THE FUTURE OF THE CHINESE MIRACLE: WILL NEO-STATIST SOES PERSIST IN CHINA'S DEVELOPMENT MODEL?

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ABSTRACT: Development theorists have long debated the economic role of the state. With regard to contemporary China, this debate has been manifested in the opposition between neo-liberal and neo-statist paradigms, in particular the role of state-owned enterprises (SOEs) in the Chinese economic 'miracle'. Neo-liberals, especially the Western financial media, have portrayed these enterprises as dinosaurs, restricting rather than contributing to economic development. However, the success of the state policies of *zhua da, fang xiao* ('grasp the large, let go of the small') and the move to 'Go Global', as well as the successful resistance to both the Asian Financial Crisis and the recent Global Financial Crisis, means that state-owned industry has remained central to China's 'miracle' growth and trade policy. Though more nuanced than popularly presented, the issue remains: will these SOEs survive China's future transition to demographic deficit and slower economic growth? We predict that they will.

KEY WORDS: China, Neo-statism, State-owned enterprises

1. INTRODUCTION: DEVELOPMENT MODELS AND THECHINESE MIRACLE

The post-2007 global financial crises have caused many to re-assess the causes and implications of the Chinese 'miracle' (e.g. Tian 2011, McGregor, 2012). Commentators worldwide are fascinated by the rapid growth that has occurred in China since the 1978 economic reforms. These reforms paved the way for the beginnings of private industry and unprecedented (for China) economic growth, exceeding 9 percent annually between 1978 and 1997 (Hu and Khan, 1997) and at rates even higher for much of the first decade of the current century. China has become the world's second-biggest economy, its leading exporter (it recently passed Germany) and the world's largest destination for foreign direct investment (FDI). The transformation of China that occurred after 1978 echoed the swift development elsewhere in East Asia in the 1960s and 1970s. In countries such as Japan and South Korea (Amsden, 1989) the national champions were private firms; China has a different model.

Whether you call it state or 'authoritarian' capitalism (McGregor, 2012), China has become a puzzle for students of economic development (Zhao, 2010). How has China, a country that prior to reform stagnated under a largely autarkic state development model, not only opened up its economy to the outside world but also in so doing engaged with the world economy in such a mutually advantageous manner? And how do we account for the dominant position that the Chinese state plays in the economy, when modern neo-liberal (orthodox?) economics posits that the state has only a limited role (e.g. in creating stable property rights, educating the labour market and maintaining social infrastructure) and virtually no place in direct goods and services production for the economy? (Balassa, 1977; Mankiw, 1995).

The Chinese approach is similar to the now-faded 'modernisation' theories of the 1940s and 1950s. As suggested by scholars such as Rosenstein-Rodan (1943), Lewis (1955), Myrdal (1957), Hirschman (1958) and Rostow (1960), this theory essentially proposed that the state would direct a shift of resources to manufacturing from agriculture. The actual development policies often associated with this approach involved shifting large segments of the rural population to state-owned/organised industry protected by import quotas, tariffs and other barriers from competition, currency controls and investment in public infrastructure. In application these policies failed to lift any countries out of Less Developed Country status (Krugman, 1994a). The advent of monetarism in the 1970s shifted economic thought decisively towards the constant returns/perfect competition model of neo-liberalism, 'structural adjustment' being its current expression in development economics. Acceptance of this ('Washington consensus') model is fundamental to the viewpoints of most Western media and economists. We ignore here 'left' critiques, such as dependency theory (Frank, 1967) and political economy (Cardoso, 1977), as these are minority paradigms and there is no evidence that they influence either the Western financial media or Beijing (Nedervesen, 2010: ch.3).

So current orthodoxy posits that the privatization of state industry is an inevitable (almost Rostovian?) process that is essential to turn state-owned 'dinosaurs' into dynamic 'dragons'**.** China's 'opening up', coinciding with the introduction of FDI and the growth of private markets (Deng 1986), has seen it presented as beginning the transition to neo-liberal capitalism (Nee, 1989; 1996; Steinfeld, 2010; *The Economist*, 2012a).

Lost in the orthodox rhetoric is the fact that economic success and development in much of the First World historically was largely built on state support and/or control of industry (Polanyi, 1944). There are many examples of the developed world's use of state-owned enterprises (SOEs), or in Europe more recently, 'national champions' (albeit privately owned), to suit the economic needs of individual economies. This background presents a conundrum to those wishing to analyse China. It is not conspicuously evolving towards a market economy. Indeed since the 1994-97 policy realignment, the importance of the state sector has increased. So are the SOEs dinosaurs that are distorting investment and slowing potential growth? Will the investment in the SOEs fail to realise adequate returns and guarantee that China will be caught in the middle income country trap? Or have its SOEs allowed the Chinese state to engage beneficially with markets, national and international?

