

**The Disinterested Government:
An Interpretation of China's Economic Success in the Reform Era¹**

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Abstract: In the last 30 years, China has reached high economic growth and successfully transformed itself from a planning economy to a market economy. To a large extent, China has achieved its successes by adopting the recommendations proposed by the standard economic theory. However, a political economy question has been left out in the literature: Why has China adopted the right economic policies and a proper road to reform? This paper attempts to provide an answer to this question. The central theme of the paper is that China has achieved its successes because the Chinese government has been a disinterested government, i.e., a government that does not favor any sections of the population and sets the long-term welfare of the whole society as its priority. We first define and analyze the concept of disinterested governments, and then proceed to provide several examples demonstrating that the Chinese government has been a disinterested government. Based on a theoretical model, we have also discussed the causes for the Chinese government to become a disinterested government.

Keywords: disinterested governments, the China Miracle, economic reform

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For any unbiased mind, China in the last thirty years must be considered as a success. It has maintained an average economic growth rate of 9.7% per annum and has transformed its economy from planning to markets. Defying repeated warnings of an imminent collapse, the Chinese society has remained relatively stable yet dynamic. The last thirty years have been the best period of time for the majority of the Chinese people in the last 130 some years since China failed its confrontation with the western powers in the Opium War.

To a large extent, China's economic success can be attributed to China's almost relentless reform drive toward a free market economy. Although its path of reform has been unconventional in much of its course, the end policies and institutions of China's reform have been clearly converging toward what the standard economics teaches a country to do. If there are success cases of the Washington Consensus, China must be counted as one of them. From this point of view, China's high economic growth record has nothing miraculous in it (Perkins, 2005). However, this view leaves an important question unanswered: if economic theories are so right, why have not most developing countries followed them? Or in other words, why has China been able to adopt the right growth recipes? This leads us to back down one step and study the political economy of China's miraculous economic growth in the last thirty years.

Central to this paper's argument is that China's success lies in its disinterested government. A disinterested government is a government that does not have differentiated interests among the segments of the society. Such a government is more likely to be what Olson (1982) calls an encompassing organization whose interests overlap with those of the whole society. That is, it is more likely to foster the overall economic growth of the country instead of advancing the interests of certain segments that it represents or forms an alliance with.

We identify three major reasons for the Chinese government to become a disinterested government in the reform era. The first reason is the lesson that it has learned from the period of 1949-1978. In that period, the Chinese Communist Party (CCP) defined itself as a working-class party and emphasized class struggles along the way of economic construction, but the results were dismal and led to a crisis of its legitimacy. The second reason is that the Chinese society was unusually equal at the beginning of the

reform, thanks to the Communist Revolution in 1949 and the egalitarian policies carried out in the ensuing period of 1949-1978. When the society is equal, the government will not have any incentive to form an alliance with any segment of the society because the strength of the alliance is not strong enough against other segments' attempts to revolt. The third reason is the CCP's conscious adjustments made to its own ideology and social affiliation. In the course of reform, it has successfully transformed itself from a working-class party to an all people's party.

In the rest of the paper, we will, in Section 1, first compare what China has done with the standard recommendations of the Washington Consensus as it was originally formulated by John Williamson. We will show that China has been following these recommendations in the last thirty years. In Section 2, we will argue that the authoritarian nature of its government is not the key for China to adopt the right economic policies. In Section 3, we present our theory of disinterested governments. We link the concept of disinterested governments to Mancur Olson's notion of encompassing organizations and discuss their differences. In Section 4, we will present evidence to show that the Chinese government has indeed been disinterested in the reform era. In Section 5, we analyze the three reasons that lead to a disinterested government in China. We conclude in Section 6 by discussing the applicability of the Chinese experience to other developing countries.

1. A case for the Washington Consensus

Many authors inside and outside China tend to believe that China has gained economic success by deliberately defying the recommendations, such as those of the Washington Consensus, advanced by standard economic theories for good economic policies. The Beijing Consensus proposed by Joshua Ramo (2004) is but one example. However, these authors have consciously or unconsciously confused China's path of transition and its aim of transition. Undoubtedly, China has adopted a non-standard path for its transition and in many cases its medium products of transition did not fall into the categories of standard economic institutions. It is also admittedly true that China does not unconditionally follow the advices and conditions provided by international donors and other governments; it opens to the world, but on its own terms and by its own paces.

However, the aim of China's transition has been clear: it is to establish a market economy, and on balance, what China has done in the last thirty years have very much followed what the Washington Consensus, as originally formulated by John Williamson, has recommended to developing countries.

In Williamson's original formulation (Williamson, 1990), the Washington Consensus has the following key policy recommendations:

- Fiscal discipline
- Reordering public expenditure priorities away from non-merit subsidies and toward public goods (e.g., health and education)
- Tax reform that combines broad tax base with moderate marginal rates
- Liberalized interest rate
- Trade liberalization
- Liberalization of inward foreign direct investment
- Privatization
- Deregulation to ease barriers of firms for entry and exit of sectors
- Strong protection of property rights

China in the last thirty years has closely followed most of these recommendations. The only recommendation that China has not followed is liberalization of interest rates. A discussion of the reasons for this exception is beyond the scope of this paper, though. In the rest of this section, we will focus on what China has achieved.

In terms of fiscal discipline, the Chinese government has been very cautious in maintaining a roughly balanced budget; its debt has never surpassed its tax revenue. Prudent fiscal policies have led to a stable economy. China has experienced three waves of inflation (mid-1980s, mid-1990s, and mid-2000s) in the last thirty years, but none of them was serious. The highest inflation rate was 24% per annum (1994).

On the expenditure side, the Chinese fiscal authority is also very prudent and even conservative. Pure inter-regional fiscal transfer has been kept to the minimum in most of the time because of the insufficient amount of formula-based transfer. The largest part of central government's transfer to local governments has been project-based. Although it tends to enlarge regional imbalance, project-based transfer has been production-enhancing because it is mostly used for infrastructure building (Yao, 2008). Before 2003,

social spending had also been kept to minimum. It has slowly picked up in recent years, but its share in government budget is still low. Indeed, the Chinese government has been frequently criticized for spending too little on social protection.

