

China: What Variety of Capitalism?

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Abstract

This paper analyzes China's political economy through the lens of the varieties of capitalism approach as formulated by Hall and Soskice (2001). It presents the current state of knowledge about China in each of the five spheres of the political economy included in the varieties of capitalism model. It concludes that China in many respects resembles a liberal market economy (LME). In addition to providing an empirical basis for further discussion of the world's second-largest economy within the varieties of capitalism approach, the analysis raises questions for future research in three areas: the existence of multiple varieties of capitalism within the same national boundary; actual practice versus formal structure; and the nature and extent of social capital.

Keywords

China, varieties of capitalism, institutions

JEL Codes

P1, P2, O53

About the Author

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Though China is now the world's second-largest economy, there is a dearth of published works that analyze the country from a varieties of capitalism perspective. A combination of factors accounts for this. First, few scholars working within the varieties of capitalism paradigm are familiar with the Chinese political economy to a degree sufficient for rigorous academic debate. Second, those scholars who are and who have published on the matter (e.g., Whitley, 1999; Redding and Witt, 2007) do not draw on the Hall and Soskice (2001) model of coordinated market economies (CMEs) vs. liberal market economies (LMEs), a framework that for better or worse has become the dominant paradigm in the study of varieties of capitalism. This makes China more difficult to place within the mainstream of the field. And third, China specialists tend not to refer to the varieties of capitalism approach but often treat China as a case *sui generis*. The overall effect is that an important opportunity for understanding Chinese capitalism and for potentially amending and extending existing theory goes largely uncaptured.

The objective of this paper is to help stimulate more debate about Chinese capitalism within the varieties of capitalism paradigm. To this end, it draws on the current state of knowledge to analyze China in the context of the five spheres of the political economy Hall and Soskice (2001) identified: the financial system, internal structure of the firm, industrial relations, education and training systems, and inter-company relations. The result, and core message of this paper, is that while China does not neatly fit into either category, in many respects it looks much more like an LME than a CME. At the same time, the analysis raises important questions for future research on varieties of capitalism in three areas: the existence of multiple varieties of capitalism within the same national boundary; actual practice versus formal structure; and the nature and extent of social capital.

An important definitional matter is the question of what “coordination” actually means. We adhere to the usage by Hall and Soskice (2001) of coordination as a process rather than an outcome. At the outcome level, both LMEs and CMEs are coordinated. What differs is the way in which this coordination is achieved: LMEs draw relatively more (but, as human societies, not exclusively) on market forces, while CMEs rely relatively more (but, by accepting some role for markets, not exclusively) on non-market interaction among economic actors. Throughout our analysis, we will include brief reviews of the kinds of processes Hall and Soskice (2001) expect for both types in each sphere.

To provide a contextual foundation for the actual analysis, we begin our exposition with a brief introduction to the different forms of business in China and the structuring of the state. We then proceed to analyze China in the context of the five spheres already mentioned. We conclude with an overall summary and the implications of our analysis for varieties of capitalism theory and research.

Firm Types and State Structure

Before we can begin our analysis proper, it is necessary to clarify two characteristics of the economic and political landscape of China that inform the analysis: the types of firms present in China, and the structure of the political system. These are topics of great complexity, and we will focus on salient characteristics relevant to the context of this paper.

The key differentiator of domestic firms in China is their ownership. In simplified terms, firms can be sorted into three buckets (Redding and Witt, 2007): private, state-owned, and hybrid. Private firms are, as the name implies, usually privately held family businesses. It is these firms that have been driving China's high growth rates. In 2007, they accounted for 75 percent of all firms in China (1998: 24 percent), 50 percent of total employment (1998: 13 percent), 32 percent of fixed assets (1998: 10 percent), and 45 percent of value added (1998: 15 percent) (OECD, 2010).

State-owned firms come in various guises. The best-known type is the so-called

state-owned enterprises (SOEs). SOEs in industries considered strategic to the development and security of China tend to be fully state-held (Naughton, 2007). Many other SOEs have been listed on stock exchanges inside and outside of China, though the state almost always retains a controlling stake (Naughton, 2007). In 2007, they accounted for 6 percent of all firms in China (1998: 38 percent), 22 percent of total employment (1998: 62 percent), 47 percent of fixed assets (1998: 69 percent), and 31 percent of value added (1998: 55 percent) (OECD, 2010). As these statistics suggest, SOEs tend to be considerably more capital intensive than private firms.

