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Institutional Change and Regional Development in China: The Case of Commodity Trading Markets

Abstract

This paper explores how institutional changes have influenced the regional development of Yiwu City, East China. The regional development in Yiwu City can be regarded as constituting a specific model in transitional China, which revolves around the establishment, growth and internationalization of local commodity trading market. The success of Yiwu model lies in the interaction between globalization, local institutions and commodity trading markets. However, we argue that the strategic coupling perspective has its limitations in explaining the development trajectory of Yiwu Model. The paper develops an integrated paradigm of regional development located between new regionalism and Global Production Network by synthesizing Scott's (2001) institutional framework. We identify a pronounced and long-established cultural-cognitive element in the entrepreneurial spirit of local people, which led to the establishment of commodity trading market at the beginning of 1980s. However, the sustainable development of Yiwu model needs to be supplemented by normative and regulative institutional pillars. We further argue that the developmental local state remains critical to the regional development in developing countries in terms of correcting market failure, encouraging entrepreneurship and creating a competitive business environment to accommodate globalisation.

Keywords: institutional changes, regional development, cultural-cognitive, normative, regulative, commodity trading markets, global production network

Introduction

In the past three decades, China has undertaken a rapid transformation from a planned economy towards a market-oriented economy (Lin, 1992; Qian, 2000; Naughton, 2007; Wu, 2008). Within little more than a generation, it has emerged as one of the principal manufacturing nations of the world. Explanations for this rapid and dramatic transformation indicate a number of factors. These include the role of Chinese policymakers in creating an incentive system that strongly favours incoming foreign investment directed at the domestic market and discourages imports, labour force growth, and structural change (Naughton, 1996). Another factor is “the creation of (domestic) market competition through the entry of new producers” (Naughton, 1996, p287). Similarly, the adoption of a fiscal contracting policy by the central government in 1980 offered powerful incentives for the local governments to develop Township and Village Enterprises (TVEs). By the mid-1990s, the TVEs had been partially privatized through the creation of joint stock companies in which individuals, households and local governments became shareholders (Mukherjee and Zhang, 2007). During this process of rural industrialisation, many small- and medium-sized enterprises (SMEs) emerged in towns and cities within the coastal regions of South and East China (Zhai, 2005; Wei et al., 2007). In the 1980s and 1990s, within these regions, one may observe the emergence of three distinct paths or models of regional development, the “Pearl River Delta Model” (Guangdong province, South China), the “Sunan Model”(Jiangsu province, East China) and the “Wenzhou Model” (Zhejiang province, East China) (Yang, 2007; Guo and Feng, 2009; Wei, 2010). These three mainstream regional development models have been undergoing restructuring process since 2000.

In this paper, we focus on a specific and increasingly influential variant of the Chinese regional development model involving commodity trading markets, namely the “Yiwu model”. It is a distinct addition to the above three mainstream regional development models and it appears to be a very much more robust variant. We argue that the emergence of this model cannot be adequately analyzed by applying the dominant strategic coupling perspective (Yeung, 2009). Instead we employ institutional theory because it enables us to identify how institutional changes have contributed to the emergence of this particular model of regional development. In particular, we look into the role of commodity trading market in regional development, which has not been fully explored in the previous research.

Commodity trading markets in rural China provide physical marketplaces for the trading of complementary and substitute commodities in large quantities. Retailing activities are marginal to such markets (NBSC et al., 2011). In 2010, the number of commodity trading markets in China reached 4,940 with total trading volume of RMB 7.27 trillion (Table 1).

Table 1 An overview of commodity trading markets in China during 2000-2010

Year	Number of commodity trade market (units)	Number of booths (units)	Area of business (square metres)	Trading volume (RMB trillion)
2000	3,087	2,115,115	82,615,615	1,567
2001	3,273	2,200,662	93,973,140	1.772
2002	3,258	2,190,814	103,131,711	1.984
2003	3,265	2,148,866	109,840,363	2.151
2004	3,365	2,229,818	124,774,690	2.610

2005	3,323	2,248,803	131,408,239	3.002
2006	3,876	2,527,987	180,723,148	3.714
2007	4,121	2,681,630	198,146,314	4.409
2008	4,567	2,839,070	212,252,204	5.246
2009	4,687	2,994,781	232,303,299	5.796
2010	4,940	3,193,365	248,323,113	7.270

Sources: NBSC, MCC and CGCCID (National Bureau of Statistics of China, Ministry of Commerce of China and China General Chamber of Commerce Information Department), 2011, *Statistical Yearbook of China Commodity Exchange Market* (China Statistics Press, Beijing)

We argue that institutional changes have played a critical role in shaping opportunities for actors and in providing normative self-reinforcing support for certain types of behaviour, while discouraging others (Beckert, 2010). It is these changes that underlie the development of the Yiwu model of regional development. By institution we are referring to ‘social structures that have attained a high degree of social resilience’ (Scott, 2001: 48). Specifically the paper has developed a paradigm of regional development that is located between two theoretical perspectives: new regionalism (Cooke and Morgan, 1998; Rodriguez-Pose, 2008) and Global Production Network (Yang, 2007; Yeung, 2009). We do this by synthesizing Scott’s (2001) institutional framework that identifies regulative, normative and cultural-cognitive systems as the three elements that ‘make up a continuum running from legally enforced to the taken for granted’ (Hoffman, 1997, p36). These three elements contribute in independent and mutually reinforcing ways to a powerful social framework embedded within the regional development. This conceptual framework enables us to differentiate between those institutional features that can readily be manipulated by the local government and those that are significantly less amenable to deliberate initiatives. Our in-depth case study of the Yiwu model causes us to argue

that the successful regional development in Yiwu City lies in the interaction between globalization, local institutions and commodity trading markets. The developmental local state remains critical to the regional development in developing countries in terms of correcting market failure, encouraging entrepreneurship and creating a competitive business environment to accommodate globalisation.

The remainder of the paper consists of four sections. Section two reviews the literature on the role of state in institutional change and regional development. The research methods are discussed in section three. Section four analyses the cultural-cognitive, normative and regulative institutional systems of Yiwu model. A comparative analysis of the role of local government in the development of the Yiwu model and the three other mainstream regional development models in China is conducted in section five. The final section comprises conclusions and policy implications.

