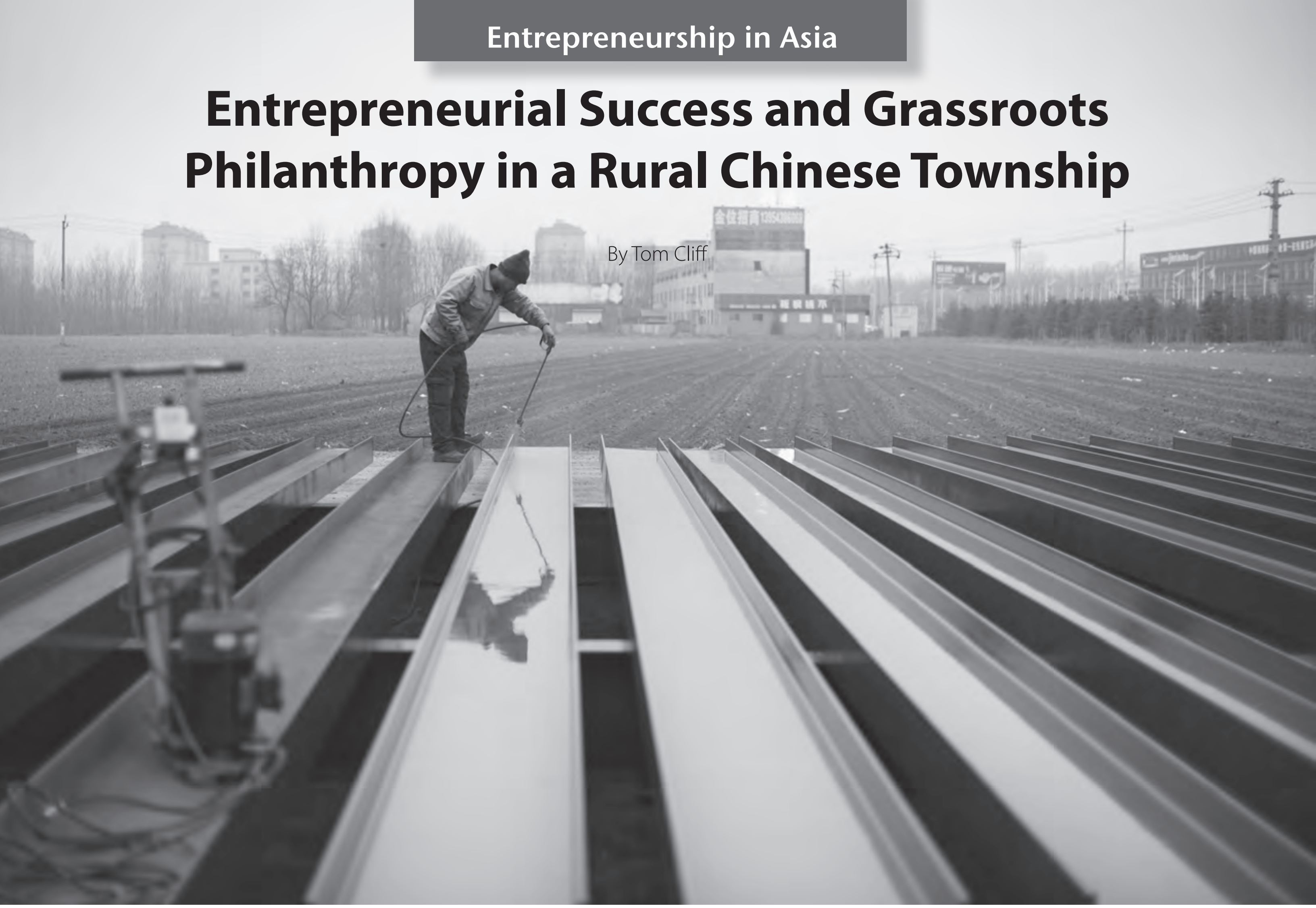
Entrepreneurial Success and Grassroots Philanthropy in a Rural Chinese Township

By Tom Cliff



A worker spray-painting steel girders in Huagang, 2016. All photos in this article are all courtesy of the author.

For five years, I have been traveling once or twice a year to an industrializing township in rural north China that I call Huagang (a pseudonym). Huagang makes a fascinating and revealing case study because it is home to two industrial clusters that have developed in a divergent fashion, leading to distinct social as well as economic consequences. Yet, only forty years ago, there was no significant economic or sociocultural difference between the two sides of the township.