The “state-owned” category also includes collective enterprises. These differ from SOEs mostly in terms of the level of government exerting ownership rights: Collectives are usually owned by a lower level of government, such as the township or village, while SOEs are the domain of higher levels such as provinces or the central government. Collectives are by now virtually insignificant in the economy, with a share of less than 5 percent across measures (OECD, 2010). We consequently exclude them from the discussion.

Hybrid firms are, as the name implies, in between. They often look and behave like private enterprises, but their ownership pattern may involve a considerable government stake. To complicate matters further, in the official statistics, they may be counted either in the state-owned or in the private sector, depending on their evolutionary trajectory. In our analysis below, we will bracket hybrid firms and focus on private and state-owned firms as the two extreme points in ownership patterns.

We will further exclude from the discussion foreign private firms operating in China. While economically significant, these firms are often hybrids combining characteristics of their home countries and the Chinese environment. They thus constitute a special, heterogeneous category.

A key characteristic of the political system in the context of this paper is its highly decentralized, quasi-federalist structure (Naughton, 2007; Redding and Witt, 2007; Carney *et al.*, 2009). Counter to conventional wisdom, which sees the central government as all-powerful and fully in control, much policy-making and implementation is devolved to lower levels of government, including revenues and outlays (OECD, 2005). This decentralization is partially an inadvertent consequence of the size of the country. The more remote areas of the country have historically enjoyed higher degrees of autonomy, as expressed in the old saying that “the heavens¹ are high, and the emperor is far.” But it is also the result of deliberate policy intended to provide room for local experimentation in order to evolve information about the feasibility of specific institutional reforms for China’s transition towards a modern economy—thus the notion that China would develop by “groping for stones while crossing the river.”

As will become clear, ownership patterns and government structure interact mostly with the financial system and industrial relations. In addition, ownership patterns have an important impact on inter-company relations.

Financial System

Hall and Soskice (2001) argued that the financial system in LMEs tends to be market-based, with concomitant demand for public disclosure of firm information. By contrast, the financial system in CMEs tends to draw relatively more on relationship forms of finance that provide firms access to patient capital in exchange for access to private information about their operations. As a result, CME financial systems tend to emphasize bank financing, with creditors using long-term business relationships to monitor the health of their debtors.

China’s financial system is clearly bank-led, relying heavily on state-owned banks to

¹ Or, in a variant, “the mountains.”

provide access to finance. In 2005, the latest year for which data are available, 78.1 percent of funds raised in the Chinese domestic market came from banks (Naughton, 2007). Treasury bonds accounted for 9.5 percent, corporate bonds, for 6.4 percent, and stock issues, for 6.0 percent of the market (Naughton, 2007). This situation is unlikely to change much, as policy-makers see dominance of banks as a means of maintaining control over the financial system (Naughton, 2007).

While this would seem to put China squarely into the CME category, further exploration shows that things are not that simple. In particular, system characteristics vary greatly depending on whether a company needing access to finance is privately owned or state-owned. Private businesses have had very limited access to official bank loans, not to mention to capital markets (Tsai, 2002; Rothman, 2005; Herd *et al.*, 2010). The latest published statistics show that in 2008, loans to private enterprises and self-employed individuals were a total of RMB422 billion, out of a total loan volume of RMB53.8 billion (National Bureau of Statistics of China, 2009)—in other words, 0.8 percent. Even if we assume that the number given only refers to short-term loans (the statistics are unclear on this point), the loan share of the private sector in that segment would amount to only about 3.4 percent (National Bureau of Statistics of China, 2009). It is possible that the actual number is somewhat higher, as entrepreneurs have been known to find creative ways to pose as a state-owned business in order to obtain access to finance (Tsai, 2002). Overall, however, private business is starved of official capital, and its predominant mode of funding is savings, loans from family and friends, and unofficial financial operations such as loan sharks and unlicensed banks (Tsai, 2002; Rothman, 2005; OECD, 2010). Rather than a CME-style coordinated structure, finance for private enterprises in China is a self-help system, with the main provider of capital—the owning family—being firmly in control.