In terms of taxation, the overall tax burden in China declined dramatically between 1978 and 1993 because of fiscal decentralization. By 1993, government revenue was only about 17% of China's GDP (Yao, 2008). The 1993 fiscal reform has greatly strengthened governments' taxation capacities and the amount of government revenues increased to close to one fourth of GDP. However, the fast growth of government revenues has raised the concerns of both the society and the government itself. The rate of corporate income tax was lowered from 33% to 25%; the deduction of personal income tax has been raised several times; and the value-added tax is likely to provide deduction for capital investment. It is noteworthy that regional competition for capital has played a role to curb the growth of government revenues.

On the international front, China has taken a road that decisively leads to liberalization of trade and foreign direct investment (FDI) although it has successfully followed its own pace of open-up. Openness, especially in the form of the Special Economic Zones, led Chinese reform in most of the last thirty years. Export-led growth was adopted as a national development strategy in the mid-1980s. Joining the WTO in 2001 marked China's full integration into the world economy. Since then, China's trade dependence ratio, i.e., the ratio of imports and exports in GDP, has been maintained at a level higher than 60%, the highest among the large economies. Besides trade, China began to open to FDI in its early stage of development. A sign to show how deep FDI is involved in the Chinese economy is that 60% of China's exports are contributed by FDI firms.

Domestically, two themes of China's reform have been privatization and deregulation whose aims are to remove the two pillars of economic planning, state ownership and price control, respectively. After fifteen years of privatization starting in the mid-1990s, most of China's state-owned enterprises (SOEs) have been either released to private hands, or transformed into public companies listed in the stock market. Only a handful (but powerful) of SOEs are still owned and controlled by the government. The removal of price control happened even before privatization. The government reform at

the end of the 1990s further removed many barriers of firms to entry and exit.

Although protection of property rights is still weak in many arenas (especially in intellectual property rights), China has made noticeable progresses in the last thirty years. The flourish of private firms is a sign to show that private ownership has been respected -- at least to a certain extent. Several revisions of the Constitution and passing of the *Property Law* have established a reasonable (yet incomplete) legal framework for property rights protection. The situation is far from perfect, but the direction has been decisively set for better stronger protection.

In addition to the proximity of its goal of transition to the Washington Consensus, China has also adopted other policies frequently prescribed by the development economics literature as essential to economic growth, among which high saving and investment rates and an emphasis on primary education are the two most significant ones. Although the income gap between rural and urban China has been enlarged, the dominance of labor-intensive exports has enabled China to bring 140 million rural residents away from agriculture and put them into higher-income industrial sectors. Sustained economic growth has lifted more than 200 million people out of absolute poverty in the past thirty years. That is, the Chinese growth has been largely inclusive, which lends supports to the emerging literature on the causal relationship running from equality to growth.

However, countries that have adopted the right economic policies by and large have been a minority among the developing countries. There have been only 13 economies that have maintained uninterrupted growth of 7% per year or higher for 25 years or longer after the WWII, most of which are in East and Southeast Asia. Lack of knowledge cannot explain why most countries have failed to adopt the right economic policies. For one thing, it only requires basic economic training to understand these policies. In addition, they have been frequently recommended and even imposed on developing countries by international donors as preconditions for their aids. A serious study should then step back and look at why governments in most developing countries have failed to adopt the right economic policies.

2. Authoritarianism, or something else?

In searching for a political economy explanation for China's economic success, an easy answer seems to be that China has benefited from an authoritarian state. This is so, as argued by the proponents of this idea, because an authoritarian state has the power to mobilize people and resources to reach high economic growth. This seems to be a received wisdom in the international arena and is often echoed inside China. In a recent article in *Foreign Affairs*, the American Secretary of State Condoleezza Rice writes: "Democratization is also deepening across the Asia-Pacific region. This is expanding our circle of allies and advancing the goals we share. Indeed, although many assume that the rise of China will determine the future of Asia, so, too -- and perhaps to an even greater degree -- will the broader rise of an increasingly democratic community of Asian states."² Clearly, Rice implicitly excludes China from the democratic camp and links China's future dominance to the authoritarian nature of its state.

However, an authoritarian state is not sufficient, nor is it necessary for China to reach high economic growth. It is not sufficient because it may set a wrong goal or represent the interests of a small group of people. China's own experience provides an example for the first case. It did not have an impressive growth record in the planning period although it definitely was more authoritarian than it has been since reform began thirty years ago. The right-wing military regimes in Latin America provide an example for the second case. These regimes protected the interests of the elites and suppressed the demand of the majority of the population. This narrow scope of mandate made sustained economic growth impossible and led to the collapse of these regimes. An authoritarian state is not necessary for high economic growth because some democracies have also reached high economic growth. For example, Botswana has a functional democracy and is among the 13 economies that have experienced sustained economic growth in the post war period. India, a functioning democracy, has also maintained high economic growth since it began its reform in 1991. A democracy can be slow in reaching a consensus, but it is not intrinsically incongruent with economic growth.

Indeed, the dichotomy between authoritarianism and democracy itself is misleading.

² Condoleezza Rice. "Rethinking the National Interest." *Foreign Affairs*, July/August, 2008. <http://www.foreignaffairs.org/20080701faessay87401-p20/condoleezza-rice/rethinking-the-national-interest.html>.

Even the most democratic countries, as long as they are built on the idea of representation, which virtually all the democracies adhere to, have elements of authoritarianism. The most telling example is President Bush's decision to continue the Iraqi war. The war is very unpopular in the United States, but it nevertheless continues because the White House insists on it. On the other hand, even the most authoritarian states leave space for democratic decisions. For example, farmers in the communes discussed and voted for economic decisions even in the heydays of China's planning era characterized by political and economic controls. Most countries fall between absolute democracy and absolute despotism. The Chinese state, although it is dominated by an authoritarian polity, does not lack space for economic liberty, popular political participation, and even genuine democracy.

