"Painted Horses": Reform Culture and the Phenomenon of Partial Reform

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I. "Painted Horses

Noted Beijing University economist Zhang Weiying often uses a particularly trenchant allegory to describe China's reform process. The story involves a village in which the primary work animals are horses, creatures that – at least as the story goes – complain unrelentingly and continually demand food, but provide precious little labor in return. In this allegorical world, zebras are just the opposite sort of animals – efficient, tireless, loyal, and unflappable. After years of extolling the virtues of horses, the village chiefs finally concluded that it would be better for everybody if the community's horses could somehow be replaced by zebras. Yet, such a switch constituted no small challenge. For decades, the village heads had harangued citizens with, and indeed staked the legitimacy of their rule upon, the idea that horses are wonderful and that zebras are evil, that horses mark the road to salvation, and zebras the path to perdition. Whether through indoctrination, fear, or just force of habit, the villagers had come to accept that horses were right and zebras wrong.

Faced with such a delicate situation, the village heads came up with a solution. Under the cover of darkness each night, they began painting black stripes on a few of the village horses. Each morning at daybreak, the villagers – aghast at seeing zebras in their midst – were repeatedly assured that these animals were nothing more than the same old horses of yore, albeit with a few harmless stripes painted on. Night after night, a few more horses would be painted, and ultimately, people grew accustomed to life among these oddly decorated animals. Everybody could rest assured that for all the painting going on, these were just the same familiar horses, and certainly not zebras.

After another long interval, the leaders, again under the cover of night, slowly began replacing the painted horses with real zebras, wonderful animals that quickly proved their worth in the fields. Village life clearly improved as a result, but all the while, the leadership maintained that these zebras were just horses, albeit with artfully applied stripes. Just as they had with the painted horses, people adjusted to life with real zebras, and though they dared not utter it, they started to conclude that these animals might indeed be real zebras, and that zebras were not so bad after all. Only many years down the road, well after all the horses had been replaced, and well after many seasons of prosperity had passed, did the leaders gather the citizenry and proclaim officially that this was a village of zebras, that zebras were good, and that horses were bad.

The allegory, though focused on China's reform strategy, indirectly hints at something else rather fundamental, an institutional form that will be the subject of this paper. Systems undergoing purposive transformation almost inevitably exhibit a plethora of "half-way" institutions, "painted horses" that do not quite fit standard models, categories, and taxonomies. It is precisely those "painted horses" that this paper seeks to understand through a culture and policy studies lens. Where do such institutions come from, how do they develop, and why do they persist? How can we explain both their evolution – an issue of dynamic change – and their tendency with each passing wave of reform to display certain static attributes over time? How should we make sense of systems like China that on the one hand have undergone radical institutional transformation, yet on the other – particularly in the financial and industrial sectors – exhibit persistent patterns of value destruction? What does it really mean to suggest that a system is stuck between plan and market?

II. China's "Unfinished" Systemic Transition

Twenty-five years into a self-described process of "system" reform (*tizhi gaige*) and transition (*guo du shiqi*), China's political economy is still replete with "painted horses." This is as true of the more abstract rules and norms surrounding economic behavior as it is for the more concrete organizations embodying those norms. Over the past two decades, there has been extraordinary, even mind-boggling, institutional change. Planned resource allocation -- particularly in the real economy -- is a thing of the past, prices have been liberalized, an industrial revolution in the countryside has been unleashed, a massive demographic shift toward urbanization is well under way, and for the country as a whole, substantial integration into the global economy has been achieved.

