

Authoritarianism and Chinese "success story"

Concerning Certain Features of Chinese Economic Growth

*I have just returned from China...
Holy Mother of God!
Goodly is the Chinese land...
The all-Chinese Emperor...
His every sneeze is law,
While Peking, his capital,
Must pray for his welfare.
I paid him obeisance,
But the ruler was not merry.
Calling upon a division of policemen,
He ordered that I be taken away.
Ah, ah, ah! Hardly will
A European mind comprehend
How without further ado into prison
An innocent man should be thrown.
Return from China
Pages of German Verse*

In this article authors tried to review Chinese economic miracle.

Majority of economists are deeply impressed by high rate of China's economic growth. They are going to search for explanations of the coming new successes of this country.

The missed point of these assessments is lack of attention to the new trend of poor formalized China institutions' development . Clearly observable in the modern Peoples Republic of China deterioration of entrepreneur's personal immunity informal guaranties means broken guaranties for private property. The government failure to defend (at least not make a threat) to private property could cause negative influence on China's economic growth in very Long Run.

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Economic growth in modern China strikes many people as impressive. China is cited as a model to emulate by economists maintaining diametrically opposed views: from libertarian (Cato Institute,¹ A. Illarionov²) to dirigiste (V. Popov³). Such unanimity reinforces the impression made by China's economic growth; albeit, if looked into more carefully, the impression may turn out to be misleading.

In the present chapter, the authors intend to demonstrate that:

Chinese economic growth is considerably less stable than is normally assumed;
The country's authorities engage in a multitude of measures of the kind which undermine stable economic growth. The last few years have seen an especially large share of this;

The case of China's growth has a lot less new and informative about it than is usually believed;

Perspectives of fast-paced economic growth in the long term, such as would enable China stably to occupy the position of a leading world economy, do obtain; however, their coming true is improbable.

Even though most wealthy countries are rule of law democracies, rapid growth of the economy in an authoritarian state is not something unusual. For many decades, the USSR impressed Western intellectuals by its economic achievements. Leaders of the Western world⁴ in good earnest considered the possibility of coexistence under conditions of USSR leadership (in volume of production and labor productivity, i.e., in case of "the triumph of socialism" in an economic competition between the two systems), even though they appreciated socialism's inability to maintain a high standard of living among its citizens. Nobel Prize winners predicted a course of unswerving development for the "most stable economy in the world" as late as the 1980s. (P. Samuelson included this forecast in his famous economics textbook, going as far as the 1989 edition⁵).

A. Przeworski⁶ noted that, given comparable average growth indicators, authoritarian states are characterized by high peak values, positive ones no less than negative ones. In other words, the chief problem economic growth under authoritarian rule must face is instability.

Now, if we expand the time span to be studied from 40 years, as Przeworski has it, to 180 years, then the difference becomes even more obvious.⁷ It probably makes sense to extend Zhou Enlai's cautious attitude toward the evaluation of the outcomes of the Great French Revolution to the economic growth observable in China beginning in the late 20th century.

¹ Cato Institute (www.cato.org) is optimistic concerning perspectives of continued Chinese wonders, the growth of Chinese potential, and the significance of this country as a partner (<http://www.freetrade.org/issues/china.html>).

² http://www.libertarium.ru/l_ptchina_china.

³ See V. Popov, "Pekinskiy kontzenzus" ("The Peking Concensus"), *Kommersant* Sept. 1, 2006; idem., "Shok i rynok" ("Shock and Market"), *Kommersant* August 30, 2006.

⁴ Foreign Relations of the United States 1961—1963, vol. V, Soviet Union, Department of State, Washington, DC (http://www.state.gov/www/about_state/history/vol_v/01_09.html); U.S. Department of State, vol. X, Part 1, FRUS, 1958-60: E. Europe Region; Soviet Union; Cyprus Office of the Historian <http://dosfan.lib.uic.edu/ERC/frus/frus58-60x1/13soviet7.html>; Horne, 1989, p. 303.

⁵ "The Soviet economy has proven that, *contrary to skepticism often expressed earlier*, the socialist command system can work and even flourish." (P. Samuelson, *Economics*, 1989, p. 837) http://www.cne.org/pub_pdf/monatsmag/2004_10_00_CNE_Monatsmagazin_eng.htm.

⁶ Przeworski, Alvarez, Cheibub, & Limongi 2000.

⁷ Yanovskiy & Shulgjin 2008.

Besides advantages offered by caution and care, as compared with haste, there are a number of other weighty reasons not to rush to conclusions about the achievements of capitalist construction in the People's Republic of China.

In a series of earlier papers we have shown that the reliability of safeguards for property rights requires reliable safeguards for the inviolability of property owners, as a necessary preliminary condition.⁸

The same papers explained the fact of the PRC's ability to attract direct foreign investment by means of a peculiar way of importing institutions from developed countries. The fact that in China there is no practice of arresting or depriving of liberty nationals of rule of law democracies implied these individuals' *de facto* inviolability (almost the same for them as at home). For a businessman, a habit of long standing of having things operate in this manner is quite tantamount to universal rule of law guarantees. In reality, the mechanism is different in principle: it is the restraint of the regime *vis-à-vis* both the sum total of the revenues exacted and the methods resorted to for getting them. However, as noted previously by Olson, only a democracy with a competition-based authority and transparent universal procedure is capable of providing guarantees for the property owner and the property owned, independently of political circumstance⁹ or personal considerations of any one particular leader.

