

## China and the Middle-Income Trap: Toward a Post Washington, Post Beijing Consensus

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Over the last thirty years, China has experienced tremendous growth, with many commentators attributing the rapid development to the “China Model” (CM) or the “Beijing Consensus” (BC), as opposed to the Washington Consensus (WC).<sup>2</sup> However, in recent years growth has slowed from double digits to single digits. In 2013, major international economic forecasters such as the IMF and JP Morgan issued warnings that growth is likely to slow further in the short term, Beijing reduced expected growth rates for the year from over 8% to 7.7%, and Moody’s lowered China’s credit ratings outlook in light of the rapid rise in local government debt. Among economists, an ever-increasing number of bears are predicting a financial crisis, economic collapse, and a very hard landing, perhaps even a lost decade a la Japan.<sup>3</sup> All of this has led to heated debate about whether the CM is now exhausted, whether China is caught in “the middle-income trap” (MIT) and whether a new model is needed for next phase of development where China attempts the difficult transition from middle-income country (MIC) to high-income country (HIC) status.

This article addresses the following five sets of issues. First, is there a CM or BC? If so, what does it entail, and does it differ from the model followed by other successful countries in East Asia? Second, is there a MIT? Are there several traps? Is China stuck in the MIT or perhaps multiple MITs? Third, what adjustments to the economic model are required for China to continue its long march toward becoming a HIC? Fourth, are political, legal and social reforms also required? If so, will all reforms proceed simultaneously or are reforms likely to be sequenced, with adjustments to the economy preceding reforms in other areas? Fifth, is there now a global convergence on a new model of development for developing countries – a Post-Washington, Post-Beijing Consensus (PWBC)?

### I. On Models and Consensus: The CM, EAM, BC and Beyond

Whenever a country or region is spectacularly successful, there is natural tendency to want to understand how that success was achieved and to emulate it. This leads to the generation of “models”, which are often portrayed as the latest consensus, as in the WC, BC, Monterey Consensus, or the Post Washington Consensus (PWC). The success of East Asian countries, and now in particular China, is no exception, and there has been a proliferation of books and articles describing, extolling and critiquing various versions of the BC, CM and the East Asian Model (EAM).

Several points are notable about these models or theories. First, they vary in detail, breadth and scope. For example, the CM comes in stripped-down versions and more elaborate versions. In general, think-tank commentators, big-picture pundits and journalists prefer the more parsimonious versions, which offer more rhetorical bang for the buck and are easier to weave into dramatic story lines that make big claims.<sup>4</sup> Economists tend to prefer lists of elements, without a great deal of attention to how the

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<sup>2</sup> By 2009, there were more than 3000 articles available on the internet discussing the China Model and related concepts. See Joseph Fewsmith, “Debating the China Model,” *China Leadership Monitor*, No. 35 (2011), <http://www.hoover.org/publications/china-leadership-monitor/article/93636>. Shaun Breslin has made available more than 106 such articles at <http://tinyurl.com/chinamodel>.

<sup>3</sup> Michael Pettis, *The Great Rebalancing: Trade, Conflict and the Perilous Road Ahead for the World Economy* (Princeton: Princeton University Press, 2013); Charles Dumas and Diana Choyleva, *The American Phoenix: And Why China and Europe Will Struggle After the Coming Slump* (London: Profile Books, 2011).

<sup>4</sup> See, e.g., Joshua Ramo, *The Beijing Consensus: notes on the new physics of Chinese power* (London: Foreign Policy Centre, 2004). To the extent that pundits and journalists do get into the details, they are

elements fit together or much discussion of which elements are necessary or sufficient.<sup>5</sup> Political scientists and legal scholars for their part tend to prefer versions that go beyond just economics to consider the political, legal and social context in which the economy operates and development takes place.<sup>6</sup>

Second, there is also a tendency for foreign scholars to prefer more analytical models, and to be somewhat more positive in their assessments because their focus is to explain the relative success of the country or region. In contrast, domestic scholars more immersed in the daily problems of developing countries and often directly involved in policy debates are often less confident about their being a coherent model, more inclined to see development as the result of a myriad of contested policy choices, more descriptive in their approach and more critical of the results.<sup>7</sup> Official or semi-official government commentators have also shied away from use of the CM, some because they are aware of the fragility of China's development and others because they do not want to stoke fears about China's rise and the challenges that creates for existing powers, China's trade partners or other countries in the region.<sup>8</sup>

Third, and following from the first two points, there is inevitably disagreement about what the model is. This often leads to rather confused discussions and debates, with participants talking past each other rather than to each other. More seriously, the proliferation of interpretations of allegedly the same model also complicates social science research, as there is disagreement about how to define the dependent or independent variable, depending on what is being tested.

Fourth, and also related, the utility of the models varies. The more extreme versions, whether minimalist or maximalist, tend to be of little use for comparative purposes or for other countries seeking to emulate the success. The minimalist versions are too inclusive, too underdetermining – they explain too little of what causes different performance in various countries. The maximalist versions are in effect a detailed description of the historically contingent features of a particular country – they lead to claims about US or Japanese or Chinese exceptionalism or uniqueness. Such claims by their terms defy comparison – although in general the claims are overstated, and often serve more of a psychological or normative function in promoting nationalism or a sense of superiority or the feeling that a particular

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often wrong, leading to a series of articles by earnest academics pointing out that in fact Japan, South Korea and the other earlier East Asian Tigers did not conform to the principles set out by the World Bank in *The East Asian Miracle*, or that the alleged BC was more of a statement of the development path Beijing was hoping to follow rather than the path it actually followed. See, e.g., John K.M. Ohnesorge, "Developing Development Theory: Law and Development Orthodoxies and the Northeast Asian Experience", 28 *University of Pennsylvania Journal of International Economic Law* 219 (2007); Scott Kennedy, "The myth of the Beijing Consensus," *Journal of Contemporary China* 19: 65, 2010, pp.461–77. For my critique of the BC, see Randall Peerenboom, *China Modernizes: Threat to the West or Model for the Rest?* (Oxford: Oxford University Press, 2007), pp. 6-7, 77-81.

<sup>5</sup> The WC proposed by John Williamson was initially a list of ten elements. Dani Rodrik then added ten elements to what he took to be an augmented WC in the 1980s. See Peerenboom, *China Modernizes*, p. 6. In holding an online debate on whether China offers a better development model than "the West" – which resulted in 53% disagreeing and 47% agreeing - *The Economist* noted disagreement about what the CM consists of but listed as key ingredients a "managed exchange rate, state control over key industries including the banking system, preference for diktat rather than democratic debate, heavy state investment in infrastructure and strong support for the export sector." See "China model," *The Economist*, 13 Aug. 2011, <http://www.economist.com/debate/overview/179>.

