

**THE END OF THE LONG BOOM?
A COMPARATIVE INSTITUTIONAL ANALYSIS OF LONG-TERM GROWTH IN CHINA**

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Draft.

*Paper for „Workshop des Arbeitskreises Sozialwissenschaftliche Chinaforschung“,
25./26. November 2016, Ruhr University Bochum*

Abstract

In this article, I offer readers a rough guide to institutional foundations for long-term growth in the People’s Republic of China. The peculiarities of the Chinese system include a selective integration into the world economy, a coordinating role for private-public growth alliances mostly at the local level, strong state permeation in corporate governance and corporate finance, segmented systems of low cost, yet comparably well-educated labor, increasing innovation capacities; and company access to large domestic markets. Mutual complementarities of these features made for an institutional “fit” and helped establishing a relatively stable growth regime in the 2000s. Yet, this variegated state-permeated capitalism is currently confronted with challenges that have to be addressed in order to tackle the question of whether the long boom is about to come to an end.

1. Introduction

Recently, speculations about the coming end of the long Chinese boom are on the rise. The objective of this article is to create a nuanced picture of China's growth model. The assumption is that we need to know more about the institutional foundations for long-term growth in order to also properly address the question whether the long boom is about to come to an end.

China's GDP growth has now surpassed every other long national growth period in the history of modernity. However, although the increasing significance of market institutions is by now indisputable, and even if the People's Republic is an essential part of a world economy organised by neoliberal precepts, it retains a specific character. In the following, China's economy is analyzed as a novel, variegated form of state-permeated capitalism. Its activity is based on close, competition-driven operations between various state and domestic business alliances at the national and sub-national level, not solely by an all-powerful, centralised steering bureaucracy – a stark contrast to analyses who do not distinguish the contemporary Chinese economy thoroughly from older varieties of state capitalism and developmental states (cf. Bremmer 2010). In order to explain foundations for the long boom, this article emphasizes mutual complementarities between different institutional spheres, which made for an institutional "fit" and allowed for the establishment of a very dynamic growth regime, especially from the late 1990s into the 2010s. It thereby aims at complementing other causal factors such as historical "advantages of backwardness" (an enormous reserve army of labor and productivity gains from the transformation of rural into industrial labor for instance) and favorable regional and global coincidences (e.g. beneficial economic dynamics in East Asia, including the importance of overseas Chinese, and an over-accumulation of capital in the West, which fostered FDI flows to China).¹

Theoretically, this article combines institutionalist insights in Comparative Political Economy (CPE) and International Political Economy (IPE). On the one hand, I highlight the necessity of reflecting on the historical evolution of national economic systems. On the other, I combine concepts from CPE with IPE, by placing national systems of capitalism in transnational contexts, thereby contributing to overcoming an artificial split within the political economy tradition. This includes

- (a) the analysis of institutional domains and their complementarities, departing from the central domains which were established by CPE research (cf. Hall and Soskice 2001; Deeg and Jackson 2007): the institutions of corporate governance (understood as the ability for corporate control); corporate finance (the means by which companies raise funds for investments); labour relations; education and training; and the transfer of innovations.

¹ A much broader analysis of the trajectory of China's growth model as well as on conceptual tools to analyze Chinese capitalism can be found in: ten Brink 2013a.

(b) the examination of the role of the state across all domains as well as the importance of domestic markets and ways of international economic integration.²

(c) the analysis of a dominant mode (or not) of coordination. The various institutions characteristic for capitalism must be connected with each other to deploy their productive capacities. On the institutional level, this is analysed by the degree of complementarity and the mutual “fit” of institutions (which can change over time). However, this does not properly address the question of how institutions translate into routinized practices of economic agents and vice versa. For this reason, different mechanisms of economic coordination are of crucial importance to understand the stability of a capitalist system (cf. Amable 2003).

In a nutshell, this research perspective allows to differentiate different models or varieties of capitalism, as exemplified in Table 1.

TABLE 1 Type of capitalism	Liberal capitalism	Coordinated Capitalism	Dependent Capitalism	State-permeated Capitalism in China
International integration	Linked to liberalized global economy, expansion via financial markets	Highly integrated in global production and trade, limited into financial markets	Full orientation towards global product markets	Selective integration, cautious against global financial markets
Dominant mode of coordination	Competitive markets and formal contracts	Interfirm networks and associations	Hierarchies in multinational corporations	Reciprocity within local private-public growth alliances
Corporate governance	Outsider control: minority shareholders	Insider control: concentrated shareholders	Control by headquarters of multinational corporations	Insider control by national owners and state actors
Corporate finance	Domestic and international capital markets	Domestic bank lending and internally generated funds	Foreign direct investments and foreign-owned banks	Internal funds and state-owned banks
Industrial relations	Pluralist, market based, few collective agreements	Corporatist, rather consensual, sectoral or national-wide agreements	Appeasement of skilled labor, company based agreements	Informality, segmentation, atomized labor
Education and training	Promotion of transferable skills	Highly sophisticated VET schemes for specialized education	No provisions beyond basic education	Advanced basic education plus segments of specialized skills
Transfer of Innovation	Market-driven	Inter-company co-operations and business associations	Intra-firm transfer within multinational corporations	Reverse engineering and adaptation, state-permeated innovation efforts
Comparative advantage	Global product and capital markets, radical innovation	Global product markets, incremental innovation	Weak domestic product markets, export orientation	Strong domestic markets for medium-tech products

² Thereby, classical CPE perspectives such as the “Varieties of Capitalism” approach by Hall and Soskice can be critically extended. Note that this conceptual perspective has been developed, inter alia, in a joint research group at Frankfurt University, which focuses on comparing capitalist institutions in large emerging countries such as China, India, and Brazil (Nölke et al. 2015; for similar perspectives on comparing capitalisms in Latin America and East Asia, see Schneider 2013; Zhang and Whitley 2013). It employs a mixed-method approach, drawing on descriptive statistics (data by international and national institutions) and case studies (secondary sources, expert interviews).