At the same time, we still witness a seemingly contradictory mix of market and non-market institutions, a mix that has existed throughout much of the reform era, and one that appears to be deepening as the economy becomes increasingly industrialized and complex. There now exists a vibrant stock market, the eighth largest in the world in terms of market capitalization (if the two exchanges, in Shanghai and Shenzhen, respectively, are taken as a single whole), but one in which only a third of the market's shares are permitted to trade. The rest remain controlled by organs of the state (Green 2003)[1]. Listed on this market are high-profile public corporations – many of which were in the past traditional socialist state-owned enterprises (SOEs) – whose shares trade internationally, whose business activities extend well into the global economy, but whose ownership remains thoroughly state dominated. Across the economy now exist myriad private firms run by prototypical capitalist entrepreneurs, but more often than not, these firms grew out of locally-owned collectives, the entrepreneurs enjoyed prior careers in the state apparatus, and the firms today remain tightly networked with various governmental agencies and personages (Oi 1999; Unger and Chan 1999; Wank 1999; Gregory, Tenev et al. 2000). The lines between public and private remain blurred at best. On the financial front, there now exist large-scale banks engaged in a bewildering array of commercial operations both domestically and internationally, yet they remain formally state-owned, they invest extensively in state firms, and – like many Chinese industrial firms – remain tightly enmeshed in the state and Communist Party apparatus.

Moving from the level of economic producers to the government itself, we again witness substantial change amidst persistent, difficult-to-classify institutional patterns. On the one hand, since the inception of reform, and with even greater alacrity since the 1990s, governmental policy makers have freed-up prices, induced greater competition through the entry of new firms, reduced regulatory barriers across a number of sectors – including sensitive areas like energy and telecommunications – and, by their own

[1] Though the shares, in rather dubious fashion, are valued at the market prices commanded by the one-third of total shares that do trade.

description, fostered the spread and maturation of markets. In so doing, they appear to pursue what Steven Vogel, writing in reference to Thatcherism in the United Kingdom, terms "pro-competitive" deregulation (Vogel 1996). They employ the power of the state to fix into place increasingly competitive markets. On the other hand, the Chinese government -- whether in terms of its extensive control of the nation's financial markets, its continued efforts to build "national champion" industrial conglomerates, or its maintenance of a political "pecking order" of firms and an accordingly tilted regulatory playing field (Huang 2003) – still to this day appears to be aggressively seeking a form of managed capitalism, something akin to what Vogel, writing in reference to Japan, terms "strategic reregulation" (Vogel 1996). The powers of the state are used to distort, supercede, or otherwise manipulate market forces.

"Painted horses" flourish in systems understood by insiders and outsiders alike as being in a state of becoming. Yet, where do "painted horse" institutions come from, what accounts for their particular characteristics, and what prevents them from evolving into "zebras"? Why do reforming systems often get stuck in seemingly sub-optimal and inefficient institutional modes? Why do institutions in reforming systems end up the way they do?

III. Reform Culture and Institutional Development

This paper argues that the answer to the questions outlined above lies in a particular form of reform culture. The notion of culture employed by the study, however, is not an expansive one claiming to describe a given people's entire way of life (Geertz

1973), or even claiming that such a way of life can be said to exist. Nor is it about a rigid set of dictates, an orthodoxy that mandates specific institutional outcomes. Instead, this study uses “culture” in a narrower sense to refer to a set of basic assumptions that individuals use, and that are shared societally, to make sense of a very specific realm of their environment, the realm of economic transactions. They are, in effect, assumptions about the way the world, or at least the economic world, works. Such assumptions can be understood as basic frames of reference (Swidler 2001), basic cognitive lenses for interpreting the empirical world, and fundamental principles of causality (Dobbin 1994) – intellectual constructs that permit individuals and groups to cope with and act upon situations of intense complexity and uncertainty.

This study argues that economic actors in China – both at the elite level in policy circles and at the grass roots level within firms – share a common set of principles about the way markets function, a common understanding of how causation operates in economic affairs. Just as we might think of a French style of industrialization in contrast to an American one (Dobbin 1994), or a British approach to deregulation as opposed to a Japanese one (Vogel 1996), so too can we think of a uniquely Chinese way of understanding markets. This unique understanding – discernable in the language that is used to discuss economic affairs, the manner by which economic actors describe their environment in interviews, and the explicit justifications policy makers provide for their actions – shapes the way economic problems are conceptualized and the types of institution-building responses that are attempted.