<sup>6</sup> Pan Wei, ed., *Zhongguo moshi: jiedu renmin gongheguo 60 nian* [The China model: understanding 60 years of the People's Republic of China] (Beijing: Central Translation Press, 2009); Peerenboom, *China Modernizes*.

<sup>7</sup> Yang Jisheng, 'Wo kan "zhongguo moshi"' [How I see the 'China model'], *Yanhuang Chunqiu*, 11 Jan. 2011, <http://www.sinovision.net/blog/56cun/details/55784.html>.

<sup>8</sup> For a brief summary, see Fewsmith, *China Model*.

country deserves to rule over others and impose its will as hegemon because its success is deserved and attributable to hard work, wise choices, or values that it alone possesses.

Finally, what it means to be a “model” may itself be understood in different ways. One common interpretation is that a model should be universally applicable and the best way to achieve the desired ends. Thus, all countries could and should follow the model. Another much more realistic understanding of a model in the context of development is that the model exemplifies one way that works in particular circumstances – it is *a* model, not *the* model. Thus, the CM or EAM might work for China and other East Asian countries, but it might not work in other places. Nor is it necessarily the best model. Other models might also have worked even better in China or other East Asian countries. One implication of taking any model as *a* model rather than *the* model is that, while it is understandable that policymakers might want to follow a model that has proven successful, they should not treat it with undue reverence, as if it were the Holy Grail. Rather, they should be aware of the shortcomings of the model, and ready to make adjustments as necessary to fit the local circumstances or changes in the global economy, etc.

With these caveats and qualifications in mind, let us turn to various versions of the CM.

The most minimalist version of the CM attributes China’s success to two factors, authoritarianism and markets. The collapse of the Soviet Union, followed by decades of economic turmoil in Central and Eastern Europe (CEE), provided initial support for China’s approach of economic reforms before political reforms and democratization. China’s ability to react quickly to the global financial crisis (GFC) with a massive financial stimulus – described by Nick Lardy as the gold standard for government responses to the GFC – has led to further praise for authoritarian capitalism.<sup>9</sup>

The problem with this version, like most minimalist versions, is that it explains too little. There are many other authoritarian regimes with markets that have not been successful. Authoritarian regimes in Latin America and Africa have not produced sustainable growth. Even in Asia there are abundant examples of failed authoritarian regimes that had some form of a market economy, including the Philippines under Marcos, Indonesia under Suharto, Thailand for various periods of military rule, as well as Laos and Burma. On the other hand, there are oil-rich theocracies such as Saudi Arabia that are now HICs, where the economy is dependent on one main resource. Authoritarian regimes hoping to emulate China will need to know much more about the CM if they are to achieve similar rates of economic growth. In any event, the CM is attracting attention from many non-authoritarian countries, and being praised by commentators from both developing and developed countries,<sup>10</sup> suggesting that the key to growth is not regime type, a finding confirmed by countless empirical studies.

As noted, economists generally prefer to define models in terms of a list of elements. The length of the list depends on the purpose. In explaining the success of East Asian Tigers, the World Bank provided a laundry list of factors.<sup>11</sup> The strategy seemed to be motivated in part by political considerations within the Bank, where the dominant view remained that Asian countries succeeded by following generally applicable neoclassical economic principles, in contrast to the view among area and

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<sup>9</sup> Joshua Kurlantzick, “Why the ‘China Model’ Isn’t Going Away,” *The Atlantic*, March 21, 2013. See also S. Halper, *The Beijing Consensus: How China’s Authoritarian Model will Dominate the Twenty-first Century* (New York: Basic Books, 2009).

<sup>10</sup> Thomas Friedman, “Our One-Party Democracy,” *New York Times*, Sept. 8, 2009.

<sup>11</sup> The World Bank cited a number of factors: sound macroeconomic management, including fiscal discipline and control of inflation; high levels of private domestic investment, domestic savings and investment in education; agricultural policies that increased productivity; promotion of exports; flexible labor markets; limited price distortions; openness to foreign technology; a demographic transition from high to low birth rates; politically insulated and reasonably compensated technocratic leaders; a business-friendly environment; and selective state interventions subject to strict performance criteria – although the Bank was ambivalent at best about the positive value of state interventions that deviated from “the neoclassical” model. The World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993).

country specialists both within and outside the Bank that in fact much of the success of Asian countries was due to the interventionist policies of the developmental state that sought to protect infant industries, favored investment over consumption, and resisted advice to liberalize the financial sector.<sup>12</sup> Thus, there was little attempt to assess which elements were most important or to sort out whether some of the contested factors such as infant industry protection were on balance positive or negative.

More recently, there have been attempts to explain how China's growth model contributed to the GFC, and why therefore it has now run its course and must be adjusted.<sup>13</sup> This school begins with basic macroeconomic principles or accounting identities and highlights a limited set of factors in China that affect global trade balances.<sup>14</sup> The basic argument is that China's growth has relied on state-led investment by suppressing domestic consumption, thus decreasing the cost of capital, leading to massive investment in infrastructure and manufacturing. More specifically, Beijing has encouraged investment and boosted growth rates by subsidizing energy costs for manufacturers, suppressing wages, tolerating environmental degradation, and engaging in financial repression (maintaining artificially low interest rates that allow banks to provide cheap financing to real estate developers and manufacturers combined with few investment alternatives for household depositors). The government has also promoted exports by maintaining a weak currency. As a result, China has run large current account surpluses, which has meant that other countries by definition had to run deficits. The GFC followed, with the real estate bubble in the US and Europe fueled by excess liquidity and the availability of cheap credit from China buying US dollar and euro bonds. Michael Pettis, one of the leading proponents of this view, argues that the global economy must now rebalance. China has no choice but to adjust the economic model because (i) other countries are no longer able or willing to import as much as consumers recover from the crisis by reducing debt and saving more, and (ii) investment-driven growth is increasingly inefficient. In the early stages of development, investment in infrastructure provides worthwhile returns, and there are many worth commercial projects to invest in. However, at this stage, capital is being increasingly misallocated. The development of infrastructure is exceeding the level of development. The huge influx of capital from the financial stimulus package in 2009 has also led to asset price bubbles and unsustainable levels of local government debt.

Not surprisingly, economists who rely on a limited set of factors to explain China's growth and the GFC do not find the CM all that exceptional.<sup>15</sup> Again, Pettis is representative:

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<sup>12</sup> Edith Terry, *How Asia Got Rich: Japan, China and the Asian Miracle* (M.E. Sharpe, 2002).

