China Builds a Market Culture

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The triumph of political marketization in China is in many respects paradoxical, resulting in hyper-growth for a period now exceeding two decades within an ownership structure that remains avowedly "socialist" and under an unabashedly Leninist political regime. Both the economic success and indications of strain, even resistance to that success seem to be indisputable, begging the question of the stability of this strange hybrid and whether it is premature even to talk of "market culture." In view of the relative chronological stability conventionally attributed to the concept of culture, and the chronic instability and controversy associated with the market, one may well ask whether we are dealing with a conceptual oxymoron, two warring subcultures, or indeed any set of phenomena clearly enough defined for empirical analysis. The problem of definition is complicated by the fact that the subjects of the analysis, while "crossing the river by feeling for stones," resolutely refuse to say what is on the other side of the river, resulting in a transitional economy without a designated destination (in stark contrast to the boldly teleological Marxist paradigm). Thus at this point we may speak confidently only of "marketization" as a dynamic but uncompleted process. This essay is a pilot study in both its analytical and synthetic dimensions, designed to explore the terrain and suggest meaningful hypotheses for further empirical research.

To begin by defining our central term, what is"market culture"? A market culture is one that is molded by, and functionally conducive to, a market economy. A "market economy," according to the classic definitions of its advent in Western culture, consists of one in which market values become relevant not only to economic transactions but to all socio-political decisions. All preferences are assumed to be commensurable, usually in monetary terms, and market players make rational choices (given their preferences) to enhance pleasure and minimize pain. As Polanyi puts it:

> A market economy is an economic system controlled by markets alone: order in the production and distribution of goods is entrusted to this self-regulating mechanism. An economy of this kind derives from the expectation that human beings behave in such a way as to achieve maximum money gains. It assumes markets in which the supply of goods (including services) available at a definite price, will be equal to the demand at this price. It assumes the presence of money, which functions as purchasing power in the hands of its owners. Production will then be controlled by prices, for the profits of those who direct production will depend on them; the distribution of the goods will also depend upon prices, for prices form incomes, and it is with the help of those incomes that the goods produced are distributed amongst the members of society. Under these assumptions order in the production and distribution of goods is ensured by prices alone. Self-regulation implies that all production is for sale on the market and that all incomes derive from such sales. Accordingly, there are markets for all elements of industry, not only for goods (always including services) but also for labor, land, and money, their prices being called respectively commodity prices, wages, rents, and interest.[1]

Despite the ideological ambivalence the Communist Party-State has displayed about its completion, the Chinese case is an excellent laboratory in which to study the growth of a market economy. In most contemporary systems the market antedates the political system and is more or less taken for granted, presenting periodic crises or political opportunities that are typically dealt with in ad hoc fashion with no other political goal than a return to economic equilibrium. To reconstruct the reasons for its emergence thus involves delving into the economic history of the early 19th century, the 17th century, or even earlier.[2] China and the other former "people's republics" in Eastern Europe, in contrast, present an unusually clear case of a quite different type, whereby the state deliberately eradicated the market as a social evil in the context of "continuing revolution" and is now intent upon constructing it ab novo. However, unlike the former Eastern Bloc countries, the reconstruction of a market economy in China is presided over and administered by a communist regime.

Clearly a market economy in this holistic sense is incompatible with "culture" as traditionally understood in terms of transcendental values. But in the more value-free sense employed by social scientists, according to which a culture "may be defined as the totality of the mental and physical reactions and activities that characterize the behavior of the individuals composing a social group collectively and individually in relation to their natural environment, to other groups, to members of the group itself and of each individual to himself,"[3] the two terms would appear to be mutually inclusive, though any causal relations are left indeterminate. If we speak more specifically of political culture, adopting the most widely accepted definition of that term as "beliefs, attitudes and values" about political objects,[4] the impact of marketization on culture can be said to be profound and pervasive. That impact may be seen in the electoral mechanism (as a political metaphor for market choice), in the formation of social classes and "interests" (interest groups, interest articulation, aggregation, and representation), and on the other side of the causal nexus, in the government's role in defining property rights, regulating fiscal, monetary, and industrial policy, the whole range of operations subsumed under "political economy." Of course, various factors make up a political culture, including national (and cultural) history, the nation-state's interactions in the global arena, and the structure of relations among kinship and ethno-religious groups and voluntary associations. Because these political factors tend to be defined by the history of the political unit of which citizens are born a part, political culture is conventionally defined in terms of national boundaries, whereas markets and their cultural impact transcend boundaries. The generic impact of the market on political culture in this sense may be said to be cross-fertilizing and homogenizing, as the logic of competition presses firms, advertising agencies, workers, and consumers to adapt similarly to the same functional imperatives. This is of course what led Marx to expect the industrial revolution to lead to an international proletarian revolution. Although socialists were disappointed by the lingering impact of political loyalties in the First World War, the fact that markets have never outbid political identities when the latter were at risk does not mean they have had no political impact at all. Indeed it is the force of that impact that has led the PRC leadership to grow ambivalent about the social automaton they have unleashed, welcoming the stimulus to economic growth and technological innovation while deploring the "ill winds" (*bu zhengzhi feng*) of cultural globalization (e.g., a youth and Bohemian underground subculture, tax evasion, social dislocation, crime and corruption). Whether these phenomena are inevitable externalities of marketization is debatable, but in point is the fact that the CCP causally associates the two.

Concisely put, our hypothesis is that the logic of market expansion is replacing "politics" as an organizing principle of social life, treating political variables in rational, instrumental, monetarily commensurable terms, despite politically powerful opposition. And as the market displaces command planning, a marketing culture, populated by modal personalities compatible with the efficient functioning of markets, may be expected to undermine and displace the culture of hierarchical authoritarianism. At this juncture, this is still very much in process, hardly a fait accompli. Much as Polanyi after the repeal of the Speenhamland poor relief law in 1834 saw a "double movement: the market expanded continuously but this movement was met by a countermovement checking the expansion in definite directions,"[5] a dynamic has been unleashed whereby the process of marketization has begun to reshape the foundations of

Chinese political culture. The causal dynamics of this process are somewhat obscured by the totalitarian legacy and bandwagon mentality of Chinese politics. Thus the process cannot be conceived as a dialectic between two clearly conceived and empirically distinct alternatives, as do those who juxtapose "civil society" versus the Party-State. We argue rather that marketization was politically driven and that, given the continuation of communist rule and the legacy of a command economy, market development has had to serve the interests of at least part of the cadre class, the most powerful group in the Chinese political economy. Contrary to the common assumption of a dichotomy between market and command, hierarchically situated state actors in China's institutional setup have much to gain, at least in the short run, by becoming market players. And by participating in market exchange, they not only expand the market but also create the incentives for further political marketization. Once it has gained momentum, market development generates its own political constituencies and reshapes power distribution and the transaction-cost structure in society to a point of no return. What this gives rise to is a market culture of a very peculiar sort.

Our main purpose in this essay is to show how the process of marketization was set in motion and gained such seemingly irresistable momentum. We begin with a conceptual analysis of China's distinctive hybrid, "socialist market" economy, its origins and dynamics of change. We then turn to the legacy of command planning in order to grasp the morally ambiguous, clandestine origins of the market impulse in China. Since the legitimation of markets in the early 1980s, their popularization has proceeded through roughly two phases. In the first, discussed in the third section, marketization coincided with the center's decentralization and devolution of authority to the basic production unit or to local levels of government. The second phase, consisting of the attempt beginning in 1993 to recentralize economic control over the economy while continuing marketization, is covered in the fourth section. We conclude with a discussion of the political cultural implications of China's socialist marketization.

A Theory of Political Marketization

When institutional economists talk about choice between forms of transaction (i.e., market vs. hierarchy), the assumed objective is simple and straightforward, to maximize profit and minimize transaction costs. However, when talking about such choices in a communist context, something much bigger is at stake. The market is not simply a place where people exchange money for products, for a rudimentary market of this type existed even under the plan. According to Victor Nee's theory of market transition, the logic of marketization means embracing a set of rules of the game that alters the nature of society as well as the polity. [6] According to Robert Gilpin, the market as an organizing principle performs the following critical roles: (1) determining relative prices in the exchange of goods and services, (2) the centrality of competition as a determinant of behavior, and (3) the importance of efficiency in determining the survival of market players.[7] By assuming these functions, marketization diminishes the importance of the state hierarchy in resource allocation and dispensing rewards in society. It threatens the communist order by ushering in a different set of organizing principles that are based on contractual relationships between relative equals, by offering a new set of opportunities for rewards, and by draining resources from state command. Therefore, all communist regimes are inclined to suppress the market as a political imperative. Table 1 depicts the severity of market suppression in pre-reform China: from 1952 to 1978, while the population and total consumption increased 67.4 percent and 295.8 percent respectively, the total number of commercial establishments (retail store, restaurant or repair shops, etc.) declined 72.4 percent (from 5.5 to 1.52 million); and the average number of people served by each commercial establishment increased from 104.4 to 6,332.5. But this raises the question of the post-1978 reform epoch: Why did those in a political position to stop a process that undermines their interests fail to do so?

