

**Societal Change, States and Governance: Insights from  
History and Other Societies**

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# Societal Change, States and Governance: Insights from History and Other Societies

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## Abstract

The nature of governance has differed widely across societies, and what is more interesting, within any particular society depending upon the stage of development. Governance is better defined in functional rather than in value terms. Functional governance aids and abets industrialisation. Industrialisation is the one change that all societies have to necessarily strive for. Without it no development is possible. In contemporary societies which are also democratic and trying hard to industrialise, that insight needs to be tempered with the limitations of the state that is a coalition of many classes.

More importantly just because functional governance was not the good governance of today, in many countries and societies in the past, does not mean, that it today cannot be both good and functional. The point though is that unless it is functional it can never be good. Functionality of governance is best assured when the policies followed by the state in its drive to industrialise the economy are correct. Therefore the main lesson from history is that the first thing to do (for both functional governance and for the industrial transformation) is to bring about the initial conditions necessary for the industrialisation of the economy. The key bottleneck here is tenurial relations in land which stand in the way of output increases from the poor farmer. The egalitarian income distribution that land reform brings, ensures that nearly all the poor are participants in the market. All other conditions necessary for the unambiguous transformation already obtain today in India.

We also describe the process of change and the sense in which the economic is primary to societal change. That does not mean that there is no scope for individual or collective action. It only means that there are particular ways in which individuals and small groups including reformers can bring about change. It is important to recognise the specific ways in which small groups including elements with government can bring about change. In any discussion of corruption and governance the case of China which despite being highly corrupt society grows can hardly be avoided. Corruption there is the means by which a bourgeois society is being born in China today. Because much of the rents are invested there is no dysfunctionality to this corruption. It would though soon become dysfunctional, since, once the party elite have all become capitalists, the gain to them and to society as a whole is greater in a non-corrupt society. That is already happening, and corruption can be expected to decline soon.

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# **STATES, GOVERNANCE AND INDUSTRIALISATION: A HISTORICAL REVIEW**

## **State, Class and Governance**

States have an existence apart from that of governments and their role is best conceptualised as the management of the economy and society within the constraints imposed by the coalition of classes that constitute any society.

The states and institutions in England during the industrial revolution, if one goes by the stories of the poor houses, the poor laws, the treatment of children and petty criminals, were hardly fair or moral, even by the standards of the society then. But they were functional (or at least not dysfunctional) in the sense of not having stood in the way of the first transformation- that forever changed society<sup>2</sup>. Hence states and institutions may be distinguished on the lines of whether or not they aided the process of transformation of society into an industrial society. Thus we distinguish between a governance that is functional in the sense of aiding and abetting the industrial transformation; and dysfunctional governance in that the state in their behaviour, rules and institutions delayed or indefinitely postponed the industrialisation. Rather than economic performance per se, it is useful to think of industrial transformation as the goal of all non-industrial societies.

## **The Western Industrialisations**

The late eighteenth century state in France and its institutions were dysfunctional to the emergence of capitalism in France and gave way in the French Revolution to make possible the development of bourgeois society. While the 'unfairness' of that pre-revolutionary state and society is quite obvious, that was not its weakness. Its basis in the dysfunctional class (the aristocracy and the landed gentry) and its feudal form were the barriers to change which therefore was violently displaced by a revolution for a new society to emerge. But unlike in England where an unchallenged bourgeoisie reigned, the French had to create or at least strengthen a vastly weaker bourgeoisie. It was only with the modernisation of Napoleon Bonaparte that bourgeois development (industrialisation via capitalist

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<sup>2</sup> These may served to secure the right to private property of the bourgeoisie against the propertyless is quite clear. In a slightly earlier period, the bourgeoisie had won the right to property against lords and rulers with political power.

development) could be put on an irreversible if slow footing. The travails of the second Napoleon show that the state had to play a new role - that of balancing the interest of not only the various sections of the bourgeoisie but also between classes. This was so because in France, the rising bourgeoisie had to share the space of the state with both an upper section of the working classes, rich farmers, remnants of the old ruling classes and a vast bureaucracy. The coalition state in France unlike in Germany, a little later under Bismarck, was only able to bring about a much slower transformation of the economy than in Germany.

In Germany industrialisation began in earnest when its elite landed interests - the Junkers - turned themselves into capitalists. With a state that had its power base in the merchants and the landlord turned capitalists its tasks were not contested. Germany therefore transformed very quickly. In America, without the baggage of a feudalism, the beginnings of industrialisation required, as a first condition, the overthrow of the British to form a large market for the benefit of American industry. The simple mechanisms of common tariffs and public investments in areas of market failure - standards, technical education, support for local production of arms and ammunition were used. But it is only with the victory of the North in the Civil War that bourgeois development can be said to have reached a point of irreversibility. One of the important issues in the Civil War was slavery which was declared illegal. But it was the right of the Union to have a common tariff to which the Southern agrarian interests were opposed, that was the real underlying issue. For the North however it was important that the American home market for manufacturers of the North remained one. The freedom of slaves as the visible issue allowed the North to seize the moral high ground and strike at the South.

