Shaun Breslin
Warwick University

Capitalism with Chinese Characteristics: the Public, the Private and the International

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INTRODUCTION

This working paper considers the politics of China’s economic transition from socialism. It is not intended to provide a comprehensive account of domestic reform in China – that would take a book in itself - but instead is conceived as providing an understanding of the domestic context of change for those scholars interested in International Political Economy (IPE) who are not familiar with the specifics of the Chinese case. It shows how different interests influenced the emergence of a public-private relationship by focusing on three factors – the changing bases of CCP legitimacy, formal policy relating to the socialist nature of the Chinese economy and state, and reform of the financial structure.

It starts from two basic assumptions. First, economic systems and structures do not just emerge on their own but are constructed to serve specific ends. This does not mean that their evolution follows some sort of pre-ordained plan. Often, as is the case with China, the development of the economic system can be dysfunctional in that the system that emerges owes more to the aggregation of numerous initiatives to interpret and implement economic change to serve particular interests than it does to the plans and strategies of national level decision making elites. Second, and very much related, emerging economic systems in transitional states are politically, historically, socially and culturally embedded – where they came from is a key determinant of where they are going.

The paper aims to show that China has moved from a state planned and state owned economy towards state regulation of a hybrid economic system with the existence of a private economic sphere that remains very close to the state system that spawned it. The form of primitive capitalism that has materialised in China is one where state actors, often at the local level, remain central to the functioning of an economic system that has dysfunctionally emerged to suit their interests. Here, my definition of capitalism is ‘the mode of production in which the private ownership of the means of production prevails and in which surplus value is appropriated by the bourgeoisie in the market’ – a market that remains under close state control.

It deploys a somewhat blunt tripartite periodisation of the reform period: 1978 to 1984 is characterised as a period of policy reformulation; 1984 to 1994 as abandoning the old system; and the period after 1994 represents the (as yet) incomplete attempt to build a new system of macro economic control based on law and regulation rather than through state planning control.
THE TRANSITION FROM SOCIALISM

In promoting reform that led China on the path to the transition to socialism, the post-Mao leadership under Deng Xiaoping had a single overriding concern – how best to strengthen the party’s grip on power. Whilst the Chinese Communist Party (CCP) might theoretically have remained a means to an end – that of creating a classless communist society – even the underpinning of a party dictatorship has now all but disappeared. In effect, maintaining the party’s monopoly on power and the position of its members as societal elites has become an end in itself.

Recognising the popular loss in faith in the CCP in the wake of the horrors of the Cultural Revolution, in 1978 Deng and others rejected mass campaigns and political programmes based on ideological indoctrination as a means of building popular support for the party. In its place, three pillars of party legitimacy emerged to underpin both domestic reform, and integration with the global economy.

The first is ideology. It is certainly true that with the de-radicalisation of the revolution and a rejection of the Maoist past, the socialist context of ideology all but disappeared. But Chinese Marxism had always been as much about China as it was about Marxism, and as many commentators have noted, nationalism remains an important element of the CCP’s approach to maintaining legitimacy. At the risk of oversimplification, the party establishes the national interest, and then does what it can to defend that national interest in the face of what is depicted as a hostile West committed to preventing China’s development.

The second is legitimacy through performance – with performance largely defined in terms of economic growth. Thus, there was a political need to ensure rapid capital accumulation to generate economic growth, and increasingly, the adoption of modified capitalist methods and insertion into the global economy was seen as the best way of ensuring this rapid capital accumulation.

The third is stability. Continued CCP rule provides the political stability and personal safety which disappeared in other communist party states where political reform led to the collapse of communist party control. Crucially, the stability provided by party rule is seen as a prerequisite for economic growth and prosperity. The CCP tolerates no challenge to its monopoly on political power, but calculates that the vast majority of the people will accept this so long as their economic wellbeing is improving, or at least not declining. What has emerged is an unwritten social contract between the party and the people whereby the people
do not compete with the party for political power as long as the party looks after their economic fortunes.

These last two bases of legitimacy can lead in contradictory directions. Incrementally, the acceptance of market forces and integration into the global capitalist system was perceived as the best way of generating quick economic growth. But market competition – both domestic and international – was perceived as potentially damaging for those employed in the state sector, and also for many rural workers. Thus, policy, until 1994 at least, entailed a careful balance between promoting market economic reforms that would increase growth and wealth, whilst simultaneously protecting those who might suffer from the introduction of those same market reforms – to create reform without losers (Lau, Qian and Roland 2000). This was largely attained through the use of the financial system to replicate many of the subsidising and protecting features of state planning and control.

It is difficult to overestimate the importance that the Chinese leadership ascribes to maintaining employment. Particularly in urban centres, maintaining employment is seen as the pre-requisite for the maintenance of social stability, and perhaps even the CCP’s continued grip on power. While growing unemployment is worrying for any regime, we should bear in mind that despite the introduction of a form of social welfare, it only has a limited coverage and China still does not have a national system of social security. With decollectivisation in the countryside and the desocialisation of the urban industrial economy, many of the certainties that the old state system provided have disappeared.

At the time of writing, China had a total labour force of roughly 711 million people – around a quarter of the world’s total labour forces and around one and a half times the combined workforce of all developed states. In the countryside, mechanisation and the replacement of collective socialist motivations with private and profit motivations resulted in the loss of an average of six million workers a year in the 1990s. It is widely accepted that around 120 million rural workers are without work for most of the year, though a figure of nearer 200 million has been mentioned in private in interviews.¹ One of the consequences of this increased rural unemployment is the growth in migration – both state sanctioned and supported, and illegal. Not surprisingly, China’s poorest provinces are the major sources of migrant workers. Neither is it surprising that many have made their way to the cities in search of jobs – to the extent that rural unemployment and underemployment is now very definitely an urban issue.

The official urban unemployment rate is around four per cent. But there is a difference between unemployed (失业) and laid off (下岗) workers – and workers can be laid
off for up to three years before they count as officially unemployed. While urban unemployment increased by about 8 per cent per annum in the 1990s, the number of laid off workers increased by around 40 per cent a year. Two thirds of these laid off workers are from State Owned Enterprises (SOEs), and, as with all things in contemporary China, there are large geographic variations with the old industrial bases of north east and central China having both the highest levels of unemployment and the highest levels of laid off workers.

