

Current Successes and Future Challenges in China's Economic Reforms

China's programme of economic reform has met with remarkable success.¹ The average annual growth rate since 1979 has been 8.8 per cent, placing China in a select group of developing countries which have achieved sustained industrial growth for over a decade. Indeed, China doubled output per person in the ten years between 1977 and 1987, one of the shortest time periods for any country to achieve such a record.² This impressive growth has in part been the result of significant increases in factor productivity in both the state and non-state sectors, a point of some importance given the well-documented failure of centrally planned socialism to raise productivity.³ The result is that China's economy is now estimated (using purchasing-power parity exchange rates) to be surpassed in size only by the US and Japan and there is a real possibility that China will become the world's largest economy by 2025.⁴ In per capita terms, there have been impressive increases in living standards evidenced by a threefold increase in the average consumption of meat and eggs between 1978 and 1991, by a more than

doubling of the average living space per person in rural areas in the same period, and by the fact that the ultimate basic consumer good, the television set, was owned by an average of one of every two rural households and by virtually every urban household in 1991.⁵

There have, however, also been some clear problems in the reform programme, most notably the inflationary pressures which culminated in the 25 per cent inflation of 1989, the rise in death rates, the emergence of significant environmental problems, increasing income inequality, and social disruption and unrest.⁶ The successes outlined above, therefore, have come at a considerable cost. It is not our intention here to establish that the benefits of reform have outweighed the costs (although we believe this to be the case) but rather to analyse the spectacularly successful aspects of the reforms, most notably economic growth as measured in conventional terms. China's success in this respect is particularly evident in comparison with the performance of most other developing countries over the same period and the economic morass which has engulfed the countries of the former Soviet bloc.

If there has been a degree of consensus over the fact of China's economic success, however, the reasons for that success and the challenges which

¹ We are grateful to Robin Blackburn, Mark Selden, Mark Setterfield and Gordon White for their comments.

² See World Bank, *World Development Report*, Washington, DC 1991, p. 12.

³ The terms 'state' and 'non-state' sectors have been used in the literature to distinguish between those enterprises 'owned by the whole state' and those owned by some other group or individual. The terminology is used widely although it is misleading in that, as we will see further below, the local state often owns enterprises in the non-state sector (a classification which arises because local-level governments do not represent the whole population). For a review of productivity in the post-reform period, see for example Kam-tim Lau and J. Brada, 'Technological Progress and Technical Efficiency in Chinese Industrial Growth: A Frontier Production Function Approach', *China Economic Review*, vol. 1, no. 2, 1990, pp. 113–24; G. Jefferson, T. Rawski, and Yuxin Zheng, 'Growth, Efficiency, and Convergence in China's State and Collective Industry', *Economic Development and Cultural Change*, vol. 40, no. 2, 1992, pp. 239–66; P. Prime, 'Industry's Response to Market Liberalization in China: Evidence from Jiangsu Province', *Economic Development and Cultural Change*, vol. 41, no. 1, 1992. For a discussion of the failure of the centrally planned system to raise factor productivity see G. Ofer, 'Soviet Economic Growth 1928–85', *Journal of Economic Literature*, 1988, and P. Bowles and T. Stone, 'China's Reforms: A Study in the Application of Historical Materialism', *Science and Society*, vol. 55, no. 3, 1991, pp. 261–90.

⁴ See IMF, *World Economic Outlook*, Washington, DC 1993.

⁵ All data are from the State Statistical Bureau, *Statistical Yearbook of China*, 1992.

⁶ For a discussion of China's inflation see, for example, P. Bowles and G. White, *The Political Economy of China's Financial Reforms: Finance in Late Development*, Boulder 1993, ch. 5; for the debate over rising death rates see A. Hussain and N. Stern, 'On the Recent Increase in Death Rates in China', Development Economics Research Programme, *Working Paper CP no. 8*, 1990, London School of Economics; for environmental problems see V. Smil, *China's Environmental Crisis: An Inquiry Into the Limits of National Development*, Armonk, NY 1993; for a discussion of the (controversial) issue of trends in income inequality see, for example, I. Adelman and R. Sunding, 'Economic Policy and Income Distribution in China', *Journal of Comparative Economics*, vol. 11, 1987, pp. 444–61.

remain for the future are still contentious issues. In this paper, we will argue that a common approach, derived from the dominant neoclassical paradigm, which attributes China's success exclusively to the introduction of the market mechanism and advocates large-scale privatization as the most important task of the future is highly misleading. We offer an alternative view which interprets China's success as demonstrating the continued economic relevance of social ownership of the means of production and which highlights the role of an active local state as a centrally important feature of China's reform programme. This is particularly evident in the industrial sector but is also found in the agricultural sector. We argue that the challenge for the future is not privatization but the cementing of market reforms within the context of an institutional framework capable of preserving and harnessing the developmental capacity of a multi-level state and the strengthening of rural collective institutions.

In the first section we briefly review the argument that China's success can be attributed exclusively to the operation of market forces and that the future success of the reforms depends on the extent of privatization. As a necessary corrective to this view, we demonstrate in the following section that the (local) state has been an important actor in the reform process and that it has contributed significantly to economic success. Furthermore, it has done this within the context of maintaining social ownership of the means of production, which has led the local state to behave in ways which are different from, and more economically beneficial than, a capitalist alternative. We also argue in section III that collective ownership rights in land have similarly provided economic benefits in the agricultural sector. In section IV we suggest why privatization should be regarded neither as a necessary nor a sufficient condition for future economic success but instead argue that a more relevant and pressing concern is a workable division of powers between local and central state interests and the consolidation of rural collective institutions.⁷ Even if this could be achieved, however, China's reforms remain essentially open-ended; China's economy and polity is clearly one undergoing rapid change in which contradictory forces are in evidence. We briefly discuss some important emerging trends by way of conclusion.

I. Marketization and Privatization

As is well known, the Chinese reforms were launched in 1979 with the aim of replacing the centrally administered allocation of resources with the increasing use of market mechanisms. The reasons why this change was thought necessary need not detain us here. What is important is that such a change was instituted and has been implemented widely. The spread of market relations can be ascertained in several ways. For example, there has been a significant reduction in the number of key commodities that are allocated centrally and, as Byrd has argued, 'functioning markets have come into being in Chinese industry and have become increasingly important in resource allocation . . . the growing importance of the

⁷ Our focus here is strictly on an examination of the Chinese case. We do not attempt to explicitly draw general lessons based upon the Chinese experience although clearly the arguments have relevance for other 'transitional' economies.

market has been intimately linked with the decline of the resource-allocation role of planning.⁸

The open-door policy has led to significant integration of China into the world economy and, as Lardy notes, 'the Chinese began to adopt a more realistic exchange-rate policy and reformed the pricing of traded goods. The value of the domestic currency in trade transactions was almost cut in half near the outset of reform and this was followed by further significant devaluations in 1985, 1986, 1989 and 1990. Although progress was initially slow, by the end of the decade the domestic prices of almost all imports were based on world-market prices . . . And a growing share of exporters was able to bargain to receive domestic-currency prices that more closely approximated world prices.'⁹ These policy changes were accompanied by a dramatic upsurge in Chinese trade and exports.

The spread of markets and the liberalization of prices were accompanied by enterprise reforms which greatly increased the decisional autonomy granted to enterprises as well as reforms which fostered the spread of private enterprises and joint ventures. The broad thrust of the reforms moved China decisively in the direction of a market (though not, we will argue, a laissez-faire capitalist) economy. In addition, the share of central government revenue and expenditure as a percentage of GDP has fallen significantly during the reform period.¹⁰ In the rural economy, the commune system was abolished and the household responsibility system (HRS) instituted which permitted land leases being given to individuals for periods up to thirty years.¹¹

These changes have been extensive, are well documented, and are not in dispute.¹² What we do wish to dispute, however, is the interpretation by

⁸ W. Byrd, *The Market Mechanism and Economic Reform in China*, Armonk, NY 1991, p. 219. See also p. 51 for examples of the decline in the state allocation of key resources such as coal, timber, rolled steel, cement and nonferrous metals. At the end of 1991 there was a further dramatic reduction in the number of inputs whose prices were subject to state control from 737 to 89. See *Renmin Ribao* (People's Daily), 23 October 1992. Furthermore, as Rawski notes, 'the widespread appearance of convergence phenomena associated with markets rather than planning shows that market penetration extends far beyond rural industry and coastal export zones.' T. Rawski, 'An Overview of Chinese Industry in the 1980s', *Research Paper Series No. CH-RPS 18*, World Bank, 1993, p. 27.

⁹ N. Lardy, *Foreign Trade and Economic Reform in China, 1978-1990*, Cambridge 1992, pp. 81-2.

¹⁰ Although the share of total (i.e. central plus local) government spending has fallen much more modestly. See Wang Shaoguang, 'The Rise of the Second Budget and the Decline of State Capacity in China', paper presented at the conference on 'Political Departures from Central Planning' held at Arden house, New York, 25-30 August 1992.

