

# Comparative Economic Development in China and Japan

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## **Abstract**

Three hundred years ago per capita incomes in China and Japan were about equal and fairly close to the global mean. At the end of the twentieth century Japanese per capita incomes are about as high as Western incomes and about seven times as high as Chinese incomes. How could this happen? Manchu China and Tokugawa Japan did not establish equally safe property rights for merchants and producers as the West did. But political fragmentation and feudalism within Japan provided something like checks and balances against arbitrary government which China lacked. Moreover, a similar lack of respect for merchants in both countries had more favourable consequences for early commercialisation in Japan than in China.

Japan's revolution from above led to a much earlier and faster restoration of orderly government than China's protracted decay of imperial rule first and its revolution from below thereafter. Whereas the Japanese revolution from above implied the preservation of human and social capital, the Chinese revolution from below led to a massive destruction of both. Moreover, Japanese nationalism was oriented toward the conquest of foreign markets and economic supremacy earlier than Chinese nationalism. This provided another Japanese advantage over China.

Japan began its process of catch-up with the West about hundred years earlier than China. In both countries high savings and investment as well as human capital formation contributed to growth. China was held back first by political instability and later by diluted property rights and distorted incentives. In the last quarter century, however, China has re-established incentives, opened up its economy, and established some substitute for private property rights. It has done well enough to have already overtaken the Japanese economy in size. The size gap between the two economies is

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likely to widen quickly, whereas the still huge gap in per capita incomes will narrow only very slowly.

## 1 Introduction

Maddison (1998: 40–41) has been courageous enough to estimate income levels and economic growth rates for China, Japan, and some other areas during the last 300 years. According to his figures, Chinese and Japanese GDP per capita were about equal to each other and to the global mean in 1700, although Europe was already ahead of both of them.<sup>1</sup> Until the mid twentieth century, Chinese GDP per capita stagnated or even fell, whereas the Japanese GDP per capita rose slowly in the eighteenth century and faster thereafter. In the middle of the twentieth century Japanese GDP per capita was about four times the Chinese value. Thereafter, Chinese per capita growth significantly improved, but the Japanese did even better until the late 1970s. How can this divergent experience of intensive growth be explained?

Before even attempting to answer this question it has to be clarified that explanatory success is always limited and provisional. Since Kuhn (1962) and Lakatos (1968/1969), it is widely accepted that all theories suffer from anomalies, that is from evidence that calls them into question. Facing this predicament there are three alternative strategies: one may overlook or deny the existence of anomalies. Then it becomes impossible to learn from experience and facts. This is definitely not advisable. Or, one may give up the explanatory and theoretical enterprise. Although this may be an acceptable position among historians, it is suicidal for a theoretical social scientist. Or, one may continue the construction of theories and explanatory sketches in spite of knowledge about their limitations. Then, anomalies are kept in mind. Then, they serve as question marks and reminders of the shortcomings of theories or of the never-ending necessity to improve them. Anomalies also point to the desirability of developing alternative explanations (as discussed by Deng, 2000, for Chinese economic history). Space constraints make it obviously impossible to discuss anomalies or alternative explanations in detail. In the context of my particular topic it also has to be kept in mind that the facts themselves – say, the safety of property rights in China or Japan – are debated among historians. What I can try to do here is no more than to develop one explanatory sketch, rooted in classical political economy, Austrian economics, modern institutionalism, and which is compatible with the findings of econometric studies concerning the most recent historical period. Anomalies, alternative explanations, or question marks are usually relegated to footnotes. Since all theories suffer from anomalies, it follows that pointing them out or admitting them does not eliminate a theory. With Lakatos (1968/1969) I insist that only a better theory can overcome a theory. My claim for the theory outlined below is not that it fits all the facts but that no other one fits the facts better, especially the undisputed facts.

<sup>1</sup> This claim is strongly denied by Pomeranz (2000: 36–43) who cites demographic data demonstrating that Europeans lived neither better nor longer than Chinese or Japanese in the eighteenth century.

## 2 An explanatory sketch

### *The productivity of freedom and property*

Inspired by Smith (1776/1976), Mises (1920, 1927), Hayek (1945, 1960, 1973/1976/1979), Weber (1922/1964, 1923/1981),<sup>2</sup> Pipes (1999) and Jones (1981, 1988), I shall attempt to analyse the economic performance of China and Japan in the last three centuries. Already in *The Wealth of Nations* Smith (1776/1976) suggested that people prefer to eat all the time rather than work, unless they perceive a chance to acquire property. Without private property rights, shirking becomes the rule and hard work the exception. Obviously this is not a prescription for intensive growth. Since the Japanese economy did much better than the Chinese economy through the last three centuries, safer private property rights in Japan than in China and, therefore, better incentives to work and to save in Japan than in China could be part of the explanation.

In the 1920s Mises (1920, 1927) suggested that economies need private property not only in order to provide incentives for working, but also to make scarcity prices and a rational allocation of resources possible. In Mises' view, private property in the means of production, for example in land or in factories, is essential: Without it, there is no free exchange of factors of production. Without such an exchange, it is impossible to know the values and opportunity costs of factors of production. Without such knowledge, there can be no rational allocation of resources. Conceivably, safer property rights in the means of production in Japan than in China could also contribute to the explanation of comparatively better economic performance in Japan than in China. Obviously, Japanese property rights in the means of production were safer in the second part of the twentieth century than in Communist China, but perhaps we can find some clues that this might have been the case in earlier periods, too.

According to Hayek (1945, 1960, 1973/1976/1979), economic freedom is productive, whereas its absence constitutes a brake on growth.<sup>3</sup> The less freedom there is, the less likely it is that knowledge scattered across thousands or millions of heads can be exploited. Even the wisest persons command only a rather tiny bit of knowledge. In Hayek's view, knowledge encompasses not only academic or book knowledge, but also

<sup>2</sup> Although my approach is inspired by Weber, it is no coincidence that I do not even quote his writing on China. For a superb criticism of it, see Elvin (1984: 382), especially his comment on the Weberian distinction between Confucian rationalism and adjustment to the world on the one hand and Puritan rationalism and mastery of the world on the other hand: 'The economic historian might be forgiven for thinking that Chinese irrigated farming, with terraced hill slopes and tamed rivers, and the Chinese rearing of animals in controlled environments (above all, silkworms, but also fish, pigs, and sheep) were symptoms of a will to mastery, whereas European rain-based farming was a symptom of adjustment.'

