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# INSTITUTIONAL CHANGE AS CULTURAL CHANGE. AN ILLUSTRATION BY CHINESE POSTSOCIALIST TRANSFORMATION

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**Abstract:** Culture of a society reflects its social values. So, through Chinese experience, we want to show that institutional change is not only an economic or a political process but fundamentally a cultural one. It is therefore based on a change in values and mentalities. Like in a chemical reaction, we discern initial conditions, factors which triggered the reaction, catalysts and elements of synthesis. Chinese institutional change per se derived from a cultural shock induced by the Chinese economic, political and cultural opening which acts as trigger. The remain paper deals with the other elements of the process.

**Keywords:** China; institutional change; culture; causality

**JEL Classification:** B41-P21-P51-Z1

## INTRODUCTION<sup>[1]</sup>

A new field of research emerged with the fall of the Berlin wall and the collapse of socialist economies: the study of postsocialist transformation. However, the first socialist country which left socialism was not USSR or German Democratic Republic, but China. By the end of the 1970's, the Chinese Communist Party (CCP) put the country on the road of reforms. Results were impressive in the sense that it results in a change of economic system. The Chinese case is a very good subject for the institutional analysis. Indeed, a consensus is taking shape on institutions which leads the researchers in social sciences to wonder about their emergence and above all the way they change. And the process of transition is also a kind of institutional change. In this perspective, how can we explain such a change while Chinese reforms were gradual? Our opinion is that cultural change plays a great part in the process. So through the example of China, this article attempts to show that institutional change is not only a political, an economic, or a social phenomenon, but is a cultural one too. More particularly, we illustrate the role played by culture in its genesis. So Chinese experience can be seen as an illustration of a cultural change which induced an institutional change. Culture is often neglected and underestimated by economists. In particular, although it may play a major part in the formation of preferences, neoclassical theory does not refer to it. Here, we argue that a study of institutional change can be significantly improved if it includes cultural factors. We do not claim that Chinese postsocialist transformation is only the result of a cultural change. Of course, other factors play a part in the process. But their influence should not lead us to forget the cultural factors.

This article prioritizes a theoretical outlook on the issue of change. Of course, China is not missing but we focus on a theoretical outline to explain change. So, in order to better understand the process of change, we suggest first, by giving an overview of Chinese economic reforms. Then, we highlight its nature. The last section finally describes the causes of postsocialist transformation.

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## 1. AN OVERVIEW OF CHINESE ECONOMIC REFORMS

Reforms were launched in 1978 with the third plenum of the eleventh Central Committee of the CCP as part of the program called "Socialism with Chinese characteristics" [<sup>1</sup>]. They consist essentially of policy reforms with limited political changes. Nevertheless, we disagree with the expression used by Barry Naughton (1999) about this program: the "dual-track strategy". On the contrary, we think that earliest reforms were not the result of a strategy, but a response to some pressing problems. So, since Chinese economy was a predominantly agrarian economy, it began in the agriculture with the household responsibility system and the familial contracts. They consist of contracts between families and the authorities. Agriculture is thus liberalized although land is not privatized. Farm families work a piece of land under contracts. Peasants were allowed to sell surplus of crops from at price market from 1982 onwards.

The early reform were characterized by a dual-track approach, mainly (but not only) in prices with both market prices for some goods and plan prices for others. By this way, agents began to learn market behavior. In the industry, like for the peasants, state-owned enterprises were allowed to sell above-plan output at market prices. The role of the state in the resource allocation therefore decreased (compulsory plan disappears in 1992-93). As for property rights, during the period of reform, we assist at a kind of "privatization from below" (Kornai, 2000), i.e. emergence of new entities. Furthermore, with the "open door policy", China opened trade with the outside world.

Finally, the pace of reforms and transformations is quickening since the beginning of the 1990's. China clearly moves away from socialism and is progressively becoming a genuine capitalist economy.

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<sup>1</sup> This section does not deal extensively with reforms in China. It gives only an "overview" or a "survey" of them. For a more detailed account of the logic of Chinese reforms, see for instance Naughton (1999). Although some reforms have been launched since the publication of this book, it remains a good introduction to Chinese reforms and their logic.

