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The state-constituted market economy: A conceptual framework for China's state–market relations

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Abstract: Scholars increasingly conclude that China has created a distinct economic system. Yet despite a growing literature with valuable contributions on the institutional arrangements under 'capitalism with Chinese characteristics', the economic mechanisms underpinning China's state–market relations remain undertheorised. In this paper we develop a conceptual framework of what we call China's state-constituted market economy. We argue that the Chinese state 'constitutes' the market economy by not only creating new markets through industrial and innovation policies, but by continuously participating and steering markets for essentials in order to stabilise and guide the economy as a whole. Essential is thereby defined as 'systemically significant from the perspective of the state'. This micro–level state–market participation in essential sectors complements macro-level state–market participation through monetary and fiscal policy. It is also distinct from the reliance on direct planning or command-and-order instruments of economic governance since micro-level state–market participation relies on utilizing market dynamics. We draw on China's statecraft tradition to conceptualise state market-constitution in China as a constant balancing act—like a dance with tigers.

Keywords: China; state-market relations; state capitalism; neoliberalism; economic stabilisation; market creation

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Introduction

China has deeply integrated into the global economy. Yet China's experimentalist reform path has created its own distinctive economic system (Zheng & Huang, 2018; Naughton, 2021; Weber, 2021). An increasing number of studies set out to discern the specific nature of China's capitalism (e.g., Huang, 2008; McNally, 2012; ten Brink, 2019; Chen, 2020; Nölke *et al.*, 2020). China is found to be sui generis, but the specific state–market relations that characterise China's variant of capitalism remain theoretically vague (de Graaff, 2020, p. 884).

Some scholars describe China as neoliberal, but this does not reveal much about the more specific nature of China's system (Weber, 2019, 2020). Others, pointing to the important role of the state, suggest China's system is state capitalist (Naughton & Tsai, 2015; Pearson *et al.*, 2021; Petry, 2020b).

But a recent literature review finds that '[d]espite the widespread mobilization of the concept [state capitalism] for both categorization and explanation, there is neither consensus about what it exactly means nor about its implications' (Alami & Dixon, 2020, p. 71). On the surface, it appears contradictory that China could be described as both neoliberal and state capitalist. This conflicted state of the literature points to a key characteristic of China's system: the *strong state* is deeply entwined with a fundamentally *marketised economy*. Depending on which of these two aspects of China's system one focuses on, it may appear as either neoliberal or state capitalist. The precise nature of the *relation* between this strong state and far-ranging, deep markets requires further conceptual clarification.

In this article, we develop the concept of a *state-constituted market economy* as a conceptual framework to unpack a set of economic mechanisms that underpin state–market relations in China. We use *constituted* in three meanings of the word as defined in the *Oxford English Dictionary*: (1) 'to make, set up or establish something', (2) 'to be the elements or material of which the thing spoken of consists', and (3) 'to frame, form'. Each of these meanings points to one dimension of the state's constitutive relation to essential realms of the market economy. The key distinctive charactersistic of China's economic system is micro-level state–market participation focused on essential economic activities. This takes different forms. The first meaning corresponds to market creation, the second to the state being a key stabilizer in certain markets, and the third to the state's efforts in steering markets.

All states have some form of stat–market participation on the macro-level in the form of fiscal policy which alters aggregate demand and central bank open market operations in the money market. In China, the state is engaged in micro-level state–market participation in essential areas in addition to such macro policies. The state has always played a role in creating markets across time and space. But beyond the state's role of initiation, neoliberal economic governance has focused on "encasing markets" (Slobodian, 2018): The state is meant to ensure the universal reach of private market forces and free private price setting. In contrast, micro-level state–market participation in China means that state–market creation is a contunious process. The Chinese state actively stabilizes market forces not only in times of crisis through bailout policies but also through continuous open market operations which amounts to a form of constant market recreation. Market steering is not unique to China and has long been an integral part of industrial and innovation policy. But in China market steering is systemically linked with micro–level state–market participation and the channeling of market forces in pursuit of large political goals is a systemic aspect of the country's state-constituted market economy.

The Chinese state relies in large parts of its economic governance on state-market participation in essential sectors as opposed to direct planning or command instruments and on indirect regulation for non-essential markets. As such we consider the Chinese economic model a market economy defined as an economy in which production is predominantly for sale on the market and organised through market relations such that all members of society depend in existential ways on markets. The state was critical in unleashing far- market forces in the decades since the beginning of Deng's reforms. But rather than assuming that these market forces are best left to their own devices the state engages with them as in a dance with a tiger – a powerful animal that can be tamed but can also get out of control.

Based on this introductory discussion of our concept of a state-constituted market economy, one may want to call China's model state-capitalist in that it combines a strong state with capitalist social relations. But we believe that attaching this label does not fill the conceptual void in our understanding of state-market relations since it tells us little about the modes of operation of the Chinese state in relation to markets or the specificities of the economic model that has emerged after more than 40 years of reform. The meaning of state capitalism in fact is at least equally ambiguous in the context of socialist history as it is in the new state capitalism literature. It has morphed from Liebknecht's early critique of state socialism amounting to the same as state capitalism, into Bukharin's observation of the statification of the capitalist economy under imperialism, war and fascism, and finally into a term invoked by dissident's to reject that the realities of the Soviet model constituted a form of socialism and by Soviet economists to characterize bourgeois economies (Sperber, 2019). As Karl (2020) reminds us, in the Chinese context, too, the term state capitalism has had a complex trajectory. Mao Zedong invoked it to describe his vision for socialist construction in the first years after the revolution when the Communist Party would have to manage capitalist relations of production. State capitalism was meant to serve as a mechanism to transform China's semi-feudal economy into a socialist one. This resonates with arguments by Chinese reformers in the early years who argued that China would have to make up lessons from capitalism as it was still in a primary stage of socialism which eventually gave rise to an 'anything goes' understanding of socialism (Weber, 2021, 2022). More recently, state capitalism has been invoked to demarcate China's "distorted" form of capitalism from its free market type and to urge for a completion of economic liberalization (Pearson, Rithmire and Tsai, 2021). In the context of such diverse meanings, labeling China as state capitalist carries little analytical value.

In our attempt at providing a new theoretical lens for the study of China's state–market relations, we respond to Helleiner's (2021a, p. 10) recent call: 'It is long past time for [the] intellectual bias [of Western-centrism] to be transcended, including for the very practical reason that the ideas of non-Western thinkers – including the Chinese ones … – have left important legacies that endure to this day.' The comparative capitalism research program has been criticised for its neglect of domestic historical foundations and its tendency to use Western experience and models as standards against which other regions of the world are measured.[1] In this paper we take inspiration from the Chinese intellectual tradition referenced by Helleiner and show how China's state-constituted market economy is deeply rooted in China's own statecraft tradition. In drawing on China's intellectual history to make sense of its present political economy we build on a nascent trend in the literature (e.g., Arrighi, 2007; Heilmann & Perry 2011; Zheng & Huang 2018; Nolan, 2018a, 2021; Huang, 2019; Helleiner, 2021a, b; Weber, 2021). But rather than essentializing China we argue for the possibility of theoretical cross-fertilization across different contexts. To this end we connect our conceptual framework to concepts of state market-participation and strategically significant prices devised by Hockett and Omarova for policy proposals in the U.S. (2015, 2016) among other contributions on US or European economies.

