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**INSTITUTIONAL INNOVATION AND FUNCTIONAL
TRANSITION OF LOCAL GOVERNMENT AND DEVELOPMENT
OF PRIVATE SECTOR IN WENZHOU AND YIWU**

Author: Yun Mao
Supervisor: Turaj Faran

Abstract

This paper selected two cities in Zhejiang Province, Wenzhou and Yiwu to take a look at the relations between the local government and their private sector since the adoption of the reform and opening policy in the late 1970s, from the angle of the functional transition of the local government's contribution to the development of the private sector. The purpose of this paper was to, through the analysis of Wenzhou's experience and Yiwu's local conditions, give suggestions to better role-playing of Yiwu's government in development of its private sector and enhance the performance of private enterprises. Based on the data collected from the website of government organizations, authentic news agencies, yearbooks, some research papers and research interviews and research observation, suggestions were given in order to sustain stable development of private sector. The suggestions include emphasizing on institutional innovation, better defining governmental function sustainable and the more detailed suggestions include further upgrading "China Yiwu International Commodities Fair", attracting more exposition participants from both home and abroad and building up a good image and reputation for the fair.

Keywords: Institutional Innovation, Functional Transition, Private Sector, Wenzhou Model and Yiwu Model

Contents

Forward	1
1.Introduction	1
1.1 The re-emerge of the private economy in China.....	2
1.2 Research purpose and questions	4
1.3 Method selection and data collection	5
1.4 Reliability and validity	6
1.5 Deposition	7
2. Theoretical framework and concepts	7
2.1 Debate on the role of the government	7
2.2 Local government’s domination in economic reforms in China	9
2.3 Redefining the economic function of the local government	10
2.4 Private sector and non-state sector	11
2.5 The local government’s functional transition	13
3. From “underground” to “overground”: “Wenzhou Model” and relationship between local government and private sector in Wenzhou	13
3.1 Expansion of “underground” private sector in Wenzhou by the adoption of reform and opening policy	13
3.1.1 Isolation from other cities in Zhejiang Province and the sparkle of institutional innovation	13
3.1.2 Local cadres’ protection attitude towards the expansion of “underground” private sector	15
3.2 Institutional innovation and functional transition of Wenzhou’s government in “Wenzhou model”	16
3.2.1 “ <i>wuwei erzhi</i> ”: economic institutional innovation by local initiatives	16
3.2.2 The functional transition of Wenzhou’s government since the middle of 1980s.....	18
3.2.3 The service-oriented government: from “doing nothing” to “doing something”.....	19
4.A “<i>youwei</i>” government: Yiwu follows the “Wenzhou” model, enough or	

not? -----	21
4.1 Yiwu: “barter brown sugar for chicken feather” -----	21
4.2 The “Yiwu” model—a copy of the “Wenzhou” model? -----	22
4.2.1 A “ <i>youwei</i> ” government -----	22
4.2.2 A “limited” government -----	23
4.2.3 A service-oriented government-----	25
5. Sustainable institutional innovation and development of private sector with functional transition of local government -----	25
5.1 efforts in institutional innovation-----	25
5.2 Better serving the private sector-----	26
5.3 Impersonal transaction and personal transaction-----	26
6. Conclusion -----	27
References -----	28
Appendix -----	31

Foreword

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1.Introduction

At 9 am on October 22nd, 2005, the square in front of the Meihu Exhibition Center in Yiwu were crowded with thousands of people both home and abroad, who were gathering to celebrate the grand fair—China Yiwu International Commodities Fair (YWICF) 2005. As a well-known commodities fair in China, Yiwu International Commodities Fair has become a famous festival for exhibitors and purchasers from all over the world to find satisfactory products and business partners. China Yiwu International Commodities Fair has now become much more international, and more and more commodities can be found in the fair. According to the statistics released by Economic & Trade Commission of Zhejiang Province, the China Commodity City Exhibition Center (website of China Fairs) and Yiwu News Net (website of Yiwu News), in 1995, the first year of the annual YWICF, the trade volume was 101million yuan and this year, the five-day trade volume in the fair is 8.098 billion yuan. The number of the enterprises participating in the fair in 1995 was only 179, and this year it reached 1700 in the 70,000 square meter’s exhibition center. Among those

enterprises, there are 18 enterprises are celebrated national brands like and 270 foreign enterprises promoting their latest products. In 1995, there was almost no foreign trade happened during the fair, but this year, 14,269 foreign professional visitors came to attend the fair, which came from 158 countries and regions, and the volume of the foreign trade reaches 661 million dollars, making up 65.3% of the total trade volume. This grand annually celebrated fair is organized by the joint efforts of Ministry of Commerce of People's Republic of China, Zhejiang Province Government and the Yiwu Government. Comparatively, the Yiwu government has a better understanding of the power of the market. Therefore, the government attaches more importance to its role of service but not regard itself as a controller. According to an official of the Yiwu government, the main task of the government is to well manage the public resources.

1.1 The re-emerge of the private economy in China

As we might all know, when we talk about economic activity in China, we cannot avoid the issue of the government's function. Before the economic reforms, the Chinese economy can be described as a government economy, which means that under a strict central planning system, the government plays a role of controlling all the economic activities, but not the actors themselves who participate in the economic activity. Along with the economic reforms being carrying out, the private sector started to become an important part of the economy. After around four years' development under more or less pressure from all the aspects of the society, the private sector encountered its new boom timing in April 1992, when Deng Xiaoping made his southern tour (*nan xun*), and addressed the famous talk, through which he sent an exciting signal to the private sector by saying that to develop is the first principle for contemporary China. According to his theory, both central and local governments started to diminish, step by step, their control in normal economic life, and instead they began to open their minds and take measures to support the development of the private sector, which stimulated the new boom of the private sector in the following decade.

