

**Shifting Central-Provincial Relations in China:
The Politics of Fixed Asset Investment in Shanghai and Guangdong,
1978-1993**

**A Thesis Submitted for the Degree of Doctor of Philosophy
at the University of London**

By

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Abstract

This dissertation argues that an interactive and dialectical model best explains the political economy of central-provincial relations in contemporary China. It rejects the "centrist" perspective of the state capacity paradigm so dominant in the existing literature on central-provincial relations in China. The centrist perspective, it is argued, disables analysts from explaining prevalent bargaining activity and discretionary behaviour by the provinces, other than in its precarious speculation on the disintegration of the Chinese state. It also precludes any hypothetical possibility of qualitative change within the central-provincial relationship, and is biased towards a static interpretation.

This dissertation employs a concept of power originated by Talcott Parsons, and discusses the *process* whereby the Centre and the provinces---Guangdong and Shanghai as two case studies---bargain with and manipulate one another. I thus adopt a rational-choice-institutional approach that emphasizes the coexistence of institutional constraints and actors' choice. The case data shows that whilst provincial discretionary behaviour is heavily influenced by central policies, the provinces are by no means merely the passive respondents to central stimuli. They exercise discretionary behaviour and multiple compliance strategies. The Centre and provinces constrain one another and are locked in a perpetual positive-sum game of bargaining.

This dissertation suggests that the central-provincial interface is like all of decision "points" in the Chinese political system---fluid and prone to perpetual bargaining. However, central-provincial interdependence compels both parties to compromise in order that their own interests can be maximized and advanced. The central-provincial relationship is not, therefore, a zero-sum game. As conflicts between the Centre and the province become more intense since the reform, each is obliged to acknowledge that the only way to enhance its own interests is through recognizing the legitimacy of the other's interests. Normative interactive behaviour in spatial politics is thus forged, and a devolution of power is cast.

Preface

The topic of this thesis was first conceived in Spring 1989, before the traumatic events in Beijing unfolded to a tragic climax. The original thinking behind it was to contribute towards the identification of factors which underline the "cyclical" pattern of national integration and disintegration throughout Chinese history, and thereby to explore the possibilities of qualitative change in the political processes.

The main body of the thesis has, however, a narrower focus and a humbler objective. It examines how two apparently "atypical" provincial-level governments, Guangdong and Shanghai, sought to achieve their respective objectives in investment expansion and economic development since 1978 within the constraints of the central government. The findings of this examination have, however, indicated that the central-provincial interface may be the locus where qualitative changes in political processes will first occur in China.

I have benefited from the assistance and guidance of numerous individuals from the initial stage of ponderances to the production of the thesis in this present form. My supervisor, Dr. David L. Shambaugh, guided me through the entire process, whether it be in London, in Hong Kong, or in Beijing. I am indebted to his critical comments as well as to his insistence for the best quality as an end product. Professors Lynn White III, George W. Jones, Nicholas Lardy, Kuan Hsinchi and Brantly Womack read through earlier drafts of various chapters and gave their invaluable comments, as did Dr. Christine P.W. Wong and Dr. Keith Forster, and Dr. Sung Yun-wing. Professor Audrey Donnithorne, Dr. John P. Burns, and Dr. Thomas Chan gave their advice when this thesis was first conceived in 1989 in Hong Kong, while Dr. Yuan Cheng gave his advice whilst I first came to London. Dr. Julia Strauss read an earlier version of the entire manuscript and offered perceptive comments and suggestions for improvement. Moreover, Jane Duckett, J. Wibowo Wibisono, and S. B. Ko, fellow doctoral candidates with Dr. David Shambaugh, offered gratifying intellectual as well as emotional support during the process of writing and research in the field.

This list of acknowledgement will go on and indeed could be at least quadrupled in length, if not because of the need for prudence regarding the unpredictable political circumstances in China that might endanger certain individuals. The brevity of this acknowledgement thus by no means reflects the extent of gratitude I feel to those individuals in China who inspired me through the

process of this work. Although not without stress and difficulties, the field research in Beijing, Shanghai and Guangzhou has been a gratifying and fulfilling experience. I have also benefited from in-depth discussions with many students from China in London.

I am grateful to Pamela Lord for her assistance with copy-editing. A number of close friends, in Hong Kong as well as in London, have provided the tacit encouragement and emotional support at various difficult times during the long period of gestation of this thesis. Last but not the least, my family has been the reliable source of support to which I turned during times of stress. My mother, sisters and brothers, and, above all, my husband, Johnny Ng, have provided the quiet but solid backing throughout the years, when my career has seen twists and turns. My gratitude to their understanding is beyond my words.

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Introduction

Statement of Topic

This dissertation is a study of central-provincial politics regarding investment in post-Mao China. It enquires into the ways in which provincial governments manoeuvred their way within the constraints and opportunities provided by the institutional context to achieve their agenda. It examines how provincial leaders bargained with central leaders regarding the formulation of central policies which have a bearing on investment and the allocation of centrally controlled resources so as to make the institutional context work to their advantage. It examines the strategies which provincial officials used to stretch the "loopholes" in established institutions and practices to make them work far beyond their original limits. The study shows that provincial governments were remarkably active political "actors" who engaged in a wide range of discretionary behaviour in order to advance their objective of investment expansion. The picture shown is not however one of one-sided activism by the provinces. Provincial governments were always constrained by central policies, which explains their eagerness to bargain with the Centre for a more favourable institutional context.

The purpose of this dissertation is to ascertain this *linkage* between institutional context and discretionary behaviour. It aims to explore the relationship between the constraining/facilitating power of the Centre and the ability to engage discretions on the part of the provinces. Accordingly, the research questions undertaken in this study can be grouped into two categories. The first group concerns the influence of the Centre: what parameters did the Centre set for the provinces regarding investment? What were the substantive central policies involved? In what ways did the Centre influence, whether it be to *facilitate* or *constrain*, the discretionary behaviour of the provinces? The second group of questions targets the discretions of the provinces. How did provincial governments manage to manoeuvre under, and regardless of, central government constraints? What strategies did they employ? To what extent did the provinces participate in formulating the very central policies which constituted their institutional context? These two groups of questions obviously cross-cut one another. This dissertation concludes that the Centre and the provinces engage in an interactive relationship.

This dissertation employs a rational-choice institutional approach in disentangling this interactive relationship between the central and provincial governments. The analysis is targeted at the *process* of central-provincial

interactions, rather than engaging in correlational tabulations of attributes and characteristics. An institutional approach means that the thrust of analysis is placed on institutions and the effect of the institutional context on behaviour. Individual actors, whether at the Centre or in the provinces, are studied in terms of their interaction with the institutional context. The starting point is that institutions undoubtedly affect the behaviour of political actors. While idiosyncratic factors, such as the quality of leadership and the temperament of individual leaders, also come into the picture, they nevertheless work within the context of the institutions. The existence of these other factors, however, implies that the effect of institutions on behaviour is not total, and that an institutional approach by no means suggests any sense of institutional determinism.

The prefix "rational choice" emphasizes that actors in central-provincial politics exercise choice on their behaviour in a rational manner, albeit within the constraints of the institutional context. Acting within a host of rules and norms did not rob the actors of their freedom to choose, by rational articulation, those specific courses of action which could best serve their interest.¹ Institutions and rules prescribe certain limits to behaviour, but actors can nevertheless exercise considerable choice within the limits. In fact this possibility of choice within institutional rules represents the basis of the very existence of discretions.

The approach of a study, it has been noted, very often affects and, to a certain extent, predetermines its conclusions.² Therefore a study which focuses attention on the top elite for explanations of policy changes is most likely to argue for a potent role of the elite in the policy process.³ By starting from the bottom end of the hierarchical relationship, this dissertation aims to provide a deeper understanding of central-provincial politics through another perspective, and

¹The complementarity of the institutional approach with rational choice is cogently discussed in Elinor Ostrom, "Rational Choice Theory and Institutional Analysis: Toward Complementarity", *American Political Science Review*, Vol.85, No.1 (March 1991), pp.237-43. Susan Shirk also employs the rational choice institutional approach in her *The Political Logic of Reform in China* (Berkeley: University of California Press, 1993), but her focus is more on the institutional context of rational choices of the actors, that is, how rational choices of actors can be explained by incentive structures built in to the institutional context, rather than emphasizing *the room for* active choice within the constraints of institutions.

²See, for instance, Paul A. Sabatier, "Top-down and Bottom-Up Approaches to Implementation Research: A Critical Analysis and Suggested Synthesis", *Journal of Public Policy*, Vol. 6 (1986), pp.21-48.

³An example is Joseph Fewsmith's study of the origins of economic reform programs of post-Mao China, *Dilemmas of Reform in China* (Armonk, New York: M.E. Sharpe, 1994). By focusing attention on the top leaders and their advisers, Fewsmith unsurprisingly found that politics at the top was the major propelling force behind the formulation of reform policies. (p.241) This research focus on the top becomes more precarious as Fewsmith extends his analysis to the later years of 1980s.

thereby to bridge the gap in the existing literature which mostly adopts a top-down perspective to the relationship. Given the recognition of the interactive relationship between the Centre and the provinces, this study has placed more emphasis on the part of the provinces. The Centre has been intensively scrutinized by the existing literature on China, whilst activity at provincial level has been relatively understudied. Two provincial-level governments, Guangdong and Shanghai, are chosen as comparative case studies to enable a study of the behaviour of provincial governments in some detail while engaging in meaningful comparisons, and thereby drawing implications for the general picture of China's central-provincial relations as a whole.

Significance of Topic

Why should we be interested in central-provincial relations at all? What is the relevance of central-provincial relations when trying to understand Chinese politics and political processes in general? The short answer is that politics between the Centre and the provinces reflects the longstanding concerns of political practitioners and observers regarding national integration in China: the most populous country of the world. More importantly, examination of this relationship illuminates the unresolved historical problem of the distribution and institutionalization of power within the Chinese political system.

The spatial dimension of politics is a perennial and persistent issue within political systems worldwide. However, the substantive content and degree of concern may vary among different countries. In developing countries, such as those in Africa, policy preferences regarding decentralization/centralization are possibly those most debated within the common endeavour to increase productivity and, therefore, wealth. It is argued that in some Western industrialized countries centre-periphery relations are largely an academic issue.⁴ Nonetheless, developments in Canada over the Quebec issue in the 1980s and early 1990s, controversies in Europe over "subsidiarity" in the European Union and the upsurge of nationalism in former Soviet republics since the end of the Cold War all demonstrate that the territorial aspect of politics, national integration and the identity of nations are still hot issues in the national development and political science of the West.

⁴See Harold Wolman, "Decentralization: What It Is and Why We Should Care", in Robert J. Bennett (ed.), *Decentralization, Local Governments, and Markets: Towards a Post-Welfare Agenda* (Oxford: Clarendon Press, 1990), pp. 29-42. I also benefited from discussions on this point with Dr. Julia Strauss, Department of Political Studies, School of Oriental & African Studies, University of London, October 1994.

Underlying the interest in spatial politics within the national boundaries of different political systems is the generic concern regarding the gap between policy formulation and implementation or, simply, the "implementation gap". Governments exist to rule and perform. The existence of substantial differentials between policies as formulated and that which is eventually implemented begs the question of effective governance.⁵ The policy-implementation gap also invites questions as to what the process of governance actually consists of. Who are the "powerful ones" who make the decisions which affect the everyday lives of citizens? When pluralism dominated political studies in the West, the emphasis on inputs to the political system relegated the dynamic political processes within the state apparatus to the status of the "black box" of politics.⁶ With the "return of the state institutions" as a focal subject of political studies, especially since the 1970s and the 1980s,⁷ questions have been asked regarding the roles of the various bureaucratic actors in the state apparatus in agenda formulation and policy implementation. It has subsequently been recognized that the structure of state institutions does indeed affect what and how things are done. The national and subnational levels of government constitute a major part of the bureaucratic maze where political agendas are struck, and policies decided and implemented. Therein lies the reason for persistent interest of political systems worldwide in the spatial dimension of politics.

⁵This dissertation employs the notion that politics is *both* a matter of allocation of "who gets what and how", and a matter of domination, rule and governance, of "us versus them". That these two views of politics, derived from David Easton and Der Begriff Schmitt, can in fact be reconciled and complement one another is cogently argued in Gianfranco Poggi, *The Development of the Modern State: A Sociological Introduction* (Stanford: Stanford University Press, 1978), pp. 2-12. Vivienne Shue also recognized the relevance and utility of the notion of politics as governance, vis-a-vis the dominant notion of politics as allocation in most China political studies in the West. See Vivienne Shue, *The Reach of the State: Sketches of the Chinese Body Politics* (Stanford: Stanford University Press, 1988), p.19.

⁶See Patrick Dunleavy and Brendan O'Leary, *Theories of the State: The Politics of Liberal Democracy* (London: Macmillan Education, 1987), p.108.

⁷There were disagreements as to when the state became again the focal point of Western political studies, or indeed whether there was any departure from the study of the state at all. One cause of such differing perceptions is the variety of conceptions of the "state" as a subject of study which disputing parties had in mind. Those arguing for a break in the study were probably thinking in terms of the study of state structures and the constituent parts and institutions of the state, while those arguing against a break thought in terms of the state as the "polity"; of the state as a whole. For examples of the former view, see Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985); Stephen D. Krasner, "Approaches to the State: Alternative Conceptions and Historical Dynamics", *Comparative Politics*, (January 1984), pp.223-46. For the latter view, see for instance Joel Migdal, *Strong Societies and Weak States: State Society Relations and State Capabilities in the Third World* (Princeton, New Jersey: Princeton University Press, 1988), p.10 (footnote 1); and Patrick Dunleavy and Brendan O'Leary, *Theories of the State: The Politics of Liberal Democracy*, which, in summarizing the concepts of the state in the various streams of political thoughts, implies that the state, either in terms of its institutions or as a whole, has always been a persistent focus of Western political studies.

However, in China the concern for spatial politics goes beyond mere generic concern over the "implementation gap". It is a more fundamental issue related to the latent yet perennial fear of national disintegration. The historical experience of disintegration results in a heightened sense of concern among students of Chinese politics and Chinese political actors regarding the political ramifications of an implementation gap.⁸ This concern over the spectre of national disintegration begs questions as to *why* the fear should have arisen in the first place. What is the linkage between the observance of implementation gap and the fear of national disintegration? Is it because the gap is so "large" in China that the centrifugal tendencies verge on secession and disintegration? How then can we measure the gap, in comparison with the gaps in other political systems? Alternatively, are there other issues associated with the implementation gap that cause the concern?

This study argues for the latter position, i.e., that other issues are pertinent. The issues involved are those concerning the institutionalization and the distribution of power between the constituent levels of the Chinese state. The contention is that underlying the concern for national disintegration lies the yet unresolved historical problem of power distribution and institutionalization within the Chinese political system. An examination of central-provincial politics in China leads us, therefore, to the core issue in Chinese politics: that of power distribution and institutionalization of the distribution. Policy implementation gaps in the post-Mao period, of the magnitude as to cause alarm at the prospect of a possible disintegration of the Chinese state, resulted from the failure of the Chinese political system to institutionalize any system of power distribution between the Centre and the provinces, and to provide a regularized avenue of reconciliation and arbitration when conflicts arose.

⁸David Goodman also noted the persistent concern of Western China scholars and Chinese politicians for the centrifugal tendencies and threat of national disintegration in China. See David S. G. Goodman, *Centre and Province in the People's Republic of China: Sichuan and Guizhou, 1955-1965*. (Cambridge: Cambridge University Press, 1986), p.4. The increasing reported occurrence of implementation gap in post-Mao China as a result of subnational discretions has attracted wide attention among Western students of Chinese politics. Many described the discrepancies between central policy prescriptions and local implementation as the reflections of regionalistic tendencies, and some even pondered the possibilities of national disintegration. See, for instance, Gerald Segal, *China Changes Shape: Regionalism and Foreign Policy*. Adelphi Paper 287 (London: International Institute for Strategic Studies, 1994); Maria Hsia Chang, "China's future: regionalism, federation, or disintegration", *Studies in Comparative Communism*, Vol.25, No.3 (September, 1992), pp. 211-27; Ellis Joffe, "Regionalism in China", *Pacific Review*, No.1, 1994; and David Goodman, "The PLA and regionalism in Guangdong", *Pacific Review*, No.1, 1994.

Research Design

Fixed Asset Investment as the Political Arena

This dissertation studies the politics between the central and provincial governments within the context of investment policy. Unlike the focus of most previous works on Chinese spatial politics which have been based largely on the resource, or input, aspect of policy processes, such as fiscal revenue allocation and personnel control, fixed asset investment forms one of the many categories of substantive policies on which revenues and resources are spent. Taking a substantive policy as the arena means starting the inquiry into the political dynamics from the output end of policy. The idea is first to discern discrepancies between central policy and provincial implementation in the substantive output of a policy area, and then work through the process whereby the discrepancies evolved in the first place. In this way the study identifies factors which gave provincial governments room to manoeuvre, and conversely, the instruments through which the Centre exerted its influence over the provinces. As it turns out, the fiscal system is, among others, a major institutional factor shaping discretionary behaviour over fixed asset investment.

What is the advantage, then, of starting from the output end, rather than from the input side of policy processes? The advantages are two-fold.⁹ First, starting from the output end focuses attention on the "implementation gap". It is then possible to pinpoint the input factors which contributed to such a gap. This approach ensures that the analyst always relates what is observed in the interaction between the central and provincial actors, the institutional context, and whatever other information is considered relevant to the study, to the original phenomenon of an implementation gap in the chosen policy area. The study is thereby process-oriented. Input factors and institutional arrangements will be studied in the search for an explanation of the implementation gap. Their relevance and role with respect to how the provinces manoeuvre their discretions or how the Centre sustains its control will also be clearly defined.

Second, working from the output side of "an implementation gap" back to the input institutions in identifying its causes safeguards analysts from falling into the analytical trap of static institutional analysis. For instance, it is common for studies focusing on fiscal arrangements to conclude that, as a result of the

⁹See Jae Ho Chung, "Studies of Central-Provincial Relations in the People's Republic of China: A Mid-Term Appraisal", forthcoming in the *China Quarterly*, No.142 (June 1995).

significant transfer of fiscal resources and authority from the Centre, there has been a substantial loss of central power vis-a-vis the provincial governments since the 1980s. The linkage between the transfer of fiscal authority and resources on the one hand, and the loss of central power on the other, is assumed to be direct and straight-forward. This assumption is itself problematic, since, as Chung has noted, the fiscal status of a province can "cut both ways of having a stronger (or weaker) say in policy-making and, at the same time, of being placed under tighter (or looser) control by the centre".¹⁰ A static institutional focus also fails to illuminate the rich shades of interaction between the central and provincial actors---i.e. the process by which actors *interact* within the institutional context to bring about the implementation gap or its absence.

Amongst the various substantive policy areas, fixed asset investment is the most important policy output of the socialist Chinese state in terms of the amount of resources put to its use. While class struggle still dominated political life prior to the Third Plenum in December 1978, investment as an item in the state budget was always the most important single issue, accounting for up to 56% of total annual fiscal expenditure.¹¹ Since 1978, with the shift of national focus in political life from class struggle to economic construction, investment activities have gained greater significance in the task of fulfilling the national goal. The materialistic emphasis of socialist ideology as well as the nationalistic bent of central leaders have made investment the most important expenditure item of the state, at both central and provincial levels. As an important activity of both the central and provincial governments, fixed asset investment therefore provides the best vantage point from which to view political processes in China, most particularly central-provincial politics. *Prima facie* evidence also suggests that investment is a mature policy area through which to explore the politics between Centre and provinces. Reports referring to difficulties experienced by the Centre in attempting to rein in the excessive investment enthusiasm of provincial governments have abounded. Provincial governments have consistently sought to increase the level of investment activities beyond the limits imposed by the Centre, often resulting in lacklustre economic efficiency. Localistic orientation in investment and market protection by provincial governments has demonstrated the increasing contradictions between the Centre's preferences and policies on the one hand and provincial incentives and policy outcomes on the other.

¹⁰Ibid.

¹¹The highest proportion was attained in 1958, the year of Great Leap Forward. See Ministry of Finance (ed.), *China Finance Statistics 1950-1991* (Beijing: The Science Press, 1992), p.116. For more discussion see Chapter Two.

The Provincial-Level as the Level of Analysis

In this dissertation I have chosen the provincial level as the level of analysis. The reasons are three-fold. First, the provincial level with its size and command of substantial resources has the *potential* of posing a political challenge to the Centre which is impossible in the case of more localized units. As Whitney has written on this point, "the diminutive size of the lowest echelon units precludes them from acquiring too much power. It is the units of the intermediary tiers with their more extensive span of control and resource base that are most likely to challenge the Centre."¹² Studies of the more localized levels, especially with respect to the township and the village, and their relations with the Centre, are essential in order to understand the extent of state penetration into society, and vice versa, within a state-society analytical framework. In order to tackle the recurrent concern over national disintegration and the threat to central power in the political system, however, one has to start from the main candidate for potential power contention with the Centre: the provinces.