At a certain stage, the "stationary bandit" assumes that resources may be obtained by means of payments referred to as taxes. This is particularly common in cases of continued growth, when even in the short term it is more profitable to support the rights of counter agents than to rob them. But then one day the "stationary bandit" can decide that money is needed urgently (for the struggle with consequences of a crisis or a flood, for war, and so on), and then the unwary entrepreneur must hand over his entire business. So as to speed up the "clarification" procedure, the entrepreneur can be put behind bars. Practices of this kind are widespread in states which are based not on the power of law, but rather on discretionary – read, arbitrary – decision making.

In the late 1970s, politically motivated violence went down sharply. In other words, life risks for the potential property owner decreased. The very notion of "being a proprietor" was rehabilitated; it was no longer considered a crime. The enormous "awning" of possible mutually profitable transactions and small businesses began to be embodied in practice, providing for high growth rates. Among other key sources of growth, something to single out is one of the lowest levels of economic development in the world at the outset, as well as an enormous supply of cheap labor in the rural areas, which is still not depleted. All this created the conditions for rapid and relatively long growth of the Chinese economy.

The Village to the City

The chief competitive advantage and growth resource for the Chinese economy at present is its human capital; China's labor force today is both cheap and relatively well prepared. In addition, the Chinese are not picky and have some notion of labor ethics.

The influx of labor from the country, where the standard of living is catastrophically low, makes competition among people in China particularly tough, forcing them to put out their best and work essentially at the limit of their capacities.

⁸ Yanovskiy & Shulgin 2008; Mau, Yanovskiy, Javoronokov et al. 2007.

⁹ Olson 2000.

Besides all the indirect and hard-to-track effects, let us note the purely economic one: acute competition makes for low cost of labor, a fact which, along with the systematically lowered yuan exchange rate leads to a decrease in the cost of export goods (that is, it raises the competitive ability of Chinese products).

Europe, Russia (the USSR), and, partly, the US have experienced decades of growth fed by the pressure of labor influx from rural areas.

The way through this development stage in the USSR was the most barbarous by comparison with large industrialized nations (as, incidentally, was also the case in Mao's China). At the same time, food export did not play the most significant role in the process. Taking food away from the villagers for purposes of export and selling to the same villagers industrial products manufactured by the fatherland – but selling them at raised prices – apparently are not of the greatest importance. More significant now is the transfer of the most hardworking, energetic, and ambitious citizens from the village into the city.

It should be noted that neither in the USSR, nor in China did policies of accelerated industrialization or amassing resources yield any substantial returns. The mere fact of the availability of an excess labor mass does not on its own guarantee high growth rates, let alone stable ones, so that, given a totalitarian politics, even this trump card does not always work. Mobilization at the cost of mass hunger and starvation when the USSR industrialized led to the attainment of the supplementary 4-5 million t of grain within two years,¹⁰ at the cost of millions of human lives lost (of the labor force). Even given the outlook for 1933-1941, this was no gain. China's uniqueness consisted in that its human resources seemed inexhaustible, while in the USSR, after starvation, war, and the GULAG, the insufficiency of the work force made itself felt as early as the 1950-60s.

To sum up: the main factor involved in the structural transformation in China – just as was the case in other countries earlier – is human capital (in the broad sense), while its depletion means exhausting the rural resources. The question arises: how long can the stimulating impact of the population influx from country into town last?

1995 saw the registering of the top rural population count in China¹¹: 860 million; a decrease followed. Today, the part comprised by rural residents makes up approximately 55% of the total population. If we take it into account that the rural population decreases by approximately 10 million per annum, then, based on an approximate count, the process of urbanization may extend for 40-60 years.

As for excess labor resources, according to some estimates, modern China's "reserve" cheap work force in the village town alone makes up some 17% of the able-bodied population of the country.¹² There is an urban "reserve," as well: 4.5% unemployment, which accounts for not less than 10% of the able-bodied urban residents. If we also take it into account that the nearly ineffective state enterprises are largely a way of concealing unemployment, the real extent of labor excess available among the population becomes impressive.

However, let us suppose that the role of the "reserve" cheap labor as a factor in economic growth will gradually go down.

First of all, the potential of the extensive economic growth model – at the expense of ever higher resource involvement in the economy – in China has largely been exhausted. But, surprising as this may seem, the reason in this case has to do not with

¹⁰ Gaydar 2005 (cf. data on p. 315, Table 8.9, with similar Chinese indicators on p. 316, Table 8.10).

¹¹ http://www.allcountries.org/china_statistics/4_1_population_and_its_composition.html.

¹² Gelbras 2005.

limited resources (at least, as already noted, labor resources are plentiful enough), but with limited demand, primarily limited world demand.¹³ In the mid-1990s, production capacity was 30-60% (the 80-90% level is considered normal), depending on the branch of the economy in question; thereafter, it only went down.¹⁴ This indicates that a multitude of enterprises had been created which resemble each other, or which are altogether not necessary (from the point of view of demand). It then becomes clear that the continued influx of labor does nothing to improve the economic situation (or else this will be growth for the sake of growth, as in a command economy).

