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Publication Date
2011

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Empowering State Capitalism in China: The Revival, Legitimization and Development of Private Enterprises

By

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A dissertation submitted in partial satisfaction of the requirements for the degree of Doctor of Philosophy in Sociology in the Graduate Division of the University of California, Berkeley

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Spring 2011
Abstract

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My research explores the interplay between the state and market in the formation of the market, and how this in turn leads to the transformation or reproduction of such structures. This is a historical examination of the revival of private enterprise in China since the late 1970s against the contemporary hostile political environment and of the current development of private enterprise. It explores three main issues: (1) how private enterprise, and generally the market economy, a political taboo under Mao’s regime, became legitimized; (2) how the state transformed in response to the development of private enterprise; (3) how private enterprise performed under such market institutions.

My findings suggest that Wenzhou’s marginal position in socialist economy, culture and administration enabled Wenzhou to become the first place for experimenting with private enterprise. The findings imply that marginalized areas had great potential for engendering new institutions; this advances the theory of institutional change. My archival study also shows that three categories of people were the earliest to engage in private enterprise: those who had some work experience in a collective or state entity; those who had done business individually elsewhere; and some cadres.

The findings of my project reject the prevalent decentralization model in explaining China’s institutional transition and lend partial support to the factional struggle theory. The findings suggest that the alliance between the local market model and central market-oriented leaders enhanced the legitimization of private economy. My findings also show that intellectual framing, which was rarely examined about China’s transition, enhanced the gradual transition of institutional logic, the establishment of market institutions and, finally, market hegemony.

In response to the development of private enterprise in the past three decades, Wenzhou transformed from a laissez faire state into a regulatory state, and then into an interventionist state. The findings reject a static view of state-society relations and advocate for an interactive approach to examining China’s transition. This study also shows that institutional isomorphism drove the convergence of developmental models among four coastal cities and suggests an empowering state capitalism in these regions.

The analysis of the nation-wide survey indicate that an entrepreneur’s political connection is crucial for an enterprise’s performance in both areas, and it contributed more to the performance of coastal enterprises than to that of inland enterprises. This gap
may imply a stronger state intervention in the market on the coast than that in the inland and demonstrate the development of private enterprise may empower a strong state capitalism.
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Acknowledgements

I could not have completed this dissertation without the generous support and valuable guidance from my dissertation committee members. Tom Gold has read my manuscripts for many times, from the very preliminary version to the final version. I am also deeply grateful to him for his advices and endless support in all respects of my graduate career in Berkeley. His art of encouragement and mentoring leads me all along the way. Beyond the spur by Neil Fligstein’s own work and wisdom, he also eased the at-first insurmountable task of completing a Ph.D. program by setting periodic milestones and providing realistic advice. Neil’s advice towards an organized and structured writing directed the dissertation on the right track. Heather Haveman invested countless hours in reading and commenting my chapters. I’m deeply indebted to her insightful comments which improved the research design as well as methodology and helped me hone my claims. Heather’s very organized working style also encouraged me to be disciplined in finishing my dissertation. Youtien Hsing helped me gain a deeper understanding about the political economy in China and East Asia as well.

I’m thankful to my dissertation group, including Julia Chuang, Jennifer Choo, Chris Sullivan, Rongbin Han, Mark Dallas, Jonathan Hassuid, Leslie Wang, Suowei Xiao, Rachel Stern, Eli Friedman, Xia Zhang, and Kun Chen. They gave me many helpful feedback and comments.

Thanks also go to those who lent great support for me to conduct the fieldwork, including Jianjun Zhang, Jian Wang, Kangdui Zhu, Xiao Ren, Yuzhao Liu, and those informants who accepted my interviews.
Chapter 1
Introduction

Since modern sociological theory grew out of the intellectual response to the rise of capitalism in the West, as reflected in the masterpieces of Marx, Durkheim and Weber, the transition to market economy in post-socialist societies may potentially have a similar intellectual impact on sociological theory. Although the Chinese government claims China as socialism with Chinese characteristics ever since 1987, scholars are increasingly calling Chinese economic structure capitalism.\(^1\) While academia and the media are hailing China’s successful, gradual economic transition, as opposed to the shock therapy implemented by former Soviet Union and Eastern European countries, some questions remain unclear in the existing literature. For example, how was capitalism constructed in China? How did the private economy revive itself under socialism? How did the private economy, once a political taboo, acquire legitimacy? How did the state, market actors and intellectuals interact with one another to form a market by defining property rights, governance structure, and rules of exchange (Fligstein 1996)? Lastly, how did the development of market institutions influence a firm’s behavior? Answering these questions would help deepen our understanding of the distinctive logic underlying the rise and development of Chinese capitalism, its features and potential developmental trend.

Before situating the project into the theoretical discussion, I will briefly illustrate the development of capitalism in China using some statistical data. A prominent element in China’s transition is the rapid growth of private enterprises and the constant shrinkage of state-owned enterprises (SOEs). A private economy was a political taboo under Mao’s rule; now it enjoys a considerable currency and has generated significant prosperity. According to the official definition, China’s private sector consists of five different kinds of ownership: individual, private, foreign, joint, and shareholding. Since 1985, the private sector has been the most dynamic source of industrial output growth. From 1992 to 2002, the number of private enterprises increased from 140,000 to 2.4 million; the annual growth rate was 33%. Their registered capital increased from 22.1 billion RMB to 2,475 billion RMB, growing by 60% annually, while the number of employees increased from 2.3 million to 34.1 million.\(^2\)

The persistent growth differentials have translated into a significant shift in the composition of industrial output by ownership types. Until 1990, SOEs and the collective economy accounted for more than 90% of gross industrial output; in 2000, SOEs above a designated size accounted for 47% of total industrial added value. It declined to 35% in 2004. In 1990, SOEs and the collective economy employed 70% and 24%, respectively, of the urban labor force. By 2000, these percentages declined to 35% and 6%, and to 25% and 3% by 2004 (Lin and Song 2007). In 2008, China’s private economy accounted for

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65% of GDP and 56% of the tax revenue. From 2004 to 2008, the shrinkage of SOEs began to slow down. In 2004, SOEs accounted for 50.9% of gross industrial output and 33.3% of gross industrial assets. The proportions declined to 43.8% and 28.4%, respectively, by 2008. Moreover, the national stimulus package in 2009, largely focused on SOEs and the drive to nationalize private enterprise in the coal mining industry in Shanxi, a northern province, led scholars to heatedly debate the reverse movement—a revival of SOEs and shrinkage of the private economy (guo jin min tui).

Fligstein (1996) theorized the construction of the market as politics, and identified the different components of the market institution as property rights, governance structures, conceptions of control and rules of exchange. Building on this theory, this dissertation explores the constructional process of market economy, or capitalism, and the features of market economy in China by focusing on three main questions: how were the private property rights, i.e., private economy, constructed; how did the state respond to the development of the market; and what are the rules of exchange in the market. For the first question, I examine the historical process of the revival and legalization of private economy in Wenzhou, a coastal municipality in China. As for the second question, I mainly look at how the Wenzhou government transformed in response to the development of a legalized private economy. I also compare it with a few other municipalities along the coast. The first two questions center around the process of institutional transition or the construction process of the market, therefore, I draw upon the theories of the field (Fligstein 2001) to explore how various actors interacted to form and stabilize the market. The third question examines the features of market economy in a static sense, so I utilize a 2006 nation-wide survey on privately-owned enterprises to explore if the socialist legacy is still affecting the market. More specifically, I wanted to explore if political connections impact private enterprises’ performance in the market and the difference, as well as similarities, between the coastal market and the inland market, which developed later.

For informational purposes, I present here a sketch of my major findings: the historical examination of the constructional process shows that the locus of market transition lies in the marginal place of socialist political, economic and cultural structure, which supplied with the grassroots initiatives for the alternative model, that is, market practice; the market camp including political and intellectual elites were crucial for the legitimization of market practice; the development of the market further drove the transformation of local states, from a planned state to a weak state, then from a regulatory state to a strong state again. The state’s strong presence in the market in the 21st century makes an entrepreneur’s political connections crucial for the private firm’s performance. Overall, the findings suggest an empowering state capitalism in China. I use the term of state capitalism to describe a system where the state is intervening in the markets to

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3 Internal reference of private economy, August 28, 2009.
5 According to wikipedia, “capitalism is an economic system in which the means of production are privately owned and operated for a private profit; decisions regarding supply, demand, price, distribution, and investments are made by private actors in the free market; profit is sent to owners who invest in businesses, and wages are paid to workers employed by businesses and companies” (http://en.wikipedia.org/wiki/Capitalism, accessed on November 8, 2010), so I use market economy, capitalism and private economy interchangeably.
protect and advance interests of big business. An empowering state capitalism in the past three decades in China indicates that the state weakened its intervention in the market in the beginning of reform to allow for the development of private economy, and that as the private economy grows the state began to regulate the market and increasingly intervene in the private economy to protect and advance the interest of big business.

**The making of private economy: driver, actors and process**

The first and foremost thing in constructing a market economy is to define private property rights, in other words, legitimizing private economy in socialist context. Property rights refer to social relations that define who have the residual claims (Jensen and Meckling 1974; Fama 1980) on the profits of firms (Fligstein 1996). In state and collective economies, the state and the collective have the claims on the profits of firms, whereas in private economies, capitalists have such claims. Market economy refers to how the market functions as the essential mechanism of resources allocation. This is in contrast to the planned economy, under which the state functions as the resource allocation mechanism. To allow the market instead of the state to allocate resources, private economy should be allowed to grow, thus, private property rights need to be defined. “[T]he constitution of property rights is continuous and contestable political process, not the outcome of an efficient process” (Fligstein 1996: 658). China launched market reform in the late 1970s, however, only in 1987 did the first regulation allowing for the development of private enterprise get passed in Wenzhou, the cradle of China’s private economy. In 1988 the amendments to the Constitution, based on this regulation, partially allowed for the development of private economy. Finally, in 1992 China legalized market economy.

How did Wenzhou become the locus of the initial change? How did this political process proceed? Who were involved in this process? Additionally, how did they interact to form the market economy? Essentially, what does this process imply about the logic underlying China’s institutional transition? I would argue that understanding the underlying logic of China’s institutional transition is very important, because the logic by and large shaped the developmental path, thus the feature, of Chinese market economy. Numerous studies attempted to explicate China’s transition from a wide variety of perspectives, generating complex and inconclusive pictures, such as the decentralization theory, factional struggle theory, market transition, local corporatism, power persistence, etc. These studies mostly focus on the transitional mechanism, that is, the causal chain linking the background conditions, market outcomes, and power and income consequences of the markets (Parish and Michelson 1996). In the following part, I will discuss some relevant literature, their value and limits, and then I will propose my own approach to exploring the making process of private economy in China, building on neo-institutional analysis.

*Decentralization, local incentive and innovations*

Decentralization theory argues that China’s decentralized structures of government and public finance played an important part in the emergence of private economy, privatization and China’s economic growth (Qian and Weingast 1996; Montinola, Qian, and Weingast 1995; Qian and Roland 1998; Chen Ping 1993; Xu and Zhuang 1998). It argues that political decentralization encouraged local reform
experiments that allowed new ideas to emerge from the grassroots level. Decentralization created political checks on the central authorities, limiting predation and convincing investors that reforms would last. Fiscal reform gave local officials strong incentives to stimulate economic growth, and it helped harden budget constraints on enterprises, forcing them to restructure. Cao, Qian, and Weingast (1999) argue that “federalism, Chinese style, has induced privatization, Chinese style.” Qian and Xu’s work (1993) suggests that, since 1958, the Chinese hierarchy has followed a multi-layer-multi-regional form mainly based on a territorial principle. The M-form has been further decentralized along regional lines during the reform, with both increased authority and incentives for regional governments. This provided flexibility and opportunities for carrying out regional experiments, the rise of non-state enterprises, and the emergence of markets. In many of China’s major reform efforts, reform began on an experimental basis in a few local areas. The successful approaches were then learned and imitated on a moderate scale by a few provinces. If these experiments succeeded, they were recommended and promoted by the central government as a national policy. This sequential set of experiments creates a series of reform templates that were adopted first at the local level and then at the national level. In doing so, local governments adapt one of the templates to their local conditions, sometimes creating new ones. This pattern has occurred in several big waves of reform, including the agricultural responsibility system, the rapid development of township and village enterprise (TVEs) and markets (Montinola, Qian and Weingast 1995). Lin and Liu (2000) investigated the effect of fiscal decentralization, initiated in China in the mid-1980s, on the growth rate of per capita GDP and found that fiscal decentralization has contributed significantly to economic growth. Oi’s findings (1995) suggested that decollectivization of agricultural production and the reform of the fiscal system were the most important institutional changes that prompted local governments to become entrepreneurial and develop rural industry. According to Oi, fiscal reform assigned local governments property rights over increases in income and created strong incentives for local officials to pursue local economic development. In the process, local governments have taken on many characteristics of a business corporation, with officials acting as the equivalent of the board of directors. This merging of state and economy characterizes a new institutional development: local state corporatism.

The decentralization argument is partially right, in the sense that decentralization granted more autonomy to local governments thus encouraging local governments to innovate practices, particularly in developing TVEs. However, there are two major limitations of the decentralization theory. First of all, it is not sufficient to explain the making process of private economy. Although local governments had much more autonomy to develop their local economy, the decentralization theory cannot provide a satisfactory answer to why private economy was first revived in Wenzhou and how the actors were involved in this process. Secondly, I do not agree that fiscal reform in the mid-1980s was conducive to the emergence of a private economy. On the contrary, following the decentralization logic, the strong incentive for the local government to develop its revenue may lead it to intervene heavily in the local economy, despite it acting as a corporation. Heavy state intervention in the market contrasts sharply with the

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6 They further argue that the M-form of the Chinese hierarchy is essentially different from the unitary state hierarchies, based on functional or specialization principles, in Eastern Europe and the former Soviet Union. See Qian and Xu (1993).
situation of a private economy; in other words, state intervention would impede the emergence and development of private enterprise. Research shows that in the Sunan area, under the local state corporatism model, there were rapidly growing TVEs, but they made up only a very small portion of private enterprises during the early reform period. Moreover, Lin and Kuang’s study (2007) suggests that there is a subsequent decline in the role of fiscal decentralization in the development of TVEs. They argue that market development and competition have constrained the abilities of local public enterprises to address revenue and employment imperatives, whereas local governments’ sales-oriented growth strategies have exacerbated governance problems. Market development and competition drove the TVEs to become increasingly privatized since the mid-1990s. Furthermore, my research on Wenzhou shows that state officials attempted to suppress the private economy when it was emerging; however, the effort turned out to be futile because of strong grassroots initiatives.

**Factional struggle, rivalry between market camp and planning camp**

In contrast to the decentralization theory, the theory of factional struggle (Cai and Treisman, 2006) argues that the driving force behind reform was not pressure from or initiatives by autonomous local officials but competition at the center between rival factions with different ideological predispositions and local connections. Faction leaders sought supremacy within the party by demonstrating the effectiveness of their chosen policies across the chessboard of China’s territorial administration. Local officials were linked to these factions and sought to impress higher-ups with suggestions that were spontaneous, and sometimes even illegal.

For the purpose of this project, I would argue that the factional struggle theory is especially valuable for understanding the institutional breakthrough at a particular place, such as the emergence and legalization of the private economy in Wenzhou. Factional theory can also explain the temporal pattern of reform, which ebbed and flowed with shifts in the factional balance of power. An example of this is the revival of the state economy and slow growth of the private economy in recent years.

However, the factional struggle theory is unsatisfactory in several respects. First, it fails to explain how the factions arrived at a consensus, and how some local practices became nationally legitimized, particularly the private economy. Second, the theory overstates the role of officials and downplays grassroots initiative. Because the idea of private economy was highly sensitive during the beginning of reform, the previous discussion demonstrated that central officials were ambivalent towards it, and local officials were unsure of the political winds. Local officials may have had the incentive to engage in the development of a collective economy, that is, TVEs. However, they still hesitated to take risks in the development of a private economy. As this study will show, the rise of the private economy was largely pushed by peasant entrepreneurs. Local officials in Wenzhou, unlike officials in other regions, were reluctant to intervene. In other words, the development of the private economy was allowed to happen, not because of the officials’ active engagement, but because of their unwillingness to take a hand in thwarting it. Of course, the unwillingness to intervene in the private economy during early reform was also risky for officials.

Third, Cai and Treisman’s theory overlooks the role of intellectuals in this transition. The competition and rivalry among different ideological predispositions
inevitably involves the work of intellectuals. As this study will demonstrate, intellectuals played an important role in framing the new institutional logic in persuading opponents and reducing resistance.

**Favorable conditions for institutional change**

Some scholars have argued that China’s disadvantageous pre-reform conditions, such as the Maoist legacy, shortage of arable land, educational deficiencies, lack of scientific and technical expertise, low levels of per capita income, industrialization and urbanization, and a weak planning apparatus, became advantages for rapid growth in the gradual transition. They claim that these conditions prevented China from experiencing the shock therapy failures in Eastern Europe and the Soviet Union, where there was over-industrialization and over-urbanization (Jefferson and Rawski 1994; Naughton 1994; Nolan and Ash 1995; Sachs et al. 1994). However, these studies largely miss the sociopolitical process of the making of capitalism, the actors and the power relationship in the field. They cannot provide satisfactory answers as to how and why China’s transition is *gradual*, whereas the transition in Russia and Eastern Europe is radical.

**Institutional change: actors, drivers and process**

As aforementioned, the making of private property rights is central to the development of market institutions. I draw upon neo-institutional analysis to explore the emergence and legalization of the private economy, the actors, the drivers, and the interactive process which makes the gradual transition possible. Institutions are rules and shared meanings, and consist of cognitive, normative, and regulative structures (Fligstein 2001; Scott 1995). In the adolescence of institutionalism (Scott 1987), scholars emphasized the institutional pressure on organizations, highlighted the durability and embeddedness of institutions as an “iron cage,” and privileged their reproduction over transformation. Such theories were challenged by many scholars; one of the prominent critiques is the neglect of agency and interests, or the reduction of agency to enactment (Colomy 1998). Scholars grew increasingly attentive to the mutability and multiplicity of institutions and to institutional change, a process of delegitimization and reconstruction of new institutions.

The drivers and sources of institutional change include: sociopolitical pressure, the components of the actors, innovation in technology and the legitimacy crisis. Oliver (1992) conceptualized the process of disinstitutionalization and identified a variety of pressures—social (increasing internal diversity), functional (declining rewards for institutional conformity), and political (shifting external dependence relationships), that are likely to promote disinstitutionalization, reverse the trend toward homogeneity and convergence in institutionalized fields. Kraatz and Moore (2002) considered how factors such as changing technical requirements, external dependence relationships, internal dissensus, lack of commitment, financial exigency, increased competition, and migration of executives in particular, may produce institutional change within both individual organizations and interorganizational fields. Zilber (2002) examined institutionalization as a process of interplay between actions, meanings, and actors, and found that the entry of therapeutically oriented members resulted in the infusion of new meanings into originally feminist practices. Greenwood and Hinings (1996) researched radical change and examined the factors promoting it. Their findings suggest that radical change is
promoted when industries are permeable to ideas and models from other fields, when fields are loosely coupled and characterized by ideological dissensus, and when such change is congruent with the values and interests of powerful actors within the field. Schneiberg (2005) explained the fundamental change in American property insurance from associations to price-competitive markets and vertically integrated markets. He advanced two arguments to explain the change. One of them is the endogenous conditions generated by the institutions for change. The other depends on the dynamic convergence of market failure, legitimacy crisis and new models of order, and the culmination of politics and policies that admit the alternatives into the fields.

In addition, the process of institutional change is a process of deligitimizati on and the construction of new institutions (Colomy 1998). This process involves uncertainty, actors’ defining their particular actions and justifying their rationality and cultural mode. Institutions can be disaggregated into schemas and resources, and institutional durability, into the process of reproduction, disruption, and response to disruption (Clemens and Cook 1999). Goodrick and Salancik (1996) advanced the notion that institutions are primary and exist as the context within which interests operate. They argue that uncertainty provides discretion, implying that organizational influence on practice will be greatest when institutional standards are most uncertain, that is, when actors may use their own particularistic interests to guide their further definition of appropriate action. Guillet (2000) brings the cultural model, specifically schema theory, to examine the middle ground, attempting to reconcile the tension between agency and structure. His research on the two different forms of property rights in agriculture in northern Spain showed that generations of farmers have culled and reduced their collective experiences with private and common property to a set of cultural models of property rights.

These studies, though mostly focusing on the organizations and industries, offer valuable insights into the emergence and legalization of private enterprise in China. The discussions of the disinstitutionalization, deligitimization, ideological dissensus, ambiguous environment, interplay between actions, meanings and actors, and cultural factors, are helpful in understanding the gradual transition from planned economic institution to market institution in China. However, the literature largely misses the initial locus of institutional change, the alliance of the actors and the interplay between the economic practice and the framing. As this study will show, after Mao’s death, the market camp and the planning proponents diverged in economic policies. The market camp needed an alternative developmental model as opposed to state planned economy to strengthen their legitimacy of power. The struggle between the two camps made the political and economic environment ambiguous, comparing to the stringent environment completely dominated by planned camp under Mao. Wenzhou was marginalized under socialist politics, economics and culture under Mao’s regime. As the political and economic environment became ambiguous since the late 1970s, Wenzhou’s underground enterprise developed rapidly. Wenzhou entrepreneurs justified their private business for their own interests under such uncertainty, and persisted in running private enterprise even under the crackdown by local officials during the beginning of reform. The poverty under planned socialism and the wealth brought by the development of private economy challenged the legitimacy of orthodox socialism, eventually leading to the legitimacy crisis of the state planned economy.
The making of private economy: Legitimacy, framing and intellectuals

**Institutional change: legitimacy, framing and intellectuals**

Scholars are increasingly attentive to the growing knowledge of legitimacy in the contribution to the emergence of new institutions: the growing knowledge of legitimacy, the change of institutional logic and the strategic use of language or rhetoric (Suddaby and Greenwood 2005). Legitimacy, as one set of constraining factors new organizations are facing when an industry is in its formative years, has two components. One is cognitive, that is, how taken for granted a new form is; the other is sociopolitical, that is, the extent to which a new form conforms to recognized principles or accepted rules and standards (Aldrich and Fiol 1994). Legitimacy functions through the mechanism of trust; in other words, legitimacy is crucial for the new organization to establish trust with its environment. The criterion of legitimacy is encoded in the institutional logic, which means deeply held and unexamined reasoning and assumptions (Horn 1983). As Friedland and Alford (1991) pointed out, logic are conceived of as organizing principles that govern the selection of technologies, define what kinds of actors are authorized to make claims, shape and constrain the behavioral possibilities of actors, and specify the criteria of effectiveness and efficiency. Logic enables actors to make sense of the world. Legitimizing a new institution occurs in tandem with the displacement of institutional logic. This is achieved through the use of rhetoric, which is an ongoing process of negotiating between institutional logic and legitimacy (Suddaby and Greenwood 2005). For instance, Lounsbury (2002) investigated the transformation of the logic guiding the field of finance and the development of financial expertise that shaped the professionalization of the finance occupation from 1945-1993.

To gain legitimacy, agency is also important; leaders may employ a number of specific rhetorical techniques to frame the new form of organization under the old rules and standards (Fiol, Harris, and House 1999). A number of neo-institutional theorists in organizational studies draw on the social movement approach to examine power struggles, the transition of power in organizational field and rhetoric (McCloskey 1985, Nelson, Megill, and McCloskey 1987, Simon 1989, Suddaby and Greenwood 2005, Voss and Sherman 2003).

Institutional analyses mostly identify organizational leaders and employees as the actors in the process of institutional change, while treating policy makers as exogenous factors. Such analysis is limited in explaining institutional change at the level of society. Furthermore, the element of power is missing from the analysis. The theory of fields nicely solves this problem and causes scholars to “focus their attention on how particular groups come to define a social terrain” (Fligstein 2001: 109). Such a process involves power—incumbents vis-à-vis challengers—and “social skill” (Fligstein 2001). In the theory of fields, the actors can operate at different levels within a field, including organizational leaders, industrial associations, and political elites.

However, a major limitation of existing institutional theory is that few scholars are attentive to the role of intellectuals in institutional change. Bourdieu’s theory offered some clues about the significance of intellectuals in this process. He implied that intellectuals play a very important role in the reproduction and transformation of institutions, and contended that classification struggle is crucial for the transformation of institutions. Although Bourdieu focused on the transition from neo-liberal capitalism to
social-welfare capitalism, his theory of classification struggle (1984, 1998) has strong analytical capacity to explain the class struggle between the dominant and dominated classes. Bourdieu agreed with Weber that capitalist institutions encapsulate a strong element of rationality, which is too strong to overthrow, a similar argument to Gramsci’s hegemony concept. Bourdieu is also in line with Weber on the role of ideas, but goes a step further to contend that the transition is predicated upon the production of ideas. In his terms, classification struggle is the struggle of another set of classification criteria and language to replace the strong neo-liberal classification of the world. According to Bourdieu, intellectuals are pivotal to such classification struggle. More specifically, he suggests that through intellectuals’ constant self-reflexivity – mainly the left wing of sociologists, a new type of language should be created for the dominated class to use to stand up against the language imposed by the neo-liberal intellectuals on behalf of the dominant class. The classification struggle, in my view, is similar to the struggle over institutional logic. Bourdieu identifies the agent of change in institutional logic. However, his suggestion that intellectuals engage in constant self-reflexivity upon the relationship between the object and subject misses the drive from the reality and the conditions for the transition.

The previous discussion indicates that in order to gain a deeper understanding of China’s gradual transition or the gradual emergence of private economy which was a political taboo under Mao’s regime, we need to examine the transition of legitimacy: how the actors made sense of or legitimized the private economy; what are the criteria of effectiveness and efficiency under new institutional logics; who are the actors and what are their roles; and what is the interplay between the meaning, the economic practice and the actors.

**Chinese private enterprise: a political taboo and Maoist legacy**

In 1956, China completed socialist reform of the ownership of the means of production, eliminating all private enterprise. In the following year, China established the people’s communes in rural areas and collectivized all farm households. For 20 years, private enterprise was a political taboo. Prior to the death of Mao in 1976, China had had one of the most extreme anti-private stances in the communist world. After the Cultural Revolution, legitimate private economic activity had almost been eradicated. In 1978, a new form started to bring market mechanics into the economy. However, studies indicated that there was some continuity of Maoist policy after 1978. Nolan and Ash (1995) point out that at the end of 1978, China’s Maoist economic legacy remained largely intact. They found that ambivalent initiatives introduced during the brief interregnum of Mao’s successor, Hua Guofeng, had done little to alter the basic characteristics of the economic system. Structural defects inherent in the former planning system, as well as features more closely associated with indigenous economic strategies, were reflected in sectoral and regional imbalances and low levels of productivity and efficiency. Yang (1996) also argued that the legacy of the Cultural Revolution did not lead directly to market-oriented reforms in industry either. Solinger (1984) and Naughton (1995) demonstrate that reform was not inevitable in the late 1970s. They found that, as a matter of fact, post-Mao leadership sought to revitalize planning precisely because planning, disrupted under Mao, fell apart under the weight of unrealistic assumptions.
In response to the resulting economic crisis, new economic leaders centered around Chen Yun launched an economic stabilization program that deemphasized heavy industry. Resources were instead redeployed to the household sector and light industry during 1979–81. The gradual change of economic environment resulted in a diminished role and desire for state redistribution and investment, while success in rural reforms unleashed desires for more reforms in other spheres of economic life. The era of reform was thus begun, without a blueprint and as a sideshow to economic reorientation.

In 1979, the central government began to encourage rural enterprise development to strengthen the soon-to-be-dismantled rural collectives. Private business was revived in order to increase employment opportunities and help enliven the economy by boosting commercialization and improving the provision of consumer goods and services (Young 1998). Empirical analysis shows that in the late 1970s, unemployment was influential in spurring privatization. Zweig (1997) argues that Chinese leaders’ decision to foster the growth of the rural private sector was intended to speed up commercialization of China’s rural economy. As he put it, the limited growth of the rural economy under the Maoist system of bureaucratic control, and the improving rural standard of living following liberalization and expansion of the private sector, demonstrate the usefulness of this policy. The above rationale spurred reformists to overcome opposition and persist in encouraging private business. Meanwhile, as the rural economy opened up, as market forces and the profit motive began to play an increasing role in the cities too, opportunities for private business increased and its position became more secure.

Numerous studies reveal that there existed broad discrimination against the private sector up to that point, particularly in the beginning of reform. Some scholars argue that the initial revival of the private sector after the death of Mao was very much in the same mold as similar moves in other socialist countries at various times: insecure and limited in scope, colored by ambivalent attitudes among both policy makers and officials down below, and leaving private operators vulnerable to extortion or harassment. Hershkovitz (1985) detailed the story of a famous peasant entrepreneur who encountered constant harassment and frustration, revealing a certain tension, or at least lack of coordination, between central government policy and local-level implementation. Scholars also found that most of the news coverage of the individual economy attributes low-level bureaucratic harassment to the persistence of leftist influences from the Cultural Revolution period: perhaps defending the purity of the socialist system, one’s own power or just out of jealousy. The scope of the squeeze is astonishingly broad (Hershkovitz 1985, Young 1998). Oi’s work (1995) also confirmed that in the early to mid-1980s, when China’s rural industry started its rapid growth, prospective private entrepreneurs, with the memory of the persecution of private enterprises during the Maoist period still fresh in their minds, were unsure of the political winds and whether policies would change. Putterman (1992) found that the state tried to suppress encroachments on its product monopolies from non-state sectors. According to Young (1995), in the early 1980s, there were constant complaints that cadres were discriminating against private businesses and seeking to hinder their growth.

One set of reasons stemmed from the general attitudes toward private business: political antipathy to private enterprise could lead to direct attacks on it, or the less antagonistic position of simply looking down on private operators could lead administrators to ignore their interests. There were also other reasons. Some
“discrimination” appears to have resulted merely from bureaucratism and the relatively powerless position of the private entrepreneur. Furthermore, Young (1998) found that, although the 1988 legitimization of larger private enterprises seemed to provide favorable conditions for private entrepreneurs, there was no great press of applicants. The new measures did nothing to change the institutionalized discrimination in favor of the state and collective sectors, including easier access to administrative approvals, credit at lower rates of interests, tax holidays, and access to limited-availability raw materials, foreign imports, and direct export approvals. Lin and Song (2007) argued that, although private enterprises have taken hold strongly in the Chinese economy, they face many obstacles to further growth. Private enterprises are not treated equally: they are discriminated against by state-monopolized banks in borrowing and are subject to numerous taxes, fees, and levies from local governments. In many aspects, private property ownership is not effectively protected by laws, and faces other challenges: there is a lack of technical and informational support, management experience, international trade and investment experience, and long-term planning.

In sum, the research discussed above indicates that, although the economic environment became slack, there was still the persistence of the socialist legacy, which competed and struggled with the new practice, particularly in early 1980s.

Legitimizing private enterprise: framing and intellectuals

Although there are extensive studies on China private enterprise, including its policies, management, firm performance and so on, how private enterprise became legalized and legitimized still remained unanswered in the existing literature. Researching this topic is significant in several ways. First, to understand the complex transition in China, it is not sufficient to just examine the changes of policies and mechanisms, because institutional transition involves regulative, normative, and also cognitive transitions. Second, the study of cognitive transition will deepen our understanding of the gradual process of transition. This study will show that the underlying the gradual policy change is the gradual transition of the cognitive understanding of socialist economy. Roland (2004) classified the institution into fast-moving institution and slow-moving institution. According to Roland, a primary example of a slow-moving institution is culture, which includes values, beliefs and social norms, and it tended to change gradually, while political institutions are typically fast-moving institutions. Third, such cognitive changes involve constant competition and struggle among institutional logics, practices, and interest groups. Exploring this conceptualization process will reveal the underlying dynamics. Fourth, only when we understand the underlying competition and struggle among different groups, can we better understand the development trajectory of China’s economy. In particular, only then can we explain the most recent reverse movement: revival of the state economy and the slow growth of the private economy.

As this study will show, the socialist orthodox still acted as the informal institutional constraints in the emergence of private economy. However, the pro-market intellectuals utilized several rhetorical strategies to frame the development of private enterprise in Wenzhou. A major rhetorical strategy was invoking the ambiguities of the old institutional logic, that is, the Marxist rhetoric and the success of new practice to create the new institutional logic for the private economy. They did so in order to
persuade the planning camp, and therefore, to reduce resistance and diffuse the private economy across the country.

**State’s transformation in tandem with the development of market**

In the preceding sections, I have discussed how to understand the feature of China’s market economy from the perspective of the constructional process. In the following sections, I will discuss the feature of China’s market economy. The state-firm relation is central to assessing the development of market institutions, particularly for the post-socialist transition economy; therefore, I will focus on how state and private enterprises interacted in the market economy. I will examine the interaction between state and private enterprises on two dimensions. The first dimension is the role of state in the market, and the second is the performance of private enterprises in the market. In this section, I will discuss if the development of market economy could transform the local state and how the local states responded to this development.

Neo-classical economics contends the arm-length transaction in the market, and treats the state as black box and gives it a minimal role in the market, though they recognize that the existence of the state is crucial for economic growth (North 1981, 20). As opposed to neo-classical economics, economic sociologists provided numerous findings which suggest the embeddedness of market, be it relations among the economic actors in the market (e.g., White, 1981; Granovetter 1985; Burt 1983, Uzzi 1996) or state-firm relations (e.g., Polanyi 1944; Dobbin and Sutton 1998, Fligstein 1996; Evans 1995), which were influenced by the re-discovery of the state in the market in 1980s (Evans, Rueschemeyer and Skocpol 1985).

Fligstein theorized that the state is important for the formation and ongoing stability of the market in terms of developing rules of property rights and exchange and governance structure (1996). He proposed two types of state in terms of state involvement, that is regulatory and interventionist. Regulatory state, e.g, US, create agencies to enforce general rules in markets, while, they do not make substantive decisions for markets; in contrast, interventionist states, e.g France, can decide firm ownership, direct investment, firm entries and exits and competition in markets (Fligstein 1996). Evans (1989, 1995) argued that state-firm relations influenced economic performance and identified predatory, developmental and intermediary states. A predatory state, like Zaire, ruthlessly extracts and provides nothing of value in return. A developmental state like Korea, promotes industrial transformation. An intermediary state, like Brazil, sometimes helps, and sometimes hinders. Dobbin and Sutton’s article (1998) explored how the federal state in the US is administratively weak but normatively strong. They defined the strength of the state in terms of constitutional limitation or non-limitation of state control of private enterprises, the separation or fusion of state powers, and as a centralized administrative enforcement agency or a series of autonomous agencies. These studies rediscovered the value of the state in the market; however, they largely treated the state as a stable and static institution.

These studies distinctively highlighted the state’s role in the market and offered valuable insights into the exploration of the state’s role in post-socialist transition; however, they have two major limitations. Firstly, this distinction is based on outcomes instead of the underlying mechanisms (Roland, 2004). More specifically, it remains unclear how a state becomes a certain type of state, be it developmental, predatory, strong
or weak. Secondly, they largely treat the state as a stable and static institution. I would argue that the institution of the state is also mutable. As Roland pointed out, “political institutions are fast-moving institutions,” though they do not necessarily change often, they can change quickly – sometimes, nearly overnight (2004: 109).

**Variants and transformation of China local states**

In a similar vein, scholars in the China studies field also tended to identify the types of local states based on their relationships to economic activity: the entrepreneur state (Duckett 1998, Lin and Zhang 1999); the clientalist state (Pearson 1997, Wank 1995; Ruf 1999); the predatory state; or the developmental state (Oi 1995, 1998 and 1999; Unger and Chan 1999). In entrepreneurial states, state agents and bureaucrats, even whole government bureaus, may go into business independently or enter into partnerships for profit. In clientalist states, officials promote and participate in the benefits of profit-making activity through personalized and particularistic ties to entrepreneurs in their localities. In predatory states, officials do not engage in business, either directly or indirectly, but instead utilize their positions to extract unproductive rents from producers and entrepreneurs through exorbitant fees, levies and fines. In developmental states, officials intervene indirectly in the economy, by “helping to plan, finance, and co-ordinate local projects, investing in local infrastructure, and promoting co-operative economic relations with external agencies.” They also create an environment conducive to growth, while they themselves do not engage in business for profit, “avoiding the formation of particular ties to ‘preferred’ enterprises and clients.” (Baum and Shevchenko 1999).

The studies reviewed above show that various types of states existed in China, and they advance China study approaches from a perspective of the state as being totalitarian to a perspective of the state. These studies are helpful in conceptualizing and categorizing the types of states, however, they are limited in explaining the underlying mechanism which drove the emergence of such type of state. Some scholars also note that the evolution of local property regimes or types of state’s intervention (Walder and Oi 1999), however, they are still weak in exploring the evolution process and the mechanism.

Quadagno’s study (1992) showed that social movements can fundamentally transform the state, implying that the emergence of market institutions and the development of private economy can also transform the state. In addition, I draw upon theories of organizational change and institutional isomorphism to examine how the local state responded to the development of private economy as well as to the pressure from regional competition and the upper government.

Studies on organizational change suggest two mechanisms: one is rational adaptation (e.g., March and Simon 1958; Simon 1962), and the other is selection (e.g., Hannan and Freeman, 1977, 1985, 1989). The proposition of institutional isomorphism asks about the homogeneity of organizational forms and practices (DiMaggio and Powell 1983), and suggested three mechanisms of isomorphism, that is, “1) coercive isomorphism that stems from political influence and the problem of legitimacy; 2) mimetic isomorphism resulting from standard responses to uncertainty; and 3) normative isomorphism, associated with professionalization” (p.150).
This study will illustrate that, as the private economy became legalized, in other words, when private property rights were clearly defined by the state, the rapid development and, henceforth, the fierce competition of private enterprise made it necessary for the state to intervene to regulate the competition and stabilize the market. When the development of local private enterprise encountered bottlenecks, the intensive regional state’s competition drove the local state to become more active in the market.

