1. Introduction

1.1 THE BACKGROUND AND SIGNIFICANCE OF THIS STUDY

This study and its possible practical significance are based on the following two basic conditions.

First, in the past several years, my research has focused on the issue of a series of fundamental economic and institutional conditions that the economic development of a country depends upon. Actually, this problem has been the core issue of economic study for the past several hundred years. The basic implication of Adam Smith’s book *An Inquiry into the Nature and Causes of the Wealth of Nations* is that the source of the economic growth of a country is the division of labor, which originates from the tendency for exchange between humans, and the economic, technological, and institutional “infrastructures” that facilitate the division of labor and make it possible for people to exchange goods, services, and knowledge. Neo-institutional economists divide Smith’s “infrastructures” into property right, institution, contract, transaction cost, and other important theoretical paradigms, and make some in-depth and far-reaching theoretical innovations. For example, neo-institutional economists consistently emphasize the importance of property right protection, the national delivery of basic public goods and services, and so on (Alchian and Demsetz, 1972; Cheung, 1983; Coase, 1937, 1960; Demsetz, 1988; North, 1982, and others). The new classical economic school, represented by Yang Xiaokai, synthesizes the transportation costs theory and modeling methods of new economic geography (NEG) and develops the strength of institutional research by Adam Smith and the neo-institutional economists. It then integrates these under a so-called framework of infra-marginal analysis in order to study the relation between the decline of transaction cost (or transaction efficiency improvement) and the evolution of the division of labor, trade development, industrialization, urbanization, and economic development. This analytical framework has an important implication for understanding the process of economic development in transitional economies; however, it has some potential problems that to some extent hinder the spread of this doctrine in China.
First, this doctrine relatively lacks a theoretical and empirical analysis of China's problems and to a large extent constructs a general analytical framework for the analysis of transitional economies. Thus, it needs Chinese scholars to develop it further. In particular, this doctrine lacks an explanation for the economic development model formed since the Qin and Han dynasties and its process of dynamic evolution. This is exactly the key to understanding the economic development and process of social evolution in China today and is also a touchstone for examining whether this doctrine can successfully explain China's long-term economic development issues. Second, this doctrine constructs a so-called infra-marginal analysis framework, where the prefix “infra” means “beyond” the marginal analysis, which has annoyed economists both within China and abroad. This is why most Western economic scholarship has been very hostile and resistant to the doctrine's view, an attitude that has also affected the spread of this doctrine in economic circles and to some extent the analysis of transitional economies.

In the past ten years, on the basis of new classical economics (NCE), NEG, and neo-institutional economics, I have promoted the concept of transaction efficiency, pioneered by Yang Xiaokai, and integrated a series of economic, institutional, and technical conditions that economic development depends upon into a transaction efficiency parameter. I have then discussed the economic ties between the parameter and city formation, the evolution of urban-rural disparity, industrialization, urbanization, urban land price escalation, suburbanization, city location, the evolution of city size and a hierarchical system, urban endogenous growth, and so on. Also, I have published a series of articles and books on transaction efficiency modeling, constituent components and econometric measurement, the relation between transaction efficiency and industrialization, urbanization, transaction efficiency and urban-rural disparity, transaction efficiency and city size evolution, and so on. Further, I have carried out preliminary investigations and survey analysis of the constituent components of transaction efficiency, such as citizen transportation efficiency and governmental governance efficiency. Compared with Yang Xiaokai's infra-marginal analysis framework, my analysis is mainly a framework of marginal analysis and a neoclassical economic framework for analysing the evolution of the urbanization process. However, equally, my analysis of China's problems is also limited to China's current problems and relatively lacks the analysis of the evolution of China’s economic development pattern in history. Under the current analytical perspective, governmental governance is an essential explanatory variable that influences China's economic development and evolution in history. This is because, since the Qin and Han dynasties, the Chinese government has formed a strong pat-
tern of intervention in the economy and society, which is hereafter referred to as the governmental governance pattern in this study. Such a pattern has become important institutional background that has influenced economic development for 1000 years. This could be a basic prerequisite for scholars who study the history of Chinese economic development and the Chinese economy because they can hardly avoid it. This study tries to extend my prior analytical framework: its aim is to validate the framework’s explanatory power of the long-standing and stable petty peasant economy pattern and its vitality, the governmental inertia governance pattern that was formed on the basis of this, and the long-term change of the Chinese economy.