2. THE CHINESE MIRACLE

The Organisation of the Economy: 'Zhua da fang xiao'

The post-1978 policy redirection presented Beijing with the challenge of dealing with the extensive state sector left over from the centrally-planned period. Rather than follow the orthodox neo-liberal path of full-scale rapid privatization (as did Russia), China instituted a policy of developing state-chosen 'winners.' This has manifested itself in the

policy of *zhua da, fang xiao* ('Grasp the Large, Let Go of the Small') (McGregor, 2005, Green and Liu 2005).
The State Council directive of 1991 and the 15th People's Congress of 1997 emphasised '*zhua da*' and cemented the concept into national economic policy (*China Daily*, 1998). The goal has been to create a limited number of SOEs large enough to allow the Beijing administration to guide the economy. The 1997 directive states that:

> We [the state] must focus on grasping a batch of large enterprise groups, unify and push forward a large number of enterprises' restructuring and development, promote efficiency of state capital and positively promote the role of these backbone large-scale enterprise groups in the national economy (cited from Sutherland, 2003: P160).

'Grasping the large' resulted in the state-preferred 'winners' of the national team, a collection of 120 SOE groups selected by Beijing to lead the economy. Most of the national team were designated in the 1991 and 1997 State Council directives but the source of this policy goes back to the 1986 selection of the Dongfeng Joint Management Company for a policy trial (Sutherland, 2003). There are a further 512 large SOEs nominated to form the 'core' of these 120 groups. The bulk of these ventures are under the direct oversight and control of the State-owned Assets Supervision and Administration Commission (SASAC).

Beijing decided that an economy dominated by many hundreds of small state industrial enterprises was too fragmented to allow efficient state control (*China Daily*, 1998). To remedy this, the state directed and protected the largest state companies to create ventures able to exploit economies of scale and form vertically integrated systems of production. Table 1 demonstrates that the state has retained most of the largest firms under its direct control.

Table 1. China's Largest Enterprises by Revenue (2004 and 2010).

Company name	2010			2004		
	Annual Revenue (US$ millions)	Country Rank	Global 500 Rank	Annual Revenue (US$ millions	Country Rank	Global 500 Rank
Sinopec †	273 422	1	5	75 077	1	31
China National Petroleum Company †	240 192	2	6	67 724	3	46
State Grid †	226 294	3	7	71 290	2	40
Industrial & Commercial Bank of China †	80 501	4	77	23 445	6	229
China Mobile Communications †	76 673	5	87	23 958	5	224
China Railway Group †	69 973	6	95	--	--	--
China Railway Construction †	67 414	7	105	--	--	--
China Construction Bank †	67 081	8	108	19 050	10	315
China Life Insurance	64 635	9	113	24 981	4	212
Agricultural Bank of China †	60 536	10	127	15 285	14	397
Bank of China †	59 212	11	132	17 960	12	339
Noble Group	56 696	12	139	--	--	--
Dongfeng Motor †	55 748	13	145	--	--	--
China State Construction Engineering †	54 724	14	147	--	--	--
China Southern Power Grid†	54 449	15	149	18 929	11	316
Shanghai Automotive †	54 257	16	151	--	--	--
China National Offshore Oil †	52 408	17	162	--	--	--
Sinochem†	49 537	18	168	20 381	8	287
China First Automobile Works Group†	43 434	19	197	13 825	16	448
China Communications Construction †	40 414	20	211	--	--	--

† Part of the national team or 512 selected enterprises.
Data sources: Data for 2010: http://money.cnn.com/magazines/fortune/global500/2011/countries/China.html;
Data for 2004: http://money.cnn.com/magazines/fortune/global500/2005/countries/C.html.

Controlling the Commanding Heights

The 'commanding heights' were defined as industries that have significant downstream linkages to the rest of the economy (Yergin and Stanislaw, 2002). They were defined as infrastructure industries (energy, raw materials), pillar industries (metallurgical, electrical, chemical, machinery, petroleum, natural gas), and financial and banking systems (*People's Daily*, 1994).

First the 15th People's Congress and then the subsequent *Outline of State Industrial Policies for the 1990s* (*People's Daily*, 1994) focused on building successful state-firms in the commanding heights. The state achieved this by creating a series of dominant enterprise groups, while encouraging smaller firms to reorganize as component suppliers within these main groups (Sutherland, 2003).

Beijing has given significant support to the industries it considers part of the 'backbone' of industrial manufacturing. SOEs in the commanding heights are prevented from going bankrupt by law, which guarantees - *in extremis* - that they will be bailed out by the government. Protection has also been given to these industries … "the state will treat part of the products of the pillar industries as infant industrial products and protect them properly." (*People's Daily*, 1994). Initially tariffs and quotas and more recently subsidies and other non-tariff barriers (NTBs) have made the domestic economy extremely profitable for much of the national team, especially the officially-favoured key SOEs.

