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China: developmental state or dysfunctional development?

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Since 1978 the Chinese Communist Party (CCP) leadership has implemented a series of reforms designed to restore the party's legitimacy by moving from a politically to a more economically mobilised society. This strategy has entailed the gradual dismantling of the instruments of state planning, and their replacement with market mechanisms, in an attempt to increase economic efficiency and productivity. With China's internal Maoist model of development and other socialist developmental models now essentially moribund, some within China, and even among the CCP itself, have looked East for inspiration—or for aspirations. Where reform in much of Eastern Europe had resulted in a decline in party authority and the descent into economic chaos, China's East Asian neighbours appeared to provide shining examples of how rapid economic growth could be compatible with continued authoritarian government.

While it is true that the Chinese reform experiment does contain some similarities with the capitalist developmental states of East Asia, we should not conclude from this that China is following a coherent strategy of emulating the NICs. China's developmental trajectory has been to a large extent dysfunctional. There are three key factors here which this paper will explore in detail. The first is the way that political demands—both from within the party–state structure itself and from other societal groups—have obstructed the formulation of a coherent and effective national economic development strategy. In the words of the title of Susan Shirk's excellent interpretation of reform in China, we must assess 'The political logic of economic reform'.[1]

Second, the reform process has resulted in a significant redistribution of economic decision-making power, primarily from central to local level authorities. The central authorities have granted local governments across China varying degrees of financial autonomy. In addition, some have exploited growing international contacts to find further sources of extra-budgetary investment finance, or pressured theoretically (quasi) independent banks and enterprises to support local development plans. As a result, China's developmental trajectory owes at least as much to the dysfunctional agglomeration of numerous local initiatives, as it does to the plans and strategies of the national level decision-making elites.

The third factor is the extent to which China's external economic interests are now influencing developmental strategies and processes. As local authorities compete with each other (not to mention other developmental states in East Asia

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and elsewhere) for investment, there has been a tendency to emphasise low-cost and low-regulation advantages to attract labour intensive component assembly investments. As employment and growth in some areas become increasingly contingent on attracting and retaining such foreign investment, some local authorities have abandoned internally defined development strategies and pay more heed to the requirements of Asian investors. While this investment has brought tangible benefits to the Chinese economy, the long-term wisdom of this strategy is more questionable. At the very least, the dynamic relationship between the local and the international adds a further question mark over the central elites' ability to adopt and enforce coherent national development programmes.

These three factors are all inextricably linked. Indeed, there is almost an evolutionary process here. The political constraints on economic strategy in the early 1980s in large part contributed to the dysfunctional growth of local economic autonomy in the second half of the decade. This localism not only exacerbated the problem of political demands influencing economic strategy, but has also in turn been a major factor in explaining the importance of international economic contacts in the 1990s. In short, inter-elite discord generated dysfunctional development, which in turn generated further unexpected developments which have militated against the adoption of any coherent programme or model for reform—either internal or external.

The Chinese developmental state: economics or politics in command?

In rejecting the Maoist model of development (and Hua Guofeng's variation on the theme between 1976 and 1978), the Chinese leadership initially looked backwards for their models to the heyday of Leninist 'orthodoxy'.The 8th Party Congress of 1956 was taken as a golden era of collective leadership pursuing pragmatic economic development strategies which placed economic development above class conflict, and even allowed for a role (albeit a very minor role) for market forces in the countryside.

But 1956 was obviously not 1978. On one level, the economic system that had helped generate rapid growth before 1956 had lost much of its appeal by 1978. Both within China and in much of the rest of the socialist world, state planning had become more associated with stagnation than with growth. On another level, there were considerable disagreements over how far the CCP could or should go in abandoning the past. All groups were firm in their commitment to shoring up the CCP's grip on power, but there was considerable disagreement over the practicalities of rejecting the past, and on what point an increased role for the market became incompatible with socialist principles.

During 1984 and 1985 consensus within the elites over the best development strategy had become severely strained. The success of limited marketisation and increased international contacts through the Special Economic Zones (SEZs) impressed key leaders such as the then Premier, Zhao Ziyang. For these more reform minded leaders, further price reform, economic liberalisation and internationalisation were the logical way forward. However, others argued that reform had already gone too far. In the Autumn of 1985, Chen Yun, one of the original architects of the post-Mao reforms, issued a strong public warning on the dangers of over-rapid development, neglect of state planning and grain production, and questioned the personal and socialist ethics of some party officials.[2]

Zhao was unprepared or unable (or both) to push his case in the face of fairly widespread and bitter opposition, particularly as he appears to have failed to persuade Deng Xiaoping to support him. Zhao opted instead for a more moderate and acceptable package of reforms, which included transferring power away from the more sceptically inclined central planning and financial institutions to the provinces.

Despite abandoning his formal positions of power, Deng Xiaoping has clearly remained the single most dominant figure in Chinese politics. Like Deng, Chen Yun and other members of the Long March revolutionary generation were also able to exert considerable political influence from behind the scenes. This confusing distribution of power has considerably impinged on the freedom of movement of formal power-holders such as Hu Yaobang, Zhao Ziyang and Jiang Zemin.[3] They not only have to consider how the party elders will respond to their initiatives, but how Deng Xiaoping will respond to any criticism from these party elders. Deng's skill at factional management has been a source of considerable success—at least by his own criteria. He has kept the party in power and more or less together despite considerable strains from both within the party and without. Nevertheless, his political balancing game has impinged on the smooth evolution of coherent and economically logical policies. If opposition threatens to disrupt unity and thus jeopardise the party's grip on power, Deng has been quick to react and abandon (more often postpone until more favourable times) offensive policies. Furthermore, Deng's patronage helped both Hu Yaobang and Zhao Ziyang assume the position of party leader in the 1980s, but both men also lost this position when Deng sacrificed their political careers for the sake of unity.