This essay will show how divergent industrial development on two sides of Huagang has affected the sociocultural and economic milieu in these respective areas. Intensive study of one small place can tell us a lot about the society or larger place in which that small place is located. The case study material presented below can be used as the starting point for further exploration of general patterns in industrial history and political economy. More specifically, the text may serve as an introduction to a number of key terms in Chinese studies and economics, which are in **bold type** and included in a sidebar on page 37.

I follow a structure that puts students and teachers in the position of a field researcher. The essay begins by sketching the socioeconomic *outcomes* of Huagang's industrial divergence (*what* can we see/find, now?), then explores the *processes* and *causes* that led to these outcomes (*how* and *why* did they come about?).

Outcomes: What Can We See/Find in One Township with Two Industrial Clusters?

Huagang is considered a very successful township. It is the main economic driver of the entire county, and was studied in the 1990s and early 2000s as a model of industrial development by Chinese academics, policymakers, and operational cadres from the municipal, provincial, and central levels. Each of the two major industries—household furniture and sheet steel—in just this one township of 50,000 people accounts for between 25 percent and 50 percent of the total national trade in their respective commodities (in China, a country of 1.4 billion people).[1] The downside of unfettered industrial development is that, like most of the surrounding townships, Huagang is heavily polluted. Nobody drinks the water. But, unlike its neighbors, Huagang is also a locus of informal social policy innovation: since 2012, the township has witnessed a proliferation of village-level nonstate welfare funds. By "nonstate welfare funds," I mean profit-earning, public benefit organizations that are financed and managed by groups of people who are not government officials—in these cases, factory owners of a given village contribute the bulk of the fund principal and sit on the governing committee, and beneficiaries are limited to people from that village.

Industry-Specific Social Policy Innovation

Nonstate welfare funds set up by all the leading furniture-producing villages—and only them—are among the starkest and most complex of the sociocultural and developmental differences between the two sides of Huagang. Furniture producers also, on occasion, fund **public goods** (e.g., road upgrades) or **club goods** (such as village gates and even small water purification plants) on their side of the township. In contrast, none of the steel-producing villages have set up organized nonstate social supports for the poorest members of their villages. Some large steel bosses have given out gifts like flour, oil, and rice to the poor of their villages at Spring Festival and have evidently contributed to road upgrades and public recreational areas (on their side of the township) in years past. But there is an important difference between these modes of charity: steel bosses' charity was irregular, independent, and one-off, whereas the informal welfare systems on the furniture side are collectively organized profit-making entities that distribute benefits on a regular (monthly, quarterly, or annually) basis.

The innovative models of the furniture producers' nonstate welfare funds, and their complex cultural and economic causes and effects, are the initial reason I chose Huagang as a research area. I called them "face funds" because donations are in part stimulated by donors' desire for respect and recognition (**"face,"** or *mianzi*) among their peers. In all cases, the economic elites (furniture factory owners) of the village initiate the philanthropic fund and are the main donors. Face funds generate profit like **underground banks**: money from donations becomes the fund principal, which the fund lends out to local businesspeople who pay interest (in 2018, about 12 percent per year) on the loan back to the fund.[2] The largest such fund has an additional innovation in that it also allows villagers to make deposits and earn interest at a much better rate than any formal cash investment (about 4 percent per year). In all cases, only the net interest (the fund's profit) is used to pay welfare benefits, so the total principal of the fund (donated monies) can only increase. One village party branch secretary instrumental in setting up one of the very earliest funds proudly described the funds as a "developmental trend" (*fazhan qushi*). Speaking in 2014, the party branch secretary meant that the "model" of financing local welfare through interest-earning informal loans that he and others pioneered in this cluster of small villages could—and would—spread across the township, the county, and eventually other parts of rural China. He has been right so far: since that time, the number of funds has multiplied fivefold; in 2018, officials and official media publicly praised the "new Huagang model." In Huagang, these nonstate welfare funds are primarily aimed at providing cash and in-kind benefits to the village's senior citizens: the largest fund gives out monthly aged pensions of between 200 *renminbi* (sixty-five–seventy years old) and 500 renminbi (ninety-plus years old), in addition to any pension or subsidy provided by the Chinese state. Many of the funds also provide scholarships to village children who matriculate to tertiary education and/or lump sum support to families facing very large medical bills due to a traumatic accident or serious disease.

Processes and Causes: Why the Distinction?

