

Singularity and Replicability in China's Developmental Experience

Barry Naughton
IR/PS, UC San Diego
La Jolla, CA 92093-0519
bnaughton@ucsd.edu

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What lessons does China's experience offer? It is perilous to try to extract simple lessons from such a complex experience. The Chinese environment is singular: size, factor endowment, policy trajectory, and historical conditions are all unique. Yet because of China's importance and developmental success, people will continuously draw conclusions about the meaning of the Chinese experience. In turn, we can draw lessons both from the insights and from the shortcomings of existing ways that China's experience is interpreted. I start with some simple propositions:

Introduction: Five Paradoxical Propositions

1. China is an important model and many draw lessons from its developmental success.
2. There is no consensus about what these lessons are, and many supposed lessons are inconsistent, incompatible or just plain wrong.
3. Despite China's remarkable institutional creativity, there is **no** specific institution which one can responsibly recommend should be replicated in other developing economies.
4. Institutional innovation in China involved modifying and strengthening, as well as abandoning, existing hierarchies. Chinese institutional innovation was highly specific to the existing institutional context, and made use of existing organizational capital at each step of the transition process.
5. Since no country has an institutional endowment similar to that of China, no country should adapt China's specific experiences. However, the *process* of institutional innovation in China can provide many lessons about the nature of institutions and the interactions between institutions and the development process. Developing countries may be able to strengthen their capacity for institutional innovation by examining China's experience.

The influence of the Chinese model has usually come not in the form of discrete lessons, but rather as a contribution to the updating of world views; that is, in revising the economic ideologies and viewpoints used to steer through complex economic phenomena. A wave of such updating occurred during the 1990s, following the collapse of Communism; and another wave is occurring now in the face of the collapse of the U.S. financial system. China has played an especially ambiguous role in the updating of economic viewpoints. I propose to address the significance of the Chinese experience by first looking at the most common ways that people have interpreted that experience. I am less concerned with analytic insight at the beginning, but rather with the formation of

various “folk wisdoms,” the relatively simple ways that people have incorporated China into existing world views while partially revising and updating those views.

When we examine China’s impact in this way, we discover that there is no agreement about the meaning of the Chinese experience, but that the prevailing folk wisdom does sort into two clusters, into, as it were, two big baskets of lessons. There is certainly no “Beijing Consensus.” Ironically, it is difficult to identify a single point on which something like consensus might exist.¹ Nevertheless, the prevailing folk wisdom does sort into two big baskets: two clusters of lessons, each of which is “comfortable” in the sense that it brings together many sharp insights that are compatible with each other. However, the two baskets do not comfortably co-exist, and indeed clash on many important points. Some insights can be drawn from the clash of their incompatible viewpoints.

1. Two Versions of the Chinese Experience

Of the two primary sets of folk wisdom circulating about the Chinese experience, the first begins with the political implications. It stresses the need for an active and decisive national leadership, and emphasizes that this is compatible with economic growth and may be good for it. In order to sharpen the contours of this version I link it to the observed political processes in the developing world today that have been called “authoritarian upgrading,” (Heydemann 2007) or “Authoritarianism 2.0” (Spector and Krickovic 2008). This is the area in which the Chinese experience is set off most starkly against the prevailing ideas and policies seen as being promoted by the US, and reflecting US interests. It is therefore probably the most *influential* of the various lessons circulating, although it has limited appeal in the US and other developed countries. In this version, the central element of the Chinese experience is seen as the success China’s leaders have achieved in moving from an authoritarian system in disarray and creating a dramatically revised, but still authoritarian, system that achieved success in increasing economic benefit and distributing those benefits to a large swathe of the population. We might label this a consultative, growth-driven authoritarianism.

The adaptation of the Chinese experience in “authoritarian upgrading” can be summarized in several key points:²

¹ Ramo (2004), who suggested the term “Beijing consensus,” is an impressionistic canvas of imaginative description.

² I have adapted these points from Heilmann (2008b); Heydemann(2007); and Spector and Krickovic (2008), who each give slightly different but consistent versions. My apologies to these authors for occasionally oversimplifying their analysis.

1. A paramount emphasis on national sovereignty as an essential precondition that allows states to pursue domestic economic reforms without succumbing either to outside domination or international instability. (Thus, this version tilts against interpretations of globalization that emphasize the dominance of international economic forces and the reduced importance or maneuvering room of national governments.)

2. Maintaining control over core parts of the economy, while liberalizing the market economy overall. Markets are the basis of all allocative decisions, but government ownership or ownership by close client or ruling groups dominates sectors with natural or policy-based entry barriers.

