Among those who muster the most righteous indignation against governments that stifle private enterprise are free-market advocates claiming to speak on behalf of the poor. In their works, the poverty of peasants and of rural migrants who eke out a living in the global South’s growing cities is caused by government bureaucrats, who provide privileges for crony capitalists and other favoured elites while smothering the entrepreneurial energies of the less fortunate. Give the poor clearly defined rights to their meagre properties, provide them with opportunities to obtain credit and stop subjecting them to onerous taxes and regulations, and they will not only find entrepreneurial solutions to their own poverty, but they will become a powerful engine for economic development.

This is the message of *Capitalism with Chinese Characteristics*, the widely acclaimed book by Huang Yasheng. In contrast to many mainstream economists, who praise China for steadily advancing toward Western capitalist practices over the last three decades, Huang argues that China started retreating from true economic liberalization in the 1990s. In the 1980s, he writes, China was developing a type of entrepreneurial capitalism in which small rural entrepreneurs played the leading role. But in the 1990s it moved toward a state-led capitalism, which favours big government-connected urban enterprises. Huang’s book, which has received considerable attention in academic and policy circles both inside and outside China and was named by the *Economist* as Book of the Year, has broken new ground in combining free-market doctrines with populist claims.
Most advocates of greater economic liberalization in China are not especially concerned about growing income inequality or about the welfare of those in the lower echelons of the economic hierarchy, but Huang belongs to a distinct subgroup of free-market enthusiasts who place the plight of workers and peasants at the centre of their analyses. Members of this subgroup, which includes prominent academics and journalists such as He Qinglian, Hu Shuli, Qin Hui and Kate Zhou, have elaborated a variety of arguments that attribute growing inequality in China to such factors as official corruption, the persistence of state ownership, overweening government control, constraints on private enterprise, urban bias among state elites, lack of transparency and crony capitalism.

Huang’s account has received particular attention for several reasons. First, he is ensconced at the top of the academic establishments on both sides of the Pacific. A native of China who earned a PhD in government at Harvard, Huang now teaches at MIT’s Sloan School of Management and has appointments at Tsinghua University’s Center for Chinese Economic Research and Center for China in the World Economy, which house many of the PRC’s most prominent and influential economists. Second, he challenges standard accounts of steady progress of market reforms in China by arguing that the conspicuous decline of rural enterprise has been caused by growing state constraints on private entrepreneurship, crafting a narrative that is at once provocative and seemingly intuitive. Third, as a champion of indigenous Chinese enterprise, he criticizes policies that favour foreign-invested firms. Fourth, he backs up his narrative with an impressive body of original research. Drawing on intensive examination of thousands of pages of primary documents from Chinese banks and rural credit cooperatives, as well as data from official surveys of rural enterprise that have been little used by academics, Huang produces a wide array of statistics which he analyses in innovative ways. For this, future scholars will be greatly in his debt.

The book is organized around a comparison of the 1980s, which Huang characterizes as a ‘rural entrepreneurial decade’, and the 1990s, which he


2 It is quite common, of course, for academics and journalists casually to suggest that the difficulties faced by China’s workers and peasants are a consequence of the government’s failure fully to carry out market reforms. It is less common to encounter scholars, like Huang, who make this theme the centre of completely elaborated scholarly analyses.
dubs a ‘state-led urban decade’. In the 1980s, Huang contends, economic policy was largely in the hands of Zhao Ziyang, Wan Li and others who were inclined to carry out liberal experiments and were sympathetic to rural entrepreneurs. After dismantling the rural communes, they allowed private enterprise to flourish in the countryside by removing government constraints and providing easy access to credit. While the cities were still dominated by sluggish government planning and state-owned enterprises, in the countryside—where the state had always been weaker and enterprising spirit stronger—small labour-intensive rural businesses became the prime engine of the rapidly expanding economy.

The liberalizing trends of the 1980s, however, ended abruptly with the suppression of the Tiananmen protests and the fall of Zhao Ziyang in 1989. Economic policy-making was taken over by a new team led by Jiang Zemin and Zhu Rongji, urban-oriented technocrats from Shanghai, who were partial to state-guided industrial planning. They disdained rural entrepreneurs and favoured big, high-tech, capital- and energy-intensive projects, funnelling money to state-owned enterprises and using tax breaks to encourage foreign investment. The result was an increasingly corrupt, crony capitalism and an urban boom in which gleaming skyscrapers were built on confiscated paddy fields. Starved of credit, rural enterprises stagnated and declined.

Huang dedicates one chapter to Shanghai, which he presents as the epitome of all that is wrong with the state-led urban model. While GDP growth has been rapid, he writes, the city’s economic development has been dominated by corporations in which government entities or foreign companies have major shares, rather than by indigenous private enterprises. To ensure the profitability of the state-connected enterprises, layoffs of state-sector workers were particularly aggressive and the development of private-sector competition was suppressed. As a result, Shanghai has relatively few small proprietors and a dearth of medium and large private firms. This lopsided development has in Huang’s view produced income polarization, with the city’s poorest residents experiencing falling real incomes.