By contrast, SOEs tend to enjoy ready access to finance. The main source of funding for SOEs is the state-owned banks (Naughton, 2007). This does not mean that banks enjoy much control over SOEs, as they are not allowed to own stock—unlike banks in CMEs—and extend many of their loans following government direction rather than on the basis of autonomous assessment and decision-making (Naughton, 2007). Listings on the stock market serve as a complementary source of external finance, but the state tends to retain a controlling stake (Naughton, 2007; Tian and Estrin, 2008). As a result, the state-owned sector has neither a bank-based nor a market-based system of corporate governance (Naughton, 2007).

Given the role of the state as owner of both, SOEs themselves as well as their primary source of funding, one might expect the state to keep close control over the activities of SOEs and their use of financial resources. In reality, this is also not the case because the Chinese state is everything but a unitary actor, as already explained. As Naughton (2007, pp. 320-1) summarizes,

To the extent that China has a control-based system [of governance], the control is fragmented among state-owned industrial holding companies, SASACs² at various levels, and government and Communist party bodies. These agencies do not share consistent interests in firm performance or managerial incentives.

The result of this fragmentation is that managers of Chinese state firms “have achieved an extraordinary degree of independence” (Naughton, 2007, p. 321) from markets, banks, and the state.

In sum, while China’s financial system is bank-led, the details of its workings set it apart from both CMEs and LMEs. Private enterprises tend to have little access to official finance, whether from banks or from markets. SOEs tend to obtain finance both from banks

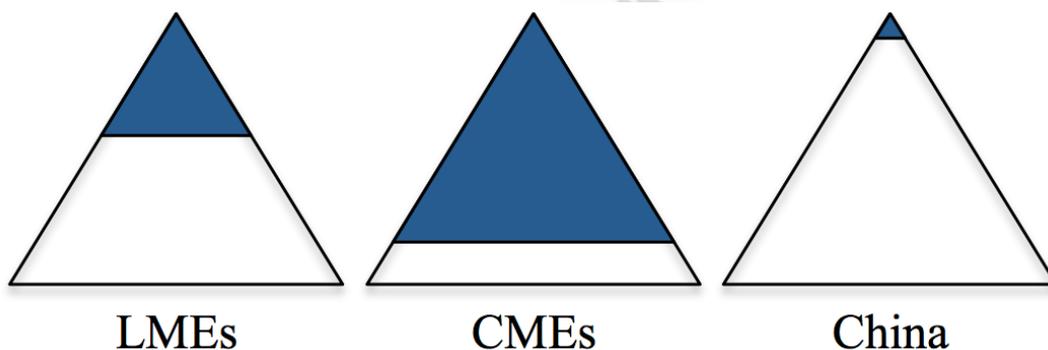
² State-owned Assets Supervision and Administration Commissions, agencies put in place at each respective level of government (center, provinces, etc.) to oversee SOEs owned at that level of government.

and markets, but are monitored and controlled by neither, nor does the state fill this gap. The financial system sphere in China seems to be *sui generis*.

Internal Structure

Hall and Soskice (2001) portrayed the internal structure of firms in CMEs as characterized by consensual decision-making involving multiple layers and constituencies within the firm. By contrast, decision-making in LME firms is taken to be top-down, with few restraints on managerial power. In a prior exposition of this pattern, Lazonick (1991) distinguished managerial from collective capitalism, with the former corresponding to LMEs and the latter, to CMEs. In managerial capitalism, leadership of the firm rests with a managerial layer consisting of both generalists and specialists, while non-managerial “operative” employees function within the confines of a top-down machine bureaucracy with clearly defined roles. In collective capitalism, but contrast, generalists, specialists, and operatives all collaborate in decision-making—i.e., almost the entire firm. If one were to depict the industrial enterprise as a hierarchical pyramid, decision-making in LMEs would occur in a triangle extending from the tip of the pyramid downwards for perhaps one third of the height. In CMEs, the decision-making triangle would extend further to the base of the pyramid, thus incorporating larger parts of the firm into the process (Figure 1).

