How the specificity of Chinese capitalism explains its position in the world economy

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Introduction

Since the collapse of the Breton Woods system and the demise of the Fordist growth regime in most OECD countries, the end of Soviet Union and the emergence of China, India, and Brazil, the international system has undergone drastic structural transformations, in search of a new world order that would be both geopolitically viable and economically more efficient than the present one.

These epochal changes have stimulated the production of a vast literature in every social science, and each research program has provided quite specific answers to questions around these major contemporary issues. Broadly speaking, some researchers investigate the origins and durability of the Chinese ascent: this is mainly the task of macroeconomists, institutional change analysts, and economic policy specialists. By contrast, researchers in international relations question the viability of the current "non-system"inherited from the decomposition of the post-World War II regime. They address the issue of capital flows regulation, the protectionist threat to free trade, the design of a new exchange rate regime, and, of course, reform of international organizations such as the IMF, World Bank, World Trade Organization, or International Labor Organization. However, China has no specific role in these discussions.

The purpose of the present chapter is to tentatively try to integrate these two lines of analysis. The core idea is simple enough: the very highly specific sociopolitical compromise observed in China simultaneously explains the success of its development strategy and its growing influence in the evolution of the world economy. One has to analyze one of the core institutional innovation of the post-1978 reform, the local-state corporatism, and its progressive transformation into a society-wide compromise on the basis of the following quid pro quo: acceptance of the monopoly of the Communist party in the political domain against a permanent increase of living standards via rapid and steady growth (second section). Within the régulation theory paradigm, this implies the dominant role of the form of competition in the wage–labor nexus and a highly specific role for the State, as the conductor of the permanent reorganization of the public and private sectors . Consequently, the related macroeconomic regime is quite specific to China. Its asymmetric insertion into the world economy is a mechanism compensating for domestic structural unbalances(third section).

1 . A genuine co-evolution of institutions and organizations

The trajectory out of a Soviet-type regime is closely related to a typically Chinese configuration that displays an original mix in which economic rationale and political are made first compatible and finally complementary (Nee 1992; Chavance 2000; Lin Justin 2004; Naughton 2007; Fairbank and Goldman 2010).

The four stages in the transformation of the Chinese economy

- After the Maoist revolution, the subsequent quarter of a century included a succession of fast booms and sudden, drastic declines associated with the leading role of investment decisions made by central authorities. In some cases, for instance, during the Great Leap Forward and more so the Cultural Revolution, the social and economic evolutions were so dramatic that the political authorities realized how inefficient Soviet-type institutions had become.
- In a sense, the first wave of reforms was intended to create degrees of freedom at the microeconomic level in order to develop production to overcome insecurity and poverty. Initially, the large State sector was left intact, but new contracts were designed in order to incentivize producers, especially those from rural areas, to extend their supply. A minimal degree of competition was created by

allowing the entry of new actors at the local level. This cautious, experimental, and pragmatic approach to decentralization inaugurated a continuous process that led to the progressive replacement of State expenditures and redistribution by the development of banks designed to channel higher savings toward credit to existing firms and new entrepreneurs. At odds with the transition of the Soviet economy after 1989 (Sapir 1998), the reforms launched a positive sum game, with no loser.

- After 1993, the second wave aimed at strengthening market economy institutions via market unification across provinces and the provision of various ownership structures for companies. Given the dynamism of all the new firms, the State sector could be downsized and the process of privatization could begin. Simultaneously, in order to control possible discrepancies at the local level, the tax system was centralized again and macroeconomic control was developed. The workers of the former State enterprises and some peasants were clearly among the losers.
- After 2001, with the adhesion of China to the World Trade Organization, the competition extended from the domestic domain to the international arena, whereas foreign direct investments were welcomed with the hope that they would diffuse frontier technologies and organizations. Furthermore, recurrently, the objectives and the instruments of the central State interventions were redesigned and adapted in order to correct emerging imbalances created by the previous stage of reform.

A complex hybrid form: the local State corporatism

This success of reforms cannot be explained by pure chance, since the process Has been observed for more than three decades. Similarly, it is not only a matter of good macroeconomic stabilization policy, since the issue at stake is the stability and resilience of a complex architecture linking institutions and organizations at the many levels of Chinese jurisdiction. A converging set of researches suggests that China has invented a way to align, at least partially, the interests of politicians and entrepreneurs .