Letting Go of the Small

The 'grasping the large' policy also has its obverse - 'letting go of the small' (*fang xiao)*. Beijing highlighted the need to 'relax' its control of the less successful areas of the state-owned economy in order to reduce the fiscal strain of subsidizing small SOEs (*China Daily*, 1997). The administration was active in selling off small and medium SOEs. In restructuring the economy around the large SOEs, Beijing allowed the privatization of most loss-making or relatively insignificant small SOEs (*China Daily*, 1998). Privatising these formerly inefficient SOEs helped promote a dynamic private sector. Of China's three million privately registered companies in 2003, over 550 000 were previously owned by the state (McGregor, 2005). This reduction in the influence of small SOEs is especially obvious in industries not deemed to be part of the commanding heights. The Chinese textile industry, once a large number of small-scale SOEs, is now dominated by privately owned and managed companies

Finally, the government's focus on 'letting go of the small' meant it no longer rescued small state enterprises when they went bankrupt. The administration decided that small companies were responsible for their own decisions and that it would not finance trading deficits. Until the introduction of the 1994 Company Law, companies were not given legal person status and the state, rather than the firm, was thus responsible for their losses. The enforcement of bankruptcy upon state Small and Medium Enterprises (SMEs) seemingly produced dramatic results (all these figures are 'rubbery') in the supposed bankruptcies of 7 798, out of 159 000, SOEs between 1995 and 2002 (*Business Weekly*, 2003), with another group targeted for debt-equity swaps (Andrews-Speed and Cao, 2005). Supposedly nearly 5 000 SOEs have gone bankrupt each year since 2002 (*Peoples Daily Online*, 2010). According to the World Bank's case study in four cities (Changsha, Loudi, Shenyang, Wuhan) the first wave of bankrupt SOEs was concentrated in the machinery, textile, chemical and other light industries (World Bank, 2000). Allowing non-favoured SOEs to go bankrupt proved a salutary measure, though it is a moot point as to the number of Provincial and Local Government SOEs that would currently be insolvent were it not for subsidies.

In the second reform period of 1994-97, the Chinese state redefined its mechanisms of economic control. It believed that ensuring growth in the state sector, especially the largest enterprises, was important for the entire Chinese economy. Beijing deliberately maintained control of the banking industry to ensure that credit was directed towards supporting the national team of prominent SOEs. Some ostensibly private firms, such as Lenovo (computers) and Huawei (telecommunications), seem to have access to capital on a basis similar to the SOEs. In the case of Huawei that has led to it being banned, on security grounds, from contracts in the West (e.g. as a contractor to the Australian National Broadband Network). So the 'state' sector is not necessarily as clear-cut as we here suggest; political influence or patronage and commercial interlinkages between SOEs and some private companies remain important.

3. GOING GLOBAL: THE STATE CHALLENGES THE SOES

Until fairly recently, it was possible for China's large government-owned companies to survive by servicing the domestic market. However, Beijing decided to orientate the largest SOEs towards export markets. Partly this was a reaction to the pressure from overseas multinational corporations seeking market share in China. This competition encouraged the government to push the national team and key SOEs to 'Go Global' (Dickie, 2005). The national team and the core SOEs have been restructured around this policy in the hopes of turning them into world giants.

Increasing domestic competition, in combination with the Beijing's desire to become a global economic power, required the SOEs and enterprise groups to focus on the international economy. The efforts of companies such as Huawei, Lenovo, China Ocean Shipping Group Company (COSCO), China National Offshore Oil Corporation (CNOOC) and other national team members have been politically supported by a Beijing leadership, eager to see them succeed in the world market (Dickie, 2005). The State Council sees the continuing strength of the state as dependent on this:

> "In our world today economic competition between nations is an act between each nation's large enterprises and enterprise groups. Nation's [sic] economic might is concentrated and manifested in the economic power and international competitiveness of its large enterprises and groups…our nation's position in the international economic order will be to a large extent determined by the position of our nation's large enterprises and groups" (Wu *et al.*, 2002).

Pushing the Large

Because of the size of globally significant firms in the international market, Beijing pushed only its largest SOEs towards exporting (Nolan, 2001). This has not always been successful, as illustrated by the pharmaceutical industry. The domestic Chinese pharmaceutical market has been dominated by the state-owned Sanjiu Pharmaceutical Group. However, Sanjiu's lack of size in comparison to the world pharmaceutical leaders has made it difficult to compete. Sanjiu's expenditure on (and quality of) research and development drastically lagged the leaders of the industry throughout the 1990s, which forced Sanjiu to remain in the smaller market of alternative medicine (Nolan and Yeung, 2001). This highlights the impediments that Chinese industries face when entering international markets, making those SOEs that have experienced success in the world market all the more impressive.