Susan Shirk has explained how the priorities of maintaining a semblance of internal party cohesion and unity has become something of a defining characteristic of how the CCP has managed the process of reform. To prevent strong opposition to reform, an ethos of fairness came to dominate policy making, or what Shirk calls an ideology of 'balancism'.[4] In practice, this meant that central decision makers chose policy options which ensured that no unit or actor lost too much, rather than those which were best for the country as a whole. In short, rather than choosing the best policy, decision makers chose the satisficing policy—the one that did just enough to satisfy and suffice.[5]

The implications of this approach to policy making are enormous. First, there is a tendency to make small incremental changes that are easier to get past obstructions within the policy-making elite than coherent and comprehensive reforms. It also means that you can back-track on specific policy if necessary without jeopardising the entire reform process. Second, Shirk notes that there was no real coherence between reforms in different areas. With individual agencies left to develop their own reforms, the result of this fragmented decision-making process was a number of unconnected, incoherent, and at times contradictory, reforms.[6]

Third, it has also created something akin to a boom and bust cycle—or more correctly an expand and retrench cycle. You Ji suggests that Zhao Ziyang advocated a rapid pace of development to prove the wisdom of his policies and to gain popular support for reform even though he knew that this policy would generate inflation and be unsustainable in the long run.[7] The flip side of this coin is that when even relatively minor problems emerge, opponents seize on the opportunity to force a rethink of policy, usually resulting in retrenchment. In his analysis of industrial reform in China, Naughton paints the following picture of the government's approach to reform: 'Unable to dominate events, the government has had to scramble repeatedly to "put out fires" and prevent disastrous outcomes'.[8] As a result of this preoccupation with short-term problems and solutions, the CCP elites were unable to 'formulate a consistent program of economic changes'. Even though Naughton was specifically commenting on the period up to 1983, this analysis remains valid for much of the subsequent period.

The capitalist developmental state and 'relative state autonomy'

In his analysis of the capitalist developmental states in East Asia, Chalmers Johnson argues that one of the key, perhaps defining, features of the East Asian NICs is 'stable rule by a political–bureaucratic elite not acceding to political demands that would undermine economic growth'. As politicians are motivated by seeking popular support in the short run, long-term economic strategy must, as far as possible, be insulated from the vagaries of competing political demands:

> Political leaders attempting to implement long term industrial policy must therefore have the capacity to depoliticize in part their key economic decisions. This is normally done by entrusting such decisions to a "nonpolitical elite," sheltered to some degree from direct political pressures.[9]

Notwithstanding the lack of substantial competitive elections, political demands have been a major factor in the Chinese economic decision-making process. Indeed, given the nature of the Chinese political system (not least the fact that the entire central decision-making apparatus is staffed by party members), economic decision making is perhaps more responsive to political demands from within than it is subject to political demands from without. Party rule in China is theoretically a means to an end—it is the vehicle for representing the wishes of the proletariat and establishing a communist society. In reality, the Chinese political system is not a 'dictatorship of the proletariat' but a 'dictatorship of the party–state'. It is true that the party devotes considerable time, effort (and more concretely money) to defending the interests of certain sections of the Chinese population, but the motivation behind these policies is to shore up the ruling elites' grip on power—maintaining party rule has become an end in itself.

Reformist leaders thus faced the dilemma of squaring long-term economic requirements with short-term political considerations. At the risk of over-simplifying the issues, we can make the following seven statements characterising the developmental process in post-Mao China which distinguish the Chinese case from Johnson's capitalist developmental state model:

1 Economic reform was promoted to protect the political priorities of the Chinese ruling elite.

2 There was a lack of knowledge and experience in utilising and controlling market mechanisms.
3 There were divergent, and at times bitter, conflicts within elites over the specifics of reform policies.
4 There were divergent, and at times bitter, conflicts within elites over the ultimate destination of the reform process.
5 Reform policies were defined to ensure that no group within the elites lost too much, thus jeopardising political stability.
6 Reform policies were adapted to ensure that no geographic area lost too much, thus jeopardising political stability.
7 Reform policies were adapted to ensure that key societal groups (notably the rural grain producers and, more importantly the state employed working class) did not lose too much, thus jeopardising political stability.

The above mentioned debate over reform in 1984 and 1985 provides a particularly good example of how some of these forces have influenced Chinese development. Another good example is the failure (over a long period) to fully reform the pricing structure for key commodities—notably grain and energy inputs. State control in these areas gives the central elites the ability to retain at least a semblance of their ability to divert resources to key areas and maintain consumption and production in areas which might fare badly under market competition for resources. It also reflects the party's uncertainty that it can survive the (at least) short-term social upheaval from the inflation that price reform would bring. For example, with inflation rising in 1988, the then party leader, Zhao Ziyang, once again argued that comprehensive price reform would remove the structural causes of inflation and was the logical way forward. However, abandoning low state-set prices would lead to considerable price rises for key goods (including food staples). For Premier Li Peng and others, growing social discontent had to be dealt with immediately, not in the long term; instead they decided to re-impose planning and price controls—to treat the symptom rather than the disease itself.

A final example here is the desire to maintain employment and urban living standards. Rising unemployment is a big enough problem in any society, but has particular significance in China. The work unit or the collective provides those welfare services normally provided by the state (or the market) in the West. If you lose your job, you could also lose your accommodation, your health care and your children's education—and all of this without any unemployment benefit to fall back on.

