

## **6 The institutional contours of China's emergent capitalism**

*Christopher A. McNally*

The purpose of this volume as laid out in Chapters 1 and 2 is to apply the capitalist lens to China's emergent political economy and thereby create a comparatively accurate understanding of China's international ascent. Chapters 3 through 5 focused on how Chinese business institutions are transforming China into one of the most formidable capitalist competitors of our era. This chapter will undertake a more expansive analysis. It will map the unique institutional arrangements permeating China's budding capitalism. The focus will rest particularly on how state and capital institutionally interact and shape China's political economy.

The next section will briefly introduce the conceptual approach taken in this chapter – the capitalist institutional lens. I will then elucidate what I hold are the three most salient institutional contours of China's emergent capitalism: “network capitalism”; the rapid absorption of China into the “new global capitalism”; and the distinctive role of state institutions in China's capitalist development. In the concluding remarks I will comment on China's long historical trajectory and argue that contemporary state-capital relations possess certain parallels to those characterizing China's imperial political economy over the past 1,000 years. However, due to the contemporary international environment this historical trajectory is likely to be broken.

### **The capitalist institutional lens**

Over the past two decades, several conceptual lenses have been used to analyze China's political economy. Most of these are grounded in recent world historical events and are of a less general nature than the capitalist lens applied in this volume. The most important interpretations are associated with the experiences of the East Asian “developmental state,” the postsocialist transitions in Eastern Europe and the successor states to the Soviet Union, as well as pure crony capitalism.

First, there have been numerous attempts to apply the concept of a capitalist developmental state, especially as practiced in Japan, South Korea,

and Taiwan, to China. Yet, these efforts either stretch the concept unduly or find that the case for China as a developmental state is not tenable (Howell 2006). Certainly, the unitary image of a developmental state guiding the economy from low-value added to high-value added production processes hardly holds up in the face of Chinese reality. Intense rivalries among the Chinese state's various agencies and jurisdictional levels put considerable implementation constraints on central policies. In fact, overlapping and incongruous features often characterize the Chinese state apparatus, including amalgamations of regulatory, entrepreneurial, clientelist, developmental, and predatory state formations (Howell 2006).

Similarly, the view of China as a postsocialist transition economy finds only one comparable world historical occurrence: Vietnam.<sup>1</sup> All of the other postsocialist transitions experienced a sequencing of political and economic reforms that, unlike China, at first prioritized political reforms. For instance, market economic reforms happened alongside the development of democratic politics in Eastern Europe and under the framework of potential integration with the European Union. Consequently, these cases faced political parameters highly unlike those present in the People's Republic of China (PRC).

Finally, an understanding of China as primarily shaped by crony capitalism fails to account for the enormous vibrancy of the PRC's political economy.<sup>2</sup> Crony capitalism is a system in which capitalists are in cahoots with state officials, using their influence over government to create an anti-competitive environment in which only their firms can prosper. While rent-seeking, corruption, and, more generally, a politicized market economy are hallmarks of China's reform era, there are other factors at work that make China's political economy much more dynamic and multifaceted than pure crony capitalism.

Applying the capitalist lens to China raises the question of whether analytical frameworks used in the literature on comparative studies of capitalism, generally termed the varieties of capitalism (VoC) approach, can be applied. To date this literature has not incorporated a comparative analysis of China. As Jonas Pontusson (2005) notes, the VoC approach forms an important fundament on which the comparative study of capitalist political economies can build, yet this literature focuses "exclusively on the nature and sources of variation among advanced capitalist political economies" (Pontusson 2005: 164). It pays less attention to how advanced capitalisms differ from those in the developing world.

To effectively capture the case of China, the VoC approach would therefore need to move beyond existing classifications to incorporate the dynamics unfolding in transitional, developing, and evolving cases of capitalism. As Pontusson (2005: 164) succinctly observes: "The VoC literature has a great deal to say about 'varieties,' but surprisingly little to say about 'capitalism.'" Despite these shortcomings, the VoC approach can serve well to inspire an exploration of the institutional contours of China's capitalism.

Accordingly, my analysis will build on the VoC approach and, in particular, its use of insights contained in the "new institutionalism." This conceptual prism understands institutions as "building-blocks of social order" (Streeck and Thelen 2005: 9). Specifically, I employ a historical interpretation of institutions, while also borrowing insights from related schools (see Thelen 1999). I see institutions as "humanly devised constraints that shape human interactions" (North 1990: 3), forming "durable lock-ins or amalgamations of interests and social relations" (Swedberg 2005: 6).

A historical view of institutions captures their "stickiness" or substantial inertia to change. Any social system is embedded in its historically formed political, social, and cultural background. The origins of a social system thus form a key influence on how it is constituted and where it is going, creating degrees of path dependency. I must, however, stress that institutions are endlessly reshaped by the ideas and interests of social actors embedded in institutional settings. An iterative view of institutional change along the lines of continuously recurring feedback loops can perhaps serve our understanding of social change best.

This chapter will apply a capitalist institutional lens to map the unique features of China's emergent political economy. As the VoC framework and approaches in radical political economy (see Lippit 2005) elucidate, capitalism evolves over time and space into distinct institutional, ideational, and distribution of power arrangements. Different institutional structures of capitalism can be distinguished across both temporal and geographical axes. Most works in the VoC literature, for example, include some sort of matrix to map institutional variations, especially among national forms of capitalism.

China's capitalist institutions, though, are in the process of forming and differ in important respects from those found in advanced capitalist systems. I will therefore consciously eschew a comparative mapping of China's capitalist institutions. Rather, I will stress certain analytical features and note their historical parallels to other forms of capitalism.

### **Mapping the institutional contours of China's emergent capitalism**

Although in terms of speed and scale the developments unfolding in China are without parallel in the past, there is congruence with the processes that catapulted Great Britain, the United States, Germany, and Japan to international prominence. All of these experienced the emergence of a capitalist political economy, manifested first and foremost by the twin processes of urbanization and industrialization. These processes in turn triggered the establishment of nation-wide infrastructures, the rapid expansion of wage labor, and the formation of professional classes.

