

chapter one

ECONOMIC TRANSITION AND THE PROBLEM OF GOVERNANCE IN CHINA

[F]ree markets could never have come into being merely by allowing things to take their course. . . . *laissez-faire* itself was enforced by the state.

—Karl Polanyi

Since 1989, China's leaders have lived in the age of trial. Confronted with one crisis after another, including the Tiananmen incident of 1989, the fall of communism in Eastern Europe and the former Soviet Union in the early 1990s, the domestic economic turmoil of 1993–1994, the Asian financial and economic crisis of the late 1990s, and the SARS (Severe Acute Respiratory Syndrome) crisis of 2003, China has nonetheless persevered on the path of liberal economic reforms and enjoyed rapid economic growth. Yet the official commitment to economic liberalization has been accompanied by major uncertainties in governance. Simultaneously having to deal with the strains and disruptions of industrialization, marketization, urbanization, and globalization, the Chinese leadership has been in a marathon quest for institutional development, rationalizing existing institutions and building new ones to cope with the unruliness of markets and bring about a regulative economic order.

Contrary to prevailing predictions, China has made substantial progress in improving the institutional framework for economic governance. To anyone concerned about the welfare of the Chinese people or about the rise of China for regional and world affairs, the significance of such institutional development is obvious. A sound institutional infrastructure is vitally important for sustained economic development.¹ Moreover, a small number of political scientists have also emphasized the importance of a well-functioning administrative state for the consolidation of

democracy.² As Joseph Schumpeter noted in his classic *Capitalism, Socialism, and Democracy*, a competent bureaucracy “is not an obstacle to democracy but an inevitable complement to it.”³ Therefore, though they are concentrated in the area of economic governance, China’s governance reforms not only bear on economic growth but will also have major implications for political development.

In this study, my first task is to document the changes in Chinese governance, including the rationalization of the administrative state, the strengthening of the fiscal sinews for the central state, the enhancement of the regulatory apparatuses, the divestiture of businesses operated by the armed forces and other state institutions, the reforms of the administrative approval system and the improvement of transparency and governmental service, the ascendance of institutions for horizontal accountability, and the introduction of myriad institutional mechanisms to cut down on waste, improve financial supervision, and curb corrupt practices. To be sure, as the Chinese leadership’s initial mishandling of the SARS crisis highlighted, in many respects China still falls far short of the standards of good governance demanded of democratic polities.⁴ Yet I submit that, in light of the circumstances and of the conventional wisdom, the magnitude and scope of China’s multifaceted governance reforms, particularly in economic governance, are quite significant and worthy of serious intellectual attention.

Second, although the Chinese leadership articulated the general goal of building a market economy as national policy in the early 1990s, many of the specific institutional reform measures for achieving that goal did not get implemented until the late 1990s and beyond. How and why did the reformist ideas get converted into policies for implementation with such a time lag? In the analytical framework adopted in this volume, I submit that the interplay of three major factors, namely changing economic conditions, internal politics/political leadership, and crises (real or perceived), have been the most important elements catalyzing the stream of policy choices to be described and analyzed.⁵

Third, this study suggests that the significance of the governance reforms as a whole may be larger than the sum of the parts. The individual reforms are generally designed to achieve certain specific goals, such as to attract more investment, to save the government money, to close loopholes in government financial management, or to cut down on smuggling. Yet together they also alter the landscape for the struggle against corruption and the exercise of governmental authority in general.

In the rest of the introductory chapter, I first present the historical setting for the study, namely the immediate efforts by the post-Tiananmen Chinese leadership to strengthen the political machinery while renewing the commitment to economic reforms. Then I note that China's partial reforms undertaken until then had forged a strong nexus between state and enterprise and survey the contrasting scholarly perspectives on that nexus. Next I draw on the general literature on the politics of reforms to see how that literature would assess the difficulties China would face to move beyond the partial reforms and build a modern market economy. Much of this literature would counsel pessimism regarding the prospects for institutional rejuvenation and transformation in China. Yet, in spite of what the literature would predict, China has undertaken myriad governance reforms to be discussed in the rest of this book. The last section provides an overview of the book's analytical framework and offers a preview of the chapters.