Huang doubts the sustainability of China’s state-led development model, citing growing corruption, recurring asset bubbles and slowing total-factor productivity growth. In the final chapter, he compares the Chinese model unfavourably with those pursued by other East Asian
countries and India. The latter is now also on a rapid development trajectory, he writes, because it has replaced economic planning with a liberal policy environment that nurtures indigenous private entrepreneurship (as China did in the 1980s). Among China’s East Asian neighbours, although Japan, Taiwan and South Korea all pursued industrial policy approaches in the past, even when the state was most involved in guiding development the private sector was always predominant. Moreover, like India, these countries did not depend on foreign investment. All of them, Huang concludes, are private-sector success stories, in which indigenous entrepreneurs played the key role.

Huang’s most striking argument concerns not development, but rather inequality. While China’s economy grew rapidly during both the 1980s and the 1990s, he contends, distribution was far more equitable under the rural entrepreneurial model than under the state-led urban model. In the 1980s, personal income grew faster than GDP and rural incomes grew faster than urban incomes. Not only were both trends reversed in the 1990s, but education and medical care became increasingly unaffordable to rural residents, leading to a decline in rural literacy and health indices. The book’s take-home message: when the Chinese government was smart enough to get out of the way and let private enterprise flourish, the economy not only grew rapidly, but the results were more equitable. In this essay, I will consider the main empirical questions underlying these claims. First, why did rural enterprises in China flourish in the 1980s and then falter in the 1990s? Second, what caused economic inequality to grow so rapidly in the 1990s?

Rural enterprises

The actual causes of the rise and fall of rural enterprises are in some ways just the opposite of what Huang proposes. Small rural firms flourished in the 1980s not because the state got out of the way, but rather because it intervened in the economy in a heavy-handed fashion in order to prevent the development of larger private enterprises. In the early years of the post-Mao era, the Chinese Communist Party was determined to prevent the development of a capitalist sector, which it viewed as a potential political threat. It allowed rural households to engage in small-scale entrepreneurial activities, and it continued to promote the development of collective enterprises run by village and township officials. Both sectors flourished with the opening of commodity markets,
but their success was due in large measure to government protection. The state, in effect, created and maintained an environment in which these enterprises could operate without facing competition from large capitalist firms. This protection took six key forms:

1. Land reform and rural collectivization, carried out at the beginning of the communist era, had eliminated the old landed and business classes, and decollectivization subsequently divided land equally among rural households. The field had been cleared and when markets were opened up in the early 1980s, there was plenty of room for entry by small rural entrepreneurs.

2. The CCP suppressed the development of new capitalist firms. Households were permitted to engage in business, but they could not legally employ more than seven people (nominally family members). This restriction was lifted only after 1987.

3. Strict limits on the sale and leasing of land further inhibited the development of larger private enterprises.

4. While contracting with foreign firms was encouraged, direct investment by foreign capitalists was severely restricted.

5. The domestic market remained by and large protected from imported goods.

6. Rural households and collective enterprises enjoyed a monopoly on employing inexpensive rural labour (which was subsidized by subsistence farming). Urban state-owned enterprises were compelled to provide permanent employment and generous welfare benefits to their incumbent workers, and the employment of temporary workers was restricted. This gave small rural enterprises an advantage in labour-intensive sectors, and many benefited from subcontracting relations with state enterprises.

The rural economic boom of the 1980s was powered largely by small factories owned by township and village governments (which were known as collective enterprises, although they were not actually owned by their employees). Small household enterprises also flourished, and by the end of the decade, as employment limits and other restrictions were eased,
private entrepreneurs began to build larger businesses. In order to claim that the rural take-off in the 1980s was largely a private-sector affair, Huang downplays the role of enterprises owned by township and village governments and exaggerates the role of the private sector. To bolster his argument, he cites Ministry of Agriculture data showing that the great majority of rural enterprises were private, rather than collective. This is true if we count all self-employed individuals as ‘enterprises’, because in that case the great majority of enterprises were simply individual artisans, peddlers and shopkeepers. The bulk of employment, however, was actually provided by the collective enterprises, which were fewer in number but significantly larger.³

According to the Ministry of Agriculture data compiled by Huang, reproduced below as Table 1, in the late 1980s, ‘household businesses’ (getihu) made up over 80 per cent of all rural enterprises, but the average number of people active in each of these businesses was only about two. The number of larger private enterprises (those with more than seven employees) was growing, but they were also relatively small, with an average of only about eight employees per enterprise, and until the mid-1990s they never provided more than 10 per cent of employment in the rural entrepreneurial sector. On the other hand, although collective enterprises were relatively small in number, they employed many more people (an average of about thirty per enterprise by the end of the 1980s), and they accounted for over half of the employment in this sector. If we were to remove from this calculation those businesses that were simply self-employed individuals, then the collective sector provided the overwhelming majority of jobs. Moreover, the collective enterprises dominated manufacturing, which was the engine of the rural take-off, while small household businesses were concentrated in transportation, commerce and services, and many of them benefited from opportunities provided by the growth of the collective factories. Nevertheless, Huang is right to characterize rural China in the 1980s as highly entrepreneurial. All rural businesses, including the factories run by township and village cadres, operated outside of the state plan and

