

Economic Transformation in China. The Role of State vs. Market

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Synopsis: The accomplishments of Chinese industry over 15 years of transformation are due to basic government policies building on competition and 'growing out of the plan'. These policies have been supported by existing institutional factors, including general and specific organisational arrangements, as well as institutional innovation at the local, and lately central, level. Other institutional factors, such as the social contract, administrative decentralisation and norms of consensus-building, have been policy constraints. The precise choice of strategy has been affected by the autonomy of main political institutions, through the flexibility of the enfranchisement formula and the authority maintained over bureaucratic agents, and through the mainly bureaucratic control of policy-formulation and implementation. The capability of implementation has been affected by "guandao" (official profiteering), a gradual loss of policy-instruments and bureaucratic coherence (independence of provinces) as well as positively by institutional amphibiousness.

The resulting system is a dual one, dominated by social ownership and the role of an active local state, and grown out of the plan instead of privatised. At the same time, almost all prices have been freed and all kinds of conceivable markets exist. Central government tends towards 'late development strategy', and the main remaining problem is to make large and medium state-owned enterprises responsive to the market. This may reflect a structural contradiction at the heart of the state socialist political economy, directing attention to the question of whose interests the state and market matrices fundamentally serve?

Introductory Remarks

"State vs. Market" is a dichotomic scheme of analysis which is hard to use in the East Asian case. The analyst working on this region is bound to find blurred lines between many conceptual pairs. There is a tendency towards institutional ambiguity and indifferentiability, and the state may be found to be pervasive, without clear boundaries. Its powers and function are diffuse and there has been little respect of due process (Ding, 1993: 317). And what is one - in the Chinese case - to make of a state economy that seems to consist of a large number of competing entities? Or state institutions that act against the state after having developed a separate social identity? The concept institution is used in a broader sense than socially constructed, routine-produced, behaviour-regulating frameworks, in order to encompass both institutions as rules-of-game and wider institutional arrangements at varying societal levels. The present context provides a welcome chance to adopt an institutional perspective, but the ideas below are of course mostly propositions which would need further investigation and in some cases field work.¹

I. Achievements of Industrial Transformation

The accomplishments of China's industrial reform over 15 years are not negligible. Table 1 gives an impression of the changes in ownership structure and the growth of markets.

In this connection and for the arguments in the following, it is important to make a distinction between "*state-owned enterprises*" (SOE) and "*township and village enterprises*" (TVE): SOE's are not independent, because they do not have property rights over state assets. The state can take back any rights granted to them (Pei, 1994: 86). TVE's were originally established with the non-agricultural assets owned by communes and production brigades

¹I would like to acknowledge an intellectual debt to Barry Naughton and Susan Shirk, U.C., San Diego and to thank Maria Edin, Uppsala University for her comments on an oral presentation of this paper.

and are in theory mainly owned by local communities, which have taken an increasing interest in them.

Table 1. Reform Indicators

	1978	1985	1988	1990	1993
<i>Proportion of total retail sales</i>					
Market prices	3%	34%	49%	45%	
Fixed prices					
Guidance prices	neg.	19%	22%	25%	95%
Fixed prices	97%	47%	29%	30%	
<i>Proportion of agricultural procurement</i>					
Market prices	6%	40%	57%	52%	
Guidance prices	2%	23%	19%	23%	90%
Fixed prices	92%	37%	24%	25%	
<i>Ownership structure of industrial production</i>					
State	78%	65%	57%	55%	42%
Collective	22%	32%	36%	36%	40%
Private	neg.	2%	4%	5%	9%
Foreign	neg.	neg.	1%	2%	7%

Reprinted from Barry Naughton, 1995, *Growing out of the Plan. Chinese Economic Reform 1978-1993*, Cambridge University Press, p. 14.

Real output in the state-owned sector doubled during the 1980s, but its share of output fell from 78% in 1978 to less than half in 1994. The total factor productivity of state-owned enterprises actually rose by 2.5% per year between 1980 and 1988 and probably for some years after that. Collective firms, a major component of the TVE-group, mostly owned and controlled by local governments, have a rising share of output (22% in 1978, 40% in 1994). Exports from TVE's surged from \$9 billion to \$120 billion between 1980 and 1994, a growth in real terms of more than 10% per year, indicating that products are saleable, not just 'tonnage and numbers.' The share of industrial products sold through markets in early 1994 exceeded 80%, and is now close to 90%. Mandatory plans control less than 10% of industrial output, though they are important parts of the output like fuel and power. Real per capita GNP grew by about 7% annually from 1978 to 1994. At the outset of reforms, state industry was also the material base of the party state, providing the main source of state revenues: In 1980 83% of government revenue derived from

industry, 83% of that came from the state sector (White, 1993: 118).

