

Local Government Entrepreneurship and Global Competitiveness: A Case Study of Yiwu Market in China

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While it is widely agreed that local governments played a critical role in infrastructure building and industrial development in China—the key factors in its “economic miracle”—the relationship between local government entrepreneurship and the development of specialised markets through which products made in China are marketed to buyers worldwide is however not well understood. This article focuses on the rapid evolution of what is now the world’s largest wholesale market—the Yiwu Wholesale Market for Consumer Goods (Yiwu Market) in Zhejiang province—and the key role played by local government at different junctures in its formation, development and continual upgrading. The fact that a global commerce hub such as Yiwu Market arose in an area with no discernible natural competitive advantage indicates that many prevailing theories on competitive advantage in locational decision-making may have overlooked the central role local governments played in catalysing local economic development. This analysis underlines the fact that local government entrepreneurship can be a major source of competitive advantage for firms.

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INTRODUCTION

The recent slowdown in the Chinese economy has led to a re-examination of the role of local governments in economic growth in China,¹ albeit in a negative direction generally. That is, while it is widely agreed that local governments played a critical role in infrastructure building and industrial development—the key factors of China’s “economic miracle”—the related massive local government debts and widespread corruption exposed recently also revealed the dark side of local government entrepreneurship. Zhang and Barnett,² for example, point out how local government debts resulting from massive infrastructure investment have increased the vulnerability of the Chinese economy to various kinds of shocks, while other scholars argue that local governments’ over-emphasis on real-estate development has reduced their incentives for promoting industrial development,³ and impacted negatively on future economic growth and social development.

One factor that has been largely overlooked in the regional development literature, however, is the more positive role local governments have played in this area of economic activity. The role of cheap labour in the rise of China as “the world’s factory” has long been acknowledged, but the key roles that the activities played by wholesale and retail markets, and the channels through which China-made products are marketed to buyers worldwide remain poorly understood. As the following discussion illustrates, local governments have played a pivotal role in critical activities such as the development of the specialised wholesale markets, which were at the heart of China’s economic miracle.⁴ These specialised wholesale markets (*zhuan ye shi chang*) enabled hundreds of thousands of small and medium-sized enterprises (SMEs)—the majority of which do not have their own marketing channels or capacities—to market their products to internal and external buyers who, in turn, also benefited from lower search costs and better selection of products provided, thereby enhancing both trade and productivity.⁵

Investigation into these specialised markets highlights two intriguing puzzles that can be unravelled by examining closely the role of local governments in these processes.

¹ Han Li and James Kai-Sing Kung, “Fiscal Incentives and Policy Choices of Local Governments: Evidence from China”, *Journal of Development Economics* 116 (September 2015): 89–104; Li Bingqin, and Guy Mayraz, “Infrastructure Spending in China Increases Trust in Local Government”, *Social Indicators Research* (January 2016): 1–16; Pan Jiun-Nan, Huang Jr-Tsung and Chiang Tsun-Feng, “Empirical Study of the Local Government Deficit, Land Finance and Real Estate Markets in China”, *China Economic Review* 32 (February 2015): 57–67; Yang Zan, Ren Rongrong, Liu Hongyu and Zhang Huan, “Land Leasing and Local Government Behaviour in China: Evidence from Beijing”, *Urban Studies* 52, no. 5 (April 2015): 841–56.

² Zhang Yuanyan Sophia and Steven A. Barnett, “Fiscal Vulnerabilities and Risks from Local Government Finance in China”, 2014, IMF Working Paper WP/14/4, International Monetary Fund.

³ Han and Kung, “Fiscal Incentives and Policy Choices of Local Governments”.

⁴ Ding Ke, *Market Platforms, Industrial Clusters and Small Business Dynamics: Specialized Markets in China* (Cheltenham: Edward Elgar Publishing, 2012)

⁵ Marco Bellandi and Silvia Lombardi, “Specialized Markets and Chinese Industrial Clusters: The Experience of Zhejiang Province”, *China Economic Review* 23, no. 3 (September 2012): 626–38.

The first puzzle is why such markets are often found in unexpected geographical locations with no natural competitive advantage, defying predictions based on models such as Porter's Diamond framework which emphasises the importance of four factors—firm strategy, structure and rivalry; factor conditions; demand conditions; and related and supporting industries—in the formation of business clusters.⁶ Second, an explanation is needed concerning why—in the scenario when the competitive advantage of such markets is expected to be in decline due to the rapid expansion of e-commerce—these markets have proven to be remarkably resilient and continue to prosper in spite of fierce competition from other markets and especially from the challenges posed by e-commerce.

This article presents a case study, focusing on the role the local government played in the development of a very important market in China: the Yiwu Wholesale Market for Consumer Goods (or Yiwu Market). The Market, though little known outside Chinese business circles, is the world's biggest wholesale market of its kind. Today, Yiwu Market boasts a physical marketplace of over four million square metres in which 1.7 million types of consumer products—including handicrafts, toys, hardware, electronics, sporting goods, and clothing and accessories—are bought and sold daily. With 70 per cent of its sales exported to over 200 countries, it is a truly global operation. Due to the significance of Yiwu in international trade, special customs checkpoints were established in 2006 to fast track custom procedures. Yiwu also has its own airport, and runs high-speed trains to major cities like Shanghai and Hangzhou.

