficiencies caused by flawed political institutions may not immediately drag down growth as long as China has strong economic fundamentals, especially high savings and investment rates. At the moment, China boasts a domestic savings rate above 40% of GDP and attracts \$50 billion of foreign direct investment per year. This pool of capital allows China to maintain an investment rate in excess of 40% of GDP and to generate robust growth even in an inefficient economic system. China, however, will unlikely be able to maintain such a high savings rate forever. Demographic changes around 2015 will increase both the population of retirees and the dependency ratio, inevitably causing the savings rate to fall. The fragility of the financial system will also prompt domestic investors to transfer wealth abroad, especially at a point when China's capital control becomes even more porous or is removed.

Rising Systemic Risks

A fast-growing economy that is simultaneously experiencing a rapid increase in inequality, massive environmental degradation, and social deficits will unavoidably accumulate systemic risks. At the current rate of increase, socioeconomic inequality in China could soon reach the level commonly associated with Latin American countries such as Mexico. High inequality may slow down economic growth both by limiting the growth of domestic consumption (since the poor will lack the purchasing power) and by increasing instability and lawlessness (as inequality exacerbates social frustrations and even legitimizes criminal behavior directed at the wealthy). Fearful of political instability and social disorder, investors would lose confidence and move their capital elsewhere. Environmental degradation poses a much greater risk. Estimates put the cost of environmental damage in China at roughly 8% of GDP.⁷⁵ With severely polluted major rivers, depleted underground aquifers, and inefficient use of water, China is experiencing enormous water-related environmental strains. The economic costs of water shortage, already severe, will likely exact a high price on growth performance, especially in the northern plains of China.

⁷³ *Zhongguo jian jianchabao* [China Prosecutors' Gazette], September 25, 1997, 1–4; and *China News*, Jan. 21, 2005, <http://www.chinanews.com.cn>.

⁷⁴ *Putting China's Capital to Work: The Value of Financial System Reform*, McKinsey Global Institute, May 2006, http://www.mckinsey.com/mgi/publications/china_capital/index.asp; Richard Podpiera, "Progress in China's Banking Sector Reform: Has Bank Behavior Changed?" *IMF Working Paper* 06/71 (Washington, D.C.: International Monetary Fund, 2006).

⁷⁵ The World Bank, *China 2020* (Washington, D.C.: The World Bank, 1997), 77.

Environmental degradation could spark political turmoil and social conflict as well, as its victims blame the state for inaction or even complicity and use desperate means to protect their livelihoods. The likelihood of an ecological disaster—such as a large-scale toxic spill polluting a major waterway, massive floods, or prolonged drought—increases dramatically in this high-risk environment. Even if such nightmarish scenarios fail to materialize, repairing the environmental damage that already has occurred will require tens of billions of dollars in spending, forcing the government to divert capital away from fixed investment and slow down economic growth. The additional health-care costs resulting from the effects of pollution will also be considerable.

The Chinese government's neglect of education and public health could endanger future growth prospects as well. This neglect obviously will result in a population that is not as well-educated, healthy, or productive. More important, underinvestment in education and public health tend to hurt the most disadvantaged and vulnerable segments of the population, thus directly contributing to inequality (with all its attendant ill consequences). The risks of a major public health disaster, such as an uncontrollable epidemic, will increase significantly. As demonstrated by China's faltering fight against the spread of AIDS and stumble in responding to the 2003 SARS epidemic, future public health shocks (for example, an avian flu pandemic) are likely and could be devastating in terms both of human lives and of economic costs.

Accelerated Political Decay

The ability of the CCP to overcome its manifold challenges depends to a critical degree on whether the party can effectively stop and reverse the political decay that, based on the symptoms and scope of corruption, appears to be well-advanced. The record of autocratic regimes in combating corruption, however, inspires little confidence. Because of several factors—dysfunctional mechanisms of political accountability, the suppression of both freedom of press and civil liberties, and the rule by man rather than by law—a monopolistic ruling party is extremely unlikely to be able to restrain the predatory behavior of its agents without introducing reforms that would empower civil society or strengthen the rule of law. If such is the case in China, the process of political decay will only accelerate in the decade to come.

Accelerated political decay inevitably will sap China's economic vigor. Corruption will weaken China's most vital economic organs, especially financial services (including banking) and infrastructure, which are critical

to future growth. Shady deals in the privatization of state-owned assets and in real estate development will deprive the state of much-needed revenues while enriching well-connected individuals. Pervasive crony-capitalistic practices will protect the vested interests of rent-seekers, thus limiting market competition and perpetuating inefficiency. Political decay also will undermine the Chinese state's capacity to cope with environmental degradation and public health crises because a corrupt officialdom habitually conceals information, covers up mistakes, and takes slow and inadequate actions against these threats to public welfare.