To sum up: These are good or even sensational results, but they are particularly based on TVE's, with SOE's in increasing trouble in the 1990s. Competition and financial pressure in the economy have increased gradually.

II. A Brief Review of the Public Policy on Industrial Development after 1978

Clearly, the first 30 years under the planned economic system were important in establishing a structurally complete industrial system, with industry accounting for around 50% of GNP in 1978. Though reformers often feel forced to paint caricatures of this period, it also had its double-digit growth figures, and, in the words of Gordon White, "it could not be described as highly centralised, nor was it particularly planned".²

Policies of economic transformation after 1978 were aimed at relaxing the state monopoly of industry (Naughton, 1992).

- 1) *First*, the planned economy was employed to shift resources to the household sector, which promptly pressed into new areas, and also to improve macroeconomic imbalances via a restructuring of output (more money, employment, food and consumer goods) (Naughton, 1994a, 1994b).
- 2) A *dual-track* system of plan and market coexisting helped extend market relations to state enterprises, which were allowed to sell part of their output at market prices.

²Important work on this era is in Chris Bramall's cross-1949 analysis of the economy of an important province, *In Praise of Maoist Economic Planning. Living Standards and Economic Development in Sichuan since 1931*, Clarendon Press, Oxford 1993; Carl Riskin: *China's Political Economy. The Quest for Development since 1949*, Oxford University Press 1987; Gordon White: "State and Market in China's Socialist Industrialisation", in G. White (ed.): *Developmental States in East Asia*, London 1988; Thomas Lyons: "Planning and Interprovincial Coordination in Maoist China", *China Quarterly*, no. 121, March 1990, pp. 36-60; Shigeru Ishikawa: "China's Economic Growth since 1949 - an Assessment", *China Quarterly*, no. 94, 1983, pp. 242-281.

- 3) *Market prices* were legitimised in the entire economy, putting increasing pressure on inadequate institutions.
- 4) At the same time, private and collective firms were allowed, and even encouraged by concessionary financial treatment and low taxes, to compete with state-owned enterprises. The state permitted TVE's to become voluntary and independent of the centre. Seventy million farmers moved from the agricultural to the non-agricultural sector in the 1980s and the number of TVE's increased from 1.5 million in 1978 to 18.8 million in 1988, growing by more than 25% p.a. The figure for 1992 was 20.8 million. At the end of 1994 there were 120 million workers in the TVE's.
At the time of its introduction, this general *lowering of entry barriers* did not seem to contain any challenge to vested bureaucratic interests, and so was easily approved. But in the words of an astute observer, the "higher prices in the market leached the best products, labour and managers out of the plan" (Shirk 1993: 343). This promoted a slow trend towards factor markets.
- 5) The absolute scope of government materials allocation plans was kept fixed, and at the same time there was a gradual breakdown of the planning system, while the economy grew, thus further "*growing out of the plan*" (Naughton, 1995).

The state also initiated:

- a controlled "opening up", including special economic zones (Howell, 1993);
- fiscal contracting to provinces and profit contracting to enterprises (Shirk, 1993);
- state regulation of private markets, which increased confidence and prevented take-over by criminal organisations like in Russia;³
- experiments within a wide range of issues: management, bankruptcy, shares, mergers, etc. In the words of Deng Xiaoping in 1992: "Don't debate it, try it".

³This is an example of supporting general trust rather than networks of personal relations?

Regarding state intervention and policy instruments, though the centre stresses macro-economic levers, there is no doubt about the state's will to *intervene*: "primarily using legal, financial, taxation, banking and other indirect regulatory means, we will also adopt necessary direct regulatory means..." [the state] The state still keeps hold of important prices and strategic firms (Su Ning, 1993: 114).

To summarise, the state let TVE's drive the market development, gradually increasing competition with the SOE's. The SOE's responded in three ways: by increasing productivity through better incentives and management, by escaping the plan and moving into the above quota area, and by diversifying organisationally through collectives and subsidiaries thus moving away from state ownership but not towards privatisation.

