

**POWER TO DOMINATE, NOT TO CHANGE:  
HOW CHINA'S CENTRAL-LOCAL  
RELATIONS CONSTRAIN ITS REFORM**

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# POWER TO DOMINATE, NOT TO CHANGE: HOW CHINA'S CENTRAL-LOCAL RELATIONS CONSTRAIN ITS REFORM

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## Defining Central-Local Relations

China does not have a federalist system of government—it has neither the constitutional division of power among different levels of government nor the separation of power within the branches of government. Nevertheless, with deepening reform and openness, China's political system in terms of central-local relations is functioning more and more on federalist lines. This paper defines China's existing political system as de facto federalism. In my earlier works on China's central-local relations,<sup>1</sup> I defined de facto federalism as follows:

A relatively institutionalized pattern which involves an explicit or implicit bargain between the center and the provinces, allowing the provinces to receive certain institutionalized or ad hoc benefits in return for guarantees by provincial officials that they will behave in certain ways on behalf of the center.

More concretely, China's central-local relationship is defined as de facto federalism because it satisfies the following conditions:

1. A hierarchical political system in which the activities of government are divided between the provinces and the center in such a way that each level of government makes final decisions in certain fields.
2. Intergovernmental decentralization is institutionalized to such a degree that it is increasingly becoming difficult, if not impossible, for the central government to unilaterally impose its will on the provinces and alter the distribution of authority between levels of government.
3. The provinces have primary responsibility over the economy and, to some extent, politics within their jurisdictions.

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<sup>1</sup> Zheng Yongnian, *De Facto Federalism in China: Reforms and Dynamics of Central-Local Relations* (London and Singapore: World Scientific Publishing, 2007); "China's De Facto Federalism," in *Federalism in Asia*, edited by Baogang He, Brian Galligan and Takashi Inoguchi (Cheltenham: Edward Elgar, 2007); pp. 213-41; "Explaining the Sources of de facto Federalism in Reform China: Intergovernmental Decentralization, Globalization, and Central-Local Relations," *Japanese Journal of Political Science*, 7(2) (2006), pp. 101-26; and "Institutionalizing de facto Federalism in Post-Deng China," in *China Under Jiang Zemin*, edited by Hung-mao Tien and Yun-han Chu (Boulder, CO: Lynne Rienner Publishers, 2000); pp. 215-32.

In China's system of central-local relations, power is divided between the central government and the provinces. Some areas such as foreign policy, national defense and population planning are controlled exclusively by the central government, and it is very difficult for the local governments to have a say in the formulation of policy in these fields. Notwithstanding, some matters are exclusively dictated by the local governments, such as local public security, road construction and school building. Most economic matters are exclusively handled by the local governments while others are shared by the central government and the provinces, such as policies which are made by the central government but implemented by the local governments. The central government also has to consult local governments in the formulation of certain policies.

De facto federalism was a product of intergovernmental decentralization. The de facto institutional arrangement has greatly contributed to China's high economic performance.<sup>2</sup> However, it has also become a major institutional barrier for meaningful nationwide reforms which have implications for both the central government and the provinces. The central government tends to be increasingly defensive politically in economic regions, recentralizing many aspects of power. While all recentralization measures have enabled the central government to sustain its domination over the provinces, they have actually discouraged changes at the provincial level. Although some provinces are economically powerful, their political power has been greatly constrained by these recentralization measures. Consequently, rich provinces are economically powerful enough to resist central policy initiatives while poor ones are economically too weak to implement central policy initiatives. They are also politically too weak to initiate any meaningful reforms within the provinces.

This paper explains how such an institutional arrangement of central-local relationship has increasingly constrained China's reform process. First, it will define power since it reflects the nature of central-local relationship. Second, it will briefly review the evolution of central-local relations and discuss how the transition from intergovernmental decentralization to intergovernmental recentralization has taken place. Third, it will use two cases to show how such a central-local relationship has constrained China's reforms. And finally, the paper will draw some policy implications.

### **Power: Structure and Agent**

To argue that the power of the central government is to dominate, not to change, does not mean that the central government does not want to change; instead, it means that the quality of the power does not enable the central government to introduce meaningful reforms in the provinces. Before this phenomenon can be interpreted, it is important to define power to enable us to see the interactions between the central government and the provinces. To establish such a useful analytical frame, this paper refers to the definitions of power given by two French sociologists, Pierre Bourdieu and Michel Foucault.

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<sup>2</sup> For a review of this literature, see, Zheng Yongnian, "Institutional Economics and Central-Local Relations in China: evolving research," *China: An International Journal*, 3(2) (2005), pp. 240-69.

While the literature on power is marked by a deep disagreement over the basic definition of power, power is usually understood as relational. Generally speaking, power has been defined either as getting someone else to do what you want them to do (power-over) or as a capacity/ability to act (power-to). Max Weber's classical definition of power as "the probability that one actor within a social relationship will be in a position to carry out his own will despite resistance"<sup>3</sup> has been widely used as a starting point for a discussion of power in social sciences. Based on this, Robert Dahl offered what he called an "intuitive idea of power" according to which "A has power over B to the extent that he can get B to do something that B would not otherwise do."<sup>4</sup> Despite disagreements among scholars, they are ready to accept Dahl's basic definition. As Steven Lukes notes, all variations of definition of power have "the same underlying conception of power, according to which A exercises power over B when A affects B in a manner contrary to B's interests."<sup>5</sup> From a very different theoretical background, Michel Foucault's highly influential analysis presupposes that power is a kind of power-over; as he puts it, "if we speak of the structures or the mechanisms of power, it is only insofar as we suppose that certain persons exercise power over others."<sup>6</sup>

Other scholars emphasize power as a capacity/ability and define it as a capacity to do something (power-to). Thomas Hobbes' definition of power as a person's "present means...to obtain some future apparent Good" is a classic example of this understanding of power.<sup>7</sup> Hannah Arendt defines power as "the human ability not just to act but to act in concert."<sup>8</sup> According to Hanna Pitkin, "Power is a something — anything — which makes or renders somebody able to do, capable of doing something. Power is capacity, potential, ability, or wherewithal."<sup>9</sup> Similarly, Lukes defines power as a dispositional concept, meaning, as Lukes puts it, that power "is a potentiality, not an actuality — indeed a potentiality that may never be actualized."<sup>10</sup>

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<sup>3</sup> Max Weber, *Economy and Society: An Outline of Interpretive Sociology*, trans. Ephraim Fischhoff *et al.* (Berkeley, CA: University of California Press, 1978), p. 53.

<sup>4</sup> Robert Dahl, "The Concept of Power," *Behavioral Science*, 2 (1957), pp. 201-15. 1957, at pp. 202-3.

<sup>5</sup> Steven Lukes, *Power: A Radical View* (London: Macmillan, 1974), p. 30.

<sup>6</sup> Michel Foucault, "Afterword: The Subject and Power," in Hubert Dreyfus and Paul Rabinow, *Michel Foucault: Beyond Structuralism and Hermeneutics*, 2nd edition (Chicago, IL: University of Chicago Press, 1983), p. 217.

<sup>7</sup> Thomas Hobbes, *Leviathan* (New York: Penguin Books, 1985 [1641]), p. 150.

<sup>8</sup> Hannah Arendt, *On Violence* (New York: Harcourt Brace & Co, 1970), p. 44.

<sup>9</sup> Hanna Fenichel Pitkin, *Wittgenstein and Justice: On the Significance of Ludwig Wittgenstein for Social and Political Thought* (Berkeley, CA: University of California Press, 1976), p. 276.

<sup>10</sup> Steven Lukes, *Power: A Radical View*, 2nd expanded edition (London: Macmillan, 2005), p. 69.

In their analyses, some scholars focus on power-to, while others on power-over. Moreover, some scholars do not see any major difference between the two concepts of power, while others believe that these two concepts of power refer to fundamentally different meanings of the word “power.” What is important is that all scholars recognize that power is relational, be it power-to or power-over, namely, power is exercised among different actors. This paper recognizes the difference between these two concepts. While “power-over” is measured by the actual performance of the power exercised, “power-to” only indicates capacity/ability to act. Whether the potentiality of the power can be actualized depends on, as Foucault would argue, the existence of “technologies” and “mechanisms” of power in which a potentiality is transformed into an actuality. In this paper, I use the power-over to refer to the capacity of the central government to get the provinces to do something that the provinces would not otherwise do, and the power-to capacity/ability of the central government to exercise its domination over the provinces.

Furthermore, to consider power as a resource of action and focus on how power is distributed are important since such a definition will lead one to see the limitations of the power – forceful actors and their capacity to coerce social agents into certain behavior. In a given society, all actors such as the state and social forces have their own power resource in their relations with one another. Whether A has power over B depends on the existence of mechanisms and technologies which enables A to exercise power over B. In China’s central-local relations, such a dimension of power has two major connotations. First, from a bottom-up view, one can assume that such power can exist at the provincial level. The provinces are active power players, and they have their own power resources in their interactions with the central government. In other words, the province is the agent of power, and it can exercise its power over the central government. Second, from a top-down perspective, one can view the central government as the structural constraints on the provinces (agencies). The structural constraints are attributed to the nature of China’s political hierarchy in which the provinces are subordinate to the central government. In other words, the central government has more mechanisms and technologies of power over the provinces, and it is also in a strategic position to establish such mechanisms and technologies.

Both bottom-up and top-down perspectives are relevant to the understanding of China’s central-local relations. Apparently, the difference between the two approaches is not so much on their different ways of defining power, but in their focal point. While the former focuses on the agency, the latter places its emphasis on the structure. Power here refers to the relationship between the structure and the agency, or between the central government and the provinces. While a power relationship necessarily connotes a competitive one between any two actors (e.g., who gets what?), it does not necessarily indicates a zero-sum game if one integrates the power-over and the power-to. These two dimensions of power fit a real-life situation where a power relation could be both a non-zero-sum game and a win-win game. Power relations mean interactions between the structure and the agency or between the central government and the provinces. In their interaction, they exercise power over one another, and transform each other. To understand such a complicated relationship, we need a new interpretation of power which will enable us to see the interactive dynamics between the structure and the agency or the central government and the

provinces in this context. The reference here is the sociologies of Foucault and Bourdieu.

Bourdieu's concept of power explores the dynamics of power relations. Bourdieu views society as a bridged structure-agency divide.<sup>11</sup> His sociology is preoccupied with the analysis of patterns of social domination and the question of how such social domination is reproduced. The analysis of power is thus inherent to his sociology, and at the same time the patterns of reproduction are studied in the practices of concrete agents. According to Bourdieu, society consists of relationships between social agents who dispose of different types of capital such as economic, cultural, social or political capital. "Capital" does not mean only material resources but also the reputation that is attributed to the owner of these resources. Social fields are spaces of particular social practices that evolve around one given purpose. As such one can distinguish in a large sense the economic field, the political field, the cultural field and so forth. And within a given field, there are different sub-fields such as the literary field and the photographic field within the cultural field, and the worker's and the small shop owner's field within the economic field and so forth. Within these fields social agents hold hierarchical positions according to their configuration of capital and its appropriateness to the field's purpose and "rules of the game." The rules of the game and the field's purpose are, in turn, defined by the need to reproduce the resources necessary for those configurations of capital that institute the social hierarchy inside the field.

But not all fields are of equal importance. The most dominant fields are the fields of the state and the market. The state accumulates several types of capital and its mechanisms of reproduction, and is empowered to define the relevant capital configurations (for instance with its decisional power over education). Bourdieu calls this power to name relevant capital and to bestow it with normality symbolic power. The state is the social field that evolves entirely around this type of power. For Bourdieu, politics is the struggle to define the relevant types of capital configuration in order to access the socially dominant position. Conflict arises when and if social agents struggle over the definition of the relevant configuration of capital.