In the next sections, the specifics of Chinese capitalism are explicated. Section 2 tackles the historical evolution of the Chinese economy, and its selective integration into the world economy. In section 3, an 'inter-personal' mode of coordination in the PRC is depicted, based on private-public growth alliances, which worked both in favor of economic growth and societal stability. Section 4 deals with key institutional domains of China's capitalism. This includes strong state permeation in corporate governance and corporate finance, a segmented system of low cost, yet comparably well-educated labor, increasing innovation efforts, and company access to large domestic markets. The last section deals with both comparative advantages, resulting from an institutional "fit" in China's economy, and possibilities for destabilization of this model. For the sake of a better understanding, I will contrast my findings with other historical types of capitalism – especially liberal, coordinated, and dependent capitalisms (mostly in the Global South, but also in East Central Europe for instance) as well as developmental states in East Asia.

2. Historical evolution and global insertion

An understanding of Chinese capitalism must include its historical evolution and the specific form and timing of its insertion into the global economy. Three phases of gradual reforms can roughly be identified: the period from 1978 to 1989, the period from 1992 to 2002, and from 2003 onwards. It resulted in a "functional fit" of institutions – although in line with theories of institutional change, this did not exist *ex ante*, but was discovered and developed *ex post*. In addition, the success of a *selective* economic opening of the economy can be demonstrated, largely guided by preferences for autonomous national development, which led to a differentiated matrix of deep integration into global trade and production networks on the one hand, and shallow integration into global capital markets on the other.

The *first phase* from 1978 to 1989 resulted in a "trial and error" reform mode which led to a success of experimentation with markets and entrepreneurialism. It also included the opening of the economy towards foreign capital, and i.e. the permission of FDI, not portfolio capital, into selected Chinese spaces. However, there was no deep integration into global capital markets, which is why China was among the few economies in the Global South that were not affected by the debt crises of the 1980s.

The *second phase* of reform roughly took place from 1989/1991 to 2002 and was an era of intensified, yet selective liberalization of the domestic economy, path-breaking company reforms that allowed private firms to become serious competitors on domestic markets, and accompanying reforms of the financial sector, in labor relations and in the education and science system. Thickly embedded private capitalists and "red capitalists" became critical factors. Last not least, China's integration into the world economy was seriously accelerated, although it was still a selective integration. While tariffs were reduced, and the government opened some domestic sectors for foreign participation, the Chinese State Council, certain ministries, and local governments held important regulatory capacities at their disposal to regulate this process and to help domestic firms to keep pace with MNCs.

From its beginning, the long boom thus can be partly explained with reference to external factors. Growing foreign direct investments and their attendant export orientation are an important element here. As an investment location, China was in the immediate vicinity of the East Asian growth region and the networks of the overseas Chinese. From the 1990s on, China benefited from another special global economic constellation. Western transnational capital was desperately looking for profitable investment opportunities (Brenner 2006). To some extent, the initial FDI of overseas Chinese thereby eased the way for the wave of FDI from Western and Japanese transnational capital. Macro-economically, the two engines of the world economy since the mid-1990s, the USA and to a lesser extent China, hence achieved growth via two different, complementary and mutually dependent paths. Whereas in the USA large chunks of GDP growth consisted of debt-financed consumption rather than investments, the Chinese boom was a mirror image of that in the USA (Hung 2008).

The *third phase of reform* from 2002 up until the 2010s demonstrated the persistence, if not strengthening of non-liberal institutional dynamics. The background of a competition-driven form of (local) governance in China should not lead to any premature conclusion that the central state has been growing weaker. In fact it was precisely its instability in the first phase of reform, culminating in 1989, which lent the central government new legitimacy. One precondition of this was the rise in its extractive power: particularly since the tax reforms of the 1990s, the central state has been able to recentralize resources to a considerable degree. Moreover, in terms of its own modernization, several waves of bureaucratic restructuring led to strong institutions such as MOFCOM and NDRC. Among others, Hu Jintao and Wen Jiabao, and later the administration led by Xi Jinping, were utilizing statist instruments to “rebalance” the economy. This was due to perceived export dependencies on the one hand, and deficient domestic demand on the other (ten Brink 2013b). It included the great economic stimulus set up after the global financial crises in 2008. Development planning remained essential to affect reforms in areas such as industrial upgrading, infrastructural construction, science and technology, human resources and education, and social welfare. Nevertheless, this form of “macro-control” (*hongguan tiaokong*) was new-style development planning aimed at planning “with and for markets” (Heilmann 2011).