Specialised markets in China such as Yiwu Market share several common characteristics. First, they are mainly wholesale markets, although some also serve retail customers. Second, they mostly specialise in specific kinds of products with a high concentration of firms—which together command a high market share nationally and globally—involved in different stages of the production process. Third, the markets occupy enormous physical space with individual vendors housed, typically, in dedicated multi-storeyed buildings.⁷

These specialised markets are popular with businesses as they offer highly competitive wholesales price to buyers, and provide ready access to comparative information on prices and quality that reduce transaction costs for producers and wholesalers. In particular, they provide marketing platforms for SMEs, allowing them to access national and world markets without having to invest in their own distribution network.⁸

⁶ Michael E. Porter, "The Competitive Advantage of Nations", *Harvard Business Review* 68, no. 2 (March–April 1990): 73–93.

⁷ Bellandi and Lombardi, "Specialized Markets and Chinese Industrial Clusters"; Ding, "Domestic Market-Based Industrial Cluster Development in Modern China"; and He Xianming, *Economic and Social Impacts of Decentralization Reform: A Case Study Based in Zhejiang* (Shanghai: Xue Ling Publishing House, 2009).

⁸ Wang Jinmin and Michael Z. Ngoasong, "The Internationalization Process of Chinese SMEs: Does Globalizing Wholesale Markets Play a Role?", *Strategic Change* 21, nos. 3–4 (2012): 143–57.

The authors examine how entrepreneurship and innovation of local governments led to the transformation of Yiwu from a small and little-known agrarian county in eastern China into a global commerce hub. The case analysis reveals the decisive role played by the local government of Yiwu county in the entire course of the formation, development and continual upgrading of Yiwu Market. As detailed below, the local government undertook a large political risk in the 1980s when it allowed farmers to engage in commercial activities. Policy innovations, such as the development of a credit system and specialisation requirements undertaken at this level, also enabled Yiwu Market to overcome the barriers constraining the development of similar markets around the world. Moreover, policy innovations led by these governments in upgrading the markets through construction of physical marketplaces, exploration of new platforms, and the integration of the physical market with e-commerce allowed Yiwu Market to continue to display impressive growth despite fierce competition domestically and abroad.

ZHEJIANG: THE “PROVINCE OF MARKETS”

Prior to the start of Chinese economic reforms in the late 1970s, the pace of industrial development in Zhejiang province was slow because it is not richly endowed with natural resources and received limited financial support from the central government.⁹

The province's gross domestic product (GDP) per capita in 1978 was 331 yuan, well below the national average.¹⁰ However, over the next three decades, the province experienced significant economic growth—its GDP increased 12.5 per cent annually between 1978 and 2014 while its industrial output grew 40 times. As a result, Zhejiang is currently among the richest provinces in China, behind only Beijing and Shanghai.

Zhejiang's rapid economic growth has received considerable attention and been written about extensively.¹¹ However, to date, scholars tracking its growth have focused on the rapid growth of the private sector, administrative decentralisation and industrial

⁹ Wang Zhikai, “The Economic Growth of China's Private Sector: A Case of Study of Zhejiang Province”, *China and World Economy* 3, no. 4 (2006): 109–20; Shi Lu and Bernard Ganne, “Understanding the Zhejiang Industrial Clusters: Questions and Re-Evaluations”, in *Asian Industrial Clusters, Global Competitiveness and New Policy Initiatives* (Singapore: World Scientific, 2009), pp. 239–66.

¹⁰ He, *Economic and Social Impacts of Decentralization Reform*.

¹¹ Bellandi and Lombardi, “Specialized Markets and Chinese Industrial Clusters”; Chen Guoquan and Li Yuanlin, “Local Government Innovations and Development of High-Capacity Counties: Analysis Based on the ‘Zhejiang Phenomenon’”, *Zhejiang University Journal* (in Chinese) 6 (2009): 25–33; Ye Xinyue and Yehua Dennis Wei, “Geospatial Analysis of Regional Development in China: The Case of Zhejiang Province and the Wenzhou Model”, *Eurasian Geography and Economics* 46, no. 6 (2005): 445–64; Yu Jianxing and Gao Xiang, “Redefining Decentralization: Devolution of Administrative Authority to County Governments in Zhejiang Province”, *Australian Journal of Public Administration* 72, no. 3 (2013): 239–50.