3. Create a consultative apparatus while limiting the autonomy of civil society and opposition groups. Establish formal procedures for social groups to influence policy, but condition that influence on acceptance of the regime-dictated framework. Work hard to understand competing social agendas and actively pre-empt them. Manage political contestation by introduction elements of competition for lower offices.

4. Government-sponsored infrastructure development and technological upgrading. Key importance is given to building telecommunications systems, even while allowing a modest, fragmented “blogosphere.”

5. Promote international economic and political linkages.

This version of the Chinese lesson has spread broadly in the developing world. By this definition, Russia is now following the China model, and so are Egypt and Kazakhstan. The model is broadly influential in Africa and in some parts of Latin America, such as Venezuela, Bolivia, Ecuador, Nicaragua, although it is impossible to say that any single country exemplifies the application of this model.

At the core of this folk wisdom is the conviction that successful economic growth gives a regime the resources it needs to maintain power and stability. By capturing the benefits of economic reforms and growth and spreading them reasonably widely among the population, a regime can survive and stabilize itself. This can work only because it turns out that both the regime and civil society are willing to compromise. The regime must be willing to reign in its inclination to arbitrary and capricious rule; having promised influence in return for obedience, it must now actually listen to broader elements of the population and adapt policy to their interests as well. Civil society accepts limits on its activity in return for improved economic conditions and a degree of personal security and property rights. Of course, the bargain is not symmetrical, because the regime has much greater ability to police the compact, and it is difficult for civil society groups to police government misbehavior.

The contrasting interpretation of the Chinese experience is primarily economic, and it has also coalesced into a kind of folk wisdom. This interpretation places its focus on a very different set of phenomena:

1. A paramount emphasis on the gradual expansion of market forces as the essential precondition that allows accelerated economic growth. Expansion of market forces is generally seen as a consequence of the steady withdrawal of direct government control over the economy.

2. Government policy toward the economy is marked by caution and pragmatism. Flexibility and the experimental approach are linked to “gradualism,” often by invoking the Chinese expression “crossing the river by groping for stepping stones.”

3. Opening to the outside world, and adopting policies to facilitate foreign direct investment, particularly in export industries. Special economic zones used to accelerate the process.

4. Strong and consistent government emphasis on economic growth, and on investment as a means to achieving economic growth.

5. Sequencing: A preference for market opening, even if partial; entry should proceed rapidly, market regulation can follow. Dual track systems of plan and market can co-exist. Product market liberalization precedes factor market liberalization. Technically more difficult reforms such as privatization and capital account liberalization can be deferred for longer periods, measured in decades.

At the core of this folk wisdom is the conviction that government withdrawal from markets is essential to driving successful economic growth. The economics folk wisdom and the political folk wisdom direct their attention to very different parts of the Chinese experience; indeed, we could say that they face in opposite directions, and reach almost opposite conclusions about what the meaning of the Chinese experience is.

What do these two conceptions have to do with each other? Of course, a smart analyst can reconcile them. It could be argued that they don’t engage at all, that they deal with different aspects of the transition process, one political, one economic, and are thus essentially orthogonal. Or it could be argued that they are essentially complementary: A government that withdraws enough from the market economy creates prosperity, which can then be translated into political stability and national autonomy. China’s developmental success then represents a kind of dialectical compromise between the political and economic sides of the model, and the particular political form of the government—the shape of the political capital created—is an arbitrary choice reflecting political and social endowments. These views are plausible, but they overlook the more fundamental conflicts between these interpretations. In fact, I argue that there are two important contradictions between the two versions of the Chinese experience, and that

understanding those contradictions can give us a better insight into the shortcomings of each folk wisdom.

In the first place, the authoritarian upgrading interpretation implies significant revision in the goals of development, both in terms of what is desirable and what is feasible. It directly challenges electoral democracy and unfettered market operation, asserting a crucial role for government control in creating stability, maintaining national autonomy, and thereby boosting other developmental goals. By contrast, the economists' folk model does not require revising anything about the goals of development. It is consistent with the view that development will ultimately bring about prosperous societies accompanied by a democratic, regulated market economy. This distinction is important in informing attitudes that people have about the Chinese experience, whether it is positive and whether replication of the Chinese experience would be a good thing to contemplate. In developing countries, the rough consensus in favor of democracy and a market economy that emerged in the 1990s has weakened substantially, and not just among authoritarian leaders. Some see this as threatening,³ and we should be aware that differences in evaluation criteria shape different understandings of the Chinese experience.

It is the second area of contrast between the political and economic folk models, though, that is the focus of attention here. This is that the political model emphasizes the conscious and intentional modification of the structures and institutions of the authoritarian regime. In the political model, the authoritarian government is seen as having been under pressure, and as a result having tried out new policies and organizational models in order to shore up its longevity. In other words, the regime is organizationally entrepreneurial. The economic model, in its folk form, ignores purposeful modification and institutional creativity altogether. In the economic model, the government retreats, and the market rises. If political changes are discussed at all, they are equated with democratization, and they are regarded as having been deferred.