As illustrated in the following, these high levels of state-permeation were largely also in the interest of large Chinese firms, which forged close alliances mostly with local state managers.

3. Private-public growth alliances: A Chinese mode of coordination

The Chinese economy changed enormously over the last decades, making it difficult to grasp the actual model of capitalism that emerged. Still, despite these changes and internal heterogeneity, one can identify a dominant mode of economic coordination. It worked both in favor of economic growth and societal stability. In particular, the special role of private-public growth alliances at the local level worked as stability “anchors” for

the growth dynamic and for weathering significant institutional changes. The Chinese economy is coordinated by closely interwoven private-public alliances, often grounded on informality. This is different from older, bureaucratic state capitalisms, but also from other models of capitalism, which (ideal typically) are coordinated by the market and formal contracts (liberal market economies), formalized networks and associations (coordinated market economies), or hierarchies within multinational enterprises (dependent market economies). I will now introduce the workings of these private-public alliances that in fact go beyond a purely corruptive or rent-seeking setup. Rather, productive “cronyist” reciprocal relations have helped reduce uncertainties in a quickly-changing economic environment.

Most entrepreneurship in China is thickly embedded into the party-state. This has also been a trend for the large and medium echelons of the private sector (Chen 2015). Both the party-state elite and businessmen have an interest in close public-private relations. Indeed, the “larger the ‘sales revenue’ of a firm, the more likely its owner is a Party member”, and the more likely that Party organizations exist in their firms (Dickson 2007: 852). The prevalence of closely interwoven growth alliances reflects a process that can be coined *unity in diversity*. Although China is a heterogeneous country, this dominant form of coordination based on informal and non-transparent personal relations and aligned through the common interest of national economic growth, acted as a pillar of unity and stability. It was largely unchallenged by wider social unrest in the 1990s and 2000s, achieved also via a temporal taming of labor. Moreover, it was flanked by a comparably strong central state able to regulate competition among local alliances and domestic class fractions (see below).

What made these public-private alliances work? Shared social and political backgrounds are often mentioned when looking for factors that make for intra-elite coherence in China (Li 2010; McNally/Guo/Hu 2007). Reciprocal *guanxi* networks add to this, stemming from blood ties or friendly turns, and resulting in intra-family “work partition” (e.g. husband as local official, spouse as well-connected entrepreneur) and amities (e.g. cadres who have strong ties to entrepreneurs from their home towns). Furthermore, shared political backgrounds often make for a conviction in the prevalent statist and long-term-oriented developmentalism. Hence, proactive industrial policies and a preference for patient capital have a high status – even among private entrepreneurs. This is exemplified, inter alia, by individual private entrepreneurs caring “about the overall development of the private economic sector and the development of specific industries” (Chen 2015: 624). It should therefore come as no surprise that even representatives of Chinese „venture capital“, mostly known as anti-state in the West, generally accept this dominant constellation. Notably, in contrast to coordinated market economies for instance, economic coordination in China is not mainly provided by formal institutions. Business associations for private entrepreneurs exist and indeed have become more vital and autonomous from the party state over time (Kennedy 2011), but are less significant when compared to the role of informal, personalized

relations between individual entrepreneurs and state managers at different administrative levels.

Regarding special features of China's interpersonal mode of coordination, three stand out: (1) competition pressures between local alliances and managerial capacities of state actors, which also impinge on the problem of corruption, (2) the significance of an enduring strong central state to minimize socio-economic disparities and divisions between capitalist class fractions, and (3) the largely favorable role of foreign capital.

(1) Although public-private growth alliances are analyzed here as representing a non-market mode of coordination, these alliances themselves are subject to competition with other alliances. Since subnational administrations in China have assumed the role of local developmental states, they attempt to build settings conducive to success by creating incentives to stimulate economic efficiency in 'their' territories (for early evidence, see Walder 1995). In this process, government officials often act entrepreneurially – and therefore are depicted as “state managers” here. At the same time, competition among state-business alliances is an important corrective against state-capturing and harmful types of corruption: In opposition to most media coverage, the overall setting in China is not predominately patrimonial. Especially local governments in prosperous regions share with their business partners the overall goals of development, upgrading and innovation to such a degree that they reduce (this is not to say they prohibit) forms of corruption detrimental to economic growth. The opportunity to successfully join in local “cronyist” growth alliances makes local politicians take entrepreneurial risks. Likewise, it fosters individual careers in the political system and within the CCP: The system of cadre-evaluation, essential for individual career paths, is mostly based on economic indicators, although some social indicators have been included lately.

(2) While local competition is of utmost importance, it is still largely *competition under hierarchy* in the last instance. With regards to the central state, the government did not just adopt capitalist growth policies and individual entrepreneurialism (ten Brink 2013a; Yang 2004). There was and still is another central-state role that is not to be underestimated: the provision of an overarching institutional architecture that accommodates competition among local alliances. One political strategy regularly used by the regime to gradually initiate reform was to introduce change in only a few test areas, followed by a wider introduction of the policy when the test proved successful. Despite the fact that experimentation procedures have been delegated to local authorities, the central administration in Beijing played an indispensable role in universalizing local innovations (Heilmann 2008). The relative autonomy of the central government, in a way, enabled it to adopt policies that advanced the interests of the entire power elite without degenerating into clientelism. This is reflected in continuing debates among central policymakers and planning experts revolving around how the party state could limit “cadre corruption” (*ganbu fubai*) and clientelist groups with vested interests.