Solinger (2001) suggests that with laid off workers, temporarily re-employed workers who are soon laid off again, and the statistical black hole of migrant workers, it is impossible to come to an accurate figure for urban unemployment in China. But based on calculations made by Hu Angang at the Chinese Academy of Social Sciences, John Giles’ work on unemployment data, and interviews with officials and academics, a figure of 15 per cent may be to the top end of estimates, but not totally unrealistic.

Establishing Reform

The reforms that began in 1978 generated a plethora of consequences - they set in motion the process of liberalisation of agriculture, and although the impact on the urban sector was somewhat delayed, provided the basis for the use of ‘the law of value’ in industry. This is not to say that those who set the reforms in process in 1978 had a blueprint for change (Naughton 1995). For example, Shirk has explained how the priorities of maintaining a semblance of internal party cohesion became something of a defining characteristic of how the CCP managed the first decade of reform. In order to prevent strong opposition to reform, an ethos of fairness came to dominate policy making, or what Shirk (1993: 77) calls an ideology of ‘balancism’. In practice, this meant that central decision makers chose policy options which ensured that no unit or actor lost too much, rather than basing action on a holistic and comprehensive set of policies. With individual agencies left to develop their own reforms, the end results of this fragmented decision making process was a number of unconnected, incoherent, and at times contradictory, reforms

Furthermore, despite a general acceptance of the rejection of the Maoist path – particularly by 1982 – there was no uniform acceptance of the wisdom of moving beyond a return to the correct policies of 1956. Some opposed further reform on ideological grounds. Quite simply, they perceived that creating a more market based system and embracing capitalist practices was not something that a communist party should be doing. Others were
opposed to specific individual policy changes that they perceived as being misguided or undermining their positions of bureaucratic power, or both.

Given these divisions, there was thus a tendency to make small incremental changes which were easier to get past obstructions within the policy making elite than coherent and comprehensive reforms that opponents could coalesce around in opposition. As reforms were not packaged together, it was relatively easy to back-track on individual changes that proved unpopular (or generated unexpected consequences) without having to back-track on the entire reform package in total.

The flip side of this coin was that when even relatively minor problems emerged, opponents could seize on the opportunity to force a rethink of policy, usually resulting in retrenchment. For example, if inflation or unemployment rose, then criticisms would result in a quick policy response, often entailing a minor reversal of policy. Rather than proactively setting the agenda with ‘a consistent program of economic changes’, Naughton (1985: 224) instead portrayed the central government as reactive, ‘unable to dominate events, the government has had to scramble repeatedly to “put out fires” and prevent disastrous outcomes’. Although Naughton’s comments were referring to the 1978-83 period, his basic understanding remained valid until at least 1992.

*From State Planning and Ownership to Primitive Capitalism*

The Third Plenum of 1978 was the first of a number of official changes to the basics of CCP polity reflecting important ideational shifts. Although the CCP formally remained committed to class struggle after the Third Plenum, this political priority of CCP rule was relegated to a secondary place behind the goal of economic modernisation. To be sure, Deng Xiaoping and others had previously argued that economic development should be the party’s main task in the short term – and public statements relating to the colour of cats and raising output came back to haunt Deng during the cultural revolution. But by moving the basis of party rule from a politically to an economically mobilised model (Wang 1988) the Third Plenum created a benchmark for a polity that laid the foundations for the more radical changes that were to come.

In terms of theory building, it was not until 1987 that the then Party General Secretary, Zhao Ziyang, provided a theoretical framework that explained the dominance of economic development as the party’s primary goal. In what was effectively an *ex post facto*
justification for what had gone before, Zhao (1987) explained that as the Chinese economy was still hugely underdeveloped when compared to:

industrialised capitalist nations .... China must go through an extremely long primary stage so that it can achieve the industrialization and the commercialization, socialization and modernization of production that other countries have secured through capitalistic means [emphasis added].

Kwan (2002) believes that this statement was more akin to justifying primitive capitalism rather than socialism.

At this stage, the promotion of private ownership and the formal acceptance of capitalist methods remained politically difficult, and the ‘Tentative Stipulations on Private Enterprises’ in 1988 did little to encourage the formal registration of private enterprises. In practice, the emergence of non-state controlled private enterprises had already played a significant role in generating economic growth. This took four forms. First, the concept of ‘individual ownership’ – 个体户 getihu – had been accepted as a legitimate form of ownership that was in some ways something less than ‘private ownership’ 私营制 siyingzhi as early as 1981.

Second, private economic activity outside of state control had emerged in the countryside through the decollectivisation of agriculture. Freed from total control over what they could produce and how much they received for their produce, rural households developed side-line activities. Third, the search for greater efficiency in farming forced many off the land, but the government was keen to prevent a massive influx of migrants into the cities, and encouraged them to leave the land but not the countryside. Many of the surplus workers were absorbed by the creation of Township and Village Enterprises (TVEs) which proved to be one of the main engines of economic growth, and a major source of China’s export boom in the 1990s.

TVEs would be categorized as being part of a state owned sector in many parts of the world. Ownership resides in local governments, and they have special and preferred access to credit, benefit from privileged trading relations with SOEs, and received political protection from local governments not afforded to individual or private enterprises (Jin and Qian, 1998). But while they are not private, they are considered in China to be very different from ‘state owned enterprises’ 国有 or 国营企业 – non-private but also ‘non-state’. This classification can create massive methodological problems in considering the nature of the Chinese economy.
depending on whether TVEs as a sector are considered to be part of the state sector, or part of
the private sector (Chang and Wang 1994; Weitzman and Xu 1994).

The transition from socialism was not a single smooth one. The incremental nature of reform led to a number of periods of retrenchment as specific problems were dealt with. For example, as inflation grew in the late 1980s, Premier Li Peng restored elements of state control, pricing and planning at the third plenum of the 13th CC in September 1988. The retrenchment campaign was not as successful as Li would have hoped, largely because many local leaders resisted central policy and maintained their own quasi-independent development strategies. Nevertheless, the number of private and individually owned enterprises ‘declined significantly’ between 1989 and 1991 through a combination of specific reforms – for example, demands for payment of back taxes – and the conservative political wind post-Tiananmen that saw increased attacks on the private sector and market economics in general (Liu 2003: 3).