In 1997, September, the Fifteenth Communist Party Congress stated that the private

economy was a very important component of the socialist market economy, which is also stipulated in an amendment to the constitution passed by the National People's Congress in 1999, March, demonstrating that the importance of the private sector has been recognized by the government and since then the private sector would get relatively more protection and more freedom from society and the government (Fu 2004:168). From then on, private enterprises in China, who have made great contribution to China's rapid economic growth, at last no longer be regarded as what Fu called "illegitimate Children"(ibid.), and at the same time it seems that they are, at least nominally, provided with the opportunity to compete with those state-owned enterprises. Among the provinces that have relatively mature private economy in China, Zhejiang Province possesses the first place. According to Asian Development Bank's *Private Sector Assessment--People's Republic of China*, which was published in November 2003, the economic output of the private sector in Zhejiang Province accounts for 95% of the province's total. During the past 10years, the private economy's development rate is 34%(p.4). Taking the weak industrial base and limited natural resources of Zhejiang Province into consideration, one cannot deny that it is miracle that this province has made such outstanding achievements, and that miracle should be attributed to the success of the private sector (ibid.).

Wenzhou is an inevitable issue when we talk about the private economy and the function of the local government in Zhejiang Province because of its rapid economy growth since the 1980s. And in the 1990s, Yiwu, a city used to be a poor rural area just as Wenzhou was, witnesses the explosive economic growth, which is also the result of the joint hands of the local government and the private sector. Therefore, it is interesting to take a look at these two cities in Zhejiang Province, Wenzhou and Yiwu, from the angle that what is the role that the local governments are playing in their way to success, and how the local governments make their efforts to change their function in order to adapt themselves to the new economic environment. Having a comparatively more developed private sector, Wenzhou experienced a lot of difficulties at the first stage of its economic development, and the local government

spares no effort to support the development of the private economy by taking measures to establish a harmonious and favorable economic environment for the private sector. The invaluable experience of the development of the private sector in Wenzhou can be taken as a good example for Yiwu, not only in the way that how the local government can change in order to fit the new situation, but also in the way that how to make the change more efficiently and more successfully.

1.2 Research purpose and questions

The purpose of this research is to generally look at the relations between the local government and the private sector in Wenzhou and Yiwu since the adoption of the reform and opening policy in the late 1970s, focusing on the functional transition of the local government's contribution to the development of the private sector. To investigate the successfully experiences and the lessons taught by experiences during functional transition of the Wenzhou's government in the past decade is of great benefit to Yiwu's government's better role playing in the development of its private sector and enhance the performance of private enterprises in Yiwu. And it is also meaningful to the development of the private sector in Zhejiang Province and even in the whole Yangtze River Delta (or Yangtze Delta Region), which is one of the most prosperous economic regions in China, and in this sense may in turn contribute to the regional economic development.

According to the above-discussed purpose of this study, the questions guiding this research are as follows,

How was the relationship between the local government and the private sector before the adoption of the reform and opening policy in the late 1970s in Wenzhou and Yiwu?

During the decade of reforming and opening, how the economic function of the local government has been changed, the transition and the innovation, and how has it

contributed to the development of the private sector in Wenzhou and Yiwu?

What are the lessons and the successful experiences that the Wenzhou government has obtained from its innovation and functional transition and adaptation, and what can the Yiwu government learn from the lessons and experiences on its way to successful private sector development and economic stimulation?

What are the future tasks for the local government in the aspects of its economic functional transition and helping the development of the private sector in Wenzhou and Yiwu, and does Wenzhou a good model for the future development of Yiwu?

1.3 Method selection and data collection

Wenzhou and Yiwu in Zhejiang Province are the two cities where this research is carried out, and the research is combined with a case study method, which well suits the design of this research that is realistic and informative, and helps finally complete the research (Yin 2004:3). Guided by the theoretical framework discussed in the following section, the cross-case analysis is employed to try to find out the answers to the research questions (Yin 2004:13,57). Qualitative methods are used in the data collection process, during which the empirical data is collected through texts reading on one hand, including documents from the website of government organizations, authentic news agencies, yearbooks and some research papers written by senior researchers, and through research interviews and research observations on the other hand, which is a indispensable way to provide for the research with concrete and understandable information.

The research interviews are designed semi-structured. As Kvale (1996) holds that “the qualitative research interview is semi-structured” (p. 27), the interviews which offer findings to this research follow a sequence of themes concerning the research questions and attach importance to leave more space for both the interviewee and the interviewer to address new ideas and true reflections. During the interview, on one

hand, it is important to make sure that questions should result in useful response of information, but on the other hand it is of no less important to follow the way of the interviewee's thinking. During processing interview information, the interviewee's thought is condensed, interpreted and reflected, though there is no main means of making good analysis and interpretation of interviews (Kvale 1996: 187).

The interviewees consist of entrepreneurs, officials from the local government and organizations. Non-random sampling is conducted in research interviews following the seven stages of an interview investigation (Kvale 1996:88) for lacking access to some enterprises and organization, which, however to some extent, benefits the generating of in-depth questions and the examination of the validity and reliability of the results.

1.4 Reliability and validity

Document interpretations, interviews and observations consist of the important basis for the whole research. Since the "facts" that are drawn from the documents by the way of interpretation may in turn have influence on the pattern of interpretation (Alvesson and Sköldberg 2000: 61), documents selected are compared with other texts written by the same author and also compared with other texts from the same background of culture (Alvesson and Sköldberg 2000: 59). Interviews and observations are carried out strictly in compliance with interview and observation guidance, which is designed under the research theoretical framework, research problem and research questions. As Kvale (1996) holds, it is difficult to get "true, objective transformation from the oral to the written mode" (p. 166), and it is more important to transform the interview into "a literary style facilitates communication of the meaning of the subject's stories to readers"(ibid.). The interviews are transcribed, analyzed accordingly and meanwhile, following the logic of postmodern analysis, it is good to represent the "reality" in different ways and give other people a chance to give voice to their thoughts (Alvesson and Sköldberg 2000: 152).

