

The Political Economy of Chinese State Capitalism

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Abstract: The paper intends to provide a framework of understanding the political economy of Chinese state capitalism in which China transformed from an economy owned and controlled by the state to one supervised and regulated by the state in combination with market mechanisms. It explores how China is able to combine political, economic and socio-cultural *innovations* in developing state capitalism with “Chinese characteristics”. It argues that the uniqueness of Chinese state capitalism can be conceptualized from the perspectives of: 1) understanding China as a “civilization-state” (vis-à-vis Western “nation-state”) that has a unique type of political culture and rationality; 2) examining the resilient capacity of Chinese culture and the Chinese party-state in sinicizing and internalizing foreign ideas and practices; 3) analyzing the Chinese state-market relationship in which institutional innovations, commodification of state power, and marketization of public resource play a positive role in securing a certain level of state-market-society embeddedness. But the paper also indicates the potential challenges and limitations of Chinese state capitalism.

Introduction

One of the puzzling questions facing many scholars of social sciences and especially those engaged in Chinese studies is how to comprehend and interpret China’s historical transformations shaped by fundamental changes and great successes in the past three decades. What are the internal driving forces and the external influences behind these transformations? There is a general consensus that China’s success in moving from an economy owned and controlled by the state (state socialism) to one supervised and regulated by the state through combining legal means with market mechanisms cannot be achieved without an active role by the Chinese state in attaining macro-policy independence and socio-political stability. Since the mid-1990s we have witnessed the emergence of a self-confident and self-proclaimed model in China labeled with contradictory terminologies - “market economy with Chinese characteristics” or “market socialism”¹. Today, the new term for China’s development by the outside world is “state capitalism”.

Some years ago, this model was coined the “Beijing Consensus”². The “Beijing Consensus” (albeit a debatable notion), embodies the Chinese’ distinct attitudes and ways of dealing with domestic politics, economic development and global balance of power. It is

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driven by China's more than three decades of success in economic development with relative social and political stability, by China's determination to innovate an alternative development path, a strong belief in state sovereignty and global multilateralism, and a strategy to accumulate the capacities of 'asymmetric power projection', i.e. how to achieve and maintain power in an asymmetric power relation with the superpowers and the multinationals (Ramo, 2004: 3-4). The increasing popularity of the "Beijing Consensus" can be seen from a voting-debate initiated by *The Economist* on the "China model". This debate is about whether China offers a better development model than the West (*The Economist*, 2011). The voting result shows a consensus by the majority that "the global financial crisis exposed critical weaknesses in western economies. China, by contrast, suffered only a brief slowdown in its fast-paced growth before surging back into double digit expansion" (*The Economist*, 2011).

There have been internal and external debates regarding whether there is such a notion called "Chinese model", despite the fact that Ramo's notion of "Beijing Consensus" does indicate some elements of admiration that generate the worldwide debate. On the one hand, the very many social and economic problems China has been experiencing call for a reassessment on its export-oriented strategy that has contributed to a short-term prosperity and stability, but has sacrificed long-term rational development and environment (Ding Xueliang, cf. Breslin, 2011: 1326). On the other hand, China has never officially recognized a "Beijing Consensus", because the variety of economic growth engines to be found in different regions and provinces not only question the simplified understanding of the Chinese development model, but also challenge the transferability that this notion implies. Through a closer look into the Chinese growth model on the basis of survey data and archival sources, some scholars find the fact that the "Chinese model" actually bears two sides of the same coin: one aspect of the model entails free market capitalism, such as competition, liberation, privatization and entrepreneurship; while another aspect of the model emphasizes the decisive role of the state in financial and political control and in promoting state-owned enterprises (SOEs) at the expense of free competition and private entrepreneurship (Huang, 2010).

Nevertheless, a central aspect of the Chinese model that is generally agreed upon and the most distinctive characteristic of the Chinese market economy is the SOEs. Today, not only China, but also the emerging economies, own the world's largest oil companies and control three-quarters of the world's energy reserves. This situation is rather ironic and is also interesting because the previous "socialism" in the form of state-led development and state ownership was claimed to be a failure, while free market and liberal democracy were claimed

to be the “end of history” (Fukuyama, 1992). The irony today is the fact that state capitalism is spreading globally, and one crucial characteristic of state capitalism is “the existence of close ties binding together those who govern a country and those who run its enterprises” (Bremmer, 2009).

Figure 1. The power of state-controlled companies in China, Russia and Brazil (capitalization on MSCI national stock market index, June 2011, % total)



(The Economist, January 21)

Apart from SOEs as its central actor, state capitalism has other forms of role-player or actor, such as the rise of “Sovereign wealth funds” (SWFs). SWFs are state-owned investment portfolios, which account for one-eighth of global investment. Some liberal thinkers claim that “The rise of “sovereign wealth funds” signals the end of the neo-liberal model and challenges western states and financial institutions to develop a coherent and long-term response” (Halliday, 2008). Some policy-makers even raise the issue to the highest level of national security. A report from the US Council on Foreign Relations questions the potential strategic implications of SWFs on US indebtedness in which foreign creditors might gain potential leverage over American policy (Council on Foreign Relations, 2008). As China is the largest buyer of the US debt, the concern about the Chinese SWFs is very understandable.



Figure 2. The list of global largest sovereign wealth funds (The Economist, 2011)

The core free-market economies, the United States and Europe, are very uncomfortable with the rise of the SWFs that move from the semi-periphery emerging economies to the center of global financial markets. The key worrying questions are: are SWFs driven by the market or by the

state? Will states such as China use SWFs strategically as a financial and investment tool, or will SWFs emerge as an instrument of political muscle?