Despite these parallels, the historical, geographical, and external conditions facing China's emergent capitalism are producing unique institutional

features, three of which I will outline here: first, the constitution of capital, particularly China's mushrooming "network capitalism"; second, the role of external factors, above all the influence of the "new global capitalism" on China's development; and finally, the Chinese state's role in initiating, enabling, and sustaining China's capitalist transition.

#### *Bottom-up: network capitalism*

Analyses of East Asia's stunning economic development have distinguished between two broad categories of capitalism, although considerable variations are found within these two categories. Asia's pioneer in capitalist development was undoubtedly Japan. Although Japan has undergone structural economic changes since the 1990s, it generated a unique form of "coordinated capitalism" during the heyday of its capitalist development. Central to coordinated capitalism is a strong state that can effectively coordinate investment behavior throughout the economy by forging close cooperative relations with private business. Ronald Dore (1997) sees Japan's form of coordinated capitalism as representative of an Asian model of capitalism in general. However, only the political economy of South Korea bears a compelling resemblance to Japan's coordinated capitalism.

The other form of capitalism distinguished in Asia is "network capitalism." It is prevalent in those regions where Overseas Chinese businesses dominate, including Taiwan, Hong Kong, and the Overseas Chinese communities of several Southeast Asian nations. Asia's network capitalism is generally associated with a generic model of Chinese capitalism and therefore sometimes termed "Sino-capitalism" or "*guanxi* capitalism" (Hamilton 1996; Redding 1990).

Network capitalism is built from the ground up and does not tend to overly rely on legal contracts and the supervisory role of the state. Rather, it depends on a myriad of small-scale (often family-based) businesses. In comparison to coordinated capitalism, these businesses do not tend to expand into large bureaucratic structures, but rather achieve wealth accumulation through the multiplication of small ventures (Lever-Tracy 2002). To overcome the disadvantages of small size, large numbers of firms coalesce into sizeable clusters of related businesses.

Naturally, all forms of capitalism are to some extent based on networks, but the Chinese variant is especially pronounced and quite open to new members. It relies on two institutions in particular: the family, especially in the form of family firms, and *guanxi*. *Guanxi* denotes the establishment of long-term informal reciprocal personal relationships. It is a form of social capital that acts as a binding agent among social actors. *Guanxi* ties can therefore create enduring trust which facilitates collaborations among firms and aids them in adjusting to changing circumstances.

Coordinated capitalism and network capitalism have both deeply affected the shape of Asia's capitalist development. Japan's coordinated

capitalism has had important practical and ideational influences on the second (starting in the 1950s) and third (starting in the 1970s) wave of capitalist development in East Asia. Central to Japan's coordinated capitalism has been the notion of a developmental state, a type of state that is conceived to have perfected methods of state intervention in the economy while heeding market forces and cooperating with private enterprise. Such state interventions, in turn, depended on the existence of small, inexpensive, but elite bureaucracies which possessed sufficient scope to take initiative and operate effectively.

One of the economies heavily influenced by Japan's coordinated capitalism was Taiwan. Taiwan is often grouped with South Korea and Japan to constitute a generic model of Asian capitalism, yet its political economy differs from its two northern counterparts. Despite remarkable policy-making and implementation capacities, the Taiwanese state's influence over private industry has been more indirect than in Japan and South Korea (Gold 1986; Wade 1990). In fact, the Taiwanese state has relied for direct economic control on a large state sector, unusual in size and reach for a non-socialist country (Gereffi 1990). Taiwan's capitalism thus combined top-down planning focused on state firms with a vibrant private sector structured by network capitalism.

This raises distinct parallels between Taiwan and the PRC. As on Taiwan, state firms and research institutes dominate most direct developmental interventions in China, such as in the aeronautic, automobile, and heavy machinery industries (Nolan 2001). And as on Taiwan, China's private sector was at first discriminated against or faced indifference by the agents of the state. This initial disregard of private sector activities by government triggered in both Taiwan and the PRC entrepreneurial responses based on family firms and *guanxi* networks (see McNally and Chu 2006). Jon Unger (2002), for instance, argues that both Taiwan and certain areas of China exhibit a common pattern of "Chinese" entrepreneurship based on family firms, informal financing, and major roles for the wives of entrepreneurs in managing internal operations. Even more significantly, large segments of the private sectors in Taiwan and the PRC have coalesced into vibrant business networks.

The fact that Taiwanese family firms and partnerships have tended to cluster into business groups based on *guanxi* ties has been widely reported (Gates 1996; Hamilton and Biggart 1997; Shieh 1992). Similar to Taiwan, networks of small-scale firms have emerged in China. These networks often boast thousands of small businesses working in similar product markets and exhibiting fine divisions of labor. They rely on reciprocity and mutuality in firm relations to take advantage of economies of agglomeration. Some of these networks even dominate their respective product categories in world markets.

However, given China's vast geographical expanse, a plethora of locally embedded networks has emerged. One prominent example is located in the

western Pearl River Delta.<sup>3</sup> Situated along state route 105 in the jurisdiction of Zhongshan City are a variety of townships and villages, each of which specializes in one or sometimes two types of products. These “specialized towns and villages” (Eng 1997) include: Dachong (mahogany furniture; textiles); Xiaolan (metal products; home appliances); Shaxi (jeans); and Guzhen (lighting products).

The origins of these specialized towns and their production clusters are quite varied. Some enjoy long traditions of working in certain product categories. These traditions either survived the Cultural Revolution or were reinvigorated by returning emigrants at the beginning of the reform era. Some clusters were initiated by foreign investors, chiefly from Hong Kong and Macau, while others were started by small private workshops at the beginning of the reform era. A final set of clusters can trace their origins back to one or several state or collective firms. Over time these firms expanded, privatized, and created collaborative relations with other firms, gradually giving rise to networks of firms working in related product categories.

Regardless of their origins, these networks have over time created specialized clusters, thus locking in advantages of agglomeration. Small firms embedded in these networks can access market information, upgrade product quality and technology, and reach economies of scale that drive down manufacturing costs (Zeng and Williamson 2003). Although at the outset there was generally little government planning or initiative involved, in recent years many of these networks have been supported by both local and provincial governments. For example, the Department of Science and Technology under the Guangdong Provincial Government initiated in 2002 a program aimed at creating centers for innovation and technology development within the confines of specialized production clusters (Bellandi and Di Tommaso 2005: 713–714).