In my earlier work, I believed that research about transaction efficiency did not give enough attention to the importance of governance and its role in facilitating the transaction efficiency of an economy; thus, a future study direction was to analyse its impact on transaction efficiency from the perspective of governance and use it to explain China’s economic development. In this sense, my current study is an interpretation of the definition of “post-doctoral research.”

Second, right now, China has entered a so-called “anxious” period in which a variety of development problems are intertwined, various development contradictions are frequently exposed, all kinds of competing theories debut and compete for audience attention, and China’s whole external environment is changing rapidly and drastically. International experience shows that when per capita gross domestic product (GDP) is between US$1000 and 3000, this is a period in which a variety of social and economic problems frequently occur. After more than 40 years of reform and opening up (RAO), today’s China has indeed come to a critical period when we need to reflect on the past, adjust the moment, and once again be poised. During this period, it has become more important than ever to decide how to analyse the experience and lessons of China’s development during the past 40 years, how to reflect on and resolve errors and omissions in the 40 year’s development process, and how to decisively and practically identify the pace and road to take for the next 30 years’ reform. Further, it is necessary to choose what kind of economic doctrine should guide the next economic or political reform and choose which development strategy and model should guide overall development. Fortunately, sapiential senior Chinese leaders could always pragmatically and promptly identify several major problems facing China, and raise a series of important ideas to solve these problems in a timely manner. For example, on October 15, 2007, at the Seventeenth National Congress of the Chinese Communist Party, on behalf of the Chinese Sixteenth Central Committee, President Hu Jintao gave a report entitled Hold High the Great Banner of Socialism.
China’s long-term economic development

with Chinese Characteristics and Strive for New Victories in Building a Moderately Prosperous Society in all Respects. In this report, Hu stressed the need to

accelerate the reform of the administrative system and build a service-oriented government. We need to focus on changing governmental functions, straightening out relations between the government and the market, optimizing governmental structure and raising governmental efficiency, and building up an administrative system that matches powers with responsibilities, divides work in a reasonable way, fosters scientific decision-making, and ensures smooth enforcement and effective oversight. We need to improve the government responsibility system and the public service system, promote e-government and strengthen social management and public services; reduce the number of matters requiring administrative examination and approval, and standardize such procedures, and reduce government intervention in microeconomic operations; we will step up our efforts to streamline government organs, explore ways to establish greater departments with integrated functions, and improve the mechanism of coordination and collaboration between government departments; cut down levels of administration, minimize its costs, and address the problems of overlapping organizations and functions and conflicting policies from different departments.

On February 23, 2008, during the fourth Politburo collective study, President Hu reiterated the important idea that “stepping up the building of a service-oriented government is an essential step to build a harmonious society.” On February 27, 2008, the Second Plenary Session of the Seventeenth CPC Central Committee adopted “Opinions About Deepening Administrative Reform,” which gave details of the deployment of the guiding thoughts, basic principles, overall objectives, and so on for the new round of government agency reforms.

Under such an internal and external situation, we could adopt the perspective of “economic man” in modern economics (that is, the perspective of enterprises and citizens), taking into account their vital interests. We could then study their technical, institutional, and economic constraints for production, management, learning, travel, and transactions, and study how they feel about the level of governance efficiency, the quality of governance, and even the Chinese government’s governance pattern. We could also investigate how to improve the efficiency of Chinese governance and the quality of government management; how to raise the transaction efficiency of the overall economy; how to reduce the transaction costs of business and citizens when they are managing, researching, working, studying, and living; and how to reduce the dead weight loss of time, energy, money, resources, and human capital that are brought about by unreasonable, opaque, and unstable institutions, policies, and measurements. Existing unreasonable governance ideas
Introduction

and methods should be reformed. Moreover, we should break free from the millennial thinking limitation that was formed in history, especially since the planned economy era, and carry forward traditions and forge ahead into the future. Indeed, it is more important than ever to practice the scientific and human-oriented concept of development steadily and dependably.

This study is founded on this basic reality and aims to investigate the long-standing and stable petty peasant economy pattern in the history of China and its impact on government’s governance pattern. In this inertial institutional pattern, this study intends to analyse the slow reaction to the changes in the internal and external economic environment and consider why the Chinese economy was looped within dynastic alternations. Ultimately, we could understand and analyse possible ways and countermeasures for China to free itself from the current plight. Although this study focuses more on Chinese economic history, our ultimate goal is to examine the current economic realities and even the future long-term development of China.