We propose that, to answer this question, one must ultimately reject the dichotomy of market vs. hierarchy. We argue

Table 1

Market Suppression, 1952-1978 (million or million yuan)

	1952	*1978*	*Change*
Population	574.87	962.59	67.4%
Gross social product (GSP)*	**101,500**	**684,600**	**574.5%**
Total consumption	47,700	188,800	295.8%
Commercial employment**	9.53	9.39	-1.5%
Commercial establishments	5.5	1.52	-72.4%
of which: Retail	4.2	1.05	*-75.0%*
Food & beverage	*0.85*	*0.12*	*-85.9%*
Other services	*0.45*	*0.09*	*-80.0%*
No. of persons served by each commercial employee	60.32	102.51	-69.9%
No. of people served by each commercial establishment	104.5	6,332.8	5960.1%
of which: *Retail*	*136.9*	*9167.5*	*6596.5%*
Food & beverage	*674.3*	*80,215.8*	*11796.2%*
Other services	*1,277.5*	*106,954.4*	*8272.2%*
Share of commerce in GSP	11.1%	6.4%	-42.3%

* A statistical category used in the place of GDP in the pre-reform era. Roughly it is the total output of industry, agriculture, commerce, construction and transportation; all in current price. ** People employed in retail, food and beverage and other services such as barbershop, shoe repair and so on.

Sources: calculated from Zhongguo guonei shichan tongji nianjian 1991 [China Domestic Market Statistical Yearbook 1991], pp. 27, 30, 53 and 54.

rather that the "decisive push" towards marketization comes from within the Party-state, and that, contrary to the conventional dichotomy between market and command, hierarchically "nested" state actors—the most powerful group in the Chinese political economy—found they had much to gain, in the short (and perhaps even the long) run, by "plunging into the market" (*xia hai*). Reinterpretations of Marxism-Leninism-Mao Zedong Thought define markets as fully compatible with socialism in its early stages (which may last over a century); market and plan are no longer mutually exclusive. In the context of the relaxation of political and ideological constraints wrought by the Dengist reforms, cadres suddenly found it possible to orient production toward either plan or market depending on the relative rewards available, positioning themselves as "insiders" in the politics of marketization. The participation of state actors in market exchange not only expanded the market but also created a self-sustaining dynamic for further market expansion, in accord with the institutional dynamic of path dependency. The question is thus why it was in the interest of the Party leadership to opt for marketization in the first place.

The Party-state is no monolith; its cadre class consists of groups with diverse orientations. The benefits of marketization have always generated its advocates within the elite, even in the pre-reform period. The failure of Mao's "continuous revolution" shifted the balance of power away from the ideologues in favor of the pragmatists, and the post-Mao politics of post-mortem succession also necessitated new directions in economic development. The Dengist coalition pushed for market-oriented reforms as a way of building constituent support both within the Party-state and among the populace at large. While local governments and lower-level state actors prospered from initial market participation, the central authorities also reaped the benefits of the ensuing growth in both political and economic terms. At a time when the regime's radical ideals were being replaced by developmental objectives as the new rallying cry, the more marketized regions and sectors were delivering clearly superior developmental results; anti-market ideologues were soon marginalized in this dynamic. Policy and institutional choices were both clearly in favor of the market.

Finally, rapid growth, especially along the coast, created a dynamic and rapidly changing economy, the complexity of which rendered it impractical to continue state planning. Changes in the transaction cost structure of the economy (especially the information costs of monitoring and control) continued to erode the capacity of state bureaucracies or the apparatus of the command economy to a point of no alternative to further marketization. When market returns were high, there was a synergy between the state (especially local governments) and enterprises to pursue market opportunities. Now, after two decades of rapid growth, intensified competition has worn the profit margins perilously thin and increased market risks to extraordinary heights. The burdens to support and subsidize the state sector become increasingly unbearable, creating incentives for the state to "let go of the small (state-owned enterprises)" in an attempt to "marketize" its burdens. Under these circumstances, the central government, responding to its diminished authority and control due to prior decentralizing and marketizing reforms, has attempted to regain its position not by resurrecting the plan but by accommodating the market: it resorts to building up the regulatory and institutional infrastructure of a market economy in order to reassert its authority and rein in the localities. In sum, the dynamics of politics and economics conspire in support of further marketization.

The Legacy of the Plan

Communism is organized around bureaucratic fiat. The operation of the command economy, and hence the maintenance of the vanguard party's revolutionary or transformative goals, its ideological visions, organizational cohesion, and the nature of the political regime, were all conceived to depend on the party-state's monopoly of resources and rewards in society.[8] Market suppression in China had a whole theoretical-ideological edifice built around it in the form of Mao's "theory of continuous revolution," which deemed the market to be the embodiment of capitalism and endeavored to replace it with a new ethos and economic system organized around the plan. Market suppression was particularly severe for farm products due largely to the system of "unified purchase and marketing" (*tonggou tongxiao*) imposed on the peasantry, which is part of a Stalinist strategy of forced industrialization in which the state forced transfer of rural surpluses to urban-industrial sectors through monopoly purchase of farm products at below-market prices. The theoretical underpinning of the suppression of the factors markets was the refusal in the official ideology to recognize the "means of production" as commodities under socialism. As a matter of fact, they were the primary subjects of state planning. Their exclusion from the market was believed to have "liberated" the forces of production and eliminated exploitation of workers by capital. The suppression of financial markets was necessitated by the "material balancing" methods of state planning, which in turn was based on the ideological emphasis on "use value" over market value. The labor market was regarded as the main institutional mechanism of capitalist exploitation and the cause of the "immiserization" of the proletariat (a main thesis of Karl Marx), and was practically eliminated by the residential permit and job assignment systems. Trading of property rights was virtually nonexistent because all property rights were owned by either the state or the collectives, and were supposed to be administratively allocated according to the needs of "socialized production," not to be allocated through the market in pursuit of profits.

Although it has often been noted that China's progress toward central planning was not as long or as thoroughgoing as the Soviet or East European experience (e.g., the plan in China never covered more than about 600 goods, only 200 of which were managed in detail, whereas the plan in the USSR covered over 60,000 items),[9] it does not logically follow from this that China's efforts at market suppression were any less intense (see Table 1). Paradoxically, the PRC may have been both more thorough in the suppression of markets and less thoroughly plan-rational than its fraternal socialist republics. The result of market suppression was a "product" economy (as opposed to a commodity economy), in which prices were set by a central plan according to the labor theory of value rather than the market logic of supply and demand. As planning was far from comprehensive, many products were also distributed through nonmarket channels (e.g., the network of work units, or *danwei*). The center of redistributive planning was the State Council, within which the State Planning Commission, the Ministry of Commerce, the Ministry of Materials and Equipment, and the Ministry of Grain all played key roles via their local branches. On the eve of reform, commerce was monopolized by the state via a three-tiered distribution system of wholesale stations and a network of state-owned retail stores and trading companies.[10] The market was not only tiered but segmented, not only regionally (*kuaikuai*) but sectorally (*tiaotiao*); e.g., the Ministry of Commerce was primarily responsible for urban markets, while rural markets were under the jurisdiction of the rural supply and marketing cooperatives, or *gongxiao hezuoshe*.[11] Producers did not produce for market demand but to fulfill a plan quota, fighting against the constraint of limited supplies. This created a "seller's market," i.e., a systematic shortage of agricultural and consumer goods, magnifying the importance of the hierarchically organized and controlled *danwei* to supply individual needs and the need to cultivate informal supply channels. This reinforced the traditional cultural reliance on connections (*guanxi*) and informal networks in pursuit of security, medicine, and other necessities not readily available through official channels.

The attempt to root out the market was part and parcel of the communist attempt to revolutionize Chinese political culture. Early in the 1950s, during "socialization of the means of production," the labor market, financial and property markets, and national involvement in international markets were all renounced,[12] and during a series of mass criticism movements a national obsession was fostered with eliminating the "tails" of capitalism (i.e., spontaneous commercial tendencies, as in small rural markets for the entail from private plots, or exchange in kind "through the back door"). Many of the institutions conventionally associated with markets, such as an acquisitive consumer ethos, or a social stratification system geared to a commercially defined meritocracy, were painstakingly uprooted to make way for the ethos of planning and subordination of self to the collective interest as defined by the bureaucratic apparatus. As the new regime consolidated its rule, the sense of emancipation and unwonted equality that initially greeted the Revolution were replaced by a culture of pervasive conformity and institutionalized dependency toward the cadre stratum. Mass support was tested by the catastrophic failure of the Great Leap Forward, and further shaken by the Great Proletarian Cultural Revolution, with its pattern of frequent factional zig-zags in pursuit of slight ideological variations of the same collectivist ideals. The repeated indoctrination of radical ideals during the latter half of the Cultural Revolution reached a grand scale of absurdity, creating a whole set of rituals and taboos, do's and don'ts. One Cultural Revolution slogan that Deng was fond of citing as a criticism of the theoretical edifice of the "Gang of Four" was: "We prefer socialist weeds to capitalist crops."