## 2. INSTITUTIONAL CHANGE AS CULTURAL CHANGE: THE NATURE OF CHANGE

By "institutional change", we refer to a change in rules (formal or/and informal) or in their enforcement mechanisms [<sup>1</sup>]. In China, this change takes the form of a postsocialist transition. Although some reforms were implemented very quickly, like the family contracts in the agriculture, by and large, this process was quite gradual [<sup>2</sup>]. A key-element to understand the Chinese experience is the ideology of the Party. The CCP has undoubtedly changed from the inside. It promotes now capitalism and foster accumulation of wealth. Here lies the cultural change: in the shift of values. It is what we try to show in this section.

### CCP's embourgeoisement

Institutional change results from the willingness of the entrepreneurs (political or economic) in a position to make policies, to change institutions to their advantage and according to their beliefs (North, 2005). In China, in a first time, these entrepreneurs were the political entrepreneurs of the CCP who initiated the process with a political goal. Indeed, at the political level, Deng's strategy was a strategy of "Playing two hands hard": a political hand and an economic hand (Qian & Wu, 2005). On the one hand, Party must do everything in its power to continue of running China. On the other hand, it must foster the economic growth. CCP uses economy as a way to stay at the helm of China. With reforms, ideology became secondary like a tool in the hand of the Party. So since the end of the 1970's, CCP entails a realization of the necessity of pragmatism. Before reforms, during the Maoist era, we can say that leaders of China were "purists". They attached excessive importance to ideology. It is not the case anymore since CCP sets itself economic growth and its maintain in power as objectives. Development appears nowadays more important than ideology. The ways of

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<sup>1</sup> Since few years, the concept of institution is used at considerable length by the economists. Although it may be difficult to suggest a generic definition, we refer here to the one given by Douglass North: "*Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conducts) and formal rules (constitutions, laws, and property rights)*" (North, 1991: 97). We can add the mechanisms of enforcement of those formal and informal rules. With a sports metaphor, we can say that in the institutional game, organizations are the players and the institutions the rules of the game.

<sup>2</sup> The issue of gradualism vs. shock therapy appeared in the beginning of the 1990's when USSR and the countries of East-Europe choose to shift to capitalism. What could be the right speed to go about it? Shock therapy refers to move from socialism to capitalism in only a wave of reforms. Conversely, gradualism supposed a more progressive implementation of them and can be illustrated by the Chinese experience. For a more detailed view on the issues of gradualism and shock therapy, see Roland (2000).

achieving those goals do not much matter. Ideology can be adjusted if necessary like in March 2007 when a law which protects private ownership was adopted.

As a result, the word "socialism" is given a new definition in post-Mao China. Nowadays, in China, socialism is not a question of property or resource allocation mechanism. It has therefore nothing to do with ownership of means of production (which may be seen as Marxian/Marxist definition) or with welfare state (social-democrat definition). Deng's definition of socialism is completely different: it refers to getting rich together! As Qian & Wu (2005) said, he likes saying "letting some people get rich first, and gradually all the people should get rich together". So Deng accepted a rise in inequalities because it leads up to a widespread enrichment. This view of "socialism" is actually a capitalist view! It is illustrated by the Kuznets' curve. In a diagram curve like an inverted U with inequality on the Y axis and economic development, time or *per capita* income on the X axis, Kuznets asserts that in a first time, development and inequalities grow together. But in a second time, inequalities begin to decrease (Kuznets, 1955). This change of perspective is a genuine cultural revolution (the "Second Cultural Revolution") after the first one which was initiated by Mao. And it is the reason why we assert that the Chinese process is a cultural process.

### **A cultural change**

What do we mean by culture? The economists and other social scientists use this concept with often a lot of meanings. Owing to this confusion on its sense, studies which rely on it are often discredited. We choose to use the definition given by North: "*the culture of a society is the cumulative structure of rules and norms (and beliefs) that we inherit from the past, that shape our present and influence our future*" (North, 2005: 6). This definition is very useful because it does not comprehend culture as a photograph or a picture: fossilized and inert. On the contrary, it is dynamic and not static. In addition, this definition insists on the beliefs (like for instance ideologies) which are foundations of it. So, we can roughly understand culture as

"perceptions" [<sup>1</sup>]. Moreover, culture is the most important parameter that we must take into account when we want to study institutional change [<sup>2</sup>].

