

Why Is China a High-Lambda Society?

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Cultural and social values influence the level of cooperativeness in society, which in turn determines the level of lambda. *Lambda* (λ) represents the parameter used to determine the degree of cooperativeness among a particular societal group or society. Martin Weitzman and Chenggang Xu (1994) used a prisoner's dilemma game to demonstrate the influence of cooperative culture on property rights theory. The prisoner's dilemma was originally described as a static, noncooperative game with complete information. It is static as it is only played once and is noncooperative, with decisions made simultaneously so that players cannot learn from one another or communicate (McCarty 2000, 326). Weitzman and Xu (1994) let the outcome of a prisoner dilemma game be quantified by the parameter λ . This λ is valued between zero and one. A high value of λ , near one, means a cooperative solution, which comes close to looking as if it were the outcome cooperative collusion. A low value of λ , near zero, means a noncooperative solution that is far from the cooperative solution, thus yielding low individual payoffs.¹

The parameter λ stands for the ability of a group of people to resolve prisoners' dilemma-type free-riding problems internally, without the inclusion of explicit rules of behavior. With a λ value of one, people in a group would be able to resolve free-riding problems completely internally, regardless of the size of the group. With a λ value of zero, not even two people, the smallest group of people possible, can resolve the free-riding problems regardless of how much negotiation takes place. With a value of λ between zero and one, people would be able to cooperate effectively when a group is sufficiently small, but they may not be able to cooperate as effectively when a group is sufficiently large (Weitzman and Xu 1994, 138). As such, λ is the degree of cooperativeness in society's culture.

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Lambda is useful in determining whether there is a need and reliance for well-defined ownership within a broad range of cultures. Weitzman and Xu (1994) suggested that there was a lot of anecdotal evidence that could be cited to argue that Asian countries are high- λ societies relative to countries in Europe, which by comparison are more low- λ societies. Traditional Chinese cultural values, which are rooted in the Confucianist, Taoist, and Buddhist philosophies, consist of a sense of order, vertical and horizontal relationships, obligation to the group, and the preference for harmony and cooperation in interpersonal relationships (Gao and Handley-Schachler 2003, 44). Confucianism provides the philosophical basis for the collectivist values prevalent in China. Social relationships are regulated by the five Confucian virtues of Ren (humanity-benevolence), Yi (righteousness), Li (propriety), Zhi (wisdom), and Xin (trustworthiness). China, using its cultural foundation, has been able to stimulate and maintain successful economic reform without reliance on or the apparent need for well-defined property rights. This paper attempts to explain why a high- λ society such as China was able to operate in the absence of defined property rights, in contrast to Weitzman and Xu (1994, 139), who relied only on anecdotal evidence. In addition to this, the Chinese “ownership maze” demonstrates ownership structures which in the formal sense are vague, ill defined, and fuzzy yet can stimulate and maintain successful economic reforms (Yusuf 1994, 76; Weitzman and Xu 1994, 131; Wang 1992, 554; Sing and Gelb 1994, 17).

In this paper, by using the notion of *cooperative culture* I demonstrate that economic reform does not need to rely on well-defined property rights at most in the short run. Throughout this paper I will demonstrate that in China cooperative culture allows for the development of efficient and successful informal institutions without the aid of standard conventional property rights. This lack of property rights is a trait unique to countries that have a high λ , and the degree of this cooperativeness is rarely seen in countries that have a low λ . In addition, I will argue that cooperative culture influences economic development and that is one of the reasons why China has a successful economic reform program. However, a process of disembedding the market has been initiated in China with its increasing capitalist characteristics that result in the destruction of trust, the rise of corruption, and the development of an inefficient and dishonest economy.

The Role of Lambda on Economic Development in China

The concept of a cooperative culture, with an absence of well-defined property rights, is an odd combination for economic success; however, this mixture has seemed to be successful in China. Collectivization has always been viewed as an inefficient economic structure (Wen, Li, and Lloyd 2002, 716–8; Smyth 1997, 234–5). All of the former socialist countries of Russia and Eastern Europe have abandoned collectivization

and attempted to adopt a free market with the establishment of well-defined property rights based on the logic that “all economic transitions from socialist countries have been based on the recognition that private ownership and freedom of contracts makes the market economy more efficient than other economic systems” (Wen, Li, and Lloyd 2002, 713).

This emphasis on the presence of well-defined property rights, according to Mei Wen, Dong Li, and Peter Lloyd (2002), is an essential part of economic transition, and thus the absence of well-defined property rights is expected to bring with it chaotic and inefficient business exchanges, not to mention, crime, corruption, and failure of any attempt from the central government to conduct successful economic reforms. As in property rights theory, “without well-defined private ownership, the firm will tend to operate relatively badly, and any system without widespread well-defined property rights will tend to perform relatively badly” (Weitzman and Xu 1994, 125). With this in mind there is a critical factor, cooperative culture that has not been incorporated in the property rights analysis. Well-defined property rights may not be the center point of economic efficiency or economic growth.