The intellectual recognition that an economy based on command planning tended to develop certain shortcomings, such as an increasing difficulty correlating supply and demand, flagging work incentives or lagging innovation, that could most easily be alleviated by resorting to the market mechanism dates back to the period of painful reassessment that followed the debacle of the Great Leap Forward, when economists such as Sun Yefang revived interest in the "law of value." This economic rethinking found a receptive audience in such key political actors as Liu Shaoqi, Chen Yun, and Deng Xiaoping, who on this basis were willing to experiment with such expedients as rural free markets, "fixing output quotas based on the individual household" and *san zi yi bao* (three freedoms and one guarantee).[13] Liu Shaoqi, for example, supported introduction of a "double track labor system" that introduced a labor market for part-time and temporary workers while "grandfathering" job tenure for the full-time unionized work force, a "double-track school system" with both vocational and academic tracks, the expanded use of profit as an index of economic efficiency, the indexing of pay scales to productivity, even consumer surveys, the stock market[14] and industrial "trust."[15] In the period after the failure of the Great Leap when some of these expedients were adopted they gave rise to a culture of post-revolutionary stratification, in which the urban proletariat was privileged over the rural peasantry, descendants of the "five good" classes were privileged over descendants of the "five black" classes, and cadres and soldiers were prized above all.

The fact that the market option was available is not a sufficient explanation for its political resuscitation when markets had just been so strenuously suppressed. The political climate that made their adoption possible was created by the widespread sense in the aftermath of the Cultural Revolution and Mao's demise that the drive for socialist purity had reached a dead end, that the incessant mass criticism of deviant tendencies led not to consensus but recoiled upon itself in factional hairsplitting or in a sense of obsessive conformity and psychological "deadening" (*mamuhua*).[16] This subcurrent of revulsion was no less political and cultural than economic, and though it was not unanimous it extended from the lowest political levels to the very highest, certainly including those political cadres (led by Deng Xiaoping) who had been publicly humiliated during the Cultural Revolution and been sent down for reform through labor. These veteran cadres, rehabilitated and reinstated by the thousands by the CCP Organization Department under Hu Yaobang after the downfall of the Gang of Four, formed the core of the "reform faction" that split with Hua Guofeng's "whateverist faction" (*fanshipai*) in favor of greater doctrinal flexibility and pragmatism and supported the restoration of Deng Xiaoping to a leading position at the Third Plenum of the 11th Party Congress.

Once back in a position to set the agenda, the reform leadership, with no policy blueprint other than a vague consensus on the goal of "four modernizations,"[17] was forced to adopt an incremental approach, but was willing to allow bold experiments by the localities and let the results guide their policies. The CCP thus found itself being transformed from a vanguard party into a "rearguard" party,[18] which selected policy and institutional choices while incorporating its political and ideological criteria ex ante. As Andrew Watson's analysis shows, market development in the rural areas was initiated "accidentally" by post-Mao institutional reforms that allowed the peasantry to return to household production and altered the practice of state purchase of farm products (in particular, the state raised the purchasing price). As a result of increased production incentives, rural output surged. When the sluggish state marketing and distribution system could no longer handle the increased volume, the state changed its long-standing policy and allowed peasants to sell part of their products on the free market (after fulfilling their obligations to the state). As a result, "the rapid growth and extension of free marketing was almost inevitable. Market centers were hastily established in villages and urban streets and both individual peasants and collective units began to trade on them."[19] As market institutions[20] (especially the so-called "wholesale markets" studied by Watson) developed, producers of all ownership types began to re-orient their production toward the market, and gradually became dependent on it for their operations. Victor Nee also identified the same process by which commercialization leads to specialization of the producers (including the peasant households) and their increasing reliance on the market as the dominant form of transaction.[21]

In urban areas, the reform leadership's first expedient was a reemphasis on workplace discipline (which Deng also stressed in 1974-1975 during his short-lived first rehabilitation), whereafter they resorted to "material incentives" (*wuzhi ciji*). These provided the discretionary income from which consumerization naturally flows, acquiring a self-sustaining momentum with snowballing vested interests behind it. These vested interests were personified in the myriad lower-level bureaucratic entrepreneurs who stood to gain most from marketization, largely because of the continuation of public property rights, which undergirded their political power while giving them market advantage.[22] The focus was on reshuffling the roles and decision-making powers among state actors, rather than on creating a new class of economic entrepreneurs outside the state. The market and non-state actors were, in the earlier years of reform, a "necessary evil" to be tolerated rather than indulged. These cadres enthusiastically supported further expansion of the market, generating the paradoxical dynamic of marketization within a Leninist institutional framework.

During the 1980s, the market acted like a giant magnet drawing people into a headlong "plunge into the sea of commerce" (*xiahai*). Commerce became not only a profession but a fashion, and the popular jingle of the day was "(of then China's one billion people) nine hundred million are in commerce, with another hundred about to commence."[23] As mentioned before, a market consists of its participants; the nation-wide rush to the marketplace created a tremendous momentum that expanded the market and raised the level of marketization.[24] By the late 1980s and early 1990s, the sidewalks of Chinese cities were thronging with not only small peddlers who came from the countryside but also moonlighting urban factory workers, school teachers, and cadres from all kinds of state units, the most successful of whom either came from or quickly sought to affiliate with the cadre class.[25] Table 2 depicts a complete reversal of the

Table 2

Market Development, 1978–1996 (million and million yuan)

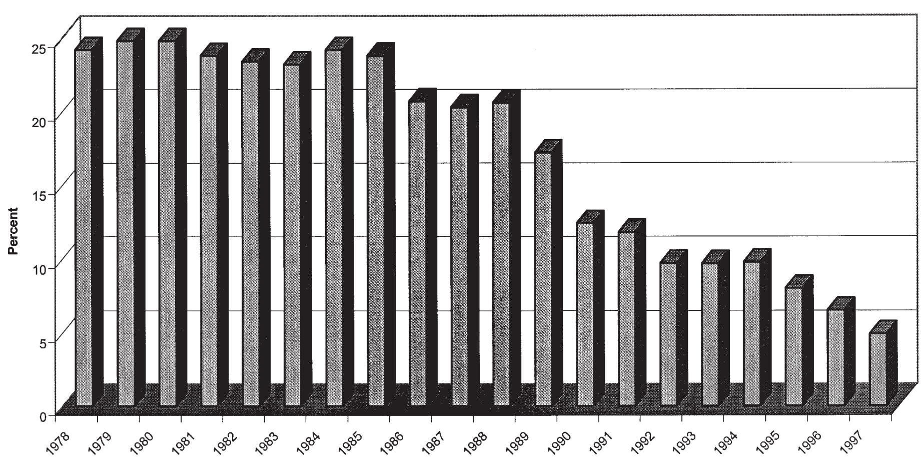
	1978	*1996*	*Change*
Population	962.59	1223.89	27.1%
GDP	684,600	6,859,380	902.0%
Total consumption*	188,800	4,019,597	2029.0%
Commercial employment	9.39	52.74	461.7%
Commercial establishments	1.52	18.58	1122.4%
No. of persons served by each commercial establishment	6,332.8	65.9	-99.0%
No. of persons served by each commercial employee	102.5	23.2	-77.4%
Share of commerce in GDP	7.3%	8.4%	15.1%

Source: calculated from State Statistical Bureau: Zhongguo shichang tongji nianjian 1997 [Market statistical Yearbook of China 1997] (Beijing: Zhongguo tongji chubanshe, 1998), pp. 14, 20, 73.

trend identified in Table 1: between 1978-1996, the population increased by 27 percent, but the number of commercial establishments grew by 1,122 percent. As a result, the average number of people served by each commercial establishment dropped from 6,332.8 to 65.9. Figure 1 shows the rapid growth of retail sales by ownership category. By far the fastest growing sector was individual ownership, but beginning from a minuscule base it did not overtake state-owned units as first in total sales until 1995.

This commercial craze was fueled by the extraordinarily high market profit margins created by the pent-up demand in the pre-reform shortage economy, as well as by the enormous gaps between state-set prices and market-determined ones. In the early 1980s, the free market price for farm products was consistently 40 percent or more above the state procurement price. Figure 1 shows the average margins of return of all state-owned industrial enterprises between 1978-1997. Note the much higher

Figure 1
Average Margins of Return of All SOEs
(tax+profit/total assets)



Source: calculated from State Statistical Bureau, *China Statistical Yearbook* (Beijing: Zhongguo tongji chubanshe), various issue profit margins during the 1980s; presumably the returns in nonstate sectors were even higher as these sectors were less constrained by state price controls than the state sector. The adoption of an incrementalist, "dualist and leading sector" approach (i.e., introducing market reform first where conditions are favorable, while allowing nonmarket patterns to persist in nonleading sectors) again had both an intellectual and a political rationale. The intellectual background is that the early reformers, like the economic theorists behind the Soviet NEP or the eastern European reforms of the 1960s and 1970s, were still committed in principle to socialism and presumed the market could be confined to a supplementary role, to fill in the "cracks" in the plan (Liu Shaoqi's metaphor), or as the bird in Chen Yun's socialist cage, these were not theorists of "transitology." The market then expanded so vigorously because the "cracks" were so large. We submit that this was an artifact of China's peculiar combination of thorough market suppression and incomplete planning. The political reason for "socialism with Chinese characteristics" is that even after the fall of Hua Guofeng and the so-called "small gang of four," the elite remained divided concerning the pace and extent of reform between the more radical reform wing led by Hu Yaobang and Zhao Ziyang and the more cautious and ideologically conservative bloc under Chen Yun and Deng Liqun, which continued to consider China's "golden 1950s" a worthy model for stable and rapid (yet ideologically correct) development.[26] Deng Xiaoping played a "swing" role in this rivalry, depending largely on his sense of the macro political-economic balance. Policy consensus was ephemeral and dependent on the ever oscillating economic conjuncture and its political side effects.[27] The lurches from left to right were painful, but policy reactions to contain them were swift and vigorous, motivated by memories of Mao's costly political divagations in the late 1950s and early 1960s. The overall consensus supported "stability," albeit punctuated by Deng's occasional interventions on behalf of accelerated growth. Though this "crossing-the-river-by-feeling-for-stepping-stones" approach has won subsequent plaudits and been invidiously contrasted to the "big bang" or shock therapy approach recommended by such renowned economists as Sachs or Aslund and adopted by the former socialist regimes in eastern Europe and the Russian Republic, it was by no means a self-conscious decision from the outset to proceed in such a distinctive manner. This approach has led to the triumph of political marketization primarily because, at any given point along the decision-making path, compared to other directions, marketizing reforms delivered the best growth results and built up such a strong cadre constituency within the state.