TABLE 1
SPECIALISED MARKETS IN ZHEJIANG

Year	Number of Marketplaces	Number of Marketplaces with Sales above 1 Billion Yuan	Number of Marketplaces with Sales above 10 Billion Yuan	Average Sales (in Billion Yuan)
1978	1,051	—	—	0.86
1988	3,632	—	—	9.63
1998	4,619	58	2	320.96
2008	4,087	139	15	979.40
2014	4,194	180	18	1,074.49

Sources: Statistical Bureau of Zhejiang Province, *Zhejiang Statistical Yearbook* (Beijing: China Statistics Press, various years).

clusters as the main contributing factors.¹² However, despite their importance, literature on the subject of Zhejiang's specialised markets is slim. This is surprising, considering the large body of works explaining the economic development of Zhejiang in general.¹³ The literature, especially in English publications, has largely neglected factors such as specialised markets and the unique distribution system that emerged in the province over this period.¹⁴

The development of specialised markets is, however, closely linked to the growth of industrial clusters¹⁵ and the key to sustaining rapid economic growth in the province.¹⁶ Zhejiang province ranks first in China in terms of its number of specialised markets and the average unit volume of transactions (Table 1), and it is aptly called the "province of markets".¹⁷

¹² Wang, "The Economic Growth of China's Private Sector"; Bellandi and Lombardi, "Specialized Markets and Chinese Industrial Clusters"; Yu and Gao, "Redefining Decentralization"; Ye and Wei, "Geospatial Analysis of Regional Development in China".

¹³ Tetsushi Sonobe, Hu Dinghuan and Keijiro Otsuka, "From Inferior to Superior Products: An Inquiry into the Wenzhou Model of Industrial Development in China", *Journal of Comparative Economics* 32, no. 3 (2004): 542–63; Kristen Parris, "Local Initiative and National Reform: The Wenzhou Model of Development", *The China Quarterly*, no. 134 (1993): 242; and Alan P.L. Liu, "The 'Wenzhou Model' of Development and China's Modernization", *Asian Survey* 32, no. 8 (August 1992): 696–711.

¹⁴ One of the reasons for such scant attention could be due to the uniqueness of "specialised market". Not only are there no equivalent institutions outside China, there is no accurate English word for the Chinese term, *zhuanYe shiChang*, literally translated as "specialised market". However, attempts have been made by some scholars to define it. For instance, Wang and Ngoasong call it a "specialized wholesale market with physical marketplaces for large-scale trading of consumer and industrial commodities in which any retailing activities are marginal"; see Wang and Ngoasong, "The Internationalization Process of Chinese SMEs". Similarly, Ding describes it as "large-scale market specialized in one types of products or several types of products that are complementary and (or) substitutable"; see Ding, "Domestic Market-Based Industrial Cluster Development in Modern China".

¹⁵ Bellandi and Lombardi, "Specialized Markets and Chinese Industrial Clusters".

¹⁶ Huang Zuhui, Lu Jia, Sun Huaping, Hu Jifei and Song Yu, "Sticky Factors in the Industrial Relocation of a Cluster: A Case Study of Zhili Children's Garments Cluster in China", *The Social Science Journal* 48, no. 3 (September 2011): 560–5.

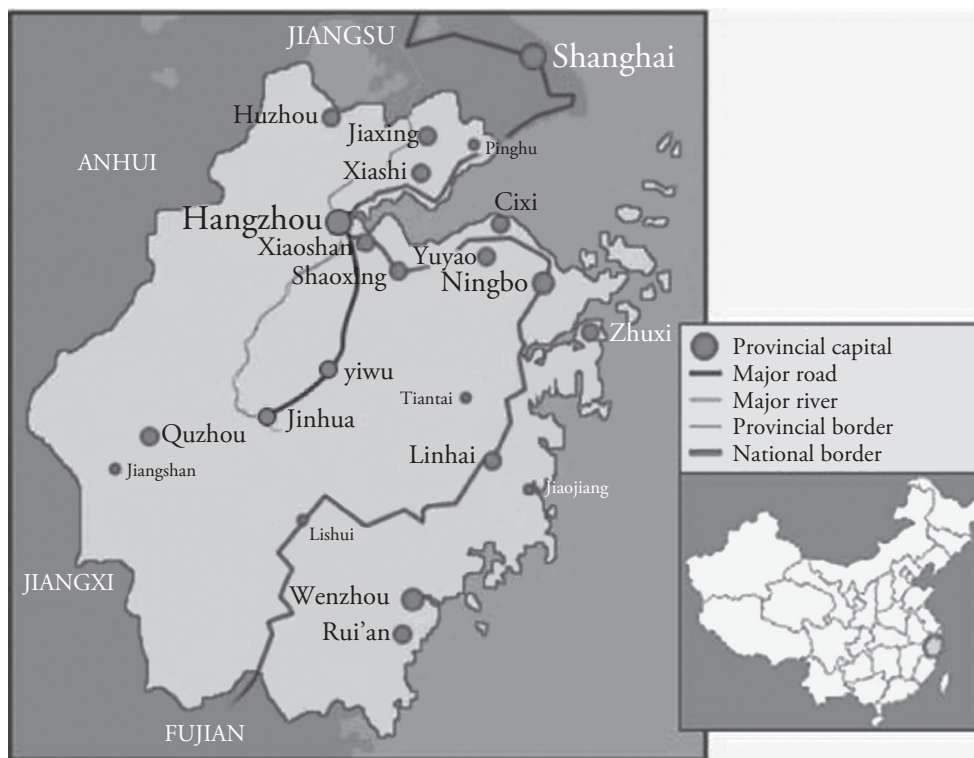
¹⁷ Ding, *Market Platforms, Industrial Clusters and Small Business Dynamics*.