1.2 SUBJECTS AND BASIC CONCEPTS

In order to give a comprehensive and systematic elaboration to the above-mentioned idea, it is necessary to provide a brief introduction to the subjects, and the scope of the basic concepts, that are mentioned in this study.

The petty peasant economy (PPE) refers specifically to the main economic structure in Chinese economic history that was built on the basis of thousands of small peasant households, or an economy entity that used peasant households as the main production unit. In this context, the rent and taxes that the peasants paid constituted the country’s main source of fiscal revenue in the past 2000 years. From this perspective, since the Qin and Han dynasties until 1911, China always had the status of a peasant economy. During the Guo Min Dang (GMD) period, although the importance of the peasant economy greatly reduced, and the GMD’s rule was centered mainly in big cities, the peasant economy was not completely subverted by a commercial economy. In China’s vast rural areas and in the northwest, northeast, and north of China, a large number of tenants and farmers still existed who were an important economic strand in the GMD era. After 1949, China moved into the planned economy era, and all the means of production including land, labor, and tools became collectively owned; however, the practical reality of nearly 30 years from 1952 to 1977 proved that the planned economy, regardless of the validity of peasant family production, and contrary to the individual willingness to implement
the concept of “large in size and collective in nature,” had no way out. Since 1978, China has adopted the household contract responsibility system (HCRS), whereby the land is contracted to households, and peasant households are approved as the main agricultural production unit by the state and the law. This has once again brought the petty peasant economy’s enthusiasm and efficiency advantages into play and China’s agricultural production efficiency has greatly improved as a result; consequently, this approach has become the vital economic foundation for China’s urban reform after 1985. We can imagine that if the substantial agricultural reform from 1978 to 1985 did not happen, and there was no HCRS, how could the government promote and conduct China’s economic reforms since then.

The second group of very important concepts are rule, management, governance, and governmental governance. The Chinese meaning of “rule” is the naked political, social, economic, and even personal obligatory management relations that governors have with those who are governed. For example, in feudal society, the monarch ruled people by means of military, administrative, social, taxation, migration, and other policies and institutional forms. In this context, governors had identity, personality, and political advantages compared with those they governed, and the relationship between them was unequal. Management belongs to a relatively modern concept category. In management discipline, it refers to managers’ conscious, organized, and constantly coordinating activities with regard to organizational resources and activities in order to achieve organizational goals effectively. Thus, its emphasis is on managers. If we examine the concept from a more general perspective, it seems to be a suitable way of summarizing management activities that the state has undertaken with regard to the economy and society in Chinese history. The English etymological meaning of governance is the methods or means that are used to rule a country or manage a company. These focus on both the governors and those governed, or the regulator and the regulated; and no matter what words we use, the relationship between them is inevitably interdependent and mutually influenced. As an old Chinese saying goes, “Water can carry a boat and can also capsize it.” This is an explicit explanation of the interdependent relationship between the two. From this perspective, the term governmental governance not only summarizes the interdependent and manager-based relationship between government, economy, society, and citizens in Chinese history, but also summarizes the mutually symbiotic relationship between the Chinese government, enterprises, and citizens.
With this breakthrough about concept and connotation, we can clearly see the driving force and reason in the transition from rulers or managers based in history to a modern two-way governance phase. At the same time, we can easily draw valuable experience from the practice of country governance in history and from contemporary Western literature about governance, and use it to work for us.

Specifically, governmental governance in this study is an important concept that is very different from corporate governance. It is the sum of a set of integral, interdependent policies, institutions, and ideas that the government uses to govern the economy, society, citizens, and enterprises. To put it another way, it is similar to what economists and sociologists call the relationship between government and society in connotation, or what the World Bank calls a set of regulations and systems that the government uses to deal with relations with the general public (enterprises, individuals, non-profit organizations, and so on). If we make a more detailed analysis of this concept, governmental governance in Chinese history should cover the following content: for example, the attitudes and policies related to how the government treats the petty peasant economy, the industrial and commercial class, the hoarding landlord class, the intellectuals and the bureaucrats, and the institutions and policies such as the land and tax system, the imperial examination system (IES), ideological guidelines, administrative systems, military systems, and so on. If we understand the concept from a more modern perspective, the so-called governmental governance in this book could include economic governance, social governance, political governance, and other aspects.

