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The Nature of the Chinese Formation and the Making of Its Welfare Regime: A Comment on Philip Huang's "Profit-Making State Firms and China's Development Experience: 'State Capitalism' or 'Socialist Market Economy'?"

Ivan Szelenyi[1,2]

Abstract

The driving forces of the Chinese economy since the reforms of 1978 are the subject of intense scholarly debate. Some emphasize the role of private entrepreneurship; others identify the public/collective sector, local or central state as the engine of Chinese growth. This article suggests that the first decade of the Chinese reform was entrepreneurial. During the 1980s, the transformation stemmed "from below." Since the 1990s, the change has been state-led, "from above." With the privatization/marketization of the corporate sector

[1]Yale University, New Haven, CT, USA
[2]New York University, Abu Dhabi, United Arab Emirates

Corresponding Author:
Ivan Szelenyi, New York University, Abu Dhabi, P.O. Box 129188, Abu Dhabi, United Arab Emirates
Email: ivan.szelenyi@yale.edu

the revenues of state-owned/controlled firms increased, but the source of these revenues was the privileged relationship of the public sector to the state, hence state-owned enterprises collected rents rather than earned profits. The "Chongqing model" has used some of these rents to fund welfare provisions with remarkable success, but a sustainable welfare system in a market economy has to be based on taxes collected from market-generated incomes and profits rather than rents of state-owned enterprises.

Keywords

property rights, modes of economic integration, welfare

Philip Huang, in his "Profit-Making State Firms and China's Development Experience: 'State Capitalism' or 'Socialist Market Economy'?" revisits the much-debated question about the nature of Chinese formations. Commentators tend to agree: the Chinese economic formation after 1978 became a mixed one. It combines private and public ownership, markets and redistribution. There is on the other hand an intense debate about whether the Chinese "mix" in the early twenty-first century can be called socialist—"socialist market economy"—or should be seen as some version of capitalism—for instance "state capitalism." Huang offers an innovative approach to the problem.

1. Huang challenges the neoliberal position, which assumes that China's dynamic economic growth can be attributed to the emergent private sector and the conversion of public property into private. He claims that China in the fourth decade of its economic reforms not only has a sizeable public sector, but this public sector is also the driving force of China's development.
2. He believes that the economic success of China can be attributed to the public sector because the state-owned enterprises (SOEs) are profit oriented and market integrated. The public sector has "comparative institutional advantages" over the private sector that makes it even more profitable.
3. The shift from redistribution to market integration—despite the survival of a substantial public sector—created unsustainable economic inequalities and environmental deterioration. China was giving up its socialist commitment to social justice and equality: it was becoming primarily a "state capitalist" formation.

4. Nevertheless, as the Chongqing model has demonstrated, the public sector can rely on its "comparative institutional advantages" and if there is appropriate political will, the public sector's profit can be used for the welfare of the "people at large," the "whole people," and hence China could turn indeed into a "socialist market economy." The nature of a formation, whether capitalist or socialist, depends on the purposes for which the profit or surplus is used.

In what follows, I will comment on each of these statements or claims.

Private versus Public Ownership

Philip Huang emphasizes that after three decades of reforms China still has a large and vibrant public sector, which is a major force behind China's economic development.

It is not that simple to define property rights—and it is especially challenging in a country like China, where "politics is in command" and a "communist" party rules. The declared political aims of the Chinese Communist Party (CCP) can easily cloud the nature of property rights. In the 1980s, private ownership was only tolerated and it is conceivable that some private firms might have been packaged as if they were collectives. Next to family farms, township and village enterprises (TVEs) were undoubtedly the driving forces of economic growth during the first decade of the reform (and have remained important since). Jean Oi saw TVEs as collectives: hence the role they played was evidence that local government rather than private entrepreneurship was the foundation of the success of the reform (Oi, 1992). Yasheng Huang, on the other hand, claims that TVEs only masqueraded as collectives; he claims only 1.5 million of the 12 million TVEs during the mid-1980s were actually collectives—the rest were private firms (Yasheng Huang, 2008: 103).

As during the late 1990s privatization became official policy, the question of property rights became even more muddled. Yasheng Huang suggests that many companies that are classified as "private" may actually be "public." OECD regards all firms whose shares are held by "legal persons" as "private," but as Yasheng Huang points out, the "legal persons" who "privatized" SOEs may themselves be (and often are) in the majority or wholly publicly owned (Yasheng Huang, 2008: 15–16). The actual ownership may be multiple cross-ownerships among public institutions (not that far from what Stark called in the East European context "recombinant property rights"; Stark, 1996).