The behavioral differences of steel and furniture elites—people who came from essentially the same cultural and economic background—are due ultimately to the *structures* of their respective industries and to those industries' *prospects* in the current and expected future political and economic environment. The different industrial structures associated with steel and furniture production shape social structures on the respective sides of Huagang. Key among these social structures are the nature and extent of **social stratification**—the relative distribution of wealth, status, and power—in the industrialized villages. Social stratification in turn shapes "**relationship networks**" (*guanxi wang*) between and among economic elites and ordinary villagers. Along with the perceived prospects of the respective industries, these social structures and networks decisively influence elites' investment (or lack of investment) in local social and industrial development. But to understand how these different industrial structures, and thus these different social structures and norms of behavior, came to be, we need to look back at Huagang's recent history.

How Did It Get This Way? A History of Industrial Development in Huagang

Postreform industrial development in Huagang followed a familiar, cyclical pattern. Reading the local situation and the national-level political winds, entrepreneurs begin an activity, such as commodity production or trade, that is not yet formally authorized. Local officials turn a blind eye, for the most part, knowing that they can shut it down any time they please (if the political winds change for the worse), but in the meantime are happy to reap the benefits of a surge in local economic activity. Other entrepreneurs gradually join in the not-yet-authorized activity. Once national-level leaders officially approve of such practices, local authorities declare the activity a good thing, encourage more people to do it, and put out regulations and slogans to keep activity within certain bounds. These bounds are based on their observations of the experimentation that has gone on while they were ostensibly turning a blind eye, as well as any national-level regulations. A period of formalization and rationalization (reduction in the number of enterprises, through attrition and mergers) ensues. The government claims some credit and grants assistance in the form of capital, land, or permissions to operate to selected leading enterprises, confirming them as models for others to emulate. This, in broad strokes, is what went on in Huagang from 1978 until the early 1990s.

The different industrial structures associated with steel and furniture production shape social structures on the respective sides of Huagang.

Before the 1980s, all of Huagang's villages were predominantly agricultural. The conditions of life—including social mores, social structures, and relations of production—in any given village in Huagang were little or no different from that of any other village in the township. The overall economic level of Huagang was slightly lower than most of the surrounding townships, because Huagang is not on any major arterial roads, has less agricultural land per capita, and had no strong collective industry. In 1978, only 2 percent of Huagang's population (about 600 people) was employed in secondary industry.[3] After the Third Plenary Session of the 11th Central Committee of the Communist Party of China (December 18–22, 1978), which marked the beginning of China's Reform and Opening Up, Huagang villagers cautiously began to engage in small-scale commodity production—mainly wickerwork, glue from animal hide, and sheet steel metalworking. There was good cause for caution: even in the early 1980s, one villager who produced and sold pigskin glue for a profit of 1,700 *yuan* was dubbed "a profiteer" and almost got thrown in jail. But aspiring villagers persisted nonetheless: one man made kitchen utensils in his back room while his mother stood guard at the front door; if anybody came, he would put his tools straight in the cellar. Huagang men also became laborers in nearby ports and manufacturing centers. Returning to Huagang with basic skills, connections, and knowledge of supply chains relating to specific industries, they set up their own small workshops. By 1998, 79 percent of Huagang's adult population worked in private industry.

Both of the current major industries in Huagang began with very small-scale ventures. The wicker furniture and basket industry eventually grew into the furniture industry of today, and the metalwork industry (producing stovepipes and braziers from sheet steel) led to the sheet steel market and then production industry. But, while the furniture cluster developed through incremental improvements in product quality and diversity, national-scale trade was central to the development of the steel cluster. Many of the outgoing laborers from what is now the steel side of town had gone to work in nearby ports that imported sheet steel from Japan and Korea. There, they learned that the standardized reams of sheet steel rarely matched the specific requirements of customers inside China. These buyers wanted specific dimensions of sheet steel in specific quantities. Sensing an opportunity, some of the men from Huagang purchased sheet steel in bulk, then brought the raw product to Huagang to resize and repackage in quantities according to customers' orders. Over time, Huagang became known as a market for sheet steel. Capital built up initially by metalworking and then by market trading helped a small number of these early entrepreneurs set up sheet steel production lines locally. State capital also played a part. Huagang's government financed and built a small industrial park on the north (now steel) side of the township in 1992, then

Table 1: **Comparison of Industrial Clusters**

FURNITURE	STEEL
Production center → national market	National market → production center
Little or no state support	Direct and indirect state financial support
Labor-intensive	Capital-intensive
Relatively late, steady capital formation	Relatively early, and faster, capital formation
3,000+ companies	10s of very large companies; max. 150 total
"Scattered vertical integration"	Traditional vertical integration
Fellow (male) villagers are "small bosses"	Fellow villagers are mostly employees

a sheet steel trading and distribution center nearby in 1996. The growing production base boosted the competitiveness and gravity of the steel trading market, and vice versa.