Our framework of a state–constituted market economy differs from and complements the concept of state-permeated capitalism (SPC) that is widely used in the international political economy (IPE) literature to capture the nature of China's economic system. By highlighting the *political* frictions and often diverging interests across different business and state actors as well as the reliance on relations of loyalty and trust within the Chinese system, SPC overcomes the false concept that the Chinese state is a unified monolith (ten Brink, 2019; Allen *et al*., 2020). SPC has also initiated rich case studies that characterise important economic institutions in China. Yet, the concept of state permeation implicitly relies on a separation between state and market that does not reflect their mutually constitutive nature. After all, for a thing to 'permeate' another, one thing has to be external to the other. As such, Massot's (2020) recent critique, that the IPE literature analytically relies on starting from state and market as separate spheres, applies to SPC. A binary conception of state versus market, however, conflicts with the fact that China's market economy has been constructed by its activist state since the very beginning

[1] See Schedelik *et al*. (2021) for a critical review of the state of the literature in comparative capitalism research.

of re-marketisation in the late 1970s, as argued for example by Zheng and Huang (2018) and Weber (2021), while the state engages in continuous market participation.

Another concept regularly invoked to described China's system is that of a developmental state. Here, too, markets and states are conceptualised as autonomous spheres with an emphasis on the independent nature of the state in relation to the market (Fine, 2013, p. 5). The framework of a developmental state has been derived through an inductive study of East Asian development successes such as Japan (e.g., Johnson, 1982), Taiwan (e.g., Wade, 1990) and South Korea (e.g., Amsden, 1989). We propose that the Chinese case requires a similar inductive treatment to derive a conceptualisation of its state–market relations rather than a simple importation of the concepts derived from the experience of the Asian Tigers. To this end, we draw on the recent scholarship on the intellectual underpinnings of China's market reforms, How China Escaped Schok Therapy (Weber, 2021) in particular. In fact, developmental state as it emerged in the neighboring cases has deep roots in Chinese history (Helleiner, 2021a, b). Beyond these shared origins the different scales of the development challenges of the Asian Tigers compared with those of China have led to different economic models. As influential reform economist Deng Yingtao (2014 [1991]) argued, while China can use exports as one element of its development strategy, the challenge of economic development on the scale of China goes far beyond the task of (re-)integrating China into the global economy in a state-led fashion.[2]

In a nutshell, we argue that state-market relations in China differ fundamentally between essential and non-essential sectors. Non-essential sectors if considered in islolation from the economy as a whole broadly resemble a neoliberal form of free market organization with a primacy of private prices and property. In contrast, essential sectors are constantly steered and stabilized by the state through state-market participation. This in turn has implications for the non-essential sectors and the economic governance of the whole economy. To develop these points we start from a discussion of the distinction between essential and non-essential spheres, then layout our broad framework of a state-constituted market economy and finally provide a more detailed account of the three modes of state-market constitutions: market creation, stabilization and steering. Throughout the text we relate our proposed concepts to alternative comparative capitalism frameworks for China's model and show how our approach can resolve contradictions in the state of the literature. The final section concludes.

Essential versus nonessential: Distinguishing economic spheres

Our analysis of state–market participation in China is based on a distinction between essential and nonessential spheres of the economy. The modern Chinese state focuses its market-constituting governance on the essential as a way to govern the economy as a whole. State–market relations vary radically between essential and nonessential spheres. Both essential and nonessential spheres are organized through the market, but in the essential sphere the market is continuously and actively constituted by the state.

In China's tradition of statecraft, a clear distinction between the essential and the nonessential has long occupied a prominent place in principles of government. An early example is the so-called *qingzhong*, or light–heavy, theory of the ancient government manual *Guanzi* (Weber, 2021). The Guanzi is acknowledged as the first economist in China by 19th century reform thinkers and the leader of the Republican revolution, Sun Yatsen (Helleiner, 2021c). As such, this text occupies a prominent position in Chinese economic thought maybe somewhat similar to Adam Smith in the West. Ye (2014, p. 98)

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2 Also see Ang (2016) for a critique of interpreting China's development as an instance of the East Asian developmental state.

translates the art of *qingzhong* (轻重) as 'weighing and balancing economic forces'. The task of economic policy in this theory is, in the words of the *Guanzi*, 'To use the thing that is "heavy" to shoot at that which is "light," to use the cheap to level down the dear' (*Guanzi* as in Hu, 2009, p. 127). From this perspective, all economic phenomena can only be understood in relation to their social context; things can be heavy or light only in relation to other things. Heavy commodities are considered essential to production or human well-being, and light commodities are seen as inessential. While some things are by their nature important to production and human well-being, such as grain, salt and iron to use the examples in the *Guanzi*, the economic weight of commodities is also subject to continuous change and reflects the season of the year, production practices, technologies and market dynamics, among other factors.

Our definition of *essential* derives from this relational logic and draws on the experience of the COVID-19 pandemic. When faced with the need to impose lockdowns, the question of what and who are essential has become a central policy question around the world (Stevano *et al.*, 2021). It was settled in an ad hoc fashion based on what governments perceived as essential for the basic working of society and economy. Taking a lead from this experience, we refer to *goods, assets and services as essential when they are systemically significant from the perspective of the state*. We are not arguing from a normative standpoint what ought to be essential and our understanding of 'essential' is historically contingent; evolves with changing material, social, political and economic conditions; and is shaped by the contestation between state actors and the interplay with social forces outside the state. A change in circumstances such as during the outbreak of a pandemic can shift the boundaries between essential and nonessential.

In using the notion of 'systemically significant' we build on the concept of Hockett and Omarova (2016). They define as 'systemically significant' all those prices of commodities that are ubiquitous in production; of investments that are ubiquitous in certain asset classes; and that are ubiquitous as benchmarks for other prices. We go beyond their focus on ubiquity. Taking inspiration from the shutdown experience and Chinese statecraft, we define as *systemically significant all those economic activities, assets or commodities the absence of which are considered by the state to undermine financial, social or political stability or economic security or which are crucial in the pursuit of economic development and other major policy goals at any point in time.*[3]

Our notion of essential has some overlap with other accounts of China's economic system but is disitinct in emphasizing the time variant nature of what is essential. Instead of trying to come up with static classifications we suggest that systemic significance or essentialness of economic activities, assets and commodities can change dynamically over time. Certain assets, activities or goods can become essential on account of changing circumstances (e.g., the COVID-19 pandemic) or evolving structural environments (e.g., climate change and technological progress). This is not necessarily at odds with accounts that focus on capturing the more or less time-invariant essential components. For example, Pearson (2015) puts greater emphasis on an institutional hierarchy that divides China's economy into tiers. The most strategic industries (e.g., metals, energy, pharmaceuticals) are tightly controlled by the state and dominated by central state-owned enterprises (SOEs). Businesses on lower tiers are governed through regulations rather than direct oversight by the government. From our perspective, this institutional reality is an expression of what is considered essential by the state. Others have used a Polanyian framework that emphasises the factors of production, labor, credit and land (Zheng and

[3] Importantly, we thus exclude all the systemically significant care work that happens within households and beyond markets. We believe care is so important, while operating based on different principles, that it requires a separate analysis.