¹¹ In January 1984, the length of land lease was officially extended to fifteen years or longer. In 1992, a central government decree extended land leases to thirty years upon the expiry of current leases. For discussion of the way in which this is being implemented see 'Chinese Peasants in the Process of Marketization: A Survey Report of Peasant Households and Markets', *Chinese Rural Economy*, no. 2, 1994, pp. 37-43.

¹² There is agreement about the broad contours of the reforms along the ideological spectrum, an agreement which is also shared by Left critics and Left

many that these changes have been solely responsible for China's success. This interpretation has become standard fare in the international financial institutions and in many academic circles and does not require exhaustive explanation here. As an example of the genre, we can simply take the World Bank's *World Development Report 1991*. This report, which crystallizes and popularizes World Bank thinking, argues that a 'market friendly' approach to economic development has been proven to be the most successful. China is used as an example of this and we read, for example, that 'the most striking [of China's economic reforms] were rural reforms that introduced price and ownership incentives for farmers. Real farm prices have increased by 50 per cent, and the agricultural growth rate rose from 2.5 per cent in 1965–78 to 7.2 per cent in 1978–88.'¹³ The message, of course, is the familiar one that 'getting prices right' and providing 'ownership incentives' causes economic growth.

The task of future reforms therefore involves addressing the issue of continuing 'irrational prices' resulting from 'partial reform' and providing more 'ownership incentives' through privatization. The problems of the agricultural economy, such as over-investment in rural housing as opposed to land, can be solved, it has been argued, by providing greater security to peasants through full private land ownership thereby increasing incentives to invest in land. In the industrial sector, the continuing losses and inefficiencies of state enterprises can be addressed by the extension of market relations and by enterprise privatization which would overcome the inefficiencies arising from having an economy characterized by 'agents without principals'.¹⁴ The World Bank perhaps sums up the argument most succinctly when it argues that developing-country experience has demonstrated that 'privatization is necessary and highly desirable, even though difficult and time-consuming';¹⁵ the experience of the former Soviet bloc amply demonstrates the proof of the second part of the sentence!

The key for future reform, therefore, is to be more 'market friendly'. The term 'market friendly' is, of course, devoid of analytical precision and slips chameleon-like from implying a direction of change to indicating a

supporters of China's reforms. For examples of the former see J. Petras, 'Contradictions of Market Socialism—Part I', *Journal of Contemporary Asia*, vol. 18, no. 1, 1988 and R. Smith, 'The Chinese Road to Capitalism', *NLR* 199, and for the latter, P. Nolan and J. Sender, 'Death Rates, Life Expectancy and China's Economic Reform: A Critique of A.K. Sen', *World Development*, vol. 20, no. 9, 1992, pp. 1279–1304.

¹³ *World Development Report 1991*, p. 38.

¹⁴ For arguments supporting privatization see, for example, J. Prybyla, 'Why China's Reforms Fail', *Asian Survey*, vol. 29, no. 11, 1989, pp. 1017–32. See also O. Yenal, 'Chinese Reforms, Inflation and the Allocation of Investment in a Socialist Economy', *World Development*, vol. 18, no. 5, 1990, pp. 707–21. The coexistence of rising productivity and loss making in state-owned enterprises is examined in B. Naughton, 'Implications of the State Monopoly over Industry and its Relaxation', *Modern China*, vol. 18, no. 1, 1992, pp. 14–41. In summary, he argues that the end of the state monopoly over industrial output has led to increasing competition for state-owned enterprises; in this situation it is quite consistent for them to make losses and increase productivity.

¹⁵ *World Development Report 1991*, p. 144.

desirable end state, namely a free, i.e. privatized, market economy. The desirability of this end state has in fact been the starting point of many proposals for designing the future course of the Chinese reforms. The intellectual justification for this recommendation comes from the neoclassical Chicago position which argues that free markets are the best allocators of resources and that markets cannot work efficiently without a system of private property rights.¹⁶

It is the purpose of the remainder of this paper to argue that the reasons given above for China's economic success are at best an incomplete explanation and that the prescriptions based upon them for future reform are inappropriate. Let us first acknowledge an area of agreement. We agree that market-oriented reforms, specifically the extension of markets and the significant reduction in the role of central planning, have been crucial elements in explaining China's economic success. Where we disagree however is that this is a complete picture; we will demonstrate that the state has remained a critical actor in the development process and that social ownership of the means of production is, and should remain, the dominant form of ownership.

II. Industry: Local Developmental Market Socialism

In the pre-reform period China's industrial sector was characterized by one predominant form of ownership. Although capitalist economies exhibit many different forms of legal organization within the parameters of private property ownership, centrally planned economies have relied almost exclusively on one organizational form, the state-owned enterprise.

During the reform period the dominance of state-owned enterprises has significantly decreased. In its place have risen new forms of ownership such as privately owned enterprises and joint ventures which were virtually non-existent prior to the reforms. However, the most significant change has been the rise in the industrial output produced by the collective sector. This sector consists largely of enterprises under the administrative control or ownership of local-level governments at the provincial, city, township and village levels. Urban collectives owned by provincial and city governments were features of the pre-reform period

¹⁶ This point is, characteristically, made clear by Friedman. He argued: 'Using or not using the market is not the crucial distinction. Every society, whether communist, socialist, social democratic, or capitalist, uses the market. Rather, the crucial distinction is private property or no private property. Who are the participants in the market and on whose behalf are they operating? Are the participants government bureaucrats who are operating on behalf of something called the state? Or are they individuals operating directly or indirectly on their own behalf? That is why, in an earlier paper delivered in China, I advocated the widest possible use not of the market but of 'free private markets'... The words 'free' and 'private' are even more important than the words 'market'. The wide use of the market that is sweeping the world is better described as 'privatization'—transferring government-owned enterprises to private hands and thereby giving greater scope to the invisible hand of which Adam Smith wrote.' M. Friedman, 'Using the Market for Social Development', *Economic Reform in China: Problems and Prospects*, edited by J. Dorn and Wang Xi, Chicago 1990, pp. 4–5.

Table 1

Shares in Gross Industrial Output Value by Form of Ownership
(1980–92)

Year	Total (billion yuan)	State %	Collective % (total)	Collective % (urban)	Collective % (rural)	Private %	Other %
1980	515.43	76.0	23.5	13.7	9.9	0.02	0.48
1985	971.65	64.9	32.1	13.3	18.8	1.85	1.20
1990	2392.44	54.6	35.6	15.0	20.6	5.39	4.38
1992	3706.6	48.1	38.0	13.2	24.8	6.76	7.11

Source: Calculated from *Statistical Yearbook of China*, 1993, p. 414.

Collective total = Collective urban + collective rural.

Private refers to private firms employing less than eight people.

Other refers to private firms employing more than eight people, joint ventures and wholly foreign-owned firms.

but the rise of rural collective industries in townships and villages has been a notable feature of the reform period. This sector represents, as we will argue below, a form of social ownership (as opposed to state ownership which is but one form of social ownership). As Table 1 illustrates, socially owned enterprises (i.e. state and collectively owned enterprises) still produce over 85 per cent of China's industrial output. Whilst growth rates may be highest in the private sector, the percentage of output which this produces is still very small and the most significant quantitative change in the composition of industrial output during the reform period has been the change *within* the socially owned sector from the state-owned to the collective sector.

Local governments have been able to promote and support local industries within their jurisdictions with resources made available by fiscal decentralization and the growth of extra-budgetary funds.¹⁷ Significantly, these governments have exhibited considerable entrepreneurial skills defined as the ability to seize new opportunities and take advantage of disequilibrium market situations; the decline of central planning and the gradual liberalization of markets has presented opportunities for new agents to enter into previously monopolized markets and capture a share of the monopoly profits. This requires classic entrepreneurial skills and it is the socially owned sector, encompassing *both* rural and urban collectives, which has responded in this way. As Naughton writes, 'when reference is made to new entries into industrial production, it is natural to think first of the rural industrial sector since this is a rapidly expanding sector relatively separate from traditional state

¹⁷ For discussion of the increasing fiscal base of local governments see R. Kojima, 'The Growing Fiscal Authority of Provincial Level Governments in China', *The Developing Economies*, vol. 30, no. 4, 1992, pp. 315–46; J. Oi, 'Fiscal Reform and the Economic Foundations of Local State Corporatism in China', *World Politics*, vol. 45, no. 1, 1992, pp. 99–126; Wang, 'The Rise of the Second Budget'.

control. However, the argument does not depend on entry solely by the new rural industries. Sufficient resources are now at the disposal of local government officials who invest in, and draw profits from, local and urban collective enterprises, so that entry of new enterprises can be sponsored by local governments within traditional ownership forms.¹⁸

The growth of the collective sector therefore has been evident in both the urban and rural areas and is not linked exclusively to the rise of rural industries. The dynamism of this sector is reflected in the fact that the collective sector now produces over 25 per cent of China's total exports and has performed best in the most dynamic coastal part of the country; in the inland and western areas they have fared less well as shown in Table 2:

Table 2

Gross Industrial Output Value by Ownership in Different Provinces
1992

Region	State-owned %	Collective %	Other %
Western	66.7	24.5	8.8
Inland	61.1	28.9	10.0
Eastern	41.7	45.6	12.7
Fujian and Guangdong	34.5	34.1	31.4
Total	48.1	38.0	13.9

Source: *Statistical Yearbook of China, 1993*, pp. 415–16.