Second, the importance of the provincial-level and its equivalent in the Chinese political system has been underlined by its persistent historical continuity, despite frequent attempts by the Centre to manipulate provincial boundaries. According to Whitney,

"From 756 A.D. (middle of T'ang Dynasty) onward the provincial-level groupings began to acquire greater authority, and they now controlled areas containing sufficient resources and population to be able to challenge the power of the centre and to usurp many of its functions including that of financial control. These areas now formed a permanent intermediate link in the chain of command between the centre and the districts."¹³

The fact that the boundaries of the provincial-level were often changed reflects, to an extent, the perceived threat of this intermediary level of government to the Centre. As Whitney has written,

"the *chun* of the Western Han and the *tao* of the early T'ang were created originally to lie conformally upon existing natural regions, since (these intermediary levels), at the time, posed no threat to the centre...As the latter areas began to acquire power..., attempts were made to weaken their base of support either by merging areas together or by dividing them still further..."¹⁴

¹²See Joseph B. R. Whitney, *China: Area, Administration, and Nation-Building* (Chicago: University of Chicago, 1969), Department of Geography, Research Paper No.123, pp. 79-80.

¹³*Ibid.*, p.119.

¹⁴*Ibid.*, p.120, quoting from Wang Gungwu, *The Structure of Power in North China during the Five Dynasties* (Kuala Lumpur: The University of Malaya Press, 1963).

The argument is that as the imperial bureaucracy developed, more power resided at the intermediary level between the central government and the lowest level of formal state bureaucracy, the county. The Centre, however, became uneasy about the growth in power of the intermediary level and periodically attempted to constrain its power by gerrymandering the boundaries. However the need for an intermediary level of government as a means to enabling the Centre to retain its hold over the more than one thousand units of county government meant that the provincial level would nevertheless continue to exist.¹⁵ Moreover, despite the repeated central manipulations of provincial borders, and the creation and abolition of entire provinces, evidence exists which also indicates the relative continuity of provincial sizes over time,¹⁶ and points to those specific occasions when the Centre had to abandon its attempts at gerrymandering.¹⁷ This suggests that provincial-level government has long been a potent political force within the Chinese political system, and therefore deserves serious attention.

Thirdly, the provincial-level has been chosen as the level of analysis because it has not been adequately covered in existing literature on Chinese politics.¹⁸ This dissertation aspires, therefore, to go some way towards filling the "gap" in this area. Most previous works on Chinese spatial politics have focused on the lower echelon levels. The reason for this focus can be traced to the development of the field of Chinese political studies in the West.¹⁹ Research at county and

¹⁵The number of county-level governments varies from exactly 1000 in the Ch'in Dynasty (221B.C.) to around 1400 units in Ming and Ch'ing Dynasties (1368-1911 A.D.). The number stood at around 1600 in the early years of the People's Republic of China, albeit drastic reductions by over 300 units during the communization and Great Leap Forward campaign in the late 1950s. See Whitney, *China: Area, Administration, and Nation-Building*, pp.75-8 (Table 6).

¹⁶Whitney argues that if the size of provinces was to be rationally decided to facilitate optimum control from a management point of view, size should be inversely correlated with the population density of the area. His findings show that the designation of provincial boundaries more closely conformed with this rational management principle in older times than in more recent years, suggesting that there was a substantial inertia and continuity in the provincial sizes, and a relative disability of the Centre to radically change them. See Whitney, *China: Area, Administration, and Nation-Building*, p.129.

¹⁷One such instance occurred in 1906, when an attempt of the Qing central government to divide Jiangsu Province into two was aborted as a result of widespread resentment to the move. *Ibid.*, p.121.

¹⁸This is recognized and noted by China studies scholars, who called for more work to be done on the spatial aspect and on the provincial level in particular. See for instance Harry Harding, "The Evolution of American Scholarship on Contemporary China", in David Shambaugh (ed.), *American Studies of Contemporary China* (Armonk, New York and Washington D.C.: M.E. Sharpe and the Wilson Centre Press, 1993), p.30.

¹⁹For a discussion of the development of the field, see David Shambaugh (ed.), *American Studies of Contemporary China*. See also Elizabeth J. Perry, "Trends in the Study of Chinese Politics: State-Society Relations", *China Quarterly*, No.139 (September 1994), pp.704-13. Perry attributes the focus of previous research on the state-society interface and the lack of attention to the interrelationships between political actors within the state and within the society to the status of the field of China studies being a "consumer field" borrowing analytical constructs from elsewhere,

township levels enabled analysts a small peep into the triangle of forces between the Centre, the local officials, and the rural society over which the local officials have direct jurisdiction and of which they are a part.²⁰ The findings of this research refine and modify one's view as to the reach of the state to society, and as such constitute an important critique of the previous totalitarianism model. While the implementation gap has been the subject of a good number of works in this area, and explanations have been sought within the state apparatus, there has not been similar scrutiny at the provincial-level.²¹ The gap in literature is obvious, thus the pertinence of a provincial-focus of analysis.

The Choice of Case Studies

This dissertation bases its arguments on the findings of two case studies: Guangdong and Shanghai. These case studies enable an indepth examination of the political dynamics on which generalizations can be built. Comparative case studies provide an additional dimension which single case studies do not give. Variations among the comparative cases draw analysts to issues which may otherwise have escaped attention. It is, therefore, with the advantage of comparison in mind that this study has adopted a comparative approach.

But why are Guangdong and Shanghai chosen? What does a comparison of this pair highlight? What can a study drawing on a comparison between Guangdong and Shanghai, probably the two most atypical areas in China since the 1980s, tell us about central-provincial relations in China as a whole? In other words, to what extent are the findings and conclusions drawn on the comparative case studies of Guangdong and Shanghai generalizable? Moreover, since Shanghai is actually a municipality, albeit of provincial-level administrative status, and Guangdong is a

rather than being a "producer field" drawing insights from China's historical experiences and generating original analyses of interest to comparativists in general. Specifically, she argues that the European construct of "state versus the civil society", being a concept stemming from an attempt to explain the emergence and transformation of capitalism in Europe, may be a too crude concept to analyse political processes in China where capitalism of the European sort has never taken root. (p.709)

²⁰Some seminal works of this category are Vivienne Shue, *The Reach of the State*; Jean Oi, *State and Peasant in Contemporary China* (Berkeley: University of California Press, 1989); and Helen Siu, *Agents and Victims in South China: Accomplices in Rural Revolution* (New Haven: Yale University Press, 1989).

²¹See for instance David M. Lampton, "Chinese Politics: The Bargaining Treadmill", *Issues and Studies*, Vol.23, No.3 (1987), pp.11-41; David M. Lampton (ed.), *Policy Implementation in Post-Mao China* (Berkeley: University of California Press, 1987); Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structure and Process* (Princeton, New Jersey: Princeton University Press, 1988); Kenneth Lieberthal and David Lampton (eds.), *Bureaucracy, Politics and Decision-Making in Post-Mao China* (Berkeley: University of California Press, 1992). In disaggregating the state institutions, most of these works focused on the bureaucratic vertical "systems" in explaining variations between policy intentions and implementation.

"province-proper", are the two areas comparable?

What the Pair Can Highlight

Guangdong and Shanghai make a good pair for comparative study with respect to their relations with the Centre because it is possible to "isolate" the effect of central policies on the behaviour of two provincial-level governments. The isolation of independent variables in real-life observation requires a substantial level of *relevant* similarity in other aspects of the objects of analysis. The first precondition of a good pair for comparison is, therefore, that the areas are sufficiently similar in those aspects which may have an effect on the dependent variable but which are not the subject of the current study.²² In the arena of investment and economic policy implementation, Guangdong and Shanghai in the late 1970s were situated at a similar base-line regarding their *potential* in attracting foreign investment and developing an export-oriented, internationalized economy ahead of the rest of the country. Both Guangdong and Shanghai are situated along the coast of China. This gives both areas---relative to the inland provinces---a similar edge insofar as being able to take advantage of the reforms since 1979. Historically both areas are commercial centres with substantial experience in doing business with foreigners. Guangzhou (then known as Canton) was among the five earliest trading ports opened to foreign trade in the middle of the Nineteenth Century, and Shanghai was the largest industrial and economic centre of the country as well as being the hub of foreign commercial and industrial activity in the early 1920s. Both have extensive overseas linkage. In particular, the first pool of entrepreneurs in Hong Kong came from Shanghai around the time of the communist takeover in 1949. Guangdong has been the largest source of emigration to Hong Kong. This linkage means that both areas already had a large reservoir of overseas Chinese capital and management expertise to tap when the Open Door Policy took effect in 1979.

The second requirement for a good pair of comparison is a large difference in the independent variable: the central policies. In this respect the differences between Guangdong and Shanghai are as important and obvious as their similarities outlined above. The Guangdong government obtained very favourable preferential policies early in 1979 which allowed the provincial government an

²²The similar potential of Guangdong and Shanghai in economic development and expanding investment enables this study to avoid the problems of isolating the effect of multiple independent variables on provincial behaviour. See David Goodman, *Centre and Province in the People's Republic of China: Sichuan and Guizhou, 1955-1965* (Cambridge: Cambridge University Press, 1986).

unprecedented latitude in manoeuvres and control over local resources. In contrast, the Shanghai government was stuck with the old centralized system for nearly the whole of the 1980s. The imposition of tight central control over a resourceful and wealthy area highlights the impact of central policies on provincial behaviour. The marked differences in central policies towards the two areas indicates that the dynamics between the two provincial governments and the Centre are substantially different. Interesting comparisons can then be made to reveal the discrete effect of central policies on the discretionary behaviour of the two provincial-level governments.

Implication for the General Picture

Guangdong and Shanghai are atypical areas. Guangdong was the favoured site of the Centre on which to pioneer reform experiments. As a result for a considerable period in the 1980s the provincial government enjoyed a degree of leverage which was the envy of other provinces. Its proximity to Hong Kong also gave the province a great advantage in obtaining otherwise hard-won capital and access to the international market. Meanwhile, Shanghai has been acknowledged as the most important economic centre of China this century. Shanghai has always topped the list of provincial-level units in terms of national income per capita and fiscal revenue per capita.²³ The huge gap between the "affluence" of Shanghai and relative poverty of some of the interior provinces made the municipality look as much as like "the other China" as it was in the treaty-port period in the 1920s and 1930s.²⁴ The question therefore arises: how do findings on Guangdong and Shanghai reflect the dynamics of central-provincial politics in China in general?

Guangdong and Shanghai may be too "peculiar" to make findings on them a representative case of every other province in China. However, the atypicality of the pair is perhaps an advantage. After all, the generalizability of an apparently typical case is often assumed rather than demonstrated. The apparent unrepresentativeness of Guangdong and Shanghai has the desirable effect of requiring the analyst to confront squarely the wider implications of the case studies, and to explicate what is otherwise often assumed.

²³As of 1990 Shanghai's national income per capita amounted to 4822 yuan and fiscal revenue per capita 1180 yuan, a long way ahead Beijing at the second place, at 3577 yuan and 702 yuan, respectively. Guangdong had only 1842 yuan and 206 yuan due to the much larger population. See *China Finance Statistics, 1950-1991* (Beijing: Science Press, 1992), pp. 336, 348.

²⁴For the reference of "the other China", see Marie-Claire Bergere, "The Other China: Shanghai from 1919 to 1949", in Christopher Howe (ed.), *Shanghai: Revolution and Development in an Asian Metropolis* (Cambridge: Cambridge University Press, 1981), pp. 1-34.

Guangdong and Shanghai had experiences in opposite extremes with respect to central economic control in the late 1970s and most of the 1980s. Guangdong was exempted from implementation of some national policies, and in fact given a new set of custom-made policies allowing a large degree of provincial discretion. On the other hand Shanghai's huge resource base continued to be tightly controlled by the Centre, the level of extraction remaining continuously high. Their extreme treatment by the Centre posits them as two poles of a continuum, between which the position of other provinces is likely to fall. The choice of two resourceful areas along the coast enables this study to highlight the conflict, and the political dynamics therein, between the demands and constraints posed by the Centre on the one hand, and the opportunities for discretions allowed by provincial socio-economic conditions on the other. The larger resource base the Guangdong and Shanghai leaderships had at their disposal, as relative to many other more "typical" and, therefore, poorer interior provinces, is indicative of the extent of *choice* of provincial leaders in the face of often contradictory pressures from the Centre. **The Guangdong-Shanghai comparison, therefore, leads to the core question concerning central-provincial politics: would provincial leaders comply with central policies if they had the means not so to do?**²⁵ As the findings of this study show, despite the great differences in central policies (the independent variable) in Guangdong and Shanghai, discretionary behaviour of the Guangdong and Shanghai governments in the 1979-1993 period had as many striking similarities as differences. Their similarities provide evidence of the prevalence of provincial discretionary tendencies in the provincial-level governments *independent of* central policies, while their differences point to the impact of central policies on the forms, strategies, and scope of manoeuvres.

Comparability

Another issue which arises when comparing Guangdong and Shanghai is whether they are comparable at all. Guangdong is a province with a sizable rural hinterland, while Shanghai, as a municipality, is an essentially urban area, albeit with a number of suburban counties. This geographical difference means that

²⁵In Goodman, *Centre and Province*, it is concluded that both provincial conditions and national policies determined provincial discretions. While this must be true, what the case of Guizhou, an extremely poor province, illuminates is at best indeterminate. The extremely deprived conditions in a province might have literally deprived the provincial leaders' ability to follow central policies, as Goodman has concluded. Alternatively, the difficult provincial conditions might have the effect of increasing bottom-up pressure on the provincial leaders to stand up against inappropriate central policies. Regrettably, this possibility was simply overlooked and ignored in Goodman's analysis. In other words, the contention is that the case of a poor province would not be able to highlight the difficult choices provincial leaders might have to make between their agency role for the Centre and the representative role for the province.

Shanghai has been much more dependent on other provinces for raw materials and food supplies than has Guangdong. This factor might indicate that Shanghai was more dependent on the Centre for coordinating planned supplies from other provinces, and for adjudicating conflicts with their suppliers as and when they arose. The larger span of control required for the Guangdong Provincial Government relative to Shanghai's is also likely to have an effect on their differential treatment of subprovincial delegation. The question therefore arises: is the spatial politics in a municipality comparable to that of a province at all?

The answer lies in the basis of comparability of Guangdong and Shanghai, and for what purposes the two areas are compared in this study. The purpose of this study is to illuminate the politics between the central and the provincial levels of government. Guangdong and Shanghai are both provincial-level governments. This single fact firmly establishes their comparability in a study of central-provincial (level) politics. The fact that Shanghai is a provincial-level municipality, rather than a "province-proper", may have implications as regards its relations with the Centre. But this does not disable Shanghai as the object of study of central-provincial politics. The reason is obvious. In a central-provincial study, the focus of analysis is obviously on, first, the different ways in which the Centre deals with different provincial-level governments with all their varieties of provincial conditions. A second focus is the ways in which the different central treatment affects the behaviour of different provincial-level governments. In other words, the differences between the relationship between Centre and Shanghai on the one hand, and between Centre and other provinces on the other, arising due to Shanghai's municipal characteristics, constitute a valid part of the explanandum.

This rationale of comparability is based on the political/administrative status of the Shanghai government within the Chinese political hierarchy. The assumption is the relevance of formal hierarchical status in Chinese politics. While fully acknowledging the importance of personal status of leaders in the political processes of the Chinese system, a good number of works have underlined the importance of formal hierarchical status.²⁶ Communication within the state system is very much regulated by the structure of the hierarchy. As Lieberthal and Oksenberg have pointed out, the Centre in 1985 had to upgrade the Ministry of Education to a supra-ministrial rank of the State Education Commission in order to

²⁶See for instance A. Doak Barnett, with Ezra Vogel, *Cadre, Bureaucracy, and Political Power in Communist China*. (New York: Columbia University Press, 1967), p.72; Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China*, pp.142-148; and Susan Shirk, *The Political Logic of Reform*.

give the former ministry a higher bureaucratic standing enabling it to issue instructions to other ministries concerning educational matters in their "systems".²⁷ Instead of sending an influential and powerful official to head the then Ministry of Education, the Centre had to lift the rank of the entire ministry. This aptly demonstrated the relevance of formal bureaucratic ranking in regulating interactions between state agencies. The provincial-level ranking of Shanghai Municipality, therefore, accords the same formal avenue of communication and interaction between the Shanghai government and the Centre as in the case of other provinces. This fact underlines the basis of the comparability between Shanghai and Guangdong in this study.

Organization of the Study

This dissertation has a total of eight chapters. Following this introduction Chapter one provides a theoretical statement of the study. The chapter elaborates the ways in which this study seeks to advance our understanding of China's spatial politics, and political processes in general. It outlines the development of the central-provincial literature, identifies the gaps this study strives to fill, and explicates the approach taken to achieve this task. The first chapter points to the need for an alternative concept of power and an alternative approach to the issue of central-provincial relationship.

Chapter Two provides a background discussion of the failure of central control over provincial investment implementation during the post-Mao period. The discussion proceeds in two parts. The first section explicates the problem of investment administration and weakening central control. It also provides an operational definition of the investment problem for the purpose of this study. The *amount* of fixed asset investment, measured in terms of the monetary value spent on the completion of investment projects, will be the focus of analysis throughout this dissertation. The second section seeks an explanation. To what extent is the problem a result of the economic reforms in the 1980s, and *which* reforms are the most crucial? This chapter observes that the Centre itself is partly to blame for its present problems. This is manifest in several aspects. First, fiscal and planning reforms approved by the Centre were pertinent in invigorating provincial incentives for investment expansion. Second, the Centre had sent contradictory messages to the provinces at different times, urging provinces to achieve ever-higher growth rates at one time and asking for restraint at another. This has had the

²⁷Lieberthal and Oksenberg, *Policy Making in China*, p.144.

effect of enabling provincial leaderships to play off the "control" message against the "accelerated growth" instruction.

Chapters Three to Six cover the details of the two case studies. Chapters Three and Four serve a dual purpose. First, the two chapters provide background information regarding the development of fixed asset investment in Guangdong and Shanghai, and identify the presence or absence of a provincial implementation gap regarding investment policies. Second, the chapters outline the institutional context of provincial investment behaviour. Specifically, two institutional arrangements, the fiscal system and the fixed asset investment planning system, are identified as being of crucial significance to the implementation of investment policy. Their development in Guangdong and Shanghai since 1949, and especially since 1979, is outlined.

Chapters Five and Six describe the discretionary behaviour of the Guangdong and Shanghai governments in their pursuit of investment expansion. The chapters show how the provincial leaders manoeuvred within the institutional constraints of central policies to bargain for more favourable central policies as well as to redefine and bypass the institutional rules. A typology of discretionary behaviour classifies provincial discretions according to the relative dependence of discretionary behaviour on the Centre. Using a single typology facilitates the comparison of the differences, as well as the similarities, of Guangdong and Shanghai as regards their discretionary behaviour. The findings of these two chapters reveal the rich varieties of discretionary behaviour of the Guangdong and Shanghai governments, thus demonstrating the vitality of the provincial-level government as a political actor.

Chapter Seven concludes the case studies with an explicit discussion about the *linkage* between institutional constraints and actors' choice, and in particular between central influences and provincial discretions. The influence of the Centre on the discretionary behaviour of provincial governments is undeniable. **The model of central-provincial relations this study puts forward is, however, not a Centre-led model with the provincial governments relegated to the agent role passively reacting to stimuli of the Centre, but an *interactive and dialectical model* which sees the policies of the Centre, the attitudes and role perceptions of provincial officials and the discretions of provincial governments as being constituent parts of a dynamic and interactive process.** The thesis can be boiled down to a simple statement: provinces are also the forces of changes at the Centre. Provincial governments are not mere passive recipients of

central resources, subject to the manipulation of the Centre. The resources and authority once delegated by the Centre to the provincial governments would become part of provincial resources and authority, which the Centre could find very difficult to withdraw.²⁸ In fact every wave of delegation gives the provinces additional leverage to enable them to enhance their position in the political system.

