



China's Economic Reforms and the Evolving Concept of Property

Charle, Edwin

(Citation)

国際協力論集, 6(2):71-97

(Issue Date)

1998-12

(Resource Type)

departmental bulletin paper

(Version)

Version of Record

(JaLCD0I)

<https://doi.org/10.24546/00181276>

(URL)

<https://hdl.handle.net/20.500.14094/00181276>



China's Economic Reforms and the Evolving Concept of Property

Edwin Charle*

Property rights legitimize patterns of accumulated wealth and power and give substance to economic incentives. In formal economic analysis the concept of property rights has been used to clarify the premises which underlie the theories of individual behavior within enterprises and to broaden the scope to which the theories apply. In both respects the focus on property rights has provided a vantage point from which to view economic and legal events such as those occurring in "transitional economies" as they move from centrally planned socialism to some new alternative national economic system. The set of property rights to emerge from the transition will measure the new system's distributional consequences as well as its potential for economic efficiency and growth and will provide, perhaps, the best source of enlightenment as to the meaning of "socialism" in the twenty-first century.

In China after the mid-1980s the relationship between the people and their "property" began to change fundamentally as the country moved (with only temporary interruptions) away from central planning and *state-ownership* of capital toward greater reliance on subordinate levels of government and on private ownership and competitive markets for allocational and distributional guidance (Hsu 1991:55). This "marketization" has been generally successful, has been accompanied by rapid economic growth, and seems likely to continue. As an integral part of this social evolution the country's property rights have changed in historically unprecedented ways in response to rapid technological and institutional development and in response to the search for socially acceptable standards of justice, equity and efficiency. This paper reviews some of

* Visiting Professor, Graduate School of International Cooperation Studies, Kobe University.
Professor, Ohio University.

the theoretical writings that incorporate the concept of property rights into economic analysis and examines the implications of that analysis to China's recent history.

Property Rights and Economic Theory

Marx's allegation of exploitation in ownership of the means of production

In *The Communist Manifesto* Marx declared his judgement regarding the economic significance of property rights in human history. He announced (in 1848) that "productive forces" had come into conflict with *bourgeois property relations* and that the resultant disharmony created the conditions for a proletarian revolution. The time had come, he declared, for the proletariat to use its power "to wrest all capital from the bourgeoisie, to centralize all means of production in the hands of the State" and thus end the exploitation of labor which had characterized capitalist ownership of the means of production. Again in his Preface to *A Critique of Political Economy* (1859) he repeated that when the "property relations" of capitalism come into conflict with the historical progress of technology the stage has been set for the ultimate triumph of socialism.

Marx attacked economic inequity and he perceived the cause of inequity to be in the institutions that gave to some the power (as property rights) to control material possessions to the (permanent) exclusion of others. In thousands of pages and millions of words he pressed his assault on distributional injustice. Simultaneously he attempted to demonstrate "scientifically" that the root cause of this injustice lay in the fact that some had to find employment at jobs where the physical objects--the units of "capital"--with which they worked were *owned* by others.

For an analysis of the rapidly expanding Chinese economy at the end of the twentieth century, Marx's arguments must be reappraised. While many are concerned about distributional inequities, few today would be willing to accept his conclusion that the basic reason for inequities is that some own the means of production with which others work. The evidence seems contradictory and

the logic unpersuasive. Nevertheless property rights by their nature as enforceable methods of exclusion suggest themselves as centrally relevant to the issue of socially tolerated inequities.

Thus John Roemer suggested that property rights may correctly be seen as sustaining distributional injustice but, he maintained, the injustice results from *inequality of access* to the means of production rather than in the fact that some own them and others use them. As Roemer sees it economic injustice is caused by the systematic exclusion of some from the kinds of opportunities open to others. This may occur under capitalism when opportunities are foreclosed. It may also exist under socialism as when inequities based on *differentials of status* work themselves into the system and cannot be removed (1995:13,33,39,291). It is markets, ironically, which help to remove such status differentials and thus can contribute in socialist states to greater equity. According to Roemer, "the elimination of differential rewards to ability is not socialism's historical task, only the elimination of differential reward to alienable property ownership" (1995:28,33).

Roemer's suggestion seems a useful starting point for an analysis of property rights in contemporary China. It concedes immediately the efficiency of competitively determined market prices and their inevitability in a modern economy. But it suggests the possibility of distributional injustice wherever individuals are systematically limited (as by property rights) from access to economic opportunities.

Property rights as building blocks in social theories.

Historically (as Marx's words remind us) the meaning of "property rights" has varied over time and from place to place. The "rights" have included a variety of legal capacities including the power to control, to exclude others from, and to appropriate the products from goods. The "goods" have included land, other physical objects, human capacities and sometimes human beings themselves. Single individuals and groups of individuals including governmental agencies have been recognized as holding property rights.

Property rights and competitive markets. Because property rights imply

the right to exclude others, they are centrally relevant where markets decide what is to be produced and for whom since “only exclusive rights can be marketed” (Macpherson 1985:80). Armen Alchian expressed the same idea when he noted that the law must “permit the title acquisition and exchange rights that would enable economic competition to induce economic use of resources” (Alchian 1969:146). Contractual arrangements are seen as dependent on property rights and these provide the basis on which markets weigh the costs of actions (Cheung 1970:27).