Western refers to the provinces of Sichuan, Guizhou, Yunnan, Shanxi, Gansu, Qinghai, Ningxia, Xinjiang and Xizhang; Inland refers to the provinces of Shanxi (Tianyun), Inner Mongolia, Jinlin, Heilongjiang, Anhui, Jianxi, Henan, Hubei and Hunan; Eastern refers to the provinces of Beijing, Tianjin, Hainan, Hebei, Liaoning, Shanghai, Shandong, Guanxi, Jiangsu and Zhejiang.

Whilst both urban and rural collective enterprises have expanded during the reform period, it is the growth of rural collective enterprises which has been the dramatic feature of the past ten years (see Table 1) and a closer examination of their structure is therefore warranted. Township and village governments are the post-reform administrative units that replaced the commune and the brigade respectively. It is under the jurisdiction of these rural administrative units that there has been a dramatic increase in industrial output. It is true that both collectively-owned and privately-owned rural enterprises have featured in this output growth but it is important to note that it is the collective sector which remains dominant as shown in Table 3.¹⁹

¹⁸ Naughton, 'Implications of the State Monopoly', p. 22.

¹⁹ The classification of rural enterprises by ownership type is a topic of some controversy. Nee argues that many private firms register as collective enterprises in order to benefit from local government favours. See V. Nee, 'Organizational Dynamics of Market Transition: Hybrid Forms, Property Rights and Mixed Economy in China', *Administrative Science Quarterly*, no. 37, 1992, p. 10. (See also O. Odgaard, 'Inadequate and Inaccurate Chinese Statistics: The Case of Private

Table 3**Rural Industrial Output and Employment by Type of Ownership**

(per cent)

Ownership	Output		Employment	
	1990	1992	1990	1992
Township	38.4	38.1	27.8	26.6
Village	36.4	36.9	33.3	34.7
Cooperatives	7.3	6.2	9.0	7.6
Private	17.9	18.8	29.9	31.1

Source: calculated from *Statistical Yearbook of China*, 1992, pp. 435–7 and 1993, pp. 441–3.

As can be seen from Table 3, rural enterprises owned by township and village governments account for 75 per cent of China's rural industrial output and 60 per cent of rural industrial employment.

Between Private and Public

Although all township and village enterprises (TVEs) are similar in that they are technically owned by the residents of a township or village, there is considerable variety in practice as to how these ownership rights are exercised. In some areas a discernible hierarchy of claims on the profits of enterprises is in evidence, whereas in others the exercise of ownership rights is more fluid. Discussing the ownership structure of TVEs in Wuxi, Luo writes that he has 'not yet found an appropriate paradigm for this peculiar system of property rights. It is heavily tinged with Chinese tradition and very different from the Western system under which the individual is the ultimate owner of property.'²⁰ Cui has suggested that the rural collective enterprises might best be characterized as 'moebius-strip collective ownership' where 'the boundaries between rural enterprises and between rural enterprises and community governments are blurred.'²¹

Rural Enterprises', *China Information*, vol. 5, no. 3, winter 1990/91.) This is disputed by Weitzman and Xu, however, who argue that 'to rationalize the success of the [township and village enterprises], many Western economists have regarded them as actually being private firms under the protective label of a collective enterprise. *But this is not in general true*, even though some counter examples can always be found.' M. Weitzman and C. Xu, 'Chinese Township Village Enterprises as Vaguely Defined Cooperatives', Development Economics Research Programme, *Working Paper CP no. 26*, London School of Economics, 1993, p. 11 (emphasis added). While there are some advantages to registering as a collective enterprise (especially to obtain local government support) there are also disadvantages (in that income, and hence taxation, can more easily be hidden in private enterprises).

²⁰ Luo Xiaopeng, 'Ownership and Status Stratification', in W. Byrd and Lin Qingsong, eds, *China's Rural Industry: Structure, Development and Reform*, Oxford 1990, p. 140.

²¹ Cui Zhiyuan, 'China's Rural Industrialization: Flexible Specialization, Moebius-Strip Ownership and Proudhonian Socialism', *mimeo*, 1993, p. 19. As Cui explains, 'moebius-strip is a kind of strip with [the] topological feature that it is impossible to distinguish their insides from their outsides.'

An economic system in which a significant and dynamic part of industry can be characterized as operating under 'vaguely defined property rights' is important and puzzling for economists who have stressed the importance of clearly defined property rights for economic efficiency and as the basis of the case for privatization in the former centrally planned economies.

Precisely how Chinese TVEs have managed to excel under ill-defined social ownership, and how they have successfully addressed the monitoring problem (i.e. how workers and managers have been induced to work efficiently), remains a topic for further investigation. Weitzman and Xu have provided one interesting hypothesis, namely, that societies differ in their degree of 'cooperative culture'; societies such as China with well-developed, and policy-reinforced, cooperative values may be better equipped to successfully utilize collective forms of property ownership.²²

This type of economic system has shown itself to be a feasible one but why might it be desirable? This requires an analysis of the *content* of social ownership. Specifically, are TVEs simply vehicles for individual enrichment and hence behaviourally equivalent to capitalist firms? Certainly the widespread reports of cadre corruption, peasant resistance to ad hoc taxation, and the fact that TVEs are not worker-owned firms operating on democratic principles might suggest that this is the case. However, whilst this may be accurate in some cases, there are in fact strong reasons for believing that TVEs do, at least in a significant number of instances, behave differently from capitalist firms and offer an interesting example of successful socially-owned enterprises.

Whilst the location of property rights varies considerably across TVEs, in practice they tend to be exercised by township and village leaders (whose powers include appointing TVE managers). Huang has argued that the rural administrative and productive organizations of the reform era are best thought of as a 'third realm' existing between state and society and do not fit into the simple Western binary classifications of state/society, state planned/free market.²³ He argues that 'the administrative authorities of these entities cannot be understood simply as part of the state bureaucracy. At this [i.e. local] level, there is a built-in interaction between state cadres appointed from outside and community cadres subject to the influence of tightly knit networks of local connections.'²⁴

²² Weitzman and Xu, 'Vaguely Defined Cooperatives'. Clearly, this is an area in need of more research. Others have sought to explain the success of China's TVEs by reference to the regional structure of China's economy (Y. Qian and C. Xu, 'Organizational Basis for Economic Transition' in G. Yang and C. Zhiyuan, eds, *China: A Reformable Socialism?*, Oxford 1994); by using a transaction costs approach (Nee, 'Organizational Dynamics'), and by pointing to a set of unique 'policy-and-institutionally-determined factors' such as the experience of rural industrialization in the Maoist period, the demand-led boom in the early 1980s and the infant industry position of TVEs (P. Ronnas, 'Economic Diversification and Growth in Rural China: The Anatomy of a "Socialist" Success Story', *Journal of Communist Studies*, vol. 9, no. 3, 1993, pp. 216–44).

²³ A similar point is also made by Lin Chun, 'China Today: "Money Dissolves the Commune"', *NLR* 201, especially pp. 37–9.

²⁴ P. Huang, "'Public Sphere"/"Civil Society" in China? The Third Realm between State and Society', *Modern China*, vol. 19, no. 2, April 1993, p. 235.

Although the Chinese township or village is by no means democratic, local preferences, especially for employment, do seem to play an important role in determining the behaviour of TVEs. Thus Naughton writes that 'while township and village officials control TVE property rights, their incentives are not identical to those of private owners. Township and village officials must take into account the interests of the local community to some extent, if they are to be effective in achieving a spectrum of economic and social indicators. That community may have a substantial preference for employment generation, which the official might want to accommodate.'²⁵ This point is also made by Weitzman and Xu who argue that 'not only is the community government's role different from a private owner of the assets, but also right of control over a TVE is more restrictive than the state's role vis-à-vis state firms in the sense that community governments have to take into account community members' preferences in their decision making. Field research has found that decisions on the establishment of new TVEs were often discussed and made collectively at village meetings.'²⁶

Thus it is not surprising to find that, as Oi writes, local governments' objective is 'defined more broadly than narrow economic interests and profits. It may include social as well as ideological interests.'²⁷ This point is developed further by Cui who argues, based on a survey by the State Statistical Bureau, that 'community-oriented motives are the most important ones for local government officials.'²⁸ The result of this has been that the redistributive function of local government has remained strong and it seems that the provision of employment opportunities for all has remained a high priority. As Lin Chun notes, 'usually by common consent such enterprises [TVEs] are obliged to take care of all the families in the community through special measures to ensure equal employment and public welfare funding.'²⁹

Thus, to a significant degree TVEs do represent social ownership albeit in a uniquely Chinese form. Employment is not guaranteed, TVEs do go bankrupt and workers do lose their jobs. Nevertheless, it seems that township and village leaders are responsive to the preferences of the local population they represent and, as a result, TVEs engage in distinct employment practices and their profits are regarded as a source for

²⁵ B. Naughton, 'Chinese Institutional Innovation and Privatization from Below', *American Economic Review, Papers and Proceedings*, vol. 84, no. 2, May 1994, p. 268. This is supported by J. Svejnar, 'Productive Efficiency and Employment', in W. Byrd and Lin Qingsong, eds, *China's Rural Industry*, which concluded that in two of the four counties studied, enterprises placed a positive weight on employment creation. These results were not corroborated, however, by M. Pitt and L. Putterman, 'Employment and Wages in Township, Village and Other Rural Enterprises', *mimeo*, 1993.