In conclusion, Chapter Eight identifies the emerging trends of central-provincial relations since the reform period. The chapter argues that the changes are resulted from compromises by the Centre and the provinces to improve their respective situation. It is impossible for the Centre totally to "eliminate" the power of the provincial governments as an intermediary level of the state hierarchy. From the perspective of provincial governments, other than at times of extreme secessionism, they have to live with the power of a central government. The mutual indispensability of the central-provincial relationship forces both parties to learn to live with one another. As conflicts protracted and bargaining became more intense, both the Centre and the provinces gradually came to acknowledge the necessity for a better institutionalization of their power relationship. Ambiguity was giving way to clarity as the defining character of central-provincial interactions, albeit gradually. The low level of institutionalization in the regulation of power relationships has often been regarded as the root of many problems in Chinese politics, such as intense elite rivalries, and uncertainty over regime succession. The trend towards increasing institutionalization in the spatial arena between Centre and provinces could signal the development of a politics of compromise and co-existence, which would radically change the character of Chinese politics.

²⁸Gerald Segal asserted a similar observation. See Segal, *China Changes Shape: Regionalism and Foreign Policy*. (London: The International Institute for Strategic Studies, 1994), pp.3, 11, 54.

Chapter One

Understanding Central-Provincial Relations: Towards an Analytical Framework

Central to the relationship between the Centre and the provinces is the concept of power. What degree of power does the provincial government command within the Chinese political system, and what is the nature of this power? This is the fundamental question which runs through the literature of central-provincial relations in contemporary China. In trying to understand this concept of power, other analysts have often dwelt on the roles of provincial leaders and the nature of the political system within which they operate. This chapter reviews the manner in which, and to what extent, existing literature has addressed and answered the following questions. To what extent do provincial leaders act as the loyal agents of the Centre, and, conversely, as representatives of their province? How can we make sense of the prevalence of bargaining behaviour between the Centre and the provinces, and the intensity of conflicts in their interactions? Do the instances of China's previous disintegration and emergence of separatist movements in some provinces signal a movement towards independence by the provinces? Or do they represent the reaction of provincial forces to a weak Centre? How should these tensions between the Centre and the provinces be interpreted? Moreover, by what approach may changes in the balance of power between the Centre and the provinces be better understood?

When examining the pertinent secondary literature, this chapter identifies its limitations and elaborates an approach that might fill the gaps. It will be argued that the major shortcoming of the existing literature stems from its interpretation of the concept of power. Specifically, one recurring problem has been that of the asymmetrical relationship between the Centre and the provinces, and whether it is of a zero-sum nature. Drawing from insights gained from Talcott Parsons' works, this dissertation seeks to develop a more appropriate analytical framework through which to understand China's central-provincial relations.

The Literature on Central-Provincial Relations

The Development of Central-Provincial Studies

The development of Western studies on China's post-1949 central-provincial relations has been heavily influenced by Western studies on the Chinese political system in general.¹ From the totalitarian literature of the 1950s and 1960s, to the "pluralist" and "conflict" approach of the late 1960s and 1970s, and through to the reform studies of the 1980s, the topic of central-provincial relations has always attracted diverse levels of attention within China studies. The different emphases in these approaches have been influenced by their interpretation of the central-provincial relationship.

Totalitarian Literature: Provincial Leaders as Agents of the Centre

From the 1950s to early 1960s, the prevalence of the Soviet model of totalitarianism within China studies resulted in a three-fold image of the post-1949 political system. It was characterized by the pervasiveness of Marxist-Leninist-Maoist ideology, a high level of centralization of political power, and an unprecedented penetration of the state into society. This early literature attempted to explain the success of the Chinese revolution in terms of ideology, leaders and organization. As such the literature saw the central-provincial relationship as one between the superordinate and the subordinate. The provincial government, as the major intermediate level between the Centre and the vast rural expanse, was perceived as acting as the Centre's agent.

This literature did not, however, deny that the intermediate level of government was granted a certain discretion as regards policy decisions. A. Doak Barnett, for instance, when describing the post-1949 Chinese system as totalitarian, admitted that the degree of autonomy granted to provincial departments by central

¹In this discussion due to practical reasons the coverage will mostly be on studies done in the United States, Britain, and to a lesser extent Australia. The discussion on the China studies literature draws heavily from David Shambaugh, (ed.), *American Studies of Contemporary China* (Armonk, New York: M. E. Sharpe, 1993); Victor Nee, and David Stark, "Towards an Institutional Analysis of State Socialism", in Victor Nee, and David Stark, (eds.), *Remaking the Economic Institutions of Socialism: China and Eastern Europe* (Stanford: Stanford University Press, 1989), pp.1-31; Michel Oksenberg, "Politics Takes Command: An Essay on the Study of Post-1949 China", in John K. Fairbank, and Roderick MacFarquhar (ed.), *The Cambridge History of China* Volume 14, (Cambridge: Cambridge University Press, 1987), pp. 543-90; Harry Harding, "The Study of Chinese Politics: Towards a Third Generation of Scholarship", *World Politics*, Vol. 36, No.2 (January 1984), pp.284-307.

ministries was at times substantial.² He also acknowledged that the provinces were, as a rule, given the task of refining central policies for the subprovincial levels of government. They therefore enjoyed considerable room for manoeuvre as well as a measure of power as intermediary.³ Similarly, when discussing the two types of decentralization analysed in the literature, Franz Schurmann argues that the decentralization of power from the central level of the state to lower levels and the decentralization of power from the state to production units were equally "real".⁴ In Schurmann's view, policy decentralization was an effort by the state to resolve the historical tensions between the Centre and the provinces. As such they should be considered as *bona fide* decentralization, which, in Schurmann's own words, essentially means that "decision-making powers are transferred downward from some central point".⁵

Not only was the importance of this decentralization from the Centre to the provinces recognized; Barnett attributed the unprecedented success of the post-1949 state to the Communist leaders' success in consciously building flexibility into the system.⁶ The Communist leaders were described as capable of placing "greater real responsibility for policy implementation upon local leaders than has been the case in the past and have demanded initiative and even innovation on the part of low-level cadres, within the limits set by centrally defined policies."⁷ It was impossible for the Centre to prescribe in detail the specifics of policy implementation in a way that could suit all local conditions. Therefore it was better openly to recognize the necessity to "adapt according to local conditions", and to contain discretions by defining their parameters. As Schurmann acknowledges, "the problem of center versus region has bedeviled Chinese governments for centuries", and this has not changed, despite the revolution, and the following dramatic centralization during the first few years after 1949.⁸

The nature and extent of provincial power as envisaged in totalitarian literature was, however, pretty limited. It was perceived mainly as an agency role. Literature of this genre also assumed a hierarchy with regard to the formulation and

²A. Doak Barnett, *Cadres, Bureaucracy, and Political Power in Communist China* (New York and London: Columbia University Press, 1967), p.72.

³*Ibid.*, p.73.

⁴Franz Schurmann, *Ideology and Organization in Communist China* New, enlarged edition, (Berkeley: University of California Press, 1968), p. 175. The then prevailing view among Western scholars as mentioned by Schurmann was that only decentralization to production units reflected "genuine" decentralization.

⁵*Ibid.*, pp.175, 213-15.

⁶Barnett, *Cadres*, p.439.

⁷*Ibid.*

⁸Schurmann, *Ideology*, p.215.

implementation of policy.⁹ Policy formulation was *by definition* the job of the Centre, with provinces allowed to exercise initiative and innovation only when implementing these policies. Although provincial leaders have, at times, been accused of building up their own independent power bases and of deviating from central policies, Frederick C. Teiwes argues that such accusations of localism merely camouflaged changes within the Centre.¹⁰ Having implemented the central policies of an earlier time, provincial leaders subsequently fell prey to the "house-cleaning purges" of the new central leadership. In fact, Schurmann has suggested that the Centre implemented the purges of 1957 and 1958 in order to ensure that its intermediaries were loyal ahead of a radical decentralization program.¹¹ Moreover, as the source of power was at the Centre, the provinces were at its mercy. In Barnett's words, "The province and other local organs had no inviolable autonomy."¹² The discretions and powers of the provinces were perceived in terms of central policy. **In essence, the totalitarian literature sees a centralized state in which power distribution is essentially an issue concerning, exclusively, the Centre. The provinces are regarded as passively abiding by decisions of the Centre as to whether more or less discretionary power should be left to them.**

Pluralist Literature: The Province as a Coerced and Responsive Entity

The outbreak of the Cultural Revolution revealed the vast mix of interests within the Chinese political system but beneath the superficial unity described in totalitarian literature. The experience of the Cultural Revolution demonstrated that actors outside the Centre could influence events. In order to explain the new phenomenon, a new theory, and a new set of concepts, was needed. After the pioneering steps of Soviet studies, China scholars turned to the pluralistic theory for new tools to understand the dynamics of the Cultural Revolution.¹³ Specifically, provincial leaders were analysed as an interest group with interests of their own to advance.¹⁴ Others disagreed with the notion of interest groups,¹⁵ and a

⁹Ibid., p.216; Barnett, *Cadres*, p.74.

¹⁰See Frederick Teiwes, "The Purge of Provincial Leaders, 1957-1958", *China Quarterly*, No.27, 1966, pp.14-32.

¹¹Schurmann, *Ideology*, p.216.

¹²Barnett, *Cadres*, p.73.

¹³For a pioneering Soviet study using the pluralism theory to analyse the Soviet political system, see Frankly Griffiths, and Gordon Skilling, (eds.) *Interest Groups in Soviet Politics*. (Princeton: Princeton University Press, 1971).

¹⁴The first explicit attempt to borrow the analytical tools of pluralism and interest group literature on the Western political system and follow the pioneering steps of Soviet studies in China political studies is David S. G. Goodman (ed.), *Groups and Politics in the People's Republic of China* (Armonk, New York: M. E. Sharpe, 1984); followed by Victor C. Falkenheim (ed.), *Citizens and Groups in Contemporary China* (Ann Arbor: Centre for Chinese Studies, University of Michigan, 1987). For studies specifically on the appropriateness of analysing provincial leaders as an interest

wide range of models was created to explain central-provincial relations.¹⁶

The goal of this search is to define the role of the provincial leaders. By "role", I mean the purposes which provincial leaders are perceived to serve. This search concentrates on the question of whether provincial officials act on behalf of the Centre or the provinces. To what extent do provincial leaders work with the Centre on a basis of mutual support within such an insecure and volatile political environment? And to what extent are provincial leaders advocates and spokesmen of provinces advancing their own interests alongside provincial interests? Should the various provincial leaders possess similar interests, do they undertake collective actions similar to a typical interest group in the West?

A favourite starting point for the literature in assessing the relationship is to study examples of conflict between the two bodies. The threat to the very survival of provincial leaders during the Cultural Revolution is an apt vehicle through which to assess the response of provincial leaders to unpopular central policy. The ferocity of the Cultural Revolution dramatized the conflict between provincial leaders' "parochical" interests---self-preservation---and their duty loyally to implement central policy. The excesses of this period gives observers a clear view of the conflicting roles of provincial leaders vis-a-vis the Centre. Parris H. Chang's work on the survival strategies of provincial leaders illuminates in detail how they reacted to the rapidly changing, opaque and highly uncertain political circumstances of the period 1966 to 1968.¹⁷ Chang's account shows that provincial leaders changed and adjusted their strategies in order to cope with the "shifting goals of the Cultural Revolutions and with changes in both the actors in and the scope of the conflict."¹⁸

group, see Goodman, "Provincial Party First Secretaries in National Politics: A Categorical or a Political Group?", in Goodman (ed.), *Groups and Politics*, pp.68-82; and Peter Ferdinand, "Interest Groups and Chinese Politics", in *Ibid.*, pp.10-25.

¹⁵A notable opponent was Lucian Pye, who maintained the inappropriateness of trying to understand Chinese politics, and therefore central-provincial relations, as bureaucratic politics. Provincial leaders form part of the vertically organized factions, instead of part of the horizontally organized interest groups. See Lucian Pye, *The Dynamics of Chinese Politics* (Cambridge: Massachusetts, 1981).

¹⁶The search for appropriate conceptions of the role of provincial leaders in the political system was part of a larger search for appropriate conceptions of the classification and alignment of actors when the homogeneous image of totalitarianism broke down. For a discussion of the models, see Harry Harding, "Competing Models of the Chinese Communist Policy Process: Toward a Sorting and Evaluation", *Issues and Studies* (February 1984), pp.13-36; and John Bryan Starr, "From the Tenth Party Congress to the Premiership of Hua Kuo-feng: The Significance of the Colour of the Cat", *China Quarterly*, No.67 (September 1976), pp.98-114.

¹⁷Parris H. Chang, "Provincial Party Leaders' Strategies for Survival during the Cultural Revolution", in Robert A. Scalapino, (ed.), *Elites in the People's Republic of China* (Seattle & London: University of Washington Press, 1972), pp.501-39.

¹⁸*Ibid.*, p.511.

A brief description of these strategies used by provincial leaders during the most turbulent period of the Cultural Revolution is illuminating on how creative and flexible provincial leaders in manoeuvring for survival can be.¹⁹ The strategies include, first, a strategy of evasion and diversion with the objective of "sacrificing the knights to save the king", which required provincial leaders to select some subordinates to be the scapegoat, and to dismiss them after alleging them being the "representatives of the bourgeoisie". The objective of the provincial leaders was to impress on central leaders that "class enemies" within their provinces had been rooted out, thus saving their own positions. Second is the strategy of deception, i.e., "news management". By manipulating the flow of information from their provinces in the official press and portraying themselves as resolute supporters of the Cultural Revolution, provincial leaders sought to ward off pressures from the Centre. Third, as pressure built up and the above two strategies proved inadequate, provincial leaders would engineer the organization of "royalist" red guard organizations. By so doing they learned from the Centre's revolutionary rhetoric and, in particular, from Mao's political strategy of outmanoeuvring his party rivals at the Centre by enlarging the scope of conflict. By creating their own Red guard groups to fight groups that were threatening to their survival, provincial leaders acted in a proactive manner to protect their own political survival. The fourth strategy is deterrence and repression. When necessary, provincial leaders would not hesitate to use their formal positional power as the state authority at the intermediate level to suppress the revolutionary rebels. In fact, because provincial leaders had so successfully employed the instruments of state coercion against rebel forces which threatened their survival, "Mao had to urge his (rebel) supporters repeatedly to 'thoroughly smash the public security, procuratorate, and justice organs'". This brings provincial leaders to the fifth strategy, which is forming civilian-military alliances. The army is the most important instrument of coercion at a time of chaos and survival. Provincial leaders therefore were keen on securing the support of local PLA commanders, using personal ties as well as calling upon the professional inclination of the army in maintaining law and order. However, given the importance of the army and the counteracting influence of the central leadership, cooperation was not forthcoming in all cases. In fact, eventually the PLA had been instrumental in a comprehensive power seizure from the incumbent provincial leaders starting in January 1967. Lobbying in Peking, the sixth strategy, was particularly used during the early stage of conflicts and possibly during some critical moments. The strategy of cooptation, the seventh strategy, refers to the

¹⁹The description of this paragraph summarizes the discussion in *ibid.*, pp.511-39.

attempt of provincial leaders to neutralize workers by acceding to their demands for better pay and working conditions. In face of the imminent threat of a seizure of power by military force in early 1967, some provincial leaders tried to preempt the seizure by handing power to the rebel groups they controlled and thereby managed to exercise control behind the scenes. This is the eighth strategy, the strategy of pre-emption. Finally, but not the least, there is the strategy of joining the "three-way alliance". By cooperating with the rebels and the military who were taking over the provincial leadership in 1967 during the power seizure, provincial leaders managed to remain part of the new provincial leadership and await for new opportunities to recapture their former power.

The flexibilities and opportunism of provincial leaders in adjusting their strategies to changing political circumstances were also vividly demonstrated in David L. Shambaugh's case study of Zhao Ziyang's provincial career.²⁰ Because of such success of provincial leaders during the Cultural Revolution, the Maoist leadership was eventually forced to call in the army to seize power at the provincial level. In Chang's view, the necessity to employ the army to exert the Centre's will was more a reflection of the Centre's weakness than of its power over the provinces. At the very least, it suggests that the strategies of provincial leaders had been effective in warding off challenges from rebel groups sanctioned by the central leadership.²¹

This is a very important observation. That provincial leaders were not blind to parochial interests might not come as much of a surprise. After all, the stakes were so high. It was not only their political future that was at risk, but also their physical survival, as well as the well-being of their families. However, it is important to interpret the significance of these central-provincial tensions in terms of the power relationship between the Centre and the provinces. For Chang, the use of coercion by the Centre suggests the shallowness of its power over the provinces.

The ability of the provinces to withstand the Centre was also noted in David S. G. Goodman's analysis of revolutionary committees.²² Goodman convincingly demonstrates that revolutionary committees were installed in order to enable the Centre to reimpose control over the provinces during the Cultural Revolution. Control was not, however, achieved easily or without resistance.

²⁰David L. Shambaugh, *The Making of a Premier: Zhao Ziyang's Provincial Career* (Boulder, Colorado: Westview Press, 1984).

²¹Parris H. Chang, "Provincial Party Leaders' Strategies for Survival", p.537.

²²David S. G. Goodman, "The Provincial Revolutionary Committee in the People's Republic of China, 1967-1979: An Obituary", *China Quarterly*, No.85, (March 1981), pp.48-79.

Notwithstanding their different focuses, the messages of Chang and Goodman are similar on one important point: both the incumbent leaders of provinces in 1966 and the "revolutionary" leaders of 1967 were able to resist the will of the Centre for a long while, and yielded only when the Centre deployed the military. In Chang's view, the military was used to seize power from the pre-1966 power-holders. In Goodman's view, the military was used to reimpose control over the Red Guard groups active in the provinces. Thus, both accounts present an image of provincial power.

This image is reinforced by the accounts of economists and sociologists which question the limits of central penetration into the local economy. Drawing from William G. Skinner's work on the Chinese rural marketing structure, Audrey Donnithorne maintains that the structure of the post-1949 Chinese economy has remained largely cellular.²³ The primitive stage of modernization in China's economy disabled the central state from effectively penetrating into the vast expanse of the periphery. The strong autarchic tendencies of provinces were hence technologically rooted and, with the crudeness of the central plan, provinces simply fell back on their own resources.²⁴ In Donnithorne's view, the decentralization reforms of 1957-58 carried out both before, and in association with, the Great Leap Forward were a cause and a result of the traditionally centrifugal tendencies of the provinces. The inability of the Centre to reach effectively the lower-levels necessitated the delegation of power to the provinces; and the centrifugal tendencies of provinces were further reinforced by decentralization.²⁵

This conclusion reached of provincial power was, however, an anomaly in the literature on central-provincial relations. Most works argued for a central dominance over the provinces, where the balance of the provincial dual roles of central agent and provincial spokesman weighs in favour of the former.²⁶ Frederick C. Teiwes, like Parris H. Chang, studied the responses of provincial leaders to central policy at a time of great stress, namely the period preceding and following

²³ Skinner, G. William, "Marketing and Social Structure in Rural China" Parts I-III, *Journal of Asian Studies* Vol.24, 1964-1965; Audrey Donnithorne, "Central Economic Control in China" in Ruth Adams ed. *Contemporary China* (London: Peter Owen, 1969); "China's Cellular Economy: Some Economic Trends since the Cultural Revolution", *China Quarterly*, No.52 (1972), pp. 605-19.

²⁴ Audrey Donnithorne, *China's Economic System* (London: George Allen & Unwin, 1967), pp.504-5.

²⁵ Audrey Donnithorne, "Comment: Centralization and Decentralization in China's Fiscal Management", *China Quarterly*, No.66 (1972), pp. 328-40; "Central Economic Control", p.151.

²⁶ In David M. Lampton's case studies of six upwardly mobile leaders, half of which had strong territorial power bases, it is concluded that the six secured their advancement in the political system by largely serving as followers. See David M. Lampton, *Paths to Power: Elite Mobility in Contemporary China* (Ann Arbor: Centre for Chinese Studies, University of Michigan, 1986), p. 294.

the provincial purges shortly prior to, as well as during, the Great Leap Forward in 1957-1958.²⁷ His conclusion however indicates a predominant Centre, and provincial leaders who respond passively to every whim of policy change at the Centre. Provincial leaders were eventually purged, in Teiwes' view, because the policies at the Centre had changed too rapidly, as a result of the ascendancy of different groups of central leaders, for provincial leaders at a distance from the power centre to follow.²⁸ Teiwes found a lower level of elite turnover in more resourceful provinces and interpreted this as a possible confirmation of the view of a predominant Centre over the provinces. Provincial leaders were "basically" responsive to the Centre, because "the rules of the game stressing provincial responsiveness to the center are clear".²⁹ Those that could more successfully respond to central demands enjoyed a better chance of political survival. As a result, the "haves prosper; the have nots struggle as best they can."³⁰

The case of provincial responsiveness to predominant central power is best elaborated by David Goodman. In his case studies of Sichuan and Guizhou at the period preceding the Cultural Revolution, Goodman found little evidence for the case of provincial power.³¹ As he has argued, provincial variations of policy formulation and implementation were often the result of provincial participation in the incremental process of national policy-making. In other words, provincial variations were often centrally mandated flexibilities and policy experiments, rather than an "exercise of provincial political power".³² Provincial conditions may have affected the form of these variations, but their effect was primarily either to *constrain* or *facilitate* the ability of provincial leaders in responding to central policies. Therefore, Guizhou's provincial first secretary, Zhou Lin, was removed in 1965 "not simply because he had succumbed to provincial political traditions but also because he had failed as a political middleman."³³ More precisely, what Goodman means is that Zhou was removed because he had been ineffective in carrying out the expected job of a central agent. The poverty and lower degree of social integration of Guizhou constrained the ability of provincial leaders to act as a central agent; whilst Sichuan's relative wealth and social homogeneity enhanced its

²⁷Teiwes, "The Purge of Provincial Leaders"; "Provincial Politics in China: Themes and Variations", in John M. H. Lindbeck (ed.), *China: Management of a Revolutionary Society* (London: George Allen & Unwin, 1972), pp.116-89.