III. Institutional (and Historical) Factors Supporting Policies

How has competition and 'growing out of the plan' been supported by institutional factors? It is necessary to make at least two distinctions. First between, on the one hand, existing, historically based, factors and, on the other hand, institutional innovations. Second between those factors supporting state capacity and implementation and those facilitating policies. *State capacity* was helped by:

1. the social and political coherence of society, yet at the same time an absence of civil society;
2. strength in implementation through the policy instrument provided by the existing planning system. It was less rigid and smaller in scope than the Soviet one, particularly through decentralisation, thus combining central with strong elements of local control over industry. In Gordon White's words: "Industrial planning and management in the Maoist era was ... a complex mixture of administrative regulation, informal networking, political bargaining and "grey" markets" (1993: 124);

3. specific regulations and structures, such as the several decades' old *hukou* or household registration system, ensured stable residence of the population during transformation (it finally broke down about 1989 which gave rise to the problematic 'floating population');
4. a generally high level of organisational experience and administrative capacity among state personnel. Also party organisational structure and discipline was historically strong, though weakened by the Cultural Revolution. The Chinese Communist Party had actually invented implementation theory in 1943, but never published scientifically!⁴
5. the organisational structure of the hierarchy prior to reform (Qian and Xu, 1993). Regional experiments in reform have been less costly to the total economy, more feasible and easily spread, because of China's multi-layer, multi-regional form in place since the first decentralisations of 1957-8. Each geographic area, at each of six administrative layers, can be regarded as a semi-autonomous operating unit (Qian and Xu, 1993: 541-8).

Institutional factors facilitating policies can be *supportive of overall, macro-economic policies* or more particularly of a general industrial strategy. In the case of China, the first category will include:

- community cohesiveness, based on both Chinese culture and positive aspects of the communist system (Pei, 1994: 189);
- high level of saving and investment in households, giving margins for policy mistakes;
- educational and health levels being relatively high;
- market institutions still within living memory.

The second category *facilitating the industrial reform strategy and policies* set out above includes mainly factors providing a strong

⁴See for instance Zhou Enlai: "How to be a good leader" (April 22, 1943) in *Selected Works of Zhou Enlai*, vol. I, Foreign Languages Press, Beijing, 1981, p. 147. The quality of officials has been improved during the reform period through the introduction of meritocratic criteria and other aspects of a civil service. The competitive exams for the civil service in 1995 had 10,000 applicants for 425 posts.

drive for increased competition, through for instance supporting the rapid entry of TVE's/collectives, as barriers were lowered:

1. Residence restrictions (hukou), and even Maoist periods of systematic reverse migration from urban to rural areas ensured that large numbers of entrepreneurs were eager and waiting in townships and villages.
2. The industrial arrangements resulting from earlier policies of rural industrialisation provided a reservoir of industrial experience, as well as a large non-state sector of existing enterprises carried over from the commune-system and more importantly at the county level. Self-reliance policies regarding "complete sets of industry" in each of 30 provinces gave a dispersion of large-scale manufacturing facilities, which was also beneficial to competition.
3. Family-networks, including overseas Chinese, gave access to informal credit, knowledge, export opportunities and other resources.
4. The lack of legal frameworks and well-defined property rights was turned into an advantage. It meant that existing TVE's could be transformed at low transaction costs, without complicated redistributions of assets. Locals generally chose to keep their original form of ownership, rather than risk privatisation, but establishing a voluntary basis and becoming free of interference in business from higher levels. Local governments own most of them and appoint managers on contract.

Finally, we come to the *institutional innovations* at the local and central level, which have served policies.

1. One of the most intriguing organisational innovations is that of local governments turning into industrial firms (Oi, 1988). Walder (1994, 1995) has shown that differences of industrial organisation, not of property rights ("community", "hybrid", "quasi-private", etc.) provide the best explanation for the strong performance of TVE's compared to SOE's in the large cities. An analogy can be drawn between, on the one hand, relations between the government and publicly owned enterprises and, on the other hand, relations in a corporation. The county government is the principal and the contract-employed professional managers of its average total of 37 enterprises are

agents. (Townships average 2 enterprises, but there is large nation-wide variation). County-officials have an entrepreneurial function. Their enterprises' stronger performance is due not to weaker (since local), but to *stronger*, more effective control over key industrial assets, because "local industrial organisation is simpler, financial incentives clearer, budget constraints are more immediate and the government's capacity to monitor its assets are greater." (Walder, 1994: 2). This kind of corporation has advantages over market co-ordination, cf. Coase and Williamson's work. The argument is valid for counties and townships, but does not cover the private and co-operative sector, nor the village-level, where enterprises may be genuinely hybrid or quasi-private.