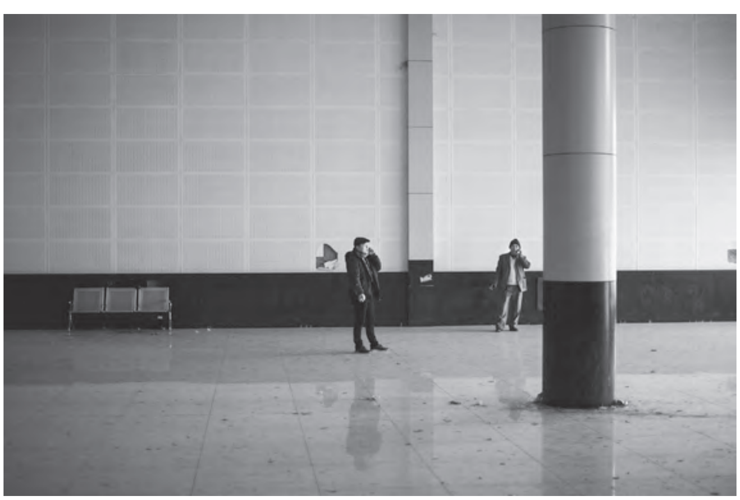
Furniture production in Huagang began as a backyard workshop-based and highly labor-intensive light industry. The first laborers returned to set up produced simple commodities requiring only basic carpentry and welding skills, then sold into a nascent but rapidly developing national market. Guided in part by leading manufacturers based in southern China, Huagang furniture producers developed their skills and expanded the range and technical sophistication of their products. With established market connections through fellow villagers and low capital barriers to entry, more and more small workshops set up. A significant handful of furniture companies have now moved up the value chain, and these bosses constitute the local elite—but still over 90 percent of the 3,000 or so furniture producers in Huagang remain relatively small and low-tech. Sheet steel production is a heavy, capital-intensive industry, with Huagang hosting 150 companies at most. In contrast to the 1990s state support for steelmaking, recent and current (2015–2019) industrial infrastructure construction on Huagang's southwest side is funded by the furniture producers themselves. The table at left compares the key developmental and structural differences between the furniture and sheet steel industries.

The furniture-producing elites' desire for "face" in their village communities acts as a social sanction mechanism, prompting them to want to be seen to do good.

In Huagang, we can observe ideal typical examples of both **Fordist** and **post-Fordist** approaches to industrial production; key attributes of these examples include, respectively, producing goods "just in case" there is demand versus "just-in-time" to meet demand and invariability versus limited variability in product type (Fordist/post-Fordist, see glossary). Despite the disparity in factory numbers, locals estimate that the total industrial output of the two sides of Huagang is roughly similar. The 150 or so steel companies run their production lines twenty-four hours per day, seven days per week, and all make the same limited range of products, while most furniture companies run a flexible production regime that allows them to adjust the product type and quantity of output to order. Furthermore, while the steel producers strive for **vertical integration**, Huagang's furniture producers form an interdependent network that I characterize as "scattered vertical integration." The companies that produce relatively complex furniture purchase accessories and component parts from smaller local companies that typically specialize in business-to-business (B2B) commerce (that is, they do not produce any items for direct sale to consumers).

An industrial village neighboring Huagang, 2015. This village industrialized earlier than Huagang, with two large collectively owned enterprises producing chemicals and paper, respectively.

This network helps give Huagang's furniture industrial cluster a competitive edge. Having suppliers and buyers in close proximity to one another has a number of economic implications. Transportation costs are reduced. Mutual familiarity, if not a close personal relationship, between the respective factory owners facilitates quality control (including returns) and credit arrangements (including end-of-year debt collection). Transactions may even be conducted in cash/off the books, and thus avoid taxation. Last but not least, wholesale furniture or furniture component buyers from other regions are attracted to Huagang because they know that they can get most, if not all, the commodities they seek in one place and at a good price. The steel producers also benefit from being part of an industrial cluster, but these benefits relate primarily to the external world: their collective ability to attract buyers and exert control over a significant proportion of the national market for sheet steel. Among themselves, sheet steel producers are structurally inclined to compete rather than collaborate, because they all make the same range of products, with the same inputs, and conduct a relatively insignificant volume of business-to-business transactions within the cluster.