The key turning point came in Deng Xiaoping’s inspection tour of southern China in 1992 - what has become known as the 南巡 nan xun. Despite not holding a formal position of power, Deng made his last significant intervention in the direction of reform – an intervention that in hindsight marked the defeat of conservatism and a watershed in reform. Acting in an ad hoc manner, Deng praised the emergence of proto-capitalist practices in open areas and called for a new policy of rapid economic reform and further opening. Deng did not formally reject socialism or embrace capitalism, but rather dodged the issue of definitions:

The fundamental difference between socialism and capitalism does not lie in the question of whether the planning mechanism or the market mechanism plays a larger role. [The] planned economy does not equal socialism, because planning also exists in capitalism; neither does [the] market economy equal capitalism, because the market also exists in socialism. Both planning and market are just economic means.3

The increasing importance of the non-state sector and concomitant decline in the significance of state planning made the concept of a planned socialist economy increasingly out of step with reality. Thus, in October 1993, the Chinese economy was re-defined as being a ‘socialist market economy’ - 社会主义市场经济. ‘Socialist’ because public ownership remained conceived as the dominant form;

The state-owned economy, i.e. the socialist economy with ownership by the people as a whole, is the leading force in the national economy. The state will
ensure the consolidation and development to the state-owned economy. 
(Article 7, PRC Constitution 1993)

But ‘market economy’ as the law of value replaced state planning as the main means of allocating and distributing resources. As a result, the rights of all sorts of enterprises to purchase, produce and sell what they wanted was increased (though not wholly liberalised – liberalisation is relative) and the number of products where the state set the price and planned production was further decreased. Within five years, over 80 per cent of all prices were determined by market forces rather than set by the state (People’s Daily 2000).

Protection, Reform and the Perceived National Interest

Until 1994, the basis of policy had been fairly consistent. New economic practices were encouraged where they generated economic growth, but vulnerable sectors of the population were protected from potentially damaging market competition. In 1994, a key sea-change occurred. Rather than viewing the national interest as being served by protecting key sectors from the market, the national interest was now viewed as being best served by forcing market competition, and creating a more efficient market economy.

Between 1978 and 1993, SOEs share of urban employment fell from 75 per cent to around 60 per cent. Over the same period, its share of industrial output dropped from 78 per cent to 43 per cent (Cao, Qian and Weingast 1999: 103). By 1994, key leaders, notably Zhu Rongji, considered that maintaining the SOEs had to be reconsidered. They were consuming large amounts of cheap industrial inputs which they utilised much less efficiently than the non-state sector.

In 1998 approximately a third made profits, a third made losses, and the remaining third broke even. This is not what you would call the outcome of successful reforms. An indication of the low productivity of the SOEs is that in 1997 they had 65 percent of the total employment in industry, had 57 percent of the value of assets, produced just 46 per cent of the value added in industry and made only 25 percent of the industrial profits. It is hard to imagine a more dismal record. (Johnson 1999: 14)

Zhou Shulian, argued that the lack of reform in the state sector was the single most important obstacle to the creation of a more efficient and competitive Chinese economy: ‘With the majority of state enterprises staying out of market competition, it is difficult to redistribute resources for better efficiency’. On one level, the ‘top slicing’ of scarce raw material, and
particularly energy, resources to the state sector denied more efficient producers of resources. On another, the quality and reliability of supplies from the state sector was often so low that the World Bank estimated that 17 percent of China's GDP consists of ‘unsaleable’ goods manufactured by SOEs (Blanchard 1997: 24).

Perhaps more important, keeping them afloat was costing billions in subsidies and loans contributing to the near bankruptcy of the Chinese financial system. In 1996, prior to the Company Law which put into operation real SOE reform, around half of all SOEs officially made a loss\(^7\), the amount that the sector as a whole lost had increased by 46 per cent year on year, and unpaid loans to various levels of government by SOEs accounted for around 10 per cent of Chinese GNP\(^8\) - and this does not even start to take into consideration the huge loans through the banking system that had very little chance of ever being paid back. Under the policy of ‘grasping the big and letting go of the small’, small SOEs were transferred to private ownership. As with earlier phases of privatisation, these SOEs were typically transferred into the hands of previous factory managers, or relatives of local party-state officials.

Larger SOEs remained within the state sector, but mergers and consolidation were encouraged. Efficiency was also encouraged through removing protection and forcing competition, and through the shedding of excess workers. From 1995 to China’s WTO entry at the end of 2001, there was a 40 per cent reduction in the number of workers in the state sector (46 million), and a 60 per cent reduction in workers in collectively owned urban enterprises (18.6 million), with a further 34 million state sector workers registered as laid off (Giles, Park and Fang 2003: 1).

**AN EMBEDDED SOCIALIST COMPROMISE?**

The financial system holds the key to both the post-1994 reforms in particular, and the type of state-private relationship that has emerged in China. If we return to the changing bases of legitimacy outlined earlier, then we can see that financial reform entailed something of a trade-off between two conflicting considerations. On one side, the desire to generate rapid economic growth; on the other the concern with ensuring stability and ensuring that important sectors did not lose too much during the transition from socialism. Policy thus represented a compromise between the embedded residual socialist system, and the ever increasing importance of market liberalisation.
Domestically, this compromise was maintained by utilising the planning system. By the end of the 1980s, official Chinese figures showed that subsidies constituted almost a quarter of total central government expenditure. Latterly, the use of the financial system to provide loans to favoured enterprises became increasingly important. As these loans are influenced by political considerations and often ordered by government officials, they can be considered to be quasi-government debt. As non-productive loans in support of political stability increased in the 1980s, then the returns on assets of China’s specialised banks dropped from around 1.4 per cent in 1986 to virtually nil by 1997 (Lardy 1998: 100).