In this study, I will illustrate how the Wenzhou government transformed from a laissez faire state in 1980s to a regulatory state in 1990s and to an interventionist state since 2003. In a laissez faire state, the state has minimal direct involvement in the market, but it can be active in defining the property rights for the entry of capitalism (Fligstein 1996). In a regulatory state, the state is active in regulating the competitive market through laws and administrative enforcement, but it is minimally involved in the investment or enterprise management. In an interventionist state, the state is actively involved in investment and enterprise management. The transformation is also accompanied with a slight change of state structure.

Private enterprise performance under market institution

As previously discussed, aside from the state transformation in response to the development of the market, another dimension to assess the feature of post-socialist transitional market economy is to examine the importance of political connections in the market. I have discussed how the development of private economy would impact and transform the state’s role in the market. Now, let us proceed to discuss how China’s private enterprise performed under the market institution. This is another way to assess the feature of Chinese capitalism. One major way to examine the transitional economic institutions is to look at the private firm behaviors in relation to the state, in other words, the importance of the political connection in the market.

Social connection (guanxi) is widely studied in China (Gold, Guthrie and Wank 2002). Organizational studies mostly focus on how manager’s political connections impact the organization’s performance in China. The market efficiency logic posits that the manager’s ties, including horizontal and vertical ties (or political connections), become necessarily efficient as market forces begin to influence business decisions and outcomes (Davies and Walters 2004, Guthrie 1998, Peng 2003). The social-capital perspective argues that when market uncertainty and competition exist in an emerging economy, manager’s ties become desirable because they strengthen a firm’s position through favored relationships with others in the value chain or favorable government protection (Luo 2003, Boisot and Child 1996, Podolny 1994). Podolny and Page (1998) argue that managers form networks and ties to obtain access to scarce resources and information to reduce uncertainty. Their connections should improve the firm’s performance (Batjargal 2003, Peng and Luo 2000).

Contingent view of political connections

Organizational scholars studying China’s transitional economy are increasingly adopting a contingent view on manager’s political connections. The impact of political connections is contingent upon two main factors. The first factor is ownership. Peng and Luo’s findings (2000) suggest that ties with officials are positively related to performance for non-state firms, but not for state firms. Fan, Wong and Zhang’s study (2007) shows
that firms with politically connected CEOs underperform those without politically connected CEOs by almost 18%, based on three-year post-IPO stock returns. They also have poorer three-year post-IPO earnings growth, sales growth, and change in returns on sales. The negative effect of the CEO’s political ties also shows up in the first-day stock return. The second factor is market institutions. China’s transition produces institutional uncertainty (Nee 1992). The lack of a set of stable legal and regulatory laws, networking, including political networking, is critical to facilitating impersonal business activities (Alston 1989). China has institutional hurdles in transferring ownership, creating further needs for sharing through networking (Boisot and Child, 1988; Peng and Heath 1996). A manager’s political network has a stronger relationship with performance when institutional support is weak, or substitute for insufficient infrastructure (Li and Zhang, 2007; Xin and Pearce 1996). Li, Meng, Wang and Zhou’s study (2008) suggests that party membership of private entrepreneurs has a positive effect on the performance of their firms when human capital and other relevant variables are controlled. The research further shows that party membership helps private entrepreneurs obtain loans from banks or other state institutions, and affords them more privilege in the legal system. Finally, they find party membership to be more important to firm performance in regions with weaker market institutions and legal protection. In other words, a party member’s advantages decrease with the increase of privatization. However, Luo’s finding (2003) differs and shows that manager’s ties tend to increase as uncertainty and competition increases and regulations become more stringent.

The disparity of market institutions between inland and coast

Sociological studies diverge on whether political connections matters in post-socialist transitional economies. Sociologists are more concerned about the transitional mechanisms involved in the distribution of resources, such as stratification and market entry. One major theory is the market transition theory (Nee 1989), which argues that the political elite’s advantage in generating economic returns decreases as the market gradually replaces political power as the source that allocates and distributes resources. The other major theory is the power persistence account (Oi 1989, 1999), which argues that political elites still have the advantage, particularly in operating the collective enterprise. When examining the entry into private enterprise, Wu (2006) considered the regional divide between urban and rural and timing. His findings suggest that both education and cadre status deter urban families from entering into private business, but promotes the entry of rural families. Furthermore, although urban cadre families are still less likely to enter into private business than non-cadre families, they are increasingly more likely to do so over time. However, cadre families’ advantages in seizing entrepreneurial opportunities were further enhanced during the late reform stage (1992-1996). I would argue that the divergence of the two accounts largely lies in location, timing and even the focus of their studies. Oi’s local corporatism mostly refers to Sunan while Nee’s market transition model is based on the survey of the Fujian rural areas in 1985, and Wu’s research clearly demonstrated the significance of region and timing in China studies.

For the purposes of this study, I will look at the impact of the entrepreneur’s political connections on private enterprise performance to explore the state-firm relations in the market. As mentioned above, we need to model the regional variation to generalize
the feature of market economy in China. There is a prominent regional divide between the coastal and inland areas in terms of the development of market institutions. The divide between the coastal and inland provinces is widely used in the spatial economies in China, and considerable studies examine the inequality along this divide (e.g., Fan 1995, 2005; Kanbur and Zhang 2005; Tsui, 1993; Veeck, 1993; Ying 1999). The coastal provinces took the lead in privatization (Li, Li and Zhang, 2000) and experimenting with capitalism. Market-oriented institutional transition can be conceptualized as moving from one primary mode of exchange to another in order to reduce uncertainty (Peng 2003). These coastal areas offer various benefits, such as low-cost labor, tax exemptions, and duty-free importation of raw materials and technology. Infrastructural support and investment incentives in these areas allow for lower operating risks and higher efficiency and returns. Compared to the inland provinces, coastal regions have relatively stronger institutional support for private enterprise, which enjoys stronger legitimacy and a relatively more stable legal and regulatory environment that decreases institutional uncertainty. Furthermore, as the market grows in scale and scope, information processing and enforcement will likely become more difficult to coordinate and sanction through managerial ties (Peng 2003).

Another dimension of the development of private economy is the state intervention in the market. Some studies in China also suggest that the roles of local governments differed in privatization in late 1990s along the coast, one example is between Sunan area and Wenzhou, and that there was much more manipulation by the governments and stronger role of governments in the former (Zhang 2008). As my findings in Wenzhou suggest that Wenzhou government is becoming increasingly stronger and transforming from a regulatory state to an interventionist state, there is a converging tendency toward strong state model along coastal cities. The increasing state intervention in coastal cities may lead the entrepreneur’s political connections matter significantly.

In addition, the most important political connections for entrepreneurs are the membership of Chinese Communist Party (CCP), the membership of People’s Congress (PC), and the membership of Chinese People’s Political and Consultative Conference (CPPCC). Among the three, People’s Congress is the legislature body and the most powerful organ, while People’s Political and Consultative Conference is an advisory body, which is less powerful. Furthermore, private entrepreneurs were allowed to join the CCP since the 16th Congress of CCP in 2002, which decreased the entry level. The changing power structure may also result in the change of the impact of each political connection on private enterprise’s performance.

The findings of this study lend the support for these hypotheses, and suggest PC membership significantly helps improve firm performance, whereas other not. In addition, this study shows that PC membership contributes more to the coastal than inland private enterprises.

Research Site Selection and Method

Wenzhou: the cradle of China’s private economy

To understand the reemergence of the private economy, we have to study Wenzhou, the cradle of China’s private economy. The municipality of Wenzhou, with 7.9
million people, covering six counties, three districts, and two cities, is the earliest place for the emergence of China’s domestic capitalism after the reforms began in 1978. This area was extremely poor before 1978, but it experienced widespread prosperity under capitalism in the 1980s. In 2008, its disposable income per capita ranked third in the nation. Wenzhou produces 70% of the cigarette lighters for the world market, 60% of the eye glasses, and 10% of the apparel and shoes for the national market. This region contributed some major innovations and breakthroughs to the development of a private economy by experimenting with land transfers, registering private enterprises under collective or state enterprises (guahu), private finance, and legitimization of private enterprises. Wenzhou became well-known across the country for issuing the first license for a household business (geti gongshang hu), having 100,000 salespersons all over China in the early 1980s, and for its 10 specialized markets of agricultural produce and industrial goods. Wenzhou entrepreneurs were the first to innovate the practice of guahu. Wenzhou was also one of the first experimental sites for rural reform authorized by the central government in 1987. It issued the first interim regulation on private enterprise in China, legitimized later in the National People’s Congress in 1987. Additionally, Wenzhou took the first step to experiment with rural shareholder partnerships in 1991.

As the first rural experimental zone for the development of domestic private enterprises, Wenzhou’s practice was termed the “Wenzhou model”—contrasted with another collective economy effort, the Sunan model—for the sake of wider applicability. This resulted in thousands of cadres, entrepreneurs, and even scholars swarming into Wenzhou to learn from its experience. The rise of Wenzhou private enterprise involved complicated dynamics from different walks of life: peasant entrepreneurs, local cadres, local scholars, cadres and scholars at the center (including supporting forces and resisting forces). Such a process is interactive.

Field approach

A large portion of the literature explaining China’s transition attempts to identify the key variable in the transition, be it state, elite (political, economic, or intellectual), or grassroots. It is of academic significance to unpack the variable, the causal relationship, or the correlative relationship among the different variables. However, for the complicated fundamental societal transition, singling out one variable runs the risk of oversimplifying a comprehensive picture. The conclusion might be misleading, because China is constantly changing, socially and economically, particularly at the policy level. This can be demonstrated in many experimental policies and zones. A considerable number of studies have explored institutional problems from organizational and industrial perspectives, while they were troubled by the problem of actors and social structure (Fligstein 2001). Alternatively, Fligstein proposed to examine this problem from the field approach by focusing on the construction of local orders (Fligstein 2001).

As the emergence and legalization of private economy and the state’s transformation involved dynamic interactions among different actors, I would argue that the theory of fields is particularly apt for the study of this process. It is easily related to

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7 In China, city refers to a more urbanized county, and the former is superior to the latter in terms of the level of administration.
8 China Information News, July 10, 2008
the actor and structure problem. “Fields” refers to the situation where organized groups of actors gather and frame the issues vis-à-vis one another. This approach nicely captures the dynamics of the complex interaction. As economist Rawski (1999: 142) pointed out:

“The success of economic reform rests on changes in people’s attitudes and behaviour in the pursuit of material well-being. In China, reform is not a sequence of events in which the state makes decisions to which businesses and individuals react. Reform unfolds as an extended process replete with interaction and feedback among government administrations, enterprises, workers and consumers. Thinking about reform as an interactive process clarifies important aspects of economic change in China.”

In his study of the 1989 student movement, Zhao (2004) argues for an interactive understanding of legitimacy in China, rather than the static conception from the Weberian tradition. Furthermore, as the studies unfold, there appears to be a disaggregation process of understanding China, or a process of seeking new significant variables to account for the variation between state and society, across the bureaucratic apparatus and different regions, etc. Also, as research through the field lens is gaining increasing currency, this approach goes beyond the dyadic relationship in favor of a dynamic perspective. I would contend that one can advance the study of China by examining the interactions among variables over a longer time span, since the relationship among variables is constantly changing during the transition period. Using a static glimpse of the relationship among some variables to explain certain phenomena runs the risk of decontextualization.

Ignoring the timing of such relationships, by treating the state as static, is one of the biggest problems of the current research; this can lead to wrong conclusions and predictions. I would argue that in the last three decades during the experimental transition, the state and society interacted with each other. The state was responsive and adaptive, having less structural inertia (Hannan and Freeman 1977), to some extent, as the famous phrase puts it, “Crossing the river by groping for stones.” The theory of fields does not mean that all variables are included; it does not overlook the danger of being parsimonious, nor does it mean over-contextualization. Through extensive examination over a longer span of time, the research still shows the significance of certain variables.

Methods and data

This research explores the interplay between the state and market in the formation of the market, and how this in turn leads to the transformation or reproduction of such structures. This is a historical examination of the revival of private enterprise in China since the late 1970s against the contemporary hostile political environment and of the current development of private enterprise. It explores three main issues: (1) how private enterprise, and generally the market economy, a political taboo under Mao’s regime, became legitimized; (2) how the state transformed in response to the development of private enterprise; (3) how private enterprise performed under such market institutions.

For the first question, I examined who are the drivers and what is power dynamics in the field. The dependent variable is the legalization of private economy, the independent variables. The alliance between the market oriented leaders, and the local market model, the marginal position, the intellectual framing, help the legitimization of private economy. puzzles: why china go through the gradual transition, how is the gradual process. Literature theories and debate: they miss the drivers, actors. The decentralization model, the factional struggle model. The field approach suggest the
challengers and the incumbent, it is interactional process, the replacement of leadership, the need for alternative model, the success of the local model, the framing of intellectuals.

This research is a combination of qualitative and quantitative analysis. The analysis of the emergence and legalization of private economy and the state transformation is mostly based on the data coming from fieldwork. The quantitative analysis of private enterprises’ performance is based on a nation-wide survey. The qualitative data draws upon my 10-month fieldwork in Wenzhou from 2007 to 2008 and three months of random visits to Hangzhou, Shaoxing, and Yiwu in Zhejiang Province, and in the provincial-level cities Shanghai and Chongqing. Except that Chongqing is an inland city, the rest of the cities are coastal cities. I chose those cities for two reasons: one is to examine the difference between the coastal and inland areas, and the other is for the ease of accessibility. Chongqing is my hometown while the other cities are close to Wenzhou. Part of the field data comes from historical archives: including policy documents, official statistics, academic writings, and newspapers. Part of it comes from my interviews with officials, entrepreneurs, scholars, and workers.

The firm data that I use in this dissertation comes from a nationwide survey of privately owned enterprises that was jointly conducted in 2006 by the All China Industry and Commerce Federation, the China Society of Private Economy at the Chinese Academy of Social Sciences, and the United Front Work Department of the Central Committee of the Communist Party of China. The sample is mainly comprised of large firms and a small portion of individual household enterprises that were drawn from 31 provinces, covering all of the political subdivisions at this level in mainland China.

The dataset is by far the best for studying the social profile of private entrepreneurs, private firms’ performance, management, and state-enterprise relations. It consists of 3837 privately owned enterprises, which represent 0.089% of the total number of privately owned enterprises nationwide. The survey on which the dataset is based involved intensive interviews with firm owners, who can be defined as entrepreneurs. It questions about the size, history, and basic financial background of their firms and their personal background, human capital, and occupational history.

**Chapters that follow**

Chapter 2 explores two main questions: what factors impacted the entry into private entrepreneurship, how the actors, i.e., peasant entrepreneurs, and cadres in the field break through the policies and construct the new institution against the ambiguous environment, and, in particular, how did they fend off the political risks. This chapter will begin with a brief introduction of rural industrialization since Mao and the development of private enterprises. Then the chapter will focus on Wenzhou’s takeoff in the early 1980s, the elements of private entrepreneurship, and the role of local cadres, peasant entrepreneurs and the central market-oriented leaders. The findings of this chapter suggest several factors make Wenzhou the earliest revival of private economy in China: Wenzhou’s marginal position in socialist economy, culture and politics, Wenzhou peasant entrepreneurs’ innovation and persistence in entrepreneurial activities, the local cadres’ protection and even encouragement, and the central market-oriented leaders’ support. The findings have four implications. First, the findings suggest that the locus of institutional change possibly lies in the marginal area of the dominant institution. Numerous institutional research examines the mechanism of institutional change, but few
study the locus of the change. Second, the study complicates the study of China’s transition by detailing the political risk and how peasant entrepreneurs, local cadres and central leaders dealt with the Maoist legacy, which is rarely examined in China’s transition into market economy. Third, the findings suggest that previous experiences in enterprise, individual business, the state sector and some connections with cadres are significant for the entry into private entrepreneurship. The findings reject the power persistence account and elite approach, and lend partial support to the marketization account. Fourth, the findings suggest an alliance between the Wenzhou market model and the market-oriented leaders in the central government, thus rejecting the decentralization theory and partially supporting the factional theory.

Chapter 3 will illustrate the intellectual involvement in justifying and legitimizing Wenzhou’s individual and private economy, that is, capitalism. During the fight for justification and legitimization, intellectuals who were pro-capitalism framed the Wenzhou model in three ways. They defended Wenzhou capitalism in terms of its contribution to development (such as employment), leading others to get rich, and engaging in public interests. Their framing drew partly upon orthodox Marxism and partly from practice. Intellectuals defended the characterization of the Wenzhou economy as socialist by applying parts of Marxism to the Wenzhou situation and by invoking the ambiguities in Marxism. Some scholars even criticized Marxism by invoking Deng Xiaoping’s words to advocate for capitalist institutional logic. The rhetorical change is in tandem with the institutional change and the factional struggle at the center, involving cadres, scholars at the central and local level, and local entrepreneurs. Such rhetorical change helped to make the transition proceed somewhat smoothly in terms of the institutional change and helped change the people’s mindsets, largely boosting their fervor for the private economy across all walks of life. This chapter will focus on the legitimization of the private economy at both the local and central levels, the establishment of a Wenzhou experimental zone, and the spread of the Wenzhou model. Theoretical implications about institutional change, in terms of legitimacy, institutional logic, language, framing, and sensemaking, will be discussed.

After the legalization of private property rights or the private economy, I then move on to explore the feature of the market economy, that is, how the local state and private enterprise interacted in the post-socialist transitional economy. Chapter 4 looks at how the state responded to the development of market economy or the transformation of local states. This chapter will discuss two stages of transformation in Wenzhou. It will begin with the discussion of the retrenchment of central support in Wenzhou after Wenzhou completed the experimental task. The rapid growth of private economy resulted in the serious problem of product quality. The market and the central government pressured the laissez faire government of Wenzhou to intervene and regulate the market. The government adopted two methods to regulate the market. One method utilizes the industry associations, whose foundation is partly supported by the government. The other method is to strengthen the legal enforcement under the slogan – “product quality is the life of the city”. The second stage of transformation is from a regulatory state to a strong state. There are two driving forces. The first is the strengthening fiscal power of the government, buttressed by the rapid growth of GDP. The second force comes from the intensive regional competition of GDP growth. The competition drove the government to actively attract foreign investment, pressure the enterprises to merge and invest in capital
intensive industries (e.g., energy, transportation, chemicals, etc). This chapter will further demonstrate that there is a converging trend of developmental models across coastal regions.

Chapter 5 continues to explore the feature of the market economy, but from the perspective of private enterprise performance in the market. It examines the importance of the entrepreneur’s political connections to private enterprise performance. This chapter will model the regional variation and compare the market in the coast with that in the inland. In addition, the analysis of this chapter is based on the nation-wide survey.

Chapter 6 concludes with the theoretical and empirical implications of the study. The theoretical implications include the locus of institutional change, the alliance of challengers, the framing of new institutional logics, the transformation of local state and the contingent view of political connections. Overall, this project suggests a empowering state capitalism, drawing upon the extended case study of Wenzhou and that nation-wide survey on private enterprise. My predication is that under such empowering state capitalism the inequality will continue to grow in the future unless China witnesses another big political risk and/or economic risk.
Chapter 2

Taking Risks in Experimenting with Private Enterprise

Introduction

China’s private enterprises first reemerged in rural Wenzhou in the late 1970s and early 1980s after three decades of extreme anti-private economy policies. Because the Maoist legacy continued to the late 1980s, the revival of private practice encountered regulative, normative and cognitive institutional resistance (Scott 1995). This chapter explores two main questions: (1) what factors impacted the entry into private entrepreneurship under the ambiguous and still somewhat hostile environment; and (2) how did the actors, such as peasant entrepreneurs and cadres in the field, break through the policies and construct new institutions against the ambiguous environment, particularly how did they fend off the political risks. This chapter will begin with discussions of the literature of transitional societies, then I will have a brief introduction of rural industrialization since Mao and the development of private enterprises. This chapter will mainly focus on Wenzhou’s takeoff in the early 1980s, the elements of private entrepreneurship, and the roles of local cadres, peasant entrepreneurs and the central market-oriented leaders.

Numerous studies attempted to explicate China’s transition from a wide variety of perspectives, generating complex and inconclusive pictures, such as the decentralization theory, factional struggle theory, market transition, local corporatism, power persistence, etc. These studies mostly focus on the transitional mechanism, that is, the causal chain linking the background conditions, market outcomes, and power and income consequences of the markets (Parish and Michelson 1996). In the following part, I will discuss some relevant literature, their value and limits, and then I will propose my own approach to exploring the making process of private economy in China, building on neo-institutional analysis.

Decentralization, local incentive and innovations

Decentralization theory argues that China’s decentralized structures of government and public finance played an important part in the emergence of private economy, privatization and China’s economic growth (Qian and Weingast 1996; Montinola, Qian, and Weingast 1995; Qian and Roland 1998; Chen Ping 1993; Xu and Zhuang 1998). It argues that political decentralization encouraged local reform experiments that allowed new ideas to emerge from the grassroots level. Decentralization created political checks on the central authorities, limiting predation and convincing investors that reforms would last. Fiscal reform gave local officials strong incentives to stimulate economic growth, and it helped harden budget constraints on enterprises, forcing them to restructure. Cao, Qian, and Weingast (1999) argue that “federalism, Chinese style, has induced privatization, Chinese style.”

The decentralization argument is partially right, in the sense that decentralization granted more autonomy to local governments thus encouraging local governments to innovate practices, particularly in developing township and village enterprises (TVEs). However, there are two major limitations of the decentralization theory. First of all, it is not sufficient to explain the making process of private economy. Although local
governments had much more autonomy to develop their local economy, the
decentralization theory cannot provide a satisfactory answer to why private economy was
first revived in Wenzhou and how the actors were involved in this process. Secondly, I do
not agree that fiscal reform in the mid-1980s was conducive to the emergence of a private
economy. On the contrary, following the decentralization logic, the strong incentive for
the local government to develop its revenue may lead it to intervene heavily in the local
economy, despite it acting as a corporation. Heavy state intervention in the market
contrasts sharply with the situation of a private economy: in other words, state
intervention would impede the emergence and development of private enterprise.
Research shows that in the Sunan area, under the local state corporatism model, there
were rapidly growing TVEs, but they made up only a very small portion of private
enterprises during the early reform period. Moreover, Lin and Kung’s study (2007)
suggests that there is a subsequent decline in the role of fiscal decentralization in the
development of TVEs. They argue that market development and competition have
constrained the abilities of local public enterprises to address revenue and employment
imperatives, whereas local governments’ sales-oriented growth strategies have
exacerbated governance problems. Market development and competition drove the TVEs
to become increasingly privatized since the mid-1990s. Furthermore, my research on
Wenzhou shows that state officials attempted to suppress the private economy when it
was emerging; however, the effort turned out to be futile because of strong grassroots
initiatives.

\textit{Factional struggle, rivalry between market camp and planning camp}

In contrast to the decentralization theory, the theory of factional struggle (Cai and
Treisman, 2006) argues that the driving force behind reform was not pressure from or
initiatives by autonomous local officials but competition at the center between rival
factions with different ideological predispositions and local connections. Faction leaders
sought supremacy within the party by demonstrating the effectiveness of their chosen
policies across the chessboard of China’s territorial administration. Local officials were
linked to these factions and sought to impress higher-ups with suggestions that were
spontaneous, and sometimes even illegal.

For the purpose of this project, I would argue that the factional struggle theory is
especially valuable for understanding the institutional breakthrough at a particular place,
such as the emergence and legalization of the private economy in Wenzhou. Factional
theory can also explain the temporal pattern of reform, which ebbed and flowed with
shifts in the factional balance of power. An example of this is the revival of the state
economy and slow growth of the private economy in recent years.

However, the factional struggle theory is unsatisfactory in several respects. First,
it fails to explain how the factions arrived at a consensus, and how some local practices
became nationally legitimized, particularly the private economy. Second, the theory
overstates the role of officials and downplays grassroots initiative. Because the idea of
private economy was highly sensitive during the beginning of reform, the previous
discussion demonstrated that central officials were ambivalent towards it, and local
officials were unsure of the political winds. Local officials may have had the incentive to
engage in the development of a collective economy, that is, TVEs. However, they still
hesitated to take risks in the development of a private economy. As this study will show,
the rise of the private economy was largely pushed by peasant entrepreneurs. Local officials in Wenzhou, unlike officials in other regions, were reluctant to intervene. In other words, the development of the private economy was allowed to happen, not because of the officials’ active engagement, but because of their unwillingness to take a hand in thwarting it. Of course, the unwillingness to intervene in the private economy during early reform was also risky for officials. Third, Cai and Treisman’s theory overlooks the role of intellectuals in this transition, which I will discuss in chapter 3. Lastly, the factional struggle account largely focuses on the power relationship among the elites, but neglects the alliance between the elites and the grassroots.

**Institutional change: actors, drivers and process**

As aforementioned, the making of private property rights is central to the development of market institutions. I draw upon neo-institutional analysis to explore the emergence and legalization of the private economy, the actors, the drivers, and the interactive process which makes the gradual transition possible. Scholars grew increasingly attentive to the mutability and multiplicity of institutions and to institutional change, a process of delegitimization and reconstruction of new institutions.

The existing literature shows that the drivers and sources of institutional change include: sociopolitical pressure (Oliver 1992), the replacement of the leaders (Kraatz and Moore 2002), the interplay between actions, meanings and actors (Zielber 2002), ideological dissensus (Greenwood and Hinings 1996), and the condition that admit the alternative into the fields (Schneiberg 2005). In addition, the process of institutional change is a process of deligitimization and the construction of new institutions (Colomy 1998). This process involves uncertainty, actors’ defining their particular actions and justifying their rationality and cultural mode (Clemens and Cook 1999; Goodrick and Salancik 1996; Guillet 2000).

These studies, though mostly focusing on the organizations and industries, offer valuable insights into the emergence and legalization of private enterprise in China. However, the literature largely misses the initial locus of institutional change, the alliance of the actors and the interplay between the economic practice and the framing. Before I present the story of Wenzhou, I briefly discuss the background of rural industrialization and development of private enterprises in China since Mao.

**Rural industrialization and development of private enterprises**

The private economy was eliminated in 1956 in China, because the private economy symbolized the exploitation and capitalism that was essentially antagonistic to Mao’s socialist ethics. For the purposes of rapid industrialization and the strengthening of the defense industry in particular, Mao’s policy mostly targeted heavy industries that exploited the rural economy through the *hukou* (urban household registration) system and scissors price had taken the form of falling prices for agricultural produce and steady prices for industrial goods. The *hukou* system prohibited rural peasants from migrating into the urban areas, and the scissors price unfairly extracted profits from the agricultural sector to the industrial sector. Nonetheless, however, according to Wong and Yang (1995), the commune system that persisted till the early 1980s was a convenient administrative framework for organizing the pre-reform types of rural enterprises, known as the commune and brigade enterprises (they were called township and village
enterprises after the commune and brigade were replaced by township and village, respectively, in 1983). Under Mao’s self-reliant development strategy, the commune undertook the role of organizing the development of some small industries through the 1960s and early 1970s. However, the rural enterprises did not thrive during the Mao period due to the generally unfavorable political and ideological climate of the time. Many rural enterprises were run like “local state enterprises” on “soft budget constraints”, with no particular urge to acquire better technology in order to improve their productivity.

The growth of rural enterprises and the revival of private enterprises began at the end of the 1970s. Several policies encouraged the growth of rural enterprises and the private sector. From 1979 onward, the government arranged a huge onslaught of publicity that promoted entrepreneurship, introducing new phrases such as *zhuanye hu* (specialized household), *wanyuan hu* (10,000-yuan household), and *jingji lianheti* (partnership or cooperative enterprise). These terms were celebrated in and saturated rural news reporting (Daniel Kelliher, 1992). China’s 1982 Constitution further recognized the “individual economy of …working people” as a complement to the public economy and offered state protection to its lawful rights and interests, although individual firms remained officially subject to employment ceilings, such as having no more than seven employees. Other positive policies included (1) the dismantling of the communes, (2) the removing of the Maoist type of restrictions on non-agricultural activities, (3) the freeing of rural markets for agricultural sidelines, (4) the creation of many business opportunities outside the state sector, (5) raising of the procurement prices for agricultural products between 1980 and 1984 that amounted to the transfer of industrial surplus for rural industrial capital formation, and (3) granting a three-year tax holiday as an incentive to all new rural enterprises starting from 1981 (Wong and Yang, 1995). As more and more new rural enterprises sprang up, the State Council issued a landmark document (Document No.4) in 1984 to formalize the political and legal status of individual enterprises. This enabled a great number of individual enterprises to obtain bank loans as “legal persons” for their expansion. Furthermore, in April 1988, a Constitutional amendment provided equal legitimacy to “the private sector.” Subsequent regulations adopted in June 1988 differentiated between “private” and “individual” firms on the basis of employment exceeding the previous limit of seven persons. Private enterprises may be sole proprietorships, partnerships or limited liability companies. The latter are restricted to no more than thirty investors (though exceptions may be granted) and their stock may not be offered to the public or disposed of without the consent of a majority of the other investors. Overall, the 1988 regulations should in principle offer many existing enterprises with more than eight workers the chance to reregister, thus allowing them to emerge from their previously gray legal status, and also provide legally-sanctioned means to organize firms with multiple individual investors.

Some numbers are helpful here in demonstrating the rapid growth of China’s rural private enterprises. Among rural enterprises, the percentage of private enterprises increased sharply since 1978, at which time the number of private enterprises was still zero. In 1985, the percentage of private enterprise and employment increased to 87.17 percent and 40.15 percent, respectively. These two percentages respectively increased to 92.64 and 52.88 percent, in 1995, and 96.57 and 71.39, in 2002. The examination of

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9 I combine the official ‘individual’ and ‘private’ enterprises in the yearbook into the private enterprises sector
10 China statistic yearbook, various volumes
policy changes at the macro-level and the increased number of private enterprises show the general developmental trend of private enterprise. This project will focus on the dynamics of institutional change: the social, political and cultural elements in the revival of private enterprises in the original locality – Wenzhou. The examination of this transitional process from a social-political constructional perspective reveals the risk in pioneering private economy. It also exposes the complex interactions between peasant entrepreneurs and local cadres, the local government and central government and the planning camp and market camp. In the rest of this chapter, I will illustrate the emergence of new institutions, the take-off of the economy, the entry into private entrepreneurship, the political risk of experimenting with private economy in Wenzhou. Furthermore, I will show the alliance between Wenzhou’s peasant entrepreneurs, local cadres and central leaders in the making of private economy. This chapter largely draws upon archival studies, some news articles and officials statistics.

Wenzhou: a glance of the emergence of new institutions

Wenzhou occupied a very marginal position in the socialist economy, culture, and administration. Its marginal position, poverty and alternative traditional culture made Wenzhou the number one testing ground for experimenting with alternative economic methods. Wenzhou is port city, located in a mountainous area with limited arable lands along the coast of Zhejiang Province. Historically, as a seaport city, Wenzhou had had a long history of commercial tradition that can be traced back to Song Dynasty, which was more than one thousand years ago. In tandem with the commercial tradition was the local cultural ideology, called the Yongjia culture, partly owing to its geographic isolation. The Yongjia culture features mercantile interests as well as virtue; it is unlike the dominant Confucianism impacting most regions of China at the time. The latter values virtue and places merchants at the bottom stratum of society. However, Wenzhou was extremely poor in agriculture and industry under Mao’s regime. Wenzhou’s private economy and commerce were eliminated, and local attempts to develop private enterprises were cracked down. In addition, Wenzhou was positioned as a site of strategic defense because of its proximity to Taiwan; therefore, there was relatively little investment from the central and provincial governments in case of warfare. The extremely poor economy produced many beggars and encouraged emigration. The techniques and business information introduced by emigrants from other places contributed the takeoff of Wenzhou’s economy. Nonetheless, the historical legacy of commerce, trade, private business, petty commodity production and entrepreneurship made the persistence of Wenzhou’s deviant practices possible. Many Chinese scholars argue that the Wenzhou cadres’ pragmatism and willingness to take risks are the keys to the speedy development of the private sector, like the deviations. They argue that Wenzhou cadres implemented state policies in accordance with their own interpretation, which took local interests into account. Even though they did not overtly support deviant practices, they did not take any serious action against them. Liu Yaling (1992) advances this argument and her research shows that the local cadres in Wenzhou historically came from a guerrilla force, which was distanced from the mainstream power of the Communist party. This diminished the penetration of central power into this area. There is also research which shows that geographic isolation reduced the central intervention. Parris (1993) argues that the development of the Wenzhou model was the result of conflict, accommodation and
‘chronic negotiation’ among ordinary members of local society and the agents of the local and central state. In his viewpoint, local cadres played a pivotal role, often colluding with local citizens to thwart central policy. The emergence of new economic institutions, alternative values and new organizations in Wenzhou reflect the shifting boundary between state and society and a redefinition of the state-society relation in contemporary China.

The literature reviewed above shows that Wenzhou’s marginal position in economic, political and cultural aspects made the revival of private economy possible in Wenzhou. There are also findings suggesting that the proximity to Shanghai (Liu Alan 1992), its overseas social network thanks to its port position (Parris 1993) and the central government support (Parris 1993) contributed to the rise of Wenzhou’s economy. I would argue that stressing one variable is not sufficient and may be misleading. The current literature is unsatisfactory in synthesizing the factors. I adopted the interactional field approach and argue that the alliance between the market practice in Wenzhou and central market-oriented leaders essentially promoted Wenzhou’s economy, in other words, the marginality of Wenzhou is necessary, but not sufficient, the marginality has to be utilized by the actors in the field, such process involved both the structure and agency.

Some Wenzhou cadres and peasants constantly tried to experiment with household responsibility and enterprises even under Mao’s hostile institutional environment. Before the widely-known story of the first experiment with of the household responsibility system in Anhui province in 1978, an even earlier attempt was already made in Wenzhou in 1956. Some leaders in the Yongjia county of Wenzhou saw the problems of low productivity under the commune system, and risked experimenting with the household responsibility across the whole county for ten months in 1956. Soon it was forbidden by the central and provincial governments. The leaders involved in this experiment were heavily punished during the anti-rightest movement in 1957 and the Cultural Revolution. However, this did not completely stop the struggle for reform. Some Yongjia peasants still risked experimenting with the household responsibility from 1966 to 1975, resulting in another round of backlash; many cadres and peasants involved in this practice were criticized. In the 1970s, a number of Wenzhou peasants persisted in running household enterprises or individual businesses despite many crackdowns; such enterprises were called underground enterprises (di xia gong chang).

In the late 1970s, Wenzhou’s local governance was still in a state of anarchy and the poor economy grew very slowly. However, several individual enterprises that registered as collective entities emerged. Such a practice was called guahu (registering under a legitimate collectivity, but operating independently from the later), since individual enterprises, including household enterprises, were not allowed under socialism. Wenzhou cadres eventually allowed this innovation because of the persistence of peasant entrepreneurs and its contribution to the local economy. Guahu largely encouraged Wenzhou peasants engaging in entrepreneurial activities. Another prominent actor in Wenzhou’s economy was the salespersons. In the early 1980s, there were roughly 100,000 salespersons in Wenzhou. The large number of salespersons demonstrated Wenzhou’s deep-rooted commercial tradition. Salespersons were categorized as individual businessmen (ge ti hu) by the administration. In 1981, the Bureau of Commerce and Industry of Lucheng district of Wenzhou issued the first license of individual businessman, and this is also the first individual businessman license ever in
China. The salespeople’s keen sense of the market greatly contributed to the emergence of specialized markets, and, consequently, the growth of household enterprises. In the early 1980s, there were ten specialized markets in Wenzhou and they became well-known across the country.

As household enterprises expanded, some enterprises began to take a risk to break through the contemporary policies, such as hiring more than eight employees. However, the government branded this practice as the private enterprises’ exploitation under the socialist rhetoric. Thus, these enterprises had to register themselves as collective entities to be legitimate. In order to enlarge the scale of economy, some household enterprises cooperated with each other and formed the shareholding cooperatives (gu fen he zuo qi ye). The guahu practice, private enterprises and shareholding cooperatives eventually became legalized in 1987.

**The takeoff of the Wenzhou economy**

After the 1978 reforms, Wenzhou’s economy took a while to takeoff. In 1979, its industrial and agricultural output declined 0.56%. The growth rate was less than 3% in 1981 and about one third of the enterprises were closed or half closed. In 1983, for the first time, Wenzhou surpassed the average growth rate of Zhejiang industrial and agricultural output. In both 1984 and 1985, the growth rates remained pretty high at above 30%. From 1982 to 1985, the industrial and agricultural output doubled, so did the local fiscal revenue. From 1979 onward, the revenue’s annual growth rate was about 16.9%, ultimately reaching 44.1% in 1985. The total revenue in that seven-year interval exceeded the total investment from the state in the last 36 years since the founding of the People’s Republic of China.¹¹

Table 2.1 clearly shows Wenzhou’s rapid growth in industrial and agricultural output and municipal revenue since 1978. The peasants’ livelihood improved dramatically. In 1978, the peasants’ income per capita was 55 Yuan RMB, whereas in 1986, it increased to 508 Yuan RMB, which was eight times that in 1978 and 12.6% above the national average peasant income. The peasants’ income per capita was much higher in the area where family enterprises and specialized markets were concentrated. The peasants’ income per capita in ten of the specialized markets was over 2000 Yuan RMB.

