

# Institutional Foundations of Chinese Economic Growth

## *An Introduction*

At the core of China's "economic miracle" is a massive upsurge of rural industrialization. The decade of the 1980s saw the economy take off in vast areas of the Chinese countryside. By 1987 rural industry surpassed agriculture as the dominant source of total rural income.<sup>1</sup> Total output generated by rural enterprises rose almost ninefold from 1980 to 1987,<sup>2</sup> as output of rural enterprises grew more than 26 percent annually from 1978 to 1990.<sup>3</sup> These industries have yielded close to one-quarter of China's total exports.<sup>4</sup> Between 1978 and 1990, the percentage of the rural labor force engaged in village and township enterprises more than doubled,<sup>5</sup> and the 57 million new jobs created from 1978 to 1986 alone

1. *Zhongguo tongji nianjian*, 1988, p. 214.

2. In absolute amounts, gross value of output from rural industry rose from 49 billion yuan in 1980 to 474 billion yuan in 1987. In 1988 total output value rose another 36 percent, constituting well over 50 percent of total rural output and almost one-quarter of total national output. Frederick Crook, "Current Problems," p. 12. *Zhongguo xiangzhen qiye nianjian*, 1978–1987, p. 569, provides a useful statistical summary of the changes in collectively owned rural enterprises from 1978 to 1987.

3. Zhang Hongyu, "China's Land System Transformation and Adjustment of Agricultural Structure—Reviewing China's Rural Reform and Development Since 1978," *Liaowang zhoukan* (overseas ed.), 25 November 1991, no. 47, pp. 16–17, translated in *FBIS-CHI-91-241*, 16 December 1991, pp. 52–54.

4. David Zweig, "Export-Led Growth," pp. 21–22; see also "Broad and Profound Impact of the Development of China's Township Enterprises," *Jingji daobao*, 20 October 1987, pp. 34–35, translated in *JPRS-CAR-87-061*, 31 December 1987, pp. 23–25.

5. It rose from 9.5 percent to 23.83 percent. Research Office of the State Council, "Town and Township Enterprises as a Motive Force in the Development of the National

equaled the total number of workers hired in all state-owned enterprises between 1952 and 1986.<sup>6</sup>

Such dramatic growth in any political system would be significant. What makes China's experience analytically noteworthy is that growth occurred without significant political change. While the late 1980s and early 1990s saw all communist governments fall from power in the Soviet Union and Eastern Europe, in China the Communist Party was in the midst of instituting economic reforms that have resulted in rapid and sustained growth. In contrast to its Leninist cousins, China refused to take bitter medicine to transform its economic system quickly with what has come to be known as the "big bang" approach.<sup>7</sup> Most notably, it firmly refused to privatize.<sup>8</sup> The private sector today is booming, but this is a product of the 1990s. China in the 1980s maintained state and collective ownership of enterprises and refused to free prices completely or abolish rationing. But it also reintroduced the market and embarked on reforms around the edges of the old system. Central planning was jettisoned only gradually, with some remnants still evident even today.

Most unexpected was the role that local communist officials played in the rural industrialization process. The rapid takeoff of China's rural industry was the result primarily of local government entrepreneurship. What lies behind this response of local cadres to reform initiatives? That is the central question posed by this book. This study seeks to illuminate how China's institutional changes—specifically, altering fiscal flows and property rights—prompted local officials in a socialist system to pursue

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Economy," *Jingji yanjiu*, 20 May 1990, no. 5, pp. 39–46, translated in *JPRS-CAR-90-066*, 29 August 1990, pp. 34–42.

6. Huang Qingde, Wang Chengde, and He Daofeng, "The Relationship Between Agriculture and Industry in China's Economic Development: Economic Growth and Structural Change," *Shijie jingji daobao*, 11 January 1988, p. 7, translated in *JPRS-CAR-88-011*, 8 March 1988, pp. 26–29. The World Bank has estimated that between 1980 and 1986, nonagricultural rural employment grew 14 percent per year; during this period, the non-agricultural labor force increased by 124 percent, or over 30 million people. The World Bank figure, however, includes only laborers in nonagricultural material-producing sectors (i.e., industry, construction, transportation, and commerce) and excludes the service sector. William Byrd and Qingsong Lin, "China's Rural Industry: An Introduction," p. 18.