In Eastern Europe during the early 1980s, when privatization of state-owned enterprises was regarded as impossible by most economists,[1] some considered conversion of the public sector into a system of "holding companies." Hence as the first step of the reform they intended to establish a number of state-owned commercial banks, which would compete with each other on the investment markets and which would purchase the stocks of SOEs as they were corporatized. If I read Yasheng Huang correctly, privatization in China during the first decade of the twenty-first century may not have been all that different from this (never realized) East European scheme.

There is another problem with Chinese property rights—which may lead to errors in the opposite direction in estimating the extent of the private sector. As Philip Huang points out, 59 out of the 61 Chinese corporations which made it to the Fortune 500 list are public companies. He estimates the number of SOEs under central and especially local government control can be over 100,000. But he does not reflect on the controversial property rights of cadres, or princelings. There is widespread suspicion that children of "revolutionary heroes" who hold public office (some as managers of publicly held firms) are actually individually very wealthy and may be the actual owners of the companies they formally only manage. This was a component of the scandal that erupted with the removal of Bo Xilai from office.

Hence, it is terribly difficult to tell which firms in China are actually private and which are public, what proportion of the GDP is therefore produced by the public or the private sector, and which sector contributes how much to the dynamism of the economy.

Not surprisingly, the estimates of the two sectors vary widely. OECD put the share of the private sector in the production of industrial value added at 71.2 percent in 2005; Yasheng Huang estimated (by defining legal persons as "public") the contribution of the private sector to be a mere 39.8 percent (Yasheng Huang, 2008: 16). Philip Huang seems to be in the ballpark when he claims that the public sector is still close to half of the non-agricultural GDP.

The definition of property rights in China under CCP rule is indeed muddy. Nevertheless, two facts are undisputed. First, China did not touch the urban public sector until the end of the second decade of the reform: privatization of the SOEs (whatever that means) came relatively late (in post-Soviet Russia and its European satellites it began in the first stages of the transformation). Second, in the non-agrarian sector while the growth of the private sector is undisputed there remains a substantial public sector even after the fourth decade of the reform.

But, Philip Huang's optimism about the success of the SOEs, their dynamism and profitability, and their role as the engine of economic growth is not

shared by all observers. The most recent challenge to this position comes from Nee and Opper (2012). Nee and Opper claim that the capitalism in China is coming "from below" as individual private owners drive the transformation of China's socioeconomic system and gradually squeeze the ineffective, unprofitable public sector out. Hence, is the Chinese transformation led "from above" by the public sector directed by the central or the local state, or is a new capitalism (or market socialism) being built in China "from below" by the forces of private entrepreneurship?

I am using Yasheng Huang to be an arbitrator between Philip Huang and Victor Nee. Yasheng Huang identified the first decade[2] as the "entrepreneurial" one (Yasheng Huang, 2008: 50–108), when the transformation took place mainly in the rural areas and was driven by self-employed enterprises (*geti hu*) and TVEs. While the public–private character of TVEs can be disputed, it is obvious that at first the new economy emerged from family farms and from local, small-scale, market-oriented industrial enterprises (TVEs). This was the opposite of the transformation strategy in Russia and Central Europe, where the privatization of the corporate sector was on the reform agenda very early on.

Therefore, in order to capture those features of the Chinese transformation that distinguish it from the Russian or Central European pathways away from redistribution, I labeled—much like Nee and Opper—the Chinese trajectory as a process "from below" while I claimed that in Russia and Central Europe capitalism was built "from above" (Eyal, Szelenyi, and Townsley, 1998: 184; King and Szelenyi, 2005: 213).

During the Chinese transformation from below, the state, without touching the public sector, created new spaces, which (typically small-scale) entrepreneurial initiative could burst into. This is what Yasheng Huang called "directional liberalism" (2008: 34). These policies were "directional" since the party-state set the parameters of the changes, but they were "liberal" or permissive to bottom-up, small-scale entrepreneurial activities. This was the opposite of what has happened in "top-down" fashion in post-communist Russia and Central Europe, where the key aim of the reform was to transform the property relations in the corporate sector and where the rapid deregulation of the economy suffocated small entrepreneurial activities by opening them up to competition from advanced Western economies.