During the data collection process, it was a pity that I didn't get chance to go to Wenzhou, stay there for a couple of days, and obtain some first hand material, which might offer a vivid image of Wenzhou today. Fortunately, there are numerous second hand material on Wenzhou, and details on the development of its private sector and local government's interaction with private sector. On the contrary, comparing to Wenzhou, it was more difficult to get second hand material on the development of Yiwu's private sector and the role that Yiwu's government played in the process of its economic take-off. To make up, I went to Yiwu and got chance to do interview, observation and other data collection, and finally completed the task of data collection.

1.5 Deposition

The above section of introduction has discussed the background of this research, the research purpose and related research questions, method selection and data collection. In the following paragraphs, chapter 2 discusses the theories and the important concepts, which serve as both the starting point and the basis of this research. Chapter 3 answers research questions about the developmental process of Wenzhou's private sector, and chapter 4 is about the issue of Yiwu's development model of private economy. Chapter 5 discusses the issue of sustainable institutional innovation and suggestions to better develop Yiwu's private sector with the functional transition of Yiwu's government. The differences between Wenzhou and Yiwu way of development in private sector are concluded in chapter 6, and the suggestions for its future development are also mention.

2. Theoretical framework and concepts

2.1 Debate on the role of the government

As early as in the 18th century, Adam Smith (1776) in *An Inquiry Into the Nature and Causes of the Wealth of Nation* used in the discussion the metaphor of the "invisible hand", which was not often used in the works but has been a well-known concept in studies of social formations. In the paragraph of discussion on the "invisible hand",

Smith argued (p.343)

By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. (P.343)

Smith in the works, like Ferguson (1767), Mandeville (1714) in their previous works, expressed the emphasis on human nature. They all believe that under a set of appropriate social regulations, the society mechanism itself can prevent the human being from evil activities and the human being is thus guided to benefit others. He held that “the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society”(P.341). By the 1930s, the “invisible hand” theory was in the central in the thoughts of western economists that the resources allocation should be administrated supervised by market competition and the state’s role should be regulate accordingly.

However, the Great Depression spread over the whole world in the early 1930s causes the chaos and disorder of the market and the problem of unemployment. Market failure became a powerful evidence for a stronger role of the “visible hand” , and thus led to the re-investigation on the role of the “invisible hand”. Keynes’s work—*The General Theory of Employment, Interest and Money*—was published in 1936. Keynes argued that a state should play an active and positive role of intervenor and governor in the sense of macro economy. Nevertheless, since stagflation became a normal problem to western countries, it started to be questioned that if it was appropriate to have a government strongly governing the market. According to Buchanan(1986), the the functional frontier of the state and the market should not be defined from an ideal angle. Samuelson (1994), a modern economy needs both market and government, without the support of these two “hands”, it is difficult to avoid market or government

failure and achieve success of a society (P. 34). The government plays an indispensable role in any modern society. Government failure doesn't lead to government desertion, and market failure doesn't lead to the conclusion that market is no use. The key is to understand that during the process of market development, market failure results in imperfect market because of the problems that rise from the market economy mechanism itself, and government can therefore play a positive role in providing remedies by cooperate with the "invisible hand".

2.2 Local government's domination in economic reforms in China

China has taken gradual reforms towards a market economy, which is witnessed as a miracle success, though it has encountered its ups and downs. The dual-track system, on one hand, serves the purpose of the development of a better off market, and on the other hand, does not make the government bureaucrats worse off as assumed (Zhang and Yi, 1997). During the reforms, local government has always played a very important role. It is fair to say that China's reform in general is a combination of the top down process and bottom up process. And some of the reforms have been started by the lower level government or even by the grass roots. Take a look at the performance of both the central government and the local government during the reform process, and the local government seems to be more creative and straightforward than the leading government. And there are facts showing that the ingredient of planning in China's economy is partly diminished by local governments. It turns out that it is a good strategy to use local governments to counteract comparatively conservative central government. (Ibid.)

Zhang and Li (1998) in *Cross-regional Competition and Privatization in China* discussed the issue on the role that local governments playing in the privatization process, and they argue that the local governments promote privatization under their motives of competing with each other, and therefore cross-regional competition results in the wide spread ongoing process of privatization. They hold that decentralization brings about the cross-region competition, and the regional

competition in turn triggers privatization. According to Zhang and Li, privatization has replaced decentralization as the trend of China's economic reforms, and local governments are the major pushing force in the nowadays privatization process (Zhang and Li, 1998). Zhang, Weiyang, Shaomin Li and Shuhe Li (2000) in *The Road to Capitalism: Competition and Institutional Change in China* investigate the relationship between China's regional competition and privatization of state-owned enterprises (SOEs) and collective-owned enterprises (COEs), and the development of truly open private sector.

2.3 Redefining the economic function of the local government

With the development of market economy, new problems and questions are coming up. Local governments are needed to solve the problem that market cannot work out by itself and enhance the efficiency of market resource allocation, and more developed a market economy is, more efficient a government is required.

The situation of ongoing economic transition in China require that governments' work should differ from what is suitable to some developed countries. According to Wu (2005), there are some key points in the aspect of functional transition of local government from the perspective of fostering and protecting the efficiency of the market. Firstly, local governments should play a limited role in government administration. They must realize that they should not be in the position of controlling over, but become the provider of social service. Secondly, it is essential for local government to use laws and regulations to monitor government activities. In order to fulfill the task of functional transition, local government must abandon rule of human in tradition and strengthen the idea of rule of law. Thirdly, in order to provide the economic development with a good and suitable environment, it is of great importance for local government to pay more attention to the issues of unemployment, income distribution and social order. Well solving of those problems may help to build a society in harmony. Fourthly, the communication between local government and the public should be emphasized in order to better serve the society and people. Fifthly, it

is necessary to reform the administrative approval system and to build a modern system of public service. Local government should do what they can to insure enterprises a market of fair competition and in good order.