Developing Business Systems and Supplier Networks

China has also attempted to improve its business systems and supplier network. The quality of supplier networks around China's firms was initially inferior to those supplying the world's largest companies (Nolan, 2001). Until the 1990s Chinese SOEs tended to engage with small, local, low quality suppliers. The state sought to remedy this by involving the national team in contracts with suppliers of high quality materials, especially other national team members, to ensure high quality and value-added production *(Ibid)*.

Technology

Another significant challenge that the Chinese administration attempted to meet was the lack of advanced industrial technology. It wanted the SOEs to catch up to and become technological leaders in the global market (Wang and Meng, 2003). The 15th People's Congress outlined the need to improve industry technologically to improve the productive capacity of SOEs (*China Daily* 1997). This was especially evident in the national team, where the state pushed scientific and technological innovation as a strategic imperative (*China Daily*, 1995; Moser, 2004). Beijing encouraged …

> "The transformation of scientific and technological achievements into real productive forces, standardizing such transformation, hastening scientific and technological progress and facilitating economic and social development", as stated in Article 1 of Law of the PRC on Promoting the Transformation of Scientific and Technological Achievements (Accessed at *People's Daily Online* http://english.peopledaily.com.cn/data/laws/detail.php?id=46 on 16 Jan. 2013).

Individual industry laws also demanded the use of advanced technology. For example, the *Coal Law of the People's Republic of China* (1996) says "the state shall encourage and support the adoption of advanced science and technology and management skills in coal exploitation and utilization." (cited in Moser, 2004). Integrating modern technology into production methods was also emphasized in *Detailed Rules for the Implementation of the Law of the PRC on Sino-Foreign Contractual Joint Ventures* (1995) and the *Foreign Trade Law of the*

People's Republic of China (1995) (cf Moser 2004). Recently, this technological imperative has been manifested in an emphasis on the development of renewable energy technology. Since 1994 over 50 percent of subsidies to state manufacturing enterprises have been innovation and technological subsidies (Haley and Haley 2013, p.3, Table 1.1).

The Chinese state has also utilised joint ventures with foreign enterprises to achieve technological catch-up. Joint ventures were until recently required by law to have a technology transfer component as a part of the agreement between the Chinese state and the foreign firm. Joint ventures were given tax exemption on imports of machinery and equipment to speed technology transfer.

The Chinese also increased their technological capacity through mergers with and acquisition of foreign companies. This was to allow Chinese SOEs to acquire access to their advanced technology. Lenovo's deal to purchase the Personal Computer arm of IBM (*Financial Times*, 2004), along with the deal between TCL (the state-owned consumer electronics group) and French company Thomson, are both examples of Chinese SOEs purchasing more advanced companies to gain control of their technical knowledge (CNN, 2003). Recently CNOOC purchased Canadian oil and gas firm, Nexen, so that it could access oil sand extraction technology (*Wall Street Journal*, 2012b).

Access to Foreign Markets

As the West became increasingly wary of its success, market access has become a significant problem for China. Consequently the Chinese government has used joint ventures to access markets in the developed world. For example, four Chinese SOEs (Wuhan, Ma'anshan, Jiangsu and Tangshan) through a joint venture with BHP Billiton, took a combined 40 percent interest in a sub-lease over BHP Billiton's Jimblebar iron ore mine in Western Australia (Wyatt, 2005). Another example is the US$600 million deal between CNPC and the Uzbekneftegaz (from Uzbekistan), which the Chinese believed would provide access to oil resources in Central Asia (Yeh, 2005).

4. SUCCESS IN CHINA: FROM DINOSAURS TO DRAGONS

Both *zhua da, fang xiao* and the 'Go Global' policies have created a cluster of industry leaders that dominate the domestic economy while beginning successfully to compete in the world market. We now turn to the implications of this success.

Between 2002 and 2010, the total assets of central SOEs grew by 240 percent and their profits by 370 percent, to a total assets value of RMB 24.3 trillion (US $3.58 trillion) and profits of RMB 1.1315 trillion (US $167.2 billion) in 2010 (all figures in current dollars). So the core SOEs have grown rapidly and contribute significantly to China's international competitive capacity (Research Division of Micro-economics, 2011). State sector development is further demonstrated by rising industrial profits and sales revenue. Table 2 demonstrates that between 1998 and 2009, SOE sales revenue and profitability have both increased.

Table 2. SOE Sales Revenue and Total Profits 1998-2010 (RMB 100 Million).

