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A Fresh Look at the Development of a Market Economy in China¹

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EDITOR'S NOTE

Translated from the French original by Jonathan Hall

- 1 Over the last 23 years China's GNP has increased sevenfold. In terms of purchasing power parity (PPP), China is number two in the world, and it has the sixth largest volume of external trade. In 2002, China was the leading recipient of foreign investment. These impressive figures are behind the widespread view that the country is experiencing an "economic miracle". The special features of Chinese culture, and the former system of socialist planning, are additional factors in the mystery of this success. It is also believed that WTO membership, which thrusts China into the slipstream of globalisation, will totally change the rules of the game in the national economy. Under this view, China is set to become the new world centre for manufacturing, taking over this role now current to South-East Asia. The optimists believe that the present phase of modernisation will be completed in the next twenty to fifty years, making the Chinese economy the largest in the world by 2030. They extend this Chinese "miracle" to the political sphere, believing that the transformed economy will have become the driving force in Chinese society. Once the new rules of the game are in place, the prospects are for the resultant economic development to bring about the emergence of an urban middle-class bourgeoisie, and this will favour democratisation of the regime. Already new generations are growing up in the cities in an environment strongly affected by the technological revolution and globalisation.
- 2 In a speech to Chinese academics, Milton Friedman predicted that "anyone who can give a clear account of the reform process in China, will win the Nobel prize in economics". The main focus of all economic analyses is centred on the institutional changes, known as "reform and opening" (gaige kaifang) implemented by Deng

Xiaoping from 1979 onwards. So every discussion is concerned with trends in economic policy, and particularly with positing a contrast between the Chinese policy of gradual reforms ² and the “shock therapy” adopted by the Soviet Union. But for all this very real interest, these perspectives remain at the macro-economic level. There is a need to go further and examine the operations of the economic institutions and agencies responsible for wealth creation, such as the Chinese enterprises, public institutions, foreign investors, and organisations to promote technological development ³. We propose to take a new look at Chinese growth by examining more closely the operations of the systems of production, since these are the real creators of that growth. It is only understanding this that the veil of mystery surrounding the “growth miracle” will be lifted, as it would anywhere else ⁴. We will take the example of the south, not because it is China’s most dynamic area in economic terms but because Guangdong contains a multiplicity of productive systems, thanks to its being the earliest to open up and therefore the fastest to develop⁵.

- ³ China is a particularly interesting case for economic theory, and for a comparative approach to economic and socio-political analyses. It confronts us in a new way with questions over the role of government in economic development⁶, forcing a fundamental rethink of the social bases of growth. Studies which restrict their analysis to the gradual transition of the socialist regime to the market economy, such as those which focus narrowly upon “privatisation”, seem to overlook at least three relevant areas of investigation: the renewal of the oldest of the systems of production, the role of the state as promoter and regulator of economic activity, and the degrees of efficiency achieved by the systems of production that appeared with the reforms. In this article we would also like to raise, however briefly, the question of the growth and durability of the different structures of production. To this end, we will resituate the empirical studies of separate enterprises within a wider frame of reference, showing that Chinese economic expansion is largely due to its being investment-driven, and that the economy itself is still quite a way from being demand-driven. This explains a considerable number of the practical difficulties encountered by all the enterprises. The main question is whether this new economy and its systems of production can sustain themselves. By “systems of production” we mean the totality of plant and human resources contributing to a productive activity⁷. A system of production may include several enterprises; in fact that is frequently the case in developing economies, where enterprises are subcontracted to those who place orders with them, and whose brand name appears on the finished product. To restrict discussion to the nature of the enterprises themselves would be to focus on the internal organisation of each one, and especially on the nature of its ownership, whereas all the evidence suggests that in China the question of ownership is less important than how the links between the different units of production operate ⁸. Accordingly, our concept of a “system of production” puts the emphasis on the arrangements made for the productive process and its development, as well as on the interrelationship between the sites of production and their users.

Figure 1: Evolution of gross investment in fixed assets (million yuans)

Note: The category of 'private enterprises includes individual companies (getihu), enterprises by shares, and mixed capital companies. The private sector is probably overestimated in this category, and, on the contrary, collective enterprises are hiding really private companies. See Guiheux, 2002, for analysis of these categories.

Source: Zhongguo tongji nianjian 2002 (China Statistical Yearbook 2002), op.cit, Table 6-2, p. 176.

The three waves of investment

- 4 The history of the rapid growth of the Chinese economy can be broken into three successive waves of investment. These waves, and the resulting growth, were not the fruit of an overall strategy on the part of the government and its economic and financial bodies. They were, rather, the outcome of an accidental conjuncture of some perfectly identifiable factors.
- 5 The first phase of the expansion was the result of the industrialisation of the countryside, for initially the reforms were aimed at that sector in particular. The ability to grow and sell products outside the state planning system led to a rapid rise in agricultural production. In the early 1980s the profits from the sale of agricultural products were massively invested in the rural enterprises, the so-called "township and village enterprises" (*xiangzhen qiye*). This growth phase lasted six years, from 1983 to 1988. The investments from it were like manna from heaven for the local authorities and the most adept among the inhabitants of the rural areas. They found themselves in quite exceptional circumstances, given the absence of any competition and the existence of a large demand hitherto unsatisfied by the planned economy. This new economic opportunity permitted the development of an "economy outside the plan" ⁹. There was considerable demand for foodstuffs, clothing and domestic durables. This demand was initially directed at light consumer producers, but it was later redirected towards heavy industry. So at this stage, agricultural resources provided the motor for growth, but the period of rapid expansion was followed, in time-honoured fashion, by a period of overheating characterised by over-investment. By the late 1980s, the buying power of the peasantry began to diminish, and the rural market, which represented 75% of the population, could not sustain the growth in demand. At the same time, all the city families had already satisfied their basic need for durable domestic items, and the upward curve in demand for agricultural products and clothing flattened out. In the early 1990s, therefore, this slowing consumer demand could no longer function as the engine for economic growth. The investment patterns of the previous decade had been directed towards light industry, which is characterised by short-term production and rapid returns. The consequence was overcapacity in the durable consumer goods industry, which meant that the current economic model was no longer viable.
- 6 The early 1990s saw the arrival of another source of investment, so-called "foreign" investment, which mostly came from Taiwan, Hong Kong and overseas Chinese. In