(3) Regarding the role of foreign capital, coordination in China has to take the power of international capital into account, but different from dependent market economies and other large emerging economies in which foreign capital is more dominant (Nölke et al. 2015; Schneider 2013). The economic integration of China did not lead to box domestic firms out of most dynamic manufacturing sectors. Although MNCs play a significant role, they were generally not able to influence coordination to the detriment of Chinese alliances. Rather they have tried to become part of domestic alliances. This in particular holds true for Taiwanese and Hong Kong entrepreneurs, defined as “patriotic capital” in the PRC. Many overseas Chinese have thereby been deeply integrated into the mainland economy. On another level, MNCs were inducing competitive pressures that also prevented strong rent-seeking, at least in coastal area domestic alliances.

All of this does not imply an analysis of China as a smoothly coordinated and governed entity. However, it contributes to an understanding as to why again and again internal tensions and conflicts did not erupt as severely as in 1989 or in other large emerging countries, where such alliances for growth could not be forged (the latest example being Brazil). As political factions and capital fractions mostly share the fundamental goals of domestic socio-economic stability, a system of checks and balances has mostly kept conflicts under control up until the early 2010s.

4. Key institutional domains

This section deals with key institutional spheres of the Chinese economy and how they each fostered growth of large national firms. At the end of each subsection, problems and potentials of destabilization are shortly depicted.

Corporate governance

Ownership of Chinese companies is largely concentrated and control of big firms rests with insiders. Matching the rather decentralized structure of the country, different state levels (e.g. central, province and city level) own, control and/or invest into companies. A complicated system of mostly decentralized state ownership with important segments dominated by private property thickly embedded in the (local) political scene has emerged, including competition among state-owned firms and various forms of state involvement in business operations (McNally 2011; Naughton 2011). In most sectors, national capital dominates.

Many large Chinese companies are exchange-listed, and usually dominated by state block-holders. In opposition to the Maoist era and previous versions of state capitalism, there is neither a classical top-down control, nor is there a single guiding enterprise model such as Chaebols and Keiretsu in South Korea and Japan respectively. Rather, restructured forms of profit-oriented and competition-driven state-controlled enterprises such as China Mobile, Baosteel, or Sinopec have emerged. Additionally, private firms such as Huawei, Midea or Geely and public-private hybrids have also been able to play a significant role in development.

Although regional and sectoral heterogeneity make for an opaque system of corporate governance, the saliency of national control is astonishing. At the “top tier”, refurbished SOEs continue to retain their influence, especially in sectors such as petrochemicals, telecommunications or electricity (Pearson 2011). In the “middle tier” where no natural monopolies and less strategic concerns exist – such as machinery, automobiles, chemicals, electronics as well as in cutting edge environmental, energy and other “emerging industries” – SOEs now coexist with big public-private hybrids and private firms. Nowadays, such large non-state firms are also seen as “national champions”. Beneath those two dominant tiers, a great variety of small and medium, mostly private, firms exist.

Because of the strategic role of government, developments in the financial sector object against the notion of a simple adaptation of prevailing Western models. Stock markets in Shanghai and Shenzhen are no liberal markets for corporate control, and shares are only partly traded. There is rather an “insider”-dominated mode of corporate governance, as Chinese listed companies regularly have very big shareholders who are able to control the company without taking into account the influence of other shareholders. Dispersed shareholding is rare, and minority shareholders are typically disadvantaged. The management of major companies is also comparably independent from short-term fluctuations on the stock markets in China.

Although since the 1990s, MNCs have increased their prominence in the Chinese economy, they do not dominate the economy. With some notable exceptions for instance in the IT industry, which is deeply integrated into global production networks, most industrial sectors are dominated by national state-controlled, hybrid and private capital, and not by foreign multinationals. Additionally, in marked contrast to more dependent capitalisms, there is no clear sharing of tasks between MNCs (e.g. higher technology, complex manufacturing) and local companies (e.g. low-tech, simple manufacturing). Rather, as the case of the IT industry illustrates, even in foreign-dominated industries, large Chinese firms have emerged as competitors for established Western and East Asian firms.

Finally, some potential malfunctions in Chinese corporate governance have to be mentioned, ranging from assumptions about soft budget constraints leading to the support of unproductive state-owned firms, to assumptions of decreasing SOE profitability in recent years (Meissner et al. 2015) and to expectations about foreign competitors increasingly outcompeting domestic Chinese firms (Brandt and Thun 2016). Certainly, the passionate debate on whether this system is economically reasonable – which liberal authors would generally deny – or whether it is superior in the long run despite economic deficiencies at plant level – which some heterodox economists would emphasize – is far from completed.

Finance for investment

Most large companies in China are relatively independent from short-term volatilities on global capital markets as well as from profit expectations by transnational investors.

