

## CHAPTER SIX

# Institutional Basis of Social Stratification in Transitional China

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The changing mechanisms of social stratification in China during its transition toward a market economy have been the subject of debates among numerous scholars (e.g., Nee and Matthews 1996; Bian 2002a; Liu 2003). The theoretical starting point of the debate is Iván Szelényi's (1978) institutionalist explanation of stratification that juxtaposes state socialism with welfare capitalism. Under welfare capitalism, markets dominate and are the major source of inequality, whereas state redistributive mechanisms are secondary and have equalizing effects. Under state socialism, the redistributive system of economic integration dominates and is the major source of inequality, whereas market-like transactions partially reduce the inequality created by redistribution. Redistributors in state socialism, through nonmarket trading of labor and commodities, control the surplus and create inequality by favoring "their own kind" in redistribution. Advantageous life chances are therefore linked to redistributive power (Szelényi 1978).

Applied to the stratification mechanisms of transitional China, Szelényi's explanation presents two opposing theories. Power transfer theory holds that increased reliance on markets induces a shift of distributive power to the market, creating new mechanisms of stratification and new elites (Nee 1989, 1996; Nee and Cao 2002; Szelényi and Kostello 1998). Power persistence theories, by contrast, posit that stratification mechanisms formed under the traditional redistributive economy persist even after the transition (Bian and Logan 1996; Parish and Michelson 1996; Walder 1995b, 1996, 2002; Zhou 2000b; Song 1998; Lu 2002). Empirical observations have confirmed the continuing advantageous life chances of government and CCP bureaucrats (Song 1998; Lu 2002; Sun 2002; Li Q. 2004; Liu 2005), a phenomenon that power transfer theory cannot explain. At the same time, although power persistence theories assert the continuation of power, they fail to explicate precisely the mechanisms through which power persists.

Three theoretical perspectives have been proposed to understand how state power influences stratification continuously. The first regards state power as redistributive power that benefits redistributors. This line of explanation, however, confuses state power with redistributive power and fails to recognize how markets have already altered the institutional basis of state power. The second treats state power as bargaining power in the political market, which brings economic benefits to its possessor during the marketization (Parish and Michelson 1996). While no longer equating state power with redistributive power, this perspective does not specify in depth the institutional basis of the bargaining power and to some extent confuses politics and markets. The third, more robust, stresses the decisive changes in the property rights regime that have engendered new state power formations and argues such changes in the property rights regime preserve and even augment the power elites' economic interests (Walder 1995b). This explanation insightfully analyzes the institutional basis of power persistence. However, it lacks a systematic and rigorous account of the new power formation and the mechanisms that influence stratification.

Building on Szélenyi's institutionalist theory of social inequality (Szélenyi 1978; Szélenyi and Manchin 1987; Szélenyi and Kostello 1998), this chapter attempts to propose an alternative explanation of the mechanisms of social stratification in transitional China. The strategy of this alternative theoretical construction is to integrate the analyses of socialist domination (Djilas 1957) and of property rights regimes (Barzel 1989; North 1981, 1990; Pejovich 1995; Walder 1992; Walder and Oi 1999; Zhang 1995, 1999; Lin et al. 1999, 2002; Zhou 2002), as well as to incorporate Sørensen's concept of rent derived from property rights transactions (Sørensen 2000), to extend Szélenyi's theory into a new framework.

The central thesis of this chapter is that, as the mechanism for reproduction of institutionalized inequality, the mechanism of social stratification is embedded within and explained by the fundamental institutional arrangements of a given socioeconomic system. In modern societies, the form of ownership of property rights and the relationship between state power and property rights (including property rights to human capital) are the most fundamental institutional arrangements. In China's current market economy, the administrative as well as contractual principal-agent relationship in the management of public property, combined with the market system (which is embedded within bureaucratic authority), form the institutional basis of social stratification. Such institutional arrangements maintain some redistributive state power and generate power elites with self-serving rent-seeking abilities. Thus, redistributive power, rent-seeking ability, and market capacity together constitute the motivating basis of social stratification in transitional China.