Huang 2018, p. 275). While there is some truth to the importance of these factors they seem too broad to capture anything specific about China and the relative importance of these factors in China's rapid urbanization and industrialization.

The limitation of an exclusive focus on time-invariant hierarchies is that it makes it hard to capture change such as in the context of the regulatory shift in 2021. Take the example of private tutoring. This sector is outside the Polanyian categories and has risen up in the tiers from a sector that used to be merely regulated to one that became much more directly controlled. From the perspective of a dynamic understanding of essentialness this can be explained in a straight forward way. When private tutoring emergend in reform era China, it was initially a small, insignificant sector catering to a handful of nuveau riche. But as urbanization and professionalization progressed, private tutoring became increasingly important in the race between Chinese kids for the scarce spots at top tier universities. With a looming college graduate unemployment crisis since the mid-2000s, the pressue to get ahead in the battle over prestigious degrees made private tutoring ever more indispensable for aspiring students and their parents to the point that this became a highly financialized USD 121 billion business in 2021 with 325.5 million students in 2019 (SCMP, 2021). Private tutoring had moved from being non-essential to being essential in relation to important concerns of the state such as social stability, the functioning of the national education system and population growth. The state stepped in not by banning the whole sector or nationalizing it but by cutting it off from venture capital and limiting its operating hours.

Our conceptual distinction between essential and non-essential economic spheres can also help shed some light on the frequent observation that the Chinese economic system is non-monolithic and the contradictory state of the literature on whether China is or is not neoliberal (Weber, 2019). If we focus exclusively on the nonessential spheres of the economy, the Chinese state appears neoliberal. The Chinese economy can even be considered more marketised than some of its European counterparts since it only marginally adheres to the principle of decommodification at the core of European welfare states (Qi & Li, 2018). But in the essential spheres, the Chinese state continuously constitutes the market operating in an explicitly non-neoliberal fashion. In parallel to the debate over China and neoliberalism, a growing number of case studies on state–market relations in China stresses that the state 'permeates' and 'penetrates' the market, but there is no consensus what this means for the nature of China's political economy. The diverging conclusions on the degree and modalities of state control are to some extent due to a focus on a range of points on the essential to nonessential spectrum.[4] By taking the essential–nonessential distinction into account analytically, we can help resolve the contradiction of China's internal variety of state–market relations.

State-market participation or dancing with tigers

China's history of thought on markets goes back to ancient times (Dunstan, 2006; Hu, 2009; Zanasi, 2020). It has a long tradition of considering the market as a 'two-edged sword' (双刃剑), a progressive

[4] For example, Jones & Zou (2017), focusing on the involvement of a Chinese SOE in one specific hydropower dam project in Myanmar that is of geopolitical relevance but not essential to China's power grid, suggest that the role of the state in relation to SOEs is fragmented and in line with that of the regulatory state. In contrast, Chen & Lees (2016) examine China's developmental state in their analysis of the essential project for China's overall economic security of building up a renewable energy sector. Similarly, Allen *et al.* (2020), in their analysis of China's solar PV industry which is a key element of the renewable energy sector, find that China's state-permeated capitalism is considerably less fragmented and more closely coordinated than that of India. Zhang & Bray (2017) have demonstrated how the expansion of the public higher education sector has at the same time created a shadow system of private schools and tutoring, whereas the latter is organised based on a logic of what they call 'micro-neoliberalism'.

force that can unleash an enormous potential for an enhancement of the material foundations of society but also dangerous in its potential to create vulnerabilities, instabilities and crises (Nolan, 2021, p. 35, 2018b). This resonates with Karl Marx's analysis of capitalism as both the most progressive and most crises-prone stage of development. For Marx this dual nature implies that capitalism prepares its own demise and gives rise to revolutionary forces that should eventually overcome the reliance on money and markets. In contrast to such a revolutionary solution pursued in China under Mao, a strand of Chinese statecraft thinking addresses the need to balance the regressive and progressive sides of markets through state market-participation. The communists employed markets as a weapon in their economic warfare in the Civil war. Some of these techniques of economic governance have been revived in the reform era (Weber, 2021). In contrast to this idea of a need for constant balancing of unstable markets, in neoclassical economics, markets are a one-edged sword, self-regulating spheres where the competitive interaction of private buyers and sellers intermediated by the free movement of prices brings about an equilibrium. This view of the market leads to the neoliberal logic of a strong state to "encase" the market and protect it from disturbences (Bonefeld, 2013, 2017; Slobodian, 2018). In contrast, from the perspective of the two-edge sword, the market is a powerful yet dangerous tool of economic governance that needs to be trained, guided and tamed by the state. It is like dancing with a tiger, it requires enormous capacities and it can go wrong at times.

In practice, all market economies are sustained by some form of state action that ameliorates at least some of the uncertainty and instability that arise from the reliance on market exchanges in the organization of social production. These mechanisms differ in degree and mode of operation. China's state-constituted market economy is characterised by a particularly intensive and extensive form of such uncertainty-ameliorating policies as well as by a commitment on the part of the state to contantly harness and channel the progressive powers of markets. A brief comparative discussion on a conceptual level will help us to develop this point.

On the most basic level all states provide a legal framework that sets rules for market behavior and police those rules. Beyond that, on at least three levels the state can ameliorate the uncertainty of exchange inherent in a market economy, corresponding with different schools of economic thought: (1) by stabilising the value of money, (2) by stabilising aggregate demand (macro-level), and (3) by stabilising individual, important markets (micro-level).

All modern states issue a fiat currency. All states also aim to stabilise the value of money to some degree through monetary policy which can limit the uncertainties stemming from the monetary sphere (1). Central banks create and participate in markets for fiat money to regulate the price of holding money (the interest rate). From the perspective of Friedmanite monetarism or the neoliberal tradition, self-regulating market forces dominate over the inherent instability just outlined. Hence, stabilising the value of money is the key to stabilising market economies as a whole (Hayek, 1966 [1929]). Conversely, the free market economy facilitated by stable prices is seen as the best arrangement to unleash the virtues of the market. The free market does not mean a market free of the state. The state polices the freedom of the market and protects it from the intervention of society or state (Bonefeld, 2013, 2017; Slobodian, 2018).