Secondly, the authorities make a concerted effort to lessen city migrant-absorbing capacity, blocking the growth of a work-qualified and educated population. This means that a deficit of qualified or skilled workers is achieved by artificial means, leading to growth in the cost of skilled labor. In the long run, this leads to a fall in the efficiency of the economy. Excess numbers of little-skilled migrants from rural areas exert pressure only on the corresponding sector of the labor market. The low cost of their work force advances the interests of construction, trade, provision of urban amenities, and the like.

But disproportionality may lead to a state of affairs such that it becomes more profitable to create labor-intensive enterprises at the expense of capital-intensive ones (use two dozen workers instead of a single hoisting crane), something which will have a negative effect on the development of technology. As China more and more insistently claims the status of a world center of economics and technology, the level of education and skill of workers becomes a determining factor for development, making “assistance from the country” unnecessary.

From our point of view, the main mistake made by economists who see China as a leader and model for imitation, consists in their blindly extrapolating trends from the period of industrialization and urbanization. This is an extremely unreliable basis for forecasts, especially for a country with no institutional foundations for economic growth; that is, no reliable guarantees for the defense of property rights and owners. Such guarantees should come as a combination of formal, impersonal legal norms and corresponding law-enforcing practice.

Concerning Achievements in Historical Retrospective

If we consider the growth of the Chinese economy in retrospective, its current successes become less dizzying, on the one hand – and more understandable, on the other. Thus, in the early 19th century, China accounted for about one-third of the world product (Table 8.1). During the period of rapid growth in the West, China’s share in world production continually fell (for reasons both internal – peasants’ wars and revolutions, and external – the growth in other countries’ contribution to the world product.) According to Maddison, by 1995, China’s share returned to the 10% level; even though it continues to grow today, it remains considerably lower than previous values. In other words, China at the close of the 20th century only restored – and even that, only partly – positions it had lost earlier in the course of the industrial growth of the West. China’s economic power is largely explained by its enormous territory and large population numbers, so that even when the per capita GDP

¹³ During the 2008-09 crisis, the excessive dependence of the Chinese economy on the export sector became obvious.

¹⁴ Gelbras 2003.

indicators are not high, the overall volume of production is greater than in other countries.

Table 8.1

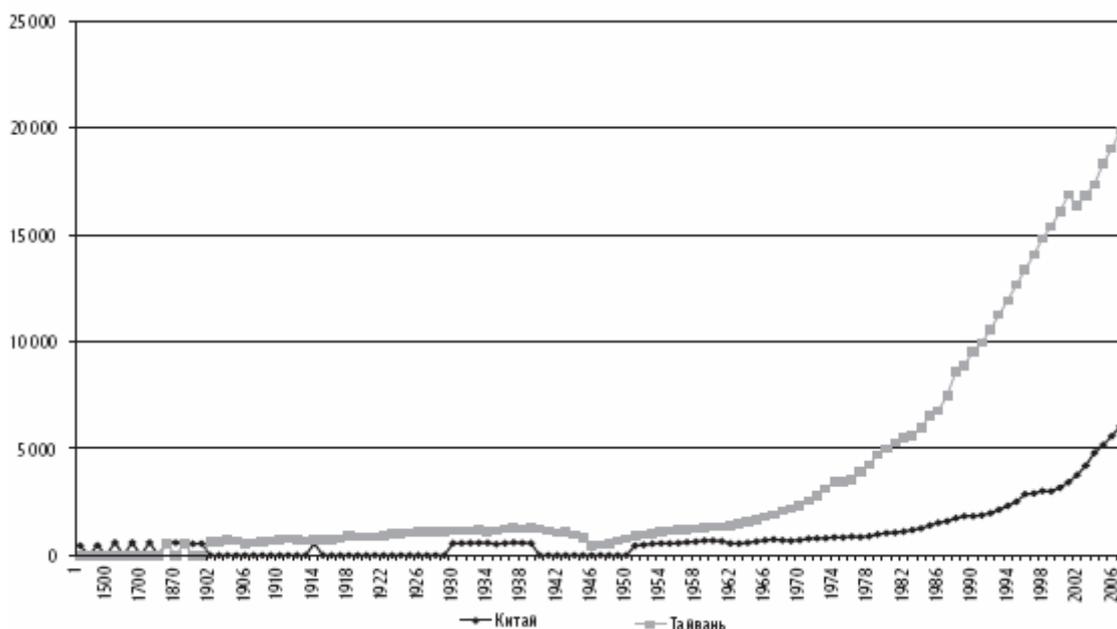
Largest Countries' Share in World Economy, %

Country	1700	1820	1890	1952	1978	1995	2006
China	23,1	32,4	13,2	5,2	5,0	10,9	16,8
India	22,6	15,7	11,0	3,8	3,4	4,6	6,1
Japan	4,5	3,0	2,5	3,4	7,7	8,4	6,1
European Countries	23,3	26,6	40,3	29,7	27,9	23,8	20,9
USA	—	1,8	13,8	28,4	21,8	20,9	19,6
USSR/ Russia	3,2	4,8	6,3	8,7	9,2	2,2	2,4

Sources: A. Maddison, *Chinese Economic Performance in the Long Run*, Table 2.2a (for statistical data see: <http://www.ggdc.net/maddison/>); A. Maddison, March 2009, http://www.ggdc.net/maddison/Historical_Statistics/vertical-file_03—2009.xls, Angus Maddison's homepage.