The transformation in China started bottom up but it turned top down during the 1990s when a major reversal in economic policies occurred (Yasheng Huang, 2008: 109–74). Power was recentralized, tax revenues began to fly back to Beijing, earlier liberalism toward indigenous private capital was toned down, and the focus was shifted to the reform of the publicly owned

corporate sector. Rather than creating new spaces for new (small) private firms, now the policy is aiming at privatizing the corporate sector and creating market integration within the public sector.

Hence, paradoxically both Philip Huang and Victor Nee can be right: they only theorize different stages of the Chinese transformation. China in 1978 took off "bottom up," change was "from below" and was entrepreneurial, but it turned during the 1990s into "top down." Nee offers the best-fitting model for the 1980s; Philip Huang (and Yasheng Huang) capture better the dynamics of the 1990s.

But does it matter whether the transformation begins from below or from above? In rather significant ways, it does (see also Hamm, King, and Stuckler, 2012, about the costs of mass privatization, capitalism from above). In the former USSR and its European satellites the process that started from above—the fast, mass privatization of the corporate sector—lead to massive job losses, a sharp decline in GDP, a jump in mortality, and so on. The relative success of the Chinese transformation can be attributed to a better sequencing of the reform (starting it bottom up before turning it into top down).

Some neoclassical economists and neoliberal politicians may be in too much of a rush to believe that economic efficiency can only be achieved by "clearly identifiable"—meaning "private-property"—rights. Nee arguably errs—if he errs at all—on this side. Philip Huang (and Oi-Walder), on the other hand, may not sufficiently appreciate how important private initiative, especially small-scale private business, was in the early years in turning the Chinese economy around.

My first thesis in this article: the Chinese reform in 1978 started from below. The economic success was driven by small-scale and mainly private entrepreneurship. During the second and third decade of the reform the emphasis shifted to the corporate sector, and China began changing more "from above," partially by privatization of corporations, partially by changes in the management methods of this sector (and by opening up to multinational capital). Whether this shift "from below" to "from above" was for the better or worse can be disputed. For Yasheng Huang it was a change for the worse and in his view in the third decade of the reform the Hu-Wen leadership made a partial return to the early entrepreneurial model. Hence, for Yasheng Huang the solution is more liberalism and more capitalist welfare state. In Philip Huang's view it was the socially insensitive excessive marketization that pushed China onto an unsustainable non-egalitarian state capitalist road. For him the solution is a socialist commitment by the political leadership to use the profits of market-coordinated public firms for the public good.

Market Integration of the Public Sector

Philip Huang seems to accept at least half of the neoclassical argument. He does believe that efficient economies have to be market integrated. He only rejects the neoclassical assumption that markets can exist only in economies where the factors of productions are privately owned. Hence market socialism is a historical potentiality. Let me reflect on two questions (and offer some modifications to Huang's position): can a public sector be market integrated? Is a public sector that is redistributively integrated always and necessarily inefficient?

The idea of "market socialism" is not new; it was first formulated by Oscar Lange in the 1930s (Lange, 1936–1937). Lange, a committed socialist, was disappointed by the inefficiencies of the Soviet economy and believed abandoning rigid central planning in favor of market integration can turn a publicly owned and run economy into an efficient one.

In the classical economics of Adam Smith, the question was not even raised: of course the transition to commercial society was the establishment of private property rights where the economy was coordinated by markets, by the invisible hand. The solution to the contradictions of capitalism was equally simple for classical Marxism. Of course, the appropriation of appropriators went hand in hand with the substitution of the anarchy of the market with rational (rational and democratic) planning.

Following Lange's pathbreaking work, many attempts were made to integrate firms in a public economy through market mechanisms. This was often met with skepticism by theorists both among neoclassical and Marxist economists and moderate success in economic policies. Some neoclassical economists (Friedrich Hayek in particular; Hayek, 1944) tended to see any planning (beyond planning for free markets) as creeping socialism, which eventually will lead to a collectivized economy and "slavery." Some Marxists, in particular the Maoist Charles Bettelheim (1976), suspected that replacing planning with markets will eventually turn property relations into private ones and regarded the Soviet Union, which implemented some measures of market integration during the early 1960s among state-owned firms, as state capitalist.

But what are the relationships between various property forms and modes of economic integration (or forms of coordination)? In searching for an answer to this question, I will try to work my way through with Kornai's theory of "soft budget constraints" (Kornai, 1980) and Polanyi's theory of modes of economic integration (Polanyi, 1944; 1957). Philip Huang, in my view, unfairly suggests that Kornai had a binary theory, identifying public property with soft budget constraints (and therefore suggesting private property can

guarantee an efficient economic system) and defining private ownership with hard budget constraints and efficiency.