³ Some enterprises that registered as collectives were actually privately run, but there is no evidence that these comprised more than a small proportion of the total, and Huang does not suggest that they did. Moreover, it seems that such false registration was largely a phenomenon of the late 80s and early 90s, after the establishment of larger private enterprises had been endorsed ideologically and gained legal sanction, but collective enterprises continued to enjoy credit and other preferences.
andreas: China

had to be enterprising. And all kinds of rural enterprises—household, collective and small-scale capitalist—flourished in the hothouse environment created by the policies of the first decade of market reforms. So, what changed in the 1990s?

The key difference was that the CCP began to promote large-scale capitalist enterprise. In order to compete in global markets, Deng Xiaoping decided, China had to develop large enterprises that operated on capitalist principles. After Deng’s famous 1992 Southern Tour, when he praised the efficiency of export-oriented foreign-invested firms in China’s special economic zones, the state stopped suppressing and instead encouraged the development of large private enterprises, foreign and domestic. The new Company Law that came into effect in 1994, together with a series of

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*More than seven employees. Source: Huang, Capitalism with Chinese Characteristics, p. 79.
related reforms, constituted a major shift toward more liberal economic policies, opening the way for the development of a private corporate sector and the privatization of the great majority of state-owned and collective enterprises. As a result, the protective environment that rural enterprises had enjoyed in the 1980s was dismantled.

Huang is right to argue that urban bias was involved in the decline of China’s rural economy in the 1990s, but he misconstrues the source of this bias. Capitalism intrinsically has an urban bias. With the development of capitalism, peasants, peddlers and artisans are displaced by capitalist firms, the size of enterprises increases, the centre of economic activity shifts from the countryside to cities, peasants move to urban areas and cities expand at the expense of the countryside. Large capitalist enterprises are headquartered in cities, and successful rural enterprises move to cities as they grow. Jiang Zemin and Zhu Rongji did, indeed, have an urban bias, but it was inherent in their preference for capitalism. They were inspired by the corporate capitalism of the West, and they favoured supermarkets over farmers’ markets, department stores over street vendors, large factories over small ones, and corporate chains over mom-and-pop businesses. They had little use for township and village enterprises or household businesses; they wanted to see large, well-capitalized and technologically advanced corporations that were well integrated into global markets. In general, they favoured private over public, and they forced the complete privatization of the great majority of state-owned and collective enterprises, and the partial privatization of most others. The state held onto control of enterprises in a few ‘strategic’ sectors, including banking, oil and other key resources, power, telecommunications and armaments; but even in these sectors enterprises were restructured so that they were responsible for their own profits and losses, which meant they had to act more like capitalist corporations.

The labour market was also liberalized. Restructured public enterprises were freed from obligations to their employees; they no longer had to provide health insurance, pensions, housing, childcare or other welfare services, and they were now free to hire and fire according to market requirements. Private enterprises were allowed to take on as many employees as they wanted, and all enterprises could now freely hire rural migrants. At the same time, the establishment of large private enterprises was now permitted and successful entrepreneurs—urban and rural—were able to get bank loans to expand their operations.
Restrictions on foreign direct investment were lifted, and capital poured in from multinational corporations in the United States, Japan, South Korea and Europe, as well as from a multitude of capitalists, large and small, of Chinese ethnic origin in Hong Kong, Taiwan and Southeast Asia. Zhu Rongji reorganized the regulatory structure so that it more closely conformed to Western practices; his declared goal was to create a ‘level playing field’ for all types of enterprises, public and private. Although some state enterprises still get preferences, the private corporate sector is expanding rapidly, and profitable private businesses have no problem getting credit or licenses.

**Credit squeeze**

Starting in the mid-1990s, rural enterprise hit hard times. As Huang documents, the total number of rural enterprises fell from 24.9 million in 1994 to 20 million in 1998 (see Table 1). Many analysts have concluded that small rural enterprises declined because they could not compete with larger firms, domestic and foreign. Huang disagrees. Instead he argues that the urban-oriented leadership that took over in the 1990s created a hostile environment for rural enterprises, and he highlights policies that made it more difficult for rural entrepreneurs to get credit.

