Hoover Institution | Stanford University

Pitfalls of State-Led Development

Brazil's Past Offers a Warning for China

Dian Zhong

China's rapid economic growth, once hailed as a miracle, is now showing increasing signs of strain amid rising global economic volatility. Most analysts would single out Communist Party rule as the key governance variable, and certainly it is. But adopting a wider comparative lens, we can describe China's system as one that falls into the category of a predominantly state-driven economy. As China seeks to expand its influence in global trade, economic, and multilateral institutions, policymakers and experts worldwide are grappling with critical questions: Can China continue to grow under its current state-led model? Or is it heading toward economic stagnation and political disruption by holding onto its development strategies for too long? Most importantly, can China adapt to avoid the pitfalls of the state-led model and secure sustainable long-term growth?

We address these questions by drawing historical parallels between Brazil and China. Brazil's experience from the 1950s to the 1970s illustrates the long-term constraints imposed by state-led development strategies. Key policy missteps—such as financial mismanagement, overreliance on public investment, neglect of private sector dynamism, and deficiencies in human capital—serve as a clear warning for China. Continuing with the "China Model" seems destined to only worsen existing issues, thus jeopardizing China's economic future and therefore its global influence.

Consider Latin America. Predominant narratives of "catch-up" economies often depict the region as a cautionary tale of failure, while East Asia is celebrated as a model, or even the model, of success. Many analysts believe that China's trajectory, mirroring that of other East Asian Newly Industrialized Countries (NICs), simply reinforces this narrative. But why did Latin America's aggressive industrial policies fail to translate into lasting prosperity? Is China's strategy of strengthening state control offering a viable alternative, or is it repeating similar mistakes? What if the supposed failures of

the Latin American model and the successes of the East Asian model aren't as clear cut as they seem? What happens when we take a longer view?

As the Chinese economy slows down, many turn to Japan or South Korea for clues about its future. We, however, take a different approach. Contrary to what many might think, China's economic path shares striking similarities with Brazil, another large emerging economy. Once heralded for its meteoric rise after World War II, Brazil saw its fortunes fade when global conditions shifted in 1974. Brazil's economic trajectory may hold key insights into the challenges China now faces. By juxtaposing the two, we offer policymakers valuable perspectives to better understand and guide China's current economic course.

Brazil was the bread and butter of world development studies during the 1970s, acclaimed for its remarkable economic growth between 1967 and 1973. By the 1990s, that spotlight shifted to China, which had sustained its growth since 1978. Brazil's strategy of intensive industrialization propelled it to the forefront of Latin America but failed to deliver long-term prosperity. Meanwhile, China's economic miracle, driven by state-led investment and rapid gross domestic product (GDP) growth, has reignited debates about the effectiveness of state control in fostering sustained national development. Brazil's economy declined sharply following the oil shocks, and now China finds itself at a similar critical juncture, with pressing needs for reform, rebalancing, and potentially a significant shift in its economic path.

Despite the historical parallels, comparative analyses between Brazil and China are rare, as they are often seen as archetypal examples of the contrasting Latin American and East Asian development models. This dichotomous labeling is problematic, as both countries deviate from these prototypes, evolving as "semifinished products" midway through their developmental trajectories.[1] During military rule, Brazil shifted from the traditional "import substitution industrialization (ISI) plus corporatist state" model, opting instead for export promotion while suppressing labor. China's state apparatus, incorporating both communist and imperial elements, stands apart from other East Asian states in its nature and control mechanisms.[2]

In comparing Latin America and East Asia, many ask: "Did the Latin American model 'lose' to the East Asian model because the state did too much or too little?" This question is misplaced. In Brazil, economic takeoff outpaced the state-building process; development and prosperity were the foundational values that united and cast the modern Brazilian state.[3] In contrast, China views the economy as serving the state, not the other way around.[4] According to Peter Evans's "predatory state" versus "developmental state" typology, both Brazil and China fall into intermediate categories.[5] In other words, the key difference between them lies not in the level of state involvement but in how they have timed and paced the use of state power to drive economic growth.

The assumption that the Latin American model "failed" is also questionable, as it stems from an imbalanced view shaped by the overwhelming pessimism of the 1980s.[6] The proactive industrial policies crafted by Brazilian policymakers during the 1960s and 1970s helped establish the most advanced industrial complex in Latin America. Later failures should not entirely erase these historic successes.[7] Conversely, the perceived effectiveness of the East Asian developmental state in generating economic growth might be overstated.[8] Whether massive inputs of capital by the state alone can genuinely stimulate productivity gains and technological progress is debatable.[9] In fact, China's economic success was likely more a result of the loosening of state control rather than a strengthening of it.