They raise investments mainly by way of internal savings, in addition to loans by national banks, and enjoy preferential support by the state. This promotes a rather strong role for patient capital and accommodates with long term strategies of firms. The effect is to preserve favorable conditions for domestic enterprises over a longer period. In opposition to coordinated market economies (as historically in Germany), domestic banks and capital markets are more state-controlled. In contrast to liberal and dependent capitalisms, state regulation of the credit sector also limits the influence of foreign capital and thereby maintains the concentration of capital particularly within domestic fractions. This setup has served the Chinese growth strategy well in the 2000s in actively allocating capital towards investment in industry, infrastructure, real estate, and increasingly services.

What are the most important sources of investment in the PRC? It is neither the domestic capital markets, although they have burgeoned into the second largest in Asia (Walter and Howie 2011). Nor are global capital markets of prime importance. The institutional characteristics of both nationally controlled enterprises as well as a rather closed financial system create incentives in which foreign investment and stock market capitalization play a minor role in investment, thus diminishing the pressure emanating from volatilities in global equity and bond markets. Foreign bank share in China never exceeded 2% in the 2000s and after (CBRC 2012). The Chinese economy has been integrated into global product markets, yet the financial sector largely was not. Partly because of this peculiar structure, the financial sector has come through the global financial crisis comparatively well.

Instead, national firms primarily use internal funds for their operations. This facilitates autonomous, and often long-term business strategies which would be less possible if firms were to rely more on (foreign) shareholders. Especially the largest domestic firms additionally finance investment via bank credit. Approximately 85 % of external loans for very large firms come from the “Big 5” state banks, other commercial banks and city banks. Reform policies thereby led to also provide loans for sino-foreign Joint Ventures (e.g. in automobiles) and private firms (e.g. in real estate or IT). The tipping point is no more if SOE or not but rather is a firm profitable and has it capabilities to pay back. (Note that the size and heterogeneity of China makes for a much more complex reality than that covered here).

Again, this was conducive to long-term strategies of many large firms. While short-term loans doubled between 2005 and 2010, long term-loans more than tripled (NBS 2012: Table 20-2). Beyond lending practices on paper, bank loans to enterprises are in fact often state credit lines, which both make for strategic advantages over global credit markets due to e.g. longer credit maturities and/or lower interest rates. Similarly, this gives state institutions at different state levels a certain 'grip' on companies. Furthermore, other direct and indirect state support especially at the local level such as cheap land, informal preferential credits, and tax rebates contributed to very favourable financing conditions. In contrast, smaller firms on the fringe strongly rely on informal sources as they are disadvantaged by prevailing lending policies (see Allen et al. 2011).

All in all, the Chinese investment regime served the national development strategy of supporting domestic growth by any means and of creating “national champions”. However, state-permeation also creates considerable problems. Whereas in Western economies banks sometimes refused to lend money, China still deals with the economic consequences of its highly expansionary credit policy after 2008. As a result, since 2010 problems of bad loans and over-investment emerged that cannot be easily confined (Shih 2015; ten Brink 2013b).

Labor relations

In China, state actors arrange for the preservation of a low wage regime, very often though by *not* intervening into business misconduct. Industrial relations are mostly regulated at the firm level, which is very different from a sector-corporatist model. They show parallels to liberal economies, which also feature firm level regulation, yet differences are observable with respect to lower wages, less worker protection and a larger informal sector. This regime was supported, inter alia, by a continuous supply of cheap rural labor power and de facto state preservation of low wages, often through the selective non-enforcement of labor standards which often only sound comprehensive on paper.

China’s industrial structure is the product of its gradual transformation into a party-state mediated, class-divided society (Chan 2015). A low wage regime, based on a segmentation and segregation of the labor force proves to be a key motor of accumulation and made for significant labor cost advantages. Note that Western MNCs producing in China are also very much benefitting from this system. Generally, labor markets are fragmented between a comparatively well-paid segment of core workers on the one side, and a larger segment of subordinated workers on the other (Lüthje et al. 2013). In 2007, only about 50 % of all firms had signed contracts with their employees and the rate for migrant workers was even lower (Friedman and Lee 2010). Although the 2008 Labor Contract Law officially altered this, it is still common for workers to sign short-term contracts of under one year.

On top of this segmented wage organization comes the *segregation* of urban and migrant workers. The *hukou* household registration system, which ties an individual’s social benefits to a particular place – very much to the detriment of migrant workers – “is obviously central to the current system of sustaining super low-cost Chinese labor in the international market” (Chan and Buckingham 2008: 604). Thus, although there exist fairly sophisticated labor laws by now, its actual implementation is weak. Moreover, the fact that wages are regulated mainly at the firm level stems from a lack of collective and cross-sector regulation of labor and social standards. Chinese trade unions, controlled by the Communist party, do not work strategically at branch or sector level, in order to curb competition between employees.

What is more, Chinese workers were not only comparably cheap, but productive. Increases in productivity thus compensated wage rises during the 2000s. A combination of low wages, heavy capital investment, positive infrastructure and transportation

network externalities, new management systems, and investment in human capital led to a historic increase in labor productivity. Indeed, China has been increasing labor productivity much faster than Brazil, South Africa, India, or any OECD country since the 1990s (Leung 2011). Only since the early 2010s, labor productivity did not outpace the increase in wages anymore.

However, although business commentators are proclaiming that the era of low-wage labor has come to an end, this has certainly not been a reality for large parts of the workforce in the early 2010s. Thus, besides its economic “efficiency”, the Chinese labor system constitutes a very delicate institutional equilibrium (Cai 2015; Friedman 2014).