Although it is true that credit was dramatically tightened under Zhu Rongji in the mid-1990s, he tightened the screws on everybody. During most of the 1980s, government monetary policy was lax and credit was easy, and after a brief spell of tight money following the 1989 upheaval, there was a new wave of easy money in the early 1990s. The sudden imposition of tight credit policies caused a crisis not only for rural enterprises, but for urban enterprises as well. In fact, the credit crunch played a critical role in spurring the restructuring and privatization of state-owned and collective enterprises. Thousands of enterprises, urban and rural, shut their doors, and others shed much of their workforce. The state banks were reorganized to operate more like commercial banks, only lending to credit-worthy customers who could offer collateral and proof of ability to repay. The credit squeeze of the mid-1990s winnowed out large numbers of enterprises, both urban and rural, and only firms that were able to adjust to the new highly competitive capitalist environment survived. In general, they were larger and better capitalized, and most of them were privately owned. In the mid-1990s, all Chinese banks were weighed down with non-performing loans, but the Agricultural Bank of
China and the Rural Credit Cooperatives (RCC) were in the worst shape. The RCC, an institution created in the 1950s as part of the rural collective infrastructure, played a particularly important role in promoting rural enterprise in the 1980s, generously providing credit to township and village enterprises as well as peasant families that came up with promising business plans. In the highly competitive environment of the 1990s, however, many could not pay back their loans. Despite the fact that the RCC’s criteria for making new loans became more stringent, the whole system virtually collapsed under a load of bad debts. Was this a result of urban bias among policy-makers? In most countries, commercial banks are not very interested in (or adept at) extending credit to small rural entrepreneurs, and some kind of state support is usually required to maintain institutions that provide credit to the smallest and weakest players. In the 1990s, when the Chinese government scaled back the support it had previously provided for the RCC, it was relinquishing the logic of a developmental state in favour of that of a capitalist banker.

Huang’s central claim is that rural enterprises faltered in the 1990s because government policies favoured state-connected urban firms. In the 1980s, however, when state-owned enterprises (SOEs) comprised a much larger proportion of the economy and were funded directly from the state budget, rural enterprises thrived. Back then, the SOEs never presented much of a threat to rural enterprises. In fact, when many township and village enterprises were first established in the 1970s, they received free technical assistance from urban SOEs. That was, of course, before profit was much of a concern. During the 1980s, when profits did begin to matter, many SOEs were content to sell old machinery and equipment to rural enterprises and give them work on contract. At that time, such contracts were the only way SOEs were able to access inexpensive rural labour. All this changed in the mid-1990s, when urban market reforms resulted in the privatization of most public enterprises and the rapid development of large private concerns. As a result of the CCP’s embrace of capitalism, small rural enterprises—collective, household and small-scale capitalist—now faced competition from much more aggressive urban firms (public and private) that had better access to capital, technology and urban and foreign markets. Large urban enterprises were now also able directly to hire inexpensive rural labour, which until then had been exclusively available to rural enterprises, and many moved into labour-intensive sectors, displacing smaller rural competitors.
Privatization and decline

There is a problem with timing in Huang’s narrative. His ‘rural entrepreneurial decade’ ends in 1989 with the political repression that followed the Tiananmen protests, which was accompanied by a brief retreat from economic liberalization. Between 1989 and 1991, all types of enterprises felt the impact of tighter monetary policy (imposed to rein in inflation, seen as a factor that spurred the Tiananmen protests), and there were new efforts to restrict larger private enterprise (which had only recently been legalized). Yet while the number of larger private enterprises contracted during this period, the number of small household enterprises continued to grow steadily until the mid-1990s.

The figures in Table 1 show that the initial retreat from economic liberalization hurt larger private enterprises, but not household businesses, while with the resumption of liberalization—after Deng’s Southern Tour and the enactment of the Company Law—the number of household businesses started to contract, just as the number and size of larger private firms began to increase dramatically. As the number of rural enterprises shrunk in the late 1990s, the relative weight of larger private firms grew substantially. This was the result both of the privatization of collective enterprises and of the centralization of capital among private enterprises. Centralization occurred among household businesses and larger private-enterprises alike, as the number of firms declined and the number of employees per enterprise increased. Similar processes of privatization and centralization were taking place in urban China, with much bigger enterprises involved.

Huang could make a much stronger case that the sudden decline of the rural economy in the second half of the 1990s was precipitated by urban bias, but he leaves out of his narrative two of the most critical policy changes that favoured urban areas. The first was the wholesale privatization of township and village factories, which consequently lost much of the local government support they had enjoyed, including free use of village land and official help in securing labour, credit, contracts and markets. Privatization was a major factor in the decline of rural industry and was widely seen as government abandonment of the rural industrial sector—in fact, Zhu Rongji wanted the government to get out of the business of running small factories, which were predominantly rural, and focus on large ‘strategic’ firms, which were exclusively urban. The
second was a sudden, sharp drop in grain prices in 1996, which hurt the entire rural economy. It might be argued that the government intentionally drove down prices, in part by flooding the market with imported grain, in order to ease the pain urban residents were experiencing as a result of industrial restructuring. Both of these policy changes could easily be placed at the centre of an argument that urban bias led to rural decline, but they are not part of Huang’s argument, presumably because they do not fit easily into his free-market thesis.