There are so many different figures for the extent of bad loans within the Chinese financial system that you can almost pick whichever figure you want. Official figures suggest that the four state owned banks had over US$240 billion worth of non-performing loans in 2003. At least as much again of bad debt is thought to be held by local institutions (Brown 2004), though in honesty nobody really knows the true figure.

Technical changes can be introduced moving towards a more market oriented system. But changing the preferences and actions of state officials is an entirely different matter. Effectively, when the PRC moved from a plan based to bank based source of credit, many – indeed most – officials continued to act as if the banks’ money was the state’s money. It was to be utilised by state officials based on their considerations of what was politically necessary, rather than controlled by bank officials based on considerations of what was economically prudent and profitable.

Decentralised Socialism

If the financial system is crucial to understanding the state-private relationship, the key to understanding the financial system is an analysis of the fragmented structure of economic power in contemporary China. There is now a relatively large literature on the relationship between central and local authorities in China. Chung’s (1995) ‘mid term appraisal’ of centre local relations in 1995 showed work on centre-local relations already constituted a sizeable and growing sub-field within Chinese studies. Not surprisingly, this canon of work has undergone substantial growth in the subsequent years, including the establishment of the journal ‘Provincial China’ in recognition of the diverse nature of politics and society beneath the national level. Although Lynne T White (1998, 1999) rebuked the mainstream ‘centralist’
literature on China in his study of Shanghai, the idea that the study of China’s political economy must look at what happens at the sub-state level is now all but firmly accepted by scholars of contemporary China.

In recognising that central control is limited by local autonomy, we should not assume that all localities have the same levels of power; or indeed, that they use power in the same ways to produce the same (or similar) outcomes (Goodman 1986). As such, in considering the nature of the Chinese state, it is important to acknowledge the role of the local state (Oi 1995) alongside the national state. It is also important to acknowledge that state power exists at different levels of the ‘local’ from the still relatively centralised provincial level right down to towns and villages. Township and village level governments have also been crucial in establishing new enterprises, and also being the basic level of revenue collection across the country, often deploying innovative and proactive means of generating income (Bernstein and Lu 2003). With a blurring of functions at the local level, governments are often left to regulate both themselves and the local economies – local economies that they might not directly own, but with which they have a hand in glove relationship.

Strong arguments have been made for arguing that the devolution of financial autonomy proved to be highly successful in generating economic growth (Oi 1999; Montinola, Qian and Weingast 1996; Xu and Zhuang 1998; Lin and Liu 2000). But it has resulted in some negative or at least problematic outcomes as well. The lack of macro-control resulted in a highly inefficient use of scarce investment capital, and allowed local authorities to pursue development strategies irrespective of national goals and strategies. Such strategies can take place without knowledge of what is happening in other localities – what is termed ‘blind investment’ – or emulate other localities’ successful ventures.

In order to maintain production in local factories, local governments set up trade barriers preventing ‘imports’ from other parts of China. This not only maintains employment in enterprises that might not be able to exist in a competitive market, but also provides finances for future local projects through local revenue collection. Bernstein and Lu (2003, chapter 4) also argue that is viewed as essential by local authorities to pay the salaries of the ever increasing number of local officials.

While Wederman (2003) perceives this as a ‘positive’ force for the transition towards capitalism, engendering competition between rent seekers, others are less convinced:

Regional protectionism – by protecting the backward, inflating trade costs, blocking the equitable allocation of resources, and hindering the formation of
large-scale economies – is becoming the main cause for the weakening international competitiveness of Chinese enterprises (Hou 2004: 24).

The power of local authorities to collect and impose fees as well as the local influence (if not control) of local banks contributes to the characterisation of many local governments as acting like old feudal economies (诸侯经济 zhuhou jingji) (Shen Liren and Tai Yuanchen, 1990).

In addition to contributing to the rather large holes in the financial system, duplication of production has resulted in over capacity in many areas. As local governments protect their local producers, this has created strains on raw material and energy supplies. For example, in 2004, despite large increases in the production of steel, China was still forced to import steel, forcing international prices up in the process, due to the poor quality of the steel produced by many locally controlled factories.

Local protectionism has also contributed to the lack of a fully functioning internal market within China. So if we return to a conception of capitalism as one where surplus value is appropriated by the bourgeoisie in the market, then we need to focus on how local markets are regulated by the local state in the emergence of Chinese capitalism.

An International Compromise

The logic of ensuring rapid capital accumulation also had a profound impact on the way in which China’s insertion into the global political economy has evolved. At the risk of oversimplification, we can divide the opening of China into four stages. The first, from 1978 to 1986 marked the gradual opening of parts of China to the global economy. Although interaction with the global economy was conceived as being beneficial to the push for growth very early in the reform process, insertion into the capitalist global economy had to be handled with care – not least because the party leadership had spent much of the previous thirty years railing against the evils of the capitalist global economy. Thus, international economic contacts were originally limited to just four Special Economic Zones (SEZs) with the (limited) freedom to conduct international economic relations. These SEZs were conceived as ‘windows on the world’ for China – allowing international economic contacts to grow, but limiting them to specific areas to allay fears from political conservatives that such contacts would lead to ‘bourgeois spiritual pollution’ (Bachman 1988).

China’s SEZs were very similar both in intention and policy to the Export Processing Zones (EPZs) that had previously been established in other regional states. Following the
example of the Kandla export-processing zone in India, Taiwan opened its first EPZ at Gaoxiong (Kaohsiung) in 1966 to attract inward investment to produce exports. A similar strategy was pursued in South Korea, which opened its own EPZ at Masan, and by Malaysia which established EPZs on and around Penang. As Jackson and Mosco (1999) note, the EPZs in Malaysia were intended to dis-embed the globalised sectors of the Malaysian economy from the domestic economy as a whole.

The success of the SEZs in attracting investment and facilitating rapid capital accumulation quickly generated a momentum for further and greater international contacts. Whilst the rest of the country was gradually opened up to international economic contacts (in geographic terms at least) a striking feature of China’s re-engagement with the global economy is a continued uneven geographic distribution, with the vast majority of investment and trade still concentrated on the coastal regions.