One can reflectively apply Bourdieu's theory to China's central-local relations. It is reasonable to consider politics as taking place in social fields and to assume that the central government and the provinces are actually such social fields. Bourdieu's theory suggests that the provinces are not completely helpless in their interaction with the central government. Instead, the provinces process their own "field" power. Through their continuous struggles with the central government for symbolic power, they facilitate the transformation of the central government while being a subordinate

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Bourdieu's sociology is reflected in his massive writings; an incomplete list of his works in English include P. Bourdieu, *Outline of a Theory of Practice* (Cambridge and New York: Cambridge University Press, 1977); Bourdieu, *Distinction: a Social Critique of the Judgment of Taste*, trans. Richard Nice (Cambridge, MA: Harvard University Press, 1984); Bourdieu, *In Other Words: Essays toward a Reflective Sociology* (Stanford, CA: Stanford University Press, 1990); Bourdieu, *Language and Symbolic Power* (Cambridge, MA: Harvard University Press 1991); Bourdieu, *An Invitation to Reflexive Sociology*, with Loïc Wacquant (Chicago, IL: University of Chicago Press, 1992); Bourdieu, *Practical Reason: On the Theory of Action* (Stanford, CA: Stanford University Press, 1998); and Bourdieu, *Acts of Resistance: Against the Tyranny of the Market* (New York: New Press, 1999).

to the state. Then the question is why such dynamic interactions between the central government and the province are unable to transform the nature of this relationship.

The sociology of Foucault provides us with the answer. Foucault's understanding of power differs fundamentally from that of most scholars in social sciences.<sup>12</sup> According to Foucault, power is not a resource or a force that is exercised by one agent over another, neither is it a determinate characteristic of a particular social or economic structure. Power is a state of social relations in which force is exercised by and through the agents, one upon another. Power is therefore ubiquitous and omnipresent as there cannot be social relations without the exercise of some kind of force between the agents. Meanwhile, power is not an individual, intentional act. As Philp interprets, "individuals are the effect of power, they are its subjects and its vehicles, not its point of origin."<sup>13</sup> Power is the form and the way by which social agents, or more precisely societies, are formed, socialized, inspired, motivated, integrated and – individually and socially – "incorporated." Power is not a "thing" but a quality of social relations. Power is the ensemble of practices by which some social agents will act upon others and transform, influence and shape their ideas, their bodies, their spaces and, even, their time. Power has thus different appearances according to the different ways it shapes the social relations. Foucault calls these different appearances "technologies of power" or "mechanisms of power" without necessarily indicating an intentional actor by these metaphors but rather a certain pattern of regular cause-to-effect chains in the way power becomes apparent.

When applying it to China's central-local relations, Foucault's conceptualization of power can de-institutionalize power and enable one to identify a natural status of central-local relations where the central government and the provinces interact. Foucault's power notion thus describes the structure of central-local relations. In other words, it implies some regular and recurring pattern of a law-like kind. To a degree, Foucault's concept of power is agent-less since it refers to a general distribution of power among social relations. In this sense, Foucault's concept is often regarded as less capable of explaining changes in human relations. Nevertheless, Foucault's concept of power is very capable of pointing to the nature of changes. Among agents in social relations, Foucault himself placed much emphasis on state power. He pointed to the transformation of state power by referring to the exercise of both "formal" and "informal" power and control on the part of the state. For example, according to Foucault, the early modern state imposed control formally to encourage certain behaviors and threatened draconian punishments for their violation; in contrast, the modern state enlists its subjects as participants in their own governance. In the process, it shifts the locus of control internally. As a matter of fact, the state instructs, commands and punishes on the one hand, and educates, informs, persuades and discourages on the other.

By combining the sociologies of Bourdieu and Foucault, one can see the dynamics of interaction between the central government and the provinces in China. The sociology of Bourdieu is capable of explaining the interactive dynamics of

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<sup>12</sup> M. Philp, "Foucault on Power: A Problem in Radical Translation?" *Political Theory*, Vol.11, No.1 (1983), p.34.

<sup>13</sup> *Ibid*, p36

central-local relations. I assume that central-local relationship is an area in which interactions between the central government and the provinces take place. The central government is a part of this relationship, not independent from the provinces. The interaction between the central government and the provinces is mutually transformational. The mutual transformation of the central government and the provinces, however, does not mean the transformation of the nature of their relationship. The sociology of Foucault enables us to explore how the existing structures in which the central government dominates the provinces can be reproduced. The domination of the central government over the provinces also means its capacity to accommodate changes in the provinces resulting from intergovernmental decentralization. The central government possesses symbolic power, reproducing itself and maintaining its hegemonic position through interacting with the provinces.

The power of domination, however, does not imply the power to change. Domination means that the central government is able to absorb the consequences of all changes in the relationship between the central government and the provinces. The structural hierarchy of the central government enables it to reproduce itself, but does not mean that the central government can exercise its power over the provinces at will. Within China's existing de facto federal structure, all actors have their own "field" power as well as power from their interdependence. While the provinces, with their own resources, can compete for power with the central government, and thus provide dynamics for changes, the central government has been able to absorb whatever changes and reproduce the same structure of central-local relations. Power as resource does imply that the provinces are not that helpless; it also means that the provinces do not have power to change their subordination to the center. As long as their subordination remains, the provinces are not autonomous in making the type of desirable changes in their territory. Meanwhile, the interdependency allows the provinces to resist central policies which they regard as undesirable to their own territories. The central-local relationship thus constrains China's reforms on all fronts.

### **Intergovernmental Decentralization and High Economic Performance**

In the era of reform and openness, China's de facto federalism has been driven by intergovernmental decentralization. Decentralization has been widely used as a reform strategy by political leaders in communist and post-communist states to resolve economic and political problems resulting from over-centralization in the old planning economy. Different ways of decentralization lead to rather different outcomes. Table 1 outlines two main types of decentralization and four major dimensions of decentralization. The Chinese leadership focused on intergovernmental decentralization. I will argue that while intergovernmental decentralization has led to high economic performance, the central government will have to shift its focus from intergovernmental decentralization to state-society decentralization to increase its capacity to enforce meaningful reforms in the provinces and in central-local relations.

#### *Intergovernmental Economic Decentralization*

Although China's reforms are said to be market-oriented, there have been few serious attempts at providing the central features of private markets, or a system of securing private property rights. Commercial law and an independent court system



were virtually non-existent. So, how did China achieve high economic performance without any of these factors assumed to be essential to economic growth elsewhere? This is largely due to what I call de facto federalism, or market-persevering federalism, as suggested by Montinola, Qian, Weingast and others.<sup>14</sup> Central to de facto federalism and market-persevering federalism is intergovernmental decentralization.

After China began its economic reform in 1979 and before the recentralization efforts in the mid 1990s, the leadership under Deng Xiaoping repeatedly emphasized devolution of authority from central to local governments. Intergovernmental decentralization provided an important set of limits on the behavior of all levels of government which was in favor of economic growth. As Montinola, Qian and Weingast point out, “By design, decentralization directly limits the central government’s control over the economy. It also induces competition among local governments, serving both to constrain their behavior and to provide them with a range of positive incentives to foster local economic prosperity.”<sup>15</sup> Intergovernmental decentralization rules out the possibility of a single government monopolizing control over the economy. “If many regions can choose policies for themselves, all can compare the results, including those which do not wish to initiate reform policies.”<sup>16</sup>

Intergovernmental decentralization also provides great market incentives. Efficient markets require two related sets of initiative for credible commitment by the state – “positive” market incentives that reward economic success, and “negative” market incentives that punish economic failure. According to Qian *et al*, the two main features of China’s political economic system – decentralization of information and authority and inter-jurisdiction competition – provide credible commitment to securing economic rights and preserving markets. During the process of economic reform, China’s central government deliberately limited its access to certain information in order to prevent the center from repeating the pernicious behavior of the previous reform period. For instance, the center allowed local governments to maintain various “extra-budget” and “off-budget” accounts. Limited knowledge of these budgets ensured that the central government could not tax them. This in turn helped local governments to prosper and generate revenue.

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<sup>14</sup> Gabriella Montinola, Yingyi Qian and Barry R. Weingast, “Federalism, Chinese Style: The Political Basis for Economic Success in China”, *World Politics*, 48 (Oct. 1995): 50-81; Hehui Jin, Yingyi Qian and Barry R. Weingast, “Regional Decentralisation and Fiscal Incentives: Federalism, Chinese Style”, Unpublished manuscript, 1999; Yuanzheng Cao, Yingyi Qian and Barry Weingast, “From Federalism, Chinese Style, to Privatization, Chinese Style”, Unpublished manuscript, 1997; and Yingyi Qian, “The Institutional Foundations of China’s Market Transition”, Paper prepared for the World Bank’s Annual Conference on Development Economics, Washington, DC, 28-30 Apr. 1999.

<sup>15</sup> Montinola, Qian, and Weingast, *ibid.*, p. 79.

<sup>16</sup> *Ibid.*, p. 80.

<b>Table 1 Two Stages of Decentralization</b>		
	<b>Stage I</b>	<b>Stage II</b>
<b>Decentralization</b>	<b>Intergovernmental</b>	<b>State-Society (Enterprise)</b>
<i>Economic</i>	<i>Central-local</i>	<i>State-enterprises</i>
	<u>Outcomes:</u> <ul style="list-style-type: none"> <li>• Local or regional property rights</li> <li>• Jurisdictional competition</li> <li>• Limited marketization</li> <li>• Local intervention</li> <li>• Local protectionism, etc</li> </ul>	<u>Outcomes:</u> <ul style="list-style-type: none"> <li>• Private property rights</li> <li>• Privatization</li> <li>• Marketization</li> <li>• Competition among individual enterprises</li> <li>• Less or no government intervention, etc</li> </ul>
<i>Political</i>	<i>Central-local</i>	<i>State-society</i>
	<u>Outcomes:</u> <ul style="list-style-type: none"> <li>• Local democracy</li> <li>• Perforated sovereignty and <i>de facto</i> federalism</li> <li>• Limited individual rights, etc.</li> <li>• Governmental “NGOs”</li> </ul>	<u>Outcomes:</u> <ul style="list-style-type: none"> <li>• Democratization</li> <li>• Popular sovereignty and individual rights</li> <li>• Political participation</li> <li>• NGOs and civil society, etc.</li> </ul>

Source: compiled by the author.

The effect of decentralized allocation of information and authority in achieving credible commitment helps to explain why many local government-owned enterprises, such as local township and village enterprises (TVEs), perform better than state-owned ones. These local government-owned enterprises have a different governance structure from state-owned enterprises (SOEs) and thus face better positive and negative incentives. By fully controlling the assets of TVEs, the local governments have access to information not available to the central government, and are thus able to resist state revenue predation in a credible way.

Competition among jurisdictions also forces local governments to represent citizen interests and to preserve markets. Jurisdictional competition among local governments increases efficiency through sorting and matching. It also serves as a disciplinary device to punish inappropriate market intervention by lower government officials. It further helps limit the government’s predatory behavior. Mobile resources quickly flee jurisdictions that practice inappropriate behavior. Competition for mobile sources of revenue prevents local political leaders from imposing debilitating taxes or regulations.

### *Intergovernmental Political Decentralization*

Unlike other communist political institutions, China's political system is flexible, thus offering opportunities for policy innovation. Top leaders in China's political hierarchy have not, as is commonly assumed, always dictated economic decisions. Rather, provincial officials have had an important say in decision-making at the central level.