### **The Dysfunctional State in Brazil**

Governance in a narrow or moral sense may well have been no worse in countries like Brazil than in the US in the early days of industrialisation. But here without cleansing the state of the Latifundia (the landed interest), Brazil could not pursue clear policies to abet the industrial transformation, and therefore the governance of the state may be said to have been dysfunctional. The issue of fairness is in this context entirely secondary. Conceivably in a state that is a coalition of various classes, chaos, and civil war (which may appear as 'governance failure'), that lead to ridding the state of the older classes which stand in the way of bourgeois

transformation may well be functional even if the process is seamy and abhorrent<sup>3</sup>.

### **Russian Mafias**

The Soviet system collapsed as an organisation and ideology completely, and no organised ('controlled') transformation to the market economy was possible, because every moment of confusion and anarchy only reduced the prospects of any such orderly transition. Having stayed long in that disorganised state the 'mafia' that is today organising production, markets and firms, cannot be seen as entirely dysfunctional even if their particular actions are abhorrent. The only system that can in itself emerge out of the present chaos without great leadership and central organisation is the 'capitalist', with all its dirty aspects. And the 'mafia' play a positive if violent role in that birth.

## **PRAXIS IN SOCIETY**

### **Technology as the Ultimate Driver**

Here our task is to define the phrase 'leverage points of change'. The 'Weberian' notion of a different protestant ethic being the 'spark' that brought about the industrial revolution was an attempt to dilute the large effect that Marx's analyses of history and technology as the determinants of change, had on academia and politics. This materialist explanation of society and societal change (the primacy of the forces of production and the constraints in the relation of production) very quickly spread among anthropologists, sociologists and economists in so many forms and ways that its essential origin in Marx is generally forgotten or goes unacknowledged. In so far as the economic base of the society under study is the first stage in our analysis the primacy of the economic is repeatedly acknowledged. The 'problem' with Marx though has been the application of this great insight into the specific capitalist society of the day, that led him to predict the demise of capitalist society. That prediction might well be true when considered at the world level and over a long period. Over a particular society and over a meaningful time span of a few generations, these have proven false. Yet the method remains essentially correct. Indeed in Volume III of Capital, Marx was led to an understanding that

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<sup>3</sup> Thus the brutal Syngman Rhee's regime in South Korea got rid of the landed interests, including rich peasants form the power base, and virtually eliminated the left wing to create a state that was just right for industrialisation in the hands of 'strongman' Park Chung Hee.

would have reversed his earlier conclusion of the inevitable fall of capitalist society based on the analysis in Volume I of Capital.

### **System, Small Groups and the Individual**

The contradiction between Weber and Marx may not be as deep as is assumed to be. (The same cannot be said of scholars like McClelland and McGregor who followed Weber in recent times). If indeed we see the protestant ethic as working through the elite to create the politics and the appropriate state for bringing about the development of bourgeois society, the changes in the culture of the masses can and would still operate through the economic. The point of the marxist analyses though was not to focus on the 'spark' (or the mutation to use a biological analogy) per se, but on the process of change, (or the process of selection). Presumably if 'sparks' are numerous enough, then they do not constitute the barrier for transformation as much as the very working of the economy; hence of the 'importance of the system over that of the individual'. This means that durable societal change cannot result unless individuals and small groups work on the economic, and on the political, that can change the basis of the economic. Thus change has its roots in the political, and it becomes necessary for reforms to understand the essential political basis of their proposals. This does not mean that existing political constraints are to be accepted as given constraints. The art is really to recognise those which can be changed quickly, (where there is a political opportunity), and others which are more difficult, and would have to be avoided a while until economy matures. Thus, a politics, today in India and in similarly situated societies, which can ensure a clean and good governance of the already transformed societies is wishful thinking. On the other hand a politics which can bring about land reform is possible with much effort, and advocacy but not immediately. While the politics that can lead to direct subsidisation and to the reform of many sectors like electricity, petroleum, fertilizer, water, irrigation, and the second stage of reform is an opportunity waiting to be exploited.