## INSTITUTIONAL ARRANGEMENTS AND THE DISTRIBUTION OF ECONOMIC RESOURCES

Property rights are relations of ownership over scarce resources. They serve in interaction with markets to allocate resources (North 1995: 65). Every individual's right to land, labor, or other scarce resources is stipulated by the law. To stipulate people's right to scarce resources (Demsetz 1967), the law must first assign to their property rights a value. In turn, the value of property rights depends on the extent to which the resources cannot be secured without the property rights (North 1981, 1990).

The institutional basis of property rights is the ownership of productive resources. In the case of state ownership of productive resources, the institutional government, which consists of state ownership of resources, redistribution of resources, and single ownership of resources, holds further that the relationship between state power and the more fundamental resources are distributed in the economies, planned economies, and market economies. Such basic institutional arrangements determine the interests and hence the power of the state.

This institutional framework takes as given the market mechanism, but does not adequately explain the market. The market and the relationship between the market and the state are determined by the relationship between the state and the market.

## STRATIFICATION MECHANISMS IN CHINA'S PLANNED ECONOMY

In traditional socialism, the state is only as the power to redistribute such resources (North 1980). Lack of incentives for production factors of production and the intervention of state power are the main reasons for the low productivity of production.

At the microlevel, the state's intervention in the economy (North 1989; Sørensen 2000)

#### INSTITUTIONAL ARRANGEMENTS AND DISTRIBUTION OF ECONOMIC INTERESTS

Property rights are relations among individuals that arise from the existence of scarce resources. They are "norms of behavior that individuals must observe in interaction with others or bear the costs of violation" (Pejovich 1995: 65). Every individual enjoys rights over some assets, be they capital, land, labor, or other scarce resources (Barzel 1989). Property rights regimes stipulate people's right to exclusively possess, use, and profit from scarce resources (Demsetz 1967). People's life chances are determined according to their property rights arrangements. The exercise of such exclusive rights, in turn, depends on the force of law, morals, and conventions, and hence cannot be secured without definition and protection by the state (North 1981, 1990).

The institutional basis of capitalist market economies consists of private ownership of productive resources, freedom to contract, and (limited) constitutional government, while the basis for socialist planned economies consists of state ownership of productive resources, central planning in resource distribution, and single-party monopoly of government (Pejovich 1995). I hold further that the relationship between property rights regimes and state power is the more fundamental institution, because it determines whether resources are distributed through the market or administratively. Market economies, planned economies, and transitional mixed economies all have such basic institutional arrangements to determine distribution of economic interests and hence people's social strata.

This institutional presupposition is different from that of Széleányi who takes as given the market and the redistributive systems of economic integration, but does not adequately analyze more fundamental institutional bases. The market and the redistributive system are themselves institutions arising from the relationship between property rights regimes and state power.

#### STRATIFICATION MECHANISMS IN CHINA'S PLANNED ECONOMY

In traditional socialist planned economies, state power is manifested not only as the power to seek surplus in the form of rent, but also as the power to redistribute such rent. Rent arises from the lack of supply elasticity (Buchanan 1980). Lack of supply elasticity can arise from both the nature of the factors of production and governmental intervention (Sørensen 2000). The sources of rent are various, but this chapter focuses on rent arising from the intervention of state power.

At the microlevel, rent arises from property rights transactions (Barzel 1989; Sørensen 2000). In order to maximize profits in the production of

goods and services, individuals use not only assets under their own control but also, through purchasing or renting, those controlled by others. The supply of others' assets may be limited due to the nature of the assets themselves or to monopoly. As a result, those who purchase or rent such assets must pay a price higher than the market price, and the suppliers gain through their monopolistic supply. Thus, rent is exceeding profits derived from preventing the profit maximization of others and depends on the ability to control asset supply (Sørensen 2000).

China's traditional planned economy was characterized by the unity of the political power of the state and public ownership of property. Such unity is formed under the absolute authority of the socialist state (Djilas 1957). If seizure of power and establishment of a socialist state—the redistributive power center (Polanyi 1944/1957; Szelényi 1978)—are through violent means, then maintenance of the authority of the newly formed state must be supported by an economic structure that answers ruling needs. In cities and towns, the state employed confiscation and joint public-private enterprise management to realize comprehensive state ownership. In rural areas, the state used cooperatives and communes to achieve collective ownership of land and the means of production (Lin et al. 2002; Dong 1999). Nationalization and collectivization can be seen as a property rights regime transformation compelled by state power. Completion of this transformation marks the metamorphosis of a regime established by force into the practical possessor of state-owned economic assets. There thus emerges a socioeconomic unity in which political, economic, and ideological powers are all in the hands of one newly formed class (Djilas 1957).