Ironically, the greatest victim of accelerated political decay would be the CCP itself, as the ruling party. The spread of collusive corruption within the party will fragment the CCP's authority and allow local elites to usurp party power. Once entrenched, networks formed by collusive officials would grow resistant to purges and anti-corruption campaigns launched by the central government. As its agents' own parochial interests diverge from the corporate interests of the CCP, the ruling party also will face increasing difficulty in implementing policies, having neither the means to motivate party agents nor the coercive instruments to force compliance. To the extent that corruption worsens socioeconomic inequality and de-legitimizes the ruling elites, political decay will further alienate the Chinese people from the CCP and further fuel social frustrations. Enfeebled from within and unloved by its own people, the CCP would be precariously positioned to weather the political and economic shocks made more likely by the process of accelerated political decay itself.

We may thus rule out the scenario of "Liberal Dream" (a strong democratic China transformed through peaceful evolution) and that of "Authoritarian Nightmare" (an economically and militarily powerful China ruled by a thoroughly unreconstructed autocracy). Given the pathologies embedded in a post-communist authoritarian regime, the most likely scenario for China would be either a frail autocratic giant or a weak new democracy. Yet the current policies of the West are based either on the "Liberal Dream" scenario (which justifies engagement) or on the "Authoritarian Nightmare" scenario (which calls for covert containment or, euphemistically, "strategic hedging"). Little serious thought or intellectual exercise appears to have been devoted to scenarios of a weak China, either democratic or authoritarian. Has China's past economic performance been so dazzling that those in the West have grown complacent and dismissive of China's underlying institutional flaws and frailties? If so, such complacency is irresponsible because these flaws—now more than just obvious—will inevitably derail China's rise.

For the global economy in general, and China's chief trading partners in particular, an economically faltering China would have serious practical consequences. Many of the rosy long-term scenarios of the growth in demand within China would not materialize. The price of commodities would likely fall as well. The much-feared oil shortage, based almost entirely on China's unquenchable thirst, would unlikely come true. In geopolitical terms, the critical bilateral relationships now cultivated by China with African, Latin American, and Asian countries likely would undergo gradual erosion; an economically stagnant China would not be able to underwrite these relationships with economic benefits (such as direct investments, aid, and imports), thus disappointing the countries in these regions that may have counted on China as an economic counterweight to the West. China would see its geopolitical influence quickly plummet in these regions. In Asia, China might find itself experiencing the same setback dealt to Japan after the bursting of the bubble economy in the 1990s. Beijing's capacity to wield economic power to gain influence in Asia would likely be undercut severely. Should India's economic rise continue at its current rapid pace, Asia's regional leadership role would migrate from Beijing to New Delhi.

Similarly, the business community in the West would experience a rude awakening as a result of such a scenario. Having bet heavily on China both as a source of demand for their products and as an offshore manufacturing center, these companies could find that strategies pursued on this basis fail to deliver the promised economic rewards. Subsequent re-thinking of the China market by these companies could lead to a dramatic curtailment of direct investment in, and sourcing from, China—a step that, while surely further exacerbating China's economic woes, nonetheless would fully reflect the habitual fickleness of foreign capital. China's relations with the West would likely deteriorate, not merely as a result of Beijing's declining economic importance but also because disappointed Western businesses would be much less willing to defend China's interests in their local capitals. Depending on the specific scenarios under which China's economic decline were to unfold, Beijing quite conceivable might accuse Western businesses and investors (especially hedge funds) of conspiring against the Chinese economy and causing the decline, a strategy that would help focus the attention of the Chinese public elsewhere but could further alienate Western businessmen and their politicians.

China's economic faltering would be a mixed blessing for the United States. The security threat envisioned by the Pentagon's planners would disappear, with China's military modernization grinding to a halt due to a lack of resources. Washington would no longer fear China's expanding influence in Latin America, the Middle East, Southeast Asia, and Africa.

The United States, however, would suffer economically. Because of the close economic interdependence between China and the United States, any significant economic decline in China would diminish U.S. access to markets, cheap credit, and profitable investments. More important would be that China's weakness would stimulate new non-traditional security threats that would emerge—potentially including risks of proliferation of weapons of mass destruction, massive environmental degradation, public health disasters, drug trafficking, illegal migration, money laundering, and counterfeiting. In many respects, the United States would have more difficulty addressing these threats since all originate within China and are protected by Chinese borders. Unless Washington finds a strong partner in the Chinese government, the United States would have few effective tools to contain these threats directly.

Since the West's economic and security interests would suffer significantly should China's economy falter as a result of the country's political stagnation, the strategic interests of the West would be best served by a rethinking of the current approach to China and an adjustment to the strategy of focusing on economic engagement as the principal instrument of integrating China into the global community. The current approach, though having yielded rich dividends in the last three decades, also has shown its limits, especially in helping transform the Chinese political system. A new approach, emphasizing China's domestic political reform as a benchmark of its integration with the West, would better serve Western interests. Western governments and businesses would do well to work as partners, not adversaries, to better protect long-term interests in China; rather than hoping for modernization-induced political change, the new course would aggressively promote democracy, human rights, and the rule of law.