This 'negative' impact of the drive for economic efficiency first became apparent in the rural sector. The de-collectivisation of the Chinese countryside may have increased agricultural production, but at the cost of the declining provision of health, education, welfare and employment. Social cohesion in some rural areas is now at breaking point, and the simultaneous rise in rural economic dislocation with the growth of gangsterism and the extension of triad activity into the mainland is no mere coincidence. The CCP elites have primarily used economic readjustment as a means of maintaining social cohesion in the countryside. This is most clearly seen in readjustments to the purchasing price for grain, and the maintenance of comprehensive purchasing systems for agricultural produce. For example, after the massive rape harvest in 1996, the state agreed to purchase the vast (and unusable) surplus. In an earlier 'rape crisis' the state actually responded by a concerted campaign to persuade the population that eating rape was 'patriotic'!

Notwithstanding the defence of rural prices and the fact that the rural population vastly outnumbers the urban community, the CCP seems to have done much more to protect employment and conditions in the towns than in the countryside. The primary factor here is the CCP's perception of the relevant importance of different social groups. Rightly or wrongly, it perceived that disaffection among the urban working classes was a greater threat to the party than the more fragmented consequences of reform in the countryside.

The party has gone to great expense to inoculate important sectors of the urban population against potential harmful side effects of the market. For example, the aforementioned semi-reform of pricing and allocation structure helps ensure an adequate and relatively equable supply of grain to all urban centres. The central state also pays a number of other subsidies and bonuses that all serve to maintain urban purchasing power and to diminish urban income differentials between different sectors and regions. Furthermore, notions of social cohesion rather the logic of economic rationality provides the basis of employment policy in many state owned industries. Although some state owned enterprises have gone to the wall, the state shores up the majority of loss making enterprises (at least a third of the total by the CCP's own reckoning), while over-staffing undermines the profitability of others.

In Delfs' words, 'the cities have been bought off'.[10] Perhaps we should clarify this statement by distinguishing between different elements of the Chinese working class. There are a number of sub-groups within the urban industrial sector, and the divisions correlate strongly with the non-wage privileges that accompany occupation in sectors distinguished by type of ownership. The key group here, at least for the party leadership, are those employed in the state sector. China's pre-reform system created a privileged working class within the urban working class, and it is this group or class that the CCP has been primarily concerned in defending.

This approach to managing reform has maintained social and economic stability and has also helped alleviate some of the spatial problems of economic reform. But short-term gains may be costly in the long run. For example, China is in danger of evolving a 'dualistic' economy. While the CCP has encouraged the development of new competitive and efficient economic sectors, it has insulated vulnerable sectors of the economy from potentially fatal market competition. The two sectors are now so isolated from each other that the flourishing cooperative, private and (particularly) foreign-owned sectors frequently cannot use products from the state sector. Components from the latter are of too low quality and supplies too unreliable for other more vibrant and market rational sectors of the economy.

More importantly for this analysis of China's dysfunctional development is the way the central elites become vulnerable to pleading for special treatment. Faced with sometimes conflicting demands upon them, the central authorities frequently respond by buying themselves out of problems. In some cases, it can end up responding to one concession by paying for another. For example, when peasant discontent has forced an increase in grain procurement prices, the state has frequently subsequently increased bonuses and subsidies to the urban sector to offset the increase in grain prices. As the Polish government found in the 1980s, regimes of this sort can find themselves sucked ever deeper into a cycle of spiralling subsidy payments. In the Chinese case, around a quarter of the national budget is devoted to subsidy payments of one kind or another—almost as much as the centre spends on development projects.

The more the centre accedes to demands for special treatment, the more it may become vulnerable to new demands upon it. In the framework of Johnson's earlier work on revolutionary potential, it risks becoming unable to cope with the pace and pressure for change resulting in 'power deflation' or a progressive reduction in system effectiveness.[11] Political lobbying (notably, but not solely, from provincial and local interests) has been an important component of the policy-making process. Although competition between regions for preferential central treatment has always occurred in the PRC, the higher potential gains and losses that market reforms unleashed enhanced this competition. An excellent example here is the way in which the Shanghai authorities successfully challenged the basis of their financial relationship with the centre in response to the preferential treatment given to Guangdong and Jiangsu.[12]

This case is important for three main reasons. First, it is a good example of how political pressures undermined the logic behind a conscious strategy. Shanghai's gains in terms of financial autonomy must be at somebody else's expense. Either the centre loses more in terms of the financial balance of power between centre and province, or other provinces lose out from the removal of the extra funds from the national budget. Second, Wang Huning notes that it reflects a new provincial confidence that localities can exert pressure on the central policy-making process:

> {Shanghai's} action in taking the initiative to ask for a new system to be put in practice differed from the old model for reform in which the central government took the initiative in these matters.[13]

Third, it had a knock-on effect in that it generated a wave of lobbying from other provinces with grievances about current policy. Immediately following Shanghai's successful approach to the centre, Inner Mongolia and Jilin formally asked (without success) to move to the Shanghai system. Hunan and Jiangsu officials similarly asked for some of the preferential treatment afforded to Guangdong, and we can only guess at the extent of the informal lobbying that also occurred.

A final problem with this strategy is its expense. While the Polish regime in the 1980s funded its subsidy payments through reliance on external debts, the Chinese regime has primarily relied on funding through budget deficits. Economic reform has generated a significant growth in national wealth, but not enough of this money has found its way to the centre for it to meet its growing commitments. The key issue here is the changing relationship between centre and provinces, which has not only had a massive impact on the evolution of the

Chinese reform process to date, but also remains a key determinant of the future trajectory of the Chinese political economy.

