## Is China Bound to Grind to a Halt?

**By Börje Ljunggren**

China and its ruling Communist Party are facing mounting problems, and institutions are at the center of the drama. It is with that thought in mind that I read Daron Acemoglu and James Robinson’s much-praised book, *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (2012), which addresses profound questions about economic and political institutions. It is not a book about China, but given China’s dramatic development during the last 30 years, I looked for what they had to say about China.

China is, however, a rather peripheral issue in their book. They devote just a dozen pages out of close to 500 to China, and do it in a surprisingly anecdotal way. Not a single economic study of China is quoted, even though the country’s economic rise may be considered the most dramatic happening in our time — and it has certainly lifted more people out of poverty in a shorter time than has happened anywhere else in history. The authors’ sources on China are limited to Roderick MacFarquhar and Michael Shoren’s classic books about the Cultural Revolution and Richard McGregor’s excellent book about the Communist Party. Acemoglu and Robinson do recognize that China has experienced a long period of “sustained economic growth,” but choose, without much evidence, to interpret this development as simply “an example of growth under extractive political institutions,” and “likely to come to an end, particularly once China reached the standard of living level of a middle-income country.”

The strength of the book is their ambition to look at economic as well as political institutions; the weakness is their tendency to try to fit everything into “one size fits all” reasoning. While it is very appealing from a value point of view, it causes empirical problems, leaving little room for hybrid ways of seeing things. They tend to take it for granted that the Chinese system will prove increasingly inadequate.

To be fair, Acemoglu and Robinson’s ambition has been to explain why nations succeed or fail,
not to analyze China’s exceptional performance in recent times. Still, given their prediction about China, it would be reasonable to expect a more specific analysis of China’s development since 1978 or the transformation of China’s economy from an autarkic one into the world’s leading export nation and an economy that is becoming deeply integrated into the global economy. Today, China alone accounts for more than one third of global growth. Whether China will keep growing or stall is thus no minor issue. China’s economic stagnation would have grave global consequences. In spite of all its institutional strengths, and China’s all too obvious weaknesses, the West has become dependent on the Chinese engine, and vice versa, and global recovery clearly lies in deeper integration.

The Chinese economy is, no doubt, facing growing problems that are aggravated by the continued global slowdown. There is a temptation to resort to stimulus measures, the way the government did in 2008, but that would deepen rather than resolve serious underlying structural problems. There are a great variety of views among scholars on China, but still broad agreement that more of the same cannot succeed. In this essay, I will develop my own views on the evolving Chinese drama in the light of some recent books of importance, in the process presenting a more complex and more challenging picture than the one sketched by Acemoglu and Robinson.

Among the most upbeat of the scholars is Justin Jifu Lin, until recently chief economist at the World Bank and now back at the China Center for Economic Research at Peking University. In his view, expressed in his 2011 volume, Demystifying the Chinese Economy, “China has great potential to continue the current dynamic growth for another two decades or more.” Lin bases his argument on the theory of the potential advantages of backwardness and the fact that when Japan, Taiwan and South Korea were at China’s current level they grew at such a pace for two decades. While expressing deep concern about the lack of state-enterprise reform, the condition of the financial sector, widespread environmental problems and China’s growing income disparities, Lin is confident that the Communist Party system is sufficiently resilient to navigate the pitfalls. The main weakness of Lin’s analysis is that the scope is too narrow, and does not consider the crucial political economy of the party state. Its ability to cope by adapting is axiomatic. The system has, no doubt, shown remarkable staying power, and among political scientists many have adhered to the “authoritarian resilience” or “adaptive resilience” school. As recently as last year, one of the world’s leading scholars on China, Harvard’s Elisabeth Perry, and her German colleague Sebastian Hellmann, even argued that the Chinese system has become more, rather than less resilient. In a volume they edited, Mao’s Invisible Hand: The Political Foundations of Adaptive Governance in China (2011), they argue that “far from decrepitude, the regime — having weathered Mao’s death in 1976, the Tiananmen Uprising in 1989, Deng’s death in 1997, and large-scale ethnic riots in 2008—9 — seems over time to have become increasingly adept at managing tricky challenges ranging from leadership succession and popular unrest to administrative reorganization, legal institutionalization, and even global integration.”