Garnaut and Song (2004) discuss in *Correcting Constraints to Private Enterprises Development* the issue of constraints to private enterprises development. They argue that policies and institutions can be the causes of constraints on private sector, and government can help to lift constraints on private sector by efforts of changing in policies and institutions, which include better defining and enforcing property rights, providing better access for private enterprises to bank credit. (p. 225-227)

2.4 Private sector and non-state sector

The main source of China's economic growth at this stage is the development of the private sector, which shows that China is currently undergoing a profound institutional transformation. There are different definitions for private sector.

It is very difficult to quantitatively measure the role of the private sector in the PRC. The current "narrowly defined" method, which is used in official government statistics, is based on the number of employees and ownership structure of an enterprise and does not accurately take into account the role of the private sector in the transitional economy. However, a broader definition may lead to double counting. (the Asian Development Bank 2003:2)

According to the method used in the official statistics, the private sector refers to domestic sole proprietorships (Wang 2004:15) or self-employed (*geti hu*) and private enterprises (*siying qiye*) only (the Asian Development Bank 2003:2). In 1981, the state council issued the File No.108 regulating that the self-employed may employ as many as 7 employees, and the purpose is to absorb the unemployed in the urban area. And the business organization that employs more than 8 employees falls into the category of the private enterprise.

Here we can see that a great number of enterprises that under other forms like

collective, town and village enterprise (TVE) and foreign-funded enterprise are not included in this definition. The collectives, especially the TVEs are the major drives of the development of the private economy in the 1980s. With the carrying out of the economic reforms, especially agricultural reforms and market liberalization, and the government policy framework building, new private enterprises not only emerged from the collectives and TVEs but also transformed from the SOEs (Song 2004:31). It is estimated that 50-75% of urban collectives and the rural TVEs are private enterprises, although they have a cover of collective ownership. Since they have closer connections with the local government, they have better access to the land and finance (ADB 2003, 2). These business organizations are not included in the narrow definition of private sector. In order to better understand the contribution made by these firms, here the definition of non-state sector should be introduced. From its name, non-state sector refers to all enterprises that are not SOEs. According to Wang (2004),

The non-state sector comprises domestic sole proprietorships (*getihu*) and private enterprises (*siying qiye*), collectives, shareholding companies, foreign enterprises solely or jointly owned by Hong Kong, Macao and Taiwan investors. (Wang 2004: 15)

Tian (2004)'s study on the effect of privatization in China shows that

The openly private sector and the collective sector, where there is much hidden private ownership, have both improved productivity and output in China, but the contribution of the private sector has been significantly greater. (p.69)

Tian also argues that it is necessary for the Chinese government to promote the development of private sector in order to improve and maintain the outstanding economic performance (ibid.). The truly open private sector and those enterprises that fall into the category of non-state sector but contribute to the development of the private economy are discussed in the following discussion.

2.5 The local government's functional transition

In recent years, the world has witnessed the changes that the political and economic environment where China's private sector had its development, although there are still uncertainties and unpredictable conditions. Going through the main national reforms--agriculture, industry and opening-up process—Zhejiang has been a major beneficiary, partly because of the authorities of Zhejiang Province's responses to the central reform agenda. It seemed that the governments lagged behind in the process of the agriculture reform led by the central government at purpose, hesitated to carry out the industry reform in the urban area, and carefully dealt with relations with the outside world (Foster 1998:146). According to Foster, at the national level, Zhejiang Province has less pressure and fewer constraints than anywhere else in China, and it “has supplemented its general thrust with policy initiatives of its own”(ibid.). In Wenzhou at first stage of its development, it was quite clear that the local government did not play a role of director but more or less let the market grow by its own development mechanism.

Since it is hard to break out from the traditional relations between the government and the market, it is an important but tough mission for both the local government and the private sector to go further on the way of functional transition of the local government in order to loosen the government control over the market. Through taking measures on changing policies and taking the initiative in institutional innovations, the local government can relief some of the pressures on the entrepreneurial activity (Garnaut and Song 2004:225).

3. From “underground” to “overground”: “Wenzhou Model” and relationship between local government and private sector in Wenzhou

3.1 Expansion of “underground” private sector in Wenzhou by the adoption of reform and opening policy

3.1.1 Isolation from other cities in Zhejiang Province and the sparkle of institutional innovation

Wenzhou city, located in southeast of Zhejiang Province has its total land area of

11,784 square kilometers and total marine area of around 11,000 square kilometers (“China Wenzhou” governmental gateway newsroom 2004), and has a total population of 7,461,900 by the end of 2004, and a population of 1,371,400 in its urban area (ibid.). There are 3 districts, 2 cities, 6 counties, 30 street communities, 119 towns and 143 villages (ibid.). Wenzhou city is of mountainous terrain, and in its territory, there are mountains of Donggong, Kuocang, Yandan, etc. Wenzhou City was “considered a strategically vulnerable frontline (*qianxian*) against Nationalist forces in Taiwan” (Parris 1993: 244), and therefore received little investment from the central government comparing to some other cities. From 1949 to 1981, Wenzhou city received 655 million *yuan* (ibid.) in total amount of state investment; however, Ningbo—another city that is comparable to Wenzhou city in its quick step of economic development—received 2.8 billion (ibid.).

Wenzhou’s mountainous terrain, dense population, the insufficient of land, shortage of investment from central government and not satisfactory transportation situation resulted in slow economic development of Wenzhou city by the adoption of reform and opening policy, and made it reasonable for those traditional handicrafts to become a necessary supplement to its agriculture economy, examples include its well-known shoe making (Parris 1993: 243). The above-mentioned constraints of resources has forced the Wenzhou people find another way to make a living. Depending on the condition of having its excellent natural port, the Wenzhou people spared no effort in doing foreign trade. And along with the development of Wenzhou’s commerce and handicrafts, the spirits of utility, moral and venture came into being step by step and meanwhile, laid a profound cultural foundation for Wenzhou’s expansion of private sector.