Previous research

As the most important organization and institutional arrangement in the society, the state plays an important role in stimulating economic growth and regional development (Evans, 1995; Zhou, 2012). Institutional change can take place at different levels including the state, the group and the individual, but the most salient institutional changes are usually organized by the state because it can fulfil the target at a lower cost than civil organizations (North,1990).

There are different typologies of the state in the literature. Evans (1995, p59) identifies four types of state involvement in industrial transformation and economic development, namely custodians, demiurge, midwifery and husbandry. 'It is an autonomy embedded in a concrete set of social ties that bind the state to society and provide institutionalized channels for the continual negotiation and renegotiation of

goals and policies'. Krug and Hendriscske (2008) discuss three types of state in the comparative business systems and regional development literature, namely, the neo-classical state, the developmental state and the corporatist state. Under the neo-classical state, free markets adjust economic activities while the state plays only a passive role in the development process (Barro and Sara-i-Martin, 2003). The developmental state plays a strategic role in taming domestic and international market forces, and harnessing them to national ends (Evans, 1995; Hsu, 2011; Zhang et al., 2011). The corporatist state involves close cooperation between the state and social groups as a means to achieving economic development.

Although China adopted a unitary centralized power system in 1949, since 1979 the central government has gradually delegated some degree of authority to local governments including provinces, prefectures, counties, townships, and villages (Zhang and Wu, 2006). As a consequence, in regard to regional development, China functions like a quasi-federalist state (Jin et al., 1999; Zhou, 2012). Although the major policy initiatives in China are top-down, their implementation are subject to local government adaptations (Blanchard and Shleifer, 2000). Thus, one of the unique features of economic reform in China is the emergence of different local business systems (Krug and Hendriscske, 2008). Furthermore, there are indications that the emergence of local business systems is gaining momentum (Zhang and Wu, 2006; Zhang, 2009). Zhang (2009) conceptualizes regional industry building as a contested process of market building in the study of the development of Internet industry in Beijing City. Market building is not only a knowledge project, but also a political project for the institutionalization of order. It requires initiatives of both economic actors and political actors in intertwined governmental fields and organizational fields. Zhou (2012) indicates that China's transition economy has experimented with

both the local developmental state-directed model and the local liberal state-partner model. According to Zhou, it is the latter that has triggered rapid entrepreneurial growth.

Hence, the local government has come to be regarded as one of the main agents for institutional change and regional development in China (Oi, 1999; Chien, 2007; Krug and Hendrischke, 2008; Nee, 2010; Zhou, 2011). Oi (1999) describes the Chinese cases as 'local state corporatism', which was mainly constituted and coordinated by the local government instead of central authorities. Local state corporatism emerged as local governments moved from simpler and more cadre-centred forms of governance to a mixed model appropriate to a vastly larger industrial economy consisting of both private and collectively owned firms. Chien (2007) explored the relationship between institutional innovations, asymmetric decentralization and local economic development with a case study of Kunshan Economic and Technology Zone in Kunshan City, Jiangsu Province. Locally initiated projects in China were regarded as an evolutionary process consisting of three types of local-central interactions including the state's intention to connive, ex-post state endorsement and ex-ante state adoption. The success of institutional innovations of the local government in China was subject to asymmetric decentralization, in which the central government possesses more powers and resources to impose their influences over the local government (Huang, 1996). The dominant perspective in regional development studies has been the strategic coupling perspective. Strategic coupling in global production networks means 'the dynamic processes through which actors in region coordinate, mediate, and arbitrage strategic interests between local actors and their counterparts in the global economy' (Yeung, 2009, p332). It takes place when there is the emergence of transnational communities, changes in industrial

organizations and initiatives by states and institutions. The strategic coupling perspective emphasizes the role of business firms (global lead firms and their strategic partners) and state institutions in globalizing regional development while ignoring specific regional assets. Employing a case study of the development of information-technology industry in Suzhou municipality of China, Wang and Lee (2007) studied the interaction between local institution building and strategic coupling in global production networks. They argue that the local government played an important part in transforming local institutions to meet the needs of multinational corporations. It was the investors from Taiwan who mediated and transplanted related institutions into the region to satisfy the demand of global logistics for speed and flexibility.

It would, therefore, appear that due to the huge regional disparities, the perspective of strategic coupling in global production networks cannot fully explain the diverse trajectories of regional development in China. Therefore, Wei (2010) proposes an alternative paradigm of regional development integrating global forces, state institutions and local assets by scaling down the global and scaling up regional indigenous capacities on the basis of Kunshan model. However, Wei failed to specify the specific regional assets and the means by which regional indigenous capacities can be developed to meet globalization.

The paper develops the integrated paradigm of regional development by synthesizing Scott's (2001) institutional pillars to study how institutional change affects regional development on the basis of developing and internationalizing the commodity trading market in rural China. Scott et al. (2002:170-174) suggested "the use of institutional logics, actors and governance structures to examine institutional structures and processes in organizational fields. Institutional logics refer to belief systems and associated practices that are operative in a field. They combine both

culture-cognitive and normative elements. Institutional actors, both individual and collective, create, embody and enact the logics of the field. Governance structures operate at the level of field or in the wider environment (e.g., nation-state structures), affecting the field's structure and activities. Such structures typically combine normative and regulative elements”.

In particular, we examine the commodity trading market, which has not been fully explored in the previous research as a special organization field in the regional development of China. Commodity trading markets constitute one of important assets in the regional development of some provinces or cities in China. In addition, the literature on the regional development of China focused more on the local state institutions (Zhang and Wu, 2006; Chien, 2007; Wei, 2009), ignoring normative and cultural-cognitive institutions. The paper investigates how the interaction between regulative, normative and cultural-cognitive institutional pillars has led to the regional development in Yiwu City.

Research methods

The paper adopts a case study approach to explore how institutional changes have influenced regional development in rural China under deepening globalization. According to Yin (2009, p.18), a case study research “is an empirical enquiry that investigates a contemporary phenomenon in depth and within its real life context, especially when the boundaries between phenomenon and context are clearly evident”. Yiwu Model is a distinct regional development model in rural China relying on the constant expansion and internationalization of local commodity trading market.