<sup>3</sup> Modern econometric studies also provide some support for this view. The data base, however, only refers to the late twentieth century. See Beach and Davis (1999: 10), de Haan and Siermann (1998), de Haan and Sturm (2000), Edwards (1998), Goldsmith (1997), Gwartney, Lawson, and Block (1996: 109), Knack (1996), Knack and Keefer (1995), Pitlik (2002), Torstensson (1994), Weede and Kämpf (2002).

the knowledge of farmers or artisans or managers in industry. Some of this knowledge is tacit, that is never systematically elaborated or written down; some of it is local, such as the knowledge of a peasant on what grows best on which one of his fields, or the knowledge of a plant manager on who reliably delivers quality inputs for a decent price and on time. Only economic freedom and dispersed decision making makes it possible for everyone to do what he knows best. Of course, there also has to exist responsibility, that is people should suffer the consequences if they get it wrong and do not exploit their resources well. Otherwise, there are too few incentives for learning, improvement, and innovation.

In addition, private property rights expand economic freedom. Owners may dispose of their property as they see fit. There is no need to ask somebody's permission. This is of vital importance for innovation, as Rosenberg and Birdzell (1986: 310) have explained so well: 'A society which delayed innovations by the amount of time required to reach political consensus would fall further and further behind a society which did not. . . . It implies the substantive criterion that the benefits of the innovation are sufficiently well understood and predictable that they can be persuasively verbalised in advance of its adoption – that is, that everything is too clear to need the test of experiment.' As pointed out by Hayek, private property benefits not only its owner but also those who own no property other than their labour power. At least, it provides them a choice about to whom to sell their labour. Moreover, even unskilled labour is more valuable in a free, innovative, and prosperous economy than elsewhere.<sup>4</sup> So, economic freedom and decentralised decision-making authority based on private property ownership are also conceivable explanatory factors of the divergent economic performance of China and Japan.

#### *On limited government*

If private property, individual liberty, and individual responsibility are prerequisites of economic development and growth, then analysing *political* system characteristics provides the main key to understanding development. As I have argued elsewhere (Weede, 1996, 2000), neither private property, nor individual liberty, nor individual responsibility are conceivable without something like limited government. Limited government, however, is not a natural state of affairs; nor has it ever been planned by the power-holders of societies. Instead it has evolved in some countries and made them prosper. It arrived later in other countries and provided them with a chance to catch-up.

How could arbitrary governmental power ever be overcome? Although Weber's (1922/1964) typology of dominion, rule, or authority (in German: *Herrschaft*) does not explicitly provide falsifiable theorising, it provides some valuable clues. In Weber's typology there are two subtypes of traditional rule: patrimonialism and feudalism. Under feudalism the ruler relies on the assistance of vassals who have sworn an oath of

<sup>4</sup> Unskilled labourers from poor countries who want to get into the US, or Japan, or Germany know this.

allegiance to him, but who own their own weapons, and some of whom may command their own troops and control their own territories. By contrast, under patrimonialism the ruler relies on the assistance of men who are personally dependent upon him and his whims, because they belong to his household, or, may be, because they are foreigners or even slaves. Obviously, a patrimonial king or emperor enjoys much wider decision-latitude than a king presiding over his vassals. Whereas patrimonialism provides unlimited power, feudalism sows the seeds of limited government. The capability of the vassals to fight and rebel provides an incentive for rulers to respect their rights. Under patrimonialism rights exist only at the top, and duties only at the bottom. Of course, there is still an imbalance of rights and duties under feudalism too, but some people below the highest stratum of society, that is some vassals, are likely to enjoy rights in addition to having duties. Feudalism provides the basis for the idea that people below the ruler may have rights.

Although the application of Western terms to Asian history may occasionally be misleading, I think by almost common judgement imperial China was a patrimonial empire (Yang, 1987), whereas Tokugawa Japan was a feudal society (Eisenstadt, 1996: 163ff.).<sup>5</sup> Therefore, one should expect that the political framework in Japan more than in China favoured private property rights. Whereas the emperor of China regarded himself not only as the ruler of China, but also as the ultimate owner of its entire territory, in Tokugawa Japan most of the land was controlled by the daimyo, that is local princes, rather than by the shogun or the emperor (Hall, 1964).

Under the Ming and Manchu (or Ching) dynasties China was a unified empire.<sup>6</sup> By contrast, Tokugawa Japan had a much more complex and fragmented political structure. At the top, there was the dualism between the ceremonial head of state, the emperor, and the military power-holder, the shogun. Below the shogun there were more than 200 daimyo, who controlled about three-quarters of Japanese territory. Although the daimyo were obliged to reside at the emperor's capital for part of the year and to leave close relatives behind when they returned to their homelands, the shogun rarely, if ever interfered with the daily governance of the daimyos' territories. Politically, Tokugawa Japan resembled Europe more than China (Jones, 1981, 1988). There was a high degree of cultural unity and market exchange across political borders, but autonomy of regional rulers from effective superior authority. By contrast, local and regional office-holders in China served at the pleasure of the emperor and could be replaced if he wanted to appoint somebody else. According to Jones (1981, 1988: 165) or Pipes (1999), combinations of political disunity or decentralisation and cultural unity, cross-border exchange, and economies of scale – as in Europe or in Japan – promoted

<sup>5</sup> Elvin (1973: 22) argues that true feudalism could never be established in China because of the state's monopoly of force.

<sup>6</sup> At the beginning of the second millennium under the Southern Sung dynasty, Chinese Civilization was politically fragmented, too. During this period China was far ahead of other civilisations. Its per capita iron production was surpassed in Europe only half a millennium later.

the recognition of property rights of vassals or princes, of merchants, artisans, and even peasants.<sup>7</sup>

For economic development the division of labour and commercialisation are crucial. Already Adam Smith (1776/1976) had observed that the division of labour boosts productivity and that it depends on the size of the market. Without merchants or middlemen the size of the market has to be severely restricted. Visible merchant wealth has always attracted the kleptocratic attention of rulers. The more politically fragmented a realm is, however, the better the chances for merchants to play off the princes against each other; or political fragmentation and rivalry provides an exit option. Because of the differences in the political structures of China and Japan one should expect to find safer property rights of merchants in Japan than in China. If the property rights of merchants actually were safer in Japan than in China, this difference in property rights could constitute part of the explanation for the divergent economic development of both countries.