Placement of discussion

Recently the topic of “state capitalism” has really occupied global attention. Since last year, the authoritative economic journal – *The Economist* – has published a series of special reports, articles and debates on state capitalism. In one of its January issues of 2012, it claims that, “The crisis of Western liberal capitalism has coincided with the rise of a powerful new form of state capitalism in emerging markets... has been rendered more serious by the rise of a potent alternative: state capitalism” (*The Economist*, January 21). To reach to a conclusion on state capitalism is rather difficult given the complexities and complications with regard to the changing world order brought about by the transformation of international political economy, along with the emergence of transnational capitalism and the rise of the BRICS. However, this leads to a renewed discussion on the “varieties of capitalism”, which refers to two distinct types of capitalist economies: liberal market economies (LMEs) and coordinated market economies (CMEs) (Hall and Soskice, 2001).

Scholars and academics both within China and without are divided on the debate on “state capitalism” in general, and on “Chinese state capitalism” in particular. The school supporting Chinese state capitalism advocates the doctrine that the state should lead economic development and the state should shape the market, particularly in strategic industries. It sees SOEs as the stability of China’s economy and the cornerstone of its spectacular market growth. In retrospect, Chinese state capitalism was once seen by the West as a transition between communism and capitalism.

The other school of scholars, that that rejects recognizing the role of state capitalism in China’s economic success, argues that the driving forces were market dynamics unleashed by over 30 years of rural reform, private-sector growth, the national policy of opening up and globalization. They say that to attribute success to state-led capitalism would be to misunderstand the past and mislead decision-making in the future. Among critical authors, Gordon Chang, who wrote *The Coming Collapse of China* (2001), recently reiterates his prediction on the eventual fall of the Chinese state capitalism model due to, among other factors, the unfair promotion and protection of “national champion” - state enterprises - at the expense of others. Nowadays, the central debate focus is directly pointed towards China’s greatest “assets” as a global power, the so-called “state capitalism”. Many critics claim that

state capitalism is “inefficient, unfair, and can eventually breed the volatility it’s intended to suppress” (Coy, 2012). Roselyn Hsueh, the author of *China’s Regulatory State* (2011), documents how the Chinese government has regulated foreign direct investment since the post-Mao economic reform and opening started in the early 1980s. According to her studies, the central government has closely-regulated sectors with high strategic value, such as energy and telecommunication, while allowing looser regulation of nonstrategic subsectors. SOEs such as China Telecom and China Petrol can dominate local markets without the risk of facing antitrust authorities. The government has been steering cheap credit towards local champions while blocking competition from private sectors as well as foreign firms.

Conceptual and Analytical Approaches

Through the lens of political economy, this paper elucidates the factors and consequences of China’s economic transformation and its unique state capitalism in maintaining high economic growth in the past three decades and in shaping the broader dynamics of global capitalism. That is to say, in many ways China’s economic growth in the past decades has been both enabled, nurtured, conditioned and constrained by global capitalism, and at the same time the successful Chinese growth model under state capitalism has heightened global competition, and accentuated the inherent contradictions of capitalist development in other countries, including many advanced economies. It can be argued that to some extent the success of Chinese state capitalism is redefining the limitation of liberal market capitalism around the world. Historically, there has been an internal-external linkage between China and the external world, intertwined with a challenge-response duality: China’s internal transformations were triggered by external challenges; meanwhile the capitalist world system had to adjust and readjust itself to the opportunities and constraints brought about by the “China factors”.

In some ways, the debate on Chinese state capitalism can be supplemented and extended from the discussion of “East Asian capitalism” in previous decades. Conceptually and theoretically, this paper draws some of its analytical references to the previous studies on state-market relations in East Asian developmental states (Evans, 1990; Haggard, 1986; Johnson, 1982; Wade, 1990; Weiss, Linda & Hobson, 1995; Woo-Cumings, 1994). Particularly in connection with the Chinese context, this paper intend to draw on the specific theoretical frameworks of a number of thinkers and scholars:

- 1) Lucian Pye (1990), Fitzgerald (1996) and Bockman (1998) who propose to use the notion of “civilization-state” to conceptualize China rather than to apply “nation-state” as a unit of analysis derived from the West-centered international relations. The notion implies that China was and still is an “empire state”, i.e. a unique historical tradition of governance, and has a unique political culture and state-society relationship. It follows that it would be a failure to apply the logic of the Western “nation state” framework to analyze and understand the evolution and development of China, including issues such as democracy, nationalism and identity. Likewise, China’s historical and cultural unity and uniqueness implies a constant “appropriation” development in the process of its national identity and territorial integrity, in other words, a continuous sinicization process. Sinicization entails a spontaneous process of absorbing foreign ideas while forcing them to be mixed with and embedded into Chinese native practices.

In order to comprehend “state capitalism with Chinese characteristics”, it is necessary to explore how external factors, historically, helped to shape China’s internal transformations, i.e. how generations of Chinese have been struggling to respond to the external challenges and attempting to sinicize external ideas in order to change China from within. One of China’s most enduring features in the 20th century has been “an unending process of internalisation of the external which we may call ‘Sinification’” (Tan, 1996: 236). The sinicization process has been historically embedded in China’s social and political transformation from a “civilization-state” to a “nation-state” as well as from a Maoist socialist state to a Dengist capitalist state (Li, 2010a; Li and Christensen, 2012).

- 2) Antonio Gramsci (1971), whose political theories provide an understanding of the “hegemony” and “passive revolution” of modern capitalism in which the leading classes are willing to adopt changes (Trasformismo)³ while retaining the essential existing features of organization and mode of functioning. Seen from this perspective, it can be argued that the Chinese party-state has also been in an uninterrupted process of “passive revolution”, i.e. continuous political adaptation, reflected in the unique “embedded” reform process⁴ as an attempt to neutralize and reduce the market *disembedding* forces caused by the structural differentiation effect. The Gramscian perspective provides a framework of understanding the new Chinese *hegemony* generated by a deliberate embeddedness struggle in a nexus of social, political and economic relations (Li and Christensen, 2010).