Yongjia County, a county in Wenzhou, boasts China’s first experiment activity on the household contract system in agriculture in 1956, which is a good example showing Wenzhou people’s strong will of efforts in reform practice and institutional innovation in the frame of strict planning system. Since then, is seemed difficult to control over

the migration of numerous peddlers without license, “underground” factories established by peasants, informal financing and other illegal economic activities in Wenzhou. Ironically, the sparkle of market economy in this area, which was regarded as disaster in building up a socialist country, became trigger of expansion of private sector, which is now believed to be a necessary supplement of the socialist market economy.

3.1.2 Local cadres’ protection attitude towards the expansion of “underground” private sector

Comparing to higher level of government, local government usually ’s support is of great importance in local economic development, The wenzhou government’s efficient and right functioning is one of the key reasons for Wenzhou’s rapid and successful economic development. Since the foundation of People’s Republic of China, Wenzhou, as a place where “capitalism” is wide spread, was always under strict control by its superior government. In that circumstance, Wenzhou’s local cadres, however, taking the risk of being replaced by their superior leaders, played a role of supporting people in Wenzhou to steadily practice their innovation and creation step by step.

It seemed natural for the local government to support Wenzhou people’s wish to improve their lives, but in fact it was very difficult for the local government to protect the local expansion of private sector. For the sake of less intervening in private economy, the local government encountered with frequent replacement. Nevertheless, the good result was that local cadres protection attitude brought about better solving the problem of resource allocation, for example absorbing more surplus labours and improving industry structure. The impetus behind the local cadres’ protection attitude towards the expansion of “underground” private sector was the lesson that important for the local cadres to adopt a positive and down-to-earth attitude in practice. In Taoism, doing nothing that is against nature (*wuwei erzhi*) is one of the profound theories, which argues that a leader should not intervene too much in steps of

implementing measures and a leader should not control over people's production activities. Only by doing so can people live steady lives and the leader get better result by less effort. Wenzhou's government's attitude towards private sector seemed to fall in well with Taoism, and laid a solid basis for Wenzhou's prosperous private economy after the adoption of reform and opening policy.

3.2 Institutional innovation and functional transition of Wenzhou's government under the "Wenzhou model"

3.2.1 "Wu wei erzhi": economic institutional innovation by local initiatives

Many researchers have discussed the Wenzhou model. Although there are debates on the role of Wenzhou's government in the latter stage of its economic development, in the initial stage of Wenzhou's private economy following the Wenzhou model, the local government's acquiescence is regarded as an important factor. According to Rong (2004), the success of the Wenzhou model should thank to "the Wenzhou residents' indomitable spirit and strong desire to start a business and become rich" (P.12). Acquiescence of the local government does not mean that the local government did nothing in the economic development and private sector's expansion; on the contrary, that reflected the local government's attitude at that time was "doing nothing that is against nature" (*wuwei erzhi*), which means doing nothing that was against the nature of the rule of economic development.

In the late 1970s, namely the initial stage of the adoption of reform and opening policy, the state owned and collectives economy was not sufficient in provide for people with satisfactory lives, and therefore, policies came out to encourage the individual (*ge ti*) economy. In the early 1980s, the household contract responsibility system was pervasive in China, and all kinds of household industrial and commercial activities turned out to be "overground" from "underground" under the names of some new economic institutional innovations, one of which was the operation form of *guahu*. Parris (1993) described the *guahu* in *Local Initiative and National Reform: The Wenzhou Model of Development* as follows,

Guahu firms attached themselves to an established collective or state unit, paying a fee for the use of its name, stationery, letters of introduction and, most important, bank account numbers and receipt books, as well as taxes paid on its income. (P. 245)

This widely spread form was an alternative for private enterprises to dodge constraints on them. The other wide spread one was the form of “red hat” (*hongmaozi*), and “red hat” enterprises “registered as collectives with the neighborhood committee or village office as their responsible administrative department” (Parris 1993:246), and according to the principle of mutual benefit, a management fee was paid to the departments.

The small household industrial and commercial enterprises were pervasive in Wenzhou in 1980s. Depending on their previous stimulation from selling handicrafts and the traditional craftsmanship, they produced small commodities that required low technology and were on demand in the market. They usually used the material that was leftover to the SOEs to produce small commodities, and these small commodities were overlooked by the SOEs (Rong 2004: 11). Due to those favourable conditions, the small household industrial and commercial enterprises came out at that time one by one as quick as thought. Along with the formation of family industry, specialized markets came into being. In Wenzhou, there have been at least 10 well-known specialized small commodities markets in the late 1980s, since the establishment of the first specialized small commodities market in Yongjia—the button market at Qiaotou Town, which started to operate in August 1979. Under the protection of Wenzhou government, these small or medium-sized enterprises “learned in imitation, developed in innovation, and improved technological spread and invention” (Rong 2004: 12).

Wenzhou government’s support to family industry and the *geti* and their innovation like *guahu* operation, not only protected the normal and smooth development of private economy, lowered the cost of trading, but also made more income of the

collectives and SOEs. And in 1987, Wenzhou government issued the interim provision for Wenzhou *guahu* operation and administration, which formally regulated rights and obligations to both parties participating *guahu* operation, and therefore provided better protection for both parties. In the 1980s, Wenzhou's government respected the grassroots innovations and creations, attached importance to them and supported their implementation. Wenzhou government, characterized as “*wuwei*”, regarded win-win strategy as guidance in its practice. In order to encourage Wenzhou people's spirit of innovation and creation, Wenzhou government took measures to protect private property rights and maintain normal market order, and attached great importance to create a favourable social and economic environment for the development of private sector. The rapid economic development and the outstanding economic performance of Wenzhou has noticed by the central government, and to some extent had impact on its change of attitude to private sector. Therefore, in 1987, Wenzhou was listed as one of the 14 pilot areas by the state council, reflecting the spirit of being practical and realistic in China's way of economic development.

