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Insinuations on China's Emergent Capitalism

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Insinuations on China's Emergent Capitalism*

I. Introduction

Of all the competing forecasts for the 21st Century, most agree that the economic and political emergence of China will be a central event. In terms of speed and scale, the developments unfolding in China are without parallel in the past. Yet, China's rise is being driven by the same historical dynamic that catapulted Great Britain, the United States, Germany, and Japan to international prominence – the emergence of capitalism. Intriguingly, few analysts have explicitly interpreted the massive socio-economic changes taking place within China as a capitalist transition.¹

Interpreting China's breathtaking transformation as a capitalist transition is complicated by how the term capitalism is understood. Quite understandably, some see capitalism as a misnomer for our present political economies because it emphasizes the role of capital over that of ideas and institutions.² Even deeper problems lie in ideological preconceptions. On the one hand, capitalism is seen by advocates of socialism and its related ideologies as a system to be overcome. Capitalism here represents a morally repugnant social system that allows a minority to own the means of production, while the majority is left to toil under exploitative conditions. On the other hand, fervent believers of capitalism tend to gloss over its dark underside and advocate the omnipotence of market forces and private enterprise in solving the socio-economic problems of our time.

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¹ There are several works that have put the capitalist nature of China's transition up front, though most focus on particular aspects of this transition and fail to specifically define the term capitalism. For example, Doug Guthrie, *Dragon in a Three-Piece Suit: The Emergence of Capitalism in China* (Princeton: Princeton University Press, 1999) puts the emergence of capitalism explicitly in the title of his book, but his emphasis rests on micro-social phenomena such as changing labor relations and firm bureaucracies. Similarly, Mary Gallagher (2005) in her *Contagious Capitalism: Globalization and the Politics of Labor* (Princeton: Princeton University Press, 2005) looks at how foreign direct investment in China has affected labor relations. You-tien Hsing, *Making Capitalism in China* (New York: Oxford, 1998) analyzes the influence of Taiwanese investors on China's emerging capitalism. Bruce J. Dickson, *Red Capitalists in China* (Cambridge: Cambridge University Press, 2003) focuses on interesting aspect of China's capitalist transition: the emergence of "red capitalists" – capital-owning strata that are closely aligned with the Chinese party-state's interests. An Chen, "The New Inequality," in *Journal of Democracy* 14 no. 1 (2003): 57; and his chapter in this volume) uses a distinct political economy approach similar to the one developed here. Naturally, the popular press and business literature have commonly noted the capitalist nature of China's transition. For examples, see Jonathan R. Woetzel, *Capitalist China: Strategies for a Revolutionized Economy* (Singapore: John Wiley & Sons (Asia) Pte Ltd, 2003) and Will Hutton, "'Confucian' Capitalism: The Genie is Out of the Bottle," *The Observer* (March 29, 2005).

² Erik S. Reinert and Arno Mong Daastol, *Production Capitalism vs. Financial Capitalism - Symbiosis and Parasitism. An Evolutionary Perspective*, Mimeo, Oslo (September 3-4, 1998).

The central role of the state, the costs of market failures, and the legitimate aspirations of civil society are often forgotten.

Perhaps because of this ideological polarization, conceptions of change in China as a capitalist transition have generally been partial, lacking in analytical depth. The Chinese Communist Party's (CCP) own ideological lenses have certainly not helped in this regard. However, we cannot restrict ourselves by ideological blinders and one-sided interpretations. I will call a spade a spade and explicitly *reinterpret* the enormous transformations taking place in China as generated by the emergence of capitalism. In other words, I will emphatically argue that what is generally perceived as China's transition to a market economy needs to be recognized as part of the process of capitalist development, with parallels to similar historical processes elsewhere in the world.

Capitalism will be viewed as a purely analytical concept. For lack of a better term, capitalism conceptualizes the nature and logic of the predominant politico-economic system of our time, with both its negative and positive attributes. Just like feudalism, capitalism is not an ideology since it contains no distinct utopian vision for the future. The term capitalism merely captures the historically unique forces that have unleashed sustained economic development in the modern era.

While this chapter strongly argues for a reinterpretation of China's massive transformation, its central objective goes further. Speaking of a capitalist transition without analyzing the consequences of such a transition would be like providing half a meal. I will therefore attempt to delineate the contours of China's emerging capitalism. Logically, this constitutes a preliminary effort. The structure of China's emerging political economy is being forged by an ongoing process, the outcome of which remains indeterminate. In fact, China's capitalist transition is by no means complete. As I will note in the concluding parts, political imperatives could conceivably halt the process and roll back achievements to date.

Nonetheless, by applying an analytical framework derived from historical and comparative materials on capitalist systems, I can analyze China's transformation and indicate certain tendencies in its political economy. These tendencies are being in part generated by the three forces of change mentioned in the introduction (*economization*; *pluralization & institutionalization*; and *international integration*). I will therefore engage in an exercise of logical analysis that will hopefully allow me to insinuate the contours of China's emerging capitalism.

To reach my objectives I will precede as follows: In the following part, I will work towards a conceptual framework for analyzing China's capitalist transition. An investigation into the fundamental building blocs of capitalist systems will be provided, followed by brief overviews of the evolution of capitalism and its institutional variations. This part will end with a proposal for a conceptual framework. In the third part, I will reinterpret China's process of reform and opening up as driven by the logic of capitalist development. Specifically, I will concentrate on the three basic elements of capitalism – the drive to amass capital; the emergence of market society; and the bifurcation of secular

authority – and elaborate how their manifestations evolved during China’s era of reform and opening up.

In the fourth part I will work towards delineating the shape of China’s emerging capitalism by briefly comparing it to varieties of Asian capitalism. I will argue that there are at least two outstanding characteristics: First, the prevalence of networked forms of capitalism in China’s domestic private sector. China therefore possesses certain similarities with the *Sino-capitalisms* of Taiwan and Southeast Asia. However, China is huge in comparison to these political economies, introducing considerable regional variations.

Second, China’s capitalist development is clearly taking place under the strong influence of globalization, but the internationalization of China’s economy has been highly partial. The strong integration of the Chinese economy into the world capitalist system has created economic spaces that are divorced from China’s domestic economy but highly integrated into global production networks.

Despite major advances, China’s transition towards capitalism remains incomplete. Substantial institutional and legislative uncertainty affects the domestic political economy, inducing private entrepreneurs to forge clientelistic and idiosyncratic ties to the party-state. Perhaps the biggest question concerning China’s future is therefore whether its political economy will stay stuck in a form of “Chinese Crony Capitalism” or continue to evolve. The concluding remarks will attempt to shed some light on this crucial issue.

II. Conceptual Framework

What is Capitalism?

The historical transition to capitalism in several world regions has over the last five centuries constituted the most momentous event. Nonetheless, specifying the exact nature of capitalism remains problematic. According to Milton Friedman, capitalism represents the “organization of the bulk of economic activity through private enterprise operation in a free market.”³ This conception expresses the popular understanding of the core characteristics of capitalism: private enterprise and free markets. Ruth McVey presents a more nuanced view, defining “capitalism as a system in which the means of production, in private hands, are employed to create a profit, some of which is reinvested to increase profit-generating capacity.”⁴ Again private enterprise is up front, but McVey also stresses the expansive nature of capital – private individuals must be given opportunities to accumulate capital to reinvest and generate more capital.

Both of the above definitions capture popular impressions of capitalism, but only partially explain the underlying political economy of capitalist systems. Building on Robert Heilbroner’s works I draw attention to three fundamental elements of capitalism.⁵

³ Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1982), 4.

⁴ Ruth McVey, “The Materialization of the Southeast Asian Entrepreneur” in *Southeast Asian Capitalists*, edited by Ruth McVey (Ithaca: Cornell University Press, 1992): 8.

⁵ Robert L. Heilbroner, *The Nature and Logic of Capitalism* (New York and London: W.W. Norton, 1985); Robert L. Heilbroner, *21st Century Capitalism* (New York & London: W.W. Norton & Company, 1993).

First and foremost is the distinctive drive to extract and accumulate capital, which must become “the major organizing basis for sociopolitical life.”⁶ Capital is intrinsically dynamic, since it can change its form from commodity into money and then back again. This dynamic nature of capital engenders a continuous process characterized by the repetitive extraction and then reinvestment of capital. In turn, this process unleashes new productive forces or as Heilbroner contends: “Capitalism is a system organized to search for, and to seize on, whatever technological and organizational changes offer profitable chances for expansion.”⁷

The second element of capitalism concerns the structuring role of markets, which dominate the functioning of the economy. Unmistakably, the first function of markets “is to allocate labor to those tasks that society wants filled.”⁸ This cannot take place in a society that controls the flow of labor, such as in feudalism or a centrally planned economy. Markets are also indispensable to channel other factors of production. Some of the most potent instruments to accumulate capital resulted from the establishment of markets for land and capital. Finally, the market system must be able to create competitive pressures via the price mechanism. Capital only can flourish when it is continuously dissolved and recaptured, forced to move from productive activities with lower returns to those with higher returns. All told, markets constitute the necessary organizing principle of capitalism. Nonetheless, “capitalism is a much larger and more complex entity than the market system we use as its equivalent . . . The market system is the principal means of binding and coordinating the whole, but markets are not the source of capitalism’s energies nor of its distinctive bifurcation of authority.”⁹

The final element of capitalism is seldom explicated, even if it is crucial. Capitalism can only emerge with the rise of a “capital-oriented class – originally always a merchant class – from a subordinate position within society to a position of leverage.”¹⁰ Capitalism thus differs from earlier socio-political regimes, such as those based on religious conviction, military force, or a fixed status system. The formerly subordinated merchant classes rise in social importance and gain control over strategic resources, making them indispensable to the state. As a result, the direct access to the means of violence wielded by state elites cedes its supremacy over the economy.

One cannot overstate this central element of capitalism. Historically, merchant classes have existed at the pleasure of state elites. Capitalism could therefore only emerge as state elites saw it in their interest to support the expansion of capital. This in turn entailed some political recognition of capital, such as the freeing of factor markets, the curtailing of predatory governmental tax behavior, and ultimately, the defense of private property rights. Capital must therefore arise with the goodwill of state elites, but, as it expands,

⁶ Heilbroner, *The Nature and Logic of Capitalism*, 143.

⁷ Heilbroner, *21st Century Capitalism*, 134-135. This drive to seek new profit opportunities in order to accumulate capital also lends capitalism its relentless pressure for change. Capitalism is therefore a system fostering progress (social, economic and political), another one of its unique historical properties. See *Ibid.*, 30-37.

⁸ Heilbroner, *21st Century Capitalism*, 99.

⁹ *Ibid.*, 96.

¹⁰ Heilbroner, *The Nature and Logic of Capitalism*, 41.

capital-holders take over strategic social functions (e.g., the relatively stable provisioning of state revenue). It is at this point that the act of withholding capital becomes an expression of power and the social force of capital “becomes increasingly capable of defying, or of existing ‘above,’ the state.”¹¹ An autonomous, self-directing economic realm appears that assures the continued existence and social influence of capital-holders.

The historical reasons for capital’s political ascendance are complex, although the underlying logic is straightforward. In an inter-state system where some state elites tolerate capital’s ascendance, those that don’t pay a high price. History is replete with examples of state elites that undermined the productive capacities of capital by high taxes, excessive monopolies, and unwarranted expropriation. Capital then either withered or left for territories with securer and higher returns, triggering economic stagnation and national decline. In contrast, state elites that yielded authority over the economy to capital actually experienced an expansion of their power in new realms. For example, the monetization of the economy creates opportunities for increased taxation and more effective governance.¹² More importantly, capital to thrive seeks reconstituted and expanding state power, especially to establish effective property rights, governance structures, and rules of exchange.

The ascendance of capital triggers capitalism’s historically most unique arrangement: the bifurcation of secular authority. As an increasingly autonomous, self-directing realm of the economy emerges it disrupts time-honored political logics. The growing flows of commodities become “subject to the directing forces of the marketplace, in addition to those of national sovereignty.”¹³ Capital-holders therefore take over the major influencing role to guide the allocation of goods and services, fostering an autonomous realm of commerce and production. The power structures of “the state” and “the economy” become different realms, each with its own logic, yet a need to coexist in the same territory. “What we do not ordinarily bear in mind is that this duality of realms, with its somewhat smudgy boundaries, has no counterpart in noncapitalist societies.”¹⁴

Put differently, in order to survive and thrive, capital must exist in a mixed state of independence from and dependence on state power. Views of the capitalist system as being based solely on private capital and markets are therefore misconceived. Although the state’s full economic power remains in the background during peacetime, it represents a key force shaping capitalist accumulation. Only with the state’s active establishment of stable property rights, governance structures, and rules of exchange can the normal operation of capitalism be assured. As Douglas North maintains: “. . . the search for

¹¹ Ibid., 94.

¹² One classical example of this is the increase in power of the Japanese state after the Meiji reforms. The monetization of obligations by subjects to the state helped create a governmental structure, giving the Meiji state a great deal more direct control over its subjects than the Tokugawa state ever had. See David L. Howell, *Status and Politics of the Quotidian* (Mimeo: Princeton University, 2002), 188.

¹³ Heilbroner, *The Nature and Logic of Capitalism*, 92.

¹⁴ Heilbroner, *21st Century Capitalism*, 69.

efficient economic organization leads us to political organization, since it is the polity that defines and enforces the economic rules of the game.”¹⁵

To sum up, three central elements distinguish capitalist systems from earlier social systems. First, capital must be able to expand in the continuous process of investment, extraction, reinvestment, and further extraction. The motivating dynamic of capitalism therefore rests in “the driving need to extract wealth from the productive activities of society in the form of capital.”¹⁶ Second, this condition can only be attained after markets constitute the organizing principle of the economy. The free flow of capital and fierce competition, including oligopolistic competition, are necessary selection mechanisms, engendering what Schumpeter aptly termed “cycles of creative destruction.” Finally, the rise of capitalists to both economic *and* political prominence constitutes the socio-political turning point for the emergence of capitalism. With the growth of capital-owning social strata an autonomous, self-directing realm for the economy transpires, bolstered by capitalists’ fundamental power to withdraw capital from use if returns are insufficient or risks too high. In this manner, the productive and financial resources controlled by capital circumscribe the hitherto dominant force of state authority.

Capitalism in Time and Space

The above three elements merely constitute the fundamental dynamics propelling capitalist systems. A variety of additional factors have created different institutional manifestations of capitalism over time and space. First and foremost, capitalism evolved in world historical time, moving from humble beginnings to a system encompassing most of the globe.¹⁷ I will here sketch aspects of the birth of capitalist production and its subsequent development with the purpose of informing the conceptual framework applied to China’s capitalist transition that follows in the next section.

The genesis of capitalism has fascinated historians and social scientists throughout modern times. Reasons given for the emergence of capitalism have encompassed cultural, ideational, economic, environmental, geographic, demographic, social, and political explanations. Due to space considerations, these explanations cannot be given exhaustive treatment. Besides, no single factor or relationship can be said to have had an all-powerful effect on the emergence of capitalism.

Seeds of capitalist production emerged in many world regions. For example, merchants in China grew rich and could bribe their way to influence. However, unless they became landed officials, their wealth remained at risk of confiscation by public officials.¹⁸ In addition, the nature of China’s empire made it all but impossible for Chinese merchants

¹⁵ Douglas C. North, “The Rise of the Western World” in *Political Competition, Innovation and Growth - A Historical Analysis*, edited by Peter Bernholz, et al. (Berlin, Heidelberg and New York: Springer, 1998): 13.

¹⁶ Heilbroner, *The Nature and Logic of Capitalism*, 33.

¹⁷ Fernand Braudel, *Civilization and Capitalism 15th - 18th Century* (New York: Harper and Row, 1982-1984); Immanuel M. Wallerstein, *The Modern World-System* (New York: Academic Press, 1974-1989); Heilbroner, *The Nature and Logic of Capitalism*, chapter 6.

¹⁸ Eric L. Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia*, Third Edition (Cambridge: Cambridge University Press, 2003): XXX.

to withdraw their capital and move to more accommodating environments. Chinese state elites therefore restrained the power of merchant classes, hampering the emergence of a self-directing economic realm.

The first time more permanent processes of the repetitive and expansive accumulation of capital emerged was in the politically autonomous city-states of Northern Italy.¹⁹ Capitalist accumulation then spread across Europe along ancient trade routes facilitated by common religious practices and trading customs. Capitalism in Europe also became increasingly tied up in imperial conquest, which allowed European economies to access more resources, new markets, and, later, larger labor forces.