Why do we stress culture? Olson (1965) showed that the existence of common interests does not necessarily lead to collective action due to the problem of the "free rider". The free rider enjoys the benefits of the collective action, even if he does not take part in it. It is particularly true in the large groups, less in the small. A solution to what is sometimes called the Olson's paradox is the one given by Douglass North (1981): the ideology. If the agents subscribe to a common ideology, common interests lead to collective action. Furthermore, neoclassical economics does not fit to understand change. For this task, North (1990, 2005) develops a theoretical framework based on institutions. In North (2005), he interprets institutional change as a cultural change including a change in the ideology. North (2005) describes the process of institutional change as the following sequence: beliefs→institutions→policies→altered perceived reality and on and on. In other words, the key element in this process is the beliefs of the agents. They determine the institutional matrix [<sup>3</sup>] which ascertains the incentive structure of an economy (for this last point, see also North, 1990). Institutional change is therefore caused by a change in beliefs.

Taking culture seriously changes significantly our perspective and our comprehension of the phenomenon of institutional change. The link between culture and polity is quite obvious in democracies since governments are dismissed by elections. Nevertheless, even considering socialism which often established itself through revolution, we consider that the most important element is the cultural one because it is the element which ensured the cohesion of the whole system. Indeed, if we observe capitalism and socialism, we can say that those two systems rest on two types of culture: individualist culture for the first and on a collectivist for the second. In other words, we do not insist on socialism as a system where the Communist Party run a country alone, but like a system which was cemented by a collectivist culture.

During Maoist era, China was characterized by a collectivist culture with a Maoist ideology. The theoretical counterpart of the collectivist culture is the Marxist theory with a

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1 Since culture is related with beliefs and perceptions, we must have in mind that there is a link between culture and cognitive phenomena. It can be found through limited rationality (Simon, 1945) and the "sensory order" (Hayek, 1952a). According to Hayek, our perception is a reconstruction of stimuli through a classification made by our senses, the so-called sensory order. So our perception of reality is always and precisely representation. As for limited rationality, it relates back to the idea that cognitive capacities of the agent are limited. So he cannot (and he has no intention of doing this) maximize his utility function. He prefers to reach a "satisfying" level of utility.

2 We should make clear that the concept of culture does not merge with the concept of institution. More precisely, our opinion is that institutions are "soaked" in culture. From this perspective, the institutional matrix of a society only reflects its prevailing perceptions.

<sup>3</sup> The sum of all institutions.

thinking in terms of classes. At the individual level, reality is analyzed through Marxism which acts like a cultural filter. And the Marxist ideology, as revisited by Mao, is the link between the cultural and the political block. Maoism acts as an ideological bedrock to the government action and is pervasive in all (or at least in most of them) Chinese institutions. Postsocialist transformation is consequently a cultural transformation in the sense that the political power which defines the rules had become more and more individualistic or at least less and less collectivist. This cultural change results in an abandonment of Marxism. Even if it ever officially mentioned, Maoism seems to become a hypothetical reference point both to the individual and the political levels.

By "individualist" and "collectivist", we refer to the (relative) cultural homogeneity of human groups which can be explained by some sociocultural elements. Those two kinds of culture are pointed out by Greif (1994) in his comparative historical analysis of the relations between culture and institutional structure. In the explanation of the success of Genoa in Mediterranean trade during the eleventh and twelfth centuries, he compares the Maghribis (Jews who live within the Muslim World) and the Genoese traders who subscribe to a more collectivist culture. If we reformulate the issue of his paper, we can say that it deals with this question: what kind of culture can also be compatible with market exchange? Greif draws the conclusion that the more the sphere of exchanges spread to a larger area and tends to become impersonal, the more the limitations of the social organizations based on individualist culture became evident. According to him, it is the reason why Genoese traders gained the upper hand on the Maghribis. So individualist culture is the kind of culture which is the more compatible with market [<sup>1</sup>].