Intergovernmental decentralization has produced what Susan Shirk called "reciprocal accountability,"<sup>17</sup> a type of power relationship between top leaders and other Chinese communist Party (CCP) cadres. According to Shirk,

[The] relationship between party leaders and subordinate officials is not a pure hierarchy: according to the party rules, the Central Committee has the authority to choose party leaders, and the Central Committee consists of party, government, and military officials appointed by party leaders. The leaders appoint the officials and the officials in the Central Committee choose (or at least ratify the choice of) the leaders. Government officials are both the agents and the constituents of central leaders; local officials are both the agents and the constituents of central leaders. Officials hold their positions at the pleasure of the party leadership, but party leaders hold their positions at the pleasure of the officials in the selectorate (e.g., the Central Committee). The lines of accountability run in both directions, turning a hierarchical relationship into one of "reciprocal accountability."<sup>18</sup>

Given the fact that officials from the provinces (e.g., provincial party secretaries and governors) are the largest bloc in the selectorate, the relationship between the center and the provinces is more reciprocally accountable than any other types of relations in China's political system. The relationship of "reciprocal accountability" matters for China's economic performance. It helps the formation of the reform coalition between the central reformist leadership and local governments. On the one hand, since provincial officials seek to be promoted in the Chinese political hierarchy, the central authorities could "play to the provinces" to gain the political support of provincial officials by providing them with political incentives through the appointment system or the central nomenklatura. "Playing to the provinces" became an important strategy of the reformist leadership to mobilize local support for the reforms. On the other hand, provincial officials could also "play to the center" because they form the majority of the selectorate and their votes are important to any top leader's political legitimacy. Once the provincial representatives in the Central Committee put the weight of the Party behind the reforms, they are capable of forcing the central leadership into implementing economic reforms in favor of local economic growth. By "playing to the center," provincial officials are able to maintain the reform momentum in favor of local growth.

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<sup>17</sup> Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley, CA: University of California Press, 1993).

<sup>18</sup> *Ibid.*, p. 83.

### *The Centralized Political Structure*

Despite decentralization elements in intergovernmental relations, the centralized structure is maintained. This structure also matters for high economic performance since it helps overcome resistance and opposition from the administrative hierarchy itself. Compared to Russia, China's political system has been able to exploit the "positive" effects of decentralization while overcoming the "negative" effects. An obvious example is that the local governments in China have actively contributed to the growth of new firms, while the local governments in Russia have typically stood in the way.

While China's central-local institutional arrangements endow local governments with considerable operational autonomy, local officials are agents of the central government (the principal). Chinese central authorities have retained a firm grip over the vital aspects of personnel allocation such as selection, promotion and dismissal. According to Yasheng Huang, two institutional factors have contributed to this. First, the Party's principle of management stresses ideological conformity and gives the CCP dominant procedural control over appointment decisions. Second, cadre management is centralized. Though considerable changes have taken place in the cadre management system, the reach of the center is both extensive and deep. Control over personnel allocation is the ultimate trump card that the center wields over the provinces. It is a fundamental constraint faced by all Chinese local officials.<sup>19</sup>

According to Olivier Blanchard and Andrei Shleifer, this type of centralized structure is a precondition for the transition to succeed.<sup>20</sup> While neo-classical political economy literature tends to focus on market competition in the rewarding of "good" behavior and punishing of the "bad" behavior, the market mechanism alone is not enough to explain China's transition from a planned economy to a market one. China's transition has taken place under the tight control of the CCP. The central government has been in a strong position either to reward or punish local administrations. By contrast, Russia's transition came with the emergence of a partly dysfunctional democracy. The Chinese central government has been strong enough to neither impose its views, nor set clear rules on the sharing of the proceeds of growth. As a result, local governments have encountered few disincentives either to resist or rein in competition for rents.

The CCP has utilized the power to appoint and fire governors to support governors whose regions have performed well economically, and to discipline those who have failed to follow its economic policies. Without such a structure, the incentives to pursue regionalist policies are too high, a tendency which cannot be eliminated solely through clever economic and fiscal arrangements. This is evident in Russia's case, where governors were elected, not appointed. As a result, the ability of the central government to reward or penalize governors through administrative and electoral support had been limited.

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<sup>19</sup> Yasheng Huang, *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations During the Reform Era*, Cambridge University Press, 1996.

<sup>20</sup> Olivier Blanchard and Andrei Shleifer, "Federalism with and without Political Centralization: China versus Russia", IMF staff paper, no. 48, 2001.

## **Intergovernmental Decentralization and Its Consequences**

Intergovernmental decentralization has been very successful in achieving high economic performance, but this comes with costs and contradictions within the administrative hierarchy. Although the centralized structure remains, the cost of maintaining this structure becomes increasingly high. Even though rapid intergovernmental decentralization did not lead to the breakup of China as it did with the Soviet Union, localism or regionalism often became uncontrollable and posed increasingly serious challenges to the central power.

Under intergovernmental decentralization, economic power shifted from the central state to local governments at different levels. For example, central revenue shrank from 40.5 percent of the total revenue in 1984 to 22 percent in 1994 while central expenditure declined from 52.5 percent to 30.3 percent during the same period (Tables 2 and 3). With their economic power, the provinces began to resist new fiscal policies initiated by the central government. When the central government wants to increase its taxes, resistance from the rich provinces has been strong.

Rapid economic decentralization also widened the income gap among provinces and regions. In coastal areas such as Guangdong, Zhejiang, Jiangsu and Shandong, local officials have developed very strong non-state sectors including collectives, private economies and joint ventures, which are very profitable and beyond the control of the central government. In inland provinces, owing to various factors such as the lack of financial resources and skilled personnel, local governments have difficulty pushing local growth. Consequently, some provincial governments achieved a high capacity to lead local development and improve local residents' living standards, while others did not. Due to an increase in local diversity, the central government finds it difficult to implement unified policies to lead and constrain local governments while local officials could easily nullify central policies.

The decline of central power prevented the central government from coordinating local economic activities effectively. Rich provinces were reluctant to cooperate with one another when they could plan local development independently. Poor and rich provinces were also reluctant to cooperate. Besides the presence of a similar industrial structure, the psychology of being victimized by rich provinces among local officials in poor provinces was also important. The lack of coordination in regional development on the part of the central government is the key factor driving widening income disparities among regions.

Year	Total Revenue	Central Government	Local Governments	Ratio (%)	
				Central Government	Local Governments
1953	21.32	17.70	3.62	83.0	17.0
1960	57.23	14.28	42.95	25.0	75.0
1965	47.33	15.61	31.73	33.0	67.0
1970	66.29	18.30	48.00	27.6	72.4
1975	81.56	9.66	71.90	11.8	88.2
1976	77.66	9.89	67.77	12.7	87.3
1977	87.45	11.39	76.06	13.0	87.0
1978	113.23	17.58	95.65	15.5	84.5
1979	114.64	23.13	91.50	20.2	79.8
1980	115.99	28.45	87.55	24.5	75.5
1981	117.58	31.11	86.47	26.5	73.5
1982	121.23	34.68	86.55	28.6	71.4
1983	136.70	49.00	87.69	35.8	64.2
1984	164.29	66.55	97.74	40.5	59.5
1985	200.48	76.96	123.52	38.4	61.6
1986	212.20	77.84	134.36	36.7	63.3
1987	219.94	73.63	146.31	33.5	66.5
1988	235.72	77.48	158.25	32.9	67.1
1989	266.49	82.25	184.24	30.9	69.1
1990	293.71	99.24	194.47	33.8	66.2
1991	314.95	93.83	221.12	29.8	70.2
1992	348.34	97.95	250.39	28.1	71.9
1993	434.90	95.75	339.14	22.0	78.0
1994	521.81	290.65	231.16	55.7	44.3
1995	624.22	325.66	298.56	52.2	47.8
1996	740.80	366.11	374.69	49.4	50.6
1997	865.11	422.69	442.42	48.9	51.1
1998	987.60	489.20	498.40	49.5	50.5
1999	1144.41	584.92	559.49	51.1	48.9
2000	1339.52	698.92	640.61	52.2	47.8
2001	1638.60	858.27	780.33	52.4	47.6
2002	1890.36	1038.86	851.50	55.0	45.0
2003	2171.53	1186.53	985.00	54.6	45.4
2004	2639.65	1450.31	1189.34	54.9	45.1
2005	3164.93	1654.85	1510.08	52.3	47.7
2006	3876.02	2045.66	1830.36	52.8	47.2

Sources: The Statistical Yearbook of China, various years.

<b>Table 3 Expenditure of Central and Local Governments (billion yuan)</b>					
<b>Year</b>	<b>Total Expenditure</b>	<b>Central Government</b>	<b>Local Governments</b>	<b>Ratio (%)</b>	
				<b>Central Government</b>	<b>Local Governments</b>
1953	21.92	16.21	5.72	73.9	26.1
1960	64.37	27.86	36.51	43.3	56.7
1965	46.00	28.42	17.58	61.8	38.2
1970	64.94	38.24	26.70	58.9	41.1
1975	82.09	40.94	41.15	49.9	50.1
1976	80.62	37.76	42.86	46.8	53.2
1977	84.35	39.37	44.98	46.7	53.3
1978	112.21	53.21	59.00	47.4	52.6
1979	128.18	65.51	62.67	51.1	48.9
1980	122.88	66.68	56.20	54.3	45.7
1981	113.84	62.57	51.28	55.0	45.0
1982	123.00	65.18	57.82	53.0	47.0
1983	140.95	75.96	64.99	53.9	46.1
1984	170.10	89.33	80.77	52.5	47.5
1985	200.43	79.53	120.90	39.7	60.3
1986	220.49	83.64	138.66	37.9	62.1
1987	226.22	84.56	141.66	37.4	62.6
1988	249.12	84.50	164.62	33.9	66.1
1989	282.38	88.88	193.50	31.5	68.5
1990	308.36	100.45	207.91	32.6	67.4
1991	338.66	109.08	229.58	32.2	67.8
1992	374.22	117.04	257.18	31.3	68.7
1993	464.23	131.21	333.02	28.3	71.7
1994	579.26	175.44	403.82	30.3	69.7
1995	682.37	199.54	482.83	29.2	70.8
1996	793.76	215.13	578.63	27.1	72.9
1997	923.36	253.25	670.11	27.4	72.6
1998	1079.82	312.56	767.26	28.9	71.1
1999	1318.77	415.23	903.53	31.5	68.5
2000	1587.94	551.43	1036.51	34.7	65.3
2001	1884.40	575.40	1309.00	30.5	69.5
2002	2205.32	677.17	1528.15	30.7	69.3
2003	2465.00	742.01	1722.99	30.1	69.9
2004	2848.69	789.41	2059.28	27.7	72.3
2005	3393.03	877.60	2515.43	25.9	74.1
2006	4042.27	999.14	3043.13	24.7	75.3

Sources: The Statistical Yearbook of China, various years.