Figure 1. Parts of the Firm Involved in Decision-Making.



The available evidence on China suggests a radically different picture in which decision-making is in essence the exclusive prerogative of the very top of the pyramid (Figure 1). In prior research, Lieberthal and Lieberthal (2003) have criticized Chinese firms for their weak integration and their tendency to be structured in silos each with top down control, and lacking in managers able to exercise integrating roles and with vision of entire value-chains. An autocratic tendency is evident in a recent study of 618 managers across all sectors of China’s economy, confirming that human resource management—in other words, the hiring, managing, and dismissing of employees—is not being strategically devolved to line managers (Zhu *et al.*, 2008). The same hierarchical sense pervades the managerial ideology (Cheng *et al.*, 2006; Kong, 2006). Ideals of discipline, control and paternalism are found to be the key organizational norms (Kong, 2006), and managers tend to be reluctant to delegate to anyone who is not personally trusted (cf. Chen *et al.*, 2002). These patterns are evident in both state-owned and privately owned firms (Redding and Witt, 2007).

Recent comparative evidence from the World Competitiveness Report (Schwab, 2010) paints a consistent picture. Asked to report the extent of delegation within firms in their specific national contexts, executives from the CMEs included in Hall and Soskice (2001) report an average score of 5.31 out of 7, with 7 being highest. The score for Anglo-

Saxon countries is 4.87, that for China, 3.60. The same basic pattern is visible in the choice between selecting senior executives on the basis of merit and qualifications or on the basis of friendship and family relationships. Here, the CMEs report an average score of 5.83, Anglo-Saxon societies, 5.95, and China, 4.70.

It seems unlikely that the situation will change much in China in the near future. First, the high labor turnover noted below is inimical especially to CME-style decision-making, as employees rarely have deep knowledge of, or much commitment to, the firm. Second, the absence of institutionalized trust hinders large-scale delegation as occurs in both LMEs and CMEs (Redding and Witt, 2007). In particular the absence of a reliable legal system means that it remains virtually impossible to hold others accountable if they abuse the trust implicit in delegation. Third, in SOEs, the continuing custom of political state appointments for the top managerial positions (Naughton, 2007), often from the outside, virtually assures a disconnect between top management and the rest of the firm, both in terms of working relationships and of objectives.

In sum, the available evidence suggests that China looks neither like a CME nor like an LME in terms of internal structures of firms. However, if forced to pigeonhole it into either category, a higher degree of structural similarities would suggest classification as an LME.

Industrial Relations

Hall and Soskice (2001) identified the organization of labor and employer interests as the key distinguishing feature in this area. In CMEs, the interests of both sides are aggregated in unions and employer associations, and the setting of wages and working conditions occurs through collective bargaining at this aggregate level. In LMEs, market conditions rather than bargaining govern wages and working conditions (see also Whitley, 1999). An associated feature is high protection against dismissal in CMEs, while management in LMEs tends to have substantial freedom to hire and fire.

Formally, China has many trappings of a CME in this area. Industrial relations have been under a tripartite framework since 2001 (Lee *et al.*, forthcoming); the All China Federation of Trade Unions (ACFTU) in 2008 had a union density of 48.3 percent and a collective bargaining coverage of 34.1 percent (Liu *et al.*, forthcoming); and employers organize in the China Enterprise Confederation (CEC), the All China Federation of Industry and Commerce (ACFIC), and numerous local associations (Lee *et al.*, forthcoming).

The reality is more complex. For one, the tripartite process is highly fragmented among “10,702 tripartite bodies across national, provincial, municipal, county, district and even street levels” (Lee *et al.*, forthcoming). This raises the question to what extent agreements thus reached can serve the kinds of coordinating functions Hall and Soskice (2001) envisioned.

Second, the ACFTU is not really a union *qua* independent representative body of employee interests, but an organ of political control for the communist party (CCP) (Taylor and Li, 2007; OECD, 2010; Liu *et al.*, forthcoming). This is logical if one considers that in a communist political system, there can be no independent unions as the Party already represents the interests of the proletariat. Accordingly, CCP endorsement is needed for new ACFTU initiatives, and the chair of the ACFTU is a member of the standing committee of the CCP and holds a government position senior to that of the head of the Ministry of Labor and Social Security (Taylor and Li, 2007).