The post-Mao leadership undertook a modernization process through economic reforms aiming at sinicizing Western market capitalism with “Chinese characteristics” and through embracing market capitalism while incorporating China into the existing world system. China is now undergoing transformative changes through a series of processes of economic, institutional and ideological “passive revolutions”. Not only has the previous class-based party-state system been replaced by a market-based party-state system, but it has also successfully integrated itself with the capitalist world system (Li, 2010).

- 3) David Wank (2001), who provides a framework of understanding the Chinese state-market embeddedness in which the previous political power by “politics in command” is commodified to accommodate and negotiate with the market power by “economics in command”. His theory of institutional clientism, provides a good analytical tool to examine China’s unique state-market-society embedding process through the lens of patron-client ties between entrepreneurs operating private firms, and cadres staffing the party-state administrative, distributive and production institutions. This matching is realized and maintained through a dynamic relationship, neither strictly political nor purely economic in character.

Wank provides a framework of understanding China’s dynamics in state-market-society relations over the last three decades, and examines how the dynamics are generated in the process of China’s market transition. What is important is to find the unique features of embeddedness of Chinese socio-cultural and socio-political adaptation through marketizing decision-making powers and commodifying state institutions and distribution mechanisms.

Figure 3. Historical evolution and factors of Chinese state capitalism

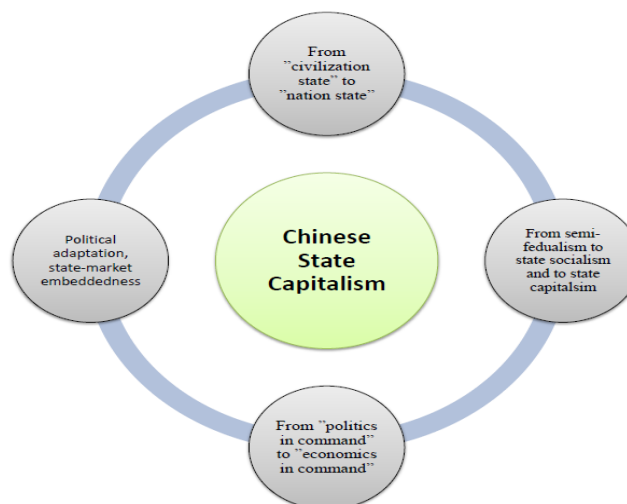


Figure 3 illustrates that Chinese state capitalism needs to be understood in the context of China's century-long dramatic transformations: 1) state and society transformed from an imperial monarchy to a short-lived republic, from a weak and decentralized warlord authoritarianism to a centralized revolutionary socialist state; 2) economically it experienced a state-led industrialization based on planned economy and socialist egalitarianism to an all-round structural reform based on market mechanisms; 3) ideologically the Chinese value systems underwent transformations from feudalism to socialism and from collectivism to individualism. The figure promotes a holistic approach to explain the transformative socio-political changes of China from an "imperial civilization-state" to a "market-driven nation-state", and it emphasizes the importance of conceptualizing these transformations from its retrospective historical, cultural and political characteristics. It indicates the fact that historically there has been a challenge-and-response dynamic in China's socio-economic and socio-political transformation, which in recent times was assisted by the resilient hegemony of the party-state within the politically and culturally defined norms and values.

The conclusion this paper intends to draw is that "Chinese state capitalism" is historically evolved, politically unique and culturally specific. It is shaped by *the synergy of a series of China's historical and internal transformations and revolutions correlating with its responses to external dynamics and challenges*. The historical transformations taking place in China can be characterized as the "sinicization processes" – an internalization of changes in ideas, thoughts, value systems, and scholarship, as well as in all spheres of life. Chinese capitalism is a distinct form of state capitalism shaped and determined by its internal political reality and characterized by the active state intervention and corporative state-business relations. The emergence of new institutional entrepreneurs and their role in institutional innovations play a positive role in encouraging marketization and decentralization of state capacities and public resources without falling into economic and social disembedding. This paper's purpose is to identify the key ingredients of the "embedded relations" between the Chinese developmental state and the market mechanisms that have led to sustained economic growth for three decades. New sets of state-market-society relations are a result of the pioneering role of new sets of economic, political and social *interactions*, generating embedded rather than disembedded development.

From State Socialism to State Capitalism

The Chinese market reform started much earlier than the downfall of the Soviet Union. It was conducted on a trial basis and was a step by step process. The initial success of the reform and the collapse of socialist bloc in Eastern Europe made the Chinese elite believe in the superiority of capitalist market forces and they pushed toward more radical reforms. The leading elite groups of the regime, including reformist intellectuals, began to reinterpret the notion of “socialism” by legitimating the incorporation of the market as an inseparable element of the socialist economy. The profit-oriented value system started to be politically and socially acceptable under the slogan “to be rich is glorious.” Thus, the intention behind the reformist approach was to redefine the concept of socialism in order to justify the legitimacy of the economic marketization. Socialism, according to the Dengist understanding, “can only appeal to the people with the basic goal of enriching the country and its people, not yet the higher goals of social equality and the full development of the person” (Ogden, 1996: 656). The meaning of socialist development has been redefined in the form of an uncompromising economism and its goal is “to achieve a ‘pragmatic’ adjustment of revolution to the demands of present reality” (Dirlik, 1989: 32).

The party-state elites realized that it was not in their interests to abandon “Chinese socialism” as a political ideology because it would obviously reduce their political and economic power. Nor did they want to return to the pre-reform system since the material wealth brought by the reform is very appealing. Nevertheless, they realized that economic marketization would sooner or later challenge their political power. The only way to maintain both their political power and economic interests was to quickly transform themselves into a new dominant economic class that could continue to rule through new class relations. Breaking down state socialism and replacing it with state capitalism would enable them to become not only de-facto owners of the means of production but also managers of the new economy. In this way they could capitalize on their official power while turning their bureaucratic privileges into economic advantages. At the same time they resisted political democratization under the banner of maintaining social stability because democratization would politically challenge their special position.