Many explanations have been put forward in an attempt to rationalize why China has been so successful in reforms with this lack of defined ownership. Chun Chang and Yijiang Wang (1994) argued that the conflict of interest between central and local governments was the answer to China’s success in economic development, while David Li (1995) suggested the risk-sharing behavior between nominal owners and local governments in an imperfect market environment was the answer. Weitzman and Xu (1994) argued that culture and sociological factors were the reason for China’s economic success through the use of ambiguous property rights. The reasoning behind this argument is that cooperation allows for economic success without the use or implementation of well-defined property rights. If individuals are bound by trust and cooperate effectively among each other they will be able to solve economic problems in such a way that there is no need for the use of written contracts or well-defined property rights. This ability to work without property rights is a controversial concept and moves away from conventional property rights theory.

In China there are two main types of property: state property, which is the property of the whole people, and the cooperatives, the township and village enterprises (TVEs). For the purpose of this paper the analysis and arguments will be directed to cooperatives and collectives in the form of TVEs, as these are the most important form of collectives in China (Wen, Li, and Lloyd 2002, 716). A TVE is an industrial business unit that is located in and owned by all the residents of a rural community. A rural community can be a township (about 3,500 households) or a village (about 200 households) owning a number of enterprises (Che and Qian 1998b, 2). In 1993 about three-quarters of the nonstate industrial output, that is, 42 percent of the national total and equal to the size of the state-owned enterprises, was produced by nonstate enterprises that involved government ownership other than the national government; TVEs accounted for nearly 50

percent of the industrial output within the nonstate sector (Che and Qian 1998a, 488–9).

The TVEs enter into informal contracts based on reputation, which is considered the core asset of all TVEs. It is the effect of reputation and culture that underpins the functioning of informal institutions in China (Smyth 1997, 235; Weitzman and Xu 1994, 141; Kung 1995, 106). However, the theory of well-defined property rights lacks the ability to factor in cultural cooperation as an important determinant of economic development. Thus conventional property rights theory may have been inadequate to explain economic development due to the fact that it does not consider this critical dimension of cooperative culture and, within such, the ability and desire to be cooperative (Weitzman and Xu 1994, 136–9).

Standard property rights theory aspires to be culture free or universal. The theory assumes explicitly and implicitly that all people are indiscriminately noncooperative regardless of their cultural background (Weitzman and Xu 1994, 126). In the prisoner's dilemma game the level of cooperativeness within the society determines the need for contracts and the use of well-defined property rights. If a country has a low cooperative nature, then the reliance on well-defined property rights and contracts expands. In China, culture and trust are stepping stones of everyday life, and as a result Chinese people do not rely on well-defined property rights, regardless of the size and complexity of the prisoners' dilemma faced. Russell Smyth (1997, 243) argued that there is indeed a need for explicit legal frameworks like defined ownership; however, this is reduced in the case of China, where informal contracts become self-enforcing.

After establishing the level of cooperativeness, the question must be asked: how does this aid in the development of effective informal institutions and why does this cultural structure allow for this alternative way of conducting business? One of the key dilemmas faced in modern-day China is the notion of ownership within the TVEs. Without a true owner who has the clear right and incentives to operate the firm for maximum profit, TVEs ought to be inefficient. This inefficiency argument was presented by Wen, Li, and Lloyd (2002, 709–11), who suggested that the difference between China and Eastern European countries lay with the relationship between ownership and efficiency. With all inputs and outputs in the TVEs being owned by the cooperative, shared evenly and used to reach a common goal, this is consistent with the cultural background in China. As such, China does not rely on a controlling entity or specific guidelines to ownership since the resources are pooled together. This cooperative element is a key component to economic transition and could be the most important factor in the success of informal institutions and TVEs in China. Thus conventional property rights theory does not provide a definitive answer on the optimal structure of ownership types in a transition economy like China or other cooperative economies. If we expand this argument, China may have found an ownership structure that allows a transition economy to progress at a rate which promotes limited freedom, market relations, and informal institutions.

In the Soviet Union and Eastern Europe the collectivization of farms supposedly should have resulted in more efficient production. This experiment failed, as Soviet and Polish agriculture suffered from let-the-other-guy-do-itism and thus was far from efficient (Goldman 1999, 390). It could be argued that by using the concept of λ and applying it to Russia and Eastern Europe, it would appear that these transition economies possessed a low λ and thus are not of a highly cooperative nature. Weitzman and Xu (1994, 142) referred to this as the “low- λ European-style capitalism.” This low cooperative nature led to stealing and corruption by organized crime groups in the transition period for Russia and in most Eastern European countries. It has been argued that these negative outcomes with the Eastern European transformation were the result of the great difficulty of establishing well-defined private property rights. But this argument suggesting that property rights are essential to economic development is somewhat blurred as the experience of cooperative nature in Chinese economic development demonstrates and as a result a gap between theory and reality is opened. The complex relationship between ownership, incentives, and the enterprise operation environment are traits of China’s development that will be developed further in this paper.