Decentralization and Bureaucratic Marketization

That marketization coincided with decentralization and devolution to lower levels of government and to production unit management has been fairly well established. The shift was made easier by the structural characteristics of the pre-reform command economy: China's was a relatively decentralized system with structural fragmentation and incomplete planning, large numbers of small and medium-sized enterprises, and a disproportionately large rural sector. In other words, unlike their counterparts in the former Soviet Union, local governments, State Owned Enterprises (SOEs) and other state actors faced fewer formal institutional constraints when redirecting production for the market.[28]

The reorientation towards the market was initiated by the decentralization reforms that were intended primarily to empower and increase the autonomy of lower state actors in enterprises and local governments. The typical scheme of reforming the incentive structure of state actors in the economy was to reduce their planned task assignment and allow them to engage in market exchange after fulfilling their plan obligations. However, coming out of the shortage economy of the Maoist era, the market enjoyed a considerable advantage over the plan in rewarding economic entrepreneurship. The enormous price gaps between the free market and state planned procurement prices for goods and services led to rapid draining of resources from the planning channels into the open market.[29] As a People's Daily commentator lamented in January, 1982,"state plans for purchasing fast-selling, scarce goods were not being fulfilled, in part because of contention between factories rushing to production sites to procure raw materials, shopworkers traveling directly to rural areas to buy up goods, and even some foreign trade departments participating in the melee, all without any concern for whether or not the local purchase task for state commerce had been completed."[30] By the mid-1980s, the typical estimate was that enterprises carrying out planned production could only obtain from the state planning channels an 80 per cent quota of the material supplies required to fulfill their planned task; only 80 per cent of this quota could be translated into actual orders at the annual trade conference (*dinghuo huiyi*, literally "ordering conference") for materials, and only 80 per cent of the ordered materials actually were delivered. In other words, enterprises were frequently forced to secure their material supply from the market at much higher prices and sell to the state the finished products at the planned price. Naturally, this caused widespread resentment and shirking in plan implementation. In addition, state and non-state actors alike rushed in a speculative craze to take advantage of the dual price structure by extracting resources from the planning channels (using their power of office and various *guanxi*) and selling them in the market to generate a profit. Soon it became apparent that the state plan was no match for the market; the government repeatedly had to raise its within-plan supply and procurement prices, which eventually converged with market prices to make the plan superfluous.[31]

Decentralization through fiscal and enterprise contracting undermined the plan from another direction as well. Under the contracting system, localities and enterprises had incentives in the intense intrastate bargaining process to reduce the scope of the central plan governing their economic activities in order to increase their discretionary power over resources. Because of the huge initial market returns, these newly autonomous state actors invariably became market players despite the statist tendencies in their market behavior. Yet another facet of state actors turning into market players is the remarkable array of "revenue-generating" (*chuangshou*) business ventures started by party-state bureaucracies, the various *shiye* (nonprofit, usually governmental) units and the People's Liberation Army units. They started businesses, often using their power of office and other state or communal resources under their control, to generate additional incomes for the members of their work units.[32] Although systematic data are impossible to come by, the typical estimate by some Chinese authorities is that over 50 per cent of the total monthly income of cadres is generated by such forms of "moonlighting."[33] Those outlets that had previously served as distribution centers of the Ministry of Trade or Commerce evolved into independent distributors or retailers, with their own warehouses, trucks, and so forth contracting independently with manufacturers or other wholesalers. Factories that previously could only distribute through the Ministry distribution networks were now free to distribute their goods directly through any channel they chose, possibly reserving a small portion for government use or distribution, especially in the case of products with national security need.[34] For examples, by 1993, the Ministry of Railways system (the ministry and its subordinate regional bureaus and sections) had started 46,000 second line businesses[35] that were independent accounting units. At the end of 1992, the ministries of postal services, telecommunication and transportation had between them 129,000 similar enterprises.[36] In 1992, 10 per cent of all new companies nation-wide were started by organizations in the Communist Party and the government, and in Liaoning Province alone, party-state organizations (*dangzhen jiguan*) started 3,590 new business ventures.[37] At the end of 1994, the state-run trade unions across the country owned 130,000 businesses.[38] The financial departments and even the tax bureaus in many localities generated an extra income through making short-term loans to cash starving enterprises using state's money flowing through their offices.[39] Almost every *danwei* was involved in several lines of businesses and ran its own secret budget (*xiaojinku*). Many kept several accounting books to deal with different authorities. The importance of non-wage income is of course not restricted to the cadre class. In 1995, wage income as a percentage of the total income for all Shanghai residents declined from 59.3 per cent the previous year to 56.1 per cent; the largest item in the non-wage income is listed as "other incomes from their work units."[40] This "second-lining" is perhaps the most striking feature of the Chinese political economy in the reform era, and it is the participation of these state actors in market exchange that removed many political obstacles to greatly quickening the pace of marketization.[41]

Illustrative of the marketization of state actors is the transformation of the material departments of the government and its subordinate firms, which formerly comprised the hard core of state planning. Before 1996, all important production materials, coal, steel, wood, cement, oil, machinery and equipment, and so forth, were in short supply. The brief period of re-centralization after Mao's death in 1976 saw the number of materials under central planning increase from 217 in 1970 to 837 (of which 256 were the so-called first-category materials directly controlled by the State Planning Commission; the rest were allocated by the various ministries).[42] Reforms in the sector not only allowed enterprises in material production and trading the opportunity to pursue the enormous profits created by the gap between the planned price and market price of materials, but also reoriented the well established state-owned distribution channels to serve the market. In fact, once decentralized and reoriented, state-owned commercial firms and distribution networks have become part and parcel of China's emerging market. By 1987, the number of first-category materials were reduced to 27,[43] and all state-owned material firms were performing dual roles: profit making as well as carrying out the plan. As might be expected, extra-plan business dealings increased rapidly: from 55.1 per cent in 1987 to 83 per cent in 1991. From 1980 to 1990, all domestic production of materials that fell under plan reduced: coal from 57.9 per cent to 40.7 per cent, steel products from 74.3 per cent to 41.5

per cent, timber from 80.9 per cent to 21.8 per cent, cement from 35 per cent to 11.8 per cent.[44] The rest of the output was sold by the producer on the market (except a small portion distributed under local government plans). In 1988, the SPC allowed certain producers of materials under direct state plan to sell at market price as long as the state preserved the right to allocate them. By 1990, 30 per cent of steel and 50 per cent non-ferrous metal produced under state directive plan were sold at the market price. With the profit generated on the market, many state-owned material firms became essentially businesses. Some branched into tourism, real estate, and other sectors, formed joint ventures with foreign capital, and provided direct services for other firms. In 1992, for example, there were 80 material service companies for foreign investment projects at the prefecture level or above that were owned by the material departments at various levels of the government. The marketing and distribution systems of the government's material departments are now open to clients of all sorts, including collective and private dealers. The state-owned specialized materials marketing network of distributors (*wangdian*) used to implement plan only, to allocate materials according to plan directives, but they are now refurbished to serve market demand. By 1990, there were 40,000 of such specialized distributors nationwide with a sale of 202.9 billion yuan,[45] and market sales amounted to 80 per cent of the total of all state-owned material trading firms. Market sale of coal was 45 per cent of the total, steel was 72 per cent, copper 81 per cent, aluminum 63 per cent, timber 78 per cent, cement 66 per cent, rubber 79 per cent, heavy trucks 82 per cent.[46] By 1995, the ratio of market sales approached 100 per cent.