For a long time, the party-state elites, who were originally made up of communist members dedicated to establishing a classless society of equality, consisted then of a group of people who perceived themselves to be dedicated to socialism and were mostly interested in maintaining their privileged positions. Before the economic reform, members of the elites

enjoyed significant advantages, not necessarily in terms of income but in terms of housing, transportation, and especially in access to resource allocation. The reform might pose certain constraints to their political power and privileges but at the same time open the channel to gain material privileges under official advocacy of personal enrichment. Ironically, this evolution proved Mao's position right during the Cultural Revolution when he pointed out that the existence of "bureaucratism" and "capitalist roaders"⁵ were right inside the Communist Party.

State Capitalism and State Enterprises

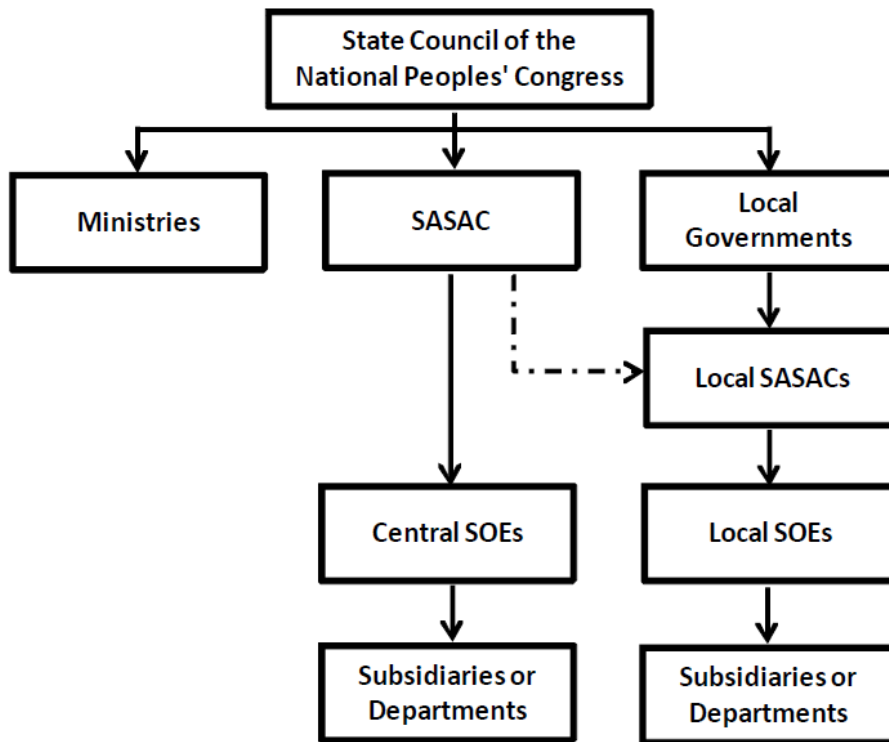
Over 30 years of rapid economic growth and comprehensive integration with the global economy, China experienced the phenomenal rise of private sectors and its increasing share of GDP during the 1980s and 1990s, when the Chinese state endeavored 1) to make the economy competitive and market-oriented; 2) to reduce the level of the government's direct intervention in economic activities; 3) to allow the market to set prices and direct material and manpower resources through market distribution channels; and 4) to allow the private sectors to have more economic freedom, and to merge the national economy more closely with the world economy (Guo, 1995: 72). Consequently, it was witnessed that there was a massive withdrawal of the role of the Chinese state from a number of social services, such as medical care, education, pension, and housing, etc., leading to many serious socio-political and socio-economic problems, such as a dramatic increase in inequality, rampant environmental degradation, and social disharmony (Li, 1999, 2006).

However, since the 21st century, the return of the Chinese state in attempting to address these problems has been witnessed. At the same, the continuing expansion of the SOE⁶ in the proportional share in China's economy and the fall of the private sector has also been witnessed. An article in the Wall Street Journal synthesizes the organization and operation of the Chinese SOEs from a research paper:

The Chinese system is based on "vertically integrated groups" of large state-owned and related companies. Each group has a "central holding company," the State-Owned Assets Supervision and Administration Commission (SASAC), which is the majority shareholder in a "core company." That company, in turn, owns a majority of shares in the state-owned companies that comprise the group, including a finance company that is a source of finance for members. Altogether, these vertically integrated groups control some 120 SOEs, all subject to government control via SASAC.

There are intra-group linkages via joint ventures, alliances, and shareholding. Also, the Chinese Communist Party (CCP) structure exists parallel to the structure noted above. The Organization Department of the Party is decisive in choosing top managers of the SOEs, and in turn some managers hold positions in government and the CCP. “These hierarchical structures are embedded in dense networks –not only of other firms, but also of party and government organs,” and exchange and collaborate on many matters of production and policy implementation. (Lubman, 2012, with some direct quotations from Lin and Milhaupt, 2011)

Figure 4. Relationships among SOEs, SASACs and central and local governments



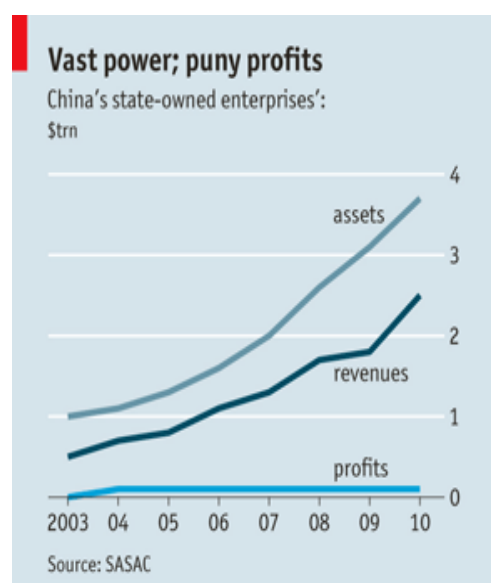
(Source: Deng, Morck and Wu, cf. Szamosszegi and Kyle, 2011: 6)