Dysfunctional development: the growth of provincial autonomy

The Chinese reform process has entailed the deliberate devolution of a significant degree of economic control to the provinces. As this was a conscious strategy, it may seem strange to talk of the growth of provincialism as a dysfunctional consequence of reform. Indeed, responding to central complaints at the loss of financial control over the provinces, a 1990 World Bank report argued that the loss of central control in the 1980s was:

> a matter of deliberate choice and not inadvertent. The Centre cannot, therefore, chafe over the loss of fiscal resources.[14]

However, this analysis somewhat misses the point. On one level, reformers adopted decentralisation policies with little forethought or research on what this would actually mean. You Ji argues that the decentralisation policies of 1984 were in part designed to undermine the influence of conservative leaders who were heavily (and disproportionately) represented in central financial and planning organs.[15] As such, the 1984 decentralisation was a means to an end rather than an end in itself—it is an example of how an acceptable policy took precedence over what Zhao Ziyang thought was the best and most logical policy.

On another level, while the centre did indeed initiate the decentralisation process, provincial and lower level authorities did not use their new powers in the manner that central leaders envisaged. This was partly a consequence of a lack of co-ordination between reforms in different areas, which almost forced provinces to adopt flexible responses to numerous and often conflicting new central initiatives. For example, changes in the fiscal relationship between centre and province were rapidly followed by the introduction of a new system which taxed enterprise profits. As the fiscal reforms were based on the old system of all enterprise earnings being collected at the provincial level, many provinces now faced substantial reductions in revenue without any corresponding decrease in their income collection targets.[16] Indeed, with revenue collection rates set to rise annually, many provinces decided to make short-term adjustments to their economic structure. A popular response was to build small factories producing consumer goods with high prices that would guarantee a fast return on investment.

Once established, these new factories needed considerable administrative support to continue producing. Energy and raw material supplies were provided irrespective of the comparative efficiency of the new factories, often by diverting supplies out of the planned sector. In order to guarantee a market for their produce (and thus guarantee provincial income through taxing profits), localities erected local tariffs and quotas to keep out imports from other provinces. Thus, the more efficient found their access to scarce commodities and markets squeezed while the inefficient continued producing thanks to their hand in glove relationship with local authorities. As a result, the growth of provincial power has not only generated significant centre–province tension, but also a growth in province–province conflict over access to raw materials.

But the provinces were not just unwilling or reluctant players in the game. A further consideration is the way in which local authorities distorted central reforms for their own end. One of the clearest examples here, and perhaps the best starting point for this analysis, is the dysfunctional consequences of the managerial responsibility reforms. In 1984, the CCP took the first steps in separating enterprise management from state control by extending reform into the industrial sector. While these reforms did indeed extend management autonomy, state intervention (and even direct management at times) remains a fact of life for most enterprises. Notwithstanding formal structural reforms, many provincial cadres' have proved reluctant to relinquish their control over local economic affairs. While it is relatively easy to make legal–structural changes, changing cultures can be a much harder and longer process. Many cadres and managers have simply not internalised the new 'political culture', and continue to relate to each other as they did in the pre-reform era. Lack of reform to political structures also strengthens such 'organisational imprinting'.[17] Where changes in the economy demanded administrative changes, reformers simply added new structures to existing ones. Where old and familiar structures remain in place, it is not surprising that they often take precedence over new and strange ones.

A second factor was the way the semi-reformed pricing and distribution structure forced managers into a position of dependence on provincial administrative control. To put it simply, reforms in other areas did not support the logic of managerial autonomy. For example, if enterprises can't afford to pay higher market prices for key industrial inputs (notably coal and other energy sources), they are essentially dependent on administrative interference to guarantee energy supplies. Furthermore, with much of the transportation system overloaded by coal shipments, it is difficult to move other commodities, even over relatively short distances, without the active support of 'sympathetic' local authorities.

Finally, we must consider the retention of party control over important personnel decisions through the *nomenklatura* system, which Burns contends is the most significant instrument of party control throughout the country.[18] While this is true, it is important to distinguish between party control and central control. From 1984, the central authorities gave up their right to vet appointments at sub-provincial leadership levels and devolved their vetting authority to provincial level party committees. Although this may have only made *de jure* what had become *de facto*,[19] it nevertheless represented a formal reduction in the centre's power at the provinces' gain. It also meant that if local authorities impinged on the new rights of enterprise managers, the threat of dismissal was a powerful cause of management acquiescence.

Rather than granting autonomy to enterprises, these reforms instead redistributed power among bureaucratic agencies. The vertical dictatorship (*tiaotiao zhuanzheng*) that characterised the system of state planning where orders flowed directly down through ministerial and government agencies has by and large been removed. But this has only been achieved at the expense of the growth of horizontal dictatorship (*kuaikuai zhuanzheng*), a dictatorship which may prove more difficult to dismantle than the central state-planned dictatorship it replaced.

Dysfunctional development and provincial financial autonomy

Enterprise management autonomy is not the only areas where provincial authorities have usurped decentralised control. In 1985, bank loans to local governments replaced central government grants as the main source of investment capital. Although banks were meant to use market based criteria in assessing the merits of each loan application, provincial authorities have frequently applied pressure on provincial bank branches to extend loans to support local economic strategies, even during periods when the central authorities were urging credit tightening. This feature was a result of the dual control of local level organisations in China. A provincial branch of a bank is vertically responsible to the bank's central offices, and ultimately to the Ministry of Finance, but at the same time, it is also responsible to the provincial finance bureau and the provincial government. The latter has the advantage of hands-on contact with the branch, since it is in direct day-to-day contact with bank officials. Furthermore, it possesses considerable power in terms of allocating goods, services and, through the *nomenklatura* reforms, leading personnel to the banks.