3.2.2 The functional transition of Wenzhou's government since the middle of 1980s

The earlier success of the “Wenzhou” model was partly contributed by Wenzhou government's attitude of acquiescence support towards private sector. “Governing by doing nothing” was the governing principal of Wenzhou's government in the early stage of the adoption of reform and opening (Rong 2004:15). In fact, Wenzhou's government did do something in order to protect the development of local private sector, evidences included policies of tax reduction and exemption, and even to some extent, kept silent on the issues of tax evasion and dodging (Rong 2004:16).

In the process of enterprise expansion, some enterprises transferred into individually owned enterprises, some more chose to transfer into cooperative enterprises, and some others limited liability enterprises. In order to ensure their normal development, Wenzhou government issued documents to guarantee their legal operation. By doing

so, Wenzhou government successfully fostered the newborn private enterprises under the discriminative system at that time, and created good social and economic environment for their healthy development.

However, since the middle of 1980s, it seemed that the market competition in Wenzhou has fallen into a vicious circle. In order to make a living in the fierce market competition, enterprises were producing lower quality goods with lower costs, which resulted in a bad reputation and a boycott to Wenzhou product. Under that circumstance, Wenzhou government break “silence”, and in 1994, the first local provision on product quality was issued by Wenzhou government on the purpose to offer guidance for quality control of Wenzhou product and to win a good reputation for Wenzhou product, which otherwise might not continue to success in market. Under this provision, a great number of private enterprises jointed efforts to standardize competition activities, strengthen quality administration in order to rebuild the image of Wenzhou product. During this process, chamber of commerce for different industries were founded and played an indispensable role in the healthy development of private sector and Wenzhou’s economy. In that stage of development, Wenzhou government made best use of its functions of guidance and steering. Institutional innovation and functional transition of Wenzhou’s government were the key reasons to the further development of Wenzhou’s economy.

3.2.3 The service-oriented government: from “doing nothing” to “doing something”

The joint efforts of Wenzhou’s government and private sector have contributed to regain reputation of Wenzhou product. Since 1995, Wenzhou private enterprises have been on their way to upgrade the institutional innovation in order to further enhance their competitive power. Along with the evolvement of the “Wenzhou” model, it is important and necessary for Wenzhou’s government to adapt to the changes. Only by creating better social and policy environment for Wenzhou’s economy can do better in resource allocation. Therefore, it is necessary for Wenzhou government to change

from governing by doing nothing to governing by doing something it should do, and consider itself as a service-oriented government (Shi 2004). According to Shi (2004), less state investment in Zhejiang province contributed to the economic development under a government with an attitude of governing by doing nothing. As for a service-oriented government, the government must redefine its function in economic activities, and should place itself on the position of serving economic activities but not control over economic activities.

The article—*Constantly improving the ability of developing socialist market economy (buduan tigao jiayu shehui zhuyi shichang jingji de nengli)* (Publicity Department of Wenzhou municipal CPC Committee 2005)—brings forward the reflection on constitution and practice of redefined relationship between the government and the enterprise in Wenzhou. Under the pressure of speeding up trend of economic globalization, Wenzhou absorbs lessons from modernization practice of developed countries. In the past, some entrepreneurs with comparatively lower education were lacking in knowledge and strategy on the development of modern industrialization, and therefore, it was necessary for government to play the role of guidance and steering in order to bring the enterprises on the whole up to a higher level.

Respecting the function of the market, Wenzhou government does its best to become “limited government” (*youxian zhengfu*) and “efficient government” (*youxiao zhengfu*), and has successfully transferred from “doing nothing” to “doing something”. Meanwhile, development strategies are taken to achieve the development of Wenzhou’s economy and society on the whole. Functional transition of Wenzhou government includes reform on administrative licensing system and diminishing the power of administrative licensing system, redefining the role of the service function of government, and making government truly serve the public. The purpose of functional transition of Wenzhou government is to build a service-oriented government of credit and incorruptness under rule of law. Wenzhou’s government has created a good social and political environment for private sector, and private sector

of Wenzhou has grown step by step in this stable environment. And entrepreneurs in Wenzhou regard Wenzhou government as their information source and service institution.

4. A “*youwei*” government: Yiwu follows the “Wenzhou” model, enough or not?

4.1 Yiwu: “barter brown sugar for chicken feather”

Yiwu, located in the middle of Zhejiang province, covers an area of 1,105 square kilometers, and it has six towns and seven street communities. Yiwu has a total population of over 1.6 million including a native population of 680,000, a temporary population of 750,000 and a floating population of 20,000. More than 6,000 foreign businessmen registered as permanent residents, and they are from almost 100 countries and areas. (Website of Yiwu China 2004)

Not like Wenzhou, Yiwu was not a place that had some sensitive issue catching the eye of society and the central government by the adoption of reform and opening policy. It is worthy to mention the culture basis for the development of Yiwu’s markets. Before the late 1970s, Yiwu was known for its commercial tradition of “bartering brown sugar for chicken feather” (*qiaotang huan jima*). Since chicken feather can be used as fertilizer, there were peasants who carried on shoulder two baskets with a bamboo pole and bartered brown sugar or other small commodities for chicken feather. And the tradition of “bartering brown sugar for chicken feather” is regarded as the origin of Yiwu’s small commodities market that later is well-known all over the country. Though “bartering brown sugar for chicken feather” seems to be a simple activity of swap nowadays, it was believed to be speculative activity by the adoption of reform and opening policy, and it shows that Yiwu government strictly controlled the commercial activities. Not until the beginning of the 1980s was “bartering brown sugar for chicken feather” permitted by the local Commerce and Industry Bureau.

Yiwu people own their success to the influence from contemporary culture of

Zhejiang Businessman (*xiandai zheshang wenhua*) and the tradition of “bartering brown sugar for chicken feather”. Hundreds of years of bartering activities helped Yiwu to lay a compound basis of its commercial culture for its later rapid development after the adoption of reform of opening policy. Thanks to its commercial culture and diligent people, Yiwu could respond quickly to the reforms and therefore formed the model of development with its characters.