Education and training

The quality of “human capital” and its institutional fit with other segments of the economy are decisive criteria for economic development. When compared to other large emerging countries, China is the most prominent case of the economically efficient provision of human capital (Nölke et al. 2015; note that this “efficiency” includes a low level of class mobility: Lin 2011; Woronov 2011). It has developed an education system in which the vast majority of the working population now receives a secondary education of 9 years or more. This largely even accounts for the migrant workforce (Friedman and Lee 2010: 516). Complementing industrial relations, a fragmentation between small groups of highly qualified labor and a much larger group of less qualified labor with a focus on general skills can be depicted. Well into the 2010s, this complemented demand for mostly medium-skills. In addition, the challenges of rising demand for higher-skilled work were also addressed by political elites, although prevailing incentives by employers and workers thwart this projected transition.

The central government’s aim over the 2000s of achieving a 4 % education spending of GDP has nearly been achieved. While in dependent capitalisms, dominant MNCs are often not in favour of a generous tax-funded public education and training system, higher education investments led to an advanced school system in China. Although there was a rise of spending across the board, it is most pronounced in higher education. Education and spending on training is to a large degree decentralized, with large regional variations. Importantly, local state-business alliances have become key players in selective and often informally organized support to vocational training. Close relationships with local state institutions lead to the option for firms of picking interns from vocational schools, and to compatible training in areas in which allied companies are operating.

Regarding incentives, the central state strongly aims at upgrading the skill formation system. Yet, this is not always implemented at the local level. The biggest hurdle to stronger employers and employees incentives to upgrade skills significantly is the high turnover rate in Chinese industries. In such fluid labor markets – we find a similarity to liberal market economies here – the complement is a system that continues to focus on general skills because companies are unwilling to invest in advanced

apprenticeship programs “imparting industry-specific skills where they have no guarantees that other firms will not simply poach their apprentices without investing on training themselves” (Hall and Soskice 2001: 30). Although some companies started their own training programmes, however, this is mostly limited to small groups of employees in need of specialized, high-quality skills.

To summarize, the education and training system functionally benefitted the demand for mostly low and medium skills well into the 2010s. Nevertheless, increased efforts by the state are necessary to cover the rising demand for higher skilled labor and to not remain stuck in a low or medium skill equilibrium so prevalent in Latin America (Schneider 2013).³ Thus, even though the government has more power than dependent capitalisms to make substantial investment in skill upgrading and business-state alliances may be more concerned about long term developments, the challenge is huge, as exemplified by the lack of business and worker incentives to implement efficient structures of skill upgrading (Koen et al. 2013).

Innovation

Ideal typically, innovations in liberal economies are spread via markets, innovation in coordinated economies is based on inter-company cooperation, and in dependent capitalisms it is based on intra-firm transfer in multinational firms. The Chinese system of innovation represents a state-permeated variety. It includes technology transfer and reverse engineering through, inter alia, a relatively weak, state-tolerated patent rights systems, and domestic, mostly incremental technological innovations through public support and public-private collaboration in selected sectors.

For a long time, China’s innovation activities concentrated on labor-intensive “imitative innovation”; hence innovation which is new to firms in China but imitative in nature. Innovation was partially achieved through technology and knowledge transfer via FDI or joint ventures. Most studies conclude, however, that technology transfer did not lead to a fundamental progress of domestic innovation capacities (Fu 2015). This has motivated Chinese state actors to increase its public innovation policy efforts substantially (Bresnitz and Murphree 2011). R&D spending has risen to 2 % percent of GDP recently.

State managers currently play a crucial role in providing the setting for progress in domestic innovation, for instance via tax incentives, procurement policies, standards setting, subsidies, and knowledge transfer via networks. In addition, a “combination of policies forcing technology transfer and China’s failure to effectively enforce protection of foreign intellectual property rights (IPR) are also seen by many as strategic moves to give Chinese firms time and access to proprietary intellectual property (IP) in order to develop competitive domestic alternatives” (AmCham 2011: 64).

³ In general, there is more competition for skilled workers than for lower skilled workers. Enterprises often complain about human resource constraints in higher skilled segments and there is an oversupply of academics vis-à-vis qualified personnel from vocational education.

There is increasing evidence that China has by now gone beyond imitative innovation and moved into real innovation. Although some authors show unclear causal effects of government innovation funding, it has also been demonstrated that the effectiveness of R&D subsidies has improved (Guan and Yam 2015). Regarding the quality of “indigenous innovation” (*zizhu chuangxin*), incremental, i.e. improvements of existing technologies in existing markets, often emerging out of customization, and “really new” innovations, i.e. innovations that embody new, yet no radical new technologies, are on the rise. Most innovation is in medium-technology and rather incremental than radical. Their main advantage is at home – fitting with the demand in medium-tech products. Some spin-offs from state-run research institutes are among those firms that were and are innovation leaders in China. Recent works identify particularly positive effects in regions with proactive local states, party organizations, and state-business alliances (cf. Yang 2014; Butollo and ten Brink forthcoming), like the technologically advanced Pearl River and Yangtze River Deltas. Although some firms are still comfortable with adapting foreign innovations for the domestic markets, R&D spending shifted from state authorities to large (state-owned, hybrid, and private) companies since the 2000s. Under increasing competitive pressures, induced partially by MNCs, firms have hence increased their innovation efforts.

