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Development and Underdevelopment: Testing Historical-institutionalist Explanation

*“From a Portuguese colony to a “miracle economy””*

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## **Introduction**

While the world was counting down the days to July 1<sup>st</sup>, 1997, the day of Hong Kong's return to the People's Republic of China (PRC), the same political developments in neighboring Macao were mostly neglected by the world's mass media (Porter, 1993, p.10). After the return to China in 1999, there were no high expectations of economic growth or development in the little enclave. However, after the handover, the small region did not fade away in the shadows of its fast growing neighbor Hong Kong nor was it absorbed by China as just another trading region. Instead, Macao started to play a significant and unique role in the development of Southern China (Porter, 1993, p.10).

From the sixteenth century, the Portuguese established themselves in Macao, remained there for four centuries, and implemented a system of shared sovereignty (Zeng & Hung, 2012, p.541). In 1999, Macao returned to China and became one of China's Special Administrative Regions (SARs). At the Macao handover ceremony, the former Chinese president Jiang Zemin by saying: "Macao, now back in the embrace of the motherland, will surely have an even brighter tomorrow" (Chinese president hails new era, 1999). From an economic perspective, the brighter tomorrow has indeed become reality for the region of Macao after its return from Portugal to 'motherland' China (Sheng & Tsui, 2009, p.419). Between 1999 and 2016 its Gross Domestic Product per capita (GDP) increased from 6458 USD into 70,160 USD, which is among the highest GDPs in the world economy. In less than two decades after the handover, Macao's Gross GDP per capita even reached three times that of Hong Kong and nearly the double of Singapore's (Zandonai, 2015, p.10). Due to its GDP, Macao developed itself as one of the 'economic miracles' of the East.

The main feature of Macao that differentiates the region from other Chinese cities is its unique status of being the only place on Chinese territory where gaming and casinos are legalized. Consequently, the backbone of Macao's economy is its gaming industry, which has now developed into a highly profitable industry, even exceeding Las Vegas in being the world's most profitable gaming city. However, despite the fact that the Portuguese had legalized casinos already in the 19<sup>th</sup> century, it took more than forty years after the legalization of the gambling industry that Macao witnessed the booming growth of its gaming industry (Sheng & Gu, 2018, p.72). The aim of this paper is to provide a detailed study on Macao's economic and institutional development and identify and understand the reasons why Macao experienced an economic takeoff in its casino industry after its handover to China.

This essay will explore specifically whether either the theory of Acemoglu and Robinson, or the dependency theory are most adequate in explaining the development of Macao after its handover to China. The theory of Acemoglu and Robinson explains differences between development among countries and regions, based on differences in their economic and political institutions. The authors argue in *Why Nations Fail* (2012) that inclusive institutions will cause strongly developed states that experience economic growth. In contrast, exclusive institutions will cause underdeveloped states, with weak economies (chapter I). According to these authors, institutions are created by, and developed as, a consequence of a state's historical development. Macao provides an unusually interesting case in context of this theory, considering its colonial history that granted the region Western-style democratic institutions, combined with the Chinese institutions based on the conservative Chinese political culture (Sheng, 2016, p.521).

In contrast to Acemoglu and Robinson, who explain differences in development by institutions as internal factors, the dependency theory explains economic development by dependency in terms of external political-, economical- and cultural influences on national development policies (Ferraro, 1996, p.59). This paper will particularly emphasize the dependency perspective on how tourism affects small economies. It is relevant to use the dependency theory in explaining the case of Macao's economic growth, since Sheng (2011) describes the ongoing economic growth in Macao as a foreign-dominated growth bubble (p.115). Macao's GDP growth is highly dependent on its relationship, especially a tourism related relationship, with other countries and mainland China (Chen & Wu, 2015, p.296).

## **Research design and Methodology**

Since this paper aims to explain the post-colonial economic takeoff of Macao, it is designed as an explanatory case study (de Vaus, 2001 p.2). The main question is whether the theory of Acemoglu and Robinson or the development theory most adequate in explaining Macao's economic growth after the return to China? To answer this question, this paper will use and compare the two prominent development theories to analyze Macao's economic casino industry boom. The first theory that will be discussed is the theory of Acemoglu and Robinson (2012). As mentioned, in this theory, economic growth is thought to be determined by the character of a country's institutions. It is relevant to discuss Macao's economic growth in view of this theory because of Macao's institutional development is a unique blend of Western and Chinese influences (Sheng, 2016, p.521). An alternative theory to apply to Macao's economic development is the dependency theory. This theory implies that the international system consists of traditional-, non-industrialized countries and modern-, industrialized countries, where

the former is called the 'periphery' and the latter the 'core' (Wallerstein, 1974). This theory is relevant to take into consideration when discussing Macao's case because, according to the dependency theory, economic growth of peripheral countries can be explained by development under dependence, which means that economic growth occurs due to external influences on economic-, cultural-, and political national policies. This paper will emphasize in particular the view of dependency theorists on tourism dependent growth in small economies. The international system of tourism will keep developing countries dependent on developed countries that provide foreign capital and tourists (Decosta, 2009, p.94). This has been the case in Macao, due to the fact that the backbone of its economy is the gaming industry, which is highly dependent on foreign capital and tourism.