Year	Sales Revenue	Total Profits
1998	33 566.11	525.14
1999	35 950.70	997.86
2000	42 203.00	2 408.33
2001	44 443.52	2 388.56
2002	47 844.21	2 632.94
2003	58 027.15	3 836.20
…	…	…
…	…	…
2009	231 314.8	14 409.4
2010	303 253.7	19 870.6

Source: National Bureau of Statistics of China, *China Statistical Yearbook 2004*, 536. 2009-2010: http://www.chinairr.org/view/V10/201101/18-66346.html. *NB. This table includes non-core small and medium SOEs.*

In 2003 the sales revenue of the SOEs accounted for approximately 40.5 percent of all sales revenue and over 46 percent of all profits in Chinese industry (NBSA, 2004: p521). The second biggest contributor was foreign-funded enterprises, contributing 18.76 percent of sales revenue and 22.2 percent of total profits (Yo, 2003). Private sector growth over the last decade has continued, but at a slower rate than the central SOEs. These SOEs are highly sectorally concentrated; currently 82.8 percent of assets of central SOEs are in the petro-chemicals, power production, defence industry, communication, transportation, mining and manufacturing, and natural resource extraction industries **(**Anonymous, 2010**).** Over the decade to 2009, the major SOEs accounted for 90.5 percent of gross industry production, 98.9 percent of petroleum and natural gas extraction, and 91.7 percent of production and supply of power and energy **(**Unirule Institute of Economics, 2011**).**

So since the introduction of the policy to create a national team of SOEs the growth of the largest of these has been particularly notable. Contrary to the neo-liberal assumption that small companies have mainly driven growth in China (IMF, 2004), the large SOEs have been particularly profitable. The national team and the wider group of 512 key SOEs targeted by *zhua da, fang* xiao have been especially successful. Since 2004, the annual revenue of large 'national champion' SOEs has been increasing by two to three times, on average, that of China's general economic growth rate.

In 1999, China had five SOEs in the *Fortune Global 500* (Smyth, 1999). By 2002, this had risen to 10 including 5 central SOEs (Nolan, 2001). There were 24 and 30 central SOEs, respectively in 2009 and 2010, ranked among the *Fortune Global 500* (Data source: *http://money.cnn.com/magazines/fortune/global500/2010/countries/China.html*).

In 2010, central SOEs generated 67.5 percent of total profit by all SOEs. The two giants - China National Petroleum Company (CNPC) and China Mobile Communication Company - contributed more than one third of total profit by all central SOEs: RMB 128.56 billion (US$18.98 billion) and RMB 148.47 billion (US$21.93) respectively **(**Unirule Institute of Economics, 2011**).**

Following neo-liberal orthodoxy, the Chinese SOEs should have become obsolete in the reform period to make way for the rise of the private market. While total government enterprises' share of output dropped in the early reform period (1978-1994), the state sector's contribution to the total output of Chinese industry has increased considerably since the institution of *zhua da, fang xiao* in 1997. For example, Table 3 demonstrates that while the SOE share of output dropped dramatically in the first period of after the beginning of liberalization reforms (1978 to 1991), between 1997 and 2001 SOE share of industrial output began to increase (Table 3). The data in this table does not distinguish between small, medium and large enterprises, but still highlights a significant increase in state output in the post-1997 period.

Table 3. SOE Share of Industrial Output Value 1978-2001.

Year	Share of total gross industrial output (%)
1978	77.6
1985	64.9
1993	47.0
1997	31.6
2001	44.4

Source: Zhang 2004.

Exports have increased massively throughout the reform period. Over the 1990s, exports by Chinese firms grew quickly (Keister and Liu, 2001: p19). Export growth has continued in recent years. In 2005, China overtook Japan, to become the third largest exporter in the world, behind the United States and Germany (Williams, 2005). Even during the GFC China's exports only experienced a short-term decline, in 2008-2009, before a bounce back that has only been limited by the post-GFC declines in consumption in Europe and the USA (Figure 1 below).

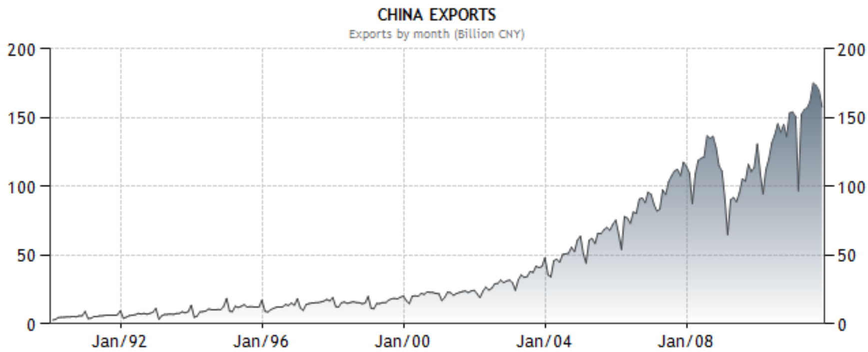

Figure 1. Historical increase in China exports (1990-2011).
Source: Unirule 2011: Trading Economics, http://www.tradingeconomics.com/china/exports, viewed on 29 November 2011.