Ronald Coase noted that it is not physical “things” which are traded in markets but rather the rights to act relative to those things (Coase 1994:11). He followed this line of thought with the observation that the more clearly the law defines those rights the more easily goods and services will be exchanged, i.e., the lower will be the “transactions costs” of market exchange. And he sees economic enterprises (business firms) as existing in order to reduce such transaction costs since they were places within which the activities of production factors are coordinated, separate from the coordination which occurs in market exchanges. Thus the efficiency of each enterprise and its impact on the rest of society reflects the set of property rights which currently prevailed and would change as those rights changed (Coase 1991:65; Coase 1992:717-18 as cited in Harris, *et al.* 1995:112).

The neoclassical vision. The set of microeconomic ideas identified as “neoclassical” assumes utility maximization as the goal of individual behavior. Efforts to maximize utility are seen as leading to certain predictable conclusions determined by the location of individuals within one or another institutional situation (say a private or a governmental agency) where they are subjected to the kinds of constraints (identified as “property” constraints) common to those situations. Property rights are defined as “sanctioned behavioral relations” (Furubotn and Pejovich 1974:2,3) and are seen to exist wherever an individual is in a position to make good his or her decisions regarding goods (Alchian 1969:144) or appropriate benefits from their use (McKean 1972:175). Thus behavior can be predicted as the responses of a rational, self-interested individuals confronting the set of property rights which their society

has evolved. *Specificity* was seen as contributing to allocational efficiency. Even short of complete ownership, the greater the specificity with which the property rights were defined the better would be the accuracy of the accounting decisions regarding an asset and the more efficient its use.

Using property rights (so defined) to analyze the behavior of individuals constrained within various kinds of enterprise is much like asking "how is an enterprise organized." Issues such as the quality of governance, the autonomy of management, the character of incentives, the hardness of budget constraints, the degree of government regulation, and the openness to competition all seem equally accessible (or inaccessible) from either direction (Wang 1998:129). The advantage of the property rights approach for present purposes is that it ties directly into the cited literature and provides an opportunity to review the insights of that literature and test its relevance to the real world experiences of the Chinese economy. Moreover, it may be analytically useful that when the issues are stated in terms of property rights a legal or juridical dimension is suggested which provides new vantage points especially in respect to the interconnectedness of enterprise behavior and the actions of the government..

Analysis of property rights as argument for the limitation of the role of government

Coase had argued that the clear assignment of property rights enabled individuals to work out (in competitive markets) efficient solutions to economic problems. This insight was then interpreted by various scholars to be especially applicable to rights of *private* ownership and was used to reinforce a long tradition in Western economic theory advocating a minimalist role for government with the government encouraged to restrict its involvement in the issue of property to the legitimization of *private* rights to external objects and to give those rights precise definition and concrete enforcement. This, it was argued, would minimize transactions costs and would produce results from exchanges which were as efficient and as fair as society could hope for. Governmentally planned redistributions were seen as usually inappropriate

because they interfered with the functioning of market forces which could be counted on to accomplish the appropriate arrangement of assets more efficiently and with greater justice.

Specificity was associated with *exclusivity*--the assurance that the consequences of one's actions were evaluated in the market place (Cheung 1970:27). Arguing from this premise a variety of concerns were voiced regarding the motives and consequences of individual actions in institutional settings where assets were controlled by public or governmental agencies or wherever assets were owned communally. It was argued that decision makers under such circumstances would often have the power to appropriate rewards without having the size of their rewards determined in competition with others. Moreover, when property rights were communal "externalities" would multiply because the consequences of activities by communal owners on their neighbors and on future generations would be less likely to be taken into account than when a resource was individually owned (Demsetz 1967:39) and it would be more difficult to capitalize anticipated future events into present market values (Alchian 1969:146).

Williamson (1963:111) suggested that the temptation of governmental administrators to expand staff unduly would prove difficult to resist and McKean (1972:175) doubted that governmental administrators faced *any* consistent set of pressures to perform efficiently. Where goods were allocated by administrative decision rather than market forces the efficiencies associated with competitive markets would be foregone since contracts with their inherent flexibility would be replaced by less flexible regulations (Cheung 1970:29). "Political pressures" compared to the pressures of the market place would lack precision and the advantage of precise money measurement and could be expected to produce uneconomic allocations (Coase 1959:69) and there was general concern because of the absence of the possibility of bankruptcy in most agencies of government (Nutter 1968:217). Where no one had exclusive right to appropriate the residual, the logic of property rights suggested that managers could be expected to divert the organization's resources to their own uses (Furubotn and Pejovich 1974:48) and the absence of private property

rights would lessen the self-policing pressures which restrain corruption (Sanchez and Waters 1973:279).

A contemporary expression of these arguments and concerns was voiced by Janos Kornai (1992:504-5 quoted in Wang, 1998:65) "public property belongs to all and none. The hazy nature of property is the ultimate reason why the interest of the manager of a firm is hazy, ambiguous, and replete with contradiction."

* * *

The "neoclassical position" sought to extend conventional microeconomic analysis (market theory) into a warning against society's inclination to sacrifice the individual to the collective and in the expression of that warning there was inevitably a defense of the *status quo* which had wide appeal. The definition of property rights which emerged identified specificity and exclusivity as means to reduce marketing costs, minimize externalities and make it possible for competitive markets to do what they do best, provide incentives for efficiency and rewards for diligence.