Huang’s diagnosis of the maladies afflicting rural China is clearly informed by one of the foundational myths of neo-classical economics—the ideal of competitive capitalism. Free competition, it is assumed, creates a level playing field on which small entrepreneurs naturally flourish. If small entrepreneurs are squeezed out, it must be the fault of the state, which tips the playing field to the advantage of favoured players. The reality is quite different. Market competition intrinsically centralizes property without the need for state intervention. Winners squeeze out losers, amass capital, capture market share and block new entrants. The state often facilitates this process by favouring the winners, but it can also inhibit it by protecting the weaker players. Over the last two centuries, peasants and small rural entrepreneurs have been the main losers as capitalism has swept across the globe. Where they have survived and continue to play an important role in advanced capitalist economies (as in a number of European and East Asian countries), it is only because state intervention has protected them from the incursion of capital. In China, small rural enterprises flourished under state protection in the 1980s and suffered after this protection was withdrawn in the 1990s. Huang’s underlying notion—that free markets favour the countryside and state intervention favours the city—is simply wrong. Free markets favour the city, and without state protection the rural household sector in China will continue to decline.

**Good and bad inequality**

In 1989 the economic sociologist Victor Nee predicted that market reforms in socialist countries would reduce inequality by shifting income from ‘redistributors’ (state and party officials) to ‘direct producers’. He illustrated this idea by discussing rural decollectivization in China, which allowed peasants directly to reap the rewards of their labour, but then went on to elaborate a general theory of ‘market transition’ applicable to
the entire PRC and, indeed, to all socialist countries. Published at a triumphant moment for free-market ideology, Nee’s article became a focal point of academic discussion. Over the next decade, as rapid class polarization in China and former Soviet bloc countries belied Nee’s sanguine predictions, scholars moved on to other theories—notably on the extent to which market reforms have enhanced the value of (good) human capital and reduced the value of (bad) political capital. Nevertheless, the expectation that markets produce equality has continued to inspire new, more elaborate, interpretations of post-socialist history. Huang’s is among the most creative. Yet his basic thesis—that the spectacular rise of income inequality in China in the 1990s was caused by state suppression of private enterprise—is difficult to square with the facts. During the 1980s, almost the entire urban population worked in the state and collective sectors and most off-farm rural employment was provided by collective enterprises. By the end of the next decade, although a significant public sector remained, the private sector had come to dominate both urban and rural China. The rise of income inequality in the 1990s was, in fact, accompanied by the rapid expansion of the private sector at the expense of the public.

There is, however, a kernel of truth in Huang’s argument: social inequality was limited in the 1980s in part because government policies facilitated the development of small household enterprises in the countryside, and it grew in the 1990s because government policies no longer favoured these enterprises. The problem with Huang’s broader argument is that he conflates two fundamentally different types of private enterprises: household and capitalist. Capitalist enterprises, which were prohibited until 1988, grew rapidly in the 1990s. Conventional Marxist analysis suggests the following explanation for the rise of inequality in China. In the 1980s, the Chinese economy was predominantly composed of state, collective and household enterprises, all of which limited income inequality. In the state and collective sectors, wage differences were regulated by the state and were relatively compressed, while in the household sector, property was distributed relatively evenly. In the 1990s, as the capitalist sector expanded at the expense of the public and

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5 The economic logics of household and capitalist enterprises are fundamentally different. Household enterprises depend on family labour and they therefore must make consumption their main goal, while capitalist enterprises depend on wage labour and they are therefore able to make profit their main goal.
household sectors, property was concentrated in fewer hands, wage differences increased sharply and income inequality grew.

Huang, of course, interprets things differently. He starts from a simple free-market ideological premise. There are, he writes, good and bad mechanisms for creating income differences: inequality arising from market incentives is good, while inequality arising from anti-competitive privileges is bad. Using the United States as a benchmark for inequality arising largely from ‘good’ mechanisms, Huang cites scholars who estimate that China’s Gini coefficient (the widely-used measure of income inequality) surpassed that of the United States in the early 1990s. ‘Based on these numbers’, he writes, ‘we can argue that in the 1980s, the rise in the Gini [in China] was due to the workings of the economic incentives, whereas in the 1990s, it was due to the blockage of economic opportunities.’

This perspective colours Huang’s analysis throughout the book; he is adept at finding ‘bad’ inequality caused by the state and blind to ‘good’ inequality caused by market mechanisms. In one of his most interesting tables, for instance, Huang scrutinizes data about the economic activities of a sample of 20,000 rural households between 1986 and 1999 (reproduced as Table 2, opposite). He compares the amount of time rural households spent carrying out their own business activities with that spent working for wages, and then calculates the income they reported from each, during three periods. He shows that during the last period (1992–99), members of rural households spent relatively less time working in their own businesses and more time working for others, even though they earned much more per day from their own business activities than from wages. In fact, over time the return to labour expended on a household’s own business activities increased by 36 per cent, while local wages declined by 33 per cent, and yet rural households chose to spend more time working for others. From this, Huang concludes that it must have been more difficult for rural households to engage in their own businesses in the 1990s, forcing members of these households to work for others instead. This, he suggests, must have been the result of government policies, and he uses this deduction to help make his case that the government became more hostile to rural enterprise in the 1990s.

