THE POLITICO-ECONOMIC DYNAMICS OF CHINA'S GROWTH

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Abstract
China's rapid growth has been driven by policy reforms that significantly reduce market frictions. Policy reforms are determined by the government according to its own politico-economic considerations. This paper embeds these politico-economic considerations in a macro model of China to endogenously study government policies, market frictions, and economic growth. In the model, an elite runs the government and maximizes its own incomes, facing a political constraint: getting enough supporters. The government provides high enough incomes to state workers in order to gain their support. It also controls capital allocations in the state and the private sector to balance between keeping enough supporters and extracting more taxes from the private sector. These policies initially generate rapid growth accompanied by declining labor and capital market frictions but in the long run, keep the frictions persistent, which are harmful to growth. The calibrated model can quantitatively account for salient aspects of China's recent development and provide predictions for future dynamics. (JEL: E22 E24 O41 O43)

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