The Chinese Constitution lays out a framework that admits a considerable amount of popular participation. The village is defined as a self-governing entity. That is, it is on farmers themselves to elect their leaders and decide on village affairs. Above the village, delegates are required to be directly elected to the township and county people's congress, the local legislative body. The same thing happens for the people's congress at the district level in the city. Above the county and district level, delegates are elected indirectly to the municipal, provincial, and national people's congress by county and district people's congress. At all levels, the people's congress has rights that are equivalent to those held by the parliament in any other country. The problem is that those rights may not be fully exercised in reality. However, there are also many positive progresses having happened at the ground.

The most significant progress is the village election. China started to experiment village elections in as early as the 1980s. In 1988, the National People's Congress (NPC) passed an experimental version of *The Organizational Law of the Village Committee* that required the village committee --- the self-governing body in the Chinese village --- to be elected. This law triggered wide spread of elections across China. In 1998, the NPC passed the formal version of the law. The most significant feature of this formal version is that it requires that the candidates for the village committee have to be nominated by villagers. By now, almost every village has begun democratic elections. The outcomes of the election are quite encouraging; studies have found that it has enhanced the

accountability of the village committee. In particular, it has increased the share of public spending and reduced the share of administrative spending in the village budget, improved income distribution, and led to more public investment (Zhang et al., 2004; Wang and Yao, 2007; and Shen and Yao, forthcoming).

Above the village, delegates to the township, county and urban district people's congresses are directly elected, as required by the Constitution. Although nomination is not free from interference of the government, there are signs that the election has become more competitive in some localities. Concurrent with this trend, county and district people's congresses are becoming more effective in monitoring government functioning, especially budget allocations. At the national level, both the NPC and NPCC (National People's Consultative Conference) are admitting more members with professional backgrounds. Although the political structure has remained more or less intact, adding these new members will enhance the two legislative bodies' ability to monitor the government. Although the system is still miles away from a true democracy, democracy as a long-term goal has taken roots in China, and even top government leaders do not deny it.³

There is also considerable room for free speech inside China's one-party system. Although there are still areas --- noticeably foreign policy, religion, and one-party rule itself --- where open public discourses are restricted, the press is quite frank in other areas including government policies in social and economic arenas, corruption, and democratization. In addition to traditional media, the Internet has provided unprecedented freedom for personal expression including dissident views on China's political system. These views have gained weights in China's political process. Government leaders at various levels take them into account in their decision making. Intellectuals have actively participated in public debates and their views are often heard and considered by government officials. Although a certain degree of censorship still exists, intellectuals are often tolerated even when their views sound very radical.

A new development is that the civil society has become much stronger in today's China. Non-governmental organizations have been accepted by the government at least as a complement for governmental actions. More subtle, but more important development

³ John Thornton. "Long Time Coming." *Foreign Affairs*, January/February, 2008.
<http://www.foreignaffairs.org/20080101faessay87101/john-l-thornton/long-time-coming.html>.

happens at the grassroots level. Old communities are reviving as life becomes more stable and income increases considerably, and new communities are emerging on the basis of common interests in addition to geographic proximity. This includes private clubs of common interests (driving, tourism, and so on), intellectual circles, as well as residential communities. The Internet plays an important role in those grassroots organizations. Although politics is often deliberately excluded from their agendas, these newly emerged communities will quickly form organized resistance once their interests are infringed by the government.

In light of the above evidence, one has to realize that the Chinese state is more complex than authoritarianism can describe, and its success of adopting the right economic policies has to be explained by a deeper mechanism than its obvious authoritarian colors. This mechanism needs to encompass authoritarianism and democracy in order to have general implications because we find successful stories in both conventionally defined authoritarian and democratic countries. The disinterested government is identified by this paper to provide such a mechanism. In the next section, we provide a general discussion of this notion and its implications for economic growth.

3. Disinterested governments

By a disinterested government, we mean a government that is impartial toward different sections of the society. To be more precise, it is a government that does not form an alliance with, or provide favorable treatments to, any section of the society. It is not necessary a neutral government that does not have its own interests. Instead, it can have its own agenda and self interests. The key argument here is that even out of its own strategic choices, a disinterested government is more likely than a partial government to adopt growth-enhancing economic policies.

A partial government, by definition, puts the interests of the groups of people it represents or favors ahead of the welfare of other groups of people. This hurts long-term growth. When the represented groups do not have political dominance in the country, it leads to competitions among interest groups which in turn, as Mancur Olson forcefully argued in his seminal 1982 book *The Rise and Decline of Nations*, leads to a higher

demand for redistribution than enlarging the pie. When the represented groups do have the political and social power to suppress other groups, it gives the government freedom to only advance the interests of the represented groups and ignore the interests of other groups. In most developing countries it is often the case that the dominant political groups are comprised of a small number of elites, which to a large extent explains the existence of extreme income inequality in these countries. Curiously enough, it is in these countries that populist governments are more likely to emerge. To a large extent, this is the result of backlash of the poor to regain power from the elites. However, a populist government, although it represents the majority of the society, is not a disinterested government, precisely because it aligns its interests with those of a specific group of people. Both theory and empirical evidence show that long-term growth does not happen under populist governments. A populist government, by definition, is obliged to engage in redistribution to please the populace. If it serves to enhance people's ability to generate income, redistribution does not hurt growth. However, most populist governments go beyond that; usually, they promise expensive welfare programs to win the support of ordinary citizens, which have to be compensated by slower capital accumulation and ultimately slower economic growth. Argentina under Peron's rule is but one example.

A disinterested government can still be predatory, but it is less so than a partial government. This is first because a disinterested government is more likely to treat each group of people equally than a partial government. This is so because treating different groups differently does not bring any gain to it but increases the chances for it being challenged by the mistreated groups. It might pay for the government to predate more on the weak groups than on the strong groups. But the weak groups often have a small stock of wealth to predate on but a large number of people who may revolt when the predation exceeds a certain level. Treating each group equally then is an optimal choice for a disinterested government in most cases. Because of that, it tends to care more about, or, to be more precisely, its pursuit is more likely to coincide with, the interests of the whole society. Related to this conclusion is that a disinterested government is more likely to care about the long-term welfare of the society than a partial government. This is so because the demand for redistribution is lower when people are treated equally (Alesina and Rodrik, 1994). As we argued a while ago, populist pressures are higher in countries

with more divisive social groups where ordinary citizens perceive themselves as being exploited by the elites.