6 Huang, *Capitalism with Chinese Characteristics*, p. 258.
What Huang does not see in the table is more interesting than what he does, and it suggests conclusions that are at odds with his broader thesis. The figures, in fact, show the dramatic class polarization that was taking place within rural China. After 1992, of the growing number of rural residents engaged in non-agricultural activities, a smaller proportion were operating their own businesses and they were making much more money, while a larger proportion were working for others and they were making much less money. Presumably, the average income of entrepreneurs was increasing because some were operating larger businesses and employing more workers (as is evident from the data in Table 1). The pro-capitalist policies of the 1990s were allowing the most successful rural entrepreneurs to enlarge their businesses, driving out weaker competitors and compelling the latter to hire out their labour.
The most interesting figures in this table concern falling wages. Before 1992, rural residents who worked locally earned an average of nine or ten yuan a day in wages (in 1978 prices), while after 1992 they earned only six yuan a day. The great majority of these wage-labour jobs were in enterprises that were originally owned by townships and villages, most of which were privatized starting in the mid-1990s. Even more interesting is the comparison between the wages for local and migrant employment (often in urban areas). Most scholars assume that rural residents greatly benefited from the opening of urban jobs to rural migrants in the 1990s. Huang’s data, however, suggest the opposite. For rural residents, local village jobs in the 1980s paid far better wages than distant urban jobs in the 1990s. In the 1980s, the labour market was highly constricted and most township and village enterprises hired local villagers, while urban SOEs provided permanent jobs to city residents. Urban jobs paid more and had better benefits, so the exclusion of rural residents from these jobs was certainly unfair. The privileged labour conditions in urban enterprises, however, allowed lower-wage rural enterprises to thrive, and they set a relatively high ceiling under which these enterprises could successfully compete and still pay decent wages. In the 1990s, the labour market was opened up, allowing rural migrants to compete for urban jobs, and at the same time the capitalist transformation of urban China compelled urban enterprises to compete to lower labour costs. The result was a race to the bottom, in which rural workers ended up making less in urban jobs than they had in the collective enterprises in their own villages, many of which were now closing.

In 1978, before market reforms, income inequality in the PRC, as measured by Gini coefficients, was among the lowest in the world. Three decades later, it is among the highest. The current Gini coefficient can be attributed to three main factors: the rural–urban income gap, regional disparity and differences within localities. All three have increased substantially, especially since China’s capitalist turn in the 1990s. The culpability of pro-capitalist market reforms is clearest with regard to income differences within localities, where class differentiation is the key factor, but capitalist transformation has also exacerbated rural–urban and regional disparities. During the Mao era, the state took extraordinary measures to shift industrial capacity from China’s coastal region to the interior, and it promoted local and regional self-sufficiency. These policy goals, which many mainstream development economists have derided as economically inefficient, underpinned the creation of
many township and village enterprises in the 1970s, when every rural commune was encouraged to build small factories. As a result, rural industries were much more evenly distributed across China’s provinces than they are today (although they were still skewed toward the more developed regions). This legacy was still evident in the 1980s, when national and international commerce was limited, and many rural industries produced for local and regional markets. As more thoroughgoing market reforms removed impediments to national and international trade and investment, however, capital flowed to major cities and the coastal region, which developed much more rapidly. State policies, including tax breaks for foreign investment and government promotion of export-oriented industries, exacerbated this process, but the main factors have been the competitive advantages enjoyed by large firms and the geographic advantages enjoyed by major cities and coastal areas.

**Dismantling state provision**

To strengthen his case about the harm done by urban bias during the ‘state-led decade’ of the 1990s, Huang includes an extensive section on declining health and education indices in rural China. His arguments here, however, are even more problematic. To his credit, he acknowledges that tremendous gains were made during the Mao era, when basic education and health care were extended to almost all villages and were provided at minimal cost. He then deftly skips over the 1980s with a few carefully crafted sentences and argues that rural literacy and health indices have declined because the urban-oriented regime of Jiang Zemin and Zhu Rongji neglected the needs of the countryside. In fact, it was during the 1980s that the real damage to both the rural education and health-care systems was done. Between 1978 and 1983, the post-Mao leadership, which believed that Mao had put too much emphasis on basic education, closed tens of thousands of village and township schools and shifted resources to elite education, leading to a sharp drop in primary- and middle-school enrolment. With regard to health care, Huang’s heroes, Zhao Ziyang and Wan Li, are particularly to blame for the collapse of the rural health-care system because they led the way in dismantling the rural collective system on which it had depended. Between 1978 and 1984, as the village collectives were broken up, the

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7 Distribution of these services during the Mao era was fundamentally unfair: in cities, education and health care were provided by the state and the quality was superior, while in villages, rural collectives underwrote much of the cost and the quality was inferior.
cooperative health-service system broke down and the ‘barefoot doctors’ (who had been paid by the collectives) set up private practices or went into other lines of work. Zhao and Wan were, indeed, champions of peasant enterprise, but as ardent advocates of marketization they had little regard for social goods provided by collective and state institutions.