Robert Wade aptly described the academic debate around the relationship between state and development as a battle of paradigms and beliefs.[10] China's rise has intensified this debate, making it more emotionally charged and ideologically driven. Moving beyond the dichotomy of the Latin American model versus the East Asian model, a focused comparison between Brazil and China can serve as a more effective heuristic for reassessing key development policies that are crucial in shaping a nation's future.

CHALLENGING TRADITIONAL WISDOM: BRAZIL VS. CHINA THROUGH A HISTORICAL LENS

Comparing the economic development histories of Brazil and China reveals striking similarities between these two giants. By examining their early development stages, governance structures, Cold War involvement, agrarian and social policy practices, and globalization strategies, we uncover the deeper patterns that have shaped the economic paths of both countries. Through a few bullet points, we challenge conventional wisdom and pave the way for more nuanced policy discussions.

EARLY DEVELOPMENT

China

- China's industrialization was historically driven by the need to prepare for conflict with Japan, leading to a state-led approach.

- Two initial industry clusters emerged during the Kuomintang (KMT) era (1927–1949): the "Treaty Port Industry" in Shanghai and Jiangsu, focusing on light industry and consumer goods; and the "Manchurian Industry" established by Japan in the northeast, which extracted industrial raw materials and produced semifinished goods.

- Since the founding of People's Republic of China, the Chinese Communist Party (CCP) has continually reframed and redefined the concept of "development" from emphasizing industrialization, collectivization, and state control

over land and production during the Mao era, to more recent focuses on social stability, environmental concerns, and the quality of development.

Brazil

- Industrialization accelerated during the 1930s when private actors faced bankruptcy after the Great Depression. Under the Vargas regime, economic strategy was marked by centralized government control of foreign trade, tariff protection, and state subsidies.

- The development goal has been to overcome commodity dependency, while the dilemma lies in the reliance on export revenue as the primary source of income.

- The military regime from the 1960s to the 1980s pursued state-led industrialization with mixed success, emphasizing urban-centric development that deepened regional and racial inequalities.

Commonalities

- The concept of development is often equated with industrial growth in both China and Brazil, with the share of industry in GDP being a key indicator of economic development. This perspective explains the motivations behind, and the notable successes of, both countries.

- The concept of development is also closely tied to the role of the state, which is seen as the primary engine for advancing the national economy from the global periphery to the core. In this context, development serves both as the goal and the rationale for state expansion.

- Development in Brazil and China encompasses more than just economic growth; it includes ensuring the survival of their national autonomy and striving for parity with Western powers on the global stage. This mindset drives the adoption of heterodox development strategies, often involving strong state control, which is seen as a catalyst for accelerating national progress beyond what a free market alone could achieve.

GOVERNANCE AND DEVELOPMENT

China

- The "developmental state" in China sprouted under the KMT government in the 1930s, which invested in education and agricultural technology, conducted national resource surveys, formulated development plans, and trained technicians. The "Natural Resources Committee" employed one million workers and controlled 70 percent of all industrial capital by 1933.

- War-induced turmoil that lasted over a decade (1937–1949) fostered a strong aversion within Chinese society to foreign influence, and a susceptibility to authoritative governance, regardless of its severity.

- The sharp shift from a planned economy to a command economy in 1958 marked a departure from the Soviet model. During this period, the Party extended its control beyond the economy to encompass all aspects of Chinese society. The Chinese communist polity, by design, does not protect the property rights of small owners and retains control over critical production factors such as land and finance, with all major banks being state owned.

Brazil

- The Brazilian polity experienced an early transition from an absolutist monarchy to a constitutional monarchy in the 1880s. It then took a century to shift from long-standing authoritarianism to a relatively stable democracy in the 1980s. Bureaucratically, there is a partial commitment to meritocracy and the training of technocrats, particularly within the realm of economic policymaking.

- The tension between "progress" and "order," the two mottos on the Brazilian national flag, was starkly evident during the military regime from the 1960s to the 1980s. This period was marked by state-led industrialization, export promotion, and strict economic discipline. However, it was also a time of significant social repression and restricted political freedoms.