Notes: SASAC – State-owned Assets Supervision and Administration Commission of the State Council

China’s state-owned enterprises have transformed and restructured and many are among the world’s largest companies, such as China Petroleum & Chemical Corporation (Sinopec), China National Petroleum Corporation (CNPC), and the Industrial and Commercial Bank of China Limited (ICBC), etc. According to Lin and Milhaupt (2011: 2), nowadays China ranks No. 3 in the world in terms of concentration of Global Fortune 500 companies after the US and Japan, while more than two-thirds of Chinese companies in the Global Fortune 500 are SOEs. On the basis of their statistics, “As of 2010, total assets of the 120 national SOEs

equaled 62% of China's GDP; total revenues were 42% of GDP. The same year, total profits of the national SOEs were \$129 billion, more than two times the total profits of the 500 largest privately owned enterprises" (Lin and Milhaupt, 2011: 5). SOEs account for 80% of the value of China's stock market (*The Economist*, January 21). Hence, it is obvious that in order to understand Chinese state capitalism, it is indispensable to understand Chinese SOEs.

Figure 5. The economic power of Chinese state-owned enterprises (source: *The Economist*, November 12, 2011)



Although Chinese SOEs have been the driving forces behind China's remarkable market growth, there are still vigorous debates around the state-led development model. Very often the expansion of SOEs is at the cost of limiting private sectors and foreign companies. *Time* magazine questions whether Chinese SOEs are "a problem for the global economy" because they are equipped with unfair state-led competitive strength to outcompete other private companies, and because "China's SOEs are potentially poised to alter the rules of global

economic competition" (Schuman in *Time*, Feb. 15, 2012). Their overseas expansion cannot avoid creating anxieties from those nations where China seeks to invest, about their links to Chinese state ownership and state control. To understand the operational governance of SOEs is rather difficult because the organizational structure surrounding China's most important SOEs still remains a "black box" (Lin and Milhaupt, 2011).

It is expected that Chinese state capitalism with its gigantic growth machine of SOEs will continue to cause debate, stress and even tension both inside China and with its overseas trading partners. Chinese SOEs have been in the vanguard of China's inroad into Africa in the past 20 years or so (Xu, forthcoming).

The Sinicization Imperativeness

Chinese state capitalism can be conceptualized in such a way that economically the Chinese economy is operated in a combination of liberal market economy mechanisms and a central-planned guideline, i.e. a mixture of the advantages of private business and the positive roles of

government. Therefore, the features of Chinese state capitalism cannot be fully described as capitalist or socialist. But the political power of Chinese state capitalism is relatively monopolized by the Chinese Communist Party with a tradition of individual “strong man” leadership. Thus, the share or competition for political power is relatively restricted and political opposition is limited. Chinese state capitalism demonstrates a strong alliance between the state, labor and industry, called *corporatism*. Its ruling legitimacy is dependent on economic performance.

From a civilization-state to a nation-state

Before we can understand the unique factors of Chinese state capitalism, we have to first of all conceptualize the historical and cultural characteristics of the Chinese state. Like all countries in the world, China has since the *1911 Revolution*⁷ identified itself as a nation-state⁸. However, for many scholars, especially sinologists and cultural-historians, China was, and still remains, in possession of the essential features of a civilization-state --- the longest unbroken existing polity in the world, dating back to 221 BC: the first unified Chinese Empire - the Qin Dynasty. Unlike Western nation-states, China's sense of identity comes from its long history as a civilization-state. That is to say, to entirely apply the unit of analysis and the logic of economic and political rationality of Western “nation-state” concept, a term that has its historical root in the formation of the modern nation-state system in Europe, to understanding China has been paradoxical. In other words, the political economy of Chinese state capitalism cannot be conceptualized in line with the theoretical frameworks of political economy derived from Western nation-state logic and rationality. The notion that China is a “civilization-state” rather than a “nation-state” was first raised by Lucian Pye in a very explicit tone:

The starting point for understanding the problem is to recognize that China is not just another nation-state in the family of nations. China is a civilization pretending to be a state. The story of modern China could be described as the effort by both Chinese and foreigners to squeeze a civilization into the arbitrary, constraining framework of the modern state, an institutional invention that came out of the fragmentation of the West's own civilization. (Pye, 1990:)

The central features of China as a civilization-state can be characterized by the fundamental social and political culture defined under the “man-rule” order. This order predetermines the narrow acceptance of a mono-moral and socio-political arrangement, in which Confucianism has been the ruling ideology for Chinese empires for centuries. Under this order the state not only enjoys natural authority but is also taken for granted as the guardian of people and

society. The power of the state permits no challenge, and its power is absolute, not relative. The state enjoys much greater natural authority, legitimacy and respect, as it is seen by the Chinese as the guardian, custodian and embodiment of their civilization. The duty of the state is to protect China's unity and integrity. The legitimacy of the state, therefore, lies deep in Chinese civilizational history. The Chinese concept is completely different from how the state is perceived in Western societies.