By the time Jiang and Zhu took over in the 1990s, the damage to the rural health-care system had already been done. What they did was to extend market reforms to the city, dismantling the work-unit system, which had provided basic health care and insurance for employees of state-owned and collective enterprises. So, on this particular front, Jiang and Zhu actually reduced rural–urban inequality by destroying the health-insurance system on which urban residents depended. At the same time, commercialization and corruption drove up fees for health care (as well as education), which hurt both the rural and urban poor.

As they carried out market reforms in the 1980s and 90s, then, China’s leaders dismantled the collective and state institutions on which health-care provision was based; only in recent years have they begun seriously to build a new health-insurance system. So far, both coverage and benefits are limited, especially in the countryside. By adding his voice to those calling for greater state provision of health care, Huang takes a stand at odds with harsh laissez-faire policies. In his analysis, however, Huang not only misallocates blame, but also misdiagnoses the cause of the problem. It was not urban bias but market reforms that undermined the health-care system.

The shortcomings in Huang’s analysis are clearly tied to his general ideological approach, in which markets solve problems created by the state. In line with the logic that markets create ‘good’ inequality and the state creates ‘bad’ inequality, Huang focuses on politically derived privileges and corruption when analysing the causes of growing inequality in the 1990s. The fundamental problem, according to his account, is that the ‘state-led’ orientation of the 1990s engendered a system of crony capitalism, and the solution is to privatize the economy still further. Corruption is indeed widespread in China today and the term ‘crony capitalism’ is not inappropriate. When public enterprises were privatized most were sold to insiders. Well-connected former officials have established many of the most successful new private enterprises; meanwhile both public and private firms routinely engage in disreputable behaviour to curry favour
with officials. It does not follow, however, that state involvement in the economy is the problem and privatization is the solution.

Over the last three decades, corruption and privatization have grown in tandem. During the Mao era, when state and collective ownership prevailed, corruption was effectively controlled through administrative and political methods (and by the fact that no one was allowed to accumulate much private wealth). In the 1980s, corruption increased along with privatization, but both did so modestly. At that time, the government continued to be much more deeply involved in the economy than it is today. This was true in rural as well as urban China, and the kind of political connections that Huang laments in the PRC’s cities today were ubiquitous in the rural economy of the 1980s: rural officials ran TVES, party cadres and their family members and friends began to establish private operations, and successful entrepreneurs of more humble origins cultivated official ties. The managers of state and collective enterprises, however, continued to have civic obligations, and they operated under administrative and public scrutiny, which curbed their venality. It was only in the 1990s, with the privatization of most of the economy, that corruption reached the proportions seen today. Privatization replaced civic obligations with an unbridled orientation towards profit, which led to corruption on a much larger scale.

Protecting capital

Rural China is home to hundreds of millions of people, and it remains a realm of peasant subsistence production and small enterprise. The capitalist turn of the 1990s put tremendous pressure on peasant households and small rural enterprises, as large capitalist companies steadily took over fields of entrepreneurial activity on which rural households depended, in industry, transport, commerce and even agriculture. More and more rural families now depend at least in part on income from wage labour, and many rural residents migrate long distances in search of work. According to official estimates, rural migrants now number more than 130 million.

The government of Hu Jintao and Wen Jiabao, who took over after the 16th CCP Congress in 2002, is clearly concerned about the social disruption and popular protests caused by radical market reforms, and it has taken a number of measures to improve social conditions in rural China.
Most significantly, agricultural taxes have been eliminated, grain-price subsidies have been increased, state investment in rural infrastructure has been expanded, and rural health and education spending has grown. In addition, a new Labour Contract Law, enacted in 2008, calls for improved wages and benefits for migrant workers and requires large companies to offer permanent employment to workers with over ten years of service. On the other hand, the government has relaxed restrictions on land leasing, with the express purpose of promoting the development of large-scale agribusiness. All of these policies have been controversial, and protracted battles continue over implementation. Employers have stalled on the labour law, and export-oriented manufacturers have been particularly vociferous, complaining that it will put them at a competitive disadvantage in global markets. Peasant advocates have opposed long-term leasing of farmland, arguing that it will create a large landless population.

The question at the centre of the most contentious issues is: should the state protect workers and small entrepreneurs from capital? Or should the state promote the interests of large-scale enterprises by eliminating such protections? Where, it is instructive to ask, does Huang stand on this question? Huang styles himself as the advocate of all indigenous private entrepreneurs in China, large and small. Indeed, as I have noted, he does not conceptually distinguish between small household businesses and large capitalist enterprises. On the one hand, small rural entrepreneurs are the stars of the book. He highlights the poorest and most vulnerable among them, arguing that entrepreneurship has thrived especially in the poorest regions of China and among the poorest strata of the population, those most neglected and least controlled by the state. On the other hand, Huang also includes among his heroes wealthy private entrepreneurs who have built multi-billion yuan corporations. While he spends much of the book celebrating the enterprising spirit of small rural entrepreneurs and lamenting their decline, he also insists that China must strive to create a more capable, sophisticated, technologically advanced and competitive capitalist sector by eliminating the ‘adverse business environment’ that ‘hampers the expansion and corporate development of Chinese private-sector firms’. Ultimately, his prescriptions add up to a coherent programme to promote China’s corporate private sector.