²⁶ 'Vaguely Defined Cooperatives', pp. 16–17.

²⁷ Oi, 'Fiscal Reform', p. 119.

²⁸ Cui, 'China's Rural Industrialization', p. 8.

²⁹ Lin Chun, 'Money Dissolves the Commune', p. 42. See also P. Huang, *The Peasant Family and Rural Development in the Yangzi Delta, 1350–1988*, Stanford 1990, p. 293 for examples. Our analysis of the TVE sector differs markedly from that of Smith who has argued in this journal that TVEs should be seen as part of the 'capitalist, or proto-capitalist, sector'. Smith, 'The Chinese Road to Capitalism', p. 60.

funding welfare programmes for the whole community.³⁰ Needless to say, the operations of TVEs are an important area for research but, at the present state of knowledge, they appear to be a unique form of productive organization behaviourally distinct from capitalist firms (and indeed Chinese state-owned enterprises).

Implications of TVE Success

The success and characteristics of the TVE sector is significant for a number of reasons. Firstly, the display of classic entrepreneurship by local governments throws light on the long-standing debate about the relationship between markets, entrepreneurship and ownership. During the socialist calculation debate of the 1930s one line of attack by the critics of socialism, and by von Mises in particular, was that it lacked the agents capable of performing the dynamic function played by private entrepreneurs in the capitalist system. Since under socialism the incentive provided by private property was missing so, it was argued, was the class of entrepreneurs. The failures of market socialism in Hungary also sparked debates about the possibility of 'socialist entrepreneurs'. Chinese local governments appear to have provided one very powerful example of such entrepreneurship in practice. Given market opportunities, public agents and socially-owned enterprises have responded in dramatic fashion; markets do not require private ownership to function. This display of entrepreneurship is even more impressive when it is realized that the boom in TVEs was not the result of deliberate central government policies aimed at fostering their development but rather an unexpected outcome to a changed policy environment.³¹

Secondly, the fact that the local state has in some ways replaced the market and intervened to foster industrialization points to the continuing importance of the role of the state in late development. The theory of 'late development' owes its origins to Liste and Gerschenkron and argued that the contradictory pressures acting upon late developers required the intervention of the state.³²

³⁰ In 1992, 61.4 per cent of the fiscal revenues of local governments in rural China came from TVEs. See *Statistical Yearbook of China*, 1993, p. 391.

³¹ Indeed, some authors write of the new entrepreneurs in tones almost reminiscent of the praise given to workers in the Maoist period. For example, Rawski writes that 'entrepreneurial leaders in hundreds of counties and thousands of production brigades were poised to take advantage of deregulation by bursting into markets they had coveted for years' (T. Rawski, 'Chinese Industrial Reform: Accomplishments, Prospects, and Implications', *American Economic Review, Papers and Proceedings*, vol. 84, no. 2, May 1994, p. 273) while Yusef argues that 'the entrepreneurial zeal of local officials, the effectiveness of the local administrative apparatus, and the strength of community cohesiveness have provided a disciplined dynamism' (S. Yusef, 'China's Macroeconomic Performance and Management During Transition', *Journal of Economic Perspectives*, vol. 8, no. 2, spring 1994, p. 91).

³² See F. Liste, *The National System of Political Economy*, New York 1885; A. Gerschenkron, *Economic Backwardness in Historical Perspective*, London 1962. Gerschenkron pointed, for example, to the pressures between savers and investors over the interest rate, and between exporters and importers over the exchange rate, as well as the more general need to provide support for industries capable of competing with earlier industrialists.

Recent studies of the success of the East Asian late industrializers, in particular South Korea and Taiwan, have again used and adapted this theory to illustrate the important role of the state in East Asian development.³³ These countries' success lies precisely in being able to design a set of policies capable of addressing these contradictory pressures, a success which has also relied on a capable state apparatus pursuing a national development ideology. In China, the provinces and lower-level governments are similarly endowed with a developmentalist ideology which has led them to intervene in the development process by actively sponsoring growth in their regions. As Oi writes, 'local officials have assumed new roles as entrepreneurs, selectively allocating scarce resources to shape patterns of local economic growth.'³⁴ Provincial, township and village officials have provided protection for their own industries, allocated credit to them and given other incentives to an extent that they can be characterized as 'mini developmental states'.

Thirdly, the operations of TVEs are important because, in their case for market socialism, Bardhan and Roemer argue that such an economic system is more economically efficient in that it would promote the production of public goods and restrict the production of public bads through internalizing externalities.³⁵ In the context of a capitalist economic system one of the most significant public bads is unemployment. In a market-socialist economy this should be mitigated by the fact that the contradictions between private profit and public costs are at least partially resolved. It is interesting to find, therefore, that Chinese local governments have objectives other than profit maximization and seem responsive to pressures for employment provision for all.

Fourthly, and not least, it is important too for the lives and welfare of the Chinese rural population which are intimately linked to the success or otherwise of rural industries. It has been argued that TVEs are less desirable than state enterprises on the grounds that wages and benefits are more generous in the latter and that the decline in the relative importance of state-owned industries should be viewed as a move in the wrong direction from the point of view of working-class living standards.³⁶ However, such a view needs considerable qualification. Firstly, while benefits are undoubtedly higher for state-enterprise workers, there is some evidence that at the end of the 1980s average wages and bonus payments were higher for workers in TVEs.³⁷ Secondly, as important as the state/collective divide is the rural/urban divide. Workers in state-owned, urban industries have been the beneficiaries of previous policies of extracting surplus from agriculture and the lack of mobility enforced

³³ See G. White, *Developmental States in East Asia*, London 1988; R. Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton 1990; A. Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, Oxford 1989.

³⁴ Oi, 'Fiscal Reform', p. 124.

³⁵ P. Bardhan and J. Roemer, 'Market Socialism: A Case for Rejuvenation', *Journal of Economic Perspectives*, 1992.

³⁶ This view can be found in Smith, 'The Chinese Road to Capitalism'.

³⁷ This is indicated by World Bank sample data reported in V. Chetty, D. Ratha and I. Singh, 'Wages and Efficiency in Chinese Industry', *China Research Paper CH-RPS 30*, World Bank, 1994, p. 21.

by the household registration system. The availability of non-farm industrial employment (even at low wages and with poor working conditions) in rural China has provided a significant addition to rural incomes and increased rural households' purchasing power to an extent which state enterprises were never able, and are still not able, to do.³⁸ Rural enterprises predominantly employ young male and (unmarried) female workers and thereby contribute significantly to easing pressure on land; TVEs now employ 112 million people and since 1990 have created about 6.5 million jobs a year thereby absorbing about 70 per cent of the annual net addition to the rural labour force. It is the case, however, that the differentiation of income *within* rural communities has increased considerably over the reform period as a result of the growth of rural industries.³⁹ In part this is because the wage-productivity link is stronger in TVEs so that those working for profitable TVEs receive higher wages,⁴⁰ in part it is because of the high variance of self-employed income.⁴¹

Attempting to classify China's industrial system at this point in its evolution is a hazardous (some might say futile) exercise. It is clear that the present situation in China presents no definitive answers and contradictory tendencies are in evidence. In spite of this, we have offered the broad contours of a classification in the belief that categories are still important and to emphasize the differences between the view presented here and that which views China primarily as a 'privatizing' economy. The combination of partial reliance on the market, active local state and social ownership leads us (provocatively) to characterize China's industrial economy as a decentralized, developmental market-socialist system. It has some of the characteristics of the classic market-socialist model in that it uses markets and maintains social ownership. However, the diversity of social ownership forms is much richer than that suggested by the original market-socialist literature and a critical role is maintained

³⁸ It is often the case that working conditions in TVEs involve long hours and insecure labour conditions. Unquestionably these are significantly worse than conditions found in state-owned enterprises (with the exception of the well-publicized prison labour force). However, it is by no means clear that such conditions are worse than those found in the agricultural sector (pre and post reform) and they may be better than conditions found in many foreign-owned enterprises operating in China. It is reported that 'at the end of 1992, only 1 per cent of foreign enterprises complied with Chinese laws requiring that workers have a union to represent them' (W. Simon, 'Heading the Wrong Way on China', *Los Angeles Times*, 22 May 1994, p. 7). Furthermore, there were over ten thousand labour disputes in China in 1993 including 2,353 disputes in the Shenzhen Special Economic Zone in the first six months (*China Daily*, 28 March 1994). Little information is given about the nature of the disputes although two disputes over pay were reported in 1993 at Japanese-owned factories in southern China. Official news media have reported on alleged mistreatment of Chinese employees by foreign managers, especially from Hong Kong and Taiwan.