The starting point is the tax reform that gives greater responsibility to each local public entity. The public status quo is maintained but there are strong incentives for local authorities to nurture the emergence of entrepreneurs who will create more value, hence a larger tax base, and finally more resources for public spending. The local State corporatism hypothesis gives a precise definition to this hybrid form (Oi 1992; Peng 2001). In a sense, this cooperation between politicians and entrepreneurs is the logical outcome of the simultaneous compliance with their respective objectives: on one hand, recover the maximum tax revenue, on the other, optimize the competitive edge of each locality via the dynamism of investment, production, and employment (Krug and Hendrischke 2007). Nevertheless, the struggle of all localities, one against another, does not turn into chaos and permanent conflict: this is the contribution of intense networking between business and government and the micro and the macro levels, whether that of the Communist Party or of Guanxi (Xin and Pearce 1996). However, this would not be sufficient to arrive at a coherent pattern at the macroeconomic level: one institution more is required. The historians and political scientists who have investigated the role and functioning of the Communist Party confirm that so-called bureaucrats have been quite instrumental in creating a group of entrepreneurs that would sustain the process of reforms and economic growth. Therefore, at the national level, the intricacy of the State-party functioning allows a permanent exchange between economic and political spheres (Bergère 2007). The mobility of the elite from the political to the economic, and conversely, is observed at all levels of the Chinese society. What is the glue that makes such a complex architecture coherent? Many political scientists suggest that the Chinese growth regime is built upon an implicit compromise: “Better standards of livings against the political monopoly of the Communist Party.” It is itself open to the most dynamic groups of society, from organic intellectuals to the most successful entrepreneurs (Domenach 2008). If one accepts these premises, the Chinese economy is not a typical capitalism moved by the exclusive search for profit by private entrepreneurs; the elites have both the political power and the control of economic resources in order to monitor the society. Therefore, the efficiency criterion is not the maximization of welfare of consumers according to a consumerist variant of capitalism; it is not the maximization of value for shareholders; it is the mix of political and economic objectives. In this configuration, the relevant actors tend to maximize investment growth rate or production growth per se (Grosfeld 1986; Zou 1991).

The politics/economics and local/national nexus

The synergy between these domains and levels can now be made more explicit. In the absence of a full-fledged legal system and of a unique form of incorporation of firms, public authorities have the ability to define, at least locally and for a given period of time, the rights around the use of resources (land, raw materials, work force, talents, etc.) and those to legitimize some rules in the appropriation of income flows. Under this umbrella, entrepreneurs may make decisions about production, investment, and technology. When they are successful, they are creating value that can be allocated for reinvestment, social and infrastructure expenditure, and contribution to the tax base of the related entity. Conceptually, this exchange may propel a virtuous circle involving bureaucrats and entrepreneurs. However, in isolation, such a system could become more predatory and corrupt than efficient in value creation. There are two additional features of the local State corporatism. On the public side, each entity is partially accountable with respect to a higher rank entity that could correct the most detrimental forms of private appropriation. On the business side, if local entrepreneurs make wrong decisions they will be penalized in the competition with other businesses nurtured by many other localities. Thus, the local State corporatism has another relevant property: to articulate the various levels of Chinese society .

Some empirical evidence may support this hypothesis. First, the pro-growth nature of the incentive system associated with the 1978 reforms is clear enough concerning, for instance, the evolution of the steel industry. Initially, all the allocations were decided by the Central government. Then, local government allocations began extending production, and after a while, the enterprise market sales were booming. A decade later, both Central and Local government production have declined, to the extent that, at the end of the period, the supply of steel was largely privatized (Naughton 2007: 93). The process has thus prevented the dramatic collapse that subsequently took place in the Soviet Union, when State firms were brutally privatized, resulting in a drastic contraction of production over quasi than one decade (Sapir 1998).