Another related concept is the pattern of governmental governance (PGG), which is an important concept that I propose in this study. It mainly refers to several relatively stable and essential features that governmental governance has demonstrated in a certain historical period. For example, we could define governmental governance between the Qin and Han dynasties and 1911 as a kind of centralized governance pattern based on the petty peasant economy, in which the petty peasant economy was the major economic base of this country, while Confucianism, the imperial examination system, and centralized governance constitute a stable feature of this pattern. Relative to this pattern, governmental governance since the reform and opening up could be categorized as a completely different and new pattern, which is reflected not only by huge changes in governmental attitudes toward industries, intellectuals, society, economics, and political management and policies, but also by other issues relating to administration. These changes are related to the centralized governance pattern in Chinese history; however, there are also some differences in its nature. A discussion about this will follow.
It is worth noting⁸ that the pattern of governmental governance is a concept with a relatively broad scope and has a more inclusive perspective than using class struggle to explain the rise and fall of the dynasties in Chinese history. This is because the theory of class struggle mainly focuses on the brutal rule of the ruling class, or “harsh government is more ferocious than tigers,” and the role that super-economic exploitation toward those governed plays in social vicissitudes. In fact, this argument stems from Marxist theory of the state and is a relatively politicized interpretation because it captures the most intensive class contradictions in social conflicts as an important cause to explain the evolution of feudal society. However, this interpretation has the limitation that it does not pay enough attention to the economic base, nature, ecology, other external environment factors, the administrative system, the social management system, and the economic management system, all of which cause the evolution of class contradictions. In addition, in feudal and capitalist society, class contradictions are relatively clearly defined; thus, this explanation is very useful. However, under the socialist system, class contradiction has disappeared, and a lot of contradictions have changed into the contradictions among the people. Moreover, the relation between the government and society has become between those who serve and those who are served. Thus, it is difficult to reuse this interpretation to give a coherent explanation about the lingering economic changes in China.

The concept of modern economic development that this study mentions mainly refers to the industrial and commercially based economic development pattern after the latter half of the nineteenth century, or the industrial and commercial economic model that was powered by industrialization and urbanization and came from Western Europe, especially England, after the Industrial Revolution in the nineteenth century.⁹ Correspondingly, the concept of traditional economic development in this book mainly refers to a kind of economic pattern that depends more on land, the agricultural economy, or the petty peasant economy and less on industry, commerce, and the trading economy. If seen from this perspective, China’s economic development pattern from the Qin and Han dynasties until 1911 could be viewed as traditional economic development, while after 1949, the industrialization-driven economic development pattern could be called modern economic development. It is worth noting that, under the modern economic development pattern, we could not say that the economy represented by agriculture does not exist; instead, it is reduced to a relatively minor status but still plays a vital role in economic development. For example, a very important matter in the British Industrial Revolution and the European industrial revolution was the increase of agricultural production efficiency and the increase of the surplus rate of grain, which was the
prerequisite of industrialization. In the same way, the prerequisite for the formation of ancient Chinese cities was none other than the increase of agricultural production efficiency and the increase of surplus grain. If this prerequisite had been forgotten, the British Industrial Revolution would not have taken place. Similarly, if there had been no high efficiency aspect to the petty peasant economy, there would have been no prosperous and flourishing city scene in Chinese history. If seen from this perspective, rural reform during the late 1970s in China is not foolish conduct on the part of Chinese leaders but is instead wise conduct that follows considerable examination of Chinese economic development and reality. This is because Chinese leaders know that there is no industrial reform, enterprise reform, population transformation, urbanization, and so on if there is no further increase of agricultural production efficiency.