### **The Economic and Society**

How does change take place in society? We had already mentioned that the ultimate engine of social change is technology, and the 'state' its tool; or, in the long run, its ineffective opposer. Governance as an aspect of the state is therefore important once the state system appropriate for the change has already been forged through political action, and prior social and political movements, that may have included revolution. For all societies not as yet developed, development is the social change without which most others are

'meaningless'. (Simple living and high thinking for more than small groups would remain an inaccessible ideal). Cultural autonomy or political freedoms are not possible without the economic freedom and the independence that comes with development.<sup>4</sup> Similarly, intellectual and cultural achievements of the society as a whole remain patchy and disarticulated from society, (when without development)<sup>5</sup>. And for nearly all large societies (except perhaps those as superbly endowed with natural resources as Iraq or Saudi Arabia) development necessarily means industrialisation. For the bulk of the population attitudinal change (an aspect of culture) follows this economic change, not the other way round. For smaller groups though, they could successfully stand beyond the economic constraints and imagine and live a world very different from their immediate surroundings to 'liberate' themselves. Thus, small groups have always existed that have believed in and practised freedom to men and women equally. Yet, for society as a whole to have this attitude required over a hundred years of bourgeois society and two world wars that brought women out of their homes, and into factories, offices and battlefields. Similarly, the few children family, the practice of birth control, or the so called second demographic transition have happened only as incomes have gone up to increase the value of women's time. Widespread education, and the development of powerful medicines have today no doubt brought down that income level when this transition occurs.

### **Industrial Transformation is The Change**

The beginnings of the transformation lie in certain political and economic conditions - a state so constituted as to be able to pursue bourgeois development; and in late industrialising densely populated economies, additionally, the carrying out of land reforms of the Type II variety of Ronald Dore<sup>6</sup>. Such land reforms in relaxing the agricultural constraint is

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<sup>4</sup> This is not to ignore that the process of economic transition may itself demand a break with certain aspects of the past and its culture, when they could stand in the way.

<sup>5</sup> Great art though may be essentially unconstrained. It may even derive a certain impetus from the intensely emotional social experience that poverty, inequality, and great suffering can engender. The audience for such art nevertheless remains thin and confined to the elite. The audience could though, in future generations, encompass the society as a whole. The works of Leskov, Gogol, Vallathol, and Premchand come to mind.

<sup>6</sup> In Dore's categorisation, Type I eliminates over lordship on land, but does not necessarily result in land to the cultivator, or in security of tenure to the actual cultivator. Type II necessarily involves the latter. This categorisation is particularly relevant for densely populated economies attempting to make their (late) industrial transformation. Japan had carried out Type I with the Meiji Restoration in 1880, but not Type II, which was carried out by the American

able to allow agriculture to grow rapidly, and for the home market for manufactures to grow very rapidly, and not run into demand constraints. Land reform in bringing those with the land and security of tenure (endowments) into the market both as producers and as consumers speed up capitalist development. In East Asia land reform was the basis of the expansion of the home market. Therein the detailed management of public services and institutional arrangements for infrastructure evolved, and was refined because of the enormous pressure for change that high-speed growth brought about. Indeed, a decade or so high growth as currently being experienced by China or Vietnam today creates sufficient 'vested' interests to ensure its continuation so that growth may well be self reinforcing (politically) when at high levels.

### **Land Reforms in Densely Populated Countries**

It is true that Type II land reforms in ensuring security of tenure to the cultivator of the land is an 'institutional change'<sup>7</sup>; but then, to so define land reforms is to rob it of its political and historical content. The institutional school conceptualised institutions in apolitical terms, as problems of design and right incentives. They did not go far enough to include politics and struggle that alter the ways of economic organisation, management and organisation, and principally of the character of the state - the ultimate organiser. And as such their position remains problematic, and does not tie up with the historical experience of either early or late industrialisers. The 'ultimate force' of change in society as a whole remains technology and technical change, and certainly been so since the First Industrial Revolution. Particular societies and regimes though could hold back the forces unleashed by new technology within and elsewhere for a while, but soon enough would have had to allow their unfolding; or be destroyed. And

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occupation under McArthur. circa 1948. Because of Type I, Japan could industrialise, but still at relatively low levels of income per head, slower growth, and with large need for migration (to China, Manchuria, and Brazil). With Type II, 'rapid economic growth' followed in Japan in the fifties and sixties. India too has carried out Type I, almost immediately after independence. Type II is still awaited (except in Kerala and Bengal). In areas of semi-feudalism Bihar, Orrisa, Assam, Madhya Pradesh, Eastern Uttar Pradesh, Andhra Pradesh, large parts of other states, agricultural growth can be very rapid if Type II (even of the security of tenure variety of Operation Barga) is carried out. In other states where land is not a major constraint, and irrigation supplies can expand Gujarat, Punjab, Western Uttar Pradesh, parts of Southern India, land reform is not critical. It is reasonable that Bengal's agriculture which had lagged other states right upto 1982-83, the time of Operation Barga, grew very rapidly thereafter at an average rate close to 6% per annum!