This has perverse implications in terms of interest representation because in many cases, CCP interests are closely aligned with those of business. Government owns many firms, and even where ownership is formally private, party officials often hold a personal stake. In addition, local government depends on tax receipts from local enterprises and

income from their land purchases, and local cadres need good business performance and high investments if they want to be promoted. As a result, the ACFTU tends to fail to promote labor's interest and shows a pattern of siding with management against striking workers (Taylor and Li, 2007).³

The situation on the employers' side is more complicated, and comprehensive accounts of it are rare. A recent survey (Lee *et al.*, forthcoming) suggests the following picture. The CEC and the ACFIC are top-down, state-controlled associations. As such, they are the counterparts of the ACFTU, with CEC having stronger standing with SOEs and the ACFIC, with private firms. One implication is thus that for SOEs, all three parties to the tripartite process are in the hands of the state.

Private business does show some signs of independent representation, though its future direction is unclear. Until 2008, only the CEC was involved in industrial relations issues, and since its organizational structure did not extend much downwards, it left a vacuum in tripartite negotiations at lower levels of administration. Local employer associations arose to fill this opening, some of them under control of local governments, but others apparently genuinely free to represent employers' interests (see also Zhang, 2007). With the entry of the ACFIC into the industrial relations arena, a number of these local associations seem to have become affiliated with the ACFIC; only time will tell whether this signals a shift of the ACFIC toward civil society or the subordination of previously relatively free bottom-up employer associations under state control.

Employment protection shows a similar divergence between outward appearance and actual practice. *De jure*, following the tightening of labor regulations in 2007, China features levels of employment protection that exceed those in the CMEs mentioned in Hall and Soskice (2001) (OECD, 2010). *De facto*, however, "employment protection is far less than *de jure*, with an enduring preponderance of fixed-term contracts involving few restrictions" (OECD, 2010, p. 153). This is consistent with survey responses contained in the Global Competitiveness Report 2010 (Schwab, 2010) about the ease of hiring and firing. On a scale from 1 to 7 (1=impeded by regulations, 7=flexibly determined by employers), China scores 4.10, about the same as the UK. This compares with average scores of 3.81 for CMEs and 4.25 for LMEs (note that the average for CMEs is pulled up considerably by free employment regimes in Denmark, Switzerland, and Iceland; the median score for CMEs is 3.20, that for LMEs, 4.0).

Overall, while China from the outside looks like a CME in this sphere, actual practice suggests that it is closer to the LME camp. In terms of interest representation, collective bargaining along CME lines is impossible foremost because there is no organization truly representing labor interests. In terms of employment protection, actual practice in China is in line with that in LMEs. Given the vested interest party officials have in business, as already mentioned, it also seems unlikely that a true tripartite structure as seen in most CMEs will emerge soon.

Education and Skills Formation

In CMEs, education and training systems are geared toward the formation of industry or firm-specific skills—often through vocational training schemes—while those in LMEs are more suitable for furthering general skills deployable across a range of industries and firms (Estevez-Abe *et al.*, 2001; Hall and Soskice, 2001). A key complementarity in this context is the duration of employment tenure: short-term employment, as in LMEs, tends to discourage the formation of firm-specific skills, as employees are unwilling to invest in skills that are not

³ This makes perfect sense in a Marxist worldview because workers opposing the interests of the party must obviously be confused.

transferable to their next job and employers are reluctant to invest in educating someone who may leave soon, possibly to work for a competitor (Hall and Soskice, 2001).

In exploring how China fits into this dichotomy, it first bears emphasizing the relative weakness of the Chinese education system, despite many advances in recent years. UNDP publishes an education attainment index, which presents a composite score of literacy and school enrollment rates at all levels (United Nations Development Programme, 2009). In this, the lowest scorer among the countries considered in Hall & Soskice's (2001) chapter is Switzerland, with a score of 0.936 (out of 1 possible). China scores 0.851, on par with Malaysia, just ahead of Suriname and just behind Lebanon. While the literacy rate in China is relatively high at 93.7 percent in 2008 (World Bank, 2010), enrollment rates are still comparatively low, especially at the upper secondary and tertiary level (United Nations Development Programme, 2009).