Limits and applicability. Criticism of the neoclassical position has come from three directions: it's been argued that neoclassical writers display excessive partiality towards *private* rights generally and neglect the fact that *privately* owned business firms are often managed by individuals who are not the owners; matters of distributional justice have been underemphasized except for warnings against socially organized redistribution schemes; and issues of economic *growth and innovational incentives* seem linked to the assignment of property rights in ways that are more complex than is implied in the exploration of static microeconomic efficiency conditions as emphasized by the neoclassical writers.

In reference to China's current transition the neoclassical ideas are valuable as a set of logical propositions for which the premises and conclusions are close enough to "common sense and casual observation" to suggest their usefulness in evaluating institutional development. Thus the admonitions seem appropriate as check points or warnings to be acknowledged and responded to as the individual is repositioned in that society. From another angle the

stunning growth rate achieved by China while its system of property rights has been largely governmental (communal) and very much in a state of flux (non-specific) provides a test of the practical relevance of the academic theories.

Douglass North and the institutional changes needed for economic growth

Another approach to the study of institutional change through the analysis of property rights is that of Douglass North in his analysis of economic growth.. In contrast to some of the writers cited above, North stressed the importance of the role of government and the possibility of its positive contribution. He focused on property rights from an historical perspective--describing his analysis as a search for an understanding of those *incentives* in human affairs which produce *cooperation*. The legalization of property rights frees market transactions from dependence on personalized knowledge and trust thus markets are widened and commerce expands (1990:11,25,27,34,67,135;1995:25). And, he noted, that if the value of an asset is to be maximized those with the rights of residual claimants should have authority to influence the terms of exchange when that asset is traded (North 1990:31).

North also offered advice regarding the dynamics of institutional change suggesting that the key to economic development is the *learning capacity of the entrepreneurs* who will need to adapt to changing conditions (North 1995:24,26). The source of their learning is the tension of competitive property rights in a struggle to survive in an environment of scarcity. If the appropriate matrix of property rights is in place competitive market prices will guide the results with efficiency and fairness (1995:23). But the reliability of property rights depends on the existence of an external enforcement agent (the state) and this raises the possibility (and likelihood in North's opinion) that the state will misuse its coercive power (North 1990:59). This likelihood of the misuse of power is the reason, he suggests, that while property rights may be rational from the point of view of the actor, property rights only rarely contribute to economic growth. Thus it is essential that the institutions that

prescribe payoffs must be devised (and policed) so as to benefit the public and not only select parties (North 1990:9,110).

* * *

From North's perspective the prospects for China's economic success may be seen as requiring that property rights be shaped to facilitate factor mobility (including capital markets to spread risk), encourage the acquisition of economic skills, and provide efficient mechanisms for the transmission of information and the invention of new technologies (North 1990:64,125). An optimal system will make possible the efficient execution of contracts and put the power to execute those contracts into the hands of claimants to the residuals generated by the enterprises. The system of rights must motivate entrepreneurs toward economic achievement while constraining them somehow from misusing of their power.

Some theoretical responses to China's history of central control

Since the focus on property ownership, the institutionalization of who owns what, lies at the ideological heart of Marxism, in the Peoples' Republic of China the concept of "public ownership of the means of production" was regarded as the foundation of the country's socialism (Hsu 1991:57). Moreover, in China the ideological importance of property was reinforced by the historical fact that national policy in the Peoples' Republic had forced the people to bear high costs in the name of property dispossession and forced collectivization. Memories of sacrifices made it difficult to abandon ideological positions which had been used to call those sacrifices into being.

But the problems associated with China's state-owned enterprises and its central planning efforts were widely perceived and from within China questions were raised reflecting some of the same concerns that were suggested above regarding enterprise inefficiency. For some time the government had sought to remedy the situation by gradually decentralizing the planning function from Beijing to subordinate levels in a search for improved administrative efficiency (Hsu 1991:79). But academic debate over these issues became public only after the issues had been opened for public discussion by government leaders

especially Deng Xiaoping. Deng had written, for example: "the purpose of enterprise reform is to free the large and medium-sized state-owned enterprises" and "to try different ways to separate ownership and management so as to give enterprises initiative" (Deng 1992:vol.3, 192 quoted in Liu 1997:15)

Ji Liu of the Chinese Academy of Social Sciences sought middle ground. He reiterated that private enterprises in a capitalist society are exploitive of their employee's surplus value but acknowledged that under capitalism the pressure of competition produces "continuing vitality." Whereas under socialist public ownership capitalist exploitation is eliminated but when the government owns all the enterprises the absence of competition saps vitality and innovation and wastes investment funds. The solution, Ji suggested, was for the government, representing the ownership interests of the people, to appoint managers who would then exercise "complete rights to manage" and "face the market". The public's continued interest could be represented and protected through a board of directors with members appointed by the government (Liu 1997:16,19,34). Other theoretical alternatives to the concept of ownership by the central government were proposed in the form of arrangements for worker control and administration by local collective units (Hsu 1991:60-1; Dong Fureng:1979, 1985, cited in Hsu 1991:58,60). Defenders of state enterprise responded with suggestions for compromise through increased responsibility for enterprise managers as evidenced in the "management contract responsibility system."