Huagang sheet steel trading hall after the morning rush, 2016.

Furniture-producing businessmen, who are also nonstate welfare fund managers, and their cars, a Huagang village, 2018.

Outside the party branch committee office, which is also the nonstate welfare fund office, a Huagang village, 2018.

These different industrial structures have a direct influence on social structures, social relations, and social behavior on the respective sides of Huagang. Steel-producing villages are highly stratified. The biggest bosses and their closest family members drive very expensive cars like Maseratis and the latest-model Land Rovers, while the local shop floor managers tend to drive small Chinese-made cars. This is because there are relatively few companies and thus relatively few company owners; only about 1 percent of the villagers are bosses. The big steel bosses do not often meet the workers on the shop floor of their own factories, and many of them live elsewhere. Furniture-producing villages are relatively less stratified because there are many more companies, and the companies are in general a lot smaller. Between 10 percent and 30 percent of the villagers have their own factory, small workshop, or trading business. On the furniture side, compared to the steel side, there is not as much socioeconomic difference between the private enterprise bosses and the ordinary workers or local villagers. As those who have factories sometimes say: “We can all afford to donate to good causes, because we all have factories! Ten thousand or even 30,000 renminbi is not too difficult to get together if your friends ask you.” And in relation to a fund that solicits interest-free deposits rather than donations, the initiator explained: “Ha ha, are we not all people who seek face? Who would pull their money from the fund and have their name drop off the list of donors, while others are still on it? Can you bear to lose such face?” The furniture-producing elites’ desire for “face” in their village communities acts as a social sanction mechanism, prompting them to want to be seen to do good. This mechanism does not operate in the steel-producing villages, because the steel-producing elites do not depend on each other or on local villagers for either their status or their economic survival.

Chinese Studies and Economics: Key Terms

Club Goods: A commodity or service that is “excludable” but “nonrival.” Excludable goods are those for which it is possible to prevent persons outside the “club” from accessing. Nonrival goods are those for which consumption by one member of a society does not (at least in theory) prevent or curtail consumption by another member of society. Note also **public goods** (below) and the related concepts of private goods and common goods. A key source for this is Cornes and Sandler (1996).

“Face” (*mianzi* 面子): Face can be glossed as “respect,” insofar as “giving face” is similar to “paying respect” and “gaining face” is similar to “gaining respect”; like respect, face giving and gaining should be observed by a third party in order to be materialized. A good, detailed introduction to the concept of “face” in China and from a cross-cultural perspective is Kipnis (1995).

Fordist vs. **Post-Fordist**: Fordism is characterized by mass production and mass consumption of a very uniform product, the pinnacle of which tends toward vertical integration. There has been an immense amount of debate over what post-Fordism actually is, or was. A key element of the post-Fordist era is flexible production, under which manufacturers contract out a significant proportion of the processes (or production of individual components) that go toward making the final product. For overview and critique, see David (1990), Amin (1994), and Edgell (2012).

Industrial Clusters: For an easy-to-read introduction to cluster theory and an argument for the competitive advantages of industrial clusters in a globalized economy, see Porter (1998). In the East Asian context, and concerned primarily with industrial development, key authors/works include Sonobe and Otsuka (2006). Both perspectives emphasize the importance of informal interfirm **relationships** that increase trust and thereby reduce transaction costs and improve competitiveness.

Public Goods: A commodity or service that is “nonexcludable” and “nonrival.” Nonexcludable goods are those to which all members of a society have (theoretically) equal access. Roads and bridges may be public goods, as may be information about weather conditions.

“Relationship Networks” (*guanxi wang* 关系网): Every individual in a society is a member of different but often-overlapping networks made up of relationships between individuals. In China, these informal social relationships are known as guanxi and are especially influential on a person’s life chances and social behavior. Guanxi can be predominantly instrumental (I use you, you use me) or predominantly affective (I like you, you like me), but it is almost always both. Foundational works include Fei (1992 [1947]), Yang (1994), and Gold et al. (2002).

Social Stratification: The relative distribution of wealth, status, and power in a given social sphere—which may range from a small unit like a village to a large unit like a country.