All in all, China has developed a rather effective innovation system when compared to other large emerging countries. Its long-term viability, however, is far from guaranteed. Several dysfunctions in the Chinese innovation system create challenges: The weak IPR system is increasingly to the detriment of Chinese firms, indicated by the fact that most Chinese civil IPR litigation now involves Chinese rights holders suing other Chinese; Chinese companies still only benefit to a rather limited degree from public technology transfer when not only advanced regions are observed; the quality of both public innovation capacity building and public research is controversial; and links between the public research system and companies are still rather weak. Thus, several reforms currently aim at improving China’s innovation system (Jefferson et al. 2014).

Domestic markets

A very large and thriving domestic market is of particular importance for China’s capitalism. In opposition to East Asian developmental states, the domestic markets of China are far bigger. Yet, while Chinese state managers selectively brought competitive pressures home, into the domestic markets, market protection and proactive support of national capital persisted. Although the regulation of the domestic investment regime has been relaxed, various state policies such as subsidies and public procurement facilitate domestic companies (Gruss and ten Brink 2016; Butollo and ten Brink forthcoming). In this setup, indigenous firms developed comparative advantages vis-à-vis foreign companies in the production of ‘good enough’ products which do not require highest levels of technology. The rise of consumerism and increasing demand for intermediate goods, i.e. goods consumed as production inputs ranging from office equipment, computers to motor vehicles and plant and machinery, led domestic firms

to successfully occupy large market segments especially in medium-tech and/or medium-range markets.

Somewhat surprisingly maybe for standard economic analyses that focus on China's opening efforts and its achievements in export, Chinese domestic industrial firms on an average sell three to four times more goods on the domestic market than abroad in the 2000s. Given the structure of domestic demand, it implied producing medium-range goods – a segment in which domestic firms enjoy strategic advantages due to their proximity to home markets, knowledge about consumer preferences, and state support. Since the 2000s, medium-range segments of the market emerged as growth drivers. In contrast, Western multinationals for a long time failed to sell medium-range products to consumers (see Brandt and Thun, 2010).

Where is demand located? Certainly, the Chinese luxury markets are quickly becoming the world's largest. However, what counts more is the rise in mass consumerism. Regardless of its relative percentage of GDP, China's consumption has been growing faster than any other large economy in absolute terms (Towson and Woetzel 2015). In particular, a new middle class pushes domestic demand, thereby also reflecting the vast need for durable goods, ranging from textiles to white goods and mobile phones, and the wish to travel – tourism has become a multi-billion RMB business recently.⁴ Next to end consumer demand, the rising demand for intermediate goods has become essential. Due to China's investment boom, domestic manufacturing firms are among the most important producers of intermediate goods. Construction is an equally important activity, which represented the single biggest portion of GDP growth in the late 2000s.

All in all, the size and structure of domestic markets hence is of major significance for understanding long-term growth. However, this must not prevail. Are we thus seeing the exhaustion of this system, as recently indicated by rising indebtedness by financial institutions, non-financial corporations such as property developers and private households?

5. Summary and outlook

This article assumes that an analysis of the institutional foundations for long-term growth can help identifying problems and instabilities that have already or may soon

⁴ To be sure, inequality gaps are wide in all regions and both in rural and urban areas. Although the government had not provided an official Gini coefficient since 2005, when it stood at 0.42 in 2005, a survey by a university in Chengdu put the country's Gini coefficient at 0.61 in 2010. Yet, although Gini readings above 0.4 are typically interpreted by analysts as a device of the potential for social disturbances, for the time being, this setup also made for important factors that fostered growth. Consumption in China still grew strongly in absolute terms, despite a relative wage share decrease of GDP to about 40 %. While for migrant workers and rural labourers average real income has risen slightly during the last years, this accounted even more for the growing middle classes. Overall, though, despite increasing inequality and high saving ratios arising from poor Chinese households having to pay a large share of health, pension, and education expenses, the rise in absolute wealth levels has made a new mass consumerism possible.

undermine China's growth model. Before moving on to this, I will briefly summarize how institutional complementarities fostered economic growth up until the early 2010s.

For a long time, the Chinese economy enjoyed comparative advantages regarding the processing of labor-intensive goods. In the 2000s however, an increasing productiveness in capital-intensive production made China a major player in medium-range technology. Notably, Chinese producers are increasingly able to serve regional and world markets for mass consumption. However, China's thriving domestic market is of greater importance. While for the most part, Chinese firms do not compete with Western MNCs for global market shares in sectors of highest value added production, due to a proactive state and a familiarity with national consumption patterns, Chinese firms have particular advantages on "their" domestic markets. A diversified industrial economy has fostered the rise of competitive national firms in several sectors such as machinery, textiles, white goods, IT, heavy industry and resources. Moreover, as China's institutional architecture was supportive of medium to long-term firm strategies, it was relatively independent from volatilities on global financial markets and policymakers were capable of protecting the economy from short-term fluctuations. Correspondingly, China has survived the global financial crisis and subsequent instabilities fairly well.