Perhaps one of the crucial ingredients for the emergence of capitalism lay in Europe's growing political competition.²⁰ A large swath of Europe possessed a common civilization and was part of a market network allowing for commodity trade across long distances. However, the European state-system was characterized by political decentralization, which engendered increasing inter-state competition. Since this competition took the form of constantly changing and ever more expensive warfare, state elites required escalating amounts of capital. To be successful state elites therefore needed to strike a political "deal": A rival social stratum – capital – was granted greater political space in return for greater tax revenue. Due to Europe's fragmented political order, capitalists could also move capital to those territories with the highest returns and lowest risks, engendering institutional competition among and within political units. Two simultaneous dynamics unfolded: the emergence of an autonomous economic realm that fostered the expansion of capital accumulation; and the evolution of the modern European nation-state system.²¹

As one would expect, not all state elites succeeded in providing the incentives that let capitalist production thrive. Divergent policies of elites, all driven by the same need to support warfare, but conditioned by different socio-political conditions, led to radically different economic outcomes. The stagnation in Spain, despite imperial conquests, and the rapid expansion in the Netherlands and specifically Amsterdam, where modern economic growth originated, portray two extremes. Europe's "freedom from overarching imperial political control . . . allowed the necessary diversity of domestic political conditions to evolve, in some of which market behavior become a dominant social and economic practice."²²

¹⁹ Fernand Braudel, *Out of Italy: 1450-1650* (Paris: Flammarion, 1991).

²⁰ Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia*; Douglas C. North, *Structure and Change in Economic History* (New York: W.W. Norton, 1981); North, *The Rise of the Western World*.

²¹ William H McNeill, *The Pursuit of Power: Technology, Armed Force, and Society Since A.D. 1000* (Chicago: University of Chicago Press, 1982); Charles Tilly, *Coercion, Capital, and European States, AD 990-1992* (Cambridge MA & Oxford: Blackwell, 1992); Michael Mann, *The Sources of Social Power, vol I: A History of Power from the Beginning to A.D. 1760* (Cambridge: Cambridge University Press, 1986).

²² Barry Buzan, "The Interdependence of Security and Economic Issues in the 'New World Order'" in *Political Economy and the Changing Global Order*, edited by Richards Stubbs and Geoffrey R.D. Underhill (New York: St Martin's Press, 1994), 90.

Institutional innovation to support capitalist accumulation, especially the establishment of effective parliamentary, legal, and financial institutions, reached a peak in Great Britain around 1760.²³ It was at this point in world historical time that capitalism began to emerge in full force. The machine-based first industrial revolution rapidly expanded the scope of capital accumulation. Over the 1800s standardized modes of work, such as assembly lines, appeared, production processes became mechanized, and expanding domestic and international markets spurred large-scale industrial development. Families, however, retained control over most firms. *Proprietary capitalism* characterized this early phase of capitalist accumulation in Great Britain.²⁴

At the beginning of the 20th century, England was the world's workshop, while the City of London acted as the world's financial center. Yet, *proprietary capitalism* persisted.²⁵ The consequent underdevelopment of modern managerial organization in Great Britain gave other economies an edge during the second, science-based industrial revolution.²⁶ In the United States, a powerful form of *managerial capitalism* started to take root. Spurred by the Great Merger movement at the end of the 19th century and the increasing liquidity of stock markets in the 1920s, stock ownership came to be separated from managerial control. Technical and administrative specialists were increasingly in charge of the day-to-day affairs of corporations. Like in the United States, several late developers rapidly developed technical training and modern managerial organizations. However, preexisting social, economic, and political institutions heavily shaped the emerging institutions of capitalism in these late developers, which include Germany and Japan, as well as several smaller European nations.

The industrial strife and massive human dislocation resulting from the Great Depression and the Second World War triggered a reconstitution of capitalist institutions. New Deal legislation in the United States and the 1946 victory of the Labor Party in Great Britain ushered in the expansion of social welfare systems. Even more pronounced changes took place in Germany and Japan. Allied occupation forces sought at first to break the highly concentrated and oligopolistic industrial sectors that had formed in close association with state interests. Ironically, the onset of the Cold War led to policy adjustments, which partially reconstituted former state-capital relations. A curious amalgam of old and new emerged, producing distinctive capitalist regimes in Germany and Japan.²⁷

In Germany one main characteristic of the new system was the institution of *codetermination*, which gave West German workers extensive formal representation in

²³ Douglas C. North and Barry W. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in 17th Century England," in *Journal of Economic History* 49 no. 4 (1989): 803-382

²⁴ Ronald Dore, William Lazonick and Mary O'Sullivan, "Varieties of Capitalism in the Twentieth Century," in *Oxford Review of Economic Policy* 15 no. 4 (1999), 103.

²⁵ Roy Church, "The Family Firm in Industrial Capitalism: International Perspectives on Hypotheses and History," in *Business History* 35 no. 4 (1993): 17-43; Alfred Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge and London: Harvard University Press, 1990).

²⁶ Dore, Lazonick, and O'Sullivan, "Varieties of Capitalism in the 20th Century."

²⁷ Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford, CA: Stanford University Press, 1982); Dore, Lazonick, and O'Sullivan, "Varieties of Capitalism in the 20th Century."

the corporate governance of firms. In Japan, labor-capital relations emphasized enterprise-based unions and “lifetime employment.” Perhaps more significantly, a generic form of *coordinated capitalism* emerged in post-war Japan.²⁸ Technically competent bureaucrats provided a blueprint for national reconstruction, directing bank loans to particular enterprises able to achieve this blueprint. This fostered close coordination among bureaucrats and large business groups.²⁹

Despite considerable differences among the institutional arrangements of major capitalist economies, several parallels can be detected during the post-war era (1945-1970). First, *managerial capitalism* had become a global norm by the 1960s. Technological complexity in the activities of large-scale firms demanded an increasing array of specialist knowledge. Control over decision-making thus passed from the owners of capital to managerial and technical specialists. Towards the end of this era John Kenneth Galbraith even argued that in the modern corporate enterprise individual entrepreneurship and leadership had become more or less irrelevant.³⁰ Second, in all the major economies the role of the state was magnified. John Maynard Keynes’ theories engendered a more active role for state fiscal policy in influencing economic cycles and growth. Moreover, in Europe and Japan post-war governments had become active as owners of productive and commercial assets in their own right, while in the United States low public ownership was compensated by the close ties between the defense industrial complex, research universities, and government officials.

The combination of low economic growth and high inflation in the 1970s ushered in a major transition: the active role of the state in the economy was first questioned and then decried. Neoliberal free-market ideology ascended. Especially in the United States and Great Britain deregulation and privatization started to dominate state economic policy; a drastic reduction in union power occurred; and shareholder value – the belief that business concerns must maximize shareholder value as measured by stock prices -- became the buzz of boardrooms. All of these changes triggered a rise in the importance of stock markets. Pension funds started to invest more and more of their assets in equity, leading Dore to refer to this new phase of capitalism as *stock market capitalism*, *pension fund capitalism*, or *gray capitalism*.³¹ At the same time, management remuneration packages changed to incorporate stock options, an attempt to tie management incentives directly to the performance of a company’s share price.

Two very remarkable facets of this latest phase of capitalism must be noted since they directly affect China’s capitalist transition. First, with the fall of Communism in Eastern

²⁸ See Mark Beeson and Richard Robison, "Introduction: Interpreting the Crisis" in *Politics and Markets in the Work of the Asian Crisis*, edited by Richard Robison, et al. (London and New York: Routledge, 2000): 11. *Coordinated capitalism* can also be compared with what Peter A. Hall and David Soskice, *Varieties of Capitalism - The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001), 8, term a *coordinated market economy*. Examples of *coordinated market economies* include Japan, Germany, and most other continental European economies.

²⁹ Johnson, *MITI and the Japanese Miracle*.

³⁰ John K. Galbraith, *The New Industrial State* (Boston, MA: Houghton Mifflin, 1967), 71.

³¹ Ronald Dore, *Stock Market Capitalism: Welfare Capitalism - Japan and Germany Versus the Anglo-Saxons* (Oxford: Oxford University Press, 2000).

Europe and the Soviet Union, the opening of China to world trade, and the implementation of market-friendly reforms in Latin America, South Asia and Southeast Asia, the dynamics of the world capitalist system are reaching more people than ever before. The rapid increase in international capital flows most succinctly expresses this new era of *global capitalism*.³² Second, Great Britain and especially the United States moved from stagnation to dynamism over the course of the 1980s and 1990s. The high-tech boom in the United States fuelled a massive increase in new ventures, new knowledge, and new business models. The individual entrepreneur was once again at the center of capitalist accumulation, aided by new technologies to manage operations and new financial mechanisms to support start-up ventures.

The drive to amass capital, capitalists' economic *and* political prominence (the bifurcation of the secular realm), and market society characterize all forms of capitalism. Yet, capitalism is undergoing continuous change throughout time and space. New institutional configurations centered on the role of the state, markets, civil society (including labor), and capital-holders are continuously generated. Global forces further interact with the development of capitalist institutions on the national level and vice versa.

Intriguingly, the growing force of *global capitalism* is reflected in a recent academic debate on the origins and influence of "varieties of capitalism".³³ The dispute focuses on whether all national capitalisms will converge to one standard (implicitly, most efficient) institutional configuration of capitalist production. This debate, however, is far from resolved.³⁴ Depending on how one selects the country and period, convergence among some advanced industrialized economies can be found. Among the most advanced and developing economies, though, the differentials point to no convergence at all.³⁵ Evidently, the large volume of research on comparative capitalisms highlights the marked differences among capitalist institutions on the national level.³⁶

³² See Beth A. Simmons, "The Internationalization of Capital" in *Continuity and Change in Contemporary Capitalism*, edited by Herbert Kitschelt, et al. (Cambridge: Cambridge University Press, 1999): 36-69.

³³ The debate originated with Michael Albert, *Capitalism Against Capitalism* (London: Whurr, 1993).

³⁴ Suzanne Berger and Ronald Dore ed., *National Diversity and Global Capitalism* (Ithaca, NY: Cornell University Press: 1996).

³⁵ Robert Boyer, "The Convergence Hypothesis Revisited: Globalization but Still the Century of Nations?" in *National Diversity and Global Capitalism*, edited by Suzanne Berger and Ronald Dore (Ithaca, NY: Cornell University Press, 1996): 29-59.

³⁶ See, for example, Andrew Shonfield, *Modern Capitalism* (London, New York and Toronto: Oxford University Press, 1965); John Goldthorpe, *Order and Conflict in Contemporary Capitalism* (Oxford and New York: Oxford University Press, 1984); Albert, *Capitalism Against Capitalism*; Neil Fligstein and Robert Freeland, "Theoretical and Comparative Perspectives in Corporate Organization," in *Annual Review of Sociology* 21 no. (1995): 21-43; Berger and Dore ed., *National Diversity*; Herbert Kitschelt, Peter Lange, Gary Marks and John D Stephens ed., *Continuity and Change in Contemporary Capitalism* (Cambridge: Cambridge University Press: 1999); Hall and Soskice, *Varieties of Capitalism*; and Neil Fligstein, *The Architecture of Markets - An Economic Sociology of Twenty-First Century Capitalist Societies* (Princeton, NJ: Princeton University Press, 2001).

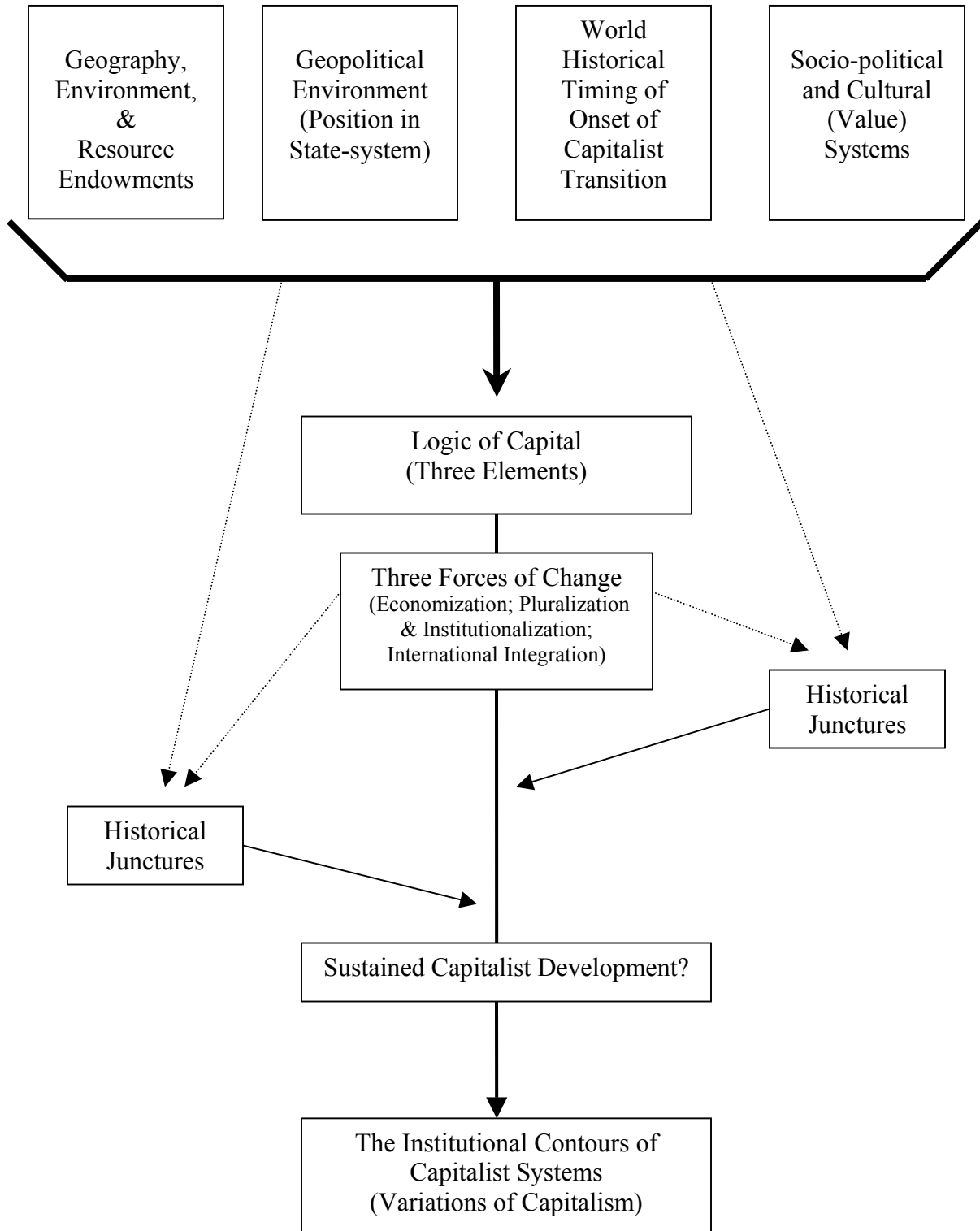
Conceptual Framework

When looking at the birth and evolution of capitalism it becomes clear that as a socio-economic system capitalism is not cast in stone. Indeed, all developed economies are currently experiencing profound changes. A technological revolution is creating entirely new industries, including biotechnology and digital electronics. Similarly, most developing economies are experiencing an acceleration of economic and social change, triggered by the growing force of *global capitalism*.

A conceptual framework that can be fruitfully applied to China's emerging capitalism must therefore be able to capture the ever changing nature of capitalist institutions, while at the same time pointing to certain tendencies that are common across all capitalist systems. Definitely, the purpose of the conceptual framework must be to shed light on the *process* of China's capitalist transition. Figure 1 represents a process model, which is most ideally suited to this task. Specifically, four parts constitute the framework: *structuring conditions* that often trigger and fundamentally shape the process of a capitalist transition; the central *logic of capital* that is relatively constant across time and space; *historical junctures* that can originate from the tensions underlying capitalist development or be brought about by exogenous factors; and the *institutional contours of capitalist systems* that result from this process.

As Figure 1 illustrates, the nature of capitalist development is understood to be path-dependent. The political, social, economic, geographic, and cultural environment in place at the outset of a capitalist transition (*structuring conditions*) shapes how capitalist institutions evolve, accounting for the institutional variations found in contemporary capitalism. Likewise, historical shocks and contingencies (*historical junctures*) are known to impinge on the process of capitalist development. Some of these originate on the local and national level, while others are driven by global forces. In this way, the model attempts to capture how the advancement of capitalism on a global scale shapes national processes of capitalist development. In the following I will briefly elaborate on each of the four constituent parts of the conceptual framework.

Figure 1: Conceptual Framework



The framework encompasses four types of *structuring conditions*, which attempt to capture the totality of physical and social factors that can influence the trajectory of capitalist development. Several have already been observed in the section on *Capitalism in Time and Space*. Undoubtedly, environmental and geographical differences condition the economic possibilities of societies. Some societies find themselves in lands of abundance, while others are faced with rugged inhospitable terrains. Geography therefore deals worse cards to some than to others.³⁷ Favorable geographical and resource endowments, however, do not necessarily facilitate the emergence of capitalism, since state elites controlling large resource endowments do not need to rely on capital-holders for greater state revenue. Indeed, many political systems in territories with resource abundance have created forms of *crony capitalism*, an embryonic form of capitalism in which the bifurcation of the secular realm is not complete. Government-business collusion is the order of the day, forestalling healthy market competition and a maturing of the social force of capital.