Weiyang Zhang of Peking University (1997:74) suggested that the state's interests in the state-owned enterprises should be transformed into the rights of a creditor (not "owner") and thus a claimant of fixed income--giving up managerial control and intervention except in the case of bankruptcy. Haiying Zhao of the University of Hong Kong warned that as the government relinquished managerial control it should insure that managers have incentives to preserve the assets of their enterprises (in addition to their responsibility to give up to the government part of their profits). To achieve this he suggested the creation of a market for stock ownership rights in enterprises with the manager's reimbursement based on stock options tied to "current and future

stock performance" (1997:121,125).

The reforms

The legal foundations underlying the country's economic enterprises were changed through a series of "reform" measures which began in 1978. The reforms were introduced gradually and piecemeal in order to learn from experience and to lessen economic and political disruption. They increased the autonomy of economic enterprises and opened opportunities for flexible prices and active markets. Restrictions on privately owned businesses were quietly relaxed and these enterprises--often with varying degrees of governmental partnership--expanded rapidly. An increasing fraction of the output of state-owned firms was freed for sale in open markets and those enterprises were permitted to retain more of their profits for reinvestment and for increases in employee compensation (Hay, et al., 1994:7). The share of profits payable to the central government was translated into taxes payable at fixed rates and thus (again gradually) the enterprises (in association with subordinate levels of government) became residual claimants (Lo 1997:107,109,111). Managers became the legal representatives of their enterprises and often were recruited by committees composed of representatives of relevant government offices, the bank, the firm's employees, and the public.

Competition between buyers and sellers was paralleled by competition between local and provincial governments seeking to attract investors by offering better services--a fact which impressed observers from India who contrasted the more successful situation in China with that in their homeland (Kundra 1996).

The reforms were monitored by many observers both Chinese and foreign including a large number of academicians. One extensive program to evaluate state-owned enterprises was launched in 1988 under the auspices of an array of international sponsors (Hay, et al. 1994:vii). The group's conclusions were typical of many. They found that the reforms had succeeded to a substantial degree and that enterprises were responding to market signals; the government's tax take from profits was becoming more "rule-based;" bonuses were

increasingly correlated with productivity;expanding profits were coming largely from cost reductions rather than from product price increases;and firms faced serious internal financial constraints on all expenditures and serious external financial constraints on investment expenditure (Hay, et al. 1994:75,112,156,200,247,321).

They also reported shortcomings and causes for concern. Gaps sometimes remained between the context in which decisions were made and a true “market test of priorities” suggesting that resource allocation could be made more efficient. There was enough “softness” in the budget constraints facing some of the enterprises that market signals were inhibited and sources of finance available to enterprises were still too narrow and monolithic. There were evidences of monopoly power--power which was sometimes actively encouraged by governmental authority. And the rights of workers were not always safeguarded (Hay, et al, 1994:9,414).

Three Criteria for Evaluating the Evolution of Property Rights in China

Three criteria are suggested here for evaluating the changing pattern of property rights in China:(1) (static) economic efficiency in terms of competitive responses to changing conditions of supply and demand;(2) technological dynamism and entrepreneurial innovativeness;(3) possible losses from weakened central control.

Property rights and the static efficiency of Chinese enterprises

How the evolving structure of property rights produced incentives that pressure enterprise managers to convert available inputs--cost effectively--into the goods and services that consumers want to buy. This is the central point of reference of the neoclassical theorists who suggested that economic efficiency depended on the existence of a set of property right incentives such that enterprise managers (assumed to be motivated by self-interest) had the consequences of their actions evaluated continuously in the market place with

open market competition determining the prices of the inputs they used (including somehow capital), the prices of the outputs which they created, and the compensation they received.

A recent survey by *legal* scholars focused on China as potential host to foreign investors noted that formal, legally enforceable contract rights in many instances were being effectively substituted for by personal contacts and trust built on experience over time. But they suggest that international extensions of market behavior require the "general applicability" of rules associated with the concept of a "rule by law". They found causes for concern in China's weak court structure, official arbitrariness, and the weakness of the concept of "rule by law" (Lubman 1996). Here the analyst must be careful. In regard to the evolution of property rights it is clearly possible that the profit incentives of potential foreign investors may be in conflict with the interests of the people of China in such matters, for example, as distributional equity or environmental protection. On the other hand the advocacy of such goals as the expansion of the "rule of law" have more universal appeal and deserve separation from narrower property rights advocacy.

Thus Robert Hsu describing Chinese enterprises in the period 1979-1988 found widespread political corruption and environmental degradation attributable to the relaxation of central planning and the gradual decentralization of authority to lower levels of government (1991:79). The World Bank (1997:29) reported "widespread asset stripping and excessive wage compensation." And a number of evaluators especially those reporting the consequences of the early reform years (the late 1980s) were critical of the excessive proportion of profits being used for employee compensation thus arguing that costs were not being minimized and that rents were being generated for those in favored situations. These were the kinds of problems predicted by the theoretical arguments of both the neoclassicists and Douglass North and the factual evidence from China seems to confirm the logic by which the conclusions follow from the premises.