- The Brazilian state acted as a unifier by integrating regional oligarchies, middle classes, industrial workers, and the poor under the banner of national modernization. However, weak democratic institutions consistently hindered its ability to push agendas that conflicted with oligarchic interests.

Commonalities

- Both Brazil and China exhibited strong economic statism and nationalism, setting ambitious goals that drove fast-paced industrialization. This industrialization was pursued not merely as a means to development but as an end in itself, representing their "places in the world."

- Both countries experienced extremely strong path dependency in their economic governance, largely shaped by external crises. This path dependency was exacerbated by a lack of stable institutional safeguards, making it difficult to counteract the risks of policy overdose that arose from prolonged emergency measures.

- An obsession with heterodox development theories was evident in both Brazil and China, where top-down planning and strategies of "unbalanced growth" were strongly favored. This approach stemmed from a belief that unconventional

methods were essential to challenge and change the international structure that they perceived as dooming them to perpetual underdevelopment.

COLD WAR IMPACT

China

- Geopolitical isolation and a staunch commitment to socialism are two sides of the same coin. Socialism was seen as the key to rapid industrialization and national greatness for China, merging internal fears of Western colonization with external reliance on Soviet aid.

- Ideologically driven paths on a fiercely competitive international stage for security and economic catch-up, combined with a mobilizing strategy emphasizing "self-reliance," led to radical economic policies in China. The state ruthlessly harnessed domestic resources, with dominant narratives justifying these choices as necessary for "consolidating the revolution."

- The lasting influence of socialist doctrines has hindered the legal protection of property rights and slowed the development of open and transparent market institutions. Rather than formally endorsing "privatization," the Chinese government chose ambiguous terms like "restructuring" or "corporatization" to avoid ideological backlash. These mental constraints continue to shape Chinese society even today.

Brazil

- Brazil's developmentalism peaked during the 1950s, fueled by an abundant supply of cheap postwar credits. However, unlike China, Brazil did not face the pressing need to leverage economic growth for national survival or ideological dominance, leading to more moderate ambitions.

- Brazil's intensive industrialization plans between the 1950s and 1970s were made possible through its strategic alignment with US foreign policy via the "Alliance for Progress" initiative. Several industrial sectors began to flourish under protective industrial policies, permitted and even encouraged by the United States to demonstrate the superiority of capitalism.

- The holistic transformation of Brazil's economy stalled after the oil shock in 1973, when debt became an unshakable burden. To adjust its balance of payments, the Brazilian military regime reverted to promoting primary exports. Inadvertently, the US-Brazil alliance during the military rule exacerbated Brazil's persistent reliance on external markets and capital for economic growth.

Commonalities

- Both China's and Brazil's economic policies and development paths were heavily influenced by external superpowers during the Cold War. China's relationship with the Soviet Union and Brazil's convenient alignment with the United States shaped their strategic economic decisions significantly.

- Ideological constraints and geopolitical pressures have obstructed both Brazil and China from fully transforming their economies into open, resilient, and diversified market economies. In many ways, the Cold War intensified the path dependency of development in China and Brazil, as both nations closed off alternative economic strategies due to rigid ideological and geopolitical considerations.

AGRARIAN AND SOCIAL POLICIES

China

- During and after the Communist Revolution, the CCP confiscated all lands and means of production. Collectivization, or the implementation of collective ownership, denied individual property rights of rural residents, further enforcing the total state control over the economic activities and social structures in the countryside.

- Although villages are theoretically autonomous, in practice, a significant number of administrative orders are imposed on them from township and county government officials without resources being accordingly provided. This resulted in a situation of "only obligations without rights."

- The existence of two distinct forms of citizenship—the agricultural household registration and the nonagricultural household registration—created a lasting division in Chinese society. Urban residents were organized into *danwei*, which evolved into a system of privilege, while rural residents were left with sporadic and self-sustained social services. Most notably, the disparity in property rights between urban and rural areas resulted in a highly distorted and unusually rapid urban sprawl, as evidenced by the real estate booms.

- The dual system's roots lie deeply in the government's strategy to extract natural and human resources for industrialization. The underdevelopment of the agricultural sector, due to the combination of the food rationing and the household registration systems, was understood as a necessary cost of industrial development. Intentionally or not, this further solidified the ties between farmers and the land, making it difficult for rural residents to break free from agricultural dependence.

Brazil

- Brazil's entrenched sociocultural issues in the agricultural sector stem from a history of full-scale slavery, persistent racism, and extensive landholdings (*latifúndios*).