The process of devolving power to banks in localities was also slightly misguided. In setting the investment quota for provincial specialised banks, the centre announced that the 1985 investment quota would depend on the amount of loans extended in 1984. In order to increase their quota, many banks decided to lend as much as possible during 1984. The result was a massive expansion in credit, with some banks actively seeking enterprises and local authorities which might accept investment loans.

The transition from central grants to bank credit to provide investment capital had a dramatic affect on the economic structure. At the start of the reform process in 1978, state planning agencies and financial authorities controlled the provision of 76.6% of internal national investment capital. Within a year of the introduction of banking reforms, this proportion had fallen to 33.2%.[20] Furthermore, increased access to direct foreign investment and loans resulting from China's opening to the international economy also enhanced the financial autonomy of some provinces. While large foreign investment and loan projects remained under central control, provincial authorities and enterprises were free to go overseas and find investors and partners for smaller projects unhindered by central controls. By the end of 1993, foreign direct investment (FDI) accounted for 12.3% of all investment in China, up from 7.7% in 1992 and from less than 1% a decade earlier. However, it is important to note that China's opening to the West did not benefit all provinces equally. For example, over 96% of the foreign exchange earned through exports from joint ventures went to the coast, and over a third of the foreign currency earned from exports from companies utilising foreign investment went to the SEZs alone.

Other imaginative ways of raising extra revenue included levying illegal charges on local health facilities, educational support, street cleaning, and so on.

But perhaps the central element here is the reform of the centre's fiscal relations with the provinces, introduced between 1976 and 1980. The logistics of the revenue-sharing reform are quite complex, not least because different agreements were made with different provinces. At the risk of over-simplifying the issue, we can identify three main departures from the old system which have contributed to the growth of provincial financial autonomy. First, with the exception of Tianjin and Beijing,[21] a five-year readjustment cycle replaced annual revisions to facilitate long-term planning. Second, rather than giving provinces comprehensive and detailed orders on how to spend and collect money, the provinces were granted autonomy to set their own priorities as long as they stayed within broad expenditure and income guidelines. Third, and most importantly for this study, provincial authorities were allowed to retain a proportion of any income collected above the agreed figure for remittances to the centre.

It is difficult to overstate the significance of these changes for the dysfunctional growth of local power. For example, the centre's failure to either step or index link provincial remittances proved to be a costly mistake. Arrangements with two of China's fastest growing provinces, Guangdong and Fujian, meant that the provincial authorities retained all excess revenue. Thus the amazing economic growth of the coastal region did not generate a proportionate growth in central income. Furthermore, rapid inflation (particularly during 1988) made it easier for provinces to meet their remittance targets, and as inflation triggered increases in central expenditure on compensation payments and subsidies, central finances soon came under severe pressure. The 50% increase in the national fiscal deficit in 1993 (despite an official government pledge to trim the shortfall) provides evidence of the size of the problem.

In combination with the banking reforms and new found access to foreign finance and partners, these revenue-sharing reforms gave many provinces the wherewithal to advance their own local development priorities. Much Western analysis has focused on the growing tensions between Guangzhou and Beijing as a result of Guangdong's ever growing economic independence. It is certainly true that Guangdong's local economic policies have been the cause of considerable conflict with the central authorities, but the growth of provincial power is not simply confined to the newly rich coastal provinces, and the conflict between national economic goals and provincial economic policies has become almost a defining characteristic of the Chinese economy in the recent era.

While old style state planning is more or less a thing of the past, the state nevertheless continues to dominate the Chinese economy. On one level, state control of the unreformed raw materials and infrastructural industries ensures that the state still exerts significant control over the national economy. The state also remains an important player in the reformed sectors of the economy, but here we must distinguish between the national state and the local state. As the latter remains a component part of the former, it may seem odd to refer to them as separate entities. However, the diversity between national and local interests that has emerged during the reform process makes this a valid distinction.

The attainment of national economic goals has been obstructed by provincial authorities across the country establishing and actively pursuing their own economic strategies. Inter-provincial competition for growth distorted the original national strategy of replacing local self-sufficiency with a market-rational regional division of labour and comparative advantage. Financial reforms have spawned an explosion of local capital construction projects that the centre is unable to control. For example, investment in capital construction increased by 35% in the first quarter of 1985, by 37% in April, and by 42% in May as a direct result of banking reforms. Crucially, investment in state-planned projects recorded a mere 1.6% increase, whereas investment in unplanned local projects rose by 87%.

As the 1980s progressed, the central authorities found themselves increasingly unable to pull wayward local authorities back in line. For example, when they ordered a decrease in investment spending in 1986, local authorities still invested a total of 4.4 billion Yuan in the first seventh months alone. Similarly, during the official retrenchment campaign of 1989, *Jingii Ribao* (Economics Daily) reported that the policy was meeting a ‘great deal of resistance’ in ‘a few’ provinces. Many areas were openly setting plans for industrial growth above the 4–5% prescribed by the state plan, and an unnamed province in Eastern China (probably Jiangsu) had gone as far as to set a planned industrial growth rate of 12–25%.[22]

Under the pre-reform system, the centre’s main tool of control over the provinces came through economic mechanisms—primarily the restrictions on local autonomy provided by mandatory planning, through control of industrial enterprises, and through control of investment capital. Economic reform saw mandatory planning replaced by guidance planning, saw the devolution of enterprise management away from the centre, and vastly increased locally controlled sources of investment capital. Yet, for much of the 1980s, the centre continued to act as if it retained these powerful levers over the provinces. With the ultimate sanction of removing the provincial leader a dangerous game to play, this left the centre with little more than exhortations to unite and comply with central priorities, and these pleas often fell on deaf ears.