³⁹ See C. Brammall and M. Jones, 'Rural Income Equality in China Since 1978', *Journal of Peasant Studies*, vol. 21, no. 1, October 1993, pp. 41-70; D. Hare, 'Rural Nonagricultural Activities and Their Impact on the Distribution of Income: Evidence from Farm Households in Southern China', *China Economic Review*, vol. 4, no. 1, 1994, pp. 59-92.

⁴⁰ See Chetty et al., 'Wages and Efficiency', p. 11.

⁴¹ See Hare, 'Rural Nonagricultural Activities' for details.

for an active state, at all levels, consistent therefore with the main features of the theory of late development.

III. Agriculture: Ownership Rights and Collective Organizations

Before the early 1980s, China's agriculture was organized in a collective-farming system with three-level management by the commune, brigades and production teams. Production teams with an average of twenty to thirty neighbouring households and scarcely fifteen to twenty hectares of arable land were the basic units of production and distribution. The members of a team worked jointly on village land and claimed a share of the output on the basis of the work points they earned in team production.⁴² The system of team farming required labour supervision to ensure adequate individual work effort. Labour monitoring was, however, very costly in agricultural production.⁴³ The difficulties of labour monitoring were aggravated by the state pricing and income policies adopted during the period which greatly limited the team's options to discipline 'free-riders' among its members.⁴⁴ Inadequate monitoring and disciplining devices resulted in low working incentives among team members.

The commune system was replaced by the household-responsibility system (HRS) during the reform period. Under the HRS, village land was originally contracted to individual households for about fifteen years. Each household organized production independently and retained all of its output or sales proceeds after paying its share of agricultural tax, selling a quota of output to the state and meeting the obligation to its team's public accumulation and welfare funds. By eliminating the need for labour supervision, the HRS improved peasants' work performance.

The distinguishing feature of China's land-tenure system in the post-reform period is the separation of individual user rights from other ownership rights which remain 'collective'. The right to use village land is granted to individual households. However, the village collective retains other rights associated with ownership. Specifically, the village collective, as the delegated owner, has the right to allocate land among its members, the right to lease land to outsiders or sell land to the state, and the right to claim rent income from the land. This system can therefore be regarded as *two-tier ownership* with use rights vested in individual households and other rights vested in the village collective.

Thus, under the HRS, peasant households are the basic units of farm production, while the village collective takes charge of managing land contracts, maintaining irrigation systems, and providing peasants with equitable access to farm inputs, technologies, information, credit, and the services of farm machinery, product processing, marketing, primary

⁴² See Chu-yuan Chen, *China's Economic Development: Growth and Structural Change*, Boulder 1982 for review.

⁴³ See M. Bradley and M. Clark, 'Supervision and Efficiency in Socialized Agriculture', *Soviet Studies*, vol. 23, 1972, pp. 465-73.

⁴⁴ Xiao-yuan Dong and G. Dow, 'Monitoring Costs in Chinese Agricultural Teams', *Journal of Political Economy*, vol. 101, no. 3, June 1993, pp. 539-53.

education and health care. The new form of village collective organization overcomes the main drawbacks of the commune system, while preserving the principal merits of economic organizations characterized by public ownership of the means of production.

Maintaining some collective ownership rights in land promotes the efficient utilization of land and labour resources in the rural areas. Regardless of its operational forms, social ownership of the means of production is essentially an economic institution which recognizes the inalienable rights of an able-bodied member to work by giving him/her access to the socially-owned means of production. Under the HRS, Chinese peasant households are given equal access to village land when employment outside the agricultural sector is scarce. Despite population growth, the existence of significant 'surplus labour' in agriculture and a decline in arable land over a decade of rural reform, no significant landless class has emerged in China's rural areas.⁴⁵ Certainly, peasants face greater uncertainties than they did in the past (and also possess greater autonomy) but equal access to farm land has provided general protection for the basic needs of village members and has raised their work capacity.

Beyond this, the village collectives have also provided an institutional vehicle through which the services of public goods are made available to the Chinese rural population, although the extent to which this vehicle has been successfully used has varied widely depending on the extent to which collective ownership rights have been exercised. In some cases, the collective claim over rent income accruing from land and other public assets has generated the revenue necessary to finance the services of public goods. The village collective offers an organizational framework for the supply of public services and monitoring of the use of those services in the village community. The key is that collective ownership rights be actively exercised. As many Chinese researchers have pointed out, peasants in villages where collective economies had a strong hold enjoyed much better social services in the areas of primary education, health care, pensions, welfare, irrigation, technical guidance, production and marketing than those in villages where collective economies were completely

⁴⁵ For discussion of the extent of agricultural 'surplus labour' (estimated to be in the region of 100 million adults) see C. Yang and C. Tisdell, 'China's Surplus Agricultural Labour Force: Its Size, Transfer, Prospects for Absorption and Effects of the Double-Track Economic System', *Asian Economic Journal*, vol. 6, no. 2, 1992, pp. 149–82. McKinley and Griffin argue, based on a nationwide survey conducted in 1988, that 'although only 3.8 per cent of the rural population is landless, it is perhaps a little surprising that there are any households without land since the post-1978 institutional reforms guaranteed to everyone access to land' (T. McKinley and K. Griffin, 'The Distribution of Land in Rural China', *Journal of Peasant Studies*, vol. 21, no. 1, October 1993, p. 76). However, they continue that 'if a rural household is landless, it is not necessarily poor; the great majority of the landless are not. Landlessness, in other words, appears to be a matter of choice, usually because non-farm opportunities yield higher incomes than farming' (p. 82). It should be noted, however, that there has been the emergence of a significant 'floating population' classified as individuals who have left the countryside and are working without official residence permits in (mainly) urban areas.

dismantled and where collective ownership rights in land were seldom exercised.⁴⁶

Because of their economic potential, village collectives have in fact been on a steady increase in China since the early 1980s. More than 2.05 million villages (former brigades) and sub-village groups (former teams) re-established collective organizations, covering approximately 76 per cent of the former production teams.⁴⁷ Most village collectives have played an important part in managing land contracts and providing their member households with a wide range of services. A recent survey conducted by the ministry of agriculture's Rural Research Centre showed that in 1990 village collective organizations were responsible for machine-ploughing more than 35 per cent of farmland, irrigating 70 per cent of irrigated area, providing crop protection to 62 per cent of protected crops and supplying more than one-third of seeds, fertilizer, insecticide and diesel-oil inputs. In 92 per cent of the villages in the survey, village collectives planned and organized farmland capital construction projects. Village collectives, on average, owned 44 per cent of the non-land farm capital assets.⁴⁸

Whilst the decollectivization of farming practices in post-reform China has received considerable attention, the part played by the continued collective ownership of land and the role of collective organizations in promoting the growth of the agricultural sector have been less appreciated. Of course, these village collectives have also been important actors in the non-agricultural rural sector as the discussion of rural industries above showed. As an indication of the importance of collective organizations in China's rural economy, it is estimated that in 1992, the income generated by rural collective and cooperative organizations accounted for 45 per cent of the total income of China's rural economy.⁴⁹

IV. Future Challenges

In discussing the desirable future course of China's economic reforms, it is often argued that the process of marketization should be pushed further and that this should be accompanied by privatization. Whilst we believe that in some instances an extension of the market is desirable it is our position that this should not be done at the expense of reducing the state's developmental capacity. Neither need the process be accompanied by privatization. We would stress that in the industrial sector, a significant challenge is to devise an institutional framework capable of accommodat-

⁴⁶ See Zhuoshan Guo and Xiu Donghua, 'A Survey and Assessment of the Situation of Refining Rural Two-Tier Collective System in Rural Guangdong', *China's Rural Economy*, 1991, no. 4, pp. 23-36 and Zhiyong Mao, 'A Discussion of Stabilizing and Refining the Household Responsibility System', *Problems of Agricultural Economy*, 1990, no. 9, pp. 10-14.

⁴⁷ 'A Survey of the Operation of China's Land Contracting System and Cooperative Organizations', *Problems in Agricultural Economy*, 1993, no. 11, pp. 45-53.

⁴⁸ Ministry of Agriculture's Rural Research Centre, 'The Current Situation of Rural Social Services', *China's Rural Economy*, 1991, no. 15, pp. 1-30.

⁴⁹ The other 55 per cent came from household agricultural production and private and/or self-employment. *Statistical Yearbook of China*, 1993, p. 394.

ing and harnessing the developmental capacity of a multi-level state and to overcome some of the weaknesses of the present decentralized system; in the agricultural sector, it is to strengthen rural collective institutions. These challenges are discussed further below and we concentrate here on our differences from the dominant marketization/privatization position and upon primarily economic challenges.