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¹¹ Wenzhou statistical yearbook, various volumes
Table 2.1, the increase of industrial and agricultural output in Wenzhou from 1949-1986

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<tr>
<td><strong>Gross industrial output</strong></td>
<td>55.06 (1949)</td>
<td>310.24 (1958)</td>
<td>1098.42 (1978)</td>
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<td></td>
<td>218.03 (1957)</td>
<td>388.87 (1977)</td>
<td>4820.61 (1986)</td>
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<td><strong>Annual increase ratio of industrial output</strong></td>
<td>18.77%</td>
<td>1.2%</td>
<td>20.31%</td>
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<tr>
<td><strong>Gross agricultural output</strong></td>
<td>113.11 (1949)</td>
<td>270.64 (1958)</td>
<td>782.47 (1978)</td>
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<td></td>
<td>285.02 (1957)</td>
<td>578.80 (1977)</td>
<td>1686.49 (1986)</td>
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<tr>
<td><strong>Annual increase ratio of agricultural output</strong></td>
<td>9.98%</td>
<td>4%</td>
<td>10.08%</td>
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<tr>
<td><strong>Gross municipal revenue</strong></td>
<td>106.82 (1958)</td>
<td>137.99 (1978)</td>
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<td></td>
<td>8.116 (1977)</td>
<td>503.28 (1986)</td>
<td></td>
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<tr>
<td><strong>Annual increase ratio of gross municipal revenue</strong></td>
<td>-1.44%</td>
<td>17.56%</td>
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Note: unit (million Yuan)
Source: Wenzhou statistic yearbook, various volumes.

The economic achievement was largely boosted by the rapid growth of household enterprises and the private economy. As of 1986, Wenzhou’s rural area boasted about 140,000 family enterprises, thousands of private enterprises, more than 100,000 salesmen across China, 70,000 getihu (individual businessmen), and about 400 small commodity markets. In 1986 Wenzhou, the state economy accounted for 17% of the total economy, the collective economy, 48%, and the individual and private economy together, 34%. Wenzhou’s rural household enterprises had some prominent features at this stage: (a) the majority of the raw materials were waste materials; (b) most of the commodities were small commodities, such as buttons, badges, cards, shoes, clothes; (c) most enterprises utilized basic technology, ranging from manual to semi-mechanical to mechanical; (d) the industry was highly labor intensive; and (e) there were three main forms of organization: partnership, private, and shareholding.

**Entry into private entrepreneurship: capable people**

Many studies on China’s transition examine the significance of the various forms of capital in the stratification. There are three accounts regarding this subject: (1) the market transition account, (2) the power persistence account, and (3) the elite approach. Market transition theory asserts that marketization (measured by the presence of private entrepreneurship activities) nullifies the advantage of political power (Nee, 1989). Contrary to Nee’s market transition theory, analyses of income distribution in China have reported that as “marketization” proceeded, the advantages of redistributive power still persisted, and returns to human capital did not increase (e.g., Bian and Logan 1996, Oi 1989, 1999; Parish and Michelson 1996; Zhou, 1996; Zweig, 1997). Walder (2003) proposed the theory of elite opportunity, focusing on how market reforms have injected new value into public properties, thereby creating differential opportunities for elite insiders. He argued that groups with an advantage in the redistributive sector did not need
to become directly involved in private businesses. Wu (2006) advances this debate by examining the entry into private enterprise, as he put it: “As entry into the private sector has served as an important mechanism through which the macro level institutional transition affects the change in income distribution among individuals, a close examination of the path to private business – namely, a close look at the backgrounds of those involved in private business – would be of particular interest to sociologists concerned with the social consequences of China’s transition to a market economy.” Wu particularly focuses on the activity of cadre families in such a transition. He found that both education and cadre status have positive impact on rural families’ entry into private business in the early reform stage (1978-1991), and the positive impact of cadre’s status is even greater during the late reform stage (1992-1996). The findings of my research in Wenzhou show that some cadres engaged in private entrepreneurial activities, lending partial support to Wu. The findings also show that previous experience in enterprises, state sector and individual businesses was significant for entering into private enterprises at the earliest stage of the private economy’s revival.

In Wenzhou, “capable persons”, nengren, were highly honored in the 1980s. Capable persons mostly included capable peasant entrepreneurs and salespersons. Capable persons constituted the very dynamic force during the rise of private economy in Wenzhou, in terms of running enterprises, pioneering new markets, and introducing new technology. I collected thirty archives of big peasant entrepreneurs and they all indicate that previous experience in running enterprises, state sector and individual businesses was significant for starting enterprises. The archives come from the bureau of Wenzhou archives. Since these are official archives, the government selected those big entrepreneurs as models into the archives. The representativeness should be cautioned, nonetheless, they still give us a clue to understand how those entrepreneurs started to engage in private business and who are they. The archival study shows that eighteen entrepreneurs had worked in collective enterprises or the state sector, seven were cadres (one township mayor, five village party secretaries, and one team leader), and five were farmers. The experience in the state or collective sector supplied them with the necessary expertise, skill social network and market experience to run a private enterprise. For instance, Chen Zemei was a skilled worker in a plastic shoe factory before he ran his own plastic enterprise. Zhang Chengtao’s experience as an apprentice in mechanics largely helped him start his own pump factory. Zhu Mingchun had worked in a collective food company and poultry lab before he ran a poultry business by himself. Ye Wengui had worked in the state sector and later went on to run an aluminum factory jointly with sixteen other people. Such experience supplied him with the social network and management expertise to run his own plastic membrane factory. Several of them had previously worked as salesmen in collective enterprises before they started their own enterprises; Chen Xianjing was a granite entrepreneur, Zhao Kailiang, a big salesman, and Liu Shangdan, a crane entrepreneur. Such relatively rich market experience empowered them with a keen understanding of the field of entrepreneurship.

Some peasants’ entrepreneurial activity stemmed from their early experience of conducting individual businesses in a guerrilla-like manner; they moved from one place to another, and some even had extensive travel experiences. For example, Wang Yongzheng had fluffed cotton for thirteen years; he later became a salesman in a village enterprise. He had traveled to twenty-nine provinces in China; such experience enriched
Wang’s entrepreneurship, enabling him to run a big business contracting shopping counters in over twenty cities. Zhang Liecheng was forced to terminate his study in junior high-school to make a living. He tried many informal jobs such as being a mechanic and a salesman. He was also able to travel to the Jiangsu, Hunan, Hubei province, and other regions in the Zhejiang province to learn more techniques and improve his skills. Those skills enabled Zhang to establish the first steel factory in his county in 1981. Liu Zhichun, born into a bad class family, and encountered all kinds of difficulties under Mao’s regime. He was forced to leave school at grade five because of poverty. Since then Liu tried various sidelines to make a living, such as being a salesman, carpenter, locksmith, and so on. He also learned by himself to improve his skills from books. His exploration in skills eventually led him to have a technological breakthrough that greatly boosted the development of his ship factory. Fang Peilin, who started the first private bank in China in 1984, was once sent down to the countryside in the northeastern part of China in his youth. Chen Zhixi was a director of a construction project before he started his own zipper factory. His travel experience to Shanghai inspired him to pioneer the zipper market and run his own business. A few of them obtained higher education that further supplied them with technological and management expertise. Wang Lin was a college graduate and started his laboratory of technology. Qian Mingqiang only received a high school education and loved reading about economics; this passion enabled him to acquire a keen understanding of he market. He later started a private business collecting commercial information.

The archival study also shows that some local cadres were directly involved in individual or joint establishments of private enterprises. Ye Kangsong, a township mayor, was inspired by the success story of a private entrepreneur who was visited and extolled by some central leaders because of entrepreneurial activities. Ye then resigned from his official post and started his private business as a peasant entrepreneur. Four village party secretaries took the lead in starting enterprises in their villages. For instance, Jin Wenyu, the party secretary of Jinhou village, started a plastic wire factory with a few others; one of the partners was his son who had work experience in a township plastic wire factory. Subsequently, other village cadres and peasants followed his lead and started their own factories. Qu Shoubin, the party secretary of Hongqiao village, and Qu Weiyin, the head of Hongqiao village, jointly took over an almost bankrupt village enterprise, which was a sewing machine factory. Zheng Hanmeng learned some telecommunication skills when he was a soldier in the army. In 1980, as the party secretary of Shangyan village, Zheng started his household enterprise by utilizing his technical skills acquired in the military.

Political risk: peasant entrepreneurs’ persistence and local leaders’ support
One of the central concerns for the peasant entrepreneurs was the political risks during the early 1980s. Since 1978, the policies toward household enterprises were ambiguous. The market camp implicitly allowed for private entrepreneurship and advocated for the general principle of getting people to become rich, whereas the

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12 Under Mao’s regime, capitalist, landlord, rich peasant, reactionary, anti-revolutionary were labeled as bad class; whereas cadre, soldier, poor peasant were labeled as good class.
13 In China, the lowest administrative organ is township, so peasant, in a broad sense, includes village party secretaries; in addition, it also includes those who resigned from official post and veterans whose registration is rural.
planning camp still upheld the socialist banner and prohibited the practice of private economy. These two camps wrestled with each other throughout the 1980s. The planning camp won over for a short period, while the market camp gradually dominated the economic field. In other words, the reform took one-step backward then two-step forward. For instance, in early 1982, the central government launched the crackdown against economic crimes such as smuggle, speculation and profiteering, and fraud, since the planning camp interpreted these activities were corrupting the officials, government and socialism. Owing to the origin of private economy, Wenzhou became the target in Zhejiang province. Thousands of entrepreneurs in Wenzhou were punished, including the eight famous entrepreneurs (ba dawang). The harsh crackdown strongly indicated the still hostile environment for household enterprises. Soon, at the end of 1982, the crackdown ceased and the market camp took the lead to advocate for the development of household enterprises. Then Wenzhou local officials launched the movement of awarding household entrepreneurs, offering green light policies to them and even making friends with them. In 1984, the No.1 central document clearly encouraged the development of the commodity economy in the rural area. All the eight famous entrepreneurs were rehabilitated by the local authorities. In late 1985, the planning camp launched another attack against the market camp, that is, the anti-bourgeois liberation movement. Hu Yaobang, the General Party secretary of the CCP and one of the market camp leaders, had to resign from his post. Hu’s resignation eventually terminated this movement as a sacrifice by the market camp.

Wenzhou experienced three stages in dealing with political risks. The first stage was from 1978 to early 1982. Some Wenzhou peasant entrepreneurs and local cadres firmly persisted in running household enterprises under the ambiguous and still hostile environment. The second stage was from late 1982 to early 1986. Local leaders began to encourage the development of household enterprises, and the central market-oriented leaders also began to lend support to Wenzhou. The harsh crackdown against household enterprises in early 1982 dealt a hard blow to the Wenzhou economy, but some peasant entrepreneurs still persisted in their private businesses. Wenzhou leaders had to change their policy and became increasingly supportive of household entrepreneurs. As the household industries began to boom and the Wenzhou model was popularized nationally by newspapers in 1985, the central market-oriented leaders began to lend explicit support to Wenzhou. The last stage was from late 1986 to 1988, featuring theorization and legalization of the private economy by intellectuals and policy makers. The next chapter will discuss this in more detail.

The central policy toward the individual and private economy was ambiguous from the late 1970s to the early 1980s. Some peasant entrepreneurs encountered various criticisms and were pretty concerned about the policies. Among these Wenzhou entrepreneurs, some had a relatively firm belief in the market-oriented policy, some received political support from the local cadres, while a few others became used to the constant crackdown against capitalism.

Some entrepreneurs followed the central policies quite often and had their own interpretation and prediction of China’s future. Ye Wengui felt that his business was politically safe once he knew that Deng Xiaoping was still elected as the president of the Central Military Committee. He interpreted this as proof that the central policy of getting

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people to become rich would not change. Chen Yizhi who was a private entrepreneur had a similar story. He firmly believed that the central policy of supporting entrepreneurial activity would not change, although the anti-bourgeois liberation campaign was already launched in 1986. He believed that because Deng was still the highest leader, the market-oriented reform would continue. Qu Shoubin decided to take over the village enterprise when he read the official central announcement about the shift of the party’s focus. In 1984, the No.1 central document clearly stipulated that peasants were allowed to invest in various kinds of enterprises and that the state should protect the investors’ rights. Fang Peilin interpreted the policy to allow peasants to invest in shares as the legalization of dividends; therefore, it also implicitly legitimized private banks that generated dividends. Inspired by this idea, Fang decided to take risk in starting his own private bank.

Some entrepreneurs persisted in their entrepreneurial activities despite the constant backlashes and political risks. Zhao Kailiang had engaged in selling cloth for some years and was used to the constant crackdown against the individual economy in Wenzhou before 1978. At that time, he was seen as evil by the authorities. However, he did not care about this and still secretly persisted in doing his business. Chen Liangkun was jailed twice by the local authorities because of his business activity, but this did not hinder his ambition to start his own enterprise in the early 1980s. Although the Jinhou village was attacked more than ten times under Mao’s regime owing to the rampant entrepreneurial activities, Jin Wenyu, village’s party secretary, still insisted on running a jointly managed enterprise in 1981 and ignored the criticism from some township cadres. As he put it, “you do your job of critique, and I do my job of running enterprise” (ni pi ni de, wo gan wo de). He even boldly declared to the villagers employed in his factory: “If someone calls this factory as capitalism, you just tell them I’m the head of this capitalist factory. I will take the full responsibility”. Liu Shangdan, a salesperson in a township enterprise, decided to start a new enterprise with a few others in 1983. His idea was dampened by his father because of the concern over policy change. However, Liu did not care about the risks and replied that he would start his own business despite a risk of being jailed.

The persistence of Wenzhou’s peasant entrepreneurs in running household industries despite the serious political risks also changed the local political environment. This can also be seen in the cases of Yuan Fanglie and Dong Chaocai, both of who were the party secretaries of municipal Wenzhou during this time. Yuan Fanglie was famous in cracking down on capitalism before he was appointed to work in Wenzhou in August 1981. He was originally assigned to correct the chaos there; that is, to crack down on the household enterprises and to improve the state sector. When he arrived in Wenzhou, his first impression was that he was in the zone occupied by his enemies when he saw numerous individual vendors and household enterprises. In early 1982, he supported the crackdown against economic crimes that involved the eight famous entrepreneurs. In the beginning, Yuan also spent a few months in an attempt to improve the state economy, but his efforts turned out to be futile. Yuan had to reach out to the grassroots community to do investigations because of the economic frustration. The investigation largely shocked him because the private sector appeared to still be booming. He also found that his policy was not welcomed by the local people. Yuan eventually changed his mind and came to support the household entrepreneurs, such as specialized and key households that were still new to him. His successor, Dong Chaocai, had a similar experience. Like Yuan,
Dong was originally assigned to strengthen Wenzhou’s state economy. However, after a few months of futile efforts, Dong realized the stubborn force of private entrepreneurship in Wenzhou. He then wrote a paper to demonstrate the significance of the individual economy in Wenzhou; his paper was even considered as Wenzhou’s capitalist manifesto.

At the local level, some cadres also had to change their attitude toward the private entrepreneurship because of the grassroots’ persistence. In late 1979, a big stationery enterprise in the town of Jinxiang disintegrated into smaller enterprises, which were then run by individuals. The township leaders ordered village cadres and peasants to merge them into a big one. However, once the leaders left, it disintegrated again; this process repeated itself a few times. In the meantime, other township enterprises followed this lead and also disintegrated into smaller ones run by individuals. As the township leadership saw that private management improved the economy, they decided to take a risk in allowing such practice. The small private enterprises then registered under the big collective entity; such practice was called guahu. Jinxiang became the first place in China to innovate guahu in 1979. Soon the guahu practice spread throughout Jinxiang and was later allowed by the Wenzhou municipal leaders. Guahu largely boosted the development of household industries in Wenzhou as the vast majority of household enterprises were registered under collective entities for the purpose of legitimacy. In 1987, the Wenzhou government eventually legalized the practice of guahu, whereas such practice remained forbidden in many other places, such as Henan province in the 1980s.\[15\]

The change of the key leaders’ attitudes greatly encouraged other cadres to support the development of the individual and private economy in Wenzhou. Several methods were utilized to encourage private entrepreneurship; examples of such policies included awarding household entrepreneurs and salespersons, rehabilitating the entrepreneurs, befriending them, offering green light policies and promoting private entrepreneur models. At the end of 1982, Yuan began firmly supporting the household enterprises. He held a big municipal public meeting to encourage and award special and key households (Lianghu, two households).

The county and township leadership followed Yuan and held similar meetings of Lianghu. Some leaders declared support for household entrepreneurs. For instance, the township mayor’s political support partly led to Ye Wengui’s determination to start the shareholding enterprises. Rehabilitating some household entrepreneurs was one of the prevalent methods that removed the stigma of being a household entrepreneur and their concern about policy change. For instance, in 1984, Yuan Fanglie personally rehabilitated the eight big entrepreneurs who were initially cracked down by him. This greatly encouraged others to engage in household entrepreneurial activities. Nan Cunhui, who is currently the No.1 private entrepreneur in Wenzhou, said that the rehabilitation of the eight famous entrepreneurs made him feel politically secure to run a household enterprise; he began his own business in 1984. In order to remove the stigma of private entrepreneurship, Zhang Youyu, the party secretary of Ouhai County, rehabilitated a household that engaged in longan sales and awarded salespersons in a big public meeting. Zhang Guisheng, the party secretary of Ruian County, encouraged, even pushed local

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15 However, the Guahu practice was completely forbidden in other regions such as Hebei and Henan provinces. A Hebei entrepreneur was sentenced to death by the local court because of his engaging in guahu activity in 1984, fortunately the Supreme Court redressed the judgment. A Wenzhou entrepreneur with a guahu license encountered legal problems in Henan province as the latter did not allow guahu and required the entrepreneur to show the legal document, this occurrence speeded the legalization of guahu in 1987.
cadres to make friends with household entrepreneurs. Some cadres were still hesitant to do this, owing partly to the fear of the rightest error in supporting private entrepreneurship, and partly to the stigma of the household entrepreneurs. Zhang decided to take a lead in visiting some big household entrepreneurs such as Chen Guiliang, who was born into a bad class family and jailed twice for his sales activity. Zhang rehabilitated Chen on the spot and declared friends with Chen, promising to support him in the future. This removed Chen’s worry, since he was concerned that his growing wealth might result in another jail sentence.

Some leaders offered green light policies for the development of household industry. For example, Zhang Youyu demanded that local authorities simplify the administration of household industries. Hu Wanli, the party secretary of Cangnan County, demanded that officials change their attitude towards serving the household entrepreneurs. Promoting private entrepreneurial models was another strategy that encouraged the development of the household industry. Hu Wanli praised the Yishan township model where the household industry was very developed. He further encouraged officials and entrepreneurs to spread the model throughout the county. Zhang Youyu extolled two party secretaries who were experienced in running enterprises. All these signals served to encourage the local officials to engage in household enterprises. He also suggested a model township mayor to spread his entrepreneurial model to another poor town. The active support also entailed certain sensitive issues such as exploitation. Sengliren, an enterprise founded by three siblings, was criticized for its large size and exploitation of workers, therefore, they had problems in obtaining loans from the financial institutions. The county leaders became aware of this and subsequently criticized the township officials who got Sengliren into trouble. The leaders even declared that they supported the so-called underground enterprise.

Certain market-oriented officials increasingly supported household entrepreneurs to encourage the development of the household industry because they needed market models to advocate for their policy and strengthen their position, while entrepreneurs actively sought support from the cadres to minimize the political risks, remove administrative obstacles and offer favorable policies. Zhu Mingchun turned to the Wenzhou Daily for help on resolving a contract dispute between his poultry enterprise and a state-owned food enterprise. Furthermore, he asked for political support from the county leaders and also requested land and capital support from the municipal leader to establish a fodder enterprise. Fang Peilin received political support from the township leader to experiment with his private bank in 1984. The bank also subsequently received support from the county and municipal leaders. However, the central bank administration did not allow for the experiment with a private bank, consequently, Fang had to liquidate his bank in August 1985. In July 1986, Fang was encouraged by the news that central leaders would allow Wenzhou to experiment with the private economy. He saw hope for the revival of his bank, thus he began to actively seek for help from the county and municipal leaders. He acquired their strong support to reopen his private bank with leaders at both levels promising to shoulder the responsibility if he got into trouble.

Cost of risking in private enterprises

Although the environment became increasingly conducive to the development of household enterprises and political criticism declined in the 1980s, allowing the rapid
growth of household enterprises remained politically risky for officials, since the increasing proportion of individual economy essentially conflicts with the nature of socialism. The expansion of enterprises was also risky for entrepreneurs because hiring more than eight employees was considered as exploitation, which was a highly sensitive issue in a socialist society. However, some local officials turned a blind eye to the breakthroughs, in turn lending implicit support to the entrepreneurs. Some even actively defended the majority of the individual economy and the expansion of the enterprises. In doing this, they shouldered the political risks; some of them even received punishment for their actions.

This section will illustrate how local officials defended the guahu practice. Guahu was criticized by the planned camp in 1984. The National Bureau of Industry and Commerce came down to investigate guahu in Jinxiang town, the place where the practice of guahu originated. The central officials claimed guahu as illegal and attempted to revoke almost all the guahu licenses. Jinxiang township leaders defended guahu, arguing that it greatly promoted the development of rural industries that consequently absorbed a large number of surplus laborers and that there would be big unemployment issues if the guahu licenses were revoked. The township leaders also proposed to regulate the guahu practice. They eventually managed to persuade the central officials and have the latter keep the guahu practice through many negotiations. Jinxiang township leaders even had a slogan: “Allowing for rational developmental activity although it may look illegal (yunxu heli bu hefa).” Under this slogan, the Jinxiang leadership turned a blind eye to the practices that broke through the policies; this behavior was considered as the essential element of laissez faire government.

In the prominent 1982 crackdown against economic crimes, the local officials were punished for protecting household entrepreneurs. The Yueqing county leadership’s early support and protection for the entrepreneurs largely boosted the rapid growth of household industries after the reform. Thus, Yueqing became the most dynamic place of household industry in Wenzhou. However, the political protection appeared costly a few years later when Yueqing was conceived as the most chaotic place in the eyes of the planning camp. Some provincial officials even reported to the central government that there were rampant anti-revolutionary and economic crimes occurring in Yueqing. This caused Li Xianian, the incumbent President of People’s Republic of China, and even Deng Xiaoping, to order the Zhejiang province to solve these problems. This was also the major reason Zhejiang provincial leaders appointed Yuan Fanglie as the party secretary of Wenzhou and assigned him the task of cracking down on capitalism there. In early 1982, when the central government launched the campaign to crackdown on economic crimes, Zhejiang province chose Yueqing county as a target. 30,000 people, consisting mostly of entrepreneurs and the eight famous entrepreneurs, received jail sentences. The crackdown severely damaged the Yueqing economy in that year. The gross industrial output of Liushi town, Yueqing’s industrial center, shrank by 50% compared to 1981. With respect to the crackdown, the Yueqing county leadership attempted to protect the local entrepreneurs and disagreed with the provincial leaders’ decision. However, all the major leaders in Yueqing were removed from their offices because of their resistance and did not get rehabilitated until 1987.

As the party secretary of Wenzhou, both Yuan Fanglie and Dong Chaocai shouldered great political risks. Yuan did not get promotion after his term in Wenzhou
because the provincial leaders were not satisfied with the reform he was initially assigned to execute. Dong Chaocai advocated for the private economy and experimental zone of Wenzhou. He also allowed Fang Peilin to experiment with a private bank, which was a highly politically sensitive and risky enterprise in the 1980s. Dong shouldered big political risks as well. After the 1989 Tiananmen incident, the planning camp gained the prominence for a few years. Dong, as a market-oriented leader, was transferred to another position in the province; this was considered as a reduction in rank (Hu Fangsong et al. 1987).

The alliance between the Wenzhou market model and the central market-oriented leaders
The market-oriented leaders’ support since 1983 was one of the important factors to Wenzhou’s rapid development. Scholars disagree on the relationship between local and central administration during China’s transition, producing two main theories. The decentralization school (Qian and Weingast 1996; Montinola, Qian and Weingast 1995; Qian and Roland 1998) argues that decentralization, fiscal reform in particular, provided the incentive and autonomy for the local governments to innovate economic experiments. The faction theory (e.g., Cai and Treisman 2006, Yang Dali 1996) argues that the driving force behind reform was not pressure from or initiatives by autonomous local officials but competition at the center between rival factions with different ideological predispositions and local connections. Faction leaders sought supremacy within the party by demonstrating the effectiveness of their chosen policies across the chessboard of China’s territorial administration. Local officials were linked to these factions and sought to impress higher-ups with suggestions and sometimes spontaneous – even illegal – initiatives. My findings suggest that the decentralization theory was not valid in Wenzhou’s case. The fiscal reform did engender some incentives for Wenzhou’s local leaders who attempted to strengthen the state and collective enterprises in the beginning. However, as the cases of Yuan Fanglie and Dong Chaocai demonstrated, their efforts turned out to be a failure. Later, they had to change their policies to support the individual and private sectors.

My findings lend some support to the factional theory. The prominent rapid growth of the individual and private economy in Wenzhou began to attract attention from the central leaders, particularly, the market-oriented leaders. In 1983, Wan Li, the vice premier, praised Yishan town’s market model in Wenzhou. In May 1985, the Jiefang Daily, the newspaper of the Shanghai municipal government, reported on Wenzhou’s achievements and coined the term “the Wenzhou model”. This largely popularized Wenzhou across the country. Ever since then, the market camp became increasingly attentive to and supported Wenzhou’s practice. In 1985, Wan praised Wenzhou’s achievements after he watched the video produced by the Wenzhou government. He told Wenzhou officials that he would forward the video to Deng. At the end of 1985, Zhao Ziyang, the Premier of the State Council, paid a four-day visit to Wenzhou and evaluated Wenzhou’s achievements very highly. In April 1986, Wan Li paid a visit to Wenzhou and encouraged local officials to experiment boldly. The central market-oriented leaders’ visits and affirmation of Wenzhou’s development lent great support to the local cadres and peasant entrepreneurs. With the support from the center, the local institutional environment became much more congenial to private entrepreneurship in Wenzhou than
in any other region. For instance, the *guahu* practice discussed above was allowed in Wenzhou but prohibited in other areas. During the mid-1980s, encouraged by the central government and local cadres’ support, a growing number of peasant entrepreneurs attempted to break through the employment limit of seven employees; some entrepreneurs even sought to run private banks. In 1986, the peasants’ initiatives and attempts eventually got the central government to allow Wenzhou to experiment with a private economy, and even private finance.

Furthermore, in 1986, the *People’s Daily* and *Peasant Daily*, both of which represented the voice of the central government, extolled Wenzhou’s economic growth and prosperity and bestowed high praise on the peasant entrepreneurship that pioneered the rural commodity economy. The market-oriented leaders even utilized the central newspapers to promote Wenzhou’s success as a way to strengthen their position and advocate for market reform. The Wenzhou model was once considered as Zhao Ziyang’s model, but, unfortunately, Zhao Ziyang was ousted from central power after June 4, 1989. Thus, after that date, the planning camp cracked down on Wenzhou and nearly revoked Wenzhou’s privilege of being an experimental zone.

**Conclusion**

The findings of this chapter suggest that several factors made Wenzhou the first place to revive private economy in China. These include Wenzhou’s marginal position in the socialist economy, culture and politics, the peasant entrepreneurs’ innovation and persistence in entrepreneurial activities, the local cadres’ protection, and even encouragement, and the central market-oriented leaders’ support. The findings have four implications. First, the findings suggest that the locus of institutional change possibly lies in the marginal area of the dominant institution. Much institutional research examines the mechanism of institutional change, but few study the locus of the change. Second, the study complicates the study of China’s transition by detailing the political risks and how peasant entrepreneurs, local cadres, and central leaders dealt with the Maoist legacy. This is rarely examined in China’s transition to a market economy. Thirdly, the revival of private economy in Wenzhou shows that there formed an alliance among the peasant entrepreneurs, local officials and market leaders in the center, such alliance largely promoted the boom of private economy in Wenzhou. This finding advances the factional theory and rejects the decentralization model. Lastly, the cadres lent support to peasant entrepreneurs by shouldering the political risk instead of seizing the business opportunities, in other words, the political power appear not to have explicit or direct advantage in engaging in private business. The findings suggest that previous experiences in enterprises, individual businesses and the state sector, and some connections with cadres are significant for entering into private entrepreneurship. The findings reject the power persistence account and elite approach, and lend partial support to the marketization account.
Chapter 3

Conceptualizing and Legalizing Private Enterprise

Last chapter discusses how the cadres at local and central levels and entrepreneurs were involved in the revival of private economy in Wenzhou, and shows that the market camp need alternative successful model to strengthen their position, and at the local Wenzhou level, the cadres and entrepreneurs invoked the ambiguity of central policies and took risk in the experiments. The question now is how this local model was adopted by the center who later made the private economy legitimate across China against the still ambivalent environment, in other words, what mechanism contributed to the institutionalization of private economy at the national level gradually.

Theories of institutional change

There is a large bulk of studies on China’s transition; and extensive literature examines the change of policies and consequences, for instance, the household responsibility system, the dual track system, the price reform, and so on. However, little attention was given to these questions: how the actors make sense of the new institutional arrangements which were political taboos under Mao’s regime; and how such reform policies were theorized and become legitimized. To explore these questions is of quite significance in deepening our understanding the graduality of transition in China. A successfully model in the marginal area was theorized, and reframed by adopting rhetoric’s

Not long after institutional scholars have begun to see institutional rules and norms as mutable, always either changing or continually being reproduced, they began to identify individual actors as agentic in transformations of institutional fields. Yet individuals do not act within a vacuum; they make sense of their choices available to them within particular social and political circumstances.

In this study, I theorize institutional change as a dual process of the delegitimization of old institutions and the construction of new institutional norms that are understood as legitimate to the point of being tacitly accepted (Colomy 1998). Institutional scholars have emphasized several dimensions to the emergence of new institutions: actors’ growing awareness of legitimacy, changes in institutional logic, and the strategic use of language and rhetoric by institutional elites (Suddaby and Greenwood 2005). Central to processes of institutional change is the notion of institutional legitimacy. During the early formative years of an industry, new emerging institutional forms are legitimated in two ways: cognitively, by being experienced and understood by actors as taken for granted, and socio-politically, by conforming to an already-recognized set of principles or accepted rules and standards (Aldrich and Fiol 1994). Though crucial in the establishment of public trust in new organizations, perceptions of legitimacy in new institutional forms are difficult to access and influence. Since institutional norms operate at a tacit level as deeply held and unexamined reasoning and assumptions (Horn 1983), once introduced their continued legitimacy is not guaranteed but rather must be reaffirmed and reproduced through discursive framing in an ongoing process of
negotiation over the tacit logics and framings of institutional norms (Suddaby and Greenwood 2005).

For instance, Lounsbury (2002) investigated the transformation in the logics guiding the field of finance and the legitimization of finance as a profession through the development of financial expertise from 1945 through 1993. There, industry leaders discursively framed the introduction of new organizational structures and norms in the language of old rules and standards (Fiol, Harris, and House 1999). In theorizing such techniques of strategic discursive legitimation, neo-institutional theorists in the study of organizations draw on framing, a concept long used in the study of social movements to examine struggles over legitimation, transitions of power and authority among movement elites, and organizational rhetoric (McCloskey 1985, Nelson, Megill, and McCloskey 1987, Simon 1989, Suddaby and Greenwood 2005, Voss and Sherman 2003).

Though institutional scholars have theorized the centrality of discursive strategies of framing in legitimizing new organizational forms, few are attentive to the role of intellectuals in institutional change. Here, I draw on Pierre Bourdieu’s theories on the role of intellectuals in the production and symbolic legitimation of knowledge. As elites equipped with the authority to classify and legitimate categories of meaning, intellectuals play a significant role in the reproduction and transformation of institutions. As intellectuals reframe and rename proper norms and practices in the private sector, I argue that they are engaged in what Bourdieu calls classification struggles – struggles over principles of “vision and division” which render some market practices legitimate and others illegitimate, creating in the process new rules to a system of practice (1984). Further, I follow Bourdieu in emphasizing the power relations among actors that are reproduced by these struggles over classification. In particular, intellectuals, by legitimizing norms and categories of knowledge, produce a universalistic and universalizing view of the entire field which in turn consecrates their positionality in a field of social relations that continually reproduces their own authority.

Bourdieu agreed with Weber that capitalist institutions encapsulate a strong element of rationality, which is too strong to overthrow, a similar argument to Gramsci’s hegemony concept. Bourdieu is also in line with Weber on the role of ideas, but goes a step further and contends that the transition should be located at the production of ideas, in his terms, classification struggle, that is, another set of classification criteria and language to replace the strong neo-liberal classification of the world. Intellectuals are pivotal to such classification struggle, according to Bourdieu. His suggestion, more specifically, is that through intellectuals, mainly the left wing of sociologists’ constant self-reflexivity, a new type of language should be created for the dominated class to use to stand up against the language imposed by the neo-liberal intellectuals on behalf of the dominant class. The classification struggle, in my view, is similar to the struggle over institutional logic. Bourdieu pinpoints the agent for change of institutional logic. But his suggestion that intellectuals apply constant self-reflexivity upon the relationship between the object and subject misses the drive from the reality and the conditions for the transition.

Evans’s research (1995) suggests that the alliance among political elites, intellectuals and businessmen played a critical role in the economic development in East Asia such as Korea and Taiwan. The long history of civil service entrance exam in China also determined the important role of intellectuals, though it was disrupted under Mao’s
regime. This chapter mainly draws upon the academic writings and news articles in 1980s and some interviews in my fieldwork. I will illustrate how the local practice in Wenzhou was interpreted and theorized mainly by intellectuals, and legalized by the local and central authorities against the ambivalent environment, further how the private economy spread across the nation. The findings suggest that the theorization of Wenzhou model by the intellectuals largely contributes to the legalization of private economy at local level and national level, and to its spread all over China. This chapter also reveals how Chinese intellectuals understood and conceptualized market economy, capitalism and socialism, and their strategies in framing the controversial practices in the late 1980s. These intellectuals did not interpret the new practice completely from a new rhetoric; they reinterpreted them by drawing in turn on Marxism, on its practical outcomes and successes, and adopted the strategic use of linguistic rhetoric to ward off the negative effect. Thus private economy diffused widely as cultural categories that are informed by higher level theoretical justifications, and easily adoptable by various actors they combined framing and sensemaking to bring about institutional change.

Framing privatization in socialist rhetoric

With the rapid revival of private entrepreneurship, Wenzhou gained vast attention nationally in early 1980s. Criticisms came from the planning camp which was still in the Maoist legacy, although there were some modifications. The planning camp emphasized the purity of socialism, the dominant portion of the state economy, equality and socialist ethics. As one senior cadre remarked, Wenzhou was like a small capitalist Taiwan, aside from the flag, all strange things emerged (Chen Guanbo, 1986). The market camp responded by advocating for development, spill-over effects and entrepreneurship. The sharp contrast between economic success boosted by private enterprise and the economic crisis brought by socialist practice resulted in victory of market institutional logic. Market scholars and local officials proposed to experiment with private enterprise, and got support from the central market-oriented leaders. In the end, Wenzhou was approved to be an experimental zone of private economy; private enterprise got legalized first in Wenzhou, then at national level. In the rest of paper, I will discuss the criticism from planning camp briefly, then will focus on how the market camp theorize Wenzhou model, the third section will discuss the compromise and legalization, and will conclude with empirical and theoretic implications. As the central focus for this chapter is to explore how scholars and policy makers framed Wenzhou model under even beyond socialist rhetoric and how the victory of such framing facilitated the experimentation with private economy in Wenzhou, the analysis of the institutional and positional context of those scholars and policy makers is beyond the scope of this project, which is absolutely worthwhile for future research. My sketchy speculation from my analysis is that the victory of market framing is essentially driven by the market-oriented leaders and the success of the private economy on the ground in Wenzhou, which has not much to do with the institutional and positional context of the scholars and policy makers. Furthermore, the criticisms from planning camp which I will present in the following are mostly the orthodox teachings in various forms, and some of them are from the direct criticism.

The nature of individual economy
The first and foremost criticism of private enterprises in Wenzhou from the planning camp is, unsurprisingly, the shrinking role of state planning in the economy. In 1980, state-owned industry, collective industry, and household industry accounted for 35%, 51% and 12%, respectively, of the gross industry output in Wenzhou. By 1985, however, the proportion of state industry declined sharply to 18%, the proportion of collectively industry increased modestly to 54%, and household industry increased significantly to 30% (Wu Xiang, 1986). Since the state-owned industries occupied only a marginal place in the economy in relation to the individually owned industries, the planning camp concluded that Wenzhou economy deviated from the socialist direction prescribed by Maoist Marxism. State planners pointed out that the rapid growth of the individual economy was due to privatization and marketization. On the other hand, intellectuals in the market camp defended Wenzhou’s economic transformation by deconstructing the structure of ownership in these individually owned enterprises, drawing historical comparisons of such development, and advocating more widely for the need of new institutional forms.

A prevalent strategy they assumed in defending Wenzhou was to analyze and evaluate socialism at the national level in order to minimize Wenzhou’s deviation from the socialist standard. Intellectuals in the market camp argued that the socialist standard should be determined by the proportion of public economy at the national level rather than the local level. Although in Wenzhou the proportion of individual economy was higher than provincial levels, at the national level the proportion of individual economy was far lower. Furthermore, a small locality such as Wenzhou was unlikely to alter the national situation (Wu Xiang, 1986, Zhang Gensheng et al, 1986; Lin Yi 1987; Dong et al, 1987). They further argued that variation across regions should allow some local areas to have higher percentage of individually owned enterprises, so as to insure that peripheral localities are not left behind in the transition to communism (Dong et al, 1987). Lin Zili, an economist in the market camp, argued that the dominant position of household industries in Wenzhou did not suggest a change of ownership structure nor privatization; rather, it simply indicated the growing diversity of market forms in the local economy (1986). He evaluated household industries from both macro-level and micro-level perspectives, and argued that Wenzhou’s household industries were regulated by macro-economic policies on production, market, income distribution, and taxation. At the micro-level, he pointed out that most of Wenzhou household industries were registered as parts of collective entity, and thus operated under the indirect control of macro-level regulations and policies. Lin further argued that the accumulation of capital in household industries does not constitute privatization, because 1) portions of profits were invested in the social reproduction needs of individual producers, just as portions of capital accumulated in socialist public sectors are redistributed to the population as part of the “iron rice bowl” of social benefits, thus resembling public assets in some ways, 2) a portion of profits were income from dividends and accumulated monetary interest, which are regulated by macro state policies and therefore could be considered state-directed; 3) entrepreneurs faced with stiff market competition were unlikely to use capital meant to cover the costs of production for private consumption. Therefore, Lin concluded that Wenzhou’s household industries should not be called privatization, but rather “the diversification of micro-economic practices.” (Lin Zili, 1986)
Some scholars disagreed on the dominant position of individually-driven or private sector economy and pointed out that the state industry in fact still controlled the “pillar,” or key industries such as energy, transportation, banking, raw materials in Wenzhou (Dong et al 1987; Wu Xiang, 1986, Hu Sheng 1985). Dong Chaocai, the municipal party secretary of Wenzhou and an intellectual as well, even invoked western economist Rostow’s theory of the role of leading sector (1959) to explain the impact of the state sectors in Wenzhou economy. He pointed out that the state and big collective enterprises accounted for 88.43% of the fixed assets of the whole industry, and two thirds of the gross industrial output value, 77% of the net industrial output value, and 78.4% of the tax revenue. Aside from the pillar industries, talents, higher quality and market-share products were all controlled by these enterprises, whereas the individually-driven economy mostly engaged in small commodities and only positioned supplemental to the economy although it covered a wide range of products, regions and labors (Dong et al, 1987).