This process contradicts the conventional idea of tremendous continuity over the Soviet period and the present one in China. In the early stages of the reform, State appropriation and spending represented one third of the GDP, but with the success of decentralization and the dynamism of production, this share has declined to 11 percent in 1994. Since then, the recuperation has been modest (Naughton 2008: 102). This means that in China, the State is neither typically Keynesian nor Beveridgian nor Bismarkian, since the provision by the State of education, health, and housing has nearly vanished. By contrast, the State has been mainly the architect of a sophisticated web of incentive contracts linking economy to polity, and vice versa, localities to provinces, and provinces to local economies.

In a sense, this is not a surprise and can be related to political science literature about the merit of federalism in limiting excessive taxation and promoting firms' differentiated strategies. Given the continental size of China, it is logical that more than two thirds of the public expenditures are local (Lou and Wang 2007: 159). This shows again the importance of decentralization of public interventions and their permanent adjustment. For instance, the excesses associated with the rather complete decentralization of taxation are corrected in the mid 1990s by a recentralization of taxation, associated with a more active role of the Central government in the redistribution of revenue across provinces.

2 . A definite institutional architecture: a régulationist analysis

How are we to convert these micro and meso analyses of the interaction between a series of local state corporatisms into a characterization of the macro dynamics of the Chinese economy? The purpose of the French Régulation School (Boyer and Saillard 2000) is precisely to explicit the role of institutional forms, i.e., a meso level concept, in bridging the micro and the macro. Therefore, there is no single pattern and dynamic for modern economies but a multiplicity, in relation to different institutional architectures (Amable 2003). A few régulationist researches (Chavance et al. 1999; Song 2001; Uni 2004, 2007; Aglietta and Landry 2007) have already paved the way for an interpretation of the origins and limits of the Chinese development strategy . In the light of their results and the present analytical framework, China is exploring a genuine and largely unprecedented brand of capitalism.

The primacy of competition

In essence, the two founding social relations of capitalism are market competition and the capital/labor relation. Their conjunction implies that accumulation is the dominant feature of this socioeconomic regime, far away from any steady state. In this respect, a structural analysis suggests that the related accumulation regime in China is highly competitive. In fact, numerous entities with different legal status and localization (village, district, province, and so on) permanently compete to capture the natural resources, the equipments, and, finally, the product markets. This logic applies to foreign multinationals; all of them want access to the booming Chinese market and low labor costs. Thus, they are ready to make concessions in terms of technology transfers. On the other hand, localities propose land tax exemption and free infrastructure in order to attract FDI. The size of the economy and the dynamism of each local State's corporatism do compensate for the lack of legal enforcement of competition by public authorities. Actually large fixed costs and increasing returns to scale are so strong that they generate a permanent state of overinvestment. This unbalanced growth pattern is sustained by very large productivity increases: rural workers are transferred from very low productivity jobs to state of the art technologies embodied into the most modern equipments. Thus, this growth pattern is mixing extensive (more workers enrolled into capitalist production) and intensive (continuous productivity increases) accumulation. The related over-capacities imply cut-throat competition, declining production costs, and thus declining market prices. The rising prices of raw materials, partially generated by Chinese growth itself, are the only countervailing forces to this deflationary bias.

The second basic institutional form, i.e., the capital–labor relation, has also quite an atypical configuration. First, from a legal standpoint, there is no single status for the worker; it differs drastically for urban and rural workers, and this differentiation is monitored by the hukou. Thus, migrant workers going from the rural to the urban zones had, until recently, no formal rights. Second, since the workers' organization is embedded in the Communist party itself, labor has no autonomy to defend its own interest and to coordinate its struggle across firms, status, and localities. Consequently, the wage–labor nexus is balkanized and serialized, and this is not strictly equivalent to a competitive wage–labor nexus, in which anonymous market forces would govern the entire working population (Zhao 2003; Knight and Li 2005). Of course, migrant workers play the role of the reserve army, but other workers employed in urban or rural firms with the relevant hukou benefit partially from profit sharing, in conformance with typical corporatism (Song 2001). However, since there are many such local corporatisms, labor segmentation and great inequalities define the normal pattern in the Chinese wage labor nexus (Table 1).