Since Manchu China like Tokugawa Japan was a traditional society, most people worked the land and made a living from agriculture. That is why peasant property rights and the resulting incentives to expand production should matter. Since political fragmentation and exit opportunities for subjects tend to make subjects better off, one should again expect that the Japanese peasant was better off than his Chinese counterpart.<sup>8</sup> This contrast should have benefited the Japanese economy.

Finally, the degree of political centralisation of societies impacts on their opportunities for innovation. Whereas powerful governments in centralised empires may prevent innovations on a grand territorial scale, the disunited ruling class of a politically fragmented society simply lacks the unity of purpose and power to do so.

### 3 Some similarities

Both Weber (1923/1981) and Hayek (1960, 1973/1976/1979) regard the rule of law and the predictability of the consequences of economic action resulting therefrom as prerequisites of capitalist development. While the rule of law slowly evolved through the

<sup>7</sup> Because of the existence of autonomous cities in Europe, but in neither China nor Japan, exit opportunities for merchants, artisans, and peasants were even better in Europe than in Japan. An explanation of the rise of the West and the comparative decline of China based on limited versus arbitrary government or the security of property rights is strongly disputed by Elvin (1973, 1988, personal communication) and Pomeranz (2000: 166ff.) who deny that property rights were safer in Europe or Japan than in China. In Elvin's view, the inadequacy of Chinese law and the defects of Chinese property rights cannot bear the explanatory burden, because commerce in China flourished until the eighteenth century. In his view, science and technology matter more than property rights. In Pomeranz' view, Britain and Europe could overtake China, because of the fortunate location of coal deposits close to centres of demand, and because of European trade with the Americas. Both factors helped to overcome ecological constraints imposed by a growing scarcity of land and timber. The reason why I do not accept Elvin's or Pomeranz' alternative explanations is simple. Their explanations are not general enough to be extendable to the contrast between China and Japan.

<sup>8</sup> Pomeranz (2000: 37) cites some studies, which demonstrate that people in the Japanese countryside, lived longer than the Chinese or Europeans.

centuries in Western civilisation, starting with the competition between emperor and pope in Continental Europe (Berman, 1983) and with the Magna Carta in Britain and certainly suffering repeated reverses, neither Manchu China nor Tokugawa Japan ever equalled European preferences for legal arrangements.<sup>9</sup> The Chinese sought harmony through virtue and hierarchy. Officialdom was obliged and supposed to be virtuous, to set an example to inferiors, but to be above the laws for ordinary subjects. Yang (1987: 8) summarises the Chinese view in these terms: ‘The emphasis on inequality in institutional arrangements implies that political authorities should not be bound by the same laws as bind other people. The “constitutionalism” developed in Western Europe was thus unknown to the Chinese. In this case, property rules developed by the people at the bottom would have less effect in constraining the people above them . . . imperial law would be seen as a device less to protect individual rights than to regulate individual behaviour.’ Although the self-perception of the ruling classes in China and Japan differed – with the Chinese regarding themselves as scholars or intellectuals and the Japanese regarding themselves as warriors (Morishima, 1982: 15) – even the thought of rights of inferiors against superiors was equally alien to both societies. In East Asia, Japan included, government rested on virtue and loyalty rather than law (Schwentker, 2002: 47).

Since Manchu China and Tokugawa Japan were largely agrarian societies, the property rights and incentives to work among peasants mattered. According to Yang (1987), property rights were unsafe and diluted, and incentives were correspondingly poor in China. Even the idea that lowly peasants might have rights against their betters, in particular imperial officials, did not really exist. All rights depended on status and dropped with declining status. According to Yang (1987: 63), peasant possession and control of land was only a transitional phenomenon of downwardly mobile families. Losing one’s office, one’s prestige, and one’s connections to the power-holders sooner or later led to a loss of control of one’s land.<sup>10</sup> Concerning variation across provinces,

<sup>9</sup> According to Günther Distelrath, lecturer of Japanese Studies at the University of Bonn, however, law-like arrangements did matter in Tokugawa Japan (personal communication). Similarly, Wong (2001: 400) points out that recent research has found that Chinese law and property rights were more developed than previously imagined. Simultaneously, however, Wong (2001: 397) argues that Chinese merchants did not rely on state adjudication and enforcement in their commercial transactions. Moreover, in Wong’s view, the boundaries between formal law and informal adjudication were blurred because officials frequently relied on non-officials. For the explanatory purposes at hand, Wong’s qualifications seem to matter more than his general point.

<sup>10</sup> Pomeranz (2000: 70ff.) disagrees with this evaluation. In his view, ‘China was closer to market-driven agriculture than was most of Europe, including most of western Europe.’ In his view, *de facto* private possession prevailed and land was quite freely alienable. Somewhat inconsistently Pomeranz (2000: 179) also observes that ‘it was extremely hard in China to seize land used as collateral’. The proportion of rented land varied from region to region. In southern China more land was rented than in northern China. Sharecropping or fixed rents provided reasonable incentives. According to Pomeranz (2000: 86) markets for farm products were probably more competitive in China than in Europe. Although I hesitate to accept Pomeranz’ claim about fairly secure property rights in the Chinese countryside, his point about obstacles to free and competitive markets in the West looks quite valid. On complex,

Macauley (2001) points out that in Fujian province more than elsewhere customary practice rather than official intent led to complex, fluid, and multiple land ownership. Most sales were conditional. Sellers could and did demand additional payments later. Sellers felt that they had a right of redemption.