YIWU MARKET: THE WORLD'S LARGEST CONSUMER GOODS WHOLESALE MARKET

Located in the south-east part of Zhejiang province, Yiwu county covers an area of 1,105 square kilometres, with six towns and seven sub-districts. When economic reforms started in 1978, the county was agrarian and among the poorest in the province. Its prospects in industrial and commercial development were downplayed due to its lack of natural resources and poor transportation links to major cities or ports.¹⁸

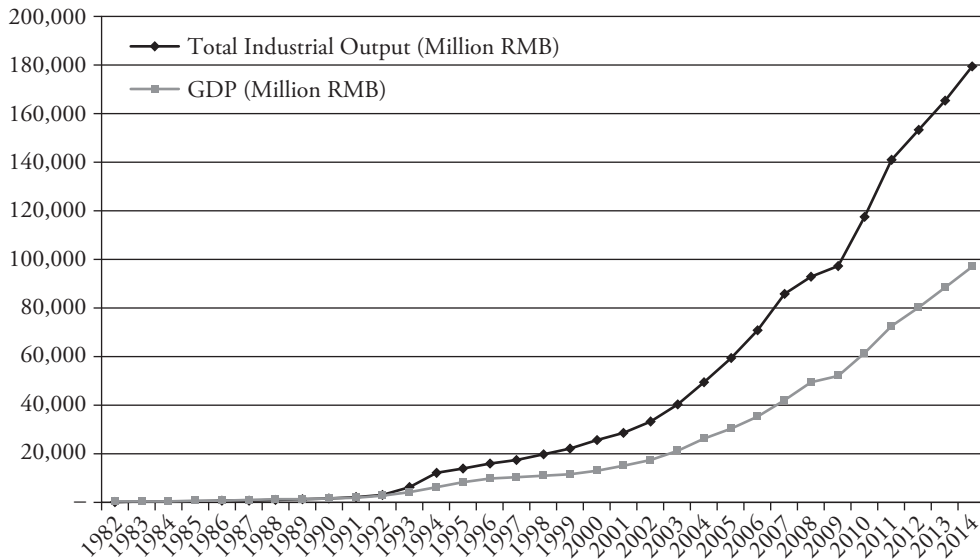
The transformation of Yiwu from a little-known county in China into a hub of commercial and industrial development of global significance began with the opening of Choucheng flea market and Niansanli market in 1974. Small-scale and open air, these markets were no different from the countless numbers of such markets around the world—but by 1990, they had evolved into Yiwu Wholesales Market for Consumer

Figure 1. Map of Yiwu County



Source: See <<http://www.yayiwu.com/city.asp>> [27 June 2016].

¹⁸ Lu Lijun, Wang Zuqiang and Yang Ziwen, *The Yiwu Model* (Beijing: Renmin Publishing House, 2008); Wang Shuzhu, *The Yiwu Phenomenon: From Small Merchandise Market in China to International Market* (Beijing: China Finance & Economics Publishing House, 2009).

Figure 2. GDP and Total Industrial Output in Yiwu, 1982–2014

Sources: Authors' calculation based on Statistical Bureau of Zhejiang Province, *Zhejiang Statistical Yearbook* (Beijing: China Statistics Press, various years).

Products (Yiwu Market). With annual net sales of one billion yuan, it is the largest such market in China.¹⁹ As this occurred, the GDP per capita in the city increased from RMB235 (US\$36) in 1978 to RMB126,707 (US\$19,932) in 2014.²⁰

The First Stage, 1982–91: Yiwu Market for Daily Necessities (Yiwu xiao shangpingshi chang)

Although trade has been a defining characteristic in the local culture and tradition of Yiwu county throughout its history,²¹ its potential benefits to economic development were not tapped until the early 1980s. This was due to the ideological rejection of commerce during the era of central planning,²² when prices were fixed by planning authorities and any form of arbitrage to explore price differentiation—considered a sign of capitalism—was strongly discouraged, if not forbidden outright. In fact, arbitrage was often regarded as an economic crime undermining the communist regime, and tens

¹⁹ Lu, Wang and Yang, *The Yiwu Model*.

²⁰ Statistical Bureau of Zhejiang Province, *Zhejiang Statistical Yearbook* (Beijing: China Statistics Press, various years).

²¹ Lu, Wang and Yang, *The Yiwu Model*.

²² Ding, *Market Platforms, Industrial Clusters and Small Business Dynamics*; and Wang, *The Yiwu Phenomenon*.

of thousands of people across the country were therefore prosecuted for committing such crimes and sent to prisons or labour camps.

In Yiwu, however, where the availability of land and other resources was highly constrained, and the rural population's livelihood depended solely on agricultural production, the county authorities granted greater leniency when it came to rules about trading and barter.²³ In addition, there was a very significant demand for consumer products in Yiwu, which did not enjoy similar product accessibility as other bigger cities. Booths or stalls with limited product offerings began to emerge in the streets of Yiwu, and by the early 1980s, several hundred people were involved in these businesses. However, growth remained severely constrained because such activities were not based on the legal rules and regulations in place at the time, thus making finance and other matters difficult.