For an understanding of growth dynamics, institutional complementarities are significant. As mentioned above, it is not only the quality of the separate institutional domains that matters but also the quality of their mutual connections. In China, those institutional complementarities are particularly strong (1) in a *corporate governance/investment finance-cluster* and (2) in a *labor/education/innovation-cluster*.

(1) With regard to *corporate governance* and *finance for investment*, Chinese firms can calculate on both preferential national networks of finance for investment and an enduring national control of enterprises through insiders, making long-term strategies practicable. At the same time, close relations with state managers and the latter's pronounced entrepreneurial stance has led firms to count on numerous types of proactive state support and a careful, selective integration of foreign firms into China, thereby enabling technology transfer, but preventing "sell out". Prevalent firm strategies to succeed by forming close, 'cronyist' relationships with state managers in that way fit with informality patterns in corporate governance and corporate finance.

(2) With respect to *industrial relations, education/training, and innovation capacity building*, a further institutional fit can be observed. Chinese growth since the 2000s is partially based on complementarities between large low wage sectors with low and medium skill requirements and an education system in which the working population mostly receives a secondary education and some special training. Moreover, the (still comparably) cheap, relatively disciplined, and adequately skilled mass labor force was complemented by an increasing output of higher skilled labourers such as engineers or technicians. This was assisted by rising public expenditure on education. In conjunction with some progress in innovation capacity building, this helped producers to effectively focus on medium-tech production of medium-range goods, in which skill and innovation requirements are not overly sophisticated. At the same time, medium-

range supply matched demand: As exemplified above, rising medium-range demand in mass consumer and intermediate products incentivized domestic firms to specialize on it. Moreover, wage increases were prevented from spiraling out of control.

On top of these two clusters, an overarching role for the reproduction of institutional complementarities and for expectational stability has been provided by the growth alliances between state and business actors, mostly at the local level. This *interpersonal coordination mechanism* mobilized resources, reduced uncertainty and helped in making institutions ‘fit’ over time, by also adapting them gradually. Finally, on the central level, the party-state provided further stability despite vast regional heterogeneity and incessant institutional change.

China’s political economy thus seems to demonstrate the advantages of state-permeated capitalism. Nonetheless, the continuity of the long boom is confronted with challenges. Rather than being constantly and necessarily stabilized and controlled, the persistence of this growth model is not guaranteed. On the basis of the analysis presented here – apart from cyclical factors – it is now possible to distinguish more clearly which destabilization factors actually are of primary significance and which are not: The notion in Western public discourse for instance that the end of the great global credit boom in the 2000s, prolonged by quantitative easing, flooding emerging economies with cheap financing, will hit China hard, can be qualified (Gallagher 2015). Since China is less dependent on external finance when compared to other emerging economies, it is also less vulnerable from financial outflows. Moreover, even though the threat of export stagnation due to demand stagnation in the West is arguably bigger, my analysis suggests that export stagnation may be or has already been compensated by domestic market growth particularly in medium-range market segments (although export-oriented sectors may indeed face serious problems).

Other destabilization potentials arising from China’s institutional architecture loom larger. With regard to interpersonal “cronyist” economic coordination for instance, there is evidence that tensions and conflicts between political and capital fractions erupt with increasing frequency, illustrated by serious recentralization efforts of the Xi administration since 2013 to address them. It remains to be seen whether anti-corruption measures only limit harmful types of corruption or also negatively affect “productive” cronyism in local growth alliances, as they might restrict intra-elite economic decision-making in this authoritarian form of capitalism (for a pessimistic outlook see Pei 2016, for a more optimistic view see Zhu and Zhang 2016).

Moreover, China’s state-permeated corporate governance/investment finance-cluster with an abundant supply of finance tends to produce excessive investment that cannot be easily confined. Even the central government is only partially coping with heavy competition between local growth alliances and the associated high-risk growth and financial policies from subnational actors leading to bad loans, over-investment and rising local indebtedness (cf. Naughton 2015, 2016 for recent policies addressing local debt and the somewhat inconsistent introduction of the “Supply-side Structural Reform”). Likewise, the largely unquestioned belief in the CCP’s capacity to command

key actors in the financial system is increasingly in doubt. All this may endanger former institutional complementarities.

Regarding the labor/education/innovation-cluster, worries exist about whether the rising demand for higher skilled labor can indeed be covered – via serious reforms in vocational training for instance. This holds as well true for the question if China can manage to move from imitation to real innovation. While upgrading in skills and innovation capacities might also contain detrimental effects on institutions such as the low wage regime, they may be insufficient with respect to the challenge of foreign firms that produce where they sell (Herrigel 2014). Foreign competitors already began to modify their strategies for medium-range segments of the Chinese domestic market and became more successful in the last years (Brandt and Thun 2016). Last not least, trapped between public promises of social justice and the enduring belief in low wages as a competitive advantage, governmental crisis management oscillates between social appeasement and business-oriented restructuring. Proposed improvements in work conditions are seen as being too sluggish, nurturing the likelihood of an increase in social conflicts and a decrease in individual advancement motivations. Although the analysis presented here is cautious against hasty speculations about destabilization, this system will be put to the test if one of its key political attributes – the objective of increased prosperity for broad sections of the population – is placed in jeopardy.

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