It is important to note that economic decentralization from the very beginning was accompanied and indeed facilitated by China's globalization. These two developments resulted in a relatively greater increase in interdependence between the Chinese provinces and the outside world, and a surprising decrease in inter-provincial interdependence. According to a study by the World Bank, as of the early 1990s, internal trade as a percentage of GDP among the Chinese provinces was 22 percent, which was lower than the then European Community's 28 percent and the 27 percent among the republics of the former Soviet Union. The World Bank thus warned that individual provinces had the tendency to behave like independent countries, increasing external (overseas) trade and reducing trade flows with each other.<sup>21</sup>

This trend was well recognized inside China. For example, in the early 1990s, two noted Chinese economists, Shen Liren and Dai Yuanchen, pointed out that rapid intergovernmental decentralization had given rise to various dukedom economies.<sup>22</sup> The consequences, in turn, have prompted the development of a discourse on recentralization which emphasized the importance of state capacity in regulating the national economy and maintaining the country as a united state. Scholars such as Wang Shaoguang and many others presented strong arguments in favor of recentralization. These scholars concentrated on how economic decentralization had weakened central power. For example, the fear of Wang Shaoguang and Hu Angang of a possible breakdown of the Chinese nation state was supported by their comparison of China with other former Communist states, especially former Yugoslavia.<sup>23</sup> Like many others, they believed that radical intergovernmental decentralization had become a major barrier to the formation of an integrated national market economy. They also argued that a highly centralized state was not necessarily totalitarian or authoritarian. Instead, to build a strong democratic China, the country had to have a centralized state. Wang and Hu published their co-authored book on state capacity (in terms of central fiscal power) in 1994.<sup>24</sup> The book was widely circulated in the academic circles and among government officials. In the same year, the central government started to initiate a recentralization movement by implementing a new taxation system called tax-division system. The Wang-Hu report undoubtedly justified the efforts of the central government in recentralizing the country's fiscal power.

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<sup>21</sup> The World Bank, *China: Internal Market Development and Regulations* (Washington, DC: World Bank, 1994). For a summary, see, Anjali Kumar, "China's Reform, Internal Trade and Marketing," *The Pacific Review* 7: 3 (1994), pp. 323-40.

<sup>22</sup> Shen Liren and Dai Yuanchen, "Woguo 'zhuhou jinji' de xingcheng jiqi biduan he genyuan" ("The Formation of the Economy of Dukedom, Its Defects and Roots in China"), *Jingji yanjiu*, no. 3 (1990), p.12.

<sup>23</sup> Wang Shaoguang and Hu Angang, "Zhongguo zhengfu jiqu nengli de xiajiang jiqi houguo" ("The Decrease in the Extractive Capacity of the Chinese Government and Its Consequences"), *Ershiyi shiji* (The Twenty-First Century), no. 21 (February 1994), pp. 5-10.

<sup>24</sup> Wang Shaoguang and Hu Angang, *Zhongguo guojia nengli baogao* (A Report of State Capacity in China), Hong Kong: Oxford University Press, 1994.



## Selective Recentralization

Around the mid 1990s, the Chinese leadership began its recentralization efforts. Re-centralization does not mean that the leadership intends to reverse the reform process and go back to the old system. What the leadership did was to selectively recentralize certain aspects of power, powers which were vital to the survival of the administrative hierarchy. In the economic realm, selective centralization was initially concentrated on two major reforms - taxation reform and central banking system reform. Since the early 2000s, recentralization has taken place in a wider range of policy areas such as environment, consumer/product safety, labor, land and so on, as the central government began to make greater attempts at establishing an effective regulatory frame.

### *Taxation Reform*

In 1994, the central government began to implement a new taxation system, a tax-division system or a federal-style taxation system. Before this system, the center did not have its own institutions to collect taxes. All taxes from the provinces were collected by provincial governments first before they were divided between the center and the individual provinces through bargaining.

With the reformed taxation system, taxes are divided into three categories — central, local, and shared. Central taxes would go to the central coffer, local taxes would go to local budgets, and shared taxes would be divided between the center and the provinces according to previously established agreements. Moreover, tax administration is centralized. Instead of authorizing local tax offices to collect virtually all the taxes, the center now collects taxes through its own institutions independent of the provinces, meaning that the center has established its own revenue collection agency — the national tax service. The new system also recognizes independent provincial power, that is, provincial authorities and lower governments can collect several types of taxes without interference from above. There are now two parallel and independent systems for tax administration — a national system for central taxes and a local one for local taxes. Shared taxes were collected by the central government first, and then divided between the center and the provinces.<sup>25</sup>

These institutional changes shifted fiscal power from the provinces to the center. Total government revenue has increased quite dramatically as a result. The proportion of central collection has increased from lower than 30 percent to around 50 percent after the implementation of this reform (see Table 2 for details). If the locally collected revenues that local governments are obligated to remit to the central coffer are included, the central government's share would constitute about two-thirds of total government revenue. Since most revenues are now collected and redistributed by the center, the fiscal dependence of the provinces on the central government has increased

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For a more detailed discussion of China's fiscal reforms, see, Christine P. W. Wong and Richard M. Bird, "China's Fiscal System: A Work in Progress," in Loren Brandt and Thomas G. Rawski, eds., *China's Great Economic Transformation* (New York: Cambridge University Press, 2008), pp. 429-66.

substantially. Before the taxation reform, the central government had to rely heavily on coastal provinces for revenue contribution. The reform has reversed this trend.<sup>26</sup>

### *Central Banking System Reform*

Similar efforts have been made to reform the central banking system. Before the reform, China's central banking system was highly decentralized. The central bank, People's Bank, had branches in every province. Local branches were often exposed to the political influence of local governments since the personnel of local branches were appointed and their welfare provided for by the local governments. This frequently led to local branches ignoring orders from the central bank and subordinating themselves to local influences. While local branches of the central bank often became an effective instrument for local governments to promote local economic growth, rapid local growth was achieved at the expense of the stability of the national economy. The decentralized central banking system eventually led to the crisis of macro-economic management after Deng's southern tour in 1992. After a new government with Zhu Rongji as China's new premier was established in 1998, the central government implemented a most daring measure to reform China's financial system: all provincial branches of the central bank were eliminated and nine cross-provincial or regional branches established. This reform has made local interferences into the central banking system impossible.<sup>27</sup>

### *Political Recentralization*

Most important are efforts in recentralizing political power. Initial political recentralization took place immediately after the crackdown on the pro-democracy movement in 1989 and the collapse of the Soviet Union in the early 1990s. The central government re-strengthened the old nomenklatura system, a traditional method for the communists to control local party cadres and government officials.<sup>28</sup> It reinforced the system of "party management of cadres" (*dang guan ganbu*), one of the most important organizational principles. This system gives the central government a dominant say over personnel decisions at the provincial and city level.<sup>29</sup> The central government also re-emphasized the cadre transfer system or the cadre exchange system (*ganbu jiaoliu zhidu*), which enables the center to tighten control over local cadres.<sup>30</sup>

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<sup>26</sup> For assessments of the 1994 taxation reform, see, Shaoguang Wang, "China's 1994 Fiscal Reform: An Initial Assessment," *Asian Survey*, XXXVII: 9 (September 1997), pp. 801-17, and Hu Angang, "Fenshuizhi: pingjia yu jianyi."

<sup>27</sup> For a discussion of China's financial system, see, Franklin Allen, Jun Qian and Meijun Qian, "China's Financial System: Past, Present, and Future," in Brandt and Rawski, eds., *China's Great Economic Transformation*, pp. 507-68.

<sup>28</sup> John Burns, (ed.), *The Chinese Communist Party's Nomenklatura System* (Armonk, NY.: M. E. Sharpe, Inc., 1989).

<sup>29</sup> *Ibid.*

<sup>30</sup> *Renmin ribao*, May 17, 1995, p. 1.

Cadres involved in the transfer consist mainly of leading members of party committees and the government. According to CCP regulations, a leading member of a local party committee or government should be transferred if he/she has worked in the same position for 10 years. The CCP Constitution mandates a five-year term for party committee positions at county level and above. Therefore, if a provincial level cadre has not reached retirement age by the end of his/her second term, he/she has to be transferred. The system of cadre transfer is an effective instrument for the center to constrain localism and prevent local vested interests from becoming too deeply entrenched.

Selective recentralization has been intensified recently in the central leadership's attempts to change the development model. During the Jiang Zemin era (1989-2002), the leadership gave highest priority to rapid economic development. But the old model was inefficient, caused greater social divides, income disparities and environmental degradation on a colossal scale, and lacked industrial innovation. All these factors impacted negatively on the sustainability of China's development. The Hu Jintao-Wen Jiabao leadership since 2002 has made great efforts to develop a new model which places emphasis on "scientific development" (namely, balanced development), and "harmonious society." This shift in emphasis is proving to be extremely difficult. Vested interests under the old model have resisted a drastic policy shift. According to one official survey conducted in 2006, the overwhelming majority (86 percent) of the respondents (no. 4,531) believed that power was too decentralized, and it is now time to recentralize.<sup>31</sup> To overcome local resistance, the central government is recentralizing in key areas, including quality control, auditing, environment, land management, statistics and industrial safety. The rationale behind these recentralization efforts is to transform the Chinese state into a regulatory one.<sup>32</sup>

Political recentralization has been effective in constraining the influence of local officials in policy making at the central level. It is true that some regions are always more powerful than other regions in economic terms. In general, the more economically developed regions are also the more politically powerful regions. However, the power of economic regions does not guarantee their political power. Take the 17th Central Committee as an example. In terms of regional distributions, the East Region is dominant with 131 members (35.5 percent), the North Region is second with 75 members (20.6 percent) while the South Region is last with the least representation of only 13 members (3.5 percent). Unlike previous central committees, members of the 17th Central Committee members come from across the regions. The share of the East Region declined from 43.3 percent of the 15th Central Committee to 40.2 percent of the 16th Central Committee to 35.5 percent of the 17th Central Committee. The North Region climbed up to the No. 2 spot, from 13.4 percent of the 15th Central Committee to 15.7 percent of the 16th Central Committee to 20.6 percent of the 17th Central Committee.

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<sup>31</sup> *Zaobao*, Singapore, November 21, 2006.

<sup>32</sup> Yongnian Zheng, *Globalization and State Transformation in China* (Cambridge: Cambridge University Press, 2004), and Dali Yang, *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China* (Stanford, CA: Stanford University Press, 2004).

“Strong economy and weak politics” is particularly true of provinces which are often regarded as being capable of imposing power challenges to the central government. Guangdong and Shanghai are two cases in point. Guangdong has the largest economy in China, but it failed to be dominant at the 17th Central Committee. Only five central committee members are from Guangdong Province, down from eight in both the 16th Central Committee and the 15th Central Committee. Seven members of the 17th Central Committee have Shanghai as their home province, but none of them are qualified to be a member of the so-called “Shanghai Gang” formed under Jiang.

Both Guangdong and Shanghai are economically significant for China. Their economic significance can be transformed into political influence. Nevertheless, once the central government feels threatened by their political influence, the former will make efforts to constrain the latter’s political influence. Take two examples. During his tenure in Guangdong, Zhang Dejiang took great initiatives to develop a development program, namely, the “9 plus 2.” The program aimed to integrate the economies of nice Chinese provinces surrounding the Pearl River Delta and those of Hong Kong and Macao. Given the fact that Zhang was a member of the Political Bureau, he was able to coordinate these provinces together with Hong Kong and Macao.<sup>33</sup> Nevertheless, this program was regarded as unjustifiable to the interest of the national economy. At the 17th Party Congress in 2007, Zhang retained his membership in the Political Bureau and was promoted to Beijing, but played an insignificant role as one of vice premiers. Indeed, ever since the establishment of the People’s Republic, Guangdong has struggled for more political influence in the central government. Guangdong, however, has never been successful since such efforts have been identified as localism which the central government is against.<sup>34</sup> In the case of Shanghai, it was extremely powerful during the era of Jiang Zemin, as reflected in the existence of the “Shanghai Gang.” The political power of the Shanghai Gang was evident when its party secretary Chen Liangyu challenged the power of the Hu Jintao-Wen Jiabao leadership. However, prior to the 17th Party Congress, Chen was removed and jailed for alleged corruption.