- The emphasis on urban industrialization resulted in the neglect of rural areas, exacerbating regional and social inequalities. During the 1968–1973 "Economic Miracle," agrarian policies were secondary to industrial objectives, reinforcing rural underdevelopment and generalized poverty.

- Efforts for agrarian reform and improvement in social services in the countryside were thwarted by powerful rural elites who, despite the federal jurisdiction, retained significant influence and blocked policy proposals that would substantially change how resources were distributed.

Commonalities

- The emphasis on top-down planning and urban-centric policies has exacerbated a systematic urban-rural divide in both Brazil and China, with lingering effects that persist to this day.

- Rural populations struggle to sustain themselves through agriculture and often lack the skills needed to participate in modern, high value-added industries.

- This development model has some inherent inconsistencies as it prioritizes capital-intensive and labor-saving sectors in settings where there is a shortage of capital and surplus of labor.

STRATEGIC ENGAGEMENT IN GLOBALIZATION

China

- Trade and foreign investment were strategically employed during the reform and opening-up years to integrate into the global economy, with an emphasis on importing capital and technology and exporting light manufactured goods in accordance with comparative advantage principles.

- Special Economic Zones (SEZs) acted as pioneers in developing land and stock markets, establishing the rule of law, and fostering autonomous and efficient governments while generating foreign exchange and creating jobs. However, this led to a significant loss of tax revenue, squandered potential domestic economic links, and disproportionately benefited Foreign-Invested Enterprises (FIEs) over their domestic private competitors.

- Hong Kong's role was crucial. It provided Chinese enterprises with access to financial markets and legal protection. The "round tripping" of Chinese State-Owned Enterprises (SOEs) underscored the institutional security offered by the Hong Kong system. However, this role has significantly diminished in recent times.

- Despite many groundbreaking reforms, the compulsory foreign exchange settlement system was kept intact, reinforcing the divide between the domestic and global markets. As a result, many of China's small and medium-sized firms, struggling to grow within the domestic market, are eager to expand overseas. This dynamic exacerbates global trade imbalances and fuels trade disputes, thereby undermining the state's ability to leverage external linkages for national development.

Brazil

- Global trade and investment engagement met with mixed success, marked by protectionist tendencies and a heavy reliance on commodity exports. Agribusiness emerged as the primary source of revenue for financing industrial imports; however, its growth inadvertently undermined the industrial sector by keeping the exchange rate high.

- Foreign Direct Investments (FDIs) and foreign loans flow into the country to take advantage of policy distortions. The influx is thus unstable and vulnerable to internal and external volatilities, exposing Brazil to significant risks of massive capital flight.

- "Deindustrialization by choice" occurred during the Itamar Franco administration when industries that were not internationally competitive were allowed to go bankrupt. Since then, the Brazilian industry has not yet been able to recapture its historical shine.

- Recent efforts to establish effective regional trade agreements and integrate into global value chains have often stalled due to the instabilities and fluctuating policies of governments, including Brazil's.

Commonalities

- Both countries need to tackle the imbalances between internal and external linkages.[11] Brazilian policymakers must strategize to prevent agricultural export revenues from undercutting their industrial capabilities, whereas their Chinese counterparts need to manage domestic market distortions caused by lingering policies from the planned economy era to ensure they do not hinder the country's integration into the global economy.

- External integration can sometimes hinder internal integration. In China, SEZs attracted substantial foreign investments, leading to disparities between domestic and foreign enterprises. Meanwhile, Brazil's protectionist policies and reliance on commodities resulted in "deindustrialization by choice." Therefore, both nations must put forward more nuanced policy guidelines to ensure that external and internal integration complement rather than counteract each other.

POLICY PITFALLS UNVEILED: WHAT BRAZIL'S MISSTEPS WARN ABOUT CHINA'S CURRENT CHALLENGES

Moving from historical context to contemporary challenges, we expose how certain policy choices have hindered, or are likely to hinder, the long-term development of Brazil and China. The unintended consequences of state-led development—ranging from financial mismanagement and suppressed entrepreneurship to the neglect of essential social services—pose a grave threat to economic sustainability. China must learn from Brazil's past mistakes to avert a similar fallout.