The second phase of opening started in 1986, with what has now come to be known as the ‘twenty-two regulations’. These regulations created a more beneficial environment for foreign investors including lower fees for labour and rent, tax rebates for exporters, and made it possible for foreign companies to convert limited profits earned in (RMB) into foreign exchange and repatriate profits. It also extended the joint venture contracts beyond the original 50-year limit, and created a legal basis for wholly foreign owned enterprises, rather than the previous insistence on foreign companies working in joint venture with a Chinese partner. This move considerably increased the attraction of investing in China – not to produce in China, but to produce exports to be sold on other markets. While foreign invested enterprises (FIEs) only accounted for two per cent of exports and six per cent of imports before 1986, the figure increased to 48 per cent and 52 per cent respectively by 2000 (Braunstein and Epstein 2002: 23). Since then, export based investment has not only dominated investment into China, but has also been a major motor of Chinese export growth.

As with domestic reform, the third key change came in the 1992. And in many respects, it was only now that China began to emerge as a global trading power. From 1993, exports increased by 60 per cent in two years (53 per cent in real terms), and doubled in the space of five years. In the process, a US$12.2 billion trade deficit was transformed into a US$5.4 billion surplus the following year, the start of a period of continual trade surpluses that have done much to politicise China’s international economic relations – particularly, but not only, with the United States. It is no coincidence that 1993 also marked the emergence of
China as a major recipient of FDI, with the figure for that year exceeding the entire preceding fourteen years of reform put together.

Gill’s (1995) conception of disciplinary neo-liberalism helps us understand the transfer of ideas and then policy from the global capitalist economy into China. Local authorities across China have competed with each other, and other export oriented economies in East Asia, to attract and then retain investment. In order to do so, local officials have put in place policies that investors want – the global market has disciplined local state actors into making the changes that global non-state economic actors want. And when local and national state actors have ignored the requirements of investors, they have usually been less than successful.

For example, in their analysis of Taiwanese investment in the Xiamen SEZ, Qi and Howe (1995) show how the Xiamen authorities originally concentrated on attracting electronics manufacturers, and designed their local development strategy accordingly. However, Taiwanese investors had different priorities, and instead brought in more and more chemicals producers:

faced with this divergence, the Xiamen authorities apparently abandoned their original goal and declared petrochemicals to be their new ‘investment emphasis’ (Qi and Howe: 1995).

A similar process occurred in Shenzhen where the local leadership tried to restructure the local economy by imposing disincentives for processing industries and component assembly. Whilst these industries did indeed decline, the high-tech and finance investments that Shenzhen was hoping to attract were not forthcoming. As a result, the local authority reversed its policy, and re-introduced a number of incentives to lure back the processing and component assembly investments (China News Service Dec. 6 1995). And when the government in Beijing removed tax exemptions on imported goods used in foreign funded enterprises in 1996, FDI declined to such an extent that the government back-tracked and reintroduced tax exemptions on such imports from 1st January 1998.

Having located China as a low cost assembly site in an international division of labour, it is proving difficult to progress to a new stage. Given the perceived importance of employment as a guarantor of social stability for the Chinese elites, then delinking from the global economy is not an option. As such, the way in which capitalism is emerging in China – or more correctly, in those parts of China that are inserted into the global economy - owes
much to the preferences of external economic actors. And given the growth priorities of Chinese elites, their ability to change this situation remains somewhat limited.

Prior to WTO entry at least, government policy relating to re-engagement was an important tool in the strategy to implement ‘reform without losers’ (Lau, Qian and Roland, 2000). As one of China’s most influential trade officials, Wu Yi, put it in 1998:

> If we cannot keep exports and investment growing, our macroeconomic growth target will be at risk …. It’s not exports for exports’ sake, we have to help achieve an 8 per cent growth rate in GDP …. It’s a political issue to boost exports …. proper export growth is critical in helping the nation reform State-owned enterprises, create jobs and promote social stability (Wang 1998).

But in theory at least, the benefits of engagement should be offset by the impact of international competition on vulnerable and inefficient domestic sectors. To understand how the two sides were satisfied, we need to follow Naughton (2000) and divide the focus of analyses into two distinct and largely separate spheres. Where foreign actors did not compete with domestic actors, then they were encouraged to come to China. This almost always entailed encouraging FDI to produce exports for external markets. The extent of incentives offered to investors will be discussed in more detail below, but what is important here is the extent to which China constructed a remarkably liberal internationalised export regime. Investment was made simple, as was bringing in components to be used in export industries - indeed, as China joined the WTO entry, some 60 per cent of all imports came into China tariff free.

But this liberal export regime sat alongside a relatively closed and protected domestic trading regime. This regime was partly designed to protect domestic producers from competition in order to main production, profitability and jobs. Thus, it protected inefficient loss making SOEs from international competition, and also ensured relatively stable incomes for agricultural producers. But it was also partly designed to provide price advantage to domestic exporters. For example, Zweig (2001: 160) has shown how small scale TVEs ‘swapped access to China’s domestic markets in return for international capital and access to international markets’. Such TVEs accounted for around half of all Chinese exports in 1996, though their significance has subsequently declined. Again we should note the uneven geographic impact of this process with rural TVEs in coastal provinces being the main engine of rural export growth.
THE DOMESTIC, THE INTERNATIONAL AND THE WTO

In its own terms, the policy was a great success. Re-engagement might not have produced all the technological and skills upgrading that it was originally thought it would deliver. But China's relative lack of openness allowed the government to defend perceived national interests by protecting domestic producers whilst supporting domestic exporters and developing new export industries on the back of FDI. Furthermore, the maintenance of a relatively closed financial system provided a bulwark against speculative capital flows. As Yu Yongding (1999: 15) put it (ironically, just prior to the announcement of an agreement between Zhu Rongji and the US) in 1999:

> For many years, observers have criticized China’s slowness in developing financial markets and liberalizing its capital account. The Chinese government itself was also worried by the slow progress. Rather theatrically, the disadvantage has turned into advantage. Owing to capital controls and the underdevelopment of financial markets and the lack of sophisticated financial instruments, such as stock futures and foreign exchange forwards, RMB escaped the attack by international speculators.