From the angle of the postwar neoclassical synthesis, the state further has to stabilise aggregate market relations through fiscal policy (2). Here, the inherent stability is mainly located on the macro level and so are the ameliorating policies. Fiscal expansion adds to aggregate demand when effective demand is falling short to prevent a deflationary contraction. The main task of the state is this macro stabilisation. Keynes in some of his writings went further in his vision for an activist state. He argued for the socialisation of investment which would serve to overcome substantial, inherent instability in a capitalist economy as well as to unleash the full productive potential through industrial policy (Crotty, 2017).

Later, Keynes added public buffer stocks for essential commodities to his proposed stabilisation policies (Dimand & Dimand, 1990; Fantacci *et al*., 2012) (3). Keynes was not the originator of such a micro-level state market-participating policy. Benjamin Graham (1937) and Henry Wallace had previously introduced this idea into the interwar policy debates, drawing inspiration from China's Ever Normal Granaries system and traditional statecraft (Will & Wong, 1991). Keynes, too, was aware of this tradition of theorising since he reviewed a Ph.D. that surveys China's history of economic thought and that covers state market-participation (Chen, 1911; Keynes, 1912). In fact, in China theories of state market-participation go back to the aforementioned *Guanzi* and were revived, discussed and perfected in imperial times (Zhao & Drechsler, 2018; Zanasi, 2020; Weber, 2021). The ancient text *Guanzi* states,

> When things are plentiful, they will be cheap; when they are scarce, they will be expensive. … Knowing this to be so, the prince pays attention to his country's surpluses and shortages and manages its wealth and goods. When grain is cheap, he exchanges money for food. ... He pays attention to the relative value (*qingzhong*) of things and manages them in order to maintain price stability. Therefore, the expensive and the cheap may be harmonized and the prince reaps his profits. (*Guanzi* as in Rickett, 1993, p. 384)

The basic logic of the statecraft techniques of micro-level state–market participation can be illustrated based on the Ever Normal Granaries that were a core institution in imperial China (Will & Wong, 1991). Grain markets are inherently unstable due to the changes of seasons that brings about regular fluctuations in supply and prices. In addition, the bad harvests can create extreme price fluctuations or even famines. The public granaries were meant to add demand around harvest time and lift the price, while adding supply when the private supplies were fading in spring and summer, thus preventing price hikes by private merchants. A system akin to the traditional Ever Normal Granaries has been reinstated in recent decades under the responsibility of the National Food and Strategic Reserve Administration that runs buffer stocks on various administrative levels not only for grain but a whole range of important commodities for consumption and production.

If we combine the element's of macro-stabilisation, a substantial degree of socialisation of investment and public buffer stocks for essential commodities in various places of Keynes' thought, we move towards our concept of a state-constituted market economy. But in our analytical framework for the study of China's political economy, the state takes on an even more constitutive role than that envisioned by Keynes. The state-constituted market economy *stabilises the value of money and the relation between supply and demand not only through indirect macroeconomic means of fiscal and monetary policy, but also on the micro-level. It actively creates, stabilizes and steers markets for a range of essential goods, activities and assets through state–market participation*.

The relation between the state and the market is subject to constant calibration and contestation in China's state-constituted market economy. Deng Xiaoping famously reinstated the market in the late 1970s arguing that it would be a tool to serve the socialist state (Zheng & Huang 2018; Weber, 2021). This is the Smithian view of 'markets as instruments of rule' (Arrighi, 2007, p. 8). But the market is not a simple instrument, it takes on a life of its own. Active stabilisation of the market is a way to try to keep the market dynamic under control. But micro-level state market-participation does not erase the uncertainty inherent in a market economy. Nevertheless, as the state acts as buyer and seller of last resort in a range of markets with wide-ranging linkages across the economy, the uncertainty is more directly alleviated than when relying on macro-interventions alone.

To be sure, the economic precariousness and exploitation that is endogenous in being dependent on selling one's labor for a living is not overcome as is evidenced by the army of 293 million poorly paid migrant workers who run China's factories and gig-services (NBS, 2022). Despite stabilization individual firms can also go bankrupt. In that sense, state-participation does replace capitalist employment relations or competition. China's state involvement in essential sectors has also to be distinguished from decommodification as theorized for in the influential work of Polanyi (2001 [1944]) who saw the laws of motion in the struggle over the (de-)commodification of the so-called fictitious commodities land, labor and capital (Işıkara, 2021). Therefore, classic frameworks in Polanyi's footsteps such as Esping-Andersen's (1990) categorization of welfare states that rely on the degree of decommodification of essentials is not well suited to capture the specificities of China's system. While the Chinese state governs some essentials such as compulsory education and medical services through partial decommodification, it governs other essentials such as grain and crucial raw materials through state-market participation. Consequently, China's economy is deeply marketised, and more state does not mean less market (Zheng & Huang, 2018). China's economy is largely commodified in that basically all production is for the market and large parts of everyday life are organised through exchange. But this commodification is constituted by the state in the sense that the state organises the commodification through market creation and pushes the boundaries of marketisation by internalising uncertainties inherent in the commodity form.

This smoothening of fluctuations in essential markets which is not captured by the decommoditification lens, can be very consequential in containing risks that can unleash systemwide crises. The significance of this can be illustrated based on the example of the real estate sector. In 2021, many commentators thought the payment difficulties of China's second largest real estate conglomerate, Evergrand, would be China's Lehman moment and would unleash global financial turmoil. This overlooked, however, that the Lehman collapse was the result of the spontaneous bursting of a subprime mortgage bubble whereas the Evergrand payment difficulties were induced by a government tightening of control over the inflated real estate sector. As such the state was ready and prepared to step in once Evergrand was pushed to the edge of bankruptcy not just to bail the company out but to teach a lesson to the whole sector and parcel out assets (Financial Times, 2021).

In the broad literature that aims to classify different economic systems, an analogous assumption to the focus on decommodification is that more market means less state capacity. This, however, does not fit with China's congruent reality of intense marketization as reflected for example in the high degree of stock market participation, the flexible labor market and the rapid rise of the gig economy (Zhou, 2012; Qi & Li, 2018) on the one hand, and extensive state capacity as evidenced for example in the unique pace at which the country is building up a renewable energy sector (Myllyvirta & Zhang, 2022) on the other. The literature on the regulatory state of the neoliberal era, for example, emphasises that the regulatory state lacks state capacity beyond its functions of setting and policing rules and sees this as a result of marketization. The regulatory state is juxtaposed with the state of the postwar era of advanced economies characterised by 'statecraft based on hierarchical, command-and-control systems which authoritatively mobilises resources and intervene directly to secure desired social and economic outcomes' (Jones & Hameiri, 2021, p. 3).[5] This way of conceptualizing these two types of states relies on drawing an opposition between more hierarchical command-and-control and more market rather than between different ways and degrees of the state's engagement with markets that correspond with different forms of state capacity. As Massot observes (2020), the market is thought of as a pure sphere of private actors, so that more market always implies less state capacity.