BRAZIL'S POLICY LAPSES

Protectionism and Missed Opportunities

- As a result of inward-focused state-led development strategies, Brazil has consistently missed opportunities to enhance its international competitiveness due to a reluctance to fully engage with global markets. The country faces challenges such as a weak rule of law, underdeveloped infrastructure, a shortage of skilled labor, and fiscal and labor laws that are not conducive to private investment. While emerging markets like Mexico and Vietnam attract significant FDIs as companies seek to reduce their reliance on China, Brazil remains unprepared to take advantage of these shifts.

Cyclical Financial Crises

- Brazil's economy has long been characterized by a heavy reliance on foreign capital, which has exposed the country to significant financial risks over the decades. During periods of low global interest rates, Brazil tends to attract substantial foreign investment, fueling rapid industrialization but also creating vulnerabilities. The external debt then accumulates and becomes an unsustainable burden, eventually crippling the economy and forcing the government to implement austerity measures, which often lead to stagnation and the reversal of previous economic progress. This pattern results in boom-and-bust cycles, where periods of growth driven by capital inflows are followed by sharp downturns when external conditions deteriorate.

Human Capital Deficiency

- Underinvestment in education, particularly at the primary and secondary levels, significantly impedes Brazil's labor market competitiveness. Inefficient resource allocation between different levels of schooling by federal and local governments often leads to unintended consequences. For example, high federal spending on tuition-free public universities disproportionately benefits the wealthier population without broadly improving overall human capital. Elitist resistance to policy change perpetuates this imbalance, contributing to the underperformance of the

general labor force. The scarcity of skilled factory workers, combined with high labor costs, stringent environmental regulations, and a chaotic tax regime, further restrains Brazil's manufacturing capacity and diminishes its appeal to international investors.

Inability to Solve Long-Term Conundrums through Policy Change

- Due to the rigidity of its political system, Brazil lacks the flexibility and institutional certainty needed for effective socioeconomic policymaking. The country's reform efforts are consistently hampered by external economic and financial vulnerabilities, as well as domestic macroeconomic instability, including high inflation, currency volatility, and significant fiscal deficits, all of which make long-term development goals difficult to achieve. Meanwhile, its political system, fractured by entrenched interests and populist threats, appears ill-equipped to enact the necessary policy changes to reverse these negative trends.

CHINA'S POLICY LAPSES

Systematic Financial Risks

- Plagued by nepotism, nonperforming assets, and bad debts, China's financial system remains dominated by state-owned banks, which frequently require government bailouts. The absence of legal accountability for banks and other financial institutions, combined with regulatory grey areas, has led to a problematic de facto self-policing by the CCP.

- Local government fiscal capacity in China is exceedingly limited, forcing reliance on monetizing land use. Attempts to implement policies that could generate local revenue without introducing systemic uncertainties, such as property taxes, have faced significant political obstacles and are unlikely to be implemented any time soon.

Deficient Rule of Law

- Western analysts should avoid the oversimplified viewpoint that China's economic success was achieved entirely without the rule of law. Instead, they should acknowledge that this success was facilitated by partial improvements in legal frameworks compared to previous periods.

- In China, where adherence to legal codes has traditionally been weak and often supplanted by sociocultural norms, the Western concept of the rule of law was, in a sense, unnecessary. For example, during the Deng era, the leader's clear policy directives acted as a functional substitute for the rule of law, offering a level of predictability similar to that of an insurance policy.

- After decades of economic expansion, the deficiency in the rule of law in China has become evident in its ongoing struggles to climb the technological ladder. This has significantly impacted high-tech companies by reshaping their business incentives and pushing decision making in a risk-averse direction. In some instances, laws are specifically crafted to target private high-tech enterprises, further complicating their growth and innovation.

Policy Overdose

- Policy overdose occurs when governments react hastily to crises without considering long-term consequences or unintended side effects. A notable example is the four trillion-yuan stimulus plan following the 2008 financial crisis. This tendency is particularly prevalent in paternalistic societies like China, where the government is often seen as a benevolent caregiver during times of difficulty.

- Policy overdose can also arise from poor communication among different levels of government, leading to policy overlap or escalation. Nation-level policies, when implemented locally, can become overly stringent, resulting in excessive control and even the use of coercion. The recent missteps during the pandemic serve as poignant examples of this phenomenon.

Statism in Business

- The state directly supervises major SOEs and holds shares in them. Despite banks playing a crucial role, they lack both the capability and the explicit mandate to actively monitor corporate performance. Control is fragmented across holding companies, State-owned Assets Supervision and Administration Commissions (SASACs), government bodies, and party committees, which hinders corporate accountability.