Exports have been one of most important drivers of economic growth in China. Goods and services exports have been taking around 30-40 percent of total Gross Domestic Product (GDP) in China. Table 4 shows that although recently there was a slight decline in exports – largely because of government attempts to stimulate domestic consumption – they have still been around 30 percent of GDP.

Table 4. Recent GDP and exports increase in China.

Recent economic indicators	**2006**	**2007**	**2008**	**2009**	**2010(a)**	***2011(b)***
GDP (US$bn) (current prices)	2,712.9	3,494.2	4,520.0	4,990.5	5,878.3	*6,988.5*
Real GDP growth (% change year-on-year)	12.7	14.2	9.6	9.2	10.3	*9.5*
Goods & services exports (% GDP)	39.1	38.4	35.0	26.7	29.8	*30.2*

Source: Department of Foreign Affairs and Trade, Canberra: General information: China. http://www.dfat.gov.au/geo/fs/chin.pdf, viewed on 29 November 2011.

5. IMPLICATIONS FOR DEVELOPMENT THEORY

The SOEs have been crucial to recent Chinese economic development. Beijing's post-1978 reforms sought to transform the Chinese economic system to incorporate market principles while still maintaining a significant degree of central political control. They allowed the government to force SOEs to coexist with the market, encouraging private investment but maintaining state ownership of the commanding heights of the economy (Guo, 2003). This has been achieved through the Communist Party's control of the 'national team.'

The state's policies of *zhua da, fang xiao* and the push into the global marketplace have been central to Chinese economic strategy. We claim that the Chinese experience is not adequately explained by neo-liberalism's focus on wholesale privatization, the separation of the state and economic liberalization. Rather, the planned neo-statist strategy of large SOEs controlling the commanding heights, the creation of a private market, as well as national financial control and government-induced export orientation, is a more useful summary of China's rapid development.

We do not suggest, however, that neo-statism is a development policy that can be universally applied. The iron control of the Chinese Communist Party, the careful planning of the state, the size and power of China, plus the particular conditions of the Chinese economy prior to and throughout reform, were unique to the Chinese experience and inhibit the universal application of the lessons from China across the developing world.

As pointed out previously, the rapid growth of private SMEs has been claimed by neo-liberals to be the source of much of China's growth. They point to the rapid gains of the private market, moving from being essentially non-existent in 1978, to accounting for at least a third of production by 2000. They then argue that the state has let go of the great majority of SOEs which, once subject to market forces, have begun to contribute to rather than subtract from growth (e.g. Hu and Khan, 1997; Jefferson and Rawski, 1999; McGregor, 2005). However, notwithstanding the noteworthy growth in the private market, to simply attribute this growth to the fact that the enterprises are 'private' is simplistic. The continued and exceptional growth of the national team enterprises in the commanding heights has contributed remarkably to the growth of the private market and must be accounted for in any explanation of the Chinese experience (Sutherland, 2003). The increasing involvement of trans-national corporations in the Chinese economy and the decline of protection of the domestic market that accompanied World Trade Organisation (WTO) membership increased the competition faced by the small and medium enterprises in the Chinese market. This has amplified the importance of the national team and key large SOEs in Chinese growth (Nolan, 2001).

The continued role of the state in directing large enterprises in strategic sectors contradicts the neo-liberal claim that the state has reduced its economic role (e.g. Steinfeld, 2010). In reality, Beijing has twice redefined its role in the reform period. In the first period (1978-91) it allowed foreign investment and ceased directly planning the activities of all state-owned enterprises, instead focusing on guiding enterprises in the fields it deemed strategic. In this period the state managed to reverse the fiscal drain of unprofitable SOEs on the central government while creating, in the large SOEs, a mechanism that has allowed that Government to continue to dominate the domestic market. In the second, post-1994, period the national champions were encouraged to go global.

This somewhat parallels the course taken by Japan and Korea. Of course explanations for that model have elaborated since Chalmers Johnson's classic work (Johnson, 1982) on MITI in Japan and similar analysis for South Korea (Amsden, 1989). After the post-1989 deflation, some analysts began to question the East Asian model (e.g. Krugman 1994b). It appears that government-business relations were more complex than Chalmers' model suggested (e.g. Kim, 1997; Okimoto, 1989). Later work has suggested that capital accumulation was central (Collins and Bosworth, 1996; Studwell, 2013) and a more important factor than productivity growth (Hsieh, 2002).

Finally, the claim that China has liberalized its financial sector misunderstands the nature of the financial reforms that have occurred. Many neo-liberals consider the fact that the state no longer distributes credit through its budgetary process as evidence of liberalization (e.g. Hu and Khan, 1997; IMF, 2004), arguing that the adoption of strong bank lending has been evidence of financial liberalization, which will allow the more efficient allocation of credit towards successful enterprises. While this has indeed occurred it has not resulted in Beijing's loss of fiscal control. The state still controls the major banks and guides national investment and development goals.