2. TVE's are in themselves an example of institutional innovation. In effect, they are a result of reallocating property rights downward via fiscal reform. The name 'collective' is misleading and it was used because many of these enterprises were originally founded by agricultural collectives. When the communes had been dissolved, officials possessed all key components of property rights. The TVE's are a form of publicly owned enterprise, but they play a very dynamic role. Weitzman suggests that their strength lies in facilitating co-operation through implicit contracts among community members locked in an ongoing relationship (Weitzman and Xu, 1993), while Naughton (1994: 266) sees them as an adaptation to the most distinctive characteristic of the Chinese transition: the early creation of product markets, which exist for a prolonged period without well-developed markets for factors of production or assets (markets for land and labour emerged only in the 1990s and financial institutions are still adapting to market forces). TVE's provided a way to convert assets into income streams, without solving the problems of privatisation. This looks like appropriation of a national publicly owned good by a local community, but ownership could not be transferred. Thus the end result has been local government ownership of firms operating in a predominantly market environment. County officials after consultation (O'Brien, 1994: 45) appoint township and village leaders on a contract containing both economic and social objectives, these leaders in turn appoint TVE-

managers on contracts containing output and profits targets. An interesting question for further research concerns the disciplining of the local officials, what incentives can be found for this group.^{5 6}

3. Throughout the reform process, and in varying reform areas, new institutional arrangements have of course been designed and implemented as formal rules or regimes. A major effort of this kind, now under implementation, was the 50-point document agreed to at the Third Plenum of the 14th Central Committee in November 1993 (WB-CEM, 1994: 132-4). It includes the framework for a new fiscal regime, credit and financial institutions, management arrangements in state enterprises, etc. It was a comprehensive relaunching of the reform drive after the stalemate 1989-1992.

Obviously then, success is due not only to the market mechanism, but also to social ownership of the means of production and the role of an active local state as mediator, for instance in facilitating access to capital for start-up firms by spreading risks to the whole local community.

⁵Maria Edin of Uppsala University has undertaken a promising research initiative in this direction. See her Research Proposal: *The Chinese Puzzle - On Local Institutions for Economic Development*, Uppsala 1994.

⁶Is there a risk of "etatization" of the non-state sector? This refers to the danger that enterprises owned by local governments in rural China will come to closely emulate state enterprises in being shielded from market forces, paying inflated wages, and determining investment strategies without sufficient regard for profitability. Will they simply be part of a more broadly defined state sector? Local governments in the richest rural areas have begun to copy the benefits of state-sector employment (pensions, cheap grain) (Putterman, 1992: 485). Walder (1995) argues that Kornai's soft budget constraints do not fully apply at the local level, because local government is dependent on a few firms, and cannot shift financial problems between them. Statistical analysis finds little evidence that township and village firms diverge systematically from profit-maximising employment and wage-setting decisions.

IV. Problems Created for Policies by Institutional Factors

1. The implicit social contract at the (state) enterprise level (worker co-operation for management guarantee of job security and welfare) prevents labour market reforms, such as the extension of the new labour contract system to other than new entrants to the labour market. The state firms are "mini welfare states".

At the state level there is "a kind of institutionalised patron-client relationship between the Chinese state and its industrial workers" (White, 1993: 143). The state stands as the provider and the workers as its dependants. This prevents action in situations of labour surplus (new entrants) and towards reducing the large redundant workforce in SOE's, estimated at 100 million, with family dependants 300 million.

2. The effects of the presence of consensus-building norms can be seen in several areas:
 - i. Lacking development of basic industries - because prices of their products are low in the absence of universal price reform, which could not be based on consensus.
 - ii. No selection of "leading industries" - since policy-makers cannot be expected to fully agree on a choice.
 - iii. Continued low economic efficiency in SOE's - caused by the gradualism and compromises still necessary in shaping fiscal and industrial reforms. For instance, the phenomenon of postponing price and tax-reform because of the necessity of consensus-building based on particularistic contracting (Shirk, 1993). But there were also more fundamental reasons for the unsolved SOE-problem, to which I shall return in my concluding remarks.
3. The dysfunctional effects of the administrative decentralisation regime can also be seen in some areas of industrial policy:
 - i. Uneconomic scale of production - decentralised, small-scale and redundant investment, lack of a