Because its pursuit is more likely to coincide with the long-term welfare of the whole society, economic growth is more likely to happen under a disinterested government than under a partial government. Unfortunately, we often find partial governments instead of disinterested governments in the developing world. There are two archetypes of governments in that part of the world, one being elite governments and the other populist governments. Of course, purely elite-dominated governments and purely populist governments are exceptional in today's world, but the mixture or alternation of the two is often observed. Many countries in South and Southeast Asia are characterized by the mixture of elite and populist politics, and many countries in Latin America are characterized by the alternation of elite rules and populist politics. These countries started with elite dominance, but democratization has opened the door for popular participation. It would have been a virtue to have more popular participation had these countries had social equality. However, the elites have continued to dominate socially, politically, and economically, which means that ordinary people would not have proportional shares in the distribution of the growing pie. As a result, they opt for demanding for more redistribution than for investing more for the future.

There are also impediments to the emergence of a disinterested government in China, although of some other kinds. Along with fast economic growth, China has had to complete the transition from a planning economy to a market economy. Except for a few (such as the rural reform) that were Pareto improving, most reform measures have involved substantial reconfiguration of gains and losses among different groups of people. Reforms would have not moved toward the market if the government had stuck with the interests of specific groups of people. In addition, China is a vast country with one of the most decentralized fiscal systems in the world, which creates strong local interests that are not always congruent with the interests of the whole countries. While it may enhance local incentives for local economic growth (Qian and Weingast, 1997), fiscal decentralization leads to regional protectionism, inferior provision of public goods with a relatively large scope of geographic coverage, and perhaps most significantly, the commercialization of local governments. Jean Oi (Oi, 1992) describes the behavior of

local governments in China by “local state corporatism”. But in reality, local governments are more than authoritarian identities that are able to contain local forces; they have become companies advancing only their own interests. It often falls on the central government to bring local interests in line with the national interests. However, the central government itself is segmented by ministries that have their own patronages and interests. Most industrial policies are proposed and formulated by ministries and it is not uncommon to find that they are captured by special industrial groups. Ministries also keep extra-budgetary revenues that evade government auditing. In summary, it is not a nature thing for a disinterested government to emerge in either China or another developing country.

It is noteworthy that our notion of disinterested governments shares some commonalities with Olson’s encompassing organizations. Olson defines encompassing organizations as those “that encompass a substantial portion of the societies of which they are a part.” (Olson, 1982, pp. 47) That is, they are organizations that represent a significant share of the population in a country. What makes a difference is that “the incentives facing an encompassing special-interest organization are dramatically different from those facing an organization that presents only a narrow segment of society.” (Olson, 1982, pp. 48) This can be illustrated by two related arguments. First, because it represents a significant portion of the population, an encompassing organization cares more about the growth of the national economy than other organizations that only represents a very small portion of the population. For example, if one-third of the population belongs to one organization, this organization then has a one-third stake in the national economy. As a result, an encompassing organization will be less likely to introduce anti-growth policies. Second, an encompassing organization will also be less likely to tolerate heavy costs imposed by excessive redistributive policies, also because it represents a large portion of the population --- its members will foot one-third of the costs if it represents one-third of the population. As a result, “Encompassing organizations have some incentive to make the society in which they operate more prosperous, and an incentive to redistribute income to their members with as little excess burden as possible, and to cease such redistribution unless the amount redistributed is substantial in relation to the social cost of redistribution.” (Olson, 1982; pp. 74)

In terms of the end result in caring more about the societal interests instead of the interests of specific groups, disinterested governments are not much different from encompassing organizations. However, the mechanisms leading to the end result are different under those two concepts. While Olson puts the size of an organization as the central pillar for its being encompassing, we emphasize the detachment of a government from specific groups in the society as the key for its caring about the interests of the whole society. An example to distinguish these two mechanisms is the political arrangements of the medieval Genoa (Greif, 2006). The initial politics of Genoa was characterized by competing clans, none of which had the absolute dominance over the others. As a result --- because of the lack of an encompassing organization in Olson's sense --- the city entered prolonged clan fights and instability. The solution that the clans found was to hire a podesteria --- a knight with his own army --- to run the city. Making money was the podesteria's primary goal. But since he was an outsider who had no personal ties with any clan, the podesteria was more likely than an insider to take a neutral stand toward city affairs, and for that matter, was more likely than an insider to advance the city's long-term welfare. That is, the podesteria acted like a disinterested government although he and his army was a small group relative to the whole city population.

In addition to the mechanisms, policy recommendations under the two notions could also be different. In a democratic polity, or any polity with a reasonable range of political diversity, it is hard to find an encompassing organization because none of the organizations can be large enough to act in an encompassing way. However, a disinterested government may still emerge in a very diverse society as long as the ruling group remains autonomous relative to the society.

Lastly, the concept of disinterested governments has more operational values than the concept of encompassing organizations. This is because we can tell whether a government is disinterested by checking the facts that whether it treats different groups of people equally in taxation, subsidies, government services, and political treatments, but we are not sure how large an organization should be in order to make itself encompassing. Indeed, in a parallel theoretical paper, my coauthor and I (He and Yao, 2008) are able to define a disinterested government as one that keeps the same rate of taxation (predation)

and provides the same level of government services to two distinctive groups of citizens.

4. The Chinese government as a disinterested government in the reform era

As we pointed out in the introduction, China's economic success has to be traced back to its underlying political economy. But marvelous records of economic growth cannot be used as evidence for the Chinese government's being disinterested in the society; instead, we need to find direct evidence to show that the Chinese government has indeed behaved in a disinterested fashion when its decisions involved conflicting interests among different segments of the society. This section provides three stories to show that the CCP has indeed put the overall welfare of the society over segmental interests even when doing that implied hurting the interests of its own power bases. Below we first discuss the emergence of the growth consensus at the beginning of economic reform, and then discuss the evolution of the dual track price system and state-owned enterprise (SOE) reform. Of course, evidence can also be found in many other areas, but these three stories illustrate some main thrusts of the disinterested nature of the Chinese government in the last thirty years.