Pejovich (2003) gives a similar argument when he argues that transition in Central and Eastern Europe is a cultural process rather than a technical one [<sup>2</sup>]. His article deals with the necessary congruence between formal and informal rules to reduce transaction costs of transition. According to him, capitalism is characterized by formal rules like *"credible and stable private property rights, the freedom of contracts, an independent judiciary, and the constitution"* (Pejovich, 2003: 349). But the outcome of those institutions depends on the culture of the country. As said by Pejovich : *"The basic institutions of capitalism require a*

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<sup>1</sup> Admittedly, this distinction is simplistic and we are aware of this. Complex societies are not homogeneous and are characterized by a mix of collectivist and individualist culture. However, in the study of postsocialist transformation, even if they are reductionist, these concepts make it easier to understand the process of change. Furthermore, it is not the point to take a stand on the issue of the best cultural model or to speak highly of one model by denigrating the other. Here, we only want to show that institutional change is caused by (and results in) a cultural change.

<sup>2</sup> Here it should be note that he restricts culture to the informal rules.

*culture that encourages individuals to pursue their private ends (...) The culture of capitalism or the free-market, private-property economy (...) encourages the behavior based on self-interest, self-determination, self-responsibility and free market competition. The culture of capitalism is merit-oriented, rewards performance, encourages risk taking, and promotes entrepreneurship. The free-market, private-property economy is then not merely an alternative method for the allocation of resources but a way of life in which each and every individual bears the value consequences of his or her decisions" (Pejovich, 2003: 350). So formal rules are not enough: they must be supported by ideology, culture or informal rules. Gradualism therefore ensures the Chinese to come round to these values through a cultural change.*

### **3. CULTURAL CHANGE AS CHEMICAL CHANGE: THE CAUSES OF CHANGE**

#### **The issue of causality**

We compare the Chinese process to a chemical reaction. This comparison has also the advantage of referring to a peculiar conception of causality. There are indeed few phenomena that can be explained by only a cause. But how did all the causes interact? Following John Stuart Mill (1851), we can discern "additive" from "chemical" interaction (of causes). In the first case, the causality is mechanical or additive like in the physical processes. It is called the "Composition of Causes" because the *"joint effect of several causes is identical with the sum of their separate effects"* (Mill, 1851 [1996]: 371). Schlicht (1998) illustrates this idea with the demand of umbrellas which is influenced by prices and climate. In this case, by the assumption *ceteris paribus*, it is relatively easy to isolate the price-effect from the climate-effect. But causes often interact to produce an outcome whose form cannot be deduced from them. For instance, if we consider the water that is associated with the molecule H<sub>2</sub>O, we cannot separate it in two hydrogen atoms and an oxygen atom. This example is given by Mill: *"The chemical combination of two substances produces (...) a third substance with properties different from those of either of the two substances, or of both of them taken together. Not a trace of the properties of hydrogen or of oxygen is observable in those of their compound, water"* (Mill, 1851 [1996]: 371). Similarly, when we study economic and social phenomena,

there are often very complex consequences of main causes [<sup>1</sup>]. And like water, they cannot either be break down into their two or more causes [<sup>2</sup>].

### **“Cultural shock” and catalysts of the Chinese institutional change**

As we use the metaphor of chemical change, we have to discern initial conditions, factors which triggered the reaction, catalysts and elements of synthesis. By initial conditions, we mean the maoist socio-economic system. The elements of synthesis are the new institutions of the post-maoist economic system. The question now is to define what triggered the process and the catalysts.

According to us, the Chinese postsocialist transformation was really triggered by what we call a “cultural shock”. By "cultural shock", we do not refer to a kind of "clash of civilizations" as theorized by Elmandjra (1991) and Huntington (1996). According to them, since the end of the cold war, international relations are characterized by a "clash" between civilizations, that is to say a confrontational encounter between the different cultures. Yet it is not in this sense that we use this expression. Here, cultural shock refers essentially to a realization, a reappraisal of the perceptions (individual and collective) and certainties due to external stimuli. In the case of China, the cultural shock is brought about the economic opening of the country after some decades of closure. It results in a reorganization of the elements of the system.

As for the catalysts, they belong to Chinese memory. *"A catalyst is a substance that speeds up or slows down a chemical reaction without being consumed. Typically, a catalyst acts by lowering the activation energy for that reaction"* (Kostiner, 1992: 109). Here, we can also isolate some catalysts. They are from two types: internal and external. In a way, there are all linked with the Chinese memory.