In the economic context, China today faces a shortage of usable skills and a skills mismatch. Li and Sheldon (forthcoming) report that since 2002, demand for technical employees has exceeded supply. By 2009, demand to supply ratios reached 1.43 at the most junior level, 2.24 for senior technicians, and 2.28 for senior engineers. The World Bank found that of 4.95 million students graduating in June 2007, 1.4 million were unfit for finding a job (World Bank, 2007). And a 2005 McKinsey study found that of 1.6 million engineers in the Chinese labor market, only 160,000—about the same as in the UK—had the requisite skills to work at the level required in multinational corporations (Farrell and Grant, 2005).

Part of the problem is that the build-up of the modern Chinese education system has emphasized general skills over vocational training (Li *et al.*, forthcoming). From 1990 to 2008, enrollment in regular secondary schools has grown from about 4.6 million to 80.5 million, a factor of 17.5, while the number of schools has fallen from 87,631 to 72,907 (Li *et al.*, forthcoming). During the same period, enrollment in *vocational* secondary schools has increased only from 3 million to 7.7 million, a factor of 2.6, and the number of schools has fallen from 9,164 to 6,128 (Li *et al.*, forthcoming). Not only are vocational training opportunities insufficient, but educational contents are often misaligned with corporate needs, as linkages between educational organizations and companies are generally absent (Li and Sheldon, forthcoming).

In principle, companies could make up for this failure of the public education system through in-house training. In practice, high levels of employee turnover are a strong deterrent against this approach (Li and Sheldon, forthcoming). Li and Sheldon (forthcoming), for instance, found annual turnover levels of up to 30 percent. Smyth, Zhao, and Li (2009) present a case study with monthly (!) turnover rates of 10 percent, with one-third of the workforce actively looking for a different job and 40 percent ready to leave without hesitation. Recent labor shortages have if anything increased the incentives for firms to poach from one another and for employees to follow the call of higher salaries. These conditions do not allow the emergence of a strong in-house training system.

It seems likely that at least part of these problems will persist into the foreseeable future. In particular, there seems to be a strong disinclination against vocational training for cultural reasons:⁴ Classical Chinese education tended to emphasize general intellectual skills, not unlike a liberal arts education in the West. By contrast, vocational training is seen to be associated with manual labor, which is not prestigious (Brabasch *et al.*, 2009). Even in Singapore, which is far more advanced in terms of GDP but retains many aspects of “Chinese” ways of business, vocational training is seen as a sign of failure in school.

Overall, China's education and training system is clearly not yet up to the levels of

⁴ On the connection between culture and institutions in general, see (Redding, 2005; Witt and Redding, 2009); in China, see (Redding and Witt, 2007).

the advanced industrialized nations. That said, the bias toward general education suggests that on this dimension, China fits better into the LME than into the CME category.

Inter-Company Relations

Hall and Soskice (2001) observed that firms in CMEs rely on connections with one another to affect the diffusion of technology across the economy. LMEs, by contrast, accomplish the same through the movement of technical personnel across companies, aided by a fluid labor market and short-term employment patterns as already noted. A number of accounts in the literature present a consistent picture (e.g., Whitley, 1999; Dore, 2000; Jackson, 2003; Witt, 2006).

The Chinese context features a high number of inter-firm alliances aiming at technology transfer in the shape of joint ventures (JV) between a local and a foreign firm. However, while such alliances tend to be voluntary in nature in CMEs, in China, they tend to be the result of legislation providing for market access in exchange for technology (Naughton, 2007). Following the entry of China into the World Trade Organization in 2001, these requirements were successively relaxed. To the extent possible, new entrants have been forming wholly foreign-owned enterprises (WFOEs), and numerous joint ventures have undergone conversion to WFOEs (Puck *et al.*, 2009). In 2004, 50 percent of the existing 510,000 foreign investment projects were JVs, while 40 percent were WFOEs. In the same year, of new investments, 70 percent were organized as WFOEs, and only 27 percent as JVs (Puck *et al.*, 2009). As China further deregulates market access, JVs are likely to disappear almost completely as an entry mode.