But if we compare per capita GDP, then, by contrast with the early 19th century, China's lagging behind the leaders has increased significantly. According to Maddison's data, in 2006, China lagged behind the US more than fivefold as based on the per capita GDP indicator (as based on purchasing power parity (PPP), the nominal gap is much greater¹⁵). In 1820, the lag behind Great Britain was less than threefold (lagging behind the Netherlands was a little greater than threefold). Taiwan continues, as before, to be ahead of China by outdoing it threefold (Drawing 8.1).

¹⁵ According to World Bank estimates, China's per capita national income in 2007 came up to \$2037, and to \$5420 according to purchasing power parity (PPP). US indicators: \$46040 and \$45840, respectively (WDI 2009), i.e., China's indicators are more than 22 times smaller than the US, or 8 times according to PPP.



Taken from: Historical statistics on the A. Maddison homepage, March 2009, http://www.ggd.net/maddison/Historical_Statistics/vertical-file_03—2009.xls.

Drawing 8.1: Dynamics of per Capita GDP in China and Taiwan, 1990 International Dollars, Geary-Khamis.

It should be noted that even though we refer to China's GDP statistics, it is quite likely that many of these figures have been considerably inflated. It is difficult to obtain objective evaluations for a whole series of reasons. Official statistics tends to exaggerate achievements and pass over shortcomings in silence.¹⁶ There are notable differences between data come up with by centralized statistical agencies and information conveyed from the provinces.¹⁷ The official GDP noticeably exceeds the more exactly measureable natural indicators, such as electric energy consumption or the volume of domestic transporting of goods, while no data at all are available to indicate that the economy as a whole has become more energy-efficient.¹⁸ All this conveys the message that the official data concerning China's GDP are inflated.

There is also no reliable information about the non-export sector.¹⁹ This sector's branches are less open, or else altogether closed to world competition. Frequently they are not quite open even for domestic competition (the bank sector and the Housing and Utilities Management). As a result, they remain backward, while insofar as growth perspectives go, they become a burden to the export sector.

¹⁶ The anecdotal-conspiratorial version of the story about the Chinese government's lowering the economic growth data so as not to irritate or frighten the world, is something we are not taking into consideration.

¹⁷ Gelbras 2003.

¹⁸ Ibid.

¹⁹ The information collection and publication mechanism at the statistical bureau of the PRC is not protected from political pressure or falsification, by virtue of dependence. (As in any totalitarian state, where published statistical accountability is also an instrument of propagandistically acting upon the surrounding world).

As for export: over the last two decades, export volume corresponded to the level of countries exceeding China's per capita GDP by a few times.²⁰ Unlike the model of the economy aimed at exporting raw materials, such as the one in practice in Russia, the "export-oriented" model is significantly more promising; however, it cannot guarantee stability or long-term growth. This last ultimately depends on the system's ability to generate new *scientific and technical knowledge*, as well as to come up with mechanisms for its implementation in practice. The state cannot compete with the free market in this field, at least, not in the long run.

Y. Gaydar (2005) notes that in addition to the non-transparency of the state and the unreliability of the statistics, there is a more fundamental problem bound up with GDP assessments. An assessment based largely on purchases made by free consumers on the free market is not easily compatible with one of wholesale acquisitions, a large part of which is determined by administrative agents.

Growth of the Chinese Leviathan

The state's not high, but systematically growing share of income (5.4% of the GDP in 1995, and 10.3% in 2007²¹) and of GDP expenditures (12.9% in 1997 and 19.9% in 2007²²) indicates that even though state fiscal interference in economics is not excessive as compared with the developed countries, this restraint is largely a forced measure. With the average income for the majority of the population hardly topping the subsistence minimum, it becomes impossible to levy taxes as per the high income bracket. Thus, in Egypt, one of the wealthiest states of the ancient world, a 20% tax burden was taken to be an indicator of the condition of slavery.²³ For its part, the state unaccountable to voters and sufficiently powerful to be able stably to levy taxes, is interested in maximizing tax collection, both in order to fortify the regime purely militarily and to "buy" political stability. This last objective is impossible to achieve at a certain tax burden level due to constant overestimating and growth of the "minimal" level which aims to provide for the state.

Even so, let us note that official data do not always – and do not fully – reflect the real interference of the state in economics, insofar as they indicate only that portion of the income which goes through budgets at different levels. Official data do not take into account illegal levies; nor do they at all assess the missed economic profit which could have accrued from activities of the state and its agents (for instance, the decision against opening a private enterprise because of formidable administrative barriers).

The level of economic freedom in China has risen as compared with the initial period of the reform. Even so, it appears that the real liberalization took place in the 1980s. Later, the situation did not improve, but rather, as per certain indications, even deteriorated somewhat (*vis-à-vis* other countries).²⁴

²⁰ Popov 2006.