<sup>7</sup> Some of the empirical difficulties of the institutionalist position are brought out in the next section.



this is true as long as it is the economy that provides the bulk of the needs of people.<sup>8</sup> Yet, for a meaningful length of time like a generation or two, and perhaps even longer, these 'forces of production' can be held back by the lack of the proper initial conditions, changing which is usually a political process, often through the state. They could also be held back by an improperly constituted state, even when the state has the correct orientation. They could still be held back by 'improper or incorrect' economic policy. The institutions required for growth and development can come along with the transformation. And states can always create and alter them, and also bring about appropriate macro-economic policy to result in economic dynamism. They can also functionally shape institutions in ways not imagined by their original creators or designers. An improperly constituted state or society that lacks the ideal conditions for late industrialisation can fail despite institutions.

### **Varieties of Actions**

Does the understanding that durable society wide change follows economic changes, mean that there is no scope for action? Not at all. There is always the scope for action in bringing about revolutions - which changes the power equations in class society and the character of the state. When the state is essentially functional to the task ahead, and the economic is held back by particular vested interests, or archaic institutions, these can be neutralised or corrected to release the economic, even if such changes would "anyway have happened". Similarly, actions, that speed up economic change which in turn creates the conditions for society at large to change, are potent. Thus, correct fiscal and monetary policy, but so also industrial policies become leverage points for change in such societies. In other words, economic policies have effects which go beyond the static, (narrowly) allocative and x-efficiency gains. Sustainability, and release of more potent forces of economic and social change (i.e. positive feedback effects) are other important aspects.

### **Working Through the Economic**

Cultural or attitudinal change among small groups including sections of the elite could sometimes be the very starting points of change. Because they in turn through revolutions, or through the levers of the state and the economy can bring about change in the economic, and so in the culture and behaviour of the masses. Thus the individual and the small group has autonomy in this vital sense. And it is important to realise this. Thus,

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<sup>8</sup> This essentially marxist conceptualisation remains a very powerful way of looking at history and social change.

attempts to preach equality of women among the masses of a largely non-urbanised still pre-industrial society would be doomed to failure. So would merely asking or 'educating' petroleum dealers in India to control corruption<sup>9</sup>. Similarly, attempting to train public sector managers to be entrepreneurial without changing the organisational situation would be fruitless<sup>10</sup>. Working for change among the elite and those who control the levers of change, to bring about change in the economic or in the 'whole' is therefore part of the praxis. Individual public enterprise managers who are entrepreneurial, or a few dealers who does not adulterate would always be there. But policy makers and the state are concerned with the system or the society as whole, and hence the constraints and opportunities in the economic ought to be at the focus of their attention. A change in governance over a part of government, which creates the changes necessary in the economy, can be potent when the process by which the economy works are deeply understood. On the other hand to expect a change in governance in the government as a whole through mere administrative fiat is imaginary<sup>11</sup>. Certainly, key governance changes in crucial aspects or functions of the government as in the legal system, or in the management of public enterprise, in the authority that carries out disinvestment, can bring about the release of economic forces, to bring durable and vast changes elsewhere, including in governance in the rest of the system. Such governance changes in key aspects of government would have to arise out of the political<sup>12</sup>, or great administrative imagination and leadership.

## **CORRUPTION IN CHINA**

### **From Party to Bourgeoisie**

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<sup>9</sup> For a discussion of the economic and policy basis for the governance failure in oil marketing see Box 2.

<sup>10</sup> The insistence on such training can in the more confident manager create a permanent hiatus between theory and practice and the practise is essentially intractable in any systematic sense. Among the not so confident, it only results in an unwarranted sense of inadequacy.

<sup>11</sup> They can through major political change and through revolution, typically the latter. If General Park Hee's or Lee Kuan Yew's vision created modern South Korea and Singapore respectively, then prior social and political changes were their foundations.

<sup>12</sup> The tragedy today in India, is that even in the limited spheres where there is political commitment (as in electricity reforms), the vested interests, and especially the bureaucracy has played an obfuscating role.