On the other hand several surveys undertaken in the late 1980s and early 1990s emphasized the fact that competitiveness and profit motivation were

increasing (Lo 1997:105). Jean Oi gave a remarkably positive evaluation of China's emergent competitive markets and the system of property rights which was coming into existence. Her conclusions were based on research from 1986 to 1991. She pointed out that the policy of power decentralization in the pre-reform (Maoist) years had created a reservoir of managerial talent in China's subordinate levels of government where the actors had become proficient at the assembly of economic resources. The system of property rights which evolved subsequently as central controls were withdrawn freed initiatives and provided the necessary incentives for these men and women to become successful economic entrepreneurs and she observed that often it was local party officials who were leading the way (Oi 1996:170,185,186)

Oi noted that most of the township and village enterprises which for many communities provided engines of growth were genuinely government owned. But she found economic incentives sharpened as local governments were transformed into genuine risk bearers and budget constraints hardened as units found that they could no longer count on being bailed out by higher authorities. Losses were felt directly by responsible individuals and by their communities and the identity of those responsible for mistakes was often visible to the public. She concluded that the emergent property rights in economic enterprises enabled local officials to exert an effective range of "industrial policies" which included the power to redistribute profits when such was deemed beneficial for the community. The flow of information regarding markets and technology was facilitated by the joint nature of powers and responsibilities among those involved and the provision of information has become a vital part of the government's infrastructure supply function. Product development, market research and the incorporation of new technologies, she felt, were expedited by this free flow of ideas. Local banks had begun to participate in the symbiotic success stories and had become effective screeners of potential borrowers (1996:173,175,178).

Joseph Cheng (writing about Guangdong) also described the effectiveness of market pressures generating efficiency in town and township enterprises. Potential bankruptcy threatened unprofitable firms, workers were paid by

piece rates, and managers were reimbursed according to profitability (Cheng 1996:70-1). Provincial leaders dependent on popular support had to respond to pressures from below (Lin 1998:427). The social status of entrepreneurs has risen (Malik 1997:108). Rural credit markets were successful in guiding intermediation for the financial needs of both the enterprises and the communities (Whiting 1996). And competition for foreign capital has encouraged provinces to establish both legal and physical infrastructure compatible with the needs of investors (Rawsky 1997:201).

The rapid growth of the Chinese economy indicates a considerable degree of efficiency at the enterprise level and Cheng and Oi and others have described enterprise behavior compatible with rapid growth. Other writers are in general agreement (McMillan and Naughton 1996:171; Qian and Stiglitz 1996:180). From the vantage point of property rights theory these pro-efficiency consequences suggest that in many instances the decentralizing reforms may have clarified individual rights regarding resources, sharpened the specificity and exclusiveness of those rights, positioned the power to dispose of resources in residual claimants, and provided an environment of effective competition among holders of property rights which limited opportunities to divert funds wrongfully to private uses.

Property rights and innovation, growth and investment

The issues of economic growth and the sustainability of that growth lie for most part beyond the scope of the static microeconomics of the neoclassical model. *Innovation* is crucial in this regard. For competitively determined input and output prices by themselves do not insure the kind of fierce competition and dedication of resources to research and development that are required if a internationally successful rate of innovation is to be generated and sustained (Lo 1997:103; Stiglitz 1994:147). In the words of Douglass North "It is adaptive rather than allocative efficiency which should be the guide to policy." And "the key to continuing good economic performance is a flexible institutional matrix that will adjust in the context of evolving technology and demographic changes as well as shocks to the system" (1995:26).

Dic Lo suggested that the pre-reform industrial structure of China may have contained some rarely recognized advantages in this regard lying outside the usual range of investigation of the competitive model (or the ancillary theories of private property rights). For the continuous upgrading of the product mix, he argued, the rigid institutional environment of the large state-owned enterprises may have generated a process of collective learning by encouraging long term commitments to proposed schemes. As contributors to "Schumpeterian entrepreneurship," China's combination of usually cited disadvantages--soft budgets, government intervention, and labor immobility--may be seen in a positive light (Lo 1997:120,136,200,201).

Nick von Tunzelmann contrasted China's recent system of enterprise reform with the efforts of other low-income countries to initiate growth and found important advantages on the Chinese side. He argued that recent history demonstrates that the attempts of poor countries to sponsor labor-intensive intermediate technologies have often resulted in technological stagnation. To give the principle of comparative advantage a dynamic interpretation an economy must develop the capacity to *enhance* its factor inputs--not just rely on those factors that are comparatively cheap at the present time. Following this line of thought, he suggested that the optimal strategy for China's technological advance would emphasize *process* changes with the goal of economizing time through such means as the reduction of machine downtime, faster processing, increased machine coordination, and increased coordination between processing components (1997:228). From this point of view the key production factor is the adaptability of the workers--a function of their "knowledge" and thus dependent on appropriate education. He suggested that this strategy of "advancing process quality" has been more successful where adopted (as in East Asia) than has reliance on "existing comparative advantages" such the use of unskilled labor where high technology is identified only in the product structure (as, he feels, was tried in India) (1997:225). The Chinese system of property rights which is currently emerging with its openness to foreign technology, its background of private and governmental entrepreneurial incentives, and its search for public as well as private achievement may be suited to such

a strategy so long as competitive pressures remain intense.