1994, Foreign Direct Investment (FDI) represented 20% of overall investment. In 2001, foreign investment from Hong Kong, Macao and Taiwan continued to represent 18% of the total (158 billion yuan) and 47.5% of foreign investment in Guangdong province (55 billion yuan) ¹⁰. The Chinese government, wishing to take advantage of this capital inflow, set up a great number of economic development zones in the coastal regions. Everywhere “hotels for overseas Chinese” sprang up to accommodate the influx, and these provided the engine for growth in the first half of the 1990s ¹¹. Some of them, like Shenzhen, are still major poles of attraction for foreign investment. Investors were attracted by favourable policies, the nature of the labour force, and the Chinese market. In addition, the common language and cultural proximity, along with shared attitudes towards combining political connections with business, encouraged this source of investment. During this phase, two-thirds of foreign investment was in the hands of small and medium-sized firms from Hong Kong and Taiwan. These made use of labour-intensive production to assemble imported parts and re-export them to supply the international market. This system received the blessing of local officials, since this economic gold also blessed them with great decision-making powers. The enterprises involved did not represent direct competition, either with the China-based township and village enterprises or with the private or state-owned ones. On the other, hand they contributed towards improving the trade balance and towards increasing employment and incomes. Moreover, the demand arising from this poorly paid labour force was directed towards the low-quality products from the communal and the state-owned enterprises. These profited from the growth in domestic demand, and still do. That is why all these enterprises survived throughout this period, despite producing goods which were in many ways outdated (See Figure 1).

- 7 This growth model, which depended upon FDI from Taiwan and Hong Kong, could have lasted for at least twenty years, by following the set pattern of integration with foreign manufacturers. But the Asian crisis of 1997 modified the underlying situation. The developed economies reduced their orders placed with Chinese enterprises, while the latter remained essentially geared to the supply of overseas markets. Simultaneously, the new rates of exchange restored a degree of competitive advantage to the other Asian countries, by making their production costs attractive again ¹². So this second engine for growth no longer worked. The third phase of development began at this juncture, with the arrival of FDI funds from industrialised countries like the United States, Japan and Europe. The Chinese government reacted extremely fast, by adopting a whole range of measures to attract this foreign investment. The huge campaign in favour of entry into the WTO must be understood in this context. That is why WTO membership became the main objective of official policy. Since 1997, investment in real estate has greatly increased, and the big cities have become showcases for China's growth ¹³. Forthcoming events like the Peking Olympic Games in 2008, and the Shanghai Universal Exhibition in 2010, provide an additional seductive appeal to international investors. As a consequence of the spectacular take-off in international investment, capital inflow from Taiwan and Hong Kong has picked up again, and continues to be an important part of the overall FDI in China (See Figure 2).
- 8 Between 1978 and 2002, the value of Chinese exports rose from 10 billion US dollars to 226 billion. In the 1980s, income from exports stimulated domestic demand for basic consumer goods. In the 1990s, exports gave a stimulus to the demand for sophisticated electronic consumer goods, particularly household equipment, making the export trade a major engine for growth. In the second half of the 1990s, China set about stimulating

demand in the sphere of tourism, real estate, and car production. In these ways, the reforms launched by Deng Xiaoping have paved the way for expansion in both consumption and production.

- 9 In a well-known article in *Foreign Affairs*, Paul Krugman defines the nature of the growth in East Asian countries as an effect of resource mobilisation, not of increasing productivity. He was commenting on a little-known article by Alwyn Young¹⁴ and his article concludes that Asia has achieved remarkable growth rates without any corresponding increase in productivity. In his view, these growth rates were more the outcome of mobilising available resources than of increasing efficiency. In short, it was a matter of “more perspiration than inspiration”¹⁵. Essentially, China has been following this model of accumulation, with variations of its own.

Figure 2: Evolution of foreign investments (US\$ billion)

Source: Zhongguo tongji nianjian 2002, op. cit, Table 6-3 p. 177, 'source of funds'.

Figure 3: Industrial production by type of enterprises, 2001. Comparison between China and Guangdong (billion of yuans)

Source: Zhongguo tongji nianjian 2002, op. cit, Table 13-3 p. 425.

- 10 Firstly, average individual income is low and the level of household savings is high. The rapid increase in China's GNP in the first stage of growth was accompanied by an increase in income disparities. Secondly, given the size of the Chinese economy and the importance of regional disparities, a single wave of investment is simply not enough. Thirdly, the Chinese state has a powerful capacity for mobilising resources, and has been able to make use of the structures of production which were actually introduced

to ensure social and political stability. This mode of economic organisation lies at the very heart of its current difficulties.

Productive systems piled on top of each other

- ¹¹ To leave the analysis of the “Chinese miracle” at this juncture would be to commit the error of looking only at the macro-economic data—like the break-up of the economy into separate spheres, the decentralisation of power, and the return of former evils like corruption, gangs, prostitution etc.—taking note only of the consequences rather than the causes of the economic changes ¹⁶. Our view is that these causes are to be found in the systems of production. With each wave of resource mobilisation, there have arisen new enterprises with their own distinct systems of production. It is these which have engendered the growth in production and returns on investment.