Cooperative Culture in China and Its Influence on Property Rights

Business practices in China are also based on traditional Chinese cultural values, which are rooted in the Confucianist, Taoist, and Buddhist philosophies, in a form of what is named *guanxi*: “cultivating personal relationships through the exchange of favors and gifts for the purpose of obtaining goods and services, developing networks of mutual dependence, and creating a sense of obligation and indebtedness” (Standifird and Marshall 2000, 21). *Guanxi* is a set of codified societal rules and values specified by Confucius during the sixth century B.C. that provide the framework for business practices even today, affirming *guanxi*’s cultural persistence and cultural embeddedness. *Guanxi*-based exchanges are taken for granted, as necessary and appropriate; the practice of *guanxi* is fully institutionalized, exhibiting a sense of perseverance independent of the nature of the exchange.

According to Chinese cultural doctrines, an individual is perceived as being a part of different overlapping social networks within defined rights and obligations in each network. Chinese ethical principles and moral standards emphasize mutual faith, understanding, and loyalty between human beings. The Chinese believe that the basic nature of human beings is good, so to write everything down in detail in a form of contract is considered a demonstration of distrust. In this way, *guanxi* permits individuals to deal with unforeseen contingencies after the agreement. Credit by financial institutions is also extended to ensure that the exchange parties maintain an amicable relationship. Consequently, a relationship based on mutual trust as a result of *guanxi* does not require legal provisions to define responsibilities and obligations. Confucian philosophers have argued against strict reliance on laws, rules, and contracts due to the complexities of

human condition. Actually, human beings know what they should do and are likely to make appropriate decisions. "Thus, trust and contracts are opposed to each other in Chinese culture" (Gao and Handley-Schachler 2003, 49).

Guanxi is primarily about cultivation of long-term personal relationships, but this does not appear to be unique. What is distinct about *guanxi* is that it plays a central role in daily social and business exchanges. "Thus, the instrumental value of *guanxi* is the reciprocal obligations of the parties involved with respect to the acquisition of resources" (Standifird and Marshall 2000, 22–3). *Guanxi* is also transferable from individual to individual and eventually leads to a network of relationships. Thus, strangers doing business become strangers no more. Once enmeshed in a network, one maintains one's reputation by reciprocating favor for favor. Reputation is a key element in the development and maintenance of *guanxi*. Although highly abstract, reputation is treated as something that can be quantified and measured. Failure to follow the rules of reciprocity and equity in a *guanxi*-based relationship results in a loss of reputation and the labeling as being untrustworthy. In such a case, future exchanges within the *guanxi* network are threatened as the loss of reputation associated with opportunistic behavior spreads quickly through the network. Opportunistic behavior with one exchange partner is inferred as opportunistic behavior with the entire network. Members of the network are reluctant to sacrifice the sunk investments in an existing *guanxi* relationship because it is near impossible to reenter a *guanxi* relationship once it has been damaged (Standifird and Marshall 2000, 34). Thus, the mere threat of network ostracism serves as a strong incentive for commitment to the individual exchange relationship.

Consequently, *guanxi*-based exchange develops into a structural alternative to markets, hierarchies, and the hybrid form as each deals with uncertainties created by bounded rationality and opportunistic behavior. The operational process of *guanxi* development permits a fairly sophisticated, but mostly implicit, means for establishing exchanges. In general, the development of a *guanxi* network reduces costs associated with searching for partners and negotiating contracts.

Standard property rights theory contains three basic elements. First, property is assigned a well-defined owner; second, the residual income goes to the owner; and, third, the owner has the right to control or to determine the use of the existing asset. In the case of TVEs, all assets are controlled by the collective and there are no defined ownership rights among the people. As such, as argued by Li (1996, 2) the existence of ambiguous property rights in the Chinese nonstate sector—the TVEs—has become a challenge to the traditional theories of property rights. Chang and Wang (1994, 435–6) put forward regarding TVEs as the solution to the ownership puzzle with the goal of improving the welfare of local citizens as "natural and useful," subject to the following two constraints: the political system in China must be preserved, and local agents must be provided with economic incentives. The latter constraint was imperative since, before economic reform, cooperatives were nonexistent as the cooperative elements common to all villagers in China—low information costs, kinship ties, trust and coopera-

tive spirit—were exploited by the Chinese state by appropriating the collective benefits (Pei 1996, 43).