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8 Huang, *Capitalism with Chinese Characteristics*, p. 292.
Huang calls for less ‘government interventionism’ and for ‘further liberalization’ of economic policy in general, and his main practical concern is to reduce further the size of the state sector and remove the remaining privileges enjoyed by state enterprises. He also calls for the elimination of the remaining obstacles to a unified national market for trade and investment, which would allow Chinese firms to expand so that they can compete successfully with foreign firms. Huang, however, is not a market fundamentalist. Indeed, he favours some of the market restrictions that had previously protected indigenous entrepreneurs from foreign capital. He was not a supporter of China’s entry into the WTO, and he sees the utility of protecting the Chinese market, especially with regard to foreign investment. He is critical of the CCP’s decision to promote foreign direct investment, and you will not find in his book the familiar Western demands that the PRC further open its capital markets or allow the yuan to float freely. Some of the policies to protect domestic capital that Huang favours would clearly be advantageous to a wide array of Chinese entrepreneurs, large and small.

Yet while Huang would like to protect all Chinese entrepreneurs from foreign capital, he has no use for market restrictions that protect small entrepreneurs from domestic capital. He sheds no tears over the elimination of the prohibition on private enterprises hiring more than seven employees, a regulation that in the 1980s enabled small household businesses to operate in many fields that would otherwise have been dominated by larger companies. He also believes that the government has no business protecting workers’ jobs or interfering in conditions of employment, and he specifically criticizes the 2007 Labour Contract Law. If enforced (unfortunately, most Chinese labour laws are not), the law would improve the bargaining power of wage workers, including the burgeoning number of rural migrants, and it would also improve the competitive position of small enterprises (which are exempted from the law’s requirements) as they struggle to hold their own against larger companies. Huang, however, is concerned that the law ‘will be very damaging to the economy’. It will, he writes, create labour-market rigidity that will ‘reduce the incentives of entrepreneurs to create businesses and will drive away existing businesses to countries such as Vietnam and India’.

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9 Huang also discussed these issues in his previous book, Selling China: Foreign Direct Investment during the Reform Era, Cambridge 2003.  
10 Huang, Capitalism with Chinese Characteristics, p. 297.
Today, the biggest threat to the long-term viability of the rural household economy comes from efforts to concentrate farmland and develop large-scale agricultural enterprises. After the rural collectives were dismantled in 1978, the land remained village property but was divided equally among village families, and the sale and leasing of land was strictly controlled to prevent land concentration and the creation of a landless population. Although these restrictions have been relaxed over the years, they continue to protect the access of rural households to land, a key foundation of the small peasant economy. For some years, however, free-market advocates have been pressing to privatize agricultural land. While presenting themselves as champions of peasants’ rights—that is, clearly delineated individual property rights—and claiming to be concerned about improving peasants’ incomes, they explicitly argue that privatization is necessary in order to concentrate farmland and allow the development of larger, more efficient agricultural businesses.

For its part, the state has been experimenting with allowing agribusinesses to lease farmland, and it may permit the individual sale of long-term use rights, which would result in *de facto* privatization. The CCP leadership is clearly divided on this issue, with some favouring the private concentration of farmland and others warning that this would result in social instability as rural families lose their means of subsistence. What is Huang’s position? Although he denounces corrupt officials who seize peasants’ land for urban development projects, in his book he steers clear of the issue of privatizing and concentrating farmland. Elsewhere, however, he has called for ‘granting full trading rights of land to rural residents’, which is the catchphrase of those who want to develop corporate agriculture.11

Huang’s programme to create favourable conditions for the expansion of China’s indigenous capitalist sector would not bring any relief to the great majority of the rural population, which depends on a combination of subsistence farming, small enterprise and wage labour. In order to promote the development of capitalist enterprises, Huang seeks to keep wages low and employment flexible, continuing to squeeze rural families that rely on the income of members who go out to work. Moreover, because the capitalist sector is expanding at the expense of small enterprise, his

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11 Huang, ‘China’s rise relied on a rural miracle. So does its future’, *Guardian* blog, 17 May 2009. Also see Huang, ‘Nongcun gaige de weijing zhiye’ [Unfinished tasks of village reform], *FT Zhongwen wang* [Financial Times Chinese Net], 18 August 2009.
programme would end up driving more rural household enterprises out of business. This is hardly a prescription to save China’s rural poor.

Huang’s book is popular because it seems to confirm—with elaborate statistical analyses—a common understanding of what is happening in Chinese society today: wealthy and corrupt officials are lording it over a hard-working population. This understanding is not altogether wrong. Corruption is rampant, and party and state officials are lining their pockets while most people are struggling to survive. The biggest problem, however, is that these officials are allowing increasingly powerful capitalist companies to run roughshod over their employees and smaller competitors. Huang’s advice—to loosen the reins—would only make things worse.