Capitalizing China

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Joseph Fan and Randall Morck (eds.)
University of Chicago Press: Chicago, 2013. 387 pp

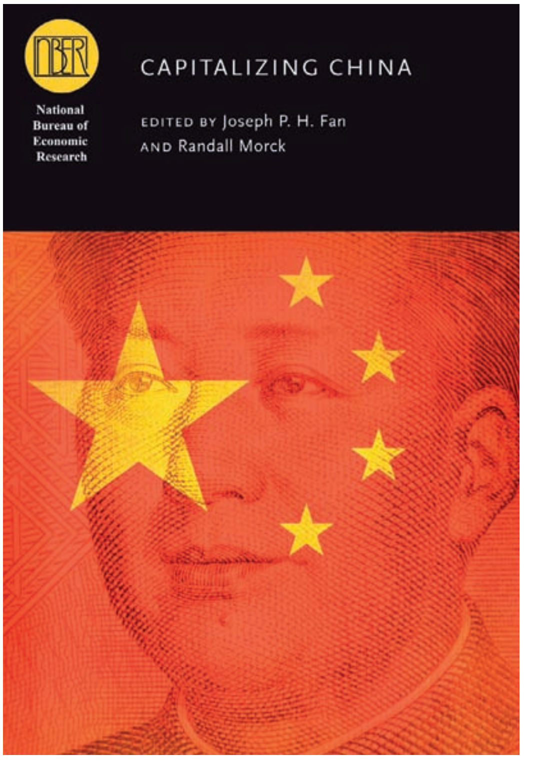
China's economic boom took many analysts by surprise because of its deviation from conventional growth theory. This volume, featuring papers from a conference co-hosted by the Chinese University of Hong Kong and the American National Bureau of Economic Research, makes a significant contribution to our knowledge. Unlike most writings on China, it is based upon a detailed analysis of rich and extensive empirical data. Although most of the contributors are US-based or -educated, the volume contains a refreshing range of views and arguments.

The editors chose to focus on the financial system, probably the most important component of the commanding heights of the economy. The book has four sections: the governance of the financial system, the governance of the stock markets, capital accumulation, and public finance. In each section, two contributors provide chapters on topics such as the Chinese savings pattern, the securities market, and fiscal institutions. The views of the discussants are also included.

A key finding is that the entire system has been designed to ensure that the Chinese Communist Party (CCP) remains in control of all aspects of the financial system. Its interests dominate. Yet, paradoxically, the system contains a considerable element of efficiency and rationality. South Africans could learn a good deal from this model, where, within the context of loyalty to the CCP, merit is rewarded and mediocrity punished.

The system is not Western liberalism in a Mao jacket. As the editors explain: "The Party directs the law. Party committees throughout business enterprises constitute parallel internal accountability systems". The trappings of Western laws and regulations are largely ignored. These insights are very important. China has developed a hybrid system with Chinese characteristics. It is neither emulating the liberal model nor embracing free markets. And the system has worked very well overall, despite obvious problems of rent capture and corruption.

All agree, however, that the low-hanging fruit that was available as China caught up with the West has almost all been captured. Future development will depend upon innovation, entrepreneurship and sophisticated marketing. Will the Chinese system be able to meet these challenges?



It is widely recognised that the system "does not allocate national savings to the most efficient uses of capital. China's tycoons, its barons of big business, are predominantly career bureaucrats and ex-bureaucrats". This did not matter when China was poor and backward. But what of the future?

There are three possibilities. Perhaps China will increasingly discard the Chinese model and adopt Western institutions and regulations. Or the system will remain rigid and dominated by princelings and bureaucrats and the economy will stagnate. Or the unique Chinese style will find a new and original way forward that maintains the dominance of the CCP but allows the economy to grow and innovate. Liberal and neoclassical Western economists argue that only the first policy can help China develop as a mature, wealthy state. Many in China believe the Chinese model contains the necessary flexibility for continued development.

It is no exaggeration to conclude that the answer to this question will, in large measure, shape the geopolitical future of our world.