7. This is most closely associated with Western economists such as Jeffrey Sachs. See, for example, his *Poland's Jump to the Market Economy*.

8. Privatization of large state-owned firms was a topic of intense debate up to the time of China's decision to begin the process in 1997. See, for example, "Maoist Document Criticizes Reforms," *South China Morning Post*, 18 July 1997, p. 10; and "Jiang's State Sector Reform Strategy Revealed," *South China Morning Post*, 29 July 1997, p. 9.

rapid industrial growth. The book also seeks to understand the political consequences of such growth.

## STATE AND DEVELOPMENT

To suggest that government intervention leads to successful economic development is nothing new. The many studies of state-led development in Japan and the East Asian newly industrializing countries (NICs) have highlighted the importance of government policies and institutions.<sup>9</sup> What is new is to cast *local* government in the lead role of the development process. Even more surprising is that these governments are communist. Such systems have generally been assumed to be incapable of reform.<sup>10</sup>

At the beginning of China's reform era, believers in a rapid market transition assumed that local cadres would simply fade from the scene or become "regulators" in an economy of household entrepreneurs, as the distribution of power shifted to producers.<sup>11</sup> Those who focused on how reform would rob communist officials of their power, which was rooted in the Leninist system of central planning and control,<sup>12</sup> argued that local cadres would resent and resist the reforms.<sup>13</sup>

Those who hold to the accepted wisdom about communist systems would probably think China's economy is booming because local officials are merely taking advantage of opportunities to line their own pockets. This is consistent with numerous stories of cadre corruption.<sup>14</sup> While one cannot discount such explanations, the spectacular and sustained

9. Among the earliest and best known is Chalmers Johnson, *MITI and the Japanese Miracle*. Johnson's more recent views on the Asian capitalist model and the role of the state in the economy are summarized in his "Capitalism: East Asian Style." Other works include Daniel Okimoto, *Between MITI and the Market*; Robert Wade, *Governing the Market*; and Kent Calder, *Strategic Capitalism*.

10. János Kornai, *Road to a Free Economy*; Jan Winiecki, "Soviet-Type Economies"; and Merton Peck and Thomas Richardson, eds., *What Is to Be Done?*

11. Victor Nee, "Theory of Market Transition."

12. Barrett McCormick, *Political Reform in Post-Mao China*.

13. See, for example, Helen Siu, *Agents and Victims in South China*; Richard Latham, "Implications of Rural Reform"; and David Zweig, "Opposition to Change."

14. Among the numerous reports of cadre corruption and profiteering, see "Party Members, Cadres Resign to Enter Private Business," *Chiu-shih nien-tai*, 1 January 1993, translated in *FBIS-CHI-93-017*, 9 March 1993, p. 1; "Vice Minister Called 'Culprit' in Bribery Case," *Ming pao*, 19 June 1993, translated in *FBIS-CHI-93-117*, 21 June 1993, p. 24; "Officials Arrest Cadres for Illegal Fund Raising," *Wen wei po*, 17 June 1993, translated in *FBIS-CHI-93-115*, 17 June 1993, p. 11; and "Anhui Village Cadres Arrested for

growth of China's economy suggests that corruption alone is an insufficient explanation.

Believers in the market might argue that a better place to look for an explanation of China's rural industrial success (and the NICs' success in general) is the rapid growth in inputs into the system, such as the huge amount of surplus labor available in China.<sup>15</sup> Some have suggested that China's rural industry would be just where it is today, even without state intervention, simply as a result of market forces.<sup>16</sup> Inputs and market demand must be taken into account, but neither explanation addresses the timing of the take-off or the dominance of publicly owned township and village enterprises over private ones.

Others who have explicitly rejected what they see as the "statist" view of China have gone to the other extreme, attributing the success of China's rural reforms wholly to "society." Some of these observers have attributed the changes to the "unorganized power of the peasants";<sup>17</sup> others refer to a "societal takeover."<sup>18</sup> While such conclusions are fashionable in the wake of the demise of communism, they fail to answer the crucial question of where peasants obtained capital and resources to fuel China's economic takeoff when personal savings were meager and the market in its infant stage of development.