Of course, there has also been variation across time in China. According to Elvin (1973: 255), ‘the disappearance of the manorial order, and of serfdom and serflike tenancy,<sup>11</sup> had profound effects on the development of Chinese society . . . It probably contributed to the higher agricultural productivity, which enabled the greatly expanded population to be fed. And obviously it meant the formation of an essentially new type of power structure at the grassroots, one in which rural power was not linked to landholding so much as to institutional position or financial strength, and located in the market towns and cities.’ In my view, two points in this quote matter. First, less concentrated landholdings and more peasant ownership boosted production. Second, political connections continued to matter in the Chinese countryside during the Manchu dynasty.<sup>12</sup>

In Japan those who worked the land did not own it, too. Nevertheless, peasant possession of land was quite safe and unlikely to be challenged.<sup>13</sup> Most of the land belonged to the shogun or the local daimyo. Nevertheless, Japanese peasants might have become marginally better off during the Tokugawa regime. According to Maddison (2001: 41), ‘the peasantry were no longer closely controlled and were much freer to capture gains in productivity for themselves. There were large rice levies to provide rice stipends for the *samurai*, but these were more or less fixed and the tax burden declined over time’.<sup>14</sup>

A final commonality between China and Japan concerns their willingness to curtail contacts with the outside world. In the fifteenth century, the Chinese had explored the oceans. They got as far as the East African coast, but then the Chinese emperor and his officialdom forbade the building of ocean-going vessels and foreign trade (Jones,

fluid and multiple ownership in Fujian province, see Macauley (2001) for a view which is not easily reconciled with Pommeranz. Deng (2003) agrees with Pommeranz on private land ownership by peasants. In his view, frequent peasant rebellions safeguarded peasant property rights. If the purpose of peasant rebellions has been safeguarding private property rights and a low level of taxation (Deng, 2003: 504–505), then I find it difficult to simultaneously accept Deng’s claims about the safety of peasant property rights and the extraordinary rebelliousness of Chinese peasants.

<sup>11</sup> Such a system of landholding prevailed during the Ming dynasty.

<sup>12</sup> Since Elvin’s (1973: 255, and even more clearly 267) quote in the main text asserts the predominance of institutional positions over trade and wealth, it is not incompatible with Jones’ (1981: 222) proposition according to which ‘the private sector emerged only after government, on sufferance. No independent law arose to shield it.’

<sup>13</sup> Personal communication from Günther Distelrath.

<sup>14</sup> The comparative success of Tokugawa Japan is surprising because of the higher tax burden in Japan than in China. According to Maddison (2001: 254) fiscal levies in Japan were about 20–25% of GDP, but only about 5% in Manchu China. But the damage of the high Japanese tax burden was mitigated by its decline over time. According to Sugihara (1996: 154) the rural tax burden declined from about 50% of the output to less than 30% from the seventeenth century to the 1870s.



1981: 233ff.). Although Chinese foreign trade continued in spite of government bans (Deng, 1997), this Chinese retreat from the high seas contributed to later Western control of the seas.<sup>15</sup> No Western ruler would have had the power to impose such a policy on Western civilisation, that is to prevent exploration and innovation on such a grand scale. Political fragmentation in the West would have made it infeasible.

In the sixteenth century, that is *before* the Tokugawa era, Japan was fairly open to outside influences, even to Christian missionaries and trade. In the seventeenth century, however, the shogun did something similar to what the Chinese had done before. He severely restricted trade with the Europeans. Only the Dutch were permitted to trade at a single outlying port, Nagasaki. He prohibited the building of ocean-going vessels and forbade his subjects to sail the high seas (Kennedy, 1987: 14–15). For more than two centuries, until the nineteenth century, the Japanese like the Chinese before attempted to minimise international interaction and thereby missed the opportunity to closely observe the development of the ascendant West.

#### 4 Some early historical contrasts

##### *On merchants and officials*

Above it has been argued that the safety of property rights from rulers is a crucial determinant of development, that merchant property is most at risk of expropriation, and that political centralisation in China was more harmful than decentralisation in Japan. Was it? Yang (1987: 64) provides a vivid account of the position of merchants in imperial China:

Confucianists tended to regard farm production as the ‘root’ . . . of society, and commercial activity as the ‘branch’ . . . to maintain a good society, the root must be strong. Accordingly, peasants were given a status next to literati, and merchants were denounced as speculators and given a lower status in society. Because political power was controlled by the landed literati, it is natural that taxation was designed to reinforce this belief in social order. The merchants were taxed but rarely protected in their rights. In fact, the commercial tax was used as a means to suppress commercial activities . . . An individual . . . registered as merchant was ordered to pay twice as much poll tax . . . In addition to these social discriminations, the merchant’s property rights were not respected by imperial authorities. Not only the merchant’s property was subject to arbitrarily high commercial taxes, but also the imperial government frequently demanded ‘loans’ from merchants, which sometimes caused them to fail . . . The insecurity of merchants’ property had the expected result of impeding trade.

<sup>15</sup> According to Maddison (2001: 24), ‘Chinese ships were much bigger than those of the Portuguese, more seaworthy and more comfortable’.

Unfortunately, Yang's quoted interpretation is at odds with Elvin's (1973: 292). Elvin sees little fundamental conflict between officials and merchants. During the Manchu dynasty he sees some fusion of both classes, because so many candidates and officials came from wealthy merchant families. If Elvin is closer to the truth than Yang, then this partial fusion of merchant and official families might still be an indicator of the frequency of official power abuse harming politically unconnected merchants and benefiting politically well-connected merchants, thereby providing an incentive to finance Confucian education and, ultimately, to have a son join officialdom (Levy, 1953/1954). Moreover, such a partial fusion of merchant and official families should have contributed to rent-seeking and price distortions and thereby reduced economic growth. At a more abstract level of interpretation one may even perceive some communality between Elvin's and Yang's interpretations. None of them sees economic freedom prevailing in China. Although Elvin (1973: 286–290) himself provides examples of impediments to trade within the then prevailing rent-seeking society, he insists on much commercialisation and large markets in Manchu China.<sup>16</sup> Again, it is possible to reconcile Elvin's and Yang's interpretations: official harassment of some merchants must have reduced commercialisation.