Government efforts have also focused on building industrial parks tailor-made for certain production processes, and exhibition centers used to showcase a jurisdiction’s specialized products. The town of Guzhen, for instance, has built a gigantic Lighting Plaza that hosts an annual exposition called the “China (Guzhen) Lighting Fair.” In fact, Guzhen has been officially recognized by the China Federation of Light Industry as the “Lighting Capital” of China. The city boasts about 3,000 registered lighting manufacturers employing over 50,000 workers.

Guzhen’s lighting cluster grew out of the skills of two collective enterprises. During the reform era, the technological expertise of these two firms was combined with an active commercial tradition. This led to the gradual emergence of perhaps the largest industrial cluster in the world dedicated to lighting goods. The specialization of the town is palpable when traveling down its 10-km long “Lamp Street,” which is lined with large exhibition spaces displaying a dazzling array of indoor lighting systems, chandeliers, street lamps, outdoor LED displays, and other lighting goods.

Guzhen and the other specialized towns in Zhongshan City have benefited enormously from their proximity to Hong Kong and Macau. The increased autonomy of local governments during the reform era allowed Overseas Chinese capital to either initiate or link up with emerging production clusters. Low-level Chinese officials driven both by their personal and career interests further facilitated these linkages. Over time, the influx of Overseas Chinese capital strengthened these localities’ bargaining power *vis-à-vis* higher levels of government (Hsing 1998: 144). Alliances among Overseas Chinese investors, local officials, and local firms expanded, creating direct linkages to world markets.

The agglomeration of large numbers of often small firms in elaborate production clusters is not only confined to China’s eastern seaboard in provinces such as Guangdong and Zhejiang. It is also becoming more prevalent in China’s landlocked interior. One example of a tightly networked cluster of textile firms is located in Yiyang City, Hunan Province (Guiheux 2003). Yiyang is far removed from China’s coastline and therefore proves that network capitalism is spreading into regions where private sector development is a recent phenomenon.

As in all economies with strong ethnic Chinese influences, the reliance of entrepreneurs on family firms and *guanxi* networks contains a clear functional aspect. Chinese government agencies and state banks tend to lend little support to private firms, especially smaller firms. Private entrepreneurs therefore rely on family, *guanxi* networks, and hybrid forms of ownership to access finance, overcome government indifference, compensate for institutional uncertainty, and create profit-making opportunities (International Financial Corporation 2000: 20–34; Wank 1999).

The changing structure of China’s political economy, though, is inducing Chinese local governments to increase their support for private sector activities (Blecher and Shue 2001; Unger and Chan 1999). Privatization has made enterprises independent of local governments, since private entrepreneurs can move across administrative boundaries to seek the best investment climate. At the same time, the yielding of substantial autonomies to local governments opened the door to strong interjurisdictional competition, with each local authority seeking to attract private enterprises with better investment conditions. The macro-outcome has been a rapidly improving investment climate for private firms and the conscious support by local governments of China’s network capitalism, especially by establishing designated industrial parks.

The highly networked structure of China’s private sector is also enabling the emergence of a plethora of hybrid ownership forms. On one hand, the initial discrimination of private firms and private property rights made the use of *guanxi* networks to hook up with government officials paramount for creating a modicum of institutional certainty. On the other, many former state managers have become private entrepreneurs (sometimes while keeping their official positions), a situation that creates incentives to leave

the ownership of assets in China vague. In both cases, *guanxi* networks have created the conditions for a variety of joint private-state ventures to flourish, such as when private entrepreneurs invite government officials to sit on their boards or act as silent investors. The hybridization of ownership forms in China and the emergence of network capitalism are thus closely linked.

In conclusion, China exhibits a distinct prevalence of network capitalism in its domestic private sector. This implies that China's emergent political economy resembles to some extent the political economies of Taiwan, Hong Kong, and Southeast Asia. Perhaps the closest analogies are to the case of Taiwan. Capitalist development in Taiwan and the PRC is characterized by a certain duality. A large state sector dominates the commanding heights of the economy and is the direct counterpart to the central government's industrial policies. However, this state sector coexists, and in the case of China, melds with a private sector characterized by a myriad of small- and medium-sized firms structured by networks based on *guanxi* relations. Put differently, while producer goods sectors, transportation, and finance are in the state's hands, the vibrancy of the domestic economy is being driven in large part by Chinese network capitalism.

#### *Outside-in: development under the new global capitalism*

Chapters 3 through 5 provided the reader with pertinent insights on aspects of China's globalization. For example, Wei Zhang *et al.* analyzed an outside-in dynamic of China's integration into the global capitalist system by exploring the unique melding of foreign (chiefly North American) and home-grown institutional arrangements in the evolution of China's venture capital sector. In contrast, Zeng and Williamson focused on an inside-out dynamic. They traced how the rapid emergence of multinationals (MNCs) domiciled in China is changing the global competitive landscape.

This section will employ a wider perspective. I will trace how the timing of China's entry into the world capitalist system at the end of the 20th century is influencing the institutions of its emergent capitalism. As noted in the paragraphs introducing the capitalist institutional lens, capitalism as a socioeconomic system is not cast in stone. It evolved in world historical time, moving from humble beginnings to a system encompassing most of the globe (Braudel 1982–1984; Heilbroner 1985; Wallerstein 1974–1989).

Somewhat ironically, capitalism's earliest origins lay in an alliance of state and capital, namely in the form of merchant capitalism. Internationally, this was a highly competitive system, but nationally merchant houses possessed the privilege of monopoly. "The secret of making high profits was to secure monopolies by one means or another, exclude competitors, and control markets in every possible way" (Fulcher 2004: 4).

Merchant capitalism was gradually replaced by a more market-driven system in the 19th century. This phase came to an end in the first half of

the 20th century as the industrial strife and human dislocations resulting from the Great Depression and the Second World War triggered a reconstitution of the basic institutions of capitalism. A form of managed capitalism (Fulcher 2004: 41–47) transpired, which was characterized by large corporations run by professional managers, corporatist class organizations, and extensive state intervention.