The Historical Context

Nineteen eighty-nine will forever be remembered as one of the bleakest years in the history of Chinese political development. A decade into the post-Mao reform era, China saw a dramatic confrontation between state and society end in bloodshed in Beijing. In a matter of hours, the worldwide exhilaration over the power of the people—built up for weeks with the aid of global television—was turned into profound disillusionment and despair by images of violence and bloodshed. The *Financial Times* of London reported that “the outlook both for economic reform and the economy are not bright.” Indeed, according to the journalist, “economic reform [in China] is likely to unravel” under pressure from the hardliners in the leadership.⁶ Writing for the *New York Times*, veteran journalist Fox Butterfield noted that an ad hoc coalition of conservative Communist Party elders led by Deng Xiaoping had prevailed over more liberal leaders such as General Secretary Zhao Ziyang. According to Butterfield, the purge of Zhao and others not only revealed the heavily autocratic nature of Chinese politics but also put in jeopardy the economic reforms that had given China a growth rate of 9 percent per year.⁷ Soon China scholars were publishing volumes on why the Tiananmen crackdown was but a new page in China's long book of autocracy.⁸

For those who lived within China after the 1989 crackdown, it was an

understatement to say that the political atmosphere was chilling. To be sure, immediately following the crackdown paramount leader Deng Xiaoping emphasized again and again that China should stay on the course of reform and opening up. Yet, as Ling Zhijun, a senior reporter for the Communist Party's *People's Daily*, noted in his diary, then Premier Li Peng and others were pursuing policies of economic stabilization (*zhili zheng-dun*) at the expense of reform and opening up.⁹ Deeply worried that the vicious attacks on deposed party General Secretary Zhao Ziyang might turn into an assault on the first decade of China's reforms, Ling reported that, amid the official criticism of bourgeois liberalization, many private businessmen, managers who had contracted for state-owned enterprises, as well as farmers had fears about being accused of pursuing capitalism and were concerned about becoming victims of political account settling at the top.¹⁰ Indeed, incoming party General Secretary Jiang Zemin quickly announced that private businessmen would not be permitted to join the Communist Party. For reformers, these were the days of doom and gloom.

Strengthening Political and Military Control

Even before students went to Tiananmen Square en masse, Deng Xiaoping had harped on the overriding importance of maintaining stability and warned against the dangers of chaos. During a meeting with visiting U.S. president George Bush on February 26, 1989, Deng argued that China, in the absence of a stable environment, would not be able to achieve anything and might even lose what had been accomplished.¹¹ To help maintain stability and prevent chaos, Deng repeatedly called for strengthening central authority. The jitters from Tiananmen, international sanctions, and the spillover effects of the Soviet breakup further prompted China's leadership to take measures to shore up the center.

Key to the Chinese Communist Party's longevity has been its power over personnel appointments. The post-Tiananmen leadership has clung tightly to the Leninist nomenklatura system, the organizational sinew of the Communist Party. In moves reminiscent of the 1970s transition from Mao, the central leadership has used its appointive power to reshuffle provincial leaders, armed police commanders, and PLA (the People's Liberation Army) regional commanders to ensure that these officials follow the wishes of the central leadership and not become centrifugal forces.¹²

Unlike the ad hoc maneuvers of the 1970s, however, regular cadre

rotations and exchanges have become institutionalized as a key ingredient of the Chinese personnel management system since the 1990s.¹³ The regulations on cadre exchanges include detailed rules of avoidance and stipulate that the exchanges are targeted at cadres with promotion prospects so that they may broaden their experience.¹⁴ Those who have worked in the same locality or department for ten years must change positions with their counterparts in other localities. Such rotations can help curb localism, strengthen central control, as well as inculcate professionalism among the elite and reduce nepotism and corruption. The results of the cadre exchange and avoidance policy are widely recognized. Between 1991 and 1999, there were 691 exchanges of cadres at the level of the provincial department deputy chief and above.¹⁵ In 1999, for example, 21 (67.7 percent) of the party secretaries in 31 provincial units were not serving in their hometown provinces.¹⁶ By 2002, the percentage had risen further to 82 percent even with provincial governors included.¹⁷ In the year before and after the sixteenth National Party Congress (November 2002), the reshuffling and rotations of provincial and ministerial leaders were widely publicized.