1.3 RESEARCH METHOD, CONTENT, AND CONCLUSION

Considering the basic research methods, this study is committed to use modern economics and interdisciplinary analysis methods to analyse the economic development pattern in Chinese history and its long-run equilibrium. Specifically, in Chapter 2, the Needham puzzle is compared with Western Europe, and the question is asked why China’s economy and technology were relatively developed before the fifteenth century but declined after the fifteenth century. In discussing this issue, we use an interdisciplinary method, because for a question that is about thousands of years of economic vicissitudes, economists may not have absolute explanatory power. In the words of an old Chinese saying, “While one man guards it, 10,000 cannot force it.” On the contrary, during the discussion of this issue for half a century, in history, philosophy, the history of science, sociology, and so on all have had a right to speak. In this regard, we should humbly learn from it, but the purpose of the literature review is to learn from every side and use this knowledge for ourselves; namely, to help the resolution of this problem in the following part of this study that uses economic analysis. The treatment I use is presumably understood and recognized by academic colleagues because the purpose of all social science is to absorb advantages and use them. In Chapters 3 and 4 we mainly use this analytical framework and methods of modern economics to analyse the economic development and evolutionary problems in China’s history and reality. In Chapter 5, we explore the dynamic evolution of the Chinese pattern of governance from the historical evolution angle. In Chapter 6, geographical, ecological, and natural factors play
a key role again and form important exogenous factors that have affected the Chinese governance pattern. In Chapter 7, we use a cross-country comparison to study the influence and impact of the surging reforms outside China. In Chapters 8 and 9, we again use the so-called empirical analysis. The integrated use of these methods reflects the instrumental methodology in social science.

From the perspective of the main content of this study, we can broadly divide this book into ten chapters. Following the current introduction describing the origins and basic framework and arrangements of this study, Chapter 2 is a literature review in which we review the interdisciplinary discussion about the Needham puzzle for the past half-century. In this chapter, we also compare, and comment on, some theoretical hypotheses about this issue in many disciplines, review the methodological bias of existing hypotheses, and finally present some possible frameworks that could be used in economics to explain the long-term evolution of Chinese economic development. In Chapter 3, from the micro perspective of the behavior of peasant families, we analyse the features of such behavior in the process of maximizing output, and consider the differences between this behavior and capitalist enterprises in the Western sense and its impact on China’s economic development model. Thus, we could find some possible explanations for puzzles in Chinese economic history from this micro level, namely, that of the petty peasant household. In Chapter 4, we discuss the formation and consolidation of China’s petty peasant economic pattern from a macro perspective, its comparative advantage in economic efficiency, its important position and huge impact in Chinese history, and the framework and inertial characteristics of the governance pattern that was formed on the basis of it. Chapters 3 and 4 are the main theoretical parts of this study. Chapter 5 offers further proof and explanations in relation to the two prior chapters. Chapter 5 also analyses the historical practice of Chinese governmental governance, from the perspective of the dynamic evolution of the Chinese governance pattern, in order to reveal the inertial pattern of Chinese governmental governance and the fundamental reason why the centralized governance pattern succeeded compared with other governance practices. Chapter 6 discusses the dramatic climate changes in the Chinese climate and natural environment that have occurred since the tenth century and their impact on the Chinese-style centralized governance pattern. In this regard, during the Song dynasty, the government was unresponsive and lacked related collective action, which means that the pattern of centralized governmental governance had begun to show its weakness. Chapter 7 discusses the rapid rise of Western Europe in the sixteenth, seventeenth, and eighteenth centuries and the challenges that it brought to Chinese-style governmental governance. The
period from the tenth century to the eighteenth century was a transitional period for China from prosperity to decline, when the Chinese-style governmental governance pattern gradually eroded while the Western Europe governance pattern continued to show its superiority. Tremendous changes occurred in the Chinese internal and external environments, but the inertial pattern of Chinese-style governmental governance still continued or was even enhanced. This mismatch between the economic base, social reality, and governmental governance was the root cause for why China gradually declined from a strong country to a weak one. Analysing this chapter from the perspective of Marxian economics, we argue that the economic base determines superstructure, and superstructure reacts on the economic base. The analysis of this chapter supports the second half of the Marxian viewpoint; namely, the inertial pattern of Chinese governmental governance hindered the further development of the economic base. Chapters 3 and 4 support the first half of the Marxian viewpoint; namely, in the long run, the point that Karl Marx makes is correct: the type of economic base determines the type of superstructure. However, once the superstructure is built up and consolidated, changing it is very difficult and costly; thus, the superstructure only reacts on the economic base in the short run.