In contrast, in our framework of China's state-constituted market economy, intensified marketisation increases the uncertainties and instabilities inherent in market dynamics and requires more, not less, state capacity. At the same time the state in China is not an all-powerful, monolithic, centralised bureaucracy that penetrates all markets as in the classical developmental state (Hui, 2017; Zheng & Huang, 2018, p. 31–2; Nogueira & Qi, 2019). This tension between more market and more state capacity is difficult to capture with frameworks that foreground a 'non-market mode of coordination' (Nölke *et al*., 2020, p. 49) as key to understanding China's state–market relations as for example SPC. Following in the footsteps of the varieties of capitalism approach (VoC), they focus on the firm level and add fragmented interests in business-state alliances and cooperation within elite networks. These networks are grounded on personal relations (*guanxi*) and a shared social background, they argue (Nölke *et al*., 2020).[6] In addition to informal ties, the rich literature on SOE governance focuses on bureaucratic design in characterizing China's state-market relations by stressing the role of the State-owned Assets Supervision and Administration Commission (SASAC), cadre management systems that facilitate the rotation and dual assignments of executives and state officials, party committees inside companies, and political campaigns to mobilise businesses (Chen Li, 2016; Leutert & Eaton, 2021).

Our framework does not challenge the importance of informal business-state alliances as well as of bureaucratic design.[7] But we argue that the importance of thse formal and informal non-market institutions can only be fully appreciated when we add that they are mobilized by the state in its efforts to stabilize and channel market forces. The importance of these non-market institutions does not mean that market forces are any less relevant. In the next section, this point is illustrated by developing three modes of state-market participation based on key empirical examples.

Three modes of state–market participation: Creation, stabilisation and steering

Mode 1: State market-creation

In China's recent history state market-creation has occupied a central place at two critical junctures: during the Civil War and again during the reform period. At both moments markets had become peripheral. During the Chinese Civil War hyperinflation was rampant and the economy had disintegrated to a degree that many peasants reverted to subsistence production. We can think of this as a collapse of the division of labor. The market had ceased to function as a coordinating mechanism for the economy as a whole as trading routes were blocked by the war. In this context, the Communists reverted to ancient statecraft techniques in their economic warfare. They stabilised the value of their currency through recreating markets for essential goods such as salt and grain and by establishing trading agencies that reinstated commercial links. This involved some of China's most influential economic thinkers and policy makers of the twentieth century, such as Chen Yun and Xue Muqiao (Weber, 2021).

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[5] Similarly, the developmental state model is often seen as relying on an all-powerful, centralised bureaucracy and state mobilisation through command-and-order (Allen *et al*., 2020, p. 2).

[6] This analytical lens resonates with approaches that emphasize crony capitalism. See Ang (2020) for a critical review of accounts that use crony capitalism as analytical lense to analyze China.

[7] See Zheng and Huang (2018, p. 378–424) for a detailed discussion of such personnel rotation.

During the Mao era markets did not disappear entirely, but they were politically suppressed (Perkins, 1966; Zheng & Huang, 2018, p. 250–1). At the dawn of reform one key question was how to recreate markets in the context of a command economy. China considered but ultimately rejected the logic of shock therapy that would have relied on destroying the planned economy to make space for markets to emerge spontaneously. Instead, China pursued a path of marketisation that consisted of a combination of liberalising peripheral sectors and using the planning institutions as market creators (Weber, 2021). China's gradualist reforms gave rise to a continuous process of market creation. In this context we refer to *state market-creation* as *the state establishing or transforming the basic infrastructure for market relations, sometimes including the market players themselves, who are at times created and at other times mobilised by the state*.

Our definition of state market-creation is inspired by Polanyi (2001 [1944]). But while Polanyi emphasises the role of the state in the creation of the national market in Europe's capitalist transformation, we suggest that state market-creation in China is both a historical process and an ongoing process. Our concept of state market-creation is in the same way related to and distinct from Ang's (2016) theory of market building and the coevolution of state and markets. Where Ang suggests that at a certain stage of economic development, market building gives way to market preserving, we argue that state market-creation is a continuous characteristic of China's economic system. In this regard our definition is close to Mazzucato's (2013) market creation of the entrepreneurial but where she focuses on innovation, state market-creation includes all essential spheres of the economy in the Chinese case. Take the example of the initial 2020 COVID-19 lockdowns. When the strict lockdown policy interrupted regular market activities and blocked normal connections between sellers and buyers during the first lockdowns in 2020, the state quickly transformed the commercial norms for the essential food market and re-establish market connections for example by linking agricultural producers with urban consumers through new e-commerce apps and mobilizing supplies through price and inventory monitoring platforms (Reuters, 2020; Weber & Qi, 2021; Zhong et al., 2021). To be sure, the limits of such ad hoc market creation have been demonstrated by the food delivery crisis that emerged for some groups of residence during the Shanghai lockdown (Foreign Policy, 2022).

Beyond such ad hoc emergency mechanisms the Chinese state has pursued massive construction of infrastructure in recent decades with the goal of extending the original market, building new connections between market players, and deepening the division of labor. China has built the world's largest high-speed railway network, which has not only drastically intensified original connections but also induced new ones between regions. A World Bank report shows that 18 percent of passengers would not have traveled if the high-speed railway were not available. The high-speed railway has also helped relatively remote places such as Guilin, Guiyang, and Qufu to attract new passengers and expand their tourism markets (Lawrence et al., 2019). Similarly, one of the motivations of the Belt and Road Initiatives is to facilitate trade and create new market connections through improving infrastructural conditions. As part of the initiatives, the Chongqing-Xinjiang-Europe Railway has made Chongqing, an inland city in southwest China, a major trading hub and an important exporter for Europe, challenging the traditional advantages of coastal cities. Manufacturers based in Chongqing such as Hewlett-Packard and Foxconn produced 25 million laptops per year for the EU market (Huang, 2020). These largescale infrastructure projects are an ongoing process with shifting frontiers that span beyond traditional transportation and also include for example China's high voltage grid which makes it possible to transport electricity across very far destinaces efficiently. This transforms the market for electricity generation (Lau, 2022).

Market creation has also been crucial in the sphere of finance, as for example in the case of the China Development Bank (CDB). As Chen (2020) shows the state has functioned as creator of a competitive market for infrastructure financing where the regulator, buyers and sellers are all state actors. As China was transitioning out of a directly planned economy, new mechanisms of finance were needed to facilitate China's strategic development projects and the CDB was designed as a core, fully public institution. Chen (2020, p. 465) illustrates that this example reflects Chinese policy makers attitudes to market creation "if there is no market out there, the state should create one by transforming existing state actors into market players." She goes on to explain that "China's interbank bond market to a large extent does resemble a 'competitive market'. … its pricing mechanism is determined by market supply and demand, and the players do react to market signals and seek profits. But the major players that constitute this market are state-owned." (Chen, 2020, pp.464-5)

But as the case of the domestic capital market shows, state-market creation in the financial sector is by no means limited to turning state entities into market actors. The state has set up state-owned exchanges and organizes the market infrastructure but unlike in the case of CDB the players on the exchanges are for the most part profit-driven, private investors (Petry, 2020a). The state has shaped the market in ways that harnesses the dynamism of private capital but constrains the scope for speculation (ibid., p. 10). As for the rest of the economy within the financial sector, we observe the logic of tight control over essential functions and entities: 'pivotal points' are state-controlled, but instead of operating based on a command-and-control logic, they follow market principles – as market designers, participants and managers to ensure that 'finance serves the real economy' (Petry 2020b). This also illustrates that state–market creation is intertwined with state–market participation. This is a trivial point when all market actors are state entities. But even where this is not the case the two are closely related.