Culture and collective cognition count across all systems precisely because the constituent elements of collective cognition differ from system to system. That the

Chinese understand, conceptualize, and describe market operation in a different manner from the French plays a large part in driving the divergent paths of institutional development observed across these systems. As this volume argues, culture impacts on institutional development generally. To understand *how* it impacts, however – to understand why institutional variation exists across systems, and to understand why many systems end up with "painted horses", but all of a different stripe – one must delve into the constitutive elements of the particular national culture in question.

The argument here is not that within any nation, all individuals adhere to a single orthodoxy, or even a necessarily internally consistent set of specific principles. In the Chinese case, individuals do not slavishly adhere to a particular economic orthodoxy, an ideology, or even what is generally understood as a particular economic school of thought. Nor is the point that debate over economic affairs is absent in China. To the contrary, economic policy and reform strategy are subjects of intensely rich debate and discussion (Fewsmith 1994; Fewsmith 2001). Bookstores, newsstands, and the television airways are packed with competing analyses of China's economic future and reform trajectory. Moreover, it is not just elites who engage in such discussions. Whether on the street corners, in their places of work, or in the privacy of their own homes, everyday citizens in China routinely discuss the economic reforms that have been sweeping their lives for the past twenty years (Dutton 1998; Barme 1999). Economic reform has entailed deep institutional reform, and deep institutional reform has entailed profound societal change. It is no wonder that debate, discussion, and competing opinions spill forth from all strata of society.

As this study argues, however, such debate, whether at the popular or elite level, takes place within a circumscribed intellectual space, one bounded by certain fundamental assumptions about the way causation in economic affairs operates. These basic framing principles, the essence of reform culture, provide the common reference points, common terms, and common meanings that are necessary for people to engage in discussion and debate. But, just as they facilitate debate, so too do they channel it in certain directions and narrow the range of options that are discussed. Similarly, so too do they limit and shape the range of possible actions people take when faced with economic problems. This is as true for elite policy makers as it is for grass roots economic actors. Reform culture does not suggest that people are somehow automatons marching robotically in step with a particular economic ideology. Rather, it suggests that groups of people share common understandings about the way the world works and about the way causation operates. Those understandings, rather than being rooted in some sort of universal truth, frequently differ from society to society. Cultural frames of reference, while not in of themselves illogical or irrational, are in some sense idiosyncratic – they differ from the alternative conceptions of causation employed by people in other places or times. Such frameworks, rather than deriving from empirical observation, in some sense precede such observation, shaping the manner by which data are classified, ordered, and interpreted. The frameworks, then, can be understood as “shot in the dark” assumptions, principles that – for those who hold them -- may make sense, may be taken for granted as common knowledge, and may in some sense prove useful for negotiating the empirical environment, but that are not in themselves held up to serious analytical scrutiny. Culture, in this sense, is a tacitly employed lens through which complex information is ordered and acted upon.

The Components of China's Reform Culture

China's reform culture is composed of several taken-for-granted principles. First, and most basic of all is the assumption that the main impediments to growth in China are institutional. The understanding, in other words, is that China over the course of modern history fell behind economically, and to some extent remains so today, because its system was (and is) inadequate. In order to achieve "catch up," therefore, the system institutionally must be changed. When specific economic problems are encountered – be they related to slow growth, bank insolvency, enterprise failure, or deflation (or inflation) – they are attributed to something about the system and its institutional evolution, and then policy remedies almost inevitably grow out of some debate about what actually constitutes the appropriate institutional fix.