I would like to offer a few amendments to Huang's interpretation of Kornai.

In my reading, Kornai's position shifted from the *Economics of Shortage* (1980) to *The Socialist System* (1992), and Philip Huang's interpretation is a better match with the later work. But in *Economics of Shortage*, Kornai is far from operating within a binary opposition. He offered a "mirrored comparison." That term was coined by David Stark, reflecting the comparative method Kornai used (and let me add with due immodesty: I also have used this method since the late 1960s) during the 1970s and most of the 1980s (Stark, 1986). Purely collectivist economies tend to operate with "soft budget constraints," which results in chronic shortages; purely capitalist economies have firms with hard budget constraints, which results in cyclical crises of overproduction. Private firms in capitalist economies actually often have soft budget constraints as well (Kornai, Maskin, and Roland, 2003). Softening budget constraints in capitalist economies under certain conditions may be good economic policy: you may bail out banks if they are "too big to fail." Many economists (with particularly great eloquence Paul Krugman in his op-ed pieces in *The New York Times*) urged in 2011–2012 that Germany soften the budget constraints imposed on Greece and other southern European countries so they would be put on a growth trajectory before they could harden their budget constraints. This is all consistent with Kornai's *Economics of Shortage* (and Oliver Williamson's theory of market/hierarchies, transaction costs; 1986). In my reading, the bottom line in Kornai's work was: pure types tend to break down; mixed economies have the best chance of surviving. *Economics of Shortage* is far from being an apologia for the "invisible hand"; rather, it is a masterpiece of critical political economy using the method of mirrored comparison rather than offering a critical analysis of one undesirable system from the perspective of another, desirable one.

In *Economics of Shortage*, there is no theory of coordinating mechanisms; hard and soft budget constraints are linked to property forms rather than coordinating mechanisms. Kornai incorporates Polanyi's theory of modes of economic integration (and my adaptation of Polanyi's theory to modern economies; see Konrad and Szelenyi, 1979) in his 1984 article. Polanyi's distinction between market and redistribution, much like Kornai's concepts of soft and hard budget constraints, also involves "pure types." Polanyi is also a theorist of mix economies since he does not believe that an economy operating with one mode of integration is sustainable. Hence he calls for redistributive intervention in case of market failure (such failures will inevitable happen in

unfettered markets). Kornai implements a slight terminological change (he substitutes "coordinating mechanism" for "modes of economic integration" and defines socialist economy as "bureaucratically coordinated" rather than "redistributively integrated"). This paper is a tour-de-force since it established astutely the elective affinity between forms of ownership of coordinating mechanisms. Private property tends to have an affinity with market coordination as much as public property has with the bureaucratic one. But in my interpretation in 1984 there is no simple causal determination between forms of ownership and coordinating mechanisms. Given elective affinity between property rights and modes of integration, an unlimited variety of mixed economic systems is possible. It can be assumed that mixed systems tend to be more adaptable to challenges than pure forms (Polanyi is also clear about this). Why does Kornai in 1984 need Polanyi and the concept of economic coordination? He was looking for the causal mechanism that links forms of property to the nature of budget constraints. It is the redistribution of surplus for extended reproduction (not public ownership per se) that is the causal mechanism leading to soft budget constraints.

Let me also concede that Philip Huang offers a rather authentic reading of the later work of Kornai. In a lecture he delivered in Moscow in March 1989 (this is chapter 2 in Kornai, 2008), he tightened his analysis and indeed suggested that the choice between property rights and forms of economic coordination is a "package deal"; if you want hard budget constraints (and economic efficiency), you have to opt for private property rights. Most of the work of Kornai after 1989 suggests there is no "à la carte"; economic policy choice is a "Prix fixe menu." This is more consistent with his *The Socialist System* (1992) and the neoclassical position rather than the classical (not neo!) institutionalism of *Economics of Shortage*.

Let me return now to the possibility of market socialism. It seems to be a reasonable position that in economic policy there is indeed no completely open "à la carte," but there is not a rigid "Prix fixe menu" either. Kornai's 1984 formulation about "elective affinity" is the more accurate one. If the factors of production are exclusively or dominantly publicly owned, then the economy tends to be bureaucratically coordinated or redistributively integrated and the major problem the economy struggles with will be the softness of budget constraints and the tendency for chronic shortages. Economies where factors of production are in private hands tend to be market integrated, and they usually have quite hard budget constraints—and the closer they are to the pure types the more likely they will suffer from chronic overproduction.