The combination of low economic growth, high inflation, and greater global competitive pressures in the 1970s ushered in the gradual demise of managed capitalism. Our current era dawned, characterized by a drastic reduction in union power, deregulation and privatization, and the ascent of free-market ideology, especially in the United States and Great Britain. I will term this contemporary period the "new global capitalism."

Two remarkable facets of the new global capitalism must be noted here as they both affect China's transition. Although globalization has been part of the capitalist accumulation process from its very inception, this new era of capitalism involves more people than ever before. The collapse of the Soviet bloc and the opening of India, China, Latin America, and parts of Africa to global trade and investment have created a truly global dynamic of capital accumulation. This is most succinctly expressed by the expanding reach of global production and innovation networks noted in Chapter 3. Equally significant, the high-tech boom in the United States and beyond fuelled a massive increase in new ventures, new knowledge, and new business models. The individual entrepreneur stands once again at the center of capital accumulation, aided by increasingly sophisticated communication technologies and financial mechanisms.

The effects of the new global capitalism on the contours of China's emergent capitalism become clear when comparing the PRC to earlier developers in East Asia. Japan, South Korea, and Taiwan during their period of rapid industrialization in the 1950s, 1960s, and 1970s opted to keep foreign investment and imports tightly under control while building up indigenous corporate institutions to compete internationally (Amsden 2001; Johnson 1982; Wade 1990). Only the much smaller economies of Singapore and Hong Kong possessed open economic environments, mainly due to their roles as trading and (later) financial hubs.

The PRC entered the world capitalist system in the 1980s and 1990s. Chinese policy makers thus faced different pressures and opportunities than earlier developers in East Asia. Even though China constitutes a continental sized economy, it is surfacing as a comparatively open system. China possesses a very high GDP to trade ratio and its export sector is highly internationalized.<sup>4</sup> Indeed, China has developed one of the highest "absorption capacities" for the forces of globalization among developing economies.

Much of China's openness did not result from central design. For sure, the Chinese leadership initiated the open door policy and established during the early 1980s four Special Economic Zones. The aim of these zones was to aid political efforts to reintegrate Hong Kong, Macau, and

Taiwan with the PRC, and to foster limited and controllable contacts with the world capitalist system. They succeeded in this latter respect and attracted the first waves of Overseas Chinese investment with their more liberal environments.

Despite these early policy initiatives, large segments of Beijing's political establishment continued to oppose strong internationalization during the 1980s and 1990s (Zweig 2002). Over time, though, these forces were run over by the many unintended consequences flowing from China's open door policy. The success of the Special Economic Zones generated further momentum for internationalization. Driven by cultural affinity and China's comparative advantage in cheap labor, Overseas Chinese moved beyond the zones to set up vast production networks. In particular, they cooperated with small-scale rural industries, which "swapped access to China's domestic markets in return for international capital and access to international markets" (Zweig 2002: 160).

In this manner, Overseas Chinese capital worked wonders. It won over cadres who, rather than enforcing restrictive central regulations, opted to use their grassroots regulatory power to facilitate international exchanges. A domestic hunger for global linkages was unleashed that generated economic gains for China's local officials and, more importantly, linked coastal communities with the global market, paving the way for them to become the "workshop of the world."

Evidently, the melding of Overseas Chinese network capital with China's own played a crucial role in opening China to the world. Between 1982 and 1994, more than 70 percent of all foreign investment in China came from Overseas Chinese sources (Hsing 1998: 147). China's opening, though, was also driven by the rampant competition among Chinese local governments for investment capital. As with the rapid growth of China's indigenous network capitalism, interjurisdictional competition triggered local adjustments to the demands of investors. The central state, seeing increased capital flows from abroad, reacted to this situation by gradually constructing a more market-friendly macro-regulatory environment.

In the 1990s these improvements began to attract the first major batch of MNC investments. Lured by China's potentially huge consumer market and its cheap and increasingly skilled labor force, these MNCs exerted further pressures to improve the investment climate. In 2001 these developments took a final leap forward with China's entry into the World Trade Organization (WTO).

The terms of China's WTO accession are onerous and exceed in most respects those of earlier developing country entrants (Lardy 2002). China's decision to join under these conditions reflects the leadership's eagerness to secure access to major export markets in the developed world. It also reflects former Chinese Prime Minister Zhu Rongji's intention to use the WTO agreement as a means to force reluctant domestic interest groups to accept greater economic liberalization (Fewsmith 2001).

Due to its WTO accession, China is now opening significant parts of its domestic market to foreign investment and trade. Even more importantly, WTO-required reforms are prodding China to establish an investor-friendly institutional infrastructure. China's accession to the WTO is thus locking the country into "international norms" of trade (Breslin 2004). These changes are also aiding China's private sector by creating greater institutional certainty and loosening restrictions on private operators' scope of business.

Both domestic and international factors have therefore interacted to accelerate China's participation in the world capitalist system. In hindsight, the increasing permeability of national barriers to world trade, the rising flows of capital and information, and the growing ability of manufacturers to move swiftly to regions with favorable endowments have all created enormous costs to any nation seeking to insulate itself from globalization. Due to the timing of China's capitalist transition, the new global capitalism opened China as much as China opened to the world.

The process of China's opening has in large part been driven by greater competition for investment capital and export markets, not only within China, but also between China and other export-oriented economies. These competitive pressures are exerting a disciplining influence, since governments must heed the desires of international investors in order to attract and retain capital. The result has been the construction of a remarkably liberal and internationalized export regime in China that favors foreign investment.

This liberal export regime, though, sits alongside a relatively closed and protected domestic trading regime (Lardy 2002). The restrictions of China's internal trading regime apply especially to key sectors dominated by state firms (petrochemicals, telecoms, airlines, etc.), agricultural goods, and the domestic financial system. Although international competitive forces are increasing after WTO entry, the duality of a liberal export regime juxtaposed with a restrictive internal trading regime is likely to continue. The closed financial system, for instance, has served as an insurance against speculative attacks on China's currency, a situation that China's leadership is unlikely to alter until the whole financial system is on a stable and internationally competitive footing.