Weitzman and Xu (1994, 121) argued that TVEs are best described as vaguely defined cooperatives, meaning an essentially communal organization, removed from having a well-defined property structure. With a lack of defined ownership, it is easy to assume that economic growth and prosperity could not be achieved regardless of the level of cooperation in China. This argument is reinforced by Li (1996, 1), who stated that “institutions of clearly defined property rights are preconditions for economic prosperity.” The argument that ownership is a vital component to economic development was also posited by Marshall Goldman (1999, 389), who believed that “private property rights are necessarily a force for economic growth and political stability” and Wen, Li, and Lloyd (2002, 709–10), who wrote that “clearly defined property rights reduces the externality and improves incentives by assigning owners the right to claim residual income and to control the firm. With these arguments, it seems that well-defined ownership is a critical element of economic development. However, in countries that have a high λ , these arguments would not be valid. If you take into account the influence of the Chinese culture as a key element in economic transition and success, you also need to understand that China, unlike other countries, possesses a high λ . This high λ allows the Chinese people to cooperate more efficiently and effectively than in other countries, without their economy being based on well-defined property. In actual fact, TVEs’ property rights are more secure with the participation of local government than in private enterprises. The national government’s interventions have been less frequent and less hostile to TVEs than to private enterprises (Che and Qian 1998a, 489). This is because the national government expects TVEs to serve its interests better by hiding less revenue and thus providing more revenue to the national government and spending on local public goods. In addition, local government participation facilitates financial contracting with state banks, implying that TVEs face a hard budget constraint (Che and Qian 1998b, 3). Consequently, some private enterprises sought protection by converting their firms to TVEs in the wake of the retrenchment of private firms between 1989 and 1991 (Che and Qian 1998b, 11).

This level of cooperation in China has allowed for the absence of well-defined property rights, which has been successfully adopted by the members of the TVEs. Importantly, Xiaolin Pei (1996, 44–5) went a step further in arguing that the success of the TVEs was mainly due to the specific characteristics of the Chinese village or rural community and not just a result of general cultural elements. As well, the nature of local governments in China is also embedded in the characteristics of the Chinese village or rural community. Therefore, property rights theory does not allow for communal social involvement and ownership, which are a reward and not an objective of the TVEs. If this is put another way, high λ -reliant countries and property right-reliant ones differ in the way they conduct their business and consequently they approach the transition process in a different way. As a result, Chang Che and Yingyi Qian (1998b, 20) con-

cluded their paper stating, “in sum, the success of TVEs in China demonstrates that there is no standard model of transition from plan to market, nor does there exist such a model for economic development.” From a cultural prospective, Yui-Tim Wong, Hang-Yue Ngo, and Chi-Sum Wong (2002, 583) pointed out “the Chinese culture has been characterized by collectivism, with an emphasis on harmony, reciprocity and loyalty. . . . [A]lso these values and beliefs have important bearing on the development of trust and commitment in the work place in China.” In this context, an implicit contract is as effective, if not more so, than a formal one in high- λ societies.

This cooperative nature and the associated high λ of the Chinese people and society allow removing their reliance on property rights. Tomas Riha (1996, 245) argued that there has been a strong body of opinion that common ownership preceded private ownership and it is therefore is a more natural state. This would be the case in China, as cooperativeness to the Chinese people is their natural state of conducting business and life. Being in this natural state allows the Chinese people to work together to find a common ground without the influence of unnecessary negotiations that can complicate the whole process, which also indicates that China has a high- λ society compared with a European state where negotiations and ownership are a necessary part of the exchange. Jan Svejnar (1990), as well as Mark Pitt and Louis Putterman (1992), indicated that TVEs are as efficient as private firms.

Thus informal contracts can be more effective than formal ones. It gives answers to the question of why informal institutions in China are so effective. The answer lies in their ability to disregard conventional style property rights theory and adopt their own cultural style of property rights theory. China’s property rights theory aspires not to be based around individual ownership rights to residual income and control but to adopt trust, reliance, and the achievement of common goals as the basis of their “standard” property rights structure. In actual fact, struggling for survival in rural Chinese communities did not foster competition rather cooperation (Pei 1996, 48).

The influence of the TVEs’ culture and their ability to derive outcomes without the need for, or reliance on, standard property rights theory is a unique trait. With this ability to undergo business based on trust, time, money, and confusion can be saved, issues also faced by cultures that rely on defined ownership rights. Riha (1996) argued that the criterion for the establishment of property rights historically corresponds to the most efficient outcome. This may be the case in low- λ societies, where they have typically a nontrusting culture.

Chang and Wang (1994, 443) argued that it “seems very natural” in the cultural setting to give control of the TVEs to the local government. The connection between local government and TVE is described by Lina Song (1990, 369) as a father-son relationship. Li (1996, 3) explained the usage of informal institutions in China by the fact that the market environment can be characterized as a gray market. A gray market is one in which transactions may be blocked due to government regulations. However, a government bureaucrat can work around the obstacles and make the transaction possible.