The thirtieth anniversary of China's reform process (1978 to 2008) has given many commentators an opportunity to reflect on overall patterns, so we see many recent examples of the economic folk wisdom:

Yet the process by which these astonishing changes have occurred owes as much to accident and experiment as to grand design. Deng likened his non-ideological,

³ "As developing nations watch the convulsions in world financial markets, they may well decide that China's model of a kind of centrally controlled capitalism is more attractive than the American model of unfettered capitalism. The danger now is that developing nations could turn instead to the Chinese model of government, with managed mercantilism as the favored approach" (Seib 2008)

gradualist approach to “crossing the river by feeling for the stones”. Many of the so-called market reforms were little more than giving space – often by turning a blind eye – to what China’s entrepreneurial citizens were already doing..... The Communist party appears to have brought 30 years of spectacularly smooth growth.... But that obscures often desperate flailing as the party cranks this lever and that to produce the economic progress on which its survival ultimately depends (Pilling 2008).

Pilling’s comment exemplifies the economics folk wisdom, perhaps in a somewhat exaggerated form (but see also Economist 2008; Huang 2008). It gives all the attention to the expansion of the market arena (indeed, attributing it to things Chinese citizens were already doing!), and characterizes official policy-making as “desperate flailing,” as if maintaining macroeconomic stability, carrying out tax reform, and engaging in massive infrastructure construction were merely incidental things that all developing economies carried out as a matter of course. Curiously, the economics folk wisdom is very good at seeing that Chinese policy-makers learned as they went; that they tried out many policies and retained only a sub-set; and did not launch the transition process with a grand design. Yet they do not seem interested in, or able to encompass, the actual process of learning and discovery that may have gone into the policy process. Neither transformation of institutions nor policy experimentation plays much of a role in the economic folk wisdom, which is extremely unfortunate.⁴

The “authoritarian upgrading” model seems to give China’s leadership too much credit for institutional changes and developmental success; in this model, the Chinese Communist Party’s self-serving narrative about correct decision-making is accepted at face value. But ironically, by under-emphasizing the unprecedented nature of the challenges China has faced, and the experimental, exploratory aspects of policy, this version actually gives too little credit to the Chinese policy process. The wholesale recasting of development strategy to conform with China’s factor endowment (Lin 2007) doesn’t receive adequate attention, and as a result the political model seriously underestimates the uniqueness of China, in terms of size, developmental stage, and readiness for growth. Oddly enough, the political model doesn’t give Chinese policy-makers *enough* credit for the sheer canniness of their economic policy-making.

By contrast, the economic model accepts an overly restricted version of the institutions at play in the Chinese transition and development experience. In the face of the extraordinary complexity of the Chinese institutional setup (itself perhaps a function of size: compare India), many observers simply throw up their hands and say, in essence,

⁴ Of course, there are much more sophisticated versions of the Chinese transition policy process, whose insights do not get picked up in the various folk models.

the process has been in the direction of market forces. As a result, the process of institutional innovation and discovery that is at the heart of the political model gets neglected. This means that the economics folk wisdom has forgotten one of the key lessons of the classic analysis in Stiglitz (1999): that conserving scarce organizational capital through institutional adaptation is one of the key advantages of a gradual transition path. But what institutional innovations made in the course of Chinese transition could potentially serve as models for other developing economies?

2. Are there any Chinese Institutional Innovations that are potentially Replicable?

The Chinese experience development experience has been marked by an extraordinary institutional creativity. A number of unique Chinese institutions and terms have gradually seeped into the awareness of those concerned with international economics: township and village enterprises (TVEs), dual-track system, and “growing out of the plan.” Specific Chinese organizations such as SASAC (State Asset Supervision and Administration Commission), and NDRC (National Development & Reform Commission), have gained some name recognition. Yet if we ask which of these institutions can be recommended for imitation by other developing economies, the answer has to be, “none.” That is, among all the remarkable institutional improvisations in China, among all the institutional solutions that China devised to tricky transitional problems, there is none that is so successful, and so robust to context, that we would feel comfortable recommending it to other countries. Of course, posing the question in this way means framing the question about the replicability of the Chinese experience in a particularly narrow fashion: What Chinese institutions can we recommend for adoption by other developing or transitional economies? By asking a narrow question we obtain a refreshingly clear and straightforward answer: None.