Yiwu is a county-level city located in the central part of Zhejiang province, East China (Figure 1). It was awarded a city status in 1988. Yiwu City covers an area of

1,105 square kilometres with 6 designated towns, 7 streets, 718 village committees and 91 residents committees. By the end of 2009, it had a census registered population of 730,183 and a registered mobile population of 1.3205 million (YYEC, 2011). It used to be a small county with scarce natural resources and a very limited industrial base before China's adoption of open-door policy in 1978. However, it has grown from an agricultural county to a modern commercial city in the past three decades. As Table 2 shows, the GDP per capita in the city reached RMB 83,539 (about USD 12,341) in 2010 (NBSY, 2011). A significant factor in this rapid growth has been the formation and development of Yiwu Commodity Trading Market, which is now the world's largest commodity trading market (YYEC, 2011). During the course of its development, it moved to six locations and undertook twelve major expansions. At the end of 2011, the physical size of the commodity trading market in the city amounted to four million square metres comprising a total of 65,000 trading booths (Table 3). The average daily number of buyers and visitors reached around 200,000. About 13,000 foreign businessmen were resident in the city to undertake procurement. In all, there were 3,008 representative offices of overseas companies established in the city (Feng and Wang, 2011).

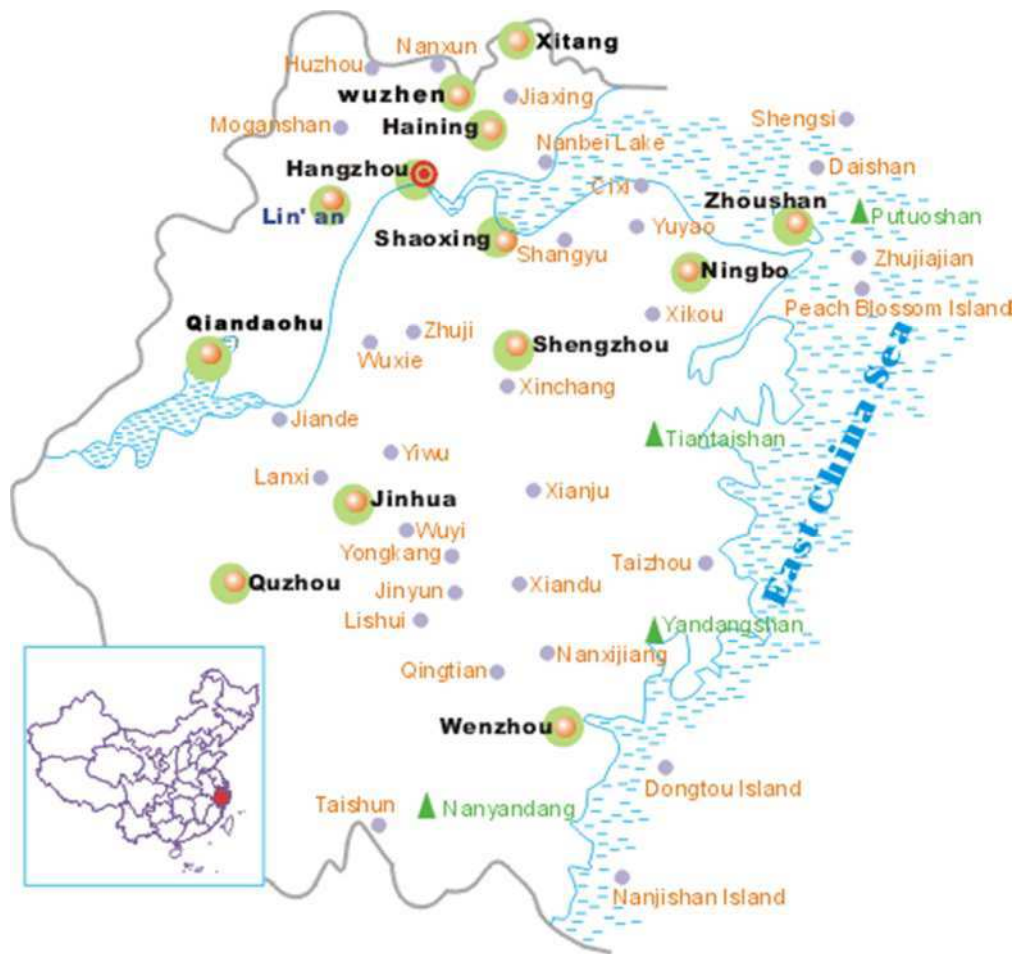


Figure 1 The location of Yiwu City in Zhejiang Province, the People's Republic of China
 Source: <http://www.zj.gov.cn/zjforeign/english/node493/node499/index.html>

Table 2 The growth of GDP per capita in Yiwu City (1998- 2010)

Year	GDP per capita (RMB)	Growth rate
1998	15,386	3.9%
1999	15,986	12.3%
2000	17,945	10.8%
2001	20,292	11.9%
2002	23,148	14.1%
2003	27,783	20%
2004	40,988	17.3%
2005	43,100	15.1%
2006	50,148	15%
2007	59,144	15.7%

2008	68,508	10.7%
2009	71,457	7.5%
2010	83,539	10.3%

Source: NBSY, 2011 *The statistical bulletin of national economy and social development in Yiwu from 1998 to 2011* National Bureau of Statistics of Yiwu, <http://www.ywnews.cn/content/20110417/ywnews111404.htm>

Table 3 The number of booths and annual turnover of Yiwu Commodity Trading Market (1982 – 2011)

Year	Number of booths	Turnover (RMB 100 million)
1982	200	0.04
1983	1,050	0.14
1984	1,870	0.23
1985	2,847	0.62
1986	5,500	1.00
1987	5,600	1.54
1988	6,131	2.65
1989	8,400	3.90
1990	8,900	6.06
1991	8,900	10.25
1992	16,000	20.54
1993	16,000	45.15
1994	24,600	102.12
1995	34,000	152.00
1996	34,000	184.68
1997	34,000	145.11
1998	34,000	153.40
1999	34,000	175.30
2000	34,500	192.89
2001	34,500	211.97
2002	42,000	229.98
2003	42,000	248.30
2004	50,000	266.87
2005	56,000	288.48
2006	58,000	315.03
2007	58,000	348.37
2008	58,000	381.81
2009	62,000	411.59
2010	65,000	456.06