Von Tunzelmann described communal and cooperative property rights in various countries which have achieved efficiency and have contributed to growth while simultaneously addressing concerns of distributional equity. Examples include the networking of small firms in Italy which benefited from the coordination efforts of local governments "setting up industrial parks... installing practices of peer review and loan guarantees in place of formal banking practice for finance, and offering communal marketing and other services to share overheads." In Japan also he found evidence of effective integration of assembly plants and the suppliers of components (1997:216). "Networks" rather than "hierarchies" were suggested as the key to continuing growth (Lo 1997:21). In these terms China's new system of property rights may contain important positive components. These include an enterprise philosophy which encourages a sense of responsibility and self-confidence in the workers (in contrast to a rigid hierarchy), a willingness to cooperate among its leaders (in contrast to strict individuality and search for profits for one's own as opposed to related enterprises), and the use of enterprise profits for general education..

Barry Naughton (1997:13-28) described China's openness to foreign markets and investors as the driving force behind its recent growth. Thus he highlighted the importance of China's willingness to accept and learn from foreign entrepreneurs permitting them to share ownership rights with domestic actors in choices of technology and strategies for international competition. Buying and selling in international markets and continuously bidding for foreign investment has pressured the managers of China's enterprises into a continuous search for ways to minimize costs. Moreover, he suggested, the aggressively intrusive influences from overseas have created pressures which encourage restructuring of manufacturing facilities in a search for more sophisticated products (a la Taiwan) and efforts to move from manufacturing into business services (a la Hong Kong). In this development the government does not seem to be shaping policy, Naughton argued, but rather has been reacting to changing circumstances, accommodating to the flows of investment funds available

from overseas. Using electronics as an example he contrasted the failed efforts of the Chinese government to create a world class competitive electronics industry whereas “entrepreneurial individuals, working under the aegis of nominally state-owned corporations, succeeded in developing industry segments in a pattern much like the Taiwan model.”

The disadvantages of a weakened center

Efficiency and growth are not the only considerations, however, in an appraisal of China's realignment of property rights in the quest for “reform.” The realignment implied in the retrenchment of the central government raises problems as the units of society (and the attitudes of the people in those units) are pulled apart and as the government loses its capacity for monetary and fiscal manipulation.

Centrifugal forces. In theory the advantages to a society of a strong central government lie in the fact that activities distant from the center are “internal” to the decision making process. Potential economic benefits include improved coordination, a broader vision of future prospects for investments, economies of scale, military prowess, and stronger bargaining power with respect to outsiders. The potential political advantage is the capacity to promote greater equity and thereby social stability. Following this logic the process of decentralization would be beneficial when the costs of gathering, processing and disseminating information outweigh those advantages (Stiglitz 1993:156). This presumably describes the situation confronting China when the reform movement was initiated.

Under China's pre-reform system of strong central government pursuing or trying to pursue a central plan, the property rights of individuals throughout the country were shaped to facilitate that organizational design. Boundary conditions and incentive systems were in place which were compatible with those centralized objectives. Subsequently with decentralization and price competition the property rights were radically recast to create incentives for profit maximization in individual enterprises and the goals of the relevant actors were changed from national to local.

From the neoclassical perspective an analysis of this transition would find causes for concern in the fact that so much of the incentive structure was thus geared to governmental-communal goals thus rendering uncertain the specificity and exclusiveness needed for accurate accounting, decisive action and effective monitoring and thereby threatening slack performance, economic irrationality and corruption. But on the other hand the process of decentralization created the tensions and conflicts necessary for *competition* with all of its attendant economic advantages. Thus predictions based on the neoclassical model would seem to be inconclusive.

The individuals who inherit China's newly decentralized power will have the advantage of closer familiarity with the enterprises they make decisions about and with the people affected by those enterprises. But the number of decision makers is increased and areas of responsibility are narrowed and thus the realigned property rights may create incentives to manage wastefully, to erect barriers to the entry of competitors, to protect local monopolies and to support infrastructure on too small a scale. Commerce could be curtailed, education impaired, environmental damage multiplied. As Joseph Stiglitz put it, "the solution to local problems does not, by any means, guarantee global efficiency" (1993:163;1995:61).

The course charted suggests that widening inequity is inevitable. Economic inequity between China's regions is an ancient concern. In recent times the policy of Mao Tse-tung was to encourage industrial balance between sections of the country and he directed industrial investment to the inland regions to offset the traditional advantages of the coast. Subsequently the policy under Deng Xiaoping favored more industrial investment in the coastal regions in order to take advantage of their favored foreign trade situation and build on it (Yang 1997:37-8,58,153). Under China's current economic reform program the decentralization of power from Beijing to the regions and subregions suggests that locational disparities will widen at least in the short run and this tendency seems likely to be strengthened to the extent that market forces become the arbitrators of productivity and wealth and as the evolution of property rights solidifies the independence of individuals and of regional and local

governments.

Roemer's concern about equality of *access* to opportunity is relevant. The need for equal access to education is a critical example. A weakened center implies a reduced capacity for the reduction of arbitrary, property-based inequities, a critically important issue if the distinction between capitalism and socialism is to retain its traditional relevance to the issue of economic justice.

Environmental pollution and unsustainable rates of extraction of groundwater constitute China's gravest physical challenges and the search for potential remedies transcends political boundaries. The same is true for certain political issues such as the need for laws to protect employee safety and minimum welfare standards. To the extent that the redesignation of property rights moves power from those with wider to those with narrower visions of responsibility society as a whole suffers at the expense of fortunately situated subgroups.