Given the failures and problems associated with state intervention not only in Leninist systems but more recently in the East Asian NICs, it is not surprising that some would resist the notion of a successful state-led development effort in post-Mao China. But not all state intervention is the same. Market economies also have some form of state intervention.<sup>19</sup>

The experiences of Eastern Europe and Russia suggest that the lack of institutional support forced many new private firms to sink before they learned to swim. As Evans has pointed out, "The appropriate question is not 'how much' but 'what kind' [of state intervention]."<sup>20</sup>

A different explanation might posit that China properly laid the foundation for reform by first ridding the bureaucracy of possible opposition

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Abuses," *Zhongguo qingnian bao*, 22 April 1993, translated in *FBIS-CHI-93-081*, 29 April 1993, p. 9.

15. Paul Krugman, "Myth of Asia's Miracle."

16. Edward Steinfeld, *Forging Reform*.

17. Kate Xiao Zhou, *How the Farmers Changed China*.

18. Minxin Pei, *From Reform to Revolution*. Pei's "takeover coalition" includes local officials as well as peasants.

19. For two insightful essays on this issue, see Paul Streeten, "Markets and States," and Kiren Aziz Chaudhry, "Myth of the Market."

20. Peter Evans, *Embedded Autonomy*, p. 10.

and installing a new breed of farsighted, well-educated officials eager to serve the interests of reform. The reason China's local officials have responded more positively to reform is that they are not the same communist officials of the past. Such a hypothesis, while useful, can take us only so far. China's reformers did try to eliminate the deadwood in its bureaucracy to improve and revitalize its cadre force, but their success was limited and appears to have been most evident at the higher levels of government.<sup>21</sup> Many of the local officials who are now leading rapid economic development are the same people who presided over a minimally functioning economy during the Maoist period.

Alternatively, one might also argue that because China is a communist system, its local officials have what Murrell and Olson call an "encompassing interest" that is much stronger than that held by officials in democratic regimes to make their economy grow rapidly. In such situations, the person with dictatorial power has "a property right in his society. . . . Just as the owner of a firm has an incentive to make the firm as valuable and productive as possible."<sup>22</sup> Murrell and Olson have dictatorial leaders such as Stalin in mind, but they state that "any leader with complete control over a society has an encompassing" interest in the productivity of that society. To the degree that such arguments are valid, they would apply primarily to the *lowest* level of the political system (i.e., the villages) where one-person rule is common. Some village leaders do seem sincerely to believe in the superiority of collective ownership.<sup>23</sup> But villages alone are not responsible for the rapid growth of industry. The theory does not explain the behavior of the supporting cast—the bureaucracy at different levels of local government above the village—in the growth process.

One other explanation is that China is still a mobilization system. Rather than taking local initiative, officials are being forced by administrative fiat to pursue growth to meet central-level targets. The success of the one-child policy certainly suggests that mobilization has not disappeared from the political scene.<sup>24</sup> Such an explanation, while plausible, could never sufficiently explain the degree of enthusiasm with which

21. See the work on bureaucratic reform by Hong Yung Lee, *Revolutionary Cadres to Party Technocrats*; and Tyrene White, "Political Reform and Rural Government."

22. Peter Murrell and Mancur Olson, "Devolution of Centrally Planned Economies," p. 253.

23. Zweig found this to be the case early in the reform period. See his "Opposition to Change." In my interviews I found cadres with similar beliefs, even at much later stages of the reform process.