²⁸Ibid., p.132.

²⁹Ibid., p.177.

³⁰Ibid., p.178.

³¹David S. G. Goodman, *Centre and Province in the People's Republic of China: Sichuan and Guizhou, 1955-1965* (Cambridge: Cambridge University Press, 1986)

³²Ibid., p.23.

³³Ibid., p.183.

leaders' ability to respond to the demands of the Centre.³⁴

But why are provincial leaders "responsive" to the Centre? What leads these analyses to conclude that central predominance prevails, when the ability of provincial leaders to engage in various strategies of self-protection and enhancement against unwelcome central control has been demonstrated by both Chang and Goodman themselves? Is provincial responsiveness a sign of provincial weakness, as the "central predominance thesis" would imply, or of provincial strength? Chang obviously argues for the latter, but his seems to be a lone voice.³⁵ What, then, has made the case of central predominance so prevalent in the literature?

An explicit answer is given in Victor Falkenheim's work. In Falkenheim's words, "The case for provincial power...requires that it be shown to be autonomous. This case is difficult to make in the face of the historically clear ability of the central government to exact compliance...and to remove (provincial leaders) from office when necessary."³⁶ Therefore, the command of coercive force by the Centre in the form of the power to hire and fire provincial leaders, and, as a last resort, the ability to deploy the military to suppress opposition, prescribes clearly the "rules of the game" under which provincial leaders are to be seen to be responsive to the Centre in order better to advance their self interests. Lynn White III's studies of Shanghai have shown sensitivity to the complexities of the concept of "local autonomy", and to the existence of activism amongst Shanghai's leaders and social groups.³⁷ However, White nevertheless sees provincial activism as subsumed into the pulling force of the Centre. Shanghai's dominance in the national economy and the national ambition of its leaders amounted to Shanghai's leaders constituting a part of the Centre.³⁸ Shanghai's leaders have been powerful, according to this view, not because Shanghai, as an industrialized city, produces a substantial share of the

³⁴Ibid., p.20.

³⁵See Parris Chang, "Decentralization of Power", *Problems of Communism*, Vol.21, No.4 (1972), pp.67-75; and an example of opposing views in Victor C. Falkenheim, "Continuing Central Predominance", *Problems of Communism*, Vol.21, No.4 (1972), pp.75-83. Similarly, Donnithorne's view of a cellular socio-economic structure with decentralized political authority in the provinces was disputed by other economists. See Nicholas Lardy, "Centralization and Decentralization in China's Fiscal Management", *China Quarterly*, No.61 (March 1975), pp.25-60; "Reply", *China Quarterly*, No.66 (1976), pp.340-54.

³⁶Victor C. Falkenheim, "Provincial Leadership in Fukien: 1949-66", in Scalapino (ed.), *Elites in the People's Republic of China*, p.202.

³⁷Lynn White III, "Leadership in Shanghai, 1955-69", in Scalapino (ed.), *Elites in the People's Republic of China*, pp.302-77; "Shanghai's polity in Cultural Revolution", in Lewis (ed.), *The City in Communist China* (Stanford: Stanford University Press, 1971), pp. 325-72; and "Local Autonomy in China During the Cultural Revolution: The Theoretical Uses of an Atypical Case", *American Political Science Review*, Vol.70 (1976), pp.479-91.

³⁸Lynn White III, "Local Autonomy in China During the Cultural Revolution".

nation's wealth, but because of their close connections with the central leadership. In fact, analysts have gone so far as pronouncing that the Shanghai leaders *are national leaders in Shanghai*.³⁹ Provincial leaders were, therefore, invariably regarded as led by the Centre as an inevitable consequence of the latter's overriding power over their future and welfare.

The dominant view is, therefore, of an authoritarian unitary state where the Centre may freely impose its command of coercive force in order to extract compliance and penalize noncompliance. Provinces are consequently in an inferior and disadvantaged position. Indeed, in trying to distinguish the dual role of provincial leaders---central agent or provincial representative, Goodman *assumes* that the former is the more dominant role. His definition of the concept of "political middlemen" expresses this assumption clearly. In his own words, provincial leaders are by definition "political middlemen" as they "are appointed by the centre and dependent on it for their political future. However, the provincial leader who does not also satisfy local requirements will find it difficult to implement *national* policy."⁴⁰ According to this definition, local requirements affect the behaviour of provincial leaders only because provincial leaders cannot ignore local conditions in their efforts to implement national policy. The dominance of the Centre is, therefore, a foregone conclusion. According to this view, the ability of provincial leaders to engage in a wide range of self-preservation strategies in conflict situations merely demonstrates the responsiveness of provincial leaders to shifts in policy and power configurations at the Centre. Their eventual defeat at the hands of the Centre during previous conflict situations therefore confirms the Centre's predominance over the provinces. The literature does not deny the existence of "parochical" provincial interests. These are seen to be the self-interests of provincial leaders for political advancement and physical survival, or that which is perceived by provincial leaders as in the interest of the province.⁴¹ But these "local requirements" are not considered as constituting autonomous provincial power.

³⁹Ibid. See also David S. G. Goodman, "The Shanghai Connection: Shanghai's Role in National Politics", in Christopher Howe (ed.), *Shanghai: Revolution and Development in an Asian Metropolis* (Cambridge: Cambridge University Press, 1981), pp.125-52.

⁴⁰Goodman, *Centre and Province*, p.13.

⁴¹For an insightful discussion of the meaning of "provincial interest", see Peter Ferdinand, "Interest Groups and Chinese Politics", in David S. G. Goodman (ed.), *Groups and Politics in the People's Republic of China* (Armonk, New York: M. E. Sharpe, 1984), pp.18-9. Ferdinand argues that since it is impossible to determine with any certainty the motives of any individual's action, it is immaterial to attempt to limit the definition of provincial interest to the "self-interests" of individual leaders, or to the subjective perception of leaders of what should be in the "public interest" of the province. In other words, provincial interest simply means a *conscious* desire on the part of provincial leaders to have public policy move in a specific direction. The motives of the leaders, whether they are acting for self or public interest, are irrelevant because the two are often mixed and indistinguishable in real terms.

They are no match for the coercive power commanded by the Centre. The emergent dominant image of provincial leaders is, therefore, of a group of agents responsive to the Centre, albeit through coercion.

Reform Studies: Province as the Unequal Bargaining "Partner"

The 1980s saw an unprecedented relaxation within the research environment as a concomitant development of the economic liberalization policies since 1979. Field work and collaborative research in China has since become possible, while previously researchers often had to speculate and infer from sketchy information. Developments in the discipline have also had an impact on the research agenda of China studies. The new institutionalism renews interest in the state structure's effect on the formulation and implementation of policies. As a result, China scholars also turned to the study of the importance of institutions in addition to their previous emphasis on leadership and elite preferences.⁴²

The resultant literature has highlighted the complex and multifaceted relationships between bureaucratic actors in the political system as regards the formulation and implementation of policies.⁴³ Not only do analysts find it necessary to account for the obvious gaps between reform policies as formulated and the results of their implementation, they are also finding it increasingly difficult clearly to define exactly what constitutes "failures of implementation".⁴⁴ Indeed, if there is "no chain of command", as such, in the political system,⁴⁵ in the sense that there is no simple, straight-forward, and one-way flow of power between

⁴²The impact of the changes in research environment and of certain other events in China is discussed in detail in Harding, "The Evolution of American Scholarship on Contemporary China", in Shambaugh (ed.), *American Studies*, pp.14-40. On the influence of intellectual developments in the disciplines on China political studies, see Nina P. Halpern, "Studies of Chinese Politics", in *Ibid.*, pp.120-37. See also Harry Harding, "The Contemporary Study of Chinese Politics: An Introduction", *China Quarterly*, No.139 (September 1994), pp.699-703; Avery Goldstein, "Trends in the Study of Political Elites and Institutions in the PRC", *China Quarterly*, No.139 (September 1994), pp.714-30.

⁴³Major works taking the institutional approach include: David M. Lampton, "Chinese Politics: The Bargaining Treadmill", *Issues and Studies*, Vol.23, No.3 (1987), pp.11-41; Lampton (ed.), *Policy Implementation in Post-Mao China* (Berkeley: University of California Press, 1987); Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structures, and Processes* (Princeton, New Jersey: Princeton University Press, 1988); Zhao Suisheng, "The Feeble Political Capacity of a Strong One-Party Regime---An Institutional Approach Toward the Formulation and Implementation of Economic Policy in Post-Mao Mainland China", *Issues and Studies*, Parts I & II, Vol.26, Nos.1-2 (1990), pp.47-80, 35-74; Lieberthal and Lampton (ed.), *Bureaucracy, Politics and Decision-Making in Post-Mao China* (Berkeley: University of California Press, 1992); and Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993).

⁴⁴See David M. Lampton, "The Implementation Problem in Post-Mao China", in Lampton (ed.), *Policy Implementation in Post-Mao China*, pp.5-7.

⁴⁵ *Ibid.*, p.3.

one bureaucratic actor and another, and between the upper levels and lower levels, any clear distinction between policy formulation and implementation is inevitably elusive. Rather than focusing on the gap between policy formulation and policy implementation, the question which might have been raised within implementation literature is: *whose* policies are actually being put into practice?

This literature has, however, stuck largely to the traditional conception of policy formulation and implementation, albeit with multiple qualifications and redefinitions. The Centre is considered as the locus of policy formulation, and the provinces that of implementation. Given this, it is surprising that research regarding the central-provincial interface has been on such a limited scale, bearing in mind the importance of the provincial level as the intermediary of policy implementation.⁴⁶ On the occasions when central-provincial relations has been considered, this has been on the basis of its being one of the numerous interagency relationships in the bureaucratic maze of interactions.⁴⁷

The picture of central-provincial relations, as part of inter-agency relationships, as expressed in this new body of literature, is one of intense bargaining relationships. The image is one of "a center forced to bargain with very powerful localities"⁴⁸, who are able to distort central policies to their advantage. Along this line Barry Naughton has described the Chinese system as characterized by a strong "implementation bias", as central policies have been distorted in ways advantageous to their implementors.⁴⁹ Similarly, when discussing tax policy reforms, David Bachman notes the rule of an "iron law of autarky" as local authorities have deliberately withheld revenues that should, in theory, have gone to

⁴⁶One major reason was data accessibility, i.e., that Western scholars have found it easier to gain access to central bureaucratic agencies than to those of the provinces. Kenneth G. Lieberthal acknowledged that "No scholar, to our knowledge, has enjoyed sufficient access to the...territorial Party secretaries to provide major insights into these bureaucratic clusters." Kenneth G. Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model and Its Limitations", in Lieberthal and Lampton (eds.), *Bureaucracy, Politics and Decision-Making*, p.5. Studying the central-provincial interface requires observation at both the central and provincial levels, and ideally, of the central-provincial relationship in one province in relation to that of another, and a third province. More research efforts, over twice that of a central focus, are required. This however gives rise to the concern that the analytical perspectives of Chinese studies are often influenced by data accessibility. See Steven M. Goldstein, "Reforming Socialist Systems: Some Lessons of the Chinese Experience", *Studies in Comparative Communism*, Vol.21, No.2 (Summer 1988), p.231.

⁴⁷An exception has been found in a recently published edited volume by scholars of largely Mainland China origin which is solely dedicated to the theme of central-local relations. See Jia Hao and Lin Zhimin (eds.), *Changing Central-Local Relations in China* (Colorado: Westview Press, 1994).

⁴⁸Goldstein, "Reforming Socialist Systems", p.228.

⁴⁹Barry Naughton, "Decline of Central Control over Investment in Post-Mao China", in Lampton (ed.), *Policy Implementation in Post-Mao China*, pp.52-3.

the central coffers.⁵⁰ The prevalence of bargaining behaviour and the propensity of lower level authorities to abort and distort central reform policies has led Lieberthal and Lampton to characterize Chinese politics, as situated below the apex and above grassroots level, as a "fragmented authoritarianism" model.⁵¹ While the Chinese system is portrayed as necessarily authoritarian, such authority is nevertheless seen as highly fragmented in the "no man's land" between the very top and the very bottom.

This model of Chinese politics as "fragmented authoritarianism", and its implication of a potent province, has to a large extent vindicated the "minority view" of strong provincial power as expressed in pluralist literature. Indeed, Lieberthal sees their approach as an attempt to synthesize two competing models. The more dominant model focuses on elite preferences and positing a centralized and top-down view. The other argues for a decentralized and "cellular" socio-economic structure.⁵² As it turns out, the factors identified within implementation literature as being major obstacles to the smooth implementation of central reform policies, for instance, the decentralized control of vital resources, are precisely the product of the "cellularity" and decentralization thesis espoused by the "minority view" in the 1970s.⁵³ This view is reinforced by a new generation of economists who, in the 1980s, started to refute the earlier dominant view of a highly centralized economic system in Maoist China. The work of Thomas P. Lyons on central planning and interprovincial integration, for instance, supports Donnithorne's view of a decentralized economic structure. It argues that the central plan was simply too crude, communication gaps between the Centre and the provinces too common and subsequent failures too frequent and substantial for central planning to work effectively at provincial level.⁵⁴ The political ramifications are thus clear. As Vivienne Shue has elaborated, the central state has never had an effective reach over the vast rural expanse at the periphery.⁵⁵ The socio-economic-political structure of Maoist China was "honeycombed and cellular"; and in the post-Mao period, it was "fragmented". The affinity cannot be closer.

This affinity, in an institutional context, applies also to actors' behaviour.

⁵⁰Bachman, "Implementing Chinese Tax Policy", p.144.

⁵¹Lieberthal, "Introduction: The Fragmented Authoritarianism Model", pp.8, 20.

⁵²Ibid., pp.10-11.

⁵³See Goldstein, "Reforming Socialist Systems", pp.226-27, for an explicit acknowledgement.

⁵⁴Thomas P. Lyons, *Economic Integration and Planning in Maoist China* (New York: Columbia University Press, 1987); "Planning and Inter-provincial Co-ordination in Maoist China", *China Quarterly*, No.121 (March 1990), pp.36-60.

⁵⁵Vivienne Shue, *The Reach of the State* (Stanford: Stanford University Press, 1988).

The image of powerful provinces subverting the Centre's preferences through their implementation of reform policies tallies with the earlier view of Parris Chang's regarding the power of provinces to withstand unwelcome central policy. In Susan Shirk's comparison of the Chinese reform experience with that of the Soviet Union, the provinces are considered to have provided the Chinese reformist leaders with an alternative power base from which to *start* reforms that would undoubtedly affect the vested interests of the central bureaucracy.⁵⁶ However, at times when reform has posed a threat to the interests of provincial governments, they have invariably acted in such a way as deliberately to resist or abort its progress. Therefore, the power of provinces vis-a-vis the central bureaucracy enabled reform to take off on a large scale in the early 1980s; but, on the other hand, the provincial power reinforced through reform enabled provinces to obstruct subsequent reforms. In Shirk's words, "Chinese-style economic reform was a policy equilibrium in the context of Chinese political institutions. Every time politicians or economic advisers tried to deviate from this formula---for example, by introducing universalistic price and tax reforms---or by recentralizing the fiscal system---they failed."⁵⁷

Indeed, the framework of provincial bargaining behaviour had been remarkably consistent. While provincial leaders were perceived as highly successful in their ability to resist unwanted central interference during the Cultural Revolution, they were also regarded as "enterprising" actors, being selective in their support or sabotage of central reform policies. The substantive policies differ: class struggle versus economic reform. However, the manner in which these, ostensibly, disparate actors tailor their behaviour so as to maximize their perceived interest is remarkably similar. During both periods provincial leaders were equally "Machiavellian" in their substantive stances. During the Cultural Revolution, provincial leaders emulated the revolutionary rhetoric of the Centre, cultivating "royalist" rebel groups whilst suppressing those hostile to them. In true essence they "waved the red flag in order to oppose the red flag". During the reform period, provincial leaders have both supported and opposed reforms. They supported those reforms which advanced their perceived interests and opposed those working against them. Moreover, when opposing unwanted reforms, provincial leaders manipulated the language of reform in the same way as their predecessors had manipulated the language of political struggle when opposing struggles against themselves. They would stress, for example, the adverse effects of the unwelcome reforms on the "enthusiasm" of the lower levels to increase production. During the

⁵⁶Shirk, *The Political Logic of Economic Reform*.

⁵⁷*Ibid.*, p.16-7.

Cultural Revolution, provincial leaders had suppressed "hostile" rebel groups by declaring them "counterrevolutionaries".⁵⁸ The events of both periods show that provincial leaders were not passive actors. Rather than merely responding to central demands, provincial leaders mobilized substantial resources for their own use. Their lower status in the state hierarchy may have made them the weaker partner of the bargaining relationship with the Centre. However, despite the disparity in theoretical power, the provinces have shown themselves nonetheless to have no small measure of power in their own right.

Unresolved Questions

Indeterminacy of Provincial Power

Through the progression of "central agent" to "responsive province", to the asymmetrical bargaining relationship with the Centre, Western China scholars have deepened their understanding of the place of the provinces within the Chinese political system. It has been eventually recognized that provinces do, in fact, wield power. However, this conclusion on provincial power is often drawn from the post-Mao reform period based on observations of discrepancies between pronounced central policy objectives and the outcome of implementation, as well as on the frequent expositions of "localistic behaviour" of provincial and lower level officials by central officials. Field work opportunities and the proximity of researchers to the field since the 1980s has made researchers more prone to accept the localism descriptions by Chinese officials at face value than researchers of an earlier period relying mostly on official documentary material for information might have been. While discrepancies of *some kind* undoubtedly existed, a suitable approach regarding the interpretation of the *meaning* of such discrepancies has remained elusive. How is the significance of the prevalence of provincial bargaining behaviour in the context of central-provincial power relations assessed? What is meant when describing provinces as powerful *but* unequal bargaining partners? Does the new implementation literature and, in particular, the "fragmented authoritarianism" model, imply that provinces are *in the process* of gaining more power, *but have still not approached a level* which would make them equal bargaining partners with the Centre?

⁵⁸Reference about the framework of bargaining in post-Mao China is found in Susan Shirk, "The Chinese Political System and the Political Strategy of Economic Reform", in Lieberthal and Lampton (eds.), pp.59-91. Details of the Machiavelli strategies of provincial leaders and how they usurped the language of Maoist leadership in the effort of self-preservation during the 1966-1968 period are found in the illuminating article of Chang, "Provincial Party Leaders' Strategies for Survival".

The fact that these important questions are as yet unanswered poses an indeterminate element in the understanding of central-provincial relationship as expressed in literature on this subject. On the one hand, the literature has made a strong case for provincial power. Provincial leaders are undoubtedly not *merely* a central agent. On the other hand, the literature maintains that the central leadership has continued to play a dominant role in the course of events. They find that, in many instances, "higher-level leaders were able to impose their will on lower levels without serious institutional constraints".⁵⁹ Therefore, the power of the provinces during the reform period may only amount to another form of "delegated provincial flexibilities". As Naughton argues in his analysis of declining central control over investment, the central leadership "have shown themselves *willing* to accept a dramatic decline in their own control over investment resources in the pursuit of the elusive goals of 'reform'. The struggles between the Center and locality for control...thus remain fundamentally unequal because the Center fights with one hand tied behind its back."⁶⁰ (emphasis added) The apparent conclusion on the central-provincial relationship is, therefore, that the substantial power which the provinces have been seen to enjoy is, again, merely a result of central policy. As and when the Centre decides otherwise, and as long as the central leadership is not weakened by divisions among its own ranks, the will of the Centre should invariably prevail.⁶¹

It is tenuous entirely to attribute the power of provinces, as exhibited in the intensity of their bargaining behaviour, and in the substantial distortions of reform policies at provincial level, to the decision of the central leadership not to impose its will. To suggest such immediately leads one to ask: why have the central leaders not acted sooner and more decisively in curbing the "power" of the provinces about whom they frequently and openly complained? When answering this question, it is necessary once more to look at the nature of provincial power.

