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China's Evolving Economic System: What's in a Name?

How China Became Capitalist by Ronald Coase; Ning Wang; Capitalism From Below: Markets

and Institutional Change in China by Victor Nee: Sonja Opper

Review by: Jane Golley

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China's Evolving Economic System: What's in a Name?

Review Article

Jane Golley

How China Became Capitalist, by Ronald Coase and Ning Wang. Houndmills: Palgrave Macmillan, 2012. xii + 256 pp. £60.00/US\$100.00 (hardcover).

Capitalism From Below: Markets and Institutional Change in China, by Victor Nee and Sonja Opper. Cambridge MA: Harvard University Press, 2012. xviii + 431 pp. US\$45.00 (hardcover).

When I was asked to review *How China Became Capitalist*, co-authored by a Nobel Laureate in Economics and University of Chicago Professor, I didn't hesitate to say yes. Unfortunately, from the preface onwards I suspected that I was going to be disappointed. This begins with a reference to Stephen Cheung, who called China's economic transition from a Communist system to capitalism "the greatest program for economic reform in history" (p. x, italics added). The book's first contradiction follows immediately thereafter, in what is to become its overarching theme: "Cheung's conclusion is doubtless correct, but what is equally extraordinary is that the series of events that led China to become capitalist was not a programme and that the final result was entirely unexpected" (p. x, italics added). In an endnote, the authors add:

Terms like "capitalist" and "capitalism" are bound to invite controversy. China today remains committed to socialism, calling itself a "socialist market economy with Chinese characteristics". Some readers in China may protest against our wording of the title. That China is still ruled by the Chinese Communist Party will probably lead many western readers to challenge us on our choice of title as well. Nonetheless, China has transformed over the past three decades from a broken economy where the market and entrepreneurship were banned to a vibrant one where market forces prevail and private enterprises blossom. Our book explains how this happened.

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Invite controversy they have! How could this statement be relegated to an endnote in the preface of a book entitled *How China became Capitalist?* Surely, the authors of a book of this title would first define what they meant by "capitalism", before demonstrating that the so-called "socialist market economy with Chinese characteristics" had—at some specified point in time—become not only consistent with this definition but also inconsistent with "socialism", the meaning of which they would also need to define. Surely they would also provide clear, convincing measures of the prevalence of market forces and the blossoming of private enterprises across China, given mounting evidence to the contrary. Would not these issues be central in a book of which the thesis is that China has already become capitalist, and by accident?

Apparently Ronald Coase and Ning Wang thought not. Chapter 1 describes China at the "Death of Mao", setting the tone with lines such as: "An enterprising people were quickly reduced to lifeless cogs in the socialist machine" (p. 1). The chapter provides a patchy account of the Maoist era, with references to the "tragic" adoption of the Soviet model of economic central planning, the "inherent anti-populism" of socialism (its "fatal flaw"), the persecution of the intellectuals and so on, culminating in the perception that dramatic change was considered necessary by the time of Mao's death in 1976. Chapter 2 covers the ideological shift that occurred in the two years after that, emphasizing the Chinese leadership's lack of a blueprint for market transformation (which weakly supports the thesis that capitalism arrived in China by accident), but also the leadership's pragmatic approach to reform and steadfast commitment to facilitating the growth of productive forces by whatever means necessary (which contradicts it).

Chapter 3 focuses on the period from 1978 to 1987, and provides a reasonable depiction of the changes that occurred "along the margins of the socialist economy, where state control was at its weakest" (p. 46). Coase and Wang identify four marginal revolutions: in agriculture; rural industrialization; the "individual" private economy (spatially concentrated around Wenzhou); and the integration of the Special Economic Zones into the global economy (also, obviously, spatially concentrated). Their key point is that these marginal revolutions underpinned China's economic success during this period and placed it firmly on the capitalist development path, which is a valid argument.