A neo-statist framework sees benefits in retaining control of certain industries to force them to compete internationally with the world's dominant firms (Amsden, 1989). The beginning of parity with international industry that has begun to occur with the policy to 'Go Global' has been instrumental in improving the production efficiency of the Chinese national team and the 512 key SOEs (Nolan 2001).

Further, neo-statism's emphasis on state control of the financial system is directly applicable to the Chinese experience. Many conventional (sic) economists argue that governments should maintain control of the allocation of credit (e.g. Amsden, 1989; Haggard, 1990; Johnson, 1995; White, 1988). The Chinese state has done this through its control of state banks. This has allowed Beijing to use credit allocation to create competition at a domestic level between industries, by using financial incentives - such as preferential or low cost credit - as a means to encourage enterprises to meet technological requirements and export goals (BOFIT, 2004).

6. THE FUTURE OF THE CHINESE MODEL

The experience of China provides evidence that it may be beneficial for some states to retain control of their own development and integration into the world economy when 'opening up' the domestic economy. The neo-liberal institutions of the International Monetary Fund (IMF), WTO and the World Bank must confront this and instead focus on building the capacity of governments to deal with economic development, rather than merely building private markets. Indeed the prominent economist, Joseph Stiglitz, has argued that:

> "The contrasting experiences of China and Russia suggest that, if one has to make a choice, competition may be more important than private property… It is competition that provides the driving force for greater efficiency and lower prices" (Stiglitz, 1999).

Nevertheless the Chinese experience merely highlights the difficulty of generalising about development paths. The Chinese state, notwithstanding its exceptionally powerful geopolitical position and large economic, natural and human resources, has still had a difficult time catching up with the developed world. It is reticent about exposing some SOEs to equity markets, following its experience in 2001 when the government floated the government shares in the China Securities Regulation Commission. The price promptly collapsed (Walter and Howie 2011: 40). China's unusual economic path may never again be seen in a developing country and thus the measures taken during its development cannot simply be applied universally across the developing world.

Here we have simply shown that the neo-statist explanation is a more useful way of seeing the Chinese economy. It has been the success of the Chinese state in implementing the policies of *zhua da, fang xiao* and 'Go Global' that has played a major part in the 'miracle' that has so often been solely attributed to the market alone. The policy of 'grasping the large' has seen the Chinese state employ protective and supportive measures to accelerate the growth of the largest enterprises in the economy. Commanding heights and infrastructure industries have been specifically targeted by the state to ensure downstream growth. The banking industry has remained firmly under state control (Walter and Howie, 2011; McGregor, 2012) in its role to allocate credit between the national team and state-chosen enterprises.

We have argued that the core of Chinese development – the large SOEs - have not been allowed to shield behind tariff walls and state subsidies. Indeed, the export promotion policies pursued by the state also highlight the usefulness of the neo-statist framework. Beijing has pushed the largest government enterprises into the global market, seeking to use international competition to improve their performance. It has also allowed foreign multinationals (and local firms) to enter and compete in Beijing's SOE's domestic market.

In 2005, the State Council abandoned many previous regulations and policies hindering the development of private firms. In 2010, this policy was updated to remove further barriers to non-SOEs entering the previously state-monopolised areas. By 2009, large private enterprises numbered 256 031, nearly double that in 2005. In that time the gross production value of non-state/private firms increased by 239 percent, from RMB 4.7778 trillion to RMB 16.2026 trillion (US$ 2.73 trillion, in current/nominal dollars). Total asset values increased by 200 percent, from RMB 3.0325 trillion to RMB 9.1176 trillion (US$ 1.335 trillion in nominal dollars). In addition private sector profit jumped from RMB 212 billion to RMB 967.8 billion (US$ 141.7 billion in nominal dollars), in the same period (Research Division of Macro-economics, 2011).

The growth of the private sector is an insufficient explanation for the economic development of China. Whilst the non-state sector has grown steadily, it is the globalising national champions that are making a disproportionate contribution to China's economic growth.

Its huge success in the past 30 years does not mean that China will continue its current strategy unaltered. At present there is some evidence that the state banks are beginning to provide capital at rates the rest of the world would consider closer to market rates and to invest in long-term loans to foreign companies (Ho and Yu, 2012), presumably to build international market share. The Yuan has been allowed to appreciate in value, by over 8 percent between 2000 and 2010. Circumstances could change. The current transition of political leadership to Li Keqiang and Xi Jinping has revealed significant tensions between alternative views of China's future, though we incline to the hypothesis that new strategic reforms will continue once the new leadership is firmly installed.

Over the next few years we expect the new leadership to strengthen central control. This will be exhibited in the reigning in of the provincial governments and their allied SOEs (Huang, 2012). Without this China will find it difficult to reduce debt (increasingly a provincial government problem – Shih, 2008) and re-calibrate its growth path away from investment and towards consumption. The provincial governments supposedly subsidise favoured business groups, seemingly independent of central objectives or efficiencies (Haley and Haley, 2013, p. 21). Perhaps one aspect of the Bo Xilai trial was that it was a signal of a policy of reigning in the over-independent provinces (cf. Nee, 1998). It is the lower level jurisdictions and local government that are the focus of social unrest about development, land seizures and corruption.