The fact that this question has yet to be answered would probably explain why scholars have chosen a "middle-of-the-road" conclusion regarding the balance of power between the Centre and the provinces. As Lieberthal observed of their fragmented authoritarianism model, this model "does not present the Center as

⁵⁹Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model", p.16.

⁶⁰Naughton, "The Decline of Central Control", p.78.

⁶¹In this connection see David Zweig, "Context and Content in Policy Implementation: Household Contracts and Decollectivization, 1977-1983", in Lampton (ed.), *Policy Implementation in Post-Mao China*, pp.255-283. Zweig argues that elite constancy, commitment, and attention were crucial factors to successful implementation of agricultural responsibility policy.

helpless, the bureaucracies as unable to co-operate, or the locales as all powerful."⁶² Nevertheless, the inclination is towards central power. This inclination is incorporated within the scope of the "fragmented authoritarianism" model. This model describes the political scene situated below the apex of the system and above local level, focusing on the part of the political system in-between the ministries and the provinces. At both ends of the political system, centralization rather than fragmentation is the dominant theme.⁶³ Ministers and provincial leaders are of the same bureaucratic rank; and bargaining is rife between equals. However, whenever the central leaders at the apex of the system choose to intervene, the model of "fragmented authoritarianism" ceases to apply as provincial leaders will be overpowered. Lieberthal has therefore written, "In sum, the picture... suggests that the top leadership in China remains very powerful, despite the reforms."⁶⁴ Lieberthal and Oksenberg have earlier come to a similar conclusion: "(B)oth Center and province command resources that the other needs, *with the balance-of-power between the two in the Center's favour*."⁶⁵ This conclusion of greater dominance of the Centre is, *on the whole*, similar to that of the "majority view" as expressed in pluralist literature. Studying central-provincial relations of an earlier period, this majority view argued that, despite the multitude of self-enhancement strategies of provincial leaders and decentralization reforms, the Centre nevertheless continued to be the predominant party.

It is, therefore, ironical that after the documentation of numerous instances of "localistic" behaviour, and subsequent rejection of the earlier view of a highly centralized political system (at least for politics within the state bureaucracy below the apex), the understanding of central-provincial relations has turned full circle. The Centre is, once more, regarded as the predominant force overpowering in its relationship with the provinces. However, as a result of new data available since implementation of reform policies, this conclusion of central predominance is precarious. Consequently, it seems that either way of understanding central-provincial relations---central predominance or provincial power---stands on slippery ground. A conclusion acknowledging provincial power disputes the obvious superiority of central power, particularly taking into account the Centre's power to appoint and dismiss provincial leaders, and when necessary, to deploy the army to obtain compliance. However, a conclusion arguing for continued central predominance is equally unsatisfactory. *It is unsatisfactory because it is almost*

⁶²Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model", p.10.

⁶³Ibid., pp.8, 20.

⁶⁴Ibid., p.16.

⁶⁵Lieberthal and Oksenberg, *Policy Making in China*, p.350.

tautologically true, other than in the extreme case of secessionist movements and the break-up of China as a unified nation. Moreover, if one concludes that the provincial discretions make no substantive difference to the central-provincial relationship, one is still necessary to state precisely what differences the discretions *do* make. There is obviously a need to explain the *meaning* of this discretionary behaviour which researchers have so avidly observed and which the literature has so laboriously documented. This sustained failure yet to do so makes a conclusion foreseeing continued central predominance highly questionable.

The Inability to Explain Change

As a result of this failure to make sense of the meaning of bargaining activities and increasing provincial discretions, the secondary literature has thus been unable to account for changes within the central-provincial relationship. It might reasonably be surmised that bargaining activities have significance, and they do make some difference. But the question is: what kind of difference? Some scholars have attributed the difficulty in its identification and explanation to data deficiency.⁶⁶ It has been argued that inadequate access to information on the pre-reform period has disabled analysts from assessing the full extent of continuity and change before and after post-Mao reform.

However, data deficiency is not the only problem, and is certainly not the sole cause of the inability of literature to account for any change. The solution to such failure is more in the literature itself, and in its conceptual framework and methodology. This can be clarified by means of a hypothetical situation. It may be assumed that it is now possible to obtain enough data on the Maoist period to compare the extent of provincial power during both periods. The comparison could take the form of a chart showing the differential of power between the provinces and the Centre at different times.

Two crucial problems remain unresolved, however. First, by what yardstick can we compare the power of provinces and the power of the Centre, and thereby arrive at a view of their relative balance of power? The root of the question is: what constitutes "power"? The literature on central-provincial relations has so far tended to be ambivalent on the question of that which constitutes the power of the provinces, whilst unanimous in stressing the importance of the coercive power of the Centre over the provinces. With this predisposition, the balance of power will

⁶⁶Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model", pp.25-7.

inevitably tilt in the Centre's favour, as observed above.

Second, the chart of provincial power and central power is likely to show variations over different periods. The problem is how to make sense of the variations. Does this mean that the development of provincial power may be conceived in some sort of continuum? Also, if there is a higher occurrence of provincial discretions during the reform period, does this then amount to an incremental accumulation of provincial power vis-a-vis the power of the Centre? The implementation literature has apparently answered in the affirmative. As Steven Goldstein points out, the assumption of some kind of evolutionary framework of central-provincial relations is evident within implementation literature.⁶⁷ The existence of an evolutionary process is clearly assumed in Lieberthal's writings on the state of the fragmented authoritarian polity as of the early 1990s, "The fragmentation has not reached the point where its constituent parts have the legitimate autonomy characteristics of a pluralist system."⁶⁸ From this perspective, the central-provincial relationship thus resembles a unilinear framework within which the forces of fragmentation at provincial level accumulate in the process of its operation.

The simplicity of a linear model is disturbing. It is disturbing because it suggests, implicitly at least, that as fragmentation forces accumulate, the forces of centralization will *in due course* be overwhelmed. The unanswered question is how this "overwhelming" can be effected. In this aspect the evolutionary framework remains silent. As Lieberthal himself rightly noted, the gap between fragmentation and legitimate autonomy is huge and of a qualitative kind. More fragmentation will *not* automatically and by the sheer force of its accumulated weight bring about legitimate autonomy. The literature, however, provides no room to explore the question of how exactly qualitative change can take place, even though it acknowledges, somewhat intuitively, the possibility of qualitative change. Its implicit linear framework of change precludes such an exploration.

Theoretical Issues

The failure of central-provincial relations literature to explain the meaning of provincial discretionary behaviour and to account for change are the result of theoretical failures over the conception of power. First, confusion has arisen over the role of coercion within a power relationship. This is behind the tautology of the

⁶⁷Goldstein, "Reforming Socialist Systems", p.231.

⁶⁸Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model", p.12.

thesis of "continued central predominance". Second, in most studies of central-provincial relations the dominant concept of power as zero-sum and that of the centrist perspective reinforce one another. The result is a static picture of central-provincial relations where the Centre and the provinces are in a seemingly endless cycle of conflict.

Coercion and Power

This is not the place to discuss the full range of the debate over the concept of power.⁶⁹ The task to be undertaken here is much more limited: to identify the implicit concept of power within the central-provincial literature discussed above, and to suggest an alternative concept. The purpose of this discussion is to provide a better analytical tool through which to understand China's central-provincial relations.

A central question in this discussion is: what is the relationship between coercion and the concept of power? Scholars writing on China's central-provincial relations and interagency relations have generally eschewed explicit discussion of their specific concept of power. In most cases when explicit reference has been made to the sources and bases of power of the Centre or the provinces, it has been based on Robert A. Dahl's notion of power "between the lines". It would be material, therefore, to start this discussion with a brief summary of Dahl's concept of power.

As the major theorist of the pluralism school in the study of the Western political system, Robert A. Dahl considers power as a relation amongst people. His intuitive idea of power can be expressed in his statement: "A has power over B to the extent that he can get B to do something that B would not otherwise do."⁷⁰ Dahl understands "power" in terms of its four aspects: the base of power, means of power, amount of power, and scope of power.⁷¹ The base of an actor's power "consists of all the resources, acts, objects, etc---that he can exploit in order to affect the behaviour of another."⁷² A major characteristic of the base of power is that it is "inert, passive". To activate the base, therefore, an actor has to engage in

⁶⁹For a glimpse of the debate and the complexities of the concept, see Roderick Bell, David V. Edwards, and R. Harrison Wagner (eds.), *Political Power: A Reader in Theory and Research* (New York: The Free Press, 1969); and Dennis H. Wrong, *Power: Its Forms, Bases and Uses* (Oxford: Basil Blackwell, 1979).

⁷⁰Robert A. Dahl, "The Concept of Power", originally printed in *Behavioral Science*, (1957), pp.201-15, reprinted in Bell, Edwards, and Harrison (eds.), *Political Power*, p.80.

⁷¹*Ibid.*, p.80.

⁷²*Ibid.*, p.81.

some actions. Such actions engaged are the "means of power". For instance, while the ability to exercise patronage, and the option of a veto are amongst the bases of power available to the President of the United States over the Senate, the President has nevertheless to pledge *promises* of patronage, or indicate a *threat* of veto in his attempt to influence the Senate. Therefore "the means is a mediating activity by A between A's base and B's response."⁷³ Meanwhile, the "scope" of A's power refers to the reach of A's means of power, and what possible responses B might make. The resultant ability of A to bend B to its will constitutes the "amount" of power which A has. In Dahl's words, the amount of power can be "represented by a probability statement: e.g. 'the chances are 9 out of 10 that if the President promises a judgeship to five key Senators, the Senate will not override his veto'".⁷⁴

The similarity between Dahl's concept of power and that employed by the central-provincial relations literature is obvious. In the mainstream of this literature, the sources of central control are identified as: (1) the power of the Centre to appoint and dismiss provincial leaders, (2) the Centre's effective control of physical forces of coercion, specifically the military, (3) the Centre's control over the propaganda apparatus, and (4) the Centre's control over key economic resources.⁷⁵ Meanwhile, the sources of provincial autonomy are (1) the sheer size of the country, (2) the cumulative result of temporary grants of authority by the Centre in the past, and (3) its intermediate position within the state hierarchy, which makes the province "the gatekeeper guarding and providing access (of the Centre) to local levels."⁷⁶ A shift in terminology reveals that these "sources of power" are actually Dahl's "bases of power" by another name.

The strength of Dahl's concept of power lies in its distinctions between the different aspects of power. Since the "base of power" is inert and passive, it is *irrelevant* to the "amount of power" A is able to exert on B unless it is effectively activated by some "means of power". Therefore, while the "base of power" encompasses *all* resources A may *potentially* employ in order to effect the behaviour of B, the extent of power A eventually exercises over B depends very much on what "means" of power A possesses, and how effective these are. There is hence a significant gap between one's *bases* of power and the *amount* of power one actually has over others, the gap depending on the *means*, which is the mediating process, and the variables which affect it. Dahl's differentiation of the four aspects

⁷³Ibid.

⁷⁴Ibid.

⁷⁵Lieberthal and Oksenberg, *Policy Making in China*, pp.347-48.

⁷⁶Ibid., pp.349-50.

of power highlights the existence of this gap between one's *potential* power and one's actual power on a specific occasion.

The danger of employing Dahl's concept of power is the greatest when one is not sensitive to these distinctions, which is the major problem relating to the literature on central-provincial relations.⁷⁷ In such literature the base of power is often confused with the amount of power actually exercised. The lists of sources of central and provincial power noted above include all identifiable sources of *potential* power upon which the Centre and provinces may draw in their interactions with one another. However, analysts have neither identified nor explained the mediating process whereby the extent of applicability of the sources of power in an actual situation is specified. Rather than being identified as the dependent variable in accordance with Dahl's concept, the base of power has been taken as the independent variable through which to interpret the meaning of bargaining activity between the Centre and the provinces. On taking the base of power as the *actual* power in force, this literature tends to compare two "lists" of power, one of the Centre and one of the provinces, and somehow arrive at a judgement on the balance of power.

Mistaking the base of power for actual power has serious implication when attempting to understand the central-provincial relationship. By definition, provincial governments are in a subordinated position vis-a-vis the Centre, which commands superior control over vital resources through its superior organizational status. For instance, control over the military certainly constitutes a base of power of the Centre, as it can deploy this resource as a means to extracting compliance from provinces. As a result, an empirical analysis of the process of bargaining behaviour and policy making appears immaterial to an understanding of central-provincial relations. A simple calculation of the balance of military power between the Centre and provinces will suffice.

Here it is noteworthy that some scholars do in fact recognize the complexities of the power concept. Specifically, Victor Falkenheim, in admitting to the "ambiguities in the concept of power itself",⁷⁸ notes that there are limits to which the Centre can use its coercive power on the provinces. Referring to

⁷⁷For an example of analysts focusing on the analysis of the "bases of power" of political actors in attempting to explain their success and failure in political survival, disregarding the gap between the *potentiality* of such power and the actual power wielded, see Lowell Dittmer, "Bases of Power in Chinese Politics: A Theory and an Analysis of the Fall of the 'Gang of Four'", *World Politics*, Vol.31 (October 1978), pp.26-60.

⁷⁸Falkenheim, "Provincial Leadership in Fukien", p.200.

provincial purges as one form of the Centre's coercive power over provinces, he notes that "purges are an extreme and relatively infrequent manifestation of central dissatisfaction and as such are *too gross an indicator* to enable us to monitor accurately central responses to provincial performance...Understanding the *normal* process of provincial administrative leadership...involves understanding what goes on within those (tolerable) limits (when there are no purges) and what precisely those limits are."⁷⁹ (emphasis added) In other words, *the crucial focus of understanding of the central-provincial relationship should be on normal periods when military coercive force or purges are not used*. Rather than dwelling on the established fear of the superior coercive power of the Centre, it is important to identify its limits.

However, as noted in earlier discussion, these theoretical ponderances have not borne fruit in their subsequent conclusions. For instance, despite his awareness of the role of coercion, Falkenheim, in his empirical analysis of Fujian, nevertheless explains events in terms of the superior coercive power of the Centre over the provinces. According to his argument, as the Centre can hire and fire provincial leaders, power essentially flows downwards from the Centre. Any occurrence of provincial discretions in Fujian prior to the Cultural Revolution was, therefore, merely a result of "mandated flexibility".⁸⁰ The implicit use of Dahl's "base of power" concept led Falkenheim to a conclusion based on the very precarious assumption he had originally guarded against. It is obvious, therefore, an alternative concept of power is necessary to provide the analytical key to a better understanding of the role of coercion in the power relationship between the Centre and the provinces, and to end the tautological nature of central power.

This alternative is found in Talcott Parson's concept of power. The major difference between Parsons and Dahl is that while coercion is clearly one of those resources forming the base of power in Dahl's concept, according to Parsons, "securing compliance...simply by threat of superior force is not (in itself) an exercise of power."⁸¹ As such, Parsons regards the focus for analysis of a power relationship as exclusive of the use of coercion. However, this does not mean that coercion has absolutely no position in Parsons' concept of power. Power for Parsons is a phenomenon of *both* coercion and consensus, but coercion, as such, is not the crucial variable in the exercise of power in a complex society.

⁷⁹Ibid., pp.202-3.

⁸⁰Ibid., p.244.

⁸¹Talcott Parsons, "On the Concept of Power", in Bell, Edwards, and Wagner (eds.), *Political Power*, p.257.

So what is the role of coercion in this concept of power, and if coercion is not the pertinent variable in understanding a power relationship, what is, then, pertinent? The role of coercion in *any* exercise of power, according to Parsons, is the "ground" of power.⁸² As the "ground" its role is akin to the role of gold metal as regards the value of money within a gold-based monetary system. The value of the precious metal gives some kind of security to the exchange value of money, but the value of money as a medium of exchange is not reducible to the total value of gold in the market. Likewise, while any exercise of power by A over B embodies coercion as the "ground" of power, the amount of power, in Dahl's terminology, is not reducible solely to the amount of coercion A possesses. For power to be assessed solely in terms of coercion potential, the system would need to be very primitive. In Parsons' own words, "just as a monetary system resting entirely on gold as the actual medium of exchange is a very primitive one,...so a power system in which the only negative sanction is the threat of force is a primitive one which cannot function to mediate a complex system of organizational coordination---it is far too "blunt" an instrument."

In other words, whilst coercion is the "ground" of power, the crucial variable of the exercise of power in a complex society lies elsewhere. Given the limited amount of coercion in any system, possessed by any actor, it is the ability of the actors to obtain compliance via symbolic means which reflects the power of the actor. Power in this stricter sense must, in Parsons' words, "be generalized and not solely a function of one particular sanctioning act which the user is in a position to impose, and the medium used must be 'symbolic'".⁸³

Parsons' concept of power carries significant implications. Unlike Dahl, and others, who treat coercion as one of the bases of power, and see the exercise of power as *sometimes* relating to the use of coercion, and *at other times* to consensus, Parsons insists that power is a phenomenon which essentially integrates both coercion and consensus. By seeing power as oscillating between different "forms of power", Dahl's concept posits an indeterminate picture of power relations between the Centre and the provinces. As the literature on China's central-provincial relations has shown, provinces are sometimes portrayed as powerful actors, and at other times as passive and virtually helpless. The "superiority" of the coercive form of power has also cast doubt on the significance of other forms of power, for instance economic power in economic policy bargaining. By rejecting this eclectic

⁸²Ibid., p.260.

⁸³Ibid., p.257.

concept of different forms of power, and by specifying the role of coercion as the ground of power, Parsons has successfully clarified the essence of a power relationship as well as the focus of power analysis.⁸⁴

Parsons' concept of power has particular utility in the analysis of power relationships in which the distribution of coercive resources is inherently unequal: the central-provincial relationship. As the national level of government, the Centre is in a superior organizational position in its role. The extent and locus of superior authority of the Centre over the intermediate level may vary depending on the details of the political system. However, there is always *some* superiority, one invariable area of central superiority being the Centre's control over the nation's military force. By excluding the use of coercion in the study of power, therefore, Parsons avoids the tautological trap of Dahl's concept, which leads analysts to conclude that the Centre is powerful *because it is the Centre*.

Power as Zero-Sum Game?

A related issue of equal importance is whether power between the Centre and the provinces constitutes a zero-sum game. Like the role of coercion in power, the ambivalence of this issue within the secondary literature has contributed to gaps in previous interpretations of China's central-provincial power relations. When refuting the generality of the "game theory", Parsons argues that power within a system does not necessarily constitute a zero-sum game. On drawing an analogy with the creation of credits in the bank system, and the contraction of the value of money under inflation, Parsons maintains that the total supply of power in a system, as the generalized medium of exchange in the realm of politics, can expand as well as contract, in a way similar to the supply of money in the realm of economics.⁸⁵ Nevertheless, as Jae Ho Chung has noted, the dominant assumption within central-provincial relations literature is that power between the Centre and the provinces is a zero-sum game.⁸⁶ This is evident from the attempts of literature to draw conclusions on the question of the balance of power. Somehow a balance sheet of power between the Centre and the provinces has to be presented, and a judgement made as to which party is more powerful *on balance*. This assumption predates the post-Mao reform period, yet it is further reinforced by the concentration of research attention on the fiscal system in the reform period.⁸⁷ As

⁸⁴Ibid., pp.251, 256-7, 280.

⁸⁵Parsons, "On the Concept of Political Power", pp.271-79.

⁸⁶Jae Ho Chung, "Studies of Central-Provincial Relations in the People's Republic of China: A Mid-Term Appraisal", *China Quarterly*, (forthcoming in No.142, June 1995)

⁸⁷This concentration on one aspect of central-provincial relations---the *fiscal* relationship---is

Chung has noted, the simplicity of the fiscal relationship, as expressed in percentage terms of provincial remittance and retained revenue, easily projects a "zero-sum" image of central-provincial relations.⁸⁸ However, the implications of these fiscal changes in relation to the respective powers of the Centre and the provinces over policy formulation and implementation have been largely overlooked. The important question, "so what?", remains unasked within the compelling simplicity of budgetary figures.⁸⁹

The assumption of the zero-sum nature of central-provincial power relations can be attributed to the dominance of the centrist perspective in such literature. Central-provincial relations have been studied primarily as a phenomenon of declining central control and weakening state capacity.⁹⁰ This is especially the case in the more recent body of literature focusing on the post-Mao period. The focus of analysis of these works is invariably one: the factors and process which lead to the apparent decline of central control over policy implementation by the provinces. The perspective is from the top-down.