The comparison and contrast of corruption in India with China is important. Corruption today (or rather yesterday) in China is no less than it is in India. Indeed, we may succinctly describe China's process of growth and evolution into a capitalist society since 1979 as one uninterrupted orgy of corruption in which party functionaries (who were both the executive and the bureaucracy) exploited their political power, their power over economic decisions and control over state owned enterprise. The latter happened especially after the managers in SOEs were allowed profit shares. Thus, the near complete egalitarian (in an economic sense) society of Mao has now evolved into a society with some inequality. The transformation of the party elite (and even lower rungs) into a bourgeoisie is, from the vantage point of its functionality to the industrial transformation, akin to the 'junkers' turning capitalists in Germany in the 1860s after several years of the Zollverein. So an entire bourgeoisie is being created out of the party members, but especially its elite. Besides corruption, per se another aspect in the accumulation has been the round haul of Chinese capital via Hong Kong, Taiwan, Singapore and the US (via 'non resident chinese many of whom are relatives of party officials), that mistakenly gets reported as FDI into China.<sup>13</sup>

What goes on today cannot be described as 'primitive accumulation' per se. The phase of 'primitive accumulation' of Marx, in China was (under 'socialism') during the period up to the mid-seventies but especially during the Great Leap Forward. And this accumulation fits the idea of 'primitive socialist accumulation' of Preobrazensky. In Russia that phase was in the twenties and thirties. Unfortunately for Russia, it actually went ahead with creating a 'socialist' society. The Second World War by its appeal to Russian nationalism prevented the contradictions of the 'socialist' thirties from being fully exposed, and the Cold War that followed only increased the resolve of the state and party to not question its basic assumption of a 'transformation without markets. The phase in China from 1979 to date can be called as one of re-emergence of capitalism and markets on the sound basis (of endowments for all) provided by nearly thirty years of communism<sup>14</sup>. The market had not been completely destroyed under communism (unlike in Russia), and the first of the liberalisations was of agriculture. Therefore consolidation of the market mechanism was not at the cost of the poor. Indeed, the consolidation of private property in the

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<sup>13</sup> It is known that about 80 to 85 % of Chinese FDI (average US \$ 40b in the late nineties) are Chinese investments from these countries.

<sup>14</sup> The Cultural Revolution, may have been a set back in more ways than, one since it took attention away from the task of accumulation. It may have also have made China critically short of certain skills like managers and bankers that it required for modern economy.

first phase was that of peasants which was followed by that of lower rungs of the party who set up petty businesses, and then that of the elite sections who then went on through big corruption to accumulate capital. In simple language "power and money cannot be divorced for too long". Similar processes came about very early, with independence, in many of the African countries variously described as bureaucratic, kleptocratic or state capitalism (Mamdani, 1976; Shivji, 1976; Leys, 1975). In India too at the state level through mechanisms such as the joint sector and surpluses from agriculture and rents from the state, a local bourgeoisie has emerged. Thus, capitalism world over shows 'corruption' as an integral aspect when the bourgeoisie emerges. To the extent that the Indian bourgeoisie (however stunted) has had an early origin<sup>15</sup> (perhaps even earlier than the Japanese), and shows an intermittent growth thereafter, there is no dramatically distinct phase of their emergence. But the eighties and the nineties (until 1996) may be seen as consolidation through profit and rents.

### **Corruption Has Suddenly become Dysfunctional**

The question that naturally arises is why is the Chinese system so actively and purposefully coming down on corruption today, when over the last couple of decades it not only turned a blind eye, but also may have actively encouraged the same? The answer lies in the returns to corruption, which have come down with growth and maturity of the economy, and the creation of a now numerous class of capitalists. Corruption which was yesterday functional to the accumulation and capitalist development is today not as the economy moves to a higher level of development wherein further corruption would mean eating into each other's profits. What was observed in the US in the twenties when corruption was finally tackled, happens today in China but a lot more suddenly.

If freedom from corruption and a legal basis for commercial interaction is treated as a good, its consumption by the masses (non-participating in corruption) is now possible, since the incomes of the masses are above that minimal level upon they can resist corruption. Given the extreme equality of Chinese income distribution, that transformation is sudden. In white goods and telephones the growth in consumption has been stupendous for the same reason. The very high growth rate of the economy is another aspect of the same phenomenon, since that high growth rate is itself inter alia a result of the equality of income distribution.

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<sup>15</sup> Even if we keep aside the early modern industrialists like Dwarkanath Tagore and others c.1860-70, whose valiant efforts fizzled out due to a hostile colonial state, there were others like Tata and Birla who came in a few decades later. (See Dutt (1911)).

## **Transformation Success is Due to Endowments**

The big question is why despite this massive corruption there has been no governance failure in the functional sense - i.e. a failure leading to the slowing down of the transformation? To answer that question is to explain the late industrialisation of East Asia, and this report is not the place for it<sup>16</sup>. Suffice it is to say that all of East Asia grew very rapidly because of land reform that were carried out in South Korea, Taiwan and Thailand (less critical since land is more plentiful) and in China and Vietnam (both under communist rule). Such reform released the home market constraint.