Rather than proceeding chronologically, Chapter 4 also begins in the early 1980s, with disparate sections on the failure of early enterprise reforms, the ideological dilemmas of the Chinese government, the dominance of Deng Xiaoping and Chen Yun in Chinese politics through the 1980s, price reforms, the Tiananmen incident and more. What Chapter 4 does not do is delve into how the four marginal revolutions expanded over time and/or space post-1987, which is what is needed to demonstrate how and when the country actually became capitalist. This is particularly problematic, given that Yasheng Huang explains how precisely the opposite occurred during the 1990s, and argues that policy reversals have resulted in "China's transition to capitalism" remaining incomplete.¹

Coase and Wang acknowledge this policy reversal in Chapter 5, which begins with the wave of political campaigns in the early 1990s against "the fledgling private sector as the economic bastion of bourgeois ideology" (p. 107): clearly a time during which private enterprises did not blossom. The chapter then meanders towards the conclusion that "capitalism with Chinese characteristics" was brought about (and, it seems, is defined) by "the development of a common national market, the privatization of state enterprises and the rise of regional competition" (p. 152). This odd definition does not accord with Huang's more apt definition of "capitalism with Chinese characteristics" as "a function of a political balance between two Chinas—the entrepreneurial, market-driven rural China *vis-à-vis* the state-led urban China", nor with Christopher McNally's related definition of "Sino-capitalism", nor any other definition that I have come across.³

Chapter 6 reverts to the late 1970s to explain China's dual-track transition to capitalism—one state-led (and therefore not accidental), and one grass-roots (but tolerated by the state and therefore also not accidental). After dismissing the idea that China is a form of "authoritarian capitalism" or "state-guided capitalism", the authors conclude: "Readers who have followed our account of how China became capitalist have good reasons to dismiss such a statist interpretation of China's economic reform as self-serving propaganda of the Chinese Communist Party" (p. 175). The chapter goes on to explain how the lack of a free market for ideas in China "has become the most restrictive bottleneck in China's economic and social development" (p. 199), although whether this lack of freedom is a defining feature of their notion of Chinese capitalism is unclear. As the book draws to a close, I do not seem to be alone in my confusion, with the authors stating:

^{1.} Huang devotes Chapter 1 of his book to the question of "Just how capitalist is China?", and shows that the share of the private sector in China's total economy, when properly measured, remained very small, even as late as 2005: Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (Cambridge: Cambridge University Press, 2008), p. 259. (Note: page numbers cited refer to the Kindle version of the book). According to this measure, then, China's economy is not very capitalistic at all.

^{2.} Yasheng Huang, Capitalism with Chinese Characteristics, p. 132.

^{3.} In particular, see the definitions of "entrepreneurial", "state-led", "oligarchic" and "big-firm" capitalism, and the discussion of how China's economic system features elements of each of these, in William Baumol, Robert Litan and Carl Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (New Haven: Yale University Press, 2007). For definitions of *guanxi* capitalism and "Sinocapitalism" (on which more below), see Christopher McNally, "China's Changing *Guanxi* Capitalism: Private Entrepreneurs Between Leninist Control and Relentless Accumulation", *Business and Politics*, Vol. 13, No. 2 (2011), Article V, and Christopher McNally, "Sino-Capitalism: China's Re-emergence and the International Political Economy", *World Politics*, Vol. 64, No. 4 (2012), pp. 741–76; see also McNally's reflections on capitalism in the Chinese context (Christopher McNally, "Reflections on Capitalism and China's Emergent Political Economy") in Christopher McNally (ed.), *China's Emergent Political Economy: Capitalism in the Dragon's Lair* (London and New York: Routledge, 2007), Chapter 2 (pp. 17–35).

It will take us decades, if not centuries, to fully explain why China became capitalist the way it did, resolving all intriguing puzzles. But we must first establish a solid understanding of how China became capitalist and ascertain exactly what we have to explain before we can possibly venture any causal explanation. (p. 202)

This quote is one of dozens that illustrate how the doubts prompted by the preface of this book were realized: it presents a disappointing, although admittedly extremely thought-provoking, account of how China supposedly became capitalist.