Governments at regional and local levels gradually adopted pro-market policies in the early to mid 1980s.[47] The two main benefits of the market to local governments were faster economic growth and an expanded revenue base. In addition, as mentioned above, with the rapid shrinking of state planned supply, many localities had to rely on the market to supply the material input for their firms to carry on their normal production. Initially, most provinces were suspicious of the market; they were still trapped in the leftist thinking of the Maoist era. However, with decentralization and the shift of the CCP's emphasis from ideological purification to economic development, localities were pitched against one another in a contest to deliver the best development results. When a few bold provinces, such as Guangdong, Anhui (under Wan Li) and Sichuan (under Zhao Ziyang), took the lead in pro-market reforms and delivered tangible results, others followed suit. As Montinola, Qian, and Weingast's analysis shows, China's de facto economic federalism created by decentralization not only allowed the market to flourish in the interstices but forced anti-market local governments to adopt pro-market policies.[48] For example, in its report at a conference on urban reform organized by the State Commission on Reforming the Economic System in 1991, Suzhou municipal government listed the benefits of promoting the market as: a) to secure factor input of production, as the planning channels could no longer supply these with any adequacy; b) promotion of the sale of local products when the central government's planning authorities no longer guaranteed their purchase; c) to promote industries: for example, by building the specialized silk market, the traditional silk industry renowned in this region was revived;[49] d) to ensure social stability by economic prosperity brought about by bristling market activities; e) to promote enterprise reform (changing their operational mechanisms) by their participation in market exchanges; f) to break the rigidity of the administrative *tiao-kuai* structure in which enterprises were trapped.[50]

To promote market development, many localities hastened to build the infrastructure for market activities. If the earlier development of these markets was characterized by spontaneity, later market centers were creations of the local governments, who would often clear out a piece of land, erect a structure, furnish transport, utility services and police patrol, and then begin to rent out spaces, from which they could collect taxes and fees. Creating market centers as new growth poles in the local economy has become a popular strategy for local economic development, a strategy commonly referred to as *zhengfu datan, qiye* *changxi* (the government sets the stage, the enterprises put on the show). Many "whole-sale markets" are established by local governments as a way to expand their organizational grip over the flourishing private traders.[51] State-promotion, therefore, has characterized the pattern of market development in China since 1980. In a more extreme case, in 1993 the municipal government of Zhengzhou, the capital city of Henan province[52] situated on the cross-road of two main railways and aspiring to become one of the country's main hubs of commodity distribution, ordered all government employees and SOE workers to set up peddler's stands at the "weekend fair" organized by the government in the central square. The objective, according to the government, was to create an atmosphere of "big city, big commerce" and improve the city's image as a center of commerce.

Marketization and the Reimposition of Central Control

The most important role played by the central state during the early phase of reform was to remove institutional impediments to marketization. There were two main obstacles to the opening of the market: the vested interests supporting state planning, which precludes marketization by demanding a state monopoly of resources; and Maoist ideology, which regards the market as the breeding ground of capitalism. As the plan faded into the background in the context of the dynamic discussed above, the removal of ideological obstacles became crucial, for "mind emancipation" under communist game rules could only be initiated from the top. As early as the 1950s and early 1960s, Chen Yun and others advocated a limited role for the market in the socialist economy. Chen envisioned a "bird-cage economy" in which the state plan laid the framework within which the "birds," that is, enterprises, can have limited space (the market) to hop up and down. The revival of the market early in the reform era had much to do with Chen's return to the center stage of economic policy-making in the late 1970's. The Twelfth Party Congress of 1982 hit upon a scheme in which "the plan is primary, the market is supplementary" (*jihua weizhu, shichang weifu*).

Two years later, the Third Plenum of the Twelfth Party Congress, in which the "Resolution on Reforming the Economic System" was passed, further developed the scheme into "a planned commodity economy" model,[53] and made it an important task of reform to establish a national market system. The Thirteenth Party Congress of 1987 not only continued the "planned commodity economy" formulation but also attempted to reconcile it with the Marxist theoretical edifice by proposing a theory of "preliminary stage of socialism," which was expected to last for at least a hundred years in China. During this stage, according to the theory, because of the low level of economic development, market forces and even private property rights have to be permitted and harnessed to promote the forces of production. During the post-Tiananmen conservative backlash (1989 – 1991), a new tune, "the internal unification of the plan and the market," was played across the land. Although coined by Deng himself, it was, in fact, used by central planners and other conservatives as a disguised retreat from the market-oriented reforms back to renewed emphasis on state planning, which resulted in a new cycle of re-centralization.[54] The decisive breakthrough came with Deng's famous southern tour of early 1992, when he renounced the traditional ideological dichotomy that equated socialism with state planning and capitalism with the market. That finally cleared the way for the CCP's Fourteenth Party Congress late in that year to adopt a "socialist market economy" as the target model of economic reforms.

Yet beginning with the attempt to reign in the inflation precipitated by Deng's southern voyage and achieve a "soft landing," partly motivated by the CCP analysis of the collapse of socialism in Europe, the leadership began to place higher priority on the need for central control of the chaotic forces of reform. Particularly since the 15th Party Congress in late 1997, the central government has asserted leadership even as the pace of marketization has accelerated. If hitherto the zeal among local state actors for marketizing reforms was revenue-driven, now the central government seemed to be motivated by the opportunity to build the institutional infrastructure of a market economy as a way of recovering some of the regulatory and revenue power dissipated to the localities during earlier decentralization reforms. This reassertion of central leadership is in part a response to the changed macro-economic environment faced by bureaucratic actors in the marketplace. On the one hand, the persistent and ever-expanding budget deficit forced the central government to take drastic actions; on the other hand, as diminishing returns to bureaucratic entrepreneurship have altered the incentives of cadre participation in market exchange, the state begins to see incentives to retreat from the marketplace.

Bureaucratic entrepreneurship has been a potent force in driving China's spectacular growth;[55] but it is effective only if the marketplace is characterized by shortage. Under shortage, marketized state actors are extremely effective in building production facilities to meet the still crude and unsophisticated demand. However, state actors' capacity to mobilize resources, plus their inherent propensity to protect "their own enterprises" during any downturn, inevitably lead to overproduction and intensified competition, which in turn drives down or even wipes out profit margins.[56] When the market is no longer profitable for state actors, the enterprises they have built become liabilities, for it is the state which must support and subsidize these loss-making firms and their workers, a proposition that is increasingly unsustainable given the mounting central budget deficit. In addition, broad participation by state actors in market exchange creates abundant opportunities for corruption, rent seeking, and market distortions. During the high-growth years when everybody benefits from the expanding economic pie, this malaise is tolerated or ignored; however, once hard times hit, such deviance becomes a politically explosive issue, a point well-illustrated by the crisis that brought down the Suharto regime in Indonesia. In other words, economic slowdown increases both the political and economic liabilities of the Party-State, which has hitherto been too broadly engaged in the economy. Economically, the state budget has to support an ever-expanding number of state cadres. Politically, corruption among cadres has become endemic and seriously threatens the legitimacy of the state. Downsizing the state is therefore a natural course of action to reduce the political and economic liability. Thus the underlying causes of China's liberalizing and marketizing reforms in recent years are very similar to those in other developing countries.[57] Table 3 describes the deficit situation during the two decades since 1978. This should also be considered in the context of declining state revenue as a proportion of the GDP (Table 4) and the manifold increase of administrative expenditure as a percentage of the state budget.

To reduce state liabilities, the central government has in recent years adopted three reform measures that are significantly speeding up the process of marketization. The first is administrative reform, aimed at restructuring the state machine to suit a market economy and, during the process, greatly reduce the number of state cadres and shrink the scope of state participation in the economy; the second is SOE reform, which follows a strategy of "grasping the big ones and letting go of the small ones" (*zhuada fangxiao*), and the third is to further improve the political, legal, and insitutional environment of private businesses. By the time a buyer's market emerged around 1996, marketization and decentralization had thrown the state planning apparatuses into complete disarray. Like Humpty-Dumpty, no amount of effort could reassemble them to reassert central planning. Illustrative of the futility of the attempts to reinstate some planning control was the humiliating failure of the post-Tiananmen round of re-centralization. Thus instead of a return to central planning, the central government has attempted to regain its position by building up the institutional infrastructure (fiscal, legal as well as regulatory) of a market economy, and pushed to dismantle the state's microeconomic management apparatus built for the command economy as a way to weaken localism and correct market distortions. Despite a period of cultural "blooming" in the aftermath of the 15th Congress (particularly during Sino-American summitry in 1997-1998), the leadership has also reemphasized

Table 3

State Budget Deficit (100 million yuan)

Year	*GDP*	*State Revenue**	*Revenue/GDP*	*Budget Balance*
1978	3624.1	1132.26	31.2%	10.17
1979	4038.2	1146.38	28.4%	-135.41
1980	4517.8	1159.93	25.7%	-68.9
1981	4860.3	1175.79	24.2%	37.81
1982	5301.8	1212.33	22.9%	-17.65
1983	5957.4	1366.95	22.9%	-42.57
1984	7206.7	1642.86	22.8%	-58.16
1985	8989.1	2004.82	22.3%	0.57
1986	10201.4	2122.01	20.8%	-82.91
1987	11954.5	2199.35	18.4%	-62.83
1988	14922.3	2357.24	15.8%	-133.97
1989	16917.8	2664.9	15.8%	-158.88
1990	18598.4	2937.1	15.8%	-146.49
1991	21662.5	3149.48	14.5%	-237.14
1992	26651.9	3483.37	13.1%	-258.83
1993	34560.5	4348.95	12.6%	-293.35
1994	46670	5218.1	11.2%	-574.52
1995	57494.9	6242.2	10.9%	-581.53
1996	66850.5	7407.99	11.1%	-529.56
1997	73452.5	8651.14	11.8%	-582.42

*Debt not included.
Source: State Statistical Bureau: China Statistical Yearbook 1998, pp. 55, 269 and Market Statistical Yearbook of China 1998, p. 32.

that downloading economic responsibility does not entail relaxing political control ("bourgeois liberalization").