In such a centralized society, the public economy is managed through an administrative principal-agent relationship (Pejovich 1995; Zhang 1995, 1999). Public ownership stipulates that the means of production belong to the people or the collectivity. It is realized, however, through the socialist state as representative of the people, and has thus turned into a form of state ownership (Kornai 1992). The state, as an institution stipulating the exercise of public power, cannot itself exercise such power (North 1981, 1990). The power of the state is exercised by its agent, the government, which is in turn a bureaucracy composed of officials of all levels. The socialist state, as an enormous asset owner, entrusts its assets to administrative departments and lower-level governments through administrative means, and delegates its management to factory directors and managers appointed by itself (Zhang 1995, 1999; Lin et al. 1999; Lin 2000).

Within this administrative principal-agent relationship, nonmarket transactions connect the human capital of the factory director or manager to the means of production. Principal-agent relationships also exist under capitalist private ownership; however, the owner of the capital (the capitalist)

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relies on contracts (Zhang 1995, 1999). Within this contractual relationship, the capitalist earns the surplus through his privileged possession of capital, and the entrepreneur earns rewards through his market capacity. In socialist planned economies, on the other hand, bureaucratic appointment replaces the entrepreneur market (Zhou 2002). To prevent the business manager from encroaching on the interests of the business owner, the state then devises a series of institutional arrangements to deprive the manager of the right to seek surplus (Zhang 1995, 1999). The state thus monopolistically both possesses and redistributes the surplus, and managers receive salaries that do not reflect the market return to their entrepreneurial ability.

Within this planned economy model, nonmarket transactions also determine rewards to nonmanagerial labor. Although legally there is equal ownership of the public means of production, no individual has the power either to determine how the assets should be employed or to seek profits (Zhang 1995), and the workers who produce the goods and services are especially excluded from the exercise of property rights over public assets. Moreover, beyond administrative controls over labor (Kornai 1992; Pejovich 1995), the household registration system and the rationing systems for food, housing, and other daily necessities further limit the property rights of labor by depriving them of transactional freedom (Zhou 2002).

In such nonmarket transactions, the state administratively suppresses the price of human capital in order to maximize surplus. This surplus is different from the profit that arises from free and competitive market transactions when property ownership is independent from administrative power. It is "state rent" (Zhou 2002) or "institutional rent"<sup>1</sup> (Lin et al. 2002) arising from administrative pricing when the state monopolizes the means of production and property rights over human capital are severely incomplete. In traditional socialist planned economies, the state seeks surplus through rent, not profit. State power is manifested on the one hand as state rent-seeking power by virtue of the state's monopolistic possession of public assets, and on the other hand, as the state's redistributive power over reproduction and consumption. Under the principal-agent arrangement, bureaucratic officials of all levels, as redistributors, may exercise these powers. Redistributors favored themselves (Szelényi 1978) and their political loyalists (Walder 1986) in their redistribution of rent for living and consumption, and this resulted in inequalities. However, in the case of socialist China, the presence of unified state control of revenues and expenditures, the severe atrophy of the market (Lin et al. 2002),<sup>2</sup> and the shackles of an ascetic ideology (Walder 1986) effectively prevented the dissipation of state rent. As a result, the rent-seeking phenomenon in which the power elites seek personal gains was restrained (Lin et al. 2002).

# POSTSOCIALIST TRANSFORMATION AND STRATIFICATION MECHANISMS

China's reforms since the late 1970s can be seen as a triple gradual process: decentralization, profit sharing, and marketization. Decentralization of state power from central to local governments includes the division of administrative power and the division of corresponding jurisdictions of public assets (Wu 2003; Walder 1995b; Walder and Oi 1999). Profit sharing can be seen as the corresponding redistribution of the right to profit from central to local governments and enterprises. Marketization is the shift from the "planned track" to "dual-track" and eventually "market track" (Lin et al. 2002; Wu 2003; Dong 1999).