This situation reached a turning point in 1982 when a group of farmers petitioned the county government to give them formal permission to engage in commercial activities. The county government then granted the farmers permission despite the central government's stipulated regulations prohibiting such activities. As a result, farmers were allowed to partake in four types of undertakings that were previously prohibited: (i) commerce activities; (ii) arbitrage; (iii) trading activities involving urban residents; and (iv) market competition. This decision, or so-called "*sige xuke*" (permission to undertake four types of activities), allowed the development of Yiwu Market and also highlights the significant role played by the local government in its creation.

Another milestone in the development of Yiwu Market was the construction of a physical marketplace in 1984. Encouraged by the early success in the growth of commerce activities unleashed by the new rules on the participation of farmers, the county government again took the lead and invested RMB57,000 in the construction of a physical marketplace to host vendors permanently. The first of its kind in China, Yiwu Market accommodated over 1,800 vendors. At that stage, however, the Market was still no different from many other similar spaces. It was a light-framed structure in an open space, built to protect merchandise from adverse weather conditions.

The availability of a physical marketplace, nonetheless, led to a second round of explosive growth in both the number of booths and types of products sold. The initial success of the new marketplace, especially evident in the local government's growing revenue collection from booth rental fees, led to its rapid expansion in subsequent years. The local government again made a major investment of RMB4.4 million to expand the physical space to 44,000 square metres to accommodate 4,096 booths. By 1990, Yiwu Market occupied 57,000 square metres, and the number of booths increased to 8,503.²⁴

²³ Luo Yadong, Xue Qiuzhi and Han Binjie, "How Emerging Market Governments Promote Outward FDI: Experience from China", *Journal of World Business* 45, no. 1 (2010): 68–79; and Ding Ke, "Domestic Market-Based Industrial Cluster Development in Modern China", Discussion Paper No. 88, Institute of Developing Economies, JETRO (February 2007).

²⁴ Lu, Wang and Yang, *The Yiwu Model*.

It should also be noted that the debate surrounding the nature of market development continued at the national level throughout the 1980s. Although the national government no longer favoured increased market development after the Tiananmen incident, Yiwu Market continued to make progress. Had the national government been the sole or main driver of market development, disruptions to this pattern of growth would have been far more significant.

The Second Stage, 1992–2001: The Hub of Wholesale Markets in China for Consumer Products (Zhongguo xiaoshangping cheng)

Tremendous growth in markets during this time raised the demand for booths in Yiwu Market, necessitating further expansion. It was, however, unrealistic to continue to significantly increase the land area supplied for the Market; instead, the government decided to construct multi-storeyed buildings. The number of booths thus surged from 8,900 to 16,000 with the completion of the first such multi-storeyed building in 1992, and the trading floor space increased to 117,590 square metres.²⁵

With the burgeoning size of Yiwu Market, improving its governance became a top priority. As observed in many similar markets around the world, growth would typically taper off after having reached a certain scale. This is mainly because individual vendors choose to diversify their range of goods to lower their average costs, without recognising that higher levels of product specialisation are needed to increase the market size of specific products. Another reason behind the slowed growth of markets is vendors' propensity to sell low-quality products to stay competitive—this ultimately undermines the long-term sustainability of the market, and promotes a race to the bottom among vendors who compete over quantity instead of quality.

Yiwu Market was confronted with both these challenges in the early 1990s. The licences issued initially to individual vendors were based on four broad categories—daily necessities, garments, knitwear and shoes—allowing them to diversify over a wide range of product types. As a result, the same type of consumer products could be found at different locations in the Market, making it difficult for buyers to search for products and compare prices. In addition, with an increased number of vendors competing on prices alone, counterfeit products proliferated and quality deteriorated. As a result, Yiwu Market began to earn a negative reputation for cheap but poor-quality products.

To reduce buyer search costs and help reverse this trend, in 1992, the Yiwu county government introduced a new classification system—“*huahang guishi*” or market zoning based on product categories—which increased the classes of products from four to 16 categories based on industry classifications, and reorganised the Market's physical space according to product categories. All registered vendors were required to declare their specialisation in these categories based on the new classification system, re-register their businesses and move to new physical locations in the Market.

²⁵ Ibid.

TABLE 2
GROWTH OF YIWU MARKET AT ITS VARIOUS STAGES OF DEVELOPMENT

Market	Year	Number of Booths	Size of Trading Floor (Square Metres)	Annual Net Sales (RMB Million)
First Stage	1982	705	4,252	4
	1983	1,050	4,252	14
	1984	1,870	4,252	23
	1985	2,847	13,590	62
	1986	5,500	57,590	100
	1991	8,900	57,590	1,025
Second Stage	1992	16,000	117,590	2,054
	2001	34,500	485,590	21,197
Third Stage	2002	43,500	725,590	22,998
	2007	56,800	2,505,590	34,837
	2008	62,300	3,655,590	38,180
	2014	70,000	4,000,000	85,700

Sources: Lu Lijun, Wang Zuqiang and Yang Ziwen, *The Yiwu Model* (Beijing: Renmin Publishing House, 2008); and Yiwu Social and Economic Development Reports, various years.