## **And to Export Oriented Policies**

Additionally, pursuit of export led growth (China since the late seventies and Vietnam later) to overcome the foreign exchange constraint and to add to demand were the keys. Successful economic transformation has therefore nothing to do with good corruption free governance as is the general belief, but is necessarily about getting the initial conditions (essentially economic) right, if need be through political action. It is certainly not caused by culture and such other sociological factors including the tautological 'work ethic'. The work ethic itself would have been the result of success in the economic task of transformation<sup>17</sup>. The essential initial condition is really that endowments are there with the majority of people for them to be able to participate in the market as producers and workers, and hence as consumers. All other aspects are really secondary or 'endogenous' to the process of transformation itself -work ethic life style, having entrepreneurial firms, technological development etc. This is not to deny some autonomousness to large firms, the state and others to via strategic investments in areas of market failure to speed up the transformation process.

## **Rents Become Capital in China**

The vast impetus to growth in China following from the relaxation, or non-existence of the home market constraint, and the pursuit of export led

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<sup>16</sup> See Morris, S. (1997) for the argument that export led growth is not laissez faire, but is the purposeful, promotion of both import substitution and export promotion at the same time, though inter alia a highly undervalued currency. Earlier economists like Lall (1994), Datta Chaudhury (1981), Alam Shahid (1989), Amsden (1989) had argued that the states' direction, and active involvement were imp[ortant.

<sup>17</sup> Who would have talked about 'Confucian work ethic' in the twenties after a visit to Shanghai or Taipei of the day?

growth means that rents have a high probability of being invested, and thus, that surplus though rent in origin becomes capital and not directly unproductive activities (DUPs), as they do in economies like India, with severe demand constraints. At investment rates of 40% plus<sup>18</sup> and growth rates of 10% plus (till the recent 'slow down' to 7.5%) all sources of surplus including those illegal have the functionality of speeding up the transformation process because they are invested. When investments in India are as low as 26-28% with a marginal savings rate close to 40% but average around 25 to 27%, the economy is demand rather than savings constrained. So the problem in India is not rents per se, but that so little of it is invested within the economy. Not only that, so little of even profits may be invested given the current strangle hold of conservative macroeconomic policy. Capital flight and avoidable waste in DUPs and other activities emerge to bring about the current 'equilibrium', and that creates its own ethos of a lazy rent seeking and rent wasting economy.

#### **BOX: THOUSANDS OF OFFICIALS PUNISHED IN CHINA'S ANTI-CORRUPTION PURGE**

*Over the past weeks, Hong Kong and Guangdong-based newspapers have documented the exposure of an elaborate smuggling operation last year in the Special Economic Zone of Xiamen, located in China's Fujian province directly across from Taiwan. Named Major Case 4-20, it is being touted as the largest corruption scandal since the establishment of the Peoples Republic of China.*

*At the centre of the accusations is the Yuanhua or Fairwell Group, a consortium of real estate and property development companies owned by Lai Changxing, one of*

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<sup>18</sup> Doubts have been raised about the stability of the Chinese banking system. In comparison to that of most other countries they seem to be so stretched that they could come collapsing like a house of cards. If growth slows down to less than 5% then the problems of the banking system would have to be sorted out. What is generally not known is that late industrialisation because it offers the scope to grow very rapidly also allows higher debt equity ratios and heigher proportions of borrowed capital to own capital, without increasing bankruptcy risk. This is because few industries face fundamental uncertainty. And with a strong state even that residual risk can be minimised. China is merely following in the footsteps of Japan, South Korea and Taiwan, of high financial repression of the economy. That strategy is today functional to the Chinese economy. It is entirely incompatible with convertibility on the capital account. South Korea, Taiwan and Thailand had opened themselves on the capital account in the nineties. That was the real cause of the currency crisis, since Japan in an earlier period had pulled through this 'risky' financial strategy to great advantage by delaying its convertibility till well after its complete industrial transformation, i.e. only in the eighties.

*the richest entrepreneurs in Xiamen. Before being closed down, with its assets confiscated, Fairwell was in the process of constructing an 88-storey skyscraper and a two tower, 30-storey international hotel. The company also owned Xiamen's soccer team, a theme park that is one of Xiamen's major tourist attractions and the exclusive Red Mansion resort that was frequented by leading military officers and the local political elite.*

*Utilising a network of contacts in Hong Kong, Taiwan and in the Xiamen and Fujian governments, Lai Changxing organised the shipment of goods such as oil and petroleum products, rubber, semiconductors, cigarettes, mobile phones and luxury cars, avoiding payment of import duties and tariffs. An estimated \$US9.5 billion of goods were smuggled into China over the course of several years, unloaded at a Fairwell dock in the port of Xiamen and sold throughout Fujian province at a lucrative profit. Police and customs officials protected the racket's activities.*