<sup>13</sup> See Michael Pettis, *The Great Rebalancing: Trade, Conflict and the Perilous Road Ahead for the World Economy* (Princeton: Princeton University Press, 2013); Charles Dumas and Diana Choyleva, *The American Phoenix: And Why China and Europe Will Struggle After the Coming Slump* (London: Profile Books, 2011); Ming Zhang, "The Transition of China's Development Model," Research Center for International Finance, Policy Brief, Institute of World Economics and Politics, Chinese Academy of Social Sciences, Oct. 31, 2012, available at <http://en.iwep.org.cn/news/518514.htm>.

<sup>14</sup> Pettis begins with three such identities. In his review of Pettis' book, Nicholas Borst simplifies matters even further: "The Savings-Investment Identity states that the difference between national savings and national investment is equal to the current account surplus. To put it more simply, production that is not consumed or invested domestically is sent abroad." See Borst, Book Review: *The Great Rebalancing*, Jan 18, 2013, available at <http://www.piie.com/blogs/china/?p=2220>.

<sup>15</sup> Those with an interest in economic history also tend to emphasize a relatively small set of factors that explain economic success, and then portray the CM as another example of that more general pattern. See, e.g., Shaun Breslin, "The 'China model' and the global crisis: from Friedrich List to a Chinese mode of governance?" *International Affairs*, 87: 1323–1343 (2011). He argues that "when viewed through a historical lens, what has happened recently in China has parallels with previous experiences of strong state-led development in Europe, the United States and East Asia." There is also a large and growing

There is nothing especially Chinese about the Chinese development model. It is mostly a souped-up version of the Asian development model, probably first articulated by Japan in the 1960s, and shares fundamental features with a number of periods of rapid growth – for example Germany during the 1930s, Brazil during the “miracle” years of the 1960s and 1970, and the Soviet Union in the 1950s and 1960s.... While these policies can generate tremendous growth early on, they also lead inexorably to deep imbalances.

At the heart of these various models are massive subsidies for manufacturing and investment aimed at generating rapid growth and the building up of infrastructure and manufacturing capacity. These subsidies make it very cheap to increase investment in manufacturing capacity, infrastructure and real estate development, generating enormous growth in employment, and they allow investors, whether private or, more typically, the state, to generate great profitability.

Most discussions of the CM or even the EAM focus almost exclusively on economic policies. However, there is more to development than a larger GDP. Political scientists and legal scholars working in the law and development tradition have emphasized the interrelationship between economic growth and political, legal and social institutions.

I have argued elsewhere that China is following a similar path to other successful East Asian countries.<sup>16</sup> The EAM – a notion which admittedly serves a useful purpose only at a high level of generalization and conceals considerable diversity when subject to closer scrutiny – involves the sequencing of economic growth, legal reforms, democratization and constitutionalism, with different rights being taken seriously at different times in the process:

- (i) an emphasis on economic growth rather than civil and especially political rights during the initial stages of development, with a period of rapid economic growth occurring under authoritarian regimes;
- (ii) a pragmatic approach to reforms, with governments following some aspects of the WC and rejecting or modifying others; in particular, with governments adopting most of the basic macroeconomic principles of the Washington Consensus for the domestic economy; rejecting or modifying the neoliberal aspects that would greatly reduce the role of the state through rapid privatization and deregulation, with the state also more active in reducing poverty and in ensuring minimal material standards to compete in a more competitive global economy; and modifying the prescribed WC relationship between the domestic and global economy by gradually exposing the domestic economy to international competition while offering some protection to key sectors and some support to infant industries;
- (iii) as the economy grows and wealth is generated, the government invests in human capital and in institutions, including reforms to establish a legal system that meets the basic requirements of a procedural or thin rule of law; over time, as the legal system becomes more efficient, professional and autonomous, it comes to play a greater role in the economy and society more generally;
- (iv) democratization in the sense of freely contested multiple party elections for the highest level of office is postponed until a relatively high level of wealth is attained;
- (v) constitutionalism begins to emerge during the authoritarian period, including the development of constitutional norms and the strengthening of institutions; social

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literature that attempts to understand China’s growth, or lack of it until recently compared to the West, in much broader historical terms, drawing on geography, biology and anthropology. See, e.g. Ian Morris, *Why the West Rules - for Now: Patterns of History and What They Reveal About the Future* (New York: Farrar, Strauss and Giroux, 2010).

<sup>16</sup> Peerenboom, *China Modernizes*.

organizations start to proliferate and “civil society” begins to develop, albeit often a civil society with a different nature and political orientation than in Western liberal democracies, and with organizations with a political agenda subject to limitations; citizens enjoy economic liberties, rising living standards for the vast majority, and some civil and political rights although with limitations especially on rights that involve political issues and affect the control of the regime; judicial independence remains limited, with the protection of the full range of human rights and in particular civil and political rights suffering accordingly;

- (vi) there is greater protection of civil and political rights after democratization, including rights that involve sensitive political issues, although with ongoing abuses of rights in some cases and with rights frequently given a communitarian or collectivist interpretation rather than a liberal interpretation.

In contrast, some Chinese political scientists that have situated China’s development within the broader political, legal and social context have emphasized the uniqueness of the CM. For instance, Pan Wei argues that the CM consists of four sub-systems: a unique way of social organization, a unique way of developing its economy, a unique way of government, and a unique outlook on the world.<sup>17</sup> He is also known for his views that reforms must be properly sequenced, and in particular legal reforms aimed at establishing the rule of law must proceed democratization. Similarly, Zhang Weiwei defines the CM in terms of eight characteristics, several of which he traces to Chinese traditions, cultural features, normative preferences and the nature of the political system, including the prioritization of development policies on the lives of the people as evidenced in the efforts to reduce poverty, a pragmatic approach based on “speaking truth from facts,” an emphasis on social stability and a Confucian inspired meritocratic approach to governance where the government is relatively neutral ideologically, enlightened and strong.<sup>18</sup>

The views of Pan and Zhang reflect the growing confidence many Chinese commentators feel as a result of China having overcome various crises from SARs to the Asian financial crisis and, at least so far, the GFC. They also reflect the growing disillusionment with foreign models and advice. Chinese reformers have long been aware that developed countries did not get rich by following the principles now being advocated for others, including free trade, the protection of intellectual property rights and financial liberalization.<sup>19</sup> Nor were many countries democracies during their period of rapid growth, and even if they were, the franchise was often limited to white male property owners, with civil and political rights much more restricted than they are today. A series of crises from the savings and loans bailout in the 1980s, the collapse of the Nobel laureate-studded hedge fund Long Term Capital Management in the 1990s, the Enron, Tyco, WorldCom, Freddie Mack and AIG scandals that rocked the securities, accounting and insurance industries in the early 2000s, to most importantly the chaos caused by the GFC, have all increased support for the view that China, and indeed all developing countries, must follow their own development paths.<sup>20</sup>

Unfortunately, the pendulum appears to have swung too far in the other direction. Confidence is now giving way to a cocky arrogance, a dangerous ethnocentric nationalism instead of a healthy sense of

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<sup>17</sup> Pan Wei, “The Chinese Model of Development,” speech presented to the Foreign Policy Centre, London, Oct. 11, 2007, text available at <http://fpc.org.uk/fsblob/888.pdf>.