24. Tyrene White, "Postrevolutionary Mobilization in China."

local governments have spearheaded growth. We know that local cadres during the Maoist period only minimally complied with central directives. An explanation needs to be given for why communist officials at the local levels departed dramatically from their previous patterns of behavior.<sup>25</sup>

## A PROBLEM OF AGENCY

There is no need to make assumptions about the nature of communist officials—either that they are corrupt or that they are motivated by lofty ideals that lead them to want to enrich their communities. Compliance with central directives in a communist system cannot be assumed. Whether officials comply is an agency problem like that in any bureaucratic hierarchy.<sup>26</sup>

For China the issue was not whether its bureaucracy was capable of generating economic growth but whether it had the incentive to do so. During the Maoist period, the constraints of the state plan and fiscal system provided localities with little inducement to generate additional revenues. Localities were required to turn over all or most of their revenues to the upper levels, which in return provided budget allocations for expenditures. The use of whatever surplus that remained within the locality was subject to higher-level approval. Rather than initiate growth, localities had incentives to try to extract as much bureaucratic slack as possible from the upper levels in the form of larger budget allocations.

China's bureaucrats could be mobilized to action, but Maoist ideology distorted incentives. Words and actions became manifestations of political attitude—what is termed *biaoxian*. Expression of such attitudes became intertwined with economic performance and was measured by ability to meet and exceed economic quotas.<sup>27</sup> Pressure to exaggerate economic performance contributed to the massive famine during the Great Leap Forward as rural cadres exaggerated production and sought to outdo each other in the sale of grain to the state, even when their own village populations had little or no grain for their own use.<sup>28</sup>

25. There is the problem of inflation of statistics, but even if that is taken into consideration, the growth is still significant.

26. See Terry Moe, "New Economics of Organization," on the usefulness of agency theory for understanding bureaucratic control.

27. Examples of this in rural and urban areas can be found respectively in Oi, *State and Peasant in Contemporary China* and Walder, *Communist Neo-Traditionalism*.

28. Bernstein, "Stalinism, Famine, and Chinese Peasants." On the famine itself, see Banister, *China's Changing Population*.

It was not the Maoist state's inability to foster economic development but the ideology and the goals of state intervention that undermined its effectiveness. Chalmers Johnson calls communist systems "plan ideological" and the capitalism of developmental states such as Japan "plan rational."<sup>29</sup> He notes that using similar policy instruments, the latter fosters market competition whereas the former, guided by a socialist ideology, replaces the market and fosters an egalitarian distribution of resources and income.<sup>30</sup> China had an "industrial policy," but its all-inclusive rather than selective scope hindered rather than promoted economic efficiency. Unlike a "plan rational" economy like Japan's, wherein state intervention is limited by a commitment to private property and the market, the Maoist state closed free markets in 1957 and created a state monopoly for the procurement and sale of most goods and services. Factories were told which products to make and in what quantities, given the materials for production, at what price to sell their finished products, and to whom the products were to be sold.

Like East Asian NICs, China had the power to "get the prices wrong," but the purpose of price setting was to ensure inflation control and an equal distribution of goods and resources within a socialist ideological context, not to provide manufacturers a comparative advantage in a competitive world market. Production hinged not on costs or on sales but on the state agencies' plan. The plan determined demand and limited consumer choice.

This book examines what happened when China's local officials were presented with a new set of incentives in the reform period. It begins with the simple premise that local officials in a communist system, like officials in any political system, are rational actors who respond to incentives and existing constraints within the limits of their cognitive ability to evaluate alternatives and process information.<sup>31</sup> Their response to reform can be determined only by looking at the concrete circumstances that affect their behavior as *agents*: incentives, constraints, skills, and resources available to those who are responsible for implementing reform and the effectiveness of monitoring by the central state as the principal. It cannot be predicted on the basis of past performance or ideological orientation.

29. Chalmers Johnson, *MITI and the Japanese Miracle*.

30. Applebaum and Henderson, in "Situating the State in the East Asian Development Process," try to refine Chalmers Johnson's distinction between plan rational and plan ideological by further dividing systems into "market ideological" and "market rational." China remains in the "plan ideological" quadrant.

31. I am here assuming bounded rationality. Herbert Simon, *Administrative Behavior*.

Bureaucratic behavior is a consequence of whether “net incentive effects upon key officials are positive or negative, and to what degree.”<sup>32</sup>

This study thus departs from previous work that focused either on the center or on the peasants.<sup>33</sup> It shifts the focus of inquiry from the center to the localities, and from the peasants to those officials charged with the day-to-day implementation of the reforms. To be sure, the reforms would not have succeeded to the extent that they have if China’s peasants had not enthusiastically responded to calls to “dare to stand out” and to “get rich first.” But one cannot extrapolate from the response of the peasants to decollectivization and growth of the agricultural sector to explain the rise of rural industry. To understand the latter, one must examine the role of local governments.