As noted earlier, reform studies have tended to adopt the traditional distinction between policy formulation by the Centre and implementation by the provinces. However, analysts do recognize the fact that policies are often formulated at the top as well as at the lower levels. They also fully acknowledge that the original intentions of central leaders with regard to a policy are often at variance with that which eventuates after implementation. Nevertheless, the insistence on posing the explanandum of research as an implementation bias leads

largely led by the course of events during reform. Some examples of these works are: Michel Oksenberg and James Tong, "The Evolution of Central-Provincial Fiscal Relations in China, 1971-1984: The Formal System", *China Quarterly*, No.125 (March 1991), pp.1-32; James Tong, "Fiscal Reform, Elite Turnover and Central-Provincial Relations in Post-Mao China", *Australian Journal of Chinese Affairs*, No.22 (July 1989), pp.1-28; Susan Shirk, "Playing to the Provinces: Deng Xiaoping's Political Strategy of Economic Reform", *Studies in Comparative Communism*, Vol.23, No.3 (Autumn/Winter 1990), pp.227-58; Wang Shaoguang, "Central-Local Fiscal Politics in China", and Lin Zhimin, "Reform and Shanghai: Changing Central-Local Fiscal Relations", in Jia Hao and Lin Zhimin (eds.), *Changing Central-Local Relations in China*, pp. 91-112, 239-60; Christine P.W. Wong, "Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China", *China Quarterly*, No.128 (December 1991), pp.691-715; Reetsu Kojima, "The Growing Fiscal Authority of Provincial-level Governments in China", *The Developing Economies*, Vol.30, No.4 (December 1992), pp.315-46; and David Bachman, "Implementing Chinese Tax Policy", in Lampton (ed.), *Policy Implementation in Post-Mao China*, pp.119-56.

⁸⁸Ibid., p.17.

⁸⁹Ibid. See Lieberthal and Oksenberg, *Policy Making in China*, p.351, for a similar observation of the indeterminacy of the meaning of a revenue flow between the Centre and a province about their relationship.

⁹⁰Two works which explicitly employed the state capacity paradigm are: Jia Hao and Lin Zhimin (eds.), *Changing Central-Local Relations in China*; Zhao Suisheng, "The Feeble Political Capacity of a Strong One-Party Regime".

researchers to view the relationship between the Centre and the provinces as an issue of central control and provincial compliance.⁹¹ When posing the research question in terms of the rise and fall of central control, analysts invariably see the answer in terms of a corresponding rise and fall in central/provincial power. In other words, the relationship is bound to be of a zero-sum nature.

But how does a power relationship resemble a zero-sum game, if, as Parsons has argued, the total supply of power is a variable? The answer is found in the absence of a regularized and institutionalized system of conflict resolution within the Chinese political system. As Tang Tsou has noted, political conflicts throughout the Chinese history are characterized by a "total victory versus total defeat" situation in which the winning side retains "all real power to make decisions, whereas the other side is totally defeated."⁹² Because of the low level of institutionalization of power and the absence of a regularized system to resolve conflicts among different forces of power within the system, political struggles in China are notable for their ferocity. If there is a prospect of total victory, it is argued, the actor with the upper hand in the conflict will not hesitate totally to smash its opponent. The target is total victory, and the defeated opponent is thus totally "eliminated" from the scene. In Tsou's words, although "at times there were compromises, concessions, admissions of defeat, negotiations, and even co-operation with...opposing forces...those were tactical measures" in search for a better opportunity to strike the final blow.⁹³ Therefore, actors may temporize but not compromise. The tradition of political authoritarianism from imperial times has forestalled the development of "a politics of compromise" in China.⁹⁴ The power relationship in this context is therefore a "A wins, B loses", zero-sum, situation.

To understand central-provincial relations with the above zero-sum framework, however, raises unsurmountable questions. Specifically, this framework disables the analyst from envisaging the circumstances whereby the rules of the game may be changed. While analysts agree that the ferocity of previous political struggles in China was due to the authoritarian nature and the low level of institutionalization of the political system, their zero-sum analysis of the

⁹¹The irony of the recognition of the complexities of a definition of "implementation failures", and the eventual decision to take policy formulation as a static concept and solely as reflected in the declarative policy statement of the Centre, is most remarkable in Lampton (ed.), *Policy Implementation*. See especially Lampton, "The Implementation Problem", p.7.

⁹²Tang Tsou, "The Tiananmen Tragedy: The State-Society Relationship, Choices, and Mechanisms in Historical Perspective", in Brantly Womack (ed.), *Contemporary Chinese Politics in Historical Perspectives* (Cambridge: Cambridge University Press, 1991), p.266.

⁹³Ibid., p.319.

⁹⁴Joseph Fewsmith, *Dilemmas of Reform in China: Political Conflict and Economic Debate* (Armonk, New York: M. E. Sharpe, 1994), pp.10-12.

central-provincial relationship suggests a static picture of power in which centralization and decentralization appear in an endless cycle. As a result they have been unable to discern any possibility of change within this cyclical pattern, other than through the mutual goodwill of central and provincial leaders to reach between themselves a "historical compromise".⁹⁵ In other words, while analysts recognize that successive decentralizations have resulted in a dispersion of authority and resources from the Centre, and feel intuitively that the system *might* evolve towards genuine autonomy for the provinces, the literature is silent as regards the possible circumstances under which this "qualitative" change in the nature of central-provincial relationship could come about.⁹⁶ The Chinese system, it would seem, is stuck in its historical tradition of authoritarianism and in a cycle of decentralization and centralization. The only possible way out, as the literature has implicitly suggested, is through the emergence of "enlightened" leaders.

To escape from such pessimistic determinism it is necessary to depart from the centrist perspective and the state capacity paradigm. Instead of posing the research question in terms of the decline of central control over unruly provinces, there should be a reconceptualization of central-provincial relations as an interactive process in which both the Centre and the provinces struggle hard in order to attain their respective objectives. The asymmetry of the relationship means that changes in institutional rules have to be agreed to and formally laid by the Centre. However, the Centre does not have "carte blanche" in this respect. Nor is it the case that that which is laid down by the Centre is invariably subverted by the provinces. It is rather pressure from the provinces which leads the Centre to prescribe the rules in such a way that they protect its interests as well as those of the provinces.

An illustration of this interactive process between the Centre and the provinces is found in Susan Shirk's study of economic reform.⁹⁷ In studying the decision made in 1979 to implement nationwide fiscal reform, Shirk found that reform was a means employed by the central bureaucracy to "divest (themselves of) responsibility", as opposed to being a preconceived plan to decentralize fiscal autonomy to the provinces, as has previously been assumed by Western scholars.⁹⁸ Given the status quo of the 1970s, central officials at the Ministry of Finance (MOF) concluded that the only way to improve the interests of the central coffers at

⁹⁵See Jia Hao and Lin Zhimin, *Changing Central-Local Relations in China*, p.10.

⁹⁶For an example, see Lieberthal, "Introduction: The 'Fragmented Authoritarianism' Model", p.12.

⁹⁷Shirk, *The Political Logic of Economic Reform*.

⁹⁸*Ibid.*, p.163.

that time was through the further step of decentralization. In Shirk's words, "the MOF had a hard enough time managing the family without enough money...The children (the provinces) argued among themselves and complained that the family head had mistreated them. In that situation, (the MOF leaders clearly felt that) it was better for the family head to divide the family and put the children off on their own. Hence, the family metaphor of the decentralization policy: dividing the family by splitting up the kitchen."⁹⁹

Therefore the 1980 nationwide fiscal reform was the result of a compromise between the Centre and the provinces. From the perspective of the Centre, further decentralization of fiscal authority was the only possible way to improve its fiscal situation. The Centre was constrained in the options it could take. The dispersion of resources in the early 1970s had led to a drastic decline in central fiscal revenue throughout the decade in both relative and absolute terms. It was considered impossible to recentralize enough resources from the provinces and to reimpose the centralized fiscal regime of the early 1950s. But without such recentralization, the Centre, with its shrinking share of resources, could not cope with its share of responsibility. The major fiscal problem of the Centre on the eve of fiscal reform was thus one of arresting the decline in central revenue, whilst delegating more spending responsibility to the provinces. By signing a multiple-year contract with provinces guaranteeing a fixed share of central revenue, the Centre therefore "clarified the responsibilities as well as resources of each tier of government and *guaranteed central income at current levels*."¹⁰⁰ (emphasis added)

Shirk's account reveals, therefore, a dynamic picture of central-provincial relations in which both the Centre and the provinces act within each other's constraints. Rather than seeing the relationship as one between a weakening but "all-powerful" Centre and the subordinated, responsive, yet "undisciplined" parochial provinces, Shirk sees the Centre responding to powerful provinces whilst seeking to strike the best deal to enhance its interests. Power between the Centre and the provinces is therefore not one of control versus disobedience, but one of calculated compromise on both sides.

However, Shirk's account nevertheless draws heavily on data from the

⁹⁹Ibid.

¹⁰⁰Ibid. The fact that the Centre had *subsequently* felt that it, again, was losing out to the provinces after the implementation of the 1980 fiscal reform is, however, a separate story. It tells the success of the provinces to outmanoeuvre the Centre and the *shifting perceptions* by both the Centre and the provinces regarding their interests. This process of provincial manoeuvring, in the context of investment policies, is the subject of discussion of subsequent chapters in this dissertation.

central side. Little, if at all, is said about the manner in which provinces sought to expand their interests within the constraints of the Centre. The perspective from the provinces is particularly important to understand why the original intentions of the Centre in embarking the 1980 fiscal reform were subsequently outmanoeuvred by the provinces. This provincialist perspective, in the context of investment implementation, will be elaborated in detail in later chapters of this thesis. Notwithstanding the focus on the centralist perspective, Shirk's analysis shows that power between the Centre and the provinces is not a zero-sum game. At that stage of fiscal reform in 1980, both the Centre and the provinces had enhanced their pre-1980 position. Both "won" in the "positive-sum" game.

But how could the politics of compromise be possible at all, if according to Tang Tsou's analysis, most political struggles in Chinese history have taken on a zero-sum game nature? Is the fiscal reform decision of 1980 merely an exception to the general rule? If not, and if as a general rule the Centre has to compromise with the provinces, from where do the provinces derive their strength? If the ground of the Centre's power, in Parsons' terminology, lies in its superior command of coercive force, what is the ground of provincial power? Why should the Centre feel compelled to reach a compromise with the provinces? Why does the Centre not "smash" all provincial resistance and emerge as a "total victory" winner?

The answer to these questions is found, as this study argues, in the intermediate position of the province in the state hierarchy. Existing works in literature have also stressed the power of the province as the intermediary. But in such studies the power of the intermediary is always double-edged. On the one hand, it gives the province substantial discretions and control over resources, whilst, on the other, making it the object of central manipulation and control. So if the ground of provincial power lies in its intermediate position, what does this strength of the intermediary consist of?

At this point it is important to note that Tang Tsou, when commenting on the zero-sum nature of political struggles in Chinese history, also notes that there are limits to which the logic of total victory versus total defeat applies. In Tsou's own words, political conflicts acquire the zero-sum nature only "if one side believes that it can win in a final confrontation and is willing to pay the necessary price."¹⁰¹ In other words, where there is a "mutual perception that a stalemate will continue indefinitely into the future, ... the expectation that there will be a final

¹⁰¹ Tsou, "The Tiananmen Tragedy", p.320.

confrontation and settlement of accounts" will gradually change.¹⁰² With no prospect of total victory for oneself, one is therefore forced to compromise with one's opponent.

Herein lies the strength of the intermediary. It is impossible for the Centre to win a total victory over its intermediary. As the intermediary of the Centre, provincial governments are an indispensable ally of the Centre in governance. The Centre has to rely on provincial leaders and lower level officials to govern society. **As individuals, provincial leaders may be purged and replaced, but as a group and an institution, provincial leaders and the provincial-level government are there to stay.** Tsou's thoughts on the limits of the zero-sum nature of political conflicts is set out in the context of state-society confrontation in the Tiananmen tragedy of 1989. In that case, the state can still rely on coercive power as the last resort in order to achieve an apparent "total victory", although the use of naked force to extract compliance reveals its weakness and illegitimacy.¹⁰³ The hands of the Centre in its struggles with the provinces are more tied and constrained. As power holders, provincial leaders possess more resources which they can use to protect themselves against the encroachment of the Centre, than that are normally available to private individuals in the case of a state-society confrontation. Indeed, it is argued that the indispensability of the province as an intermediary constitutes "the basis for a bargaining relationship between the (Centre and the provinces)...(As a result), over time,...the balance (of power) may have gradually shifted somewhat in the province's favour."¹⁰⁴

What the literature has yet to contemplate is that the structural indispensability of the intermediate level in the state hierarchy has precluded a "total victory" situation for the Centre. The Centre may win in specific instances of confrontation, but the necessity to rule *through* an intermediary dictates that its victory is short-term and incomplete. An ideal example are the cycles of centralization and decentralization since 1957. Each round of recentralization reclaimed only part of the power and resources which had been decentralized earlier, and each subsequent round of decentralization brought the provinces control over more resources and a broader room for manoeuvre.¹⁰⁵ The

¹⁰²Ibid., pp.320-1.

¹⁰³Ibid., pp.316. On this point, Tsou's remark bears remarkable affinity with Parris Chang's over the Cultural Revolution, and Parson's over the role of coercion in the concept of power in general.

¹⁰⁴Lieberthal and Oksenberg, *Policy Making in China*, p.350.

¹⁰⁵For discussions on the "diminishing returns of repeated recentralization" and the cumulative effect of successive decentralization-recentralization cycles in the province's favour, see Zhao Suisheng, "The Feeble Political Capacity of a Strong One-Party Regime", Part 2, p.55; Lieberthal and Oksenberg, *Policy Making in China*, p.349; Carl Riskin, "Neither Plan nor Market: Mao's

organizational position of the province guarantees therefore that it cannot be "totally eliminated" by the Centre in any central-provincial conflicts. As the stalemate persists, the Centre is forced to compromise with the provinces, as happened at the time of the 1980 fiscal reform decision. Rather than seeing the course of economic reform as a process through which central policies are distorted by provincial implementation, this new picture of central-provincial relations shows a process of accommodation and compromise. **As neither the Centre nor the provinces can decisively win over and eliminate the other, both are forced to accommodate the interests of the other and to compromise.**

The implication of the non-zero-sum nature of central-provincial power is significant. It envisages change. In a zero-sum framework, any possibility of change awaits the wisdom of the victor after all accounts have been settled and its opponent eliminated. In a non-zero-sum framework, the forces of change are built in to the system through the power of the actors over one another. The amount of power at the disposal of the Centre and of the provinces differs, but their interdependence and long-term co-existence requires both parties to compromise. A strong Centre during the 1950s, for instance, still found it necessary to decentralize power to the provinces in order better to implement its policies. Something has to be given out in order to get back something in return. Consequently, as provinces gather more and more resources as a result of successive decentralizations, their bargaining power vis-a-vis the Centre increases. With increased power, the provinces are in a position to demand more concessions from the Centre than before. The result is the increased occurrence of central-provincial conflicts as manifested during the reform period. **In these circumstances, if increased institutionalization of the power distribution is the way out of protracted conflicts, it will *not* come into being as a result of the wisdom of some enlightened leaders. Rather the leaders, central and provincial, will become enlightened of the need to institutionalize when they see this as the only way out of such protracted conflicts and as the best means available through which to protect their interests, given the constraints of their opposite number.**

Toward An Analytical Framework

Building on what has been achieved in existing central-provincial studies, and gaining from the above an insight into an alternative concept of power, this

Political Economy", in William A. Joseph, Christine P. W. Wong, and David Zweig (eds.), *New Perspectives on the Cultural Revolution* (Cambridge: Harvard University, The Council on East Asian Studies, 1991), p. 143.

study aims to arrive at a better understanding of this relationship. Above all, this will be a story about the provinces. Compromise requires the cooperation of both parties. Shirk's account has focused on the Centre's story. This study, therefore, seeks to show the story from the provincial perspective and also elaborate on two concerns. First, how do the provinces constitute an unsurmountable "opponent" of the Centre? This involves the description of strategies which provincial leaders have deployed in order to enhance their interests and to disable the Centre from winning a "total victory". This part of the story also forms a sequel to, and a substantiation of, Shirk's story of the Centre. It explains in detail how and why the Centre, in the context of investment implementation, has found itself unable to recentralize the system. The second issue concerns the way in which the provinces seek to advance their own interests and to contain the power of the Centre by striking compromises with the Centre which, by definition, also works in the interests of the Centre. In other words, while the first aspect elaborates on the power of the provinces vis-a-vis the Centre, the second aspect of the story demonstrates how that power, together with the power of the Centre, achieves *qualitative* changes within the central-provincial power relationship.

Main Features of the Framework

Rational-Choice Institutionalism

This study employs the rational-choice institutional approach in examining central-provincial relations. The term "rational-choice institutional" approach has two alternative meanings. First, it refers to an approach in which the rational behaviour of actors is analysed in terms of the structures of incentive built in to the institutions of a system. That is, the emphasis is on the institutional *context* of rational choices. This approach stresses the impact of institutions on the rational choices of actors, and is an "institutional" approach *par excellence*. The prefix "rational choice" is meant as a minor qualifier. It is the definition used in Susan Shirk's rational-choice institutional study of economic reform.¹⁰⁶ Another meaning of the term stresses the *co-existence* of a rational choice of actors, and of institutions setting the basic parameters and rules for the exercise of such choices. The emphasis is on what institutions do *not* constrain. The message is that, notwithstanding the impact of institutions on the choices of actors, institutions are not so "totalitarian" that they leave no room at all for choices. This second meaning of "rational-choice institutionalism" therefore presupposes and builds on the first

¹⁰⁶Shirk, *The Political Logic of Economic Reform*, p.7.

meaning. Indeed, it is an improvement on the first in the sense that the reemergence of institutionalism as a major analytical framework in political science in the 1970s has led to debates regarding its scope and relation to the earlier rational choice approach.¹⁰⁷ Whilst, in the first meaning, rational choice is subsumed into an institutional approach, in the second meaning the two are regarded as complementary to each other. The second meaning does not refute the first meaning, but questions its claim regarding the scope of the impact of institutions on behaviour. In this sense the term could be modified to read "rational-choice-cum-institutionalism" to identify more clearly the fundamental complementarity of rational choice and institutions. In this study it is this second meaning of rational-choice institutionalism which is adopted.

The rational-choice institutionalism in this study focuses on the *linkage* between institutions and actors' choice. Both the institutional context and actors' choice within this context are covered, with the focal point of analysis on their interactions. In China political studies, it is increasingly recognized that institutional rules and choices of action by individuals together determine the course of events.¹⁰⁸ Institutions and actors' choices respectively form the focus of analysis of two major approaches of China political studies---the institutional approach and the elite model. Despite the recognition of the limitations and partiality of both approaches by their proponents, there have been no conscious efforts to reconcile the two and incorporate their perspectives.¹⁰⁹ By studying both the institutional context and actors' choices, this study attempts a synthesis. In the context of central-provincial relations, the Centre and the provinces pose the most important institutional constraint on each other. Therefore the application of rational choice institutionalism to a study of central-provincial relations directs the analyst to identify the choices made by provinces under the institutional constraints posed by the Centre, and vice versa, as well as to illuminate the processes through which the choices are made.

¹⁰⁷See Elinor Ostrom, "Rational Choice Theory and Institutional Analysis: Towards Complementarity", *American Political Science Review*, Vol.85, No.1 (March 1991), pp.237-43, for an excellent exposition on the fundamental complementarity of rational choice and institutional analysis in this latter sense.

¹⁰⁸For instance, Shirk towards the end of her work noted the limitation of the institutional approach. She has written "I often found myself unable to explain changes in policies by the institutional context and fell back on *ad hoc* explanations instead." The "*ad hoc*" explanations are, in an "rational-choice-cum-institutional approach", the roles played by actors' choices within the constraints of the institutional context. Shirk, *The Political Logic of Economic Reform*, p.339.

¹⁰⁹See Goldstein, "Reforming Socialist System", p.231.

Provincialist Perspective

As noted above, this study adopts a primarily provincialist perspective. This means that the focus of the study will be on the choices of provinces under the institutional constraints of the Centre, but *not* vice versa. The reason for adopting a provincialist perspective is simple. Relatively more has been done from the perspective of the Centre. Specifically, as noted above, Shirk has shed light from the Centre's perspective.¹¹⁰ For this reason it is believed that more may be illuminated about the central-provincial relationship in a study focused on the provincial side of the story.