The dependent variable in this study is Macao's economic growth, and will be measured by the GDP as an objective variable. In the dependency theory, economic growth is determined mainly by the international relationships between countries, particularly, if a country is part of the core or periphery. In the theory of Acemoglu and Robinson, the variables that determine economic growth are the institutions of a country which have extractive and inclusive characters, which will be explained in the second chapter. In this paper, the term 'institutions' refers to the "formal regulations and informal norms in political, economic and social systems, these regulations and norms structure policy outcomes and shape the political incentives, normative values and policy actors" (Chou, 2015, p.23) (Acemoglu & Robinson, 2012).

This study will use a qualitative case study method, which allows us to examine the specific context of Macao's economic development. Through a detailed literature analysis, describe the contemporary events of Macao to understand the postcolonial economic development of the region, and examine Macao's political and economic events, during the Portuguese era and Macao as a SAR of China. The first chapter will provide a theoretical framework in which the two development theories will be discussed. The second chapter will give an empirical overview of the institutional and economic development of Macao during the Portuguese era and the handover to China. As Godinho argues, the modern history of Macao must be seen in connection with the settlement of the Portuguese and the policy choices made by their administrations in interaction with the Chinese authorities and community (2012, p.107). This chapter will therefore give a detailed empirical overview of the crucial policy choices made by Chinese and Portuguese cooperation that resulted in the economic prosperity of today. Finally, the third chapter will assess the value of the development theories of Acemoglu and Robinson versus the dependency theory, in explaining the rapid economic growth of Macao after the return to China.

## **Chapter I: Theoretical framework**

### **The theory of Acemoglu and Robinson**

The first theory on economic development that will be discussed is the theory of Acemoglu and Robinson. In their book “Why Nations Fail”, these researchers attempt to answer the question of why some nations economically fail and why other nations succeed economically. Their explanation is based on the institutional differences created by the differences in historical development of countries. The authors imply that political institutions influence the power relationships of a society, which will affect the development of the character of the economic institutions in a state (Acemoglu and Robinson, 2012, p.91). In other words, economic institutions are endogenous and are determined as collective choices of a country’s society. However, not all individuals and groups in society will prefer the same set of economic institutions so the group with the most political power, is likely to secure the set of economic institutions that it prefers. Due to this argument, the theory of Acemoglu and Robinson implies that political power influences the economic institutions of a country.

Economic institutions in society determine economic outcomes because they influence the structure in society (Acemoglu, Johnson & Robinson, 2005, p.389). As a result, the character of the economic institutions, that were formed and developed over time, determine the inequality among countries today. Acemoglu and Robinson make a distinction between inclusive and extractive political and economic institutions (Acemoglu & Robinson, 2012, p.429). Extractive political and economic institutions keep poor countries poor, and hold back the economic development and growth. Extractive political institutions keep power in the hands of a few and put no boundaries to this power, whereby the non-beneficiary part of the population stays poor and unprotected. This form of extractive political institutions will create extractive economic institutions. In extractive economic institutions, there is no protection of property rights and there are no checks and balances between institutions. Therefore, individuals and corporations are unlikely to invest in and innovate the economy because of economic uncertainty, which makes it impossible to generate sustainable economic growth in states with extractive economic institutions (Acemoglu & Robinson, 2012, p.31).

On the contrary, Acemoglu & Robinson imply that inclusive political institutions will cause economic inclusive institutions that will stimulate economic growth. One of the main features of inclusive economic institutions is the ability to participate in the economy for the

whole population of a country. Because of the mass participation, there are incentives for individuals to invest and to develop and use their skills. These inclusive economic institutions are created because of the presence of inclusive political institutions. In inclusive political institutions, decisions are made by the rule of law and the population is protected from power abuse by the political and economic elite by checks and balances.

Rich countries of today became rich because of the presence of inclusive political and economic institutions, which created an upward spiral towards economic growth (Acemoglu & Robinson, 2012, pp.306-317). Therefore, the maintenance of the rule of law, protection of property rights, protection of expropriation and plural decision making in inclusive economic institutions, are key to driving economic growth in a country. In short, economic institutions matter for economic growth because they shape the incentives of key economic actors in society. Besides, economic institutions influence the investments in physical and human capital and technology, and the organization of production (Acemoglu, Johnson & Robinson, 2005, p.389).

In Acemoglu and Robinson, the authors use the situation in Egypt in the 90s to illustrate the consequences of extractive political institutions on the economic growth (Acemoglu & Robinson, 2012, p.395). Egypt was run as a quasi-socialist society in which the government played a central role in the economic development. There were attempts to make the economic institutions more inclusive but it did not change much because of the unstable combination of extractive political institutions with little inclusivity of the economic institutions (Acemoglu and Robinson, 2012, p.399). “The inevitable outcome, which came during Mubarak’s reign, was that economic institutions became more extractive, reflecting the distribution of political power in society.”; in this citation, Acemoglu and Robinson argue that it is a likely outcome that the economic institutions become more extractive because of the extractive political power in society.