The geopolitical environment was and remains one of the major factors triggering or hindering the emergence of capitalism. The history of Europe and East Asia shows that states facing grave national security threats have been more likely to allow capitalist development to proceed. This is for a simple reason. The need to marshal sufficient resources for national security induces state elites to allow the emergence of a rival power stratum – capital. Most late developers in the post-World War II period, including Taiwan, South Korea, and Israel, embody this principle.³⁸ However, when no threats to regime survival exist and/or rich resource endowments are available, as in many nations of Sub-Saharan Africa, then competitive pressures can be lagging or even non-existent, fostering *crony capitalism* and bad governance.³⁹

The literature on capitalist development has been especially attentive to how differences in institutional arrangements can be traced back to at which point in world historical time a nation transitions to capitalism. The first countries to undergo capitalist transitions faced no established competitors. Great Britain industrialized first, followed closely by the United States, which benefited from a vast continental hinterland and massive immigration. Similarly, Canada, Australia, and New Zealand, although developing a few decades later, could harness abundant natural resources and the transfer of knowledge and institutions from Europe. In all of these cases, technological advances and institutional change were relatively gradual.

³⁷ As Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia* argues, the incidence of major natural disasters was a hindering factor for the emergence of sustained capitalist development in India and China. Although faced with less abundant climate and soil conditions, Europe benefited from the lower incidence of major natural disasters (hurricanes, earthquakes, etc.), which in turn provided better incentives for long-term investments in irrigation and infrastructure. Another prominent statement on the importance of environmental factors is Jared Diamonds, *Guns, Germs, and Steel* (New York: W.W. Norton & Co., 1997).

³⁸ Joel S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton: Princeton University Press, 1988).

³⁹ See Jeffrey Herbst, "War and the State in Africa," in *International Security* 14 no. (1990): 117-139.

By the late 19th century several late developers appeared. Chiefly, these include Germany and Japan, although Italy and France, as well as many smaller European countries are considered late developers as well. Most of these countries experienced a much more rapid capitalist transition. Competition from more established enterprise and market institutions was fierce, even though previously developed technologies could be copied. Many late developers thus harnessed their financial systems to intimately support the rapid development of industrial firms.⁴⁰ Large-scale integrated firms emerged within the span of one decade in cutting-edge industries such chemicals, steel, and electronics. Educational institutions, bodies of law, and state administrative structures also underwent rapid transformations in the face of the greater competitive pressures exerted by already well-established capitalist systems.

Besides harnessing new financial and enterprise institutions, the role of the state was magnified considerably in late developers.⁴¹ Indeed, in the Russian and Japanese cases it became a prime driver of industrialization. During the late 1920s and 1930s this development was even taken a few steps further under the Soviet Union. However, an overemphasis on planning and state investment occurred at the expense of competition and the free flow of capital. Despite considerable successes in establishing integrated industrial complexes, Soviet central planning ultimately ended as a failure.⁴²

World historical timing therefore draws our attention to one crucial aspect of capitalist transitions. As is the case in China, the institutional infrastructure supporting capitalist production in most developing countries tends to be incomplete. Financial infrastructures are ineffective in channeling funds to the most productive ventures. Likewise, families remain in control of most private firms, while managerial organizations are underdeveloped.⁴³ Firms in developing economies are therefore handicapped, especially when facing highly sophisticated competitors from already well-established capitalist systems. A common reaction in developing countries is the deployment of state and state-sponsored institutions to create competitive advantages for indigenous firms.⁴⁴ Evidently, the threat of a loss of national economic sovereignty looms large for late developers, even more so for nations that undertake development under *global capitalism* in the early 21st century.

The final structuring condition pertains to socio-political and cultural systems that influence the introduction and subsequent development of capitalist institutions. The influence of cultural and religious values on the commencement of capitalist production

⁴⁰ Alexander Gerschenkron, *Economic Backwardness in Historical Perspective: A Book of Essays* (Cambridge, MA: Harvard University Press, 1962).

⁴¹ Gerschenkron, *Economic Backwardness*.

⁴² See Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, NJ: Princeton University Press, 1992).

⁴³ See, for example, Gary G. Hamilton and C.S. Kao, "The Institutional Foundations of Chinese Business: The Family Firm in Taiwan," in *Comparative Social Research* 12 no. 0 (1990): 95-112 on Taiwan; and Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995) on Brazil and India.

⁴⁴ One excellent illustration of this is Taiwan, see Robert Wade, *Governing the Market -- Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 1990).

has been most prominently dealt with by Max Weber in his *The Protestant Ethic and the Spirit of Capitalism* (2001 [1904]).⁴⁵ Nonetheless, how cultural and religious value systems support the drive to amass capital and the emergence of market society is controversial. Confucianism, for example, was at first held to be inimical to capitalist development and then later seen as highly supportive. In a similar vein, it is difficult to establish which socio-political systems are especially supportive of capitalist accumulation. Certainly, the nature of political elites and their interaction with other social interests influences the emergence of capitalist social relations. For instance, a powerful landed oligarchy keeping peasants in quasi-feudal circumstances has been held to be inimical to the emergence of a bifurcated secular realm and liberal polity.⁴⁶

The four *structuring conditions* impinge on the *logic of capital*, sometimes supporting it, sometimes undermining it. In brief, the *logic of capital* is the interaction among Heilbroner's three elements: the drive to amass capital, the rise of capital and therefore the emergence of a bifurcated secular realm, and the appearance of market society. Although these are the constant and fundamental building blocks of capitalist systems, most observers are more attuned to several popularly known manifestations. As noted in the introduction to this volume, we see the *logic of capital* as emanating *three forces of change*: economization; pluralization & institutionalization; and integration into the world capitalist system (globalization).

Economization is most closely related to the appearance of market society, but tied to all three elements of the *logic of capital*. While the term marketization is used more often, we prefer economization. Economization captures the total impact of growing competitive pressures on businesses, individuals, and state organizations, including the social, political, ideological, and economic manifestations that follow on. It also expresses how the economy becomes of much greater importance to state elites, be it for national survival or for popular support. Indeed, the economy under capitalist development becomes a force driving much policy thinking and policy-making.

The pluralization of social interests is most directly associated with the bifurcation of the secular realm. As economization progresses it engenders the accumulation of wealth. The emerging capital-owning social strata foster dynamics that lead to social pluralization, including the formation of new professional and class interests. New social interests in turn create pressures for institutional restructuring. In particular, more powerful capital-owning social strata seek reconstituted and expanding state power. Social pluralization therefore creates dynamics that pressure the state to improve legal, political, economic, and media institutions in order to foster higher institutional transparency and certainty – what is commonly referred to as institutionalization or what the Chinese label *zhengguihua*.

⁴⁵ Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (Chicago and London: Fitzroy Dearborn, 2001 [1904]).

⁴⁶ Gunnar Myrdal, *Asian Drama - An Inquiry into the Poverty of Nations* (New York: Twentieth Century Fund, 1968).

Finally, integration into the world capitalist system expresses how all capitalist development produces pressures for international integration. This is especially so in the case of China, since it is undertaking development in the era of *global capitalism*. Integration into the world capitalist system also conveys the dual nature of the international system: as structured in hierarchical relations where certain actors possess superior power and wealth; and as driven by competitive opportunities that have allowed actors to rise in the hierarchy *via* wealth accumulation and other elements of power.

As the *logic of capital* unfolds it is impacted by *historical junctures*.⁴⁷ Historical junctures are transforming events or shocks that shape the trajectory of a capitalist transition. Some examples are wars, economic crises, and political revolts. Historical junctures can be of mostly endogenous origin. These are events triggered by the process of capitalist development, such as the rise of capital and pressures from new social interests. Conversely, historical junctures can be of largely exogenous origin. Wars and externally triggered economic crises are cases in point. Historical junctures are further influenced by the *structuring conditions*, which can act as catalysts for or mold the intensity and outcome of such shocks. In some cases, such as political regime change and major wars, historical junctures can even halt the process of capitalist development all together.

The final part of the conceptual framework – *the institutional contours of capitalist systems* – denotes variations in the forms of local, national, and global capitalisms. Most works on the varieties of capitalism include some sort of matrix to map institutional variations, especially among national forms of capitalism. For instance, Hall and Soskice when dividing advanced capitalist systems into two types – *liberal* and *coordinated market economies* – focus on four core aspects: financial systems; corporate governance systems; industrial relations; and education and training systems.⁴⁸ However, almost a dozen additional factors seep in during their analysis, such as the nature of inter-company networks, legal systems, quasi-public research institutes, economic policy making, and the organization of the political realm. Clearly, attempts at producing an encompassing matrix of institutional variations among capitalist systems are bound to suffer either from oversimplification or unmanageable complexity. I will consciously eschew a map of institutional variations among capitalisms, especially since in China capitalist institutions are merely in the process of forming.

Nonetheless, to elucidate how the *logic of capital* is unfolding in China I will emphasize three analytical features. First, as Heilbroner observes, “the issue that takes on an often obsessive prominence in every capitalist nation . . . is the relationship between business and government.”⁴⁹ State-capital relations, including the nature and constitution of the state, are thus of primary analytical importance. Second, the nature and constitution of capital, including its relations to other social interests and its internal structure (corporate

⁴⁷ I borrow this concept from Stein Rokkan, Peter Flora, Stein Kuhnle and Derek W. Urwin ed., *State Formation, Nation-Building, and Mass Politics in Europe: The Theory of Stein Rokkan (Comparative European Politics)* (Oxford: Oxford University Press: 1999).

⁴⁸ Hall and Soskice, *Varieties of Capitalism – The Institutional Foundations of Comparative Advantage*, Chapter 1.

⁴⁹ Heilbroner, *21st Century Capitalism*, 68.

governance and ownership systems; industrial relations; business networks) is key. Finally, a capitalist system's external orientation, especially the way in which openness to trade and foreign direct investment are managed, plays a prominent role.

While looking at the process model represented in Figure 1, some might hold that it is devoid of human agency. In reality, human agency is present throughout the conceptual framework. It exists in the *logic of capital*, which is ultimately driven by the human desire to better one's material lot, be it by trading, innovating, or accumulating capital. It is also especially prominent in the *historical junctures*, since a society's response to such shocks often decides whether the process of capitalist accumulation is halted or proceeds. Put differently, human agency permeates the process model and therefore cannot be analytically distinguished. This is not to diminish the extremely important role of human agency, in particular leadership. Leaders taking a long-term view who are willing to reconsider traditional values and create the conditions for successful group decision-making are vital to thriving capitalist development.

In summary, the conceptual framework in Figure 1 focuses on the process of a capitalist transition. It emphasizes the path-dependent nature of capitalist development and allows for considerable historical contingencies to interrupt the process. The conceptual framework therefore incorporates a central analytical thrust. Although the force of *global capitalism* is sure to exert strong pressures for convergence among the institutional configurations of capitalist systems, it is unlikely to generate homogeneous institutional arrangements (at least as long as there still are nation-states). Indeed, diverging *structuring conditions*, path-dependent institutional development, and transforming national events will continue to generate different patterns of national capitalisms. The purpose here is to understand the factors and processes shaping the contours of China's emerging capitalism.

III. Capitalism in the Dragon's Lair

Capitalist production has thrived in Overseas Chinese communities stretching from New York to Singapore. Driven by an admirable commercial acumen, these communities have been successful in amassing large amounts of capital and building internationally competitive business institutions, some of which span the globe. The success of Overseas Chinese communities, including those in Hong Kong, Macao, and Taiwan, which are adjacent to China proper, has earned the Chinese the reputation of being formidable business practitioners – “The Jews of East Asia.” Yet, up until recently sustainable capitalist production never took root in the vast territory of Mainland China.

To be precise, the seeds of capitalist production emerged within China at various historical junctures. Certainly by the late Qing Dynasty commercialism increased in importance, spurred by changes within the Chinese economy and the influence of colonial powers.⁵⁰ During the Republican era from 1911 until 1949 capitalist production thrived in various pockets of the country, most notably in the foreign concessions along

⁵⁰ William T. Rowe, *Hankow: Commerce and Society in a Chinese City, 1796-1889* (Stanford: Stanford University Press, 1984).

the Eastern Seaboard. However, imperialism, the political influence of warlords, the corruption and largely ineffective governance of the Kuomintang (KMT), the Japanese occupation during World War II, and the long lasting civil war created conditions inimical to sustained capitalist development.

Even as the KMT retreated to Taiwan in 1949 after losing the civil war, it remained highly skeptical of private enterprise. Initial strategies of industrial development focused on state enterprises and “import-substitution” industrialization, both to support a counter-attack on the Mainland and to assure the island’s survival when war broke out. Only as the prospects for a successful counter-attack became dismal and aid monies from the United States were destined to wane in the 1960s did the KMT look to private Taiwanese enterprise as a new potential source of economic dynamism.⁵¹

On the mainland, the CCP’s rise to power initiated a gradual, though 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 with the increasing normalization of both China’s domestic political realm and external relations emerged the will to fundamentally restructure the country’s political economy.

It is fascinating to note that the grounds for initiating economic reforms and a capitalist transition in China are not much unlike those prompting the leaders of other Asian “late developers” to begin fundamental transformations.⁵² At the outset of reforms in 1978 China’s leaders perceived grave threats to regime survival. The tragedies of the Cultural Revolution had caused a loss of revolutionary legitimacy. The CCP therefore redefined its purpose to seek economic modernization.⁵³ Externally, China had undergone a strategic shift, which in turn influenced shifts in economic policy. Due to its bitter rivalry with the Soviet Union, China formed a *de facto* alliance with the United States in the mid-1970s, opening the door to economic cooperation with capitalist countries. Chinese leaders recognized at this point the dynamism of adjacent economies in Asia and the geopolitical benefits of economic wealth. An image of China as technologically backward came to the fore, triggering policies to encourage external trade and investment.⁵⁴

⁵¹ Thomas Gold, *State and Society in the Taiwan Miracle* (Armonk, NY: M.E. Sharpe, 1986); Tun Jen Cheng, "The Politics of Industrial Transformation," PhD Dissertation, (Berkeley, CA: University of California 1987).

⁵² These “late developers” chiefly include Japan, South Korea, Taiwan, Hong Kong, and Singapore. See Richard Stubbs, "War and Economic Development: Export-Oriented Industrialization in East and Southeast Asia," in *Comparative Politics* 31 no. 3 (1999): 337-355 on how national security concerns prodded the leaders of these economies to initiate sustained efforts at economic transformation.

⁵³ Frederick C. Teiwes, "The Chinese State During the Maoist Era" in *The Modern Chinese State*, edited by David Shambaugh (Cambridge: Cambridge University Press, 2000): 105-160.

⁵⁴ Bruce Cumings, "The Political Economy of China's Turn Outward" in *China and the World: New Directions in Chinese Foreign Relations*, edited by Samuel S. Kim (Boulder: Westview, 1989): 203-236.

Although Mao's mass movements had weakened the Communist party-state, it remained exceptionally dominant over society in the late 1970s. Following the traumatic experiences of the Cultural Revolution, the state could marshal its organizational and ideational resources to reject "high Maoism" and introduce sweeping economic and social reforms. The intrusive Leninist organizational apparatus was employed to mobilize resources on a national scale, especially by altering the incentives facing local cadres to encourage markets, develop new enterprises, and integrate with the global economy. No social interests outside of the party-state possessed sufficient power to oppose these sweeping economic and social changes.⁵⁵ Therefore, in another parallel to Asia's "late developers," the Chinese government enjoyed a high level of political autonomy at the outset of reforms that allowed it to implement transformative economic policies.⁵⁶

Throughout the reform era external and internal conditions reinforced a mindset among top CCP leaders that perceived industrialization and technological upgrading as a means for national and regime survival. As one Chinese interviewee put it, "the CCP became addicted to high economic growth."⁵⁷ The seeming need to assure national survival by industrialization can be traced right up to the present. The Fourth Plenum of the 16th Communist Party of China's Central Committee held in September 2004 issued a report on "Enhancement of the Party's Governance Capability." In it, the CCP points out that China's reform and development has reached a critical state in which "hostile forces are still pursuing their strategic attempts to westernize and separate our country."⁵⁸ Threat perceptions that generate the political will to continue China's reforms therefore permeated three generations of CCP leaders. Quite ironically, this political will has by default prodded the Chinese leadership to embark on a capitalist transition.

For reasons of simplicity and general acceptance, I will here take the launch of China's capitalist transition to be late 1978 as Deng Xiaoping initiated the policy of economic reform and opening up. Of course, one could trace the antecedents of reforms back to Mao's normalization of relations with the United States in 1972, experimentation with agricultural and industrial reforms in the early 1960s, and farther back to the Republican and Imperial eras. Nonetheless, 1978 marks a clear break with the past.

Despite certain commonalities with the "late developers" of East Asia, in particular the perception of an imminent threat to national (and regime) survival and the existence of a high level of political autonomy, the legacy of the People's Republic of China (PRC)

⁵⁵ Teiwes, "The Chinese State during the Maoist Era," 159-160.