Related to the overall institutional focus, a second component of China's reform culture involves assumptions about the sorts of firms believed to drive economic growth. Since the inception of the first rounds of agricultural reform in the late 1970s, China has experienced an absolute burgeoning of entrepreneurship and new enterprise creation. Hundred of thousands of small to medium-sized firms have emerged, initially in the publicly owned collective sector, but increasingly in more fully privatized forms. The rise of such firms has – to varying degrees over time – received official approbation, particularly at the local level, and such firms are widely recognized as important sources of job creation. Nonetheless, for many Chinese, both within government circles and beyond, these entrepreneurial creations are viewed as anything but the fundamental motors of national growth. Instead, that role is assumed to belong to the nation's large scale, vertically integrated, horizontally diversified industrial conglomerates. In this essentially Chandlerian vision, one that would have been equally taken for granted fifty years ago in most industrialized countries, large firms are understood to drive progress, and in so doing, are viewed as constituting the fundamental underpinnings of capitalism and modernity (Chandler and Hikino 1994; Penrose 1995; Chandler and Hikino 1997; Nolan 2001). Small firms, from this perspective, are fine for providing jobs, supplying minor inputs or services, and serving a variety of other ancillary roles on the fringes of the economy, but the real action, the real locus of progress, and the real fount of creativity is to be found in a handful of large scale firms, key assets of the entire nation.

Whether one agrees or disagrees with the large firm focus, one can see how when combined with a set of additional assumptions, the view takes on a certain internal logic. Starting off, there is the plausible notion that over the long term, because of diminishing returns to basic factor accumulation, growth ultimately depends on productivity improvements. Productivity improvements, in turn, depend broadly on technological innovation – new tools, new materials, and new ways of doing things (Solow 1957). The next analytical jump, essentially a "shot in the dark" assumption, is that innovation in the modern industrial age stems from vast amounts of tacit knowledge accumulated over long periods of time. Such knowledge accumulation presumably exceeds the capacity of individuals, and can only exist within long lasting organizations. Know-how and creativity, in other words, rather than reposing in individual entrepreneurs, are instead understood as existing in massive corporate organizations, organizations that are somehow greater than the sum of their constituent employees. Individuals are talented, perhaps, but only by being situated in an organization and surrounded by comparable peers do they reach their full potential. Notions about diminishing returns to resource accumulation may drive the emphasis on technological innovation, but notions about increasing returns to knowledge and scale certainly drive the emphasis on the large firm and its association with modernity.

Flowing from this understanding is the assumption that as repositories of vast amounts of accumulated tacit know-how, key production organizations have an intrinsic value of their own, a value that somehow exceeds that of their constituent parts, and a value that somehow comes prior to that which is assigned by markets. In effect, such organizations come to represent the value of increasing returns to scale, scope, and knowledge. Individual employees may come and go, and market valuations may rise and fall, but the organizations, as repositories of knowledge and the only real producers of major innovation, somehow have intrinsic value. They are integral to the national growth process, and as such, must be fostered and preserved.

Just as the second component of China's reform culture pertains to the motor of economic growth, the firm, the third pertains – in effect – to the critical surrounding medium, the market. In China today, at elite and grass roots levels alike, there is unflagging faith in the power of markets to foster growth. The assumption, however, is not so much that markets foster growth through efficient allocation. They are not envisioned primarily as modes of allocation, selection mechanisms that continual deploy resources to some recipients and withdraw it from others (and, in the process, lead to the rise and fall of enterprises and other constellations of assets). Instead, the market is understood as a treatment, an incentive mechanism that when applied to existing organizations allows their intrinsic potential to surge forth and flourish. On the fringes of the economy, the market certainly induces churning as myriad small firms come and go, and myriad entrepreneurs attempt to grab newfound opportunities and rents. Fundamentally, though, at the core of the economy – the core at which policy is directed and from which national growth outcomes can be expected to derive – markets are seen as a treatment, the latest and most modern instrument for unleashing the potential of modern industrial producers. Just as the modern large-scale enterprise is understood as having intrinsic value as a repository of organizational knowledge, such too are such enterprises understood as somehow preceding the market. The particular constellation of assets they embody does not represent some sort of market-induced allocation outcome, but rather precedes market forces.