### State Incapacity

All these measures of recentralization have drastically increased state capacity, be it fiscal power (as Wang Shaoguang would argue) or personnel appointment (as Huang Yasheng would argue). Recentralization and state capacity, however, are hardly identical. These measures have enabled the central government to accumulate its power resources vis a vis the province. Nevertheless, as discussed earlier, “power-to” is different from “power-over,” namely, to get something done when facing

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<sup>33</sup> See, Zheng Yongnian and Zhang Yang, “cong CEPA dao ‘9+2’: zhengzhi dongle yu goujia” (From the CEPA to ‘9+2’: political motivations and frame), in John Wong and Li Jiangtao, eds., *Hezuo yu gongying: fanzhusanjiao jingji hezuo ji dui dongnanya de yingxiang* (Cooperation and Win-Win: Economic Cooperation in the Greater Pearl River Delta and its Impact on Southeast Asia), Guangzhou: Guangdong renmin chubanshe, 2006, pp. 73-92.

<sup>34</sup> Zheng, *De Facto Federalism in China*, Chapter 6.

resistance. In terms of “power-over,” the power of the central government has been in decline. It has failed to produce any significant changes in the provinces. Examples are ample. While its revenue has increased rapidly in the past decades, the central government has not been able to reduce income disparities of various forms. It has yet to provide sufficient public goods such as healthcare, social security, education and environment. While fiscal recentralization does not generate expected results, it has led to unexpected consequences. For example, while fiscal centralization has drastically reduced revenues of local governments, it has also encouraged corruption of various forms at local levels. As shown in Table 4, while the central government has accumulated an increasingly large amount of revenues over the years, local governments are in serious deficits, which have contributed to widespread corruption at local levels.<sup>35</sup>

A full description of state incapacity and its consequences is not appropriate here. As such, this section only presents two cases, one economic, and the other political, to show why recentralization has become an increasingly serious constraint on China’s further reforms. The economic case, namely the state-owned enterprise (SOE) reform, attempts to demonstrate how recentralization has discouraged the central government from achieving what it had planned. The SOE reform was to restructure the economy and provide an institutional foundation for the development of small- and medium-sized enterprises (SMEs). It, however, turned out that the reform has created an institutional setting for state monopoly which is a major barrier to sustainable development. The political case, namely, the rise of social forces and bottom-up political participation, shows that recentralization has contained the social initiatives of political development.

### *The SOE Reform*

The SOE reform has been the core of China’s economic reform for almost three decades. The reform has achieved great success in improving the productivity and efficiency of state-owned enterprises. Although China began SOE reforms in the 1980s, radical reforms only took place after Deng’s southern tour in 1992. It was heavily debated whether China should adopt a market economy approach until 1992 when the Fourteenth National Congress of the CCP clearly stated that China’s economic reform was to establish a socialist market economy. The pursuit of “market economy” status provided the necessary conditions for China to begin large-scale economic decentralization. Since then the SOE reform has gone through two phases: the strategy of “grasping the big and letting go of the small” under the previous premier Zhu Rongji and the management by State-Owned Assets Supervision and Administration Council under the current premier Wen Jiabao.

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<sup>35</sup> Shuanglin Lin, “China’s Government Debt: How Serious?” *China: An International Journal*, 1: 1 (March 2003), pp. 73-98.

<b>Table 4 Deficits of Central and Local Governments (billion yuan)</b>			
	<b>Total</b>	<b>Central</b>	<b>Local</b>
1953	-0.60	1.49	-2.10
1960	-7.14	-13.85	6.44
1965	1.33	-12.81	14.15
1970	1.35	-19.94	21.30
1975	-0.53	-31.28	30.75
1976	-2.96	-27.87	24.91
1977	3.10	-27.98	31.08
1978	1.02	-35.63	36.65
1979	-13.54	-42.38	28.83
1980	-6.89	-38.23	31.35
1981	3.74	-31.46	35.19
1982	-1.77	-30.50	28.73
1983	-4.25	-26.96	22.70
1984	-5.81	-22.78	16.97
1985	0.05	-2.57	2.62
1986	-8.29	-5.80	-4.30
1987	-6.28	-10.93	4.65
1988	-13.40	-7.02	-6.37
1989	-15.89	-6.63	-9.26
1990	-14.65	-1.21	-13.44
1991	-23.71	-15.25	-8.46
1992	-25.88	-19.09	-6.79
1993	-29.33	-35.46	6.12
1994	-57.45	115.21	-172.66
1995	-58.15	126.12	-184.27
1996	-52.96	150.98	-203.94
1997	-58.25	169.44	-227.69
1998	-92.22	176.64	-268.86
1999	-174.36	169.69	-344.04
2000	-249.93	147.18	-485.08
2001	-247.30	282.40	-529.70
2002	-314.96	361.69	-676.65
2003	-293.47	444.52	-737.99
2004	-209.04	660.90	-869.94
2005	-228.10	777.26	-1005.36
2006	-166.25	1046.52	-1212.78

Sources: The Statistical Yearbook of China, various years.

## *The Zhu Rongji Initiative*

In the mid-1990s, Zhu Rongji formulated a new strategy for the SOE reform called “*zhuafa fangxiao*” (grasping the big and letting go of the small). It was officially established as China’s new economic reform strategy at the 15th Party Congress in 1997. This strategy gave the SOE reform a clear direction, especially in the case of the large SOEs. “Grasping the big” means developing large, strong and competitive enterprises and enterprise groups into cross-regional, cross-sectional, multi-ownership and multinational big firms. “Letting go of the small” implies that the government allows small- and medium-sized SOEs to face market forces. The government would actively support SMEs, especially technology companies, to develop and become “specialized, lean, unique and innovative.” The government would use various realistic methods, such as joint ventures, mergers and acquisitions, leasing, contracting, shareholding and selling-off, to deregulate and invigorate SMEs. The ultimate goal of this strategy was to privatize most of the SMEs and control only a limited number of large central and local SOEs. The latest policy on big SOEs issued by the Chinese government focuses on seven key areas and industries related to national security and economic lifelines, including military industry, electricity and the electrical grid, oil and the petrochemical industry, telecommunications, coal, civil aviation and shipping.<sup>36</sup>

When the Zhu administration initiated and implemented the policy of “grasping the big and letting go of the small,” it had an ambitious strategic perspective. Most industrialized countries have successfully developed many large enterprise groups. As a big country, China certainly needs to establish enterprise giants to form the pillar of the national economy and to enhance its international economic competitiveness. More importantly, the existence of such large enterprise groups in critical areas will also provide strong support to national economic security. In designing such a strategy, the Zhu government aimed to follow the path taken previously by Japan and South Korea.<sup>37</sup>

Privatizing state-owned SMEs was also a rational choice for the Chinese government. A large number of state-owned SMEs were inefficient and unprofitable. They were not competitive in the market and often became heavy financial burdens on all levels of government. Their ambiguous property rights more often than not caused serious managerial agency problems. According to international experience, privatization could be an effective means to restructuring these SOEs, thus improving the efficiency of the whole economy. Moreover, privatizing SMEs was also socially and politically significant. SMEs could play a highly important role in the provision of employment opportunities and the rationalization of income distribution.

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<sup>36</sup> “Qi hangye you guoyoujingji jueui kongzhi, guoqi zhengti shangshi jiang tisu” (Seven Industries Firmly Controlled by the State, SOEs Listing to Be Accelerated), *People’s Daily* (December 19, 2006), <http://finance.people.com.cn/GB/5185910.html>.

<sup>37</sup> For a detailed discussion of this strategy, see Yongnian Zheng, *Zhu Rongji Xinzheng: Zhongguo gaige de xinmoshi* (Zhu Rongji’s New Deal: A New Model for China’s Reform) (River Edge, NJ: Global, 1994), chapter 4.

In 1997, the Chinese government set a goal for the SOEs to turn around their loss-making condition within a three-year phase. In September 1999, during the Fourteenth Plenary Session of the 15th Party Congress, the government adopted the policy of diversifying SOE ownership to establish a modern corporate system. By reforming, reorganizing, restructuring and strengthening management and other areas, the objective of turning around the loss-making SOEs was largely achieved by the end of 2000. Many previously loss-making SOEs began to make a profit; some others went bankrupt and withdrew from the market, while some were merged and restructured. However, this three-year plan was criticized for its poor efficiency. Although the plan incurred large costs and resources, its implementation was believed to have been in line with the planned economy, and thus was criticized for not being able to make substantial progress in the SOE reform. SOEs continued to be subject to soft budgets.

It turned out that the policy of “grasping the big and letting go of the small” was carried out too hastily in many ways. In its implementation, “grasping the big” was exaggerated ruthlessly by all levels of government. Government officials tried to use political and administrative means to merge enterprises in order to create giant monopolies, simply for the sake of appearing to be “big” disregarding other economic and social considerations. With the implementation of this policy, various positive aspects of big enterprises, such as the capacity for innovation, efficiency and competitiveness, did not develop as initially expected. Many Chinese SOEs have become internationally famous for their huge size, but their large assets are often assembled by the state in various ways other than from the profit of their ventures. Further, these giant SOEs are often monopolies which control the upstream supply market for the entire industrial chain. Therefore, they earn hefty monopoly profits at the expense of consumers.

In industrialized countries, privatization has improved industrial efficiency and kept a balanced public service sector in many cases, such as the UK in the 1980s and 1990s. However, the Chinese local governments did not have a systematic and effective plan for the privatization process. They simply “let go” of the state-owned SMEs to the market. Consequently, sizable state-owned assets were lost due to inappropriate administration and regulations. Enormous numbers of employees were laid off during the process, causing social unrest and even conflicts between the government and the public.

The aim of privatization is to improve the efficiency of the economy, provide better services to the public and ultimately increase consumers’ overall utilities. However, in China local governments used administrative power to enforce privatization in favor of the capital owner rather than the public — the tax payers. Many SMEs, after being privatized, struggle to survive. Since they do not enjoy a supportive financial, legal and policy environment, their development has been greatly constrained.

The number of SOEs and employees has decreased dramatically since the “grasping the big and letting go of the small” policy was put into force. The Chinese government has often claimed that the SOEs’ economic efficiency and competitiveness are improving and the quality of state-owned assets enhanced. However, these assessments, which are based on numerical evidence, have to be



regarded with caution. The overall improvement of the SOEs' profitability is very likely due to the exclusion of many badly performing SMEs under the "letting go of the small" policy, and not due to higher efficiency amongst existing firms. Also, the increase in SOEs' profits very likely comes from the monopolistic income of those newly merged large firms under the "grasping the big" policy, rather than from SOEs' better performance in the market.

### *The Wen Jiabao Initiative*

At the 16th National Congress of the CCP in 2002, the direction of SOE reform was further re-adjusted by the newly appointed Hu-Wen leadership. The government continued to make efforts to restructure the state-owned economy and reform the state assets management system. According to the new policy initiatives, except for a handful of SOEs to be run solely by the state, the government would implement a diversified ownership structure in the majority of the SOEs and control only the important enterprises. Governments at the central, provincial and municipal levels were required to set up special institutes to represent the state as performing investor's responsibilities.