*Since an official investigation began late last August, all government and party officials in Fujian province have been banned from leaving China. At least one trial has already taken place. Those alleged to have been on Fairwell's payroll include Lan Fu, Xiamen's vice-mayor in charge of foreign trading and security; most of the leaders of the Xiamen Communist Party branch; the deputy chief of the Fujian police; the chief of police in Fujian's capital of Fuzhou; the heads of Xiamen's Customs, Security and Telecommunications bureaus; and the Xiamen branch managers of China's three largest banks. A vice-governor of Fujian may also face allegations.*

*More than 150 other senior officials in Xiamen have been detained. Hundreds of police, military and customs personnel have been questioned. Also implicated is Xu Ganlu, a former head of security in Xiamen who was promoted in 1996 to director of the Exit and Entry Administration, one of the highest posts in the Ministry for Public Security. He has been placed under house arrest.*

*On Wednesday, a spokesman for the Chinese government denied reports by senior Washington Post journalist John Pomfret that Fujian's largest state-owned import-export corporation, China (Fujian) Trade Holdings, and its former head Lin Youfang, were involved. Lin Youfang is the wife of the Beijing Communist party boss Jia Qinglin, one of the most powerful political figures in China. Before moving to Beijing in 1997 he was Communist party secretary in Fujian.*

*He sits on the 22-member Politbureau, is a close confidante of President Jiang Zemin and opened the PRC's 50th anniversary celebration last October 1. Last Thursday, Lin Youfang made an unprecedented appearance on state television to prove she was not under arrest and deny any involvement in the Xiamen scandal.*

*The Chinese government has also denied allegations of involvement by relatives of General Liu Huaqing, a former Politbureau member and currently the vice-chairman of the powerful Central Military Commission.*

*According to the most recent information in the Guangzhou Daily, some 400 anti-graft police, headed by China's top anti-corruption prosecutor Liu Liying, are investigating the case. The newspaper reported on January 22 that "as investigators dig deeper and deeper, they find not only more people involved but people at a higher level of government". The investigation has extended from Xiamen to Fuzhou and another major city, Zhangzhou.*

*The lurid details about the goings-on in Xiamen put flesh and blood on a staggering statistic released on January 12 by Wei Jianxing, the head of the Chinese regime's Central Commission for Discipline Inspection. In the last 12 months over 130,000 cases of official corruption have been investigated and more than 132,000 government and Communist party officials punished, including 17 ministers.*

*The crackdown was signaled in December 1998 with the beginning of "The Three Stresses" campaign, consisting of the upholding of state ideology or one-party rule; obedience to the central government; and combating corruption. Extended across the country last June, the campaign demanded that all government officials and managers of state-owned firms attend a series of day-long criticism sessions in which lower functionaries were encouraged to denounce the conduct of their superiors.*

*The result of the "Three Stresses" was a dramatic intensification in corruption investigations in the second half of 1999. China's public prosecutors office had reported that in the first half of the year it had investigated corruption allegations against 1,000 Communist party and government officials, 3,466 judiciary officials, 1,769 financial officials and 7,886 managers of state-owned enterprises—a total of around 14,000 individuals.*

*As well as Fujian, crackdowns have taken place in the coastal provinces of Guangdong, Hainan, Zhejiang, Jiangsu, Shandong, Liaoning and the Beijing and Shanghai municipalities—that is, in most of China's key economic regions. As well as action against smuggling rings and bribe-taking by government officials, national campaigns were conducted last year against foreign exchange fraud, the manipulation of prices, abuse of police power, interference by local authorities in the courts and the misuse of public construction funds. As a result, thousands of provincial and city government officials have been purged.*



*The purge within the government is being directed from the highest level. President Jiang Zemin initiated the "Three Stresses" campaign and Premier Zhu Rongji has made numerous speeches denouncing corruption as an obstacle to the development of China's economy and entry into the World Trade Organisation. Last August, the national auditor general brought down a report that declared \$US14.2 billion in taxation revenue—over 20 percent of the budget—had been misappropriated by government officials and that action had to be taken to recover it.*

*With the New Year, there is every sign the campaign is being escalated. The main Communist Party organ, the Peoples Daily, featured a four-part series from January 10-14 on the struggle for "clean government," which included a litany of abuses by officials and the actions against it by the central authorities.*

*At a meeting of the Central Commission for Discipline Inspection on January 12-14, unit head Wei Jianxing unveiled new anti-corruption laws banning government officials accepting gifts or employing members of their family within areas under their administration. He stated: "In a market economy officials need to be conscious of the separation between public and private affairs".*