It is with this in mind that Chinese policy makers talk about “exposing” firms to the market, and “enlivening” firms through market forces. As described in detail in Chapter Three, this particular discourse emerged early on in China’s experiments with enterprise reform, and has lasted for over twenty years to the present day. The market, in this discourse, by attaching value to inputs and outputs, and by permitting that value to be apportioned to stakeholders in the production process as a reward, is understood to serve as a basic incentive mechanism. Presumably, in this particular understanding of property rights, the producer – to the extent she enjoys the fruits of her labor and is held responsible for liabilities she accrues – will be induced to expand the assets under her control and create value. To the extent the market is truly in place, the incentives will all be aligned correctly, and she will be able to realize the full potential of her assets. Importantly, as noted before, the potential of these assets, and even their physical form (in terms of the boundaries of the firm, for example), are understood as factors preceding, rather than stemming from, the operation of the market. In China's reform culture, then, the market is at once invested with extraordinary faith (faith that it will be the source of enterprise and national salvation), but also relegated to a rather secondary, instrumental status (a status subordinate to the modern industrial producer itself).

IV. Why Culture?

In studies of institutional development, cultural and ideational explanations , with some notable exceptions (Hall 1989; Berman 1998; Huntington and Harrison 2000; Blyth 2002; Swenson 2002), are frequently relegated to the peripheries, accorded a secondary status at best. As drivers of economic outcomes, they are viewed as nebulous and vague, particularly relative to ostensibly more concrete, measurable variables like economic interests and societal groups. Scholars may recognize intuitively that different societies seem to handle problems in different ways, and that these patterns may persist even in the face of tremendous socio-political change. Nonetheless, when it comes to pinpointing the evolution of institutional systems in strict analytical terms, the standard practice is to assume economic rationality, to assume that straightforward material interests constitute the base of the political economy. As Peter Hall notes, ideas – and by extension, the cultural lenses through which ideas are integrated – are treated simply as "so much froth on the long waves of economic development (Hall 1989).

Given these established practices, why reach for the cultural explanation first? Why treat ideas and culture as the base rather than the superstructure of a political economic system? Why not just assume economic rationality and proceed from there?

In its emphasis on culture, this study argues that policy makers and other economic actors make "shot in the dark" assumptions to order reality and cope with uncertainty. Such assumptions then become critical in shaping overall institutional development and structure. What is important to recognize is that similar *a priori* principles of causation are adopted by scholars themselves as they go about studying institutions and institutional change. Like their counterparts in the policy world, scholars routinely make "shot in the dark" assumptions to order reality, assumptions about causation that make it possible to think about economic or political rationality and interest-maximizing behavior. That is, the notion that interests constitute the base of a political economy (and ideas or culture the mere superstructure) is built on an analytical foundation no sturdier – and indeed, as this study will argue in the Chinese case, empirically weaker – than that of the cultural perspective.

The "Transition" Perspective: Transition as a Path between Known Endpoints

To get a better sense of these standard scholarly assumptions, one might return to the allegory that began this chapter. That allegory, beyond just describing Chinese reform, expresses something fundamental about the way scholars approach institutional change more generally. As noted in Chapter Two, in much of the literature on post-socialist transition, and even on economic development more broadly, change – as in the allegory -- is understood as a movement between known endpoints. The questions worthy of study, then, are presumed to reside not in the endpoints themselves – ostensibly known institutional systems -- but rather in the journey between them (Kornai 2000). Particularly in the realm of transition, much scholarship presumes an understanding of how command planning operated, and equally presumes an understanding of how markets function, but then vigorously debates the means of getting from one system to the other. Arguments turn on the appropriate pace and sequencing of pro-transition policies, the most effective strategies for marshalling popular support for systemic transformation, and the degree to which a system has actually approached the final goal.

When intermediate institutions arise – the “painted horses” of the allegory -- standard analytical approaches offer two broad frameworks for coping with them. The first framework leans toward taxonomy, attempting to identify intermediate institutions with either one of the ostensibly known poles of the institutional spectrum. Optimal institutional change is understood as a progressive movement from the economic irrationality of the plan to the economic rationality of the market, movement along what amounts to a linear path of rationality.