Thus, the gray market gets its name due to the uncertainty regarding whether the transaction will be “white” or “black,” in other words, legal or illegal. Facing a gray market, the entrepreneur has an incentive to include the government as an ambiguous owner (Li 1996, 16). Ambiguous property rights arise when the owner’s rights are not guaranteed beforehand. Instead, owners have to fight for actual control *ex post*. Strangely enough, the otherwise private firm is optimally chosen to have an ambiguous owner and property rights. The benefit of ambiguous property rights is that, when the transaction is black, the firm can get help from bureaucrats. In other words, the arrangement of ambiguous property rights is a response to the grayness of the market, which is a form of market imperfection. Hence, by choosing to register the firm as a collective, entrepreneurs intentionally invite the local government to share the rights of control. In addition, local government ownership of TVEs matches both local and national governments’ interests. In this way, local government ownership escapes state predation, increases local public goods, and reduces costly revenue hiding (Chang and Wang 1994, 467). Hence, the national government may have less incentive to prey on TVEs than on private firms as local government activities provide important revenue-enhancing services. In 1985 about 46 percent of the after-tax profits of TVEs were reinvested, and 49 percent were used for local public expenditure; in 1992, 59 percent of after-tax profits of TVEs were reinvested, and 40 percent were used for local public expenditure (Che and Qian 1998a, 489). Once the local government is involved in the operation of the firm, it is difficult to pre-assign control rights and the division of control becomes blurred: control rights are ambiguous (Li 1996, 5). Thus, the ownership structure of the TVEs has emerged as an organizational response to imperfect state institutions as it reduces the consequences of state predation in the absence of institutions to constraint the state. As such, local government ownership attempts to overcome “state failure” (Che and Qian 1998a, 491).

The experience of China’s transition process can easily be contrasted with the transition process in Russia and Eastern Europe. The implementation of shock therapy, the dominant form of transition in Russia and Eastern Europe, resulted in “maximal dislocation” of the existing institutional fabric of transition economies, which resulted in regressive institutional changes (Bush 2001, 523). This is in contrast to the principle of “minimal dislocation” of institutional change, as has been adopted in China. While dislocations are unavoidable during transition, dislocations should be minimized so as to result in an institutional structure conducive to higher levels of instrumental efficiency. In addition, the “maximal dislocation” of the existing institutional structure was imperative for the shock therapy process so as to transform the organization of the economy from being based on relative prices administered by political authorities to an economy organized by price-making markets. Customs, relationships of trust, morals, and culture were perceived, by shock therapy supporters, as obstacles to the establishment of the dominant role of the market in the economy. The transition economies had to get rid of the “embedded” social relationships. The “disembedded” economies of Russia and Eastern Europe are dominated by market economic relationships over custom, trust,

morals, and culture. In contrast, in China the success of TVEs, which is based upon the high- λ structure of the society, demonstrates that embedded markets can flourish when the market is in harmony with culture and when the same culture does not have a “market mentality” (Polanyi [1944] 1975). Sui Pheng Low and Yuquan Shi (2001, 276) argued that all social behavior is embedded in a particular context and is connected to culturally based, deeply held values and beliefs. These values and beliefs are the blueprint of every Chinese citizen, which have been maintained through economic development and linked with the development of the market process.

Problems of Economic Development in China

The world has monitored with great interest the rapid economic development and reforms in China. The present process of desocialization and creation of nonprivate property in a postsocialist society is a unique process without precedent in modern history (Riha 1996, 245). Nevertheless, with over 6,000 years of history and tradition, throughout many provinces and cities emerges the imminent problem of cultural differences affecting China’s economic development (Woo-Seng and Prud’homme 1999, 315). China’s cultural legacy poses a direct threat according to Chi Fulin (1999, 1), who argues that current conflicts exist between rule by individuals versus rule by law, a bureaucrat-oriented culture versus a people-oriented culture, all-embracing government versus limited government, and government-driven development versus market-driven development.

China is likely to continue its transformation and grow in importance both politically and economically (Woo-Seng and Prud’homme 1999, 313). With the absence of well-defined property rights and a culture that seems very difficult to change, commentators of mainstream economics persuasion argue that Chinese economic development is under a serious threat. As they argue, unless the fundamental cultural element is removed from China and private property rights are established, the point has been reached where any further central government reforms could attract unwanted levels of corruption and cause a lack of acceptance of the reforms among the Chinese people. This conflict is made worse due to the cooperative nature and reluctance of the Chinese people to change. The emphasis of traditional Chinese values is on the status quo (Gao and Handley-Schachler 2003, 44). In the same way, governments in postsocialist countries let organized crime syndicates divide a substantial part of privatized socialist property among them, while robbing ordinary citizens of their fair share and depriving them of social security (Riha 1996, 245).