Mode 2: State market-stabilisation

Our definition of state-market participation builds on our reading of essential statecraft classics in China like the Guanzi and the work of legal scholars Hockett & Omarova (2015). The latter in turn draw on Keynes who – as we discussed in the previous section – took inspiration from the example of China's grain buffer stock systems. Hockett & Omarova (2015) have devised their concepts as part of a reform agenda for the US in the aftermath of the 2008 global financial crisis. Despite these different context, we find their careful derivation of definitions helpful for our attempt to device a conceptual framework for China. They emphasize that the state can play a critical role in mainting market exchange by bearing 'two complementary types of risks': the risk of the seller that a commodity or asset in question does not sell is overcome by the state acting as 'buyer of last resort', while the risk of the buyer of not finding the product they are trying to buy is ameliorated by the state acting as 'seller of last resort'. In other words, they propose that the state should ameliorate the uncertainty of exchange inherent in market dependency not only on the aggregate level through macroeconomic stabilisation but through state participation in specific markets. We suggest that this is an ongoing practice in China in essential markets.

State market-stabilisation includes market stabilising state participation that ranges from counterbalancing normal fluctuations for example for staple food items to market-preserving emergency measures such as in the context of the 2015 stock market crisis. It can also itself trigger turbulences. As in the case of the 2021 Evergrande default, the 2015 crisis, too, followed from a strengthening of regulations. In this case by the China Securities Regulatory Commission (CSRC), which triggered the burst of the bubble. In response to the crash, CSRC mobilised state-controlled financial institutions to stop selling and buy stocks on a massive scale(Li et al., 2020), thus reversing the panic and stopping the free fall of the market.

China today commands buffer stocks, operated by state agencies or state-owned firms, for staple food items such as pork, sugar and oil and essential producer goods such as metals and oil, as well as medical supplies. These reserves are mobilized in face of market turbulences and since perishable goods have to be continuously restocked constantly participate in the market by selling and buying stocks. This serves both purposes of consumer and producer price stabilization as well as securing food and raw material availability. Some key institutions are the National Reform and Development Commission, the National Food and Strategic Reserves Administration and more specialised reserves such as the China National Cotton Reserves Corporation. The size of reserves is not publicly known for most stocks but is estimated to account for only a small share of the nationwide consumption, with the exception of grain. During the Mao period state market-participation was replaced with the unified system of purchase and sales for grain and other essential agricultural goods. The state monopolised the grain trade (Ash, 2006). In the early years of reform and opening-up, grain markets were re-introduced as households were allowed to produce for the market once they had fulfilled their share in the state-commanded grain output quota. As a result, state market-participation reemerged for grain and has been considerably strengthened in more recent years, especially in the context of the violent world food price fluctuations in the 2000s (Huang & Yang, 2017). In the current cycle of global food price spikes that followed from the COVID-19 pandemic and the war in Ukraine, the central bank governer Yi Gang has once more emphasized the centrality of grain prices in China's monetary policy (PBoC, 2022).

Even though somewhat less essential than grain, pork has become an important consumption good for most Chinese people and the price of pork takes a significant weight in the official consumer price index. The state's control over pork is less strict than grain; nonetheless, the government runs a frozen pork reserve through a state-owned firm, China Merchandise Reserve Management Center. During 2020, when pork price rose rapidly due to swine fever, the Reserve Management Center constantly released reserves of frozen pork while also importing pork on a large scale in order to increase domestic supply. Market participation aimed at maintaining a relatively stable price ratio between pork and corn, which is a primary input for pork production. As Figure 1 shows, these measures successfully stabilized pork prices within a relatively short period.

China has established buffer stocks, operated by state agencies or state-owned firms for staple food items such as grain, pork, sugar, oil, essential producer goods such as metals, and medical supplies. When the world oil prices collapsed in 2020, the Chinese state reserves made headlines about their global buying spree stocking up reserves both to ensure greater energy resilience as well as to have leverage to insulate the domestic market from later price hikes. The size of reserves is not publicly known for most stocks but is estimated to only take a small share of the nation-wide consumption with the exception of grain. The key lies in leveraging reserves effectively. Nevertheless, the release of reserves can repress market speculation and (re-)create an expectation of stable prices. Meanwhile, the state agencies or state-owned firms operating the reserves are usually vital players in domestic commerce and international trade. They can increase reserves by both domestic purchase and redistribution across regions and by imports, which strengthens their influence on the domestic market (SCMP, 2021; Weber & Qi, 2021; Xian, 2020). Beyond maintaining reserves, market participation in a range of essential commodities requires complex state capacity to monitor essential markets on a continuous basis and add supply either through imports or the mobilisation of businesses through informal and formal ties.

[Figure 1 here]

In the context of the inflationary pressures that have arisen in the aftermath of the COVID-19 pandemic recoveries, the specific logic of China's state market-stabilisation also became salient. While in the rest of the world the debate around a potential stabilising state intervention has focused on a tightening of monetary policy, the Chinese government focused its efforts on stabilising the prices of key commodities that showed rapid price rises since the first months of 2021. Consider inflation as a decline in the value money where the value of money is expressed in terms of a basket of goods: x amount of dollars = y amount of basket of commodities. The macro-focused stabilization approach seeks to stabilize the value of money by adjusting the supply of money in the money market. In contrast, the Chinese government sees restraining the monetary supply as a means of last resort. It would increase interest rates and affect all sectors and business activities across the whole economy. It focuses instead on the right-hand side of the equation. Releasing reserves of important commodities, organizing or encouraging imports and calling on state-owned enterprises to abstain from participating in speculative price hikes is meant to bring down the money price of goods that weigh heavy in price indeces since they are key inputs across a wide-range of sectors or are important consumption goods.

A similar logic applies in the sphere of fiscal policy. In China a complex infrastructure for targeted investments is in place that importantly involves the SOEs. Rather than focusing on the macroeconomic dimension of expanding fiscal spending in order to lift up aggregate demand in response to a crisis, China's stabilization policies for the economy as a whole involve the mobilization of state and private businesses around tailored investment programs. These programs are usually focused on major innovation, infrastructure building, and other government priorities. In these programs, SOEs are leading investors, who are more willing to implement more risky investments. Qi & Kotz (2019) find that SOEs play a critical role in investing countercyclically. As Figure 2 shows, SOE investments tend to go up when private investments decline and decrease during private investment booms. In the fiscal realm, market creation and stabilization overlap. Expanding and deepening markets involves large scale investements as in the case of infrastructure. Such gigantic investments aligned with missions such as the creation of a high speed railway network have been typically mobilized in response to significant growth slowdowns and global turbulences as in 2008 and again in 2022 (SCMP, 2022).