This duality is also expressed in another institutional facet of China's emergent capitalism. Economic spaces that are divorced from China's domestic economy but highly integrated into global production networks have been created in some Chinese localities. The industrial parks in Suzhou and Kunshan adjacent to Shanghai in Jiangsu Province are examples of how certain jurisdictions are adopting a "Singapore model" – they rely on MNC capital for domestic economic development. Industrial parks in these jurisdictions are segregated from the domestic economy at large and provide excellent hard and soft infrastructures. Separate governance systems have therefore been created for the sole purpose of accommodating MNC capital.

To conclude, China's development under the new global capitalism has shaped the institutions of its emergent political economy. After the initiation of the open door policy, ethnic Chinese investors built bridges linking China to world markets. In the process, the network capitalism of Overseas Chinese melded with networks of Chinese domestic producers. Gradually, the investment climate improved to the extent that global production networks incorporating MNCs made China their base for assembly operations. After WTO accession, China's integration into the new global capitalism further accelerated, starting to spawn the first generation of Chinese MNCs and bringing increasingly sophisticated ideas and technologies to China, as with the rapid growth of China's venture capital sector.

At this point, it still is unclear how successful China will be in moving away from its role as a low-cost assembly site in the international division of labor to more value-added production processes. As Chapter 3 argues, MNCs and Chinese domestic corporations are already upgrading their operations and undertaking intensive research and development efforts. One thing is for sure: China's insertion into the global capitalist system is highly unlikely to be reversed. As in the past, external economic actors will continue to interact with domestic forces to shape the institutional contours of China's emergent capitalism.

#### *Top-down: the role of the Chinese state*

In Chapter 3, Dieter Ernst and Barry Naughton elucidate how the central state continues to control the top tier of Chinese industrial firms and thus the commanding heights of the Chinese economy. In addition, internationally competitive mid-tier firms are often privately run, but remain closely linked to state agencies or continue to be partially owned by local governments. Unmistakably, China's industrial capitalism remains heavily shaped by the hand of the state.

This is little wonder. China's reform era did not start from a clean slate but rather originated from a state socialist system in which the state owned the vast majority of productive assets. After the establishment of the PRC in 1949, the Chinese Communist Party (CCP) undertook a gradual, but ultimately highly thorough process of nationalizing most industrial, commercial, and agricultural assets that were in private hands. This process reached a peak with the collectivization movement in the late 1950s, ebbed during the early 1960s, and was then driven to new extremes during the Cultural Revolution (1966–1976). Only in the late 1970s emerged the will to leave the state socialist legacy behind and fundamentally restructure China's economy.

Why would the CCP leadership desire to change a state socialist system which facilitated its political control? Internally, the chaos of the Cultural Revolution created a pressing need to regain legitimacy for the CCP. Externally, CCP rulers noticed the rapid wealth accumulation taking

place in Asia's capitalist developers. The realization dawned that increased economic wealth could translate into internal legitimacy and international power. A reform process gingerly exploring capitalist development began.

The factors prodding China's reform leadership are actually not much unlike those prompting the leaders of other nations to explore capitalist development: the existence of perceived or real threats to national and/or regime survival (Stubbs 1999; Tilly 1975). Throughout the reform era the Chinese leadership perceived industrialization and technological upgrading as a means to buttress CCP legitimacy and China's national greatness. This mindset continues to the present and provides ample incentives to continue China's reform process.

In essence, China's leadership jettisoned communist ideological limits and displayed a strong "will to develop." A dual aim of ensuring socio-political stability *and* rapid economic growth emerged, generating a unique melding of policies. The party retained the power of its personnel appointment process – the *nomenklatura* system – to control the career tracks of China's economic, political, and social leaders. Simultaneously, party leaders encouraged economic decentralization and experimentation to encourage rapid economic growth.

The *nomenklatura* system constitutes the backbone of the Chinese polity. It functions like mucilage, the main source of systemic coherence that strengthens central authority by creating incentives for party members to adhere to central edicts. The CCP's *nomenklatura* system, with its counterpart in the government's administrative hierarchy, thus persists in guiding the behavior of local cadres (Edin 2003; Huang 1996). Since 1978 this system has evaluated CCP leaders primarily in terms of local economic performance, creating strong incentives for local cadres to ensure high paced economic growth in their jurisdictions.

At the same time, reforms granted greater autonomy to local governments, leading rapidly to the decentralization of economic decision-making. Local autonomy was reinforced by the central state's fiscal disengagement. Higher government levels granted fewer and fewer financial resources to local government units, forcing these to rely on local economic prospects for increased revenue flows.

The result of combining strong incentives for maximizing economic growth with local autonomy was that local governments became ever bolder in undertaking economic experiments. Local initiatives often circumvented restrictive central policies. Especially along China's coastline, local governments engaged in feverish attempts to attract foreign capital. This introduced foreign knowledge, technology, and ideas to China's vanguard of reform. It also opened up political space for the recognition of domestic private entrepreneurs, giving rise to China's vibrant network capitalism noted above.

The central state often tried to clamp down on local autonomies, though with limited success. Ebbs and flows of permitting, restricting, and again



permitting economic liberalization have therefore come to characterize the initial reform process. For example, in the aftermath of the 1989 Tiananmen Incident the central government put a halt to economic liberalization measures, especially the sway of nascent private entrepreneurs. However, by 1992, Deng Xiaoping's *nan xun* (Southern Tour) reinvigorated the reform process and opened up spaces for bolder reform initiatives. In the end, the CCP's desire to ensure regime stability and enhance China's international power forced it to facilitate grassroots liberalization efforts, thus enabling ever more expansive processes of capital accumulation.

Overall, the Chinese state remains a central force, but its reach is not absolute. CCP incentives have generated a "growth-above-all-else" mentality among local cadres, prodding them to see restrictive central policies as running counter to local growth prospects. The result: local cadres often stifle the effective implementation of central policies and foster resource misuse in terms of industrial duplication and environmental degradation. In view of this situation, we might best understand China's state as constituting a "diffuse developmental state" (McNally and Chu 2006). Due to their "growth-above-all-else" mentality, local leaders stand at the forefront of establishing symbiotic interactions with private firms and undertaking direct developmental interventions. The central state, in contrast, sets the overall incentive and policy framework, although local autonomies tend to limit the reach of many central policies.