In March 1998, Zhu Rongji's new government launched an ambitious reform drive to overhaul state institutions. The target was to cut both the personnel and institutions of the government by one half in three years. By October 1998, most industrial ministries of the State Council had been abolished, their macro-economic regulatory functions repackaged into the new MITI-like super-ministry, State Economic and Trade Commis-

Table 4
Profit Rate as Percentage of Production Cost of SOEs in Major Industries

Year	*1996*
Light Industry	-0.27%
Heavy Industry	2.71%
Coal Mining and Dressing	3.05
Petroleum and Natural Gas Extraction	12.16
Ferrous Metals Mining and Dressing	-2.84
Nonferrous Metals Mining and Dressing	3.69
Non-mining Minerals Mining and Dressing	-1.52
Other Minerals Mining and Dressing	1.01
Logging and Transport of Timber and Bamboo	1.94
Food Processing	-4.48
Food Production	-1.79
Beverage Production	3.61
Tobacco Processing	22.66
Textile Industry	-7.05
Garments and Other Fiber Products	-1.07
Leather Furs Down and Related Products	-7.06
Timber, Bamboo, Palm Fiber and Straw Products	-6.20
Furniture Manufacturing	-1.63
Paper making and Paper Products	0.66
Printing and Record Medium Reproduction	2.81
Cultural Educational and Sports Goods	-0.22
Petroleum Processing and Coking Products	2.62
Raw Chemical Materials and Chemical Products	2.20
Medical and Pharmaceutical Products	2.29
Chemical Fiber	-2.75
Rubber Products	-0.13
Plastic Products	-1.50
Nonmetal Mineral Products	-4.50
Smelting and Pressing of Ferrous Metals	2.08
Smelting and Pressing of Nonferrous Metals	-0.75
Metal Products	-3.15
Ordinary Machinery Manufacturing	-1.91
Special Purpose Equipment Manufacturing	-2.59
Transport Equipment Manufacturing	0.55
Electric Equipment Manufacturing	-0.29
Electronic and Telecommunications Equipment	3.25
Instruments Meters Cultural and Office Machinery	-6.12
Other Manufacturing	-4.13
Electric Power steam and Hot Water Production and Supply	7.96
Gas Production and Supply	-8.53
Tap Water Production and Supply	9.27

Source: *China Statistical Yearbook*, 1997, p. 441.

sion, and the SOEs attached to them reassigned to the localities or become independent operations. The size of the personnel of the State Council was reduced by 47 per cent. Reforms at the local level are expected to follow the same blueprint. Three ways have been designed to marketize the industrial ministries (*bumen*) at both the central and local levels: 1) to turn them into business entities (corporations, enterprise groups, holding companies etc.) that are stripped of their government administrative functions; 2) to turn them into semi-official trade associations or business councils (*hangye zonghui*), and 3) to turn them into macro-regulatory agencies. The *bumen*-turned enterprise groups or holding companies can incorporate non-state enterprises. The trade associations and business councils draw their membership from the whole industry regardless of the ownership classification. And the macro-regulatory agencies are supposed to treat all firms, state-owned, collective, foreign invested and private and so on, as equals under the same market rules of competition.

A major part of state budget expenditure has hitherto been claimed by the so-called *shiye danwei*. These nonprofit enterprises used to include all of the many professions considered part of the service sector of the economy, such as schools, universities, research institutes, agencies of public administration, the health care profession, banks, the legal system and other professional services. Under socialism these were subsidized by the state, and most of the people working in *shiye danwei* were classified as state cadres who lived off the state payroll. The reform of the *shiye danwei* involves pushing them to become independent business entities, thereby also expanding China's service sector (*di san chanye*, or tertiary industry). According to the reform plan, *shiye danwei* are classified into three types according to their current financial conditions. The first consists of those that generate regular revenues; they are to be treated as enterprises and expelled from the state ranks. The second type consists of those that would face considerable difficulties if completely disconnected from the state budget; they are to retain contracts with the government for a fixed amount of state subsidy and will be granted more autonomy to develop their own revenue sources. The third are those that must remain completely dependent on the state budget; the reform plan for them is to put them on an endowment system with their initial funding endowed by the state.[58]

The *zhuada fangxiao* strategy (grasp the big enterprises, drop the small ones) of SOE reform similarly reflects the general trend of shrinking the scope of the state and expanding the scope of the market. This should also be understood in the context of mounting fiscal pressure on the state. Table 4 shows that the returns of SOEs were negative in many industries. Figure 1 indicates that since 1996 the state sector as a whole has registered net losses in ever-larger amounts. As a result, as soon as the 15th Party Congress put forward the reform line of "grasping the big ones, letting go of the small ones," local governments were in a selling frenzy to get rid of their loss-making SOEs. The change of attitude among the localities was so dramatic that the central government had to step in to curtail the fire sale.[59] SOE reform has also stripped SOE workers of their privileges of state sector employment, privileges the state finds itself no longer able to pay. Workers now have to contribute to the housing fund, their medical care, pension plans and other insurance; not only their life employment tenure is history, tens of millions of them have been "laid off" (*xiagang*) and relegated to the vicissitudes of the marketplace. In effect, labor, even in the privileged state sector, has been marketized, notwithstanding all the CCP's Marxist principles.

Finally, after the 1987 "theory of the preliminary stage of socialism" removed the ideological obstacles to private ownership, a 1999 amendment to the State Constitution has granted private businesses equal legal status with the state and collective sectors in China's market economy. To the state, the benefits of a vigorous private sector are manifold: it generates employment when the state needs it the most to head off social unrest; it provides a new growth engine when bureaucratic entrepreneurship is faltering; its ups and downs do not increase the political and economic liability of the state the way the state and collective sectors do due to massive state involvement in these sectors. The labor-intensive tertiary sector, particularly retail or repair shops and restaurants, was first to take advantage of this license. By 1996 the retail sector consisted of about 9.2 million very small (one- and two-person) retail shops, of which about 7.8 million were privately owned, about 1.2 million collectively owned enterprises (averaging six employees per venture and accounting for 28 percent of sales), and some 290,000 state-owned enterprises, mostly department stores, accounting for 41 percent of sales. The wholesale distribution system, in contrast, remains predominantly government-run; it consists of warehouses segmented into regional, county, and township units, each level supplying the ones below according to decisions made at the top (foreign companies are barred from entry).[60]

Conclusions

China's political marketization, the crown jewel in its highly successful "reform and opening" policy, which since Tiananmen has provided the new basis of the regime's legitimacy, turns out upon closer analysis to be more shrewd improvisation than strategy. True, the theoretical rationale for marketization was prefabricated in the wake of the disastrous Maoist efforts to subordinate planning to revolutionary revitalization in the Great Leap Forward and Cultural Revolution experiments. After discrediting its economic stewardship in utopian crusades, the Party-State reverted to this policy repertoire under the name of "reform and opening up" in order to raise living standards and regain popular trust. We have noted that some see market development as a package deal, like a cruise ship (not a taxicab), from which one cannot easily disembark;[61] while others see it as an institutional artifact painstakingly constructed by and on behalf of a constituency of political interests. No doubt in the Chinese case it has been both. In the eyes of the leading reformers it seems to have been the former; they used the image of a package deal to carve out a realm of autonomy and protect the still fragile market from its formidable opponents. Yet no one really knew (or could say?) what was in the package, what was on the other side of the river everyone was crossing. To the bureaucratic entrepreneurs who operationalized the reforms, on the other hand, this was a policy windfall to be creatively construed and exploited to the utmost, in both their own and the national interest. This new class is what has given the market its elemental thrust while at the same time making it so difficult to regulate or steer in any centrally determined direction. Thus hierarchy and market melded seamlessly together, minimizing bureaucratic interference while tapping the financial and entrepreneurial resources of the state. Accelerated GDP growth provided reinforcement and momentum, as marketization advanced from 5 percent in the early 1980s to more than 60 percent at the turn of the millennium, according to a careful and comprehensive recent Chinese analysis, making its most rapid progress in commmodities markets while lagging somewhat in markets for factors of production (including financial and technology markets).[62]