⁵⁶ On the importance of the "structural autonomy" of the state in implementing transformative economic policies see, for example, Chalmers Johnson, "Political Institutions and Economic Performance" in *The Political Economy of the East Asian Industrialism*, edited by Frederic Deyo (Ithaca, NY: Cornell University Press, 1987): 136-164 and Peter Evans, "The State as Problem and Solution: Predation, Embedded Autonomy and Structural Change" in *The Politics of Economic Adjustment*, edited by Stephan Haggard and Robert R. Kaufman (Princeton: Princeton University Press, 1992): 139-181.

⁵⁷ Informant 181. Interviews and fieldwork for this paper were undertaken during the summers of 2001, 2002, and 2004. In addition, some materials are derived from earlier fieldwork undertaken in China, including the summer of 1988 and the period from 1995 to 1997. All interviews were conducted without the aid of translators in either Mandarin or Cantonese. Interviewees were assured of utmost confidentiality, and a coding system has been employed to protect their identities.

⁵⁸ *People's Daily*, "Enhancement of the Party's Governance Capability," (September 19, 2004).

introduces distinct dynamics. First, China's territory is much vaster than those of East Asia's "late developers." Due to its larger production capacity and domestic markets, the PRC followed different economic strategies from those employed by its East Asian neighbors. China's vast landmass also introduces considerable complexities to governance. Since national and local governments differ in their interests, viewpoints, and resource levels, problems of managing central-local relations are prominent.

Second, the Communist party-state spent the period from 1949 until 1978 managing a command economy. The PRC's economic reforms therefore faced a two-pronged challenge: at the same time as it had to overcome the obstacles of "late developers," such as weak financial and enterprise institutions, it had to undertake the transition from a command economy to a market system. This two-pronged challenge left salient impacts on China's quest for industrialization.

The central question remaining for this section is whether what started to unfold in China after 1978 is actually a capitalist transition. Indeed, given the PRC's dissimilar ideological and political vantage points when compared to other East Asian "late developers" can we at the end of the day speak of capitalism emerging in the Dragon's lair? A noted Chinese economist, Fan Gang, when arguing that China had undertaken successful globalization noted the following characteristics of China's reforms: "development of the private or non-state sector; price liberalization in the domestic market; relaxation of government control and central planning; privatization of state-owned enterprises; and development of the legal framework for private enterprises."⁵⁹ These reforms in turn are giving rise to an improved environment for foreign investment and the building of a legal framework. To observers of instances of capitalist development, including the transition economies of Eastern Europe, all this must sound quite familiar. Nonetheless, the CCP insists that it is not pursuing capitalism and that this is the emergence of a "socialist market economy with Chinese characteristics."

This paper is not about semantics, but rather about providing an unclouded analysis. Its purpose is to use the wealth of materials on capitalism and capitalist transitions to further elucidate the nature of China's massive transformation. Following this logic, I will first emphatically argue that what is taking place in China is undeniably a capitalist transition, albeit one that is yet far from reaching a mature stage of institutionalization. I will apply Heilbroner's three fundamental elements of capitalism – the *logic of capital* – to the case of China, elaborating how China's reform trajectory can be understood as generated by the drive to amass capital, the emergence of market society, and the embryonic bifurcation of secular authority.⁶⁰

The Drive to Amass Capital in China

China's economic development has not followed any predetermined economic strategy and is therefore best conceptualized as a process of upward spiraling virtuous cycles of

⁵⁹ Fan Gang, "A Made-in-China Solution to Globalisation," *South China Morning Post* (October 19, 2004).

⁶⁰ One could equally argue that China's reform path is being manifested and generated by the *three forces of change* – economization; pluralization & institutionalization; and international integration – used in this volume. This is the major thrust of other chapters.

induced reforms.⁶¹ Early on, the most important reforms raised prices for agricultural goods and then replaced the people's communes in the countryside with the household responsibility system. This allowed households to gain lease rights over land and enabled the emergence of farmer's markets for produce. The result of these developments was a rapid rise in agricultural productivity and a rural consumption boom.

During this period farmers rapidly increased their propensity to save.⁶² In a sense, rural households acted as the catalysts in China's drive to amass capital. They invested in small-scale private enterprises (the *getihu*) and provided much needed investment funds. However, since savings were predominantly deposited in state-owned financial institutions, most investment decisions remained in the hands of local township and village governments.

Quite unique to China's developmental patterns, local officials did not squander most of this capital in conspicuous consumption. Rather, they invested it in a manifold of government-guided ventures, which became known as the Township and Village Enterprises (TVEs). There are several reasons for this. First, China never operated a command economy as centralized as those found in Eastern Europe and the Soviet Union. As Susan Shirk puts it, "soon after the communist takeover, the Chinese system became a multitiered, regionally based system in which much of the responsibility for planning and coordination devolved to local governments."⁶³ This situation was reinforced during the Cultural Revolution when Mao's policies encouraged local self-sufficiency and triggered a wave of rural industrialization under the heading of the "five small" industries.⁶⁴ At the outset of reforms local Chinese governments were therefore already in charge of industries over which they possessed some autonomy.

Local self-rule was further reinforced as Deng's reforms continued to grant greater autonomy to local economic actors, a process that rapidly evolved into economic and political decentralization. At the same time, local government units received decreasing amounts of financial support from higher levels, forcing them to look for new sources of revenue. Finally, the economic performance of local economies emerged as the principal yardstick for cadre evaluation under the Communist Party's *nomenklatura* system and the state's administrative hierarchy.⁶⁵ This provided powerful incentives for cadres to maximize local economic growth, since a thriving economy generated much better chances for promotion.

⁶¹ Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1990* (Cambridge: Cambridge University Press, 1995); Gary H. Jefferson and Thomas G. Rawski, "Enterprise Reform in Chinese Industry," in *Journal of Economic Perspectives* 8 no. 2 (1994): 47-70.

⁶² Naughton, *Growing Out of the Plan*, 142-144. Between 1978 and 1982 total household savings in China jumped from 4% of national income to 11% (Naughton, *Growing Out of the Plan*, 142).

⁶³ Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley and Los Angeles: University of California Press, 1993), 29.

⁶⁴ Naughton, *Growing Out of the Plan, 1978-1990*, 145.

⁶⁵ Yasheng Huang, *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations during the Reform Era* (Cambridge: Cambridge University Press, 1996); Maria Edin, "State Capacity and Local Agent Control in China: CCP Cadre Management from a Township Perspective," in *The China Quarterly* no. 173 (2003): 35-52.

A highly powerful combination of incentives transpired. Local officials were granted the political space for economic experimentation, faced strong incentives to find new sources of revenue and maximize economic growth, and received a boost in capital from higher agricultural productivity and savings. The result was much greater investment in TVEs and their emergence as China's dynamo of industrialization in the late 1980s.

Several concurrent reforms added extra fuel to capital accumulation in the TVE sector. During the 1980s and early 1990s the pricing structure was gradually liberalized, state-owned enterprises (SOE) given greater management autonomy and profit incentives, and foreign trade and investment allowed to enter sections of the domestic economy. Taken together this bundle of reforms set in motion cycles of induced reforms, where each small step at liberalization created pressures for further liberalization. For example, by easing the state monopoly over industry, TVEs were able to enter monopolistic markets protected for the benefit of SOEs. This at first produced super-profits for TVEs and then gradually intensified competition, leading to the erosion of the state industrial sector's monopolistic profits.⁶⁶ In turn, lower profits in state firms hurt local government revenues, inducing local leaders to experiment with capitalist measures such as bankruptcies, enterprise takeovers, and shareholding ventures as early as the late 1980s.⁶⁷ However, only in the early 1990s did the unintended consequences of these initial reforms culminate in the central government announcing a wide-ranging plan – the establishment of a “socialist market economy” – that aimed at restructuring the Chinese economy along market lines.

The introduction of the household responsibility system in agriculture, the rise of the TVEs, and the political will to establish a fully-fledged market economy laid the groundwork for capital accumulation in the private sector. Although TVEs functioned along commercial lines with flexibility in the management of labor, they nonetheless represented a unique form of local government-owned industry.⁶⁸ Initially, they benefited in many ways from their close association with local government, since this facilitated regulatory approval and access to finance. However, as TVEs over-expanded and faced ruthless competition during the first half of the 1990s, their economic profitability declined. Local governments were confronted with fiscal crises and started to tinker with a range of reforms, most involving some form of partial or full privatization.⁶⁹ Therefore, as with other reform achievements, cycles of induced reforms encouraged local leaders to experiment with privatization measures and ways to support private business. Indeed, as problems in the TVE and state industrial sectors became more notorious, the greater

⁶⁶ Barry Naughton, "Implications of the State Monopoly over Industry and its Implications," in *Modern China* 18 no. 1 (1992): 14-41.

⁶⁷ Dorothy J. Solinger, "Capitalist Measures With Chinese Characteristics," in *Problems of Communism* 38 no. 1 (1989): 19-33.

⁶⁸ Barry Naughton, "Hierarchy and the Bargaining Economy: Government and Enterprise in the Reform Process" in *Bureaucracy, Politics and Decision Making in Post-Mao China*, edited by Kenneth G. Lieberthal and David M. Lampton (Berkeley and Los Angeles: University of California Press, 1992): 245-179.

⁶⁹ Jian Zhang, "Property Rights and Managerial Incentives within a Rural Chinese Shareholding Cooperative Enterprise," in *Issues and Studies* 37 no. 6 (2001): 29-58; Jonathan Unger, *The Transformation of Rural China* (Armonk and London: M.E. Sharpe, 2002).

economic contribution and lower draw on financial resources of Chinese private firms accelerated their development.⁷⁰

China's private sector started from very humble beginnings and faced discrimination during the reform era. As Garnaut and Song put it, "The success of the private sector in a regulatory environment overwhelmingly geared to the requirements of state-owned enterprises is remarkable."⁷¹ In the 1980s the Chinese private sector was merely tolerated as an experiment and small-scale private enterprises with no more than eight employees, the *getihu*, were allowed to exist in sectors where large state firms had no presence. Even after actual private enterprises (*siying qiye*) were sanctioned in 1988, many private entrepreneurs shied away from this ownership form due to government discrimination. Entrepreneurs preferred to wear a "red hat" and registered their firms as collective enterprises.

A more tolerant environment emerged for the private sector after 1992 with the call for the establishment of a "socialist market economy." Many "fake collectives" or "red hat" firms started to openly convert into private firms. The introduction of China's first Company Law in 1994 also opened new avenues to ascertain private ownership by making the corporate form of a limited liability corporation available. As a result, private firms began to rapidly increase in number and size, while moving into new industrial and commercial sectors.

Concurrent to these developments, changes in China's openness to foreign trade and investment increased the size of China's foreign-invested private sector. As with the liberalization of China's pricing structure and the rise of TVEs and private firms, cycles of induced reforms opened up many Chinese localities to foreign trade and investment. Feverish efforts to establish global linkages were driven by the entrepreneurship of local leaders, which possessed the ability and faced individual incentives "to manipulate or evade centrally erected barriers to global transactions."⁷² Especially along China's Eastern Seaboard the rapid formation of international linkages in the late 1980s opened up avenues for TVEs to form joint-ventures with foreign capital. In particular Overseas Chinese entrepreneurs used TVEs as convenient low-cost export platforms, allowing TVEs to gain access to foreign technology and marketing channels. This meshing of Overseas Chinese network capital with TVEs produced a highly internationalized private sector in Chinese seaboard provinces following TVE privatization.

Although the Chinese government publishes no data on the contribution of the private sector to Gross Domestic Product (GDP), Xiaolu Wang was able to estimate the contribution of domestic and foreign private firms to Chinese GDP at about 50 percent in

⁷⁰ Ross Garnaut and Ligang Song, "Private Enterprise in China: Development, Constraints and Policy Implications" in *China's Third Economic Transformation*, edited by Ross Garnaut and Ligang Song (London and New York: RoutledgeCurzon, 2004), 6.

⁷¹ *Ibid.*, 2.

⁷² David Zweig, *Internationalizing China: Domestic Interests and Global Linkages* (Ithaca and London: Cornell University Press, 2002), 17.

1999.⁷³ If including collective enterprises, many of which can be safely assumed to be operating as quasi-private firms, this contribution to GDP rises to two thirds. Overall, privatization has been very widespread in agriculture, industry, construction, retail trade, and road transport. However, it lags in the service sector, especially finance, and producer goods industries.

In a nutshell, the rapid growth of the Chinese economy during the reform era has been driven by the non-state sector.⁷⁴ First, the household responsibility system enabled capital accumulation among rural households that then fed a rural consumption boom and the rise of the TVEs. As competitive pressures increased for TVEs, many local governments resorted to a variety of privatization measures. These measures were given legitimacy by the central government in the mid-1990s under the policy of “fang xiao” (“to let go of the small”), triggering the privatization of most small- and medium-sized SOEs and TVEs under local governments. The drive to amass capital that is underpinning China’s rapid economic growth has therefore shifted from state entrepreneurship to private entrepreneurship. This is analogous to the experiences of other instances of capitalist development.⁷⁵

Due to China’s geography, the world historical timing of the onset of its capitalist transition, and the legacy of its socio-political system (China’s *structuring conditions*), the drive to amass capital emerged unevenly throughout the country, creating widely differing local political economies. Interactions among state and business vary considerably from predatory to developmental.⁷⁶ For example, predatory behavior among state officials typifies a vast area chiefly located in China’s agrarian hinterland. Due to a scarcity of resources and fewer profitable opportunities to invest, local cadres abuse their official positions to extract exorbitant fees and fines from the peasantry and small business, therefore stifling private entrepreneurship.⁷⁷ In other localities more benign clientelistic state-business relations have emerged. *Guanxi* networks (networks based on personal ties) create an accord by which officials gain pay-offs and political support, while entrepreneurs acquire favorable business loans and other preferential treatment.⁷⁸

⁷³ Xiaolu Wang, “The Contribution of the Non-State Sector to China’s Economic Growth” in *China’s Third Economic Transformation*, edited by Ross Garnaut and Ligang Song (London and New York: RoutledgeCurzon, 2004), 25-26.

⁷⁴ *Ibid.*, 26.

⁷⁵ One classical example is Meiji Japan. The state served during the 1870s as the principal entrepreneur, manager and financier of modern industry, only to sell most government-established factories to private capitalists during the retrenchment of the 1880s. See Peter Duus, *The Rise of Modern Japan* (Boston: Houghton Mifflin Company, 1976).

⁷⁶ Richard Baum and Alexei Shevchenko, “The “State of the State”” in *The Paradox of China’s Post-Mao Reforms*, edited by Merle Goldman and Roderick MacFarquhar (Cambridge and London: Harvard University Press, 1999): 333-360.

⁷⁷ Thomas P. Bernstein and Xiaobo Lu, “Taxation Without Representation: Peasants, the Central and the Local States in Reform China,” in *The China Quarterly* no. 163 (2003): 742-763.

⁷⁸ David Wank, “Bureaucratic Patronage and Private Business: Changing Networks of Power in Urban China” in *The Warning of the Communist State: Economic Origins of Political Decline in China and Hungary*, edited by Andrew G. Walder (Berkeley: University of California Press, 1995): 153-183.

The rapid development of the TVEs in many of China's wealthier areas expresses a pattern of state entrepreneurship, in which local officials directly manage local firms to maximize profits and productivity.⁷⁹ As governance problems and financial pressures increased, local governments moved away from direct entrepreneurship to supporting private firms. In some cases, this is taking the form of hands-off regulatory support, while in others the state plays a developmental role. This developmental role is conceptualized as being related to the developmental state model found in Asia's "late developers."⁸⁰ Entrepreneurship is left to privately owned firms, but state officials exercise guidance over private sector development *via* indirect levers, such as implementing quality control standards, providing financial incentives, and managing industrial parks.

The reform and opening up of China's economy unleashed by Deng Xiaoping in 1978 started a gradual but accelerating process of capital accumulation. Although this process of capital accumulation remains highly uneven throughout the country, it has transformed the face of China's political economy. As local state interests took the lead and acted in a highly entrepreneurial fashion to establish new enterprise ventures and foster international linkages, they created much greater competitive pressures. Cycles of induced reforms unfolded that ultimately concentrated much capital accumulation in China's rapidly growing private sector. The higher productivity of Chinese private firms therefore allowed them to overcome government discrimination and develop from very humble beginnings to constitute the driving force of China's contemporary economy.

Naturally, reforms in the state sector also played an important role, especially by making SOEs more responsive to market forces, by improving their governance, by shrinking their work force and numbers, and by partially privatizing them via stock market listings.⁸¹ Nonetheless, there is little doubt that the central actor in China's reform narrative is the extraordinary vibrancy and dynamism of private capital accumulation. Evidently, this drive to amass capital confirms that China is in the midst of a capitalist transition. So does the fact that China has developed a market system, which acts as the organizing force for the allocation of the vast majority of goods and services in China.

The Emergence of Market Society

The emergence of a market economy and its attendant social manifestations has been the most widely noted aspect of China's transition. Barry Naughton analyzed succinctly how the Chinese economy outgrew the planned system in an evolutionary manner to establish a market economy by the mid-1990s.⁸² Since then marketization has continued to progress.

⁷⁹ Jane Duckett, *The Entrepreneurial State in China* (London and New York: Routledge, 1998).