The Chinese state has therefore played a crucial role in initiating, managing, and sustaining the process of capitalist development. However, it would be a stretch to conceive of it as an internally coherent actor along the lines of the developmental states which have characterized the coordinated capitalisms of Japan and South Korea. Rather, the Chinese state constitutes a bizarre and often contradictory system. It might display enormous "developmentalism," but institutionally it is not a homogenous actor that can effectively coordinate private economic activities in the interests of the nation.

In other respects, though, there are some compelling resemblances between China and Asia's earlier capitalist developers. Like these earlier developers, China boasts a very high savings rate enabling high levels of investment in fixed assets (infrastructure, real estate, factories, etc.). Jonathan Anderson (2006: 12), for example, argues that from a macroeconomic perspective the PRC "looks almost exactly like its Asian predecessors." Growth relies heavily on fixed asset investment and export-oriented industrialization, while domestic consumption demand lags behind.

Macroeconomic parallels are only part of the resemblance. Savings have to be effectively converted into investments *via* financial intermediaries. Accordingly, the states of most late capitalist developers have harnessed financial institutions to intimately support the rapid development of industrial firms in cutting-edge industries (Gerschenkron 1962). This is reflected in how the state exerted direct influence over financial institutions in South Korea

and Taiwan to guide investments into higher value-added industries (Wade 1990; Woo 1991).

In parallel, state control over finance has allowed Chinese policy makers to keep interest rates low, thus unleashing waves of credit expansion. When these expansions get out of control, the Chinese state tends to use administrative measures, especially the sanctions and rewards the CCP can hand out *via* its *nomenklatura* system, to squeeze credit growth (Huang 1996). The Chinese state has in this manner been able to maintain a considerable degree of macro-economic stability while facilitating vast investments in education, industry, and physical infrastructure.

As in other state-guided financial systems, the Chinese system has its dark underside. This is reflected in the amassing of nonperforming loans and inefficiencies in the allocation of capital (Lardy 1998). Local government leaders, for example, can influence the branch managers of local state banks to finance projects for political or social reasons without regard to commercial profitability, a further reflection of the downsides of local government autonomy.

Another cause of financial sector inefficiencies is that Chinese state banks extend large amounts of credit to state firms. This, though, encumbers economic efficiency, since the corporate governance systems of Chinese state firms tend to provide dysfunctional incentives to their managers (McNally 2002). Much of China's large stock of nonperforming loans can be traced back to the inefficiencies of state firms.

The importance of state firms reflects another institutional feature that differentiates China's emergent capitalism from its East Asian counterparts. For sure, the Taiwanese and Singaporean governments have made extensive use of state firms for industrial policy purposes. China, though, had to face head-on the legacy of a state socialist system. As a result, the Chinese state had to consciously focus resources on the construction of market institutions during the reform era. This included a fundamental restructuring of the state apparatus and the building from scratch of financial and enterprise institutions necessary to run a successful market economy. Clearly, the PRC differs strongly from its East Asian predecessors in terms of its institutional legacy.

An equally fundamental difference to Asia's earlier capitalist developers lies in size. China's landmass is vast and introduces considerable complexities to governance. As noted above, the central government's interests and viewpoints differ from those of local governments, creating substantial problems of policy coordination and implementation. China's large size also introduces starkly differing local conditions, creating an image of many local forms of capitalism coexisting within China. In some areas, local governments cooperate with private entrepreneurs in symbiotic relations to foster capital accumulation, while in others, local government officials engage in predatory behavior, creating political economies that contain "the worst of feudalism, capitalism, and socialism all in one."<sup>5</sup>



The above was merely meant to sketch the role of the state in China's emergent capitalism. It is certainly not possible to reflect the totality of institutional arrangements characterizing the Chinese state's interaction with economy and society. This would have to be the subject of a book-length exposition.<sup>6</sup>

Nonetheless, the foregoing shows that there should be little doubt as to the state's contribution to China's capitalist development. There should also be little doubt that due to China's large size, state socialist legacy, timing of entry into the world capitalist system, and other factors, conceptions of the Chinese state must differ from those of the Asian developmental state. The Chinese state exhibits strong developmental impulses, but ultimately constitutes a multifaceted entity in which "a complex mix of local state formations, policies and economies" (Howell 2006: 292) coexist.

### Concluding remarks: a historical perspective

China is in the process of creating a unique form of capitalism, incorporating aspects of network capitalism, the new global capitalism, and state-led capitalist development. One of the central characteristics of China's emergent capitalism is a marked duality, reflected, for instance, in the coexistence of an internationalized export regime alongside a relatively limiting internal trading system. More fundamentally, this duality is manifested in the Chinese state's continued dominance over crucial aspects of the economy, tempered by the dynamism of China's small-scale capitalist producers.

The two processes of state-led development from above and network-based development from below meet at the local level, where local officials and private economic actors have played a crucial role in initiating, enabling, and sustaining capitalist accumulation. As a consequence of this dynamic, state-capital relations have been localized and engendered considerable variation. Some local political economies resemble Singapore by their dependence on MNC capital. Others rely heavily on Overseas Chinese capital that melds with China's indigenous network capitalism. And yet others are anchored in the lasting importance of China's state sector.

Perhaps the best means to comprehend the marked duality of China's emergent capitalism is to employ a historical perspective. In particular, there is a striking resemblance between China's contemporary political economy and the political economies of the Song to late Qing dynasties. Hill Gates' (1996) work elucidates this point:

The Chinese people have lived for at least a thousand years within the reach of two different political-economic patterns that offered them different and partially contradictory possibilities and limitations. One is the state-managed tributary mode of production for state use, the

other the petty-capitalist mode, a system of commodity production by kin corporations.

Gates (1996: 7)

These two modes of production displayed a tendency to grow more sophisticated and complex over the course of history, although the duality of a state dominant mode juxtaposed with petty capitalist production remained intact. For instance, during the late Qing dynasty petty capital gradually gained in force, especially in commercial centers such as Hangzhou, where more completely privatized channels of production and commerce took hold (Rowe 1984). Moreover, as Western capitalists began to encroach on China, the state dominant mode resisted these developments. Petty capitalists, in contrast, embraced new opportunities for profit, "often in flagrant contravention of ruling-class wishes" (Gates 1996: 8).