According to Deng (2003: 495), imperial China was fairly commercialised, but commercialisation nevertheless remained limited. On the one hand, there were 'amateur peasant marketeers' or 'semimerchants' crowding out professional merchants; on the other hand, there was state control of the trade in some key commodities. In Deng's view, 'the merchant sector suffered capital drain', and 'it was probably easier to leave the professional merchant class than to join it'. In sum, the proposition of strong limits to the process of commercialisation in China, and by extension to widening the market and the division of labour, looks more credible to me than alternative views.

Although the Confucian disdain of merchants and commercialisation was largely shared in Japan (Piper, 1995: 57), taxation in Tokugawa Japan was quite different. The Chinese *and* Japanese started from the presumption that merchants are unproductive. Whereas the Chinese concluded from this that heavy taxation could do little harm, in Tokugawa Japan their presumed lack of productivity made merchants comparatively safe from taxation (Distelrath, 1996: 68; Ikegami, 1995: 175). Merchants were simply not productive enough to be heavily taxed!<sup>17</sup> Whereas Chinese anti-commercialism contributed to make trade more difficult, Japanese anti-commercialism unintentionally favoured it. In my view, the comparatively favourable position of Japanese traders has to be seen against the background of political fragmentation in Japan. In effect, political fragmentation tends to be a precursor to or substitute for limited government. For

<sup>16</sup> Elvin (1973: 294) also plays down the role of political obstacles to growth. Unfortunately, he could not yet deal with rent-seeking and its effects on growth. On rent-seeking, see Buchanan, Tollison, and Tullock (1980).

<sup>17</sup> This ideology, however, did not always protect merchants from samurai and authorities. Getting loans back from them frequently was a problem (Schwentker, 2002).

Chinese merchants exit from the emperor's control was about equal to exit from civilisation. By contrast, relocation from one prince's to another prince's domain must have been conceivable in Japan.

In order to assure daimyo loyalty, the daimyo themselves had to live in the shogun's capital for some time during the year and to provide close relatives as hostages for the rest of the year. Such a way of life among the ruling families must have stimulated the establishment of a transportation network, commercialisation, and expanded the size of the market (Morishima, 1982: 58–62). The daimyo faced expenses in the capital as well as for the movements between their home territories and the seat of the shogun in Edo. Actually, they became dependent on merchant assistance and managerial expertise. Mere subsistence economies at home would have been incompatible with the life style and aspirations of ruling families.

At the level of ideals, Chinese society was always open, but Japanese society was closed. Ideally, even a gifted young Chinese peasant could study classical literature, philosophy, and art, pass the imperial examinations, and become an imperial official, that is an elite member.<sup>18</sup> In Japan, however, the sons of peasants were expected to remain peasants, the sons of merchants to remain merchants, and the sons of samurai (warriors) samurai.<sup>19</sup> Of course, ideals of openness and meritocracy were frequently neglected in China. Nevertheless, different ideals did matter – not least for rich merchants and their offspring. Rich merchants could afford to pay for a classical education for one of their sons (Elvin, 1973: 292). Moreover, they had an incentive to do so. Families with some educated members, or better still with some imperial office-holders among them, were safer from bureaucratic harassment than others. Their property rights were more likely to be respected. Therefore, sons of many rich peasants studied, took examinations, and occasionally even became officials. Then, the family could acquire land to be worked by tenants and even leave the despised trading business. Whereas the Chinese merchant class always lost some of their most talented members to the economically less productive gentry or to the bureaucracy, the closure of the Japanese stratification system<sup>20</sup> preserved talent and capital in this sector of the economy (Levy, 1953/1954). Later, at the end of the nineteenth century, merchants and their descendants played a crucial role in managing the transition to industrial society in Japan.

<sup>18</sup> In fact, most of those who passed the examinations never became officials. Frequently, they had to pay bribes in order to get an appointment.

<sup>19</sup> Because of the long peace most of the samurai became administrators rather than actually serving as fighters. With 5% or 6% of the population, the samurai estate was much larger than West European nobility's. Moreover, paying their stipends was a heavy burden on the shogun or the local prince (daimyo). See Schwentker (2002: 44).

<sup>20</sup> Since the early nineteenth century the borderlines between estates, even between samurai and merchants, became permeable. Some samurai began to trade or to work as artisans, to intermarry with members of the merchant class, or they adopted individuals from rich merchant families (Piper, 1995: 61; Schwentker, 2002: 51).

*On political development*

Political systems evolve. They do not only progress, stabilise or develop. Some of them decay.<sup>21</sup> In imperial China the decay of dynasties, or the loss of the mandate of heaven, was a recurrent topic of historical inquiry. The main difference between a monocratic civilisation and a politically fragmented one is whether political decay affects all of it or whether some regions evade it. In the nineteenth century, China and Japan came under pressure from the Anglo-Saxon powers: first China under British pressure; later Japan under American pressure.<sup>22</sup> Asian regimes, Manchu China as well as Tokugawa Japan, then suffered from political decay and could not defend themselves against their Western challengers. But politically fragmented Japan benefited from the fact that some Japanese daimyo were more effective rulers than other daimyo. Political decay did not affect all of Japan equally. Modernisers established themselves in some regions first, Satsuma and Choshu among them, and only later – after the abdication of the shogun and the restoration of power to the emperor – achieved national power. Japan had a revolution from above and returned to effective and now centralised national government within less than a decade. By contrast, the agony of the Manchu dynasty lasted until 1911. No effective and unchallenged national government was established on the mainland until the Communists took power in 1949. In between the Guo Min Dang (or Kuo Min Tang) and the Communists fought for power. There was much violence; there were millions of deaths and four lost decades in between the Manchus and the Communists.

Historians and social scientists disagree about the advantages and disadvantages of revolutions from below, as in China, and revolutions from above, as in Japan. Moore (1966) is probably the best-known critic of the Japanese revolution from above.<sup>23</sup> But Scalapino's (1964: 69, 85) analysis of Japan looks more persuasive to me: 'The nation as a whole did not waste its energies or resources in the mass liquidation of persons and institutions . . . It is questionable whether the limited social mobility that has characterised twentieth century Japan has served as a barrier to modernisation, especially in its early and middle stages. The principle of hierarchy conserved the traditions of a committed and well-qualified elite on the one hand, and a disciplined and malleable people on the other. In a society so ordered, there is little waste through violence and there is a heightened capacity for sacrifice.' To put it somewhat differently: by contrast to the Chinese, the Japanese avoided the liquidation of much human capital and the destruction of custom and tradition-based social capital which promotes co-operation and efficiency. Before World War II, even much of Japan's industry was traditional in kind (like silk and cotton *textiles*), rooted in the countryside, and based

<sup>21</sup> For recent theorising about political decay, see Huntington (1968) or Olson (1982); influential earlier treatments are Marx and Engels (1848/1966) or Schumpeter (1942).