The adoption of a provincialist perspective has more deep-seated considerations, however. The literature on China's central-provincial relations, as discussed above, has adopted a primarily top-down, state capacity paradigm. This is, in part, the result of the relatively greater visibility and accessibility of the top levels of the political system, and, in part, the result of the influence of theoretical constructs such as the centre-periphery paradigm on the analytical framework of the analysts. The centre-periphery paradigm starts with the simple idea that "societies have a centre to which their members orient themselves and which influences their conduct".¹¹¹ As Shils explains, "The centre, or the central zone, is a phenomenon of the realm of values and beliefs. It is the centre of the order of symbols, of values and beliefs, which govern the society."¹¹² But values and beliefs have to be acted upon. Therefore "the Centre is also a phenomenon of the realm of action. It is a structure of activities, of roles and persons, within the network of institutions."¹¹³

In theory, the construct itself is not a spatially delimited concept. The central zone in different societies may reside in different actors and different institutions, and within a society the locus of "the centre" may well differ according to different subjects of concern.¹¹⁴ However, in practice, the authority of the national government has often led analysts to assume that the national government is "the centre" in the society. The source of this bias towards the national Centre in the search for the "centre" is rooted in the definition of "centre". In the words of Edward Shils, "The decisions made by the elites contain...values...(which) we shall

¹¹⁰Shirk, *The Political Logic of Economic Reform*.

¹¹¹Edward Shils, *Centre and Periphery: Essays in Macrosociology* (Chicago: University of Chicago Press, 1975), p.xxxi.

¹¹²*Ibid.*, p.3.

¹¹³*Ibid.*

¹¹⁴*Ibid.*

call the central value system of the society...*It is central because it is espoused by the ruling authority of the society....*One of the major elements in any central value system is an affirmative attitude toward *established* authority."¹¹⁵ (emphasis added) Shils thereby links the "central zone" to the ruling authority of the society. In so doing, the identification of the "central zone" with the national government, which is undoubtedly the most established ruling authority in modern societies, and above all of a political system, is perhaps inevitable.

This in turn has profound significance in terms of how the central-provincial relationship is understood. As the "central zone", from where values flow to the periphery, the central government is by definition the source of authority and the originator of policies. The provinces, as the "periphery", are the object of rule and of integration by the Centre. The occurrence of noncompliance signals the refusal of the "periphery" to integrate with the "centre" and is a deviational and dysfunctional phenomenon, leading to a "weakening" of the capacity of the "centre" to govern. Any notion of local autonomy in this analytical framework is thus anomalous. To the extent that autonomy assumes some kind of legitimacy and independence of discretions by the lower-levels, there is no place for local autonomy in this conception of the political system.

The provincialist perspective of this study, therefore, seeks to avoid the pitfalls of the assumption regarding the locus of the "central zone" in the existing literature. By focusing research attention on the behaviour and choices of provincial actors, this perspective seeks to highlight the activism in parts of political system other than the national Centre. Specifically, it calls attention to the possibility that **the province, as well as the national Centre, could be the "central zone" of values, beliefs, and actions. Provincial autonomy is not some kind of residual category which exists beyond the reach of the Centre.**¹¹⁶ It is the product of compromise between the Centre and provinces based on the insurmountable power of both over the other. It is noteworthy that previous works have noted the multiplicity of "centres" within the political system, the loci of "centre" shifting according to the arising issues, and that the lower-level units of the state could be, and have been, the "fountain of political ideas and administrative

¹¹⁵Ibid., pp.3-5.

¹¹⁶So should be the case of the power of the society in the state-society paradigm. However, most works in the state-society paradigm have assumed a statist perspective, and tend to regard the state as the "centre", and the society as the "periphery" in a centre-periphery analytical framework. Shue's analysis of state-society relations in Maoist China is an example of this assumption. See Vivienne Shue, *The Reach of the State*, pp.42, 54-69.

techniques".¹¹⁷ A provincialist perspective facilitates a better elaboration of these insights and observations, and, consequently, a deeper understanding of their significance.

Clarifications and Definitions

The Centre

Unless otherwise specified "the Centre" in this study means the national-level government vis-a-vis the subnational levels. The central actors in this study of central-provincial relations are primarily the State Council, and the various central government ministries and agencies subordinated to it. Given the heterogeneity of interests amongst these constituent units of "the Centre", the concept of "the Centre" does not assume the existence of a unified entity acting coherently in its interaction with the provinces. Rather it is acknowledged that there are often contradictions and inconsistencies in the instructions and guidelines issued by different central actors to the provinces, adding to the complications to the central-provincial relationship. In fact, provinces have often benefited from such inconsistencies within the Centre by playing one central actor against another, thus advancing further their interests. Accordingly, the locus of "the Centre" shifts according to contexts and issues being discussed, since a different policy matter involves a different group of central actors. When the context of discussion is non-specific, "the Centre" in this study generally refers to the top central leadership of the State Council.

The Province

"The province" means the provincial-level government, including provinces, provincial-level municipalities, and autonomous regions. Specifically, "the province", as in the case of "the Centre", refers basically to the provincial leadership. In a similar heterogeneity to that of "the Centre", "the province" is composed of various provincial departments and agencies. Horizontally there are numerous provincial departments; vertically the choices and preferences of the "provincial-level" are in part a function of the choices and preferences of the subprovincial levels, i.e. the cities, counties and townships. Within each provincial

¹¹⁷Lynn White, "Local Autonomy in China", p. 490. On the multiplicity of centres, see Ferdinand, "Interest Groups and Chinese Politics", p.21. On Guangdong and Shanghai serving as the sources of inspirations for national economic reform policies in the post-Mao reforms, see Jia Hao and Lin Zhimin (eds.), *Changing Central-Local Relations*, p.5.

department there is also a heterogeneity of actors, from the head of department to working-level officials. However, as in the case of the Centre, there is a hierarchy amongst the actors of the province, and it is possible to speak of the province as a single actor in its relationship with the Centre. The heterogeneity of the province forms part of the story of how strategies and courses of actions are formulated in its relations with the Centre.

The Subprovincial-Level Actors

The subprovincial levels enter this study as variables that help to explain behaviour at provincial level. These actors include the subprovincial levels of *government*, namely, the city, the county, and the township. They also include the actors in the semi-governmental sectors: the state enterprises (budgetary or extrabudgetary) and the collective enterprises. The dominant role of the state in the public sector, and in the economy in general, enables us to regard state and collective enterprises in the province as part of the state at sub-provincial levels. In particular, this study shows how the extrabudgetary sector has enabled the Guangdong and Shanghai governments to outmanoeuvre the Centre in respect of revenue and investment policies. Moreover, as a result of extensive subdelegation of investment authority and decentralization of fiscal resources to the subprovincial levels of government, Guangdong's Provincial Government has been able to sustain a rapid growth of investment in the face of repeated pressures to contain investment from the Centre.

In existing literature on Chinese politics the term "local" has been used to refer to different subnational levels of government. Depending on the level of analysis of the study, the term "local government" could mean the provincial-level, or the more grassroots level of county or township, and sometimes of the village. The former has the predominant usage in literature on central-provincial relations within China, or literature written by Western-trained scholars from the Mainland. The identification of the term "local government" or, in Chinese, "*difang*", with the provincial-level as opposed to "the Centre" or, in Chinese, "*zhongyang*", reveals the importance of the provincial-level government in China's spatial politics as accorded by Chinese scholars. Conversely, the more frequent use of the term to refer to the grassroots level of government amongst Western scholars reflects their greater interest in the interface of the state and the society at the grassroots level.

To avoid confusion about the referent of the term "local", this study seeks to avoid its use as far as possible. Wherever possible more specific terms such as

"provincial-level", "subprovincial" and "municipal" are used. The term "lower level" is often used to refer to subprovincial levels of government in the context of discussion within the province and, at times, to all subnational levels generally when it is used as opposed to the central level. However when discussing fixed asset investment in Guangdong and Shanghai, as well as nationally, the usual usage of central as opposed to local investment will be followed. This also applies to the discussion about "local" fiscal revenue in the two areas. In both cases "local" means "provincial/municipal", as a whole, encompassing the subprovincial grassroots levels, rather than referring to the grassroots levels only.

Methodology

The research design of this study is detailed in the Introduction chapter. This last section of Chapter One describes the methods of data collection as well as some observations made during the process. Documentary research was done in the Universities Centre, the Chinese University of Hong Kong, where there is a comprehensive collection of provincial newspapers, periodicals, monographs and reports from China. A substantial portion of the materials for the case studies was also obtained in the field.

The documentary materials used in this study can be classified into five general types: (1) national and provincial newspapers; (2) monographs and edited volumes; (3) national and provincial periodicals; (4) statistical information; (5) policy documents, rules and regulations, as well as records of central-provincial communications. All are important in shedding information, from different angles, on central-provincial relations regarding fixed asset investment.

In general information drawing from newspapers serves both to sensitize the author to the pertinent issues on the subject at an earlier stage of the research, as well as providing data on a specific aspect. At times the information from the newspapers is very important and revealing. In an example, the Guangdong government articulated their oppositions in a provincial newspaper in early 1989 to the central restrictive measures imposed during the retrenchment started in late 1988.

Monographs and edited volumes span diverse topics and cover materials written by authoritative figures including senior officials in the provincial and central governments and research reports and views espoused by individual scholars. In general, they are important in providing detailed information on

pertinent topics such as the administration system of fixed asset investment, the "problems" regarding the implementation of investment policies and reforms to the various relevant economic management systems nationwide and in the two provinces. Apart from books shedding light on the institutional context of central-provincial relations and the implementation of investment policies, often from a centralist perspective, there have also been an increasing flow of books written from the provincialist perspective. These books, sometimes written and published by senior official sources in the provinces, themselves represent the efforts *par excellence* by the provinces to influence the agenda of discussion in the nation over their work. This kind of "lobbying" publication is particularly prevalent in Guangdong since the late 1980s.

Periodicals published by relevant national and provincial units have provided probably the most important source of documentary information in terms of its scope and depth. Since nearly all major government units in the Chinese government publish their own periodicals, this source provides invaluable information regarding the most up-to-date situation in the relevant areas. For instance, the periodicals published by the provincial finance bureaux of the Guangdong and Shanghai governments, as well as by the Ministry of Finance in Beijing, give detailed and revealing information regarding the fiscal system and its operation nationally and in the two provinces. Similarly, there are the periodicals by the provincial as well as national statistical bureaux providing statistical information and analyses regarding the implementation of fixed asset investment and the economic situation in general. The periodicals by the national and provincial-level planning commissions provide information regarding the deliberations on the planning system, as well as more general and comprehensive economic management concerns of the national and provincial government. The periodicals by the national and provincial commissions on economic system reform or by other senior "think tank" units provide information regarding the latest thoughts and plans about reforms, as well as in-depth reviews of the implementation of previous reform measures. The periodicals by the national and provincial banks provide information on finance as well as investment, while periodicals by the audit bureaux illuminate the channels whereby provincial and lower-level governments use to maximize locally retained revenue. The authors of articles in these periodicals are usually officials of the units publishing the periodicals, and their articles constitute some kind of reports of their work. A careful combing of these sources can in fact startle the researcher as to the amount as well as richness of information which is available for public scrutiny within this ostensibly "closed" political system. Although some of the periodicals are stamped

as "internal" (neibu) publications, they are nevertheless openly available in public libraries in the country, for instance, in the National Library in Beijing. In fact, as the macro environment becomes more liberalized, more and more "neibu" periodicals are being turned into "open" publications.

Statistical information on fixed asset investment and fiscal finance is important to this study of central-provincial relations since objective information of this kind provides the necessary context for the interpretative discussion of central and provincial manoeuvres and counter-manoevres. Such information is found in openly published national and provincial statistical yearbooks, as well as in various diverse sources. In general, statistical information on fixed asset investment and, to a less extent, on fiscal finance, abounds, but more specific information, for instance, that on the flows of central investment funds to provinces, and vice versa, is less readily available. However, specific information of this kind is of pertinent interest to this study of central-provincial relations. In this respect, more information has been found in the field regarding Guangdong as opposed to Shanghai.

The last, but not the least, type of documentary information is information on relevant national and provincial rules and regulations, as well as on central-provincial communications. There are a good number of published compendia of national and provincial rules which provide the basic framework of formal policies regarding the operational environment of the two provincial governments. In general information of this kind is quite adequate. Regarding information on central-provincial communications, however, information is more scant. This is, however, a very important area since this points directly at the interface of central policies and provincial discretions. A detailed record of central-provincial communications also illuminates the process of central-provincial bargaining and how deals have been struck. The utility of this kind of source is illustrated by the four volumes of records of central-Guangdong communications between 1979 and 1987, compiled by the Guangdong authorities, and available in the Universities Services Centre, Chinese University of Hong Kong. The availability of this important source on Guangdong enables this study to break through much of the "black box" in the process of interactions between the central and Guangdong leaders. No similar information on Shanghai is, however, available.

Whilst these documentary materials have been very important in providing information for this study, interviews conducted in the field with central and provincial officials of Guangdong and Shanghai are equally important and

revealing. The interviews have been important in four aspects. First, some important documentary materials which were otherwise unavailable have been obtained only through the interviews. Second, the interviews enabled the author to clarify, confirm or elucidate information contained in documentary materials. Third, discussions in interviews alerted the author to pertinent documentary information which would otherwise remain "buried" in the vast quantities of materials. Fourth, interviews produced new information which was not available in the documentary materials. An important area of information which has relied heavily on interviews is the process of central-provincial bargaining and interactions. Another important area concerns the factors of consideration of and strategies used by the provincial governments in handling their relationship with the Centre. Interviews were also pertinent to understanding the "grey areas" of legitimacy regarding provincial discretionary behaviour, through, for instance, getting information from central respondents regarding the "informal" interpretation of formal central rules and policies.

I made three trips to Guangzhou, the provincial capital of Guangdong, in 1993, and two to Shanghai in 1994. From October 1993 to August 1994 I lived in Beijing and was able to carry out a good number of interviews with the relevant authorities. Altogether there have been about 50 face-to-face interviews with over 40 different individuals, supplemented by shorter, follow-up telephone conversations. On the whole, the officials I contacted were very helpful. The level of contact is mostly at the middle level of the hierarchy in a government department. Although there were no interviews with mayors, governors or ministers, I did not find this at all inhibiting to my research. Officials I interviewed generally had a very good knowledge of how policies were worked out and implemented. As the ones who were actually responsible for the "implementation" of policies, they provided details of how the system actually worked. This is especially valuable for this study, whose focus is on what actually happens on the ground.

Getting to the apex of the provincial-level government may, however, reveal more about the details of dynamics during provincial bargaining with the Centre. The fact that no interviews were held with a mayor, governor, or party secretary does put certain limitations on this study. However, it is unlikely that provincial leaders would want to reveal their bargaining details to an outsider. To do so would both embarrass and annoy the Centre, or, should it have lost in its past

bargaining with the Centre, cast the province in a poor light.¹¹⁸ It is therefore the speculation of the author that more information on this aspect is limited in the foreseeable future.

In Guangdong I was able to conduct interviews with officials involved in planning, finance, statistics, audit, tax, land administration, and banking, as well as with members of the local academic community. The ranks of officials interviewed ranged from the division-chief level to section-level of a provincial department. Impressions gathered from these interviews suggest the development of a fairly open attitude within the provincial bureaucracy. Officials were mostly frank and willing to talk, although their sensitivity was apparent as regards the need for confidentiality. However, in general Guangdong's officials displayed a sense of independent judgement regarding the boundary of confidentiality, and appeared to feel quite comfortable and confident in taking discretions. In a few cases, I was able to obtain interviews through direct calls to the relevant departments without any formal introduction from other official units. The Guangdong government appears to be operating like any government bureaucracy in terms of its openness, albeit at an earlier stage of development.

In Shanghai, interviews covered officials from streams spanning finance, planning, Pudong administration, banking, policy research, as well as members of universities and independent researchers in the burgeoning "private sector" of research-consultancy. The range of rank of the officials is similar to that of Guangdong. Shanghai's officials were, however, generally more cautious than their Guangdong counterparts. They showed less willingness to take discretions over the dissemination of information. However, there were exceptions and, in general, their caution did not mask their intellectual capacities or their ability to reflect and analyse. As long as one could break the ice, they were willing to talk and a few were particularly helpful. Shanghai's officials often had rather strong feelings concerning their relationship with the Centre. They were also inclined to compare

¹¹⁸Information about bargaining details was considered sensitive and highly confidential by both the Centre and the provincial governments concerned. An example is the annual control figures of fixed asset investment the Centre (via the State Planning Commission) strikes with each provincial government every year as a central control instrument of the level of total investment in the localities. The Centre wanted to keep the information confidential not because of any concerns of national security considerations, but because the Centre would not like provinces to know how others had fared, so as to avoid the situation that one province might exert pressure on the Centre based on what the Centre had or had not done to other provinces. (Respondent No. 29, Beijing interview, May 1994) Similarly, provinces normally took a low profile about their successes in gaining concessions from the central government so as not to embarrass the Centre and avoid other provinces from learning from their "tricks" and strategies. (Respondent No. 9, Guangzhou interview, December 1993).

their situation with that of Guangdong, pointing out the preferential treatment Guangdong had received ahead of them and to the prospect of Shanghai overtaking Guangdong in the near future. In some aspects, the latter was regarded as already accomplished.

Interviews in Beijing focused on more or less the same group of institutions. These included finance, planning, audit, policy research, law, and the universities. The range of the rank of officials is similar to the case in Guangdong and Shanghai. Most were of the division-chief rank, with some of a higher and some of a lower rank. The purpose of the interviews was to obtain information on the Centre's side of the story. The focus of the interviews was three-fold. First, questions were asked regarding information on relevant central policies, especially those "informal" policies which existed beyond the letters of the formal rules and regulations. These usually involved interpretations of the formal rules which were adopted by the central officials in their interactions with the provinces, and were material in defining which specific discretionary actions by provinces were tolerated or considered deviant by the Centre. Second, questions were directed to obtain the Centre's assessment regarding the implementation of relevant central policies by the Shanghai and Guangdong governments, and by other provinces in general, and the difficulties which the Centre had experienced in imposing its will. Third, questions were asked regarding the Centre's previous actions, as well as existing and future plans of action, in view of the above difficulties caused by the provinces. Questions were also asked on the process of bargaining between the Centre and the provinces.

In general the interviews in Beijing were very useful in shedding light on the difficulties experienced by the Centre in imposing their will on the provinces. But officials at the Centre generally did not know much about the workings of provinces. Except for those who had previous experience of working in the provinces, most respondents elaborated on the difficulties of the Centre and the contradictions of the existing system. Moreover, most respondents from Beijing appeared to have adopted an implicitly centrist perspective. Some were adamant that the provinces should be reined in for their "unscrupulous" behaviour. Others were more resigned to provincial power and unruliness. Officials at the Centre were obviously, and understandably, more involved in the power and predominance of the Centre than were officials in Shanghai and Guangdong. Some even expressed a conspicuous sense of cultural or intellectual superiority over the provinces. As a result they expressed a predisposition to exerting control in a traditional way, although they also recognized that any such attempt would

probably be futile. On the occasions when such attempts have failed, they have had no option but to work out alternative measures together with the provinces. The *affective inclination* of central officials is, therefore, for centralization and control, but this is an increasingly impossible task, now that the provinces have accumulated power as a result of the successive decentralization programs by the Centre. The overall impression that arises from the interviews is: the forces of "qualitative" change in the relations between Centre and provinces, from one of fragmentation to legitimate autonomy, reside more within the provinces than within the Centre. The Centre is, more and more, being forced to seek compromise with the provinces.

Fixed Asset Investment Administration: Decline in Central Control

As a developing country, the channelling of investment resources has been a major task for the government of the People's Republic of China. Regardless of changes in their political agenda, the Chinese leaderships have, since 1949, sought to build up the economic strength of the country by increasing investment. Therefore while before 1976 the central leaders were preoccupied with social transformations and political struggles, various investment programmes had nevertheless been launched, irrespective of political rhetoric.¹ For the periods of 1953-57, 1958-60, and 1971-75, the percentage of capital construction investment expenditure within the total national budget reached 37.1%, 55%, and 40.2% respectively. From 1950 to 1978, the average percentage was 35%, whilst the peak figure for a single year stood in 1958 at 56%.² When the national agenda was shifted to modernization and economic development in 1976, and after the Third Plenum in 1978 particularly, the linkage between investment and the attainment of the national goal became still more direct. However, as a result of the decentralization reforms of the 1980s, the percentage share of investment expenditure, as part of the total national budgetary expenditure, has, ironically enough, declined conspicuously. For instance, in 1979 the share stood at 40.4%. However, by 1991 it had more than halved to 19.4%. Investment has, nevertheless, remained the largest expenditure item in the state budget.³

The importance of investment within the agenda of the post-1949 Chinese government makes it an ideal medium through which to observe the dynamics of political processes, and specifically, of the processes between the central and provincial governments. Both the Centre and the provinces have been heavily involved in investment decisions. The decline of investment expenditure as a proportion of the total fiscal expenditure since the 1980s by no means denigrates its importance as a function and a task of the Chinese state. It rather reflects the changes in the relationship between the central and the provincial governments

¹These include, for instance, the industrial construction projects of the First Five-Year-Plan period (1953-57), the campaign to increase steel production capacity during the Great Leap Forward in 1958-60 and the construction of the "Third Front" industries from the early 1960s to the 1970s. Of course, very often these economic projects form part and parcel of the political campaigns, the most spectacular being the industrial projects during the Great Leap Forward.