After this rather lengthy theoretical digression let me return to the property rights and modes of economic integration in the Chongqing model—as I

understand it. In Philip Huang's analysis, the Chongqing model is as close to the ideal of "market socialism" as possible. In the Chongqing model although most state firms operate in infrastructural development and public services, not all do so. There are some SOEs in the sphere of production—and all are in fierce competition, and their success is measured by their profitability. They generate substantial profits and this has propelled a "stunning GDP growth at an average of 16 percent per year in the past five years (2007–2011)." The most intriguing and innovative suggestion by Huang is that state firms do have a "comparative institutional advantage" over private firms and it is that, rather than abundant cheap labor, usually identified as the engine of China's unprecedented growth, which is the source of high "profits" in the public sector and overall economic success.

But what are those "comparative institutional advantages"? Let me cite Philip Huang: "In the new competitive and marketized environment of China's mixed economy, the state enjoys obvious advantages vis-à-vis private enterprises, in overcoming bureaucratic obstacles, in mobilizing resources, in providing special subsidies and tax breaks, in bending or violating its own laws and regulations on labor and the environment, and so on, all to make the [state-owned] enterprise more profitable."

I find this quote crucial and it indeed specifies the institutional arrangements that give an advantage to the public sector. Let me start by stating: I find nothing objectionable in the state giving preferential treatment to the firms it owns. This means nothing more than the state exercising its property rights over its own property. Does this in any way threaten the efficient functioning of the economy? Not necessarily; the outcome depends on the concrete circumstances. Preferentially managed public firms can foster successful macroeconomic performance. Thus, for instance: the economy is heading into a recession; the rate of unemployment is increasing; consumer-demand is shrinking; deflationary pressures are building up. Under these circumstances it makes a lot of sense for the public sector to maintain or even increase the level of employment by offering publicly owned firms special treatment and indeed "soften their budget constraints," giving them tax benefits, even subsidies.

My only question is: why is this market integration? This—in my understanding—is the opposite of market integration. It can be a (wise) redistributive intervention of the state in which private profits (mostly future earnings—hence using budget deficits or increasing sovereign debt) are rechanneled to the public sector to boost the economy. The U.S. economy would have benefited if state governments had done this in 2008–2012. Rather than

reducing public employment (which is what many state governments did) they should have expanded it. If they would have done so in the proper way (creating jobs with multiplier effects, hence jobs *not* in public service, but in the sphere of production), the United States and the world economy would be in better shape today. The Chinese economic leadership followed the recipe of Keynes (and rather successfully, managing the global crisis better than any other country in the world) in dealing with the 2008–2009 global financial crisis. It channeled some 600 billion dollars into the economy, almost all of it into the public sector ("In Downturn, China Sees Path to Growth," 2009; von Roda, 2010). I call this massive—and well-used—redistribution.

If the Chongqing municipality did what Philip Huang suggests it did, then it indeed rechanneled (redistributed) resources from the private sector to the public and invested them in a smart way. It did the right thing, but this had preciously little to do with markets. So is this a system of "market socialism"? It hardly is. It is "socialist" to the extent there is a dominant public sector, which can redistribute its revenues for politically defined purposes, such as achieving social justice and equality rather than profit maximization. If the state is the real owner, it has (and should have) the right to expropriate (some of) the revenues from the firms it owns and allocate those according to political criteria. Finally, since the revenues of publicly owned firms exceed the profits of private companies inasmuch as SOEs have special privileges (less bureaucratic red tape, subsidies, etc.), those are rents rather than profits (since they arise from— at least in part—a monopoly and not free competition).

So I disagree with Philip Huang on two counts. First, I do not see the system he has described as a "market" coordinated one. As he tells us, for its own companies, Chongqing municipality has bypassed the bureaucratic obstacles private firms have had to deal with; it has mobilized resources to support SOEs; it has offered them special subsidies and tax breaks and adjusted its own laws. "Politics is in command," the state has acted as "redistributor" rather than impartial referee. Second, since I believe in the viability (and desirability) of mixed economies (combining public and private ownership, markets and redistribution), I do not accept the premise that the public sector can only be efficient if it is market coordinated. The public sector (if it is indeed "public") will always have a redistributor-owner state, but if its management is uncorrupt and competent, it can (and must) play a crucial role in correcting market failures. This does not reduce but increases the overall efficiency of the economic system. Public ownership and redistribution—if offered in appropriate doses and at appropriate times—are good for the economy and society.