2011	65,000	515.12
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Sources: ①Lu L, Bai X, Wang Z, 2003 *Market in Yiwu: From Candy Gang to International Trade* (Zhejiang People's Press, Hangzhou); ②NBSY, 1978-2010 *Yiwu Statistics Yearbook 1978-2009* (National Bureau of Statistics of Yiwu, Yiwu); ③ Fang Q, Huang Z 2011, "The turnover of China Commodities City exceeded RMB 4.5 billion in 2010" ,http://yc.ywnews.cn/content/201101/10/mtyw_36585.htm. ④ CCC Group, 2012, "The turnover of China Commodities City exceeded RMB 5 billion", <http://www.cccgroup.com.cn/getContext.asp?id=727>

Huberman and Miles (2002, p.12) indicate that selecting “appropriate population controls extraneous variation and helps to define the limits for generalizing the findings”. The primary source of data comprises a series of thirty semi-structured interviews with key informants conducted between July 2008 and January 2012. Each interview lasted for about one hour. The anonymity of interviewees was maintained. The key informants were ten SME owners, fifteen booth-keepers, two senior managers from Zhejiang Yiwu China Commodities City Group Co., Ltd (Yiwu China Commodities City) and three local government officials from the Administration of Industry and Commerce (AIC), Market and Trade Development Bureau, Overseas Chinese and Foreign Affairs Office of Yiwu Municipal Government. Among the interviewees, twenty-two were male while eight were female. Their ages ranged from twenty to sixty. The ten sample SMEs were purposely chosen as the leading firms in the local industrial clusters of Yiwu City while fifteen booth-keepers were randomly interviewed at various locations of Yiwu Commodity Trading Market. The interview questions with SME owners and booth-keepers included their scope of business, entrepreneurship and venture creation, the internationalization of business through the commodity trading market, participation in the local industrial associations, and their viewpoints on local governance and sustainable development of Yiwu Commodity Trading Market. The senior managers of Yiwu China Commodities City and the local government officials were interviewed on the history, operation, management and internationalization of Yiwu Commodity Trading Market, the formation and

governance of industrial associations, the regulations and policies adopted to stimulate the development of commodity trading market, the SME promotion policies and the challenges for sustainable development of commodity trading market. In order to facilitate the data analysis, the interviews were recorded and transcribed. The transcription was sent back to the interviewees to validate the interview data. Then the data was categorized following the three institutional pillars, the growth and internationalization of commodity trading market and regional development. The quotes we have employed in the article are typical quotes from the four groups of informants.

One potential weakness of our approach is that given we have asked our respondents to reflect on past events, there is a danger of ex-post rationalizations. To counter this, we have made active use of secondary data in order to validate the statements from our respondents. These data include *Yiwu Statistics Yearbook* for the years from 1990 to 2010, the official documents published by Yiwu Municipal Government and the coverage by the official media reports from 1982 to 2011 on the institutional change and regional development in Yiwu City. Finally, having grown up in the region, the Chinese author had extensive personal knowledge of developments in Yiwu City over many years, which he was able to draw on during the interviews.

Institutional Pillars in the Evolution of “Yiwu Model”

In this section we analyse the institutional changes Yiwu city has undergone during the past three decades. In particular we examine the interaction among the cultural-cognitive, normative and regulative pillars of institutions under Scott’s (2001) framework and the role these institutional pillars have played in the establishment,

growth and internationalisation of commodity trading market, thereby leading to the regional development of Yiwu City.

The cultural-cognitive pillar

One historic feature of Yiwu City is a culture of bartering and in particular the tradition of “exchanging of chicken feathers with candy”. At the beginning of the 17th century, limited land holdings and scarce natural endowments led farmers in rural Yiwu to engage in itinerant bartering with neighbouring regions. They exchanged candy with chicken feathers, which were used for making handicrafts or compost. By 1736, there were some 10,000 farmer-peddlers in Yiwu region, who were popularly referred to as the “Candy Gang”. This loose-grouping of farmer-peddlers had evolved into a large-scale rural commercial organization in the region that traded in a variety of daily necessities such as needles, thread, and towels (Zhou, 2009).

After the founding of the People’s Republic of China in 1949, the size of the “Candy Gang” in Yiwu County decreased dramatically because the state-owned commercial enterprises and trading cooperatives controlled commodity circulation all over the country. However, in the 1950s, a small number of former “Candy Gang” members were tolerated travelling around collecting chicken feathers and other second-hand articles through cooperation with local state-owned trading cooperatives (Zhou, 2009). The commercial activities of peddlers were completely prohibited during the Cultural Revolution from 1966 to 1976.

Economic policy was gradually liberalised when China started economic reform in 1978. Farmers were allowed to undertake some small business activities with temporary licenses issued by Yiwu Municipal Government. some former members of the ‘candy gang’ went to the big cities to purchase small commodities such as toys,

buttons and socks for their barter trade in rural areas. They usually sold the surplus commodities at the local periodic commodity markets (Zhang, 1993). Then in 1979, some peddlers started to set up fixed stalls in the main street of Choucheng Town in Yiwu county, selling toys, needles, threads, feather dusters, scrubbing brushes and so on. The high demand for booths led Yiwu Municipal Government to establish the first-generation Huqingmeng Small Commodity Trading Market at Choucheng Town in 1982. Most of the booth keepers were former 'candy gang' members. The first-generation market comprised some 200 formal stalls with business permits and 600 peddlers with or without temporary business permits. Normally about 3,000 people participated in the business transactions of the commodity trading market, reaching 5,000 around the annual spring festival. As the commodity trading market quickly developed, there was a continuing strong demand for business stalls from the rural farmers. As a result, Yiwu Municipal Government expanded the market three times between 1982 and 1989, increasing the number of business stalls to 8,400 (YCN, 2008).

"I was born in Dianxia village with four sisters and brothers. My village is about one hour's ride from the City. Because my families were poor, I followed my father to Jiangxi province to exchange chicken feathers with candy after quitting junior high school. I started to sell toys with my family at the wholesale market in the mid-1980s. Since I tasted the bitterness in my childhood, I behave honestly and unyieldingly. I believe that I can make money with the strategy of small profits but quick turnover."