The rural enterprise systems of production

- ¹² The first type of productive systems are the township and village enterprises. These enterprises grew up in the early 1980s, and operate as private companies, but for reasons of ideological acceptability they are officially registered as collective enterprises ¹⁷. They work with raw materials and employ low-cost labour, and are concentrated in various sectors of production, which they quickly came to dominate ¹⁸.
- ¹³ At the same time, the larger collective enterprises already in place started to operate as “private” firms. A good example of this is the Yueqing enterprise in Shuikou (Guangdong province). Starting as a tap manufacturing plant, it modernised and became the organising centre of a myriad of small plumbing firms. Consequently, Shuikou township is now at the head of a whole industrial sector selling to the entire country. A large number of other enterprises have set themselves up along the same lines, both in Guangdong and in the rest of China. Well known brand names like Legend, TCL, Hai'er, Konka and Galanz are similar enterprises that arose with the first phase of expansion, and prospered mostly because their status as collective enterprises gave them access to public funds (see Figure 3).
- ¹⁴ All these enterprises ¹⁹ were primarily suppliers to the domestic market, only turning later to production for export. Galanz in Shunde, a town close to Canton, is typical. It started as an assembly plant for microwave cookers, whose step-up transformers and magnetron tubes were imported from Japan for US\$20. The same components imported from Europe cost US\$30. The leaders of the enterprise made a quick visit to the European manufacturers and offered to buy transformers at US\$8 and become the Own Equipment Manufacture (OEM) producer for the European firm ²⁰. The Europeans made their own rapid calculations and accepted the offer. They transferred all their equipment and production lines to Shunde, including their assembly technology. The Japanese offered the same OEM arrangement, with a purchase price for the transformer of US\$5. Today Galanz produces the transformer *in situ* for US\$4, and the enterprise claims to control 30% of the world market and 70%-80% of the domestic market. How has that been possible? In an interview, the owner explained that in Europe the production line runs for six hours a day, and five days a week, adding: “Because of strikes, they actually only work an average of four days, or between 24 to 30 hours a week. I took over their production techniques and set up a system of three eight-hour

shifts, which works out at a 160-hour week. My productivity is six to seven times higher than in Europe, but each wage bill is between 3% and 5% of the European wage”.

- 15 The success of these enterprises is to be explained not only by the match between the foreign clients' search for low costs and Chinese productive capacity, but also by their entering into a stable exchange system along OEM lines. The Galanz factories produce on behalf of two hundred multinational firms from every quarter of the globe. The Chinese enterprise takes care of the manufacturing end while the technology, brand name, and marketing remain in the hands of the foreign multinationals. It is striking how quickly the enterprise has grown, which is why it is a frequently cited example. The quest for increased turnover is a constant factor, with the enterprises taking advantage of their low production costs. In addition, such enterprises actively seek out foreign partners to ensure access to technology and market outlets. What the Chinese enterprises are looking for is this technology transfer, both material (in the form of products, equipment, and processes) and organisational (quality control and management skills).

The systems of production set up by the overseas Chinese investment

- 16 A second type of production system appears in enterprises which were established by the second wave of investment from Taiwan and Hong Kong. Industries producing textiles and clothing, electronics and electrical household goods, were relocated to the Pearl River delta. These enterprises share some features with those of the first wave, but they also have some specifics of their own. Firstly, the investors not only established the enterprises, but brought with them their own networks of suppliers and customers. The Taiwanese and Hong Kong enterprises which set themselves up on the mainland to take advantage of low production costs, were backed by more than thirty years experience as suppliers to the multinationals. In addition, they have their own way of doing business, to which the entrepreneurs from Guangdong were quick to adapt. Secondly, they had more complex production techniques, even in the case of less sophisticated industries like shoes, clothing and basic electrical goods. Thirdly, these overseas Chinese established strong ties with mainland officials and local government bodies. They brought the local power structures into the very operations of their own systems of production. More effectively still, in an increasing number of cases, the local authorities appealed to them to help strengthen technological development and to launch technical education initiatives (such as practical demonstrations, technical training, and apprenticeship schemes). There were also centres to promote technological innovation, aimed at providing technical know-how to enterprises in a particular sector of production (for example, shoes and underwear in Nanhai). In the industrialised world such centres are usually organised by the chambers of commerce or public education bodies. In China, they are handled by the joint enterprises, to which a foreign partner brings both its expertise and its market.
- 17 In the Pearl River delta area, these enterprises owned by foreign capital employ thirty million workers from the most impoverished provinces of China. There are reckoned to be another thirty million potential migrants in the inland provinces, which guarantees continuing low labour costs. The foreign enterprises have easily been able to make use of this situation, turning the whole area into one huge factory, with intense local

concentrations according to the type of products. Shunde is the main centre in China for the manufacture of electrical household goods, Ronggui is the largest centre in the world for air-conditioning unit production, Shaxi is the centre for leisure wear, Humen (Dongguan) for clothing, etc.²¹