In 2003, the State-owned Assets Supervision and Administration Council (SASAC) of the State Council was established. SASAC supervised 196 central SOEs and RMB 6.9 trillion (US\$ 0.9 trillion) state-owned net assets.<sup>38</sup> Since then, local SASACs have been gradually established. This arrangement was intended to solve three key problems concerning the implementation of property right liabilities. First, vertically, it clearly defined the property right liabilities among governments at different levels. Second, horizontally, responsibility was localized, which was not the case while many government departments had administrative authority over the enterprises. Investors' rights were centralized to the SASAC from various departments, including the Ministry of Finance, the Central Work Commission of Enterprises, the Financial Work Commission, the State Economic and Trade Committee, the National Development and Reform Commission and the Ministry of Labor and Social Security. Third, the government's executive power and the SOEs' ownership rights would no longer affect each other. These were the major breakthroughs in the institutionalization of the SASAC system. Currently there are 159 central SOEs supervised by the SASAC, down from 196 in 2003. SASAC is aiming to further reduce the number of SOEs to between 80 and 100 by 2010.

According to the official definition, besides being an investor, SASAC is also responsible for guiding the reform and restructuring the SOEs, forming the board of supervisors in large SOEs on behalf of the state, supervising and managing state-owned assets by statistical and audit means, and developing relevant regulations and laws.<sup>39</sup> The establishment of SASAC indicates that the Chinese government is aware of the significance of inefficient and asset-losing SOEs.

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<sup>38</sup> "Li Rongrong: Guoziwei de chengli shuoming chuziren kaishi daowei" (Li Rongrong: The Establishment of SASAC Means Investors Are in Place), China News (May 22, 2003), [www.nyconsulate.Prchina.org/chn/xw/t30193.htm](http://www.nyconsulate.Prchina.org/chn/xw/t30193.htm).

<sup>39</sup> SASAC data.

An important part of the reform directed by SASAC is the personnel system reform as an essential part of building modern corporate governance of SOEs. Managerial positions would be filled through open competition rather than by administrative appointments. The new system also emphasizes the value of talent in an enterprise. From 2003 to 2006, 81 senior posts in 78 central SOEs were openly advertised and recruited and 20 deputy senior posts in 10 central SOEs were recruited through internal competition.<sup>40</sup>

The core issue for SOEs is the problem of soft budget constraints. On one hand, SOE managers do not have the incentive to cut costs and to maximize profit simply because the enterprises are owned by the state. On the other hand, if the SOEs perform badly, the state cannot simply let them be eliminated by market competition. Rather, it will find ways such as the provision of financial subsidies and creation of a monopoly environment to bring the SOEs out of their predicament. For SOE managers, it is much easier to plead for support from the state than to build the business in the competitive market. Therefore, there is no reason to expect these managers to improve the efficiency of firms. In such cases, SOEs rely on the state for survival and often become a heavy burden to public finance. The establishment of the SASAC and the related institutional adjustments by the State Council have transferred the task of state-owned assets management from several government departments into one, hopefully reducing the inefficiency caused by the bureaucracy. However, greater efforts are needed to solve the problem of soft budget constraints.

#### *SOE Monopoly and Its Discontents*

After years of reform efforts, the number of SOEs in the whole economy has decreased significantly and SOEs' strength has increased. By the end of 2006, the number of central SOEs supervised by the central SASAC had decreased to 159 while their total assets reached RMB 12.27 trillion (US\$ 1.59 trillion), a 16.2 percent rise from the previous year. Their sales, realized profits, tax payment and net assets have strong yearly growths of 20.1 percent, 18.2 percent, 20 percent and 15.2 percent, respectively.<sup>41</sup> The 1,031 SOEs supervised by the local SASACs also achieved similar outstanding performance.<sup>42</sup> Furthermore, SOEs, especially large SOE groups, are concentrating on monopoly industries. Sectors such as oil and gas, telecommunication and other information transmission services are predominated by state-owned or state-holding enterprises. Some other sectors, such as electricity, heat production and supply, coal mining and washing, transport and transportation equipment manufacture, which are the key industries related to the national economic lifeline, are mostly shared by the SOEs.

The obvious result of such a situation is an enhancement of the profitability of SOEs. One might think that the high profitability of the SOEs would benefit the

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<sup>40</sup> "Guoziwei fu zhuren: woguo jiang jiji tuijin guoqi renshizhudu gaige" (Deputy Director of SASAC: China Will Actively Promote the Reform of Personnel System in SOEs), Xinhua (October 25, 2006), [www.gov.cn/jrzg/2006-10-25/content\\_423735.htm](http://www.gov.cn/jrzg/2006-10-25/content_423735.htm).

<sup>41</sup> "2006 nian guoziwei gongzuo huigu" (SASAC Work Review 2006), [www.sasac.gov.cn/2006rdzt/2006rdzt\\_0021/gzw/default.htm](http://www.sasac.gov.cn/2006rdzt/2006rdzt_0021/gzw/default.htm).

<sup>42</sup> *Ibid.*

country's fiscal revenue through taxation. However, this does not seem to be so. While SOEs are increasing their tax contribution to the state, the negative effects of the excessive concentration of SOEs in monopoly areas are greater.

Due to their low efficiency, SOEs do not have comparative advantages, especially in competitive industries. Therefore, SOEs are being moved from competitive sectors to monopoly sectors. These SOEs subsequently claim, proudly, that they are turning losses into profit. This is especially true for SOEs supervised by local SASACs. While the monopoly of central SOEs are justifiable for national strategic reasons, local SOEs often exercise monopoly wherever it is profitable. The increase in profits does not stem from an improvement in firm efficiency, but from the benefits of monopoly. SOEs have been strengthening their control of upstream resources of industrial chains. Their extra profits come at the expense of the general public.

Usually, a firm's profitability comes from effective management and an increase in efficiency. In China, there might be a slight improvement in the management and efficiency in SOEs when they become monopolies. However, what firms actually seek for in monopolies is the monopoly in pricing, which brings them the extra monopoly profit. In other words, the profitability of the monopoly sector is not due to its efficiency, but to the benefits of the monopoly.

Monopolies cause unfair competition in the market. Employees in the monopoly sectors earn extraordinarily high incomes, and this has become a major source of China's widening income gap and rising social tensions. In their own closed-market setting, these conglomerates operate according to their own rules and not to market principles. Prices are often inflated to feed the needs of the employees of these monopolies. For example, a graduate in a major coastal city earns an average of about 2,000 RMB per month, but a highway toll collector working for a monopoly earns as much as 8,000 RMB per month. An investigation by the Guangdong provincial government shows that in 2006, although many big SOEs in the province were making losses, the wages of their employees continued to increase.

The growing trend of monopoly also amplifies inefficient economic expansion in China. A vivid example is the world's top 500 Chinese firms. They are basically monopolies and fundamentally different from multinational firms of industrialized countries as they do not have strong market competitiveness even though they are physically large.

Ten years ago, China's SOEs struggled to control their expenditure to pay their employees' salary. The Chinese government then tried to "revitalize" and "save" SOEs. But today, the topics associated with SOEs are "high salary", "huge profits" and "dividends sharing." Price inflation in SOEs has generated enormous popular dissatisfaction.<sup>43</sup> To deal with these issues, a series of new policies are being put into practice. SASAC, together with labor and social security, finance, and audit departments, has tried to put a check on the salary of employees in monopoly

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<sup>43</sup> "Renmin luntan diaocha: 96.5% de ren dui dangqian gongzi buman" (People's Forum Survey" 96.5% of Responses Indicate Dissatisfaction about Current Salaries), Xinhua (June 5, 2007), [http://news.xinhuanet.com/fortune/2007-06/05/content\\_6202484.htm](http://news.xinhuanet.com/fortune/2007-06/05/content_6202484.htm).

sectors.<sup>44</sup> Li Rongrong, Director of SASAC, revealed that from 2007, SOEs would be required to pay dividends to the state treasury again, twelve years after the suspension of this policy in 1994.<sup>45</sup> However, this policy also led to the concern that it would justify SOEs' monopoly behavior since the SOEs concerned would argue that their dividend payments contributed directly to the state's fiscal revenue. Furthermore, if there is no well-designed channel for the government to systematically use this income, for example to subsidize SMEs, or to spend on education and social security funds, then this dividend payment to the government would not fulfill the purpose of income redistribution.

Due to various institutional defects, corruption is often prevalent in SOEs. In SOEs, the unjustifiable corporate power structure and unclear statutory responsibilities and duties prevent the development of an effective system for keeping power in balance. Poor law enforcement and low opportunity cost provide insiders with strong incentives for corruption, which results in the huge loss of state assets. Corruption in SOEs bears two characteristics: the majority of individuals implicated are senior managers, and the amount of money and assets involved is massive.<sup>46</sup> Senior managers in SOEs normally have unsupervised power over everything within the firm. Consequently, they abuse this power for their own benefits. The Chinese government has also found that monopoly industries have the highest incidences of corruption and bribery. In recent years, the government has targeted the monopoly SOEs in its anti-corruption drive.<sup>47</sup> However, no matter how effective the law enforcement departments are in fighting corruption, their actions are merely palliatives if there is no institutional reform alongside. To eliminate corruption in SOEs, the Chinese government will have to reform the SOE system and break the administrative monopolies.

Another controversial issue closely related to SOE reform is its impact on the survival and development of SMEs, particularly private ones. SMEs currently contribute about 60 percent of China's gross domestic product and 50 percent of the country's tax revenue, and provide over 75 percent of total urban employment opportunities. SMEs are responsible for about 65 percent of inventions and patents

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<sup>44</sup> "Tiaozheng longduan hangye gongzi buru wanshan guoqi zhili jizhi" (It Is better to Improve Management Mechanism, Rather Than Adjust the Wage System of SOEs in Monopoly Sectors), *Yanzhao Metropolis Daily* (March 19, 2007), [http://news.xinhuanet.com/comments/2007-03/19/content\\_5865109.htm](http://news.xinhuanet.com/comments/2007-03/19/content_5865109.htm).

<sup>45</sup> "Guoziwei yancha yangqi 'xiao jinku', wei yangqi shangjiao gongli pulu" (SASAC Rigorously Investigates Central SOEs' 'Little Treasuries' to Prepare for the Resumption of Dividends Payments from Central SOEs to the State), *Beijing Times* (February 16, 2007), [http://news.xinhuanet.com/fortune/2007-02/16/content\\_5745865.htm](http://news.xinhuanet.com/fortune/2007-02/16/content_5745865.htm).

<sup>46</sup> "Guoqi laozong zha jiu chengle fubai 'zhongzaiqu'" (How Did SOE Bosses Become the 'Disaster Area' of Corruption?), *Guangming Daily* (February 1, 2007), <http://gov.people.com.cn/GB/48380/5354562.html>.

<sup>47</sup> "Longduan hangye fubai guo shouru gao, zhongyang jiang xiang longduan guoqi kaidao" (Monopoly Sector Has Much Corruption and a High Income, and the Central Government Is Targeting Monopoly SOEs), *Oriental Outlook* (October 26, 2006) [http://news.xinhuanet.com/fortune/2006\\_10/26/content\\_5251320.htm](http://news.xinhuanet.com/fortune/2006_10/26/content_5251320.htm).

and over 80 percent of new product development.<sup>48</sup> Nevertheless, China's industrial and financial policies have long favored state-owned and large firms. Many studies have found that SMEs in China are much more financially constrained than their larger counterparts.

Before its reform, China's state-owned banking sector simply took orders from the government to allocate financial resources to the SOEs, while denying the same resources to China's most efficient private SMEs. Official statistics show that although over 99 percent of the firms in China were SMEs in 2005, they shared only 16 percent of total bank loans, the dominant means of external finance for Chinese firms.<sup>49</sup> The majority of SMEs in China are private firms. With the banking reform, state-owned banks (SOBs) have become increasingly commercialized. They could make rational business decisions independent of the government. However, due to information asymmetry in the market and in traditional bank relations, SOBs still prefer to lend to large SOEs, not SMEs.