<sup>18</sup> Zhang Weiwei, “Yige giji de pouxi: zhongguo moshi ji qi yi” [Analysis of a miracle: the China model and its significance], *Qiushi*, no. 6, 2011, [http://www.qstheory.cn/hqwg/2011/201106/201103/t20110325\\_74156.Htm](http://www.qstheory.cn/hqwg/2011/201106/201103/t20110325_74156.Htm).

<sup>19</sup> Ha-Joon Chang, *Kicking away the ladder: development strategy in historical perspective* (London: Anthem, 2005).

<sup>20</sup> See, generally, David Kennedy and Joseph Stiglitz, eds., *Law and Economics with Chinese Characteristics: Institutions for Promoting Development in the 21<sup>st</sup> Century* (New York: Oxford University Press, 2013).

patriotism, and a more belligerent triumphalism manifested in more aggressive policies abroad and the foolish belief at home that China has escaped the adverse affects of the GFC and the march toward superpower status will proceed on schedule, with China catching up to and surpassing the US by 2050 if not 2030. Chinese academics, pundits, and leaders have now taken to lecturing their counterparts in developed countries about the need to get their own houses in order and to learn from China – much as happened when Japan had its moment in the sun before the real estate bubble burst and the economy collapsed. Whatever the wisdom of this premature self-congratulatory back-slapping, from a methodological perspective, emphasizing the uniqueness of the CM reduces its utility for comparative research or for policymakers from other countries hoping to benefit from China’s experience. At best, they are left with the advice to adopt a pragmatic approach and to create their own development model based on experimentation given their particular endowments and local circumstances.

## II. Middle-Income Traps

Although China’s rise has led to a certain amount of chest-thumping by many eager to see China resume its rightful place as one of the great civilizations of the world, cooler heads are aware that many countries have enjoyed high growth rates for years, only to experience problems that prevented them from becoming HICs. The slowdown in China’s economic growth combined with the slow pace of political reforms has given rise to concerns that China is now or will soon be caught in the dreaded MIT.<sup>21</sup>

Debates about whether China is stuck in the MIT are plagued by many of the same problems as discussions about the CM. Much depends on how one defines the terms. For instance, some commentators deny that there is such a thing as “the MIT.” Citing unclear definitions and the lack of empirical evidence, *The Economist* argued that development is difficult at every stage, and there is no reason to single out the middle-income level.<sup>22</sup> But the fact remains that very few MICs become HICs. In 1960, there were 101 MICs (using the World Bank definition).<sup>23</sup> By 2008, only thirteen had become HICs.<sup>24</sup> Moreover, although everyone presumably would agree that development is challenging at all levels, it does not follow that the challenges are the same at all levels. There are many important ways in which MICs differ structurally from LICs and HICs, with significant implications for the development process.<sup>25</sup>

A more credible objection is that given the wide diversity of MICs, they will inevitably confront different development challenges. Accordingly, MICs face not one but multiple MITs. To further complicate matters, different disciplines tend to emphasize different MITs. The World Bank succinctly summarizes the most common version of the MIT favored by economists:<sup>26</sup>

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<sup>21</sup> See, e.g., Barry Eichengreen et al., "When Fast Growing Economies Slow Down: International Evidence and Implications for China," NBER Working Paper No. 16919, March 2011.

<sup>22</sup> See, e.g., *The Economist*, “Middle-Income Claptrap: Do countries get ‘trapped’ between prosperity and poverty?” Feb. 16, 2013, available at <http://www.economist.com/news/finance-and-economics/21571863-do-countries-get-trapped-between-poverty-and-prosperity-middle-income-claptrap/print>.

<sup>23</sup> The World Bank considers countries with GNI per capita from \$1,026 to \$12,475 to be MICs. More specifically, the World Bank classifies countries with GNI per capita of \$1,025 or less as low income countries (LICs), \$1,026 - \$4,035 as lower middle income countries (LMIC), \$4,036 - \$12,475 as upper middle income (UMIC), and \$12,476 or more as high income (HICs). See <http://data.worldbank.org/about/country-classifications>.

<sup>24</sup> World Bank *China 2030: Building a Modern, Harmonious, and Creative High-Income Society* 2012, p. 11, available at <http://www.worldbank.org/en/news/2012/02/27/china-2030-executive-summary>.

<sup>25</sup> See Randall Peerenboom, “Law and Development in Middle-Income Countries: Conclusion,” in *Law and Development in Middle-Income Countries: Avoiding the Middle-Income Trap* (forthcoming Cambridge University Press, 2013), available at <http://ssrn.com/abstract=2205163> (discussing both quantitative and qualitative reasons for distinguishing between LICs, MICs and HICs).

<sup>26</sup> World Bank, *China 2030*, p. 12.

The factors and advantages that propelled high growth in...countries during their rapid development phases—low-cost labor and easy technology adoption—disappeared when they reached middle- and upper-middle-income levels, forcing them to find new sources of growth.... Large productivity gains occur through a reallocation of labor and capital from low-productivity agriculture to high-productivity manufacturing. As countries reach middle-income levels, the underemployed rural labor force dwindles and wages rise, eroding competitiveness. Productivity growth from sectoral reallocation and technology catch-up are eventually exhausted, while rising wages make labor-intensive exports less competitive internationally. If countries cannot increase productivity through innovation (rather than continuing to rely on foreign technology), they find themselves trapped.

In short, poorer countries are able to take advantage of their backwardness to catch up by combining foreign technology with cheap labor to produce inexpensive clothes, toys and electronics consumed by people in rich countries. But once wages increase, they need to move up the value-added chain and increase efficiency and productivity.

It bears noting that this version of the MIT applies to larger countries with manufacturing-based economies. But the economies of some MICs are based on tourism, their status as tax havens, gaming and casinos, or natural resources. These MICs might be trapped, but the nature of the trap will be different.