- 18 Dongguan, which is close to the border with Hong Kong, is an example useful for examining the operation of the systems of production financed by FDI from Taiwan and Hong Kong. Dongguan is a relatively small town which serves as a centre of production for a great number of specialised products: coffee, computer mice, and other computer components. Its systems of production are known by the expression *sanlai yibu* (literally “three resources and one obligation”⁽²²⁾), and are similar to the Mexican *maquiladoras*, in which products are manufactured from imported materials, and assembled according to models provided by the foreign client. The industrialisation of Dongguan began in the early 1980s, well ahead of the surge in the second wave of investment in the rest of the country, thanks to the relocation of industries from Hong Kong²³. The driving force behind its growth has been the manufacture of OEM products for its clients. Since 1989, Dongguan has attracted numerous Taiwanese enterprises specialising in information technology and shoes, and these have built up a network of local suppliers to reduce the time and cost expended in purchasing raw materials and parts, while meeting the standards set by the needs of international clients. The supply networks provide a link between local and foreign enterprises. They are all members of a single constituted system of production: customers, suppliers and manufacturing units are all closely integrated, and the whole system benefits from the comparative advantage of cheap labour. The parameters are set by the global market, and contributions from the local authorities in terms of innovations or technical support are minimal. The key question confronting these systems of production is how to move on from the stage of providing low-cost assembly to foreign customers, to become complete OEM suppliers, or even achieve ODM (Own Design Manufacture) status²⁴.
- 19 By the end of the 1990s this system had reached its limits²⁵. Production costs were relatively high in comparison with other regions of China. Foreign enterprises were being set up in China with their own supplier networks, and some regions were becoming direct competitors. In Suzhou, close to Shanghai, a number of firms have taken advantage of the cheaper local labour and the availability of direct links with the multinationals. Consequently Suzhou is now about to overtake Dongguan as the world’s largest producer of computer parts. The Shanghai and Zhejiang region has entered into direct competition with Guangdong²⁶. The exhaustion of the model of production in Dongguan is due to the difficulty in upgrading the systems of production. This illustrates a key point in the theory of industrial development, namely that the creation of enterprises is a process quite distinct from their development (see Figure 1)²⁷.

The systems of production set up by FDI

- 20 The third wave of investment was provided by the industrialised countries. Currently, numerous “third generation” systems of production are being piloted by foreign firms. The four hundred largest of these have investments in China. The world’s leading manufacturers of telecommunications and oil industry equipment, cars and machine tools, have already set up their own production networks in China. These investments are often focused on the Shanghai region. Foreign firms begin by setting up a

representative's office, and then establish their production sites. Foreign investors' objectives are no longer just to relocate the manufacturing process to cut costs and then re-export, but to develop a market in China itself (see Figure 4).

Table 1: Basic indicators of foreign companies. Investments and exports (US\$ million)

2001	Number of foreign enterprises	%	Total investments in foreign enterprises	%	Exports from the province	%	Exports of foreign enterprises	%
China	202,308	100.0	875,077	100.0	286,758	100.0	123,233	100.0
Guangdong	41,102	23.3	221,823	25.4	95,838	36.0	54,114	40.8
Beijing	19,602	9.7	92,001	10.5	29,387	11.0	18,642	12.5
Shanghai	18,190	9.0	112,888	12.9	26,864	10.1	15,958	12.0
Fujian	15,403	7.4	51,259	5.9	13,926	5.2	8,288	6.2
Shandong	13,753	6.8	42,516	4.9	18,130	6.8	9,236	6.9
Liaoning	13,158	6.5	63,797	7.3	10,748	4.0	8,299	4.7
Zhejiang	11,184	5.5	34,064	3.9	24,201	9.1	7,009	5.3

Source: Zhongguo tongji nianjian 2002, op. cit, Total Exports: table 17-10, p. 626; Investments: table 17-20, p. 636.

Figure 4: A scheme of the piling-up of productive systems

- 21 These new systems of production are still at a preliminary stage, and the foreign firms involved are beginning to perceive the problems which any enterprise must encounter, in whichever country it first sets up operations²⁸. Even those foreign firms which are already established are still finding it difficult to make any profit. For a foreign firm everything is more expensive in China, from land purchase to building costs, installations, employee recruitment and training, communications with headquarters, relations with government offices handling labour and the environment, and commercial dealings with suppliers. It is more expensive to set up an integral system of production than to collaborate with a local supplier (see Figure 5).
- 22 Unlike the systems of production established under the first two waves of investment, these firms have no difficulty making use of efficient managerial techniques, and in setting up organisational structures geared towards their production goals and their market. Their difficulties arise solely from their relations with their social environment. The future legal and institutional setting within which they will operate, will be a decisive factor for these “third generation” systems of production, and so the foreign investors who back them are relying on the complete opening of the Chinese

economy in accordance with international agreements. It is still too early to make a full assessment of this third wave, and of the eventual outcome of the super-imposition of these three different systems of production on top of each other.

Do the state enterprises amount to a distinct system of production?

- 23 Discussions of the modernisation process in China tend to focus mainly on the emergent systems of production, namely on those which arose after the opening-up reforms. But there is another system of production which is easily overlooked because it is out of harmony with all the talking up of the “miracle”. This system of production, namely the state sector, plays a very important role in the economic ethos of the country.
- 24 Before the reforms, China was a socialist country whose economy was based on the state enterprises. The enterprises, the Party administration, the schools, and the hospitals were all single “work units” (*danwei*), and were in turn all completely integrated into the structure of the planned economy of the single-party state. These “work units” were there not only to produce goods, or supply services and training; they were also charged with major administrative, political and socio-economic functions (like health, education, housing and ration coupon distribution), fulfilling the role of different areas of state administration. This system still remains the social and economic basis of the so-called “socialist market-economy system”. The different newly emergent systems of production have established themselves on top of this underlying economic and political basis of society. For over twenty years now, the reforms have been seeking to improve the operations and achievements of the state enterprises, while also making their property rights and management powers more transparent, but without dismantling the enterprises themselves, along with the political and administrative apparatus of which they are a part. So even though the planned economy may have disappeared, this economic and political system still remains. As the new millennium dawns, this system still includes government administrative offices and Party organs, both central and local, along with social organisations, and state monopolies like banking, radio and TV, and the other media.
- 25 The state enterprises are the very heart of this system. Although they have lost many of their markets to the new systems of production, they still enjoy privileged access to the financial resources of the country. Between 1985 and 1992, the share of the state enterprises in the GNP fell by 6%, but their financial resources only went down by 4.7%. Since 1992, the share of the state enterprises in overall industrial production has continued to decline, but their investments have been increasing by 1.5%. In the 1980s, the government transferred considerable resources to the state enterprises by reducing the taxes on their returns. Next, in order to continue its financial support to the state sector, in the early 1990s the government introduced the sale of public debt in the form of bond issues, and then, in the second half of the decade, it organised support through bank loans, making it easy for the state enterprises to obtain credit at preferential rates. More recently, the government has set up and supported the stock markets with the same goal of financing the state sector. In this way the state enterprises benefit from public financial resources unavailable to the so-called “private” firms, and at the same time they have greater ease of access to other types of resource like, for example, the publicly funded research centres and universities ²⁹. At the present time, the policy

of supporting industrial giants (*zhuada fangxiao*), which is still far from successful, is centred on several very large-scale public enterprises³⁰.