- Efforts to reform SOEs often fall short as they are perceived as symbols of national security and economic autonomy, with their overseas operations becoming key to China's international prestige-building strategy. Additionally, the inefficiency of SOEs is often tolerated as a necessary cost for developing new sectors in a competitive global economy. Some SOEs, backed by national banks, have achieved notable technological breakthroughs—such as CRRC Corporation in high-speed train production—thereby reinforcing the justification for state dominance in business.

- SOEs are also entrenched with corporate interests that are difficult to dismantle, particularly as they often contribute significantly to local government revenue. This arrangement allows Chinese corporate managers considerable discretion, fostering an environment conducive to rent-seeking behaviors.

REASSESSING THE CHINESE MIRACLE

The "China Model" Poses No Challenge to Neoclassical Economic Principles

- Unlike other East Asian NICs, where state and business closely cooperated through reasonably functional market operations, China's economic rise was more closely tied to the state's gradual withdrawal from market activities. Three key driving forces can be identified in China's economic growth: labor-intensive production, integration into the global economy, and substantial inflows of foreign capital. Together, these elements facilitated market functionality and laid the foundation for economic growth.

- The shift from a labor-intensive to capital-intensive and high-tech-oriented economy, driven by the "Shanghai technocracy" in the late 1990s and throughout the 2000s, contradicted China's comparative advantage. Misplaced priorities that favored the public sector over the private sector led to declining productivity gains. These detrimental interventions inhibited the country's economic dynamics but were mistakenly celebrated as successes of the "China Model" due to the overoptimism fueled by the high GDP growth rate.

Chinese Miracle with Brazilian Characteristics

- China seems to be following Brazil's path from the 1970s: top-down planning by techno-bureaucracy, urban-centric development under an authoritarian regime, overreliance on public investment and inefficient SOEs, the "crowding out" effect of private investment, and the withering of entrepreneurship. Additionally, as well as the Brazilian military rule, China has adopted a strategy of "unbalanced growth" prioritizing economic efficiency over social equality, with approaches like "grow now, distribute later" and "first develop the cities, then the countryside."

- China is approaching what could be considered Brazil's "1974 moment." After years of deliberate industrial policies and heavy investment in high-tech sectors, Brazil made little progress in improving its overall competitiveness and was hit by an economic downturn following the first oil shock in 1974. Likewise, China may soon encounter a bottleneck effect, as its strategy of pushing labor-augmenting technology in a capital-scarce economy has always been economically unsustainable and vulnerable to adverse circumstances.

- **The worst-case scenario** could include an economic slowdown and prolonged stagnation, a continuous decline in return on investment (ROI) and Total Factor Productivity (TFP) growth, and the middle class slipping back into poverty as opportunities in the private sector diminish. This may lead to the emergence of a massive informal sector driven by the systemic rural-urban divide and increased political repression as the regime's "performance legitimacy" withers.

The Administration's Misalignment with China's Critical Economic Needs

- The current administration may be misplacing its key economic priorities. It appears to underestimate the importance of the labor-intensive sector—not only a source of employment but also a driver of innovation. Additionally, it seems to be curtailing the proactive role of local governments in fostering entrepreneurship and improving resource allocation. There also appears to be an overreliance on public investment and SOEs at the expense of the private sector. However, it is precisely the labor-intensive sector, local government autonomy, and increasing private investment that have been pivotal in China's historical ascent up the global value chain thus far.

- The neglect or reluctance to uphold essential institutional frameworks for a market economy, such as judicial independence, remains "the elephant in the room." Ideological muddling continues to pose a significant threat to sustainable growth by attributing issues arising from power abuses to capitalism, faults in command to market dynamics, and setbacks resulting from reactionary measures to reform efforts.

- Additionally, political disruptions in Hong Kong, justified under the pretext of national unity, have introduced significant risks and uncertainties for the future.

The Real Story behind the Chinese Miracle

- The Chinese Miracle should be analyzed not just based on its current economic performance, but within its historical norm, which reflects its inherent capacity for growth. It is crucial to recognize that previous missteps significantly diverted China's economic performance from its natural trajectory—this explains why even minor policy corrections have led to notable achievements. In other words, to truly understand what China did right, we must first examine what it did wrong in the past.