⁸⁰ Marc Blecher and Vivienne Shue, "Into Leather: State-led Development and the Private Sector in Xinji," in *The China Quarterly* no. 166 (2001): 368-393; Jonathan Unger and Anita Chan, "Inheritors of the Boom: Private Enterprise and the Role of Local Government in a Rural South China Township," in *The China Journal* no. 42 (1999): 45-74.

⁸¹ For one of the more up-to-date and detailed economic analyses of the condition of China's state sector see Carsten Holz, *China's Industrial State-Owned Enterprises Between Profitability and Bankruptcy* (New Jersey and London: World Scientific, 2003).

⁸² Naughton, *Growing Out of the Plan*.

A Chinese study undertaken by Beijing Normal University in 2003 notes that government control of prices decreased from 141 items in 1992 to only 13 items in 2001. The economic value of goods and services traded with price controls has similarly decreased: for retail goods from 5.6% in 1992 to 2.7% in 2001; for agricultural goods from 10.3% in 1992 to 2.7% in 2001; and for producer goods from 19.8% in 1992 to 9.5% in 2001.⁸³ This means that for the vast majority of goods and services traded in China the market serves as the organizing principle for allocation. In fact, the central planning system has ceased to exist, although for a few select industrial goods (wood; gold; tobacco; salt; and gas) the government continues to issue guidance plans.

Viewed from this perspective, China is a market economy. This fact, though, remains heavily debated in international trade politics. Countries such as Singapore, Malaysia, and Thailand recognize China as a market economy, while Australia declared in April 2005 that it is ready to do so as well.⁸⁴ The European Union, the United States, and Japan, on the other hand, hold that China's is not a market economy. The central reason stated is that the Chinese economy continues to be permeated by state influence. Perhaps most importantly, state firms dominate China's financial system and the Chinese central government directly guides the pricing of money. China has so far failed to develop genuine financial capitalism. Several crucial producer goods also remain almost exclusively in the hands of state firms (e.g., petrochemicals). Their pricing continues to be guided by the state, conferring on state leaders considerable direct influence over the economy.

The strong influence of the state in producer goods industries and the financial system expresses the mixed nature of China's economy. Although strong private and state sectors co-exist, the legacy of decades of top-down central control over the economy creates a lingering tendency towards government interference. When put in historical perspective, though, government management of China's developing market economy follows earlier examples of industrialization, especially in continental Europe and East Asia.

For instance, the state's control over finance has allowed China to keep interest rates low, thereby lowering costs for investors and generating a boom in fixed asset investment. Parallel situations are common during many instances of capitalist development, especially when financial markets are relatively closed. The European social democratic systems in the post-World War II era facilitated private investment in physical capital *via* low and subsidized interest rates.⁸⁵ Similarly, South Korea and Taiwan used state control over the banking system to steer low interest loans to industrial sectors.⁸⁶ State control

⁸³ Beijing Normal University Economics and Resource Management Institute, Zhongguo shichang jingji fazhan baogao (2003) [China's Market Economy Development Report (short version)] at <http://past.people.com.cn/GB.jinji/36/20030414/971145.html> (accessed April 1, 2005).

⁸⁴ *South China Morning Post*, "Howard Stands By Decision On Market Economy," (April 20, 2005).

⁸⁵ Kitschelt, Lange, Marks and Stephens eds., *Continuity and Change in Contemporary Capitalism*, 7.

⁸⁶ Wade, *Governing the Market*; Jung-En Woo, *Race to the Swift -- State and Finance in Korean Industrialization* (New York: Columbia University Press, 1991).

over finance naturally has its dark underside. In China, the amassing of non-performing loans and inefficiencies in the allocation of capital reflect this.⁸⁷

A second example concerns the central government's control over the pace at which certain sectors are opened to foreign investment and competition. Chinese policies rely heavily on attracting and managing foreign capital to gain export avenues, managerial skills, and technological capabilities. However, the Chinese central government has attempted to carefully manage the opening of domestic markets to foreign competition. Numerous and stringent criteria are often established to control the pace of market opening, since the government wants to give domestic firms sufficient time to increase their competitive edge. As with other instances of capitalist development, the Chinese state is using its control over trade and financial flows to increase domestic firms' competitiveness in the international realm.⁸⁸

Careful management of foreign investment and trade, though, has not precluded a general trend towards greater openness. China's WTO accession reflects how the government is intent on using the gradual introduction of international competition to force domestic corporations to improve their efficiency. Ironically, one of the greatest success stories of centrally implemented reforms in China rests in consistent efforts to buttress and rationalize market forces. Put differently, the "developmentalism" of the Chinese central government has consistently veered towards generating greater competitive pressures and treating various forms of capital more evenly. Central directives tend to be market-friendly, encouraging foreign trade and investment, and, more recently, private sector development. Therefore, the central state sets a competition-inducing incentive and policy framework, but yields enormous power to local governments. As a result of this dynamic, most direct developmental interventions in China tend to be localized. In fact, localized interventions are mostly to blame for rampant government interference in China's market economy.

As noted before, the state administrative hierarchy and the CCP's *nomenklatura* system provide powerful incentives that encourage cadres to support local economic growth. This has tempted local cadres to use a variety of administrative tools to directly guide local economic forces, even if these actions at times run counter to central government edicts. Systemic ties between local firms and government cadres also tend to create incentives that favor local forms of protectionism. The result is government interference and the uneven application of policies regarding taxation, openness of markets, intellectual property rights protection, land policies, environmental protection, the rule of law, etc.

The upshot of this state of affairs is the emergence of a fully-fledged market economy that acts as the organizing principle for the allocation of the vast majority of goods and services in China. Yet, this is a highly politicized market economy. Although the central government's policies aim to construct markets and introduce competition, central

⁸⁷ See Nicholas R. Lardy, *China's Unfinished Economic Revolution* (Washington D.C.: Brookings Institution Press, 1998).

⁸⁸ See M. Castells, *The Rise of Network Society* Second Edition (Cambridge, MA: Cambridge, 2000), 334.

leaders continue to wield enormous powers over key economic aspects. This includes first and foremost the allocation of financial resources and the management of foreign investment in key sectors as a tool of industrial policy. However, the central government is not the major culprit. The most insidious instances of interference are found on the local level. The underlying problems are of a political rather than economic nature. Systemic ties between local governments and businesses tend to produce strong incentives for direct developmental interventions. While such interventions can achieve developmental goals, in the long run they slow down the creation of an increasingly autonomous and self-directing realm of commerce and production.

Just as it took twenty years to shift the locus of capital accumulation to China's private sector, an autonomous realm of the "economy" separate and distinct from the "state" is only gradually emerging. Over time, political reforms that lead to institutionalized constraints on government behavior must be strengthened to solve deep-seated conflicts of interest in China's political economy. As the next section elucidates, such efforts are increasingly visible, but so far neither capital nor the market have matured sufficiently to reach their full economic and political potential.

The Embryonic Bifurcation of the Secular Realm

The unique social formation of capitalism is distinguished by the rise of capital, which results in the bifurcation of the secular realm. The role of the state and its relation to economic forces plays *the* decisive role in this evolution, since an increasingly autonomous economic realm can only occur with "the recognition of clear 'constitutional' constraints on the power of the state to violate private space of the individual or to commandeer his or her property."⁸⁹ In other words, a functioning private property rights system in all its legal, political, and social manifestations constitutes the foundation of mature capitalist systems.⁹⁰

In the PRC the bifurcation of the secular realm – the distinction between an autonomous realm of the "economy" and a realm of the "state" – is at best embryonic. As the recent study by Bruce Dickson on China's "Red Capitalists" elucidates, most individuals and groups in China at present do not seek autonomy but "rather closer embeddedness with the state."⁹¹ Indeed, higher levels of economic development and a more highly developed private business sector actually create higher levels of shared interest among government and business.⁹²

This should be viewed as a logical state of affairs. Since the CCP and especially local cadres are highly supportive of the drive to amass capital, the interests of local state leaders and capital converge in "symbiotic" relations.⁹³ China's entrepreneurs remain willing to be co-opted by the CCP and support the formation of corporatist links between

⁸⁹ Heilbroner, *The Nature and Logic of Capitalism*, 89.

⁹⁰ See Hernando de Soto, *The Mystery Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000) on this point.

⁹¹ Dickson, *Red Capitalists in China*, 159.

⁹² *Ibid.*, 160.

⁹³ For another example of the emergence of "symbiotic" state-business relations see Anek Laothamatas, "From Clientelism to Partnership: Business-Government Relations in Thailand" in *Business and*

business associations and state organs, both to gain political recognition and to better access state resources. Capital therefore hardly represents an autonomous force for fundamental political change at this point.

Put differently, the question of whether China's burgeoning entrepreneurs are a likely catalyst for democratization misses the point, at least for the time being. The real question is whether capital can prod the Chinese state to restructure and yield substantial autonomy to the realm of the "economy." This would include the building of a relatively impartial legal system, an effective state administration with few incentives to directly interfere in the economy, and the recognition of capital's legitimate economic and political aspirations. It would also include the emergence of semi-autonomous professional associations, each of which possesses a distinct ethos. For instance, associations representing lawyers, accountants, auditors, statisticians, financial analysts, and surveyors are all necessary to provide high-quality, publicly verifiable information that can aid in the enforcement of market rules and laws.

Dickson's study illustrates that capital is quite optimistic about such prospects, seeing the greater institutionalization of China's polity and the rising political status of capital as opening up opportunities to influence state policy. Perhaps most importantly, entrepreneurs put hope in China's nascent legal system as a means to solve problems.⁹⁴ My interviews with Chinese entrepreneurs reveal similar attitudes.⁹⁵ Most private entrepreneurs exhibit a strong interest in raising levels of institutional certainty and predictability, especially by improving the efficacy of state agencies, courts, and markets. In fact, capital sees itself as a partner of the Chinese state, willing to push for a fairer and less arbitrary system of market norms and rules. It is particularly interested in the recognition of private property rights and the establishment of a less politicized market economy, but remains fearsome of full-scale democratization.

Evidently, the bifurcation of the secular realm in China is in the process of unfolding. Looking back over the reform period, the drive to amass capital and the emergence of market society generated a substantial *pluralization* of social interests, including the emergence of distinct professional and class interests. Simultaneously, considerable *institutionalization* of government and business bureaucracies occurred, including deep structural reforms to government administration and the state sector. Three developments directly related to the bifurcation of the secular realm are noteworthy.

First, China's legacy of running a command economy created an administrative structure that put separate line ministries in charge of specific industrial and commercial sectors, creating ample opportunities for these bureaucracies to influence enterprise managers and economic exchanges. Such an arrangement proved highly unsuitable to China's quest of

Government in Industrialising Asia, edited by Andrew MacIntyre (St. Leonards: Allen & Unwin, 1994): 195-215 on Thailand. See also Gerschenkron, *Economic Backwardness in Historical Perspective: A Book of Essays on Germany and Russia at the turn of the 19th century*, as well as John Waterbury, *Exposed to Innumerable Delusions: Public Enterprise and State Power in Egypt, India, Mexico, and Turkey* (New York: Cambridge University Press, 1993), chapter 8 on Egypt, Mexico, Turkey, and India.

⁹⁴ Dickson, *Red Capitalists in China*, 163.

⁹⁵ Informants 20-30, 83, 182.

establishing a fully-fledged market economy. Waves of bureaucratic restructuring in China's central government occurred in 1982, 1988, 1993, and 1998.⁹⁶ The 1998 reforms finally succeeded in reducing the number of central government ministries from forty to twenty-nine. Line ministries directly overseeing industrial sectors, such as the Ministries of Chemical and Metallurgical Industry, were downsized and fused into the newly expanded State Economic and Trade Commission.

Nonetheless, bureaucratic infighting persisted, especially over industrial policy. The State Development Planning Commission, the Central Enterprise Work Committee, and the State Economic and Trade Commission all continued to share overlapping responsibilities. The bureaucratic reforms of 2003 finally managed to fuse industrial policy and planning functions into one entity, the National Development and Reform Commission. The central government also revamped the State-owned Asset Supervision and Administration Commission into an agency with the task to centralize responsibility for managing state assets and their personnel.⁹⁷

Other government administrative reforms addressed the establishment of a civil service personnel system, the formation of a supervisory structure for China's expanding financial system, and the hiving off of for-profit service organizations (*shiye danwei*) from their bureaucratic sponsors. The outcome of this bundle of state administrative reforms has been quite remarkable. Using a gradualist and pragmatic approach to institutional reform, the Chinese state eliminated most aspects of the command economy's bureaucratic legacy. Despite certain idiosyncrasies and a relatively large state sector, the PRC now possesses a bureaucratic structure amenable to that of a developing and globalizing market economy.⁹⁸

Linked to these reforms of governmental structure has been the gradual privatization of the professions. Virtually nonexistent prior to 1978, most professions in China started under the sponsorship of government agencies. Large chunks of the accountancy profession, for example, grew out of the Ministry of Finance's bureaucracy on central and local levels. The lack of independence among professionals, however, created strong conflicts of interest. Government sponsorship also sheltered professionals from litigation and disciplinary action, creating perverse incentives.

Towards the end of 1996 the Chinese government ordered accountancy firms to disaffiliate themselves from their governmental sponsors, and by the end of 1998 most accountants had formed private practices, either in the form of partnerships or as limited

⁹⁶ Dali L. Yang, "Rationalizing the Chinese State: The Political Economy of Government Reform," in *Remaking the Chinese State: Strategies, Society, and Security*, edited by Chien-min Chao and Bruce J. Dickson (London and New York: Routledge, 2001), 25.

⁹⁷ Susan V. Lawrence, "Navigating the Shake-Up," *Far Eastern Economic Review* (February 20, 2003), 26-29.

⁹⁸ See Yongnian Zheng, *Globalization and State Transformation in China* (Cambridge: Cambridge University Press, 2004).

liability corporations.⁹⁹ Similar reforms occurred for other professions, such as for lawyers and surveyors. Expanding autonomy has improved the integrity of China's professions and created better incentives to generate accurate information. The process, though, remains ongoing. Major capacity and governance constraints are handicapping the role of China's burgeoning professions.

A second remarkable development has been the gradual writing and codification of China's legal system. Starting virtually from scratch, the Chinese government has passed a series of laws, especially in the economic domain. Formal legal constraints have been enacted to govern contracts, corporations, intellectual property rights, and market exchanges. The judiciary has also been revamped and is undergoing a rapid process of professionalization. Nonetheless, there remain big gaps in the system. Judges continue to be appointed via the CCP's *nomenklatura* system, local government interference in judgments is common, as is corruption, and insufficient avenues for legal recourse exist. In many aspects, China's legal system remains dominated by CCP interests.

The development of China's legal system has been characterized by policy experimentation, leading to informal and spontaneous legal developments, which then are legally clarified and codified. Induced virtuous cycles of reform have therefore also been at work in the emergence of legal safeguards. For example, in regard to property rights legislation Frank Huang remarks, "the development of property rights in China is an evolving formalization process that may be visualized as a path to increasing clarity. During this process, ideological, jurisprudential and technical constraints have been gradually unraveled, and individual proprietary interests have been steadily crystallized and secured."¹⁰⁰

In 1978 China started out with a strong tendency to ideologically discriminate against private property rights. This produced an oft-noted anomaly: how could China grow economically at such a rapid pace in the absence of a sufficiently defined private property rights regime.¹⁰¹ Several explanations have been proffered for why this was possible; including how *de facto* property rights gradually emerged supported by unique bureaucratic structures, *guanxi* networks, and other informal social networks. Spontaneous and informal property institutions have certainly played an immensely important role in the emergence of China's private sector. As marketization progresses, though, a gradual process of fusing *de facto* with *de jure* property institutions is

⁹⁹ Jie Tang and Anthony Ward, *The Changing Face of Chinese Management* (London and New York: Routledge, 2003), 145.

¹⁰⁰ Frank Xianfeng Huang, "The Path to Clarity: Development of Property," in *Columbia Journal of Law* 17 no. 2 (2004), 222-223.

¹⁰¹ Andrew G. Walder and Jean C. Oi, "Property Rights in the Chinese Economy: Countours of the Process of Change" in *Property Rights and Transitional Models*, edited by Jean C. Oi and Andrew G. Walder (Stanford: Stanford University Press, 1999): 1-26; Victor Nee and Sijin Su, "Institutions, Social Ties, and Commitment in China's Corporatist Transformation" in *Reforming Asian Socialism: The Growth of Market Institutions*, edited by John McMillan and Barry Naughton (Ann Arbor: University of Michigan Press, 1996): 111-134.

emerging.¹⁰² In other words, considerations of economic efficiency are producing a realignment that is strengthening formal private property rights.

This strengthening of formal private property rights parallels the third key development affecting the bifurcation of the secular realm: advances in the political recognition of capital. Fundamentally, the CCP realized in the late 1990s that the discrimination of domestic private entrepreneurs was counter-productive. As the most vibrant sector in the economy, producing increasing shares of tax income, employment, and technological innovation, the private sector would have to be supported to assure China's continued economic development and competitiveness. The result has been a gradual process of incorporating private entrepreneurs into the Communist Party and politically recognizing private property rights.