Therefore, after China's defeat in the Opium War⁹ and especially when the imperial system broke down in the early 20th century after the 1911 Revolution, releasing a great deal of cultural iconoclasm among Chinese intellectuals toward Confucian political and moral order, it was still very rare to find anarchist defenders of self-interested individualism. It was still commonly accepted that the state granted rights and determined their limits (Ferdinand, 1991). Likewise, during the following periods of revolutionary socialism after the victory of the Chinese communist revolution, the role of the Chinese state was radicalized with the injection of the dictatorship of the Communist Party, i.e. a party-state¹⁰, in which orthodox Marxism and Maoism became the single paradigmatic and political moral order¹¹, where Confucian stability and harmony was replaced by class struggle and political mobilization, which were radicalized for economic development and socialist construction. The economic reform in the past three decades has gradually separated the political role of the Communist Party and the administrative role of the state (government management).

In line with this background understanding, we can comprehend that China has been struggling to adapt itself to the Eurocentric framework of nation-state logic since it was forcefully pushed into being part of the capitalist world order. However, being a civilizational state for more than two millenniums China has also been struggling to *sinicize*¹² the adaptation process by injecting it with strong and enduring Chinese characteristics. In China's contemporary history, this *sinicization* process includes the periods of the Chinese Communist revolution, the Maoist socialist experiments and the Dengist market capitalism (Li, 2010b). Understanding the characteristics of China as a "civilization-state" provides a framework of understanding the Chinese developmental state and its unique state-market relations reflected in the so-called "Chinese model".

The economic base of the political hegemony and the rising challenge

Both Mao and Post-Mao Chinese regimes faced unprecedented challenges to the reconciliation between the maintenance of Chinese political identity (socialism) and economic

rationality and market mechanisms (capitalism). The Chinese socialist project not only involved arenas at political, economic and ideological levels but also took place at the levels of epistemology and ontology which Mao struggled to transform during his life time. For Gramsci and Mao, the struggle to build such a project represented an extremely difficult and complex task in which many obstacles lay in the realm of culture and ideology involving interactions between various relationships, such as politics, state, civil society, class etc. The importance of studying the Gramscian hegemony approach is that it problematizes the state-society relations under state socialism and brings to light some of its complexities. Through careful reviewing Gramsci's political thought and theoretical concepts as well as their implications, we are enabled to read Marx in the conditions of modern Western capitalism as well as of the experiences of the socialist experiment.

Gramsci's hegemony theory is also adequate to explain the post-Mao transformation and the new type of hegemony generated from marketizing Chinese socialism. That is to say, that the Chinese reform practices reflect some general qualities of the Gramscian hegemony theory in which the CCP and the post-Mao leadership have been adapting themselves in a process of "passive revolution"¹³, and the new hegemony is realized through a reconstituted historical bloc on the basis of convergence of interests and through neutralizing the pressures of various contending forces that might otherwise trigger profound structural transformations.

Over the past decades it has been a consensus that the CCP has shown a remarkable capacity and resiliency in the governance of China's economy and political stability. An interesting dialectic phenomenon is that on the one hand, economic progress has in some aspects reduced the power and influence of the CCP. But on the other hand, economic gains and rising living standards have also softened the social demand of political liberation and have created new legitimacy for the Party and state. Eventually the CCP is in a "riding tiger"¹⁴ dilemma in which the credibility of the Chinese government has come to rest on its market performance, a tendency which makes it politically vulnerable to economic setbacks (Li and Christensen, 2010).

The State-market Embeddedness

Understanding developmental state

Largely inspired by the intense curiosity about this first case of rapid industrialization outside the Western cultural sphere, Japan and the East Asian newly industrialized economies became the object of various academic studies and interpretations. The World Bank published a

special report on *The East Asian Miracle* (World Bank, 1993), which generated a global debate on the various factors behind the East Asian success.

The Chinese experiences can be explained by referring to the core features of the dominant paradigm for the development of what Chalmers Johnson calls the “Capitalist Developmental State”¹⁵. China’s catching-up strategy clearly resembled the East Asian experiences: building on a strong authoritarian leadership and an elite bureaucracy pursuing developmentally oriented policies, including the direct role of the state in governing the market¹⁶. China’s success in the last three decades of economic reform has been led by a strong and pro-development state that is capable of shaping national consensus on modernization and maintaining overall political and macroeconomic stability in order to pursue wide-ranging domestic reforms. There are a few unique features of this type of developmental state which have fostered the dynamic aspects of China’s economic growth:

- 1) It sees social and economic development as the over-arching objective of the state. It creates social stability and political predictability and maintains a manageable equality in distribution in order to prevent crisis between capitalist accumulation and class/sectoral exploitation. It plays a leading role in fostering, guiding and ensuring economic growth and technological modernization over the long-term.
- 2) It puts forward national development goals and standards that are internationally-oriented and are based on non-ideological external referents. It is eager to absorb worldwide development experiences without abandoning its own policy-making sovereignty as to when, where and how to adopt foreign ideas. The state is determined to plan an active role in financial control over the economy even in face of international pressure to liberalize its financial sectors.
- 3) It sets up an infrastructure of productive forces and labor markets which target the global market so that its export-oriented economic growth is sustainable on a long-term basis. Its national education system is also designed to serve the economic growth and foreign market.
- 4) It initiates state-driven industrial policies. It recognizes and empowers bureaucratic elites capable of administering the system and decision-making without being subjected to political influence by various interest groups so that it can function professionally and independently. On the other hand, economic policy-making processes involve close government-business collaborations in order to correctly respond to market signals.

5) It believes that free market mechanisms sometimes need explicit “administrative guidance” and “directed credit” which pick up the winners or prioritize some industries over others. Public and private sectors are promoted to work together to pursue social and economic goals. Government not only regulates business enterprises but also assists them with overheads and other preferential policies. It channels foreign direct investment to target strategic private businesses while business enterprises assist government to reach social and economic goals.

6) It does not allow liberal ideologies to confuse the national consensus and does not permit the development of political pluralism that might challenge its goals. It does not see Western democracy as a political system on its own that will necessarily lead to economic and social development. It believes what a country needs at its initial developmental stage is discipline more than democracy.