Table 1 - The five institutional forms: the Chinese configuration

Institutional forms	*Main features*	*Impact upon*	
		Regulation mode	*Accumulation regime*
1. Forms of competition	Acute competition among numerous and various entities (firms, provinces, localities)	A tendency toward constantly declining production costs and prices	The driving force of accumulation
2. Wage–labor nexus	• Dual status (rural/urban) • Balkanized and serialized works • Absence of own collective organization	Strong influence of the large pool of rural workers on competitive wage formation	Unbalanced income distribution: low and declining wage share
3. Monetary/ credit regime	Dialectic between large-scale decentralization and need for control at the macroeconomic level	A fine-tuning in reaction to quickly evolving domestic/international economy	A tool to sustain and manage a high growth regime
4. The State/ economy nexus	• A pragmatic and anticipatory central state • A multilevel/ complex governance	High reactivity to emerging disequilibria	Periodic reconfiguration of institutional forms
5. Insertion into the international economy	A selective insertion – Constraints upon FDI – Control of external current account – Specific domestic norms	The exchange rate is a key political variable, along with domestic credit, in smoothing external shocks	The trade surplus is the consequence of domestic imbalances between production/demand

The entry into the world economy: the consequence of a pro-growth Chinese (implicit) compromise

This is a powerful original feature of the Chinese growth regime. The entry into the international relations does not come from outside but is essentially a domestic decision. Quantitatively, the opening of the Chinese economy is impressive, but qualitatively, public authorities have a remarkable amount of control over entries of capital, the management of norms, the interventions in the exchange market, and the constitution of large reserves in order to prevent the equivalent of the 1997 Asian crisis. The core argument of this chapter is that it is not the expression of an ideological or doctrinal preference but the projection of the domestic accumulation regime into the world economy .

There is a clear hierarchy whereby the integration into international economy is the consequence of the domestic institutional forms. Nevertheless, Chinese officials are not free to follow a fully autonomous external policy. They have to cope with the highly specific dynamism of a competition-led accumulation regime in which cut-throat competition is the engine for an overinvestment tendency. Given the dependent nature of the wage–labor nexus, segmented, serialized, and for many workers competitive, the related overcapacities cannot be reduced through the dynamism of household consumption. De facto, the weak bargaining position of labor has been associated with a quasi-continuous decline of the wage share in national income. This might stabilize and halt the decline of the average profit rate, but it does not reduce the gap between production capacities and aggregate demand. Furthermore, the difficulty of access to credit by private firms is inducing cash-flow-driven investment (Reidel and Jin 2007), whereas the poor public welfare system (unemployment benefits, healthcare, and lodging) is an incentive for building strong household savings that are a response to the uncertainties of families and individuals over the life cycle. The permanence and the rise of the Chinese trade surplus over more than a decade are the expressions of this unbalanced domestic accumulation regime. In other words, contemporary China is a stellar example of the hierarchical domination of competition, at home and consequently at the world level. From a theoretical point of view, it is clear that almost all institutional forms do take into account the nature of competition. This is exactly one of the definitions of an institutional hierarchy (Isogai et al. 2000; Boyer and Saillard 2000; Boyer 2005a). From an empirical standpoint, in 2000, CEOs of listed companies reported that the most important constraining factor in management was the product market (79.1 percent) whereas the stock market (4.8 percent) or the labor market (4 percent) were minor constraints (Naughton

2007: 321

3.The macroeconomic regime: trade surplus is compensating structural domestic unbalances