- 26 The state enterprises have not only used their privileged access to finance investment in production. Over the last two decades, a large part of their investments have gone into housing their employees, and into funding social security payments and pensions, that is to say, into the social benefits needed to maintain social stability.
- 27 With the coming of the reforms, the state enterprises underwent major transformations, but their basic nature has not changed. There is no question of entirely privatising the state sector, but rather of selling off certain parts of it to procure new sources of finance. But the offers of shares for management buy-out did not deliver the promised results, and they have since become the focus of intense debates over the chances for personal gain which they afford. A large proportion of these systems of production are in decline, and their future depends on the ability of the government to keep up the flow of investment towards them. The banks and the stock exchange seem only to exist to channel this flow in their direction. And despite everything, these public enterprises still enjoy easier access to other major resources, of a technological nature, than the other kinds of enterprise³¹. So, to a large extent, the challenge facing the state enterprises is to improve their ability to produce more and to innovate.

Uncertainties over the behaviour of the various economic players

- 28 How long will these growth engines continue to perform? And how long can the present structure of the Chinese economy be sustained? These persistent questions dominate all the debates about China. To answer them, a fundamental reflection on the nature of the market economy is unavoidable³².

Figure 5: Investments in fixed assets China (left) and Guangdong (right) (billion of yuans)

Source: Zhongguo tongji nianjian 2002, op. cit, Table 6-2 p. 176.

- 29 Economic development requires trust: that means trust in oneself and in one's own working tools, and trust in the other economic performers, but also trust in the institutions and the rules of the game³³. It has become commonly acknowledged since the work of Karl Polanyi and the economic anthropologists⁽³⁴⁾, that this latter form of trust is an indispensable component of any economic system. This non-material element is a necessary supplement to capital and labour. Mutual trust is the basis for the long-term development of systems of production.
- 30 Although the contribution of trust to economic performance is difficult to quantify, it can be clearly stated that the ability of the economy to continue functioning over a

long period requires certain rules and accepted norms to underpin the relations between the various economic actors. Does this trust between the agents themselves, and towards the economic system as a whole, exist in China today? Have the new systems of production contributed towards its emergence? Has the arrival of a private ownership economy promoted those rules in the operations of the market which respect the rights of the different actors, consumers, enterprises and workers alike?

- 31 Economists who favour the process of gradual change in the Chinese economy give a positive answer to these questions. Their argument is that the gradual introduction of private enterprise is forcing the economic system to adopt the contractual rules necessary for its satisfactory functioning. And indeed, the sheer number of economic reforms, and the massive redrawing of legal provisions, give some grounds for believing in the progressive adoption of new rules which will pay greater respect to the rights of others, and will be less arbitrary in the application of legal sanctions ³⁵. If this proves to be the case, China will have found the magic formula for moving from a socialist economy to a market-based one, without any noticeable crisis, and within a political continuum free from upsets on the scale of those which Russia encountered at the time of the implosion of the socialist system there.
- 32 Better still, according to this view, the population as a whole, and more particularly those who are involved with the emergent systems of production, seem to believe that economic success is all that counts, whether it is that of an individual or of the overall system, and that this individual or collective success will give rise to an improvement in the law, and in social and judicial norms. In sum, the idea is that progress will be the fruit of economic success. Paradoxically, this idea is supported by the legacy from the old socialist ideology which proclaimed a strong belief in economic determinism. Developments in other domains are supposed to come as a result of economic changes ⁽³⁶⁾, so most intellectuals seek economic explanations for social and political developments ³⁷.
- 33 But we should recall that this widely shared belief is itself very new, and it contains two weaknesses. Firstly, only the success stories are highlighted in connection with the emergent systems of production, and only the strengthening of the private sector is given any consideration, not its failures ³⁸. Secondly, the state enterprise system and the overall political structure, which remain firmly under the operational control of the rules governing the Party and the state, are forgotten. Simultaneously with the appearance of the new systems of production, there was a decentralisation of political power to enable greater flexibility in the chains of command, and this was accompanied by an increase in the personnel employed within the new structure ³⁹. At the provincial and municipal levels, the political structures involved saw the birth of a greater freedom of action and a lessening of disciplinary control from the central government. The actors on the lower rungs of the ladder were able to work in their own interests ⁴⁰. Following the reforms, the fiscal powers of the state were reduced, and the commercialisation of the public administration and services was a response to this new situation. The local governments have set up a lot of agencies which charge fees for formerly free services. The universities now charge for their courses. The schools and private colleges have enrolment fees. The hospitals sell their medicine at very high prices.
- 34 The government is encouraging this galloping commercialisation, while at the same time preaching against corruption ⁴¹. But the state itself supports these transactions

because it needs the financial resources which they provide. People's dealings with government agencies are assuming the nature of commercial transactions, like most social relations in China nowadays. This logic of immediate economic interest, without a safety net or institutional restrictions, affects all social activities, inside or outside the political structure.