Although they are the engines of growth in the Chinese economy, SMEs are discriminated against in terms of access to external funding, market opportunity, property rights protection, and taxation. The latter two were given some relief to some extent when China's new Property Law and Corporate Income Tax Law were put into effect on 1 October 2007 and 1 January 2008, respectively.

Even in developed market economies SMEs play exceptionally important roles, and they desperately need government support to survive and develop. In China's transitional economy, if the government "let go of the small" and puts them entirely at the mercy of the market, the country would be at risk of losing its most efficient SMEs to foreign and domestic competitors when China becomes a fully open economy according to its WTO obligations. On the other hand, if China ruthlessly pursues the policy of "grasping the big", it may use its limited financial resources to subsidize and invest heavily in its inefficient large SOE sector, even at the cost of providing necessary public goods. Consequently, resources would be seriously misallocated. If this becomes the case, China's economic development could not be sustained leading to social instability.

In fact, SASAC itself has also been criticized for the ambiguity between its own administrative function and its market activities. SASAC specifies its responsibilities as safeguarding the rights and interests of owners and preventing the loss of state-owned assets. On the one hand, as a government agent it fulfils the duty of managing state assets, and as an investor it operates the firms and leads the restructuring of SOEs. On the other hand, as a quasi-governmental body, it is responsible for market regulation and control on behalf of the government; SASAC has been given the dual rights of an investor and a supervisor.

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<sup>48</sup> Speech of Deputy Primer Zeng Peiyan on the National SME Forum (September 14, 2006), available at Department of SME, National Development and Reform Commission of China, [http://zxyqs.ndrc.gov.cn/ldxw/t20061103\\_91615.htm](http://zxyqs.ndrc.gov.cn/ldxw/t20061103_91615.htm).

<sup>49</sup> National Development and Reform Commission data in "Guojia fagaiwei: zhongxiaoqiye daikuai bizhong haizai xiajiang" (NDRC: The Ratio of SME Loans Is Still Falling), China Business Times (January 20, 2006), [www.smegd.gov.cn/news/article/news/jinmao/200601/20060120095115.htm](http://www.smegd.gov.cn/news/article/news/jinmao/200601/20060120095115.htm).

Power has a self-inflation logic. SASAC has repeatedly emphasized the importance of the growth of central SOEs' profit. This mode of economic development raises doubts over whether SASAC intends to further strengthen the current monopoly profit model of SOEs or that it might use its administrative power to benefit various interest groups in the course of conducting market operations.

China has been reforming its SOE sector since 1984 as a key element in its urban economic reform. It has made tremendous achievements, but has also met with immense difficulties. The Chinese government has been endeavoring to optimize the sector, but with little success. The monopoly status did not increase the productivity of the SOEs; neither did the monopoly profits benefit the majority of the tax payers, creating, instead, income disparity. The reform so far has improved the situation of the SOEs in the short term, but hurt the unfavored SMEs. Yet, if the SOEs' monopoly status continues to be tolerated or even encouraged, the economic recourses will shift from the more productive sectors and firms to these monopolists, hampering China's growth in the long term. The Chinese leadership does not seem to have a clear direction of how SOEs should be further reformed. Should the government improve the productivity and efficiency of the SOEs to make them more competitive in the open market, or should they create and enhance the monopoly positions of SOEs to gain that extra profit, thereby allowing them to remain inefficient? Though the hypothesis has not been proved, the leadership seems to believe that only a strong central SOE sector will be able to safeguard China's economic security and compete with foreign multinationals. Or should the government develop a well functioning SOE sector to provide high-quality public goods and services to benefit the whole society? To continue with the SOE reform, the Chinese authorities need to find answers to these questions first. It will undoubtedly be a tough process of bargaining and balancing among different interest groups. This is one of the most vital problems faced by the Chinese economy today.

### *Political Participation From Below*

Participation from below does not mean that the central government does not play an important role in this process. Indeed, without political support from the central government, no bottom-up participation initiative would have been possible. To highlight participation from below, this paper emphasizes that there is an increasingly high demand for political participation from the society, but centralization has served effective political and legal constraints on bottom-up initiatives. In the case of the SOE reform, centralization does not enable the central government to fulfill its planned policy mission since the policy is manipulated, reinterpreted and modified during the implementation process. The case of political participation seems to have backfired too since it is centralization that has nullified local initiatives. While there is a wide range of areas where participation from below has taken place, this discussion focuses on the development of local semi-competitive elections and non-governmental organizations (NGOs).

### *Semi-competitive Local Elections*

This refers to rural village elections for village committees since the late 1980s, and township elections for the heads of townships since the 1990s. The rural election

system was formally introduced in the late 1980s after it was practiced by rural residents in some provinces. In the late 1970s, China initiated the rural reform which was characterized by radical decentralization based on the household responsibility system. The popularity of this system soon led to the collapse of the old system of governance, i.e., the production brigade system, and eventually the collapse of the commune system. In 1987, the National People's Congress (NPC) passed the Village Committee Organic Law of the PRC (Experimental). According to the law, "village committees should be established in China's rural areas in order to safeguard farmers' opportunities and rights of political participation. The control over village cadres by farmers and the level of villagers' self-government will be improved through direct election of the directors, deputy directors and members of the villagers' committees, thus upgrading the quality of farmers' political participation."<sup>50</sup> Since the mid 1990s, the election system has developed rather impressively. According to the Ministry of Civil Affairs, which has been tasked with the implementation of this election system, more than 80 percent of China's 930,000 villages had conducted at least one round of relatively democratic elections by early 1997. By 2001, this system was widely adopted by the whole country.

The fact that the central government nationalized this bottom-up initiative did not mean in any sense that the CCP was to give up its rule in the countryside; instead, it was aimed at strengthening the rule of the party in rural areas by accommodating democratic elements.<sup>51</sup> So, while the village committee was elected by villagers, the CCP committee continued to exist. The rapid spread of rural democracy, however, soon created contradictions between the elected body and the party branch in the same village. While the elected village committee can draw its legitimacy from villagers, the party branch often faced challenges in dealing with the former. To eliminate this contradiction, many provinces have developed a system of "two-ballots" in which the party secretary in a village is subject to a popular vote, meaning that in these places both committees are elected.<sup>52</sup> The parallel system of the party and the village branch continues, but their relations with each other are transformed.

Reformist leaders in the central government have also allowed direct elections at the township level—the basic level of administration—on an experimental basis. In the mid-1990s, China experienced its first cases of township elections for key township officials. Since then, the new election practices have been adopted in many townships in many counties of a number of provinces. The positions open to the elections have been extended from township vice mayors to township mayors, and sometimes even township Party secretaries. The number of cases increased from a dozen in the mid-1990s, to several hundreds in the late 1990s, and to several

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<sup>50</sup> Cited in Jiang Wandu, "Grassroots Democracy Taking Root," *Beijing Review*, 39 (11), March 11-17, 1996, p. 11.

<sup>51</sup> Lianjiang Li and Kevin O'Brien, "Accommodating 'Democracy' in a One-Party State: Introducing Village Elections in China," *The China Quarterly*, No.162 (June, 2000), pp. 465-89; and Li and O'Brien, "The struggle for Village Elections," in Merle Goldman and Roderick MacFarquhar, eds., *The Paradox of China's Post-Mao Reforms* (Cambridge, MA: Harvard University Press, 1999), pp. 129-44.

<sup>52</sup> Lianjiang Li, "The Two-Ballot System in Shanxi Province: Subjecting Village Party Secretaries to a Popular Vote," *The China Journal*, No.42 (July, 1999), pp. 103-18.

thousands by the early 2000s. Compared to village elections, township elections are more constrained by various factors, thus earning their name of “semi-competitive elections”<sup>53</sup> as coined by the scholarly community.

Township elections were policy products, not legal ones. As a matter of fact, township elections have not been justified in Chinese laws, and remain controversial even though they are now widespread. For example, in August 2006, Sheng Huaren, then Vice-Chairman of the NPC Standing Committee, reiterated that direct elections of township government leaders were illegal and warned that evil foreigners were using the tool of human rights and democracy against China.<sup>54</sup> The political support from the leadership, both at the central and local level, is the key factor which has facilitated the implementation of this system.<sup>55</sup> Apparently, once such political support disappears, there is no way for local democracy to spread to the whole nation and extend to higher levels of government.

Besides village and township elections, China today is experimenting with different kinds of democratic element such as the election of urban community committees, inclusion of independent candidates running for local people’s congresses, emergence of what China called “rights-democracy,” and social movements.<sup>56</sup> But certainly, the government has cracked down on many of such “rights-democracy” movements by disgruntled social groups such as farmers, migrant workers, and urban poor.

### *The Growth of NGOs*

The development of NGOs has been a major part of state-to-society decentralization.<sup>57</sup> This is especially true since the early 2000s after the leadership began to place an emphasis on social reforms. Reforms have led to not only a relaxation of state control over society, but also the active establishment and sponsoring of NGOs by the state to offload certain state functions to them. Chinese NGOs have increased steadily in numbers over the years. The statistics of the

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<sup>53</sup> For example, Hairong Lai, *The Causes and Effects of the Development of Semi-Competitive Elections at the Township Level in China since the 1990s*, PhD thesis, Department of Political Science, Central European University, Budapest, January 2008.

<sup>54</sup> See Lisheng Dong, “Grassroots Governance and Democracy in China’s Countryside,” in Zhengxu Wang and Colin Durkop, eds., *East Asian Democracy and Political Changes in China: A New Goose Flying?* (Singapore: The Konrad Adenauer Stiftung, 2008), pp. 155-168.

<sup>55</sup> Lianjiang Li, “The Politics of Introducing Direct Township Elections in China,” *The China Quarterly*, No. 171 (September, 2002), pp. 704-23.

<sup>56</sup> “Rights-democracy” refers to citizens from the marginalized or disadvantaged social groups asserting or defending their rights by a variety of means, including competing in local elections and asserting the right to recall a delegate who was deemed incompetent, corrupt, or unwilling to represent voters’ interests to a local people’s congress. For a discussion of all these forms of democracy, see Li Fan, “Is Democratic Development in China Sustainable,” in Wang and Durkop, eds., *East Asian Democracy and Political Changes in China*, pp. 135-51.

<sup>57</sup> Qiusha Ma, *Non-Governmental Organizations in Contemporary China: Paving the way to civil society?* (London and New York: Routledge, 2006).



Ministry of Civil Affairs (MCA), which is in charge of NGO registration, show that before 1978 there were only about 100 national social organizations in China. By the end of 2003 this number had reached 1,736. Meanwhile the number of local-level social organizations grew from 6,000 to 142,121. The number of private non-enterprise organizations (PNEOs), which did not exist before the reforms, reached 124,491. By the end of 2005, there were 168,000 social organizations, 146,000 PNEOs, and 999 foundations. However, scholars found that a large number of associations had been left uncounted. By adding different types of non-registered NGOs, Wang Shaoguang believed that the total number of civil organizations had reached 8.8 million by 2003.<sup>58</sup> Despite its rapid development, scholars have argued that NGOs in China are still underdeveloped. For example, the number of civil organizations per 10,000 people in China is 1.45, but the same number in France is 110.45, United States is 51.79, Brazil is 12.66, India is 10.21, and Egypt is 2.44.<sup>59</sup>

In the West, an NGO is autonomous and independent from the government. In China, however, the autonomy of NGOs depends on their relations with and thus their political “distance” from the government. Government regulations stipulate that any social organization must be approved by and registered with the civil affairs departments at the county level or above, while foundations (e.g., charity organizations) must be approved at the provincial or central government level. Any civil organizations which do not register with the MCA are outlawed. Government regulations require every social organization to find a “professional management unit” (*yewu zhuguan danwei*) to act as its sponsoring agency. Only after obtaining the approval of its sponsor can an NGO apply for registration with civil affairs departments. The sponsor must be a state organ above the county level or an organization authorized by such an organ. It must also be “relevant” to the activities proposed by the NGO, i.e., it must have responsibilities in the same field in which the NGO operates. Regulations also disallow NGOs with similar missions to coexist in the same geographic area.