The above interview quotation from the owner of one of local medium-sized socks companies indicates that the tradition of "exchanging chicken feathers with candy" is deep-rooted. The entrepreneurial mentality of local Yiwu people is an essential, "taken-for-granted" (Scott, 2001) component of the local mind-set. Even

now the trading mentality is still prevalent in the rural areas, as indicated by the following remarks made by one of the local government officials in the interview.

“The people in Yiwu City are enthusiastic about creating new ventures with painstaking efforts. They are good at grasping new business opportunities. It seems that they are never satisfied with what they have achieved. Their insatiable hunger for establishing new business is the prime mover of sustainable economic development in the region”.

Therefore, we argue that this latent cultural-cognitive institutional pillar is one of significant factors in explaining both the birth and rapid growth of the commodity trading market in Yiwu city. The entrepreneurial mentality embedded in the local culture has not only preceded policy changes of the local government but also precipitated the policy initiatives that resulted in the establishment of the first-generation of commodity trading market. However, as we will now argue, normative developments underpinned by regulative changes have also been of significance for encouraging entrepreneurship and making Yiwu Commodity Trading Market stay ahead of other commodity trading markets in China.

The normative pillar

One of the important normative initiatives underlying the Yiwu model is the formation and development of industrial associations to establish industrial standards and self-discipline, strengthen inter-firm collaboration and promote effective communication between industrial firms and the local government.

Currently there are twenty-two industrial associations, among which twenty are directly related to the main industries of Yiwu Commodity Trading Market and two are business service industrial associations including Internet Entrepreneurs

Association and Automobile Distribution Industrial Association (YMTDB, 2011). The industrial associations in Yiwu City have contributed to the establishment and adjustment of industrial transaction districts within commodity trading market at different locations by undertaking the large-scale survey and submitting the requests of associated enterprises to Yiwu Municipal Government, as indicated by one clock booth keeper in the interview, who also worked as deputy director of Yiwu Horological Industry Association.

“In 2003, 26 industries were competing to enter International Trade City District Two. At that time, the horological industry was not a big industry in the commodity trading market. At first, the industrial association won 50 booths through communicating and negotiating with Yiwu China Small Commodity City and Yiwu Municipal Government. Then we went to Guangdong province to attract more than 200 clock and watch makers to enter International Trade City District Two. In addition, the industrial association can make requests to Yiwu Municipal Government for more land to support the expansion of associated enterprises in the same industry”.

The industrial associations have played a remarkable role in promoting industrial upgrading by establishing industrial standards, providing different types of professional training and organizing the local enterprises to attend domestic and international exhibitions. For example, Yiwu Toys Industrial Association established Zhejiang University Yiwu Toys Innovation Centre in 2007, which offers R&D and design training courses for the local toys manufacturers. In 2009, Yiwu Handicrafts Industrial Association formulated the first industrial standards of handicraft picture frames in China to improve the quality control and ensure the consistency of safety standards of domestic manufacturers. Yiwu Electronic Commerce Association has

forged strategic cooperation with the leading e-commerce institutions including eBay and Taobao University in 2011 (Chen, 2011).

In addition, our interview indicates that the birth and rising of industrial associations in Yiwu City result from the rapid development of Yiwu Commodity Trading Market rather than the direct intervention by the local government, as remarked by one local government official in the interview. It indicates that normative institutions have gradually played a more important part in the regional development of China.

“Industrial associations play a very important role in the regional development of Yiwu City. Therefore, we attach much importance to its autonomy and independence. The government officials are not allowed to take any positions in the industrial associations.”

The regulative pillar

In addition to cultural –cognitive and normative institutional pillars, Yiwu Municipal Government has created and implemented a series of regulatory measures designed to ensure the smooth operation and rapid expansion of commodity trading market since the early 1980s. These regulative measures include the “*Four Permissions*”, classifying commodities by industry within the same district of commodity trading market (*Hua Hang Gui Shi*), the reform of land use institutions and urban planning, rewarding and subsidizing industrial development and export-oriented economy, and taking steps to crack down on illegal behaviour such as counterfeiting and infringement of intellectual property rights.

“Four Permissions”

The launch of the commodity trading market by Yiwu Municipal Government in 1982 was a risky decision since rural farmers in China were not allowed to undertake any commercial activities freely at the beginning of economic transition. Afterwards, the local government put forward the ‘*Four Permissions*’ (*sige xuke*), which provided institutional support for developing commercial activities in Yiwu County ahead of other regions in the middle and western part of China. The farmers in the county were allowed to undertake four types of business activity, namely, engaging in commerce in the urban area, undertaking long-distance logistics, competing with state-owned enterprises and opening up the commodity market (Ding, 2007). These policies removed the barriers on free commercial activities in rural Yiwu imposed by the old institutional framework under the planned economy and introduced market competition to the local economy. They not only clarified the role of commodity trading market in the regional development, but also highlighted the determination of the local government to develop market-oriented distribution system in rural China.

Although the central government of China liberalised the national distribution system in 1986, the circulation channels were mainly controlled by the SOEs (Baldinger, 1998). As a buyer’s market for consumer goods came into being in rural China in the mid-1980s, the state-dominated distribution system could not satisfy the substantial demand from the whole country (Taylor, 2003). Therefore, Yiwu Municipal Government gained the first-mover advantages of developing rural distribution industry through the platform of commodity trading market.

Classifying the commodities by industry within the same district of commodity trading market

At the beginning of 1990s, Yiwu Municipal Government started to strengthen the specialisation of wholesale markets at different locations. It conducted an analysis of

profitability patterns across the commodity trading market, which suggested that purchasers responded positively to co-location of booths engaged in the same type of commodity because it enabled them to compare prices easily and conveniently. In turn this stimulated competition which drove down prices and attracted more clients (Wang and Ngoasong, 2012). As a result of these findings, the Administrative Bureau of Industry and Commerce (AIC) affiliated with Yiwu Municipal Government, started to adopt a new regulatory institution of “*classifying the commodities by industry within the same district of wholesale market*” when the fourth-generation wholesale market was launched in 1992. In order to create a fair competitive business environment, the AIC undertook a mandatory classification of booths by industry. A *Third Notice on the Adjustment of Booths within Yiwu Commodity Trading Market* was issued on the 21st January 1992 to divide the Huangyuan commodities trading market into eight transaction areas covering 16 categories of consumer commodities including yarn, toys, cotton goods, thread and ribbon, cultural and sports goods and so on. The booths were allocated to the businessmen by industries they were pursuing (YMPCO and YMGO, 1999).