- unified national market and real competition between regions.
 - ii. Coexistence of a low general technological level and new high technology. This leads to technological gaps and wasteful use of new technology - there seems to be a lack of government capacity and co-ordination in this area (Nørby, 1995: 162).
 - iii. Trade protection and defects of the export system - policies of the localities are uncoordinated.
 - iv. Inflationary pressures, because of reduced state ability to implement macro-economic policies (WB-CEM, 1994: 33).
4. Last but not least, 'guandao' or official profiteering - and cadres in business - was encouraged by several institutional traits, lack of transparency and legal clarity (Ostergaard and Petersen, 1991: 95).

These historically based constraints are to a certain degree negative aspects of factors otherwise supporting the policy: stability-promoting ones like the social contract and the consensus norm, those promoting an entrepreneurial spirit, like decentralisation and the appeal to cadres' business sense.

V. Decision-Making Institutions affect the Choice of Strategy

The precise choice of strategy, and the success of economic transformation, has been affected by the autonomy of main political institutions, through the flexibility of the enfranchisement formula and the authority maintained over bureaucratic agents, and through the mainly bureaucratic control of policy-formulation and implementation.⁷

1. The character of civil society in China is embryonic, and in one view the situation may be better described by the concept of *institutional amphibiousness* (Ding, 1994).⁸ This

⁷The leading developer of this train of thought is Susan Shirk, see particularly Shirk 1993 on which the above categorization is based.

⁸For a useful review of the applicability of the concept of civil society on China see Gu Xin: "A Civil Society and Public Sphere in Post-Mao China?"

refers to institutional parasitism ('independent' organisations in fact being parasitic to party-state structures) and institutional manipulation and conversion (i.e. 'turning' of regime-established social organisations by critical forces and replacing of their goals with private ones). Thus organisational structures in late communism may be found to serve conflicting purposes, because of the complex interplay of political and economic forces.

Both the above phenomena exist, there is a mutual infiltration, but penetration of state structures by social groups has not arguably reached the core of the party-state, which keeps its *autonomy* in formulating policy.

2. *Flexibility* of the enfranchisement formula. The mechanisms for changing the internal rules and representation formula of decision-making institutions are critically important for the capacity of a political system to reform (Shirk, 1993: 347). Simply because of the need for social groups who will benefit from reform changes to be able to outweigh those well-placed groups identified with and benefiting from the previous development strategy. By reconfiguring government and party institutions to favour particular policy outcomes, leaders can indirectly empower groups that favour reforms. Deng Xiaoping used the low degree of institutionalisation of the Chinese regime maintained by Mao Zedong to advance reform, enabling him to pack meetings, bypass even the Politburo, etc. Formal and informal party norms did of course set limits, even for him. But conservative opposition was oriented toward maintaining economic progress as a prerequisite for political stability and avoiding the breakdown of institutions.
3. The third feature is *authority*. By maintaining its nomenclature power, the party-state can affect the recruitment to the higher levels of bureaucracy, rejuvenate it and give career incentives for bureaucrats to support reform. The necessity of a certain leader responsiveness to their bureaucratic agents means, however, that really painful reform measures are difficult.

An Overview of Western Publications", *China Information*, vol. 8, no. 3, Winter 1993-1994, pp. 38-52.

4. Mainly *bureaucratic control* over policy-formulation and implementation has several consequences:
- societal actors gain influence through '*virtual representation*' via bureaucratic organisations, this goes for the World Bank too. (Societal actors include enterprise managers and workers, urban entrepreneurs, overseas investors, provincial leaderships, WB, IMF, ADB, etc.)
 - political *clout in central* bureaucracy is important. Heavy industry has it, and its share of investment has not been cut; agriculture lacks it and it has paid the price. The resulting policy is harmful, both in its short-term political and its medium-term economic consequences.
 - *incrementalism* due to an informal consensus rule for decisions (Lieberthal and Lampton, 1993) may also be the reason why investments in various branches appear to have been based on fixed relative shares, and to be seemingly unresponsive to changes in final demand. The result is that the share of light industry actually declined, while key infrastructure sectors like energy and telecommunications, despite much talk of bottlenecks, barely increased their share of the total fixed asset investment between 1981 and 1987. (Lardy, 1993: 120; White, 1993: 125-6).
5. A relationship of reciprocal accountability (they tend to appoint each other) between party top leaders and a 500-strong "selectorate" (central, provincial, and military leaders) means that there is a preference (or leadership incentive) for *particularistic contracting* solutions (fiscal contracting, profit-contracting). It has prevailed over policies taking the form of universal rules (price reform, tax reform) (Shirk, 1993).