<sup>22</sup> Psychologically, the impact on Japan's government might have been reinforced by the shogun's title, which implied victory over the barbarians (Schwentker, 2002: 55).

<sup>23</sup> But one should keep in mind that Moore is more interested in democracy than in economic growth. Here, the analytic concerns are different.

on rural habits and values permitting, for example long hours and harsh working conditions for young girls.

Since World War II nationalism has acquired a bad reputation. Still, it has been argued (Greenfeld, 2001) that nationalism has supplied much of the motivation for economic growth. Japan after the Meiji restoration provides the most persuasive example for this proposition. Making economic growth and the conquest of foreign markets into a patriotic duty, Japanese nationalism provided an opportunity for merchants and manufacturers, for entrepreneurs and workers to contribute to national glory. Whereas the status of merchants in Tokugawa Japan was low and contemptible, since the late nineteenth century entrepreneurs, manufacturers, and merchants could acquire dignity and respect by glorifying Japan in the conquest of foreign markets. Nationalism and international competition quickly dissolved the rigidity of the feudal stratification system. China has been lagging Japan in this respect by at least hundred years. Since the 1980s, however, economic nationalism in China is well on its way to overcoming domestic obstacles to growth. Inviting 'capitalist' entrepreneurs to become members of the ruling and still nominally 'communist' party symbolises this process.

## 5 Attempting to catch-up

### *Japan's race to the top*

Although nineteenth-century China suffered worse humiliations from Western powers than Japan did, the Japanese after the Meiji restoration seriously tried to overcome backwardness, whereas China remained mired in backwardness for about another century.<sup>24</sup> The guiding aspiration of Japanese reformers was 'rich nation, strong army' (Samuels, 1994; Tominaga, 1990: 42), that is the Japanese government aspired to build the economic foundations for great power status. As testified by successful wars against the Chinese in 1895 and against the Russians in 1905, they quickly succeeded. Why did they succeed?

Most econometric research (Barro and Sala-i-Martin, 1995; Dollar, 1992; Easterly, 2001; Edwards, 1998; Greenaway and Nam, 1988; Levine and Renelt, 1992) about the determinants of growth refers to the post World War II period. Nevertheless, its findings might provide some clues to Japan's early success to catch-up with the West. By and large, there seems to be widespread agreement on three issues and some serious disagreement on a fourth one. First, there are potential advantages of backwardness. Some poor countries have grown much faster than others. A number of reasons might contribute to this finding. Conceivably, it is easier to make productive investments in an economy that is somewhat lagging behind the pioneers of economic development. The more backward

<sup>24</sup> In my view, it is not entirely clear whether one should date serious Chinese attempts to catch-up in the late 1940s or rather in the late 1970s. After all, under Mao Zedong the Chinese economy still grew more slowly than the global economy. Only under Deng Xiaoping did the Chinese do better than the rest of the world (Maddison, 1998).

and agrarian an economy still is, the more labour may be reallocated from agriculture to industry and later to services. Such a process of reallocation may fuel productivity gains. Most importantly, poor and backward countries may borrow technologies from more advanced countries. It is easier and faster to imitate than to innovate. Of course, open-mindedness and willingness to learn from others is a prerequisite for realising this particular advantage of backwardness.

Second, there is the widely shared view that human capital endowment matters. Convergence of backward economies with richer ones seems to be conditional on human capital formation. Third, economic openness, export orientation, and economic freedom seem to be helpful. There is less agreement about the role of investment. Most of the older econometric research was impressed by the robustness of the relationship between investment and growth, whereas more recent research (Bleaney and Nishiyama, 2002; Barro and Sala-i-Martin, 1995; Blomström, Lipsey, and Zejan, 1996) underlines the endogeneity of investment. Although investment might still speed up growth, investment itself might simultaneously depend on growth. Moreover, the latter effect might be stronger than the former effect. Finally, it is not clear whether one should narrowly or broadly define investment. According to De Long, Bradford, and Summers (1991), it is only equipment investment which boosts growth.

Applying these general arguments about the determinants of growth to Japan, Japanese performance from the late nineteenth to the late twentieth century is certainly compatible with the existence of advantages of backwardness (Maddison, 2001: 139). Since the Japanese achieved high degrees of literacy and high secondary school enrolment ratios quite early,<sup>25</sup> strong human capital formation and willingness to work long hours seem to have boosted growth and contributed to conditional convergence. It is more difficult to judge the impact of economic openness, export orientation, and economic freedom on Japanese development.

The Friedmans' (1981: 53) claim that Japan did rely on markets and market incentives. In the nineteenth century, the Western powers had imposed a treaty on Japan which forbade it to impose customs duties higher than 5%.<sup>26</sup> Under such conditions big price distortions became impossible. The Japanese economy had to exploit comparative advantages. Efficient resource allocation prevailed instead of political planning and resulting in errors. Such an account of the Japanese success story is frequently criticised (Johnson, 1982; Samuels, 1994). Admittedly, Japan always had an industrial policy. The state promoted and even established some industries. It provided subsidies, formal and informal protection, for example, by 'buy Japanese' campaigns, social pressure, bureaucratic harassment, and government procurement. On the other hand, one should

<sup>25</sup> According to Banks (1971: Segment 6), Japanese primary school enrolment rates in the 1880s were similar to British ones a mere decade earlier. In the 1880s secondary school enrolment ratios in Japan overtook the French ones. The first available Chinese values, for 1919, lag far behind Japanese achievements at the same time. Moreover, Japanese students put in much longer hours than students did elsewhere. According to Morishima (1982: 183) their working day could extend up to 15 hours.