To make matters worse, provincial leaders exploited disunity within the central leadership itself, particularly during the 1989 retrenchment campaign. It was no secret that some central leaders, notably Zhao Ziyang, disapproved of retrenchment policies, and that the tide might sweep back in favour of the reformers. What was the point of making short term cutbacks if the period of retrenchment was going to be short-lived? Indeed, the lesson of the 1980s was that a further wave of reform soon followed a period of retrenchment (usually sooner rather than later). By the end of the decade there was no expectation or confidence that the retrenchment policy would last, and that: ‘having experienced short-lived bouts of contraction over the preceding three years, enterprises attempted, initially, to ‘wait out’ credit restraint’.[23]

The transition from plan-rational economic control levers to new approaches more in keeping with emerging quasi-market structures is a slow and ongoing process. Furthermore, those mechanisms that might once have served to pull the provinces back in line now have to operate from the reality of increased provincial autonomy. For example, the introduction of a new income tax system in 1994 has gone some way to redress the balance between central and provincial control of revenues. However, as the provinces remain the main conduit of fiscal information to the centre, there is considerable scope for local authorities to exercise ‘creative accounting’ to support local priorities. Surveys from within China show that faking deficits to avoid taxation is now commonplace (if not the norm). As such, the best efforts of financial supremo, Zhu Rongji, to create a more rational macroeconomic structure remain in large part contingent on encouraging provinces (and lower level authorities) to subvert their own developmental strategies to national objectives.

The growth of provincial autarky is a consequence of a number of factors. First, as noted above, developing light industrial bases was a relatively quick way of ensuring that provinces could meet their financial obligations. Second, infrastructure defects have obstructed the free flow of goods across the country, and mean that local production can be the only way of ensuring supplies. Third, the provinces, like the centre, are keen to maintain employment and social stability in urban centres.

Fourth, provincial autarky is a response to the uneven central treatment of provinces during the reform process. There is considerable resentment at the special treatment granted to Guangdong in particular (but the coastal region in general) to facilitate rapid economic development. Furthermore, despite repeated assurance to the contrary, many in the interior remain unconvinced of the merits of trickle-down theories of development. Indeed, Ji Chongwei paints a picture of local economic strategy built around emulating any successful project elsewhere:

> Whenever one chunk {of the country} starts to produce something, every other chunk wants to get into the act, fearing it will be left out. Latex medical gloves, for example, have recently been selling well on the American market, so in a flash 200 plus production lines went up in China.[24]

To make matters worse, 10 projects were under construction in the USA which would provide all that country’s domestic needs on completion. So even those Chinese manufacturers which had a foothold in the US market faced the contraction (and ultimately the removal) of its demand. The desperate bid to make money in the short run undermined long-term prospects—as Ji complains, ‘the poorer we are, it seems the more we squander investment’. In addition, Li Xianguo argues that this duplication of regional economic activity ‘has destroyed regional specialisation and division of labour’. Any short-term gains may have been made at the expense of long-term economic efficiency, and have also stretched the energy, raw material and transport sectors. As such, ‘the result of indiscriminate copying is actually a non-development policy’.[25]

Dysfunctional development: expanding international economic relations

> The more that the scale of goods and assets produced, exchanged, and/or used in a particular economic sector or activity diverges from the structural scale of the national state—both from above (the global scale) and from below (the local scale)…then the more the authority, legitimacy, policymaking capacity, and policy implementing effectiveness of states will be challenged from both within and without.[26]

Perhaps the area where China's developmental process appears closest to the capitalist developmental states is in the absorption of foreign capital to finance economic development. While the initial intention of the party elites was to concentrate and therefore control international economic contacts, this proved to be an elusive task. Indeed, the development of quasi-autonomous economic policy in Guangdong in particular has been much facilitated by the influx of foreign capital and has long since contributed to the dysfunctional spatial pattern of development. These trends are now being intensified in Guangdong and emulated elsewhere, to the extent that the relationship between the local and the international is now a significant driving force behind China's developmental process. It is also going a long way to undermine the central state's ability to control (not to mention dictate) China's developmental trajectory.

Using foreign capital to aid the developmental process has become a feature of development in East Asia. Indeed, the experience of other East Asian states has clearly influenced Chinese decision makers (not least Deng Xiaoping). As Johnson notes:

> the Koreans and Taiwanese have given virtuoso performances in how to use foreign and multinational capital without at the same time becoming subservient to it.[27]

Bernard's & Ravenhill's analysis of East Asian development suggests that Johnson underestimated the importance of 'structural dependence' on Japanese technology in Korea and particularly Taiwan.[28] Nevertheless, the 'subservience' to foreign capital is more marked in parts of China than at similar stages of development in the NICs.

While many in the West perceive China as a major potential market, other investors, particularly from the rest of East Asia, are more interested in using China as a low-cost, low-regulation production base for components assembly. It is this latter form of investment which dominates in many parts of China, and is the main focus of attention here. Where investors are keen to access the Chinese market, the Chinese side have something that the investors want (ie access to the market) and can negotiate accordingly. But in the case of these export-based investments, the Chinese side is competing with other Asian states (and European regions) for investment, so the foreign side can exert considerable pressure to ensure the best possible deal—it has something that the competing host economies want.

This international competition is intensified by the competition within China from different provinces and localities keen to attract new investments. Localities are not only striving to offer bigger and better incentives to gain new investments, but also to lure existing investments away from other parts of China. This inter-local competition is manifest in intense competition to gain more investment, irrespective of the quality of that investment. In too many cases, the local authorities concerned set targets for attracting x number of investments, or x amount of contracted investment capital, and don't pay enough attention to how these investments will affect their industrial structure in the long term.