Zeng Wenyuan and Jiang Yaochun, two scholars from Shanghai, argued that although the state industry was in relative decline in terms of its proportion to total industrial output, it still grew fast at the annual rate of 8.8% during 1981-1985, and the growth rate in 1985 was even at 10% (Zeng and Jiang 1987). They further framed the socialist element in Wenzhou economy by deconstructing the structure of individual economy. The authors invoked a governmental investigation which suggested that the individual economy was composed of diverse ownership structures including household enterprises, private enterprises and shareholding cooperatives, and that in this diverse set of ownership practices, truly private enterprises only accounted for 11.4% of the agricultural and industrial gross output (Zeng and Jiang 1987).

The second strategy was taking a historical perspective in evaluating the private sector economy. In response to the criticism against Wenzhou economy, Wu Xiang, the associate director of Rural Development Research Center of State Council, drew the example of household responsibility reform to illustrate changing attitudes toward new practices of individual ownership. He pointed out that though in the beginning, the household responsibility was also criticized as perversely capitalist, these criticisms were later wholly refuted (Liu and Tang, 1987). Another scholar invoked a similar historical comparison in supporting the Wenzhou model by de-emphasizing the importance of the dominance of state-owned enterprises in pillar industries. As he put it, although state economy accounted for 19.1% in early 1950s, the control of pillar industries by the state gradually led the state economy dominate the economy effectively. Therefore, he argued, there should be no worry over lower proportions of state-owned enterprises in Wenzhou’s economy (Lin Yi, 1987). Jin Fushou, a scholar from Zhejiang Rural Policy Research Center, took this argument to its next logical step by down-playing the importance of form of ownership in the economy altogether, arguing that it is difficult to tell which form of ownership is more advantageous in the maintenance of a socialist economy, and encouraging a diversity of forms of ownership in the Chinese economy (Liu and Tang, 1987).

These arguments of historical comparison also deployed strategies of highlighting the sharp contrast of past poverty to contemporary prosperity to glorify the positive consequence of private economy. Zeng and Jiang narrated the historical development in Wenzhou: its industry was weak due to its exclusion from state-led development as a
strategic defense site in 1950s, factories were in almost constant chaos in the 1960s because of the Cultural Revolution, there was little investment from the state in the 1970s, and the annual industry growth during the Cultural Revolution was only 0.1%. On the other hand, from 1977 to 1985, the agriculture and industry output and fiscal revenue increased by four times, and the rural income per capita increased by eight times. An extreme poor Wenzhou rapidly became a very rich area, due in large part to the rapid growth of individual economy during this period (Zeng and Jiang, 1987). Li Yunhe, a scholar from Zhejiang rural policy research center, illustrated this point by quoting a peasant saying, “The achievements in the past three decades before 1978 is much less than those achieved during the short period after 1978.” Li further brought about the story of Pingyang county to illustrate his point: Ping Yang county completely rid its territory of beggars after the reform through the rapid growth of its private economy (Liu and Tang, 1987). Another framing strategy argued that the growth of private economy pushed the state industry to deepen its reform and speed up its production (Zeng and Jiang, 1987).

Private enterprise and exploitation,

One central debate over the Wenzhou economic model was about exploitation. Big enterprises were called dahu in Wenzhou. There are two types of dahu: partnership and private enterprise (siren qiye), those with more than eight employees. There were a number of private enterprises in mid 1980s. Marxist state planners pointed out that if an entrepreneur hires more than eight employees, there is chance for the employer to exploit the surplus labor of these employees, thus constituting exploitative capitalist production. Since exploitation should be completely forbidden in socialism, such ownership forms should be strictly disallowed in all industries and regions. Pro-market scholars, however, defended this phenomenon in various ways. Their first strategy was to invoke the contradiction and ambiguity of Marxism. One scholar pointed out the page number and quoted a passage of Marx: “very similar things may result in different consequences under different historical contexts,” thus implying that private employment (gugong) under socialism was fundamentally different from that in capitalism (Chen Guanbo, 1986). A second strategy was to downplay the negative impact of private employment. It was argued that such exploitation was trivial since the public economy still dominated the majority of economy (Chinese Academy of Social Science, 1986). A third strategy was to highlight the positive role of private enterprise, such as accumulating capital, providing job opportunities, improving the economy and satisfying the social needs. Some scholars also argued that those private entrepreneurs were highly capable (nengren) in doing business and management, and that their value should be honored for the sake of economic development (Zhang Gengsheng et al, 1986).

Si Defu, a professor from Peking University, offered a theoretical perspective to support pro-market advocates, and argued that private employment was inevitable in the development of commodity economy\textsuperscript{16}, since a commodity economy must allow the free

\textsuperscript{16} The term of commodity economy is another prominent framing strategy among Chinese intellectuals and policy makers. Commodity economy, is essentially equivalent to market economy, according to Wu Jinlian, the steadfast proponent and market camp leading theorist. The term of commodity economy was coined by Russian theorists, and Chinese market camp theorists borrowed this term to offset the resistance from the planning camp. It was first introduced in 1981 by Xue Muqiao, another leading figure in market camp, while it encountered severe criticisms from the planning camp which dominated in academia and policy making, although Xue got support from Hu Yaobang, one of political leaders in the market camp. In 1984, during the third plenum of the Twelfth CCP congress, one task was to
movement of all inputs to production in the market, including labor. As for the case of Wenzhou, he pointed out the large number of surplus rural laborers, owing to the scarcity of land, and the rapid development of household industries justified the existence of private employment. Si further distinguished private employment in Wenzhou from that in capitalist societies. According to his view, the employees in Wenzhou were not like proletariats who did not own the means of production under capitalism; and furthermore, such employment was voluntarily chosen by employees, some of whom were even friends or relatives of the employers. Since such exchanges of labor could be considered a mutually reciprocal exchange of aid among friends and kin, they were fundamentally different from a capitalist exchange of labor for a wage among proletariats who had no choice but to sell their labor for livelihood. Finally, Si pointed out that all employers were themselves directly involved in production as well as management, thus diverging from capitalist definitions of the manager as exclusively engaged in matters pertaining to the ownership of the means of production (Si Defu, 1986).

The fourth framing strategy these pro-market advocates deployed was to coin new terminology. Lin Zili coined the term “non-labor income” to replace the term “exploitation.” He argued that it was possible for someone to appropriate other’s labor under the principle of equivalent exchange of labor in socialist commodity economy. Therefore such “exploitation” cannot be completely eliminated, even in a purely socialist economy. However, it can be controlled by the state through macro-adjustment policies, given that private enterprises are not dominant in the economy as a whole. In Lin’s view, the concept exploitation was specific to class struggle, and therefore its use during the 1980s was anachronistic, given that class-struggles instigated by Mao during the 1950s were long in the past. Lin further pointed out that under socialist egalitarianism some people also appropriated others’ labor, but this was to be labeled simply as “socialism,” not exploitation. Therefore, the profits accumulated by those who appropriate the labor of others in private enterprise should still be considered the profits of socialism (Lin Zili, 1986).

Some scholars supported the private employment through implicit framing, that is, by story-telling without explicit evaluation. Fei Xiaotong, a sociologist and the vice-chair of National Committee of Chinese People’s Political and Consultative Conference, who strongly advocated for township and village enterprise model (TVE), raised private employers’ concern: they wanted to enlarge their enterprises and had to hire more laborers, but were highly concerned about punishment because of ambiguous state attitudes toward such capitalist-seeming practices. He also vividly contrasted the economically depressed conditions of most employees’ hometown regions, to their high salaries, the likes of which were impossible in their hometowns. Fei’s accounts implicitly supported private employment (Fei Xiaotong, 1986). Many scholars used such strategies of ambiguous framing to imply that private employment in a commodity economy was a new thing which was different from the exploitation in capitalism, and to suggest that a new perspective was needed to examine private employment in place of exploitation-based perspectives on capitalism. In addition to these intellectuals’ framings, market define the nature of Chinese economy. There were two options, one is planning economy, and the other is market economy. Market camp suggested the commodity economy as a realistic compromise to reduce the resistance from the planning camp, otherwise the marketization process would be heavily obstructed by the planning camp. http://www.eeo.com.cn/observer/special/2010/01/13/160494.shtml
entrepreneurs also offered their perspectives. Ye Kangsong, an entrepreneur who ran a fruits ranch and hired tens of labors, framed the relation between employer and employees as one between a stakeholder and his team members, implying of course, that everybody can share the achievement of team work. He illustrated this point by saying that workers voluntarily worked hard (Liu and Tang, 1987).

Some scholars advocated for legalization of private enterprises from the perspective of administration and management. Although the private enterprise form was rather large in scope and called dahu, translated literally as “large enterprise”, it was still treated as an individually-owned enterprise in state administration for purposes of taxation. Scholars pointed out such conflation resulted in some administrative problems and also created unease among private entrepreneurs, arguing for a need for the legitimization of private enterprise for better regulation. Gu Yikang, a scholar from the Zhejiang Rural Policy Research Center, agreed that regulation and guidance were crucial in the issue of private employment. He suggested that employers and employees should be equal in political and economic status, and that the rights of both parties should be protected. For instance, private employers should be honored as entrepreneurs (qiyejia), yet also should provide social security to their employees, just as their socialist counterpart, state enterprises, provide social welfare benefits for state employees. So he urged the legislation of an employment law to deal with the problem of distribution of surplus value. In his words, “If private employment is well directed and regulated, it can also serve to strengthen socialism.” (Liu and Tang, 1987)

**Inequality, polarization, egalitarianism**

The third major criticism of the Wenzhou model from the planning camp centered around inequality. As a small number of people became rich, visible practices of conspicuous consumption emerged in Wenzhou, such as the purchase of private cars and the construction of lavish mansions (Zeng and Jiang, 1987). Proponents of state planning criticized this expanding inequality and even polarization in Wenzhou, a clear deviation from the principles of socialism.

On the side of pro-market proponents, one argument acknowledged this growing inequality, but refuted state planners’ criticisms of economic polarization. It was argued that underlying the increasing inequality was a growing population becoming wealthy. Though the poor remained poor, Wenzhou’s absolute share of the pie was growing, and in time, poverty could be minimized and eliminated. Market proponents further criticized the notion that socialist principles required a form of social egalitarianism which would not allow anybody to become rich before others do. One central principle of socialism, after all, they argued, was to live a good life. The authors also pointed out that in Wenzhou some cadres were relatively poorer than the entrepreneurs, an observation they evaluated in a very positive tone (Zeng and Jiang, 1987). Some scholars pointed out a trickle-down effect of the development of private enterprises. They argued that the job opportunities provided by the big enterprises not only helped solve the problem of the surplus labor from the poor regions, but also distributed the wealth, technology, skill to the poor regions indirectly. In their views, this form of redistribution, though through market mechanisms, was firmly in the spirit of socialism in the sense that it helped realize common prosperity (gongtong fuyu)—a central goal in socialism (Chinese Academy of Social Sciences 1986; Liu and Tang, 1987; Si Defu, 1986).
Wenzhou model versus Sunan model: private enterprise versus TVE

Vehement criticisms of Wenzhou economy by state planners were also partially driven by Wenzhou’s juxtaposition to an already established model of TVE-led model in Sunan, long embraced by most scholars and policymakers. In southern Jiangsu, particularly Wuxi, Suzhou and Changzhou, TVEs developed rapidly during the 1980s, and scholars soon labeled this model of development the Sunan model. Widely embraced by the scholars and policy makers for providing evidence that collectively-owned enterprises could drive entire local economies, the Sunan model offered proof that collectively-owned and therefore public sectors of the economy could stimulate growth under socialism. In contrast to the Sunan model, the Wenzhou economy appeared controversial, owing to its high portion of individually-owned or household industries. Some scholars defended the strategy of Wenzhou model’s by arguing that the Wenzhou model could be applied to more regions in China than the Sunan model because it developed from poorly developed base with underdeveloped infrastructure, needing minimal state investment. Pre-take-off Wenzhou was far more representative of most regions in China than the Sunan model in its already relatively prosperous localities (Chen Xiangke, 1986, Zhang Gensheng et al, 1986; Liu and Tang, 1987).

Some scholars took a moderate tone to defend Wenzhou model. They argued that Wenzhou model was not privatization, and that Wenzhou development was not antagonistic to but rather complemented the Sunan model. They pointed out that each model had its strengths and weaknesses and could be applied to corresponding areas respectively (Fei Xiaotong, 1986; Chinese Academy of Social Sciences, 1986). Wu Xiang, however, disagreed with the possibility of wide application of Wenzhou model, instead praising the business-friendly institutional environment that the Wenzhou model was capable of cultivating, even in the originally backwards region of pre-take-off Wenzhou. He pointed out that Wenzhou was especially rich in “capable persons” and that its government had cultivated a business-friendly environment, suggesting that other places make efforts to cultivate institutional environment conducive for business and capable persons, thereby essentially transplanting Wenzhou model in other regions of China (Wu Xiang, 1986).

The essence of socialism, the logic of new institution and pragmatism

Underlying the debate about the nature of Wenzhou economy was a scholarly disagreement about the essence of socialism. The planning camp stressed the purity of socialism, that is, public ownership, equality and social justice. The market camp prioritized development and efficiency, and criticized the inefficiencies of pure socialist redistribution which had resulted in poverty in so many regions (Ma Jiaju, 1988). Market proponent economist Ma Jiaju argued that in the wake of poverty, the first and foremost issue at hand was development, the cultivation of proper market incentives, and institutional efficiency. Market camp scholars argued that like any social system, socialism was not purely one or another thing, but composed of diverse and multiple ownership forms. According to their logic, the nature of socialism was determined by the dominant ownership at national level; furthermore, the reality of geographically uneven development across China in fact necessitated a corresponding combination of multiple ownership forms in practice (Lin Yi 1987, Shanghai Academy of Social Sciences, 1986). Some scholars argued that the rural collective economy under Maoism had produced
slow industrialization and the impoverishment of the peasantry, and they also invoked peasants’ deep suspicions about the so-called advantages of socialist model in the past. They cited central Party principles of socialism to position their arguments. According to a new interpretation of Marxism popular among central policy makers, there was no ideal type of socialism, and the fundamental task of socialism was to develop the forces of production, to enrich the people, and to eliminate poverty. This interpretation replaced the past understandings which treated poverty as socialism in the end (Ma Jiaju, 1988; Lin Yi, 1987). Wu Xiang argued that scholars should apply this new institutional ethics to evaluate the innovation such as Wenzhou’s economy (Liu and Tang, 1987). Market camp scholars further employed the strategy of citing market leaders’ words to strengthen their arguments. For instance, Deng’s quotations such as “practice is the sole criterion of truth”, were widely cited by market-proponent intellectuals.

Another relevant issue these proponents faced in reframing the essence of the socialism was a widely-accepted theory of socialist stages, contending that there are three stages in socialism, and that China was still in the beginning stage. Some scholars strongly advocated the application of the theory of socialist stages to evaluate Wenzhou economy. They pointed out that since China was still at the beginning stage of socialism, and the foremost task was to develop the economy, therefore a diversity of ownership forms must be allowed (Liu and Tang, 1987).

Many scholars asserted that it was the masses who selected the new ethic of the market, that is, economic development, and that theorists should respect the masses’ wisdom and their selection. As they put it, “only those from the wisdom of the masses, can be supported by the masses, therefore can grow into full blossom”, and “No matter how heatedly scholars are debating whether Wenzhou economy is socialism or capitalism, the masses are very clear whether Wenzhou economy is becoming better or worse.” (Wu 1986; Liu and Tang, 1987)

The encouragement of theoretic breakthrough

This theoretical framing was something of a breakthrough for proponents of the Wenzhou model. Its framing in a redefinition of socialism and a state-sanctioned reinterpretation of Marxism was supported and even encouraged by China’s central leaders. Zhao Ziyang, the General Secretary of CCP and a market proponent as well, criticized the obsolete thoughts of the planning theorists and pointed out they were isolated from the practice of socialism in real life. He encouraged theorists to break through the tradition and orthodox with an open mind. As he stated, “only through this way, [could] the theory … guide the practice” (People’s Daily, July 10, 1987).

Deng Xiaoping’s principle of pragmatism also lent great support for the framing of Wenzhou model. Deng’s famous saying— “practice is the only standard of testing the truth”, was widely cited by scholars to fend off the criticism against Wenzhou’s achievements. Zeng and Jiang (1987) suggested the planning camp theorists focus on China’s practice, rather than the orthodoxies. They highlighted the significance of this theoretical framing in terms of guiding the practice. As they put it, if there was no theoretic guidance, there would be no hope for the reform; for instance, many big entrepreneurs in Wenzhou were very much afraid of the change of policies because of the ambiguity of theories and policies. In a similar vein, Gu Yikang argued that nothing but a
theorization of Wenzhou model could help remove the hesitance and fear among entrepreneurs (Liu and Tang, 1987).

**Proposal for experiment**

Jin Xiankuan, a local scholar in Wenzhou, attempted to adjudicate the disputes over the Wenzhou model. He contended that the Wenzhou model was merely a fortunate accident of development, and that scholars should be cautious not to over-interpret the phenomenon. According to him, privately-owned market institutions were indeed leading Wenzhou development for the time being, but this phenomenon would be short-lived owing to various factors; public ownership should therefore still be treated as the dominant form. He disagreed with those contributions to the debate which insinuated the weakening of the concept of socialism and the nature of economy, and asserted that only socialism could lead stable and concerted development. He also disagreed with the argument that high percentage of individually and privately-owned enterprises in Wenzhou was a limited regional phenomenon, and he interpreted the principle of regional variation in a strict way, arguing that the Wenzhou model should only be applied to extremely backward areas closely resembling pre-take-off Wenzhou. In Jin’s view, Wenzhou already became rich, and if the Wenzhou model spread to most regions, the private sector would come to dominate in most areas, eventually alter the dominant position of the public sector at national level and therefore the nature of socialism (Jin Xiankuan, 1986). Jin pointed out that if Wenzhou became an experimental zone, this could be avoided.

In contrast, a number of scholars and policy makers positively evaluated the Wenzhou model as an experiment contributing to the exploration of socialism, argued that it would be too rash to decide the nature of the Wenzhou economy and it should allow for experimentation for some time to allow it to mature (Zhang Yeping, 1986; Wu Xiang, 1986; Si Defu, 1986). In the similar vein, many scholars and policy makers suggested labeling Wenzhou as an experiment in development as a compromise (Zhang Gensheng et al, 1986; Du Runsheng, 1985, Ma Jiaju 1988).

Zhang Gensheng and his colleagues pointed out both benefits and downfalls would emerge in the overall Wenzhou project of individual economy and private enterprise, and they suggested that simple glorification or criticism was not a good solution; the best way remained a careful regulation of the downfalls of Wenzhou development through experimental measures. Only after the experiment became successful, could the model be spread to other areas (Zhang Gensheng et al, 1986). Ma Jiaju invoked Deng’s words about experiment with socialism with Chinese characteristic and advocated for a similar experiment in Wenzhou which would pinpoint and correct for inevitable errors (Ma Jiaju, 1988). Du Runsheng, the director of Rural Development Research Center of State Council, suggested Wenzhou experiment with finance structures, such as the institution of a floating interest rate\(^\text{17}\) and the establishment of shareholding companies (Du Runsheng, 1985). These proposals led to the establishment of experimental zone in Wenzhou in 1987.

The alliance of policy makers, intellectuals, and peasant entrepreneurs

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\(^{17}\) Floating interest rate was not allowed in Chinese banking in 1980s.
The rapid growth of the Wenzhou economy largely driven by household enterprise gained increasingly attention from the media and policy makers in the mid 1980s. The term ‘Wenzhou model’ was first coined in Jiefang daily, the official newspaper of Shanghai municipal government, in May 1985. Since then, central leaders, particularly market proponents such as Premier Zhao Ziyang, Vice Premier Wan Li, and other leaders began to pay visits in Wenzhou. In the meantime, a number of scholars visited Wenzhou for research, hailing from the Central Policy Research Institute, Chinese Academy of Social Science, Shanghai Academy of Social Science, Zhejiang Academy of Social Science, Fudan University, and Zhejiang University, and others (Chen Guanbo, 1986). These visits lent large political and theoretic support for Wenzhou’s development and the legitimization of its private economy.

The market camp also organized conferences involved theorists, policy makers, local cadres and peasant entrepreneurs. Wang Guicheng, the director of Rural Development Research Center of CASS, remarked during a conference that the intellectuals were coming to learn from the peasant entrepreneurs, who would act as their teachers of development. He advocated that intellectuals should break through the enclosure of the academy from practice, and should be actively involved in economic practice with peasant entrepreneurs, so as to prevent theory from lagging behind reality (Liu and Tang, 1987).

The Western influence and backlash

Western theories besides Marxism and Leninism were largely considered schools of thought poisoned by capitalism, and were heavily criticized by scholars and ideologues under Mao’s regime. The high living standard in the developed countries and particularly China’s neighboring four East Asia tigers, shook the foundations of Chinese leaders’ understandings of socialism and capitalism. Early in 1979, Deng Xiaoping remarked that market economy was a method which could be utilized in both capitalist and socialist society. Given the persistence of Mao’s legacy, Deng’s words were not widely spread at that time. However, later in 1979, Deng launched China’s “open up and reform” policy and allowed for experiments in capitalist growth in four special economic zones (SEZs) where foreign capital and joint ventures would be introduced. Some scholars felt it unfair that the capitalist experiment in these four SEZs sparked little controversy in comparison to the Wenzhou project, given that development in Wenzhou was far less publicly reported and publicized. In interviews, a few of my informants explained this by pointing out that the SEZs were Deng Xiaoping’s pet project, and consequently given high priority due to Deng’s authority, yet Wenzhou unfairly lacked such strong support as Deng’s special attention to these SEZs (informant 1, 2). They saw this as evidence lending support to the factional theory, and indicating that the uneven development across regions was partially due to unevenly distributed factional support from the center.

Nonetheless, these experiments with capitalism in SEZs were also accompanied with introduction of western theories into academia, literature and arts, supported by the liberal ideologue, Hu Yaobang, the General secretary of CCP in early 1980s. Intellectuals turned increasingly to embrace western thinking. In the Wenzhou debate, there were also signs of scholars’ application of western experiences to Chinese development. For instance, Dong Chaocai applied Rostow’s theory to discuss the role of Wenzhou’s state economy.

18 Zhao became the General Secretary of CCP in 1987.
sector; to which Zhang Renshou, a scholar from Zhejiang Economics Research Center, responded by arguing that rashly determining the nature of the Wenzhou economy by applying theories from the West, where complex commodity economy thrived, highly different from the Chinese economy, ran the risk of oversimplification (Liu and Tang, 1987). However, the introduction of Western ideas encountered two major backlashes from the planning camp. One was the anti-spirit pollution campaign in 1983, and the other was anti-bourgeoisie liberalization campaign in 1986. The two campaigns struck the market camp hard, and as a result, Hu resigned from his post in 1987. This demonstrated the constant negotiations between the market camp and the planning camp, and also made most scholars very careful in applying Western economic theories to advocate for market institutional logic.

*Linguistic game of justifying market innovation*

Linguistic games were a prominent strategy employed not only in theoretical debates over the essence of socialism, but also in the framing of ‘capitalist’ or market-oriented practice by intellectuals and journalists. A new term was coined to legitimize the innovation of the Wenzhou model, and its ambiguity reduced its clash with old institutional logics, providing instead possibilities for a reinterpretation of the old.

A prominent story was often told about the linguistic game of land transfer adopted by a journalist. The household responsibility reform improved productivity on land, and in the meantime the household industry became increasingly profitable; therefore, more and more peasant entrepreneurs transferred surplus lands to families specializing in farming. However, such practice was explicitly forbidden by the No. 1 central document in 1983. The prohibition made many peasants and entrepreneurs involved in land transfer pretty worried. Some were even afraid of being jailed. Wenzhou Daily, the official newspaper of Wenzhou government, decided to take a risk by reporting the land transfer in a positive tone, framing the land transfer as a good solution to the problem of surplus lands and a way to increase agricultural outputs. Gong Mu, a journalist, believed that the central document could not be applicable to everywhere in China owing to wide variation in development across regions. His supervisor suggested figuring out a new term which would not conflict with the central policy. Gong Mu coined two new terms: rangbao (to ‘let’ land) and shoubao (to ‘receive’ land), both with the same connotation as zhuangbao, (to transfer land) the official term for land transfer, yet not yet sanctioned for local practice. These new and ambiguous terms were locally interpreted as governmental permission for rural residents to begin conducting land transfers, and slightly after their usage in the media, practices of land transfer spread quickly across parts of rural China. Even more radically, Gong’s editorial, which implicitly suggested a need to revise the central policy, brought about a state-sanctioned law allowing land transfers, made explicit in the State Council’s No.1 central document in 1984 (Chen Guanbo, 1986).

Gong had another similar experience of influencing the central policy. Although there were peasants migrating to urban areas for jobs, state policy still prohibited their urban resettlement through the hukou registration system. No newspaper would dare take a risk to report an editorial decrying the exclusion of these peasants from urban citizenship, since it is precisely their exclusion which makes possible their cheap labor fueling urban industrial growth. Gong reported a story of seventeen peasants founding
Defending capitalistic ethic and morality

The planning camp criticized Wenzhou model not only from the economic perspective, but also from a moral perspective. These moral criticisms pointed out phenomena such as the conspicuous consumption of the rich; the sharp contrast of living styles among the wealthy and the extreme poor; the low quality of Wenzhou products under the Wenzhou model; the emergence of Wenzhou Christianity, considered a foreign import running counter to the principles of socialism; the revival of superstitious rituals such as mourning ceremonies among the Wenzhouese; the spread of pop music in Wenzhou, widely considered a distasteful pastime among the petty bourgeoisie; the revival of bigamy in Wenzhou; and rising reports of collusion between state cadres and shady entrepreneurs brokering in illegal contrabands.

The market camp scholars utilized literature form to defend both Wenzhou’s capitalistic ethic and its moral trappings. Chen Guanbo (1986) vividly depicted some fascinating stories, which encapsulated the messages of refuting socialist ideology implicitly, and mocking class struggle and unnecessary vigilance on capitalism. For instance, in one story:

Zheng, a teenager in Jinxiang Town, was searching for enterprises names and addresses nationwide for business contract. He contacted many directors of post offices across China, who supposedly could serve as a source of enterprises names and addresses. However, many post office directors thought he was crazy and ignored him, although Zheng proposed sharing profits with them. One cadre in a northern province, who was still highly vigilant of class struggle, reported to the police that someone from the southeast coast was collecting confidential information. Soon policemen arrived in Jinxiang to investigate this case. Later they found that Zheng was only a teenager and he just intended to make money. Pressured by Wenzhou local leaders’ protection, the policemen just gave Zheng a light punishment (Chen Guanbo, 1986).

In response to criticism against the Wenzhou capitalistic ethic which highlighted greed, self-interest, and monetary fetishes as improper imports of capitalism, some national journals and newspapers extolled the philanthropic behaviors of Wenzhou entrepreneurs in order to minimize the stigma of entrepreneurship. For instance, the journal “minzhu yu fazhi” (democracy and legality) reported entrepreneur Yang Zonghao’s donation to education and to rescue missions following a record-setting forest fire in northeast China in 1987. The news article went a step beyond straightforward reportage of his philanthropy to generalize the ethics and morality of wealthy entrepreneurs. As the article put it, “there are thousands of entrepreneurs who are enthusiastic in donating to education and public services.” The writing even mocked the propaganda of Communist ethics which glorified those cadres who donated one penny to the collective but refrained from publicizing their acceptance of large donations from private entrepreneurs. Many intellectuals extolled the development of public infrastructure funded by profits contributed by rapidly growing household industries in Wenzhou. They pointed out that these supposedly private-sector profits were in turn
reinvested in the public services, funding education, infrastructure, theatres, TV stations, and senior apartments in Wenzhou, and they concluded that such profits and their contributions to the public good were essentially in line with the basic principles of socialism. A number of news articles by the central official newspapers and journals advertised Wenzhou’s prosperity, focusing on Wenzhou’s night markets, fashions, and shopping centers, and glorified Wenzhou’s private entrepreneurs, particularly its women entrepreneurs, for their hard-working spirit, efficiency, self-reliance, and their strong support for education and cultural investment through contributions of private capital (See Gao Haihao, 1986; Ma, Licheng, 1987; Song Meiya, 1986; Xue Quanrong, 1986; Lin Weimin, 1986; Du Qiuying, 1986; Zhang Zhengxian, 1987; Ding Xueping et al, 1987; Wang Xuexiao, 1986; Hu Baoqing, 1987; Tang Yijun, 1987; Maolie et al, 1986; Ye Hui, 1987; Wang Jianfan, 1986; Yang Lieshen, 1986).

In response to moral criticisms of the Wenzhou model focused on the unseemly business practices of entrepreneurs and the low quality of goods produced in Wenzhou private enterprises, some scholars redirected the blame for these blights on a central administrative planning system which restricted peasant entrepreneurs from procuring raw materials of the same high quality as those procured by state enterprises. They further argued that the high consumer demands faced by these efficient yet unsupported peasant entrepreneurs at such an early stage of their product development were unreasonable. Journalists showed sympathy to peasant entrepreneurs, echoing their complaints of the discrimination they faced in Wenzhou, and eulogizing their hardworking spirit. These editorials kindly reminded readers that there were still some wrinkles to be ironed out in the formation of the Wenzhou commodity economy, gambling, superstitious practices, and the circulation of fake goods among them (Ding Xueping et al, 1987).

**Legalizing Wenzhou model, founding of Wenzhou experimental zone**

Wenzhou leaders increasingly realized that the individual and private economy was crucial for Wenzhou’s development, since it aided in absorbing rural surplus labor while simultaneously developing local urban industries, a contribution which was crucial given the dearth of state support offered to Wenzhou both before, during, and after its take-off. Aside from the theoretical explorations of the meaning of socialism and debates over the moral value of local entrepreneurship, Wenzhou still simply needed a pragmatic solution to its marginal positionality in China’s terrain of development and invisibility to central state prerogatives. This experiment in market forms easily gained a consensus of support among local political leaders, intellectuals and peasant entrepreneurs.

Dong Caocai strongly proposed to develop Wenzhou’s private economy, and his papers advocating for private economy were circulated widely among circles of state officials. The central government decided to consider an experiment in establishing a private sector economy in Wenzhou, and asked the Wenzhou government to draft a proposal. The proposal was jointly drafted by Wenzhou government and Zhejiang Policy Research Center. Meanwhile, the Central Policy Research Center also held a conference discussing the Wenzhou experimental zone. Zhejiang provincial leaders submitted the proposal to the central government in September 1986, and it was finally approved one year later. In October 1986, when Zhejiang provincial leader inquired central government official Wan Li about approval of the proposal, Wan told him to start the experiment first,
instead of waiting for the central government’s approval. Beginning in November 3, 1986, the experimental proposal was enforced in Wenzhou. Several central leaders also visited in Wenzhou and encouraged the development of private economy before the formal approval by the State Council in September 1987. The experimental zone had the privilege of breaking through the old institution and policies, and the central task of the experiment was to legalize and legitimize the individual economy and private economy, for the sake of local administration and Wenzhou’s economic development.

In August 1987, Wenzhou legalized the practice of *guahu*, the registration of private enterprises under collective entity. *Guahu* was innovated in Wenzhou, at a time when most individual businessmen and household enterprises were still registered as collective entities. However, it was due to increasing discontent over problems Wenzhou businessmen encountered when traded with partners in other regions who demanded a legal entity, that legalization of *guahu* was passed in 1987. Wenzhou became the first region to legalize *guahu* practices.

In October 1987, Wenzhou legalized private enterprise (*siren qiye*). Private enterprises were still highly sensitive, although market camp intellectuals continued to defend this organizational form. This political sensitivity resulted in private entrepreneurs’ hesitation in expanding their businesses; some entrepreneurs even rechanneled their profits into conspicuous consumption rather than risk reinvesting profits into firm expansion. The Wenzhou government realized the urgent need to legalize and thereby maintain the growth of private enterprises. Wenzhou’s legislature issued the interim regulation on private enterprise on October 26th, 1987. This was also the first regulation on private enterprise in China. In April 1988, an amendment of Constitution was passed in the standing committee meeting of National People’s Congress which stated that: “the state allows the existence and development of private economy within the range stipulated by laws. Private economy is supplemental to socialist public economy. The state protects the rightful rights and benefits of private economy, and direct, monitor and manage the private economy.” On June 25th, 1988, the first national interim regulation of private enterprise was passed. Five Wenzhou people including cadres and private entrepreneurs participated in the legislation meeting of private enterprise sponsored by the State Council (Hu Fangsong, et al, p.43).

During the process of legitimizing the Wenzhou model in 1986 and 1987, thousands of cadres, intellectuals, peasant entrepreneurs and journalists visited Wenzhou, to learn Wenzhou’s experience, many hailing from prosperous regions such Guangdong and Jiangsu, others hailing from poor regions such as Guangxi, Gansu and Sichuan. According to a rough estimation, about 15,000 cadres from all over China paid visits to Wenzhou between 1986 and 1987.

**Conclusion and Discussion**

China’s institutional transition from a state planned economy to a private economy emerged in tandem with the rise of the private enterprise as a new organizational form. Organizational theories traditionally explain the emergence of new organizational forms in three ways: by examining the resources and spaces available to institutional actors; by pointing to highly random episodes in a process of evolutionary change; or by examining how institutional actors mobilize the resources available to them. The first approach, ecological theories of institutional change, emphasizes the technical
environment of change, the efficiency of institutions, and the process by which outcomes are selected. That is, it presumes that the emergence and decline of organizations can be charted at the population level, and is largely determined by institutional resources, not by individual organizational adaptation. The second approach is more deterministic, contending that organizational transformation proceeds randomly, through the coping and strategies of internal actors. The third institutional approach focuses on the norms, regulations, and perceptions of rationality and legitimacy within organizations and in the larger institutional field which constrain and support organizational change. This institutional perspective stresses the convergence or isomorphism of organizations, and institutional change is central to its analysis.

The rise of the Wenzhou model and its development of individually owned private-sector enterprises mirroring the practices, norms, and forms of capitalist enterprises, demonstrate the significance of legitimacy in the change of institutions. Private sector practices in Wenzhou ran sharply against socialist orthodoxy and therefore the legitimacy of their market logics were widely questioned and criticized by state officials and intellectuals. Orthodox Marxism in China strictly emphasizes equality over efficiency, the state and collective sectors over the private sectors, the socialist collective ethic over the capitalist ethic of individual contribution. Yet the economic crisis undersigned by orthodox Marxism and brought to its extreme manifestation in the Great Leap Forward, constituted a weakening of the legitimacy of socialist rhetoric and provided an opportunity for intellectuals, officials, and entrepreneurs to usher in a new ethic of private sector production. Deng Xiaoping, who took a pragmatic stance on the socialism development and sought alternative economic methods to improve the economy and people’s living standard, lent symbolic authority to what would become the new criterion of legitimacy for power. Efficiency and “getting rich first,” as Deng Xiaoping put it, gradually became the new dominant principles of the market. It’s no surprise that this transformation in institutional logics coincided with the turnover of China’s central administration and governance structure, which lent these new practices a consecrated symbolic language of legitimacy. The economic crisis, together with a turnover of administration at the highest levels of central government, initiated the transformation of institutional logics and their newly won legitimacy. Strengthened by their successful on-the-ground experimental implementations, and framed in the popular media and in political discourse in the language of socialist rhetoric, this logic was quickly legitimated and its concomitant practices of private ownership in the market became widespread. Intellectuals and some officials who embraced the new institutional logic, emphasized the contradictions, shock, turbulence of the old logic, and framed the new as an attempt to improve on and reinterpret the old. These intellectuals did not interpret the new practice completely from a new rhetoric; they reinterpreted them by drawing in turn on Marxism, on its practical outcomes and successes. That is, they emphasized the structural, material conditions of economic life, and understood the situations they found themselves in; in another words, they combined framing and sensemaking to bring about institutional change (Benford 1993, Gamson et al 1992, Fiss and Hirsh 2005, Weick 1993). As a theorem explicating the success of certain institutional logic put it: “Why do certain entrepreneurshipships for the change of institutional logic succeed? The more it fit into the existing culture, the more likely it succeeds.”
Another strategy of their new framing was the strategic use of linguistic rhetoric to ward off possible negative reactions. Framing or rhetoric, as the art of persuasion, essentially amounts to a competition for public legitimacy through the mobilization of the symbolic (Snow and Benford 2000, Snow et al 1986.). Yet in the Wenzhou case, discursive framings of private sector practices gained public support not simply due to the brilliance of their rhetoric, but also was supported by recent successful outcomes of these new market practices – the private economy – under the new criterion of legitimacy – efficiency, economic growth and a rising living standard.