In any event, a 2012 World Bank report, written with significant participation from Development Research Center of the State Council, emphasized that China is now in danger of falling into this version of the MIT trap as wages have increased and China has reached the limits of gains from the exploitation of foreign technologies. To avoid the trap, new growth drivers are required, including “increased efficiency in input use, higher human capital investments, increased innovation, and a shift to high-value services.”<sup>27</sup> The report lays out six strategic directions for China’s future:

- Completing the transition to a market economy;
- Accelerating the pace of open innovation;
- Going “green” to transform environmental stresses into green growth as a driver for development;
- Expanding opportunities and services such as health, education and access to jobs for all people;
- Modernizing and strengthening its domestic fiscal system;
- Seeking mutually beneficial relations with the world by connecting China’s structural reforms to the changing international economy.

Although the World Bank report focused on economics, as observed in relation to the debate about the CM, development is not only about growth in GDP. There are political, legal and social dimensions to development as well, all of which can also be a source of traps. Political scientists see the problem more in terms of capture, corruption and preservation of power by the elites, entrenched interests and the ruling regime. For instance, Tom Ginsburg argues:

Middle-income countries face a particular set of challenges that are, ultimately, political rather than technical or purely economic in nature. The basic problem is one of path dependency. Institutions that are suitable for growth at the early stages of development may not be able to work for later stages. Instead, the regime that gets the country to middle-income status may stick with the strategies and institutions that have worked to date. After all, early-stage economic growth underpins regime legitimacy, and may generate increasing political returns that lock in particular structures. The challenge for the political leadership in middle income countries is how

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<sup>27</sup> World Bank, China 2030, p. 11.

to reform the political and institutional bases of growth at the right time to avoid what the economists call a “local maximum.”... Developmental regimes that manage to transform their political bases and economic institutions to fit the changing environment may survive. Those that do not may be cast aside in favor of a new coalition. Alternatively, the regime may survive but keep the country stuck in middle-income status, or even witness de-development or stagnation.<sup>28</sup>

Ginsburg also sketches a legal version of the middle-income trap in which courts lack autonomy and have limited jurisdiction to decide key types of cases, as is the case in China.<sup>29</sup> To overcome this trap, the ruling regime must be willing to empower the courts. But ruling regimes in MICs are often reluctant to do so for fear that the courts will undermine their power. Such fears may be justified when one considers the key role courts have played in triggering some democratic transitions. Even if leaders are willing to empower courts, the courts must have the capacity to shoulder the additional responsibility. In many MICs, either the political will to empower autonomous courts is lacking or the judiciary simply lacks the professional skills and capacity to handle the responsibility.

Powerful political or economic interests can also capture the legal system and undermine rule of law. Many commentators have suggested the concentration of wealth in CEE has given rise to a form of political capitalism in which powerful economic actors have usurped the courts and undermined rule of law. In contrast to the more favorable opinions about constitutional courts, the regular courts are seen as chronically dysfunctional and strikingly inefficient:

The evidence is undisputable – and the picture is abysmal. Survey after survey, opinion poll after opinion poll confirm that in Eastern Europe judges (as opposed to Justices) have a reputation as self-interested actors whose moral and professional integrity has been compromised, and courts are perceived as under-performing institutions that basically fail to deliver what is expected of them. In 2005 – i.e. *after* the first round of EU’s eastward expansion as a result of which most former Soviet satellites gained full membership – Estonia was the *only* country where more than 50% of firm managers assessed the courts as “honest and uncorrupted.”<sup>30</sup>

The dominant view attributes the disappointing performance of regular courts to political economy factors. Privatization created a powerful class that saw rule of law and strong independent regular courts as either unhelpful for, or a threat to, their economic activities and interests. Former communist *apparatchiks* turned *entrepreneurchiks* as a result of privatization “stood to benefit if courts were marginalized, legal norms were not implemented, and the reach of law-enforcement agencies is curtailed.”<sup>31</sup>

There is ample evidence that the current system in China favors the haves over the have-nots, although this is generally true in most countries.<sup>32</sup> More worrisome, there are increasing signs that entrenched interest groups that have benefitted from the status quo are capturing the policymaking process and blocking reforms that would enhance the public good, albeit at their expense.<sup>33</sup> The Hu-Wen

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<sup>28</sup> Tom Ginsburg, “The Politics of Law and Development in Middle-Income Countries,” in *Law and Development in Middle-Income Countries*.

<sup>29</sup> See Fu Yulin and Randall Peerenboom, “A New Analytical Framework for Understanding and Promoting Judicial Independence in China,” in *Judicial Independence in China: Lessons for Global Rule of Law Promotion* (Randall Peerenboom ed., New York: Cambridge University Press, 2009.)

<sup>30</sup> Venelin Ganey, “The rule of law as an institutionalized wager: constitutions, courts and transformative social dynamics in Eastern Europe,” *Hague Journal on Rule of Law* 1:2 (2009)

<sup>31</sup> *Id.*

<sup>32</sup> He Xin and Su Yang, “Do the ‘Haves’ Come Out Ahead in Shanghai Courts?” *Journal of Empirical Legal Studies*, 10:1 (2013), pp. 120-145, 2013.

<sup>33</sup> See, e.g., *Law, Wealth and Power in China: The Commercial Law Revolution* (John Garret and Yingjie Guo, eds. Routledge 2011). For a discussion of the risk of CCE-style political capitalism occurring in

regime repeatedly promised to promote social harmony by addressing income inequality and regional imbalances, bolstering the social safety net and promoting scientific, sustainable growth. However, they left office with income inequality as high or higher than when they took over, the medical system in disarray, and environmental degradation significantly worse. Moreover, they were unable to rein in powerful interest groups, curtail corruption or rebalance the economy from state-led investment to consumption. Not surprisingly, the number of mass demonstrations continued to rise dramatically. The government's response was to place even more emphasis on social stability, resulting in a shift in power toward the public security and political-legal committees and a crackdown on both political- and social-cause activist lawyers.

In sum, all MICs face a variety of economic, legal and political challenges or traps. But for all versions of the MIT, the basic problem is the same. What worked in the past no longer works. Countries need to change and adopt new strategies, but they do not or cannot, often because they cannot overcome political economy barriers to reform. For China to avoid getting stuck at this level of development, it will need to adjust the economic model of development and proactively pursue more fundamental political, legal and social reforms, although not necessarily all at once.

### III. China May Not Be Stuck in the MIT, But the CM is Not sustainable

Economists are divided about whether growth is likely to continue in the 6-8% range, and if so for how long, or slow to 3-4% or even less at some point.<sup>34</sup> However, there is a general consensus that the CM has run its course, and that there must be a transition from state-led investment to a more consumption-based economy. As early as 2007, Premier Wen Jiabao acknowledged that there were structural problems to the CM that caused “unsteady, unbalanced, uncoordinated and unsustainable growth.”<sup>35</sup> He went on to summarize the main economic issues in his report outlining the 12<sup>th</sup> Five-Year Plan. Echoing concerns about the MIT, he emphasized that development is a complicated process, different levels of development give rise to different challenges, and China faces many domestic and international challenges. Wen invoked the Marxist idea that there must be adjustments to the superstructure to reflect changes in the economic substructure: there is a need therefore to coordinate economic, social, legal and political reforms.