²¹ World Bank, WDI 2009, Table 4.10.

²² http://www.adb.org/Documents/Books/Key_Indicators/2008/xls/PRC.xls.

²³ A point reflected in the Pentateuch; see Genesis 47:24.

²⁴ As per the index methods of www.freetheworld.com, the level of economic freedom in China has risen from 4.42 in 1980 to 6.17 in 2006 (with 10.0 being the highest index value possible). At the same time, China's rating has dropped from 80th to 88th; <http://www.freetheworld.com/2008/EconomicFreedomoftheWorld2008.pdf>.

There is no talking about decisive influences on the economic growth of the state (or of the market) under mixed economy conditions. Even so, state influence turns out to be appreciable. For instance, it comes to the fore in GDP and export structure, where heavy industry and related export goods took the lead in growth rates beginning in the 1990s, while light industry, which had seen furious development in the 1980s thanks to small private businesses, lagged noticeably behind.²⁵ Structural shifts of this kind are most likely conditioned by state influence, a circumstance possibly reflected less by direct interference in economics than by preference given to large corporations, many of which have intimate ties with the Communist Party of China (CPC).

There are grounds for supposing that in the future, as the GDP grows, state involvement will be on the rise, as well. This is due, first of all, to the physical feasibility of collecting higher taxes (*obtaining higher revenue payments*) without running the risk of undermining tax²⁶ (administrative-revenue) foundations. Secondly, with the deterioration in business climate, the state's chances of ignoring the excess labor force's discontent drop sharply. An authoritarian state can renounce "social" redistribution entirely, provided that it sustains high economic growth rates on a sound basis, i.e., on the basis of a favorable business climate. As a consequence of this last, normally, the gap in income among social groups and regions is preserved (the higher the growth rates without the distorting interference by the state, the more reliably do the disproportionate ratios soften in the long run.) It then becomes logical for the government to persecute leftist extremists harshly for "instigating class conflict," as was the case in Turkey. However, if the authorities are themselves prone to turn to social demagoguery, and business climate deteriorates in the process, it becomes difficult to do without bribing the excess labor force among the population. The bribery in combination with perks for clerks who inflate the resources required for their offices lead to the emergence of a stable tendency: growth in the overall burden for the state.

Action along these lines and the authorities' political decision not to rely on the population strata which have made particularly large gains as a result of the reforms make business climate deteriorate even further. In the long run, this promotes great expectations among the would be ruralized folk population strata, and thus poses a threat to socio-political stability; an extremely dangerous development, considering that the CPC is no monolith in its own right. The party works less as a coalition than as a conglomerate of special interest groups. China's institutional weakness consists in the absence of a return connection in society: the population has no way to impact the decisions made by the leadership, and as the likelihood of revolutionary

²⁵ In particular, steel production in 1990-2007 increased by a factor of 7.37, machinery construction product exports increased 48-fold, textile products exports – by a factor of 6.8. At the same time, the GDP increased by a factor of 5.3. See <http://www.adb.org>.

²⁶ As shown by M. Olson (Olson 2000) and V. Mau (V. Mau, *Nalogovaya sistema: Vernost' ordynskoy traditsii* [Taxation System: Fidelity to the Orde Tradition], in *Vedomosti* [Gazette], March 5, 2007; <http://www.vedomosti.ru/newspaper/article.shtml?2007/03/05/121750>), the purport of taxes in a non-democratic state is radically different from the meaning which taxation carries in a democratic country. In this latter case, the taxpayer covers – even if not quite willingly – the costs of providing public goods. At the same time, in a democracy, especially when tax brackets are ascertained in tandem with the introduction of every new piece of legislation pertaining to the budget, as was the case in the US in the 19th century, the level of willingness turned out to be quite high, as opposed to the democracies of today where universal suffrage is in effect. By contrast, in a non-democratic country, any payments made to the order of the state are for all intents and purposes unconnected with the volume or quality of the public goods. Rather than a tax, they resemble a tribute, that is, ransom paid to the violent attacker so as temporarily to postpone the moment of destruction.

proclamations lessens, the leaders' motivation for introducing further reforms also goes down.

New Tendencies

The New Generation's Choice

There are serious grounds for supposing that the trend of liberalizing the economy and weakening state control, exhibited during the first years of Chinese reform, has been disrupted.²⁷

This is indirectly confirmed by a 2007 survey of Peking students. According to the survey data, state service took second place among sought after professions (first place went to working in transnational corporations). 13% of the students surveyed would have liked to work in state enterprises, and only 1% wanted to go into private enterprise.²⁸ Competition for state service positions beats every thinkable record.²⁹

Similarly, the late Middle Ages, a period with a comparable level of property rights protection and entrepreneurship prestige, saw the most talented and energetic individuals, even after they had succeeded in trade, often attempt to purchase titles and land, so as to become like "all normal aristocrats,"³⁰ that is, to break through and become part of the elite. Belonging to the elite determined not just the possibility of short-term success, but also a reliable (to the extent that this is altogether possible) status for the family in the long term. This meant a status not merely political, but also economic, insofar as in a country where prevailing violence³¹ replaces law, might (that is, violence) is the predominant source of stable ("legitimate") wealth.