Commodification of state institutions and marketization of bureaucratic power

Many people might be puzzled by some underlying questions: how does a market economy emerge from a communist system? And can the emergence of market mechanisms and communist state politics coexist? In the Chinese case, many researchers including Wank find that the resurgence of private enterprise following the economic marketization does not lead to any weakening of the patron/client relationship as neoliberal theories would argue, but rather to the emergence of a new, more commercialized or cash-based form of clientelism (Wank, 1999), which is identified as a unique feature of “a market economy with Chinese characteristics”. The interweaving of the various forms of collaboration between the public and the private reveals an interesting combination of public-private co-operatives, where the “patronage” and the land are provided by the local government while the capital comes from private entrepreneurs. For example, some co-enterprises, particularly hotels and restaurants, in which the “public status” is bestowed by the local government whereas the funds are private, are leased to private operators, etc. What the state needs is to sustain its capacity to construct and maintain institutional environments that provide positive incentives to entrepreneurs and managers at the firm level to invest in economic growth.

Based on his ethnographic study of the role of personal-social ties between private entrepreneurs and local officials Wank elucidates the vitality and dynamics behind the success of the re-organization of China’s emerging market economy. To be inspired by the theoretical thinking of Wank (1999), we can identify the Chinese state-market corporatism as a type of

“institutional clientism”, i.e. distinctive features of the interactive relations between private business and state institutions including local political structures at various levels:

- Institutional clientism implies the transformation of institutionalized social relations from monopoly to marketization of the country’s resources, either through an official’s position or through clientist ties between private actors and office-holders. It is an integrating process in which policy-making and the controlling power of state institutions are incorporated into economic calculations and business activities that reflect market commodification values.
- State policies and decision-making rationalities on resource allocation are integrated into market competition logic in which local governments compete with each other over capital and labor resources by providing a competitive local policy, local infrastructure and business environment. But they nevertheless are centered on social relations including private businesses that seek to have a share of these resources. The state’s previous direct monopoly is replaced with new regulatory monopoly aiming at both facilitating and constraining market interactions such as licensing, quota allocations etc. This type of state-market clientelist relations can promote efficiency in an emerging market because it promotes long-term calculation rather than short-term speculation.
- Institutional clientism involves a reconfiguration process in which state politics are more directed toward market competitive ends. However, the new market system cannot function independently from the political system in which the legacies of the communist party-state create and constrain processes of cooperation and competition. This is because institutions are not neutral and they are culturally and socially conditioned. The party-state has been developing strategies in order to cope with the new changes. For example, the Party is willing to co-opt new party members including the new capitalists and create new links with other emerging organizations and social forces.
- Institutional clientism is maintained through an institutional framework in line with *social trust*. The new clientelist relations promote state-market cooperation, thus avoiding an “either-or” situation, i.e. either the politics politicizes the market or the market marketizes the politics. In other words, the market itself has no objection to political authoritarianism as long as it cooperates with market mechanisms. The emphasis of clientism is aimed at the maintenance of social order and political stability and such an expectation has to be understood and incorporated into market interactions.

- Since the patron-client relationships are based on social trust that reflects the interests of both sides, private business is keen on its ties with officialdom. In this type of relationship, “power is embodied not only in the monetary gains derived from trade but also in position in network. Diffuse forms of social, symbolic, and cultural capital shape relative resources and outcomes in interpersonal bargaining” (Wank, 1999: 31). To do business is understood not solely as utility-maximizing in market transactions but as cultivating the personal and social relations (in Chinese “*Guanxi*”¹⁷). The Chinese party-state likes to dine and dance with private business so that it is able to continue to control the politics while becoming enriched and strengthened by the market.
- The public-private clientelism unveils that formal legal property rights and the definitions of an individual entrepreneur are less important than the “social environment” in determining the outcomes of business activity and market performance. In other words, having a good relationship with local Party and state officials is much more central for securing successful business than the formal ownership classification of that enterprise. Commercial rationality in China is less determined by relying on market opportunities than by cultivating strong ties with “*Guanxi*” that in turn will facilitate those market opportunities.

These characteristics of “institutional clientism” have given the Chinese state two advantages. The first is that the market reform has not brought about politically independent social forces and autonomous business interest groups which can challenge the state’s power. Although private economies have become one of the main sources of government revenue, the entrepreneurial classes still rely on the political and institutional environment to survive and prosper, and they still need the state’s protection to solve their disputes and conflicts with other subordinate classes as well as to reduce their social vulnerability and precariousness. The second is that the emergence of private enterprises in reforming China’s socialist economy has not reduced the embeddedness of organizational decision-making, but rather it has spawned the development of new forms of embeddedness. It demonstrates the institutionalization of a symbiotic relationship between private business and government officialdom as the communist system transforms into a market economy.

Conclusion Remarks: Rising Challenges Ahead

This paper provides a framework of understanding Chinese state capitalism from the perspectives of the transformations of contemporary China from a civilizational state to a capitalist developmental state, and the unique state-market relations reflected in the “Chinese model”. The post-Mao market transition along with the institutional reforms is characteristic of a distinctive style of state capitalism in which the marketization of the former command economy, the active role of the Chinese party-state and local government, the variety of forms of property and business ownership, the traditional culture of clientele-based social relations, the institutional legacies of socialism, and the emergence of market-based institutions all provide rich empirical context to conceptualize and theorize the “embeddedness” characteristics and the new socio-institutional hegemony in the Chinese model.

Historically China has been able to display a capacity for absorbing foreign ideas and influences and sinicizing and transforming them into parts of its native value systems, such as the sinicization of Buddhism. Also historically the CCP has been attempting to sinicize China’s development path during different periods in line with its ideological transformations, such as “Chinese Marxism”, “Chinese socialism”, and “socialist market economy or market socialism” (Li, 2010b). Is Chinese state capitalism market socialism, or vice versa?