As a result of these strict rules, many grassroots NGOs were unable to register, either because they failed to find government agencies that are willing to act as their professional management units, or because other NGOs with similar missions had already been registered in the sites where they intend to base their operations. In order to exist legally, some NGOs registered with industry and commerce bureaus as businesses instead, even though they engage in public-benefit activities and are non-profit-making. There are also unregistered, hence illegal organizations which nevertheless carry out activities openly and which have been left alone by the government instead of being banned according to the regulations.

Nevertheless, the registration requirement does not apply to eight big national social organizations which are often referred to more specifically as “people’s organizations” (*renmin tuanti*) or “mass organizations” (*qunzhong tuanti*), such as All-China Federation of Trade Unions, the All-China Women’s Federation, and the

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<sup>58</sup> Cited in Zengke He, “Institutional Barriers to the Development of Civil Society in China,” in Zheng Yongnian and Joseph Fewsmith (eds), *China’s Opening Society: The Non-state sector and governance* (London and New York: Routledge, 2008), p. 162.

<sup>59</sup> *Ibid.*, p. 163.

Communist Youth League. These social organizations were created by the Party/state and perform administrative functions on its behalf. Indeed, they are independent organizations, and are not under civil affairs' supervision. Their heads are appointed by the top leadership of the CCP. Government regulations also exempt from registration requirement "organizations formed within administrative agencies, social organizations, enterprises, or service units which are approved by these organizations and which only carry out activities internally."<sup>60</sup> University student unions fall under this category since they do not need to be approved by and registered with the civil affairs departments as long as they have been approved by their universities. Some grassroots organizations are not required to register with the civil affairs departments, such as property owners' committees (*yezhu weiyuanhui*) which are formed by owners of apartments in the same housing compound and urban community-based organizations, e.g., leisure activity groups formed by residents in the same neighborhood.

Moreover, the development of NGOs in different functionalities has been uneven. In the economic sphere, the government has attempted to reduce its direct management role by establishing intermediary organizations such as trade associations and chambers of commerce to perform sectoral coordination and regulatory functions. In the social welfare sphere, the government wants to foster NGOs onto which it can offload some of the burden of service provision. In the social development sphere, the government wants NGOs to mobilize societal resources to supplement its own spending.<sup>61</sup> These NGOs will have to perform their role according to the party line – they will be "helping hands" rather than independent organizations.

The political influences of China's NGOs also vary widely across different areas, as well as between different NGOs. In some areas such as poverty reduction, charity and environmental issues, NGOs are encouraged to play a greater role. But in other areas such as religious issues, ethnicity, and human rights, the influence of NGOs is much weaker. Also, some NGOs are more powerful than others. Most commercial organizations are extremely powerful in influencing the government's policy-making process. It is not difficult to find business people sitting in the People's Congress and the Chinese People's Political Consultative Conference at different levels of the government. But workers and farmers are not allowed to organize themselves, and thus do not have any effective mechanisms to articulate and aggregate their interests. In fact, the decline of workers and peasants in the total membership of the party implies their weakness in China's political system.

When powerful social groups organize themselves, they become ever more powerful. There is no effective means for weak social groups such as workers and farmers to promote their own causes. As long as the party-state does not allow these weak social groups to organize themselves or to be organized, they are unlikely to have a say in the decision-making process or gain equal citizenship rights as other

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<sup>60</sup> The State Council, "Shehui Tuanti Dengji Guanli Tiaoli" (Regulations on the Registration and Management of Social Organizations), Beijing: the State Council, 1998.

<sup>61</sup> Jude Howell, "NGO-State Relations in Post-Mao China," in David Hulme and Michael Edwards, eds., *NGOs, States and Donors: Too Close for Comfort?* London: Macmillan Press Ltd, 1997, pp. 202-15; and Linda Wong, *Marginalization and Social Welfare in China*, London and New York: Routledge, 1998.

social groups. The fear of their organizational power has justified all measures of centralization by the party-state in exercising tight political control over social forces. Needless to say, centralization serves as an effective means to contain participation and democracy from below.

### **State-Society Decentralization: A Solution**

Intergovernmental decentralization has served as an effective means for China to achieve high economic performance. It was effectively implemented due to great incentives from both the central government and the provinces. The rationale for the central government, especially the reformist leadership, was that rapid economic development would enable the party-state to deliver economic goods to the people and thus maintain its political legitimacy. This is also true for the provinces. Rapid local economic development would not only bring wealth to local officials, but also help in their political career since local economic growth was the most important indicator for their promotion in the hierarchy of the party-state. Therefore, intergovernmental decentralization was a win-win game for both the central government and the provinces.

Nevertheless, both the nature and rules of the game changed at a later stage. With intergovernmental decentralization, economic decision-making power shifted to the provinces. Instead of privatization, property rights were decentralized to the local governments rather than to individual enterprises or entrepreneurs. Local governments became de facto owners of state enterprises. Understandably, even though the central government gradually withdrew from the economic affairs of individual enterprises, local governments became highly interventionist. Generally speaking, intergovernmental decentralization created an institutional setting and legitimacy for local governments to intervene in economic activities within their jurisdictions. Intergovernmental decentralization does not necessarily deny marketization. As a matter of fact, marketization was encouraged due to intense competition among different jurisdictions and enterprises with different forms of ownership. Local protectionism existed at the early stages of economic reforms; however, with the growth of market mechanisms, it was constrained. All these factors contributed to high local economic performance.

Intergovernmental decentralization empowered local governments and made them more efficient in responding to social demands and changing socio-economic circumstances. It thus changed the interaction pattern between the central government and the provinces. With an increase in local responsibilities, central-local relations became interdependent. While in principle the central government still held great power over local governments, cooperation from the provinces became essential. The provinces developed and strengthened their own power bases and created incentives for the central government to adjust its relations with the provinces. The provinces had the power to not only deal with local affairs but also influence decision-making at the central level.

Intergovernmental decentralization also empowered local governments in their interaction with society. The focus of intergovernmental decentralization was power shifts not between the state and society, but between the center and the provinces. The central leadership did not want to decentralize political power to the society; instead,

it believed that political participation should be constrained and that mass mobilization would not help in the transition to an efficient government. With intergovernmental political decentralization, the political spaces for free expression and collective actions by individuals and social groups were extended; however, limited political participation from below took place, as in the case of the development of semi-competitive local elections, as social forces remain weak. In actuality, intergovernmental decentralization has produced local regimes of dictatorship, and local high economic performance has been associated with serious human rights violation on the part of the local governments.

Therefore, selective recentralization, as described in this paper, is justifiable. Selective recentralization was able to not only change the interdependency between the central government and the provinces, but to regain the domination of the central government over the provinces. More importantly, it was to engage state-society decentralization. In order to implement state-society decentralization, the central government has to re-centralize power first since intergovernmental decentralization empowered local governments and powerful local governments often become a barrier to state-society decentralization.

Selective recentralization did enable the central government to regain its domination over the provinces, meaning that it re-established its “power-over” (e.g., the provinces). Nevertheless, selective recentralization did not enable the central government to reestablish its “power-over” (get things done in the provinces). Why? Among others, a key factor is that state-society decentralization has been greatly constrained by both the central government and the provinces. Without state-society decentralization, the central government does not have a level of legitimacy which would enable it to establish its “power-over” while society is not empowered to establish either its power-to (both the central government and the provinces) or its power-over (change policies by the central government and the provinces).

So, the game of power continues to be played between the central government and the provinces. Without the participation of social forces, the central government still lacks the infrastructural power to dictate the provinces, meaning that the central government is not able to ask the provinces to do what it wanted them to do. While the central government maintains its official domination over the provinces and has de jure power to veto initiatives by the provinces, the provinces also have de facto power to veto policy initiatives by the central government. When a party has the power to nullify decisions by another party, a policy deadlock becomes inevitable. This characterizes China’s central-local relations today. As long as such a situation prevails, it is unlikely for both the central government and the provinces to engage in any major meaningful reforms.

To avoid such a situation, state-society decentralization is inevitable. In other words, the society must be empowered. Only when its power is mandated by the whole society can the central government gain not only power-to but also power-over the provinces. When the society becomes an active actor in the game, local dictatorships can be constrained and avoided. It is unfair to say that the central leadership is unaware of the importance of state-society decentralization. As discussed in this paper, the purpose of the SOE reform under Zhu Rongji was to empower the SMEs, especially in the private sector. Similarly, many measures of

social reforms by the Hu Jintao-Wen Jiabao government were to empower society as in the case of the development of NGOs and local semi-competitive elections. All these measures of empowering society, however, were either too reluctant or too cautious. Social changes have forced the party-state to open its process to social forces, as in the admission of capitalists into the ruling party. The party-state, as a well-entrenched vested interest, continues to be resistant to social forces. Before the political process is opened wide to social forces, the game between the central government and the provinces will not lead to drastic political changes in China.

Special Section on Central and Local Relations and Environmental Governance in China. Information. On the other hand, changes to bureaucratic discretion through the introduction of minimum sanctions. The bold reform programme unveiled at the third plenary session of the 18th Central Committee in November 2013 – the “Decision on Some Major Issues Concerning Comprehensively Deepening the Reform” – calls for the “strictest possible rules to protect the ecological system” in the name of building an “ecological civilization.”<sup>Footnote 37</sup> The document outlines central leaders’ plans to use more “sticks” in environmental. The contributions to this special section show how the central government’s role in environmental protection has grown in importance in recent years. The main policy tools for China to pursue its grand strategy in Central Asia include properly handling border issues, eliminating potential conflicts, developing good-neighbourly and friendly relations with Central Asian countries. In order to achieve mutual benefit and win-win situation, China will continuously upgrade the level of strategic partnership, actively develop economic cooperation and energy cooperation with Central Asian countries. The fourth is not to seek to establish a sphere of influence. China actively participates in regional cooperation in Central Asia, but does not seek to establish its own sphere of influence. From objective conditions, this is not impossible. China’s path to political reform over the last three decades has been slow, but discourse among Chinese political scientists continues to be vigorous and fo... Thereafter, the primary task of the party and its government changed from seizing political power to consolidating it, from destroying the old state to building a new one. The foundation of the CCP’s legitimacy also gradually changed from revolution to reform and from political movement to law making. This political development advanced down Cite this Item. Since its founding, the government has revamped its administrative system more than 10 times. Reform has sped up recently, with a goal to transform governmental functions and improve administrative efficiency. The regulatory power of the central government over the economy has been gradually shifted from micro-management to macro-management. A new civil service system has been in place since 1993.[2]. The decentralization drive has caused major change in state-local relations. Although the latest anti-corruption campaign has led to some recentralization of judicial and party disciplinary power, fiscal decentralization has characterized the new central-local governmental relationship and produced de facto fiscal federalism. China exerts growing influence around the world. On the occasion of the 70th anniversary of the People’s Republic of China, we have witnessed extensive media coverage of China’s rising economic and political power. Chinese values have also received growing attention in the context of Chinese business and Chinese people going global. China’s rise will impact societies across the globe, including in Western Europe and the United States, where China’s growth tends to face mounting resistance and scepticism. Much political commentary has stressed China’s differences with the West and underemphasis