One of the first steps in explicitly recognizing private capital occurred in September 1997 during the 15th. Party Congress when private enterprise was recognized as an "important element" of the Chinese economy. This recognition was codified during the National People's Congress in March 1999 with a constitutional amendment. Perhaps the most important watershed occurred in July 2001. During a speech celebrating the 80th birthday of the CCP, party leader Jiang Zemin made a dazzling pronouncement: private entrepreneurs could formally enter the CCP. His speech recognized profound changes in China's political economy, especially the rise of new social interests. The CCP leadership opted to adapt the party by co-opting the growing ranks of wealthy and economically influential private entrepreneurs.

A final step in the private sector's march to prominence occurred in the spring of 2004. After years of lobbying by the All-China Federation of Industry and Commerce, the official association of private business in China, the Chinese constitution was amended to redefine private property as "inviolable" and committed the state "to protect lawfully acquired private property."¹⁰³ Following this, the Chinese State Council issued guidelines in January 2005 to implement the constitutional amendment. The guidelines encouraged private capital investment and expressed an eagerness to create a level playing field for private entrepreneurs by granting private companies greater access to markets and finance.¹⁰⁴

In many ways, official steps to politically recognize the Chinese private sector followed actual developments on the local level. Already in the mid-1980s private entrepreneurs were encouraged to enter the CCP.¹⁰⁵ However, after the Tiananmen demonstrations in 1989 a formal ban on private entrepreneurs becoming CCP members was issued. This did not stop local officials, especially along the rich Eastern Seaboard, from actively co-opting private entrepreneurs. During the 1990s many local cadres also left government

¹⁰² Frank Xianfeng Huang, "The Path to Clarity: Development of Property," in *Columbia Journal of Law* 17 no. 2 (2004): 191-223.

¹⁰³ See "Detailed Amendments to the Constitution," *People's Daily* (March 15, 2004).

¹⁰⁴ Cary Huang "Private Sector Brought into the Fold," *South China Morning Post*, (January 15, 2005), p. A6.

¹⁰⁵ Bruce J. Dickson, "Cooptation and Corporatism in China: The Logic of Party Adaptation," in *Political Science Quarterly* 115 no. 4 (2000/01), 525.

service and opened their own business operations (the phenomenon of *xiahai*, literally “to enter the sea”). As a result of these trends, many entrepreneurs were party members by the late 1990s, and those that were not could form close *guanxi* networks with local government officials. Despite ideological reservations on the part of the CCP, interest convergence between the local party-state and private business developed rapidly. Local entrepreneurs became politically active and started to take part in the policy making process.¹⁰⁶

These trends accelerated after the CCP became more eager to co-opt private entrepreneurs and allowed them to join the party’s ranks. By 2004 about one out of every three private businessmen were card-carrying members of the CCP. This situation was even more pronounced among owners and managers of big privately owned firms.¹⁰⁷

Viewed from this perspective, moves to recognize formally the importance of private business and enshrine the inviolability of private property rights are primarily symbolic. Nonetheless, this symbolism creates crucial political space for the formation of an autonomous realm of the economy. Developments to date therefore express how the bifurcation of the secular realm is progressing, albeit slowly, in the PRC. In fact, in one area of China’s political economy it might have neared completion: within private firms that have CCP representation.

The private owner of a medium-sized pharmaceutical company in Western China noted that his corporation established a party committee since several CCP members worked within the corporation. One of his two business partners acts as the party secretary, but the owner himself is not a member of the committee. Therefore, unlike in state firms, this party committee does not wield any real power. Its work stays in the background and focuses on building the party’s grassroots organization and conducting political study sessions for its members. The party committee also actively supports the establishment of a corporate culture, but management is fully in charge of all economic matters. Evidently, the power structure within this private enterprise forces the party organization to be deferential *vis a vis* management and economic imperatives.¹⁰⁸ A clear division of labor is established that distinguishes the political realm from that of the economy.

In other situations, the owner/manager of a private firm acts concurrently as party secretary. Heike Holbig has argued that this enables a form of “counter co-optation” – private firm managers co-opt the party apparatus for their purposes rather than the other way around.¹⁰⁹ Certainly, in such situations CCP work within private enterprises becomes subordinate to the entrepreneur’s overall objectives, but strengthens the entrepreneur’s political credentials with local government and party bodies.

¹⁰⁶ See Dickson, *Red Capitalists in China*.

¹⁰⁷ *South China Morning Post*, “China’s Capitalists Embrace Communism,” (February 12, 2005), B2.

¹⁰⁸ Interviews 28 & 8.

¹⁰⁹ Heike Holbig, “The Party and Private Entrepreneurs in the PRC,” in *Copenhagen Journal of Asian Studies* no. 16 (2002): 30-56.

Notwithstanding these examples, the bifurcation of the secular realm in China is far from complete. Private enterprises continue to face discrimination in financing, market access, and regulatory approvals. Private property rights, although enshrined in the constitution, remain a work in progress. Legal codes are incomplete and ambiguous. Most importantly, powerful economic interests, government agencies, and state banks can still collude with local courts when there are conflicting claims. In most instances, these powerful interests sway judicial decisions.

One manifestation of the continued discrimination against private business in China is the formation of shadow markets, especially in finance. Most private firms are unable to obtain bank loans since the state banking system continues to favor state firms or those with very close ties to the state. The result has been the rapid development of an underground financial market in which various forms of informal networks act as financial intermediaries. The higher interest rates that private firms starved for capital are willing to pay induces individuals to pool their capital in these informal networks. A report of the Central University of Finance and Economics notes that 30 percent of all lending in 2003 was extended through such networks, amounting to loans valued between 740 billion yuan and 830 billion yuan. Heilongjiang, one of the provinces most dominated by state concerns, actually had the highest rate of underground financing, reaching close to 50 percent.¹¹⁰ The development of financial capitalism therefore directly influences the extent to which private firms can formally obtain capital.

In a nutshell, the playing field is still heavily tilted in favor of state interests or interests closely aligned with the state. There is no impartial judicial system, no clear-cut regulations concerning property rights, and no full political autonomy of the interests of capital. This explains why most large private firms in China seek alliances with government and party officials. They remain willing to be co-opted individually, which results in a myriad of clientelistic relations among individual private entrepreneurs and state officials.¹¹¹ Business associations of private firms are in a similar situation. They continue to be closely tied to the party-state's influence *via* corporatist links.¹¹² The same applies to various professional associations, including those representing accountants, lawyers, surveyors, etc. Although gradually a distinct professional ethos is emerging for each of these associations, they remain to varying degrees under the party-state's oversight.

In the end, Leninist principles of political organization continue to permeate the Chinese political economy. The CCP jealously defends its monopoly on legitimate political organization, attempting to control and co-opt all social interests possessing resources that could challenge the party's monopoly. Although a private sphere separate and distinct from the public domain has emerged in China and is eroding the government's

¹¹⁰ *South China Morning Post*, "Private Sources Contributed 30pc of Loans in 2003," (January 6, 2005), A10.

¹¹¹ See David Wank, "Private Business, Bureaucracy, and Political Alliance in a Chinese City," in *The Australian Journal of Chinese Affairs* no. 33 (1995): 55-71; and Thomas Gold, Doug Guthrie and David Wank ed., *Social Connections in China: Institutions, Culture, and the Nature of Guanxi* (Cambridge: Cambridge University Press: 2002).

¹¹² See Dickson, *Red Capitalists in China*.

coercive abilities, moves towards creating effective constitutional constraints on the party-state to encourage greater institutional certainty and predictability have been very timid at best. The bifurcation of the secular realm is therefore embryonic. China's capitalist transition remains a work in progress.

IV. Delineating the Contours of China's Emerging Capitalism

I have applied the *logic of capital* to the case of China, elaborating how the country's massive transformation is being generated by the drive to amass capital, the emergence of market society, and the embryonic bifurcation of the secular realm. My purpose was to show that what is taking place in China is undeniably a capitalist transition, albeit one that remains in the process of unfolding. This reinterpretation of China's political economy would be incomplete without going one step further. We need to ask ourselves what the contours of China's emerging capitalism are likely to be.

On the surface, the most visible manifestation of China's emerging capitalism is its enormous dynamism. China is undergoing perhaps the largest effort in human history to establish a continental infrastructure. Roads, railways, telecommunication systems, power generation and transfer networks, and ports are being developed with breathtaking speed and scope. In recent years the establishment of the world's second largest expressway network constitutes one of the most impressive efforts, with more than 4,000 km of expressway built each year since 1998. Total length of China's expressway network reached 34,000 km by the end of 2004, the second longest in the world. Plans for the future are even more ambitious. The Chinese State Council approved in December 2004 a blueprint for a national expressway system of 85,000 km in length, spanning the country to include all cities with 200,000 or more residents.¹¹³

Besides the growing integration of the country by the comprehensive building of infrastructure, China is experiencing an accelerating process of urbanization. So far about 200 million farmers have found jobs in non-agricultural trades and the growth rate of urbanization is at nearly two percentage points annually.¹¹⁴ This represents the biggest move in human history from the land to the city. Urbanization and industrialization are also triggering the rapid expansion of wage labor, the creation of new educational opportunities, and the formation of professional classes. On the flipside, there is a dark quality to the unfolding of these processes. Social and regional inequalities are mounting, amplified by urbanization and greater mobility. The largest industrialization witnessed in the history of civilization is also causing environmental destruction on a shocking scale.

While these phenomena are often unparalleled in scale, they are not much unlike the processes that have transpired in other instances of capitalist development. All cases of sustained capitalist development have witnessed the intertwined processes of industrialization and urbanization, concerted efforts by business and state to establish a nation-wide infrastructure, and developments in social stratification and change,

¹¹³ David Fang, "Expressways Will Link Main Cities Across Country," *South China Morning Post*, January 14, 2005, A4.

¹¹⁴ *People's Daily*, "China to Push Forward Urbanization Steadily," May 12, 2005.

especially the growth of wage labor, professional, and capital-owning social strata. Despite these similarities, distinct institutional frameworks encompassing social, economic, and political relations shape each capitalist transition. Put differently, although there are some fairly basic qualities that define the logic and nature of capitalism anywhere, China's capitalist transition is likely to produce a set of unique institutional manifestations.

To understand these unique features of China's emergent capitalism I must engage in an exercise of institutional analysis. Institutions are the "humanly devised constraints that shape human interactions."¹¹⁵ They are the formal and informal "rules of the game" that structure incentives in social, economic, and political interactions. Ultimately, "institutional change shapes the way societies evolve through time and hence is the key to understanding historical change."¹¹⁶

China's capitalist transition is perhaps the most important historical event of the 21st Century, necessitating a historically conscious institutional analysis to understand its evolution. Figure 1 presented earlier outlines a conceptual framework for such an analysis. It attempts to capture the dynamic and contingent nature of the process of capitalist development. It also provides a heuristic tool that permits the application of historical and comparative materials concerning other instances of capitalist development, especially those that have taken place in East Asia, to the case of China.

Naturally, this constitutes a preliminary effort, since China's political economy is being shaped by ongoing processes and could be exposed to various shocks (*historical junctures*). To which extent China's reforms will lead to sustained capitalist development over the long run is not yet certain. Undoubtedly, one of the biggest questions confronting China's future is whether its capitalist transition will continue or political imperatives stall reforms and create an enduring form of "Chinese Crony Capitalism." I will come back to this point in the concluding remarks.

Although there are inherent dangers in analyzing an ongoing process, I will venture to outline two especially prominent patterns. First, in several regions of China *network capitalism* has become a central feature of their political economies. This raises strong parallels to earlier developments in Taiwan, Hong Kong, and the Overseas Chinese communities of Southeast Asia. Second, China's development is taking place in the era of *global capitalism*. This is structuring the choice sets open to Chinese policy makers and business leaders, in turn generating novel responses to the challenges of late development and globalization.

The Asian Context: Network Capitalism

Analyses of East Asia's stunning economic development have distinguished between two broad categories of capitalism, although considerable variations can be found even within these two categories. Asia's pioneer in capitalist development was undoubtedly Japan.

¹¹⁵ See Douglas North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press), p. 3

¹¹⁶ Douglas North, *Institutions*, p. 3

Although Japan has undergone structural economic changes in the last 15 years, 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 sees Japan's form of *coordinated capitalism* as representative of an Asian model of capitalism in general.¹¹⁷ However, there are considerable variations within Asia's capitalisms and only the political economy of South Korea bears strong resemblances to Japan's form of *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. The indigenous business sector of Singapore fits this model as well, although due to its limited influence throughout Singapore's post-independence development it is not characteristic of the city-state as a whole. Asia's *network capitalism* is generally associated with a generic model of Chinese capitalism and therefore sometimes termed *Sino-capitalism* or *guanxi capitalism*.¹¹⁸ It is the dominant characteristic of Overseas Chinese businesses and has emerged as an important current within global capitalism.¹¹⁹

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. It rather 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.¹²⁰ To overcome the disadvantages of small size, large numbers of firms coalesce into clusters of businesses that can display enormous flexibility in adjusting to changing circumstances. These clusters are linked through horizontal networks of particularistic ties based on trust (*guanxi*), which "provide the underpinning basis for a complex network-based organizational structure."¹²¹

Naturally, all forms of capitalism are to some extent based on networks, such as those focused on country club memberships and "old boy" school ties in the United States. However, the Chinese variant is especially pronounced and quite open to new members.

¹¹⁷ Ronald Dore, "The Asian Form of Capitalism" in *The Corporate Triangle*, edited by P. H. Admiraal (Malden: Blackwell, 1997): 35-58.

¹¹⁸ S. Gordon Redding, *The Spirit of Chinese Capitalism* (Berlin: Walter de Gruyter, 1990); Gary Hamilton, "Overseas Chinese Capitalism" in *Confucian Traditions in East Asian Modernity: Moral Education and Economic Culture in Japan and the Four Mini-Dragons*, edited by Wei-Ming Tu (Cambridge: Harvard University Press, 1996): 328-344, Gary G. Hamilton and Nicole Woolsey Biggart, "Market, Culture, and Authority: A Comparative Analysis of Management and Organization in the Far East" in *The Economic Organization of East Asian Capitalism*, edited by Marco Orru, et al. (Thousand Oaks: Sage, 1997): 52-94.

¹¹⁹ Constance Lever-Tracy, David Ip and Noel Tracy, *The Chinese Diaspora and Mainland China, an Emerging Economic Synergy* (Houndsmill (UK) and New York: MacMillan (UK) and St. Martin's Press (US), 1996).

¹²⁰ Constance Lever-Tracy, "The Impact of the Asian Crisis on Diaspora Chinese Tycoons," in *Geoforum* 33 no. 4 (2002): 509-523.

¹²¹ Richard Robison and Mark Beeson, "Introduction: Interpreting the Crisis" in *Politics and Markets in the Wake of the Asian Crisis*, edited by Richard Robison, et al. (London and New York: Routledge, 2000), 13.

It relies on two institutions in particular: the family, especially in the form of networks of family firms; and *guanxi*. Although *guanxi* is often translated as “connections” or “membership,” these English terms hardly capture the depth of *guanxi* relations in Chinese communities. *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 economic (as well as social and political) actors to create enduring trust that facilitates business dealings.

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 1980s) wave of capitalist development in East Asia. Central to Japan’s *coordinated capitalism* has been the notion of a “developmental state” – states that are conceived to have perfected market-conforming methods of state intervention in the economy by using essentially mercantilist trade and industrial policies to force a rapid pace of national economic development.¹²² For example, state bureaucracies in Japan, especially the Ministry of International Trade and Industry, promoted certain industrial sectors by making use of a highly technocratic, merit-based corps of bureaucrats that devised a variety of trade, monetary, and financial incentives to guide the economic activities of private enterprises. These interventions tended to focus on the continuous upgrading of industrial structures and their counterparts were large clusters of privately held firms – the *keiretsu*.

Japan’s form of *coordinated capitalism* has spurred considerable emulation in East Asia. For example, with mixed success Malaysia and Singapore have both tried to make use of long-term planning by the state in cooperation with the private sector to affect industrial upgrading. However, these cases hardly approach the model of *coordinated capitalism* pioneered by Japan. Only in the political economies of South Korea and to a lesser extent Taiwan is the model replicated. Both of these countries were socially and culturally dominated first by China, and then by Japan. Similar to Japan, both of these countries aggressively utilized export-led industrialization in the 1960s and 1970s, employed state involvement to guide flows of credit and/or coordinate economic activity, and been characterized by business groups. However, the institutional patterns of capitalism in South Korea and Taiwan differ from each other as well as from Japan.¹²³

In South Korea, large conglomerates – the *chaebol* – form the core of the economy. The *chaebol* differ from the Japanese *keiretsu* in two important ways. First, unlike the *keiretsu*, which are controlled by professional managers, the *chaebol* are family-owned firms. Second, the *chaebol* are diversified, yet vertically integrated business groups in which ownership and investment is centrally directed. The largest *chaebol* are highly self-sufficient, including sets of firms that produce most intermediate goods and services

¹²² Johnson, *MITI and the Japanese Miracle*; Frederic Deyo ed., *The Political Economy of East Asian Industrialism* (Ithaca: Cornell University Press: 1987).