Before proceeding, we must deal with one apparent exception. Hasn't the Chinese policy of Special Economic Zones (SEZs) been replicated around the world? This is the exception that proves the rule. It is true that Chinese SEZs have been an inspiration in many countries, including most strikingly India, with its SEZ policy of 2000 and SEZ law of 2005. But of course China did not originate the SEZ, which came from Ireland (after 1958) and Taiwan (1966). Indeed, ironically, India even had its own unsuccessful Export Processing Zone at Kandla in 1965, though it was not successful. So while China may well have emboldened policy-makers in India and elsewhere to give new priority to SEZs, this can hardly be considered a Chinese innovation.⁵ Indeed, what

⁵ “The prime mover of the [Indian SEZ] proposal, the Commerce and Industry Minister, Mr. Murasoli Maran, has been highly impressed by the stunning success of the Chinese SEZs.” Ashok Kundra (Chairman

is most innovative about Chinese SEZs (aside from their sheer incongruity in the Chinese planned economy of the early 1980s) is size, multi-functional use as a laboratory of multiple types of reforms, and openness to the domestic economy (Naughton 2007: 408-410). India has taken note of some of these, for example requiring new SEZs to be over 10 km², but overall Indian SEZs are much more like standard Asian Export Processing Zones than like Chinese SEZs. Nothing exceptional about Chinese SEZs has been imitated in the outside world. Chinese SEZs are not a good candidate for replication.

Why, then, are there no Chinese institutional innovations that travel well? In fact, this is because the most important Chinese institutional innovations represented careful compromises between the pre-existing institutional framework and the innovations necessary to support economic growth. Innovation was carefully adapted to the existing institutional landscape. We can illustrate this point through three examples.

The first example is that of township and village enterprises (TVEs), arguably the most distinctive and certainly the best-analyzed element of China's success. TVEs combined local public ownership with freedom to enter and profit from entrepreneurial skills. As many analysts have recognized, giving a stake in the entrepreneurial start-up to the local government was an effective second-best approach to overcome bureaucratic obstructionism (Chang and Wang 1994; Che and Qian 1999; Rodrik 2008). TVEs were dependent on a unique compromise about property rights. What has been under-emphasized is that to make this compromise possible within the framework of China's existing administrative hierarchy it was necessary to repeatedly adapt that hierarchy to make it compatible with the new institution. Budgetary arrangements were relaxed so that TVEs and their local government owners could retain large shares of increased revenues; and superiors with personnel authority agreed to keep successful managers and village officials in place for long periods, giving them appropriate time horizons for the task of long-run economic growth. The existing administrative hierarchy, in other words, was repeatedly adapted to provide appropriate incentives and continued enforcement of government policy. At the same time, revisions accommodated the existing distribution of power. Local government officials had power: TVE governance rules were restructured in ways that acknowledged that power, but shifted the incentives for the types of behavior that would be rewarded. This type of "fiddling" within the existing institutional structure continues on to the present, although the vast bulk of TVEs have been privatized for a decade or more. Even more dramatic changes in budgetary rules have occurred in the past 3-4 years, as agricultural taxes have been abolished and a system of inter-governmental transfers set in place; even as restless changes have taken

of the Indian Tariff Commission), "SEZs: how well will they perform?" *The Hindu*, August 16, 2001, accessed at <http://www.hindu.com/thehindu/2001/08/16/stories/06160001.htm>; see also Ministry of Commerce and Industry, "Introduction to India's SEZs," at www.sezindia.nic.in

place in the degree of village democracy. Most villages elect their own leaders. TVEs are sometimes regarded as “informal” institutional adaptations, but this is not correct. Although regulations were complex, they were clear to market participants. TVEs became important within a hierarchical institutional context that was constantly being adapted to meet the needs of economic growth and institutional innovation.

The second example is the dual-track economic system. While this term is sometimes used to cover a wide variety of phenomena, the most striking and thus paradigmatic application was its use within the state-owned enterprise (SOEs) sector. While the average TVE never had a compulsory output plan, virtually all SOEs did. A key innovation was allowing SOEs to buy and sell at market prices, on the condition that they fulfill their annual compulsory output and purchase plan. This gave firms access to market prices “on the margin” and got them started on the many changes in orientation and operations needed to adapt to a market economy. After operating the dual track system for a decade, the transition was so smooth that when the compulsory plan was abolished at the end of 1993, there was scarcely an economic ripple. Yet again, this dual track was not the result of a simple withdrawal of the planned economy. At least three active policy measures were required to make it work. First, the compulsory output plan had to be set at a slack level, or frozen, in order to ensure that individual firms had sufficient capacity to produce for the market. Second, firm managers had to have a financial interest in increasing profit, and experimentation with financial incentive systems (in the early and mid-1980s) was an essential precondition of the widespread adoption of the dual-track system (during the mid to late-1980s). Third, and least recognized, is that the administrative hierarchy itself had to be restructured and given a new set of incentives to make it compatible with this kind of profit-oriented activity. In fact, during the 1980s and 1990s, China adopted massive reforms of its hierarchical system (Naughton 2008). Those reforms completely threw out the old set of incentives and career paths, and replaced them with a set of incentives that were much more explicit; much more high-powered; much more focused on economic growth; and were made consistent with newly restructured career paths that were much more predictable as well. These changes re-focused the attention and behavior of bureaucrats in the hierarchy in a way that was highly compatible with the incentives of SOE managers, and allowed the dual-track system to take root, and ultimately led the economy to grow out of the plan. The hierarchical institutions, again, have been continuously adapted to meet the needs of economic growth and institutional innovation.