Monetary and fiscal powers. Decentralization creates new property rights in men and women with respect to local assets redirecting their attention toward the maximization of the welfare of local groups. This is achieved at the expense of the central government's capacity to use its monetary and fiscal powers to maintain price stability and to encourage full employment and growth. Subordinate units of government have increasingly acquired the power to channel taxes to themselves and have less incentive to insure that tax quotas imposed by the central government are satisfied (Liew 1997:98,117). They have taken control of most public expenditures in their locality and directly participate in the management of local enterprises. The central government's control over credit has been weakened by the growth of local credit sources which have goals as to amounts to be loaned which are different from those of the central government (Oi 1996:181,182;Lo 1997:106;Hsu 1991:103;Naughton 1996;Yang 1997:44,57,77)

In the last half century the people of every country have come to expect their central governments to be actively engaged (at least from time to time) in the pursuit of macroeconomic stability and full employment. And one of the hopes of every country with "socialist" aspirations has been improved

macroeconomic performance and deliverance from the problems associated with the business cycles identified with private ownership-capitalism. Not only are China's aspirations regarding distributional equity threatened by the decentralization of her property rights but the country's capacity to regulate tax flows and public expenditure levels is also called into doubt and thus the capacity in times of shock or stress to maintain enough aggregate stability to function as a modern state.

Conclusion

A review of the microeconomic theories associated with property rights suggests their general usefulness in an analysis of the static efficiency consequences of China's economic reforms. That part of the theories incorporated into the neoclassical paradigm also provides an interesting vantage point from which to observe China's changing situation but seems to fail to find support for anti-government interpretation. Professional managers have been found and their functional role has expanded. The scope of managerial responsibility has been defined with greater precision and an environment has been created (not everywhere but with increased frequency) which has subjected enterprise management to genuine competition and effective oversight. Economic success has resulted but government involvement has remained strong especially at the sub-national level.

In regard to innovation and the dynamic dimensions of growth thus far the reform measures have been generally successful for more than a decade. To sustain this achievement into the future China must generate the kind of innovational responses that will make it an effective player in international markets and prevent the kind of stagnation at low levels of productivity that has characterized other countries with large populations of poor people and low levels of education and technology. The future is uncertain of course but voices of cautious optimism have been raised suggesting that China's emergent system of property rights seems capable of generating and supporting innovation. Much will depend on the country's ability to train (and keep) a flexible,

competent labor force.

From the macro-perspective China's chosen direction of change appears far more problematic. If the process of decentralization continues, it will jeopardize the kind of coordinated monetary and fiscal policies required for a centralized response to future problems of inflation, imbalance in international payments and unemployment. Moreover, China seems to be abandoning--in the process of acquiring competitive markets--the central control needed to offset inequities and (gravest of all for the long run) will be seriously handicapped in its capacity to protect and maintain the physical environment.

Bibliography

Alchian, A. (1969) "Corporate Management and Property Rights," in H. Manne, ed., *Economic Policy and the Regulation of Corporate Securities* (Washington D.C., American Enterprise Institute) reprinted in Furubotn and Pejovich, *Op. Cit.*

Barzel, Yoram (1989) *Economic Analysis of Property Rights* (Cambridge:Cambridge University Press)

Cheng, Joseph Y.S. (1996) "Structures and Functions of Town and Township Governments in Guangdong" in MacPherson, Stewart and Cheng, Joseph Y.S., eds. *Economic and Social Development in South China* (Cheltenham, UK:Edward Elgar)

Cheung, S. (1970) "The Structure of a Contract and the Theory of a Non-Exclusive Resource," *Journal of Law and Economics* 13 (April)

Clarke, Donald (1996) "The Execution of Civil Judgements in China" in Lubman, *Op. Cit.*

Coase, R. (1959) "The Federal Trade Commission," *Journal of Law and*

Economics 2 (October)

Coase, R.H. (1991) "The Nature of the Firm:Influence" in Williamson, Oliver and Winter, Sidney, eds. *The Nature of the Firm:Origins, Evolution, and Development* (Oxford:Oxford University Press)

Coase, R.H. (1994) *Essays on Economics and Economists* (Chicago:University of Chicago Press)

Demsetz, Harold (1967) "Toward a Theory Of Property Rights," *American Economic Review* 57 (May) Reprinted in Furubotn and Pejovich *Op. Cit.*

Ellerman, David P. (1992) *Property and Contracts in Economics* (Oxford:Blackwell)

Feinstein, Charles and Howe, Christopher, eds.(1997) *Chinese Technology Transfer in the 1990s* (Cheltenham UK:Edward Elgar)

Furubotn, Eirik and Pejovich, Svetozar, eds.(1974) *The Economics of Property Rights* (Cambridge MA:Ballinger)

Goodman, David and Hooper, Beverly (1994) *China's Quiet Revolution* (Melbourne:Longman Cheshire)

Hay, Donald, Morris, D., Liu,G., Yao,S. (1994) *Economic Reform and State-Owned Enterprises in China, 1979-1987* (Oxford:Clarendon Press).