The growth consensus

A strong China has been the dream of several generations of Chinese leaders since the Opium War. The painful lesson learned from China's encounters with the western powers in the 1800s has been that without economic power, China would be bullied by others. Unfortunately, economic growth had been interrupted by civil wars, the Japanese invasion, and the incompetence of the Guomintang government. The establishment of the People's Republic in 1949 gave China a chance to concentrate on economic growth, but the dream had been shattered again and again by political movements, one wave higher than the other. The restoration of a pragmatic leadership centered at Deng Xiaoping in the late 1970s finally gave China another chance to pursue its century-long dream of economic prosperity. The growth consensus emerged as a way to unite the country toward that goal.

The essence of this consensus is to put economic construction at the center of all

government and societal endeavors. For that, the CCP quietly dropped its conviction to an egalitarian society and began --- in Deng Xiaoping' words --- "to let some people get rich first". That is, it shifted the CCP's agenda from redistribution to economic growth, accomplishing one important step from a populist government to a disinterested government. This shift had not been an easy one, as one can expect for a country that had been dominated by orthodox Marxist teachings. To win popular supports in the party, Deng Xiaoping initiated the "truth debate" at the end of 1978. The debate was not directed to whether to have more markets, but was framed in a philosophic discussion about the sources of truth. This had been proven a wise political strategy; it disguised the true intention under a classical Marxist issue, preempting the rejection of the conservatives to start the debate. The conclusion of the debate was that there could be only one source of truth, which was practice. From then on, a wide door was opened to experiments and changes. These changes would ultimately transform China into a totally different country, but the leadership was so determined at the time that embracing the market was the only way for China to start growing again. To preempt the conservatives' rebuffing, Deng Xiaoping set the tone for the party by simple words: "Do not debate."

The growth consensus has accomplished several things. The first was that it has unified the party and the country. After the dark years of the Cultural Revolution, people had got tired of the political rhythm and needed a new direction to head to. The CCP itself was divided. Mao's successor, Hua Guofeng, despite being milder than the Cultural Revolution ultra-radicals, still held on to Mao's legacy and took China further down the radical direction. Deng Xiaoping and other moderates believed that changes were needed, but did not want to have head-on confrontation with Hua. Shifting the party's emphasis to economic construction would lead to changes in the system, but in the same time it would also preempt the objection from the radical camp.

The second accomplishment was in the area of system changes. Some of these changes were envisioned and planned by the moderate camp --- for example, the increase of agricultural prices was a planned move to stimulate grain production, but many were unanticipated. The return to family farming was not planned; but since it worked to increase output, it was accepted and even encouraged by the CCP. The rise of the rural industry and privatization of SOEs were other examples. Once the objective was set,

institutions became a tool to realize it.

The third accomplishment was related to the change of the CCP's ideology. Starting with allowing some people get rich first, the growth consensus has watered down the CCP's old convictions. After thirty years of evolution, today the CCP is hardly a party built on political ideology. We will come back to it at the end of this section.

The growth consensus has other unintended and undesirable consequences, though. In areas where economic growth has been overemphasized, we have found environmental degradation, social inequality, the erosion of the social safety net, and even the commercialization of local governments. A full discussion of these consequences would be a diversion to the theme of this paper. But it is worth emphasizing that while on balance the growth consensus has served China well in the last thirty years, its unaltered continuation may turn itself from a virtue to a vice.

The dual-track price system

The dual-track price system was a compromise reached in 1984 between radical abandonment of and continuous adherence to socialist planning. Under this system, SOEs were given the opportunity to sell their products and buy inputs in the free market after they fulfilled their planned quotas. The market prices were higher than the quota prices. The most significant example was the dual exchange rate regime that was in place between 1984 and 1994. The central government maintained an official exchange rate, but in the same time opened a swap market in Shanghai where enterprises had some freedom to buy and sell their foreign earnings at a higher but floating exchange rate.

The dual-track price system had opened up a wide door for economic incentives to play an important role in SOEs' decision making. However, its unintended consequences might have been more significant than its impacts on SOEs. One of these unintended consequences was that it provided a chance for non-SOEs to thrive. The best known example is the township and village enterprises (TVEs). These rural enterprises were not in the central government's planning and it was very difficult for them to buy materials and sell their products before the reform. Although they had extraordinary growth in the 1970s (Lin and Yao, 2001), their contribution to the national economy was marginal. The dual-track price system gave TVEs a chance to get access to markets and inputs and they

flourished quickly.

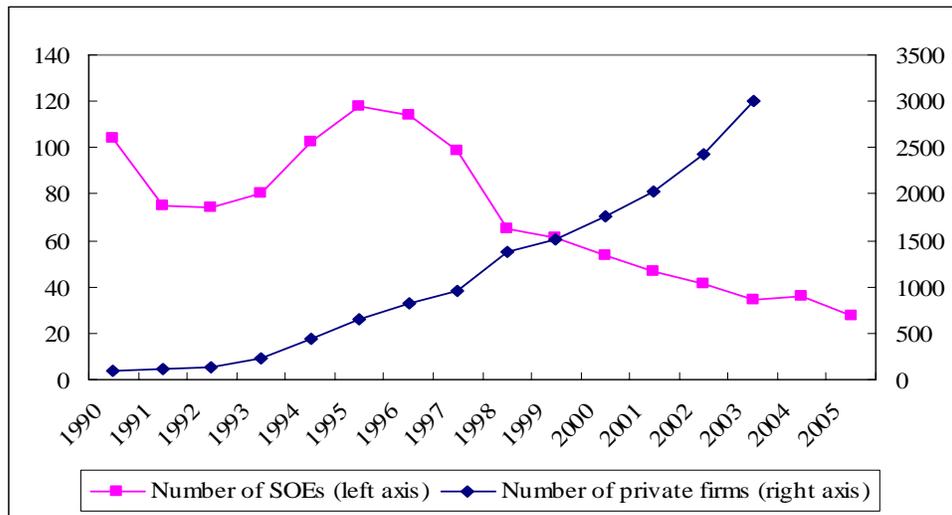
Lau, Qian, and Roland (2000) believe that the dual-track price system had brought Pareto improvements to China. To a large extent, this assessment is true. However, the dual-track system also had serious downsides. One of them was that the price differences, sometimes extraordinarily high, created a huge space for rent seeking. Enterprises and government officials who controlled the quotas could easily get rich by selling their quotas to other enterprises and individuals. At the end of 1980s, *guan-dao*, or official profiteering, became a popular phrase and aroused deep resentments from the public. However, the people who controlled the quotas were CCP insiders, and to many scholars (e.g., Murphy, Shleifer and Vishny, 1992), this would make further changes to the system very difficult.