However, although Acemoglu and Robinson argue that economic growth is an outcome of inclusive institutions, the authors also argue that rapid economic growth is still possible under extractive institutions. This has been the case in China, as China is well known for creating economic inclusiveness under political extractiveness. In fact, despite many imperfections in its economic and political system, China has been the most rapidly growing nation of the past three decades (Acemoglu & Robinson, 2012, p.69). The country has made the switch from economic policies that caused enormous poverty to policies that encourages economic growth by free market incentives (Acemoglu & Robinson, 2012, p.69). This is achieved by Deng Xiaoping and his allies, which radically changed the direction of the Communist party. The authors

impose that political decisions determined the switch from communism and toward market incentives in China” (Acemoglu & Robinson, 2010, p.96). In this view, China is an example of economic growth being determined by political institutions. The Beijing government maintains its authoritarian political rule with the Communist party, although it created free market institutions and encouraged private entrepreneurship. There is no sign of China making the transition to inclusive political institutions (Acemoglu & Robinson, 2012, p.99). According to Acemoglu (2013), the reason for economic growth under extractive institutions is that it will create output and resources to be extracted, particularly to the elite. The elites will control the productivity activities and the output of the production will cause direct benefits to the ruling elites (Acemoglu, 2013). In particular, the emergence of relatively inclusive economic institutions need the precondition of a secure feeling of the elite in their positions, their fear of losing control has to be minimal.

In the era before the economic reforms, China faced poverty because of the extractive economic institutions that kept its economy weak. China’s economic system was led by a socialist central planning under which all economic decisions were centralized and taken by the Chinese authorities (Lei & Yao, 2008, p.346). The Chinese elite was afraid of technological and institutional change, this fear held back China in its economic development. After the economic liberalization reforms of Deng Xiaoping, the Chinese experienced economic growth under extractive political institutions, however, with a more inclusive perspective on economic institutions. This is, according to Acemoglu (2013), mostly due to a catch up during a prosperous time, attributable to technological and geopolitical forces. Hence, the turning point of the Chinese economic growth comes from economic reforms that relaxed the central planning and allowed private enterprises to participate in the free market and respond to market incentives (Acemoglu, 2013).

### **The dependency Theory**

As an alternative theory to Macao’s economic growth, the dependency theory will be discussed in this part. The dependency theory explains economic development with view on a country’s relationships within the international framework. From a dependency theorist perspective, developing countries have internal and external, institutional and economic structures that keep them in a dependent position relative to developed countries (Holden, 2004, p.113). States are parts of the “world economy” and are linked through functional relationships for their mutual benefit and maintenance (Wallerstein, 1974; Decosta, 2009, p.65). This system is illus-



trated by “core” that represent Western developed countries and the “periphery”, which represent the underdeveloped “third world” countries (Wallerstein, 1974). The relationship between core and periphery reflects an international division of the process of transferring surplus from the periphery to the core (Wallerstein, 1974; Decosta, 2009, p.65). Therefore, dependency theorists believe that the external and internal political, economic and institutional structures of developing countries keep them dependent on developed countries (Decosta, 2009, p.65).

This paper will emphasize the dependency theory perspective on tourism, since Macao’s economic growth is heavily dependent on its gambling tourism (Chapter II). Tourism has been an integral component of economic development strategies in developing countries due to the industry’s potential to increase tax revenues, attract foreign investment and create new jobs (Scheyvens, 2008, p.22). The dependency theory has a big influence on tourism research, with respect to the way in which the international tourism structures reflects the historical patterns of colonialism and dependency (Sharpley, 2000, p.7). The system of international tourism can be seen as an example of the dependent relationship between the core and the periphery (Decosta, 2009, p.65). The development theory explains the effects of tourism on development as financial dependence of periphery countries on tourists from core countries, whereby the periphery countries, in the long term, will be trapped in a global system over which they have little control (Decosta, 2009, p.87). Foreign trans-national corporations will control the economy, in order to finance tourism development in the host country (Decosta, 2009, p.87).

Also according to Britton (1996), small economies will become structural dependent on core countries as a consequence of increasing reliance on foreign tourists and foreign corporations (p.6). The tourism industry is characterized by the domination of foreign ownership, and therefore reinforces the characteristics of structural dependency and imposes dependent development on peripheral destinations (Britton, 1996, p.107). According to Hao (2008), the high level of dependence in Macao’s economic growth can be seen in Macao’s heavily dependent status on foreign influences that are willing to spend and invest their capital in Macao’s casinos. This fits the view of the new dependency theorists, which assumes that the interests of the exploiter and the exploited can overlap (Dos Santos, 1970, p.233). In other words, when the interests of the exploiter and the exploited overlap, development is possible even when there is dependency (Hao,2008, p.2) In this view, Scheyvens (2008) argues that despite the potential of the tourism industry to create wealth and economic growth, dependency on tourism, is likely to create enormous challenges in overcoming inequality and poverty.

Dependent development has been the case in Macao according to Hao (2008) because, despite its dependence on foreign actors, there is economic development because of the high

revenue taxes from the casinos as the main source of income of the Macanese government (p.3). Despite being dependent on foreign capital, the casino industry development generate wide economic benefits to the local economy. The casino industry boom has positive effects on the economic growth, per-capita income, overall employment and poverty alleviation. Besides, service sectors as finance, real estate and construction work benefit from the casino industry growth (Sheng & Gu, 2018, p.73).