The dominant imperial state thus attempted to control both capital and markets for its own purposes. A reliance on personalized ties to undertake business dealings was strongly reinforced by state officials, since these viewed impersonal business dealings that could lead to the amassing of large fortunes as a potential threat to state dominance (Gates 1996: 32). Ultimately, the driving force of Chinese history was "the petty-capitalist tendency toward accumulation unrelentingly harnessed by tributary might, turned to tributary rather than capitalist purposes" (Gates 1996: 8).

In this sense, real capitalist accumulation could never progress.<sup>7</sup> The dominant state attempted to check any challenge, setting social limits on the private accumulation of resources. Sizeable wealth that could not be effectively hidden within the realm of family and kin was often converted into political power (*via* investing in the education of offspring to pass examinations for public office). "The rich had to find a public role to safeguard private property" (Gates 1996: 38). The state dominant mode put political control over commercial efficiency.

This historical legacy has left a deep imprint on China's emergent political economy and raises the question of whether a similar dynamic is playing out at present. The state's dominance over crucial industrial and commercial interests means that much capital accumulation remains driven by the state. Moreover, many private firms, despite their cumulative importance, remain small in scale. Only in the last five years have more powerful private corporations emerged in such sectors as real estate, electronics, foodstuffs, etc.

China thus exhibits an emergent political economy characterized by two opposite forces: state-led development from above; and development from below that is activated by Chinese network capitalism and the forces of the new global capitalism. Both of these interact and drive the growing importance of markets in China's political economy. The result: a gradual strengthening of private capital and its associated social interests.

Nonetheless, these interests remain politically weak, reflecting how both China's imperial history and Leninist state structure shape its emergent political economy. An Chen hones in on this point in Chapter 8 and argues that China's capitalists are inherently state-subservient, middle and professional classes are just emerging, and the lowest rungs of society are politically powerless. Therefore, despite almost thirty years of rigorous capitalist development, no social force beyond the state possesses the political clout to challenge the CCP. State dominance remains intact, making a transition toward democracy quite remote.

How long state dominance can remain intact, though, is unclear. China's emergent political economy creates a dynamic that pits a state-led logic emphasizing political control against a capitalist logic emphasizing efficiency and capital accumulation. Maryanne Kivlehan's chapter (Chapter 7) on the Chinese media sector captures these tensions pertinently. In her view, prospects for material gain will continue to drive media professionals to produce news that meets consumer demands, thus pushing the envelope of press freedom and reducing state dominance.

Logically, a state-led logic harnessing capital accumulation for the purposes of CCP legitimacy must at some point exhaust itself. Certainly, we do not live in a static world. There are enormous competitive pressures emanating from the global capitalist system. Rapid capital accumulation within national borders can serve a state to repel these pressures. Consequently, CCP hegemony does not stand above any perceived need for economic expansion. Rather, the two are intricately linked. The CCP must ensure continued economic growth to retain its own internal political legitimacy while ensuring China's standing in the world.

Competitive pressures emanating from the international system could therefore prompt Chinese state and party in the direction of continued economic liberalization, fostering increased political prominence for private capital. Whether this will ultimately result in the bifurcation of secular authority and the emergence of a "constitutional" state, as mentioned in Chapter 2, remains to be seen. I will come back to this problem in the concluding chapter (Chapter 12) when I attempt to highlight the most likely future scenarios facing China's emergent political economy.

## Notes

- 1 For comparative attempts along these lines see the contributions in Nee and Stark (1989); and McCormick and Unger (1996).
- 2 See Wedeman (2003) and He (1998) for crony capitalist interpretations of China's developmental dynamics.
- 3 The following information on Zhongshan City's production clusters builds on various interviews undertaken during the summers of 2005 and 2006. See Footnote 5 in Chapter 2 for information on interviews conducted in China.
- 4 See Chapter 9 on these points.
- 5 Interview, summer 2004, Chengdu.

- 6 See, for instance, the excellent recent works on this topic by Zheng (2004) and Yang (2004).
- 7 There has been some debate on this point, reflected by the substantial literature on whether indigenous commercialization and the resulting "sprouts of capitalism" during imperial times represented capitalism in China. For a brief overview of this literature see Gates (1996: 18; 38–41).

## References

- Amsden, A. (2001) *The Rise of the Rest*, New York: Oxford.
- Anderson, J. (2006) "China's True Growth: No Myth or Miracle," *Far Eastern Economic Review*, 169(7): 9–16.
- Bellandi, M. and Di Tommaso, M.R. (2005) "The Case of Specialized Towns in Guangdong, China," *European Planning Studies*, 13(5): 707–729.
- Blecher, M. and Shue, V. (2001) "Into Leather: State-led Development and the Private Sector in Xinji," *The China Quarterly*, (166): 368–393.
- Braudel, F. (1982–1984) *Civilization and Capitalism 15th – 18th Century*, New York: Harper and Row.
- Breslin, S. (2004) "Capitalism with Chinese Characteristics: The Public, the Private and the International," Asia Research Centre Working Paper No. 104, Perth: Murdoch University.
- Dore, R. (1997) "The Asian Form of Capitalism," in P.H. Admiraal (ed.) *The Corporate Triangle*, Malden: Blackwell.
- Edin, M. (2003) "State Capacity and Local Agent Control in China: CCP Cadre Management from a Township Perspective," *The China Quarterly*, (173): 35–52.
- Eng, I. (1997) "The Rise of Manufacturing Towns: Externally Driven Industrialisation and Urban Development in the Pearl River Delta of China," *International Journal of Urban and Regional Research*, 21(4): 554–568.
- Fewsmith, J. (2001) "The Political and Social Implications of China's Accession to the WTO," *The China Quarterly*, (167): 573–591.
- Fulcher, J. (2004) *Capitalism: A Very Short Introduction*, New York: Oxford University Press.
- Gates, H. (1996) *China's Motor: A Thousand Years of Petty Capitalism*, Ithaca, NY: Cornell University Press.
- Gereffi, G. (1990) "Big Business and the State," in G. Gereffi and D. Wyman (eds) *Manufacturing Miracles*, Princeton, NJ: Princeton University Press, pp. 90–109.
- Gerschenkron, A. (1962) *Economic Backwardness in Historical Perspective: A Book of Essays*, Cambridge, MA: Harvard University Press.
- Gold, T. (1986) *State and Society in the Taiwan Miracle*, Armonk, NY: M.E. Sharpe.
- Guiheux, G. (2003) "The Transformation of an Urban Economic Area in Hunan Province: From State Enterprise to a Specialised Market," *China Perspectives*, 49: 4–16.
- Hamilton, G.G. (1996) "Overseas Chinese Capitalism," in W. Tu (ed.) *Confucian Traditions in East Asian Modernity: Moral Education and Economic Culture in Japan and the Four Mini-Dragons*, Cambridge, MA: Harvard University Press, pp. 328–344.
- Hamilton, G.G. and Biggart, N.W. (1997) "Market, Culture, and Authority: A Comparative Analysis of Management and Organization in the Far East," in