For a third example, we may take the complex of institutional measures taken to create China’s super-high domestic saving and investment rate. As most know, China for the past several years has invested over 40% of GDP in new fixed capital, and along with a current account surplus—that soared to 8% of GDP in 2007—domestic saving was

almost 50% of GDP over the past few years. The Commission on Growth and Development (2008: 34-37) gives first priority to high investment in their list of policies associated with rapid growth. They note approvingly that China invests even more than the 5-7% of GDP that they recommend for physical infrastructure investment. What many do not realize, however, is that this substantial investment effort has not been a consistent characteristic of China's reform era. For more than a decade after reforms began, China under-invested in infrastructure as it gave the economy a breathing space after decades of extravagant socialist investment plans. As late as 1990-1992, China was investing only 4% of GDP on physical infrastructure (narrowly defined as transport, communications and electricity). The extra-ordinary saver and investor we know today only emerged after the mid-1990s, after almost 20 years of successful reforms. China's investment in (narrow) physical infrastructure jumped above 6% of GDP in 1993-97, and then jumped again to 8% of GDP and above after 1998. What did China do to achieve this remarkable investment effort?

In essence, China subordinated most institutional issues to the quest for a high and adequate investment effort. A high investment effort and a rapid growth rate have been consensus objectives of Chinese leaders for the past fifty years.⁶ The leadership was alarmed at the under-investment of the early 1990s, and worried broadly about the declining effectiveness of the national government. As a result, they focused institutional development on measures that would strengthen the government and restore its ability to lead investment programs. Since the beginning of reforms, China had maintained a positive rate of return to savers. Inflationary episodes had occurred but had generally been controlled with 18-24 months, and depositors had been protected with inflation supplements. As a result, household saving rates had increased at the beginning of transition and stayed high. There had never been an expropriation of saving balances such as happened in other transitional economies.

Nevertheless, the investment effort was deemed inadequate. In order to address this issue, China began a massive series of institutional reforms:

- The tax system was overhauled in 1994, giving China a much broader tax base, and substantially increasing the central government's share of the total tax take;

- State enterprises that dominated infrastructure provision were allowed to retain all after-tax profits, providing a dedicated financial source for some infrastructure investment.

- Key infrastructure sectors were restructured to reinforce state domination but provide oligopolistic competition between 2 or 3 main providers: this was true of telecom, electricity, and airlines, while railroad remained a de facto monopoly. Entry barriers kept

⁶ The Growth Commission notes the importance of national leadership in generating growth (pp. xx-yy), and it is certainly true that leadership consensus on this issue strongly characterizes China.

profitability high while rivalry ensured that re-investment would also be high in these sectors.

---Policy banks were set up within the state banking system to systematically channel funds to infrastructure investment.

---After 1998, central government infrastructure bonds were issued to add another financial source.

Yet all these innovations were complementary to a fundamental, ongoing characteristic of China's institutional set-up. Local government officials have long had a strong incentive to invest in both infrastructure and productive (revenue-generating) investment projects. In part, this is due to soft budget constraints—the asymmetric structure of risk and return in projects, an asymmetry that characterizes bureaucratic decision-making in most places. In part, the strengthening of incentives to expand revenue-generating activity that was referred to in the description of the dual-track system may have further increased local official's incentives to invest. In either case, local officials have strong incentives to invest so long as they can gain access to funding. Nor is this a transitory characteristic of the Chinese system. On November 10, 2008, the Chinese government announced a fiscal stimulus plan to respond to the global financial crisis, envisaging a 1.18 trillion RMB increment to central government investment spending, designed to elicit more than 2 trillion RMB in additional local government investment. In fact, within two weeks, local governments proposed an astonishing total of 18 trillion RMB (about US \$2.5 trillion and 60% of GDP) of local projects. Clearly, local governments still see the possibility of soft budget constraints when it comes to investment spending.