Modes of Economic Integration and Inequalities: Welfare Systems in Transition from Redistribution to Market Economy

Philip Huang proposes a new welfare model derived from the Chongqing model: the profits generated from the "comparative institutional advantages" of publicly owned but market-integrated firms can be used by the governments to fund welfare provisions, subsidize public housing, free education, free health care, appropriate pension funds for the whole people who are, in principle at least, the owners of the public firms anyway. It could be an alternative to the Western-style welfare state model (be it liberal, conservative, or social democratic), where welfare is funded from taxes from market-generated private incomes and from welfare regimes where private firms provide welfare provisions for their employees (such as the Japanese welfare system).

The question of the sources of inequalities is uncontested in the social science literature. Both neoclassical economists and Marxists agree: markets create inequalities. Neoclassical economists tend to emphasize that such inequalities are necessary to create sufficient incentive for economic activity, and Marxists blame inequalities on the exploitation of the capitalist system, but there is no disagreement between the two schools of thought about the sources of inequalities.

Adam Smith disagreed. He lived and theorized under the conditions of transition to a commercial (capitalist) society from an agrarian (feudal) one, hence market transition for him meant undermining traditional privileges. Under these circumstances the market might mean more equality or at least more equality of opportunity. But Adam Smith was long forgotten until the transition from socialism to capitalism took place.

In 1988, Victor Nee in an agenda-setting article offered the provocative proposition that market transition serves the interest of the poor, what he called the "direct producers"; it is the "cadres" who are the losers in the transition. A firestorm erupted: how could he claim the direct producers win from markets when we know cadres benefit no matter what (see, among his critics, Walder, 1996, Xie and Hannum, 1996 and many, many others) and markets can only generate inequalities anyway? I was also engaged in this controversy. In my empirical work during the 1960s in socialist Hungary, I observed that bureaucratically allocated (redistributed) scarce resources typically went to the already privileged. Ironically, socialist "redistribution" was not a redistribution from the "haves" to the "have-nots" but a reallocation of resources to those who were regarded as more necessary for the expansion of the economy, hence to those who were already well rewarded. Socialist redistribution

had an economic rather than social aim. Therefore, in redistributive economies the secondary market forces initially could serve the interest of the direct producers, those underprivileged by the system of redistribution (Szelenyi, 1978). Nevertheless, as the logic of the system changed, as the market became the dominant mechanism, the market began to generate most of the inequalities and state redistribution had to counteract that tendency.

Inequality measured by the Gini coefficient (which usually uses the distribution of wages and salaries) is usually claimed to have been lower in socialist redistributive economies. Philip Huang also claims that China before market reforms was among the most egalitarian countries in the world: the Gini was .30 even in 1982 (and could have been even lower during the Cultural Revolution). But by 2005 it had jumped to .45 (making China one of the more unequal countries in the world). Huang also reports a massive increase in the urban–rural gap during the market reform.

The egalitarian character of communist societies in my view is grossly overestimated. First of all, we do not have decent income data from the communist epoch and, as we know, statistics were manipulated to fit the ideological premises of the regime. Furthermore, wages and salaries did not adequately measure inequalities under socialism. Fringe benefits (access to better housing, special shops where rare consumer goods could be purchased at subsidized prices, chauffeur-driven cars, free vacations at party-government guest houses, access to high-quality medical care available only to high-ranking cadres with private hospital rooms, treatment by the best medical experts, etc.) were allocated much more unequally than wages and salaries. Hence, we know little about the *actual* inequality especially between the ordinary masses and privileged high party-government cadres (though we have some ethnographic accounts of the luxuries the inhabitants of Zhongnanhai enjoyed while hundreds of millions of Chinese faced starvation). Finally and most importantly, while the overall level of inequality (excluding now the super-privileged few in Zhongnanhai and similar high cadre enclaves) might indeed have been lower than in market economies, the mechanisms that generated the inequality were different. Whereas in capitalist societies the market allocation of wealth and income is the major source of inequality, in socialist societies it is the redistributive intervention of the state that is the source of economic (and social) privileges. Thus, the issue of the extent of inequalities and the mechanisms of their generation is crucially important in evaluating the social implications of market transition and considering strategies to construct welfare regimes appropriate to emergent market economies.