During this gradual process of reforms, the principal-agent relationship in the public economy evolved into one that is both administrative and contractual. Such a relationship is the institutional basis of the state's power to seek and redistribute surplus in the form of rent, as well as the institutional precondition for the power's evolution into the power elites' rent-seeking ability.<sup>3</sup> At the same time, the market that has developed under the persistence of the political structure is one embedded in the socialist bureaucratic authority structure. Such an embedded market is the institutional precondition for both returns to market capacity and for state power's evolution into the power elites' rent-seeking ability.

## *Principal-Agent Relationship and the Persistence and Evolution of Power*

Decentralization of control and profit sharing has partially eroded the extensive overlap among political power, property rights, and redistributive power. The devolution of ownership has empowered enterprise managers to rely on market transactions to allocate assets and distribute the surplus, and to set wages to reflect differential levels of human capital (Lin et al. 1999; Dong 1999).<sup>4</sup> However, from the early years of reform to "expand enterprise autonomy" through the recently established joint-stock systems, the state has never relinquished either ownership of public assets or the power to control surplus (Lin et al. 1999; Wu 2003). While the original intent of the reform was to grant enterprises greater managerial autonomy and right to derive profit, the political decentralization that accompanied the economic decentralization has actually transferred the property rights and profits from one level of government to another and not entirely to the enterprises (Wu 2003). Reform, therefore, has not altered basic principal-agent management of state-owned assets. The contrast to the prereform period is that the postreform principal-agent relationship is both administrative and contractual when the state is entrusted with the ownership of public assets—

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Such an administrative relationship is the unique feature of the institution. Under this system, it serves its control over or dismiss local governments, organizations and management of property rights. It ordered the possession of surplus. State power controls the rent in an explicit

This principal-agent relationship power's evolution from the principal to the agent that the property hierarchy of multiple levels of the officials, of public property. Because owners and do not derive surplus, principals will control property. More power who should reside in departments—administration, administrative choose or supervise state-owned assets as cliques. When rent that should

Although the highly centralized expenditures for new institutions gained the authority and now have separate central governments' own financial extra-budgetary



and contractual—as when the government and the enterprises enter into contracts with each other.

Such an administrative as well as contractual principal-agent relationship is the unique link between state political power and property rights, and is thus the institutional basis of state power's persistent influence on stratification. Under this principal-agent relationship, the central government preserves its control of local governments by preserving its power to appoint or dismiss local officials and state-owned enterprise managers, whereas the local governments, managerial organs of state-owned assets, and party organizations and departments all have their own means of influencing the management of state-owned assets (Wu 2003). State political power and property rights have not been separated, nor has the government surrendered the possession of public assets and the corresponding power to seek surplus. State power can still seek surplus in the form of rent and distribute the rent in an exercise of redistributive power.

This principal-agent relationship is also the institutional basis of state power's evolution into the power elites' rent-seeking ability. It is different from the principal-agent relationship under private capitalist ownership in that the property owner is personified, that is, is a natural person. In the hierarchy of multiple principal-agent relationships in transitional China, none of the officials, or representatives appointed by these officials, is the owner of public property, although they do exercise practical control (Zhang 1995). Because owners are absent at every level of the principal-agent relationships and do not derive any profit that corresponds to their supervisory power, the principals will not actively supervise the agents as do the owners of private property. Moreover, due to the absence of the ultimate owner, the question of who should restrain the actual principals—local governments and relevant departments—also becomes problematic. Without incentive and supervision, administrative officials would be irresponsible when they, as principals, choose or supervise their agents. When choosing agents, they will entrust the state-owned assets to those who are willing to pay rent to themselves or their cliques. When supervising agents, they may conspire with them to share the rent that should enter the national treasury or local revenues.

Although the principal was also absent in the traditional socialist model, the highly centralized fiscal system of unified state control of revenues and expenditures had effectively prevented the dissipation of the rent. Under the new institutional arrangements, on the other hand, local governments have gained the actual ownership of the state-owned assets under their jurisdiction and now have strong rent-seeking powers. Institutional arrangements that separate central and local government finances promote the local governments' own fiscal irresponsibility and permit the local governments to have extra-budgetary income and "private treasuries" that dissipate state rent.