But the CCP has proven this prediction wrong. The dual prices began to unify in the early 1990s, and by 1994, the last dual-track of prices, the dual exchange rates, were unified. The CCP had not been held back by vested interests. Instead, it had the resolution to rip off the privileges enjoyed by its own insiders.

SOE privatization

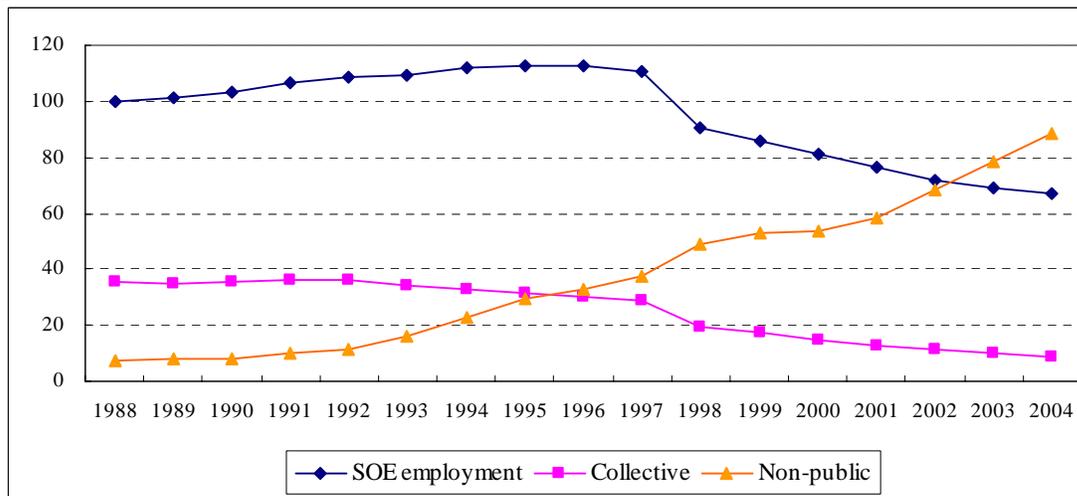
The best case to show the Chinese government's being disinterested is SOE privatization. Reform of the state-owned enterprises (SOEs) has been a major aim since urban reforms began in 1984. Although there were calls for privatizing the SOEs, the government's emphasis was initially on boosting performance by changing the SOEs' internal governance through contracting. Serious privatization started in several localities after Deng Xiaoping's visit to southern China in 1992. (Huang and Wei, 2001; Yao, 2004). In 1995, after extensive discussion, the central government issued the policy of "*zhuada fangxiao*", or "keep the large and let the small go". The state decided to keep 500 to 1,000 large state firms and allow smaller firms to be leased or sold. From the "let the small go" part of the policy came the term "*gaizhi*", meaning "changing the system". In many cases, it led to privatization. By the end of 1998, more than 80 per cent of state and collective firms at or below the county level had gone through *gaizhi*, which involved direct privatization in most cases (Zhao, 1999). By 2005, 76.7 percent of all industrial SOEs existing in 1995 had either been privatized or gone bankrupt (Figure 1).

Figure 1. Number of SOEs and number of private firms in the industrial sector (1,000)



Sources: NBS (1990-2005); NBS (1990-2004).

Figure 2. Urban employment in SOEs, collective firms and non-public firms (million persons)



Sources: NBS (1988-2004).

Accompanying privatization, employment in SOEs dropped (Figure 2). Consistent with the trend of the number of SOEs, employment in SOEs increased before 1996, but started to drop since then. The largest retrenchment happened in 1998 when 20 million people lost their jobs in SOEs. By 2004, the SOE sector lost 40% of its jobs that it had in 1995. The retrenchment in collective firms has been smoother, but much deeper. In 2004, their employment was only one fourth of that in 1991, the highest in the 1990s. In the

meantime, employment in the non-public sector had increased by 24 times between 1988 and 2004 and become the largest sector in urban China, hiring 71% of the urban labor force. In fact, the non-public sector became the largest sector in as early as 1998.

It is noteworthy that privatization might not be the reason for the large scale unemployment. Huang and Yao (2006) even find that privatization increased employment due to their better performance. There were a heavy number of redundant workers in SOEs before their privatization; many of them had not got paid for years. Privatization, however, triggered off the shake-off of those redundant workers. There had been numerous protests in the country against privatization. This was a serious challenge to the CCP and put it under a conundrum: If it supported privatization, it would lose the support from its own power base --- the working class; if it gave up privatization, institutional transition would be halted and China would lose the chance to catch up with the developed world. The way CCP has adopted to solve this conundrum was to quietly continue privatization and in the meantime to do everything that would reemploy laid-off workers. This strategy has worked. By the mid-2000s when SOE privatization closed to its end, most of the unemployed workers had found new jobs or been put on government welfare programs. One consequence, however, that needed the CCP to take care of was that privatization had shattered its old ideology. The CCP needed to create a new ideology.

The above three stories reveal three main thrusts of the disinterested nature of the Chinese government. First, the growth consensus shows that the Chinese government was able to gather potentially diverging forces toward the goal of economic growth. It is often found in other developing countries that the politics is so divisive that it is virtually impossible for the government to form a consensus even on the most obvious improvements to the national economy. Second, the convergence of the dual-track price system toward the market track indicates that the CCP was willing to rip off the privileges of its own members, or in other words, that the CCP was able to disregard the interests of the elites and adopt policies that were good for the whole society. Third, the SOE reform shows that the CCP could resist populist pressures in adopting a more efficient ownership structure than the state ownership of firms even if this meant to shake its own power base. It remains our task to show why the Chinese government has been disinterested in the last thirty years.