The two internal catalysts are the Great Leap forward (1956-1958) and the Cultural Revolution (1966-1976). In a context of ideological tension between China and USSR, the first is a way of surpassing the old ally. It is ratified by the second session of the ninth congress of CCP. Great Leap forward aims at rushing development and to catch up capitalist countries the most quickly as possible. A slogan of this period was precisely "To catch up

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<sup>1</sup> The idea of complexity is expanded in Morin (1974).

<sup>2</sup> Yet, it must be stressed that the metaphor of chemical reaction does not be likened to the Hayek's so-called "scientism" (Hayek, 1952b) because it is precisely only a metaphor. We do not claim that economics which is a social science should be analyzed like chemistry which is a "harder" science. The metaphor of chemical change is convenient because it refers to elements which are evanescent like the institutional change which implies economic, social, cultural and political elements.

Great Britain in fifteen years". The Chinese regime relies on its capacity to get the masses to support this plan. The Great Leap forward is also characterized by a willingness to do without the external assistance except for the USSR. But it was only a wishful thinking (objectives settled were unrealistic) and the failure of the Great Leap forward proved it. Starvation appeared in the winter 1958. Because of the bad weather and the fact that agriculture was neglected, more than 30 millions of people died [<sup>1</sup>]. This episode of Chinese history was an important setback for Mao who was dismissed in 1959. So, few years later, in 1966, he decided to launch the Cultural Revolution.

The Cultural Revolution ended with Mao's death in 1976. As an anti-rightist campaign, it attempts to correct the "right-winger" tendencies of the Chinese society and ended by more than 20 millions of deaths. Red guards (young people from 15 to 19) protested against privileges and what they see as the embourgeoisement of the society. The Cultural Revolution should bring back the revolutionary zeal by fighting Soviet "revisionism", using terror and torture. The Chinese lived in constant fear of informers. The children sometimes denounced their parents. Education was abolished. The *Little Red Book*, a collection of quotations from Chairman Mao, was published in 1966 in Chinese and translated afterwards in several languages. It was used to build the personality cult of the chairman Mao. During this period, China descended into chaos.

The external catalyst is the economic revival of countries which belong to the same geographical and in some extent to the same cultural area than China. These countries walked on the western path and their strategy was successful while Chinese economy was drained. It is very important since Chinese nationalism is peculiar. Nationalism and jingoism exist in every country all around the world. This aspect of human identity is overdeveloped in most societies. In this respect, China makes no exception. However, the Chinese one differs from the other kind of nationalism due to desire for revenge after the nineteenth century, "the century of the shame". Chinese civilization is a multi-thousand years old civilization. Between the sixteenth and the eighteenth centuries, it economically held sway over and throughout Asia and even the rest of the world. Current economic performances are therefore only a revival of its past successes. For instance, during the Song dynasty (eleventh and twelfth centuries), China was undoubtedly the most advanced country in the world (see Frank, 1998). In 1750, Chinese manufacturing production accounted for near a third (32,8%) of the world production while the European one was lower than the quarter (23,2%) (see Bairoch, 1997).

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<sup>1</sup> For an extensive discussion on the causes of the famine and the failure of the Great Leap, see Lin & Yang (1998).

Yet, China in the first half of the twentieth century was significantly weakened and was therefore a country in crisis. Maoist Communism was probably a solution to a situation which was seen as a humiliation. And currently, through another way of development, China tries to regain and to carve out a place for itself in the world, in particular in relation to the Asian countries.

## CONCLUSION

To explain the process of institutional change is very difficult because it is a complex phenomenon. It is true that it remains a mystery about Chinese change. Why China succeed in the way of postsocialism while other countries do not? We cannot (and we should not) reduce the answer to a mono-causal explanation. The aim of this article is not therefore to give such an explanation of the roots of the Chinese postsocialist transformation. We only wanted here to lay stress on the importance of a factor which is often neglected by economists: culture. Through the change of ideology, culture plays a decisive part in the process of change. So, Chinese postsocialist transformation results from the conjunction of several factors: the country's opening which lead to a "cultural shock", Great Leap forward, Cultural Revolution and the revival of most Asian countries which act as internal and external "catalysts". The process described is more cultural than political. In this perspective, political changes are only a sign of cultural changes.

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### Appendix: The Chinese postsocialist transformation