To make matters worse, many foreign investors have not fulfilled the promises they made during the negotiation process. For example, a survey in Beijing of

Taiwanese investments found that the average actual investment was as little as 29% of the contracted amount.[29] In some cases, the privileges extended to attract investment outweigh the financial gains to the locality. Of 30 000 joint ventures audited by the National Administrative Bureau of State-owned Assets, the Chinese party had lost 90% of its capital in 80% of cases—a total of 10 billion Yuan.[30]

The development of off-shore production centres is now a key feature of China's development. Asian investors, many of them overseas Chinese from Taiwan, Hong Kong, Singapore and the Chinese diaspora,[31] are establishing large-scale production sites in China which are bringing employment and revenue to the country, and facilitating greater links with the international economy. Nevertheless, there are a number of question marks that remain over the long-term impact of this type of investment for China's future developmental trajectory. On one level we face the danger of an ever increasing cycle of higher incentives (and neglect of regulatory standards) to attract investment. In Palan's & Abbot's terms,[32] there is a danger that provincial competition will bring about a dysfunctional 'downwardly mobile' state strategy which the central state cannot control.

The isolation of the foreign investment sector from the domestic Chinese economy also raises a number of concerns. Much investment from the rest of Asia into China is component assembly (screwdriver assembly). This investment uses low skills and low technology, and is generating remarkably few forward and backward linkages into the host economy.[33] A further area for consideration is China's growing dependence on foreign investments for export activity. Around 38% of Chinese trade is the import–export activities of foreign investors, but this national figure underplays the importance of the foreign direct investment (FDI)-trade link in China's coastal region. Guangdong, for example, has received 40% of all foreign investment since 1979 and now provides 41% of the entire country's exports, of which 68% 're-exports'. With the expansion of foreign investments further north in recent years, this heavy investment–trade linkage is increasingly important in other coastal areas as well.

It is perhaps stretching the point too far to say that China's global trade is now contingent on foreign investments—but not too far. At the very least, both external observers and the Chinese government itself has to come to terms with the complexities of developing coherent national state strategies, given the complexities of life in an interdependent international economy. And this brings me to the second point here. Official policy towards China's integration into the international economy has long been one of ensuring that the SEZs 'meet the needs of the international community'.[34] With numerous localities outside the SEZs now also gearing their strategies to the interests of the international economy, the aggregate impact of these local strategies is undermining the logic (and efficacy) of coherent national strategy.

Partly as a consequence of lobbying from 'unfavoured' provinces, the Ninth Five Year Plan carried promises of moving the focus of investment towards northern and central China. These may well turn out to be empty promises, given the combined priorities of China's major external investors and local authorities further East. Perhaps more indicative of the underlying dynamic here was Liu

Ji's 'forecast' that the Bohai Rim was to become the next centre of foreign investment.[35] This 'forecast' is a pretty sound bet because it is already a reality, not least because of the aggressive and proactive campaign by the Dalian authorities to encourage foreign investment. As such, Liu Ji's statement was more a reactive recognition of reality, than a prescriptive plan for future developments.

However, it is not only the national state that is facing problems in staying in control of events. In their analysis of Taiwanese investment in the Xiamen SEZ, Qi Lou and Howe show how the Xiamen authorities originally concentrated on attracting electronics manufacturers and designed their local development strategy accordingly. However, Taiwanese investors had different priorities, and instead brought in more and more chemicals producers. Faced with this divergence, the Xiamen authorities apparently abandoned their original goal and declared petrochemicals to be their new 'investment emphasis'.[36] A similar process occurred in Shenzhen where the local leadership tried to restructure the local economy by imposing disincentives for processing industries and component assembly. While these industries did indeed decline, the high-tech and finance investments that Shenzhen was hoping to attract were not forthcoming. As a result, the local authority reversed its policy, and re-introduced a number of incentives to lure back the processing and component assembly investments.[37] It seems, then, that the interaction with the regional economy which did so much to facilitate the development of dynamic quasi-autonomous economic policies in some parts of China may now be undermining these localities' ability to control and dictate strategy within their own territories.

Conclusions

This paper has emphasised the obstacles to effective long-term economic policy making which have influenced (and continue to influence) the Chinese reform process. While it has concentrated on impediments to central control and effective national policy coordination, this does not mean that the central state is no longer influential or has no control. For example, the growth of investment after 1992 was in many ways a response to Deng Xiaoping's tour to southern China which indicated a new central commitment to expanding international contacts. Nevertheless, the central state has been unable to control the consequences of its initiatives. It has set new processes in motion, but has then too frequently been placed in a responsive and reactive position as other agents (both internal and external) have taken the initiative and imposed their own agendas. Indeed, one of the features of the reform process in the 1980s was the centre's increasing inability to force provincial authorities to accept periodic economic retrenchment campaigns (particularly Li Peng's campaign of 1988).

The question of the transferability of any model of development cannot be answered by reference to one case study—I will leave that task to others. What this example shows is that it is impossible to understand the dynamics of the Chinese reform process without acknowledging the specific historical, political and social context that has informed the reform process. Notwithstanding the growing importance of the international economic environment for China's development, perhaps the central determinant of China's development strategy is the uncertain and unclear relationship between central and local authorities. Until and unless this relationship is stabilised, it will be extraordinarily difficult to develop a coherent and cohesive national strategy for development: in Johnson's words to facilitate 'the *national* mobilization of a *united* people for economic goals'.[38]