Bourdieu highlights the role of intellectuals in struggles over classification, or as social movement theorists would put it, over framing. However, Boudieu is pessimistic about the prospects of social movements from grassroots levels, movements such as working class movements. In his viewpoint, workers are constrained by their use of a dominating yet invisibly operating language of symbolic power produced by capitalist elites and intellectuals, at least in contexts where no alternative languages of the intellectual Left is available. Where working class movements are successful, they succeed due to their deployment of available alternative framings of language and classifications of knowledge, which symbolically legitimate their position. In the case of the legitimization of the private economy in China, aside from intellectual’s efforts, the process of ‘classification struggle’ or the legitimization of private economy was largely dependent on proclamations of legitimacy consecrated by central state power, which were themselves often persuaded by the successful results of bold bouts of on-the-ground experimentation. In this sense, the case of Wenzhou goes beyond Bourdieu’s depiction of the role of intellectuals and state power in struggles of classification, by and large centered around the interests of intellectuals in reproducing a social order in which their authority can be reproduced. Instead, I find Chinese intellectuals and state officials, inspired by the emergence of an alternative utopia of private-sector yet distinctly socialist growth, lending the symbolic authority of their status to a cause which does little to reproduce the status quo of socialist authority.

The story behind China’s overall fairly peaceful and successful institutional transformation from socialism to capitalism lies partly in negotiations over discursive and symbolic framing among intellectuals, cadres and entrepreneurs. Wenzhou’s sustained private sector growth strengthened its legitimacy and acceptability as an alternative model of economic development, and the discursive framing of its fairly radical and new norms of firm ownership, employment relations, and market exchange as essentially socialist warded off negative reactions. Rather than simply speaking over their competitors by arguing that Wenzhou’s advantages outweighed its disadvantages, pro-Wenzhou elites spoke for their opponents, monopolizing the discursive space by reinterpreting and redefining what it means to serve the socialist cause. In this way, they simultaneously created a new cognitive category of what socialism is, allowing new institutional forms such as private enterprise ownership and individual economies to diffuse widely as cultural categories that are informed by higher level theoretical justifications, and easily adoptable by various actors (Strang and Meyer, 1993). This discursive work of redefining cultural categories and schemes of meaning, however, was carried out in micro-level processes of mobilization in which actors infused new practices with changed meanings as a means of consciously or subconsciously justifying actions in line with their own interests, and competing for power in a field in flux, at the nexus of
various cross-cutting social relations among actors occupying various positions and with access to forms of capitals of different volumes, kinds, and degrees of power.

The framing of capitalistic practice in Wenzhou also demonstrates how ambiguity in terminology can be utilized by intellectuals, journalists, and other producers of knowledge in the legitimization of new institutions. Edelman found that laws that contain vague or controversial language regulate organizational procedures more than the substantive results of those procedures, and that laws that provide weak enforcement mechanisms leave more room for organizational mediation than laws that are more specific, substantive and backed by strong enforcement (Edelman 1992). In the Wenzhou case, market elites, journalists, and intellectuals used a highly ambiguous set of Marxist terminologies to reinterpret the words and policies of central leaders, thereby gradually compelling institutional changes in on-the-ground economic practices which eventually came to be consecrated and institutionalized in the form of new policy passed by the central state.

Lastly, the framing of elite debates over the Wenzhou model also reveals how Chinese intellectuals understand markets. In China’s transition from socialism to what Deng Xiaoping famously called “socialism with Chinese characteristics,” pro-planning and pro-market advocates interpreted the realm of the market in remarkably different ways.
Chapter 4

Transformation of the Local State

On August 8th, 1987, Hangzhou consumers’ association set five thousand fake and shoddy shoes (jiamao liezhi) made in Wenzhou on fire in the Wulin plaza, Hangzhou, the capital of Zhejiang. Twelve years later, on December 15th, 1999, in the same place, two thousand fake Wenzhou branded shoes (jiamao Wenzhou) made in other regions were set on fire by a Wenzhou shoe entrepreneur. In the late 1980s and late 1990s, thousands of entrepreneurs, officials, journalists and intellectuals swarmed into Wenzhou from all corners of China to learn the Wenzhou model, as shown in chapter 2. Since 2003, the Wenzhou government organized tens of visits for officials and entrepreneurs to learn the experiences of other places, particularly Sunan and Shanghai. Before the 21st Century, both governmental projects and foreign direct investment (FDI) were minimal in Wenzhou. However, since 2003, the Wenzhou government began to aggressively attract FDI, develop heavy industry and support the merger of enterprises, and Wenzhou saw a sharp increase in the foreign capital actually used, heavy industry, and big and medium-sized enterprises.

Chapter 2 and 3 explored how the private economy was revived and legalized in Wenzhou and nationally, while suggesting that private entrepreneurs’ risk in engaging in the private economy, the local cadre’s willingness to shoulder the political risk and the support from the market-camp leaders and intellectuals are crucial factors. This chapter will explore how the development of the private economy influenced relations between the local state and the market after the legalization of private economy. The findings suggest that the Wenzhou local government transformed from a laissez-faire to a regulatory to an interventionist state. The first transformation was largely forced by the market and the central government, and the second transformation was driven by the local states’ competition for economic growth. This chapter has four sections: the first section will address the initial transformation from the laissez-faire to the regulatory state, the second part will address the second transformation, that is, from a regulatory state to an interventionist state, while the third section analyzes and discusses the convergence of state’s transformations along the coast from a horizontal comparative angle. The last section will conclude with implications. This chapter largely draws upon in-depth interviews, official statistics and news articles.

State in the market

Neo-classical economics largely focuses on the mechanism of market, but gives little attention to the state. They argue for the arm-length transaction and see the state as a black box, although it recognizes the importance of the state in economic growth (North 1981: 20). As opposed to neo-classical economics, since 1980s, sociologists re-discovered the value of state in the market (Evans, Rueschemeyer and Skocpol 1985), they increasingly view the market embedded in the society.

Scholars exerted great efforts in conceptualizing the types of state in the market. According to Fligstein, the state plays an important role in the formation and stabilization of the market through developing rules of property rights and exchange and governance
structure (1996). In Fligstein’s viewpoints, there are two types of state in lens of state’s involvement in the market, that is, regulatory and interventionist. A regulatory state, such as US, does not make substantive decisions in the market, but creates rules to regulate the market through agencies. In contrast, an interventionist state, such as France, is powerful in make decisions such as firm ownership, investment, firm entry and exit, and competitions in the market. Evans (1989, 1995) identifies three types of states in terms of the relations between state and market, that is, predatory state, developmental state and intermediary state. A predatory state ruthlessly extracts the market but provide no return of value, Zaire is the best example; a developmental state like Korea formed an alliance among the political elite, intellectuals and business to lead the development of economy; an intermediary state lies in between a predatory state and a developmental state, and Brazil is such an example. Dobbin and Sutton (1998) complicate the strength of state in the market, that is, the demarcation between a strong state and a weak state. They define the strength of state in a few aspects: a, constitutional limitation or non-limitation of state control over private enterprises; b, the separation or fusion of state powers; and c, as a centralized administrative enforcement agency or a series of autonomous agencies. They find that the federal state in the US is administratively weak but normatively strong; by contrast, France is administratively strong but normatively weak.

Such categorizing the role of state is valuable in discovering the value of state in the market, however, they largely treat state as a stable and static institution when distinguish the nuances of state’s involvement in the market, and are unsatisfactory in answering what factors result in such a state and the change of institutions.

In the field of China studies, scholars also tend to identify the different types of local states by their roles in economic activity: the entrepreneur state; the clientalist state; the predatory state; or the developmental state (for a more detailed analysis, see chapter 1). The studies reviewed above show that various types of states existed in China, and they advance China study approaches from a perspective of the state as being totalitarian to a perspective of the state. However, these studies are helpful in conceptualizing and categorizing the types of state, whereas they are limited in explaining the underlying mechanism which drove the emergence of such type of state. Some scholars also note that the evolution of local property regimes or types of state’s intervention (Walder and Oi 1999), however, they are still weak in exploring the evolution process and the mechanism.

**Transformation of the local state**

Organizational studies mostly focus on profit and non-profit organizations, while less attend to the government in the market. Instead, the existing organizational literature mostly treats the government as an institutional force and a key element of the external environment of organizations. However, some clues for the transformation of local states can be obtained from studies on organizational changes. There are two major theories in explaining organizational change. One is rational adaptation, and the other is ecological theory. The former posits that organizations can adapt to the environment in a bounded-rational way (March and Simon 1957; Simon 1962), whereas the latter contends that organization change is limited by strong inertia pressures (Hannan and Freeman, 1977, 1984, 1989). Scholars are increasingly brought institutional analysis to adjudicate the mechanisms of adaptation and ecologic selection (Haveman and Rao, 1997, 2006).
Haveman and Rao (1997) found that the coevolution of thrift organizations and institutions was primarily driven by selection, and that adaptation was constrained by both institutional factors and technical factors.

**Institutional isomorphism**

The proposition of institutional isomorphism asks about the homogeneity of organizational forms and practices (DiMaggio and Powell 1983), instead of the variation among organizational structures and behavior (e.g., Child and Kieser, 1981, Hannan and Freeman 1977). DiMaggio and Powell (1983) identified three mechanisms of isomorphism, that is, “1) coercive isomorphism that stems from political influence and the problem of legitimacy; 2) mimetic isomorphism resulting from standard responses to uncertainty; and 3) normative isomorphism, associated with professionalization” (p.150).

As the force of private economy was growing, how the government of Wenzhou responded to the growing new force; in addition, how the upper administrative apparatus reacted to the Wenzhou’s market and how this reaction impacted the local field in Wenzhou? Drawing upon the theories of organizational change and institutional isomorphism, I would expect that the mechanisms of adaptation and institutional isomorphism drove Wenzhou state transformed from a laissez faire state to a regulatory one and then to an interventionist state, such mechanisms largely offset the structural inertia during critical juncture. A laissez faire state has minimal direct involvement in the market, but it can be active in defining the property rights guiding the entry of capitalism (Fligstein 1996). A regulatory state actively regulates market competition through laws and administrative enforcement, but it is not very involved in investment and enterprise management. On the contrary, an interventionist state is actively involved in investment and enterprise management.

**Transition from a laissez faire state to a regulatory state**

The two fire incidents, mentioned in the beginning of this chapter, demonstrate the significant improvement of Wenzhou product quality. And this improvement results from the transformation of a chaotic market into a regulatory one, thus also reflecting the transformation of a laissez faire state to a regulatory state. In this section, I will answer two questions: What forces drove the transformation and how did the state transform? My findings suggest that the market reaction and pressure from the central government enabled the emergence of industry associations, which played an important role in regulating competition and product quality, and strengthened the Wenzhou government’s ability to enforce product quality laws and regulations. The industrial associations were semi-autonomous and financially independent, but some associations had a key officer appointed by the government. The industrial associations and the government were both similar and different in their respective treatment of the market. The government focused more on policy making, law enforcement, and technology and infrastructure investment for the sake of regulating and improving product quality, employing slogans such as “product quality is the life of the city.” But the industry associations focused more on enterprise self-disciplining and regulating market competition, such as quality standard, training and brand establishment. Meanwhile, the government and industry associations also worked together in law enforcement.
In Wenzhou, product quality had been a controversial issue in the early 1980s, and it was one of the heavy criticisms from the planning camp who labeled it as chaotic capitalism. While, the market-oriented camp pointed out this problem that apparently needed addressing. However, they mainly defended and tolerated this phenomenon, as they argued that these enterprises needed time, technology, and capital to develop higher quality products. Some market-oriented scholars and policy makers even joined the entrepreneurs to criticize the state’s restriction of rural private enterprises’ access to critical raw materials (Ding Xueping et al, 1987). As the ban on the private economy was lifted and the achievements of private enterprises were eulogized and advertised, the state became more tolerant of the negative aspects of private enterprises. Ironically, however, the lack of regulation of private enterprises, particularly of product quality, and the rapid growth of the private economy led to the emergence of rampant quality problems.

Regulating product quality: industry associations

The quality of shoes made in Wenzhou became notorious at the end of 1980s. On August 8th, 1987, at Hangzhou’s Wulin gate in Zhejiang province, 5000 pairs of shoddy shoes manufactured in Wenzhou were set on fire. In 1990, six central departments worked jointly to crack down the fake and shoddy leather shoes made in Wenzhou, and this joint crack-down particularly targeted Wenzhou, given both the quality issue and the losing support from the center as the market-oriented leaders were ousted after Tiananmen movement.

After the fake leather shoes made in Wenzhou were set on fire in Hangzhou by the local consumer association, a semi-governmental organ, the Wenzhou government sought to deal with this matter but felt awkward negotiating with the Hangzhou consumer association. Thereafter, it realized that it would be better if there were an association that can be responsible for self-discipline. Thus, in the summer of 1988, the Lucheng shoe industry association was founded.

The association was semi-autonomous. First of all, it was registered under the Lucheng economic committee, a governmental organ, and the association’s head secretary, who was responsible for everyday operation, was also appointed by the government’s economic committee. Second of all, the association cooperated with the Lucheng governmental office of shoe quality regulation (Lucheng qu xieye zhiliang zhengdun guanli bangongshi). In 1989, the Lucheng district government formed a team, led by the deputy governor, to regulate shoe product quality in order to develop the shoe industry. The team also established an operating office, and the director of this office was the head secretary of the shoe association. At that time, local governmental agencies and many companies were assigned one or two personnel to regulate shoe quality. Lucheng also established 26 secondary shoe associations that had staff sizes of up to 1000 people. All shoe enterprises in Lucheng had to join the association; the highest number of members was 1800. In 2000, the membership declined to 905 because of mergers or closures (Wang and Mu 2002).

However, the association’s funding mostly came from membership dues. The president, vice president and board members were elected. This afforded the association some autonomy against government intervention. The Lucheng Shoe Association was involved in regulating the market, particularly in areas regarding quality control, by

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19 The central district of Wenzhou
issuing quality standards and providing training and supervision. In the beginning, its major task was to promote product quality, as the major problem of the shoe industry was low quality. One of the major tasks for the association was to cooperate with the Lucheng government to improve the quality of the shoe products. The association made detailed improvement plans and stipulated the standards required of the enterprises in detail. Later it also performed sample inspections for all the enterprises, and those who passed the inspections were still inspected annually. For instance, one national inspection showed that the rate of qualified enterprises in the Lucheng shoe industry was only slightly higher than the national average, while two small enterprises were even criticized and exposed by the media because of poor quality products. The association found through investigations that small enterprises lag behind in product quality, thus it proposed to the district government to strengthen the management of the shoe industry. Thereafter, the district government focused on monitoring small enterprises. The association responded to the district government’s calling by cooperating with several governmental departments to give classes on the new quality standards.

Against the similar backdrop of the government not being able to resolve the issues of a chaotic competition and low product quality, there were tens of industry associations established since the 1990s in Wenzhou. These associations were also semi-autonomous. For instance, the secretary was appointed by the government and works as the liaison between the entrepreneurs and the government. Here I briefly describe another two influential industry associations in Wenzhou.

**Case one, the Wenzhou Fashing Association.** The garment industry is the second pillar industry in Wenzhou and started in the early 1980s. At that time, it was composed of street vendors that were still family firms that boasted a large volume of sales but low product quality. In the beginning of the 1990s, the Wenzhou garment industry still remained in pre-brand competition; the market was extremely chaotic with enterprises imitating each other and cutting prices. In order to regulate the market, Liu Fusong, the manager of Golden Triangle Clothing Factory, with the help of other entrepreneurs and Wenzhou’s Federation of Industry and Commerce, founded the Wenzhou fashion association. The association actively served member enterprises by regulating industry competition in preventing and punishing unfair competition, therefore winning the trust of its members (Wang and Mu 2002).

**Case two, the Lucheng Cigar Lighter Association.** In 1991, cigar lighter enterprises, trammled by the chaotic competition, formed the Lucheng Cigar Lighter Association. Around 1993, stimulated by large orders from overseas Chinese and foreign companies, the Wenzhou cigar lighter industry experienced a crazy period of steep rise and decline in sales volume. Market punishment allowed the enterprises to learn the importance of the quality and reputation. In the latter half of 1993, the Wenzhou government issued an official document that authorized the cigar lighter association to certify enterprises, inspect product quality, set the lowest protective price, and patent protection, etc. The cigar lighter association led its members won the anti-dumping law suit charged by the European Union in 2002.

In sum: as the private economy revived in Wenzhou against the competition for legitimacy, the local government assumed a variant of laissez faire state in the market, and the chaotic competition and the low product quality resulted in the cost for Wenzhou entrepreneurs from the market; in the meanwhile, the central government pressured the
local state to respond to the market, these led to the establishment of industry associations to regulate the market with the government. The Wenzhou government also played an important role in coordinating the enterprises during the establishment of these industrial associations, such as the cigar lighter and leather shoe association that regulated market prices to prevent the reduction in product quality due to malicious price cuts.

**Government slogan: product quality is the life of Wenzhou**

In order to improve product quality, the Wenzhou government proceeded to strengthen legislation. In 1993, the Wenzhou government proposed the slogan of “Product quality is the life of Wenzhou (zhi liang li shi)”, which was seen as a second startup for Wenzhou. In this year, the Wenzhou government launched the 358 campaigns which sought to improve the quality of Wenzhou product and make brands at provincial, national and even world level. On May 10th, 1994, the Wenzhou government held a 10,000 people meeting to promote the slogan, “Product quality is the life of Wenzhou.” The mayor Chen Wenxian called out: “Product quality is the life of Wenzhou, and it is critical to Wenzhou’s survival.” After the meeting, the Wenzhou government issued the blueprint of 358 projects. Other authorities planned a concrete blueprint of product quality by industry and specified the different foci products and enterprises should have in the three stages. The Municipal Economic Committee targeted key industries and products for conducting monthly analyses and quarterly inspections on 184 products based on 205 quality indices (Sheng Limin et al, 1996).

On October 19, 1994, the Wenzhou government promulgated the “Measures of Implementing Quality is the Life of Wenzhou”. It is the first local regulation promoting “Quality is the Municipality’s Life” (zhiliang lishi). According to the measures, the government, authorities and heads of enterprises are mutually responsible for quality issues that may arise. Once there occurred a large scale of product quality problems within a jurisdiction, the corresponding government, authorities and heads of enterprises should share the responsibility for them. The second major article stipulated that once the producer who produced the fake, shoddy and low quality commodities was caught, he or she would be severely punished if it were a first offense. But if he or she were caught for the second time, he or she would not be allowed to register any enterprises with the Wenzhou government.

In the beginning of 1994, a number of steel enterprises were involved in producing low quality products. The Bureau of Technology Supervision (jishu jiandu ju) learned about this and notified the Municipal Construction Committee, who ordered all the construction companies to not to use steel produced by non-licensed enterprises. The Electricity Power Department cut off the power to those enterprises that produced low-quality steel. The regulation (zhenggai) lasted for 100 days, resulting in more than ten non-licensed enterprises being banned.

**Investment in technology**

Aside from promulgating policies and strengthening regulation of product quality, Wenzhou further launched technology regulation (zhenggai) on a large scale to improve product quality. In 1995, the governmental investment in technology rectification exceeded six billion Yuan. During the Eighth-Five period, Wenzhou had introduced 107

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20 Measures of Implementing Quality is the Life of Wenzhou” 1994
projects and invested 125 million US Dollars, which was 13.4 times the total of sixth-five and seventh-five periods.

Many enterprises also realized the significance of expertise and technology, and they also invested much in human resources. CHINT, the largest enterprise in Wenzhou, which mainly produces low-voltage electrical products, organized six technology conferences to invite experts and professors to train its managers. It also offered more than 40 training classes that engaged 1000 employees. Within one year, its products passed the validation of ISO9001 international quality system certificate, while some of its products also passed the validation of ISO9001 American FMRC Company’s quality system certificate. The improved quality and prestige brought in rapid output growth, and in 1994, its output reached 150 million Yuan, doubled that of 1993; subsequently, in 1995, both the output and profit more than doubled those of 1994 (CHINT newsletter, January 1996).

The regulation of rural private enterprises also helped qualify them for the government designed Industrial Park, which boasted a concentration of standard factory buildings and modern business buildings. The government largely supported such regulation, particularly technology regulation. According to the eighth-five-year plan (1991-1995), the Wenzhou government invested in 1,614 technology related innovation projects that cost about 2.5 billion Yuan, which was 6 times that of the seventh-five-year plan. 108 big enterprise groups received major support from the government. As of 1995, the gross output of Wenzhou’s rural industry amounted to 48.7 billion Yuan, increasing by 9.3 times since 1990. In 1995, peasants’ per capita income was 2,594 Yuan, increasing by 184% since 1990. Ever since the second startup project, Wenzhou’s economy developed at a rapid but sustained rate. In 1995, its GDP reached 40 billion Yuan, increasing by 2.2 times since 1990. The fiscal revenue increased from 889 million Yuan in 1990 to 2.467 billion Yuan in 1995 (Chi Quanhua et al 1996).

**Investment in infrastructure and construction of industrial zone**

The Wenzhou government’s other method to improve product quality was to invest heavily in infrastructure, such as constructing industrial zones. A large number of shareholding partnerships moved into the Industrial Park, transitioning from small workshops (zuofang) to modern enterprises, and from manual labor to industrial automation. The 102 enterprises, such as Liming Hydraulic and Angel Locks, that initially moved into the Industrial Park had a new start in equipment improvement, quality improvement, brand creation, new product development, export and establishment of modern institutions. After Liming Hydraulic introduced the most advanced equipment from the US after it moved into the Industrial Park, its products received extraordinary reviews by its clients, including some big steel enterprises in China. Delixi had only 8 employees at the time of its establishment, but it generated a yearly output of 50 thousand Yuan. Encouraged and supported by the government, Delixi merged 36 enterprises, becoming one of the largest enterprises in the low-voltage and machine tool electrical apparatus in China. Its output reached 190 million Yuan in 1995 (Yang Yinyuan et al 1996).

Toward the end of 1995, there were 108 large enterprise groups in Wenzhou. Such mergers were driven by the demand for product technology, the scale of demand in

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the industrial market, and entrepreneurial management skills. But in some industries, such as the cigar lighter industry, which sold commodity goods but boasted a large market, there exist no large enterprise group. However, more than 3000 cigar lighter factories formed associations by specialized category, and the yearly output of the Wenzhou cigar lighter industry reached 1 billion Yuan in 1994, ranking No.4 in the world.

After three years of efforts, the rampant phenomenon of fake, quack commodities, and cheating nearly disappeared except for some sporadic incidents till 1996. Notorious Wenzhou fashion brands such as Kangnai, Ji’erda, Fudeli, to name a few, have become nationally famous after they improved their reputation through regulation. Other Wenzhou products including apparel, lighters, low-voltage apparatus that experienced similar regulation processes also improved their reputation. As of 1996, two of Wenzhou’s brands won national contest, 20 won provincial contest. A product quality inspection in 1995 showed that the percentage of qualified products reached over 90%, which is above the average passage rate of Zhejiang province. This demonstrated a sharp improvement of Wenzhou product quality which was notorious in late 1980s. Improved product quality increased the sales of Wenzhou products; in 1995, the market transaction amount of all Wenzhou products totaled 24.8 billion Yuan, which was a 10 billion increase since 1994.

Chapter 2 shows that how the initiatives of peasant entrepreneurs, and Wenzhou local cadres’ shouldering the political risk and hands from the market led to the re-emergence of private economy, and chapter 3 show how the intellectuals and policy makers at different levels framed and legitimized Wenzhou private economy. Both chapters focused on the revival of private economy in 1980s. The revival stage of private economy demonstrated Wenzhou government assumed a laissez fair state. The flipside of the government’s non-intervention and non-regulation of market led to the chaotic competition in the market and the low product quality in this region. Pressured by the market feedback and the central government, Wenzhou government began to actively regulate the market and experienced the transformation from a laissez fair state to a regulatory state since late 1980s. The regulation of market improved Wenzhou product quality and made some Wenzhou brands, which in turn also continuously boosted Wenzhou economy. However, at the turn of 21st century, Wenzhou economy began to slow down, comparing to other regions. In those coastal regions such as Suzhou, Ningbo and Hangzhou, the government played an interventionist role in the market, e.g., strong guidance for the industry, and strong efforts in attracting foreign direct investment, etc. In addition, the intensive regional competition further drove Wenzhou government experience the second transformation from a regulatory state to an interventionist state.

Second transformation: from a regulatory state to a moderate interventionist state

Crisis: Slow growth of the Wenzhou economy
In 2003 and 2004, there were extensive news in the media about the death of the Wenzhou model. The news articles reported numbers and citations from some officials and scholars to illustrate the decline in GDP growth and foreign capital. They also noted

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the industry and capital outflow, expensive land costs, how the economy was trapped in
the low value-added industries, and lastly, how the weak government fell short of
planning and service in Wenzhou.

Since the end of 1990s, Wenzhou had seen slow economic growth, the outflow of
Wenzhou enterprises and capital, a high concentration of labor-intensive and low value-
added industries. Wenzhou’s GDP growth from 1978 to 1998 continuously ranked at the
top among Chinese cities; its GDP increased from 1.3 billion Yuan to 100.5 billion Yuan;
the annual growth rate was 15.4%. In some years, the rate was above 20%, peaking in
1993 at 42.2%. The glorious Wenzhou model received widespread attention in China and
about 1.5 visiting delegate per day (Zhou Qi 2004). However, since 1998, the annual
growth rate began to slow down. In 2003, its GDP growth rate of 13.1% ranked second to
the last, but the growth rate late further declined to rank as the last one in Zhejiang
province in 2004. The gap between Wenzhou and Zhejiang’s two leading cities,
Hangzhou and Ningbo, was increasing.

Wenzhou also saw increasing outflows of its industries and capital. According to
a 2003 survey by the Wenzhou Statistic Bureau, about 1000 enterprises had relocated,
including the low-voltage apparatus, knitting, apparel and luminaire industries. They
moved to areas such as Shanghai, Guangdong, Beijing, Shandong, and some inland
provinces. Some of the more well known pillar enterprises such as CHINT, East China
electricity group, JuneYao aviation group also moved, and Shanghai was the top choice
for relocation, though some of them just moved their headquarters there. As of 2004,
more than 500 enterprises moved to Shanghai (Ma and Si 2004). There was also a
tendency of migration of industries, and even including some new industries. For
example, the whole luminaire industry moved to Guangdong, while the leading furniture
enterprises moved to Shanghai and Dongguan in Guangdong. Furthermore, more than 20
leather enterprises and 20 cloth enterprises moved to Lishui in Zhejiang, and 45 knitting
enterprises jointly moved to the west. The stainless steel industry in Longgang, Wenzhou,
was a relatively new industry with an annual output that accounted for 70% of the
national market and one-seventh of the international market. In the meantime, those
stainless steel enterprises moved to Shanghai, in the Jiangsu province, and Lishui, in the
Zhejiang province, due to land limitations (informant 3).

Another example of the outflow of Wenzhou’s capital was the large amount of
money spent on speculating in real estate, stock market, coal mine and cotton. Wenzhou’s
presence became pretty prominent and unique in these markets. In 2004, there was about
180 billion Yuan worth of speculating money in Wenzhou. As of the end of 2004, the
balance of savings deposits of urban and rural household was 97 billion Yuan; this means
that about 100 billion Yuan were spent on speculating in real estate across the country
(Wenzhou statistic yearbook 2005). Many real estate speculation groups (chaoloutuan)
were funded by Wenzhou private enterprises (Huang Zhihong, 2004).

In spite of the outflow of big and small labor-intensive enterprises, for almost 20
years since the reform, Wenzhou’s economy still mostly concentrated on labor-intensive
and low-tech and light manufacturing industries such as apparel, leather, cigar lighters
and shoes; even among the second generation of entrepreneurs. Wenzhou was famous for
being the commodity capital of China for its products such as shoes, leather, eyeglasses,
cigar lighters, etc. However, in other regions of Zhejiang, such as Hangzhou, Ningbo and
Shaoxing, high-tech, heavy, and other new industries were developing rapidly at the turn of the century, boosting economic growth.

Underlying the outflow of Wenzhou entrepreneurs’ complaints about the high costs of land, human resources and poor governmental service underlie the outflow of Wenzhou’s private enterprises. According to a survey in Yueqing in 2003, the very origin of the Wenzhou model was the large concentration of low-voltage apparatus enterprises. Among the 85 enterprises that emigrated, 24.7% was due to self-development, 24.7%, to land costs, and 50.6%, to policy and administrative factors (Wang and Zhang, 2004).

Wenzhou is extremely short on land, and its arable land per capita is 200 square meters. In 2002, the demand for industrial land in Ruian county of Wenzhou was about 62,500 acres, but the quota was only about 9,375 acres. The average cost of land in Wenzhou was over 1.25 million Yuan per acre in 2003. It was even higher than that of Shanghai’s suburbs, which cost about 0.5 million Yuan per acre (Wang and Zhang). Furthermore, the land approval process became increasingly red-taped. The approval of a land application needed more than 100 stamps from various authorities, and there were a variety of fees imposed on the enterprises. Various inspections by the agency of enforcement made even the entrepreneurs who abided by the laws complain: “Sometimes there are miscellaneous inspections, and the boss himself had to accept them, otherwise, you will get molested by the officials under various excuses next time. We have to cultivate good relations with the government.” (informant 4). Some officials speculated in Wenzhou’s real estate, and this resulted in some unfair transactions. Certain enterprises could obtain land even for free through guanxi, while others had to pay more regardless of their urgent need for land (Luo and Zhou, 2004).

Extensive efforts to attract investments from the inland provinces were another factor of the migration of Wenzhou’s enterprises. The inland provinces offered favorable conditions, including tax deductions, low land prices, and political awards such as the title of honorable mayor (informant 5). Right after the 2004 Spring Festival, the mayor of Shenyang, a capital city in a northeastern province, led a delegation of more than 100 people to visit Wenzhou, and received 35 billion Yuan worth of investments from Wenzhou. In September 2003, led by Aokang – the leading shoe enterprise in Wenzhou – a group of Wenzhou shoe enterprises invested one billion Yuan in Chongqing, an inland city, to construct the western capital of shoes. In the same month, 35 Wenzhou entrepreneurs invested 1.5 billion Yuan on 35 projects in two cities of Sichuan, a western province. In addition, they also invested 3.5 billion Yuan in Suzhou and 7.6 billion Yuan in the northeastern provinces; Shandong, a coastal province attracted 13.6 billion Yuan worth of investments from Wenzhou entrepreneurs within one week (Zhao Suhong, 2004). According to a governmental investigation in 2003, there were about 1.6 million Wenzhou businessmen dispersed throughout the nation and contributed approximately 56 billion Yuan to the annual GDP. Another survey in 2001 indicated that Wenzhou entrepreneurs founded about 40,000 enterprises elsewhere outside of Wenzhou and produced an average output of 7 million Yuan per year. The average annual output of enterprises above designated value is 36.1 million Yuan; there are about 100 enterprises whose output exceeded 100 million Yuan, while more than 30,000 enterprises produced output that exceeded 10 million Yuan. Wenzhou entrepreneurs established the Wenzhou village, Wenzhou Industrial City in Xinjiang, Yunnan and Gansu, and the Western Shoe Capital in Sichuan (informant 6).
Crisis framing

The intellectuals, entrepreneurs, journalists and officials differed in their respective framing Wenzhou’s crisis. Some defended the Wenzhou model, while others identified problems and proposed suggestions for development. Although there were some defenses, the prevailing opinion was that Wenzhou was encountering a crisis and that Wenzhou’s government should be responsible for guiding the economy. Such a framing of the crisis, coupled with the provincial government’s demand for GDP improvement and the replacement of the leadership, caused the Wenzhou government to transform from a regulatory to a moderately interventionist state.

One defense emphasized GNP instead of GDP, pointing to the fact that Wenzhou entrepreneurs had huge investments throughout the country and overseas. Such defense mainly came from some officials and local scholars such as Li Qiang, the Party Secretary, Liu Qi, the Mayor, and other local economists. Li further defended Wenzhou’s green GDP and sustainable development by noting the resource limitations, such as the shortage of land (Weng and Liu 2004). Liu argued that because Wenzhou’s economy was big, a one percent increase actually translates into an increase of one billion Yuan. Zhang Renshou, a strong advocate of the Wenzhou model, illustrated the point through examples of US and China’s growth (Zhong, Liu and Si 2004). The local economists reasoned that the slow growth was owing to institutional constraints at the national level, and that Wenzhou was not entirely at fault (Zhong, Liu and Si 2004).

Another defense centered on the outflow of Wenzhou’s capital and enterprises. Li Qiang argued that Wenzhou’s capital was expanding rather than leaving. He further argued that Wenzhou’s outward capital expansion was evidence that Wenzhou entrepreneurs was able to engage in capital management while conserving Wenzhou’s land resources by relocating their companies. Ma Jinlong, Wenzhou’s leading economist, argued that Wenzhou was constrained by its geographic location. He claimed that Wenzhou was a secondary municipality instead of a regional center, and some industries could only develop in a regional center. His theory also resonated with some Wenzhou officials. Zheng Yuanzhong, the head of the Zhuangji Group, a leading apparel enterprise in Wenzhou, once suggested that Wenzhou officials take measures to keep the enterprises. One official replied, “when the pot can no longer hold the growing fish, we have to put the fish into a bigger pot outside of Wenzhou” (Luo and Zhou 2004). This was a prevalent mindset among officials and local scholars.

Aside from proposing defenses, some scholars, officials, journalists and entrepreneurs also identified the major problems that Wenzhou was facing, such as land and human resource constraints, the small portion of foreign direct investment, the limited number of heavy industries, slow institutional innovation, and, lastly, a weak government. The general consensus was for the government to actively guide the economy to improve GDP growth. It wanted the government to upgrade the industries by investing in heavy industry, attracting foreign direct investment, facilitating the merging of big enterprises, and expanding infrastructure investment.

A. The waning of institutional innovation in Wenzhou

Some scholars argued that Wenzhou was losing the advantage of its leadership position in economic reform. Since the 1990s, China’s reform shifted from the rural to
the urban areas, therefore, Wenzhou’s rural reform, which was the most dynamic in the 1980s, gradually lost its economic and political since 1990s. Furthermore, Wenzhou’s private economy was heavily attacked by the central government during 1989-1991, as the planning camp reasoned liberalization including the development of private economy was a major cause for the Tiananmen movement. The major supporters for Wenzhou lost their power. During this period, the central government made three investigations to examine Wenzhou economy is socialism or capitalism during this period. It also launched the campaign to attack Wenzhou fake and shoddy products. The lost of support from the central government largely reduced Wenzhou’s ability to innovate. The Wenzhou government tried applying for the legal status of a relatively bigger city for about two decades to gain more autonomy in local legislation, which was seen as crucial to economic, political and social innovations at the local level. However, Wenzhou has not yet been approved for the legal status of a relatively bigger municipality. There was a rumor that this was because the Wenzhou government did not have a good relationship with the central government (Wang Shengke, 2006).

In the meantime, the institutional difference between Wenzhou and the other regions shortened substantially. The institutional gap in the 1980s contributed greatly to Wenzhou’s rapid growth, in comparison to the relatively slower economic growth in other areas. While, some poorer regions began to take off as their market institutions matured, those learning visits to Wenzhou partly contributed to this process. Particularly, after 1998, there was fewer of learning from Wenzhou across the country. Many cities sped up marketization and offered favorable policies toward private enterprises. The market institutions in some coastal cities, such as Shunde, Dalian and Qingdao, became as mature as those in Wenzhou. These cities went even further by developing brand enterprises in industries such as refrigerators, air conditioners, washing machines and automobiles; meanwhile, Wenzhou was still concentrated on apparel, leather and other small commodities (Pang Yahui, 2004).

Several things can illustrate the waning of institutional innovation. The first and foremost is financial innovation. Wenzhou was once active in experimenting with private banks and flexible interest rates in the 1980s; however, these efforts were suppressed in the late 1980s and early 1990s. For more than a decade, financial innovation stagnated although Wenzhou was rich in private capital, which was estimated at 300 billion Yuan. At the end of 2002, Wenzhou gained the status of Comprehensive Finance Experimenting Zone, but it did not make much breakthrough except for the flexible interest rate. In 2004, Wenzhou private capital funded two venture capital corporations, but these efforts were once heavily criticized by banking officials (informant 7).

On July 28th 1991, Wenzhou entrepreneur Wang Junyao boldly contracted the flight course between Changsha and Wenzhou, becoming the pioneer in China’s private charter flight business. The first privately chartered flight company in China – the Wenzhou Tianlong Charter Company Limited - was hence formed. It was later renamed as the JuneYao Group, whose further development continued in other cities. On August 18, 2002, the JuneYao Group became a shareholder of China Eastern Airlines Wuhan, Ltd. It was the first privately owned enterprise that became the shareholder in a wholly state-owned business. In June 2005, JuneYao acquired the permission to establish Shanghai JuneYao Airlines Co., Ltd and started its first flight in September 2006. In March 2006, the JuneYao Group successfully became the biggest shareholder of China’s
first privately owned airline company - Okay Airways Co., Ltd, and thus laid its foundation in Shanghai and Tianjin, corresponding to the Asia Pacific aviation hub in Shanghai and the Binhai New Area of Tianjin. One reason for JuneYao’s further development in other cities is the limitation of market entry in Wenzhou. Wenzhou capital investments pervade the entire country, however, among 80 industries in Wenzhou, private capital was allowed into only 41 industries (informant 8).

The third example is the experiment of direct election of county mayor. Wenzhou had attempted to experiment with the direct election of the county mayor. As one scholar remarked, a mayor elected directly by the electorates would significantly improve government service. However, because of institutional constraints at the national level, the experiment was eventually not allowed (Informant 9).

B. The shortage of foreign direct investment

Some scholars and officials argued that the shortage of foreign direct investment in Wenzhou was another major factor causing slow economic growth. From 1998 to 2002, Wenzhou attracted about only 300 million Yuan of foreign direct investment, and none came from the top 500 companies in the world. A 2003 World Bank report ranked Wenzhou’s investment environment as one of the least favorable among 23 cities in China. During a conference meeting, an overseas Wenzhou entrepreneur even questioned Li Qiang, the Party secretary, “It takes 3 to 5 days to get an application approved by the government in other cities, why it takes half a year longer in Wenzhou?” (informant 10).