¹²³ Gary G. Hamilton, "The Organization of Capitalism in South Korea and Taiwan" in *East Asian Capitalism: Diversity and Dynamism*, edited by A.E. Safarian and Wendy Dobson (Toronto: University of Toronto Press, 1996): 19-44; Wade, *Governing the Market*.

for finished products.¹²⁴ Up until the late 1990s the Korean government acted in a highly centralized fashion to guide the investment behavior of the *chaebol*, therefore making the South Korean government's control over the economy perhaps the most pronounced among the capitalist economies of East Asia.¹²⁵

Although Taiwan is often grouped with South Korea and Japan to constitute a generic model of *coordinated capitalism* in East Asia, its political economy differs strongly from its two northern counterparts. Most Taiwanese business groups, like the *chaebol*, are family-owned, but they tend to be much smaller and have limited vertical spans of control. More importantly, Taiwanese industrial policy has been more indirect and was unable to rely on direct counterparts in the private sector, such as the *keiretsu* in Japan and the *chaebol* in South Korea.

This does not imply that the Taiwanese state failed to build up remarkable policy-making and implementation capacities. Supra-ministerial institutions, the missions and organization of which changed over time, played crucial roles in upgrading the technological level of Taiwan industry.¹²⁶ Robert Wade specifically notes that the Taiwanese government made plans to introduce the steel and electronics industries long before market players had considered these industries to be viable.¹²⁷

Perhaps the most profound difference with the classical model of *coordinated capitalism* is that the Taiwanese state relied for direct economic control on a large state sector, unusual in size and reach for a non-socialist country.¹²⁸ State enterprises ventured into shipbuilding and automobile manufacturing, and predominated in steel manufacturing, petrochemical refining, banking and utilities until the 1990s. To exert influence over the island's private firms the Taiwanese state used indirect means, such as changing the prices of material inputs produced by upstream state enterprises.¹²⁹ By the 1970s Taiwan's state also started to gradually use government funded research institutes, such as the Industrial Technology Research Institute, to support and spin off private technology firms.

In brief, government support in Taiwan focused on state enterprises and therefore only indirectly influenced private sector development. Indeed, up until the 1980s much of Taiwan's private sector developed despite the state rather than because of it. This raises distinct parallels between the Taiwanese and Mainland Chinese case. State firms and research institutes dominated developmental interventions in the PRC throughout the 1980s and 1990s, undertaking projects fraught with risks or long repayment horizons and leading efforts in areas of technological innovation such as in the aeronautic, automobile,

¹²⁴ Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).

¹²⁵ Alice Amsden, *Asia's Next Giant*; Wade, *Governing the Market*.

¹²⁶ Gold, *State and Society*; Stephan Haggard, *Pathways from the Periphery* (Ithaca, NY: Cornell University Press, 1990).

¹²⁷ Wade, *Governing the Market*.

¹²⁸ Gary Gereffi, "Big Business and the State" in *Manufacturing Miracles*, edited by Gary Gereffi and Donald Wyman (Princeton, NJ: Princeton University Press, 1990): 90-109.

¹²⁹ Gold, *State and Society*; Cheng, "The Politics of Industrial Transformation."

and heavy machinery industries.¹³⁰ Both Mainland China and Taiwan thus relied on state enterprises for direct developmental interventions; and in both Taiwan and the PRC there was a lack of nationally prominent private firms that could act as the central state's counterparts in implementing industrial policies.

Nonetheless, the nature and consequences of industrial policy deeply diverge in these two cases. China's territory is much vaster than Taiwan's, which introduces considerable complexities to governance, especially in terms of managing central-local relations. As a result, the Chinese central state mainly sets overall incentive and policy frameworks, while yielding substantial autonomies to local actors to conduct developmental interventions and build close relations with the emerging private sector. In this sense, the PRC has developed a "diffuse developmental state."

Perhaps the most intriguing parallels between Taiwan and Mainland China emerge when analyzing the nature and structure of their private sectors. In both cases the private sector was at first discriminated against or faced indifference by the agents of the state. Since government agencies and state banks lent little support to most private firms, these relied on family and *guanxi* ties to overcome government discrimination and institutional uncertainty.

In both Taiwan and certain areas of Mainland China (e.g., Wenzhou, the Pearl River Delta) a high percentage of private enterprises originated as family firms. Families played crucial roles by contributing core capital, providing labor inputs, and performing managerial functions. In regard to Xiqiao in the Pearl River Delta, Jon Unger notes that most private firms originated as partnerships, but later splintered into small family firms.¹³¹ Immediate family took precedence since it could be relied on in terms of trust. Nonetheless, in some of the most successful and largest firms partnerships endured, overcoming the traditional Chinese familistic approach to business.

Unger argues that in both Xiqiao and Taiwan entrepreneurs reacted to their environment with a similar set of responses, expressing a common pattern of "Chinese" entrepreneurship. For example, many private firms in Taiwan first were formed as partnerships to pool capital, but then dissolved into family firms.¹³² Also similar to Taiwan, private firms in Xiqiao engaged in a high rate of reinvestment to upgrade and expand their business, while bank loans were spurned. Finally, in both Taiwanese and Xiqiao family firms the wives of the entrepreneurs tended to oversee key operational aspects.

While the reliance on family firms at the outset of industrialization is not unique, a second characteristic – the reliance on *guanxi* networks – is distinctive of how Chinese entrepreneurs built Asia's *network capitalism*. In Taiwan, family firms and partnerships

¹³⁰ Peter Nolan, *China and the Global Economy: National Champions, Industrial Policy and the Big Business Revolution* (Basingstoke: Palgrave, 2001).

¹³¹ Unger, *The Transformation of Rural China*, 135-139.

¹³² A similar situation was also prevalent in Hong Kong private firms. See Siu-lun Wong, "The Chinese Family Firm: A Model," in *British Journal of Sociology* 36 no. 1 (1985): 58-72.

have tended to cluster into business groups based on *guanxi* ties.¹³³ These groups are horizontally structured groups of businesses, often with widely varying internal structures and fluid boundaries. Reciprocity and mutuality characterize firm relations within these clusters. In fact, employers have been found to give financial support and subcontract orders to their former employees who, driven by the aspiration to “become one’s own boss,” succeed in accumulating skills, capital, and social connections to set up their own factories. With these mutual supports, relatively small firms can take advantage of considerable economies of scale, and the networks of both large and small firms can be extended.

While Taiwan represents in many ways the classical case of *network capitalism*, this form of capitalism is prevalent wherever there are strong ethnic Chinese influences in an economy. As in Taiwan, the predominance of family firms and *guanxi* networks partially reflect the cultural-institutional resources of the Chinese. Focusing on “the psycho-social legacy of China,” Gordon Redding has argued that these networks form the “spirit of Chinese capitalism.”¹³⁴ Although Redding stresses the psychological and cultural origins of *guanxi* networks, the reliance on family firms and business networks have a clear functional aspect.

In all cases of Asian *network capitalism*, state elites strategically launched capitalist institutions that allowed private enterprises to explore and connect with global markets. However, the incompetence, indifference, or discrimination of state officials *vis-à-vis* private enterprise during early stages of industrialization created highly uncertain and even hostile institutional environments. As a result, Chinese entrepreneurs in Taiwan, Hong Kong, and Southeast Asia marshaled traditional Chinese “values of trade” based on family and *guanxi* networks, creating a collective institutional solution to the lack of trust in governments.¹³⁵ These networks allowed initially weak enterprises to overcome problems in accessing financial resources, resisting government predation, acquiring marketing intelligence, and developing new technologies.

This situation has strong parallels to China’s emerging capitalism. Like in the Chinese communities of Southeast Asia, Hong Kong, and Taiwan, business networks built on *guanxi* ties have been of great importance in China’s capitalist development.¹³⁶ Throughout the reform era private firms in China faced considerable insecurity. Above all, the status of private property rights was extremely uncertain. Private entrepreneurs therefore used *guanxi* networks and hybrid forms of ownership to collude with local government officials. Without this, most private firms would not have gotten access to

¹³³ Jiexuan Chen, *Cooperative Networks and Life Structure* (Taipei: Lien-jing, 1994); Hill Gates, *China's Motor* (Ithaca: Cornell University Press, 1996); Hamilton and Biggart, “Market, Culture, and Authority”; Gwoshyong Shieh, *Boss Island* (New York: Peter Lang, 1992).

¹³⁴ Redding, *The Spirit of Chinese Capitalism*.

¹³⁵ See Gungwu Wang’s conceptualization of Chinese trading values in *Community and Nation: China, Southeast Asia and Australia* (St. Leonards, New South Wales: Allen & Unwin, 1992). See Chan Kwok Bun ed., *Chinese Business Networks: State, Economy and Culture* (Denmark: Nordic Institute of Asian Studies: 2000) on the situation in Southeast Asia.

¹³⁶ Mayfair Mei-Hui Yang, “The Resilience of Guanxi and its New Deployments: A Critique of Some New Guanxi Scholarship,” in *The China Quarterly* no. 170 (2002): 459-475.

land, obtained business licenses, and raised capital.¹³⁷ Ultimately, *guanxi* networks compensated for institutional uncertainty and created profit-making opportunities.¹³⁸

Given China's vast geographical expanse, several forms of *network capitalism* have emerged. For example, in Southern Jiangsu most private firms have grown out of privatized state and collective firms. These firms cultivate closely networked relations with their former government supervisors. However, due to their origins family has seldom dominated these enterprises.¹³⁹ In the quintessential capital of China's *network capitalism*, Wenzhou City, a very different pattern of entrepreneurship is found. Since there were few locally owned state firms at the outset of reforms in 1978, the family became the entrepreneurial core for the development of a plethora of enterprises. These tend to coalesce into vast business networks, dominating, for example, the world manufacturing of lighters. Some of these networks have also grown far beyond Wenzhou, linking up distant production and sales locales.

Beyond Wenzhou, networks of thousands of small businesses exhibiting fine divisions of labor are common throughout China, creating clusters that specialize in certain product ranges and lock in advantages of agglomeration. Such networks/clusters include Chenghai (toys), Shenzhen (toys, loudspeakers, and Christmas decorations), Datang (socks), Shengzhou (neckties), Jinjiang (shoes), Dongguan (shoes and furniture), Zhongshan (door locks), and Zhuhai (electric lighting fixtures). As a result of their clustering, small firms can attain economies of scale, access market information, and upgrade their product quality and technology, in the process driving down manufacturing costs. In many instances such "competitive networks" have come to dominate global markets in their product area.¹⁴⁰

Gilles Guiheux provides a detailed example of one instance of China's emerging *network capitalism* located in the city of Yiyang in Hunan Province.¹⁴¹ Yiyang is actually far removed from China's coastline, therefore proving that China's *network capitalism* is not confined to the prosperous coastal regions and spreading into regions where the private sector's development is quite recent. The development of a textile production network in Yiyang actually grew out of three state textile firms, which went bankrupt during the 1990s. Since former workers did not receive unemployment insurance or other supports, most of them resorted to becoming individual entrepreneurs, filling the void left by the bankrupt state firms. Individual entrepreneurs used their acquired skills and trading networks to set up a myriad of mainly family-owned textile workshops. One of the

¹³⁷ International Financial Corporation, *China's Emerging Private Enterprises--Prospects for the New Century* (Washington D.C.: International Financial Corporation, 2000), 20-34.

¹³⁸ David Wank, *Commodifying Communism: Business, Trust and Politics in a Chinese City* (Cambridge: Cambridge University Press, 1999); Katherine R. Xin and Jone L. Pearce, "Guanxi: Connections as Substitutes for Formal Institutional Support," in *Academy of Management Journal* 39 no. 6 (1996): 1641-1658.

¹³⁹ Hans Hendrichske, "How Local Are Local Enterprises? Privatisation and Translocality of Small Firms in Zhejiang and Jiangsu" in *Provincial China* 8 no. 1 (2003), 30-31.

¹⁴⁰ Ming Zeng and Peter J. Williamson, "The Hidden Dragons," in *Harvard Business Review* 81 no. 10 (2003): 92-99.

¹⁴¹ Guiheux, Gilles, "The Transformation of an Urban Economic Area in Hunan Province: From State Enterprise to a Specialised Market" in *China Perspectives* (September/October 2003): 4-16.

former state factories gradually converted into a textile market which includes many privately owned production stalls. The other two opened their premises to larger-scale private firms. In this manner, the real estate of former state firms was directly put to use to support networks of private operators. For example, in late 2002 after four years of development, the textile market included nearly 300 small workshops.

The result of this transition has been that in the space of less than ten years the three former state firms had given way to a multitude of small workshops, most of which produce within a family framework. There are also several dozen larger private firms. All of these include as central operators former employees of the state textile mills. In essence, the private Yiyang textile producers have grown out of the rubble of the city's state sector. Nonetheless, the state remains the owner of the premises in which these private textile producers operate. This has generated an increasingly symbiotic relationship between the empty shell of the former state textile mills and the new private firms. For example, a former factory director acts as the administrative head of the newly established specialized market for textile articles. Indeed, this former factory head has become an ardent supporter of the interests of his tenants since the expansion of private commercial activities has become the purpose of the textile market.

The local government exhibited at first indifference, not unlike the experiences of the private sectors in Overseas Chinese communities. Only as the textile market and private enterprise gained in economic importance did local government officials start to pay attention. At this point, old machinery from the state mills was rented out to the new start-ups and more effort put into developing the textile market. With the help of the former heads of the state textile mills a management committee including local government officials was formed. This committee acts as intermediary between private operators and various government offices, protecting, for example, the interests of individual entrepreneurs against the predatory behavior of government officials. It also has become an advocate for the further development of the textile market, lobbying the local government for investments in infrastructure and better governance.

As in other areas of China, the local government in Yiyang moved from reprimanding the activities of private operators, to indifference, and then to actual support.¹⁴² Interestingly, the spokesmen for the new entrepreneurs are the former factory directors, who have become both managers and political leaders of the production networks. The networks have thus grown out of the planned economy via an endogenous process that allowed former government representatives to transform themselves into advocates of private sector development *vis-à-vis* the local government. The local government's change of heart can also be traced back to emulation. In Yiyang, leaders of the textile market traveled to other more advanced areas of China to study their experiences. They brought back news of best practices, further influencing the local government's attitude in governing emerging production networks.

The change of heart on the part of the local government can most fundamentally be traced back to the changing structure of China's political economy. Privatization has

¹⁴² See also Unger and Chan, "Inheritors of the Boom" and Blecher and Shue, "Into Leather."

made enterprises independent of local governments. Individual entrepreneurs are now free to move across administrative borders to seek the best investment climate. At the same time, the yielding of substantial autonomies to local governments to define their own industrial policies has opened the door to strong inter-jurisdictional competition, with each local authority seeking to attract private enterprises with better investment conditions. The macro-outcome is a rapidly improving investment climate for private firms and the conscious support by local government authorities of *network capitalism*, especially by setting up designated industrial parks.

Inter-jurisdictional competition, emulation, and endogenous processes of creating private sector advocates out of former state representatives are accelerating the spread of *network capitalism* in China. In turn, the networked structure of China's private sector is enabling the emergence of various hybrid ownership forms. On the 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. Many private entrepreneurs have therefore invited government officials to sit on their boards or act as silent investors. On the other hand, the emergence of former state managers as private entrepreneurs (sometimes while keeping their official positions) created incentives to leave the ownership of assets in China intentionally vague. In both cases, *guanxi* networks have created the conditions for a variety of joint private-state ventures to flourish. China's emerging *network capitalism* has opened the state sector to the influence of private interests and ultimately furthered property rights reforms. The hybridization of ownership forms in China and the emergence of *network capitalism* are closely linked.

Finally, China's *network capitalism* has been influenced by and further accelerated the spread of Overseas Chinese capital into China.¹⁴³ Between 1982 and 1994, more than 70 percent of all foreign investment in China came from Overseas Chinese sources.¹⁴⁴ Especially in the early 1980s, when China's investment climate was abysmal, investors from Hong Kong used processing arrangements as a cheap and flexible means to take advantage of China's cheap labor pool. Their connections with and demands on local governments triggered improvements in China's investment environment. The competition for low-cost export platforms caused Overseas Chinese network capital to follow their Hong Kong counterparts, creating a beelike swarming effect that brought ever-greater investments of Overseas Chinese network capital to China.

The increasing autonomy of local governments in China allowed Overseas Chinese network capital to link up with low-level Chinese officials, who, driven by their personal and career interests, facilitated cross-border flows of capital. As a result, the linkages established between Overseas Chinese investors and local officials not only created direct linkages to the world market for Chinese localities, but also strengthened these localities bargaining power *vis-à-vis* the central government.¹⁴⁵ This in turn allowed the alliances

¹⁴³ Hsing, *Making Capitalism in China*.

¹⁴⁴ Hsing, *Making Capitalism in China*, 147.

¹⁴⁵ Hsing, *Making Capitalism in China*, 144.

among local officials and Overseas Chinese capital to expand, further accelerating the international integration of China.