[Insert Figure 1]

Institutions, in this view, are either on the optimal path, and thus will naturally reach the market endpoint, or they are not, in which case they should be treated as not having begun the change process at all. That is, the reforming system is, by definition, understood as "partial," existing somewhere on a spectrum between the poles of plan and market, but the question becomes which pole, in essence, the system is truly gravitating toward. Is the system partially reformed and well on its way to becoming a full-fledged market, or is it partially reformed because it is still essentially stuck in a mode of state-dominated allocation? Half-way institutions, in this light, either get dismissed as plain old horses in disguise – dressed-up versions of traditional command planning (Sachs and Woo 1997; Rawski 2002; Rawski 2002) – or lauded as nascent zebras, true market entities (Mcmillan and Naughton 1992; Overholt 1993). When reform has truly taken root and the system is understood to be on an inevitable trajectory toward the market endpoint, "painted horses" become mere ephemera on the path to economic rationality, stepping stones that ultimately either evolve into standard market forms or fade away into obsolescence.

A second framework, while still conceptualizing transition as a movement between known endpoints, treats intermediate, "partially reformed" institutions as longer-lasting fixtures worthy of explanation in their own right. The first framework attempted to characterize institutions in terms of systemic endpoints. The second framework, however, recognizes – and seeks to explain why -- change can begin, go half-way, and halt; or, begin, and then somehow veer off the optimal path entirely.

[Insert Figure 2]

The key assumption is that persistent, entrenched intermediate institutions, since they clearly diverge from our understanding of what those at the final "market system" destination are supposed to look like, are by definition economically irrational. Indeed, it is here that the second framework really goes to work, for it aims to identify an alternative political or social logic to explain that which appears to defy economic logic (Bates 1981; Shirk 1993). The question becomes, "Why should reasonable men adopt public policies that have harmful consequences for the societies they govern?" (Bates 1981). In other words, why build and perpetuate "painted horse" institutions that depart from economic rationality? The argument, in various guises, becomes that the people who build them are driven by explicitly non-economic factors. Such factors have included anti-market political ideologies (Lin, Cai et al. 1996; Huang 2003), retrograde interest groups (Shirk 1993; Shleifer and Treisman 2000), social welfare preferences (Hall and Soskice 2001; Swenson 2002), and regime type.

Both frameworks, of course, say something descriptively accurate about systems in reform. Such systems, by the intent of those inhabiting them, are trying to move from one conceptualized starting point – a given set of institutions -- to another conceptualized endpoint, new institutions that better serve the needs of society. Moreover, such systems, through the course of change, frequently do exhibit institutions that somehow fail to achieve their stated ends – growth proves elusive, resources get wasted, and value gets destroyed.

Yet, beyond just offering description, such frameworks embody statements about causation, statements that, prior to empirical observation, tacitly posit certain notions of how the world works, while at the same tacitly dismissing others. Like the assumptions economic practitioners make about markets, the assumptions scholars make about economic rationality are intellectual constructs to make sense of the world, constructs that serve as lenses through which empirical observation is filtered. The lens of economic rationality does not dictate a particular explanation for institutional development, no more than reform culture dictates specific economic policies. What the lens does do, however, is to severely circumscribe the range of explanations that are considered. As is argued most particularly in Chapter Four, the explanations that are considered – the social and politic logics to account for economic illogic – are highly problematic.

With regard to interest-based approaches, virtually any institutional outcome can be identified *ex post* as beneficial to some societal interests and detrimental to others. Yet, in the actual unfolding of reform, whether in China or elsewhere, it has consistently proven difficult to determine *ex ante* which interests are strong and which are weak. Those who at a given time appear invincible – whether peasants, urban laborers, or local governmental officials in the Chinese case – have one by one fallen by the wayside and had their narrow interests undermined by new reform measures. Indeed, in the Chinese case, it is extraordinary the extent to which policy reformers have been able to run roughshod over a series of interests, each in their heyday believed inviolable. At the same time, as this study argues, certain patterns have persisted in reform policy – particularly in the financial and industrial sector – even as interests have come and gone. The evidence suggests that it is reformers who build coalitions of interest rather than coalitions of interest that build reform. Furthermore, as this study argues, the manner by which groups perceive their own interests may differ from society to society, given that assumptions about how actions lead to outcomes are particular to given cultures. The fallback position in interest-based arguments then becomes their pitfall – the tendency to argue that the strong always win, and that the winners are, by definition, strong.