At the same time, no evidence is available that the higher level of state interference and redistribution of wealth in China has brought inequality down.

Naturally enough, the deterioration in the investment climate most painfully affects the small private entrepreneurs in villages and small towns, a fact which limits employment opportunities and artificially contributes to the influx of migrants into the large cities.

The Labor Force Market: Some Trends

India's experience demonstrates that freedom of emigration and mass emigration abroad of the most talented and enterprising youth does not unambiguously spell out a loss for the country. Just the opposite holds: such a turn of events can serve as a catalyst in the long run, similar to what happened with growth of various branches of high tech, when Hindus successful in the West blazed the trail for

²⁷ Huang 2008.

²⁸ *Ibid.*, p. 282.

²⁹ Even reports along these lines appear: "37,021 applications were submitted for admission to exams for state service positions in the city of Weifang in Shandong Province in 2009, a figure that exceeds the previous year's number by 15,070, and that with 50-400 pretenders per available slot." See <http://www.epochtimes.ru/content/view/22981/4/>

³⁰ See, for instance, Kotelnikova 1987. Some entrepreneurs in Russia today make purchases abroad, in countries where property is securely protected, but the purchases themselves appear *prima facie* not to be entirely justified (from the point of view of profit, for example). At the same time, motivation along the lines of expanding the share of the not very profitable, but secure assets appears to be extremely rational in all the situations described, from investing local human capital in preparing for state service, to acquiring football teams abroad.

³¹ Quasi-legitimate acts of coercion by those holding power.

US investments in their home country. In this sense, the liberalization of emigration procedures in China is a progressive development in the long term,³² except that one important condition needs to be observed. In order for a successful Chinese to have the wish to return home, bringing along the capital and the knowledge acquired abroad, more is needed than just the formal opportunity to open a business quickly, to export profits, and the like; guarantees must also be in place for property and property owners. In India these latter, at least, do exist. The situation in China is at present far from being similarly clear.

But what if the departure of the energetic younger generation for foreign lands does not sooner or later lead to a return movement – an influx of human capital “with interest” embodied as new knowledge, experience, reputation, and earned funds? Then this process will signify an “easing up of the unemployment problem” by dint of the departure of potentially highly qualified workers, managers, and entrepreneurs (along with their later being replaced by potential janitors, blue-collar workers, metal workers, and lathe turners).

The process can be visualized by referring to the rapidly growing Chinatowns in Canadian cities, including suburbs which had been initially wealthy. Besides, today’s Chinese, unlike those born in the 1960s, normally should not be expected to operate to their own detriment for the sake of the Fatherland’s interests or those of the Party. Only children in city families, they have no grounds to feel any obligations to the state. After spending years and decades in the West, they most likely adapt there considerably more thoroughly than their predecessors did.

One point needs to be made a note of in this connection. The oft discussed measures taken by the CNR to control the internet are not, if considered in their own right, all that important, but they are indicative of two developments:

Informational closure, standard for all societies except competitive rule of law democracies;

China’s lower (for the above reason) ability to compete in the struggle to attract the best educated scientists and technical workers, or investments in venturesome projects. The very opportunity for the state as entrepreneur to manipulate information lowers the level of trust, a circumstance which is particularly dangerous for high-risk long-term projects.

A factor further impacting the deterioration in the structure of labor force availability in the CNR is the policy of controlling the birth rate. The authorities are in effect preventing the reproduction of the stratum of educated and highly competent city dwellers. At the same time, opportunities for controlling population growth in rural areas were and continue to remain limited; that is, the shortage in educated city dwellers is “compensated for” by the influx of still ambitious and energetic villagers. (In rural areas, controlling the birth rate is made difficult by an objective factor: the low level of “social” services offered by the state brings down the country folk’s interest in providing state registration for newborns.) But the supply of energetic, enterprising village youth is limited (such people are an evident minority among the migrants). A villager arrived not in order to “conquer the capital,” but simply in order temporarily to resolve the problem of sustenance, can in no way make up for the shortage (the “underborn” or the emigrated) of more educated city dwellers.

³² Gelbras 2005.

The indicated increase in the state's involvement has a positive correlation with the growth of corruption.³³ At the same time, the active anti-corruption policy pursued by the authorities is a priori ineffective, insofar as "doctors" treat "illnesses" which they themselves provoke.

The situation worsens considerably due to the unripe condition of the legal system in China, as well as the ambiguity enshrouding the interpretation of the law. Various state and quasi-state agencies assume the right to determine rules concerning different aspects of social and economic life, but finding out whether they really are authorized to do this often turns out to be impossible. The system features no effective or generally acknowledged way of resolving such questions.³⁴ The great variety of regulations issued by various agencies leaves no opportunity for businesses to work only within the limits of the strictly legal. The situation is typical of most developing countries, where nearly every economic agent unavoidably finds him or herself violating at least some law – and, thus, is constantly facing the possibility of repression by the authorities. We may say that, due to the absence of a single unified source of ultimate authority in the system, there is no single legal order in China. Instead, a multitude of "legal" orders obtains, each outfitted with a field of jurisdiction of its own, as well as its own power hierarchy and rules.³⁵

The widely publicized campaign for fighting corruption, initiated for the purpose of supporting CPC prestige and pursuing populist goals (redirecting popular discontent from state authority as a whole to particular officials and oligarchs), is in practice a way to do away with political competitors.