What do these three examples show? They show very strongly that Chinese gradual marketization cannot remotely be described as a simple withdrawal of the state and revival of an autonomous market sphere. Instead, marketization has always been accompanied with a process of institutional adaptation and innovation. That institutional adaptation has been closely tied to specific characteristics of the Chinese environment—of course—but more concretely to the chains of authority and delegation that cross over from the economic to the governmental side of the economy. These institutional adaptations are therefore obviously unsuitable for imitation by other economies that have totally different institutional characteristics. It is not that China is unique, it's that all economies are unique and vary substantially in institutional context and endowment.

Each of these institutional adaptations involves messy trade-offs and obvious costs as well as benefits. Each institutional innovation involves a compromise with existing power-holders that would not be at all desirable, except that the co-optation of existing power-holders is part of what has ensured the success of the innovation. None of

these institutional innovations are “best practice,” because all involve accepting and perpetuating significant market distortions, while failing to permanently lock in unambiguous property rights and new arms-length regulation. Indeed, even the essential “flexibility” and “pragmatism” of the Chinese approach turns out, on closer inspection, to be deeply intertwined with the institutional peculiarities of the Chinese system. Heilmann (2008a) shows that China’s experiments were embedded within the political system and characterizes it as “experimentation under the shadow of hierarchy.” This is realistic, and a far cry from the implicit model of open-minded empiricism that is sometimes imputed to Chinese reformers.

3. Features of Institutional Change in China

Since we will search in vain for a specific Chinese institution that should be replicated in other developing economies, we must re-frame the questions about the replicability of the Chinese experience and the lessons to be learned. First, what does the Chinese experience tell us about the way we conceive of institutions? We looked at Chinese institutional innovation as being fundamentally adaptive: How does this adaptable institution view compare with the way that institutions are generally viewed in economics? Institutional economics has certainly been flourishing in economics in recent years, but in terms of economic growth, most of the work has focused on the causal relationship between “high quality” institutions and economic growth. In this work, institutions are generally taken as exogenous. Institutional innovations that strengthen property rights, lengthen their time horizons, and give individuals stronger and more reliable rewards for economically productive behavior elicit a response. Better institutions lead to more productive activity, increase investment and ultimately create economic growth. There is much in the Chinese experience that conforms to this interpretation. The *outcome* of individuals responding to better incentives clearly fits. Incentives for saving, investment and entrepreneurship in China have been dramatically strengthened. From the top to the bottom of the society, individuals have responded to these incentives with a dramatic increase in productive behavior. This is the truth at the core of the marketization narrative.

However, institutional economics provides surprisingly little guidance in explaining what types of institutional innovation have been adopted in China. Clearly, institutional mechanisms and institutional quality are not exogenous to the Chinese institutional environment or political system. Nor does it seem that those reforms were adopted first which promised the biggest efficiency gains. Instead, institutional innovations are adopted only when they both promised efficiency improvements and were acceptable to existing power-holders. We can discern some important patterns in the way institutional innovations have been adopted.

First, existing institutions have been widely “repurposed.” We have almost never seen in China a case in which completely new people have been brought in to staff a new administrative function. Instead, existing organizations have been given incentives to shift their mission in a more compatible with a market economy. Promotion patterns within the existing organization change to reflect new qualifications for the new mission, and over time a new generation brings organizational ethos to the top. This is assuredly a gradual pattern of institutional change, and it allows the transition process to reap the huge advantages of “preserving ‘lumps’ of social and organizational capital” (Stiglitz 1999). It has the cost that old ways of doing things only gradually die out, as an elder generation passes from the scene. This organizational persistence may also inhibit the adoption of certain kinds of transplanted institutions.

Second, partly due to the above, many institutional innovations have the character of a bargain, or contract, between the existing power-holders and the needs of a more efficient, growth-oriented policy. That is, institutional changes succeed because vested interest groups are brought into the new institutional set-up. Their interests are protected up to a certain extent. We see this, for example, in the way that bureaucrats are brought into new corporations *and* new regulatory institutions. In a broader sense, it is possible to argue that the whole transition process fits into such a pattern, since Communist Party leaders have been given a stake in the marketization process, and became reasonably confident that marketization would benefit themselves and their families. If one imagines the Chinese reform process as a Coasian bargain between growth-oriented reformers and vested interest groups, one can capture almost all of the key dynamics. Economic nationalism provides a common language for the various groups to communicate, and an expanding economy the resources to consummate the bargain.

Third, there is an enormous amount of institutional innovation in the system, most of which fails. Institutional innovation rewards entrepreneurship. Entrepreneurs find the opportunity for gain in the discovery of a new way of doing things. The system is set up in such a way that political entrepreneurship is rewarded. In that sense, the political system resembles the economic system: investment and entrepreneurship are rewarded, while the costs of failure are dispersed over the system as a whole. Local government officials have plenty of opportunities to exercise their “animal spirits,” by promoting local programs that might get them noticed in Beijing, and ultimately promoted. This generates a lot of wasteful activity, but it also succeeds in generating a lot of institutional innovation. It is crucial that China’s size and quasi-federal governmental structure provides an opportunity for innovators to fail without causing enormous systemic damage. As Heilmann shows, local experimentation occurs under the shadow of hierarchy, so that

experiments are frequently limited or cancelled when they appear to be failing, or running out of control.