Perhaps even more than the first generation of late developing states in East Asia, China’s re-engagement with the global economy appeared to be a great example of how to reap the benefits of the global market-place whilst maintaining strong defences against the dangers of globalisation.

It thus came as something of a surprise to many that the government moved to end years of at times rather bitter negotiations by signing an agreement with the US government in November 1999 with the aim of facilitating China’s entry into the WTO. There was considerable surprise, unease and at times downright opposition to this move from within China itself. Deng Liqun, for example, saw WTO entry as another step on the road towards the creation of a new capitalist ruling class in China which exploits the Chinese workers and farmers (SCMP 2000). Han Deqiang (2000) captured a popular mood by claiming that not only would WTO membership endanger Chinese jobs and incomes, but would also subject China to the vagaries of a global economy dominated by US hegemony. What China needed, for Han, was not the free market liberalism of Adam Smith, but the strong state model of ‘the national system of political economy’ construction championed by Friederich List, and followed by industrial planners during German and Japanese industrialisation. For the sceptics, an existing fragile system could potentially become unstable if WTO commitments made it impossible to continue providing support for vulnerable groups. Agricultural incomes
could fall through a reduction of subsidies and an influx of cheaper grain from the international markets; loss making enterprises could go to the wall, and even those that were operating at a profit might fall into the red in the face of increased international competition; exporters – particularly from the state sector - might suffer through the eradication of government support.

Even after signing an agreement with the US in 1999, it took two years of negotiations with existing WTO member states before China finally joined at the Doha Ministerial Meeting of 2001. In the end, the terms of Chinese entry far exceeded the obligations of previous ‘developing country’ members. As Kawai and Bhattasali (2001: 2) from the World Bank argue, ‘In many areas, the range of liberalization measures agreed surpasses efforts made in many developing and developed countries’ (emphasis added). Indeed, Jeffrey Garten (2001) argues that Chinese concessions have gone so far that the US should accept that it will be politically and economically difficult for the Chinese government to implement all the agreements.

The decision to join, and join on the conditions negotiated in 2001, was partly down to the need to secure access to major markets in the developed world. More important, it reflected the changing conceptions of some leaders of the long term benefits of restricting domestic sectors from competition, and their concerns over the type of capitalism that was emerging in China.

It is incorrect to talk in terms of ‘China’ wanting to join the WTO. The reality is that the decision to join, and join on the conditions outlined above, was the decision of a relatively small group of leaders. In particular, Zhu Rongji, whilst clearly having the support of Jiang Zemin, all but put his reputation and career on the line by establishing the target of WTO entry. Zhu Rongji was a key figure in moving to reform the economic system in the 1990s. Rather than see the national interest as being served by protecting vulnerable sectors from competition, Zhu began to perceive China’s long term economic interests as best served by removing the protection previously offered by the state, and creating a more market efficient economy by competition.

Unable to push through reform in the face of bureaucratic obstruction – particularly, but not only, from local authorities, Zhu turned to an international constituency for reform when he visited Washington in March 1999. As Fewsmith (2001: 574) argues:

Frustrated by bureaucratic obstruction to fundamental reform, Zhu was willing to avail himself of foreign competitive pressures to force restructuring.
In an attempt to settle a WTO deal once and for all, Zhu offered a wide range of concessions to the US government. A deal here would have given external validation and support for Zhu’s position, and impose externally defined constraints on more reluctant officials in China. Many within the Chinese policy elites thought that these concessions went too far, and even expressed downright anger at the lack of consultation in private non-attributable interviews. To make matters worse for Zhu, even these concessions failed to gain an affirmative response from the US.

Not surprisingly, those who were sceptical of Zhu’s approach were not slow to capitalise. Calls for caution and restraint were also fuelled as Zhu’s anti-inflation strategy pursued after 1994 overshot its targets and turned into deflation. With workers concerned about potential unemployment, and the possibility of increased education, health, welfare and housing payments, repeated interest rate reductions and keynesian reflation strategies failed to have any impact on domestic demand. The potential, then, existed for a rethink of policy. Not a return to the old Maoist path, but a more moderate path of liberalisation and a much slower pace of opening to the world (if not a moderate reversal).

For a second time, Zhu looked to the international community and the United States for external support and validation, and to bolster his domestic position (Groombridge and Barfield 1999). Within the US itself, there was a growing recognition that the alternatives to a Zhu Premiership and Zhu’s economic preferences were not that palatable. Thus, by November 1999, Zhu was looking for external support and pressure in his battle with other members of the Chinese party-state elites. At the same time, US interests were keen to lock China into the world system and to lock it into a liberalisation agenda – and the best way to do this was to find a way of maintaining Zhu Rongji’s position within the Chinese leadership.

This is not to suggest that existing WTO members would have signed any deal whatever the concessions on offer. But in addition to negotiating specific deals that would benefit producers in the developed world, negotiators from the US and the EU in particular saw WTO entry as serving wider interests. In the short run, it provided Zhu with an external tool to use to pressure reluctant domestic forces to accept greater domestic liberalisation. In theory at least, it should also massively reduce the significance of leadership change in China, as the freedom of new leaders to set new initiatives should be constrained by the limitations established by WTO membership criteria. In the long term, it should lock China in to ‘international norms’ of trade that have been established by the advanced industrialised
democracies. As an official White House statement on China’s WTO entry stated in March 2000:

China's accession agreement will deepen and help to lock in market reforms -- and empower those in China's leadership who want their country to move further and faster toward economic freedom …. and increase the likelihood that it will play by global rules. (White House 2000)

For proponents of this view, Chinese membership should also eventually lead to social and political change in China on the way to democratisation:

In opening China's telecommunications market, including to Internet and satellite services, the agreement will expose the Chinese people to information, ideas, and debate from around the world. And China's accession to the WTO will help strengthen the rule of law in China. (White House 2000)

CONTEMPORARY CHINA: WHAT KIND OF STATE, WHAT KIND OF CAPITALISM?