<sup>26</sup> Of course, the Western powers forced China to maintain low tariffs, too (Maddison, 2001: 117).

not put Japan too far into the statist corner. Protectionism is well known from American and European economic history; state-owned enterprises were important in France and Germany; industrial policy by government procurement and national (or imperial) preference has been the rule rather than the exception in the West. But Japan benefited (against its will) from international treaties putting a cap on its custom duties in the late nineteenth century. Simultaneously, 'the largest noncoerced privatisation of industrial facilities' in the late nineteenth century occurred in Japan (Samuels, 1994: 39). Moreover, the Japanese state remained lean. According to Tanzi and Schuknecht (2000: 6), Japanese general government expenditure as a share of GDP was below British, French, and German values from the 1870s through the 1990s. So, the superior Japanese performance is compatible with a free market interpretation, in particular in comparison to China.

### *China's belated entry into the race*

In analysing Chinese performance one may distinguish two separate take-off thresholds: first, the Communist conquest of power in 1949, because thereafter per capita incomes in China grew rather than stagnated or fell; second, the end of Maoism and Deng Xiaoping's reforms in the late 1970s, because only thereafter the Chinese economy began to outperform the global economy, that is only then did the Chinese catch-up really begin. The first Communist achievement rested on ending the civil war, at least as far as the mainland was concerned. Certainly, the Communists did nothing like imposing law and order (Domes, 1985). Instead they expropriated rich landowners and redistributed the land to poor peasants and tenants. Then they diluted all property rights and interfered with incentives by collectivising agriculture. In the late 1950s, with the so-called 'great leap forward', they forced comparatively small collectives into larger communes, thereby further diluting property rights and attenuating incentives to work. Simultaneously, ideological indoctrination of peasants was reinforced. Since time spent in studying Mao Zedong thought was not spent in the fields, it had an opportunity cost. Another distraction arose from a misguided attempt to increase rural iron production. Decisions when and where to plant were no longer made by peasants guided by experience, but by party cadres. In fact, the 'great leap forward' comes as close as possible in the real world to a giant experiment to test the explanatory sketch above, based on Smith, Mises, and Hayek. If the 'great leap forward' had achieved its goals, then the explanatory sketch would have been falsified and in deep trouble. But the 'great leap forward' was a disaster and resulted in mass starvation. While estimates of the number of victims vary from 16.5 to 50 million (Fu, 1993: 235, 304), 30 million (Sandschneider, 1998: 73) seems to be a middle one.

The 'great leap forward' was not the only Maoist disaster. In the late 1960s the cultural revolution began. This is not the place to analyse its ideology or purpose, but merely to point to two effects. Again, millions lost their lives, at the beginning because of the actions of the red guards against the hated establishment, later because of the actions of the 'people's liberation army', which put them down in the end and restored



order. In addition, serious schooling or human capital formation was interrupted for an entire decade. Nevertheless, one may argue with Drèze and Sen (1998) that Chinese efforts and successes in spreading schooling and literacy to almost all young adults in the countryside before the cultural revolution greatly contributed to economic growth after Mao's death and Deng's reforms.

The final turning point in Chinese economic development was achieved only under Deng Xiaoping's enlightened leadership in the late 1970s.<sup>27</sup> Reforms began in the countryside. Agriculture was decollectivised by assigning land and responsibility for production to small working groups of a few families or even to individual households or persons, that is incentives to work hard and to increase production were restored. Since the overwhelming majority of the Chinese population in the 1970s and 1980s lived in the countryside and worked the fields, this mattered. Within a decade or less, rural per capita incomes doubled. Simultaneously, the discrepancy between higher urban and lower rural incomes narrowed from about 2.4 in 1978 to about 1.7 in 1985. In the beginning market reforms not only boosted growth but equalised incomes too (Wu, 1996: 66).<sup>28</sup>

Agricultural reforms were complemented with other reforms. Economic decision-making was decentralised. Much of it was shifted from the central to provincial and local governments. So-called township and village enterprises (TVEs) were established. Even truly private enterprises became tolerated. Prices were permitted to respond to supply and demand. Already in 1993, 95% of all retail prices were market prices, 90% of agricultural prices, and even about 85% of investment equipment prices (Schüller, 1998: 279). Entrepreneurs, including cadre entrepreneurs, became residual claimants to profits and local governments became residual claimants to taxes (Qian, 2000: 154–155). The devolution of power to regional and local levels reinforced competition. TVEs have to compete with each other. The reach of 'their' local government is not long and strong enough to protect them. Even if the ownership is still collective,<sup>29</sup> many TVEs have to compete as if they were private- and profit-oriented enterprises.

Since China has not yet established the rule of law, property rights are still somewhat insecure. In market-preserving federalism (Weingast, 1995; Montinola, Qian, and Weingast, 1995), however, the Chinese have implemented a functional substitute for it. Where lower levels of government treat enterprises and investors worse than elsewhere in China, where regulation is especially burdensome, where arbitrary taxation hurts more than elsewhere, where corruption exceeds Chinese expectations, there investors

<sup>27</sup> Even in the 1973–90 period, however Mainland China still had a lower GDP per capita growth rate than the Republic of China on Taiwan (Maddison, 2001: 143). Only in the 1990s did the Mainland start to close the gap with its hostile sister republic on the other side of the Taiwan Strait.

<sup>28</sup> Since then, however, the urban–rural income divide has become starker again. According to some estimates (Kristof and WuDunn, 1994: 173), it was 4 to 1 in the early 1990s. Still, this resulted from faster urban income growth, not from stagnation in the countryside.

<sup>29</sup> It is not always easy to determine the true owners of TVEs. Some private entrepreneurs prefer to register 'their' enterprise under collective rather than individual ownership in order to avoid discrimination (Schüller, 1998: 283).



need not go. Competition among themselves forces local and regional governments to act *as if* they wanted to respect private property rights.<sup>30</sup>

Another major policy reversal of the Chinese government concerns the transition from a largely closed to a fairly open economy. At the end of the twentieth century China may have exported about 30% of its gross domestic product (Noland, Liu, Robinson, and Wang, 1998: 58). This is extremely high for such a huge economy. Another indicator of openness is China's attractiveness for foreign capital. In 1998, for example, China received about 43 billion US\$ in foreign direct investment. By contrast, neither India nor Russia got even one tenth of this amount (World Bank, 2000/2001: 314–315). Since opening up, China has pursued an export-oriented growth strategy, much as South Korea or Taiwan did before China.<sup>31</sup> But in contrast to Japan, South Korea, and Taiwan, China relied heavily on foreign direct investment. In the mid 1990s, foreign-invested enterprises contributed about 15% to gross fixed capital formation, about 20% to industrial output, and about 41% to exports (Gallagher, 2002: 347).