According to Hong Seng Woo and Celine Prud’homme (1999, 314, 317), the Chinese value harmony, good relationships, and politeness; they are preoccupied with the concept of “face”; and they are very sensitive about maintaining face in all aspects of social and business life. This is a trait of high- λ societies. This is one of the reasons why the Chinese government has been cautious in its political and administrative reforms

program. This caution has led to a commitment to maintain public ownership as the principal body of the system, while encouraging the development of private and mixed public-private ownership.

However, many problems continue to exist in the transition to a market economy in China. Importantly, there are areas of poverty as a result of significant regional disparities and, at the same time crime, corruption, bribery, and extortion. Administrative interference, price manipulation, inefficient state-owned enterprises, and attempts to monopolize production and trade at the local level all underscore the need for checks and balances for an effective market economy (Intriligator 1998, 246; Singh and Gelb 1994, 27). China's market-oriented reform appears to have become irreversible (Cao, Fan, and Woo 1997, 39). At the same time, China today stands on the brink, facing fundamental choices as to the direction the country should take. Actually, the name of the system may have had little effect on its actual practices (Weil 1996, 78). The balancing act of the Chinese leadership between the revolutionary socialism implemented by Mao Zedong, emphasizing public ownership and welfare, mass-based collectivism and egalitarianism, and the market reforms of Deng Xiaoping, with their increasingly capitalistic characteristics, privatized forms of property, and class polarization, have now reached a level of contradiction that must be resolved (Weil 1996, 11). The majority of the literature, of course, recommends the initiation of reforms aimed at establishing a full market capitalist system, since "China's rapid growth momentum cannot be sustained without deeper reforms" (Gelb, Jefferson, and Singh 1993, 20). Indeed, the analysis of China's reforms reveals that the dynamic process of change tilts toward market capitalism.

While the Chinese model has produced rapid economic growth, the system has come to look more and more like capitalism with Chinese characteristics, instead of socialism with Chinese features (Weil 1996, 229). Ironically, despite its retention of socialist language and even Communist rule, building capitalism around the edges of a still-functioning state socialist system has proved to be a more viable path to capitalism than the processes adopted in Russia and Eastern Europe (Kotz 1999, 24–25). Consequently, the Chinese process of transition to a market economy most likely would evolve into a market capitalist system; a process of disembedding the market has already started. Unless the cultural legacy is rooted out, market economic principles could be seriously distorted or, even worse, the outcome could be an inefficient and corrupt market economy. At the same time, economic growth in the interior regions, as opposed to the coastal provinces, is declining, producing income inequality and mass migration to the cities.

Countries that have a high λ value would not rely on contracts as much, and the amount of government intervention in the economy would be relatively low as well. However, what would be the impact of further government market reforms by forcing contracts on a culture that is of a high λ ? With all things being equal, it is safe to suggest that government regulations would be less favorable to high- λ -value societies based on the finding that "contracts are classed as damaging TVE's spirits" (Cai 1990, 201)? If

this is the case, then the impact of further government market reforms by enforcing contracts, a requirement of the disembedded market economy, on a highly cooperative society is unclear and may have negative effects on the economy and the welfare of the society.

Corruption and Privatization

There has been a widely recognized level of corruption in China, which is running rampant and unregulated, as a by-product of China's reform process (Wood 1994, 31; Hornik 1994, 30; Yang 1993, 22-3; Yu 1993, 5). In a high- λ society, trust and cooperativeness are substitutes for well-defined property rights, and the market is embedded in the pre-existing culture. But as the transition in China involves increasing capitalist characteristics initiated by the central and local governments, a process of disembedding of the market has been initiated and with this comes an increasing level of corruption as culture is effectively destroyed and substituted with the market mentality. This way of thinking would suggest that corruption in China could escalate to severe levels. It has been suggested that a solution to this level of corruption would be the introduction of private property rights, which would be secure and transferable (Perkins 1994, 28; Lin, Cai, and Li 1996, 225). The level of λ is also affected, resulting in a reduced cultural λ and a reduction in cooperatives.

Since corruption does not allow for legal recourse, corrupt "contracts" are not legally enforceable. This is why corruption can go hand in hand with opportunism, renegeing, and threat of denunciation. Corrupt deals can thus affect the confidence of individuals regarding mutual promises (Lambsdorff 2002, 829). In China, trust is a critical element in culture and business. Trust in organizations mediates the relationship between distributive justice and affective commitment as well as the relationship between procedural justice and affective commitment (Wong, Ngo, and Wong 2002, 585). Commitment and loyalty are fundamental clauses in the social contract that every individual in TVEs accepts and lives by. "They [TVEs] regard friendship as the most secure way of doing business" (Cai 1990, 201). Low- λ cultures do not trust each other and thus need contracts to undertake business, where high- λ cultures believe that "your word" is good enough (similar to binding contracts in high- λ societies). When the market is disembedded, this trust, like a contract, can be broken, manipulated, and forced on individuals, which in return can corrode the fragile workings of the TVEs and result in the effective dismantling of the collective system.