Also, according to Sheng & Gu (2018) Macao is an example of a tourist dependent ‘small state economy’. Small state economies can be heavily dependent on international tourism. A ‘small economy’ is defined by Sheng & Gu (2018, p73) as a price taker in the international markets, featured by the smallness of population, land area, and GDP. As a consequence, small economies typically end up specializing in certain sectors, which offers a way to overcome size constraints. By specializing the tourism industry, other parts of the economy will decline, such as the manufacturing industry. After the liberalization of the gaming industry (Chapter II), casinos received a preferential treatment by the government. As a consequence, traditional businesses, particularly in the manufacturing industry, have been abandoned (Sheng, 2017, p.100). Scheyvens (2008) argues that in many small developing states is the tourism industry the only sector that experienced growth over the recent years. As a consequence, small economies are likely to become tourism dependent in terms of income gained by tourism as a percentage of a country’s GDP (p.22). Although, the status of Macao as Asia’s gaming leader continues, new gaming destinations would challenge this status and could easily destabilize its economic growth. The concern of the Macanese population is growing due to the fact that only little attention has been paid to Macao’s need to diversify its economy by creating an open environment that stimulates the emergence of a variety of new industries and mitigate the risk of economic collapse as a result of its narrow focus (Sheng, 2017, p.104).

## **Chapter II: The features that led Macao into today’s economic prosperity**

### **Macao’s democratization process**

The first feature that makes Macao an unusual part of China is the fact that it has democratic institutions. Macao can be considered as a “transitional” society, which went through political, legal and administrative changes (Lo, 1995, p.1). The democratic reform of Macao has been crucial to its economic development because the democratic status of Macao withheld the region from being absorbed by China after the handover. The establishment of democratic

practices and institutions started in the late 1970s under Portuguese administration. According to Apter (1973), given the fact that Macao's democratization process started during the Portuguese era, colonialism in Macao has not been necessarily a bad phenomenon in which the colonizers only exploited the people, but was also conducive to the development of a representative government, nationalism and efficient administrative process (Apter, 1973). Lo (1995), describes Macao's undergoing transition as a long process where the political institutions in Macao will be modelled to western-style democracies for at least, the next decades. The view of Lo (1995) is in line with the modernization theory, which considers development as a linear path that lead to the transformation from traditional to modern society in a political, economic and social way.

Almost five centuries ago, the Portuguese reached the south China coast and established a permanent settlement in Macao. From the beginning as a Portuguese colony, Macao could be considered as a wealthy European settlement and a key link in the East Asian trade network (Porter, 1997, p.282). Besides, since the Portuguese era, Macao has been not only a financial link, but also a cultural and commercial portal between the east and the west (Metaxas & Folinas, 2016, p.7). The emergence of two important features of a modern society took place in Macao: the process of democratization and political mass participation. Yee defines democratization as:

a process where the civil liberties of individuals and groups are protected by law; free, open, and fair elections are held; mass participation and political parties are free to develop, respectively; political institutions are organized in such a way as to provide checks and balances among themselves (Yee, 2005, p.227).

China encouraged the democratic reforms in Macao because of the fact that a significant part of the Macanese population was pro-China and through democratic institutions, the pro-China Macanese could influence the Macao administration in favor of China (Lo, 1995, p.27). As a result, the Portuguese administrators in Macao succeeded in democratizing the composition of political institutions. The first success of Macao's democratizing process occurred when the Portuguese colonial administrators introduced direct elections to one third of the seats in the legislative institutions. The Organic law of Macao, established in 1976, stipulated that the legislative assembly would have seventeen members of which six should be directly elected, six indirectly elected and five appointed (Lo, 1995, p.31). The new legislative election was an important starting point in the citizen participation process of Macao. Citizen participation in

politics is a crucial indicator in the process of democratization. This introduction of direct elections of the legislative institution was due to the Portuguese determination to give substance to their claim of a democratized Macao.

The political system of Macao developed features of democratization that are mentioned above by Yee (2005). The Macanese are free to form political associations and parties and the rights of the Macanese are protected by Macao's Basic law, which provide the checks and balances between the legislative and executive power (Yee, 2005, p.227). Despite the presence of these crucial elements of democratization, Yee argues that Macao developed into a partial democracy (2005, p.227). A partial democracy defines a political regime in which the accountability of government to citizens is limited, the right to freedom of expression and access to information are restricted and independent associations and organizations exist but are carefully monitored by the government (Yee, 2005, p.277). Despite the fact that, being one of China's SARs, Macao constitutionally enjoys an independent legislative, executive and judicial power from Beijing, the region is characterized by the lack of political dialogue, imbalance of power at the policy making level and the actual governing of Macao is strongly led by the core beneficiary group and the corporate elite of Macao (Sheng & Tsui, 2009, p.423).

At first, China made a promise of non-interference or minimal intervention in Macao, as stated in the principle of 'One country two Systems'. However, as argued by Yee (2005), because of Macao being a partial democracy, Beijing does intervene in Macao's economic policy (Sheng, 2017, p.103). For instance, in 2008 when the Macanese government changed the laissez-faire economy in a regulated economy, the government intervened in the free-market by explicit instructions from the Beijing government to control the growth of the gaming industry (Sheng, 2017, p.103). On the 22th of April 2008, Macao's Chief Executive announced that the number of gaming licenses would be frozen and that no new casinos would be built in order to prevent further overheating of Macao's economy. Not only in an economic, but also in a political perspective the Chinese thus intervened in Macao. Another example of political interests of China practiced in Macao is given by Sheng and Tsui (2009) that argue: "Macao is a place to exhibit and spread propaganda of China's openness, and to show how capitalism and democracy can coexist with socialism. This is conducive to the possible future reunification with Taiwan. In this way, Macao's prosperity has significant political meaning and consequently political benefit for China." (Sheng & Tsui, 2009, p.421)

In short, the democratization process has been crucial to Macao's independent status as a Chinese SAR. Despite an independent status, the region has developed into a partial democracy, which implies that "Macao is *de jure* administered by Portugal but *de facto* controlled by

China”, where the Chinese state plays an important role in Macao’s political decisions and economic prosperity. Also considering the gaming industry, foreign casino companies gain their licenses through lobbying the Beijing government’s officers that are responsible for Macao’s affairs (Sheng & Gu, 2018, p.76). The development of the gaming industry is strongly affected by mainland China’s attitude.