Since the mid 1980s income inequality in China is growing again. At the end of the twentieth century the top 20% income shares in China and the United States were about equal, that is in between 46 and 47% (World Bank, 2000/2001: 282–283). Because of its strong growth performance, incomes of the poorest 20% in China nevertheless improved by 3.8% per year (Dollar and Kraay, 2001: 40). Although the People's Republic of China still lags far behind its sister Republic of China on Taiwan, behind Japan, and behind the West, its incipient catch-up trajectory has already contributed to some improvement of the global size distribution of income (World Bank, 2002).

## 6 Conclusion

Neither Manchu China nor Tokugawa Japan developed safe property rights for merchants, artisans, or peasants. In both societies the masses had to feed the ruling classes but they enjoyed few rights. Freedoms or rights *to be asserted against superiors or authorities* were inconceivable. Independent courts of law did not exist. But the situation in China and Japan differed in some important respects. Because of feudalism in Japan and patrimonialism in China, because of political fragmentation in Japan and imperial unity in China, arbitrary rule was more limited and could be more easily overcome in Japan than in China. Whereas Chinese in contrast to Japanese merchants could escape their contemptible status by studying the Confucian classics and acquiring land, that is by joining the gentry, Japanese merchants who had to remain merchants enjoyed safer property rights and a lighter tax burden than their Chinese counterparts.

<sup>30</sup> In the long run it is dubious whether market-preserving federalism can substitute for the rule of law. The Chinese government itself seems to entertain some doubts and to push for a more legalistic approach, for example by expanding education in law (Pei, 1998).

<sup>31</sup> On export orientation and its benefits, see Dollar (1992), Dollar and Kraay (2002), Edwards (1998), Greenaway and Nam (1988), World Bank (1993, 2002). As the closing page of Elvin's (1973: 319) book demonstrates, China's growth by export orientation is not only compatible with the institutionalist approach of this paper, but also with his focus on technology and the 'high-level equilibrium trap'.

That is why market transactions and commercialisation probably grew more strongly in Japan than they did in China. But the Japanese peasantry had to carry a significantly larger tax burden in order to supply its ruling class than the Chinese peasantry did. Nevertheless, Tokugawa Japan could first catch-up with China and then overtake it in productivity and per capita income.

In the nineteenth century, both countries came under Anglo-Saxon pressure to open up for trade. Because of political decay in both countries none of them could put up an effective resistance. Whereas China suffered from more than a century of economic stagnation and declining per capita incomes before the mid twentieth century, the Japanese began effective reforms and growth strategies much earlier. Japan's revolution from above was prepared by modernisation in some outlying regions. It avoided the wanton destruction of human and social capital. Order was maintained. Protectionism and the corresponding price distortions were limited by foreign pressure. Some state-established and state-owned enterprises were already privatised in the late nineteenth century. An early focus on schooling and human capital formation as well as strong saving and investment permitted the Japanese to exploit the potential advantages of backwardness.

By contrast, Chinese political decay in the nineteenth century prepared the country only for civil wars and a revolution from below in the twentieth century. Millions were killed or starved to death. Traditions were not respected by the Communist victors of the civil war. Nevertheless, the reestablishment of some semblance of order and peace permitted the Chinese economy to overcome a legacy of declining per capita incomes. But Maoist policies of collectivisation diluted property rights, reduced incentives to work, and substituted political decision-making by cadres for the application of local and tacit knowledge of peasants. These policies resulted in the worst episode of mass starvation in the entire twentieth century. Thereafter, Mao's cultural revolution interrupted education and human capital formation. Only after Deng Xiaoping reintroduced family farming and re-established incentives to work in the countryside did China's economy start to grow more strongly than the global economy. In the last quarter century, improved incentives, strong saving and investment, and strong human capital formation (compared with equally poor countries elsewhere) permitted the Chinese to start to catch-up and to realise some advantage of backwardness. The devolution of authority to provincial, county, and city governments permitted the establishment of market-preserving federalism, that is the establishment of a functional substitute for the rule of law. Opening up the economy permitted the exploitation of comparative advantages and the useful employment of at least some part of China's huge pool of unskilled and semi-skilled labour.<sup>32</sup>

<sup>32</sup> In this paper I neglect the unsolved problems of the Chinese economy. Worst among them are generally loss-making state-owned enterprises (SOEs) who even in 1999 still employed 24 million people (see Lardy, 1998; Maddison, 2001: 147). Moreover, many SOEs survive on loans from state banks. SOEs are largely responsible for non-performing loans in China, which might lead to a major banking crisis.

If economic growth is the dominant goal of Chinese national policy, then Japan has the characteristics of an ideal neighbour (Conley and Ligon, 2002: 181): wealthy, educated, and avoiding tax-addicted government. Such characteristics maximise cross-country spillovers. In the late twentieth century, the East Asian economies, including China and Japan, have become more interdependent. After the mid 1980s, appreciation of the yen forced Japanese exporters to establish subsidiaries and suppliers in low-wage Asia, including Mainland China. This relocation of production by Japanese enterprises implied 'the re-Asianisation of Japan' (Gilpin, 2000: 268). So far as Japan is concerned, this was not only an attempt to overcome the consequences of the strong yen, but also part of a security strategy, of a hope for 'peace by trade'.<sup>33</sup> According to Gilpin (2000: 269), 'through trade, investment, and foreign aid, the Japanese hope to transform China into an economic partner more interested in peaceful economic coexistence than in military expansion and political confrontation'.

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<sup>33</sup> On 'peace by trade' see Russett and Oneal (2001), on the even broader concept of a 'capitalist peace', of which 'peace by trade' is a crucial component, see Weede (2003).

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