A local-level approach to the study of reform and development recognizes the role of the central government and its political elite in the formulation of policy—it is the center that establishes the institutions of rule.<sup>34</sup> The successful economic reform process in China began with the formulation of policies at the national levels of government by a fairly small political elite led by Deng Xiaoping.<sup>35</sup> Without the green light from above, or at least from key elements within the central leadership, it is unlikely reform would have occurred.<sup>36</sup> But although enlightened reform initiatives from the center are a prerequisite for institutional change, well-intentioned policies do not ensure successful implementation, as the failures in the Soviet Union and elsewhere suggest.<sup>37</sup> While it is useful to understand how different elites and factions within the central leadership

32. Anthony Downs, *Inside Bureaucracy*, p. 201.

33. An exception is the wide-ranging study of local government and its economy during the reforms by Marc Blecher and Vivienne Shue, *Tethered Deer*.

34. As Robert Bates, *Miracle of the Market*, p. 149, notes for other developing contexts, “whether the interests animating political conflict in agrarian societies results in ideologically motivated clashes or in private struggles among competing particular interests depends at least in part upon the structure of political institutions and the incentives they generate for politicians. The analysis of political change in rural societies thus must explicitly incorporate the study of national political settings.”

35. On elite-level politics involved in the formulation of China’s reforms, see Joseph Fewsmith, *Dilemmas of Reform in China*; also Susan Shirk, *Political Logic of Economic Reform*.

36. For a contrasting view, see Daniel Kelliher, *Peasant Power*, who argues that once the peasants instituted the household responsibility system, the leaders had no choice but to follow. Zhou, *How the Farmers Changed China*, takes a similar, if more extreme, position.

37. For comparative discussion and examples, see Merilee Grindle, ed., *Politics and Policy Implementation*; and Merilee Grindle and John W. Thomas, *Public Choices and Policy Change*.



jockeyed for power and to be aware of the support that each gave to policies regarding rural industry,<sup>38</sup> that information fails to provide a satisfactory explanation of how these ideas were transformed into rural industrial growth and why that growth took the form that it did in different parts of the countryside. One needs to zoom in on the local levels, to those whose responses in the end determined whether China's policies toward rural industrialization were implemented.

The statist literature rescued the "state" from "society," but it is necessary to heed Lowi's reservations about viewing the "state" as "a unitary, solitary reality that can be brought into theory as some kind of a measurable force."<sup>39</sup> This is doubly important when the state in question is usually categorized as a "strong" state.<sup>40</sup> The assumptions underlying such a label do little to illuminate the process of political and economic transition that is occurring in the former communist countries or in a reforming communist system such as that of China.<sup>41</sup> Local-level officials in China are members of the official bureaucracy and professionals in a "well-bounded" system;<sup>42</sup> they act as part of the administrative apparatus, as part of the "state," but local governments are distinct entities apart from the central state and society, with their own agendas, and increasingly with their own resources.

This study is an institutional analysis of economic development at the local level that views local officials as political and economic actors distinct from the central state.<sup>43</sup> It delves into the process of economic development to examine the changing political and economic contexts in which local officials operate. It asks how institutional incentives affect the adoption of certain development strategies and how local governments calculate and maximize their interests. It explores the mechanisms by which localities have satisfied diverse interests and dealt with their su-

38. See, for example, Dali Yang, *Calamity and Reform in China*, chap. 8.

39. See Theodore Lowi, p. 891 in Eric Nordlinger, Theodore Lowi, and Sergio Fabbrini, "Return to the State." See also my *State and Peasant*, chap. 1.

40. Joel S. Migdal, *Strong Societies and Weak States*.

41. For a useful critique of the artificial line drawn in the literature between state and society, see Timothy Mitchell, "Limits of the State."

42. They are not those whom Eric Nordlinger, *Autonomy of the Democratic State*, identifies as coming in and out of the state.