### **The handover to China**

In the era of Mao Zedong, the Chinese leader stated that he wanted to “eliminate all of the privileges that the “imperialist” enjoyed in China, the payment of all debts they had with “his New China” and the exodus of all foreign troops and militias that were stationed in his regime” (Fernandes, 2008, p.228). However, in relation to Macao and Hong Kong, the Chinese leadership maintained a whole different policy and stated that “it was necessary to adopt more flexible solutions to a peaceful transition policy”. As argued by Fernandes (2008), this foreign policy was adopted “in order to avoid a confrontation with the West, especially with the USA, and to maximize Chinese political, economic, financial, trade and intelligence interests in the two Western-administered city-states and abroad.” (p.227). In light of this foreign policy, the Chinese leadership decided that the status quo of Macao and Hong Kong should be remained after the handover (Fernandes, 2008, p.228). Mao Zedong clarified this policy in a speech that emerged the regime’s guidelines for relation with foreign powers:

The Chinese leadership is willing to discuss with any foreign government the establishment of diplomatic relations on the basis of the principles of equality, mutual benefit and mutual respect for territorial integrity and sovereignty, provided it is willing to sever relations with the Chinese reactionaries, stops conspiring with them or helping them and adopts an attitude of genuine, and not hypocritical, friendship towards People’s China. The Chinese people wish to have friendly co-operation with the people of all countries and to resume and expand international trade in order to develop production and promote economic prosperity. (Fernandes, 2008, p.228)

By this statement, Mao Zedong declared that the Chinese wish to have friendly cooperation with all countries to encourage international trade in order to promote economic prosperity (Fernandes, 2008, p.228). In this light, the Trade Department of the CCP created the Nam Kwong Trading Company, which promoted the trade ties between mainland China and Macao, and vice-versa.

After the Tiananmen massacre, the Beijing government tried to seek support of the Portuguese and attempted to isolate the “hostile” British (Fernandes, 2008, p.228). Friendship and good relations between China and Portugal prevented interfering with and criticizing the Portuguese administration in Macao. This attitude changed when Hong Kong returned to China in

1997, Macao was no longer needed as bargaining chip between the Chinese-British relations and the Beijing government started to increase pressure on the Macao government to follow the transfer of administration (Fernandes, 2008, p.228). Eventually in 1999, Macao returned to the PRC. The handover of colonial Hong Kong from Great Britain to China can be considered as an institutional blueprint for the handover of Macao. In the Hong Kong Basic law, Article 5 states “the socialist system and policies shall remain unchanged for 50 years”, the Preamble states “the People’s Republic of China adopts the principle of One Country Two Systems to maintain the prosperity and stability of Hong Kong by taking account of its history and realities” (Yee, 2014, p.3). The Macao Basic Law, which was published some years later, is largely a duplicate of the Hong Kong Basic Law (Yee, 2014, p.3). Both basic laws grant the Special administrative regions of Macao and Hong Kong a high degree of political autonomy, financial and judicial independence. The Beijing government keeps responsibility for all foreign- and defense affairs of Macao (Edmonds & Yee, 1999, p.801).

However, although the handover of Hong Kong can be seen as a blueprint for the return of Macao, there is also a sharp contrast to the handover of British Hong Kong to China because of the fact that the return of Macao to China was significantly less violent with fewer Chinese outbursts and disputes (Chan, 2003, p.495). This has been a result of the friendly relationship between Portugal and China as described by Fernandes (2008), the Portuguese only operated with high tolerance and respect to the Chinese government (Chan, 2003, p.495). As a result of the friendly decolonization process, the new principle of “Macao People Ruling Macao” was born (Simpson, 2018, p.75). At the Macao handover ceremony, this principle has been emphasized in President Jiang’s speech, claiming: “After the return of Macao, the Chinese Government will unswervingly implement the policies of "one country, two systems", Macao people administering Macao, and a high degree of autonomy” (Chinese president hails new era, 1999). In the spirit of this principle, the new government administration of the Special administrative region was formed.

### **The development of Macao’s gaming industry**

In the beginning of the 19<sup>th</sup> century, the Portuguese law encouraged uniformity in the colonies by the rule “all laws would be applied in the same manner in all colonies” (Godinho, 2012, p.108). This approach changed after the Portuguese constitution of 1838 by Article 137: “The overseas provinces may be governed by special laws as required by the convenience of each of them” (Godinho, 2012, p.108). This article explicitly allowed exceptions to general laws in the different colonies to handle local problems and recognize the traditions and practices

of the non-European communities in the Portuguese colonies.<sup>1</sup> By this law the Portuguese aimed to maintain an environment of flexibility, peaceful coexistence, negotiation and adaptation in their ruling. In the light of this growing flexibility of decision making within the colonies by the Portuguese representatives, Governor João Maria Ferreira do Amaral, was able to establish the foundation of the modern gaming industry in Macao. In his period as a governor, the new British colony of Hong Kong, rapidly became an enormous commercial hub (Godinho, 2012, p.108). Many Macanese moved to the new colony to look for jobs and a more prosperous life, and the Portuguese colonial government was forced to seek alternative sources of revenue to cover the decline by the devastating competition from the British colony Hong-Kong and its new superior maritime power (Godinho, 2012, p.108). The substantial source of revenue to support Macao's economy was found in the policy of granting exclusive or monopoly rights over certain businesses, including gambling which became the financial backbone of Macao's economy (Godinho, 2012, p.108).