A related approach attempts to link partially-reformed or otherwise sub-optimal institutions to regime type, the argument being that governments – especially authoritarian governments – resist changes that undercut political control. In the Chinese case, the argument is frequently made that though the regime seeks legitimacy by promoting growth (ostensibly via the market), it resists the very forms of complete marketization that would undercut its political control and ability to serve politically powerful interests. Thus, the argument goes, to the extent the government remains authoritarian, or socialist, or communist, reform has always been, and will continue to remain locked in an incomplete, half-way institutional pattern.

Again, in a *post hoc* sense, the argument is plausible, for at any stage in reform, one could hypothesize that further reforms would erode governmental control. The problem empirically, however, is that at each stage in reform when this argument appeared plausible, the government took the next step further, thus eroding its traditional sources of control. Reform and its attendant institutional changes have, by definition, entailed an erosion of traditional forms of governmental control over resources. Command planning, after all, is a thing of the past. At the same time, the development of the market has placed increasing demands on the government to provide the public goods of market regulation.

In this context, "political power" itself becomes a problematic term, at least to the extent it is understood in unitary terms. Governmental aspirations to control are, arguably, omnipresent, yet highly unspecified across national systems. In some systems, control is understood as managerial and market enhancing. The governments that exert it push extremely interventionist measures through organizationally coherent bureaucracies. In other systems, where the market itself is understood as a virtue, control is exerted to lower barriers to entry, break up monopolies, and create new governmental bureaucracies to ensure fair competition. The question is not whether the government seeks control, but rather what it thinks the appropriate means and ends of control are, and how it understands the causal relationship between its control efforts and economic outcomes.

Particularly in reforming systems, the interesting questions involve not the degree of governmental power – whether it is rising or falling – but instead the form of governmental power, whether it entails direct control over resources, or indirect forms of regulation. Moreover, the intent of power becomes critical. Is power directed toward undermining the market, or is it aimed at supporting the market? Are poor outcomes the product of excessive governmental efforts to distort market signals, or inadequate governmental efforts to provide basic regulatory support, factors such as basic property rights protection, enforcement of transparency rules, and protection of investors? In the case of China, political officials undoubtedly are concerned about power. At the same time, if power and control were the sole concerns, why would reform have been undertaken at all? If the answer is that legitimacy is also a concern, and that legitimacy depends on market-fostered growth, then clearly there is a more complex process going on, some sort of balancing between the competing imperatives of growth and power. As this study argues, it is at the very least worth exploring how officials and other actors understand those relationships, those relationships between political action and economic outcome.

Economic Rationality and Competing Perspectives on Market Function

While interest-based arguments have clear analytical weaknesses, a more important point involves assumptions scholars make, especially when studying transition, about the unitary nature of markets. In discussions of transition, assumptions of economic rationality presume some sort of movement between fixed systemic endpoints. At the very least, there is the presumption in the abstract of a linear slope of economic rationality against which empirically observable cases can be measured. That slope can be conceptualized only to the extent that the market destination is understood as clear and unitary.

Yet, if we put aside cases of transition, and instead turn toward discussions of developed systems, we find in fact that great debate still exists over what in institutional terms fundamentally comprises the market. In other words, the known endpoint in the discussion of transition suddenly becomes less-than-known once the debate turns to market systems more generally. The unitary nature of the market – its clarity as an institutional form – effectively disappears. The point is not that political economic systems, whether that of China or anyplace else, have the option of pursuing a "third way," an alternative to either plan or market. The "market," in some sense, is the only option for transitional and developing systems. Yet, what exactly is meant by the market? What, in essence, is the set of institutions that constitutes it? We understand what does not constitute a market -- administratively-set prices, planned allocation of investment, input-output plans for material goods, etc. – and it is clear that these institutions must be eliminated at some point in the transition to the market. Yet, what exactly should be built in their stead?