5. Factors leading to a disinterested government in China

Why have the Chinese government and the CCP in particular been disinterested in the last thirty years? There could be many causes. The Confucian culture may have helped; the humiliating history since the Opium War may have helped; and the CCP's political structure and dominance may have helped. But they may be too specific to China to have any implications for other developing countries. In this section we will try to provide three causes that I believe have some general implications for other developing countries.

Lessons learned in the 1949-1978 period

The 1949 Communist Revolution and the ensuing land reform and nationalization of industry created an equal society in China. It seems that the CCP should choose to behave in a disinterested way; after all, the vast majority of the Chinese population at that time belonged to the peasant and worker classes, it seemed odd that the CCP's aim to serve these two classes could hinder it from being an encompassing organization. But like Peron, the CCP's policies between 1949 and 1978 had a strong populist flavor, albeit under the cover of a socialist state.

In the countryside, family farming was quickly replaced by the People's Commune; peasants were forced to work together. The Great Leap-forward of 1958 led to disastrous results including a grand scale famine. The commune system established after the Great Famine featured a work-point remuneration system that treated adult laborers more or less the same regardless of their actual efforts. The system was equivalent to a taxation system that taxed more able people and compensated less able people.

In the city, salaries were set at very low levels, but people working in the state sector were heavily subsidized by the government in foods, health care, pension, housing, and children's education. The burden to the government was high. In addition, the city obtained net transfers from the countryside through the so-called "price scissors", despite the already difficult life the peasants had to endure.

On top of those detrimental policies was the emphasis on class struggles in the political arena. Any unorthodox actions such as selling one's sideline products in the market, or even raising a large livestock would be regarded as a sign of "going the

capitalist road” and quickly suppressed. Class struggles should have been a means to protect the interests of the working class, but in the end became a weapon against the working class itself. More than that, the whole country was brought into a political hysteria in the Cultural Revolution. Anyone who dared to deviate from the political rhythm would be accused as a class enemy and be sent to a labor camp. Class struggles became a convenient weapon for one group of people to suppress another group of people.

After the Cultural Revolution was ended by Mao’s death in 1976, the moderates in the CCP began to rethink the policies implemented in and before the Cultural Revolution. One thing clear to them was that the hyper-rhythm on serving and relying on the working class would not serve China well in terms of economic growth and in the end would hurt the working class itself. After the Third Plenum of the Eleventh Party Congress held in November 1978, the term “class struggles” has been permanently eliminated from the CCP’s official documents and public discourse. The CCP embarked a road toward a disinterested organization.

An equal society

The Chinese society became an equal society since 1949, but the CCP’s emphasis on being a working-class party hindered it from being disinterested in the society. After that emphasis began to wither away in the reform era, an equal society has helped the CCP to adopt growth-oriented policies in several aspects.

First, an equal society has guaranteed that the CCP members came from roughly equal social groups, so the party did not have to be burdened by its class origin. This can be contrasted with the National Congress Party (NCP) in India. Most of the NCP founders, such as Gandhi and Nehru, were Brahmins, and it has largely remained as a party controlled by upper castes throughout the history. This had hindered its efforts to implement a serious land reform after India’s independence when it had monopolistic political power in the country. Dispersed membership in the CCP allowed it to implement policies that are better for the country as a whole than for specific classes.

Second, an equal society sets the CCP relatively free from being captured by vested interests. In the story of dual-track prices, the CCP leadership beat the conventional wisdom by depriving of the privileges enjoyed by some of the CCP insiders because it

knew that the vast majority of Chinese people would support its action. The same is true for the CCP's continuous fights against corruption. Had the country not been equal but instead been controlled by some powerful segments whom the CCP depended on, like what happened to Guomintang in old China, it would have been hard to imagine that the CCP could have moved so boldly.

Third, an equal society has also facilitated the success of the CCP's growth-oriented policies. Take the example of fiscal decentralization. If there were one thing that Chinese economists have consensus on the cause of China's economic success, it would have to be fiscal decentralization. But fiscal decentralization has not been a panacea. It certainly has not worked in Russia. In developing countries, fiscal decentralization often leads to local governments' being captured by local business powers. China stands out as a success largely because its society is relatively equal at the local level; no one has the resources and wills to capture the government. To the extent that the recent literature has shown a positive relationship between equality and economic growth, we have reasons to believe that an equal society has helped China to achieve high economic growth in other areas. This relatively "easier" result in turn encourages the CCP to adopt growth-oriented policies.

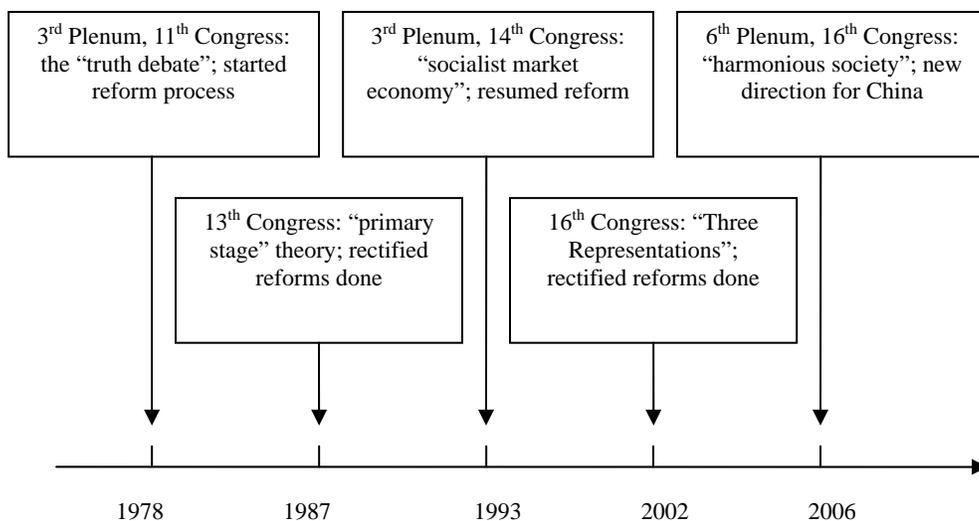
An equal society has also been emphasized by some authors in discussing the political economy of the East Asian developmental states. For example, Woo-Cumings (1997) links Korea and Taiwan's economic successes to their relatively equal social and economic structures created by the Japanese colonial rule. The Japanese intentionally suppressed rural elites and urban industrialists to prevent organized upheavals against their colonial rule. This adverse intention, however, has proven to create a favorable condition for these two economies to succeed because it uprooted the foundation for entrenched interests. "This discontinuity had a powerful leveling effect, equalizing incomes more than in most developing countries and providing a fertile ground for instituting effective interventionist states, which were given a relatively free hand to forge a developmental coalition as they saw fit." (Woo-Cumings, 1997; pp. 331) From this perspective, Mainland China is not much different from Korea and Taiwan although the equal social structure was created its own revolutions instead by foreign imperial rules.