Governor João Maria Ferreira do Amaral initiated the formal authorization of the commercial operation of two Chinese types of gaming from that time, which became, the casino gaming industry of today. Hence, Macao's gaming industry was legalized already in the early years of the Portuguese ruling in order to save the economy. Nevertheless, Macao did not have an economically significant role as a gaming city in the first decades of the Portuguese era (Sheng, 2017, p.96). In first instance, small gaming operators operated in a competitive environment, and this market failed to bring much revenues to the Portuguese government in Macao. Therefore, the government decided to grant a monopoly on the gaming industry which had to pay an annual gaming tax in return to the government of Macao. The first influential monopoly in the Portuguese era was the Sociedade de Turismo e Diversões de Macau (STDM), ruled by Stanley Ho (Porter, 1993, p.13). One of the core extractive economic institutions is a monopoly-based economy, where a small group monopolizes the power of a certain industry. This has been the character of Macao's gaming industry under the monopoly granted by the Portuguese to the STDM. The STDM agreed to pay 0.373 million USD tax per year to the Macao government. Besides the tax agreement, they agreed to be held responsible for the development of tourism and infrastructure of Macao as well (Porter, 1993, p.13). Although some economic growth occurred by the monopolized gambling industry, there were still no signs of rapid economic growth yet in this era.

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<sup>1</sup> The aim of this law can be compared with Article 31 of the 1982 PRC constitution which defines the legal basis of the "One country two systems" policy (Godinho, 2012)

When Macao returned to China, both the government of China and Macao, decided on a ten years planning to stimulate the economy with tourism as a main pillar (Simpson, 2018, p.75). In the light of this ten years planning, in 2001, the new government of Macao decided to liberalize the gaming industry. The new government decided to stimulate the economy by ending the monopoly arrangement (Simpson, 2018, p.75). By liberalizing the gaming industry, foreign companies were able to enter the Macanese casino market (Simpson, 2018, p.75). At that point, the government of Macao started to invest heavily in all tourism related areas. When the gaming monopoly came to an end, the gaming industry entered a new phase with many new players entering the scene, including gaming corporations from the Las Vegas industry. Macao transformed from a tiny unknown city into the most lucrative gaming city of the world, even exceeding Las Vegas in its gaming revenues.

After the liberalization Macao’s gaming industry became open to foreign corporations, external investments and employment from non-resident workers *e.g.* from mainland China, Thailand and the Philippines (Gu & Tam, 2011, p.589). Another important change that was implemented to support Macao’s growth has been the launch of the ‘Free Travel Scheme’ (FTS) policy in 2003. The Beijing central government, wanted to boost the economy of Hong Kong and Macao, by stimulating visitors from mainland China to visit the cities. By doing this, the central government removed existing barriers for individuals from mainland China to visit Macao and Hong Kong (Mieiro, Ramos & Alves, 2012, p.67). Visitor freedom as the FTS has been a crucial for the output growth and economic welfare of Macao as a tourist resort in South-East Asia. The consequences of the FTS policy can be seen in the visitor arrival statistics of Macao (Figure 1), which shows that, both the Chinese tourist arrivals and the gaming revenue are increasing equally.

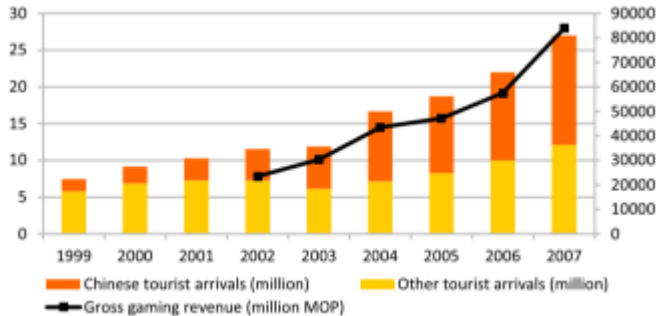


Figure 1: “Gross gaming revenue and the tourist arrivals” (Gu & Sheng, 2018)



This can be seen as unsurprising as the majority of the Chinese population admires gambling, whereas within mainland China gaming is strictly prohibited (Gu & Tam, 2011). Macao has become the only place on China's territory where the Chinese demand for gambling can be fulfilled. Consequently, the economic growth of Macao shows a significant connection between Macao's GDP and the number of visitor arrivals the city receives, both from China and from foreign countries. It can be argued that the city's casino gaming business and its visitors determine the GDP performance. The FTS has been a critical policy in attracting external tourists and foreign investments that boosted the casino revenue generation and consequently, rapid economic expansion of Macao (Gu & Tam, 2011, p.589). Between 2003 and 2010, Macao's GDP grew by 3.3 times and its growth rate had been above twenty per cent during that period. In the period 2011-2013, the growth continued that much, Macao turned into the fourth richest region in the world due to its GDP per capita (Li & Zeng, 2015, p.386).