Chinese Guarantees

Even when at the peak of its success, China never had a developed or capacious transactional sector. Chinese banks and investment companies were and continue to remain subject to state control – and ineffective. Reference has already been made to problems of private investment in venture projects.

All this has a direct bearing on the inadequacy, as previously mentioned, of the guarantees for property and business, available as such and unaccompanied by guarantees for the property owner. This is particularly pertinent to the fate of large, long-term, transaction-heavy projects bound up with such a multiplicity of market risks, that investing any further per country political risks in the profit becomes impossible. That is, this is a reality for projects requiring that capital be tied up for a long period of time and that a sizable number of agents cooperate together. This means projects requiring non-personal, formal guarantees, rather than ones grounded in someone's personal pledge,³⁶ the business reputation of someone's partner, or the promise given by a political leader or official.

Newspapers and information agencies in July 2009 reported the arrest of a group of employees of the Australian company *Rio Tinto*, including an Australian national. The company is a major provider of iron ore for China's black metal works. Earlier, the same company had rejected the

³³ In earlier times, corruption used to be thoroughly effective, in the sense that as a rule, obligations incurred by corrupt officials were unfailingly lived up to. This is precisely what aroused the "enthusiasm of American entrepreneurs," as described by L. Aron (Aron 2001).

³⁴ Clarke 2006.

³⁵ *Ibid.*, p. 51.

³⁶ Greif 1994.

Chinese side's offer to invest nearly \$20 milliard in *Chinalco*, a Chinese state corporation. Chinese special services accuse company employees of industrial espionage, by means of which the Australians allegedly obtained information enabling them to get an "extra" \$102 milliard from China (!).³⁷ All this is at the very time when in Australia the discussion is in progress about the 2008 attempt by Chinese special services to break into the Australian Prime Minister's mail.³⁸

Before becoming the world's workshop, Great Britain went through an almost century-long period of guarantees for the inviolability of the individual person, along with the refusal to engage in practices of arbitrary taxation or other similar measures. That is, property guarantees have for many years been provided there by sturdy guarantees for the property owner. This is why even when it lost its former status of world power and mover of world economics, this country did not slide into the crowd of "developing" countries, but continues along its course of normal economic development.

Some of the most important factors shaping China's investment appeal include the sense of political stability,³⁹ along with the high level of reliability of informal agreements (the "good corruption," when a corrupt official strictly fulfills contracted obligations⁴⁰). In addition, foreign investments were "protected" by informal guarantees from arbitrary arrest for nationals of the developed countries (the old rule of law democracies).⁴¹

It seemed that the "prosthetic" Western guarantees for the inviolability of the individual person of the property owner (the investor) worked perfectly when joined with another informal rule abided by among Chinese leaders back since the time when Deng Xiaoping was gradually taking his departure from work matters: not to destroy each other's "feed sources."

But informal guarantees did not last long. Something happened which made it clear that the authorities had for all intents and purposes made the decision to violate the last of the "guarantees" of the kind in question.⁴²

Given a certain amount of luck, earning milliards in China can be done relatively quickly, but losing the same money is something which can be done even faster. Getting into the *Forbse* lists in China is not seen as an achievement, but rather as an additional risk factor.⁴³

³⁷ http://www.channelnewsasia.com/stories/afp_asiapacific_business/view/448282/1/.html.

³⁸ http://www.nytimes.com/2009/07/10/world/asia/10riotinto.html?_r=2.

³⁹ A sense which is largely illusory, considering that per capita average income approaches the dangerous threshold when further development will only be possible after a revolution. See Mau & Starodubrovskaya 2001, p. 63, Table 2.2; Mau, Yanovskiy, Javoronkov, et al. 2003, par. "Problems of Authoritarian Modernization."

⁴⁰ Aron 2002.

⁴¹ <http://www.iet.ru/ru/importirovannye-instituty-v-strana-s-pere-odnoi-ekonomikoi-effektivnost-i-izderzhki-nauchnye-trudy-68-2.html>.

⁴² The case of Rio Tinto and the arrest of Stern Hu, an Australian national, were accompanied by comments made by officials to the effect that the legal process would only raise China's attractiveness for direct investment: "It will not impair China's efforts in terms of attracting FDI. On the contrary, we believe it will benefit China's (efforts to get) FDI," Vice Commerce Minister Fu Ziyang told reporters at a briefing." *Business News*, August 12, 2009 (http://www.channelnewsasia.com/stories/afp_asiapacific_business/view/448282/1/.html).

⁴³ Huang Guangyu, "China's Richest Man Disappears amid Corruption Investigation," *The Times*, November 25, 2008 (<http://www.timesonline.co.uk/tol/news/world/asia/article5221230.ece>).