Our point has been that the impact of marketization on politics has been to establish a market culture. Though it is hard to say too much about its exact content this early in the transition, so far the major impact on Chinese political culture seems to have been a massive divertissement of popular interest away from politics to the ever widening range of commodities and services to be procured (or sold) in the market, thereby forming the basis for a more autonomous civil society that may ultimately result in a more pluralist and self-critical polity. Yet China's route of marketization without privatization, melding hierarchy and market, not only smoothed the barriers to rapid reform, but arguably made it more difficult to define a distinct and self-bounded market culture. This socialist market with Chinese characteristics gives rise to a hybrid culture characterized by extensive interpenetration and informal networking or "connections" between government and society, rather than the sharp disjunction between public and private with well-defined hedges against conflict of interest that has characterized Western market cultures. Complicating the situation is that China adopted a market culture before developing a civic culture or any clear conception of the public interest. The attempt to institutionalize legal norms, for example, has been under suspicion on both sides of the market divide: entrepreneurs believe the legal bureaucracy to be purely an agent of the Party-State principal (as signaled by the shift from "rule of law" to "rule through law"), and they protect themselves accordingly with different sets of books, secret budgets (*xiaojinku*), and what not; while the leadership believes its legal minions to be thoroughly corruptible via bribes and payoffs (apparently quite accurately). The result has been a vigorous but cutthroat market culture struggling for autonomy not only from the government but also from normative regulation. Thus according to recently published figures, more than half of the 4 billion or so business contracts formed each year are fraudulent, and some two-thirds of China's SOEs "cook" their books. Corruption consumes 13 to 17 percent of China's annual GDP, tax evasion robs the government of some 50 percent of its earmarked revenue, 40 percent of all commodities sold are counterfeit, and (according to conservative estimates) the underground economy makes up 20 percent of GDP.[63] The authorities have attempted to crack down on the rising tide of crime and corruption by waging since 1983 a series of "strike hard" (*yan da*) campaigns, meting out Draconian punishments including the liberal application of capital punishment (no fewer than 68 crimes may warrant capital punishment, including accepting a bribe of more than US$12,000, and each "strike hard" results in several thousand executions, more than the total of the rest of the world combined). Yet these campaigns seem to have had no appreciable deterrent effect.

Emerging markets typically have difficulty establishing a credible normative regime, not only in China or the former Soviet republics but on the 19th and early 20th century American frontier as well. Hegel predicted more than 180 years ago (corroborated by subsequent social scientific research) that the impact of marketization would be the dialectical creation of civil society, consisting of lineage networks and "corporations" (by which he meant voluntary communities, as economic corporations did not yet exist), and the construction of a state of law (Rechtsstaat) to regulate the chaotic market.[64] Assuming that China's market culture follows this pattern, what political upshot may we anticipate as it matures? To dispose first of facile projections, if the Party-State succeeds in maintaining its hegemony, as it shows every sign of intending and being able to do, any prospect of an untrammeled free market leading directly to political pluralism should be taken with a grain of salt. Like the Meiji oligarchs, the PRC leadership has been willing to divest itself of liabilities by downloading economic responsibility, but this has coincided with a tightening of political, ideological, and security constraints. These are designed to ensure that continued expansion of a market autonomy will have no political ramifications: market players will be granted functional autonomy only conditional upon institutional warranties of continued political loyalty. Within this bounded sphere of competence, market players have been quick to express and pursue their interests (including not only their own and their families', but those of the units of which they are a part). Given the government's inclination to place relative priority on political/ideological conformity in establishing a normative regime, and its institutionalized inclination to protect its investment in successful entrepreneurs, the inference seems safe that there will continue to be ample room for market players to continue to pursue their (apolitical) interests autonomously. Market culture will thus continue to expand and take root. Under these rules of the game, however, the political impact is likely to be subtle, perhaps even counterintuitive. Just as the CCP leadership seems safe in concluding there is no automatic connection between marketization and democratization, for example, marketization is quite compatible with hyper-nationalism. While we have argued that the inherent thrust of marketization is toward international cultural homogenization, market downturns or dysfunctionalities (such as poverty or mass unemployment) have in the past sometimes had explosive foreign policy consequences. It should not be forgotten that both Nazi Germany and Showa Japan were market economies.

If the political impact of China's adoption of market culture seems at least for the foreseeable future to be limited to the functionally relevant needs of the largest market players and sectors (and particularly open-ended with regard to foreign policy), are there perhaps more specific features of China's evolving market culture whose monitoring might prove useful for those interested in China's future political evolution? We would suggest at least three indicators bear close scrutiny. One will be exactly how much autonomy the market is finally able to claim, given the ongoing tug-of-war between security and propaganda hierarchies on the one hand and entrepreneurs, intellectuals, consumers, and their bureaucratic patrons on the other. It seems likely that the point of no return in this determination will be property rights: will the government privatize, and in what precise way? Property is most accurately conceived as a bundle of rights, and if these rights are downloaded it will be interesting to see in what mix, to whom, and with what qualifications. The answer will affect the overall balance between society and the state and the ultimate prospects for democratization. The trend line over the course of the reform era has clearly been toward downloading more and more property rights, first because the users do not otherwise take responsibility for or properly maintain property they do not own, and second because the government has not been able to manage these assets profitably and thus finds it expedient to divest itself of liabilities. But as noted above, privatization involves a subtle confidence game between government and the private sector in which the latter promises the former to respect its political strictures in exchange for the autonomy to ignore them. A second factor will be to what extent the market can be regulated and equilibrated to preclude market failure. The government has been sensitive to the need to perform this newly conceived task effectively, has upgraded its personnel training and recruitment policies toward that end, and its overall record has been impressive. In the mid-1990s, the government used financial reform to pull the economy out of its inflationary binge and tame the business cycle, and in the late 1990s it used fiscal policy to pull it out of the deflationary spiral that ensued. Its achievements in bureaucratic downsizing, SOE and housing reform, albeit incomplete, have surpassed even those of the preceding Deng Xiaoping regime.[65] To be sure, much remains to be done: factor markets and the wholesale sector are still relatively unmarketized, and inadequate transportation infrastructure, regional trade barriers, and overcapacity in various areas of commodity manufacture indicate that national markets are insufficiently integrated. Third, to what extent can the negative externalities of marketization be contained, such as large and apparently unjustified income inequalities, unemployment, and cadre corruption? An emergent externality that has proved particularly galling to the authorities is the use of China's small but rapidly expanding computer network—in itself a prized harbinger of the nation's leap into high-tech—by free-riding political and sectarian dissidents, who have used it to coordinate their resistance. It is in this third area that the government's record has hitherto been perhaps least reassuring, and its increasing attempts since 1998 to muzzle the press and implement a security crackdown on internal dissent and visiting foreign scholars indicates inter alia that the leaders are acutely sensitive to their vulnerability. True, the balance between eliminating negative externalities and throttling the market is inherently a delicate one—human rights considerations aside.

Upon successful answers to these questions will depend the overall credibility of the market institution, which will surely affect its future popularity and capacity to embrace other areas of life—such as politics. To the extent that the government encounters difficulties in any of these areas, market development will tend to stall and the leadership is likely to retreat and resort to coercive and/or preceptoral techniques to contain dissent, boost the economy and maintain the political status quo. Yet the short-lived post-Tiananmen retrenchment indicated that barring a totally unanticipated complete market collapse, the leadership cannot go "home" again. The bottom line is the market's indisputable success at boosting GDP growth and raising living standards, which despite all "externalities" has given it greater credibility than the Party's ideological promises. It is a tribute to this performance that the government now defines its legitimacy in terms of its ability to manage the market. And despite the ideological incongruence involved, there are political advantages (aside from the market's economically superior performance) in the shift from plan to market. As in bourgeois democracies, the market serves as a useful, seemingly neutral cushion to diffuse dissent. To the extent that it succeeds, the leadership can claim credit and fight the business sector for a share of the profits. The risk is on the downside: market systems, being highly mobile and exposed to myriad stimuli, tend to be politically effervescent, while one-party dictatorships tend to lack the requisite circulation of elites to absorb protest and adapt quickly (as most recently demonstrated in the Asian Financial Crisis). Should China's socialist market fail, the future of "people's democratic dictatorship" becomes an increasingly bald calculus of coercive power versus quasi-revolutionary "turmoil."

Notes

1. Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 1957), pp. 68-69.
2. See respectively Polanyi, *Transformation*, pp. 53-69; C. B. Pacpherson, *The Political Theory of Possessive Individualism: Hobbes to Locke* (London: Oxford University Press, 1962), pp. 37-58 *et passim*; and Fernand Braudel, *Civilization and Capitalism: 15th-18th Century*, vol. III, *The Perspective of the World*, trans. Sian Reynolds (New York: Harper & Row, 1984), pp. 620 ff.
3. Polanyi, *Transformation*, p. 132.
4. Gabriel Almond and Sidney Verba, *The Civic Culture* (Boston: Little, Brown, 1965).
5. Polanyi, *Transformation*, p. 65.
6. Victor Nee, "A Theory of Market Transition: From Redistribution to Markets in State Socialism," *American Sociological Review*, vol. 54 (October, 1989), p. 663.
7. Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), p. 19.
8. See Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton: Princton University Press, 1992), and Zbigniew Brzezinski, *The Grand Failure: The Birth and Death of Communism in the 20th Century* (New York: Scribner's 1989).
9. Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993* (New York: Cambridge University Press, 1995), pp. 41-42.