Such periodic reshuffles and rotations clearly mark local officials as subordinates in a giant hierarchical organization, in effect, a "China Incorporated." Whereas in Russia the Communist nomenklatura system disintegrated and power fell into the hands of elected regional governors not beholden to the Kremlin, the Chinese central leadership has been able to pull the levers of the nomenklatura system to enhance hierarchical discipline and curb localist tendencies that had become prominent with the decentralizing reforms of the 1980s.¹⁸ Such discipline has been crucial for the execution of a diverse range of major policy initiatives to be discussed in this volume, ranging from tax and fiscal reforms to the divestiture of businesses operated by the PLA, the armed police, and other state institutions.

No modern state can go without a coercive apparatus. Yet the mobilization of the regular army (the PLA) against students and other civilians in 1989 was an indication of the failure of the internal security apparatus. The use of military violence against peaceful demonstrators underscored the legitimacy crisis facing the ruling elite, hurt China's image badly, and resulted in a severe downturn in China's international relations. It also raised serious issues concerning the proper role of the armed forces in domestic politics as well as fears of military insubordination. Most foreign countries typically use the police or special antiriot police units in situa-

tions of domestic unrest. To avoid a repeat of the Tiananmen debacle of using the regular army to quell domestic unrest, the Chinese leadership quickly began to reconstitute the instrument of state surveillance and violence. It has steadily enlarged and strengthened the armed police (to more than a million troops) as well as the antiriot units of the ordinary police and expanded the domestic functions of the Ministry of State Security. In 2000, the armed police commander was formally appointed a member of the Central Comprehensive Governance and Control Committee (Zhongyang Zonghe Zhili Weiyuanhui), the oversight group in charge of crime fighting and social stability.¹⁹

Finally, the central leadership has used efforts to curb corruption as a powerful whip to wield above the heads of officials. Chen Xitong, the powerful party boss of Beijing, for example, was put in jail for corruption. Since 1998, the national-level anticorruption bureau, the Ministry of Supervision, and the Party Central Committee's Central Discipline Inspection Commission have been actively involved in detaining "big tigers" in the provinces.²⁰ In Chapter 7 I shall return to the issue of organizational control in anticorruption.

*Renewing the Commitment to Economic Reforms:
Changing the Paradigm*

Sadly, the Tiananmen confrontation derailed serious initiatives to reform the political system from above.²¹ Nevertheless, the efforts by the post-Tiananmen Chinese leadership to beef up organizational discipline and fortify its means of coercion went hand in hand with renewed commitment to economic reforms. For Deng Xiaoping, political stability, particularly the continuity of Communist Party leadership, was a necessary condition for further economic reforms. Deng clearly recognized that the promotion of economic development through further economic reforms would be essential if the ruling elite were to regain the sort of performance legitimacy it had acquired in the 1980s. In many ways, Deng followed in the footsteps of his East Asian authoritarian predecessors in South Korea, Taiwan, and even Singapore and hoped that authoritarianism coupled with reform and development would provide the recipe for keeping the Communist Party in power.