### **Which feature has been the most crucial in launching Macao's economical 'takeoff'?**

As seen in the previous parts of this chapter, despite the democratic reforms and the legalization of the gambling industry, Macao's rapid economic growth took years to 'takeoff'. Macao enjoyed relatively much freedom to develop its own institutions, though, with the approval of China. These institutions made Macao into a unique region on the territory of China, which has been able to grow into one of world's richest regions. Because of the maintenance of a friendly relationship by Portugal and China, Macao continued enjoying its autonomous status being a Chinese SAR. Consequently, Macao continued to have its own legal system that legalizes gambling, which has become the backbone of Macao's fast growing economy of today. However, the Beijing government has made the core decisions that caused Macao's extreme rapid economic growth after the handover to China. As seen in the previous part of this chapter, the 'takeoff' of the economy started after the ending of the gambling monopoly in combination with the launch of the free travel scheme. After these decisions, the economy of Macao started to grow rapidly. This will be further discussed in the next chapter where the question will be answered whether the case of Macao's economic growth can be best explained by the theory of Acemoglu and Robinson or the dependency theory.

### **Chapter III: Analysis of Macao's post-colonial economic boom by the theory of Acemoglu and Robinson and the Dependency theory**

In view of Acemoglu and Robinson's theory, Macao is an interesting case because of the economic rapid growth that started after the handover to China, a country with extractive

political institutions while they were part of a modern Western country. The Portuguese colonizers from the West did settle in Macao, and established extractive economic institutions by monopolizing the backbone of Macao's economy, the gaming industry. Extractive economic institutions such as the STDM monopoly, are characterized by high barriers to entry the market and are designed to enrich a small elite rather than cause economic growth to the whole population of a country. In a monopoly based industry the power is monopolized by a small group which benefits of the economic outputs of the industry. In 1999, Macao became part of China, a country where there is a limited degree of public participation, and forming political parties is illegal and extractive political institutions are ruled by the elite and based on authoritarian mechanisms (Weiss, 2013, p.1).

Nevertheless, despite being part of a country with extractive political institutions, Macao experienced rapid economic growth after the handover (Chapter II). The main reason of Macao's economic take off has been the decision to end the gaming monopoly, in combination with the adoption of the Free Travel Scheme whereby mainland Chinese were able to visit Macao more easily, because of the eased travel regulations. These two crucial decisions for the extremely rapid economic growth of Macao are made by the Beijing government. The fact that the Beijing government made two steps towards more inclusive economic institutions in Macao with a significant positive impact on the economy, showed that the Beijing politics were not purely extractive at that time, in particular, from an economic perspective. This agrees with the assumption of Acemoglu and Robinson that increasing economic inclusiveness and economic growth can occur under political extractive institutions (Acemoglu & Robinson, 2012). Given these facts, it can be stated that Acemoglu and Robinson's assumption on the economic growth of China as a country can be applied to the economic growth in the Chinese region of Macao as well. The Chinese government decided to end the extractive colonial institutions and opened up the gaming monopoly. As a result, the gaming market became open to foreign investments and capital, which caused a rapid economic growth, already for more than two decades (Chapter II).

Additionally, an alternative explanation for the economic growth by emphasizing Macao's role within the international system can be seen in the dependency theory. In view of Sheng (2011), Macao's economic growth fits into the dependency theory due to Macao's lack of self-sufficiency and the economy being highly dependent on external influences. Macao is a small economy that only is able to grow under external influences, particularly, foreign capital from tourist visitors. Despite the fact that the case of Macao fits in the arguments of being economically dependent of tourist capital and that the region is lacking self-sufficiency, the

dependency theory is less useful in explaining the takeoff of Macao's rapid economic growth for the reason that the dependency theory mostly explains for underdevelopment. The core assumption of the dependency theory is that poor countries continue to be impoverished because of unequal international trade relationships with the core countries. As argued by Decosta (2009), the dependency theory explains underdevelopment as the outcome of unequal relationships within a world system between the developed nations and the less developed nations (p.299). As seen in the first chapter, Macao experienced an extremely rapid economic growth after the handover to China due to its GDP. Considering this, the dependency theory cannot be used as an alternative theory to explain the reasons of the economic takeoff of Macao after the handover to China.

Hence, the theory of Acemoglu and Robinson is most sufficient to explain the reason behind the economic growth in Macao after the handover to China, given the fact that the Chinese liberalized the economy of Macao by ending the gaming monopoly, which had kept the economy small and insignificant for decades. The Macao case fits as a regional reflection of the authors assumptions on the economic growth of China as a country, which created inclusive economic institutions under an extractive political regime that caused economic growth. However, Acemoglu and Robinson imply that economic growth under extractive political institutions is not sustainable economic growth. This can be argued in particular for Macao's case considering the fact that a casino industry causes problems in society in a social and economic perspective, such as casino related crime and corruption. Besides, it is actually an extractive form of economy due to the fact that only a small beneficiary group receive the revenue from the casino taxes (Li & Zeng, 2015, p.390). Meanwhile the middle and lower class of the Macanese population face a great amount of social and economic downsides that comes with a casino based economy that occurred (Li & Zeng, 2015, p.390).