In addition to reducing the buyer search costs, the new classification system also provided more incentives to merchants to develop newer and better products. Competition intensified as booths specialising in similar types of products were concentrated in the same area and had to compete on product price and quality.²⁶ The new classification system resulted in an explosive growth in the number of booths, hitting 33,000 by 2001, while sales increased more than tenfold.

As expected, the existing vendors were strongly opposed to the new classification, as it required them to choose their specialisation and thus give up the flexibility of operating in different categories. Eventually, however, the vendors gave in, and the county government held firm control over the ownership of booths.

A vendor rating system, introduced in 2000, was another innovation that was instrumental in reversing earlier trends and led to the further development of Yiwu Market. This system, piloted by the county government, classified vendors into six categories—AAA, AA, A, B, C and D—based on their credit worthiness. A vendor's rating could influence the intensity of supervision and regulation from the government: booths with a credit rating of A, AA or AAA were monitored once a month; those rated B were monitored no less than once a week; C-rated booths could be monitored at any time; and those with D were expelled from the Market. This new credit rating system played a critical role in strengthening buyer confidence in Yiwu Market and in validating its continual growth. It also spurred vendors to pay greater attention to the quality of their products and services, in addition to prices.

Besides investing heavily in the infrastructure of Yiwu Market and making significant efforts in its governance, the Yiwu city government also took a lead role in

²⁶ Sheng Shihao and Zheng Jianwei, *Zhejiang Phenomenon: Industrial Clusters and Regional Economic Development* (Beijing: Tshinghua University Press, 2004).

TABLE 3
SELECTED INDUSTRIAL CLUSTERS IN YIWU

Industrial Clusters	Description
Hosiery	The largest hosiery production hub
Apparel	One of the four shirt production hubs; 1,200,000 shirts per day
Jewellery	70 per cent of market share in the country; over 8,000 firms
Zippers	25 per cent of market share in the country
Arts and crafts	70 per cent of market share in the country; over 1,300 firms
Stationery	Major production hub for ball pens pencils and gel pens
Printing	Largest production hub in the country, over 600 firms
Wool textiles	30 per cent of market share in the country

Source: Jin Xiangrong, Zhu Xiwei, You Zhuoya and Zhang Xu, "Industrial Clusters of Yiwu and Huangyan: Small and Medium Enterprises and Challenges for Industrial Upgrading", in *Trend Analysis of Industrial Upgrading in China: Case Studies (II)*, JRP Series 144, Institute of Developing Economies, Japan External Trade Organization, 2007, at <http://www.ide.go.jp/English/Publish/Download/Jrp/pdf/144_1.pdf> [27 June 2016].

its expansion, focusing on other factors imperative to sustain the Market's competitive advantage. Before the 1990s, the bulk of products sold at the Market were produced elsewhere, and buyers often went to the suppliers directly after their initial interaction with market vendors.²⁷ However, by the mid 1990s, to add value to the county economy, the Yiwu city government initiated a new development strategy. Called "*yin shang zhuan gong yi gong chu mao*" ("to reap the benefits of synergies between the Market and industrial development"), it aimed to encourage merchants in Yiwu Market to set up factories locally to produce goods sold in the Market, thus reducing transaction costs further while promoting local employment and technological development.

However, the merchants faced several obstacles. These included a lack of access to credit and insufficient capacity in research and development (R&D) necessary for innovation in production, thus preventing them from moving upstream in the supply chain. As such, the county government employed several strategies to overcome these challenges. First, government-owned local banks were encouraged or coaxed to offer easy financing access to booth operators who set up their own local manufacturing base.²⁸ Second, the government promoted the development of industrial clusters for selected types of products, such as jewellery production and textiles, by offering subsidies to firms to set up factories in these specific sectors.²⁹ Third, there was a strong emphasis on developing industrial leaders in each priority sector to take the lead role in R&D and product development activities.³⁰

The success of these strategies resulted in another burst of rapid growth in the industries located in Yiwu. By 2000, there were about 16,000 SMEs specialising in over 20 industries in Yiwu city, turning it into a production powerhouse of socks, shirts, zippers, handicrafts, pens and ornaments.³¹

²⁷ Ding, *Market Platforms, Industrial Clusters and Small Business Dynamics*.

²⁸ Lu, Wang and Yang, *The Yiwu Model*.

²⁹ Ibid.

³⁰ Wang, *The Yiwu Phenomenon*.

³¹ Wang and Ngoasong, "The Internationalization Process of Chinese SMEs".