[Figure 2 here]

Mode 3: State market-steering

The goals of the Chinese state go beyond the act of creating markets as an end in itself or stabilising the economy in its existing configuration. The Chinese government has a long-term agenda and is characterised by the bolt ambitions of an 'entrepreneurial party state' (ten Brink, 2019). This practice includes what Hockett and Omarova (2015, p. 129) define as 'market moving' – actively alternating prices through state market-participation towards meeting policy goals. The basic mechanism is similar to that described in the previous section stabilization and can involve market creation. There is an analytical overlap, but rather than aiming to recreate an existing market balance in its steering mode the state participates in the market to create a new balance. Unlike in Mazzucato's *Entrepreneurial State* and the innovation and industrial policy literature more broadly, market steering is not only about creating new technologies or sectors but also about balancing liquidity and the distribution between sectors and groups in society.

Market-steering has a long history in Chinese fiscal policy. In traditional statecraft the state monopolized the salt trade and limited supply in order to extract revenue from high prices. State commerce was also used as a way to absorb excess liquidity (回笼) by sales of expensive luxury goods. Both techniques were used in the early years of the People's Republic of China. Bringing the salt trade under control was an important source of finance for the Communist revolution (Weber, 2021). To counter inflationary pressure after the disaster of the Great Leap Forward, cakes made with imported Cuban sugar were sold at a high price to absorb excess liquidity of high-income households (Lowenstein, 2019).

Consciously setting prices in ways that diverge from costs was at the core of the Maoist price system (Perkins, 1966; Lardy, 1983; Weber, 2021). Prices were used as a mechanism for redistribution across sectors. In the 1980s, China's market reforms raised the question of what to do with this redistributive price system. China abstained from a big bang in price reform that would have reset all prices overnight and pursued a dual-track price system instead. The core of the old price system was initially left in place while market prices emerged at the margins (Weber, 2021). For most of the economy this dual-track price system is long gone. But for certain essential upstream producer goods such as electricity it continues as one element of China's economic policy (Yeo, 2020). For example, granting producing enterprises access to a cheap energy supply is a way to encourage certain sectors.

Importantly, the grain price also continues to be steered by the state depending on the circumstances in the interest of the rural producers or the urban consumers. In the early 1980s, China experimented with abolishing the state's grain trade and replace it with taxation. However, the government ultimately abstained realizing that the functions of state market-participation went beyond taxation. This became again apparent in 1993 when the resumption of market reforms sparked a grain price inflation. In response, the state intervened in the market by selling grain from public reserves and abstained once more from liberating the grain market. Zhu Rongji – commonly known as China's most neoliberal leaders – pledged that the state grain system should continue to stabilize and steer that market price of grain by increasing or releasing grain reserves (Zhu, 2011, p. 496). When in the 2000s urban–rural inequality had become so high that it began to endanger social stability, the Chinese government mobilised and expanded the public grain reserve system. To increase farmers' incomes and encourage production, the state guaranteed a minimum procurement price for a range of major grains, thus steering the market in favor of agricultural producers (Huang & Yang, 2017).

Another important example of market steering is the market for urban land. Unlike in the grain trade, the local government is the only lawful owner and supplier of urban land, while the demand for land comes from a multitude of predominantly private players. The local governments lease the land to non-state users for a fixed period. Monopolizing the urban land supply has allowed local municipal governments to obtain land transfer revenues as an important supplement to local fiscal income, which has financed in considerable parts rapid and large-scale urbanization and local infrastructure building since the mid-1990s (Xu, 2011; Knight, 2014). Figure 3 shows the relative size of land transfer revenue, which has been a crucial income source for local governments. A common practice of local governments is to lease land for manufacturing firms through one-on-one negotiation instead of public bidding, which can lower the price and thus attract manufacturing investments (Tao et al., 2010).

In this way, local governments are shaping the outcome of the land market. State-owned investment platforms hold large shares of urban land and have easy access to credit. They not only play a crucial role in municipal infrastructure building but also are the key player in supporting the development of highly risky frontier technologies. Domestic high-tech companies such as BOE and TCL in the LCD industry and Suntech in the photovoltaic industry have substantially benefited from the financial support of state-owned investment platforms. Since 2014 local governments have established industrial guiding funds, which are state-owned venture capitals that make investments in high-tech companies. By June 2019, industrial guiding funds amounted to 4 trillion yuan (Lan, 2021).

[Figure 3 here]

Market steering does not always require the direct participation of the state as a buyer or seller. It can also guide the expectations of non-state players about new frontiers of expanding markets. China has transferred the legacies of the planning system, particularly the five-year plan system, into indicative planning (Heilmann & Melton, 2013). A five-year plan proposes a variety of social and economic goals, including aspirational rather than mandatory ones that serve to align expectations of non-state players. This involves large-scale public investments and channels private investments into frontier technologies and innovations. The state shapes profitability expectations with political commitments on industry and macroeconomic levels as well as through financing by state-owned banks.

Take the electric car industry as an example. By early 2021, the number of electric cars in China has reached 5.8 million, this accounts for 50 percent of electric cars globally (Xinhua-News, 2021). China proposed a plan for the development of electric cars in 2012, aiming at overcoming the reliance on oil and countering environmental pressures as well as to transform the traditional auto-manufacturing industry into a technological leader (State Council, 2012; Altenburg *et al*., 2017). Since then, the state has provided substantial subsidies, but also shaped the expectations of potential manufacturers and customers through creating a state-supported ecosystem for electric car innovation, investing in a wide and dense network of charging infrastructure, running a more favorable plate allocation system for electric cars, encouraging the usage of electric cars as taxies, and crucially pledging that by 2035 no new combustion-engine cars may be sold in China. This has created a clear expectation that profitability and survival on the Chinese market for car manufacturers will depend on their competitiveness in electric cars – a powerful form of steering of the private and public business activities of a whole sector.

Conclusion

China has created a distinct economic system. The conceptual framework developed in this paper aims to contribute to a theorisation of the economic mechanisms that underpin modes of state–market relations. We propose the concept of a state-constituted market economy and argue that through market-participation the Chinese state seeks to ameliorate uncertainties and instabilities in essential spheres of the economy while harnessing the power of market forces. This involves the continuous redefinition of the boundaries of essential and nonessential sectors. The state creates and participates in markets for essentials in order to stabilise and steer the economy as a whole. It thereby mobilises private market actors but at the same time aims to retain sovereignty over the essential parts of the economy. This is a constant balancing act – like a dance with a tiger. The state enters a Faustian bargain with the market. Market forces, once unleashed, can spiral out of control despite efforts to stabilise or steer them. The state-constituted market economy has a more fine-grained state capacity to counter bubbles and instabilities but is by no means free from crises, as the financial turmoil in 2015 and the attempts to deflate the real estate sector in 2021 illustrate.