4.2 The “Yiwu” model—a copy of the “Wenzhou” model?

The successful experience of development has been included in the previous paragraphs of discussion on the “Wenzhou” model. Lots of researches have been done on the “Wenzhou” model, and more or less, Yiwu’s experience of development is overlooked by people. Is there difference between the two development paths? Does Yiwu follow the Wenzhou’s way of develop private sector? Does the Yiwu government contribute to Yiwu’s development of private sector? What contributions Yiwu government has done to facilitate the development of Yiwu’s economy? Answers will be given in this section.

4.2.1 A “*youwei*” government

It is true that at the first stage of economic development, Yiwu benefited from Wenzhou’s experience of helping to establish markets, but Yiwu’s government did not simply copy Wenzhou’s model of developing private sector. It was wise for Yiwu’s government copy the “Wenzhou” model considering Yiwu’s own situation. That is to say to adjust the “Wenzhou” model to Yiwu’s conditions, but not learn by rote. Comparing to Wenzhou government’s “*wuwei*” at the first stage of development, Yiwu’s government played the role of guidance and steering at the very beginning. Just because Yiwu’s government has Wenzhou’s development experience as reference, Yiwu’s government learned how to play the role of guidance and steering in the development of the private sector.

The year of 1984 is special to Yiwu people, because it was in that year Yiwu

government made the decision of opening up the Yiwu small commodities markets to the outside world, and these small commodities markets were established by peasants who have limited market knowledge in the beginning stage of the adoption of reform and opening policy. It was essential for Yiwu people of that time to have leaders who had the spirit of being practical and realistic. Under the constraints of strict planning system, the Yiwu government of that time put forward the decision of “four permissions”—permission to peasants’ commercial activities; permission to the urban rural market; permission to long-distance trading; permission to multi-channel competition (Pan 2002). From then on, the career of Yiwu’s small commodities markets started to take off. Yiwu’s government attached importance to the requests from the private sector, and guided and encouraged Yiwu people to take part in market economic activities. Without the support from Yiwu’s government, Yiwu people could not overcome the obstacles in the beginning phase of private economic development. Comparing to the “Wenzhou” model, Yiwu’s way of development has the mark of governmental guidance and steering at the very beginning.

4.2.2 A “limited” government

Since the adoption of reform and opening policy, Yiwu government has been playing a role of guidance and steering while the “invisible hand” has been the key power in the resource allocation. Yiwu government is not only responsible for market regulation and order maintaining but also keep an eye on the adaptation of market development strategy at the appropriate timing. Therefore, it can be said that the constant upgrading of Yiwu’s markets is based on the joint efforts of the “invisible hand” and policy guidance. Yiwu government put forward the developmental strategy of “*xingshang jianshi*”(commerce-oriented development strategy) (Meng, Jiang 2004) channeled resources to commercial and trade industry, which in turn contributed to the rapid growth of Yiwu’s private sector.

At its first developmental phase, Wenzhou’s private enterprises emphasized more on manufacturing, since it had a better of basis of manufacture industry as discussed in

the previous section. However, different from the “Wenzhou” model, the core of the “Yiwu” model in the beginning stage of reform, the development way of Yiwu’s private enterprises, was commerce and trading. Businessman and product are the backbones of the so-called “Yiwu” model. In the 1990s, there was a market tide spreading over the whole country. At that time, Yiwu government put forward a developmental strategy of “linking commerce and trading with industry” (*gongmao liandong*) on the basis of the former strategy of “commerce-oriented development” in order to boost up the local industries. Through years of carrying out strategy, in Yiwu, dominant industries include garment, toy, accessory, art and stationery. The development of manufacturing offers strong support to the local markets.

Yiwu small commodities markets have its downs and ups in the 1990s. In the late 1990s, with more and more markets established in other cities in China, Yiwu’s private enterprises encountered their winter. However, Yiwu people themselves found their way out. More and more Yiwu enterprises turn to international market for better profit. Again, Yiwu government did its best to support people’s innovation. In 2002, Yiwu’s government brought forward the blueprint of “China Yiwu International Trade City”(Meng and Jiang 2004), which accelerates the transition from giving priority to domestic trade to pay equal attention to both domestic trade and international trade. A good example is the China Small Commodities Exposition held annually by Yiwu. Since 1995, Yiwu has witnessed the 10th China Small Commodities Exposition. And it is worth to mention that from the year of 2002, the exposition was upgraded and co-organized by Ministry of Commerce of China and Yiwu government. The China Small Commodities Exposition serves as a window showing Yiwu today to the outside world. Yiwu government set it as the goal for Yiwu’s economic development to make Yiwu an international center of distribution and logistics. As a slogan put forward by Yiwu government, to build the largest supermarket in the world perfectly directs Yiwu’s private sector a promising future.

4.2.3 A service-oriented government

In order to ensure the long-term rapid development of Yiwu's economy, Yiwu government spares no efforts to establish a set of administration and service system. To tone in better with evolvement of the "Yiwu" model, Yiwu government does its best to create a favourable social and policy environment in which private enterprises enjoy more profit. Take market administration and service as example, Yiwu government attaches importance to market developmental planning and market administrative policy adjusting by its efforts of macro-control, and urges the departments of commerce and industry, tax and quality inspection to offer better service to enterprises. As soon as a set of administration and service system is established, government departments quit playing the role of hosting the game and let more enterprises take part in organizing the game.