Jansen and Wu have pointed out that inequalities, and in particular the urban-rural income gap, were substantial at the end of the Maoist epoch (the

income gap varied over time during the Mao regime: occasionally it was substantial, occasionally quite low). According to their calculations, in 1978 urban households earned 2.35 times more than rural ones—a non-negligible level of inequality. Most importantly for our current analysis, the early market reforms—surprisingly—resulted in a "massive growth of rural incomes," and by 1985 this ratio was reduced to 2.14 (later to take off again and reach 3.22 by 2005; see Jansen and Wu, 2011: 3). Fan and Sun also reported a decline of interprovincial inequalities during the early 1980s (Fan and Sun, 2008).

Let me return to Adam Smith and Victor Nee. One does not have to be a stubborn neoliberal to acknowledge that in the (early) transition from redistribution to the market inequalities can decline and the elite privileged during the former redistributive regime may lose some of its privileges (until it learns the new market "game"). I am with Nee in this debate with one qualification: he overgeneralized his findings (based on data from the 1980s). In his 1988 article, he seems to suggest that markets as such benefit the "direct producers." This is untenable. Markets do benefit lower-income groups if they are entrepreneurially oriented as long as redistribution is the dominant integrative mechanism. As the market becomes dominant, it creates inequalities and only redistributive intervention of the state can moderate such inequalities. Nee and Opper make the same overgeneralization in their new book on "capitalism from below," not recognizing that China's transformation did start from below but by the 1990s had shifted to change "from above." The root problem is in the nature of theorizing. Nee (and neoclassical, neoinstitutionalists) tend to offer generic theories, which are supposed to apply to all conditions in all times. My strong preference is (and I believe Philip Huang shares my epistemological point of departure) for genetic (contextual) theories which try to understand how concrete individuals (or institutions) act under specific historical circumstances.

Let us return after this additional theoretical digression to the welfare arrangements the Chongqing model has offered. In light of the above elaborations, this is the way I understand the Chongqing model: through various mechanisms the municipal government of Chongqing has guaranteed a rent to SOEs, ensuring in this way that their revenues would be higher than those of private firms. This has enabled the municipal government of Chongqing to appropriate 30 percent of the revenues of the companies it owns (controls). The municipal government has opted to use this income to provide welfare benefits (more for Chongqing's legal residents and some for migrant workers—though given the substantial and increasing municipal budget it could allow more of the migrants to apply for urban residency status). The goals are noble

and the achievements (in providing inexpensive, decent quality public housing, good education, and healthcare) as Philip Huang reports them are impressive. Let me nevertheless raise some concerns:

1. The system is too dependent on the political will or the good intentions of one or a few political leaders—be it Bo Xilai, Huang Qifan, or someone else. But are there any institutional arrangements that assure the resources appropriated by the state—central or local—will not be wasted on "bureaucratic conspicuous consumption" such as construction of Olympic "monuments," underutilized high-speed trains, multilane empty highways, and so on (Yasheng Huang claims there is much of this in China; 2008: 286–87), not to speak of corruption (which Bo Xilai is accused of)?
2. Philip Huang makes a strong case that in Chongqing the revenues from SOEs do not serve only the purposes of welfare redistribution, but are also a vehicle to promote economic development (the railway link for instance between Chongqing and Europe). Marxists have often critiqued the Western welfare state systems for being primarily subsidies to private capital (by reducing the cost of labor and socializing some of costs of capitalist reproduction). There is a kernel of truth to this, but this is certainly even more an accurate description of state socialist redistribution as a strategy of accelerated economic development. The Stalinist leader of the early 1950s, Mátyás Rákosi, in Hungary famously used to say: "Let's not eat the goose that's laying the golden eggs" (meaning much like U.S. Republicans do: first should come growth—supply—and once it is achieved we will take care of welfare). Even if Philip Huang is correct and Bo Xilai and his fellow leaders in Chongqing did strike a balance between economic growth aims and social justice considerations, are there institutional guarantees such that this system will not shift toward promoting growth rather than serving social equality? How can we prevent future leaders in Chongqing and elsewhere in China from being more concerned with the geese than with the eggs?
3. If the economic system is shifting toward one dominated by market integration, why would one want to fund the welfare system from the still substantial but shrinking public sector revenues? Is this system sustainable at all in the long run? (i) If the shrinking of the public sector continues, when will it reach the point where it can no longer maintain adequate welfare provisions for "the whole

> people"? (ii) Since in the Chongqing model welfare provisions are funded from rents which in one way or another have to come from the profits of the private economic actors, will this not eventually undermine the private sector?