10. For a survey of the prereform state-owned marketing and distribution system, see Andrew Waltson,"The Reform of Agricultural Marketing in China since 1978", *China Quarterly,* no.113, (March 1988), exp. pp.5-13; see also Sun Shengming et al. eds. *Zhongguo Shehuizhuyi Shangye Shijian Sishi Nian* [China's Forty Years' Practice of Socialist Commerce] Beijing, 1991)
11. See Wei Feng et al. eds. *Zhongguo Gongxiao Hezuoshe Jianshe* [The Development of China's Supply and Marketing Cooperatives], Zhengzhou: Henan Renmin Chubanshe, 1992).
12. Cf. Liu Siwei *Zhongguo Shangping Shichang Fayu Yianjiu* [Studies in the Development of China's Commodity Markets], Changsha: Hunan Chubanshe, 1996; Liu Shuinian ed., *Dangdai Zhongguo Wusi Liutong* [Contemporary China's Material Circulation], Beijing: Dangdai Zhongguo Chubanshe, 1993.
13. As more than amply documented in Red Guard polemical writings during the Cultural Revolution.
14. Lowell Dittmer, *Liu Shaoqi and the Chinese Cultural Revolution* (Armonk, NY: M. E. Sharpe, 1998, 2nd edition).
15. See Bo Yibo, *Ruogan Zhongda Jueche yu Shijian de Huigu* [Reminences of Some Major Decisions and Incidents] Beijing: Zhongyang Dangxiao Chubanshe, 1993), Vol. 2, Chap. 40.
16. See Lowell Dittmer, *China's Continuous Revolution* (Berkeley: University of California Press, 1987).
17. Industry, agriculture, science and technology, and national defence.
18. A concept borrowed from Igantius Wiboro. See his "From 'Vanguard Party' to 'Rearguard Party': New approach by the Chinese Communist Party in the countryside" (unpublished paper, the East Asia Institute, National University of Singapore)
19. Ibid. p. 13.
20. Especially the so-called "wholesale markets" analyzed by Watson.
21. See Nee, "Organizational dynamics." His point is that this process shifts power away from state hierarchy. However, we should note that many of these market participants (including the most powerful ones) are themselves state actors.
22. See Lance Gore, "Growth without Privatization: the Non-economic Motives for Economic Development among China's Bureaucratic Entrepreneurs" (Singapore, The East Asia Institute working paper)
23. *Shiyi Renmin Jiuyi Shang, Haiyou Yiyi Daikan Zhang*.
24. See Barry Naughtton, *Growing out of the Plan*.
25. If these entrepreneurs were not cadres or family members of cadres, they would hasten to join the Party in order to make useful business contacts; and the more successful they became the more they would typically seek to do so, to avoid the glass ceiling that could otherwise be expected to impede further expansion. Beginning July 1, 2001, the Party's cooptation of capitalists was made official in a speech by Jiang Zemin marking the Party's 80th anniversary. *Washington Post*, July 2, 2001, p. 1.

26. Although in retrospect, the period of stable institutional development was fleeting indeed, consisting of a few months surrounding the 8th Party Congress. It was preceded by land reform,"socialization of the means of production,"thought reform of urban intellectuals, the Three Anti and Five Anti movements; and followed by the Hundred Flowers, Antirightist Movement, and the Great Leap Forward. See Timothy Cheek and Tony Saich, eds., *New Perspectives on State Socialism in China* (Armonk, NY: M. E. Sharpe, 1997).
27. L. Dittmer,"Patterns of Elite Strife and Succession in Chinese Politics,"*China Quarterly,* no. 123 (September 1990), pp. 405-430.
28. Watson made the same argument, in"The Reform of Agricultural Marketing."
29. (Zhou Zexi and Hu Jingen eds., p.39-1) accoding to the State Planning Commission, the planned prices of all commodities in the first half of 1992 were below world market price, among which, crude oil was lower by 77.3 per cent, timber by 66.6 per cent, corn by 59.2 per cent, wheat by 32.4 per cent and copper by 32.7 per cent, while those of domestic market prices were significantly higher: copper higher by 14.5 per cent (21 per cent in 1991), lead by 12.6 per cent (26 per cent in 1991), soya been oil by 69.6 per cent (86.7 per cent in 1991).
30. *People's Daily,* January 8, 1982, cited in Solinger *China's Transition from Socialism,* p.247.
31. Even in 1990 the central government selected 234 key enterprises to put into a "double guarantee" system: the state guarantees the supply of factors of production and the enterprises guarantee profit and taxes turned over to the state and production under the state directive plan. However, when material supply became abundant since the mid-1990s, such arrangements became unnecessary.
32. However, here the profit motive is mixed with the survival motive: according to author's interviews, stagnant salaries, shrinking budgets and rising inflation have often made the normal operation of and even the subsistence of the members of many units impossible without additional income.
33. Interview with officials at the State Council's Development Research Center in 1997.
30. Rajeev Batra,"Executive Insights: Marketing Issues and Challenges in Transitional Economies,"*Journal of International Marketing*, v. 5, n. 4 (1997), pp. 95-114.
35. That is, outside their official line of business or railway transportation. These include hotels, department stores, restaurants and manufacturing.
36. Zhang Delin, *Chanquan: Guoyou Qiye Gaige yu Guoyou Zhichan Jianguan* [Property Rights: The Reform of State-Own Enterprises and the Monitoring and Management of State-owned Assets] (Beijing: Zhongguo Cajing Chubanshe, 1993), p.53.
37. *Ibid.*
38. *People's Daily* (overseas edition) May 3, 1995.
39. Author's China interviews.

40. *People's Daily* (overseas edition), May 3, 1996.
41. In 1998, the government made determined efforts to cut the ties between businesses and their parent organizations in the party-state, the military, the police, the court, the state-owned banks etc. It is yet to be seen how these efforts transpire in reality, especially in the localities where cadres have grown dependent on these enterprises, financially and otherwise.
42. According to state regulation then, market trading of all first category and most second category materials were strict prohibited. Liu Shuinian ed., *Dangdai Zhongguo*, p.104.
43. See list, *Dangdai Zhongguo*, p.104.
44. *Dangdai Zhongguo*, p.120-1
45. *Dangdai Zhongguo,* p.127
46. *Dangdai Zhongguo*, p.122
47. See Dorothy Solinger, *China's Transition from Socialism,* esp. chapter 10.
48. See Gabriella Montinola,Yingyi Qian, and Barry Weingast"Federalism, Chinese Style@ *World Politics,* October 1995.
49. For another examples, the button market of Qiaotou township of Zhejiang accounts for 85 per cent of the country's sale of buttons, and 700 hundred or so button manufacturers sprang up in the vicinity, producing 70 per cent of the nation's buttons.
50. He Guanghui, *Zhongguo Chengshi* [China's Cities] Ti 1 Pan. (Beijing: Gaige Chubanshe: Xinhua Shudian Congdian Beijing Faxingsuo Faxing, 1990).
51. See Solinger, *China's Transition from Socialism*, p.236.
52. A province renowned for government zealots and stupidity.
53. *You Jihua de Shangpin Jingji*. Note here the term"market economy" (*shichang jingji*) is avoided in favor of"commodity economy"(*shangpin jingji*), indicating the lingering ideological taboo associated with the market and its capitalist tendencies.
54. However, this round of recentralization ended in total failure because of the level of marketization the economy had attained during the 1980s and the promarket interests developed within in the state.
55. See Lance Gore,"Market Communism", esp. Chapter 4.
56. See Lance Gore,"The Communist Legacy in Post-Mao Economic Growth."
57. See Chaudhry,"The Myth of the Market and the Common History of Late Development."
58. Luo Gan"On the Plan for Party-State Institutional Reform,"1993.
59. Worried about the dissipation of state assets in the process, Zhu Rongji soon found himself parroting the new official line in the Chinese news media that "selling is not the only method of reforming small and medium-sized SOEs."
60. Batra,"Executive Insights."
61. The argument was that the market mechanism being adopted had its own inherent"laws,"as Xue Muqiao put it in an influential article published in the early 1980s, and that if the market were adopted these were simply part of a function-

ally autonomous package, much like the manual that accompanies a newly acquired desktop computer.

59. Chen Zongsheng, Wu Zhe, Xie Siquan, et al., *The Extent of Marketization of Economic Systems in China* (Huntington, NY: Nova Science Publishers, 2000).
63. Bruce Gilley, "People's Republic of Cheats," *Far Eastern Economic Review*, June 21, 2001. Much of these market gains apparently become flight capital: in 2000, some US$64 billion flowed into Hong Kong from the Mainland in the form of FDI, almost equalling the $63 billion that left Hong Kong for investment elsewhere (often, back in the PRC). The coincidence of the two figures leads to the suspicion the funds are being laundered. David Lague, "china's Money Industry," *ibid.*
64. G. W. F. Hegel, *Philosophy of Right*, trans. with notes by T. M. Knox (New York: Oxford University Press, 1st ed., 1958).
65. See Yingyi Qian, "The Institutional Foundations of China's Market Transition," unpublished paper prepared for the Annual Bank Conference on Developmental Economics, Washington, DC, April 28-30, 1999; and Dali L. Yang, "Remaking China: The Transformation of Governance and State-Economy Relations in the Age of Great Reform," unpublished manuscript provided courtesy of the author, 2000.