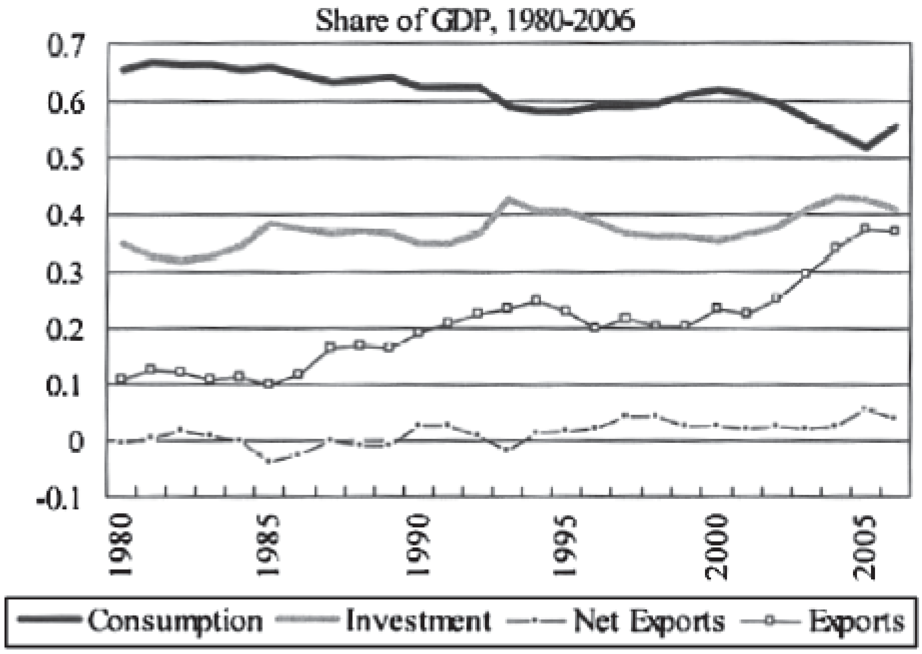
The purpose of régulation theory is not only to make explicit the mechanisms that deliver coherent institutional architectures by chance, compatibility, complementarity, hierarchy, or co-evolution. It intends to convert a qualitative diagnosis into a quantitative appreciation of the emergence, maturation, and the crisis of various development modes, defined as the conjunction of mechanisms of short-run adjustment (they define a régulation mode) and the factors that govern long-term growth (they support an accumulation regime). The related exercise has now to be fulfilled for the Chinese development mode.

A structurally unbalanced growth pattern

One finds global statistical evidence of overaccumulation in the fact that however difficult might be the measure of a capital stock, the output–capital ratio has been permanently declining since the early 1990s. Nevertheless, the rate of profit is not declining accordingly because the profit share has been compensating for the deterioration of the so-called “productivity of capital” . Mechanically, the counterpart of the higher profit share is a lower wage share. Whereas the number of wage earners has drastically increased with the shift from rural to urban labor, the share of household consumption in total demand has declined. Such a trend makes highly improbable the wage-led regime that has been an implicit orientation of the Chinese government since early 2000 (Aglietta and Landry 2007).

On the demand side, quite clear long-run trends can be observed. Of course, the rate of investment is fluctuating with the succession of acceleration and deceleration periods along with a tendency to increase through the various phases of economic reforms. Simultaneously, the share of exports in total production has increased dramatically from 10 percent in 1980 to nearly 40 percent in 2006. However, the most impressive evolution concerns the quasi-permanent decline of the share of consumption. Within a model of optimal growth, one would expect that an initial big push of investment finally converges toward a steady state with a constant share of investment and consumption. On the contrary, in China, the deepening of capital is an ongoing process, the relative share of consumption declines, but the anticipated crisis of over accumulation has not happened between 1980 to 2006, which is quite a long period indeed. The spectacular rise of exports and the more modest increase in trade surplus have played a determinant role in stabilizing a quite unbalanced domestic growth regime (Figure 1).