Fourth, because experimentation is constantly occurring within an overall institutional context that is fairly well understood and monitored, there are rarely catastrophic failures of institutional implementation. In other words, there are usually not huge divergences between new rules as promulgated and their enforcement in practice, or, more accurately, when such divergences occur they are usually corrected reasonably quickly. Periods of uncertainty during rapid institutional turn-over are rare. Those episodes when market participants are uncertain what the new rules are, and daring but illegal behavior promises outsized gains, occur relatively infrequently. We can see this most clearly in the process of financial reform. Through the 1990s, China adopted program after program of financial sector reform, most of which failed. Investment trust companies, hothouse stock markets, and a wide array of bond-like fund-raising instruments were tried, but none fully succeeded and many ultimately collapsed. In many cases, individuals benefited from the failed experiments, and in all cases, the ultimate costs showed up on bank balance sheets as non-performing loans. Put together, these efforts could be described as a financial debacle, and they contributed to the ultimate write-off of more than a third of GDP in non-performing loans in the late 1990s-early 2000s (Naughton 2007: 462-63). Enormous real costs were involved in this failed experimentation, but the system was able to absorb the costs without a catastrophic financial crisis or breakdown. As Stiglitz (1999) points out, it is precisely in the financial sector where the agency chains are longest that we should expect the most difficulty in establishing a new functioning system. Chinese experience certainly bears this out: we are only today witnessing a halfway credible attempt to get a functioning modern financial system up and running. The Chinese experience was not in avoiding the costs of financial experimentation and failure, but rather in containing those costs such that other developmental processes could go forward.

Fifth, there is constant discussion and debate about growth, the institutional set-up, and proper strategic decisions. The debate about economic choices in China comprises at least as broad a range of alternatives as similar discussions in the US and Europe. The discussion is extraordinary lively and encompasses a range of options. Moreover, discussion is often future-oriented and accompanied by “planning.” An enormous amount of planning takes place in China, and has since the very beginning of economic transition thirty years ago. A great deal of this planning is unrealistic, or suffers from an immense disjunction between goals and instruments. Indeed, much of this planning is difficult for outsiders to understand, since it seems unrealistic and anachronistic. But these planning exercises do mean that policy-makers are forced to be explicit about their expectations and objectives. As a result, failure is relatively evident. Although the

political system mutes the publicity given to failure, it is fairly obvious to insiders. Policy is therefore subject to continuous appraisal and re-appraisal, and regular mid-course adjustments. The quality of debate has been high, as stressed by the Commission on Growth and Development (2008: 67-68)

In other words, what the Chinese experience tells us is that institutional innovation is not exogenous, but rather emerges from a national institutional framework. Perhaps it is not unreasonable to make an analogy between national institutional innovation system and the more orthodox “national innovation system,” as in Nelson (1993) and much subsequent literature. The analogy is not exact because a national innovation system includes organizations whose primary function is to produce technological innovations. There are no such organizations in the Chinese institutional innovation system. But the overall environment that generates and evaluates institutional innovations in China is relatively robust. If there is anything about China’s developmental experience that can be usefully studied and adapted by other developing countries it is the generally supportive environment created for institutional innovation.

4. Lessons and Conclusions

Examination of the Chinese experience leads first to some insights about the nature of institutions and institutional change, and subsequently to some tentative suggestions for the practical lessons for other developing economies. The process of institutional change in China shows the enormous role played by institutional “repurposing.” This shows clearly that many different institutional forms are functional substitutes and that, as Rodrik (2007) stresses, there is no one-to-one mapping between institutional forms and institutional functions. There are many more-or-less good institutional forms that can be harnessed to provide long-run incentives that are compatible with economic growth.

This brings the endogeneity of institutional innovation into sharp focus. Institutional innovations in China have typically been compromises between the desire to reward productive behavior and the reluctance to surrender control over resources. That is, a closer look at institutional innovation reveals the extent to which it is interwoven with political systems and struggles over power and resources that are inevitable, but may not be pretty. However, this is true of all institutional innovation, so it doesn’t make sense to ignore it in our discussion of specific cases. The interweaving of institutional choice and power and implementation means that there is limited usefulness in treating institutional analysis as a form of comparative statics. It is not very useful to treat the movement from centrally planned to market economy as a comparative static problem, in which the objective is to move from one equilibrium to another. It may be true that there

is a long-run trend to convergence in relatively similar capitalist market systems, but this process seems to unfold only over the very long run. Indeed, even the American variant of this developed and regulated market system seems still to be very much a work in progress, and how much more true is this of developing economy variants.