7. CONCLUSIONS

For Australia this has important implications, as China transitions from being merely a customer to becoming a major investor in Australian primary production. China was the largest foreign investor in Australian resources between 2008 and 2013 (*Weekend Australian*, 30-31 August 2013). Whilst the volumes of such investment are still small, relative to total US, British and Japanese investment in Australia, we are currently the biggest destination in the world for Chinese FDI. Already there is major Chinese investment in Rio Tinto and other Australian resources projects (eg the Gindalbie iron ore mine in mid-western WA) The China Metallurgical Group Corporation is even building an iron ore mine (Sino Iron Ore Project) as a sole contractor and operator. So the Australian resource and agricultural sectors can expect to include Chinese companies, some SOEs, in the future.

Officially Beijing implements “socialism with Chinese characteristics”. On the economic front this means “a multi-ownership-oriented basic market economic system, with the public ownership in the dominance” (CPC, 2007). SOEs have been, and are being, streamlined to become more efficient and more responsive to market forces, and the state is limiting its role in certain sectors. Still, saying that China is reforming its economy and becoming more market-oriented is not the same as saying that it is abandoning the state sector, or that the private sector is dominant.

There is no easy way to predict what shape China’s economy will take in 2030. The current economic direction of China - ‘commanding heights’ state capitalism (e.g. Deng *et al.*, 2011) – will most probably continue. Yet the Chinese economic situation is not stable. That raises the question of the fate of China’s burgeoning multinationals in the face of a possible future slowdown in the Chinese economy and its becoming stuck in the middle-income trap.

There is no doubt China faces serious challenges. Firstly it has to manage a transition from labour-intensive to higher value-added manufacturing (Chen *et al*., 2013). As Chinese labour supply slows, probably sharply from 2020, wages will rise. This is already happening; Nomura claims minimum wages rose six fold between 1994 and 2011 (cited in Haley and Haley, 2013; See also *Wall Street Journal*, 2012a). Following these wage rises industries will eventually be restructured to shed labour-intensive manufacturing. There will be a necessity to lift productivity (Lu, 2011). Here skills and education are important problems (Chen *et al*., 2013), as is exceedingly high levels of income inequality

(Haley and Haley, 2013: p.19). Profound income inequality adversely affects Beijing's strategy of shifting from investment and exports to domestic consumption (Zhu, 2013). The impending Chinese demographic deficit will probably slow long term economic growth and Japanese-style economic stasis may threaten. Indeed a (temporary?) growth slow-down may even be imminent (Thornton, 2012), unless the new Xi-Li leadership can boost domestic consumption.

The major SOEs will probably remain state-owned, because they are central to Beijing's economic management and national aggrandisement strategies (Beeson, 2013, p.199). The major SOEs perform two functions for the Chinese Communist Party: they mitigate popular domestic resistance to Chinese economic globalisation (Sohn, 2012) and well serve a party state which is focused on preservation of its constituent elite (Bremmer, 2010). The SOEs have not just economic but also political rationales.

Eventually (if only to allay foreign concerns) the major SOEs may build on their corporatisation in the 1990s (Szamosszegi and Kyle, 2011: 72) to become responsible to all shareholders (Anderson and Guo, 2005) and increasingly independent of direct government control. They will pursue the same strategies – buy ailing companies with strong brands in other countries; forming joint ventures overseas in order to increase expertise in new areas, off-shoring labour intensive production, develop vertically integrated international supply lines, etc. – that other multinationals pursue. Only when the national champions have become truly internationally competitive will their access to cheap capital from state banks end as China's geo-strategic objectives will have been achieved.

Notwithstanding that the Chinese government does not feature this 'reform', it has begun liberalising the financial system in a strategy described (in another context) as 'signal left, turn right' (Huang, 2012). This strategy was demonstrated recently when a prominent Chinese think tank (the Development Research Centre of the State Council) participated in a World Bank report on the Chinese economy. The report recommended liberalising various elements of Chinese policy but stopped short of the usual neo-liberal strictures about ending state control of the economy (World Bank, 2012).

Predicting the future is difficult. Nevertheless we are confident that the large 'national champion' SOEs will eventually make the transition to full multinational enterprises and, to an extent, de-couple from direct control by the state (ie they will be dividend yielders to their principal shareholder but no longer need to be strategically directed by Beijing). China's SOEs have been forced into the international competitive environment and so they will have to remain competitively efficient. Perhaps in 50 years' time Sinopec and Lenovo will be as familiar names around the world as are Shell and Microsoft today.

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