Chapter 8 discusses the empirical evidence of the relationship between the Chinese governmental governance pattern and long-term economic changes. Although we lack sufficient econometric tests on the relationship between them, the available information still supports my view that the inertial pattern of Chinese governmental governance, namely, the fogeyism of the Chinese government’s governance either in terms of technology, institutions, or efficiency, was the fundamental cause of China beginning to lag behind the West after the fifteenth century. Chapter 9 discusses why the great change in Chinese governmental governance was the fundamental cause of the great Chinese economic miracle over the past 40 years from the perspective of the past 40 years’ reform and opening up. I believe that 40 years of reform and opening up has not proved that the Chinese people are more intelligent than the people of any dynasty in Chinese history, or that the technical progress over the 40 years is more advanced than other technological progress in the history of China. On the contrary, the reform and opening up has fully proved that as long as the government are shrewd and pragmatic enough to launch appropriate institutional reforms in a timely manner and in accordance with the economic development situation, abandon those institutions and governance obstacles that hinder the enthusiasm of people and businesses, and bring the potential and enthusiasm of the economy, enterprises, and people into full play, then we can naturally expect a good economic development performance in the end. Chapter 10 gives the general conclusion of this book, discusses the
future of Chinese governmental governance, and predicts the trend and character of the governmental governance pattern in the future.

From the perspective of the main conclusion of this study, we can generally reach the following basic conclusions.

First, the long-standing physiocracy pattern of economic development in the history of China and the stable “China Equilibrium” that it brought had systematic and institutional sources, which cannot be clearly understood by any single factor. Thus, any attempt to use the analytical method of a single perspective or a single factor without taking into account the merits of other analytical methods is not worth the effort. More importantly, this may not be helpful in understanding China’s past, present, and future. However, it is worth noting that this study does not oppose the analysis of this issue from a single perspective; after all, a specialized study can improve people’s awareness and understanding of the issue.

Second, the long-standing physiocracy pattern of economic development in the history of China was influenced by Chinese geography, topography, climate, ecology, and other exogenous factors. On this basis, it formed a comprehensive inertial governmental governance pattern that included Confucianism-dominant ideology, officials who believed and practiced physiocracy, the imperial examination system, the tax system, government administration institutions, and so on. Moreover, China’s economic environment and the external environment have gradually changed since the tenth century; however, the inertial governmental governance pattern did not make suitable, reasonable, timely, and adequate adaptations and upgrading in accordance with the changes in the internal and external economic, political, and technological environment. As a result, China’s domestic economy and natural environment underwent tremendous changes, and the outside world was not as it used to be, but the old inertial governmental governance still continued. The government at that time did not undertake timely adaptations to the governance pattern and ideas, and introduce innovations; instead, it tried to set the rapidly changing realities in the context of the original carriage. Thus, the mismatch between the horse and carriage hindered China’s economic development significantly. Consequently, China’s economy stabilized in a “low-level equilibrium trap” that was high at the beginning but later became lower. This approach is the important institutional root cause to understanding China’s economic development and social changes over the past 1000 years.

Third, since the reform and opening up, China’s economic development has been called a miracle to some extent. The reason is that the Chinese government’s governance pattern has undergone a major transformation. China’s government has turned from the relative openness of the first half
of history (221 BC–AD 1127) and relative seclusion of the second half (1279–1911) to comprehensive and bold opening up (1978–2018). The government has turned from physiocracy to a situation where “agriculture and commerce are of the same importance,” from the relatively free flow of the population in the first half of Chinese history, “coding the households according to people’s birthplace,” and then relatively little flow of the population, to gradual free flow after the reform and opening up. In other words, the biggest transformation of the Chinese economy since the reform and opening up has been the transition of the Chinese governmental governance pattern. This has turned from “respect of ancestors’ traditions” and “respect of Confucian orthodoxy” in history to realism and scientific development, which represents a move from the inward to the outward, from conservation to innovation, and from “cutting the foot to fit the shoe” (forcing something to fit) to being practical and realistic.

China’s traditional culture, the moral bottom line of society, citizens, social habits and so on, has also been impacted and is an issue that is important and worthy of discussion.