Thus even as Deng led the patriarchs to oust the liberal-minded party General Secretary Zhao Ziyang and crack down on the student

demonstrators, he was careful to reiterate his commitment to economic reforms.²² When reforms appeared to stall under Jiang Zemin, Deng made a celebrated tour to southern China in early 1992 to stoke the fires of bold reforms and innovation. In his remarks on the tour, Deng stated that the criterion for judging reforms should go beyond capitalism and socialism. Whether foreign investment or the market in general should be protected in China depended on whether these and other institutions or organizations are conducive to the development of productive forces, the enhancement of national strength, and the improvement of people's living standards. For Deng, socialism, like capitalism, can have both plan and market.²³

Prompted and emboldened by Deng, Jiang Zemin and his colleagues put reform back on the agenda and contemplated the construction of a new economic order.²⁴ Speaking at the Central Party School in spring 1992, Jiang noted that the limited introduction of the market had enlivened and energized the Chinese economy. For Jiang, while the state would continue to play an important role in the economy, market competition would provide the incentives for firms to improve their performance, and a well-functioning market mechanism would be indispensable to the development of the socialist economy. While Jiang said that there was no rush to end the raging debate on the proper role of the market in a socialist economy, he nevertheless stated that more and more people in socialist countries had come to recognize and appreciate the virtues of the market.²⁵ He argued further that "it is baseless and incorrect for some people to worry that a larger role for the market would mean going capitalist." The thirteenth Party Congress, held in 1987, had called for China to build a "socialist planned commodity economy (*shehui zhuyi jihua shangpin jingji*)," a self-contradictory phrasing that caused much headache for those who had to explain the term to ordinary people and foreign visitors. Jiang now proposed the term "socialist market economy (*shehui zhuyi shichang jingji*)." ²⁶ The change in terminology was duly endorsed at the fourteenth Party Congress in October 1992. Though seemingly innocuous, this terminological shift to "market economy" with "socialist" as the adjective was profound; it marked the first time in history a ruling Communist Party in a socialist state had decided to embrace the market.²⁷

The comprehensive economic reform platform Jiang outlined in 1992 marked China's move away from Hayekian experimentalism to Polanyian programmatic reform. For much of the 1980s Chinese reforms proceeded in an

ad hoc manner under the nonstrategy of “groping for stones to cross the river.”²⁸ For both ideological and other reasons, China’s leaders were neither sure about how deep and treacherous the river was nor clear about where they wanted to land on the other side. Now Jiang and his colleagues clearly saw themselves as playing the leading role in recasting China’s economic institutions. Specifically, Jiang’s Central Party School speech outlined key aspects of China’s market transition. The government would transform its functions such that it would desist from micromanaging firms and focus on providing macroeconomic control through economic levers. The state would “vigorously nurture and develop the market and build a unified and complete socialist market.” This called for the state to improve and enforce regulations for a well-functioning market while promoting trade in products as well as stocks, bonds, technology, labor, information, and real estate. Major efforts should be made to improve the infrastructure, including both hardware (telecommunications, computer networks, banks, transportation) and software (accounting, auditing, statistics, taxation), in order to ensure economic order.²⁹ Rather than continuing to serve as administrative appendages of the government bureaucracy, state enterprises would become market-oriented.

Partial Reforms and the State-Enterprise Nexus

Jiang’s proposal for a “socialist” market economy was overdue. After more than a decade of reforms, the supply of most farm and consumer products had become plentiful. As a result, as the next chapter will note, planners were able to remove price controls on most products and allow the formation of product markets without engendering the sort of hyperinflation that characterized the shock therapy administered to most former planned economies. Nevertheless, from the perspective of reform history, the formation of product markets was only the beginning of the long march to a market economy.