Even when the market option is understood as the only option, as it is in most systems effecting purposive change today, the exact nature of that option institutionally is quite uncertain in analytical terms. Are market systems in essence self-regulating, or do they demand an institutional foundation? How complex and extensive must that foundation be? Is its main purpose to protect market actors from the state, and thus avoid "politicization" and "government failure" (Boycko, Shleifer et al. 1995; Shleifer and Vishny 1998)? Or, is its main purpose to permit the state to protect economic actors from one another by addressing information asymmetries, and thus avoid "market failure" (Stiglitz 1994; Stiglitz 1998)? Taking even the most minimalist formulations in which the state exists just to provide basic property rights, what exactly constitute such rights in modern industrialized systems with complex producers? Are we talking about shareholder rights, and all the rules, regulations, and regulatory bodies that arise to ensure enough corporate transparency to make those rights meaningful? Are we referring to the extensive procedures and legal entities required to resolve situations in which property rights claims – namely those of creditors – overlap when property obligations, namely those of debtors, go unmet? Or alternatively, are talking primarily about restrictions upon the state – North and Weingast's "credible commitments," in effect (North and Weingast 1989)? Just what and how much is needed to make a system a "market," and even more tricky, a "rational" market that presumably generates wealth?

Such questions have long been, and still are, honestly debated with respect to advanced market systems. Most important, how one answers those questions – how one assumes a market fundamentally works -- profoundly influences what one believes constitutes a rational and coherent set of market institutions. Depending on what the starting assumptions are, one observer's "painted horse" might be another's "zebra." Those who assume that the fundamental source of economic failure in markets is the state will posit one set of institutions as a benchmark for rationality (Shleifer and Vishny 1998). Alternatively, as **Figure 3** suggests, those who assume that economic failure stems primarily from information asymmetries and agency problems between market actors – problem that must be remedied through state intervention – will posit a quite different set of optimal institutions (Stiglitz 1998).[2] The point is not that correct answers are unattainable. Nor is the point that every institutional setup found in developed market systems is economically acceptable or effective. Many are not, and lead to stagnation, crisis, and other socially destructive outcomes. Rather, the point is simply that sophisticated debate persists about what it is that makes even the healthiest market systems – those most nearly approaching textbook models -- healthy. That it does suggests both that analytical uncertainty exists and that proponents of various sides of the debate set off with entirely different *a priori* assumptions about how markets function.

[2] In addition, considerable differences of opinion exist regarding the exact nature of the command system, and the nature of variation across real-world examples. Numerous scholars have argued that specific aspects of China's pre-reform economy made the task of reform in China substantially different from that in the former Soviet Union Qian, Y. Y. and C. G. Xu (1993). "The M-Form Hierarchy and China Economic-Reform." European Economic Review **37**(2-3): 541-548, Naughton, B. (1995). Growing out of the plan : Chinese economic reform, 1978-1993. New York, NY, Cambridge University Press, Sachs, J. D. and W. T. Woo (1997). "Understanding China's Economic Performance." NBER Working Paper No. w5935, Qian, Y. Y., G. Roland, et al. (1999). "Why is China different from Eastern Europe? Perspectives from organization theory." European Economic Review **43**(4-6): 1085-1094..

[Insert Figure 3]

Such analytical uncertainty about developed markets makes characterizations of economic incoherence in transitional or developing systems highly problematic. These characterizations – based on a presumption of a unitary reality for market institutions -- in one fell swoop assume away all the analytical debate and uncertainty that surrounds the operation of markets in the real world. An illusion of certainty is created, certainty about the nature of what reforming institutions *should* ultimately look like, and certainty about the extent to which many of these currently reforming institutions *are* economically irrational.

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