In fact, an explanation of the unsustainability of Macao's growth, assumed by Acemoglu and Robinson can actually be found in the dependency theory. This theory explains underdevelopment or the inability to experience economic growth as the outcome of unequal relationships within a world system between the developed nations, or "core," and the less developed nations, or "peripheries" (Wallerstein, 1974). The economic growth of Macao can be questioned in its sustainability, due to Macao's dependent position as it thrives on gaming tourism from mainland China and foreign countries. According to Godinho, Macao is totally dependent on the gaming industry and recently made efforts and attempts to diversify Macao's economy, such as on textiles and other industrial products, have failed for the most part (Godinho, 2014,

p.2). In the dependency theory, this phenomenon is called ‘displacement of national bourgeoisie’: because of the gaming industry expansion, other enterprises have had to find ways to survive in the market and not lose business to the big casinos (Hao, 2008, p.7). Industries on textiles and toys, for example, have been disappearing and settled elsewhere because of the high land and labor prices in Macao (Hao, 2008, p.7).

The dependence of Macao’s economic growth on the gaming industry implies that the continuation of the unique status of legalized gaming city is crucial for the economic survival of Macao. The risk is that if gaming would be legalized in Hong Kong or the Guangdong province, Macao as it exists today would likely disappear (Godinho, 2014, p.3). If the city loses its privileged position as legalized gaming city in the region there is no alternative activity present, which is capable of supporting the territory of Macao. Consequently, a gaming recession would be likely occur and the manufacturing sector would not recover to the levels of the pre-gaming boom, and the economy thus will shrink rapidly as a result. The dependency on the gaming sector is a high risk for Macao, as its economy will always fluctuate in line with the increase or decrease of visitor arrivals (Mieiro, Ramos and Alves, 2012, p.2).

In fact, this threat might become reality, as the Chinese government has been drafting a proposal to decide over the legalization of online and physical gaming and casino building in Hainan, a region as big as Switzerland in North-Western China (Who will win if Hainan, ‘China’s Hawaii,’ follows Macao to become a gambler’s paradise, 2018). The South China Morning post already stipulated, “If the Macao model is tapped, tourism and entertainment industries may be boosted along with gambling. The province will attract more shopping malls, hotels and providing an opportunity for related developers” (Who will win if Hainan, ‘China’s Hawaii,’ follows Macao to become a gambler’s paradise, 2018). However, Song Yu, professor from the Macao University of Science and Technology (MUST), considers the news not as a threat to Macao. On the 12<sup>th</sup> of June (Zhu, 2018), Yu reacted in the Macao daily news by saying “neighboring regions or countries, if they carry out gaming businesses, won’t still be able to replace Macao because Macao has a deep cultural heritage and a long history of gaming.” (Zhu, 2018). In addition, he assumed, “I think there will be an impact of sorts, but it will not be too big. Hainan will open horseracing, or some marginal gambling modes, these modes will not be influential at all. Horseracing is not Macao’s main gambling aspect. Macao is mainly about mass and VIP rooms.” (Zhu, 2018). The future will tell whether Song Yu is right and if Macao is able to survive such competition, or face a casino revenue crisis with no other economic sector to save the economy.

## Conclusion

Until Portugal returned Macao to China, Macao was the last remaining European colony in Asia. The city was not prominent, and had only little prospect for growth. However, Macao has emerged as world's most lucrative gaming city and one of the richest regions in the world in terms of its GDP per capita. Due to its status as a SAR, despite China's political and economic control, Macao was able to maintain its own jurisdiction and institutions and followed its own path of development within the Chinese system. Macao became a well-known entertainment destination with a strong global position in the world's tourism industry because of its legalized gaming industry. The reason why the economy did not takeoff immediately after the legalization of the gaming industry can be found in the fact that it has been a monopolized industry during the Portuguese era, which isolated foreign capital from the industry. After the era of local controlled gaming monopolies, the liberalization era caused a massive inflow of foreign capital and visitors. Decisions made by mainland China have been crucial to the economic development of Macao. In particular, the fact that the Chinese Communist Party had banned any form of gaming activity in mainland China and the enactment of the Free Travel Scheme in 2003, where mainland Chinese individuals were allowed to visit the city.

Although both the dependency theory and the theory of Acemoglu and Robinson are useful to explain certain parts of the development of Macao, the latter theory seems to give the best explanation of Macao's highly unusual post-colonial economic growth by emphasizing the transformation towards an open economy instead of a monopoly based economy. Macao can be considered as a regional example of the authors' assumptions on China's economic growth. As a Chinese SAR ruled by political extractive institutions, the region experienced rapid economic growth. It will be interesting to question whether the explanation by the dependency theory on the unsustainability of Macao's regional growth can be seen as a reflection of the economic sustainability of China as a country. Nevertheless, the dependency theory is useful in explaining the likely unsustainable growth of Macao by emphasizing the downsides of a casino-based industry. Macao's status as highly dependent from its casino tourism makes the city strongly vulnerable to foreign influences. In this perspective, Macao is trapped in a tourism system controlled by foreign actors that are willing to invest their capital in the casinos of Macao. In a dependency theory perspective, the dependent status will cause impoverishment because of the lack in a self-sufficient development.

Even though, the gambling industry has been the most important tool for Macao's growth and development, a casino dependent market is likely to create a dependent economy

and increasing inequality in Macao. A threat to the economic development of Macao is the upcoming casino development in other Asian countries and even in China itself, such as in the city of Hainan. To overcome this threat, sustain its economic development and to mitigate the dilemma between high risk and negative social impact versus the financial positive impact, Macao must differentiate its image and business from solely a gaming industry into an area where tourists come to see a unique region where cultural heritage from the Western culture and the Chinese civilization blends into one.

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