In sharp contrast to Wenzhou’s small share of foreign direct investments, some coastal cities such as Suzhou, Hangzhou, Ningbo, and Shaoxing saw a rapid growth in FDI, which accounted for a significant portion of the local economy. The market economy driven by the growth of private enterprises in Wenzhou was once treated as a model by many regions. A comparatively similar situation was the Sunan model in the Jiangsu province. Sunan once featured township and village enterprises, but it began to lose its glory since the late 1980s. In the middle of the 1990s, governments in the Sunan area, such as the Suzhou government, began launching campaigns to privatize TVEs. Meanwhile, the governments still had a strong role in directing the economy, particularly in attracting foreign capital. Suzhou city established the Sino-Singapore industrial park, which housed a number of foreign companies. In 2003, the amount of foreign investment in Suzhou ranked No.1 in China, and the annual growth rate of foreign investment from late 1990s to 2003 was more than 30% (Suzhou statistics yearbook, various volumes). In the meantime, since the early 1990s, the central government largely focused on transforming the Shanghai metropolitan area into the international hub for the upper-ladder division of labor, such as the finance and high-tech industries. Consequently, Shanghai’s traditional labor-intensive industries largely moved to Suzhou due to the proximity of the two areas (Luo and Zhou, 2004). These factors largely contributed the rapid economic growth of Suzhou.

The developmental models of Hangzhou, Ningbo, and Shaoxing are more similar to Suzhou than Wenzhou. These cities are also locationally close to Shanghai. In the 1980s, they had strong collective economies with a historically strong state presence in the market. Similar to Suzhou, these areas were also relatively rich in land resources, and they had a long tradition of commerce and industry. In comparison to Wenzhou, these
cities have gained much more investment from the upper-levels of government. Hangzhou is about a one-hour ride away from Shanghai, Shaoxing, a two-hour ride, and Ningbo, a three-hour ride; Wenzhou is the furthest away from Shanghai with a seven-hour ride. Some of Shanghai’s more traditional sectors also migrated to the Hangzhou, Shaoxing and Ningbo area. These cities had a locational advantage over Wenzhou. Part of Shanghai traditional sectors also transferred to this area, and these cities are also more attractive for talents than Wenzhou because the former’s close proximity to Shanghai. Statistics showed that the less than 100,000 technicians in Wenzhou accounted for 1.26% of Wenzhou’s population, relatively lower than the average 2.3% in Zhejiang (Luo and Zhou 2004).

The low ratio of fixed assets investment in Wenzhou also contributed to Wenzhou’s investment shortage. In 2003, the ratio of investment on fixed assets among 11 cities in Zhejiang ranged from 31% to 80%, but less than 20% in Wenzhou. The investment in fixed assets is strongly associated with the growth of GDP in many regions (Wang Shengke, 2006). Another reason for Wenzhou’s slow growth is the shortage of large enterprises. One official commented that there was no enterprise owned by the central government (informant 11). In addition, the heavy and high-tech industry quickly became the engine for the economic growth along the coastal areas at the turn of the 21st century. The success of Hangzhou, Ningbo and Shaoxing was partly owing to the rapid development of the heavy and information technology industry. However, aside from light industries, Wenzhou did not feature a variety of industries, heavy industry in particular. Big enterprises also developed very slowly. In the first half of 2003, there were 57 enterprises with industrial output exceeding 100 million Yuan, and the total industry output was 13.2 billion Yuan, increasing by 16.7% than that of the first half of 2002, but it was still 1.8 percent slower than the average industry output. Whereas in Zhejiang, there were 791 enterprises with output exceeding 100 million Yuan, and total industry output increased by 34.5%, which was 18% higher than Wenzhou’s growth rate. As of the first half of 2003, there was only one Wenzhou enterprise listed in the stock exchange market.

C. The attraction of the strong government model

Some scholars and officials argued that one of the more successful experiences in Suzhou, Ningbo and Hangzhou was the strong governmental guidance in the market. In his comparison Wenzhou and Wuxi’s privatization, Zhang (2008) argued that in Wuxi, a city in southern Jiangsu province or Sunan, the local government was heavily involved in the manipulation of privatization, proving the strong presence of government in the Sunan model. Furthermore, the Suzhou government played an important role in attracting foreign direct investment, which in turn improved governmental services and capacity for directing the economy.

Wenzhou was once proud of its laissez-faire state, in which the state and society worked together to get rich in almost two decades. In the 1980s, there was a famous story in Wenzhou: a peasant in the town of Jinxiang grabbed the rice bowl from the township mayor and questioned him, “you are eating rice, but we do not have anything to eat”. Another folk saying in Wenzhou also illustrated this point: “The key for Wenzhou’s success is the hands-off of government in the market. Wenzhou’s mayor used to not have
much to do, resting or playing golf on weekends and holidays.” One scholar remarked that the laissez-faire state resulted in a weak state (Informant 12).

A Wenzhou official pointed out that a key element of the weak state in Wenzhou was manifested in its fiscal income (Informant 13). In 2003, the total fiscal income in Wenzhou was 15.177 billion Yuan, while the local revenue was 7.896 billion Yuan after deducting federal taxes. In contrast, the total fiscal income and the local revenue were 40 billion Yuan and 22 billion Yuan, respectively, in Suzhou (Wenzhou statistic yearbook and Suzhou statistical yearbook). Wenzhou’s fiscal revenue was not in proportional to its economy. An official in the Finance Bureau explained that tax collection was difficult in Wenzhou because Wenzhou’s enterprises were small in size but large in quantity (informant 14). The relatively small amount of local revenue limited the government’s capacity for investing in local projects, including infrastructure, public service and industrial projects. For instance, the seaport construction was planned for more than ten years but never started due to the shortage of government investment. The fiscal budget further limited the officials’ ability to guide the local economy. Until 2004, the Economy and Trade Committee (ETC) produced the guidance rules for the different industries; they specified what kind of practices should be encouraged, limited, or ousted. An official in the Development and Planning Committee (DPC) commented that the Wenzhou government’s ability to guide was very poor before 2003 (informant 15). Ruan Hui, the associate mayor, remarked that the government needed to guide the coordination of resources, because the upgrading of industries should ultimately be boosted by the big enterprises (Yu Jifeng 2004).

However, although the local revenue was relatively low, the income per capita was high in Wenzhou. In 2003, the urban disposable income per capita was 16,035 Yuan, as opposed to 9,272 Yuan in Suzhou (Suzhou statistic yearbook 2004). This was often a defense for the Wenzhou model from some local officials and scholars.

The high income per capita indicated that Wenzhou people were rich, so the government sought other ways to improve the revenue. One way was to increase land rent, consequently leading to the skyrocketing of housing prices. An official in the DPC disclosed that the funding for many municipal construction projects mostly came from the added value from the land transfers (informant 16). This boosted the cost of land and partly contributed to the emigration of Wenzhou enterprises.

As previously discussed, from the very beginning of reform, Wenzhou state had a limited involvement in the economy due to the weak state revenue. Local officials mainly offered political and economic support indirectly. And this limited involvement of the state indirectly helped the rapid development of private enterprises. The private entrepreneurs cultivated strong ties with the local officials for economic and political support. The dynamic privatization initiatives led the success of the Wenzhou economy and also strengthened the power of private entrepreneurs. The strong ties between the entrepreneurs and officials were unlike the vertical relationship Sunan entrepreneurs and officials had. The private entrepreneurs in Wenzhou had a relatively stronger voice at the local level than their Sunan counterparts (Zhang 2008). One official even remarked that Wenzhou entrepreneurs were so shrewd in doing business, “how could those entrepreneurs dare to come to Wenzhou do business?” (informant 17).

Transformation of the Wenzhou model
In spite of some scholars more or less defending Wenzhou’s economy, the “decline of Wenzhou model,” or even “dying of [the] Wenzhou model,” in the media and regional GDP competition imposed great pressure on the local officials, since GDP growth was one of the major criteria for official promotion (Li and Zhou 2005). Since 2003, Wenzhou began to see a transformation of the government’s role in economy and the structure of the market, that is, there was an increase of governmental guidance in the market, including increased investment in infrastructure, heavy industry, and education. It also began to aggressively attract foreign direct investment, facilitate the merging of big enterprises, increase local fiscal revenue and improve government services. In addition, the market entry for private enterprises were widened; local enterprises, supported by the government, grouped together to strengthen their competitive edge in the market and entered into the newly opened capital-intensive industries.

A. Learning from other regions

In 2003, Wenzhou launched a campaign: “Learning from other regions” (zou chu Wenzhou xue quanguo). On January 22, 2003, the Wenzhou government held a big conference named “The entire nation learnt from Wenzhou, and Wenzhou should learn from other regions” (quanguo kan Wenzhou, Wenzhou xue quanguo). About 50 entrepreneur representatives attended. In the heated discussions, many Wenzhou entrepreneurs realized that Wenzhou was losing its advantage because its model was being replicated in other areas such as the Guandong province. Toward the end of 2002, the Guangdong government organized media tours to Wenzhou to learn from the Wenzhou experience. Zhou Jinmiao, the vice President of Kangnai Co. Ltd, a leading apparel enterprise, remarked that the Guandong government’s visits imposed tremendous pressure on his company. He realized that the rapid growth of private enterprises in other regions would further intensify the existing competition, given the already intensive competition between Wenzhou private enterprises and other state-owned enterprises (Liu and Zhang 2003). Compared to the big enterprises at the national level, entrepreneurs of Wenzhou’s big enterprises recognized that there was a considerable gap between Jinkeda Beer and Tsingtao Beer or Yanjing Beer24, and between Kangnai and the top Chinese and foreign enterprises in China. Some entrepreneurs complained about government services and the investment environment. The head of the C&U Group, a bearing manufacturer, commented on the emigration of Wenzhou capital and enterprises. He complained that the cost of human resources in Wenzhou was very high and his company had to offer a big package of benefits. The head of Hufon Group, a new material company, planned to move its research and development center to Shanghai where the costs of human resources were relatively low. “To run enterprises in Wenzhou is not easy,” remarked Xie Tielan, the head of Yuetu Appliances Group Co., Ltd. because the bureaucratic process usually delayed the projects that were designed to enlarge the size of the enterprise. He further pointed out that sometimes enterprises had to start their projects prior to or even without government approval; it seemed like a thief’s action.

Entrepreneurs pleaded for the government to support enterprises. For instance, the head of Aihao Pen Co., Ltd said that the authorities should help rather than punish enterprises, because the businesses already shouldered huge pressures from the market. Shao Qixing, the president of Hailuo Group Co., Ltd – an umbrella company – proposed

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24 The former was Wenzhou’s leading beer company, whereas the latter two were big conglomerates at national level.
an analogy: the government should restore water to feed fish, help enterprises instead of regulating them, award enterprises instead of punishing them, and, lastly, government agencies should compete with each other in servicing enterprises. The head from Huafon, further pointed out that improvement in government services would not only break through the development bottlenecks constraining Wenzhou enterprises but would also help attract foreign direct investments.

All the participants agreed that the leaders might want to help enterprises, but the functionaries reduced the efforts and suggested that the latter should get more training. Mao Kangfu, the vice mayor, who represented the government, also advised the enterprises to develop strategies in the areas of innovation, rectification and diversification. The Bureau of Personnel invited experts, scholars, technocrats, managers, and model migrant workers to a conference and discussed how to improve the environment of human resources and how to attract more talents (Liu and Zhang 2003).

From January to March 2003, Wenzhou government organized tons of visits to such coastal cities as Dongguan, Yiwu, Shanghai, Suzhou, and Dalian. Many entrepreneurs, scholars, officials and journalists were involved in those visits. The slogans of the learning visits were as follows: (1) “learning openness from Dongguan,” “learning governmental service from Shanghai,” (2) “learning how to attract FDI from Suzhou,” and (3) “learning about the market from Yiwu.”(Ding Chunlin et al, 2003)

B. Strengthening government guidance and investment: Campaign of 100 projects and 100 billion Yuan (bai xiang qian yi gongcheng)

Beginning May 2003, the Development and Planning Committee (DPC) started an investigation centering on the Campaign of 100 Projects and 100 Billion Yuan. They proposed to offer national treatment to private capital and make it easier for private capital to enter the market. Since 2004, the Wenzhou government launched the campaign of 100 projects and 100 billion Yuan. This campaign included 103 projects with a total investment of 204 billion Yuan within five years; 40% of the investment came from private sources. These projects aimed to expand the supply for public goods, break through infrastructural bottlenecks, widen the urban framework, and enlarge the room for development. In 2004, the focus was on port, transportation, energy, Industry Park, irrigation works, and reclamation. There were 101 key projects with a total investment of 15 billion Yuan, which was a 60% increase compared to 2003. Many projects started in 2004, including a railway connecting Ningbo, Wenzhou and Taizhou, a highway connecting Jinhua, Lishui and Wenzhou, a highway connecting Zhuji and Yongjia, and a Wenzhou power station.

In April 2004, the Wenzhou government passed an ordinance of deepening investment and financing system, in order to break through various monopolies in Wenzhou and to allow the entry of private capital into the market. The urban gas and water industry became the first to admit the entrance of private investment under this ordinance. It was the 42nd industry accepting private investment in Wenzhou. Private capital began to come back to invest in the ports, highways, urban gas and sewage treatment companies, etc.

In early 2004, Wenzhou government changed the slogan from “product quality is the life of Wenzhou and brand is the life of industry” to “brand is the life of Wenzhou.” It also publicized a red and black list detailing enterprises with good and bad credit. Red
enterprises had the right to waive the annual inspection. On November 23, 2004, the Wenzhou government decided to establish 30 to 40 big enterprise groups. An official in this meeting remarked that the establishment of some leading enterprises would help upgrade the industries (informant 18). In early November, a conference on industry planning sponsored by Zhejiang provincial government was held in Wenzhou. The meeting invited famous regional planning experts such as Liu Shijin, the associate director of the Institute of Development and Research of State Council, and Wang Jici, a professor of regional planning from Peking University, to help design the guidance plan for Wenzhou’s development.

Since August 2003, Wenzhou started to revolutionize government efficiency (zhengfu xiaoneng geming). The government adopted an iron fist approach to improving the business environment, established a center to monitor governmental agencies, and punished some inefficient and poor service officials. Furthermore, the government redesigned some governmental procedures and six departments passed the ISO9001. In 2004, in order to improve local education and the environment to attract more talents, the Wenzhou government merged Wenzhou University and Wenzhou Normal University to establish a new Wenzhou University. It also promulgated policies that encouraged overseas Chinese to start businesses in Wenzhou by introducing an annual financial incentive 3 million Yuan.

**Foreign investment projects, the introduction of a new model**

As discussed in the above section, Wenzhou is rich in private capital but very poor in FDI. At the end of 2003, the FDI in Wenzhou was about 800 million US dollars. Wenzhou officials saw that the rapid growth in Suzhou, Hangzhou, Ningbo and Shaoxing was largely motivated by the high amount of FDI, therefore, they became increasingly determined to attract foreign direct investment. Liu Qi, the mayor of Wenzhou, remarked that Wenzhou needed the technology and management brought by the foreign companies. This further prompted the government to step up efforts to attract foreign capital for purposes of improving the traditional industries. As opposed to the approaches utilized by Suzhou, Hangzhou and Ningbo to attract FDI, the Wenzhou government chose to brokerage the marriage between local and foreign companies.

In October 2003, the Wenzhou government held the first conference for Wenzhou natives scattered around the world, in an attempt to attract overseas Wenzhou entrepreneurs to invest in their hometown. In April 2004, the Wenzhou government held the most important foreign-oriented economic conference; all the major leaders came to the conference to show their strong support. Those who made prominent achievements in attracting FDI were set as exemplars by the political leaders.

In July 2003, the marriage between Jialete Pumps and EBARA, a Japanese company that ranks in the top 500 internationally, was largely supported by the Wenzhou government, and became a model for joint-ventures. The Japanese partner indicated that the joint-venture received strong government support. A major reason the government supported the joint-venture was because it understood that the merger would not only help improve the pumps industry but also the supporting industries. An entrepreneur who supplied machinery to Jialete Pumps remarked that he had to upgrade his equipment due to the demand for higher product quality. Following the Jialete Pumps example, Xiameng, a brand apparel company, cooperated with Ermenegildo Zegna, an Italian company;
CHINT cooperated with GM, while Toyota Tsuso Corporation decided to set up an office in Wenzhou. In 2003, the foreign investment in Wenzhou reached 120 million US dollars, which was a 49% increase compared to 2002.

At the end of 2004, the Zhejiang government appointed Wang Jianman, the party secretary of Xiaoshan, to replace Li Qiang as Wenzhou’s Party Secretary. Wang’s most prominent achievement in Xiaoshan was his success in attracting FDI. The replacement was interpreted as the introduction of the Xiaoshan model to Wenzhou by scholars and officials.

In early 2005, Wang launched the “No.1 Project” to attract FDI. He stated the goal as “12345 projects”. According to these projects, Wenzhou will aim (1) to attract investments from ten of the world’s top 500 companies; (2) to have the added-value of high tech industry account more than 20% of the added-value of industries above designated scale, (3) to have more than 30 big enterprise groups whose sales exceed one billion Yuan, (4) to have more than 40 nationally famous brands, and (5) to reach a gross industrial output of over 500 billion Yuan.

Wang’s approach to obtaining FDI had Wenzhou characteristics: the marriage between private enterprises and foreign companies (yi min yin wai, min wai he bi). Wang encouraged thousands of private enterprises to form joint ventures with foreign companies. And the government promulgated favorable policies toward joint ventures: a joint venture with top 500 companies in the world enjoys land prices that are 20% lower than the average. A joint venture with a world leading manufacturer enjoys land prices that are 10% lower than the average, while a key joint venture project receives more favorable treatment. To reach these goals, the municipal government specified the criteria used to evaluate performance and had the local officials sign the soldier’s writ with Mayor Liu Qi. According to the specified criteria, foreign capital was treated as five times more important than domestic capital in the evaluation process. Wang even warned that the failure to obey would be severely punished. An official remarked, “this was the first time Wenzhou so strongly advocated for attracting FDI” (informant 19).

Wang explained his opinions on FDI: “We need to introduce wolves into our home in order to acquire more advanced technology and management to broaden the market, so that we can dance with them”.

Table 4.1 shows that there was a sharp increase in the foreign capital actually used in Wenzhou since 2003. Compared to the previous year, the increased rate of FDI usage in 2003, 2004 and 2005 were 49.2%, 74.8% and 70.7%, respectively, while in most other years, the rate was either less than 40% or negative.

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Table 4.1, indexes in Wenzhou

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<th>Year</th>
<th>Ratio of Big-medium enterprise</th>
<th>Ratio of State-owned enterprise</th>
<th>Ratio of Heavy industry</th>
<th>Ratio of Light industry</th>
<th>Foreign capital actually used</th>
<th>Fixed asset /GDP</th>
<th>Expenditure of government finance /GDP</th>
<th>Financial revenue /GDP</th>
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Note: Unit for FDI is $10,000, others are percentage. Source, Wenzhou statistics yearbook, various volumes

Ratio of big-medium enterprises: the gross output value of big-medium enterprises over the total gross industrial output value

Ratio of state-owned enterprises: the gross output value of state-owned enterprises over the total gross industrial output value

Ratio of heavy industry: the gross output value of heavy industry over the total gross industrial output value.

Ratio of light industry: the gross output value of light industry over the total gross industrial output value.

Heavy industry oriented
Since 2003, Wenzhou began heavy industry oriented developments, replacing the goal of establishing an international city that boasted light industry. A vast majority of FDI projects were concerned with heavy industry, including manufacturers and the petrochemical industry. For instance, in the first three quarters of 2005, Wenzhou attracted 141 FDI projects, of which 127 projects involved the manufacturing industry. In August 2005, the Wenzhou government set a goal of establishing coastal industries, including shipping, electronic, seaport and logistics industries led by the petrochemical industry. Mayor Liu Qi was in charge of this project. Liu was once the head of a big state-owned petrochemical enterprise. Liu remarked that when GDP per capita reaches $2,000, the industrial structure will transition from light to heavy industry, based on the international experience. According to the plan issued by Wenzhou’s petrochemical industry in March 2005, there was an estimated investment of 30 billion Yuan over the course of next ten years. A local official remarked, “Although there is no petroleum oil in Wenzhou, Wenzhou is learning from Korea and Japan, since Wenzhou has the advantage of the seaport, market and abundant capital.”

As illustrated in Table 4.1, there was a sharp increase in the ratio of heavy industry to overall industries since 2003. For more than two decades prior to 2003, the light industry dominated in Wenzhou, accounting for about 60-70% of the businesses. In 2003, it was the first time that heavy industries assumed the leading role with a ratio of 50.5%, which steadily increased to 59% in 2007. In addition, table 4.1 shows that there is a steady increase in the ratios of fiscal revenue to GDP, fiscal expenditure to GDP, and state-owned enterprise to all industries since 2003.

The wave of mergers

Since 2003, there began a wave of mergers in Wenzhou. Eight locker enterprises merged to become the Qiangqiang Group, while forty zipper enterprises merged together, and 65 furniture enterprises merged to form a conglomerate. Two consortiums were founded in 2004.

Wenzhou industries accounted for a significant portion in both the national and world market. As of the end of 2003, knitting accounted for 70% of the national market, leather, 70%, cigar lighters, 90%, and eyeglasses, 80%. The cigar lighters industry, in particular, accounted for 70% of the international market. As a number of Wenzhou entrepreneurs started businesses outside of Wenzhou and the Wenzhou model was replicated in other regions that had lower operating costs, Wenzhou started to lose its advantages when faced with intensive competition. Around 2003, Wenzhou industries experienced a few international anti-dumping lawsuits. These cases greatly exposed the weaknesses of Wenzhou enterprises: small scale, low-tech, and low added-value. The low-price strategy also encountered several anti-dumping lawsuits. In the other words, market competition was one of the forces that drove the need to upgrade Wenzhou’s industries. There were two ways in which Wenzhou’s industries could improve: one is to upgrade from traditional, labor-intensive industries to capital-intensive, high-tech industries, and the other is to upgrade the technology used by existing industries. The Wenzhou government, to a larger extent, chose the second method, and aimed to

28 The successor of Liu, Mayor Shao was the head of Ningbo Port Co. Ltd. This reflected the provincial government’s intent of developing heavy industry and seaport industry in Wenzhou.
construct Wenzhou as an international city of light industry by improving technology used within traditional industries. Since 2004, the government began to push for the upgrade of industries through governmental projects and FDI.

In May 2003, eight lock manufacturers merged to form the Qiangqiang Group with government support. Soon, this model was replicated by other industries under strong encouragement from the government. The rationale underlying the mergers is that the lock enterprises faced intensive competition from the late-developing regions who had lower operating costs but competed in the same niche market. They were forced to move up to a higher division of labor that was more capital and technology intensive; therefore, merging became a viable option. Lock entrepreneurs also learnt the lesson of Wenzhou’s luminaire industry in the late 1990s. They concluded that the luminaire industry lost to other regions primarily because of the failure to upgrade its industry. Wenzhou is base to some of China’s largest lock manufacturers, with four lock enterprises ranking among the top ten in the nation. However, among 500 lock enterprises in Wenzhou, the annual sales of most enterprises were less than 5 million Yuan, while the annual sales volume for the largest lock enterprise was less than 200 million Yuan. The size of their operations limited their ability to upgrade and innovate. Under the intense competition, the Wenzhou lock industry’s sales in the national market declined by 10 percent as of the end of 2002.

After the merger, Qiangqiang invested 20 million Yuan to develop semi-high-end products that targeted the developed countries. The merger also received attention from foreign companies, particularly from Korean and Japanese lock companies, who occupied the mid and upstream markets and intended to cooperate with Qiangqiang Group. Furthermore, Korean lock enterprises even promised to transfer the lock manufacturing base to Wenzhou and aimed to construct Wenzhou as the largest lock manufacturing base in Asia.

The merging of lock enterprises stimulated a wave of repercussions among Wenzhou entrepreneurs. In the previous two decades, hundreds and thousands of households and entrepreneurs were involved in running enterprises and businesses in Wenzhou. Such strong entrepreneurial spirit had a long historical root, as discussed in chapter 2, and was strengthened by the rapid development of private enterprises. The flipside is that Wenzhou businessmen would rather be an entrepreneur of a small company than an employee in a large company. This attitude is expressed by the Chinese saying “ning zuo ji tou, bu zuo feng wei”. The Qiangqiang model became a revolutionary breakthrough in the mindset of Wenzhou entrepreneurs. Supported by the government, eighty leading furniture enterprises merged together, and forty zipper enterprises jointly formed a conglomerate, aiming to establish the zipper base, mould industry merged together to tackle with the technology innovation (Wang and Zhang 2004).

Table 4.1 further illustrates the consequences of mergers in Wenzhou. Before 2003, the output ratio of big and medium-sized enterprises to the overall industrial output was less than 7%, while the same ratio saw a sharp increase to 18.9% in 2003, and 31.5%, in 2007.

The transformation of enterprises, listed companies in the Stock Exchanges, Although Wenzhou entrepreneurs tried many innovations that contributed to the growth of small enterprises, particularly at the policy level in the 1980s, the vast majority
of the enterprises were still family firms. As of the end of 2002, among the 1200 companies listed in the Shanghai and Shenzhen Stock Exchange, 200 were privately owned and 26 were Zhejiang companies; however, none of them was from Wenzhou. Ironically, although Wenzhou was the cradle of private economy, Wenzhou only had one company listing in the two stock exchanges.

Both the provincial and municipal government was active in encouraging private companies to go public. In 2002, the provincial government strongly recommended a few hundred private companies for initial public offering (IPO) on overseas stock exchanges, but only one company among them was from Wenzhou. In 2003, the provincial government held a conference to specifically promote Wenzhou enterprises for IPOs by inviting leading securities companies from Shanghai, Nasdaq, Hong Kong, London and Singapore. In contrast to the government enthusiasm, Wenzhou entrepreneurs held a lukewarm attitude toward IPOs. Entrepreneurs from two leading enterprises, CHINT and Delixi, did not even attend the meeting (informant 21).

In 2006, the Wenzhou government promulgated favorable policies, such as land and tax reductions, to encourage enterprises to go public. Only two companies ended up going public in 2006, and two more in 2007. In 2008, the Wenzhou government issued more policy incentives, and CHINT became the sixth company to go public in 2010.

_Establishment of two consortiums (caituan)_

In June 2004, two consortiums were founded in Wenzhou. Zhongrui became China’s first consortium. The initial registered capital was 558 million Yuan, equally shared by nine shareholders. Shareholder companies included Shenli, Aokang, Fapai, Guoguang, Taili, Xingli, Xinya, Yaohua, and Yuanyang eyeglasses. Nine shareholders were selected from 30 candidates who had a good brand, credit, and scale. Zheng Shengtao, the president of Zhongrui, remarked that they attempted to make a private consortium that integrated industry and financial capital. Chen Shisheng, the board member, said, “it was hard for each individual enterprise to undertake the projects over one billion Yuan, so we needed to group together to make money across the country and all over the world.” Some shareholders sought to invest in trusts, securities, and real estate via Zhongrui. At the founding ceremony, Zhongrui got three contracts, including a contract for a power station – a joint investment in which Zhongrui held 65% of the shares, while the Wenzhou government held 35%. It also acquired a sewage disposal project that involved cooperating with AUCHAN, a French company.

Another consortium is Zhongchi, which was founded right after Zhongrui in Yueqing, Wenzhou. Zhongchi mainly invested in real estate, mergers and acquisitions of state-owned enterprise, trade, finance, venture capital, public infrastructure, and the high-tech industry. The establishment of consortiums further indicated the convergence of strong enterprises in Wenzhou.

_Comparison: Suzhou, Hangzhou, Ningbo_

In this section, I will illustrate Wenzhou’s change by comparing Wenzhou to Suzhou, Hangzhou, and Ningbo. These cities, particularly Suzhou, are being set as comparative references to Wenzhou by scholars, officials and journalists. The Wenzhou model enjoyed its golden age from the late 1980s to the late 1990s. It was a model under which rapid growth was brought about by the development of the private economy. In
sharp contrast to Wenzhou, the Sunan model, typified by Suzhou, which was glorified before the mid-1980s and featured township and village enterprises, began to decline due to ownership and efficiency problems. Since the late 1990s, the Sunan area saw the rapid privatization of TVEs due to intervention by the local government (Zhang 2008), who also simultaneously played an important role in guiding the economy by attracting FDI. Table 4.2 shows that from 1995 to 1992, the actual usage of FDI in Suzhou was about 30 to 60 times that in Wenzhou. From 2004 to 2007, however, the discrepancy in the usage of FDI between these two cities closed. Between this time period, the FDI usage in Suzhou was only 12 to 25 times that in Wenzhou.

As the previous discussions show, the developmental models in Hangzhou and Ningbo are closer to the Sunan model. Table 4.2 also illustrates how Wenzhou was also catching up with Hangzhou and Ningbo in the use of FDI, though a big gap still remained. The growth of Wenzhou’s FDI usage ranked No.1 among the four cities in 2004, 2005 and 2007, and No. 2, in 2003 and 2006.
Table 4.2, Foreign capital actually used (unit: $10,000)

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Source: Wenzhou statistic yearbook, Suzhou statistical yearbook, Hangzhou statistic yearbook, Ningbo statistical yearbook, various volumes

The discrepancies in heavy industry between Wenzhou and the other three cities were quickly disappearing. According to the date available, table 4.3 shows that from the middle of the 1990s to 2002, the proportion of heavy industry in Wenzhou was significantly lower than that in Suzhou, Hangzhou and Ningbo. The sharp increase in the ratio of heavy industry since 2003 enabled Wenzhou to close the competition with the other three cities; Wenzhou even surpassed Hangzhou in a few number of years.
Table 4.3, Ratio of heavy industry: the gross output value of heavy industry over the total gross industrial output value.

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<td>58.3</td>
<td>65.0</td>
</tr>
<tr>
<td>2007</td>
<td>59.1</td>
<td>68.7</td>
<td>57.0</td>
<td>67.0</td>
</tr>
</tbody>
</table>

Source: Wenzhou statistic yearbook, Suzhou statistical yearbook, Hangzhou statistic yearbook, Ningbo statistical yearbook, various volumes

Table 4.4 shows that the gap in the number of big and medium enterprises between Wenzhou and the other three cities was also closing. In 2000, the proportion of big and medium-sized enterprises in Wenzhou was 6.8%, which was 37.2% and 36.8% lower than that in Hangzhou and Ningbo, respectively. However, in 2007, the proportion of such enterprises in Wenzhou increased to 31.5%, which was only 16.9% and 14.3% lower than that in Hangzhou and Ningbo, respectively. Since 2000, Wenzhou saw a slight increase in its proportion of SOEs, although the proportion was very small as opposed to two decades ago. And the ratios of SOEs in three cities were approaching closely.
Table 4.4, The ratio of the gross output value of big and medium enterprise over the total gross industrial output value

<table>
<thead>
<tr>
<th>Year</th>
<th>Wenzhou</th>
<th>Hangzhou</th>
<th>Ningbo</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>2.97</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>2.09</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>2.31</td>
<td></td>
<td></td>
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<tr>
<td>1981</td>
<td>2.48</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>2.15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>2.05</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>2.45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>9.88</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>2.72</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>7.19</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>6.38</td>
<td></td>
<td></td>
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<tr>
<td>1989</td>
<td>6.09</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>6.53</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>6.32</td>
<td></td>
<td>41.7</td>
</tr>
<tr>
<td>1992</td>
<td>6.20</td>
<td></td>
<td>42.4</td>
</tr>
<tr>
<td>1993</td>
<td>6.75</td>
<td>44.0</td>
<td>43.6</td>
</tr>
<tr>
<td>1994</td>
<td>6.52</td>
<td>37.1</td>
<td>39.5</td>
</tr>
<tr>
<td>1995</td>
<td>6.46</td>
<td>35.2</td>
<td>33.8</td>
</tr>
<tr>
<td>1996</td>
<td>18.91</td>
<td>63.4</td>
<td>58.7</td>
</tr>
<tr>
<td>1997</td>
<td>25.97</td>
<td>67.4</td>
<td>51.3</td>
</tr>
<tr>
<td>1998</td>
<td>30.27</td>
<td>54.7</td>
<td>53.8</td>
</tr>
<tr>
<td>1999</td>
<td>29.49</td>
<td>54.6</td>
<td>55.3</td>
</tr>
<tr>
<td>2000</td>
<td>31.51</td>
<td>58.4</td>
<td>55.8</td>
</tr>
<tr>
<td>2001</td>
<td>29.55</td>
<td>56.6</td>
<td>56.5</td>
</tr>
</tbody>
</table>

Source: Wenzhou statistic yearbook, Hangzhou statistic yearbook, Ningbo statistical yearbook, various volumes

As the previous discussion illustrated, although Wenzhou’s developmental model was approaching the Suzhou, Hangzhou and Ningbo model, Wenzhou took different approaches to acquiring FDI and developing big and medium-sized enterprises. In Suzhou, Hangzhou, and Ningbo, the government simply acquired FDI for the local economy, whereas in Wenzhou, the government mainly served as marriage broker between local enterprises and foreign companies due to the strong foundation of private
enterprise in Wenzhou. In terms of developing big and medium-sized enterprises, Wenzhou mainly adopted the merger strategy that was also supported by the government. Even under the government’s strong advocacy for foreign capital, some local officials and entrepreneurs still complained against this method. Several entrepreneurs complained about the supranational treatment of joint-ventures. A local official was concerned about the extensive efforts spent on acquiring FDI. He said that some projects, such as the joint-venture with Coca-Cola, were not as helpful to upgrading Wenzhou’s industries, because they may not be able to bring advanced technology to Wenzhou (informant 22). An eyeglass entrepreneur said, “Those land policies that favor foreign capital gave joint ventures supranational treatment” (informant 23). An apparel entrepreneur complained that it was Wenzhou entrepreneurs, rather than foreign companies, who feed the officials (informant 24). Another apparel entrepreneur said the influx of FDI squeezed the market for local entrepreneurs (informant 25).

**Conclusion**

This chapter illustrated the transformation of the Wenzhou government from a laissez-faire to a regulatory to a moderately interventionist state, while also demonstrating the three factors driving the transformation. Both of transformations were ignited by the crisis. The first transformation was ignited by the product quality crisis, whereas the second one was ignited by the crisis of slow growth of GDP. Furthermore, they were driven by different mechanisms. More specifically, the first transformation was driven by market forces and the central government, while the second transformation was driven by regional competition, isomorphism and increased fiscal revenue. The findings have several theoretical implications. First of all, this study identified the transformation of local states and the mechanisms underlying the transformations, thus going beyond the state-society theory that defined the relationship between state and society as being static. Second of all, my research also further develops the study of organizations and institutions. The transformation of the local state is a form of organizational change.

This study of local state transformation in China implies an empirical study of state transformation as an organizational change. The change of state as an organization is in the following aspects: the priority of policy making and law enforcement, and the structure of government. As illustrated in Wenzhou, in early 1990s, Wenzhou government prioritized the policy making of product quality and the enforcement of regulating the market. Coupled with the change of priority, the government sponsored the establishment of industry associations on the one hand, and assigned more personnel in inspecting the product quality. Since 2003, Wenzhou government prioritized the governmental guidance in the market, the heavy industry, the merger of big-medium enterprises, the FDI attracting and the large enterprise going public. The coupled governmental structure changes included the replacement of leadership indicating a strong intent to bring other successful models to Wenzhou, new policies of incentive for officials in attracting FDI, new design of governmental agencies in accordance with the ISO9000 standard30, and establishment of governmental agency of IPO. The theory of institutional isomorphism also lends some analytic power in explaining the state transformation of Wenzhou, particularly for the second transformation, as we see a

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30 The ISO 9000 family of standards relate to quality management systems and are designed to help organizations ensure they meet the needs of customers and other stakeholders
convergence of developmental models across Wenzhou, Suzhou, Hangzhou and Ningbo. The coercive isomorphism comes from the replacement of leadership, and the mimetic isomorphism comes from the successful models in Suzhou, Hangzhou and Ningbo. The adoption of ISO9000 by Wenzhou government clearly illustrates the normative isomorphism.

However, Wenzhou’s isomorphism with Suzhou, Hangzhou and Ningbo featured its own characteristics given its strong foundation of private enterprise, particularly in the method of attracting foreign direct investment. Likewise, the privatization in Suzhou in late 1990s which modeled Wenzhou also had its own feature given the strong foundation of state guidance in the market.

Extended case study, from micro to macro: empowering state capitalism

What’s the implication of the Wenzhou’s transformation for the whole China’s development? The extended case method applies reflexive science to ethnography in order to extract the general from the unique, to move from the “micro” to the “macro,” and to connect the present to the past in anticipation of the future, all by building on preexisting theory (Burawoy 1998:5). I would argue that the transformation of Wenzhou state illustrated the process of empowering state capitalism in China, that is, a transition from a weakened state intervention to a stronger state intervention in the market to advance the interest of big business.

Both transformations were not driven by the governmental rational adaptation to the environment. However, the driving forces shared a similarity, that is, the coercive power from the upper governmental agency, which relates to an increasingly stronger neo-authoritarian regime. From the central down to the local government, China is witnessing an empowering state capitalism – an increasingly stronger state intervention in the market since the late 1990s.