The CCP's ideological adjustments

In the last thirty years, the CCP has undertaken a series of ideological shifts, some small, some large, but their cumulative effects have been substantial. Maybe its core conviction --- to build a strong and equitable China --- has not been changed, but its ideas about how the society should be organized toward that goal have been radically changed. The party has transformed itself from a proletarian party to an all people's party. Figure 4 shows CCP's major ideological shifts and their timings in the period of 1987-2006. We can identify three waves of ideological shifts in this time period.

The first wave was between 1978 and 1987. The Third Plenum of the Eleventh Party Congress held in 1978 started the reform process by giving up the radical ideology of the Cultural Revolution and adopting a pragmatic approach to economic institutions. Then the Thirteenth Party Congress held in 1987 acknowledged the reforms that had been started since 1978 and summarized them in the "socialist primary stage" theory. This theory gave up the goal of building communism in China, but instead emphasized that China was still in the primary stage of socialism and thus should adopt a flexible approach to economic institutions.

Figure 3. CCP's major ideological shifts: 1978-2006



The second wave started in 1993 and ended in 2002. After the 1989 Tiananmen Incident, there had been a major setback in China's reform process. It was until the spring

of 1992 when Deng Xiaoping paid his visit to the south that the reform was started again. As an official acknowledgement for the direction of the reform, the Third Plenum of the Fourteenth Party Congress held in 1993 proposed the concept of “socialist market economy” and started the largest wave of reforms in the 1990s. The conclusion of this wave of ideological shift was the announcement of the “Three Representations” in the Sixteenth Party Congress held in 2002. The CCP no longer represents only the proletarians, but instead represents “the requirements of the advanced productive forces in China, the future direction of China’s advanced culture, and the essential interests of the vast majority of Chinese people.” The CCP has since formally declared to become a party of the country instead of a party of the working class. In terms of what the CCP had done in the 1990s, this declaration was not new. The structural adjustment and SOE privatization in the 1990s had shown that the CCP had given up its role as the guardian of the working class’s interests. In other words, it had declared to be disinterested in the society.

The third wave has just started; its symbolic move was the announcement of the concept “harmonious society” by the Sixth Plenum of the Sixteenth Party Congress held in 2006. A harmonious society features “democracy and the rule of law, fairness and justice, honesty and mutual love, energetic dynamics, peace and order, and harmony between man and nature.” The key words are “fairness and justice”. The growth consensus has left many problems unsolved and accumulated along its way to sustain high economic growth. One major consequence of the spearheaded growth of the last thirty years has been the enlarged income gaps between rural residents and urban residents --- with urban per-capita income being 3.3 times of rural per-capita income, China is the most divided country in the world in terms of urban-rural gap --- and between the coastal region and the inland regions. There are also 22 million urban residents who are on government welfare system. This new wave of ideological shift is aimed at remedying those negative sides of high economic growth. Some people tend to believe that the shift symbolizes the return of the egalitarian policy of the past dressed in a populist overcoat. However, extreme inequality has been both theoretically and empirically proven to be detrimental to economic growth; therefore, this new shift of the CCP ideology is still consistent with its role as a disinterested government.

The first and third causes have implications for other developing countries because they show the importance of pragmatism in driving China's reform and economic success. Pragmatism rejects ultimate truth, and for that matter, it ought to reject first best in policy making. A pragmatist is always aware of the tentativeness of the current state of affairs including the institutions that run the society and is always ready to make changes once small improvements are possible. He is also keen to learn from its failures. The second cause is related to the social structure of a country. An equal society pays in many ways; this paper shows that it provides a foundation for the government to act more in the interests of the whole society.

6. Conclusions

This paper has provided a political economy explanation for China's marvelous record of economic growth. Our explanation is centered at the notion of disinterested governments. We have provided evidence to show that the Chinese government led by CCP has indeed been a disinterested government in China's reform era. We identified three causes for that to happen, which we believe have general implications for other developing countries.

In a sense, China is unique in its historical and contemporary political settings. But the key idea coming out of this paper remains valid for all the developing countries, that is, a disinterested government is key to a country's adoption of pro-growth policies. Most countries have failed to create such a government. It is a commonality rather than an exception that countries are either captured by business elites or hijacked by populist pressures. A society that is both economically and socially equal is more likely to create a disinterested government. Perhaps social equality is more important than economic equality because social inequality is often associated with races and stigmas, but economic inequality can be rectified by government policies.

One remaining question is whether China's one-party system hinders the applicability of the Chinese experience to other developing countries many of which have at least a nominal democratic system. As I pointed out earlier, the CCP's dominance may have helped the Chinese government to become disinterested. This can remain valid even if we

are sure that an authoritarian state is neither necessary nor sufficient for a disinterested government to emerge. It is possible that the CCP's rule has blended well with China's historical, social and cultural settings to reach a unique mix which is conducive to the emergence and sustainability of a disinterested government. However, the Chinese experience provides a valid lesson for other developing countries even if that is the case. Every country is unique, but every country has elements conducive to economic growth. It is the task for each country to piece together those elements to make them the dominate forces in the society. In a sense, it is not the form of the government that matters; what matters is the incentive structure in the society --- the formal and informal rules that guide people's actions. Each country should and can find a way to build up an incentive structure that is conducive for a disinterest government to emerge. Such a structure does not need to emulate any existing models, but rather to utilize any resources including traditional but seemingly unorthodox mechanisms. Again, a sense of pragmatism will help.

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