The continued active intervention of government at all levels in the economy has been criticized by many. Certainly there are cases where government actions have been wasteful, for example, in the inter-provincial resource wars, such as the wool war, which have characterized the reform period.⁵⁰ Whilst a lowering of inter-provincial trade barriers and a greater degree of competition between provinces may be beneficial this cannot, in our view, form the basis of a generalized prescription against government intervention. This prescription has often been implicit in much of what has been written about the need for greater marketization in China. It is evident, for example, when Wong and Dai write that local interventions 'adversely affected economic efficiency and hampered reform efforts to create competitive markets populated by autonomous economic agents.'⁵¹ This presupposes that the Walrasian fiction of an economy consisting of 'competitive markets populated by autonomous economic agents' is capable of being used as a valid description of actual economies. Starting from the view that the Walrasian general equilibrium system provides an accurate picture of an economy's workings produces the obvious result that government intervention should be eliminated.

Whilst there are clear problems with some of the ways in which local interventions have taken place, and China is no different in this respect from other countries, the case for further marketization needs to proceed on a case-by-case basis rather than be guided by neoclassical dogma. In our view, the challenge facing the reformers is to extend the market where necessary whilst maintaining, rather than dismantling, a strong activist state. Whilst local state activism has to date clearly led to impressive economic results, the future success of the reforms depends upon a workable division of powers between centre and local government being found. Much has been written about centre–local fiscal and expenditure conflicts, a topic of considerable importance not only for the insights that it provides into the dynamics of decentralization but also because of the necessity of generating sufficient government revenues to fund social programmes which are increasingly seen as being the responsibility of society (i.e. shared between governments, enterprises, communities and

⁵⁰ See, for example, A. Watson, C. Findlay and Y. Du, 'Who Won the Wool War?: A Case Study of Rural Product Marketing in China', *China Quarterly* 118, 1989, pp. 213–41.

⁵¹ C. Wong and Dai Yuan Chen, 'Editor's Introduction', *Chinese Economic Studies*, vol. 25, no. 4, 1992.

⁵² The argument here, in fact, extends beyond the funding of social programmes. The fiscal crisis of the central government has also resulted in IOUs having to be given to farmers as payment for state agricultural procurements, a situation which has resulted in rural discontent. For discussion of central–local relations see Jia Hao and Lin Zhimin, eds, *Changing Central–Local Relations in China: Reform and State Capacity*, Boulder 1994.

individuals), and not solely of the enterprise (or the state).⁵² However, here we wish to focus on the division of responsibilities concerning the central economic policies of the late-development model.

The State as Mediator

These policies concern trade, technology, and finance. In each of these areas the role of the state has been evident in mediating between world-market forces and national interests—both in setting key prices (such as the exchange rate and the long-term interest rate) as well as in guiding the economy along a particular path. Whilst the market has served as a useful benchmark which has given planners useful information it has never been allowed to be all-pervasive in its influence.

It is precisely in these areas that the central–local conflicts need to be solved. Competition between provinces has often led to arbitrary investments and requires a more, rather than less, comprehensive national industrial strategy to rectify. The provinces' desire to explore any and all methods of raising financial resources locally for their own development purposes has led to pressures on the local branches of the state banking system and thereby contributed significantly to inflationary pressures. The Chinese financial system must be seen in the context of the wider politico-economic struggle for resources which operates vertically between various levels of government as well as horizontally. It is these underlying conflicts over the distribution of resources, and the absence of any well-specified rules for solving them, that has placed China's financial system at the centre of competing pressures and is responsible for continued inflationary pressures.⁵³ These same conflicts and pressures have also led to the proliferation of financial institutions outside of the state sector which, together with the provinces' appetite for stock markets as a way of raising resources, poses a significant threat to the ability of the centre to maintain sufficient control over the flow of financial resources to pursue national developmental objectives.

Competition between the provinces hungry for foreign investment has also created problems as provinces vie with each other to attract foreign firms. This threatens to limit any gains which might be made by China from technology transfer as the bargaining power of multinationals is increased with the fragmentation of the Chinese state.⁵⁴ Here again a case can be made for greater central authority and a resolution of centre–local responsibilities which preserves the developmental capacity of the central Chinese state.

⁵³ See Bowles and White, *Political Economy*, ch. 5 for extended discussion.

⁵⁴ Inland cities and provinces have been particularly eager to attract more foreign investment and, to compete with the more advanced coastal provinces, have been offering particularly attractive deals to foreign investors. For example, officials in Wuhan, an important industrial city on the Yangtze river, recently allowed a Hong Kong company to purchase a 51 per cent share of a money-losing state-owned printing company, the first time that a foreign company had been allowed to purchase a majority stake in any Chinese state-owned enterprise. As part of the deal, Wuhan officials cancelled all the enterprise's debt and allowed the new managers to lay off 1,200 of its 1,900 workers. See *Far Eastern Economic Review*, 19 November 1992, pp. 66–7.

The institutions of late development which were successfully employed in China's East Asian neighbours all had one common feature in that state economic power was highly concentrated in key ministries and agencies. In China, the impact of the reforms has been to significantly decentralize economic power to lower-level governments but the ability of the state apparatus to maintain its developmental capacity requires that such a process of decentralization be carried out coherently. Certainly, this may require that some functions be put back under central control.

For its part, the centre could learn from the apparently greater selectivity with which local governments treat their enterprises. According to Oi, 'the strategy of selective support for certain enterprises [by local government] is reminiscent of Japan's administrative guidance.'⁵⁵ The central government, enterprise reforms and increasing productivity of state-owned enterprises notwithstanding, is still apt to protect all of the state-owned enterprises under its jurisdiction. To the extent that this results from the institution of state ownership and the soft budget constraints that state-owned enterprises operate under (compared to local enterprises) then ownership reform which retains social ownership is desirable. Such reform is possible, is likely to involve the formation of socialist joint-stock companies,⁵⁶ and is a form of ownership reform which has been influential in China and has already been implemented on an experimental basis.⁵⁷ Feasible alternatives do exist, therefore, and it is not the case that budget constraints can only be hardened by privatization; the experience of the TVE sector has demonstrated that hard budget constraints can be imposed upon socially-owned enterprises through market competition and that it is possible to motivate public entrepreneurs and workers through appropriate compensation schemes.

The need to retain and in some cases increase the power of the central authorities is relevant not only from the perspective of maximizing the potential of the developmental state, it is also necessary as a corrective to the problems which have become apparent in the decentralized, local state system as it has evolved over the reform period. This is perhaps most obviously witnessed in the case of rising inter-provincial income equality. The spatial distribution of income has certainly become more unequal over the reform period⁵⁸ and the ability to correct this can lie only in a greater redistributive role for the central government. Increasing spatial inequality has also meant that the TVEs in the least prosperous provinces have had to face not only weaker local markets for their products but also punitive extractions from local governments which view them as one of the few sources of revenue from which to finance social expenditures. As

⁵⁵ Oi, 'Fiscal Reform', p. 119.

⁵⁶ See A. Wood, 'Joint Stock Companies with Rearranged Public Ownership: Invigoration of China's State Enterprises Further Considered', Development Economics Research Programme, *Working Paper CP no. 11*, London School of Economics, 1991, and M. Nuti, 'Feasible Financial Innovation Under Market Socialism' in C. Kessides, T. King, M. Nuti and C. Sokil, eds, *Financial Reform in Socialist Economies*, Washington, DC 1988, for theoretical discussion.

⁵⁷ See P. Bowles and G. White, 'The Dilemmas of Market Socialism: Capital Market Reform in China—Part II: Shares', *Journal of Development Studies*, vol. 28, no. 4, 1992.

⁵⁸ See Brammall and Jones, 'Rural Income Inequality' for details.

Huang notes, 'poorer townships without strong industries have sparse revenues, sometimes not even enough to cover the relatively inelastic requirements for public services. Some of these townships engage in a kind of "fiscal predation" on their own enterprises, even if unprofitable, forcing them to borrow to meet payments to the governments. The result is a vicious circle of poverty. It is in backward areas like these that low-investment private enterprises have flourished the most relative to collective enterprises.'⁵⁹ In a decentralized system, even with social ownership of the means of production, it is a standard result that rewards are more closely tied to productivity so that income inequality can be expected to increase. In China it seems that this has been allowed to progress to the point where the economic viability of the socially-owned sector in the poorer regions has been threatened and clearly cannot be solved without a more active and redistributive role for the central government.

The enormous environmental problems which China faces also point to the need for a greater role for government. There is no doubt that in the quest for economic growth and 'modernization' the importance of environmental concerns has been secondary; the continued rush by both rural households and local governments to replace farmland by concrete and asphalt and the central government's attraction to mega-projects, the Three Gorges project included, bear witness to this. Given this, the development (or, more accurately, modernization) versus environment debate may have already been won decisively by the former. However, what prospects there are for mitigating the environmental consequences of rapid growth are unlikely to be found in privatization and are likely to involve increased state intervention, especially at the central or provincial level, given that environmental problems are seldom restricted to the boundaries of local governments.

The Problems for Agriculture

Turning now to the agricultural sector, there has clearly been significant growth during the reform period following the introduction of the HRS and the increase in state procurement prices. However, despite the advantages in labour management, household farming by itself is insufficient for sustained growth in agricultural production. Indeed, some of its disadvantages have already begun to manifest themselves in terms of inadequate investment in agricultural land and inadequate marketing, distribution and transportation infrastructure. A conventional prescription to solve these problems has been to privatize land, i.e. move to a one-tier private-ownership system. We will argue that land privatization will not provide a solution to agriculture's problems but an approach which refines the HRS and strengthens rural collective and cooperative institutions offers more promise; we present this argument in some detail because it is probably in the agricultural sector that any attempts at large-scale privatization would initially seem the most attractive.