While we characterise the essential parts of China's economic system by stressing the active state participation in the market, peripheral spheres of the economy are largely left to private actors alone and are only indirectly steered or stabilised through their links with essential sectors. One key to understanding China's political economy lies in capturing this dual nature. The state-constitution of markets for essentials works not against commodification but rather facilitates a wide-ranging commodification of all spheres of the economy. Further research is needed to conceptualise the channels through which the state market-participation in essential sectors affects the nonessential ones and to study the implications of state market-constitution for the role of fiscal and monetary policy.

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Figures

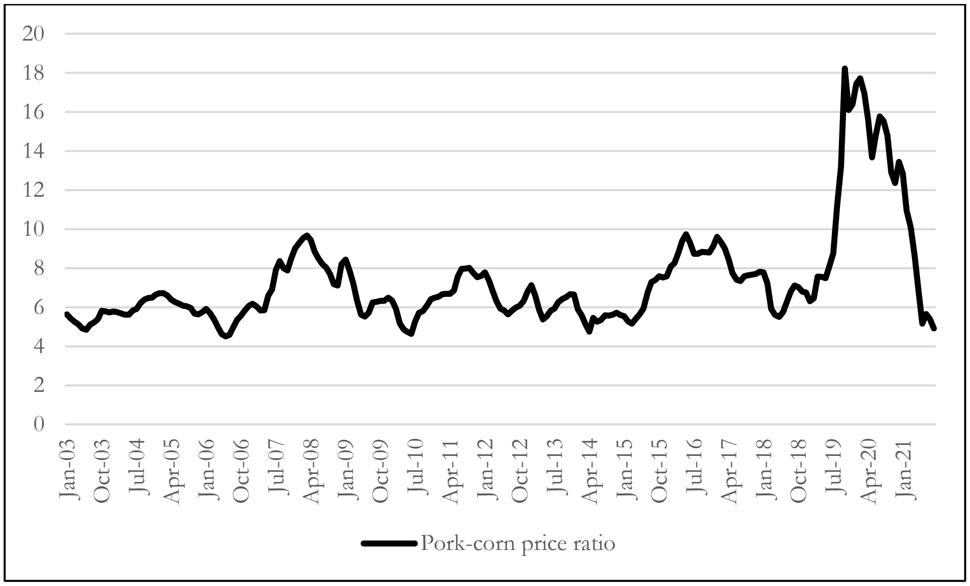

Figure 1: Monthly pork-corn price ratio over the period Jan 2003-Sep 2021
Sources: National Bureau of Statistics.

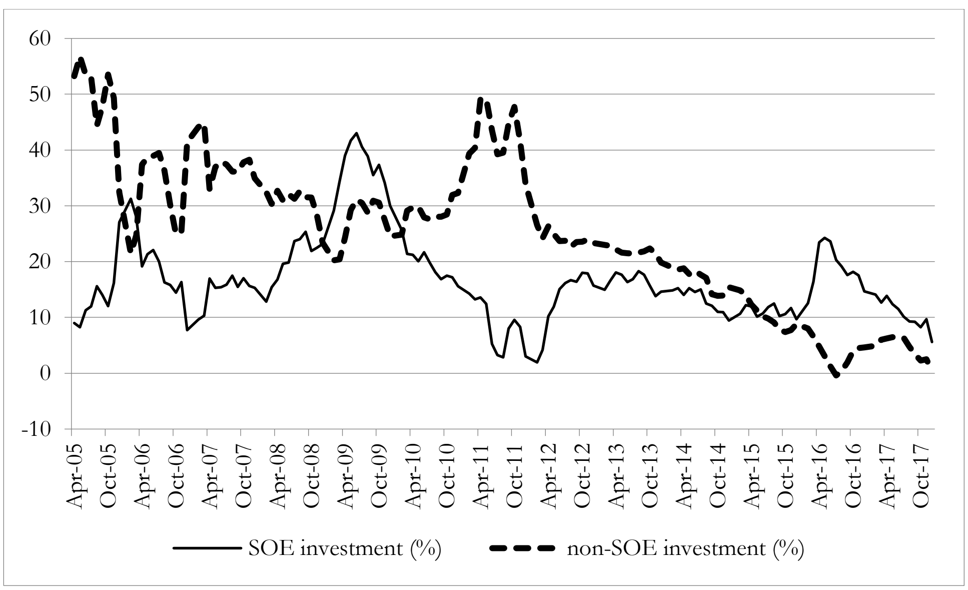

Figure 2: Annual nominal growth of SOE investment versus non-SOE investment, April 2005–Dec 2017
Sources: National Bureau of Statistics (http://data.stats.gov.cn)
Notes: The annual nominal growth of investment is the growth of monthly investment relative to investment of the same month in the last year. The figure presents the three-month moving averages of the annual nominal growth rates. The NBS does not publish monthly SOE investment data since Dec 2017.

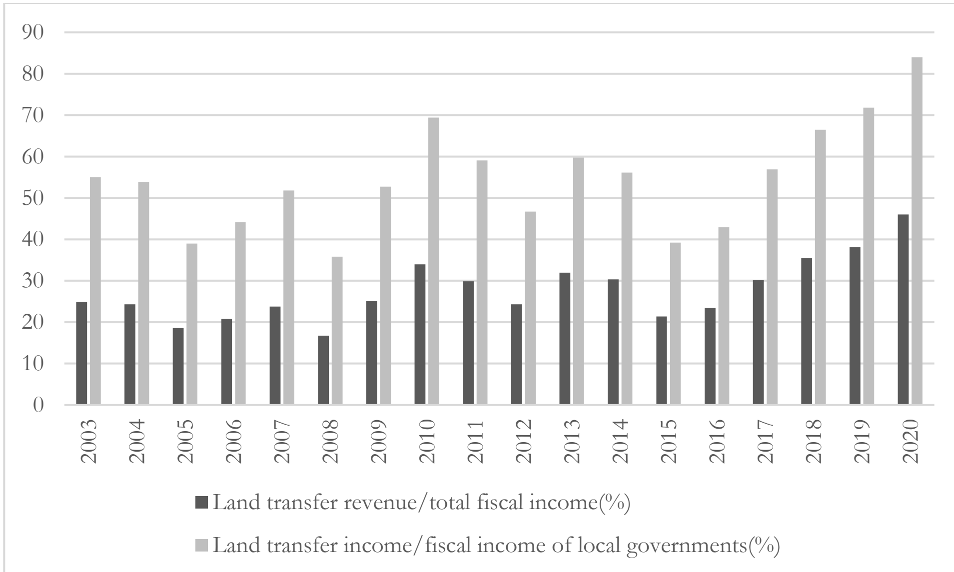

Figure 3: Relative size of government land transfer revenue, 2003-2020
Sources: Ministry of Finance, P.R.C. and China Land Resource Yearbook.
Notes: Total fiscal income is the sum of the central government's fiscal income and local governments' fiscal income. The figure shows the relative size of land transfer revenue, which is treated separately in China's fiscal system and not counted as a part of fiscal income.