The Third Stage, 2002–Present: Global Commerce Hub (guoji shangmao mingcheng)

By the end of the 1990s, the success of Yiwu Market had inspired many other local governments in China to follow suit, resulting in fierce competition. Meanwhile, however, the rapid growth of e-commerce also posed a serious disruptive challenge to the fundamental basis of Yiwu Market. Its vendors faced declining profit margins due not only to heightened competition for domestic buyers from other similar specialised markets, but also from e-commerce platforms such as *Taobao*.³²

This time, the Yiwu city government³³ responded to these challenges by expanding the global reach of Yiwu Market and embracing the e-commerce revolution. In 2002, it outlined a new development strategy to build a global commerce hub, “*jianshe guoji shangmao chengshi*”. This new strategy aimed to create a new business model by integrating international trade fairs, foreign trade services, logistics, commodity inspection, customs declaration and international finance within one comprehensive marketplace.³⁴

The launch of the Yiwu International Trade Fair in 2001 was an essential component of this new initiative. By 2006, the annual Yiwu Fair had attracted an attendance of 103,205 buyers, of whom 16,056 were from overseas, representing 161 countries. The Yiwu Fair has now become China’s third-largest exhibition, after the China Import and Export Fair in Guangdong province and the East China Fair in Shanghai city.³⁵ Stimulated by the success of the Yiwu Fair, many other new fairs also began to be held in Yiwu, raising the number from 11 in 2001 to 27 in 2005. In 2005, the total transaction volume of these fairs amounted to over 10 billion yuan, accounting for over one-third of the total transaction volume of Yiwu Market.³⁶

The Yiwu city government also invested RMB200 million to construct a new Yiwu International Logistics Center, which offers one-stop clearance for exports and imports. Handling an annual tonnage of 400,000 TEUs,³⁷ the Yiwu International Logistic Center has become an important inland port for Shanghai and Ningbo. In 2007, exports accounted for 70 per cent of the total transaction volume of Yiwu Market. More than 10,000 representatives from over 100 countries took residence in Yiwu because of their purchasing work. In addition, more than 40 per cent of air passengers to and from Yiwu were from outside the country. International air passenger traffic to and from Yiwu airport exceeded 500,000 for the first time in 2007.³⁸

³² Lu, Wang and Yang, *The Yiwu Model*.

³³ “Yiwu county” was upgraded to “Yiwu city” in 1988, but its administrative level remains at county level.

³⁴ Ding, “Domestic Market-Based Industrial Cluster Development in Modern China”.

³⁵ Wang and Ngoasong, “The Internationalization Process of Chinese SMEs”.

³⁶ Lu, Wang and Yang, *The Yiwu Model*.

³⁷ TEU stands for twenty-foot equivalent unit, which is used to measure the cargo-carrying capacity of a container ship.

³⁸ Ding, *Market Platforms, Industrial Clusters and Small Business Dynamics*.

The widespread adoption of e-commerce worldwide presented both a challenge and an opportunity for Yiwu Market. On the one hand, the availability of online commerce platforms diminished the reliance on physical brick-and-mortar physical marketplaces like Yiwu Market. The growth of business-to-business (B2B) firms such as *Alibaba* weakened the position of commerce hubs capitalising on physical marketplaces. The benefits of conglomeration in a single location were now deemed less valuable, since buyers could compare specifications and prices of products from different producers spread throughout the country and sold in different markets without having to physically visit the trading hubs. On the other hand, however, the internet potentially expanded the global reach of such markets for firms and consumers that were previously restricted by time and space to benefit from a physical wholesale market.

Yiwu Market's new global ambitions were timely as they coincided with the emergence of e-commerce in China and retained the Market's first-mover advantage. Yiwu Buy, or *Yiwu Gou*, was launched in 2012 as an integrated online trading platform for retailers who sourced their products from Yiwu Market. The growing reach and sophistication of electronic commerce allowed buyers from around the world to purchase from the Market as well as from worldwide wholesalers and retailers found in Yiwu, allowing them to compete against retail giants, such as Walmart, Carrefour and Tesco, which had become dominant by sourcing their merchandise directly from China. Unlike *Taobao*, which provides an online platform for small businesses and individuals to open online shops (business to commerce [B2C] or commerce to commerce [C2C]), *Yiwu Gou* serves merchants operating in Yiwu Market by providing them with an online platform to sell their products to retailers, including the online shops that are active in *Taobao* (B2R).

DISCUSSION: LOCAL GOVERNMENT INNOVATIONS IN THE DEVELOPMENT OF YIWU MARKET

A salient feature of the development of Yiwu Market is that it is in Zhejiang province, which is at the leading edge of private-sector development in China. In Zhejiang, private enterprises account for 58 per cent of the provincial GDP—the highest in China. As a result, it is no surprise that some scholars have argued that the government's *laissez faire* approach involving passive or minimal intervention was the key determinant of the province's economic success.³⁹ However, a closer examination of the development of Yiwu Market shows local government played a critical role at every stage of its development, from establishment, to expansion and upgrading.

The decision by the local government in Yiwu to grant permission to farmers to engage in commerce activities, for example, was crucial to the development of the Market. This decision, formulated as “*sige xuke*” (permission to undertake four types

³⁹ Ye and Wei, “Geospatial Analysis of Regional Development in China”; Huang Yasheng, “Rethinking the Beijing Consensus”, *Asia Policy* 11, no. 1 (2011): 1–26.

of activities), laid the foundation for the development of Yiwu Market. Xie Gaohua, the then Party secretary of Yiwu county who was primarily responsible for the decision, is widely heralded as the founder of Yiwu Market. Certainly, the decision-makers did not anticipate the Market's growth and success.