- The term "reform" (of the Chinese economy starting in 1978) may be somewhat misleading, as it largely represented the revitalization of China's once-suppressed traditional economy. Historical continuities include small-scale family enterprises, reintroduced as Township and Village Enterprises (TVEs); the prosperous Lower Yangtze River region, which led expansions in manufacturing and export capacity; and overseas connections, particularly through Hong Kong, which paved the way for the reemergence of FDIs and private enterprises.

- Several factors behind the Chinese Miracle have been overlooked and under-appreciated: entrepreneurship, which was nurtured by local governments seeking tax revenue; mass education in the countryside, gradually achieved during the Mao era, which allowed Chinese factories to train migrant workers through step-by-step demonstrations for mass production; and the strategic reintegration into the global value chain through the export of cheap manufactured goods to the world. However, all of these strengths are now diminishing.

THREE POLICY GUIDELINES FOR SUSTAINED GROWTH

Brazil's economic path serves as a valuable precursor, showing that China's journey toward sustained growth requires a thoughtful reassessment of its development strategies. We propose three key policy guidelines, spanning three dimensions: enhancing knowledge and awareness of China's true economic strength, reinforcing economic principles and institution-building, and investing in the most valuable asset of any national economy—its human capital.

THERE IS AN URGENT NEED FOR POLICYMAKERS TO DEBUNK THE NARRATIVE OF THE CHINESE MIRACLE BY CLARIFYING THE DUAL NATURE OF CHINA'S ECONOMIC GROWTH.

Two simultaneous processes have accompanied China's economic growth: firstly, the loosening of state control, which revitalized the traditional Chinese economy and sparked a resurgence of local government autonomy and widespread entrepreneurship; and secondly, the strengthening of the state, as evidenced by the recentralization of fiscal and financial policymaking, an overreliance on state-led investment and SOEs, and a shift from local economic incentives to targeted, urban-centric, and high-tech-focused policies.

The first process, which was the true driver of the Chinese Miracle, has been largely underappreciated and even dismissed, while the second process, responsible for China's current economic challenges, continues to be celebrated and perpetuated by the regime, which now finds itself "locked in" with vested interests. This duality necessitates a critical reassessment to foster a more balanced and sustainable growth model.

PRESERVE AND PROMOTE COMPETITION, BOTH DOMESTICALLY AND INTERNATIONALLY, BY CULTIVATING STRONG INSTITUTIONS THAT ENSURE TRANSPARENCY, PREDICTABILITY, AND A FAIR ENVIRONMENT WHERE BUSINESSES AND PARTNERSHIPS CAN THRIVE.

Competition is still the key to economic growth, but it doesn't come naturally. Both Brazil's struggles in the late 1970s and China's successes in the 1980s underscore the essential role of competition, in both domestic and international markets, in reducing transaction costs, fostering entrepreneurship, and stimulating efficiency. The lack of competition led to productivity losses in Brazil's manufacturing industries, while a reasonable degree of competition with other Asian economies rapidly transformed China's labor-intensive manufacturing sector into a key driver of its economic growth.

However, effective competition requires robust institutional safeguards, including the rule of law, judicial independence, clear and fair fiscal policies, and well-regulated financial systems to prevent illicit flows and encourage investment. Brazil can boost its regional competitiveness by integrating more closely with neighboring South American countries,

while China must dismantle mechanisms that perpetuate elitist interests within the state-led development model and foster a legal environment that treats all economic players indiscriminately.

To be respected as key stakeholders in globalization, countries such as Brazil and China are compelled to "play by the book," adhering to the rules set by neoliberal frameworks. While this may come at a cost—particularly in an era of rising economic populism—the ability to compete fairly in global trade must remain a top priority. China cannot afford to be sidelined, nor can the world afford to shut China out. Open and competitive trade relationships must be restored, as they are crucial for addressing broader economic, social, and geopolitical challenges in China that might otherwise be too difficult to tackle directly.

ENSURE INCLUSIVE, BROAD-BASED HUMAN CAPITAL DEVELOPMENT BY SHIFTING FROM STATE-LED ELITIST EDUCATION MODELS TO EMPOWERING CITIZENS THROUGH EXPANDED ACCESS TO LIFELONG LEARNING OPPORTUNITIES AND AUTONOMY-DRIVEN ECONOMIC PARTICIPATION.

At its core, long-term economic growth is driven by productivity gains, which largely stem from improvements in human capital. Populous developing nations such as Brazil and China often lack the capital and expertise needed for groundbreaking technological advancements; therefore, it is crucial for them to adopt policies that are both economically sound and inclusive to enhance human capital.