- 35 This unlimited reign of an “axiomatic of interest”, as Alain Caillé calls it, appears to us to dominate the entirety of Chinese society. The new systems of production have favoured its development, and in the realm of interactions between private economic actors, the overriding rule is competition at all costs, with no regard for trust, and with no other criterion than success or failure ⁴². The really fierce competition is not between the state enterprises or the multinationals, but between the large number of small enterprises, and this has an enormous effect on prices ⁴³.
- 36 Even in the coastal regions, despite their being more open and more accustomed to free market transactions, there is daily evidence of this lack of trust and an absence of clear rules governing business conduct. Not only do enterprises look mostly for short-term profit, without bothering about long-term capital accumulation, but they also seek to avoid partnerships and external input. They focus on speed, rapid expansion, and competitive prices. Even when they know each other by name, which is often the case, the owners of enterprises producing the same items and in the same municipality, never inform each other of their training needs or their labour problems. The large number of dinners which they attend are merely intended to show that everything is alright, not to discuss together their technical, legal or economic needs. A shared space for social intercourse is far from being established. As for the imposition of any official limitation, for whatever motive (including labour and environmental protection rights), this appears to such proprietors as an unacceptable state encroachment into private business, and an infraction of the mandate: “Enrich yourselves!”. Finally, our interviews have shown that the enterprises know their clients well enough, but they do not know the state of their market. Only very few of the owners are able to say whether their market is rising or falling, and very few can give an indication of its size, whether at the national or regional level. This uncertainty is quite clearly at the heart of their behaviour.
- 37 Even the state enterprises are forced into this competitive pattern (⁴⁴), although it is in marked contrast to the known and respected rules which pertain in the political order. Both Chinese and foreign economists talk of an opposition between the market and the state. However, the crucial factor is not to be found in this opposition between the public and the “private” sectors, but rather in the difficulty of even imagining the emergence of an economic sphere outside the political system, in which confidence in a shared respect for the rules would itself be the rule rather than the exception. At present, it even seems rather difficult to maintain that Chinese society is dominated by the market economy, because it lacks the essential ingredient of such an economy, namely respect for the rules which underpin mutual trust. In its place there is deep uncertainty, and this engenders opportunist behaviour, whatever the existing property laws or the kind of market in operation, private or public. That is why it seems vain to believe that the growth of the structures of production outside state control will eventually lead to the adoption of rules which will inspire trust in the proper workings of the market. All indications are that the rules based on the socialist system are still firmly in place. Such things as the laws restricting personal freedom of movement,

budgetary rules, employment laws, purchase regulations in the public markets, and the lack of trustworthy statistics, are all signs that there has been no change in the political system. And in the absence of any rules and standards of proper conduct, established not by force but by general consent ⁽⁴⁵⁾, all that remains is the Hobbesian war of all against all. In the final analysis, this is the actual condition of all the economic relations outside the state, while the latter simply acts as a benevolent onlooker.

- 38 For all the enterprises set up by the first wave of investment, survival is achieved through meeting immediate demand, and this depends on extremely short-term calculations. The very few enterprises which seem capable of reaching a higher level, in technical expertise and in relations with their suppliers and customers, are those which often just happen to have a joint agreement with a foreign partner, or those whose market conditions just happen to force them to make more dynamic choices, such as investing in research and development (R&D), or undertaking engineering improvements. But in any given town, such enterprises can be counted on the fingers of one hand, and in a whole region they amount to no more than a few dozen ⁴⁶. The enterprises belonging to the second wave of investment depend for their survival on their ability to offer their clients a range of OEM items, an ability which they have usually developed before setting themselves up in China. Finally, the Western and Japanese enterprises which have established operations in China have done so precisely for long-term strategic goals, namely to be present as players on the Chinese market ⁴⁷. For these companies the improvement of the legal framework is of crucial importance ⁴⁸.
- 39 For its part, the state enterprise system of production is destined to continue. This is not because of any economic logic, but because of a decision to support them for political and social reasons. For these enterprises, modernisation is still on the agenda. Until now, the modernisation of the state sector enterprises has only been considered from the angle of the ownership of capital. It has been just a question of share sales, financial takeovers, and debt cancellations. But for the state enterprises themselves, as for the banks, productivity remains a key question. This involves improvements in management efficiency, the introduction of planning capabilities, the development of the engineering and R&D side, and the ability to actively adapt and improve products and procedures. All these aspects of innovation seem to us not merely useful but absolutely necessary. What is at stake is not the present sharing of the diminishing pile of goodies, but increasing these firms' capacity to produce real value.
- 40 In the immediate future, the new systems of production will still need to feed the political structure and the state enterprises financially. But they are no longer capable of sustaining the national growth by themselves. To achieve this, a new wave of investments must be encouraged. If growth is to continue in the future, new systems of production will have to appear on the scene. Moreover, the different systems of production will find themselves increasingly engaged in collaborative activities.
- 41 It is too soon to foretell whether a business ethos will take root in China, along with its accepted norms to underpin mutual trust. There is nothing in the present behaviour of those involved which would allow us to believe that there will be a real crystallisation of the private sector in China along these lines. Nor is it possible to believe that the present generation of entrepreneurs will distinguish themselves by their ethical choices. But it is possible that, under pressure from foreign competition, better distribution networks and a greater market sophistication may be introduced. If so,

some enterprises could be encouraged to undertake bolder ventures. All this presupposes solid support from the state, linked to a strategy for the various sectors, and to thorough-going training schemes, as the examples of Japan and South Korea amply demonstrate. Sustaining growth has to go through a strengthening of the systems of production currently in place.