Let me take a strong position on the above issues. In Maoist China—much like during the classical system of socialism in the USSR and Eastern Europe—there was no welfare system. In China the function of the work-unit-based "welfare" provisions was to minimize consumption (one bowl of rice . . .)[3] and maximize investment in the productive sector while giving privileged access to valued scarce resources to those who were judged by the redistributors to be particularly important for the political stability and economic growth of the system (high cadres). When the system began to make concessions and offered market opportunities to peasants and rural residents through TVEs, this temporarily offered relief, boosting incomes of the poorest segments in the society (this is the moment of truth in Nee's market transition theory). But as markets and private business became dominant (even Philip Huang claims that only about 50 percent of the non-agricultural GDP is from the public sector, but the majority of the GDP—if agriculture is also counted—of course already comes from the private sector), it became apparent China does not have a system to cater for the unemployed, the elderly, the young, the poor.

Hence the task of the post-communist capitalist societies and the increasingly market-based Chinese system—be it state capitalist or market socialist—is to build a welfare regime. History tells us that in any genuinely market-integrated system this can be based on (1) welfare redistribution by the state funded from fair and progressive taxes on market-generated incomes of individuals or firms or (2) a paternalistic commitment of firms to the welfare of their current, past, and future employees (Japan being the prime example), or some combination of these two systems.

The Chongqing model (much like the "local state corporatism" of Oi and Walder) appears to be a transitory, laudable but arguably temporary solution to the devastation the absence of a welfare system caused during the phase when the market was becoming the dominant mechanism. The Chongqing model and local state corporatism are not sustainable solutions—they are only "substitutes." Let us assume that markets become the dominant coordinating mechanisms and private property is not only tolerated, but is also the majority form of ownership (as appears to be the case in China). If under such circumstances we remain committed to the values of equality and social justice, the task is to create a welfare state based on taxes on market-generated

incomes, thus providing equal opportunities and decent living conditions for all.

This is *not* an argument against the public sector. Publicly owned and managed firms have proved to be competitive in genuinely competitive markets (such as Volkswagen and other firms did until they were squeezed out by neoliberal ideologies). But this is an argument against strategies to buy political peace by offering public goods to constituencies from rents channeled to the competitive market sector by SOEs and to run a paternalistic system of public provision by political cadres of good will. The Chongqing model may be driven by good intentions and may have resulted in some positive social outcomes, but its institutional arrangements appear to be unsustainable. Hence a government-run welfare system funded from taxes on market-generated incomes seems to be the more transparent, more predictable way to counteract inequalities of the market economy. Bo Xilai's fall from power may not just be a personal tragedy of a person assumedly of good intentions, but may indicate that the institutional arrangement of the Chongqing model may be flawed.

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Notes

1. The received wisdom was that although you can nationalize private ownership, you cannot privatize public property. As a leading Hungarian reform economist, Márton Tardos, told me once: "we know how to make fish soup from fish, but we do not know how to make fish from fish soup," implying nationalization was an irreversible process.
2. Many commentators see this as a short decade lasting from 1978 until 1985 (see Jansen and Wu, 2011). After 1985, especially after 1989, there has been increasing pressure to move the reform to the urban-industrial sector.
3. Since most of this consumption was not paid for in personal incomes, but funded from the revenues of collectives, Kornai most unfortunately called this system of collective poverty a "prematurely born welfare state" (1992; cf. chapter 7 in Kornai 2008), though it was only the mechanism of accelerated economic growth and had nothing to do with equality or social justice.

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Biography

Ivan Szelenyi is Dean of Social Sciences, Max Weber Professor of Social Sciences, New York University, Abu Dhabi, and William Graham Sumner Emeritus Professor of Sociology and Political Science, Yale University. He is a Fellow of American Academy of Arts and Sciences and an ordinary member of the Hungarian National Academy of Sciences. He is author/coauthor of *The Intellectuals on the Road to Class Power* (1979), *Urban Inequalities under State Socialism* (1983), *Socialist Entrepreneurs* (1988), *Making Capitalism without Capitalists* (1998), and *Patterns of Exclusion* (2006).