Although the Chinese system is very good at generating indigenous institutional innovation, it has a decidedly mixed record of adopting outside institutions. Indeed, since the mid-1990s, China has adopted the whole panoply of “best practice” corporate institutions, at least in theory. The modern corporate organization has been adopted, even in state-owned firms, along with regulatory institutions that are, in theory, independent. But most observers would agree that the adoption of these transplant institutions has been decided slow and uneven. Most importantly, the transplanted institutions do not seem to have really taken on the institutional functions they originally evolved to take on. Instead, they robe traditional administrative hierarchies, giving bureaucrats new procedures and tools for decision-making, but not altering the traditional distribution of authority. This imperfect transplantation may be concomitant to China’s strong record of generating domestic innovation. The conservation of social and organization capital and the compromise with existing power structures may liberate indigenous innovation but retard the adaptation of transplanted institutions.

For most developing countries, the question will be whether they can replicate some aspects of the Chinese experience. The analysis presented here suggests that the most important benefit would come from imitating some of the institutional entrepreneurship that underpins Chinese transition success. Of course, it is meaningless to copy the Chinese “national institutional innovation system,” but there are some aspects of the overall Chinese intellectual and institutional environment that could usefully be replicated:

First, the overwhelming consensus in China in favor of economic growth can be usefully transplanted to other developing economies. National governments can demonstrate both the overall “future orientation” and the conscious choice of growth as an “overarching goal,” of the nation, as recommended by the Commission on Growth and Development. But obviously this will not be done by having governments make grandiose statements about growth, which will lack credibility. In fact, it can only be done by having pervasive planning processes, where planning involves articulating objectives; describing scenarios; and setting benchmarks. The failed process of trying to achieve a single, centralized national plan has given planning a bad name; more plans, including more failed plans, can contribute to a shared future orientation and jump-start the process of institutional change necessary to achieve accelerated growth.

Second, institutional innovation needs to be focused on raising infrastructure investment rates. Many countries today are rolling out infrastructure investment programs to serve as stimulus packages in the face of the gathering world recession. China is among them. While it is reasonable to worry about the cost of poorly designed and built infrastructure, this trend is basically positive and should be encouraged. Developing countries should subordinate other legitimate concerns to the need to accelerate infrastructure construction. The pendulum has swung too far away from this kind of policy. At the same time, a stress on local institutional innovation may make it possible to expand infrastructure investment with less waste than in the past; home-grown mechanisms to provide proper incentives to maintain infrastructure in a sustainable fashion are quite feasible.

Third, a vigorous environment of economic debate and policy contention is essential. Although China is far from being a democracy, it enjoys a vigorous and robust discussion about nearly every aspect of economic policy. In part, this is simply one of the advantages of size: China's intellectual community is large because the population of concerned citizens is enormous. Robust evaluation and criticism can be achieved in many environments, and this helps to make institutional innovation possible by limiting some of the down-side risks.

Fourth, the good news is that a virtuous circle is involved in the process of growth and institutional innovation. As growth accelerates, people begin to shift their orientation, and it becomes easier to coordinate expectations about the future. Planning becomes more important and the quality of planning increases. Moreover, as income increases, the Coasian bargains needed to elicit acceptance of new institution become easier to strike. Short-term and long-term institutional solutions become easier to conceive, and the process of change is eased. Chinese experience certainly abundantly demonstrates this fact.

Overall, developing economies may gain by increasing the importance they attach to institutional innovation. Growth as a goal requires support for institutional change; the greater the extent to which institutional change can be locally grown, the more smoothly a developing economy is likely to move to a more rapid growth path. Today, few question the intrinsic benefits of gradualism in large-scale policy reform, if it can be achieved. However, we are still short of concrete advice that can assist countries in generating indigenous institutional change; strengthening overall system robustness-against-chaos; and harmoniously adopting growth-supporting institutional change. We face the odd conundrum that everybody talks about the Chinese model—and some even talk about a “Beijing consensus,” even though there is not a single plank of this so-called consensus that commands significant agreement. The Chinese experience strongly

enforces a general principle, that economic growth takes place when market and non-market elements of an economic system are in a healthy inter-dependent relationship with each other. But the Chinese experience equally supports the assertion that the specific nature of this inter-dependent relationship is indeterminate. There is no single or any simple correct way to handle this relationship.

As a result, there is no specific feature of Chinese institutional innovation that can be replicated. However, there will always be a demand for a few key simplifications of the Chinese experience that give others guide to action. As social scientists, and as China scholars, our responsibility is to provide those lessons where possible, but also to insist on the irreducible complexity of economic and social development.

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