### *Embedded Market and Power Evolution*

The core of the ideal market is a pricing system based on free exchange, which in turn is based on private ownership not subject to intervention by the government or any other external authority. Such a free market is, however, dependent on a series of institutional preconditions: free property, free labor force, rational law, and rational state. Under such institutional arrangements, every individual, every enterprise, and even the state can freely take advantage of market opportunities, but none can expropriate the property of others through individual power or other nonmarket means (Weber 1981). In such a market economy, the market participants—due to their different wealth, skill, and labor—possess different market capacity in the exchange competition and hence occupy different market positions, that is, different class situations (Weber 1978, Giddens 1973). Differences in market capacity determine the employer-employee division, income differences, employment insurance, promotional opportunities, and welfare benefits (Giddens 1973).<sup>5</sup>

China's marketization has always been advanced under the control of state power. In China's current market economy, the government still controls substantial public assets and is not external to the market. It both makes market rules and participates in market activities (Walder 1995b). The institutional basis of the socialist market economy with Chinese characteristics is far from the ideal institutional precondition envisioned by Weber or the new institutionalist economists. China's market is one embedded in the socialist bureaucratic authority structure. In such a market economy, state power is central to the emerging processes of social stratification.

First, state administrative power sets market entry rules, thus rendering the bureaucrats extensive rent-seeking space. Next, the various administrative and executive organs, especially local governments and the relevant departments, can, in accordance with certain state policies, take upon themselves the management of the private sector. When democratic supervision and rule of law are not yet well established, there are minimal restraints on the self-serving rent-seeking ability of relevant bureaucrats. Third, the nonstate sector is subject to unequal treatment in the areas of bank loans, land appropriation, taxation, and employment of labor. Non-state-owned enterprises thus pay rent to the power wielders to overcome a variety of entry barriers (Dong 1999; Wu 2003).

A market so embedded in bureaucratic state authority limits enterprises' positions as market entities with complete property rights and creates opportunities for state agents to derive substantial rent (Barzel 1989). This rent is the source for the relevant power elites' pursuit of personal gains through power. Second, the limitation on state-owned enterprises' positions

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as market entities also reduces autonomy to set prices. As a result, the pricing mechanism is not entirely based on the market, but is also subject to intervention from administrative authorities (Dong 1999). Distorted prices then create opportunities for the power elites to seek rent through the price differentials. During the 1980s, it was very common to seek rent through dual-track pricing (Lin et al. 2002). Third, the state-embedded market limits the role of entrepreneurship. In the public sector, administrative authority to a large extent determines the appointment and income of the enterprise managers; bureaucrats can therefore enjoy rent from the appointment of managers. Fourth, the continuing reliance on the perquisites of administrative rank limits the free flow of production factors such as capital and land, thereby creating additional opportunities for rent seeking. And finally, party-governmental power erects entry barriers by monopolizing certain industries, providing substantial rent-seeking space for the managers in such industries.

#### *Multidimensional Bases of Stratification and the Structure of Stratification*

So far, through an analysis of the institutional basis of planned economies and market economies, I have attempted to provide a new logical interpretation of the stratification mechanisms before and after China's current market reforms.<sup>6</sup> I hold that mechanisms of social stratification ought to be explained by the relationship between state power and property rights that determine the characteristics of the socioeconomic formations. In China's traditional planned economy, the state monopolized the means of production and managed them through administrative principal-agent relationships. Property rights over human capital were incomplete. Such basic institutional arrangements determined that human capital could only be rewarded through nonmarket transactions, and that surplus existed in the form of state rent. State power was manifested not only as the power to seek surplus in the form of rent, but also as the redistributive power to distribute such rent. The redistributors stratified society by favoring "their own kind" or the politically loyal in the redistribution. In China's current market economy, an administrative as well as contractual principal-agent relationship combined with the market system, which is embedded within bureaucratic authority, to form the institutional bases of stratification. Redistributive power, rent-seeking ability, and market capacity constitute the multidimensional bases of stratification.