*Addressing the meeting on January 14, Jiang Zemin declared: "All party members should keep a clear mind about this: there is danger ahead if party control and discipline are slack". He described the key reason for corruption as "party organisation and leadership is lax in a great number of regions and units". He stated that: "No matter who it is, no matter how high the post, those who deserve punishment will be punished... There will be absolutely no leniency".*

#### *Corruption and capitalism*

*Describing the initial restoration of capitalism in his valuable work *The Deng Xiaoping Era*, author Maurice Meisner noted: "By the mid-1980s Deng Xiaoping's much celebrated market reforms had produced a capitalist economy that revolved around the use of political power for personal profit. That it was an economic system based on official corruption was hardly a secret in Chinese society".*

*With the legitimisation of private property, by the end of the 1980s entire networks of regional and local bureaucratic patronage emerged, especially in the eastern coastal regions that were attracting substantial foreign direct investment. What has been revealed about the Xiamen Special Economic Zone is by no means an isolated occurrence. The ability to make profit in China has in large measure depended upon the necessary political connections or *quanxi*. A characteristic shared by many of China's private entrepreneurs is that they, or their fathers, were leading Stalinist officials who acquired their initial private wealth through the plunder of state assets.*

*Jiang's remarks about "danger ahead" points to what is without question a consideration in the corruption purge: the sensitivity of the Beijing regime to the widespread alienation among the working class and peasant masses. The all-pervasive corruption and gross social inequality is a major social grievance among the Chinese working people. It was one of the central causes of the 1989 Tiananmen Square protests and one of the appeals of the banned Falun Gong movement to ordinary people has been its denunciations of the loss of morality in society—an indirect criticism of the regime.*

*Social tensions are now far more explosive than 11 years ago. Last year alone some 60,000 protests took place over unpaid wages and pensions, excessive taxation and other official abuses of authority. In a January 24 report by the Hong Kong Standard, the director of Public Security in Guangdong, Chen Shaoji, described massive protests across the province last year, triggered by widespread bank failures and a series of related corruption scandals. He described 1999 as "the most difficult period since we implemented the open-door policy [in 1979]".*

*Beijing is also using the corruption scandals to strengthen its control over the regions. With the international experiences of the disintegration of Yugoslavia and the Soviet Union in mind, Beijing has sought to reverse the relative regional autonomy from the central government that developed in the 1990s and end the existence of local power bases.*

*In 1998 the Peoples Liberation Army was ordered to divest itself of its considerable and highly regionalised business activities. In the same year the government of Guangdong was almost totally purged and replaced with figures selected by Beijing. One aspect of the current corruption purge, as in the case of the Falun Gong crackdown, is the central government's assertion of control over the provinces and state apparatus and the elimination of any potential rival.*

*The purpose of the crackdown on corruption, however, goes beyond an attempt to forestall social discontent and to maintain a strong central government. Economic factors are also in play. One of most significant social changes in China is that, two decades after the first free market reforms, a definable class of capitalists has emerged that is no longer dependent upon bureaucratic position for its accumulation of wealth. It now holds ownership of considerable productive and financial capital in the form of property, shares and private businesses.*

*Weighed against the local networks of politically-sponsored smugglers, black marketers and extortionists, are the interests of China's major domestic companies. While still euphemistically called state-owned enterprises, they are in fact share-listed and traded daily on the Shanghai, Shenzhen and Hong Kong stock markets.*

*Eight of them rank in the Fortune magazine 500 largest corporations in the world and Chinese oil and steel companies are preparing to list on Wall Street. Also growing rapidly in economic and political clout are the thousands of privately owned companies that now have equal legal status to state-owned companies and can gain export-import licenses.*

*Oil provides one example of the conflict of interests. It is estimated that 42 million barrels of oil were smuggled into China during 1998 and sold at lower prices than those charged by the dominant oil corporations, under conditions of economic deflation and falling corporate profits. Similar situations could be cited for virtually all commodities. The smuggling crackdown resulted in government revenue from import duties increasing by 78 percent in 1999 and unquestionably contributed to the rise in profitability for numbers of Chinese companies.*

*Pressure to control the corruption of government officials is also coming from transnational corporations and Western governments. With China's impending entry into the World Trade Organisation and the slashing of tariffs and other trade barriers, foreign capital will be able to operate with unprecedented freedom in the domestic economy. As with the attack on "crony capitalism" in other parts of Asia, transnational companies will not tolerate the obstacles placed in their way by having to pay-off tier after tier of bureaucracy to get their products into the market.*

*The national regime in Beijing is attempting a transition from being the highest level of a vast Stalinist bureaucratic stratum into being the efficient instrument of a Chinese capitalist class and international investors. In the process, it is being forced to undermine layers of the bureaucracy beneath it and millions of officials are losing access to long-held privileges, generating frictions and tensions.*

**James Conachy**

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