Their point of departure is that no explanation of Chinese resilience thus far has been very convincing. In contrast, their central and thought-provoking thesis is that a Maoist-inspired work style — which might be described as a “guerrilla policy style” based on ideological control and mass mobilization — is still playing a role in China. They seem eager to stress that they don’t claim to predict the future, just to explain the past. What is puzzling is that they seem to think that the “Maoist work style” will remain an asset rather than become a liability. This does not seem to sufficiently take into account how the system has changed over the last decade as the elite has become increasingly self-enriching and society has changed beyond party control with civil society online and offline becoming an increasingly powerful and unruly factor.

Carl E. Walter and Fraser J. T. Howie, both with some 20 years of experience in the Chinese financial sector, argue in Red Capitalism: The Fragile Financial Foundations of China’s Extraordinary Rise (2011) that the Chinese party-state is increasingly dominated by “special interest groups,” foremost by a so-called National Team, and that this is a “game-changer in China’s political economy.” In their analysis, Walter and Howie seem to be getting at the raw nerves of power. At its core, this National Team is described as consisting of elite party and commercial interests centered on the large, monopolistic state-owned enterprises (SOEs), or National Champions. These “National Champions...
China is suffering from a huge reform deficit. In addition to the causes described above, the current state of affairs is due to the Communist Party’s unwillingness to recognize what is driving the Chinese economy. In recent years since the global financial crisis broke out, close to 50 percent of GDP has gone into investments, an exceptional level leading to a doubling the entire capital stock in six to seven years. This has for far too long created an illusion of economic dynamism, but such levels are unsustainable, and the allocative efficiency is falling.

The crucial role of entrepreneurs in today’s China is at the same time far from understood. In their recent book, Capitalism from Below: Markets and Institutional Change in China (2012), Victor Nee and Sonja Opper turn the tables by looking at entrepreneurial dynamics at the grass roots level. During a six-year period (2006-11), they twice surveyed more than 700 small-to-medium enterprises (SMEs) in the Yangtze Delta region, including Shanghai, Zhejiang, and Jiangsu. Their main finding is that China’s success to a much larger extent than generally assumed is the result of the entrepreneurial ability of SMEs rather than the performance of SOEs: “Local knowledge gained through a cumulative wealth of manufacturing experiences in interaction with regional markets for new technology, contributes to rapid cycles of innovations” within close-knit and highly specialized business communities. This development has driven “bottom-up institutional change” that has facilitated the private sector’s autonomous growth decoupled from the mainstream state-controlled economy. According to the authors, the political elite has, rather than being proactive, at best followed up by legitimizing what already has taken place on the ground.

The same is true when it comes to innovations. We know that the government is investing heavily in R&D. Data from Thomson Reuters show that there has been a dramatic quantitative growth in the volume of Chinese patent applications and in the number of Chinese peer-reviewed scientific journals. This is all of great importance. What is less well understood about Chinese innovativeness is the integration of different stages of the Chinese production system into global chains of production. In their book, The Run of the Red Queen — Government, Innovation, Globalization and Economic Growth in China (2011), Dan Breznič and Michael Murphree focus on the way “China has been sustaining its run of rapid economic growth … by innovating in many stages of production, but not in novel-product R&D” It is rather a question of “inherent interdependencies” created within the global system of production — a position, they stress, that is “against the declared wishing of the central government,” which is focused on product R&D. To the authors, China’s rise to economic power is directly tied to the maturation and to the broad international spread of this global system of fragmented production. A major theme of Acemoglu and Robinson’s brief reflections on China is that the country’s growth is based on “adoption of existing technology and rapid investments, not creative destruction,” but empirically driven analyses such as those I have described above remain outside their radar screen. When considered, the picture becomes less easily reduced to simple conclusions. China’s growth is losing steam, but it is far from being without vital sources of growth.