Based on these motivating factors, I propose a stratification framework consisting of ten strata to map out a holistic profile of the stratification structure of current Chinese urban society, shown in Figure 6.1.<sup>7</sup> At the very

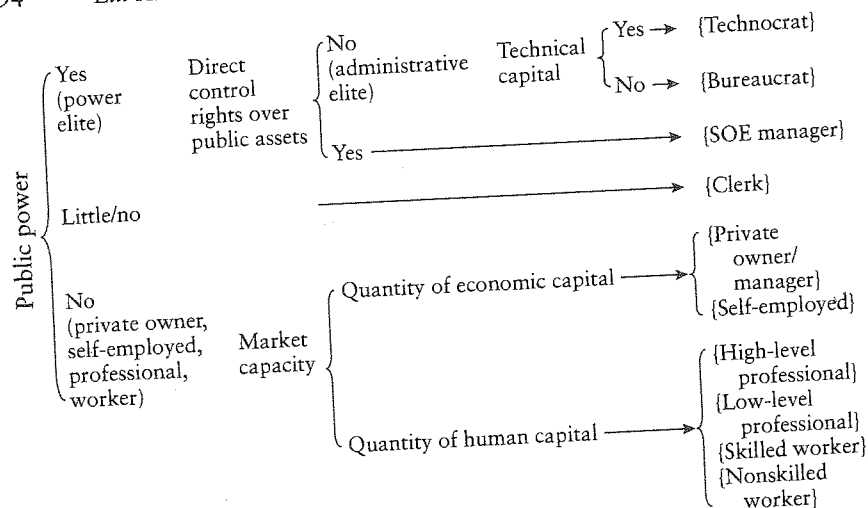


Figure 6.1. A framework of class analysis in urban china

top of this stratification order are the *technocrats*, including cadres in party and governmental organizations and state-owned enterprises and nonprofit institutions who have professional titles and shoulder leadership or administrative responsibilities. This stratum differs from the nontechnocratic power elites in the next stratum in that they possess not only leadership responsibilities, but also skilled professional ranks. Below the technocrats are the *bureaucrats*, including leading cadres in party and governmental organizations and institutions and party affairs workers in state-owned enterprises. These people enjoy cadre positions and shoulder some leadership or administrative responsibilities, but do not have skilled professional ranks. Compared to those who are not part of the power elites, they have a greater likelihood of possessing redistributive power and more rent-seeking opportunities. The third stratum among the power elites are *state-owned enterprise (SOE) directors or managers*. They enjoy the rights of directly using state-owned assets and thus controlling the surplus. On the one hand, their power reflects entrepreneurial ability or market capacity; on the other, through the state-owned assets and employment opportunities under their control, they enjoy more rent-seeking opportunities than do staff or workers.

Among those with no public power, several strata form the rest of the stratification order. *Private enterprise owners and managers* are the owners or controllers of private property and their privilege of the possession of capital is manifested in their market capacity to obtain profits from capital in the market competition. *High-level professionals* enjoy neither redistrib-

utive power nor they possess more than the greater than the from high-level are mostly or cadres of parties, they rarely very weak, but likelihood the obtain limited

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utive power nor rent-seeking opportunities derived from state power, but they possess rich human capital, which is manifested as a market capacity greater than that of low-level professionals. *Low-level professionals* differ from high-level professionals in that their market capacity is weaker. *Clerks* are mostly ordinary staff in public departments. Compared to the leading cadres of party and government organizations or enterprises and institutions, they rarely enjoy redistributive power and their rent-seeking ability is very weak, but they may, through contact with the power elites, have more likelihood than the workers of nearing redistributive power and may even obtain limited rent-seeking opportunities.

At the bottom of the stratification order are self-employed skilled workers and unskilled workers. *Self-employed* urban Chinese have neither redistributive power nor rent-seeking opportunity but can rely only on their market capacity, consisting of limited economic and human capital, to survive in the market competition. *Skilled workers* enjoy neither state power nor economic capital, but can rely only on their market capacity, consisting of their own human capital, to survive in the market competition. They enjoy, however, more human capital than nonskilled workers. *Nonskilled workers*, like the skilled workers, are relying only on their human capital, but their human capital is less than that of skilled workers.

In constructing this theoretical framework, I have treated "rent-seeking ability" as a consequence of institutional arrangements and an internal mechanism of stratification. However, further research is needed to devise effective standards for measuring rent-seeking ability, to explicate how "rent-seeking ability" reveals a new stratification mechanism, and to test the hypothesis by empirical materials. Such research, I hope, will lead to a new and deeper understanding of the social stratification order in postsocialist China.