Hsu, Robert C. (1991) *Economic Theories in China, 1997-1988* (Cambridge:Cambridge University Press)

Itoh, Kakoto (1995) *Political Economy for Socialism* (New York:St Martin's Press)

Jiang, Xiaojuan (1997) "Chinese Government Policy Toward Science and Technology" in Feinstein and Howe, eds., *Op. Cit.*

Kornai, Janos (1992) *The Socialist System: The Political Economy of Communism* (Oxford: Clarendon Press).

Kundra, Ashok (1996) "EPZs/EOUs of India: Relevance of Chinese Experience" in S.P. Gupta, ed., *China's Economic Reforms* (New Delhi: Allied Publishers).

Liew, Leong (1997) *The Chinese Economy in Transition* (Cheltenham, UK: Edward Elgar)

Liu, Ji (1997) "Separating Government and Enterprises" in Wen and Xu, *Op. Cit.*

Lin, Zhimin (1998) "Conclusion: Provincial Leadership and Reform" in Cheung, Peter, et al., *Provincial Strategies of Economic Reform in Post Mao China* (London: M.E. Sharpe)

Lo, Dic (1997) *Market and Institutional Regulation in Chinese Industrialization, 1978-94* (UK: St. Martin's Press)

Lubman, Stanley (1996) *China's Legal Reforms* (Oxford: Oxford University Press)

Macpherson, C.B. (1985) *The Rise and Fall of Economic Justice and Other Papers* (Oxford: Oxford University Press)

Malik, Rashid (1997) *Chinese Entrepreneurs in the Economic Development of China* (Westport CN: Praeger)

McKean, R. (1972) "Property Rights Within Government," *Southern Economic Journal* (October 1972) Reprinted in Furubotn and Pejovich *Op. Cit.*

McMillan, John and Naughton, Barry, eds. (1996) *Reforming Asian Socialism* (Ann Arbor:University of Michigan Press)

Naughton, Barry (1996) "China's Macroeconomy in Transition" in Walder, Andrew, *Op. Cit.*

Naughton, Barry ed. (1997) *The China Circle* (Washington:Brookings Institution)

North, Douglass C. (1990) *Institutions, Institutional Change and Economic Performance* (Cambridge:Cambridge University Press)

North, Douglass (1995) "The New Institutional Economics and Third World Development" in John Harriss, Janet Hunter, and Colin Lewis, eds., *The New Institutional Economics and Third World Development* (London:Routledge).

Nutter, G. Warren (1968) "Markets Without Property:A Grand Illusion," in N. Beardsley and L. Drewry, eds., *Money the Markets and the State* (Athens:University of Georgia Press, 1968)

Oi, Jean C. (1996) "The Role of the Local State in China's Transitional Economy" in Walder, Andrew, ed., *China's Transitional Economy* (Oxford:Oxford University Press)

Qian, Yingyi and Stiglitz, Joseph (1996) "Institutional Innovations and the Role of Local Government in Transition Economies" in McMillan and Naughton, *Op. Cit.*

Potter, Pitman (1996) "Foreign Investment Law in the People's Republic of

China:Dilemmas of State Control” in Lubman, *Op. Cit.*

Rawsky, Thomas (1997) “Implications of China’s Reform Experience” in Wen and Xu, *Op. Cit.*

Roemer, John E. (1994) *Egalitarian Perspectives* (Cambridge:Cambridge University Press)

Ryan, Alan (1984) *Property and Political Theory* (Oxford:Basil Blackwood)

Sanchez, N. And Waters, A.R. (1973) “Controlling Corruption in Africa and Latin America.” Paper presented at the Southern Economic Association Meetings

Stiglitz, Joseph E. (1994) *Whither Socialism* (Cambridge MA:MIT Press)

Stiglitz, Joseph (1995) “Social Absorption Capability and Innovation” in Koo, Bon Ho and Perkins, Dwight, eds., *Social Capability and Long-Term Economic Growth* (New York:St. Martin’s Press)

von Tunzelmann, G.N. (1997) “The Transfer of Process Technologies in Comparative Perspective,” in Feinstein, Charles and Howe, Christopher, eds., *Chinese Technology Transfer in the 1990s* (Cheltenham, UK:Edward Elgar).

Walder, Andrew G. (1996) *China’s Transitional Economy* (Oxford:Oxford University Press)

Wall, David and Yin, Xiangshuo (1997) “Technology Development and Export Performance” in Feinstein and Howe, eds., *Op. Cit.*

Wang, Xiao-qiang (1998) *China’s Price and Enterprise Reform* (New York:St. Martin’s Press).

Wen, G.I. and Xu, D. eds. (1997) *The Reformability of China's State Sector* (Singapore:World Scientific)

Whiting, Susan (1996) "Contract Incentives and Market Discipline in China's Rural Industrial Sector" in McMillan, John and Naughton, Barry, *Op. Cit.*

Williamson, O. (1963) "Managerial Discretion and Business Behavior," *American Economic Review* 53 (December)

World Bank (1997) *China 2020:Development Challenges in the New Century* (Washington:World Bank).

Yang, Dali L. (1997) *Beyond Beijing* (London and New York:Routledge)

Zhang, Weiying (1997) "The Reform of State Owned Enterprises:Whither to Go" in Wen and Xu, *Op. Cit.*

Zhao, Haiying (1997) "Restructuring Chinese State-Owned Enterprises:A Contractual Approach" in Wen and Xu, *Op. Cit.*