More specifically, the main tasks for the next period are:

- Adjust the nature of the economy: adjust the balance of investment, trade and consumption

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China, see Randall Peerenboom, “The Political Economy of Rule of Law in Middle-Income Countries: A Comparison of Eastern Europe and China,” *UCLA Pacific Basin Law Journal* (2011). If anything, the risks are now higher as interest groups have become more firmly entrenched and the Party appears to have lost the ability to make and implement policies that benefit the broad majority at the expense of these powerful interest groups.

<sup>34</sup> For a more bullish view, see Nicholas Lardy. For a bearish view, see Michael Pettis. Lardy v. Pettis, Debating China's Economic Future, Nov. 2, 2012, available at <http://blogs.wsj.com/chinarealtime/2012/11/02/lardy-vs-pettis-debating-chinas-economic-future/>; Lardy v. Pettis: Debating China's Future, Round 2, Nov. 7, 2012, available at <http://blogs.wsj.com/chinarealtime/2012/11/07/lardy-vs-pettis-debating-chinas-economic-future-round-2/>.

<sup>35</sup> Premier Wen Jiabao's Press Conference of 2007/03/17,” Ministry of Foreign Affairs of the People's Republic of China, [www.fmprc.gov.cn/eng/zxxx/t304313.htm](http://www.fmprc.gov.cn/eng/zxxx/t304313.htm). Yao Yang, “The end of the Beijing Consensus? Can China's model of authoritarian growth survive?” *Foreign Affairs Online*, Feb. 2, 2010, <http://www.foreignaffairs.com/articles/65947/the-end-of-the-beijing-consensus>,

- Adjust the mix of industry, services, and the information economy
- Move up the value chain from low-quality processing to higher value-added work
- More emphasis on innovation, research and development
- More emphasis on sustainable green growth

There is then a growing consensus in China that the economy must be rebalanced from investment to consumption, the focus on aggregate GDP has come at too high a cost in terms of inequality and environmental degradation, and China is in danger of succumbing to the type of dysfunctional political capitalism that has undermined reforms efforts in CEE.

But will the Xi administration be any more successful than the Hu administration in addressing these problems?

Again, economists are divided about the evidence to date as well as the long-term prospects for fundamental change. Optimists such as Huang Yiping argue that Chinese leaders have learned their lessons from the financial stimulus of 2009, which led to “new fiscal burdens, the emergence of potential non-performing loans, overcapacity in some areas of infrastructure, extreme imbalance problems, and inflation and asset bubble risks,” and have reached a consensus on the need to tolerate slower growth. He also suggests that China has begun rebalancing the economy away from state-led investment and exports toward consumption, with the current account surpluses falling from 10.8 per cent of GDP in 2007 to 2.6 per cent in 2012, consumption rising as a percentage of GDP between 2007 and 2011, and inequality falling from a high of 0.49 in 2008 to 0.474 in 2012 measured by Gini coefficients.<sup>36</sup>

Most economists however argue that there is little evidence of sustained shift toward consumption, and that even with projected increases consumption as a percentage of GDP will remain extremely low by world standards.<sup>37</sup> Fearful of a slowdown, the government allowed a massive surge in credit in the last quarter of 2012 and the first quarter of 2013, leading to many of the problems of the 2009 stimulus but with less of a beneficial impact on growth. Meanwhile, Daniel Rosen cautions that “improvements in China’s external balance to date have not been locked in with reforms – including a fully flexible exchange rate or bankruptcy proceedings for factories that oversupply the market regardless of demand leading to disruptive surges of exports – which will help ensure that external balance is the norm instead of reliant on heroic political effort.”<sup>38</sup>

While there is general agreement about the need to rebalance the economy, there are deep disagreements about how this is to be done and how fast to proceed.<sup>39</sup> Economists such as Pettis and Dumas argue that the current levels of debt are unsustainable, China will be forced to rebalance and live with growth rates of 3-5% or lower for the next decade, and the longer China waits to rebalance, the more costly and painful it will be. Others question whether the debt levels are unsustainable,<sup>40</sup> and argue that the imbalances can be addressed over a period of years, thus allowing growth rates to continue around current levels.<sup>41</sup>

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<sup>36</sup> See Huang Yiping, “China’s new growth model,” East Asia Forum, April 14, 2013, <http://www.eastasiaforum.org/2013/04/14/chinas-new-growth-model/>.

<sup>37</sup> See Pettis, *The Great Rebalancing*, noting that by 2005 household consumption had dropped to unprecedented levels of 40 percent of GDP, and despite promises to address the situation, dropped further to the “almost surreal” level of 34% in 2010.

<sup>38</sup> Daniel Rosen, “Back to Gignormous: China’s 2018 Current Account,” Rhodium Group, April 22, 2013, <http://rhg.com/notes/back-to-ginormous-chinas-2018-current-account>.

<sup>39</sup> In China, this is often portrayed as a debate between the New Left and those on the right. Although useful as a first cut, there are widely divergent views within these broad categories. See generally, Charles W. Freeman and Wen Jin Yuan, “China’s New Leftists and the China Model Debate after the Financial Crisis,” *Center for Strategic and International Studies* (2011).

<sup>40</sup> Borst, *Review of the Great Rebalancing*.

<sup>41</sup> See Lardy, Round 2; Borst, *Review of the Great Rebalancing*; Huang, *China’s New Model*.

Despite the disagreements, there is a general consensus that the main obstacles to reform arise from entrenched interests. As the World Bank report notes, “the close links between the government, big banks, and state enterprises have created vested interests that inhibit reforms and contribute to continued ad hoc state interventions in the economy.”<sup>42</sup> There are many with reason to oppose the reforms considered essential if China is to rebalance the economy and avoid the MIT: the large state-owned banks that have benefitted from restrictions on foreign competition; the large state-owned enterprises that have benefitted from subsidized energy and electricity, easier access to loans and the security markets, and preferential policies that aim to create domestic champions to compete with foreign multinational companies; the princelings, that is the offspring and relatives of top party and government officials, who have been granted oligopolies in key sectors such as telecommunications, mining and energy production; and the provinces in the eastern region that have benefitted from preferential tax and investment policies and the buildup of new infrastructure.