Huang Yasheng (2008) argued that China experienced two drastically different reform phases in the 1980s and 1990s. He described the 1980s as “directional liberalism”31 and the 1990s as a complete reversal of that, arguing that there was a recentralization of power in the urban areas and at the center of government. His findings implied the existence of interventionist states at many levels since the 1990s. Naughton’s research(1995) also suggests that a liberalization movement started from parts of countryside since late 1970s, then moved to cities in middle 1980s, and there was a recentralization trend in 1990s. My findings are somewhat in line with their arguments. An important reason for the revival of private enterprise and the laissez-faire state in Wenzhou in the 1980s was the support from the liberal leadership at the center. The directional liberalism faded after the Tiananmen movement in 1989, a crisis in the eyes of Communist Party, in another words. The movement prompted a new authoritarianism that began to dominate political ideology at the center. The state gained a stronger control of society since the mid-1990s, and moved toward an interventionist state. It was also strengthened by the fiscal reform in 1995 that recentralized fiscal power in the hands of

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31 Huang defined directional liberalism as follows: “The Chinese political system circa 1980, arbitrary and as absent of self-constraints as it was, marked a substantial marginal change from the status quo ante of the Cultural Revolution. The incentive effects – that the would-be private entrepreneurs felt increasingly assured of the safety of their assets – came from this dynamic development” (Huang 2008: 35)
the central government. Local economic crises prompted the replacement of the local leadership by the upper authorities. During the product quality crisis, Wenzhou’s governor, Dong Caocai, who was a strong advocate for the development of market economy in Wenzhou, was removed from his post. Since the mid-1990s, GDP growth became a central criterion for the promotion of local officials in an authoritarian personnel control system (Li and Zhou 2005). During the second crisis that featured slow GDP growth, Zhejiang provincial leaders decided to appoint Wang Jianman, the party secretary from Xiaoshan city to become Wenzhou’s party secretary. The provincial leadership expected Wang to bring the Xiaoshan model of FDI led growth to Wenzhou. The new authoritarian regime, legitimized by GDP growth, pushed the local governments to be responsive to the local markets. In other words, the authoritarian regime, with its administration personnel control system that posited economic performance at its center, strengthened the competition, mutual learning and isomorphism across regions, thereby forcing the local state to be more adaptive and responsive to the markets. As the data shows, aside from Suzhou, Hangzhou and Ningbo, Wenzhou also saw the rapid growth in FDI growth, state investment, fiscal revenue growth rate, and rate of fiscal expenditures, in other words, an increasing stronger state guidance and intervention in the market—an empowering state capitalism.
Chapter 5

Coastal-inland Disparity of Political Connection and Private Firm Performance

Introduction

China’s private sector economy is enjoying a golden age of prosperity. In 2008, the private sector accounted for 65% of GDP and 56% of tax revenue. However, as discussed in the previous chapters, not long ago, as recently as the early 1980s, private enterprises were politically taboo. The initial legalization of private enterprise occurred in the Wenzhou municipality in 1987, and then in 1988, the amendment to the Constitution legalized private enterprise at the national level. However, the progress was temporary and disrupted by the 1989 Tiananmen massacre. At that time, the Chinese leadership switched back to the socialist orthodox and cracked down heavily on liberalization and privatization efforts.

This resulted in a sharp economic recession between 1989 and 1991. Deng Xiaoping, the powerful leader who strongly advocated for market reform, made a famous southern tour talk in 1992. His talk eventually put China back onto the track of a market economy. Ever since 1992, China has seen a rapid growth of private enterprises, and neoliberalism gathered momentum again. A wave of privatization began in the middle of the 1990s. The reform guideline of the state-owned enterprises was to hold onto big ones while letting go medium-sized and small ones (zhua da fang xiao). A large number of medium-sized and small state-owned enterprises got privatized. Almost all the collective-owned enterprises, particularly the township and village enterprises, got privatized by the end of 1990s. Aside from privatization, the legitimization of private enterprise encouraged a rapid growth of private investment (Huchet and Richet 2002). Although state firms still had the privileges, such as market entry and obtaining loans and land, the discrimination against private enterprise lessened. The amendment to the constitution in 1999 stipulated that private economy is part of the socialist market economy, thus further enhancing the status of private enterprise. Private enterprise was allowed to invest in more industries, such as finance and foreign trade, and listed in domestic stock markets. Some private enterprises even won lawsuits against the local governments. In 2005, the state council promulgated new policies, called the “36 articles”, to encourage the development of the private economy. These policies made it much easier for private enterprise to enter the market and lessened the discrimination against private enterprise, although they still face many obstacles to further growth (Lin and Song 2007).

Chapter 2, 3, and 4 focused on Wenzhou to explore the revival, legalization and development of private economy and the interplay between the state and market during this process through the lens of institutional change. The findings suggest an empowering state capitalism along the coast cities, particularly since the 21st century. This chapter attempts to move beyond the extended case study to explore such interplay at the national level, that is, does the story on the coast apply to the inland provinces. Limited by the qualitative data available, I utilize a nation-wide survey on private enterprise in 2006 to

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Footnote:
32Internal reference of private economy (minying jingji neican), August 28, 2009
examine the state-firm relations between the inland and the coast, more specifically, how political connections impact private firm’s performance on the coast and in the inland.

This chapter draws upon three literatures: management, political economy and spatial economics. The management literature shows how political connections impact firm performance and the contingent view shows different factors moderate the association between political connections and firm performance. Building on the contingent view, I draw upon the literature of political economy to examine how different political connections impact private firm performance; secondly, the literature of political economy in China shows the regional variation of state-firm relations, I draw upon the literature from the spatial economics and focus on the divide between coast and inland, and focus on how the divide between inland and coast moderates the associations between political connections and private firm performance. I have two major questions in this chapter: a, do the impacts of different political connections on firm performance differ? b, do the impacts of political connections on firm performance differ between inland and coast?

**Political connections**

The study of the implication of political connections, particularly in business world, is growing in economic and management literature. Scholars define political connections in many ways depending on the purposes of studies:

For the studies in the US, political connections refer to 1) the role of connections created by contributions to electoral campaigns, and 2) the political experience of outside directors. For the studies in the non-US societies, the connections refer to those generated by means other than campaign contributions, for instance, one of the large shareholders or top officers is, a member of or close to top governmental officials; such as the political influence of dominant business families in Canada (Morck et al 2000), established friendship with top officials in Indonesia (Fisman 2001); political connections in Maylasia, (Johnson and Mitton 2003).

In china studies, most scholars mainly refer political connections to the membership of Chinese communist party (CCP), membership of People’s Congress (PC), membership of People’s Political Consultative Conference (CPPCC), cadre status. In this chapter, limited by the availability of data, in terms of political connections, I focus on membership of CCP, PC, and CPPCC, three most common political connections for private entrepreneurs.

**Value of political connections and forms**

There is a growing body of studies on the values of political connections for firms. It has been found that political connections help firms to secure favorable regulatory conditions (Agrawal and Knoeber, 2001) and access to resources such as bank loans (Khwaja and Mian, 2005; Faccio, 2006), which ultimately increases the value of firms (Fisman, 2001; Ramalho, 2007) or improves their performance (Johnson and Mitton, 2003).

Scholars increasingly see the impact of political connections on firm performance is contingent on several factors: such as industry, ownership, and institution. Agrawl and Knoeber (2001) suggests that politically experienced directors are more prevalent in
firms, where sales to government, where the cost of the environment regulation is higher, where the retail competition made politics important in the US.

Peng and Luo’s findings (2000) suggest that ties with officials are positively related to performance for non-state firms but not for state firms in China. There are also findings which show that political connections are less common in the presence of more stringent regulation of political conflicts of interests. Political connections are particularly common in countries that are perceived as being highly corrupt, in countries that impose restrictions on foreign investment by their citizens, and in more transparent systems. (Faccio 2006), A manager’s political network has a stronger relationship to performance when institutional support is weak (Xin and Pearce 1996; Li, Meng, Wang and Zhou 2008).

However, little research examined the impact of different political connections, and how the impact varies across time; In addition, the market institutions mostly focus on the ratio of private investment, legal institution, less on the state’s role in the market; there is research examining the market institution from the perspective of country, but little research from the perspective of region within a country

**Political connections, marketization, region, coast-inland divide in China**

Scholars in China studies diverge on the value of political connections in the transitional economy. A large body of studies on China’s transition examine the impact of various capitals to if the base of power changes and how. There are two major accounts, that is, market transition account, and power persistence account. Market transition theory asserts that marketization (measured by the presence of private entrepreneurship activities) nullifies the advantage of political connections (Nee, 1989). Contrary to Nee’s market transition theory, power persistence argues that as “marketization” proceeded, the advantages of political connections still persisted in terms of income distribution (e.g., Bian and Logan 1996) and engaging in private business (Wu 2006).

In addition, scholars in the China studies field has identified the regional variation of local states based on state’s distinctive roles in economic activity: such as the entrepreneur state in Tianjin (Duckett 1998), the clientalist state in Fujian (Wank 1995), and the predatory states in inland provinces such as Sichuan, Hubei, Anhui and Henan which are often associated with poverty, heavy tax and fee burden imposed on the peasantry, and peasant protest (Bernstein and Lu 2000); or the developmental state in Shandong, Liaoning, Jiangsu (Oi 1995, 1998 and 1999) and Guangdong (Unger and Chan 1999)33. These studies are helpful in deepening our understanding of the dynamics underlying the development across different regions; however, the major limitation is the overgeneralization due to the paucity of research sites under examination.

I would argue that the divergence discussed above largely lies in location and timing. Nee’s original formulation of market transition theory (1989) was based on a 1985 survey of the coastal Fujian rural areas. Bian and Logan’s findings (1996) drew upon the surveys in urban Tianjin in 1988 and 1993. The literature reviewed focus on a paucity of regions. Nonetheless, these studies implicitly indicate that the coast is more developmental oriented than in the inland in the past three decades.

33 See discussions in chapter 1 and chapter 4
The spatial economics perspective illuminates a prominent divide between the coastal and the inland provinces, and a considerable number of studies examine the inequality along this key dimension. The spatial economics view has two foci; one of them is the pattern of inequality. Though scholars debated about the changing pattern of regional inequality (e.g., Chen and Fleisher; 1996, Fan 1995, 2005; Kanbur and Zhang 2005; Tsui, 1993; Veeck, 1993; Ying 1999), there is a general agreement among researchers that there exists heavy inequality between the inland and coastal provinces, particularly during the post-reform period. The other focus is the factors determining the inequality. These studies have also identified a variety of determinants that explained changes in regional inequality. While some researchers highlight factor endowments such as location, labor, and infrastructure (e.g., Chen and Fleisher, 1996; Hare and West, 1999; Bao et al., 2002; Demurger et al., 2002), many more conclude that factors related to policy are more important. These factors included regional policies that boosted capital investment (including foreign) in the coastal provinces and open zones (e.g., Fan 1995; Kanbur and Zhang, 1999; Wei and Fan, 2000), decentralization of central control (e.g., Tsui 1991; Veeck, 1993; Wei, 1999), industrialization and economic agglomerations (Tsui, 1998; Wei and Kim, 2002), and improved factor mobility due to market expansion (e.g., Jian et al., 1996). However, the literature misses the firm practice on the ground, how firms practice and what are the state-firm relations in these two regions remain unclear. Little research examined the state and private firm relations between the coastal and inland regions in spatial economics.

In sum, the literature reviewed suggest the contingent view of political connections, little research examine the impact of different political connections, how the impact of political connections vary across time and region, the market institution mostly focus on the privatization and legal institution, china studies diverges on the state-firm relations across regions, but they overgeneralized their findings just from a paucity of regions, the spatial economics illuminate the prominent divide between inland and coast, but they miss the firm practice on the ground.

**My intervention in this gap**

I have two interventions in the gap: one is the structure of political connections among CCP, PC and CPPCC, and the other is the different development of private economy between coast and inland.

**The structure of political connections**

The previous discussion of the development of private enterprise since 1980s shows that there is an increasing legitimacy and widening of market entry for private enterprise, and this also suggests that legitimacy and market entry was a big problem for private enterprise in China. As discussed in chapter 2, Wenzhou private entrepreneurs and local cadres shouldered political risk in experimenting with private economy, and they innovated *guahu* practice to legitimize the status of private enterprise. Another dimension relating to the legitimacy is private entrepreneur’s political connections. In China, the most common political connections for private entrepreneurs are the membership of Chinese Communist Party (CCP), the membership of People’s Congress (PC) and the membership of Chinese People’s Political Consultative Conference (CPPCC). After 1992 the growing legitimacy of private enterprise encouraged many
CCP members start with their business, CCP also began to accept the application for membership from the pool of private sector, and the major breakthrough occurred at the CCP’s sixteenth Congress in 2002, when the membership charter was revised and private entrepreneurs were allowed to apply for CCP membership, and this signaled the enhancement of the private entrepreneurs’ political status.

The People’s Congress is China’s legislature, which, as stipulated by the Chinese Constitution, is the highest organ of state power in China at each administrative level. Local PCs have the power to elect chief officials at their own administrative levels, to draft and approve local laws and policies, and to impeach government officials when necessary.

The People’s Political Consultative Conference is an advisory body to the government in China. As the entry of CCP membership became easier, it is safe to say that PC is more powerful than CCP and CPPCC in current China. I would hypothesize:

\[ H_1: \text{The benefit of political connections for firm performance varies with the power of political bodies. Membership in the PC is most beneficial, while membership in the CCP and CPPCC are less beneficial.} \]

Different development of private economy between coast and inland

Although China’s private sector economy is growing fast, the development of private economy differs across regions, particularly between the inland and the coast. I measure the development of private economy in two aspects: one is the ratio of private investment over the overall investment; the second is the state intervention in the market.

China takes the experiment method and the model of regionally differentiated development in developing private economy. The coastal regions were allowed to take the lead in the development of private enterprise; consequently, the degree of privatization in the coastal provinces has been consistently higher than that in the inland provinces during the last three decades. Measured by private investment over overall investment, in 2008 the private portion in the coastal provinces in 2008 was 71 percent, which was 10 percent higher than that in the inland provinces as shown in table 5.1. Nonetheless, there were sharp increase in terms of privatization in both areas; in 1997, the ratio was 36 percent for the coast, and 28 percent for the inland.
Table 5.1, ratio of private investment between coast and inland provinces

<table>
<thead>
<tr>
<th></th>
<th>Private investment/total investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>33.91</td>
</tr>
<tr>
<td>Tianjin</td>
<td>31.91</td>
</tr>
<tr>
<td>Hebei</td>
<td>24.18</td>
</tr>
<tr>
<td>Liaoning</td>
<td>31.98</td>
</tr>
<tr>
<td>Shanghai</td>
<td>29.05</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>38.17</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>41.24</td>
</tr>
<tr>
<td>Fujian</td>
<td>47.45</td>
</tr>
<tr>
<td>Shandong</td>
<td>25.61</td>
</tr>
<tr>
<td>Guangdong</td>
<td>39.89</td>
</tr>
<tr>
<td>Hainan</td>
<td>49.72</td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>COAST</td>
<td>35.74</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Shanxi</td>
<td>20.03</td>
</tr>
<tr>
<td>Guangxi</td>
<td>42.11</td>
</tr>
<tr>
<td>Neimeng</td>
<td>24.74</td>
</tr>
<tr>
<td>Jilin</td>
<td>28.95</td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>17.26</td>
</tr>
<tr>
<td>Jiangxi</td>
<td>34.96</td>
</tr>
<tr>
<td>Henan</td>
<td>35.70</td>
</tr>
<tr>
<td>Hubei</td>
<td>36.62</td>
</tr>
<tr>
<td>Hunan</td>
<td>37.44</td>
</tr>
<tr>
<td>Anhui</td>
<td>37.25</td>
</tr>
<tr>
<td>Chongqing</td>
<td>38.39</td>
</tr>
<tr>
<td>Sichuan</td>
<td>30.60</td>
</tr>
<tr>
<td>Guizhou</td>
<td>29.48</td>
</tr>
<tr>
<td>Yunnan</td>
<td>27.07</td>
</tr>
<tr>
<td>Tibet</td>
<td>7.28</td>
</tr>
<tr>
<td>Shanxi</td>
<td>32.75</td>
</tr>
<tr>
<td>Gansu</td>
<td>24.18</td>
</tr>
<tr>
<td>Qinghai</td>
<td>13.07</td>
</tr>
<tr>
<td>Ningxia</td>
<td>18.87</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>13.94</td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>INLAND</td>
<td>27.54</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>COAST-INLAND</td>
<td>8.20</td>
</tr>
</tbody>
</table>


Another dimension of the development of private economy is the state intervention in the market. Existing literature shows the variation of state roles in the
market economy. Scholars identified different types of state in terms of state involvement, for instance, regulatory state and interventionist state. Interventionist states (e.g., France) are involved in making substantive decisions for many markets. They may own firms, direct investment, and heavily regulate firm entries, exits, and competition in markets. In contrast, regulatory states (e.g., the United States) create agencies to enforce general rules in markets, but do not decide who can own what and how investments proceed. There is research which (Dobbin and Sutton 1998) explored how the federal state in the US is administratively weak but normatively strong, as opposed to France. Some studies in China also suggest that the roles of local governments differed in privatization in late 1990s along the coast, one example is between Sunan area and Wenzhou, and that there was much more manipulation by the governments and stronger role of governments in the former.

My fieldwork in Wenzhou suggest that Wenzhou government is becoming increasingly stronger and transforming from a regulatory state to an interventionist state, which is manifested in the governments aggressive attracting FDI, pushing for the merger of private enterprises, and developing heavy industries. My findings in chapter 4 also suggest that there is a converging tendency toward strong state model among four coastal cities including Wenzhou, Suzhou, Hangzhou and Ningbo.

As the privatization increases in both inland and coast and there is increasing state intervention on the coast, I would hypothesize:

\[ H_2: PC \text{ contributes more to the coast private enterprises than to those on the inland} \]

**Research design and data**

I test the hypotheses \( H_1 \) by estimating the profitability equations using ROE and ROA. More specifically, I estimate the following performance equation.

\[ \text{Profitability} = \beta_0 + \beta_1 P + X\delta + \epsilon, \]  

(1)

The dependent variable or profitability in this chapter is private firm performance, which is measured by return on equity (ROE) and return on assets (ROA). And the independent variable is political connections or \( P \) in the equation, which is measured by the CCP membership, PC membership and CPPCC membership. The vector \( X \) in the equation represents a complete set of control variables that include entrepreneur’s attributes (age, gender and education), firm’s attributes (size, industry and year of operation) and the provincial privatization ratio.

As the central task for this chapter is to examine how the divide between coast and inland moderates the relationship between political connections and private firm performance, so I created a dummy variable coast as a moderate variable. I test hypothesis \( H_2 \) by estimating the following performance equation.

\[ \text{Profitability} = \beta_0 + \beta_1 P + \beta_2 P \times \text{coast} + X\delta + \epsilon, \]  

(2)

The method I use is ordinary least squares (OLS) regression. The firm data that I use in this chapter comes from a nationwide survey of privately owned enterprises that was jointly conducted in 2006 by the All China Industry and Commerce Federation, the China Society of Private Economy at the Chinese Academy of Social Sciences, and the United Front Work Department of the Central Committee of the Communist Party of China. The sample mainly comprises large firms and a small portion of individual
household enterprises that were drawn from 31 provinces that cover all of the political subdivisions at this level in mainland China. The dataset is by far the best for studying the social profile of private entrepreneurs, private firms’ performance, management, and state-enterprise relations. This survey in 1991 is the first nation-wide sample survey of privately-owned enterprises and their owners. After 1991, the survey was conducted every two years. The datasets are owned by Universities Service Center for China studies in the Chinese University of Hong Kong. The 2006 data comprises 3837 privately owned enterprises, representing 0.089% of the total number of privately owned enterprises nationwide. The survey on which the dataset is based consisted of intensive interviews with firm owners, who can be defined as entrepreneurs, on questions about the size, history, and the basic financial background of their firms and their personal background, human capital, and occupational history.

**Results**

**Descriptive analysis**

There are 1690 observations for which there is relatively complete information about the variables of interest. 1113 observations come from 11 provinces in the coastal regions, accounting for 66% of the total sample. The remaining 577 observations come from 20 provinces in the inland. A primary analysis of the data shows that 42% of private entrepreneurs hold CCP membership, 22% hold PC membership, and 26% hold CPPCC membership. Table 5.2 also shows that the average of ROE for private enterprises is 0.33, and the ROA is 0.24.

**Table 5.2, summary statistics**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Observations</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>CCP membership</td>
<td>1690</td>
<td>0.42</td>
<td>0.49</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>PC membership</td>
<td>1690</td>
<td>0.22</td>
<td>0.42</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>CPPCC membership</td>
<td>1690</td>
<td>0.26</td>
<td>0.44</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Male</td>
<td>1690</td>
<td>0.89</td>
<td>0.32</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Age</td>
<td>1690</td>
<td>45.08</td>
<td>8.12</td>
<td>22</td>
<td>80</td>
</tr>
<tr>
<td>Junior high or below</td>
<td>1690</td>
<td>0.14</td>
<td>0.34</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Senior high</td>
<td>1690</td>
<td>0.38</td>
<td>0.49</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>College</td>
<td>1690</td>
<td>0.31</td>
<td>0.46</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Graduate</td>
<td>1690</td>
<td>0.17</td>
<td>0.38</td>
<td>0</td>
<td>1</td>
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<tr>
<td>Profit(million yuan)</td>
<td>1690</td>
<td>1.93</td>
<td>7.90</td>
<td>-4.86</td>
<td>162.22</td>
</tr>
<tr>
<td>Equity (million yuan)</td>
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<td>13.05</td>
<td>54.86</td>
<td>.01</td>
<td>1407.78</td>
</tr>
<tr>
<td>Total current loan(million yuan)</td>
<td>1690</td>
<td>5.90</td>
<td>32.13</td>
<td>0</td>
<td>1013.11</td>
</tr>
<tr>
<td>Asset(Million yuan)</td>
<td>1690</td>
<td>19.61</td>
<td>80.16</td>
<td>.01</td>
<td>2420.89</td>
</tr>
<tr>
<td>Leverage</td>
<td>1690</td>
<td>0.22</td>
<td>0.26</td>
<td>0</td>
<td>0.993</td>
</tr>
<tr>
<td>ROE</td>
<td>1690</td>
<td>0.33</td>
<td>1.22</td>
<td>-10.35</td>
<td>28.21</td>
</tr>
<tr>
<td>ROA</td>
<td>1690</td>
<td>0.23</td>
<td>1.05</td>
<td>-1.96</td>
<td>28.21</td>
</tr>
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<td>1200</td>
<td>228.71</td>
<td>644.07</td>
<td>1</td>
<td>10973</td>
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<tr>
<td>Firm age (years)</td>
<td>1690</td>
<td>7.14</td>
<td>4.28</td>
<td>1</td>
<td>21</td>
</tr>
<tr>
<td>Tax ratio</td>
<td>1651</td>
<td>0.06</td>
<td>0.26</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Fee ratio</td>
<td>1323</td>
<td>0.03</td>
<td>0.29</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Coast</td>
<td>1690</td>
<td>0.66</td>
<td>0.47</td>
<td>0</td>
<td>1</td>
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</tbody>
</table>
The results in table 5.3 shows that comparing to inland private firm, coast private firm averagely is higher in ROE, ROA, profit, total current loan, asset, leverage, tax ratio, fee ratio and firm age. In addition, coast private entrepreneurs are older and less educated, and they have a lower membership in PC, CPPCC, but higher membership in CCP. The difference of CPPCC membership, age, education, leverage, and firm age are significant at 5 percent or 1 percent level.

Table 5.3, summary statistics: inland versus coast

<table>
<thead>
<tr>
<th>Variable</th>
<th>Inland</th>
<th>Mean (Std. Dev.)</th>
<th>Coast</th>
<th>Mean (Std. Dev.)</th>
<th>Difference</th>
<th>Mean (Std. Dev.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Observations</td>
<td>577</td>
<td></td>
<td>1113</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>Inland</td>
<td>Mean (Std. Dev.)</td>
<td>Coast</td>
<td>Mean (Std. Dev.)</td>
<td>Difference</td>
<td>Mean (Std. Dev.)</td>
</tr>
<tr>
<td>ROE</td>
<td>0.29</td>
<td>0.70</td>
<td>0.35</td>
<td>1.41</td>
<td>-0.06</td>
<td>0.06</td>
</tr>
<tr>
<td>ROA</td>
<td>0.20</td>
<td>0.39</td>
<td>0.25</td>
<td>1.26</td>
<td>-0.05</td>
<td>0.05</td>
</tr>
<tr>
<td>CCP membership</td>
<td>0.40</td>
<td>0.49</td>
<td>0.43</td>
<td>0.50</td>
<td>-0.03</td>
<td>0.03</td>
</tr>
<tr>
<td>PC membership</td>
<td>0.24</td>
<td>0.43</td>
<td>0.21</td>
<td>0.41</td>
<td>0.03</td>
<td>0.02</td>
</tr>
<tr>
<td>CPPCC membership</td>
<td>0.35</td>
<td>0.48</td>
<td>0.22</td>
<td>0.41</td>
<td>0.14***</td>
<td>0.02</td>
</tr>
<tr>
<td>Male</td>
<td>0.88</td>
<td>0.32</td>
<td>0.89</td>
<td>0.31</td>
<td>-0.01</td>
<td>0.02</td>
</tr>
<tr>
<td>Age</td>
<td>44.06</td>
<td>8.13</td>
<td>45.61</td>
<td>8.06</td>
<td>-1.56***</td>
<td>0.41</td>
</tr>
<tr>
<td>Junior high or below</td>
<td>0.11</td>
<td>0.31</td>
<td>0.15</td>
<td>0.36</td>
<td>-0.04**</td>
<td>0.02</td>
</tr>
<tr>
<td>Senior high</td>
<td>0.34</td>
<td>0.48</td>
<td>0.40</td>
<td>0.49</td>
<td>-0.05**</td>
<td>0.02</td>
</tr>
<tr>
<td>College</td>
<td>0.33</td>
<td>0.47</td>
<td>0.30</td>
<td>0.46</td>
<td>0.03</td>
<td>0.02</td>
</tr>
<tr>
<td>Graduate</td>
<td>0.21</td>
<td>0.41</td>
<td>0.15</td>
<td>0.36</td>
<td>0.06***</td>
<td>0.02</td>
</tr>
<tr>
<td>Profit(million yuan)</td>
<td>1.72</td>
<td>6.31</td>
<td>2.03</td>
<td>8.61</td>
<td>-0.31</td>
<td>0.40</td>
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<tr>
<td>Equity (million yuan)</td>
<td>13.40</td>
<td>6.30</td>
<td>12.87</td>
<td>50.13</td>
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<tr>
<td>Total current loan(million yuan)</td>
<td>5.55</td>
<td>43.26</td>
<td>6.08</td>
<td>24.47</td>
<td>-0.53</td>
<td>1.65</td>
</tr>
<tr>
<td>Asset(Million yuan)</td>
<td>19.42</td>
<td>104.68</td>
<td>19.71</td>
<td>63.91</td>
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<td>4.11</td>
</tr>
<tr>
<td>Size (log asset)</td>
<td>5.88</td>
<td>1.85</td>
<td>5.92</td>
<td>1.86</td>
<td>-0.04</td>
<td>0.10</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.20</td>
<td>0.25</td>
<td>0.24</td>
<td>0.27</td>
<td>-0.03**</td>
<td>0.01</td>
</tr>
<tr>
<td>Tax ratio</td>
<td>0.06</td>
<td>0.07</td>
<td>0.07</td>
<td>0.31</td>
<td>-0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Fee ratio</td>
<td>0.02</td>
<td>0.07</td>
<td>0.04</td>
<td>0.36</td>
<td>-0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>Firm age</td>
<td>6.44</td>
<td>4.12</td>
<td>7.50</td>
<td>4.32</td>
<td>-1.06***</td>
<td>0.22</td>
</tr>
</tbody>
</table>

Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and *** respectively.

**Regression results**

**Political connections and profitability**

In table 5.4, model 1, and model 5 show that the impacts of CCP and CPPCC on the private enterprise’s ROE is positive, but the impact is not significant, whereas the impact of PC membership is significantly positive. Being a PC membership increases a firm’s ROE by 0.228 at one percent significance level. Likewise, table 5.5 shows similar results, both CCP and CPPCC’s impacts on a private firm’s ROA are positive, but not significant, whereas, PC membership increases a firm’s ROA by 0.2 at one percent significance level.
The results consistently support H1. The results in table 5.4 also show that the impact of firm size is consistently negative to a private firm’s ROE at significance level of one percent, whereas the leverage is consistently positive at the same significance level. The impacts of gender, age, education, firm age, industry and the provincial privatization ratio are not significant.

Table 5.4, OLS regressions examining the impacts of the political connection and political capital on ROE in coast and inland private enterprise

<table>
<thead>
<tr>
<th></th>
<th>M1</th>
<th>M2</th>
<th>M3</th>
<th>M4</th>
<th>M5</th>
<th>M6</th>
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<tr>
<td>Coast</td>
<td>0.065</td>
<td>0.066</td>
<td>0.076</td>
<td>0.072</td>
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<td>(0.067)</td>
<td>(0.067)</td>
<td>(0.068)</td>
<td>(0.068)</td>
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<td>(0.064)</td>
<td>(0.064)</td>
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</tr>
<tr>
<td>CCP*coast</td>
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</tr>
<tr>
<td>PC</td>
<td></td>
<td>0.228***</td>
<td>0.235***</td>
<td></td>
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</tr>
<tr>
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<td>(0.075)</td>
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<tr>
<td>PC*coast</td>
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<tr>
<td>Male</td>
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<td>0.001</td>
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<td>0.012</td>
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<td>-0.001</td>
</tr>
<tr>
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</tr>
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<tr>
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<td>(0.004)</td>
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</tr>
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<td>College</td>
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<td>(0.115)</td>
<td>(0.114)</td>
<td>(0.115)</td>
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<tr>
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<td>-0.108***</td>
<td>-0.121***</td>
<td>-0.122***</td>
<td>-0.111***</td>
<td>-0.111***</td>
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<td></td>
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<td>(0.020)</td>
<td>(0.020)</td>
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<td>(0.122)</td>
<td>(0.122)</td>
<td>(0.122)</td>
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</table>

Standard errors are reported in parentheses. Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and *** respectively. All regressions control for industrial and provincial privatization ratio.
### Table 5.5, OLS regressions examining the impacts of the political connection on ROA in coast and inland private enterprise

<table>
<thead>
<tr>
<th></th>
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<th>M2</th>
<th>M3</th>
<th>M4</th>
<th>M5</th>
<th>M6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast</td>
<td>0.068</td>
<td>0.068</td>
<td>0.078</td>
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<td></td>
<td>(0.058)</td>
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<td>(0.058)</td>
<td>(0.058)</td>
<td>(0.058)</td>
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</tr>
<tr>
<td>CCP</td>
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<td>0.052</td>
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<td></td>
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<tr>
<td></td>
<td>(0.055)</td>
<td>(0.055)</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>CCP*coast</td>
<td></td>
<td></td>
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</tr>
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</tr>
<tr>
<td></td>
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<td></td>
<td></td>
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<td>(0.065)</td>
<td></td>
</tr>
<tr>
<td>PC*coast</td>
<td></td>
<td></td>
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<td>0.173</td>
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<tr>
<td>CPPCC</td>
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<td></td>
<td>0.087</td>
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<tr>
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<td>(0.062)</td>
<td>(0.063)</td>
</tr>
<tr>
<td>CPPCC*coast</td>
<td></td>
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<td></td>
<td></td>
<td>0.052</td>
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<td></td>
<td>(0.119)</td>
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<tr>
<td>Male</td>
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<td>-0.012</td>
<td>0.008</td>
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<td></td>
<td>(0.081)</td>
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<tr>
<td>Age</td>
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<td>0.005</td>
<td>0.006*</td>
<td>0.005</td>
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<td>0.006*</td>
</tr>
<tr>
<td></td>
<td>(0.003)</td>
<td>(0.003)</td>
<td>(0.003)</td>
<td>(0.003)</td>
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</tr>
<tr>
<td>Senior high</td>
<td>-0.026</td>
<td>-0.026</td>
<td>-0.028</td>
<td>-0.033</td>
<td>-0.021</td>
<td>-0.021</td>
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<tr>
<td></td>
<td>(0.082)</td>
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<tr>
<td>College</td>
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<td>0.058</td>
<td>0.059</td>
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<td>0.067</td>
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<td></td>
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<td>(0.086)</td>
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<tr>
<td>Graduate</td>
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<td>0.051</td>
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<td>0.053</td>
</tr>
<tr>
<td></td>
<td>(0.099)</td>
<td>(0.099)</td>
<td>(0.099)</td>
<td>(0.099)</td>
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<tr>
<td>Size</td>
<td>-0.088***</td>
<td>-0.089***</td>
<td>-0.100***</td>
<td>-0.100***</td>
<td>-0.091***</td>
<td>-0.091***</td>
</tr>
<tr>
<td></td>
<td>(0.017)</td>
<td>(0.017)</td>
<td>(0.017)</td>
<td>(0.017)</td>
<td>(0.017)</td>
<td>(0.017)</td>
</tr>
<tr>
<td>Leverage</td>
<td>-0.171</td>
<td>-0.171</td>
<td>-0.181*</td>
<td>-0.182*</td>
<td>-0.165</td>
<td>-0.163</td>
</tr>
<tr>
<td></td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.105)</td>
<td>(0.105)</td>
</tr>
<tr>
<td>Firm age</td>
<td>0.005</td>
<td>0.005</td>
<td>0.003</td>
<td>0.004</td>
<td>0.003</td>
<td>0.002</td>
</tr>
<tr>
<td></td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
<td>(0.006)</td>
</tr>
<tr>
<td>Obs</td>
<td>1690</td>
<td>1690</td>
<td>1690</td>
<td>1690</td>
<td>1690</td>
<td>1690</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.044</td>
<td>0.045</td>
<td>0.0494</td>
<td>0.050</td>
<td>0.045</td>
<td>0.045</td>
</tr>
</tbody>
</table>

Standard errors are reported in parentheses.
Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and *** respectively.
All regressions control for industrial and provincial privatization ratio.

**Interaction between political connections and coast**

In table 5.4, model 2, model 4 and model 6 test the interaction between coast and political connections to examine whether coast has a added impact on private firm’s ROE or not. The results show that Being a PC membership increases a firm’s ROE by 0.235 at one percent significance level, controlling for the interaction effect, in addition, PC membership’s positive contribution to the ROE of coastal private enterprise is 0.269 higher than that to inland private enterprise at a slight significance level of ten percent; whereas the results show that coast does not have added impact with CCP and CPPCC on
a private firm’s ROE. In Table 5.5, model 4 shows that PC membership contributes to a firm’s ROA by 0.205 at one percent significance level, while PC membership’s different contribution to an inland firm and a coast firm is not significant. Model 2 and 6 show that coast does not have added impact with CCP and CPPCC on a private firm’s ROA. In sum, the results partially support hypothesis 2, though not very robust.

**Further tests: Where is PC membership important?**

I test the importance of PC membership in three aspects: obtaining loans, tax discounts and fee discounts. In Table 5.6, the results show that PC helps private entrepreneurs in obtaining loans, not in tax or fee discounts. Being a PC member helps private entrepreneurs obtain 6.20 million Yuan at a significance level of one percent. PC membership appears to help private entrepreneurs more in obtaining loans on the coast than those in the inland, but the impact is not significant. The added impact of PC membership on coast private firm’s ROE needs further exploration.

**Table 5.6, OLS regressions examining the impacts of PC membership on the access to the current loan, tax ratio and fee ratio**

<table>
<thead>
<tr>
<th></th>
<th>Current loan</th>
<th>Tax ratio</th>
<th>Fee ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast</td>
<td>60.911</td>
<td>48.668</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(175.507)</td>
<td>(175.412)</td>
<td>(0.014)</td>
</tr>
<tr>
<td>PC</td>
<td>620.147***</td>
<td>638.373***</td>
<td>-0.005</td>
</tr>
<tr>
<td></td>
<td>(192.107)</td>
<td>(192.089)</td>
<td>(0.016)</td>
</tr>
<tr>
<td>PC*coast</td>
<td>837.831</td>
<td>-0.028</td>
<td>-0.014</td>
</tr>
<tr>
<td></td>
<td>(391.319)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>136.933</td>
<td>112.873</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td>(247.206)</td>
<td>(247.195)</td>
<td>(0.021)</td>
</tr>
<tr>
<td>Age</td>
<td>24.046**</td>
<td>22.326**</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>(10.095)</td>
<td>(10.116)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>Senior high</td>
<td>183.175</td>
<td>156.048</td>
<td>0.022</td>
</tr>
<tr>
<td></td>
<td>(246.447)</td>
<td>(246.507)</td>
<td>(0.020)</td>
</tr>
<tr>
<td>College</td>
<td>514.043**</td>
<td>489.788*</td>
<td>0.004</td>
</tr>
<tr>
<td></td>
<td>(257.159)</td>
<td>(257.132)</td>
<td>(0.021)</td>
</tr>
<tr>
<td>Graduate</td>
<td>1239.028***</td>
<td>1223.381***</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(292.485)</td>
<td>(292.262)</td>
<td>(0.024)</td>
</tr>
<tr>
<td>Firm age</td>
<td>29.089</td>
<td>30.665</td>
<td>-0.003*</td>
</tr>
<tr>
<td></td>
<td>(18.781)</td>
<td>(18.775)</td>
<td>(0.002)</td>
</tr>
<tr>
<td>Obs</td>
<td>1690</td>
<td>1690</td>
<td>1651</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.044</td>
<td>0.047</td>
<td>0.008</td>
</tr>
</tbody>
</table>

Standard errors are reported in parentheses.
Significance levels 0.1, 0.05 and 0.01 are noted by *, **, and *** respectively.
All regressions control for industrial and provincial privatization ratio.

**Conclusion and Implications**
Based on a nation-wide survey, this chapter examined the impact of political connections on private firm’s performance and how the divide between coast and inland moderates this impact. The findings suggest that the impact of political connection differs across the forms. CCP and CPPCC, two less powerful political connections, do not have significant impact on firm’s profitability, however, PC membership, the most powerful political connection among the three, has significantly positive impact on private firm’s performance. In addition, PC membership contributes more to the coastal than inland private enterprises. A closer examination on where is PC membership important, the findings suggest that it significantly helps private firms obtain current loans, but there exists no significant impact on tax or fee discounts. Furthermore, the findings do not show significant difference between coast and inland in terms of the PC membership’s impact on obtaining current loan, tax and fee discounts. I would speculate that although there is higher privatization on the coast than in the inland, the increasing stronger state intervention on the coast may explain why PC contributed more to the coast private firms than to those in the inland.