Fourth, where is the future of China’s economy? We do not have powers of clairvoyance, but we do have a clear understanding of, and judgment about, history and reality; namely, China now has diversified economic sectors. For example, in 1998, Chinese private enterprises accounted for 27 percent of GDP, their importance was secondary to the state-owned economy, and they were the second largest sector of the national economy. As of the end of 1999, China’s private enterprises only obtained 1 percent of total bank loans. At that time, the total number of listed private enterprises in the Shanghai and Shenzhen stock market did not exceed 1 percent of the total listed companies. In 2008, Chinese private enterprises accounted for more than 65 percent of GDP and represented 70–80 percent of the added value of China’s GDP and 65.24 percent of the gross value of industrial output. The profits of private enterprises also accounted for 57.98 percent of the national total profits. Moreover, private enterprises created 80 percent of the new jobs in the country, 75 percent of total innovation, 65 percent of the total inventions and patents, and 80 percent of total new inventions and new products; however, the state-owned banking system lent less than 10 percent of its loans to private companies.14 We should bear in mind that the Chinese government did not give all the super-national treatment that foreign enterprises can enjoy to domestic private enterprises. It was not until 2010 that the Chinese government launched the “36 Articles for the Non-State Economy”; for example, foreign banks can undertake some banking and offer other financial services in China, but Chinese private enterprises still suffer from the pain of ischemia in lacking enough private banks. In addition,
foreign hospitals and state-owned hospitals have combined their ventures to offer medical services in China, but why are there still a few private hospitals that can enjoy the same national treatment as the state-owned hospitals? Also, China’s education system still bears the deep imprint of the planned economy, China’s social security system needs to be improved, China’s research and development sector are still more monopolized by state-owned agencies, and so on. All these necessitate a return of China’s governmental governance to the people-oriented state as soon as possible, and the prompt embarkation of the Chinese government on the broad road of service-oriented government, both of which are changes that could make immeasurable contributions to the long-term development of China’s economy.

1.4 STUDY INNOVATION AND LIMITATIONS

The innovation of this study lies in the way that we study Chinese economic evolution from a new perspective; namely, the perspective of the pattern of governmental governance based on the petty peasant economy. In relation to current studies of Chinese economic history, this study does not adopt the method of so-called dynastic history; namely, analysing the evolution of economic development in each dynasty first and then forming a general impression of the evolution of economic development as a whole. Instead, this study analyses Chinese economic history over the past 2000 years as a whole from a perspective of how rulers govern the country and sustain dynastic ruling, which is a comprehensive perspective of social, economic, political, and managerial aspects, and so on rather than any one angle.

In relation to other studies, taking this approach has two advantages. First, it helps penetrate into the common pattern of dynastic governance in Chinese history and open the paradox of the Chinese economy in the long run. In particular, governmental governance in each dynasty is supposed to build itself on certain natural, geographical, economic, cultural, and political traditions. According to the principles of Marxian economics, the economic base determines the superstructure, while the superstructure reacts on the economic base. However, the situation in Chinese history is very different from this principle. As for the pattern of governmental governance in Chinese history, the rulers make full use of the natural and economic condition first, then build a stable alliance with ideology and wise intellectuals, and grasp the economic base of a viable petty peasant economy in their hand tightly as a result. At the same time, governments kept an eye open on local economic development, military development, and knowledge progress outside the system. If it was deemed good for the
state, it would survive; otherwise, it would be suppressed by the state. Thus, at the macro level, we find that the pattern of governmental governance always kept a dynamically stable balance, even though the Chinese economic base kept changing over several thousand years. We also find that the Chinese empire was very different from the West and would resurge again and again in the economy by copying the pattern of governmental governance, even though it would wither because of a temporary weakness in the economy and because of military force and external invasion. The second advantage is that it is easy to find the turning point, or the very important transformation of development, from a long-run perspective and see the forward direction of the Chinese economy more clearly.

However, taking the approach advocated here also has some limitations. For example, some readers may find specific examples to illustrate the impracticality of this framework and argue that this analysis uses a constant measurement to measure complicated and diversified reality. My point is that every analysis has its advantages and disadvantages; however, if one analysis or approach is helpful for understanding the essence of a problem, why not try it? This is the difference between scholars and the ruler. As a scholar, the most important thing is to find something new, or to explore a question that has never been explored. We do not need to worry about whether an argument, a model, or a hypothesis put forward by us several years ago was wrong or not several years later. If it is wrong, just correct it; if it is right, just applaud. This is the way of undertaking research for a scholar. However, as a ruler, or the person managing a country, a city, or a county, you cannot take the risk of brave innovation or adventurous exploration in governance because this brings uncertainty to development and the future. Nonetheless, there is a dilemma because if a country does not pursue innovation and development, it loses ground and becomes the victim when facing, or competing with, other countries.15 This indicates the extreme importance of cooperation between scholars and officials, in which the former conduct theoretical innovation and explore the possibility of new knowledge, technology, policy, and institutions, thereby reducing the possibility of blind experiments by the country, while the latter focus on applicable policy and viable institutions through the means of using the positive aspect of theoretical exploration and discarding the negative aspect according to the situation.