Victor Nee and Sonja Opper's Capitalism From Below: Markets and Institutional Change in China excels in every way in which the book by Coase and Wang does not. Like Coase and Wang, Nee and Opper downplay the role of the state in explaining China's economic transition, arguing that the emergence and growth of the private economy was neither envisioned nor anticipated by China's political élite. They focus on the informal norms and social networks of enterprises and individuals, whose actions underpinned bottom-up capitalist institutional change and enabled enterprises and individuals to thrive in an emerging market economy, despite the lack of formal rules safeguarding their property rights and the initial disadvantages of having to function outside the state-owned enterprise system.

The book is beautifully structured and written, making it far easier to summarize than Coase and Wang's. Chapter 2 presents a simple, clear conceptual framework for an "endogenous multi-level causal model of institutional change", on which the rest of the book builds. Chapter 3 introduces the seven surveyed cities that are the focus of the book's empirical analysis, and presents the survey methodology (with the full set of survey questions provided in an appendix). Chapter 4 focuses on the various institutional innovations and forms of cooperation used by credit-constrained peasants-turned-entrepreneurs to start up and expand production. Chapters 5, 6 and 7 build on this idea by examining how these entrepreneurs minimize the costs of operating outside the state system, relying on various organizational strategies, marketing networks and industrial clusters, and labor standards and norms. Chapter 8 examines the capacity of the private sector to innovate, expand and move up the value-added production chain, followed by a brief consideration of the role of political connections in Chapter 9, and conclusions in Chapter 10. Throughout the book, theory is combined seamlessly with anecdotal evidence and survey-based analysis, all placed in historical context to present an extremely cohesive, readable and convincing account of the re-emergence of entrepreneurialism in China during the last three decades.

The Nee-Opper thesis is consistent with the "entrepreneurial, market-driven rural China" half of Huang's definition of "capitalism with Chinese characteristics".4

^{4.} Yasheng Huang, Capitalism with Chinese Characteristics.

For Huang, this is without doubt the better part of China's emerging capitalist system, and he argues that the Chinese economy has prospered whenever it has been allowed to dominate. Nee and Opper's book strengthens Huang's argument, and updates it with the use of 2009 survey data. It also provides partial support for Coase and Wang's thesis, in that private enterprises are shown to be "blossoming" in select parts of the country. Importantly, however, the book's focus on just seven cities in the Yangzi Delta leads Nee and Opper to acknowledge: "Clearly, our study does not aim to represent China as a whole. As in earlier studies of the rise of capitalism in the West, our intention is to study the regional sprouts of capitalist production, which may only gradually spread to other regions to eventually alter the nature of the entire national economy" (p. 71). Thus a key question that emerges from Nee and Opper's book is whether, when and how this form of entrepreneurial capitalism might spread across the country to become the dominant form of capitalism in China.

It is impossible to answer this question without reflecting on the interactions between Chinese entrepreneurs and the state. Nee and Opper do this in Chapter 9. Here they consider the prospects for state capitalism in China, by which they mean the co-existence of markets as the main coordinating mechanism in the economy and the political hegemony of the Communist Party, and which implies the importance of state-company relations utilizing personal connections to acquire economic advantage. They provide evidence that the value of political connections is on the decline, concluding: "Markets not only create the incentives for profit making; they also provide the opportunities to decouple from the political sphere as producers shift from unproductive rent seeking to productive entrepreneurship" (p. 258). This conclusion fits in neatly with their depiction of a resilient, innovative and expansionary private sector, and suggests that the authors see "entrepreneurial" capitalism—one of the "good" forms of capitalism defined by William Baumol, Robert Litan and Carl Schramm, in which the state plays a fairly minimal role—as the logical end point of China's capitalist transition.