NOTES

1. We would like to thank Professors Cai He, Qiu Haixiong, Wu Nengquan, Xu Yong, Jean Ruffier, Gilles Guiheux (is this the correct spelling?), and Sophie Faure, in addition to two careful anonymous readers of this article, for their many helpful discussions and reflections on China's social and economic development. The research involved was conducted through joint collaboration between the IRD (Institut de Recherche pour le Développement) in France, the Guangdong Institute for Research and Development (ZURIGuD), and the Centre Franco-Chinois de Sociologie de l'Industrie et des Technologies (Zhongshan University, Université de Lyon-3, and the IRD). The opinions expressed are our own. A preliminary draft was a paper presented to the seminar on "Ethics and productive efficiency" at the University of Lyon-3, in January 2003.
2. See Justin Yin Yifu, Cai Fang, and Li Zhou, *Le miracle chinois, Stratégie de développement et réforme économique* [The China Miracle], Paris, Economica, 2000.
3. The view of this growth as miraculous arises from a macro-economic perspective. See Robert E. Lucas' lecture, "Making a Miracle" in his collection *Lectures on Economic Growth*, Cambridge, Mass., Harvard University Press, 2002.
4. There is a large body of literature on Asian economic development. On Japan, see in particular Ian Inkster's excellent book, *Japanese Industrialisation 1603-2000: A Global and Analytical Approach*, London, Routledge, 2000; and on South Korea, A. Amsden's *Asia's Next Giant: South Korea and Late Industrialisation*, London, OUP, 1989.
5. Ezra Vogel, *One Step Ahead: Guangdong Under Economic Reform*, Cambridge Mass., Cambridge University Press, 1989. Since the publication of this work, many others have also shown the persistence of certain economic and social structures. Cf. Thierry Sanjuan, *A l'Ombre de Hong Kong: le delta de la rivière des Perles*, Paris, L'Harmattan, 1999.
6. A critical overview of the role of politics in Asia is to be found in the collection by Henry S. Rowen, *Behind East Asian Growth: The Political and Social Foundations of Prosperity*, London and New York, Routledge, 1998.
7. Jean Ruffier, *L'efficience productive: comment marchent les usines*, Paris, Editions du CRNS, 1996.
8. This is just an indication of the main thrust of our research at the Centre franco-chinois de sociologie de l'industrie et des technologies de Canton.
9. Cf. Barry Naughton, *Growing out of the Plan: Chinese Economic Reform 1978-1993*, Cambridge, CUP, 1995.
10. See *China Statistical Yearbook 2000*.
11. These special economic zones were established in the early 1980s, but their major expansion occurred in the 1990s.
12. Not completely, by any means. Wages bills are higher in the other Asian countries than in China.

13. Cf. the work of Guilhem Fabre, which shows nonetheless that the growth in real estate sales, encouraged by various means, has still been unable to efface the effects of the property bubble brought about by speculation in land values; Guilhem Fabre, *Le miroir chinois de la transition: Genèse d'une crise 1989-2000*, Paris, L'Harmattan, 2000.
14. Alwyn Young, *A Tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore*, NBER Macroeconomics Annual, MIT Press, 1992.
15. Paul Krugman, *The Return of Depression Economics*, London, Allen Lane, The Penguin Press, 2000, pp. 32ff.
16. A good journalistic account of the various opinions on the economic and political future of China is to be found in Gordon G. Chang, *The Coming Collapse of China*, New York, Random House, 2001. A recent special issue of the *China Economic review*, December 2002, Vol. 13, No. 4, also addresses the issue. See in particular the catalogue of problems drawn up by Thomas Rawski in "Will Investment Behaviour Constrain China's Growth?", *ibid.*, pp. 361-372. There is a fiercely critical analysis of the economic reality in China by He Qinglian in "China's Listing Social Structure", *New Left Review*, No. 5, 2000, pp. 69-99. When this was republished in China, in the review *Shuwu* (Changsha, March, 2000), it cost the author his professorial post.
17. Gilles Guiheux (as above), "The Incomplete Crystallisation of the Private Sector", *China Perspectives*, No. 42, 2002, pp. 24-35. Strictly speaking, collective enterprises do not include private enterprises, but actually a good many collective enterprises are "lent" to a private enterprise management team. Often the most important enterprises are to be found in this category.
18. In nine sectors the total output increased in value by 10-15% per year; these were domestic electrical goods, hand tools, paper, domestic chemical products, organic chemicals, furniture, textiles, agricultural products and beverages, and coal and ferrous metals.
19. Collective enterprises, but also shareholder enterprises which took over from the collectives after the change in the law in 1998.
20. The "Own Equipment Manufacture" is an arrangement which allows the supplier to become an integral part of the customer's productive system, as though the parts were produced by the customer himself.
21. See Haixiong Qiu, *Establishing Nanhai as a Technology Model City*, Canton, Research Institute for Guangdong Development, 2001, p. 234.
22. *Sanlai* or "three resources"; these are the raw materials, the parts, and the samples provided by the foreign investor. *Yibu* designates the repayment by the local enterprise to the foreign investor in the form of the finished products.
23. In Dongguan, as in the rest of the province, the impossibility of setting up private enterprises at the time led to the flow of local investment into joint enterprises, thus showering the Hong Kong investors with an additional layer of riches. See the work of Huang Yasheng on foreign investments in China during this period, <http://www.people.hbs.edu/yhuang>.
24. Under the Own Design Manufacture arrangement, the supplier designs his own production methods while still retaining the designation as supplier to a foreign customer. The most systematic study of the training delivered by this technological upgrading is provided by Garay Gereffi, "International Trade and Industrial Upgrading in the Apparel Commodity Chain", *Journal of International Economics*, No. 48, 1999, pp. 37-70.
25. This phenomenon can also be observed in the border regions of northern Mexico, where the *maquiladoras* developed from being simple low-cost assembly plants to become more complex systems of production, participating in the international flows of capital and commodities: the latter are in turn the source of investment capital for the factories located in Mexico or other foreign countries. Not only have the *maquiladoras* changed in form and function, but they have become part of a truly innovative economic and technological dynamism. Cf. Daniel Villavicencio, "Le développement des maquiladoras du Nord Mexique et l'importance des réseaux

binationaux d'innovation", a paper given to the IRD seminar, "Savoir et développement", Paris, January 27th-28th, 2003.