The formal relationship between party, state and economy has been established by changes to the organisational principles and structures of the Chinese state, ideational change reflected in reforms to the party and state constitution, and by China’s insertion into the capitalist global economy. In terms of structures, government restructuring after 1998 was designed to make a final move from government control over the economy to government supervision and regulation ‘through legal and economic means’. The key pillars in this supervision and regulation were initially the Ministry of Finance, the People’s Bank of China and the State Planning Commission (renamed the State Development Planning Commission in 2000). In 2003, ‘planning’ disappeared altogether, as the Planning Commission was merged with the Structural Reform Office of the State Council to create The State Development and Reform Commission. Significantly, the need to put in place a new regulatory framework resulting from China’s WTO commitments led to the merger of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) with the State Economic and Trade Commission (SETC) to create a new Ministry of Commerce. For the first time, the relationship between the international and the domestic was officially accepted. In combination, the reforms of 2004 established a governmental structure designed to regulate the economy rather than control it.
In ideational terms, the key turning point came in a speech by the then Party leader, Jiang Zemin on the 80th anniversary of the creation of the CCP in 2001. Jiang’s proposal to allow private entrepreneurs to join the communist party raised concern and bitter protests from many party members (Dickson 2002, 2003). Despite the protests, the party constitution was amended at the 16th Party Congress in November 2002 to include Jiang’s theory of the ‘Three Represents’ to Marxism-Leninism-Mao Zedong Thought as the Party’s guiding principle. As a result, the CCP formally represents not just the Chinese proletariat, but also China’s advanced productive forces, China’s advanced culture, and ‘the fundamental interests of the overwhelming majority of the Chinese people’. As a consequence, the CCP is no longer just the vanguard of the proletariat, but of ‘Chinese People and the Chinese nation’, and membership is open to ‘any advanced element’ including private entrepreneurs.

In truth, few people in China are really concerned about how the party theoretically justifies its oversight of economic reform as long as that economic reform is bringing tangible economic results. It is not so much what the party says as what it delivers that conditions popular attitude to its continued grip on power. However the Three Represents is significant as it marks the official recognition that the fundamental basis of CCP rule, and thus the fundamental basis of the Chinese political regime, has changed.

Whilst party members were exhorted to study the theory of the three represents, the concept of a xiaokang 小康 society was promoted for the wider population. The concept of xiaokang is sometimes associated with a ‘middle class’ society, is better understood as referring to the creation of a moderately well off society\textsuperscript{12} - ‘less affluent than “well-off” but better off than freedom from want’ (Xinhua 2002).

In creating an understanding of the contemporary Chinese state, it is perhaps helpful to think in terms of different types of space. Political space remains occupied by the CCP. To be sure, the party has become more flexible and listening – for example, to think tanks, intellectuals, and to the delegates of the National People’s Congress. It might be becoming a more internally democratised party, and indeed, has an evolving class basis that makes it a very different party than before. But whatever the party is and whatever it represents, the party resists any substantial challenge to its domination of this political space by any possible means.

However, alongside this monopoly of political space, we need to consider the fragmentation of authoritarian power in the national space. Any analysis that ignores the role and power of local authorities at different levels will simply fail to understand the real dynamics of economic, social and political change in China. If China is becoming a
Since the end of the Maoist period, the party has allowed its control of social space to diminish. On one level, there is now a private space, with the de-politicisation of the private life of individuals. To be sure, there are limits – the One Child Policy perhaps being the single most important exception. There are also societal limits based on conceptions of morality that many in the west would regard as conservative. But by and large the party does not dictate what individuals can do in their private lives as long as it does not cross the line into political action. This may not seem like a particularly remarkable degree of freedom unless one considers the intense politicisation of private individual action that characterised the pre-reform political system.

On another level, the party has allowed social groups to emerge and play a role in the social space. However, these social groups do not necessarily play the same role as civil society in other states. For example, business associations in China are mandated to represent both their membership and the government. In this respect, they perhaps serve the role of transmission belts between party and society that the Leninist mass organisations of the pre-reform era failed to perform. If it is civil society, it is party dominated civil society that reflects only a relative relaxation of control over society that, for the time being, the party is still able to reverse if and when it sees fit.

In terms of economic space, the relationship between state and economy is, to say the least, blurred. Strong elements of state control remain in place. The unashamedly pro-neoliberal Heritage Foundation ranked China as 127th out of 157 countries in a league table of economic freedom in 2003. And this was after the liberalisation policies that had been put in place after WTO entry.\(^\text{13}\)

The above mentioned changes in the party and state systems have moved China increasingly towards something that resembles a regulatory state. But as Wank (1998: 2-3) argues, in reality it is all but impossible to distinguish between the public and the private, and formal legal property rights and definitions are less important than the ‘social environment’ in determining market activities. By this, Wank means that having a good relationship with local party state officials is much more important for doing business than the formal ownership classification of that enterprise. Commercial rationality in China is less about searching out market opportunities than searching for strong ties for local officialdom that in turn will guarantee those market opportunities (Wank 1998). Whilst accepting that personalised networks of relationships in business are not unique to China, and that the need
for these relationships are a result of the nature of the Chinese market than any cultural norms, establishing what the Chinese call guanxi 关系 relationships are an essential form of social capital in China (Gold, Guthrie and Wank 2002: 7).

So despite the fact that the non-state sector is now bigger than the state sector, the state-economy relationship remains extremely strong in contemporary China. Much of what is considered non-state remains heavily connected to officialdom through various mechanisms. Much of the non-state sector in contemporary China has its origins in the party-state sector that spawned it. Dickson (2003) focuses on the emergence of new entrepreneurial elites from the ranks of the political elites, concentrating on the children of party state officials, and those entrepreneurs who have left formal political office to become economic elites – the process of xiahai 下海. Particularly at the local level, power holders are switching the prestige, influence and wealth that came from forming part of the political structure for the wealth that comes from being a factory manager, or a member of the board. To be more accurate, they are not so much swapping one source of power for another, but using their political positions to increase their economic potential and bargaining power.