This means more than simply expanding government spending on health and education. As mentioned before, Brazil's approach of heavy federal spending on public universities has proven to be costly and exclusive, whereas China's policies from the 1950s to 1980s —emphasizing mass rural education and "learning-by-doing" in the workplace—were more cost effective, inclusive, and equitable.

However, China's 1990s shift toward a research-focused, innovation-driven higher education system, while neglecting basic education for rural students, has eroded these earlier achievements. This change may turn education into an elitist sorting mechanism, diminishing rather than enhancing the country's future growth potential.

The broader implication of these lessons is the urgent need to reduce the state's direct role in economic affairs. While state-led development can yield impressive short-term gains, it inevitably introduces systemic risks to sustained growth. Cutting down Leviathan's limbs may be difficult and unpopular in late-industrialized countries such as Brazil and China, but resisting the state's tendency to overextend is the only proven path to long-term prosperity.

The state's expansive role is often justified by its perceived obligation to address all societal issues at once; therefore, rather than merely advocating for the self-restraint of state power, the real solution lies in fostering a more self-reliant civil society. To achieve this, the societal mindset must undergo a fundamental shift, from dependency to autonomy. The future prosperity of Brazil and China hinges not on how powerful their governments can be, but on how effectively those governments empower their people to stand on their own.

NOTES

1. Peter B. Evans, "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State," *Social Forum* 4 (1989): 561–87.

2. Chenggang Xu, "The Origin of China's Communist Institutions," in *The Cambridge Economic History of China*, vol. 2, *1950 to the Present*, eds. Debin Ma and Richard von Glahn (Cambridge: Cambridge University Press, 2022), 531–64.

3. Atul Kohli, "States and Economic Development," in *State-Directed Development: Political Power and Industrialization in the Global Periphery* (Cambridge: Cambridge University Press, 2004), 167–80.

4. Yongnian Zheng and Yanjie Huang, *Market in State: The Political Economy of Domination in China* (Cambridge: Cambridge University Press, 2018).

5. Peter B. Evans, "Predatory, Developmental, and Other Apparatuses," 561–87.

6. Albert O. Hirschman, "Seven Exercises in Retrospection," *Latin American Research Review* 22, no. 3 (1987): 7–36.

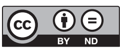
7. Ben Ross Schneider, "The Developmental State in Brazil: Comparative and Historical Perspectives," *Brazilian Journal of Political Economy* 35, no. 1 (2015): 114–32.

8. Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (1994): 62–78.

9. Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (Cambridge: Cambridge University Press, 2008), 233–98.

10. Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, 4th ed. (Princeton, NJ: Princeton University Press, 2018), xliii–xlviii.

11. For definition and analyses of the concepts "internal linkages" and "external linkages," see Peter B. Evans, "Predatory, Developmental, and Other Apparatuses," 561–87.



The publisher has made this work available under a Creative Commons Attribution-NoDerivs license 4.0. To view a copy of this license, visit https://creativecommons.org/licenses/by-nd/4.0.

Copyright © 2024 by the Board of Trustees of the Leland Stanford Junior University

The views expressed in this essay are entirely those of the author and do not necessarily reflect the views of the staff, officers, or Board of Overseers of the Hoover Institution.

30 29 28 27 26 25 24 7 6 5 4 3 2 1

ABOUT THE AUTHOR

DIAN ZHONG
Dian Zhong is a research and teaching fellow in the Hoover History Lab at the Hoover Institution, specializing in the comparative political economies of development in Latin America and Asia. She has written extensively on political institutions, regime change, economic transitions, Third World geopolitics, and China's foreign policy toward Latin America.

The Hoover History Lab

The Hoover History Lab (HHL) uses the study of the past to analyze contemporary policy issues. The lab's members research and write about how our modern world came into being, how it works, where it might be headed, and what are the key drivers of change, to enable policy interventions. HHL integrates diplomatic-military, political-institutional, economic-financial, and scientific-technological history and prioritizes engagement along three impact vectors: government officials, private-sector investors, and scholars and students.

For more information about this Hoover Institution research initiative, visit us online at hoover.org /history-lab.

Hoover Institution, Stanford University
434 Galvez Mall
Stanford, CA 94305-6003
650-723-1754

Hoover Institution in Washington
1399 New York Avenue NW, Suite 500
Washington, DC 20005
202-760-3200