Summing up, the factors described here partly help to explain the success of reforms, partly yield insights into the causes of remaining defects in the industrial pattern, such as the lack of change in industrial structure over the reform period.

VI. Concluding Remarks - State and Market?

How can one conclude on all this? And what was the initial question?

For a start, State versus Market seems a rather inadequate distinction. The Chinese case seems to be at least one of state *and* market, with the TVE's owned by the (local) state but functioning in an environment of competition and markets. The above ideas have hopefully also suggested that the TVE-policy in particular is *embedded* in institutions, many of which - ironically - are aspects of the Maoist past which turns out to contain strengths (economic planning, commune-industry/rural industrialisation, self-reliance, hukou-system, the Cultural Revolution's shake-up of bureaucracy, etc.). This has permitted China to "grow out of the plan system" and to move away from state ownership, but not towards privatisation. Rather towards a social ownership at the local government level. The benefits of TVE growth remain in the community, profits being reinvested, thus expanding employment, and also used to fund social services.

The *state* then is clearly holding its own.⁹ Taken together, the social ownership of the TVE and the SOE accounts for 86% of industrial output. The number of bureaucrats has expanded from 20 to 30 million during the reform years,¹⁰ and at the macro level the state is very much in command, and pursues a "late development strategy", only somewhat weakened by corruption. It retains an interventionist role, pursues an industrial policy, combats inflation, inequality and unproductive spending, mediates trade, is finance-entrepreneurial via selective credit allocations, and tries - with less success in the field of technology, to guide the economy and mediate (Nørby, 1995). It is also a 'Developmental State' defined as a state which sets out to promote national development by means of institutionalised patterns of policy intervention guided by some kind of plan or strategic conceptions, and plays a central role in that process (White, 1993: 4).

At the same time, product *markets* have been completely established and factor markets are developing, markets for land and labour emerged in the 1990s and financial institutions are clearly adapting to market forces. Competition is intense. Together the

⁹See Solinger 1989 for a jaundiced view of the system as statist.

¹⁰This should of course be seen against a background of new roles and the need for new agencies.

private sector and de facto private agriculture accounted for 34% of GNP already in 1989 (Prime, 1994: 871). At the moment, comprehensive institutional changes are being implemented in fiscal, financial and management areas.

Yet, problems certainly remain. Less has happened in the urban-industrial economy, where the fundamental nature of the state-enterprise relationship has changed little (White, 1988). The dynamism of the non-state sector highlights the problems of the large and medium-size SOE's. The encouraged competition had the least effect in areas such as heavy state industry, raw materials and energy, because private and collective entrepreneurs find it difficult to enter these sectors. For many other reasons, some of them institutional ones, *the SOE's* have not become sufficiently responsive to the market, and 45% of them are losing money on a grand scale, causing a constant central budget deficit, fuelling inflation, and preventing the centre from making the necessary investments in agriculture and infrastructure.

Gordon White has called China the last test case for the viability of the idea of *Market socialism*: that is retaining a basically socialist economic system (including some form of state planning and some kind of public or social ownership), but incorporating the rational and beneficial elements of capitalist market systems to improve economic performance and increase social welfare (1993: 10).

Finally, it is perhaps necessary to draw attention to the "competitive view" of the state-market relationship. Since both state and markets are "matrices of differentiated interests, historically and structurally determined" (White, 1988: 187), a fundamental change in the state-economy relationship is bound to affect the *balance of power between social groups*. Thus, coupling the state and the market is not just a technical or managerial problem, it is also a "for whom" question: whose interests do state and market serve? This may well be what is blocking the solution of the SOE-problem, and it may indeed reflect "a structural contradiction at the heart of state socialist political economy" (ibid.: 188).

It is likely to be solved over time, however, and probably to the detriment of the privileged state-workers in their mini welfare states. The project of market socialism involves change in the developmental aspect of the state, but not in its political aspect. There is a contradiction between these two dimensions of change, and success in the first one is likely to lead to a breakdown in the second one (ibid. 1993: 6).

This may in the first instance lead from state socialism to state capitalism and later to an East Asian form of democracy, through an empowerment of the middle class which can already be observed.

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