43. In this study, I adopt North's broader definition of institutions as "a set of the rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interest of maximizing the wealth or utility of principals." This definition focuses attention not only on existing structures but also on policies, such as reform initiatives, adopted at the center and passed on to the local governments for implementation. Douglass North, *Structure and Change*, pp. 201–2.

periors at higher levels of government and with subordinates below. It considers the effect of the resource endowments that local officials have had at their disposal, the constraints they have faced in making their choices, and the changes that have occurred over time.

## PROPERTY RIGHTS AND ECONOMIC GROWTH

North and Weingast, among others, point to the importance of secure property rights for economic development.<sup>44</sup> Scholarly discussion has been limited, to a large extent, to market economies, with a focus on law that protects the assets and income flows of companies or individuals—those who own and operate the firms within a market economy—from arbitrary expropriation by government. The importance of this principle underlies the felt need in formerly socialist countries such as Poland and Russia to privatize. There is, however, no inherent reason why only individuals or privately held companies, as distinct from governments, can be entrepreneurs. Similarly, there is no inherent reason why property rights are effective incentives only if they are assigned to non-government entities.

Privatization need not be the sole path to economic growth in reforming communist systems—and, in any event, it has nowhere yielded results approaching those obtained in China. Publicly owned firms may be capable of playing the same role as privately held firms. This study examines the impact of the assignment to local governments of new property rights over surplus revenues beginning in the 1980s. It assumes that growth can occur when property rights are given to such organized entities under a regime that provides sufficient incentives to pursue growth.<sup>45</sup> Furthermore, given that these rights were granted to local governments by the central state pursuant to a policy change and were not guaranteed by law, this study raises the question of how secure these rights have to be. Are predictability and stability of property rights—what is sometimes called *credible commitment*—sufficient? This is most puzzling in light of the dramatic growth of the private sector in the 1990s. All evidence suggests that China still lacks what most in the West would see as “clear and secure” property rights for private business.

44. Douglass C. North and Barry Weingast, “Constitutions and Commitment.”

45. For a theoretical statement on this aspect of property rights as an incentive, see Yoram Barzel, *Economic Analysis of Property Rights*.

This study is intended to provide some insight into how to reconcile the lack of such protection and the growth of both collective and private business.

## LOCAL STATE CORPORATISM

Property rights and incentives are essential but not sufficient to explain China's rural growth story. There remains the question of how such growth was achieved in a state that was still communist. Accepting the view that communist officials want to maintain their power, one would expect them to spur economic development only to the extent that it does not jeopardize their political positions. This study examines how collectively owned industrial enterprises better served both the political and the economic interests of local cadres during the initial stages of reform. It also examines the more puzzling shift in strategy in the 1990s when local governments turned from their earlier strategy and began promoting the private sector, even selling some of the collectively owned enterprises for private operation. This study details how in China the administrative power of local officials helped to facilitate rather than hinder the rapid economic development, first of the collective and then of the private sector.

My answers to these questions center on the merger of government and economy in the reform period, resulting in an institutional development that I label *local state corporatism*. The term *corporatism* requires some elaboration, because the way I use it differs from the way it has been used in previous studies and because my own use of the term has evolved over time. First, I am not concerned with the role of the central state in the vertical integration of interests within society as a whole. This departs from general uses of the term by such writers as Schmitter,<sup>46</sup> as well as from the recent use of the term by those studying China.<sup>47</sup>

46. Philippe Schmitter defines *corporatism* as "a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, noncompetitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports." "Still the Century of Corporatism?" pp. 93–94. Joseph Fewsmith, *Party, State, and Local Elites*, following Schmitter's definition, uses a similar understanding of corporatism to describe China during the Republican period.

47. Others have recently begun using the term *corporatism* in Schmitter's sense to understand the relationships between different interest groups and the central state. See Anita Chan, "Revolution or Corporatism?"; Mayfair Yang, "Between State and Society"; Peter

The corporatism that I describe is constituted and coordinated by local government—specifically counties, townships, and villages—not central authorities.