Urban planning and land development

The reform of regulatory institutions in Yiwu City has been undertaken within the national institutional framework. It was approved by Zhejiang Provincial Government to undertake a pilot reform of the right to use the state-owned land on 22 June, 1991. Yiwu Municipal Government promulgated *Interim Regulations of Yiwu City Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas* on 25 July, 1991, stipulating that the local government, in accordance with the principle of the ownership being separated from the right to the

use of the land, implements the system whereby the right to the use of the state-owned land in the urban areas may be assigned and transferred. The urban construction land is lent with compensation and duration. As the owner, the local government monopolizes the primary land market. On 5 August, 1991, the right to use the state-owned land in front of Yiwu Railway Station was auctioned in the city for the first time. The highest bidding price hit RMB 6,200 per square metre. Afterwards, Yiwu Municipal Government initiated the reform of the right to use the state-owned land in administrative towns in the whole region (YCN, 2008).

By the end of 2008, Yiwu Municipal Government had collected more than RMB15 billion land grand fees. The institutional reform of the right to use the state-owned land has not only improved the intensive use of land, but also accumulated a large amount of capital for urban construction. The pace of urbanization and economic development has greatly accelerated (YYEC, 2011).

Emergence and formation of industrial clusters

Since the industrial base in the region was weak with very limited state investment in the previous planned economy era, Yiwu Municipal Government aimed to promote industrial development to maintain its advantage over the distribution industry in rural China in the 1990s. In 1992 it adopted the development strategies of '*Encouraging Industry with Commerce*' and '*Correlating Manufacturing and Trade*' to encourage the booth-keepers to transform commercial capital into industrial capital (Wang and Ngoasong, 2012). Meanwhile, it launched various incentive schemes to promote industrial development (Table 4). The industrial promotion schemes have led to the rapid industrial development in the region and contributed to the prosperity of Yiwu Commodity Trading Market further. About 16,000 manufacturers are engaged in 20 main industries in the region (YMTDB, 2011). Some industrial clusters have emerged

and developed rapidly including socks, ornaments, zippers, shirts, handicrafts and so on (Bellandi and Lombardi, 2012).

Table 4 The industrial promotion schemes in Yiwu City since 2000

Year	Industrial Promotion Schemes
2003	<ul style="list-style-type: none"> • Subsidize the establishment of municipal, provincial and national R&D centres of industrial enterprises to stimulate indigenous innovation
2004	<ul style="list-style-type: none"> • Set up an industrial development fund to reward and subsidize hi-tech enterprises, scientific SMEs and hi-tech products • Subsidize the industrial enterprises to make scientific innovation and institutional innovation
2005	<ul style="list-style-type: none"> • The annual top 50 industrial enterprises benefit from favourable fiscal, land, scientific and financial policies. • Reward the industrial enterprises that have passed ISO14000 quality accreditation system • Reward industrial enterprises whose brands have been recognized as famous at the local, provincial or national levels
2006	<ul style="list-style-type: none"> • Allocate RMB 30 million annually to subsidize local industrial enterprises to make technical upgrading • Establish a scientific incubation fund to finance hi-tech start-ups
2008	<ul style="list-style-type: none"> • Allocate RMB 2.71 billion on the innovation and technological upgrading of local enterprises • Allocate RMB 3 million in 2008 and RMB 2 million after 2008 annually to the development of Yiwu Creative Industry Park • Subsidize the establishment of R&D research institutions in the creative industry

Sources: The authors' interviews; YMPCO, YMGO, 2006 *A Collection of Important Policy Documents of Yiwu Municipal Committee and Yiwu municipal Government*. (Yiwu Municipal Party Committee Office and Yiwu Municipal Government Office, Yiwu)

Internationalization of Commodity Trading Market

After China joined in the World Trade Organization at the end of 2001, the Yiwu Municipal Government aimed to develop the city into an international small commodity trading, innovation, exhibition and logistics centre, transforming the commodity trading market from marketing domestic commodities to global commodities (Huang, 2010). With this strategy, Yiwu International Trade Mart, the latest generation of the commodity trading market, was launched in 2002. This

created a new commercial model by integrating exhibition, negotiation, transactions and e-commerce within one comprehensive commodity trading market.

The globalisation of Yiwu Commodity Trading Market and its region has been attributed to various incentive schemes to develop the export-oriented economy adopted by Yiwu Municipal Government (Table 5). In addition, the local government uses a strategy of “*exhibition-driven trade*” to promote the internationalisation of SMEs on the basis of the commodity trading market. A special fund was set up to develop international exhibition economy by Yiwu Municipal Government in 2007. The 2011 China Yiwu International Commodities Fair attracted 2,621 enterprises from 43 countries and regions (CYICF, 2011). As e-commerce has become a useful complement to the physical commodity trading market, Yiwu Municipal Government started to subsidize and reward the development of e-commerce in 2010 (YMTDB, 2011).

Table 5 The incentive scheme on the development of export-oriented economy in Yiwu City

Year	The incentive scheme
2006	<ul style="list-style-type: none"> • Reward the exporting enterprises • Reward the local enterprises forming strategic alliance or joint ventures with global top 500 foreign enterprises • Reward the local enterprises making outward foreign direct investment
2007	<ul style="list-style-type: none"> • Set up a special fund to develop international exhibition economy • Subsidize the exhibition companies to hold professional exhibitions with the number of booths exceeding 200 in the city • Reward the state and provincial sponsored exhibitions held in the city

	<ul style="list-style-type: none"> Reward the exhibitions in the city sponsored by the leading international exhibition organizations and national industrial associations
2010	<ul style="list-style-type: none"> Subsidize the local enterprises with 10% of their actual investment when they establish an independent e-commerce trading platform or adopt an innovative business model

Sources: The authors' interviews; YMPCO, YMGO, 2006 *A Collection of Important Policy Documents of Yiwu Municipal Committee and Yiwu municipal Government*. (Yiwu Municipal Party Committee Office and Yiwu Municipal Government Office, Yiwu) ; YMTDB, 2011, "The support policy to promote the development of e-commerce in Yiwu City" http://scfzj.yiwu.gov.cn/hyzz/zcfg/201010/t20101026_287172.html.