Underground Banks: An informal organization that takes deposits and lends money like a bank, but is not registered with the relevant authorities. In the Chinese context, these may be “nonlegal,” which means they are not considered legal but they are an open secret and are for the moment tolerated, or they may be “illegal,” which means that they are considered a potential threat to financial or political stability and try to stay more hidden from the eyes of authority. Key studies on informal finance in China include Tsai (2002) and Hsu and Li (2009).

Vertical Integration (vs. “Scattered Vertical Integration”): Classical vertical integration is where a firm develops or acquires business operations that precede or succeed its original core business. For Huagang sheet steel companies that originally performed zinc plating (galvanizing) on raw sheet steel, this might mean producing the raw sheet steel themselves instead of purchasing it or value-adding by applying colored surfaces to the galvanized sheets. Scattered vertical integration is where many different companies, owned by different people but located in the same industrial cluster, perform various operations in the production chain or make component parts for the final product.

The cyclical loosening and tightening of restrictions on civil and economic activity is a hallmark of Communist Party governance.

The Socio-Structural Dialectic and State Intervention

Strong relationship networks among the village economic elite are a precondition for fund setup because the fund initiators need to get a group of the most respected factory owners of that village to donate to the fund in order to mobilize the rest of the industrialists and ordinary villagers to donate also. In a society underpinned by kin, native place, and now business relationships, the open support of leading village members creates legitimacy for any such proposal. Local informal legitimacy is essential, because 90 percent of these funds are not registered with the local authorities—and thus do not have formal government approval or legal status. Getting people to donate under these conditions relies entirely on interpersonal trust among the members of a very small community that shares a common identity—in this case, a village. Cross-village elite networks among furniture producers exert peer pressure on the elites of neighboring villages to set up funds. As many fund donors like to assert: "If you are not good to the old people of your own village—your own parents—how can you be trusted in business?" Conversely, fund donors' informal but public performance of filial piety (respect for parents and elderly relatives) positively boosts their reputations both within and beyond their natal villages. A good reputation is good for business. In this way, the deployment and reproduction of guanxi and face are integral to the funds' operation.

Another factor is prospects. The sheet steel and furniture producers face similar challenges to the prospects of their respective industries, but to quite different degrees. Economic slowdown within China and globally has impacted the demand for both commodities, but much more heavily in the construction sector that uses sheet steel than in the redistributive and service sectors that purchase relatively low-end furniture. Massive overcapacity in China's steel sector has further driven down the price and prompted the central government to make production cuts a policy priority. Sheet steel production also falls foul of stated government policy priorities because it is highly polluting. This is perhaps the most important and nonnegotiable of the hard realities. With a growing certainty that most of the smaller factories will be closed down sooner rather than later, sheet steel producers are not incentivized to invest in local relationships or industrial infrastructure. In summary, furniture producers' philanthropic behavior is strongly influenced by their immediate socioeconomic environment—"face," status, and particular social networks—but this environment is itself shaped by the national-level political and economic environment, and the actions of the local state.

The example of Huagang affirms that the state is a major factor in Chinese industrial development, but shows that "letting go" may be as consequential as specific interventions. The cyclical loosening and tightening of restrictions on civil and economic activity is a hallmark of Communist Party governance. "Loose" periods serve to encourage and bring forth ideas, innovation, and energy from nongovernment societal actors. Authorities watch from a distance before moving in to pick winners and models, and outlaw new activities, organizations, and institutions that are seen as heading in a direction that may threaten Communist Party power. As well as changes in the overall environment, this cyclical approach is driven by the creative limits of top-down governance and by uncertainty about the effects of intervention. As the successful development of the furniture cluster demonstrates, the consequences of state interventions (or lack of intervention) cannot always be accurately foretold. ■

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Some of the content of this article also appears in Tom Cliff, "Face Funds" (2017), and "Goodwill is Good Business" (forthcoming), but it has been rewritten, condensed, and significantly reorganized to suit pedagogical purposes.

NOTES

1. Industrial and population data in this article are provided by the *Shandong Provincial Conditions Webpage* (*Shandong sheng qing wang*) published by the Shandong Historical Conditions Office (Shandong shi zhi ban) at "http://www.sdsqw.cn," accessed June 7, 2019.
2. Direct quotes and fund/industry data in this article come from interviews conducted by the author in 2018.
3. Data from the *Shandong Provincial Conditions Webpage*, accessed June 7, 2019.

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