The central state set the reform process in motion and provided localities with the incentives and the leeway to develop economically, but local government has been the activist state that has determined the outcome of reform in China. My use of the term *corporatism* follows those who stress that corporatism need not refer to the unit that does the organizing and aggregating, but denotes a form of state-society relations where narrow interests within society are organized and integrated so as to achieve higher-order goals—namely, stability and economic growth for the state and society as a whole.<sup>48</sup> *Local state corporatism* is my attempt to describe a context that exhibits the essence of the category “corporatism” as it has been traditionally used, but contains sufficient differences to warrant a separate category. The modifiers *local* and *state* are meant to specify these differences.<sup>49</sup>

Second, in this book my use of the term *corporatism* is intended to convey both a “corporate” and a “corporatist” meaning. In my earlier formulation, local state corporatism was used primarily to highlight the workings of local government and the economy that it oversees as a corporation.<sup>50</sup> That stemmed from the dominance of the collectively owned enterprises in the 1980s. It was primarily the corporate nature of growth that first led me to adopt the term. I used it to highlight the ability of local government to intervene directly by virtue of its ownership of these firms. Local governments ran their firms as diversified corporations, redistributing profits and risks, and thereby allowing the rapid growth of rural industry with limited resources. Local governments took on many

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Nan-shong Lee, “Chinese Industrial State”; and Jonathan Unger and Anita Chan, “China, Corporatism.” While these studies provide some useful insights, it is questionable whether the central state at this point is corporatist. Local governments are much more able, because of the smaller size of the community, to exercise control and offer effective inducements to create a corporatist relationship. The center may formulate guidelines, but it is the localities that hold the power to decide which groups are actually treated as legitimate and what treatment they will receive.

48. Ruth Berins Collier and David Collier, “Inducements Versus Constraints.”

49. This is what David Collier and James E. Mahon would call a second-category specification of the broader term *corporatism*. “Conceptual ‘Stretching’ Revisited.” Giovanni Sartori would probably call this “traveling,” but it is not “concept stretching.” “Concept Misformation in Comparative Politics.”

50. My earlier formulation is contained in “Fiscal Reform and Economic Foundations.”

characteristics of business corporations, with officials serving a role equivalent to that of a board of directors.<sup>51</sup>

In the 1990s a new aspect of local state corporatism emerged as local governments moved from simpler and more cadre-centered forms of governance to a mixed model appropriate to a vastly larger industrial economy consisting of both private and collectively owned firms. The degree to which the local corporate state has been able to restrain the private sector from becoming an independent economic class points to the emergence of a corporatist rather than a free market system, at least at the local levels. This feature of the local corporate state has led me to broaden my initial focus to accentuate and incorporate the corporatist meaning of the term *corporatism*. I see the Chinese case as a subcategory of *state corporatism*.

Corporatist groups in Schmitter's definition of state corporatism "were created by and kept as auxiliary and dependent organs of the state which founded its legitimacy and effective functioning on other bases."<sup>52</sup> Collier and Collier highlight the point that in state corporatism, interest associations are "dependent and penetrated."<sup>53</sup> What needs clarification in the Chinese case is the interest associations that are being penetrated and made dependent. Most instances of corporatism have been found in historical situations where the interest groups are fully formed and a central state steps in to control the existing organizations.<sup>54</sup> The corporatist nature of the local state-society relationship in China is obscured because the local state, as part of a functioning Leninist state, has the ability to prevent the formation of independent groups.

The most politically significant group, and the group that historically has contained the seeds of a civil society and has been a precursor to a more democratic system of rule, is the private entrepreneurs.<sup>55</sup> Theories

51. I present a preliminary version of this argument in "Chinese Village, Inc." Others have made similar analogies between local governments and business entities. See, for example, articles in William Byrd and Qingsong Lin, eds., *China's Rural Industry: Structure, Development, and Reform*.

52. Schmitter, "Still the Century of Corporatism?" pp. 102–3.

53. Collier and Collier, "Inducements versus Constraints," p. 978.

54. See, for example, Alfred Stepan, *State and Society*, especially part 1. Stepan uses *corporatism* to refer to "a particular set of policies and institutional arrangements for structuring interest representation. . . . In return for such prerogatives and monopolies the state claims the right to monitor representational groups by a variety of mechanisms so as to discourage the expression of 'narrow' class-based, conflictual demands. Many . . . have used such corporatist policies for structuring interest representation" (p. 46).