Measures to eliminate counterfeiting and protect intellectual property rights

The fight against counterfeit and fake goods has been a big challenge for the developing countries (Vithlani, 1998). And the Yiwu Commodity Trading Market is no exception. In the mid-1990s, some SMEs produced and marketed counterfeits and inferior products in order to reap substantial profits, thereby undermining the reputation of Yiwu Commodity Trading Market (Qiu, 1997; Chow, 2003). Subsequently, Yiwu Municipal Government has been taking initiatives of cracking down the illegal business behaviour of counterfeiting at the commodity trading market since 1995. The counterfeit goods were confiscated immediately once they were spotted. The reputation of commodity trading market was restored and has been maintained with the consistent efforts to fight against counterfeiting by Yiwu Municipal Government.

The internationalisation of Yiwu Commodity Trading Market has imposed higher demand for the protection of intellectual property rights (IPR). Yiwu Municipal Government has created some innovative practices in IPR protection to maintain the reputation and credibility of commodity trading market. For example, it has established a multi-layered network and adopted an monitoring and interconnecting mechanism of various divisions of local government. An IPR Supervision and Service Centre was established within the commodity trading market

in April 2009, in which Yiwu IPR Bureau, Yiwu Entry-Exit Inspection and Quarantine Bureau, Yiwu Quality and Technical Supervision Bureau, Yiwu Industry & Commerce Bureau and Zhejiang China Commodities City Group work together to deal with the IPR infringement. Meanwhile, the above divisions can share information and undertake mutual supervision.

The above regulative institutions are crucial to correct market failure and promote the sustainable development of the whole region. Yiwu Municipal Government created an appropriate path for the development of commodity trading market and at each critical stage, provided a mix of rewards and coercive measures as indicated by the following remarks made by one of the local government officials in the interview.

“The local government should create a sound business environment in which all the people have equal opportunities to participate in business competition. For example, restructuring the logistics market, prohibiting the collection of illegal fees, regulating the property price, cracking down counterfeit and fake goods, constructing the supporting infrastructure of commodity trading market and maintaining a fair competitive environment are in the scope of the local government. We must complete these important tasks.”

In the process of regulative institutional building, the local government officials played an important part in formulating and implementing effective development strategies to encourage entrepreneurship, satisfy the demands of local and international businessmen, and meet the needs of rapid growth of commodity trading markets (Table 6).

Table 6 The role of party secretaries in institutional change and regional development of Yiwu City

Time	Name of Party Secretary	Development strategy	Critical events in regional development
April 1982 -November 1984	Gaohua Xie	<ul style="list-style-type: none"> ● <i>Four Permissions</i> ● <i>“Developing County by Prospering Commerce”</i> 	Launched the first and second generation of commodity trading market in 1982 and 1984 respectively
November 1984 - March 1987	Zhongguang Zhao	<i>“Target the whole of China, enter Hong Kong and Macao, penetrate into the international market and prosper Yiwu County on the basis of the commodity trading market ”</i>	Launched the third generation of commodity trading market in 1985
March 1987 -September 1991	Shangjin Zhen	<i>“Developing City by Prospering Commerce”</i>	Yiwu commodity trading market was ranked the first among comprehensive commodity trading markets in China with annual trading volume hitting RMB1.025 billion in 1985
September 1991 -August 1997	Gaowen Yan	<ul style="list-style-type: none"> ● Classifying the commodities by industry within the same district of commodity trading market ● <i>‘Encouraging Industry with Commerce’</i> and <i>‘Correlating Manufacturing and Trade’</i> 	Launched the fourth generation of commodity trading market in 1992 and the fifth generation of commodity trading market in 1995
August 1997 -March 2000	Jinyong Zhao	<ul style="list-style-type: none"> ● Internationalize the commodity 	<i>“Yiwu City Modernisation</i>

		trading market	<i>Outline</i> ” was issued to promote re-creation, re-development and re-elevation in Yiwu City
March 2000 - March 2002	Zhihai Li	Established Yiwu City State-owned Assets Investment Holding Co., Ltd, which is the main shareholder of Yiwu Commodity Trading Market	Started the construction of International Trade City District One
March 2002 - March 2007	Guohua Lou	<i>“Developing Yiwu Spirits and Constructing a Modern Commercial and Trading City”</i>	<ul style="list-style-type: none"> ● Zhejiang China Small Commodity City Group Shareholding Co., Ltd was listed at Shanghai Stock Exchange on 9 May 2002 ● Launched International Trade City District One, District Two and District Three
March 2007 -September 2009	Weirong Wu	<i>“Emancipating Minds, Entrepreneur-ship and Innovation ”</i>	<ul style="list-style-type: none"> ● Launched International Trade City District Four ● Developing e-commerce
September 2009 -Present	Zhiping Huang	Integrating e-commerce with the physical wholesale market	<ul style="list-style-type: none"> ● Launched International Trade City District Five ● Started the construction of International Capital Goods Market

Sources: The authors' fieldwork; Huang, Z. H. and Zhang, D. L. (2007) *Why is Yiwu* (Zhejiang People's Press, Hangzhou) p44-46; PHOYMPC, 2008 "Important events in Yiwu City (October 1976 – December 2000)", Party History Office of Yiwu Municipal Party Committee, http://dsyjs.yiwu.gov.cn/dsdsj/1/200811/t20081113_153198.html

Globalisation, institutional change and regional development

The Yiwu model is a significant addition to the three well-known regional development models in China, that of Wenzhou , Sunan and the Pearl River Delta . However, the trajectory of institutional change and regional development of Yiwu model differs from that of the other three leading regional development models.