Woo-Seng and Prud'homme (1999, 318) stated that Chinese people place high value on the notion of trust, and this belief is a cultural and business feature. Trust implies a person's reputation for trustworthiness on both a professional and personal level as well as credibility in a business situation. Without trust, the Chinese find it difficult to envisage how businesses are going to operate. Thus, the consequence of relying

on this is that Chinese people do not do business with people they do not know or trust (Herbig and Martin 1998, 40). This poses clear problems for China in the area of disembedded market economic reforms in that it is important to have incentives like ownership; otherwise it can lead to opportunistic behavior that can seriously undermine economic performance. Therefore the threat of opportunistic behavior is high. Matthew Fairholm and Gil Fairholm (1999, 102–103) identified personal selfish interests as a force that hindered the development of trust among members. In a process of disembedding the market, with trust being so important in China, it also opens the door for corrupt dealings. This opportunistic element due to the disembedding of the market is not only negative for a country that relies on trust but also counterproductive as it tears away at the tightly woven communities and reduces any chance of smooth and effective economic development. In addition to this, corrupt dealings affect confidence. Johann Graf Lambsdorff (2002, 829) argued that corrupted deals go along with absence of confidence regarding mutual promise. This poses a critical internal problem for China as corruption can escalate and have the potential to reduce investment and consumer confidence.

Even with China being a high- λ society it appears that corruption underlies the disembedding of the market process. The reason for this is that trust can be broken. The higher the λ , the higher the cooperativeness within that society as well as trust. The disembedding of the market process results in a strong positive relationship with opportunistic behavior. This opportunistic behavior can lead to corruption if given the chance. Interpreting local government ownership of TVEs as an organizational response to the problem of state predation, local government ownership is a mechanism for limiting state predation. As such, local governments endogenize ownership rights by directly serving the interests of the national government. But as the TVEs escape the sphere of state power, they also naturally escape the rule of law, which results in opportunistic behavior. The independence of the TVEs officials, together with the rapid industrialization in the village, makes opportunism extremely attractive. With the right to control the common resources of the TVEs, every village official has the means to become an opportunist (Pei 1996, 57).

Stated differently, trust exists where one party believes the other party will not act opportunistically. Within *guanxi*, opportunist behavior with one exchange partner is interpreted as opportunist behavior with the entire network. Opportunist behavior becomes an attractive option only when the expected payout from opportunistic behavior outweighs the expected costs. In a *guanxi* network, the cost of opportunism is the potential loss of exchange opportunities with all members of the network. The larger and more richly connected the *guanxi* network, the greater the assurance that an individual exchange partner within the network will not risk the potential network ostracism that could result from opportunistic behavior. But as the disembedding of the market process is initiated, this destroys *guanxi* and with it the network relationships. The mere threat of network expulsion in a disembedded market economy does not provide assur-

ance that one's exchange partner will not act opportunistically, thereby eliminating the need for trust within market exchange relationships.

It has been suggested that the solution to these unprecedented levels of corruption is the institutionalization of private property rights, which are secure and transferable (Perkins 1994, 28; Lin, Cai, and Li 1996, 225). In addition, the informal institutional arrangements in the transition to a capitalist economic system have become internally inconsistent. Informal institutions entail costs, which become more manifest as the nonstate sector grows in size and informal avenues are no longer sufficient, requiring the excessive use of direct administrative means (Smyth 1997, 248-9). Subsequently, in this context it is argued that the reform of property rights in China is more important than immediate privatization. Increasingly, economic actors can coordinate their interests through market institutions and social networks, bypassing the local party organization to some extent. The question is whether a communist government, accustomed to political monopoly and unfettered control over economic resources, can create a legal and regulatory framework within which enterprises can further broaden their autonomy.

However, for China to maintain successful economic development it has been argued that the design and implementation of well-defined ownership will be essential in the long run. The development of the commercial economy demands a clearly defined relationship between assets, benefits, and obligations. The portion of the assets in traditional public ownership forms is not clear; there is no exact construction of assets and benefits. The development of a commercial economy demands that firms should have independent power of production and operation (Haiyan 1991, 64-5). As economic reforms continue to undermine the traditions of the Chinese society by adopting and increasing the role of markets in the economic system, TVEs become anachronistic and undesirable forms of organizational relations. As such, privatization is the natural outcome (Chang and Wang 1994, 450).