Historically, the development of modern market economies in different countries has pushed states to “develop rules about property rights, governance structures, rules of exchange, and conceptions of control in order to stabilize markets.”³⁰ In the United States, the historian Robert H. Wiebe famously noted, the march of nationalization, industrialization, mechanization, and urbanization exerted enormous strains on the ethos and institutions of small-town America and prompted a search for order.³¹

The state that was forged in the Civil War became inadequate to the push and pull of industrialism, and “a qualitatively different kind of state” was built in the late nineteenth and early twentieth centuries during what is now known as the Progressive Era.³² Civil service reforms were introduced to curb the corrupt localism and particularism of patronage politics; a managerial and regulatory state arose to tackle problems ranging from poor public health to monopolies. Echoes of the Progressive Era political struggles and negotiations over the shape of this regulatory state continue to be heard in today’s United States, often magnified in episodes such as the collapse of Enron and Worldcom.³³

In contrast to the “leisurely” pace of development that the early industrializers enjoyed, many underdeveloped countries with per capita income levels similar to China’s suffer from the lack of a state capable of the basic tasks of governance, and some of these countries remain afflicted by civil war or are otherwise known as failed states.³⁴ In China, the post-Mao reformers inherited a modernizing state that was wrought on the anvil of the Chinese civil war and the purgatory of Maoist rule. It was this state that had, under Mao’s leadership, ruthlessly pursued land reform, collectivization, and forced-draft industrialization while suppressing popular demands for consumption, thus lending support to theories of late development that gave center place to the role of a strong state.³⁵ Even though ruinous Maoist policies such as the Great Leap Forward and the Cultural Revolution did much to weaken the bureaucracy, post-Mao China inherited a substantial Leninist state apparatus bent on modernization. In Huntingtonian terms, the post-Mao Chinese state started with plenty of organizational resources and mobilization capacity.

Yet the reformation of socialist economies led by Leninist parties presents special challenges. In these economies the state, partly through the central planning apparatus, became omnipresent and largely abolished market-based exchanges.³⁶ Rather than building state capacity to take care of the markets, the daunting task of market reforms in socialist economies not only involves the introduction of markets but also the rebuilding of the state into one that is qualitatively different and suited to markets. Simply put, market reforms cannot succeed without the reconfiguration of the socialist state. It is necessary to get the omnipresent state to retreat in some areas of the economy, to change its behavior in others, and yet to build and rebuild the institutions and capacity to govern markets and provide various forms of public goods. The making of markets must go hand in hand with

the remaking of the state. Whereas previously liberal international institutions such as the World Bank were strong advocates for the downsizing of government and of generally reducing the role of the state, even these institutions have come to appreciate the importance of building effective states by the late 1990s.³⁷

Though China has enjoyed rapid economic growth, until the late 1990s the Chinese leadership had far less success in transforming the functions of government and the nature of the Chinese state in general. As is well known in studies of China and discussed in the following chapter, it was the government at different levels and in various guises that eagerly pursued investment opportunities in the 1980s and sought to protect their investment interests. The dual-track reforms not only entailed the continuation (albeit gradual shrinkage as a percentage of total economic activities) of the plan but also meant the persistence of bargaining relationships between state (as well as collective) enterprises and their bureaucratic superiors. These relationships were ones of mutual dependence.³⁸ The enterprises counted on their superior government agencies for supply of energy and raw materials at subsidized prices, assistance with access to capital (bank credit and grants), protection from encroachment (including encroachment by other state agencies), favorable treatment in regulatory enforcement (environment, quality, and so on), and various forms of preferential treatment (such as tax and interest exemptions or steering projects their way). In return, the enterprises furnished their bureaucratic superiors with revenue (both in-budget and extra-budget as well as other forms of income), employment (which often served as a patronage benefit), and products for the plan. As a result, economic reform and administrative reform were caught in a classic chicken-and-egg situation. As long as the government supplanted the market, state enterprises would do well to seek a bureaucratic umbrella.³⁹ Yet the remaking of the administrative state stalled, because the webs of relationships engendered demands for administrative protection, coordination, and decision.⁴⁰ The bilateral interdependence amid partial reforms provided fertile soil for government expansion during an era of rapid economic growth. Between 1978 and 1995, Chinese state revenue grew by 5.1 times while administrative expenses in state expenditure expanded by 17.8 fold.⁴¹ Most ominously, government administrative expenditure as a percentage of total government expenditure rose from only about 5 percent in the mid-1970s to nearly 15 percent by the mid-1990s.