In the 1980s, the economic development in Yiwu City was contiguous to that of Wenzhou City. Wenzhou Model was influential because it symbolized the emergence of private economy in China in the 1980s. It was bottom-up rural industrialization on the basis of commercial tradition, private capital, family businesses and commodity trading markets (Shi et al., 2004). The commodity trading markets played an important part in rural industrialisation of these two cities (Shi and Luo, 2000; Huang and Zhan, 2007). Many small commodities produced by TVEs in Wenzhou City were marketed and distributed by the commodity trading market in Yiwu City. In addition, the industrial bases of these two regions were similarly weak with limited state investment (Zhang and Li, 1990; Lu, 2006). However, since the late 1990s, Yiwu City and Wenzhou City have exhibited radically different trajectories of regional development (Lu et al., 2008). While the commodity trading markets in Wenzhou City declined as a result of inter-generational, relational and structural lock-ins (Wei et al., 2007), Yiwu Commodity Trading Market not only flourished, but internationalised thanks to effective regulative institutional building by Yiwu Municipal Government. In contrast, Wenzhou Municipal Government played a relatively passive role in regional development. Governing by non-interference was one of the main features of Wenzhou model, which was subject to its historic, social and cultural circumstances in the region (Wei et al., 2007). Now Wenzhou model is

being spatially restructured involving technological upgrading and industrial diversification (Wei, 2009).

Both the Sunan model and the Pearl River Delta model have shown different development and restructuring paths. The rural industrialization of the Sunan model was realized on the basis of a large number of local state-directed TVEs in the 1980s, which were gradually privatized in 1990s. Afterwards, the local government in south Jiangsu province changed its function from developing TVEs to attract FDI with increasing industrial transfer from developed countries to China. The region has gradually become one of important production bases for global IT industry (Wang and Shi, 2006; Wei, 2010). Similarly, the Pearl River Delta Model was driven by the inflows of manufacturing investment from Hong Kong and Taiwan in the 1980s and 1990s. Its development path has been reshaped by the translocal dynamics since 2000 including institutional interactions between home and host regions within GPNs (Yang, 2007). The foreign invested enterprises and multinational corporations have played an important part in institutional change in both the Sunan model and the Pearl River Delta Model (Wei, 2002, 2010; Yang, 2007). It is the strategic coupling process between local firms and global lead firms in GPNs leading to the regional development in these two regions under deepening globalization (Wang and Lee, 2007; Yang, 2007).

However, we argue that the strategic coupling perspective has its limitations to explain the development trajectory of Yiwu Model. The institutional change of Yiwu model was mainly induced by rural entrepreneurs, private businesses and the local government rather than that of multinational corporations. The prosperity of commodity trading market, which is the core of Yiwu model, is an endogenous organizational field leading to regional development. In accounting for the success of

the Yiwu Model, its explanation lies in the close interaction between globalization, local institutions and commodity trading market. Cultural-cognitive, normative and regulative institutions all count in the regional development. The tradition of “*exchanging chicken feathers with candy*” meant that the entrepreneurial mentality of local people preceded and supported local government commodity trading market initiatives at the beginning of the 1980s. However, the cultural-cognitive institutional pillar by itself could not have driven to the formation and development of the commodity trading market. It needed to be supplemented by the development of normative and regulative institutions to correct market failure, encourage entrepreneurship, stimulate industrial development and internationalize the region.

Conclusions and policy implications

The paper has explored the process of institutional changes and regional development in rural China with a case study of Yiwu model, which is a distinct regional development model relying on the constant expansion and internationalisation of local commodity trading market.

The Yiwu model has been diffused to other provinces of China and some developing countries in Asia, Africa and the Middle East (Wang and Ngoasong, 2012). In that the commodity trading market remains an important institutional infrastructure in the developing world, the Yiwu model has four notable policy implications for regional development both within China and other developing countries. First, the sustainable development of commodity trading market needs to be backed by the local industrial development. As an important component of local production system, the commodity trading market performs both distribution and phase market functions by linking local producers, customers and middleman traders (Bellandi and Lombardi,

2012). Without integrating with the local industrial production system, the commodity trading market would not be able to achieve sustainable development.

Second, a developmental local government remains critical for the regional development of developing countries. When moving towards the market-oriented economy, it is highly important for the local government to formulate and implement effective regulative institutions to maintain market order and undertake effective resource allocation. Almost all the privatised commodity trading market in China suffered from a great loss due to the skyrocketing booth rents and shortage of appropriate development strategies. However, under the “Yiwu model”, the local government, which is the main shareholder of the listed commodity trading market, has been in firm control of the core assets and has taken effective actions against IPR infringement.

Third, the local government needs to communicate and cooperate with industrial associations to promote industrial development and improve regional governance (Zhou 2009). Regulative institutions need to interact closely with normative and cultural-cognitive institutions to promote sustainable regional development.

Finally, under the deepening globalization, the endogenous organizational field such as the commodity trading market is more likely to sustain its development if it can integrate with GPN successfully. It is important for the local government to act as an institutional entrepreneur and encourage international entrepreneurship when globalizing the region.

The latest development of Yiwu model is in line with the argument of Rodriguez-Pose and Crescenzi (2011, p779) in that “...increasing interconnectedness between local areas (and their communities) has favoured local actors’ awareness of the impact of external conditions on local performance, making coordination between different policy actions and the reconciliation of top-down and

bottom-up development policies increasingly relevant and necessary. ” The institutional change under Yiwu model has been undertaken within the national reform and openness framework. However, the local government continues to engender institutional innovation that results in significant local adaptations of top-down policies. This has not met with opposition from the state. Indeed, in 2011, the state council gave the green light to Yiwu City to carry out an international trade pilot reform. Thus, Yiwu City became the first county-level international trade reform pilot in China. It was allowed to undertake international trade experiments in nine areas including exploring and carrying out new forms of trade, optimising export mix, strengthening the building of Yiwu Commodity Trading Market, exploring new forms of modern distribution, promoting industrial transformation and upgrading, exploring international markets, accelerating the pace of “going out”, advancing the unified development of internal and external trade, and tackling international trade frictions and barriers (YCN, 2011). The bottom-up institutional building and construction in Yiwu City will continue to have direct influence on the top-down policies of the central government. It would appear that institutions will continue to be developed regionally as a product of an interaction between top-down and bottom-up development policies meaning that novel models of regional development will become increasingly common.

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