#### IV. Political, Legal and Social Reforms

For all of the talk of China as the next superpower, it confronts all of the typical challenges facing other MICs with respect to good governance, corruption, rule of law, environmental pollution, human rights and other indicators of human well-being. This is not surprising as there is a well-established correlation between wealth and all of these other features. On the whole, China outperforms the average country in its lower-middle income class, but lags far behind HICs, on most of these measures.<sup>43</sup> Disaggregating the data further demonstrates that greater wealth makes a significant difference at the lower-middle income stage, but after that, although wealth matters for both upper middle-income countries and HICs, policies matter more for producing better outcomes.<sup>44</sup> What matters most is how wealth is distributed, and what measures are adopted to deal with environmental issues, alleviate poverty, reduce inequality, raise literacy rates, decrease child mortality, curb corruption, enhance administrative efficiency and promote the rule of law. China is now reaching the upper-middle income stage, where throwing money at problems will be less crucial than adopting effective policies.

One of the distinctive features of MICs as opposed to HICs is that they confront a wide range of challenges at once, economic, legal, social, political and geopolitical. They must adopt, from a range of conflicting options, the correct economic policies and create a business environment that is supportive and effective; establish and strengthen economic institutions needed for a market economy; promote research and development and adopt policies to stimulate innovation; react in a timely fashion to external crises; build an efficient administrative system; root out corruption; train thousands, and in some cases, hundreds of thousands of civil servants, judges, lawyers, notaries, accountants, and police; create a welfare system; improve education and the healthcare systems; oversee the urbanization process; deal with increased pollution; and manage tensions with other countries that may arise as they become more powerful and begin to assert themselves on the international stage. Many MICs are simply overwhelmed by the sheer number and scale of the challenges, which exceed the capacity of MIC governments. Even a country as large as China, with an excellent tertiary system and a large pool of well-trained civil servants, is hard pressed to address all the pressing issues simultaneously.

Given all the challenges, MICs such as China must set priorities and sequence reforms. They simply cannot deal with all issues at once, or fully implement the ambitious programs set out by development agencies based on the institutions, rules and regulatory structures in HICs that took decades, if not centuries, to develop.

Successful MICs require strong, flexible and proactive leadership to keep reforms on track. There will not be many quick wins left at this stage. Reforms will encounter resistance from state organs,

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<sup>42</sup> World Bank, *China 2030*, p. 12.

<sup>43</sup> See, e.g., Peerenboom, *China Modernizes*. pp. 40-41.

<sup>44</sup> Peerenboom, “Law and Development in Middle-Income Countries: Conclusion,” in *Law and Development in Middle-Income Countries*.

market actors and citizens. Strong leadership will be necessary to forge the alliances required to overcome resistance from entrenched interest groups. China's leaders will need to prioritize reforms based on a political as well as economic cost-benefit analysis of which reforms are easiest or, if difficult, likely to deliver the biggest impact. Flexibility is essential as new challenges, both internal and external, arise constantly. Governments that are nimble and quick to adjust in light of global crises or when policies fail to deliver the expected results are the ones that come out on top. Those that hesitate miss the opportunity and fall behind. All too often governments, whether in LICs, MICs or HICs, are too reactive rather than proactive. They are able to muster the political will to undertake the structural changes needed to get ahead only when forced to do so by crises. Internal or external shocks may provide the incentive to break through barriers, but then governments often adopt policies without adequate reflection. Policymakers with their backs to the wall may also have to choose from a more limited range of options that are less than optimal. Moreover, if reforms are delayed, the costs in the end may be much higher.

The prevailing view is that the Hu-Wen administration failed to act aggressively and proactively enough to major challenges. The delay in rebalancing the economy allowed interests groups to grow wealthier and more powerful, making the task of the new Xi regime all the more difficult. Although steps were taken to improve governance and strengthen the legal system, the political-legal system became more politically subservient and concerned with social stability under Zhou Yongkang as head of the Political-Legal Committee and SPC President Wang Shengjun.<sup>45</sup>

The Xi administration is likely to focus on economic reforms and rebalancing the economy for the next five years rather than political-legal reforms. The global economy remains weak. Europe has yet to emerge from the crisis, and many economists still predict that Greece and other debtor countries will be forced to exit the Eurozone. The risk of increased trade protectionism and the threat of a trade war remain, with China still facing international criticism over exchange rates, the lack of financial liberalization, government subsidies for state-owned enterprises and infant industries, and policies that discriminate against foreign companies in favor of national champions. Perhaps most importantly, rebalancing the economy will require overcoming many powerful interests at a time when the line between the political and economic spheres has become blurred if not vanished as result of the decision to allow capitalists into the party and the increased concentration of wealth.

It is unlikely that the Xi administration is going to want to do battle on two fronts by taking on both major economic and political reforms at the same time. The current makeup of the Politburo Standing Committee does not suggest major political reforms are in the offing. None of the five members (in addition to Xi and Premier Li Keqiang) are known for their political reform credentials. Nor has Xi indicated so far that major political changes are coming. He has mainly attracted attention for encouraging officials to speak plainly rather than in bureaucratese at meetings, curtailing government spending on banquets and trips, and promoting a vaguely defined but rather nationalistic "China dream." By all accounts, he continues to affirm the leading role for the Party in governing, and shows no signs of a latent desire to become China's Gorbachev.

On the whole, we are likely to see the steady but incremental institution building that has gone on for the last three decades rather than major reforms for the next five years. There have been hints of a much needed rebalancing of the political-legal system in the form of a shift of power from the public security and political-legal committees toward the courts and the procuracy, including discussions about eliminating or reforming the form of administrative detention known as "re-education through labor," preventing the local head of the public security from being the head of the political-legal committee, the downfall of Zhou Yongkang in the wake of the Bo Xilai scandal, and the appointment of Zhou Qiang to replace Wang Shengjun as head of the SPC. There has also been renewed talk about China ratifying the ICCPR, although the likelihood of that happening seems slim. It also seems unlikely that a constitutional court will be established any time soon. Nor is it likely that the judiciary will be afforded significantly greater autonomy in politically sensitive cases.

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<sup>45</sup> Carl Minzer, "China's Turn Against Law," *American Journal of Comparative Law* (2011).

But prioritizing economic reforms is not necessarily bad. One general lesson for MIC governments is that at the end of the day, to use a popular phrase from American political campaigns, “it’s the economy, stupid.” What separates MICs from HICs is wealth. The only way MICs are ever going to join the ranks of HICs is by growing the economy. There is, after all, a reason that so much of the development literature is by economists.