A question of central importance becomes whether the Communist Party, in spite of its vested interests, will have the capacity to build on these sources and the foresight to develop credible institutions in support of entrepreneur- ship and innovation. There is huge potential in the combination of China’s several million entrepreneurs, the six million graduates that annually come out of China’s universities (one third of them being engineers) and a Chinese innovation system that recognizes the global interdependence of the Chinese production system. It would be fatal not to recognize the implications for global chains of production.

The Party would have to mess up things badly for China not to become a middle-income country! In its preparations for the recent 18th party congress, the Party was busy with more immediate challenges, such as how to deal with Bo Xilai and how to restore an image of unity after the worst crisis faced by the party since 1989. Unprepared for the future, the congress stressed “stability” rather than deeper reforms and the transition of power to the fifth generation of leaders was left hanging in the air as five trusted men from the fourth-and-a-half generation, all between 64 and 67 years old, joined Xi Jinping (59) and Li Keqiang (57) on the new Standing Committee of the Politburo, beginning a new act of the Party’s Machtverdienende drama. Wang Yang and Li Yuan- chao, fifth-generation reformists, were left waiting another five years for their turn.

What do the new leaders want to achieve, in addition to maintaining power? In the midst of a complex leadership transition, China is facing mounting domestic and international challenges. Will the new leaders have the ability to perform beyond their personal limits? Will they be able to put China on a new reform path focused on institutional development, even challenging entrenched elites? Fighting corruption was on top of Hu Jintao’s agenda — at least in rhetoric — ever since he came to power 10 years ago, but it is a more serious problem today than when he took office. The cake is several times bigger and the investment-driven nature of the economy has generated increasingly huge opportunities, at the central as well as local level. The result is a huge accumulation of corruption over time. In his first speech as Party Secretary, Xi Jinping made the fight against corruption his top priority, and a few concrete cases have born witness. It remains to be seen whether the efforts will be sustained, and whether the methods used will be those of the party-state or will bring China closer to being a country ruled by law. The tradition of the Party is to use its internal disciplinary machinery as the main vehicle rather than promoting the independence of the legal system or the investing capacity of media. Social media such as Weibo have grown exponentially, but so have the efforts to control them. In the absence of democratic institutions, they have emerged as a challenging force for accountability.

No Communist party in history has been able to clean up from within, but nor has any Communist party been in power while a country has undergone the development that China has achieved in the last 30 years. What makes the Chinese drama fascinating is the way society as such is changing. The Party is, in a sense, a victim of its own success. In spite of its immense security apparatus and censorship system, the Communist Party is facing steadily increasing challenges, which cannot be resolved through increased repression. An online civil society, with more than 500 million Internet users and more than 300 million microbloggers on sites such as Weibo, is exposing abuses of power like never before. Most challenging for the Party is the growing connectivity between what happens offline and online. Local events, such as the protests against land-grabbing in December 2011 in Wukan village, no longer remain local. Given that the number of “mass incidents” during the last few years is estimated to have reached 180,000, this connectivity constitutes a threat to the Party’s core principle of the monocratic organization of the party state.

China is entering an era of social dynamics that will sorely test the Party and its leadership. Acemoglu and Robinson are right in saying that the only sustainable way of responding is to allow inclusive institutions to develop. This is China’s huge challenge. There is no way backwards, just the unprecedented task of moving beyond the entrenched interests of the party state as society becomes more urban and interconnected and the middle class less concerned about just immedi- ate interests. The striking vitality of Chinese society cannot be dismissed. The Party will be forced to retrace and China’s new leaders who have taken over will have no choice but to resort to more deliberative forms of authoritarianism, or crumble. They have to perform a balancing act on a slippery slope, without any known script to follow.

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