The adoption of household contracting created about 200 million small and fragmented household farms. While agricultural production does not

⁵⁹ Huang, *Peasant Family*, p. 261.

display strong economies of scale, a complete decentralization of ownership rights to household level (i.e. full-scale privatization of farmland) is likely to raise transaction costs considerably in areas such as land exchange, credit allocation, capital formation and provision of public goods, with detrimental effects on agricultural development. Each of these adverse consequences of land privatization is explored more fully below.

Firstly, land privatization would cause a waste of land and human resources. The land sales market in capitalist economies is typically ineffective in promoting productivity-enhancing land circulation because private ownership of land often creates a wide divergence in the expected prices of land assets between sellers and buyers.⁶⁰ Land exchange, when it occurs, is likely to be limited mainly to distress sales in areas where the capital market is poorly developed and the insurance market is non-existent.⁶¹ Peasants who are forced to alienate farm land are usually the first ones rationed out of the land-rental market as well as the labour market due to the increasing returns to scale in the food-productivity conversion of a worker at low income level.⁶² In consequence, the incidence of landlessness is highly correlated with rural poverty, malnutrition and involuntary unemployment in developing countries.

Secondly, land privatization would undermine the access of the Chinese agricultural sector to the credit market. Land assets are preferred collateral for institutional loans in a free-market economy. However, privatization of village land would fragment collateral assets and therefore reduce the quantity of loans requested by the farm sector because the landholdings of Chinese peasant household farms are homogeneously small. Since it is costly to collect information on the past behaviour of small agents and to assess the profitability of a small investment project, loan-processing displays strong economies of scale.⁶³ The high transaction costs in the formal credit market have to be compensated by high interest rates, yet high interest rates may induce the adverse behaviour of borrowers and raise the rate of default. Facing the problems of imperfect information and adverse selection, banks frequently choose to impose interest-rate restrictions and to ration small borrowers out of the credit market.⁶⁴ Credit rationing against the small-

⁶⁰ H. Binswanger, K. Deininger and G. Feder, 'Power, Distortions and Reform in Agricultural Land Markets', *Handbook of Development Economics*, edited by J. Berman and T. Srinivasan, Amsterdam 1992.

⁶¹ H. Binswanger and M. Rosenzweig, 'Behavioral and Material Determinations of Production Relations in Agriculture', *Journal of Development Studies*, vol. 22, 1986, pp. 503-39.

⁶² See P. Dasgupta and D. Ray, 'Inequality as a Determinant of Malnutrition and Unemployment: Theory', *Economic Journal* 96, 1986, pp. 1011-34; P. Dasgupta, 'Inequality as a Determinant of Malnutrition and Unemployment: Policy', *Economic Journal* 97, 1987, pp. 177-88; and K.O. Moene, 'Poverty and Landownership', *American Economic Review*, vol. 82, no. 1, 1992, pp. 52-64.

⁶³ A. Braverman and J. Gausch, 'Rural Credit Markets and Institutions in Developing Countries: Lessons for Policy Analysis from Practice and Modern Theory', *World Development*, 14, 1986, pp. 1253-67.

⁶⁴ Carter, M., 'Equilibrium Credit Rationing of Small Farm Agriculture', *Journal of Development Economics*, vol. 28, 1988, pp. 83-103.

farm sector is a common problem in low-income private market economies. Private property rights in land will not offer a solution.

Thirdly, land privatization would discourage agricultural investment. The advocates of private ownership rights have blamed ownership insecurity for the decline in land investment in the post-reform period and proposed land titling as the primary measure to stimulate agricultural investment.⁶⁵ What has been ignored in the private property-rights argument is the complexities of Chinese economic reality. Because of the paucity of the land-sales market commonly observed in free-market economies, the land-rental market has to be introduced to facilitate land transfers.⁶⁶ Therefore private ownership of land does not guarantee ownership security for the tillers. Moreover, banning the landlord-tenant relationship is not always an efficient and feasible option to promote farm investment. It is likely that the operation of land-rental markets under private ownership in China would create a great number of small absentee landlords, because most landholders will leave agricultural production for employment in other sectors in the process of agricultural transformation. Their claim on rent income from land assets would extract a substantial amount of economic surplus out of agriculture, thereby enlarging the already wide income gap between agricultural and non-agricultural sectors and discouraging farm investment. It is also doubtful that the absentee landlords would have the ability and adequate incentives to monitor tenants' investment behaviour so as to ensure optimal land investment.

Furthermore, ownership rights in land are likely to be of secondary importance in the determination of household investment behaviour, compared with other economic constraints facing the small-farm sector in China. Small farm size and ill-functioning capital-rental markets often discourage private investment in indivisible capital assets.⁶⁷ The absence of insurance and futures markets exposes peasants to high risk and uncertainty in agricultural production and market exchange. These factors, together with imperfect capital markets, mean that small farmers are typically reluctant to undertake medium- and long-term investment, regardless of their land-title status. Without significant improvements in the economic environment facing small household farms, therefore, efforts to enhance farm investment via strengthening tenure security alone are unlikely to achieve any success.

Lastly, a full-scale privatization of land would make it more difficult to provide adequate public goods such as irrigation, technology extension, health care and primary education for the rural population. It could be argued that under the private-household farming system, the services of public goods in China's rural areas could be supplied by local

⁶⁵ R. Prosterman and T. Hanstad, 'China: A Fieldwork-Based Appraisal of the Household Responsibility System' in Prosterman et al, *Agrarian Reform and Grassroots Development*, Boulder 1990, pp. 103-38; D. Perkins, 'Completing China's Move to the Market', *Journal of Economic Perspectives*, spring 1994, p. 29.

⁶⁶ Binswanger and Rosenzweig, 'Behavioural and Material Determinants'.

⁶⁷ G. Feder, L. Lau, J. Lin and Xiaopeng Luo, 'The Determinants of Farm Investment and Residential Construction in Post-Reform China', *Economic Development and Cultural Change*, vol. 41, no. 1, 1992, pp. 1-26.

governments and financed through taxation. Collection of tax payments from small peasant-household farms has, however, proved very costly because a large portion of household output is made for self-consumption and money income is unrecorded. Without reliable sources of tax revenue, there would be no public services in the village.⁶⁸

Thus, the adoption of the household responsibility system has improved peasants' work incentives, but the advantages of household operation in labour management can not be logically extended to support the full-scale privatization of village land, and such a programme is inconsistent with allocative efficiency and economic growth in rural China. However, there is an efficient institutional alternative to private-household farming within the existing framework of the two-tier ownership system.⁶⁹

Maintaining some collective ownership rights in land not only provides a solution for the unmitigated human disaster of poverty and landlessness which frequently occurs under private ownership rights in land, it also promotes efficiency-enhancing land circulation. With collective ownership of land, land allocation is determined by the right of a member to work. Peasants hold on to a piece of land only because farming yields an expected income at least as high as the alternative income sources. When off-farm employment offers a farmer a wage rate higher than his imputed farm income, he would be willing to relinquish his land-lease to those who have not found non-farming jobs. The farmer has no need to hoard land for security, since the village collective promises him the right to regain access to village land if he loses his non-farming employment in the future. By internalizing the pervasive externalities of private ownership rights in land, collective land ownership encourages land transfer, and hence promotes the development of specialization and the division of labour.

Furthermore, the two-tier ownership system is capable of raising small-farmer productivity by improving their access to credit since the village collective can act as an intermediate agent between the banking system

⁶⁸ Indeed, in some areas where the collective ownership rights in land have not been adequately exercised, the HRS has already led to declining standards of social services. In villages where collective assets were completely divided up among villagers, the network of health care, primary education, family planning, irrigation and technological extension collapsed. The adoption of the HRS also disrupted the network of agricultural research-extension, causing a reduction in the promotion of new farming technology in certain areas (Y. Lin, 'The Household Responsibility System Reform and the Adoption of Hybrid Rice in China', *Journal of Development Economics*, vol. 36, 1991, pp. 353-72). In addition, public investment in irrigation and water-conservancy projects has suffered a sharp decline since the 1978 rural reform created an institutional vacuum in this field (Shao Ning, 'Development and Reform: China's Agriculture in the 1990s', *Social Sciences in China*, vol. 13, no. 2, 1992, pp. 16-22). The decline in the supply of public goods clearly undermines the dynamic performance of Chinese agricultural sector.

⁶⁹ A complementary position (although differing on the importance of state institutions) is found in M. Selden, 'Households, Cooperative and State: Reflections on the Future of China's Countryside', paper presented at the International Conference on China's Rural Reform and Development in the 1990s', Beijing, 3-7 December 1993.

and member households by borrowing from financial institutions and then issuing loans to member households.