Nevertheless, it is *not only* the economy. MICs must strive for sustainable high quality growth. They must also strengthen governance institutions, build up social welfare systems and meet the demands of citizens for a higher quality life. If the Xi administration is successful at rebalancing the economy towards consumption, it will have laid the groundwork for more rapid and fundamental political, legal and social reforms in the second term. The people will be better off, having benefitted from higher interest rates and the end of financial repression. Growth will be more equitable. There will be fewer environmental problems, and more resources available for prevention and cleanup. Spending on education, job training, health care and pensions will have increased. There will be more subsidized low-income housing. Illegal land takings will have decreased, and compensation increased. State oligopolies will face more competition, bringing down prices and improving the quality of services. The have-nots will have gained relative to the haves. The Xi administration will enjoy broad support, and have the political capital to take on political reforms without fear – or at least lower risk – that the process will undermine the Party in the way *perestroika* led to the breakup of the Soviet Union.

#### V. Toward a PWBC?

The state’s role in the neoliberal WC was minimal, limited to ensuring basic security and providing the necessary infrastructure to facilitate transactions and administer justice, with a corresponding emphasis on deregulation and privatization. In contrast and in keeping with the EAM, Beijing has actively intervened in the economy and played a key role in setting economic policy, establishing functional government institutions, regulating foreign investment and mitigating the adverse effects of globalization on domestic constituencies. The failure of the neoliberal WC to generate sustained growth in Latin America and the economic woes resulting from the Big Bang in CEE, combined with the more recent success of some CEE countries and the success of East Asian states where the state has played a greater role in the development process, has led to an emerging consensus that it is time to bring the state back into the picture. However, the role of the state is now being recast to avoid the minimalism of the neoliberal state and the excesses of the EAM’s developmental state.<sup>46</sup>

Reflecting the emerging view, the World Bank sketches how rebalancing the economy will require a change in the role of the government and in society in China:

It is imperative that China adjusts its development strategy as it embarks on its next phase of economic growth. At its core, this adjustment requires changing the role of government and its relations with the market, the private sector, and society at large. While the government needs to withdraw from direct involvement in production, distribution, and resource allocation, it will need to focus greater attention on designing and implementing the policy and regulatory framework that empowers others to participate in economic decision making so that the desired outcome of rapid, inclusive, and sustainable growth is achieved. To play this role, the government will need to transform itself into a lean, clean, transparent, and highly efficient modern government that operates under the rule of law. In redefining its role, the government will need to accelerate reforms in the state-owned sector and combine it with further development of the private sector. It will also need to advance reforms in factor markets (capital, land, and labor) to help strengthen the foundations of a market economy and promote greater competition and innovation. At the same time, society’s role will need to change significantly, with the middle class becoming a

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<sup>46</sup> Bojan Bugarcic, “Law and Development in Central and Eastern Europe: Neoliberal Development State and Its Problems,” in *Law and Development in Middle-Income Countries*.

major force in promoting harmonious development through greater participation of the people in the development process.<sup>47</sup>

Whereas in the neoliberal-driven WC approach in CEE the problem was an invisible hand and too little government intervention, in China the problem has been too visible a hand and too much government intervention. This suggests that there may be some convergence on a PWBC. What is required now is a smart state with a light touch able to address deficiencies in the market and adopt a long-term perspective that facilitates sustainable growth. The state can, *inter alia*, support basic science and research and development, work with the private sector in setting standards, and cooperate with NGOs and civil society in establishing public-private regulatory hybrids.

## VI. Conclusion

This article has addressed five sets of issues. First, in regard to the CM, the CM is really a variant of the EAM. This model, while useful for countries during the catch-up phase, suffers from serious shortcomings, including misallocation of capital, overinvestment in infrastructure and favored industrial sectors, unsustainable increases in debt followed by financial crisis; suppression of wages, low interest rates and other forms of financial repression; manipulation of exchange rates and overreliance on exports; serious environmental degradation; and perhaps most importantly of all the rise of powerful interest groups that capture the political process and resist reforms needed to adjust the economic model in ways that ensure more sustainable and equitable growth.

Second, given the diversity of MICs, there is no single MIT. Different countries face different challenges. Nevertheless, the common challenge for MICs is that what worked in the past no longer works for the next stage of development. Moreover, reforms will generate winners and losers, and in most cases, powerful interest groups that benefitted from the existing economic, political and legal arrangements will resist much needed reforms. Many MICs will then face some kind of economic or political crisis, leading to increased socio-political instability and often regime change; others will muddle along with dysfunctional but stable governments. In either case, growth will slow, inequality will rise, governance will be weak and the momentum for more fundamental institutional reforms will be lost.

Third, there is now a general consensus in China and among foreign economists that the CM has run its course. Moreover, there is a general consensus, reflected in the latest Five-Year Plan, that the economic model must be adjusted to stimulate consumption and decrease reliance on state-led investment. However, there are still many debates about how that transition is to be achieved, with significant consequences for which groups will be hit hardest.

Fourth, for China to overcome the current challenges and join the league of HICs will require major changes to the economic model, as well as fundamental political, legal and social changes. The government's role in overseeing and intervening in the economy will need to change, with the government playing a less interventionist and direct role in particular sectors or companies and a more strategic role in coordinating projects and providing information especially in projects with multiple inputs and long term payoffs; facilitating extensive collaboration and communication between the public and private sectors; and promoting entrepreneurship, innovation, and new product development. A more consumption based economy will empower Chinese citizens, NGOs and civil society, who will demand more say in and benefit from the policy-making, interpretation and implementation processes.

Nevertheless, China is likely to proceed in a gradual, step-by-step way. The main task for the next five years will be to rebalance the economy, which is more of a political-economy challenge than a purely technical economic problem. Assuming in the next five years the Party is able to overcome the vested interests that have benefited from the current model and want to maintain the status quo, the conditions will be favorable for embarking on more fundamental, rapid and ambitious political, legal and social reforms. Whether the Xi administration will be able to rebalance the economy, and then in his next

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<sup>47</sup> World Bank, China 2030, p.18.

term to take advantage of the opportunity for political reforms, remains to be seen, but with five new members to be appointed to the Politburo Standing Committee during his second term, there is some basis for hope.

Finally, there appears to be an emerging PWBC that recasts the role of the state in the development process. To be sure, developing countries that manage to overcome the middle-income trap tend to be pragmatic rather than dogmatic. Ideologically driven development agendas tend to fail, whether the right leaning neoliberal WC or radical left populism. Policymakers should be wary about the latest magic-bullet on offer, whether the WC, BC, EAM, or PWBC. Nevertheless, lessons have been learned during the past several decades, and the PWBC highlights some of them, including the need to avoid relying too heavily on either government or markets. There is growing support for a middle way, between the invisible hand of the neoliberal WC and the too heavy hand of the government in China and other East Asian developmental states, with the specific contours determined by local context.