Figure 1 - Rising trend of investment share

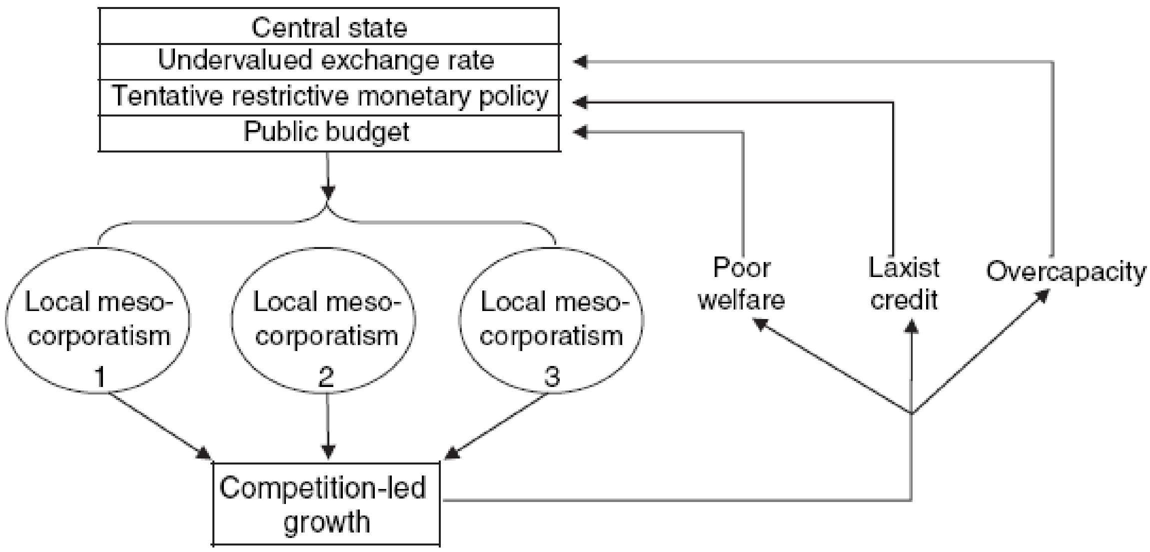


Source: Minqi (2007), p. 43.

The challenging task of the Central State: controlling vibrant and numerous local State corporatisms

The unfolding of this competition-led accumulation regime generates three major imbalances. First, the quasi-destruction of public welfare has triggered a widening of social inequalities, but poverty has declined along with the dynamism of growth. However, nearly all groups in Chinese society suffer from the difficulty of access to and the cost of such basic collective goods as education, health, and protection against unemployment. Therefore, the Central Government tries to alleviate this potential source of social and possibly political conflicts. Second, the financial system has been modernized, and centralized entities have been created in order to rationalize the credit and reduce the misallocation of capital. Nevertheless, at the decentralized level, the alliance between business and political authorities continues to generate non-performing loans. Their objective is not efficiency in the allocation of resources but support to the ongoing sociopolitical compromise. Third, and more importantly, the Central Government has to deal with the permanent overcapacities and the need to sustain a high rate of growth, just to absorb the flow of migrant workers from rural to urban zones. The exchange rate policy is part of the related policy. Therefore, the multiplicity of levels and entities is simultaneously a chance for Chinese growth but also a source of recurring and potentially dangerous imbalances (Figure 2).

Figure 2 - From the local to the national: the three major tools of the Central State.



The appearance of a mercantilist State

Therefore, the present analysis challenges a common diagnosis about the specificity of China: it is a contemporary example of a mercantilist State that would accumulate excessive reserves for pure geopolitical reasons. However, the whole Chinese institutional architecture generates macroeconomic adjustments that assume that the external position is the key adjusting variable. Consequently, in the absence of a redesign of the whole domestic accumulation regime, it is probably naive to imagine that the exchange rate policy of China could be decided in conformity with the reduction of world imbalances.

Conclusion

The main issue addressed in this chapter is simple: what are the emerging links between the inner dynamism of the Chinese economy and the redesign of the world system? It proposes the following provisional conclusions.

1. The high rate of Chinese growth results from a genuine form of mixed economy that organizes the synergy between polity and economy, the public and the private, the local and the global.
2. After 1978, a local State corporatism has emerged and promoted strong incentives to increase investment, production, and employment and redistribute the related economic and political benefits. At the provincial and the national level, this implies strong competition due to the permanent reproduction of overcapacities. Over time, an equivalent logic has been extended to the urban/coastal regions and finally at the national level. It is built upon an implicit but strong compromise that exchanges high growth and the hope of better living standards for the monopoly of political power held by the Communist Party.
3. Under this regime, serialized and segmented workers (rural/urban, according to the legal status of the firms and the different sectors . . .) absorb the cost of the related overaccumulation. The decline of the workers’ share in GDP leads to a structural imbalance in demand generation, and this generates a permanent surplus in international trade. This is the common root of both the rapid and relatively stable Chinese growth and the rising share of Chinese exports in world trade.

4 The decision to keep a controlled exchange rate regime, implying an undervalued yuan, is not necessarily evidence for a typical mercantilist strategy, since it might well be the consequence of the projection of the basic Chinese socioeconomic regime into the world economy. The control of the volume and direction of credit, as well as the ability to react quickly, to experiment constantly, and to try to anticipate emerging problems are other typical attributes of the Chinese State.

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