5. Sustainable institutional innovation and development of private sector with functional transition of local government

5.1 efforts in institutional innovation

Zhang (2004), in his paper *Wenzhou model: Does it match its fame? (wenzhou moshi: shengming zhixia, qishi nanfu?)*, argues that since 10 years ago, Wenzhou has slowed down its step of institutional innovation, which was the key reason for Wenzhou's outstanding achievements in private economy and is an essential determinant of Wenzhou's future economic development. If there is no effort to be made in constant institutional innovation, the future of "Wenzhou" model might be worrying and become a headache of Wenzhou people. His analysis suggests that the slowing down has connection with Wenzhou government's self-satisfactory on the reform achievements. It seems that the local officials, maybe unconsciously, are not willing to take risks in reforming, since their contribution has resulted in outstanding achievements of private economic development in Wenzhou. However, without the spirit of innovation and reform, Wenzhou's economic development cannot go any further.

Not simply copying the "Wenzhou" model, Yiwu's private sector has its own

characters and way of development. However, it is similar to Wenzhou's situation that the spirit of institutional innovation was playing a very important role in Yiwu's private economic development. According to the lesson drawn from the Wenzhou case, Yiwu's government should bear it in mind to continue on its way of institutional innovation, no matter how satisfying the achievements would be. Though Yiwu government has reason to take pride in what they have done when taking a retrospect, it is necessary for Yiwu government to continue to practice reforms and innovations, and keep on striving on the way to another success.

5.2 Better serving the private sector

Nowadays, it is a trend for Wenzhou enterprises to move out of Wenzhou due to scarcity of inexpensive land and labour. There are more labour-intensive enterprises than technology-intensive enterprises in Wenzhou. However, because of scarcity of land and labour, Wenzhou's private enterprises have to move out of Wenzhou to find cheaper land and labour, and their moving out might lead to slowing down of Wenzhou's economic development.

Yiwu's current success is, to a great extent, due to institutional innovation and government's role of guidance and steering. Yiwu's government should continue to attach great importance to better serve its private sector by constantly keeping an eye on market order and improving developmental environment of market. Apart from guarantee inexpensive land, the government should also further build up credit market, share information with enterprises and crack down on fake product and unfair competition.

5.3 Impersonal transaction and personal transaction

It is discussed in the previous sections that the "Wenzhou" model is characterized with the development of its private sector. Shi (2004) brought forward the phenomenon that, as one of the 14 coastal open cities, Wenzhou attracts less foreign investment than others. And it is also worthy of observing that lots of Wenzhou

businessmen go out of Wenzhou and invest outside Wenzhou. Professor Shi analyzed the phenomenon with the theory of personal and impersonal transaction. In his opinion, the way of personal transaction did contribute to the development of Wenzhou's private economy at the first stage of the adoption of reform and opening policy, because at the beginning phase of economic transition, personal transaction could guarantee a comparatively smoother deal between the two parties. However, along with the formation of personal transaction, trading parties tend to be fixed. Therefore, the quick expansion and market large-scale migration resulted in flowing out investment.

According to Shi, personal transaction way of doing business is one of the obstacles to Wenzhou's further economic development, though it had great contribution to Wenzhou's outstanding economic achievements. Following the "Wenzhou" model, Yiwu's businessmen used to follow the way of personal transaction. However, with the development of Yiwu's private economy, Yiwu businessmen start to care little on whom they make deals with. The expansion of market does not rely on migration, since market expands much quicker under the system of impersonal transaction.

6. Conclusion

Although Yiwu's development of private sector seems to be similar to Wenzhou's, it has its unique characteristics. Yiwu, having a global-market-oriented economy, has already going out of the "Wenzhou" model. However, it is not to say that the "Wenzhou" model is no use to Yiwu any longer. On the contrary, lessons have been drawn from the "Wenzhou" model and served the development of Yiwu's private economy. Yiwu benefited from having Wenzhou's experience as reference, and its success is partly the result of the adjustment to local conditions. Therefore, Yiwu's experience of development can in turn be taken as reference by other cities.

Apart from emphasis on institutional innovation and better defining governmental function, there is another issue that I would have a discussion on—E-business. Yiwu's

impersonal transaction way of doing business seems to be an obstacle for Yiwu's enterprises to Yiwu's "going global". Most Yiwu businessmen would rather sit and relax waiting for customers than go out to look for customers due to cost and their traditional way of doing business. It is one solution to the problem that Yiwu government offers information of customers, and ensures the market well known by customers who are looking for cheap and good products. Examples include further upgrading "China Yiwu International Commodities Fair", making the fair a real professional one, and attracting more exposition participants from both home and abroad. It is very important to build up a good image and reputation for the fair and further introduce the fair to the outside world.

Another solution is E-business. If Yiwu's private enterprises can work hand in hand with the Internet, it is certain that Yiwu's enterprises will thus become much more competitive in the international market. Although E-business has been pervasive in western countries for years, it is a modern way of marketing for Yiwu's enterprises. However, in some new markets in Yiwu's, there has been Internet access installed in every stall. Therefore, it is predictable that in the near future, Yiwu's private economy will stay growing with the pervasive adoption of the Internet technology.

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Appendix

Semi-Structured Interview Guide

Interview themes:

The development of private sector in Yiwu;

The policies favourable to private enterprises;
The efficiency of policies;
What new policies are expected be carried out;
How those policies will affect the development of private sector in Yiwu;
Confidence in influencing the government's decision.

Interview questions:

Are you Yiwunese?

Do you live in Yiwu?

Can you say something about the private sector before the adoption of reform and opening policy?

Do you think that Yiwu's government contributed to the development of private sector?

Can you say more about it?

What do you think of the current economic environment?

Are you satisfied with the current government policies to private enterprises? Why?

In which way do you think that government policies towards economic development nowadays have helped the private enterprises?

Do you feel that you get benefits from those policies?

Can you recall any benefit that you have ever got thanks to the policies of the local government?

What kinds of policies are they and how they influence your daily life?

What policies that you think the government should have made to help economics but the government has not paid attention to?

How those policies do you think can help your business?

Do you think the government can hear your voice? How?

For what percentage do you believe the government may take the policies into practice if the government officials hear your voice?

Do you think that Yiwu has large potential to develop and its economy has large space to expand? Why?

How much do you know about E-business? Have you ever had a deal through the

Internet? How?