A challenging question facing China is whether it has the ability to sustain state capitalism without further institutional reforms regarding the rule of law, governance and accountability. There has been a continuing debate within China about the sustainability of its development model. China must carefully learn the historical lessons of “middle income trap” in which, when per capita income reaches \$10,000-12,000 a year, many developing economies seemingly tend to become stagnated and stop further development due to the lack of institutional change and adaptation.

One of the further reforms that need to be carried out is in the political domains. The rise of the Chinese middle class and civil societies together with the imperative tendency of societal pluralism brought about by modern technologies such as the internet, will sooner or later challenge the political economy of Chinese state capitalism. This is because the Chinese state-market relations, in spite of their relative stability, still need to be compatible with the increasingly pluralistic social formations, i.e. social classes, civil associations, and individualism. Political change and adaption in this new critical era seem to be inevitably indispensable.

If political reform is an inevitable consequence of China's economic expansion, is the CCP willing to further modify the political system to make the political economy of the state capitalist system viable? To find the definitive answer is very difficult. But an open-ended answer is that if the CCP is able to create state capitalism with Chinese characteristics, and it has shown in the past decades a capacity of resiliency in accommodating new challenges, it will presumably be able to establish a political economy with very evident Chinese characteristics as well in the coming era of varieties of capitalism.

Notes

¹ The word "capitalism" as a socio-economic system is seen by the Chinese party-state as being politically incorrect to be applied in formal and official Chinese contexts. Therefore, such expressions like "socialist market economy" and "market socialism" are considered more politically correct than "capitalist market economy" and "market capitalism."

² The phrase comes from Joshua Cooper Ramo's book *The Beijing Consensus* (2004). It is coined to describe what he believes to be a third model of development challenging the mainstream development discourses. It denotes a path to development that does not necessarily require conforming to free-trade neoliberal dogma defined by the *Washington Consensus*.

³ "Trasformismo" used by Gramsci refers to a strategy of elite politics aiming at accommodating opposing forces that may disrupt the status quo and threaten the hegemony of the elite. It includes the creation of a flexible, centrist coalition of government to isolate the extremes of the left and the right and the incorporation of extended cultural, social, economic, and political networks.

⁴ Although it is recognized that Chinese economic reform contains many disembedding elements where the economy (market) is empowered to play its due and logical roles, there has been a strong "visible" hand to embed the market reform with political establishment and with socio-cultural settings.

⁵ According to the Marxist original definition of "capitalist", which is defined in terms of "ownership of means of production", there would be no single capitalist in China after the nationalization of means of production

⁶ A clear and comprehensive definition and information of China's state-owned enterprises (SOEs) can be found from Szamosszegi and Kyle (2011).

⁷ The Republican Revolution of 1911 overthrew the last dynasty – the Qing Dynasty (1644–1911) and turned China into a republic. It is also called *Xinhai Revolution* in Chinese because the year 1911 was a *Xinhai Year* in the sexagenary cycle of the Chinese calendar.

⁸ The emergence of "nation-state" as a notion and a unit of international relations is a relatively contemporary phenomenon formally derived from the Westphalia Treaty. The

political and cultural legitimacy of a nation-state is based on sovereign and ethnic entity within a defined territorial unit. Historically and culturally as a civilizational state China was not familiar with the nation-state framework of understanding.

⁹ The opium wars (1839-43, 1856-60) were fought between Great Britain and China. They began when the Chinese government tried to stop the illegal import of opium into China by British merchants. China was defeated in both wars. As a result, western powers especially the British gained significant commercial privileges and territory.

¹⁰ China is a single-party state, in which the Chinese Communist Party (CCP) as the ruling party forms the government, and no other parties are permitted to run candidates to replace the ruling party. Even though China has a few more political parties, they more or less function as allied parties and as the symbol of national unity, democratic politics and political participation.

¹¹ Even the neo-Marxist theories, such as Kauskysm and Gramscianism were not accepted to exist in parallel with orthodox Marxism and Maoism

¹² “Sinicize” implies a process of transforming any foreign idea, value, practice and international relations into Chinese in character or to change or modify them with Chinese influences, such as the sinicization of Marxism, the sinicization of socialism and the sinicization of capitalism.

¹³ The Gramscian notion of “passive revolution” refers to a style of state class politics in which far-reaching modifications in various societal domains are accepted by the ruling class in order to respond to organic crisis and to defuse social contradictions. This “compromising modification” aims to regenerate the realization of general consensus or consent through which social control is maintained

¹⁴ The Chinese idiomatic expression of “Riding tiger” bears the dialectic implication of dilemma situation in which one enjoys the power of riding on the back of a tiger, while finding it hard to get off for fear of being bitten.

¹⁵ The notion of a “capitalist developmental state” was first applied by Chalmers Johnson, who uses this term to describe the state-market relations in Japan and other newly industrialized countries, such as South Korea, Singapore, Taiwan and Hong Kong. See Johnson, Chalmers (1982) *MITI and the Japanese miracle: The growth of industrial policy, 1925-1975*. Stanford, California: Stanford University Press; and Johnson, Chalmers (1995) *Japan: who governs? The rise of the developmental state*. London: Norton.

¹⁶ There is copious literature on the newly industrializing countries in East Asia, such as Evans, Peter (1990); Haggard, Stephan (1986); Wade, Robert (1990); Weiss, Linda & Hobson, John M. (1995); Woo-Cumings, Meredith (1994); etc.

¹⁷ Guanxi means personal “relationship” and “connection”. In China it is the right “Guanxi” that makes a big difference in ensuring successful business. By getting the right “Guanxi”, enterprises and institutions can minimize risks, frustrations, and disappointments when doing business in China. It is acquiring the right “Guanxi” with the right people, the right network and the relevant authorities that will determine a business’ competitiveness.

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