Walder (2002) argues that a wave of privatization that began in 1988 gave a new impetus to this process. But rather than own or run the enterprises themselves, officials more often retained control by proxy. On one level, they established new enterprises run by their relatives, or transferred ownership of publicly owned assets to private enterprises owned by ‘cadre kin’. They then allocated state contracts to these enterprises and provided protection through local state power. On another level, when public enterprises were privatised, the existing managers of the enterprises, with whom local officials had a close working relationship, were typically the first people to be considered as potential new owners. This form of privatisation did not entail government officials directly taking control of public enterprises and assets, but a form of ‘insider privatisation’ (Walder 2002: 13) whereby officials directed the privatisation process towards close contacts or relatives, and ensured that the success of these enterprises remained contingent on the new owners’ relationship with the local government.14

Ding (2000a) has referred to the resulting relationship between political and economic elites as ‘nomenklatura capitalism’ and considers this process of privatisation as comprising illegal asset stripping (Ding 2000b). For example, existing state owned companies would remain in existence, but perform a role of providing cheap supplies to a new privately owned company. Or employees would remain on the books of and be paid by state owned enterprises, whilst actually working for affiliated private companies (usually officially
classified as being collectively owned for legal purposes). Whatever the specific tactic employed, losses would be located in the state sector, and profits in the private.

But the coalescence of political and new economic elites is not just a one-way process. Private entrepreneurs in China find it difficult to make headway unless they have a good relationship with the party-state elites. Even those who have no formal contacts with the party-state are essentially dependent on strong support from local authorities in order to survive. Indeed, successful ‘private’ local enterprises frequently, more correctly usually, succeed thanks to the protection and aid afforded to them by local state elites. In an economy where land, raw materials, transport and finance capital are still in relatively short supply, occupying a gatekeeper role (or knowing somebody who does) has an important economic premium. As such, a form of business-local state is an essential pre-requisite for successful economic activity.

Thus, there is, and long has been, a tendency for emerging private enterprises to form an alliance with local governments. This has often resulted in what are effectively private companies being officially classified as collectively owned ‘in order to obtain the security and privileges that those governments extend to collective firms’ (ADB 2003: 63) – ‘red hat’ enterprises. This can include extending ownership to the local government, local party-state leaders taking a seat on the company board in a private capacity, or simply paying a fee relative to output or turnover to the local authorities. In addition to hard factors, such as easier access to capital, being classified as collectively owned ameliorated what Liu (2003: 4) refers to as ‘ideological harassment’.

Furthermore, new entrepreneurial elites are trying to stabilise their positions by joining the party. And crucially, even before the formal decision to allow ‘advanced productive forces’ into the party, some local organisations were more than happy to not only accept these entrepreneurs into the party. They deemed the economic growth that new enterprises provided as beneficial for local development and the provision of revenues for the local government. Party membership and the benefits it provided for the private entrepreneurs, were also often provided as a prid pro quo for more tangible private economic rewards for party state officials in the form of a seat on the company’s board, or other means of remuneration.

This hand in glove relationship has led a number of observers to describe China as a corporatist economy. There is some value in this concept, particularly if we modify the idea and think in terms of local corporatism where local governments develop ‘institutional ties with civic and professional groups to bring them into the state’ (Dickson 2003: 4). But the
classic idea of corporatism with governments interacting through peak organisations with representatives of economic and social groups perhaps involves a conception of a greater degree of independence from the state (or party, or party-state) than is really the case in China. Yep (2000) also argues that peak organisations such as business organisations lack the necessary coherence and homogeneity to represent their sectors as a whole, and provide the effective means of state-society dialogue foreseen by corporatist models.

CONCLUSION

The Chinese economic system works because it serves the interests of key elites – both economic and political. This does not mean that it is ‘efficient’ in terms of the allocation of resources as the problems of the financial system indicate. Nor does it mean that it is ‘fair’. But while there have indeed been losers of reform (either absolute or relative), the interests of those groups that count most in the power structure are served by the system that they have (often dysfunctionally) generated. It works because it serves the political and economic interests of those who have had the most control over its evolution.

Economic reform in China might not yet have generated democratisation, but it has generated massive political change – notably the transformation of relationships between existing state actors, and the changing basis of their power. There is a symbiotic relationship (at the very least) between state elites and new economic elites. They have effectively co-opted each other into an alliance that, for the time being, mutually reinforces each other’s power and influence, not to mention personal fortunes. What we see, then, is a process of reformulation of class alliances within China. Rather than being a dictatorship of the proletariat, the party leadership increasingly resembles an authoritarian executive leadership acting on behalf of the bourgeoisie (and in many respects, generating the bourgeoisie), whilst providing palliatives for social groups that could jeopardise stability if they lost too much. It is an economic system where the state creates the space for the private sector to dominate and regulates the market to ensure that the new bourgeoisie can appropriate surplus value thanks to the bourgeoisie’s close relationship with the party state - capitalism with Chinese characteristics
NOTES

1. There are considerable regional variations – largely caused by the still very labour intensive rice planting and harvesting periods.

2. See various publications on http://www.msu.edu/~gilesj


4. At this stage, TVEs were the main source of increased non-SOE employment, though after 1994, foreign invested enterprises became increasingly important.


7. Though interviews in China at the time suggested a real figure nearer two thirds.


9. These were Xiamen in Fujian Province, and Zhuhai, Shantou, and Shenzhen in Guangdong. When Hainan Island was later separated from Guangdong to become a province in its own right, it was established as the fifth SEZ.

10. Unless indicated to the contrary, the trade data used in this paper all originates from sources that use figures from the PRC General Administration of Customs. These figures are lower than those estimates of non-Chinese agencies due to different accounting methods. While these figures might deflate the real value of exports by western standards, they are the only way of ensuring the use of common figures, and therefore making like-to-like comparisons.

11. See also Lardy (1998, 2002).

12. Jiang Zemin’s speech to the 16th Party Congress calling to 建设小康社会 was officially translated by the party in English as ‘Building a Well Off Society’.

13. And ranked China as less free in 2003 than before China joined the WTO in 2000. The only areas where China came out ‘well’ (by the Heritage Foundation criteria) was a 2 for the low level of fiscal burden, and 1 for monetary policy due to low levels of inflation. See http://cf.heritage.org/index/country.cfm?ID=30.0

14. There is a close relationship between this kind of relationship and corruption.
REFERENCES