Of course, this does not mean that the two-tier ownership system is without its own problems. Chief among these are the necessity of maintaining a trained and competent cadre group and certainly the potential problem posed by corruption must be addressed through the public accountability of village officials. Another dimension of internal management in a village collective is the control of free-riding problems by member households. Two-tier collective ownership eliminated shirking in team farming, but still faces moral-hazard problems in the areas of credit allocation, social-services financing and land investment. Peasants may regard loans issued by publicly-owned banks or by the village collective as grants and be reluctant to repay them. The services provided by the village collective may be treated as social welfare and the recipients unwilling to pay their share of costs. Peasants may also be tempted to renege on their contractual obligation in land maintenance and improvement. Thus the viability of a village collective is strongly linked to its success in disciplining free-riders among its members. Fortunately, the monitoring of agent behaviour in loan repayment and soil conservation can be done at fairly low cost in the type of small and closed village community which characterizes China's rural economy.

The Future for Social Ownership

In this paper we have argued that China's economic success can be interpreted as the success of an economy which gives significant scope to market forces but which also retains a critical role for the state and widely uses the institution of social ownership of the means of production. Our argument has consisted of a number of different parts. Firstly, we argued that the introduction of markets has played a significant part in the economic transformation and success of the Chinese economic reform programme. However, we have also argued that viewing the introduction of the market as the sole reason for this success is not credible. In so far as the state has played a crucial role in the development process as an economic actor China bears comparison with her East Asian neighbours, South Korea and Taiwan; just as the neoliberal explanation of the East Asian NICs' success has been shown by recent scholarship to be inadequate so the same is true of the 'market-friendly' explanation applied to China. The case for the economic efficacy of unbridled market forces and for the centrality of unambiguous private property rights (i.e. privatization) as the prerequisite to economic success has simply been proven false by recent Chinese experience.

However, our argument has gone further than this: China is not simply a case of successful state-led development, it is an example of successful *socialist* state-led development. Our interpretation here has relied upon defining socialism as first and foremost an economic system based upon social ownership of the means of production.⁷⁰ The fifteen-year economic

⁷⁰ Of course, socialist society cannot be reduced only to this. The social relations of production in the workplace and the degree of political democracy are also, at minimum, important to consider. An assessment of Chinese socialism in this broader context, however, falls beyond the scope of this paper.

reform programme has still left 86 per cent of industrial output in the hands of the socialized sector and the most important structural change has been the change of output composition *within* the socialized sector, with collectively-owned enterprises increasing their share of output at the expense of state-owned enterprises. Even with respect to rural industries, the fastest growing industrial sector, collectively-owned township and village enterprises are dominant. The growth of the collective sector has been spurred by the entrepreneurial abilities of local government officials as the local state has intervened directly in the development process to support enterprises and fashion the pattern of economic growth. We have argued that the TVE sector behaves in ways different from capitalist firms and that local officials, who in practice control property rights of TVEs, do respond in some way to local pressures and interests, especially for employment and social-service provision. This is certainly not classic state socialism and neither is it recognizable as a worker-owned economy. It is a peculiarly Chinese system fashioned out of the historical legacy of the importance of the commune and the brigade and the stable residence of the population enforced through the household registration system. Whilst it may be a long way from an imagined democratic socialist model, it nevertheless offers a real-world example of successful economic development based on (various forms of) social ownership of the means of production as an alternative to capitalist development. In the agricultural sector, whilst the move to private farming with the advent of the HRS has gained much publicity, the role which continues to be played by collective ownership and collective organizations in fostering the growth of the agricultural sector has tended to be overlooked.

In our view the task of the next round of reforms is not to move to full marketization of the economy and to privatize major parts of the economy as many both inside and outside China advocate. Rather we have argued that the most important task is to develop institutional frameworks which will permit the central state to maintain its developmental capacity, to correct for the undesirable outcomes of a decentralized system whilst allowing sufficient reign to the entrepreneurial activities of the local state. In the agricultural sector, sustained growth with equity requires that collective-ownership rights be more actively exercised. In short, we believe that the development of market socialism along the lines indicated above provides a better alternative to the programme of privatization in addressing the key issue of maintaining growth and promoting social justice.

In focusing upon future challenges, we implicitly recognize that the economic system which we have outlined as operating in China now is one in transition. The question is, in transition to what? It cannot simply be reduced to the same (or a similar) process of transition which is occurring in central/eastern Europe where a clearly identified capitalist end state is desired. In this paper we have stressed the role of the TVE sector and it might well be questioned whether this sector is a permanent feature of the Chinese economy and whether it is likely to retain the content of social ownership in any meaningful way. Some have argued that TVEs have arisen largely as a result of the underdeveloped state of the law defining and protecting property rights⁷¹ or because of continued

⁷¹ Nee, 'Organizational Dynamics'.

price distortions existing during the reform period.⁷² Others, such as Smith, argue that the lower-cost advantages of private enterprises (such as their ability to avoid paying any welfare benefits) will inevitably lead to the victory of private over collective enterprises.⁷³ However, it should be remembered that collectively owned TVEs have shown themselves to be a remarkably resilient form of economic organization over the past fifteen years, and studies of collectively owned TVEs and private rural enterprises show no significant differences in productivity levels between the two.⁷⁴

A more serious challenge is perhaps the transition to a form of corporatism, possibly similar to that found in China's East Asian neighbours. TVEs have strong links with state-owned enterprises but, more significantly, also with private firms and especially foreign firms.⁷⁵ The fusion of local and foreign capital interests may produce a brand of corporatism, possibly similar to that witnessed elsewhere in the region.⁷⁶ The failure of the central government to deal with regional income inequalities has also meant that significant labour migration has taken place from the poorer to the richer, coastal, provinces. Here TVEs have hired both local and non-local labour with the latter often being hired as wage labourers on terms less advantageous than the local 'insiders'.⁷⁷ These developments may rob the TVEs of any progressive and meaningful role as agents of socially-desirable development. However, it should also be remembered that despite the surge in foreign direct investment (FDI) in 1992 and 1993, this remains highly concentrated both by source and by location. Hong Kong FDI dominates and is heavily concentrated in Guangdong, Taiwanese investment is concentrated in Fujian and Japanese investment in Shanghai and the northeast. These source and spatial concentrations reflect historic and/or cultural factors and the penetration of FDI into other parts of China has been much more limited.⁷⁸ This is partly reflected, as shown in Table 2, in the fact that the ownership composition of industrial output differs considerably between Guangdong and Fujian and the rest of China (including other coastal regions). In short, whilst the transition to a form of East Asian corporatism is a distinct possibility, it should also be remembered that all of China is not Guangdong.⁷⁹

⁷² Naughton, 'Chinese Institutional Innovation'.

⁷³ Smith, 'The Chinese Road to Capitalism'.

⁷⁴ See Svenjar, 'Productive Efficiency', and Pitt and Putterman, 'Employment and Wages'.

⁷⁵ See G. Jefferson and T. Rawski, 'Enterprise Reform in Chinese Industry', *Research Paper Series, China CH-RPS 28*, World Bank, 1994 for discussion of the links among TVEs and between TVEs and state firms.

⁷⁶ On the existence/possibility of the rise of a form of corporatism in China as the dominant social formation see, for example, Oi, 'Fiscal Reform' and Lin Chun, 'Money Dissolves the Commune'. See also Hinton, 'Can the Chinese Dragon Match Pearls with the Dragon God of the Sea?: A Response to Zongli Tang', *Monthly Review*, vol. 45, no. 3, July–August 1993, for the view that a comprador capitalism is emerging.

⁷⁷ For example, it is reported in *Business Week* (17 May 1993) that the village of Changan in Guangdong has a resident population of thirty thousand and employs a hundred thousand 'outsiders' in foreign firms, joint ventures, and TVEs.

⁷⁸ See P. Bowles and B. MacLean, 'Regional Blocs: Will East Asia be Next?', *Cambridge Journal of Economics*, forthcoming, for further discussion of this point.

⁷⁹ A similar point is made by Huang who argues that 'with all the press being

The Chinese economy has evolved in quite unexpected ways since 1978, and with unexpected results; our main point in this paper has been to argue that it cannot be adequately understood by neoclassical economic analysis and that there may be lessons to be learnt by those still interested in alternatives to capitalist development and feasible socialism. There remain distinct socialist elements in both the industrial sector (with state-owned enterprises and with a more fluid, perhaps peculiarly Chinese, dynamic rural TVE sector) and in the agricultural sector (with the continued exercise of collective rights). However, it is clear that the Chinese economy and polity are undergoing rapid change, and whether the present conjuncture will evolve in a way which maintains these elements must remain an open question.

given to agricultural de-collectivization, to capitalistic industrial development in the home communities of the overseas Chinese in Guangdong and Fujian, and to free-market and family enterprise in a place like Wenzhou, it is easy to distort or forget the reality of collective industry. But that is in fact the dominant mode of rural organization in the Yangzi delta, and indeed in most of China. It is the form of productive organization that powered most of the rural industrialization that took place in the 1970s and 1980s, and it is what distinguishes the China experience from that of most other Third World countries' (*Peasant Family*, p. 265).