26. It may well be that the current advantage enjoyed by Shanghai over Guangdong is due to the availability of skilled labour. In Shanghai, foreign enterprises seem to occupy the more sophisticated sectors like pharmaceuticals. What we are witnessing is perhaps less the growth of a capacity for autonomous development in this region than the expansion of Foreign Direct Investment in the technology-intensive sectors.

27. The more heavily industrialised areas bring about the dismantling of industries in the less advanced areas. This phenomenon, first noted in the case of the nineteenth century European industrialisation, is being repeated nowadays. Currently the "winning" areas are those which have invested heavily in new technologies, even within the traditional industrial sectors. Cf. Georges Benko and Alain Lipietz, *Les régions qui gagnent*, Paris, PUF, 1992.

28. This has again been verified by a recent enquiry on behalf of French firms, headed by the "Mission Economique de Canton"; see the Report by Verillaud, "Les investissements étrangers en Chine", Mission Economique, Canton, April-May 2002. See also Xavier Richet, Wang Hua, and Wang Wei, "Foreign Direct Investment in China's Automotive Industry", *China Perspectives*, No. 38, 2001, pp. 36-42; and S. T. Walsh *et al.*, "Direct foreign manufacturing investment decisions for China", *Engineering Management Journal*, No. 11, 1999, pp. 31-39.

29. According to informants in January 2002 in Shuikou, a Guangdong industrial centre for the production of plumbing installations, and in December 2002 in Jiangmen, in a collective enterprise producing washing machines. The traditional clientele served by the major industrial research centres has always been the large state enterprises.

30. Jean-François Huchet, "Concentration and the Emergence of Corporate Groups in Chinese Industry", *China Perspectives*, No. 23, 1999, pp. 5-17.

31. Here we have in mind the great number of research and technical development centres. Cf. Gu Shulin, *China's Industrial Technology*, Routledge, 1999.

32. We are referring here to works like Alain Caillé's *Critique de la raison utilitaire*, Paris, La Découverte, 1988; or S. Rosefielde, *Comparative Economic Systems: Culture, Wealth, and Power in the 21st Century*, Oxford and Harvard Mass., Blackwell, 2000.

33. For institutionalist economists, this amounts to trust in institutions. Cf. Douglas C. North, *Institutions, Institutional Change and Economic Performance*, Cambridge, CUP, 1990.

34. Cf. Karl Polyani, C. Arensberg and H. Pearson, *Trade and Markets in Early Empires*, Glencoe, IL, The Free Press, 1957.

35. Thomas Rawski, "China Reform Watch: Turning Point Looming", *China Perspectives*, No. 38, 2001, pp. 28-35.

36. This point of view was also maintained by academics in the United States, like Cui Zhiyuan or Gan Yang.

37. See Hui Wang, "Fire in the Castle", *New Left Review*, 2000, pp. 69-99; he discusses the debates conducted by Chinese intellectuals connected with the board of the journal *Dushu*, and their more or less complete support for so-called "liberal" views in the 1990s.

38. If these are not always failures, they are at least vulnerable. Yang Bing, one of the richest men in China, and an exemplary model, is currently in jail.

39. This provides a component of what Guilhem Fabre calls the "new 'new class'".

40. See Jane Duckett, "Bureaucrats in Business, Chinese-style: The Lessons of Market Reform and State Entrepreneurialism in the People's Republic of China", *World Development*, No. 29, 2001, pp. 23-37. The bureaucracy is very far from being inactive, and the state enterprises by no means live only on the crumbs thrown to them by the central government. On the contrary, such enterprises and local officials are veritable instigators of highly profitable commercial activities. The same point is made by Jean C. Oi, see "The Role of the Local State in China's Transitional Economy", *The China Quarterly*, No. 144, 1995, pp. 1132-1150. The concept of "local state

corporatism” has enjoyed great success in throwing light on the economic operations of the political bureaucracy. A recent application of this idea to the situation in Guangdong is to be found in Qiu Haixiong and Xu Jianniu’s forthcoming article in Chinese, “Analysis of the Guangdong industrial clusters as examples of ‘local state corporatism’”.

41. Discussion of this topic has largely dried up, at a time when corruption is more on the agenda than ever, and when the government is launching campaigns for administrative probity.

42. Several businessmen have told us of cases of pressure, misappropriation, and falsification of invoices, which are sometimes life-threatening.

43. One of our team recently visited a pharmaceuticals firm in Shanghai, and they clearly confirmed that their main worry did not arise from the presence of American firms but from a small private competitor of this sort in Fujian. Nearly all of the private firms that we have visited brought up price undercutting as the only major threat.

44. This competition is the main source of their problems. See Dong Xiao-yuan and Louis Putterman, *Investigating the Rise of Labor Redundancy in China’s State Industry*, Working Paper No. 00-9, Dept. of Economics, Brown University, June 2000.

45. At another time and in different terms, Cornelius Castoriadis called this the social “imaginary”. See Cornelius Castoriadis, *The Imaginary Institution of Society* (1975), tr. Kathleen Blamey, Cambridge Mass., MIT Press and Oxford, Polity Press, 1987; (pb. ed. 1997).

46. Through our own on-the-spot investigations, we are attempting to obtain precise data on these obstacles to growth.

47. Pien Wang, Kulwant Singh, and Wenfeng Tong, *Determinants and Outcomes of Knowledge Transfer: A Study of MNCs in China*, Singapore, Best Paper Proceedings, Academy of Management Conference, 2001.

48. The importance of the stakes here is reflected in Jefferson’s hope that changes in the legal framework will be brought about by pressure from international agreements. See Jefferson, “China’s Evolving (implicit) Economic Constitution”, *op. cit.*