Evidently, Overseas Chinese capital was an important force in integrating China into international trading and production networks, some based on the ties of ethnic Chinese, while others went far beyond their Asian roots. *Network capitalism* in China brought much greater foreign investment, created competition, transferred technologies, and introduced trading connections and managerial skills.

In conclusion, China exhibits a distinct prevalence of networked forms of capitalism in its domestic private sector. The political economy emerging in China therefore parallels to some extent the evolution of *network capitalism* in 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. On the one hand, a large state sector dominates the commanding heights of the economy and is the direct counterpart to the central government's industrial policies. On the other hand, 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 and outward orientation of the economy is being driven by Chinese *network capitalism*.

Development under Global Capitalism

One of the major distinguishing characteristics of China's capitalist transition is the timing of its entry into the world capitalist system. Japan, Taiwan, Hong Kong, South Korea, and Singapore developed at earlier periods in world historical time, generating different choice sets for policy makers and business leaders. As with the Southeast Asian economies entering world markets in the 1970s and 1980s, China's responses to the challenges of late development are being shaped by the strengthened forces of globalization. China must therefore be understood as a late-late developer in the era of *global capitalism* and part of the third wave of industrialization in East Asia.

After the Second World War a number of late-late developers appeared. Several Latin American countries experienced rapid industrialization, which often relied on close cooperation among the state bureaucracy (including state firms), domestic capital, and multinational corporations.¹⁴⁶ Changes in political regimes, insufficient internal reforms, and the mismanagement of external finances, however, impeded capitalist development in most of Latin America. Much more sustained development took place in the late-late developers of East Asia that were part of the second wave of Asian industrialization (after Japan).

Four East Asian economies – South Korea, Taiwan, Hong Kong, and Singapore – were part of this second wave and experienced a particular set of factors influencing their capitalist transition. First, in one way or another all of these four economies were

¹⁴⁶ Peter Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil* (Princeton, NJ: Princeton University Press, 1979).

considered front-line states during the Cold War. They faced strong national security threats and were granted privileges by the United States to take advantage of U.S. markets and technology. Second, all four of these economies could benefit from institutional diffusion. The United States was especially influential in South Korea and Taiwan, advising their governments on a range of economic matters and prompting the implementation of wide-ranging land reforms. Hong Kong and Singapore were influenced by Great Britain due to their colonial legacy. In at least three cases, Japan's generic form of *coordinated capitalism* also served as an important developmental example. Finally, all of these East Asian economies were able to take advantage of the rapid growth and industrialization that took place in Japan after the Second World War and the need for goods and services by the United States to fight the Vietnam War.

Following Japan and the late-late developers of South Korea, Taiwan, Hong Kong, and Singapore, a third wave of development gripped East Asia starting in the 1980s. This wave included several Southeast Asian countries such as Thailand, Malaysia, and Indonesia. Although China entered world markets slightly later, it can also be considered part of this wave of industrialization. Indeed, after the Asian Financial Crisis in the late 1990s hit Southeast Asian economies particularly hard, the Chinese economy continued to soar, putting China at the forefront of Asia's third wave of industrialization.

As with its Southeast Asian counterparts, the changing international environment has created a set of options for China's policy makers that differ from those faced by earlier Asian developers. Perhaps most importantly, China has surfaced as a much more open political economy than those of Japan, South Korea, and Taiwan. Naturally, Singapore and Hong Kong possessed highly open economic environments due to their role as trading and (later) financial hubs. However, Japan, South Korea, and Taiwan kept foreign investment and imports tightly under control to build up domestic competitors.¹⁴⁷

Faced with the pressures and opportunities of globalization, Chinese policy makers opted to gradually open the economy to large amounts of foreign direct investment and trade. As David Zweig explains, much of this openness was not by central design. Large segments of China's political establishment tended to be neo-mercantilist at least up until the late 1990s.¹⁴⁸ Opposition to strong internationalization therefore existed, but was run over by the many unintended consequences flowing from China's open door policy. Leadership initiative, especially by Deng Xiaoping and Zhao Zhiyang, was at first key, but once the door to rural China was opened in the 1980s, "network capital from Taiwan and Hong Kong swarmed to the coastal countryside searching for cheap labor and colluding with officials to evade regulations governing joint ventures and foreign trade."¹⁴⁹

Overseas Chinese investors were therefore at the forefront of the forces of globalization, driven by cultural affinity and China's comparative advantage in cheap labor to set up vast production networks. Their capital worked wonders, winning over cadres that, rather

¹⁴⁷ Wade, *Governing the Market*; Johnson, *MITI and the Japanese Miracle*; Amsden, *Asia's Next Giant*.

¹⁴⁸ Zweig, *Internationalizing China*.

¹⁴⁹ Zweig, *Internationalizing China*, 261.

than enforcing restrictive regulations, opted to use their grassroots regulatory authority to facilitate international exchanges. A domestic hunger for global linkages was unleashed that generated economic gains for China's local bureaucrats and, more importantly, linked coastal communities with the global market, paving the way for them to become the "workshop of the world."

Local adjustments to the demands of investors driven by inter-jurisdictional competition interacted with efforts by the central state to construct a market-friendly regulatory environment. Virtuous cycles of induced reforms unfolded that created a much better investment climate by the late 1990s. Large Multinational Corporations (MNCs) became more and more attracted to the lure of China's potentially huge consumer market and its cheap and increasingly skilled labor pool. This development took a major leap forward with China's entry into the WTO in 2001. WTO accession is not only opening vast slices of China's market to foreign investment and trade it is also pushing forward the establishment of an investor-friendly institutional infrastructure. Moreover, WTO entry is finally freeing China's private sector from many of its restrictions, accelerating its integration with *global capitalism*.

Both domestic and international factors have therefore interacted to accelerate China's participation in world trade and foreign investment, allowing its internationalization to grow faster than any country in the world during the 1990s. In hindsight, the increasing permeability of national barriers to world trade, the rising flows of capital and information, the expanded influence of international organizations, and the increasing 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, *global capitalism* opened China as much as China opened to the world.

The historical timing of China's capitalist transition in combination with its unique national characteristics generates four aspects of its internationalization that are noteworthy. First, China's rapid internationalization has allowed its economy to become a force for regional economic integration. At first, networks of ethnic Chinese investors built bridges integrating China with Asia, but soon global production networks incorporating MNCs and regional players, especially in electronics, started to base assembly operations in the country. After WTO accession, these networks started to upgrade to more value-added production processes while undertaking global research and development efforts. China is therefore rapidly becoming a central node of the world economy with special significance for Asia's regional integration. Evidently, China's economic boom from 2002-2005 has benefited its Asian neighbors enormously in economic terms. China's growing regional role, however, is taking place at an early stage of its economic development. Substantial institutional uncertainties in China combined with an economic or political crisis could therefore destabilize Asia's rapidly growing economic regionalism.

Second, China's size is an enormously important factor shaping its international integration. Interdependence with the international capitalist system is certainly

constraining Chinese policies. China's WTO accession and continued engagement with MNC leaders and international economic institutions stands testament to how Chinese policies are constrained by the need to continuously attract international capital, technology, and managerial skills. However, at the same time that China's policies are being constrained by increased economic interdependence, China's huge size is making it a rapidly rising player on the international economic stage. This in turn gives China a measure of international influence. Perhaps the clearest indication of this is China's ability to resist repeated demands by its major trading partners, especially the United States, to revalue its currency. When facing a similar situation, Japan, South Korea, and Taiwan were unable to stand firm since they were too dependent economically and militarily on the United States.¹⁵⁰

Third, China's international economic influence is not only a result of its size but also of its relative openness. The relentless opening of sector after sector to foreign trade and investment made China one of the largest global importers of raw materials, machinery, and equipment. Global markets will therefore be increasingly shaped by Chinese economic events. Large shares of Foreign Direct Investment (FDI) and international trade also transformed China into the darling of corporate chiefs in North America, Japan, and Europe. The unintended but important consequence of this is that China has created powerful domestic lobbies within its trading partners. These want to keep the China trade flowing. For example, China's production base for U.S. MNCs is very important to their corporate profits. The probability that the U.S. government would act in a radical manner to protect domestic markets from Chinese goods is therefore low. Ultimately, such moves would inflict severe self-damage. A protectionist backlash similar to the one that took place against Japan in the 1980s therefore looks unlikely, although the going will get much rougher as China gains competitiveness in capital goods and higher value-added activities.

Finally, within China's domestic political economy strong incentives to attract international capital have created economic spaces that are divorced from China's domestic economy but highly integrated into global production networks. 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. This model is achieved by establishing industrial areas that are segregated from the domestic economy at large and provide excellent hard and soft infrastructures. Put differently, separate governance systems are produced for the sole purpose of accommodating MNC capital.

The consequence of this last point is that China's capitalist development is producing many separate and distinct local political economies. Some of these resemble Singapore by their dependence on MNC capital. Others rely heavily on Overseas Chinese network capital that melds with China's emerging *network capitalism*. And yet others are anchored in the lasting importance of China's state sector, sometimes cooperating with international capital, in other instances going their own way with massive state support.

¹⁵⁰ Mark O'Neill, "New Power Player Takes Center State in Rich Man's Club," *South China Morning Post*, June 20, 2005.

In addition, these political economies can connect and develop hybrid forms, creating a plethora of “capitalisms” within China. Naturally, in some areas of China little or no development is taking place, thus resembling an unstable predatory form of state-capital relations. The upshot is that both the extent of capitalist development and the accompanying internationalization of China’s economy have been highly partial. China is a patchwork of political economies, none of which dominates.

V. Concluding Remarks and Future Scenarios

China is undeniably in the process of a capitalist transition. But is this transition sustainable? And where will it lead? Answering these questions necessitates some futuristic thinking, something that is generally discouraged in the social sciences. Nonetheless, I will engage in an exercise of logical analysis by exploring tendencies already present in the structure and motivations of China’s social actors. This will hopefully allow me to put forward possible future scenarios in China’s development. In other words, I will utilize the materials presented on China’s emerging capitalism to generate insights into how its capitalist transition might ultimately unfold.

China’s Incomplete Transition

The perhaps most influential feature of China’s transition is its incompleteness. As one Chinese colleague puts it, “China is far away from socialism and far away from capitalism.” In particular, the bifurcation of the secular realm – the establishment of an autonomous, self-directing realm of the economy – is not complete. China’s embryonic market economy remains too politicized. The precondition of a high degree of institutional certainty and predictability necessary for China’s private sector to expand and upgrade technologically is only partially established. In other words, substantial institutional and legislative uncertainty affects the domestic political economy, inducing private entrepreneurs to forge clientelistic and idiosyncratic ties with the party-state.

To reach greater institutional certainty structural political reforms will be necessary. These reforms are likely to include reforms to the legal system, especially greater professionalism and independence of the courts. There also needs to be less government interference in the economy accompanied by higher standards of accountability and transparency. Finally, reforms must include expanded channels for institutionalized policy input and feedback, such as e-government and/or media reforms. Ultimately, reforms must bring corruption under control, strengthen the checks on government leaders and bureaucrats, and create stronger institutions to protect the rights and interests of investors.

Political Imperatives

Political imperatives could conceivably halt China’s capitalist transition and roll back achievements to date. There are many historical examples of this. Clearly, there is a distinct danger that China’s political economy could become stuck in a form of “Chinese Crony Capitalism,” perpetuating the present situation in which most large private firms must seek close clientelistic ties with government officials. To move away from “Chinese Crony Capitalism,” China’s political leadership must face major political trade-offs.

One of the key distinguishing aspects of capitalist systems is the potential for capital to restrain state action and therefore gradually construct a self-directing and autonomous realm of the economy. Since capital moves according to where the greatest returns are, states in order to retain and generate new wealth must create favorable conditions for capital accumulation. These conditions include establishing secure property rights, functioning markets, and predictable policies. At the same time, capitalist development expands state power enormously. States can make use of the superior productive capacities unleashed by the growth of capital, therefore marshalling greater and superior institutional, human, and material resources.

One of the most misunderstood aspects of capitalist development in popular conceptions is that it is a purely “private” economic system. Quite to the contrary, the expansion of capital-owning classes serves to expand and reconstitute state power, since capital demands more effective state power. In essence, capitalist development leads to a process of mutual empowerment whereby both the realm of the “economy” and that of the “state” expand. The structural power of capital can keep in check the vagaries of state power and reshape state action.

However, the world’s history shows that few state elites are willing to strike this “deal” with capital. Since states are inclined to acquire a monopoly over the concentrated means of physical coercion within their territory, they tend to squash potential competitors for power. Capital represents such a competitor, because its possession of wealth can rival the influence of the state. Before capital matures, however, state elites can easily opt to suppress an emerging autonomous realm of the economy. State power can directly influence property rights and exchange systems, thus halting economic change. As the lack of widespread capitalist development in the world attests to, capital leads a highly precarious existence at early stages of development. Predatory threats from state elites are common, inducing capitalists to move their holdings to safe heavens. One of the necessary conditions for capitalist development to take off is a modicum of security provided by the state to capital.

Put differently, to allow capitalist development to proceed there need to be immediate pressures that induce state leaders to permit capital an expansion in its political sway. Ultimately, real or perceived threats to national and/or regime survival are the most common forces pushing state elites to enable capitalist development. Judging from how China’s Communist leadership views the external environment (as basically hostile and intent on subverting its rule), there are some reasons for optimism.

Failure of the Political Transition

Conversely, a CCP leadership that feels the power of capital becoming too large could resort to strong nationalism, using it to snuff out the forces of change. Indeed, China’s polity remains highly insecure and immature. External shocks and endogenously created shocks, such as a military conflict with Taiwan, a major world recession, or a social upheaval within China, could derail China’s capitalist transition and generate a nationalist backlash leading to inward-looking economic policies. A form of Chinese fascism,

although a distant possibility, would express the leadership's inability to move towards an autonomous, self-directing realm of the economy.

The consequences of such a political transition would be dire for the world. China is already a giant trading power that is rapidly advancing military capabilities and expanding its diplomatic and cultural reach. An upsurge of Chinese nationalism would create immense dangers for the Asia Pacific region and the world that must be squarely faced.

Even without a nationalist backlash, the internal political situation in China could destabilize the country. The strains of China's capitalist transition are evident. Widening income gaps (and the perception thereof), massive environmental degradation, and plentiful instances of corruption and bad governance attest to this. However, most importantly the leadership might lack the political will to complete the transition. Political reforms could stall, pushing China into an equilibrium state characterized by crony capitalism, increased corruption, and continuing major lapses in governance. The upshot would be a period of economic stagnation and domestic socio-political instability.

Ultimately, China needs a new social contract. Since the leadership requires economic growth to shore up its domestic legitimacy, it must win the support of China's burgeoning entrepreneurs. At the same time, the CCP must lower social and regional disparities. The necessary redistribution of income would not only ameliorate these disparities, but also help to increase internal consumption and thus move China away from its dependence on external markets, especially the United States. To reach these objectives the Chinese leadership must strike a quintessential capitalist "deal": give private entrepreneurs fully secured property rights in return for the more effective collection of tax revenue. In other words, the Chinese leadership must proceed with further political reforms to create institutional certainty and predictability. In this manner, greater tax revenues can be garnered to bridge the increasing gaps among rich and poor and stimulate domestic consumption.

International Implications

A highly nationalist China is the most pessimistic outlook. On a more positive note, the trajectory of China's development so far shows that it has surfaced as a much more open political economy than many of the earlier developers in Asia (chiefly Japan, South Korea, and Taiwan). This has allowed China to become a force for economic integration, something that has benefited its Asian neighbors enormously in economic terms. Indeed, China's *network capitalism* facilitates economic integration, especially among the *Sino-capitalisms* of Taiwan, Hong Kong, and parts of Southeast Asian economies. In addition, China's political efforts to engage with the region, especially the China-ASEAN Free Trade Area that is in the making, bode well for China's role in regional integration. China's emergence as a major trading power might therefore unfold quite smoothly, and China could conceivably become a new world center for economic activity by the next decade.

However, China is already a colossus at a very early stage in its capitalist transition. Seldom has the world seen such a large economic power emerge in such a short time. Since China's authoritarian political constitution is unlikely to change in the near future, the Asia Pacific region and the world will be faced with a large economic power that nonetheless contains substantial institutional and legislative instability. The incongruity between China's rapidly growing international power and its only partially institutionalized polity generates a degree of insecurity and unease *vis-à-vis* the present world order among China's elite. China's size and transitory nature could therefore have destabilizing influences. There is also the potential for China's leadership to mismanage the transition with wide-reaching effects. As popular commentators have started to put it: "If China sneezes, the world catches a cough!"

If China's economic trajectory does not change, it will become a formidable economic competitor. As a result, geoeconomic and geopolitical competition will heat up. Clear signs of this are already visible, such as increasing tensions between China and Japan. Quite naturally, as China's international power grows other regional powers must realign their foreign policies. This promises to be a difficult process, especially for Japan and, by extension, the United States. Can the world cope with Capitalism in the Dragon's Lair? This will be the major question for the geopolitics and geoeconomics of the 21st Century.