Among domestic firms, there is arguably limited need to form alliances as a means of technology diffusion. China's system of intellectual property protection suffers from notoriously weak enforcement (Keupp *et al.*, 2010), so one can argue that Chinese firms are free to copy what they need. In addition, skilled workers freely move among competing companies, taking knowledge with them, and poaching is common (Li and Sheldon, forthcoming).

Those networks that do exist seem to focus on roles other than the technology transfers envisioned. Business associations, as already discussed, seem to have evolved mostly in response to industrial relations needs; there is no clear evidence that they contribute to technology diffusion. Private sector firms are further frequently embedded in local production networks (Zeng and Williamson, 2007). In these, a number of small firms collaborate in the production of a given product, similar to the pattern seen in European industrial districts (Whitley, 1999). This form of collaboration can be highly efficient and effective; for instance, in the early 2000s, such networks, which are usually highly localized, accounted for 70 percent of the world market in cigarette lighters, 50 percent, in shoes, 26 percent, in toys, and 20 percent, in neckties (Zeng and Williamson, 2007). Given the low levels of technology in these industries, technology diffusion is not a major function of these networks.

SOEs and, to a much lesser extent, some private firms have also banded together to form business groups (*qiye jituan*) (Ma and Lu, 2005; Keister, 2009). However, since most of these groups are actually dominated by a large SOE (Ma and Lu, 2005; Keister, 2009), including through ownership ties, these groups are perhaps best thought of as hierarchical conglomerates rather than as networked business groups without a dominant member, as one would find them in Japan (Gerlach, 1992).⁵ Interlocking directorates among member firms seem to serve as an information source about technological innovations (Keister, 1998), but

⁵ Networks are customarily defined as “any collection of actors ($N \geq 2$) that pursue repeated, enduring exchange relations with one another and, at the same time, lack a legitimate organizational authority to arbitrate and resolve disputes that may arise during the exchange” (Podolny and Page, 1998, p. 59).

to our knowledge, no study has documented the actual diffusion of technology—as opposed to knowledge about it—within business groups. What is known is that business group membership has been losing in value over time (Carney *et al.*, 2009); since technology plays a larger role in Chinese economic development today than in the past, this would seem to speak against a major role of business groups in technology diffusion.

In summary, in the context of inter-firm relations, China again looks more like an LME than like a CME. While inter-firm relations related to technology diffusion exist, these are not a means toward long-term technological cooperation, but short-term relationships foreign firms entered as a price for market access and terminate as soon as they can. However, if we conceive of this sphere as one related to networking among firms more generally, China begins to look a bit more like a CME, especially if we relax the definition of “social networks” to include Chinese-style business groups.

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Conclusion

Table 1 summarizes the results of the preceding analysis for each sphere. While it is clear from the discussion that China does not perfectly fit either ideal type, the evidence at this point of time suggests that its workings on balance more closely resemble an LME than a CME. This is particularly true with respect to private firms, which by now constitute the bulk of economic activity in China. The one clear deviation from the tendency toward LME-style processes is the financial system, which seems to be a case *sui generis*, at least for now.

Table 1. Summary of Findings.

Sphere	Finding
Financial system	<i>sui generis</i>
Internal structure	LME
Industrial relations	LME
Education and training	LME
Inter-company relations	LME

This assessment is of course not the final word on China. The Chinese economy is still far from living standards prevalent in advanced industrialized countries, and its institutional structure, both formal and informal, is still showing signs of transition from central planning to a more market-based economy. At the same time, as we have pointed out in various places in this study, the presence of vested interests and cultural predispositions are likely to hinder rapid institutional change.