This decision provided Yiwu a significant first-mover advantage in initiating and developing the Market well before the central government lifted the restrictions nationwide two years later. By the end of the 1980s, many counties within and outside Zhejiang province had come to emulate the strategy pioneered by Yiwu to establish a physical marketplace. However, Yiwu's first-mover advantage has afforded it a status unmatched by other jurisdictions, and earned it a reputation for being *the* hub for sourcing consumer products.⁴⁰

County government policy innovations in building and upgrading of its associated infrastructure then played a key role in furthering the success and growth of Yiwu Market. In addition to innovations in governance, the local government made massive investments in improving the local infrastructure needed to support the growing market. For example, the Yiwu city government invested RMB200 million to construct the Yiwu International Logistics Center, which offered a one-stop clearance for exports and imports at a critical juncture in its evolution.

As discussed earlier, policy innovations in market governance undertaken by the county government also helped to overcome several inherent weaknesses in the wholesale market system as its scale increased. The new product classification system introduced in 1992 for Yiwu Market, "*huahang guishi*", successfully dealt with rising search costs for consumers as the Market expanded and the number of vendors selling similar products rose exponentially. Another innovation crucial in the rapid development of Yiwu Market was the establishment of the bank credit system and the corresponding management practices. The credit rating system introduced by its county government also played a vital role in the continual growth of Yiwu Market as it pushed vendors to pay greater attention to product quality, in addition to price, at a critical juncture when the reputation of the Market for quality goods was in jeopardy.

The local government in Yiwu also played a significant part in enhancing the resilience of the Market through adaptive innovations to address the challenges of increased national and e-commerce competition. These innovations stimulated the market to prosper from shifts in the economic and market conditions.

CONCLUDING REMARKS

There are many consumer product wholesale markets around the world—most of them have longer history than Yiwu—but none has matched the scale or scope of Yiwu Market. While there is no disagreement over how local governments' innovations

⁴⁰ Sun Zhenming and Martin Perry, "The Role of Trading Cities in the Development of Chinese Business Cluster", *International Business Research* 1, no. 2 (2009): 69.

contributed to the development of specialised markets in China, the nature of such contributions is poorly understood in economic and regional development circles. Some scholars claim that the success of specialised markets is attributed to the adoption of a *laissez faire* approach to governance, i.e. with passive or minimal intervention⁴¹ being the key. But others argue that the local governments' efforts in promoting private enterprises and industrial clusters have been essential to the development of specialised markets.⁴²

The authors of this article agree with the latter and emphasise that the development of Yiwu Market is defined by the extensive and persistent involvement of the local government at every stage of its development. It is indeed arguable that there would not be a Yiwu Market were it not for the early intervention of the local government. Besides, were it not for the timely implementation of effective governance innovations that enabled Yiwu Market to upgrade, from a local to a global player, it could well have withered into irrelevance at several points—as had many of the Market's counterparts in China and elsewhere.

Hence, the analysis in this article serves to make a threefold contribution. First, it directs our attention to the fact that specialised markets emerging in China are a major contributing factor to the country's economic growth, and also that these markets' lower transaction costs are an important competitive advantage for growth. Second, it contributes to a better understanding of local governments' contribution to economic growth in terms of their role in developing specialised markets. Third, the findings will have significant policy implications for the potential to harness local government entrepreneurship in sustaining economic growth both in China and elsewhere.

With respect to the latter point, the analysis underlines that local government entrepreneurship can be a major source of competitive advantage for firms. The fact that a global commerce hub like Yiwu Market arose in an area with no discernible natural competitive advantage indicates that many prevailing theories on competitive advantage in locational decision-making may have overlooked the role of local governments as a catalyst for local economic development.

The findings also offer policymakers in China and elsewhere significant implications of the role that local governments can play in sustaining economic growth. While policymakers may tend to attribute economic difficulties to local governments, more research is required to fully understand the actual contribution of local government entrepreneurship in various locations. The analysis suggests that local government entrepreneurship was instrumental in not only creating but also *sustaining* economic growth in China, and could also serve such a role in many other countries.

⁴¹ Ye and Wei, "Geospatial Analysis of Regional Development in China".

⁴² Wang Jici and Tong Xin, "Industrial Clusters in China: Embedded or Disembedded?", in *Linking Industries across the World: Processes of Global Networking*, ed. Claes G. Alvstam and Eike W. Schamp (Burlington and Aldershot: Ashgate, 2005), p. 223; Huang Zuhui, Zhang Xiaobo and Zhu Yunwei, "The Role of Clustering in Rural Industrialization: A Case Study of the Footwear Industry in Wenzhou", *China Economic Review* 19, no. 3 (2008): 409–20.

This recognition of the local government's role in economic growth should be welcome news to local leaders in developing countries frustrated by their national governments' policies. The Yiwu experience demonstrates that there is considerable room for entrepreneurship at the regional and local levels to further a community's advancement. The development of Yiwu Market suggests that while sound policies on the part of national governments are vital, there is ample room for local governments to seize local development opportunities and to build regional, national and even global leadership positions in commercial and other kinds of economic activities.