If we see theoretical innovation through this lens, it is recommended that researchers remember the following words written by Zhao Gang, a famous economic historian:

Many scholars address the importance of careful study of a small question. This is in general correct given the following two conditions. First, the time
China's long-term economic development

input in this careful study and its result should be commensurate, otherwise too much effort in a small question is not necessary and is even a kind of waste of human capital, because academic research is not handicraft, in which too much work but little progress is not supposed to be quality work. Second, after careful study of a small question for some time, it is necessary to synthesize the small findings in order to find the whole picture. Many laboratories may test the leaves in a forest; but without knowledge of the forest as a whole, the tests are not a good example of forestry study.16

If seen from this perspective, it is possible to regard this study as a synthesized work rather than a carved handicraft. Certainly, criticism is warmly welcome. The next thing to do is to experience my exploration of the forest of Chinese economic history.

NOTES

1. Adam Smith indicates in his book *An Inquiry into the Nature and Causes of the Wealth of Nations* that the division of labor is subject to exchange capacity and market size; or to put it another way, the division of labor is affected by many factors such as the natural environment, location, geography, and infrastructure. In fact, this point is already connected to the concept of infrastructure to some extent. However, Hall and Jones clearly defined the so-called “social infrastructure,” by which they indicate a series of basic institutions, technologies, and conditions such as the natural environment, geographical conditions, resource endowments, roads and transportation, and related technology for economic and social development. For details, see R.E. Hall and C.I. Jones, “Why do Some Countries Produce So Much More Output Per Worker than Others?” *Quarterly Journal of Economics*, February, 1999, 83–116.

2. Yang Xiaokai wished to study Chinese economic history from the perspective of the new classical economics and wrote the unpublished “Notes on China’s Economic History in a Hundred Years” before his death. However, his explanation only covers economic history over the past one hundred years rather than Chinese economic history in the past 2000 years, which is our focus in this book.


Introduction

Cities in the Yangzi Delta,” supported by the Shanghai Shuguang Project 2008 and the Shanghai Pujiang Human Resource Project 2009.
5. Yang Xiaokai wished to study Chinese economic history from the perspective of infra-marginal economics. I learned a lot from Professor Yang’s book. The contents of this current book are actually an explanation of Chinese economic history from another perspective. Certainly, this is my exploration in which I would like to invite more thinking and exploration in this field.
7. Thanks are due to Tian Guoqiang, who reminded me that some important definitions were necessary for readers in the defense of my post-doctoral thesis on June 20, 2009.
8. Thanks are due to an anonymous referee of the Shanghai Gezhi Publishing House who raised questions on the difference between the class struggle hypothesis and governmental governance.
9. Thanks are due to Guoqiang Tian, who reminded me of this concept in my post-doctoral defense at Shanghai University of Finance and Economics, June 20, 2009.
10. For example, Paul Bairoch, a famous economic historian, wrote in his book Cities and Economic Development in 1988 that an increasing amount of evidence shows that it was not cities that were formed before agriculture but agriculture was formed before cities. The rise of agriculture unavoidably aroused the urbanization process. Certainly, urbanization without population agglomeration and surplus food provided by agriculture could not happen. However, the rise of agriculture was the engine that pushed urbanization development sooner or later. Bairoch discussed the relationship between the increase in agricultural production efficiency brought about by deep agricultural change and later industrialization in another section of his book; for example, p.156.
11. Similarly, Zhao Gang, a famous economic historian, discussed the importance of agricultural development to city formation and development in his discussion of ancient cities in China. For details, see Zhao Gang, Symposium on Chinese Cities’ Development History, Beijing: Xinxing Press, 2006.
13. In fact, China’s decline as a whole, which started in the fifteenth century, only occurred because of the superiority of China in ancient times. This is why the Chinese economy was still the biggest economy in the world until the 1820s and why China’s GDP still accounted for 32.9 percent of that of the whole world. However, technology, institutions, etc. in China all approximately attained their peak in the fifteenth century.
15. Deng Xiaoping once discussed the relationship between stability and development this way: stability was more fundamental, while development was a very important engine, or was actually a kind of stability and innovation to some extent, and stability without development would be unstable. He said that China should keep a good balance between them.