Apart from providing an empirical departure point for further exploration of China within the varieties of capitalism paradigm, our study raises three large questions that may have implications for further theoretical development of the field. The first such question is how to accommodate the possibility of multiple varieties of capitalism within the same national boundaries. Our analysis suggests that at least in some spheres, private and state-owned Chinese firms play by different rules of the game. One possible interpretation is that this state is a temporary artifact of China's transition from central planning to a market orientation. The shrinking of the state-owned sector as well as the emergence of a hybrid sector amalgamating elements of both can be interpreted as a harbinger of eventual convergence on a single model (though this may be so far off in time as to raise the question of when a transitory state stops being transitory). However, there is also the possibility that private and state-owned firms may represent two distinct, sustainable punctuated equilibria. In this view, hybrid firms may either be a third equilibrium in between the others (Redding and Witt, 2007), or just the tails of the statistical distributions centered on these equilibria.

The answer to this question has implications for the understanding of the future evolution of varieties of capitalism, and in particular, studies of convergence or lack thereof. There is general agreement in the varieties of capitalism literature that institutional convergence among the advanced industrialized countries has been at best partial. However, if we allow for multiple equilibria within the same national context, then the question of institutional convergence at the national level becomes moot, as firms subject to convergence pressures may create their own equilibrium points. For instance, the emergence of a subgroup of Japanese firms with the trappings of a more Western-style corporate governance regime (Jackson and Miyajima, 2007) may not be the beginnings of eventual systemic institutional change in Japan, but an adaptive response around a new equilibrium point by a select group of firms.

The second such question grows out of an ironic feature of the Chinese political economy: In several spheres, China has the formal trappings of a CME paired with actual

practices that are more reminiscent of an LME. This raises the question of how to handle deviations of actual practice from formal structure. From the perspective of institutional theory, it is clear that actual practice trumps formal structure (Aoki, 2007). Once institutions lose their ability to “structure human action” (North, 1994, p. 360), they cease to be institutions, even if they officially remain in effect. The attendant process of “deinstitutionalization” is well-documented in the sociological literature (Oliver, 1992; Ahmadjian and Robinson, 2001), and works across the social sciences widely acknowledge that deviance from existing institutions is an important driver of change in the affected institutions (Hirschman, 1970; Oliver, 1991; Boddewyn and Brewer, 1994; Schoppa, 2006; Witt, 2006).

The focus of a good part of the varieties of capitalism literature to date has been on formal structures. For instance, Streeck and Thelen (2005) explicitly bracket informal institutions, and the bulk of the edited volume by Aoki *et al.* (2007) explores changes in the formal structure of Japanese corporate governance. At some level, this emphasis on formal structure is justifiable, because economic actors in most of the advanced industrialized countries do play by the official rules of the game. However, once we move to Latin Europe or Japan, this alignment of practice and structure starts to deteriorate. For instance, in a chapter in the edited volume by Aoki *et al.* already mentioned, Dore (2007) illustrates how the structural changes noted in the other chapters of the book were not necessarily followed by changes in actual practice. And once we leave the advanced industrialized world, correspondence between structure and practice tends to break down, as we have seen for the case of China. This suggests a need to acknowledge, in the words of Aoki, that “the law defines the formal rules, but we should ultimately be concerned with are [sic!] the ‘ways by which the game is actually played’” (Aoki, 2007, p. 434).

This leads to the third large question, namely, whether and how to incorporate social capital into the varieties of capitalism framework and discourse more generally. For Hall and Soskice (2001), variations in alignment between formal structures and actual practice did not pose an issue because their sample was composed of law-abiding societies. By contrast, looking at a wider range of contexts, Whitley (1999) found the need to include the dimension of trust in formal institutions into his framework. Redding (2005) in turn generalized this dimension to social capital, which in his definition comprises both interpersonal trust and trust in overarching formal and informal institutions. Subsequent works in this vein indicate that high levels of institutionalized trust are rare outside Western Europe, Japan, and the Anglo-Saxon economies (Redding and Witt, 2007), a finding that is also consistent with patterns in corruption levels in different nations (Transparency International, 2009). This suggests a need to find a role for variations in social capital in the Hall and Soskice (2001) framework. It seems likely that the attendant loss in parsimony will be more than compensated by enhanced geographic applicability of the model. As the economic center of gravity of the world shifts away from the West, this will help secure the continued relevance of the varieties of capitalism approach to socio-economics.

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