This end point is far from guaranteed, however. McNally stresses the importance of political *guanxi* networks for China's private entrepreneurs in his version of "Sino-capitalism", which embodies a unique combination of "top-down state-led development with bottom-up entrepreneurial private capital accumulation". Although his research resonates with Nee and Opper's in its emphasis on informal institutions and social networks, it differs in its focus on private–state linkages that enhance entrepreneurs' chance of success in a state-dominated system, thereby sustaining a critical role for the state as well. Recent commentary

^{5.} William Baumol, Robert Litan and Carl Schramm, Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity.

Christopher McNally, "China's Changing Guanxi Capitalism", and Christopher McNally, "Sino-Capitalism".

^{7.} Christopher McNally, "Sino-Capitalism", p. 744.

on the "renewed concentration of power in the state-controlled segment of the economy" following the global financial crisis in 2008–09, and on the 145,000 state-owned enterprises with deep ties to the Communist Party élite, indicate that the top-down vs. bottom-up "competition" in China's economic transition is far from over. These and other complex interactions between market and state will critically shape China's multifaceted and ever-evolving economic system, regardless of the name that is used to describe it.

According to Ezra Vogel, 10 Deng Xiaoping never believed that he was experimenting with capitalism without using its name, despite his critics who claimed the contrary. Instead, Deng saw single-Party rule, public ownership of the land, a dominant role for state ownership and state economic planning as essential components of "socialism with Chinese characteristics", a phrase he is credited with adopting. 11 In his keynote report at the 18th National Party Congress in November 2012, outgoing President Hu Jintao stated that "the path of socialism with Chinese characteristics, the system of theories of socialism with Chinese characteristics and the socialist system with Chinese characteristics are the fundamental accomplishments made by the Party and people in the course of arduous struggle over the past 90-plus years". It is highly unlikely that the new generation of leaders under President Xi Jinping will deviate from this long-established Party line, particularly given that Deng's checklist can still be used to characterize the Chinese economy today. As an early indication of this, in Xi Jinping's opening address at the Congress he not only reiterated the points made by Hu Jintao but also referred to "socialism with Chinese characteristics" 75 times. 13

Despite maintaining throughout his life that China was firmly on a socialist path, Deng also expressed the view that it was unnecessary to ask if something was called "capitalism" or "socialism". More than two decades later, I would argue to the contrary. There is a glaring gap between the official Chinese perception of a deliberate transition towards "socialism with Chinese characteristics", at one extreme, and that of an accidental transition towards entrepreneurial capitalism,

^{8.} Stephen Roach, "China Changes Leaders: Reform and Open Up", *New York Times* (8 November 2012), http://www.nytimes.com/2012/11/09/opinion/china-should-reform-and-open-up.html (accessed 14 November 2012).

^{9.} Keith Bradsher, "China's Grip on Economy Will Challenge New Leaders", *New York Times* at http://www.nytimes.com/2012/11/10/world/asia/state-enterprises-pose-test-for-chinas-new-leaders.html?pagewanted=all&_r=0 (accessed 14 November 2012).

^{10.} Ezra Vogel, *Deng Xiaoping and the Transformation of China* (Cambridge MA: The Belknap Press of Harvard University Press, 2011), p. 400.

^{11.} Ezra Vogel, Deng Xiaoping and the Transformation of China, p. 684.

^{12.} See "Hu: China to Follow Path of Socialism with Chinese Characteristics", http://news.xinhuanet.com/english/special/18cpcnc/2012-11/17/c_131981259.htm (accessed 30 November 2012).

^{13.} See "Jinjin weirao jianchi he fazhan Zhongguo tese shehui zhuyi" (Uphold and Develop Socialism with Chinese Characteristics), http://news.xinhuanet.com/2012-11/19/c_123967017.htm (accessed 30 November 2012)

^{14.} Ezra Vogel, Deng Xiaoping and the Transformation of China, p. 685.

at the other. This gap calls for ongoing efforts to clarify the nature of China's economic system, not only at the margins or in the Yangzi River Delta but in urban China, inland China and Party-state-controlled China as well. Otherwise, we may never truly understand what Ronald Coase and Ning Wang rightly call the great story of our time.