55. For a classic statement of the link between an independent economic elite and democracy, see Barrington Moore, Jr., *Social Origins of Dictatorship*.

of market transition predicted that these “producers” would wrest power from local officials.<sup>56</sup> But as of now, this has yet to occur in China’s countryside. The present study will investigate the constraints that local government applies to the private sector, but it will also show that inducements are offered to private firms under local state corporatism.<sup>57</sup> The corporatist nature of this relationship offers an explanation of how communist cadres in China can promote the emergence of an economic elite that in other settings would be independent and therefore threatening. It provides clues to interpret the loosening of control in a Leninist system.

### INSTITUTIONAL REFORM, INCENTIVES, AND CHANGE

John Zysman argues that “by following the money flows in the market economy and in the institutions that structure that flow we can learn a great deal about the uses to which the society’s resources are put, the people who make the allocative decisions, and the process through which control is obtained and exerted.”<sup>58</sup> I utilize this approach to study the impact of changes in China’s fiscal flows on local governments and on those who serve within them.<sup>59</sup>

Fiscal flows were altered by two institutional changes in the early 1980s. One was decollectivization, the second was fiscal reform. The enthusiasm with which local officials embraced economic development stemmed directly from these two policies. Decollectivization and the return to household production robbed villages and townships of rights to the income from agricultural production. The fiscal reforms hardened budget constraints on local governments while, at the same time, granting local governments rights to and use of surplus revenues generated from development. The conjuncture of fiscal reforms and decollectivization in the early 1980s presented officials at the county, township, and village levels with both the necessity and opportunities for economic growth.

56. This development is explicit in Nee’s theory of market transition. “Theory of Market Transition.”

57. On corporatism as a combination of constraints and inducements, see Collier and Collier, “Inducements Versus Constraints.”

58. John Zysman, *Governments, Markets, and Growth*, pp. 7–8.

59. There are a number of macro-level studies of financial control in transition systems, including Ronald McKinnon, *Order of Economic Liberalism and Gradual versus Rapid Liberalization*; and Richard Bird and Christine Wallich, “Local Finance and Economic Reform.”

But whether economic growth takes place depends on more than incentives. The particular configuration of resource endowments, political constraints, skills of local leadership, and severity of budget constraints determined the variations in responses to institutional incentives in different localities in China. Consequently, no single pattern adequately describes development during the reform period.

Finally, the successful use of one set of incentives may undermine the effectiveness of another. The incentives offered to the localities to pursue rapid growth have had unintended political consequences in the behavior of local officials as agents of the central state. The last part of the book analyzes the corollaries of rapid rural industrialization, as well as the effects of the buildup of local resources, on the central state's ability to control the development process that it has unleashed so successfully.

## PRÉCIS OF THE STUDY

Chapter 2 describes how decollectivization and fiscal reform changed the rules for the disposition of locally generated revenue. It presents the institutional framework that has allowed localities to benefit from the residual revenue generated by economic growth. Interests and incentives created by these new rules are shown to have provided the impetus for the rapid development of rural collective industry. The discussion is limited to the county, township, and village levels—those most directly involved in rural industrialization.

Chapter 3 considers the intervening variables that determined the response of different localities to the institutional reforms and the incentives embedded within them. This chapter sketches the geographical and temporal variations in the development of rural industry. In an attempt to unveil the logic of local development, it considers factors that affected the selection of particular types of strategies. It considers how changes in the political and economic context influenced the evolution of management and ownership forms in rural industry from a predominance of collectively owned enterprises to today's more varied mix of collective, private, and shareholding systems.

Chapter 4 examines the sinews of the local "corporate" state. It details the mechanisms that have allowed local governments to foster rapid rates of growth. It lays out the constraints and inducements local governments use to mobilize and co-opt different types of rural industry—including the private sector—to serve their own interests. It stresses that key strategies and tools used to achieve economic growth are derived