- M. Orru, N.W. Biggart, and G.G. Hamilton (eds) *The Economic Organization of East Asian Capitalism*, Thousand Oaks, CA: Sage Publishing, pp. 52–94.
- He, Q. (1998) *Xiandaihua de xianjing – dangdai Zhongguo de jingji shehui wenti* [The Pitfalls of Modernization – China's Present Economic and Social Problems], Beijing: Jinri Zhongguo chubanshe.
- Heilbroner, R.L. (1985) *The Nature and Logic of Capitalism*, New York and London: W.W. Norton.
- Howell, J. (2006) "Reflections on the Chinese State," *Development and Change*, 37(2): 273–297.
- Hsing, Y. (1998) *Making Capitalism in China*, New York: Oxford University Press.
- Huang, Y. (1996) *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations during the Reform Era*, Cambridge: Cambridge University Press.
- International Financial Corporation (2000) *China's Emerging Private Enterprises: Prospects for the New Century*, Washington, DC: International Financial Corporation.
- Johnson, C. (1982) *MITI and the Japanese Miracle*, Stanford: Stanford University Press.
- Lardy, N.R. (1998) *China's Unfinished Economic Revolution*, Washington, DC: Brookings Institution Press.
- (2002) *Integrating China into the Global Economy*, Washington, DC: Brookings Institution.
- Lever-Tracy, C. (2002) "The Impact of the Asian Crisis on Diaspora Chinese Tycoons," *Geoforum*, 33(4): 509–523.
- Lippit, V.D. (2005) *Capitalism*, New York: Routledge.
- McCormick, B.L. and Unger, J. (eds) (1996) *China after Socialism: In the Footsteps of Eastern Europe or East Asia?*, Armonk, NY and London: M.E. Sharpe.
- McNally, C.A. (2002) "Strange Bedfellows: Communist Party Institutions and New Governance Mechanisms in Chinese State Holding Corporations," *Business and Politics*, 4(1): 91–115.
- McNally, C.A. and Chu, Y. (2006) "Exploring Capitalist Development in Greater China: A Synthesis," *Asian Perspective*, 30(2): 31–64.
- Nee, V. and Stark, D. (eds) (1989) *Remaking the Economic Institutions of Socialism: China and Eastern Europe*, Stanford, CA: Stanford University Press.
- Nolan, P. (2001) *China and the Global Economy: National Champions, Industrial Policy and the Big Business Revolution*, Basingstoke: Palgrave.
- North, D. (1990) *Institutions, Institutional Change and Economic Performance*, New York: Cambridge University Press.
- Pontusson, J. (2005) "Varieties and Commonalities of Capitalism," in D. Coates (ed.) *Varieties of Capitalism, Varieties of Approaches*, Basingstoke and New York: Palgrave Macmillan, pp. 163–188.
- Redding, S.G. (1990) *The Spirit of Chinese Capitalism*, Berlin: Walter de Gruyter.
- Rowe, W.T. (1984) *Hankow: Commerce and Society in a Chinese City, 1796–1889*, Stanford, CA: Stanford University Press.
- Shieh, G. (1992) *Boss Island*, New York: Peter Lang.
- Streeck, W. and Thelen, K. (2005) "Introduction: Institutional Change in Advanced Political Economies," in W. Streeck and K. Thelen (eds) *Beyond Continuity: Institutional Change in Advanced Political Economies*, Oxford: Oxford University Press, pp. 1–39.

- Stubbs, R. (1999) "War and Economic Development: Export-Oriented Industrialization in East and Southeast Asia," *Comparative Politics*, 31(3): 337–355.
- Swedberg, R. (2005) "The Economic Sociology of Capitalism: An Introduction and Agenda," in V. Nee and R. Swedberg (eds) *The Economic Sociology of Capitalism*, Princeton, NJ and Oxford: Princeton University Press, pp. 3–40.
- Thelen, K. (1999) "Historical Institutionalism in Comparative Politics," *Annual Review of Political Science*, 2(1): 369–404.
- Tilly, C. (1975) "Reflections on the History of European State Making," in C. Tilly (ed.) *The Formation of National States in Western Europe*, Princeton, NJ: Princeton University Press, pp. 3–84.
- Unger, J. (2002) *The Transformation of Rural China*, Armonk, NY and London: M.E. Sharpe.
- Unger, J. and Chan, A. (1999) "Inheritors of the Boom: Private Enterprise and the Role of Local Government in a Rural South China Township," *The China Journal*, (42): 45–74.
- Wade, R. (1990) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton, NJ: Princeton University Press.
- Wallerstein, I.M. (1974–1989) *The Modern World-System*, New York: Academic Press.
- Wank, D. (1999) *Commodifying Communism: Business, Trust and Politics in a Chinese City*, Cambridge: Cambridge University Press.
- Wedeman, A. (2003) *From Mao to Market: Rent Seeking, Local Protectionism, and Marketization in China*, New York: Cambridge University Press.
- Woo, J.E. (1991) *Race to the Swift: State and Finance in Korean Industrialization*, New York: Columbia University Press.
- Yang, D.L. (2004) *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China*, Stanford, CA: Stanford University Press.
- Zeng, M. and Williamson, P.J. (2003) "The Hidden Dragons," *Harvard Business Review*, 81(10): 92–99.
- Zheng, Y. (2004) *Globalization and State Transformation in China*, Cambridge: Cambridge University Press.
- Zweig, D. (2002) *Internationalizing China: Domestic Interests and Global Linkages*, Ithaca, NY and London: Cornell University Press.