The Present Moment

The 2008-09 crisis and the way the leadership of the largest developed countries responded to it (panic and expanded state interference) strengthened the CPC leaders' certainty that the policy of state management of the economy is the right way to proceed; in particular, this included a policy of controlling the banks.⁴⁴ Banks remain subject to direct state control, and the state pays for their failures, occasionally recapitalizing them, as well.⁴⁵ The decreasing volume of world markets and export opportunities has a negative impact on perspectives of even post-crisis growth. In order to augment the share of the market, it will probably prove necessary to lower prices, and that means lower profits. This is extremely dangerous for an economy whose growth is entirely bound up with the export sector and investment.

A further circumstance, and one even more dangerous for the future of the Chinese economy, is the new foreign policy of "restarts" and acknowledging China's special status, introduced by the US President Obama administration. Taken as an indicator of the atrophy – as admitted by the American side itself – of the sole remaining "superpower," the policy weakens the motives still restraining the Chinese leadership from actively re-allotting foreigners' property.

The considerations listed above do not mean that the Chinese economy is about to collapse. The direct investments already made preclude the possibility of a rapid departure of capital, even if all parties were to understand that conducting business in China is dangerous. However, it is obvious that new projects will be reevaluated in light of new information, a fact which, in our opinion, cannot fail to impact the Chinese economy's future growth rates.

The state mass media's essentially anti-corruption and anti-capitalist rhetoric accompanying the arrests and the confiscations facilitates the short-term strengthening of the ruling group. At the same time, the signals China receives from the West about the impunity of such measures, along with the "dizziness" occasioned by local and foreign business success, all lower the likelihood of stopping practices of this kind in the future. Their continuation portends more than a mere slowdown in growth rates....

There is an obvious correlation, which can be reliably documented, between the stability of rule of law democracy in a country and high-level economic development. The question of the causality direction vector between the two poles has been under discussion for a long time, and is far from having been exhausted.⁴⁶ As noted by G. Buchanan, history is the only laboratory available to the economist. China and its history, including the one fashioned before our very eyes, form no exception.

It would appear plausible that only a rule of law democracy provides the best guarantees for private property, insofar as it provides for the inviolability of the property owner; hence, it provides the best conditions for long-term economic growth.⁴⁷ The suggestion has also been made earlier that the successes achieved in the

⁴⁴ In effect, the issue at stake involves opportunities which the state leadership reserves for interfering at the time and location which it finds appropriate, using the methods which it alone chooses; that is, the issue is one of a policy of absence of safeguards against interference at any arbitrary time or place.

⁴⁵ "Heritage Foundation Events: The New Strategic and Economic Dialogue with China: Fresh Start or Waste of Time? Discussion hosted by Derek Scissors; Speakers S. Dunaway, E. Gresser, T. Smith" (<http://www.heritage.org/Press/Events/ev072109a.cfm>).

⁴⁶ For instance, see the summary analysis of this discussion in Yanovskiy & Shulgin, "Instituty, demokratiya i ekonomicheskiy rost: test 180-letnego razvitiya" ["Institutes, Democracy, and Economic Growth: Testing 180 Years of Development"], *Ekonomicheskaya politika [Economic Politics]* 2008, № 3, pp. 57-75.

⁴⁷ See *ibid.*

course of China's authoritarian modernization are, on the one hand, linked to the lower risk of being victimized for most Chinese, and on the other, that they are linked to guarantees for nationals of rule of law democratic countries. These de facto guarantees remained in effect up until recently,⁴⁸ observed by the Chinese authorities.⁴⁹

The nearest decade in China will most likely serve as a test for both theories about the direction of the causality vector between democracy and economic growth, and our hypothesis concerning one of the reasons for China's success.

If a substantial slowdown in economic growth rates sets in precisely during the next ten years, while a considerable "reserve" supply of cheap labor continues to be in evidence, such a development will serve as an argument in favor of our hypothesis.

If, while maintaining the institutions currently in existence and in the absence of guarantees for property owners and for property, there will be no slowdown in economic growth rates in China, this will be a strong argument in favor of the hypothesis that only rich countries can permit themselves the luxury of democracy.

Conclusions

Extrapolating from China's high economic growth rates for the future is extremely dangerous in light of a number of problems:

Exhaustibility of quality labor force reserve;

Observed rapid deterioration in business climate in the wake of the ineffectiveness of "unwritten rules" and instability of the 1980-early 2000s "traditions" favorable to business;

Mass media-provoked "anti-corruption" campaign, social tension, and corresponding growth in risks of socio-political instability;

Provocation of growth of expectations among the labor-excessive population (which expects its share from the re-division of property of the wealthiest co-citizens).

Given falling growth rates, there are grounds to expect unswerving growth in state social obligations. The same direction is taken by the motivation, noted by Niskanen, for officialdom (particularly civil officialdom) to inflate the budgetary expenses of the officials' agencies.⁵⁰ Thus, the "butter along with cannon" trend in China enjoys better perspectives than the growth trend of direct foreign investment.

Development scenarios in which China will occupy the place of one of the largest world economies are less likely to become reality than those bound up with the intensification of the problems elaborated above.

⁴⁸ Prior to the Rio Tinto case and the arrest of the Australian national Stern Hu.

⁴⁹ Mau, Javoronkov, Yanovski, et al. 2003.

⁵⁰ W. Niskanen, *Bureaucracy and Representative Government* (Chicago: Aldine-Altherton, 1971).

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