Notes

1 S Shirk *The Political Logic of Economic Reform in China*, Berkeley, CA: University of California Press, 1993.
2 Xinhua, 'Chen Yun's speech to the conference's closing session', *BBC Summary of World Broadcasts*, 25 September 1985, FE/8065/C/1.
3 They have also, at one time or another, faced the added dilemma of building a sufficiently large coalition to win the struggle to succeed Deng, but in a way that does not threaten Deng's own power bases and interests.
4 S Shirk 'The Chinese political system and the political strategy of economic reform' in K Lieberthal & D Lampton, eds, *Bureaucracy, Politics and Decision Making in Post-Mao China*, Berkeley, CA: University of California Press, 1992, p 77.
5 A term used by Lindblom in his incremental model of policy making.
6 Shirk 'The Chinese political system and the political strategy of economic reform'.
7 You Ji, 'Zhao Ziyang and the politics of inflation', *The Australian Journal of Chinese Affairs*, No 25, 1991, pp 69–91.
8 B Naughton, 'False starts and second wind: financial reforms in China's industrial system', in E Perry & C Wong, eds, *The Political Economy of Reform in Post-Mao China*, Cambridge, MA: Harvard University Press, 1985, p 224.
9 C Johnson, 'Political institutions and economic performance: the government–business relationship in Japan, South Korea and Taiwan', in F Deyo, ed, *The Political Economy of the New East Asian Industrialism*, New York: Cornell University Press, 1987, pp 151–152.
10 R Delfs, 'Lop sided growth', *Far Eastern Economic Review*, 4 April 1991, p 24.
11 C Johnson, *Revolutionary Change*, Boston, MA: Little, Brown, 1966.
12 See Zhang Zhongli, 'Shanghai He Shanghai Jingjiqu Zai Zhongguo Jingji Xiandaihua Zhong De Diwei He Zuoyong' (The position and role of Shanghai and its economic zones in the modernisation of China's economy) *Shehui Kexue* (Social Sciences), Vol 1, 1988, pp 18–22.
13 Wang Huning 'Zhongguo Bianhuazhong De Zhongyang He Difang Zhengfu De Guanxi: Zhengzhi De Hanyi' (Ramifications of changing relationship between central and local government in China) *Fudan Xuebao* (Fudan University Journal), Vol 5, pp 1–8, 30.
14 World Bank, *China: Macroeconomic Instability and Industrial Growth Under Decentralized Socialism*, Washington DC: World Bank, 1990, p 82.
15 You Ji, 'Zhao Ziyang and the politics of inflation', *The Australian Journal of Chinese Affairs*, No 25, 1991, pp 69–91.
16 P Ferdinand, *Centre–Provincial Relations in the PRC Since the Death of Mao: Financial and Political Dimensions*, Working Paper No 47, Department of Politics, University of Warwick, 1987, pp 7–9.
17 J Child, 'The process whereby organizations acquire structures, programmes, staffing profiles and cultures which reflect characteristics at the time of their founding and which they tend to retain subsequently', *Management in China During the Age of Reform*, Cambridge: Cambridge University Press, 1994, p 308.
18 J' Burns, *The Chinese Communist Party's Nomenklatura System*, Armonk, NY: M E Sharpe, 1989, p xxxi.
19 The sheer number of appointments falling under the Central Committee's remit had grown so large that they simply approved provincial nominations in most cases. To save time, some local authorities had stopped seeking higher approval before the 1984 reforms. J Burns, 'China's Nomenklatura system', *Problems of Communism*, Vol 36, No 5, 1987, pp 36–51.
20 Zhu Li, 'Zijin Fengpei De Zhuyao Gaibian' (Major Changes in the Distribution of Funds in China), *Jingji Guanli* (Economic Review), No 9, 1987.
21 The municipalities were considered too important for national finances to be granted the same degree of fiscal autonomy as other provinces. Although Shanghai was initially treated in the same way, it mounted an impressive lobbying campaign and forced a reorganisation of its financial obligations to the centre in 1985.
22 Yan Kalin, 'Prices rise? Prices fall?', *Jingji Ribao* (Economics Daily), 1 February 1989.

[23] World Bank, *China: Macroeconomic Instability and Industrial Growth Under Decentralized Socialism*, p 9.
[24] Ji Chongwei cited in 'Do regional responsibility contracts point the way in which reform should head, or are they just an expedient?', *Gaige* (Reform), No 3, translated in *Joint Publication Research Services*, 7 September 1988.
[25] Li Xianguo, 'Quyu Fazhan Zhanlue De Neiyong Ji Zhiding Fangfa' (The contents and formulation methods for a regional development strategy), *Keyan Guanli* (.Science Research Management), No 2, April 1988, pp 14–19.
[26] P Cerny, 'Globalization and the changing logic of collective action', *International Organization*, Vol 49, No 4, 1995, p 597.
[27] C Johnson, 'Political institutions and economic performance', p 163.
[28] M Bernard & J Ravenhill, 'Beyond product cycles and flying geese: regionalization, hierarchy, and the industrialization of East Asia', *World Politics*, 1995, Vol 47, p 194.
[29] China News Service, 17 July 1995.
[30] China News Service, 24 November 1995.
[31] Something in the region of 80% of all foreign direct investment in China is 'Chinese' in one context or another. However, it is difficult to assess the real extent of this Chinese investment given the number of external agents who use Hong Kong companies as the conduit for their Chinese portfolios.
[32] R Palan & J Abbott, *State Strategies in a Global World*, London: Pinter, 1996.
[33] Note that this is partly because the stagnating state sector is unable to ensure the reliable supply of quality components.
[34] Li Boxi cited in China News Service, 3 July 1995.
[35] China News Service, 15 November 1995.
[36] Qi Lou & C Howe, 'Direct investment and economic integration in the Asia Pacific: the case of Taiwanese investment in Xiamen', in D Shambaugh, ed, *Greater China: The Next Superpower?*, Oxford: Oxford University Press, 1995, pp 94–117.
[37] China News Service, 6 December 1995.
[38] C Johnson, 'Political institutions and economic performance, p 139 (emphasis added).