Nevertheless, actual privatization is taking place in China through spontaneous privatization and "state asset stripping" by local cadres who are often transformed into entrepreneurs. This was the means by which hard-line opponents of reform were given some stake in the new system in order for reform to progress smoothly. Meanwhile, the government is quite successful in privatizing small and less important businesses, effectively permitting the growth of a sizeable private and semi-private capitalist economy outside the state sector. If present trends continue, Robert Weil (1996, 36) and Richard Smith (1993, 86) argued that the "collective sector" will gradually merge with the private capitalist sector. It does not thereby follow that a large state sector would be a permanent part of China's market economy.

In 1995, China began reform in privatizing and restructuring the state-owned enterprises under the slogan "grasping the large and letting go the small" (Cao, Qian, and Weingast 1999, 104-105; Lau 1999, 58). It was announced that 1,000 of the largest state-owned enterprises were to remain under state control and that the 13,000 large and medium-sized state-owned enterprises, as well as most of the 350,000 smaller com-

panies, were to be denationalized (Zwass 1999, 229–30; Lau 1999, 58). The sale of state enterprises occurs by auctioning or corporate transformation, where most shares are sold to private individuals, or a share-based cooperative system (SBC), where shares are sold mostly to employees (Che and Qian 1998b, 21–2). The all-familiar picture has emerged in China, where firms were either bought by foreigners or the share distribution favored managers who have acquired shares from workers who often immediately resell their share allocation (Cao, Qian, and Weingast 1999, 111; Lau 1999, 59). The SBC, with its supposedly “cooperative” features, was obviously a useful formula to disguise de facto privatization.

The privatization process has been initiated by local governments and tolerated, sometimes even encouraged, by the national government. It has become in the local government’s interest to privatize or restructure enterprises due to the hard budget constraints of local governments and the increased competition from the nonstate sector that has made it increasingly costly to maintain these inefficient enterprises. It has also been a strategic move, as in all elements of the reform process in China, to assign the responsibility of privatization to the local governments. Local governments can pursue the reform at a speed suitable to local conditions. The national government does not force local governments to reform all at once or all at one speed. Thus, if the local government found that workers were not being absorbed as fast as predicted, it could slow down the pace of privatization or lay-offs. This, in part, accounts for the unevenness of privatization across localities (Cao, Qian, and Weingast 1999, 114).

Conclusion

The study on ownership and how cooperative culture affects the reliance on defined ownership indicates that there is a connection between cooperation and the absence of defined ownership rights. This paper has stated the development of unconventional rights theory is based on λ . From this λ perspective, the connection between cooperative culture and the absence of defined ownership is strong but not long lasting, as demonstrated in China. This results, in some circumstances, in more efficient exchanges than in countries that need or have a reliance on defined property rights. The structure of the TVE is an organizational response to the imperfect formal institutional structure in China (Che and Qian 1998b, 20). As this organizational structure is unknown to mature market economies and as such it also is supposedly inefficient, it has functioned quite positively given the institutional reality of China.

This perspective constitutes a challenge to conventional theories of property rights. Previously ownership was regarded as a necessity in transition economies and was the foundation of economic efficiency; however, since there are high transaction costs and high- λ societies are reluctant to be ruled by law as opposed to rule by culture, it would seem that cooperative culture through collectivization is and may be proven to be more efficient and effective than clearly defined property rights at most in the short run.

The Chinese village after reform is “a hybrid organizational model that encompasses elements of the market and hierarchical governance,” making the transition process smooth and evolutionary (Pei 1996, 61). Nevertheless, countries that are cooperative in nature would, however, in time lose their cooperativeness and high λ ranking if a process of market disembedding is initiated and those characteristics were replaced by individualism and private ownership. This cultural change may have a negative effect on the people and the country’s economic and political stability. When economic reform is put in place to define ownership—through spontaneous privatization, asset stripping, and corrupt dealings—which would then separate and disband the collectives, the fragile social fabric would break down. With China being such a high- λ society, the outcome of economic reforms in the future would also affect the level of λ . This effect would be negative as the result of an increase in individualism and opportunistic behavior, which are also traits of low- λ societies. There needs to be a balance between the implementation of property rights and maintaining the unity, trust, and cooperativeness of the Chinese people. Without this balance the level of λ of the Chinese culture is under threat, which could undermine the whole reform process. A solid understanding of the possible effects of individualistic reforms and private property must exist in order to prevent an inefficient, corrupt, and dishonest economy.

Notes

1. Unfortunately, Weitzman and Xu (1994) did not provide a method of how lambda (λ) is measured. They treated λ as a quasi-fixed reduced form parameter as they were interested in examining the likely relationship of various values of λ , taken as given, with property rights theory. Accordingly, for the purpose of our paper I also take λ as given.

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