This chapter has several contributions. First, it differentiates the impact of different political connections on firm performance; secondly, it differentiates privatization and state intervention in the market; thirdly, a comparison of the data between 2006 and 2002 shows the change of state-firm relations in China: timing matters. The findings disagree with Li Hongbin et al (2008), whose findings suggest that Communist Party membership significantly improves private firm performance. From a longitudinal viewpoint, the disagreement between this study and Li et al’s findings (2008) might be due to the timing of the research. Their research was based on a similar survey in 2002, when the Communist Party began to allow the private entrepreneurs to officially join the party, so party membership at that time might have mattered significantly. Li et al’s research shows that the proportion of party membership in a 2002 survey was 0.26, while it was 0.42 in the 2006 survey.

Fourthly, this chapter complicates the market-transition theory and power persistence theory, and overcomes the overgeneralization of state-firm relations in China studies. My findings suggest the value of political connections is contingent on region, that is, the divide between the coast and inland. Lastly, this chapter differentiates the state-firm relations between the coast and the inland, and advances the studies of spatial economics.

One of the limitations for this chapter is that it only focuses on domestic private enterprises; future research needs to examine the association between political connections and firm performance, net the effect of ownership. Another limitation is that, in most regression analyses, the R-squared is very low; almost all of them are below 0.1. This means that the variables do not explain much about the variance. This is related to the quality of dataset, which, although is by far the best dataset, still has a number of missing values. If more variables were included, a large portion of missing values may distort the results. A better survey dataset, which is always an ongoing goal for China studies, is needed to test these findings.
Chapter 6
Conclusion

In the concluding chapter, I will highlight my main findings, illustrate the logics underlying the process of China’s transition, then, I will discuss the nature of Chinese capitalism, and lastly, I will open up for some implications for the development of capitalism in the future.

**Revival of private enterprise: defining private property rights**

**Institutional change: emergence of new institutional form**

A key dimension in China’s gradual transition from socialist planning economy to capitalist market economy is the revival and legitimization of private enterprise. The re-emergence of the institution of private economy is in tandem with the deconstitution of old institutional force, and the process is one step back and two steps forward. The initial change was driven by the political and economic crisis brought by the Cultural Revolution after Mao’s death. In the center, the market-oriented camp was seeking for an alternative road to replace the planning road, to make a stronger, wealthier and modern China to legitimize the leadership. The decentralization started from late 1970s, and allowed for local autonomy to encourage individual incentive.

The private enterprise revived first in Wenzhou. There were several factors contributing to such re-emergence in Wenzhou. Existing literature shows that Wenzhou was a marginal area in socialist economy, administration and culture, which I called the advantage of institutional marginality which had the great potential to engender new institution\(^\text{34}\). The central and provincial governments invested significantly less in Wenzhou owing to its proximity to Taiwan, in addition, Wenzhou had a long history of trade and distinguished business culture as opposed to the Confucian agricultural culture. Thirdly, Wenzhou cadres were a marginal force in the communist party before 1949. The poor socialist economic base and poor economy, plus the somewhat autonomous administration and local business culture, drove this area for change, that is, engaging in household and private enterprise. The marginality of institutional legacy is not sufficient to explain the re-emergence of private enterprise in Wenzhou. The utilization of such marginality is necessary, in other words, this process is not a rational-choice model, instead, actors matter in the transformation of fields (Fligstein 2001). My findings detail how actors from different walks of life “translate existing rules and resources to produce local orders” (Fligstein 2001:116) in Wenzhou, including peasant entrepreneurs’ innovation and persistence in entrepreneurial activities, the local cadres’ protection and even encouragement, the central market-oriented leaders’ support, and market-oriented scholars’ framing.

In terms of the earliest categories of engaging in private enterprise, thirty archives of big peasant entrepreneurs show that previous experience in enterprises, state sector and individual business was significant for the starting of enterprises. The archive study shows eighteen entrepreneurs had worked in collective enterprises or state sector, seven were cadres (one township mayor, five village party secretaries, and one team leader), and five were farmers. The experience in state or collective sector supplied them some capacities of running private enterprise, such as expertise, skill, social network and

\(^{34}\) In the state-society framework, the society would be stronger when it was far away from the center
market experience. Some peasants’ entrepreneurship stemmed from their early experience of doing individual business like a guerrilla moving from one place to another or some travel experiences. The archive study also shows that some local cadres were directly involved in starting private enterprises individually or jointly.

The revival of private economy in Wenzhou experienced three stages in dealing with political risks. The beginning stage was from 1978 to early 1982. Some Wenzhou peasant entrepreneurs and local cadres firmly persisted in running household enterprises under the ambiguous and still hostile environment. *Guaahu* practice, an institutional innovation, first emerged in Jinxiang town in 1979, innovated by the township leaders, later spread to the whole region of Wenzhou. It largely boosted the development of household enterprises in Wenzhou. The harsh crackdown against household enterprises in early 1982 was a hard blow to the Wenzhou economy, meanwhile, some peasant entrepreneurs still persisted in their private business. Wenzhou leaders had to change their policy and became increasingly supportive to household entrepreneurs. The second stage was from late 1982 to early 1986. The local leaders began to encourage the development of household enterprises. As the household industries began to boom and the Wenzhou model was nationally popularized by newspapers in 1985, the central market-oriented leaders began to lend explicit support to Wenzhou. The institutional innovation, entrepreneurs’ persistence in engaging in household enterprise, local cadres’ protection and the market-oriented leaders’ support, led the practice going forward on the ground with growing legitimacy against the counterforce from the planning camp.

The third stage is theorization and legalization of private economy which involved intellectuals and policy makers from late 1986 to 1988. Using socialist rhetoric to frame Wenzhou’s capitalism largely legitimized private enterprise, in a theoretic and cognitive sense, which finally led to the legalization of private enterprise in Wenzhou in 1987 and nationally in 1988.

**Institutional change: framing and legalization**

The rise of the Wenzhou model and its development of individually owned private-sector enterprises mirroring the practices, norms, and forms of capitalist enterprises, demonstrate the significance of legitimacy in the change of institutions. Private sector practices in Wenzhou ran sharply against socialist orthodoxy and therefore the legitimacy of their market logics were widely questioned and criticized by state officials and intellectuals. Orthodox Marxism in China strictly emphasizes equality over efficiency, the state and collective sectors over the private sectors, the socialist collective ethic over the capitalist ethic of individual contribution.

The framing centered around the nature of Wenzhou’s individual economy, the size of private enterprise which relates to the definition of exploitation, inequality, private enterprise versus TVE, the essence of socialism, and the capitalist ethics. Market-oriented scholars and policy makers defended Wenzhou’s economy in several aspects: analyzing and evaluating socialism at the national level in order to minimize Wenzhou’s deviation from the socialist standard; pointing out that the private enterprise in Wenzhou is different from that in capitalism; downplaying the negative impact of private economy and emphasizing the contribution of wealth by the private economy through the comparison with the past poverty and the contemporary prosperity; coining the term non-labor value to replace the term of exploitation; emphasizing the tricking-down effect to
counterattack the egalitarianism which resulted in poverty; highlighting the wider applicability of Wenzhou model under China’s context; intellectuals glorified the private entrepreneurs’ philanthropic and hard working spirit.

It’s no surprise that this transformation in institutional logics coincided with the turnover of China’s central administration and governance structure, which lent these new practices a consecrated symbolic language of legitimacy. The economic crisis, together with the turnover of administration at the highest levels of central government, initiated the transformation of institutional logics and their newly won legitimacy. Strengthened by their successful on-the-ground experimental implementations, and framed in the popular media and in political discourse in the language of socialist rhetoric, this logic was quickly legitimated and its concomitant practices of private ownership in the market became widespread. Intellectuals and some officials who embraced the new institutional logic, emphasized the contradictions, shock, turbulence of the old logic, and framed the new as an attempt to improve on and reinterpret the old. These intellectuals did not interpret the new practice completely from a new rhetoric, they reinterpreted them by drawing in turn on Marxism, on its practical outcomes and successes. That is, they emphasized the structural, material conditions of economic life, and understood the situations they found themselves in; in other words, they combined framing and sensemaking to bring about institutional change.

Another strategy of their new framing was the strategic use of linguistic rhetoric to ward off possible negative reactions. Framing or rhetoric, as the art of persuasion, essentially amounts to a competition for public legitimacy through the mobilization of the symbolic. Yet in the Wenzhou case, discursive framings of private sector practices gained public support not simply due to the brilliance of their rhetoric, but also was supported by recent successful outcomes of these new market practices – the private economy – under the new criterion of legitimacy – efficiency, economic growth and a rising living standard.

The framing of capitalistic practice in Wenzhou also demonstrates how ambiguity in terminology can be utilized by intellectuals, journalists, and other producers of knowledge in the legitimization of new institutions. In the Wenzhou case, market elites, journalists, and intellectuals used a highly ambiguous set of Marxist terminologies to reinterpret the words and policies of central leaders, thereby gradually compelling institutional changes in on-the-ground economic practices which eventually came to be consecrated and institutionalized in the form of new policy passed by the central state.

Lastly, the framing of elite debates over the Wenzhou model also reveals how Chinese intellectuals understand markets. In China’s transition from socialism to what Deng Xiaoping famously called “socialism with Chinese characteristics,” pro-planning and pro-market advocated and interpreted the realm of the market in remarkably different ways. One might see the party line of market proponents in the Wenzhou debate as an echo of Albert Hirschman’s (1982) description of the market endorsed by liberal economists as emphasizing the positive effects of market institutions on civil society; and the view of the planning camp as echoing Fourcade and Healy (2007)’s description of the neoliberal market as a commodified nightmare in which markets undermine social relations, corrupt political life and corrode character.

**Development of private economy: transformation of local state**
The previous discussions show how different actors were involved and participated in the institutional establishment of private economy. After the legitimization of private enterprise, the interplay between state and market presented a different scenario. Wenzhou government assumed a variant of laissez faire state in the revival of private enterprise, such as hands off from the economy, innovating institutions to allow for the household enterprise donning legitimate identity, encouraging the development of household enterprises, advocating for the development of private economy through new framings. The government was active in defining and shaping the private property ownership, a key dimension of market institutions, whereas it was non-active in guiding, regulating and intervening in the economy.

The rapid growth of private economy in the early stage brought about chaotic competition and low level of product quality. Thousands of Wenzhou fake and shoddy commodities were found in the market, and the consumer association setting Wenzhou shoddy shoes on fire set alarm to the Wenzhou government in 1988. Furthermore, market-oriented leaders were ousted from the central leadership after the Tiananmen movement in 1989 and the planning camp strengthened its counterattack against the private economy. The central government sent three groups to Wenzhou to investigate whether Wenzhou was carrying out capitalism or socialism. And seven central departments jointly launched a campaign against Wenzhou fake and shoddy commodities. The coercive forces from the market and the central government pressured the Wenzhou government to transform from a laissez faire state to a regulatory state. The Wenzhou government became increasingly active in regulating the market. And the regulating assumed two forms. The first was through the sponsorship of the industry associations and the joint efforts of government and industry associations. Since the late 1980s tens of industry associations emerged, partly supported by the government. The associations were semi-autonomous in terms of their funding, operation and election, while, a crucial official of the associations was appointed by the government, who served as a liaison between the associations and the Wenzhou government. The industry associations assumed various tasks: emphasizing self-discipline among members, setting up product quality standards, inspecting industrial products with the government, offering training courses for enterprises in technology and product quality.

Aside from the associations’ efforts, the government further prioritized the product quality, and set a slogan “product quality is the life of Wenzhou”. The second method was more political and henceforth more powerful. The government strengthened the enforcement of cracking down on fake and shoddy commodities, and put great efforts in helping enterprises improve technology and product quality, such as offering favorable policies encouraging the technology renovation and innovation, investing and creating a better infrastructure including standard factory. In addition, the government began to support big enterprises to establish brands through favorable policies in land, tax, etc.

In the late 1990s, the efficiency and growth brought by the private economy in Wenzhou, coupled with a dominant advising of privatization in the central government which argued that private property ownership is crucial for the enterprise’s efficiency influenced by neo-liberalism, spurred another wave of learning from Wenzhou and a widespread wave of privatization across the country. Conditioned by the local features, the privatization in some coastal cities assumed different forms, for instance manipulated
privatization in Sunan owing to the legacy of strong government intervention in the collective economy (Zhang 2008). Aside from privatization, some cities exerted increasing efforts in attracting foreign direct investment in high technology industry and heavy industry, and they saw a rapid growth of GDP. However, Wenzhou began to see a declining growth of the local economy, and the growth rate declined almost to the bottom in Zhejiang province. Coupled with the slow growth were outflow of capital and industries, and locked in of labor intensive and low added-value industries, partly owing to the constraint of land, resources, and poor government service, although Wenzhou products gained same fame and established many brands.

Since 2003, Wenzhou started a campaign of learning from the country, and sent tens of visits to Suzhou, Shanghai, Dongguan, and Yiwu to learn the successful experience of attracting foreign direct investment, government service, market institutions and opening policies. The Wenzhou government also launched a campaign of liberating one’s mindset in order to change the cognitive understanding of Wenzhou model and Wenzhou economy. Many intellectuals, local officials, entrepreneurs and journalists advocated for better government service and strong support from the government. Some even advocated for the replication of the successful experience of strong state model from Suzhou. Against this atmosphere, the Wenzhou government began to play an active role in the economy and the market. The Wenzhou government encouraged the merger of big enterprises, served as a marriage broker between the local enterprise and foreign companies, improved its role in guiding and directing the economy, and investing in heavy industry such as seaport industry, petro-chemical industries. The replacement of the Wenzhou government leadership at the end of 2004 further advanced the strong state model. The appointment of new leaders intended to bring a successful model of attracting foreign direct investment from another city to Wenzhou on the one hand, and to develop heavy industry on the other, as one was experienced in attracting FDI, and one had rich experience in petrochemical industry and one had rich experience in seaport industry. The new leadership did exert great efforts in attracting FDI through substantial favorable policies toward the marriage between local enterprises and foreign companies, and in developing heavy industries.

Since 2003, Wenzhou began to see a rapid growth of FDI, and the growing ratio of heavy industry and big-medium enterprises, all these indicators were approaching closely to the comparative cities including Suzhou, Ningbo and Hangzhou.

Both of these transformations were ignited by the crisis. The first transformation was ignited by the product quality crisis, whereas the second one was ignited by the crisis of slow growth of GDP. Furthermore, they were driven by different mechanisms. More specifically, the first transformation was driven by market forces and the central government, while the second transformation was driven by regional competition, isomorphism and increased fiscal revenue. This study of local state transformation in China implies an empirical study of state transformation as organizational change. The change of the state as an organization is in the following aspects: the priority of policy making and law enforcement, and the structure of government. As illustrated in Wenzhou, in the early 1990s, the Wenzhou government prioritized the policy making of product quality and the enforcement of regulating the market. Coupled with the change of priority, the government sponsored the establishment of industry associations on the one hand, and assigned more personnel in inspecting the product quality. Since 2003, the Wenzhou
government prioritized the governmental guidance in the market, the heavy industry, the merger of big-medium enterprises, the FDI attracting and the large enterprises going public. The coupled governmental structure changes included the replacement of leadership indicating a strong intent to bring other successful models to Wenzhou, new policies of incentive for officials in attracting FDI, new design of governmental agencies in accordance with the ISO9000 standard, and establishment of governmental agency of IPO.

Furthermore, the convergence of developmental models across Wenzhou, Suzhou, Hangzhou and Ningbo illustrates the proposition of institutional isomorphism (DiMaggio and Powell 1983). The coercive isomorphism comes from the replacement of leadership, and the mimetic isomorphism comes from the successful models in Suzhou, Hangzhou and Ningbo. The adoption of ISO9000 by the Wenzhou government clearly illustrates the normative isomorphism.

However, Wenzhou’s isomorphism with Suzhou, Hangzhou and Ningbo featured its own characteristics given its strong foundation of private enterprise, particularly in the method of attracting foreign direct investment. Likewise, the privatization in Suzhou in the late 1990s which was modeled on Wenzhou also had its own features given the strong foundation of state guidance in the market.

As an extended case study, the transformation of Wenzhou state also illustrated the process of empowering state capitalism in China. Both transformations were not driven by the governmental rational adaptation to the environment. However, the driving forces shared a similarity, that is, the coercive power from the upper governmental agencies, which relate to an increasingly stronger neo-authoritarian regime. This regime reduced the “structural inertia” (Hannan and Freeman 1984) at the local level. From the central down to the local government, China is witnessing an empowering state capitalism.

Huang Yasheng (2008) argued that China experienced two drastically different reform phases in the 1980s and 1990s. He described the 1980s as “directional liberalism” and the 1990s as a complete reversal of that, arguing that there was a recentralization of power in the urban areas and at the center of government. His findings implied the existence of interventionist states at many levels since the 1990s. My findings are somewhat in line with his argument. An important reason for the revival of private enterprise and the laissez-faire state in Wenzhou in the 1980s was the support from the liberal leadership at the center. The directional liberalism faded after the Tiananmen movement in 1989, a crisis in the eyes of Communist Party, in another words. The movement prompted a new authoritarianism that began to dominate political ideology at the center. The state gained a stronger control of society since the mid-1990s, and moved toward an interventionist state. It was also strengthened by the fiscal reform in 1995 that recentralized fiscal power in the hands of the central government. Local economic crises prompted the replacement of the local leadership by the upper authorities. During the product quality crisis, Wenzhou’s governor, Dong Caocai, who was a strong advocate for the development of market economy in Wenzhou, was removed from his post. Since the mid-1990s, GDP growth became a central criterion for the promotion of local officials in an authoritarian personnel control system (Li and Zhou 2005). During the second crisis that featured slow GDP growth, Zhejiang provincial leaders decided to appoint Wang Jianman, the party secretary from Xiaoshan city to become Wenzhou’s party secretary.
The provincial leadership expected Wang to bring the Xiaoshan model of FDI led growth to Wenzhou. The new authoritarian regime, legitimized by GDP growth, pushed the local governments to be responsive to the local markets. In other words, the authoritarian regime, with its administration personnel control system that posited economic performance at its center, strengthened the competition, mutual learning and isomorphism across regions, thereby forcing the local state to be more adaptive and responsive to the markets. As the data shows, aside from Suzhou, Hangzhou and Ningbo, Wenzhou also saw the rapid growth in FDI growth, state investment, fiscal revenue growth rate, and rate of fiscal expenditures, in other words, an increasingly stronger state guidance and intervention in the market—an empowering state capitalism.

**Development of private economy: political connections in the market**

The extended case study of Wenzhou, plus some comparative illustrations of three coastal cities, demonstrated an empowering local state along the coast. To get a better generability of analysis, I moved onto a larger picture through the analysis of the 2006 nation-wide survey. Official statistics show that privatization is growing rapidly in both inland and coast, but the ratio of private investment over overall investment on the coast is constantly higher than that in the inland. My findings in chapter four also suggest that there is a converging tendency of the strong state model across Wenzhou, Suzhou, Hangzhou and Ningbo, four of which are on the coast. I tested how the variation of state intervention and privatization in the market impact the role of entrepreneur’s political connections in the private enterprise performance. I adopted the prominent divide between coast and inland as a demarcation of state intervention and privatization. The political connections include the Chinese Communist Party membership (CCP), People’s Congress membership (PC), and Chinese People’s Political Consultative Conference membership (CPPCC). The enterprise’s performance is measured by ROE.

The results of the survey analysis generate several findings: the impact of CCP membership and CPPCC membership on private enterprise’s performance is little, but the impact of PC membership is positive and significant; furthermore, PC membership contributed slightly significantly more to the enterprise performance on the coast than to those in the inland. The findings suggest PC membership, as the most powerful political connection among the three, matters significantly for private enterprise in China in 2005 when the privatization ratio is pretty high, and the entry of being a party member of private entrepreneurs became easier. Although my findings differ from Li et al’s (2008) in terms of the impact of CCP membership, the difference suggests that as privatization increases, entrepreneurs are seeking for more powerful political connections, that is, the impact of less powerful political connections declines, and the impact of more powerful political connections increases. PC membership’s larger contribution to the coastal enterprises than to the inland ones suggests that PC membership is more powerful and the state intervention might be stronger on the coast than in the inland. Finally, my findings suggest that PC membership does not have advantages in tax, and fee, however, it has advantages in obtaining loans, and the advantage on the coast is significantly positive as opposed to in the inland.

Overall, the results imply that as the private economy developed to a certain point, the state began to intervene in the market, and confirmed the extended study of Wenzhou which transformed from laissez faire state to regulatory state, then to a moderate
interventionist state. In other words, the quantitative nation-wide analysis further indicates a trend of empowering state capitalism, that is, a transition from a weakened state intervention to an increasingly stronger state intervention in the market.

**Theoretic implications**

Unlike the shock therapy adopted by USSR and East European Blocs, the formation of market institutions occurred in a gradual way in China. It was gradual in several ways: first, the private economy re-emerged in the marginal area, that is, Wenzhou was very poor in a socialist economy, weak in socialist administration, and marginal in Confucian culture; secondly, it was experimented in this area for a few years, and experienced one step back and two steps forward; the local cadres shouldered the political risk in allowing and even advocating for the development of private enterprise, local cadres and private entrepreneurs worked together to innovate news ways in legitimizing the private enterprise; third, scholars debated about the defining of private property ownership, and the local economic achievements made the market rhetoric more convincing, in addition, the market rhetoric adopted a revised Marxist rhetoric which reduced the resistance from the planning camp. In sum, the regulative and cognitive pillars of institutions (Scott 1995) got established gradually and transformed the fields through the constant interaction between the challengers and incumbents (Fligstein 1996; 2001), including alliance, power struggle and framing.

This research has a few theoretic implications regarding institutional change including the change of institutional logics and framing and regarding the interplay between state and market. It shows that the institutional transition from socialist planned economy to capitalist private economy occurred at the marginality of socialist economy, culture and administration, and suggests that the marginal placement has great potential to engender new institutions. This advanced what Fligstein proposed about the change in the field and the power relationship between the incumbent and challengers (Fligstein 2001). Fligstein’s theory is weak as to where the challengers come from. This study also follows the lines of using social movement literature to explain the institutional change and shows how intellectual and policy makers’ framing of the private economy facilitated the gradual transition in China. The framing also indicated how Chinese intellectuals and policy makers understand the private economy, and they see the development of private economy as a method of enriching people’s life and the nation’s wealth.

This study also suggests that neither decentralization theory nor the factional struggle theory is sufficient to explain the transition in China. This study takes the perspective of institutionalism to explore the drivers and actors in the institutional change, and suggest the locus of the challengers, how the challengers formed the alliance, the base and the strategies of challenger’s framing in legitimizing the new institutional logics.

In terms of the theoretic implications of the interplay between the state and the market, this study shows how the state transformed in response to the market, and how the state impacted the market at different stages. The findings reject a static understanding of the state-market relations. The changing interaction between state and market at the local level is conditioned by the macro institutions at the national level, that is, the “directional liberalism” (Huang 2008) in the 1980s driven by the crisis of Cultural Revolution, and the recentralization and neo-authoritarian regime since the 1990s driven by the crisis of the Tiananmen Movement in 1989.
It’s dangerous to make predictions about China as it is undergoing constant changes. However, some implications of China’s experience can be drawn from these analyses, that is, unless there is another political crisis and economic crisis, the state capitalism will strengthen, as the state’s power is unchecked by the society, and the rationale is further strengthened by developing large, capital intensive, heavy industry and high tech industries. As the state is growing stronger, what is the implication for the income per capita? Extensive research shows that although the strong state model in Suzhou led the economy to develop rapidly, the income per capita in Suzhou is lower than that in Wenzhou (e.g., Zhang 2008). It is safe to predicate that under such empowering state capitalism the inequality will continue to grow in the future unless China witnesses another big political risk and/or economic risk.
Appendix A

Research methodology

This research explores the interplay between the state and market in the formation of the market, and how this in turn leads to the transformation or reproduction of such structures. I chose to focus on the revival, legitimatization and development of private enterprise. My whole hypotheses are as follows: the economic and political crisis leads Chinese leaders to allow for the local autonomy to experiment with an alternative model – the development of private enterprises, the alliance between the local market model and market-oriented leaders and scholars makes the gradual transition possible; and as the private economy boosts the economy, the state becomes increasingly powerful.

To examine the interplay between the state and market along the line of historical development of private enterprise, I broke it into four more specific questions through the lens of institutional perspective: 1), how private economy first revived in Wenzhou, or what factors contributed Wenzhou to engender a new institution? 2), how private enterprise, and generally the market economy, a political taboo under Mao’s regime, became legitimizied? 3), how the development of private enterprise impacted the state’s ability in the market? and 4), how private enterprise performed under such market institutions. The first two questions focus on the birth of new institution, the rest two questions focus on the consolidation and adjustment of the new institution.

I adopted the theories of field (Fligstein 2001) to examine the first two questions, that is, the challenger and incumbent constantly interacted with each other to form and articulate the new institution with the emergence of fields. I examined the actors, driving force, legitimizing and interactions in this field. The method I used is mainly historical qualitative narrative. I did not clearly define the independent variables and dependent variables in chapter 2 and chapter 3, and it is largely interactive analysis (Rawski 1994). The current literature of factional struggle and decentralization model is not satisfactory in explaining the gradual transition, and the studies exploring the factors of Wenzhou’s takeoff are not sufficient either. I hypothesize that the gradual revival and legitimizing of private economy is experimental and that the market camp drew the success of Wenzhou model to justify the logics of new institution and to legitimize it nationally.

To examine the interaction among actors in the emergence of the field, I looked at the profile of peasant entrepreneurs, the evolution of local governmental policies, the alliance between the local officials and the central leaders including the visits and support from the central government, the replacement of Wenzhou leadership by the provincial government, the persistence of local cadres and peasant entrepreneurs. For the indicators for the progress of new institution, I looked at the percentage of individual and private economy, the proposal and establishment of experimental zone, innovation of guahu and spread of such practice.

As Wenzhou is the first place to give birth to domestic private enterprise, this determines the research site for my project is mainly in Wenzhou. The data in this chapter partly comes from my supplementary field research in Shanghai. Shanghai technicians played an important role in Wenzhou’s takeoff in early 1980s, and Shanghai media and academia were very active in advocating for Wenzhou model.

The major data sources are largely historical archives, and some are official statistics and news articles. Some historical archives are not open to the public. I could
access these archives thanks to the great help from my former college classmate who is a significant government official in Wenzhou. I also had some interviews with local officials, scholars and entrepreneurs to triangulate the validity of the historical archives.

To explore the process of legitimization, I adopted the method of content analysis. I researched the scholarly articles from 1984 to 1988 to examine how the market camp articulate and frame the concept of market, capitalism in China, and how they advocate for market-oriented reform, and how the scholars, entrepreneurs and market-oriented leaders formed the alliance to legitimize the Wenzhou model – a private economy model. I did not find many articles to defend Maoist socialism, which made my story somewhat one-sided. My speculation is that as the publication is always highly censored in China, and since the middle 1980s the market camp became increasingly powerful in the center, the ideology department may increasingly allow for the market voice and suppress the voices of Maoist socialism.

After the legitimization of private economy, the follow-up questions moved onto the interplay between the state and the market under the social reproduction of fields. The third question explores how the private economy impacted the state’s transformation, while the fourth question examines how the state impacted the performance of private firms. Chapter 4 tacked the third question. In this chapter I still focused on Wenzhou. I examined the state transformation through historical comparison of Wenzhou itself and horizontal comparison with Suzhou, Ningbo and Hangzhou. The major methodology is extended case study. I also incorporated some comparative analysis. My justifications for this choice are as follows. To examine the state’s transformation from a quantitative perspective is not easy, as the collection of the data at state level is rather difficult in China. A possible quantitative way for scholars to rely on is to analyze the official statistics. However, we need to be cautious in using China’s official statistics; furthermore, complete reliance on statistics would miss the dynamics in the real world. So I adopted multiple methods to triangulate the validity of the data. First, the extended case study on Wenzhou would show a deep insight of the dynamics between state and market with the development of private economy; secondly, the additional horizontal comparison would show more clearly about the relations among variables.

The existing literature largely treats state as a static institution. My empirical research showed that Wenzhou experienced two transformations, that is from a laissez faire state to a regulatory state, and then from a regulatory state to an interventionist state. Drawing on adaptation theory and institutional isomorphism, I hypothesized that both mechanisms work together to drive these transformations. The unit of analysis is state. I developed several measures to measure the state transformation: state’s efforts in intervening in the market such as encouragement for enterprise’s merge and attracting FDI, state’s efforts in creating rules and agencies to regulate the market, and state’s direct investment in the market. The driving force I explored included the feedback from the market, the pressure from the central government, the competition between regions and the replacement of leadership by the provincial government.

The data mainly comes from my fieldwork in Wenzhou, partly from my supplemental field research in Shanghai, Yiwu, Shaoxing and Hangzhou, the latter three are cities in Zhejiang province. Many of Wenzhou big corporations are now headquartered in Shanghai, and Wenzhou businesses have wide connections in Yiwu and Shaoxing. As discussed above, I chose Hangzhou as a supplemental research site for the
purpose of comparison. For the data of Suzhou and Ningbo, I used the second-handed materials. There is already extensive research on Suzhou – the representative of Sunan model, and Ningbo is geographically close to Hangzhou and also socioeconomically similar to Hangzhou. The data sources include historical archives, official statistics, and news articles. I also did extensive in-depth interviews with officials, scholars and entrepreneurs. I adopted snow-ball sampling for in-depth interviews. As the unit of analysis is not about official and entrepreneurs, but the historical transformation of state, so snow-ball sampling is good enough for the validity of data. The trust in ethnography study is always an academic issue, particularly in a strong-tie society such as China. I spent quite a few months to hang out with my informants and to gain trust with each other; aside from my college classmate, I also have two other close friends in Wenzhou, and their introduction largely enhanced the trust between my informants and me. I checked the validity of my field notes back and forth as the trust increased.

As chapter 4 shows that there is a convergence of strong state model across four coastal cities, the follow-up questions in chapter 5 are how the empowering state capitalism influenced the firm performance and how is the state-firm relation in inland. Chapter 4 adopted method of extended case study and comparative analysis to examine the state’s transformation, attempting to draw the conclusion from micro to macro and to gain deep insight of the dynamics between market and state from the perspective of state. For chapter 5, the unit of analysis is at firm level, so a quantitative analysis at national level is more appropriate for the sake of generalizability. In order to explore how state impacts firm performance or state-firm relations, I choose to focus on how entrepreneur’s political connections influence firm performance.

I hypothesized that the benefit of political connections for firm performance varies with the power of political bodies, membership in the PC is most beneficial, while membership in the CCP and the CPPCC are less beneficial. I test the hypothesis by estimating the profitability equations using ROE and ROA. The dependent variable or profitability in this chapter is private firm performance, which is measured by return on equity (ROE) and return on assets (ROA). And the independent variable is political connections, which is measured by the CCP membership, PC membership and CPPCC membership. A complete set of control variables include entrepreneur’s attributes (age, gender and education), firm’s attributes (size, industry and year of operation) and the provincial privatization ratio. In addition, I examine how the divide between coast and inland moderates the relationship between political connections and private firm performance, so I created a dummy variable coast as a moderate variable. The method I use is ordinary least squares (OLS) regression. The firm data that I use comes from a nationwide survey of privately owned enterprises in 2006 (for a more detailed description of the data, please see chapter 5).
Appendix B, Definitions of variables in chapter 5

<table>
<thead>
<tr>
<th>Variable name</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coast</td>
<td>A dummy variable which equals 1 if an entrepreneur is from either of the following 11 coastal provinces: Liaojing, Hebei, Beijing, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong, Hainan, Guangxi</td>
</tr>
</tbody>
</table>

**Owner's attributes**

<table>
<thead>
<tr>
<th>Variable name</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>CCP</td>
<td>Party membership A dummy variable which equals 1 if an entrepreneur is a party member, and 0 otherwise</td>
</tr>
<tr>
<td>PC</td>
<td>PC membership A dummy variable which equals 1 if an entrepreneur is a member of the People’s Congress at any level, and 0 otherwise</td>
</tr>
<tr>
<td>CPPCC</td>
<td>CPPCC membership A dummy variable which equals 1 if an entrepreneur is a member of the Chinese People’s Political Consultative Conference at any level, and 0 otherwise</td>
</tr>
<tr>
<td>Senior High</td>
<td>A dummy variable which equals 1 if an entrepreneur’s education is senior high or below, and 0 otherwise</td>
</tr>
<tr>
<td>College</td>
<td>A dummy variable which equals 1 if an entrepreneur’s education is college, and 0 otherwise</td>
</tr>
<tr>
<td>Graduate</td>
<td>A dummy variable which equals 1 if an entrepreneur’s education is graduate, and 0 otherwise</td>
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</table>

**Firm's attributes**

<table>
<thead>
<tr>
<th>Variable name</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (million yuan)</td>
<td>Number of persons employed. (take the value of 1 for a worker employed for the whole-year; 0.5 for employment for less than one year but more than 6 months; and 0.25 for employment for less than 6 months</td>
</tr>
<tr>
<td>Employment</td>
<td>Return on assets</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on equity</td>
</tr>
<tr>
<td>ROE</td>
<td>Amount of debt divided by total assets)</td>
</tr>
<tr>
<td>Leverage</td>
<td>Log(asset)</td>
</tr>
<tr>
<td>Size</td>
<td>Loan balance from banks at the end of 2001</td>
</tr>
<tr>
<td>Total Current loan (million yuan)</td>
<td>Amount of taxes divided by sales in 2001</td>
</tr>
<tr>
<td>Tax/sales</td>
<td>Amount of fees divided by sales in 2001</td>
</tr>
<tr>
<td>Fee/sales</td>
<td>Years of operation since established</td>
</tr>
</tbody>
</table>

**Other control variables**

<table>
<thead>
<tr>
<th>Variable name</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector indicators</td>
<td>16 industry sector indicators</td>
</tr>
<tr>
<td>Provincial indicators</td>
<td>the privatization ratio of 31 provinces</td>
</tr>
</tbody>
</table>
### Appendix C, List of informants

<table>
<thead>
<tr>
<th>Informant</th>
<th>Position</th>
<th>Unit</th>
<th>Location</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informant 1</td>
<td>Professor</td>
<td>Party school</td>
<td>Wenzhou</td>
<td>September, 2007</td>
</tr>
<tr>
<td>Informant 2</td>
<td>Professor</td>
<td>Party school</td>
<td>Wenzhou</td>
<td>September, 2007</td>
</tr>
<tr>
<td>Informant 3</td>
<td>Official</td>
<td>Bureau of Industry and Commerce</td>
<td>Lucheng, Wenzhou</td>
<td>October, 2007</td>
</tr>
<tr>
<td>Informant 4</td>
<td>Entrepreneur</td>
<td>Garment factory</td>
<td>Wenzhou</td>
<td>October, 2007</td>
</tr>
<tr>
<td>Informant 5</td>
<td>Entrepreneur</td>
<td>Shoe factory</td>
<td>Wenzhou</td>
<td>October, 2007</td>
</tr>
<tr>
<td>Informant 6</td>
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<td>Bureau of Industry and Commerce</td>
<td>Wenzhou</td>
<td>November, 2007</td>
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<tr>
<td>Informant 7</td>
<td>Manager</td>
<td>Venture capital corporation</td>
<td>Wenzhou</td>
<td>November, 2007</td>
</tr>
<tr>
<td>Informant 8</td>
<td>The associate head</td>
<td>Bureau of Industry and Commerce</td>
<td>Wenzhou</td>
<td>November, 2007</td>
</tr>
<tr>
<td>Informant 9</td>
<td>Professor</td>
<td>University</td>
<td>Wenzhou</td>
<td>February, 2008</td>
</tr>
<tr>
<td>Informant 10</td>
<td>Entrepreneur</td>
<td>Garment factory</td>
<td>Wenzhou</td>
<td>February, 2008</td>
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<tr>
<td>Informant 11</td>
<td>The secretary of the Wenzhou party secretary</td>
<td></td>
<td>Wenzhou</td>
<td>February, 2008</td>
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<tr>
<td>Informant 12</td>
<td>Professor</td>
<td>University</td>
<td>Wenzhou</td>
<td>March, 2008</td>
</tr>
<tr>
<td>Informant 13</td>
<td>Official</td>
<td>Finance bureau</td>
<td>Wenzhou</td>
<td>March, 2008</td>
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<tr>
<td>Informant 14</td>
<td>Associate head</td>
<td>Finance bureau</td>
<td>Wenzhou</td>
<td>April, 2008</td>
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<tr>
<td>Informant 15</td>
<td>Official</td>
<td>The Development and Planning Committee</td>
<td>Wenzhou</td>
<td>April, 2008</td>
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<td>Informant 16</td>
<td>Official</td>
<td>The Development and Planning Committee</td>
<td>Wenzhou</td>
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<tr>
<td>Informant 17</td>
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<td>Wenzhou</td>
<td>May, 2008</td>
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<tr>
<td>Informant 18</td>
<td>Associate head</td>
<td>Statistics bureau</td>
<td>Wenzhou</td>
<td>May, 2008</td>
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<tr>
<td>Informant 19</td>
<td>Secretary of the mayor of Wenzhou</td>
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<td>Wenzhou</td>
<td>May, 2008</td>
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<tr>
<td>Informant 20</td>
<td>Associate mayor</td>
<td></td>
<td>Changnan, Wenzhou</td>
<td>May, 2008</td>
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<tr>
<td>Informant 21</td>
<td>Manager</td>
<td>Low voltage enterprise</td>
<td>Yueqing, Wenzhou, Wenzhou</td>
<td>May, 2008</td>
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<tr>
<td>Informant 22</td>
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<td>Bureau of technology</td>
<td>Wenzhou</td>
<td>June, 2008</td>
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<td>Wenzhou</td>
<td>October, 2007</td>
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<td>Entrepreneur</td>
<td>Apparel factory</td>
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<td>October, 2007</td>
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<td>Informant 25</td>
<td>Entrepreneur</td>
<td>Apparel factory</td>
<td>Ouhai, Wenzhou</td>
<td>October, 2007</td>
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