²Calculated from Ministry of Finance (ed.), *China Finance Statistics, 1950-1991* (Beijing: Science Press, 1992), pp.116-19. The average percentages are arrived at by averaging the annual percentage shares.

³*Ibid.* By 1991, however, the expenditure on education, science and health had caught up and, at 18.6%, was only marginally below the share of capital construction investment.

over investment since the reforms in the 1980s.

In this respect, Barry Naughton has documented the inability of the Centre to impose its will on investment, which has increasingly become an "internalized", and thus independent, activity of subnational governments.⁴ Decentralization of investment administration had been intended as a *means* and a strategy through which to encourage subnational governments to develop the local economy and facilitate the implementation of the Open Door Policy. Decentralization was, in itself, never the *objective* of the Centre's reform program.⁵ However, in practice, the reform has resulted in a significant dispersion of investment resources and authority from the Centre to the provinces and below. Two processes were at work to result in this "unintended outcome". The first is the "implementation bias" of subnational governments, whereby they tilt central policies in their own favour, and the second is the political difficulty involved in challenging what is, on the whole, in the vested interests of the system. According to Naughton, this development has led to a major shift in the balance of power between the Centre and the provinces since the 1980s.

This chapter looks into this dispersion of investment resources and authority on a national level. The dispersion at a provincial level, within Guangdong and Shanghai, will be discussed as case studies in Chapters Three and Four respectively. This chapter has specifically two purposes. The first is to state and provide a working definition of the main investment problems in the context of this study: central-provincial relations. The second is to examine and explain this problem. The structure of this chapter is accordingly organized into two major sections: (1) disaggregating the investment problem; and (2) explaining the phenomenon.

⁴See Barry Naughton, "The Decline of Central Control Over Investment in Post-Mao China", in David Lampton (ed.), *Policy Implementation in Post-Mao China* (Berkeley, University of California Press, 1987), pp.51-80. By "internalised" activity, Naughton means (p.75) that the local governments as a result of the reforms in the 1980s are controlling most resources needed to plan production and investment. As a result the Centre is increasingly at a loss to find adequate devices with which to control the localities. Naughton later qualifies some of his conclusions in a 1992 article, when he notes that the Centre is also developing more sophisticated instruments with which to improve its grasp of information and enhance effective and efficient information flows between the Centre and the localities. See Naughton, "Hierarchy and the Bargaining Economy: Government and Enterprise in the Reform Process", in Lieberthal and Lampton (eds.), *Bureaucracy, Politics and Decision-Making in Post-Mao China* (Berkeley, University of California Press, 1992), pp.245-79.

⁵See Naughton, "The Decline of Central Control", p.51.

Disaggregating the Investment Problem

A prerequisite for analysing central-provincial interactions in investment policy is that of assessing the Centre's control over (1) the total amount of investment, and (2) the direction and allocation of investment resources. Concerning the former, the Centre has, since the reform period, failed to exercise effective control over the total amount of fixed asset investment made each year. In the process of investment planning and implementation since 1979, the annual planned quotas of total investment as applied to the provinces, described by Chinese economists as "central control figures", have, as a rule, been surpassed rather than observed. The amount of investment implemented in a province over and above the prescribed annual quotas of total investment scale---the "central control figures"---is described as "excess investment" in this study. Regarding the second aspect, the Centre has since the 1980s been unable to control the allocation of investment resources. As a result of the decentralization reforms, as will be noted later in this and the case study chapters, the power to allocate investment resources has been effectively dispersed amongst numerous other actors at provincial and lower-levels. Consequently, a sizeable portion of investment resources have been used in projects which, from the perspective of the Centre, bring only dubious benefits to the national economy as a whole.

Underlying the concern over total investment scale and the allocation of investment is concern over the efficiency of investment. The Centre has often, publicly, blamed excess investment at provincial level for causing "overheating" in the economy, and for constraining the supply of raw materials to more desirable projects. However, in reality the fundamental concern of the Centre is that a substantial portion of investment taking place in the provinces has been spent on projects regarded by the Centre as being of questionable benefit from the national perspective---that more investment might result in more waste.⁶ In other words, concern over the scale of investment in practice has *subsumed* and *presupposed* the concern over investment direction and efficiency.⁷

⁶In a survey by the Construction Bank of China on the 275 medium-large sized capital construction projects completed between 1984 and 1986, it was discovered that overspending amounted to 28% of the total original estimates. A total of 174 projects did not attain the originally designed production capacity --- 74% of the total number of projects. 206 projects, or 87.7% of the total, spent more than they were originally budgeted. 70% of this overspending is attributable to mismanagement and faults in the original plans while the remaining 30% may be due to inflationary factors or upward adjustment of spending standards of the original plans. See Wang Haibo (ed.), *Zhongguo Guomin Jingji Gebumen Jingji Xiaoyi Yanjiu* (A Study of the Economic Efficiency of the Various Sectors of the Chinese National Economy) (Beijing: Jingji Guanli chubanshe, 1990), pp.430, 432.

⁷There are, broadly speaking, two schools of thought among economists in China on what is the

That the total scale of investment *per se* is not the issue is supported by the fact that during some historical periods exceeding the planned quotas of investment was regarded as a good and positive phenomenon. This was particularly so in the case of the First Five-Year Plan period between 1953-57, when surpassing the planned targets of production and investment was considered as a positive economic achievement.⁸ Investment efficiency was, at that time, relatively high and the direction of investment was basically controlled by the Centre. Since then, however, investment has gradually moved away from the control of the central government, and the efficiency of projects has declined.⁹

The decline of central control over investment, therefore, refers to the Centre's inability to direct appropriate levels of investment resources to those

major issue in investment. The more predominant school places emphasis on the *scale* of investment, and argues that excessive demand for investment relative to resources available is the major problem. The other school focuses directly on the inefficiency problem of the supply side, and argues that the major problem as it exists rests with the *inefficiency* of investment decisions rather than the level of investment *per se*. It is clear that in the first school, the efficiency issue is in fact assumed and taken for granted. The line of argument becomes that, given that there is inefficiency, if there is less investment, there is less waste. Examples of the former school, the "demand generated" theory, are Wu Xiaoqiu (ed.), *Jin Yunxing Lun* (On the Tight Operation) (Beijing: People's University of China Press, 1991); Fan Gang et al., *Gongyouji Hongguan Jingji Lilun Dagang* (A Sketch of the Macro-economic Theories Under a Public Ownership System) (Shanghai: Shanghai United Bookstore Press, 1990). For discussions on the "excessive" accumulation ratios and the search for a proper level of accumulation, see for instance Wang Haibo, "Guanyu Woguo Jilei Yu Xiaofei Bili Guanxi de Chubu Fenxi" (On the preliminary analysis of the relationship of the accumulation ratio and consumption ratio in the PRC.) *Zhejiang Xuekan*, No. 1 (1981), pp.13-27. For a full-fledged exposition of the latter school, the "supply inefficiency school", see Wu Ruyin, *Economics of Inefficiency: The Theory of Centrally Planned Economy Reconsidered*. 1992. Yang Linfeng criticised the "demand school" for exaggerating the inflationary effects of investment, while neglecting the contribution of additional investments to increasing effective supply in his "Woguo Guding Zichan Touzi Chanchu Xiaoying" (The efficiency of fixed assets investments in China), *Touzi Lilun yu Shijian* (Theory and Practice of Investment), No.1 (1989), pp.20-22. Sun Yonghong and Geng Qingjun argue that the scale of investment between 1979-88 was not excessive in their joint-authored article, "An Assessment of the Yearly Investment Scale Between 1979-1988", *Investment Research*, No. 3 (1990), pp.19-24. For a debate between the two competing schools, see Wu Jiang and Wang Yongjun, "Touzi Buzu" (Insufficient Investments: A Harsh Reality), "Touzi Buzu Bulun" (The Theory of Insufficient Investments: A Supplementary Argument), *Investment Research*, No. 8 (1988), pp.6-11, and No. 8 (1989), pp.17-21; and Fan Yifei and Zhang Hejin "Bo Touzi Buzu Lun" (Refuting the Theory of Insufficient Investments), *Zhongguo Touzi Guanli* (China Investment Management), No.11 (1988).

⁸This attitude is obvious in Xie Minggan, and Lou Yuanming (eds.), *Zhongguo Jingji Fazhan Sishi Nian* (Forty Years of Economic Development in China) (Beijing: Renmin chubanshe, 1990), pp.170-71. When discussing the investment over the decades of the People's Republic, excess investment beyond the targets of the First Five-Year Plan was regarded as a successful "victory", while excess investment in later periods were described as causing wastage and reflecting the loss of central control.

⁹For an authoritative discussion of the investment efficiency issue of the various periods by the State Planning Commission, see Lin Senmu, and Jiang Guangxin (eds.), *Zhongguo Jiben Jianshe Gongzuo Shouce* (Handbook of Capital Construction Investment in China) (Beijing: Fazhan chubanshe, 1992), pp.653-62. Altogether seven indicators were identified through which to reflect investment efficiency. The First Five-Year Plan period has the highest rating for most of the indicators.

sectors it sees fit. It refers also to their consequent inability to ensure that waste is minimized at the level of project management. However, as will later be noted, the failure of the Centre in these issues of efficiency and allocation is one endemic to the socialist system of public ownership and the economic management system. Short of more fundamental changes to the system, this failure is likely to remain a relatively constant phenomenon.

However, since the question of efficiency and allocation is, as noted above, subsumed in the concern over the quantity of investment, it is possible, in this study, to take the scale of investment as the *operational* indicator of the level of discrepancy between central investment policy and provincial investment implementation.¹⁰ In other words, **the extent of excess investment over and above the central control figures is a measure of the level of provincial non-compliance regarding the Centre's policy on investment.** This measure has two major advantages. First, it is a relatively simple indicator amenable to measurement and comparison across provinces; whereas taking as an indicator the level of inefficient investment is more difficult to ascertain and more subject to dispute.¹¹ Second, in the absence of a more precise measurement of efficiency levels, it may for the time being be assumed that the level of investment across provinces is fairly similar. The scale of investment and the extent of excess investment can thus be presumed to subsume the question of efficiency. Throughout this study, therefore, the efforts of the provincial leaderships to increase the *quantity* of investment will be the focus of analysis. The issue of investment direction is assumed to have been subsumed in the discussion over quantity and will not, therefore, be analysed at length.

Successive Excess Investment: Loss of Central Control

As the operational indicator, the scale of investment presents a picture of investment over and above centrally prescribed quotas during successive years of the 1980s and, therefore, an unambiguous decline, if not a total loss, of central control. A report on investment by the State Planning Commission so describes the

¹⁰It should be reemphasized that the choice of operational indicator does not mean that the author is supporting the "demand generated theory" of the problem of investment and the economy. The concern here is to find a relatively simple and easily amenable indicator to measure and reflect the extent of non-compliance of provincial governments *vis-a-vis* central orders on investment since the 1980s, and then to analyse the behaviour of the provincial governments in how they can manage to do so.

¹¹This is reflected in the discussion on investment efficiency in Lin Senmu and Jiang Guangxin (eds.), *Handbook of Capital Construction Investment in China*. Multiple indicators do not always tally with one another and this injects an element of indeterminacy and ambiguity over the *exact* level of efficiency of investment for a year.

situation: "Over the years there have been very obvious gaps between the amount of investment planned and that eventually spent. In practice, the value of investment completed each year was, almost invariably, in excess of the value in the plan."¹² Table 2.1 below shows the extent of excess investment over and above centrally prescribed quotas:

Table 2.1

<u>Period</u>	<u>Excess Investment in Total Investment¹</u> <u>(Billion Yuan)</u>		
	<u>Quotas²</u>	<u>Actual Investment</u>	<u>Excess Investment (%)</u>
1981-85	360 ³	532 ³	47.8
1986-90	1296 ⁴	1974 ⁵	52.3

Notes and Sources:

1. Figures for 1981-1985 cover investment in the state sector only; those for 1986-1990 also include the non-state sector.

2. Figures for both periods are quotas originally prescribed at the beginning of the five-year plan periods, prior to amendments and adjustments being made in the interim.

3. See Xie Minggan and Lou Yuanming (eds.), *Zhongguo Jingji Fazhan Sishi Nian* (Forty Years of Economic Development in China) (Beijing: Renmin chubanshe, 1990), p.187.

4. Ibid., p.189.

5. See State Statistical Bureau (ed.), *Statistics on Investment in Fixed Assets in China, 1990-1991* (hereinafter *Statistics on FAI (Year)*) (Beijing: Zhongguo Tongji chubanshe, 1993), p.19.

Table 2.1 shows the total value of investment completed as being roughly 1.5 times that of the value originally set by the Centre as the limit. In fact, not only were the quotas successively surpassed, the Centre was also often forced, in the middle of the financial year, to revise and raise the limits originally set by the planned quotas. In this way a portion of the excess investment and deviations of the provinces has been recognized as legitimate and "legal". Table 2.2 gives more details to the picture:

¹² See State Planning Commission, Investment Research Institute, and the State Statistical Bureau (eds.), *China Investment Report, 1991*. (Beijing: Zhongguo Jihua chubanshe, 1991), p.18.

Table 2.2

Excess Investment in Total Investment¹: Original and Adjusted Quotas

<u>Year</u>	<u>Quotas</u>	<u>(Billion Yuan)</u>	
		<u>Actual Investment</u>	<u>Excess Investment (%)²</u>
1981	(30)38 ³	44.3 ⁴	(47.7)16.6
1982	(38)44.5 ⁵	55.6 ⁴	(46.3)24.9
1983	(36.2)58 ⁶	59.4 ⁴	(64.1)2.4
1984	65 ⁷	74.3 ⁴	14.3
1985	(140)150 ⁸	168.0 ⁴	(20)12
1986	228 ⁹	302.0 ¹⁰	32.5
1987	287 ¹¹	364.1 ¹⁰	26.9
1988	330 ¹²	449.7 ¹³	36.3
1989	n/a	413.8 ¹³	n/a
1990	455 ¹⁴	444.9 ¹⁵	-2.2
1991	500 ¹⁶	550.9 ¹⁵	10.2
1992	570 ¹⁷	785.5 ¹⁸	37.8
1993	800 ¹⁹	-	-

Notes and Sources:

1. Total investment refers to total "societal investment"¹³ which comprises investment both inside and outside of the state sector. However the coverage of the quotas was only extended to the non-state sector from the mid-1980s. The figures in the table correspondingly have different coverages: 1981-1984---all figures refer to capital construction investment in the state sector; 1985---investment in the state sector; 1986 onwards, total investment comprising the non-state sector.

2. The excess investment percentages are calculated from the figures in the other two columns of the table. For some years the original figures of the quotas and the subsequently adjusted figures are available. The original quotas, and the corresponding excess investment percentages, are listed in brackets. Figures for the other years are presumably adjusted figures of the quotas.

3. See Xie Minggan, Lou Yuanming (eds.), *Forty Years of Economic Development*, p.187.

4. See *Statistics on FAI (1950-1985)*, p.9.

5. See report on the "1983 National Economic and Social Development Plan", in *Nanfang Ribao*, December 20, 1982.

6. See the "Report of the Sixth Five-Year Plan", in *Nanfang Ribao*, November 30, 1982.

7. See the "Report on the 1984 National Economic and Social Development Plan Bill", in *Nanfang Ribao*, May 16, 1984.

8. See Wu Jinglian and Wu Ji (eds.), *Zhongguo Jingji di Dongtai Fenxi he Duice Yanjiu* (An Analysis of the Dynamics of the Chinese Economy and Some Solutions) (Beijing: People's University of China Press, 1988), p.38.

¹³The concept, "societal investment", refers to all investment in a defined geographical jurisdiction irrespective of the ownership relations of the units responsible for the investment, or the funding channels of the investment. It is a standard statistical measure in official statistical yearbooks. The concept is a product of the economic reforms of the 1980s. Prior to the reform, investment was basically monopolized by the state sector and most projects were included in the state investment plan. The concept "societal investment" was, therefore, then nonexistent. Since the 1980s more and more investment was conducted outside of the state sector and, in particular, outside of the state plan. It has therefore been necessary to have a new concept through which to measure the total value of investment that takes place on the ground. Since then, the value of societal investment for the pre-1980 years has been reconstructed and published in statistical yearbooks.

9. Calculated from data on total investment completed and the amount of excess investment. For the former source see Note 10 below. For the latter see *China Capital Construction*, No.10 (1988), p.14.
10. See *Statistics on FAI (1986-1987)*, p.12.
11. See *China Capital Construction*, No.2 (1988), p.9.
12. See *China Investment and Construction*, No.3 (1989), p.22.
13. See *Statistics on FAI (1988-1989)*, p.13.
14. Calculated from State Planning Commission and State Statistical Bureau (eds.), *China Investment Report, 1992* (Beijing: Zhongguo Jihua chubanshe, 1992), p.1. The figure is the quota in the adjusted plan.
15. See *Statistics on FAI (1990-1991)*, p.16.
16. See *China Investment Report, 1992*, p.1. See also Ma Hong and Sun Shangqing (eds.), *Economic Situation and Prospect of China, 1991-1992* (Beijing: Zhongguo Fazhan chubanshe, 1992), pp. 2, 207.
17. See Ma Hong and Sun Shangqing (eds.), *Economic Situation and Prospect of China, 1992-1993* (Beijing: Zhongguo Fazhan chubanshe, 1993), p. 207.
18. See *Statistical Yearbook of China 1993*, p.146.
19. See *Ming Pao* (Hong Kong) October 30, 1993, p.13, quoting the vice-director of the Construction Commission for the Three Gorges, Guo Shuyan.

Table 2.2 shows that during the four years for which the original and revised planned quotas are available, quotas were usually revised substantially upwards in order to approach the level of the actual value of investment. Consequently, after the revisions, percentages of excess investment could often be slashed by more than half. In 1983, to cite a more conspicuous case, the planned quota was revised upwards by 60%. As a result the percentage of excess investment was reduced from the original 64% to a negligible 2.4%. This demonstrates the success with which provincial governments could make the Centre adjust its criteria of control and legitimize what would otherwise have been illegitimate. However, the fact that the extent of excess investment often remains substantial, even after the central control figures have been significantly revised upwards, reflects again the ineffectiveness of the Centre's control over the level of investment undertaken in the provinces.

The statistics above indicate the discrepancy between that which is prescribed by the Centre and that which is eventually achieved. Whilst central government ministries who, themselves, also implement investment, are responsible for part of the excess investment, the trend since the 1980s has nevertheless been that provincial governments have been the more important actor in the investment scene. Consequently, that which is reflected in the statistics measures, to a large extent, the extent of non-compliance of provincial governments. Table 2.3 below shows the percentage of total investment which is basically the result of investment decisions by the central government.¹⁴

¹⁴The table is adopted from State Planning Commission and State Statistical Bureau (eds.), *China Investment Report, 1992*, p.30. The "central government" here refers to both the State Planning Commission and projects by the central ministries.

Table 2.3

Percentage Share of Centrally Decided Investments in Total Investment (%)

<u>Year</u>	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
<u>Share</u>	41	34	40	32	36	32	31	32	30	32	33

Notes:

1. Centrally decided investments cover (1) those capital construction and technical renovation projects in the state sector which are under the subordination of the central ministries, in other words, central capital projects; (2) those "above ceiling" locally subordinated capital construction and technical renovation projects, thus requiring the approval of the State Planning Commission at the Centre.

2. From 1979-1984 the "ceiling" was 10 million yuan; from 1985 to 1990 it was 30 million yuan.

3. The value of the second part, that is local projects which are above the ceiling, is estimated by taking 35% of the total value of medium-large sized projects in the state sector for 1980-1984, and 25% for 1985-1990.

Source: The table, including the notes, is adopted from State Planning Commission and State Statistical Bureau (eds.), *China Investment Report, 1992*, p.30.

The share of total investment arising from the decisions of provincial and lower-level governments rose, therefore, from an already high percentage of 59% in 1980, to 68% in 1983. The share of investment approved by the provincial and lower-level government, as opposed to the central government, has since remained at this high level of around 70%.

Given that an absolute majority of investment is the result of decisions made within the provincial boundaries, it is no surprise that the Centre has been largely unsuccessful in carrying through its control measures over investment. For instance, at times when the Centre sought to reduce the scale of investment, provincial governments would often act by reducing investment in less profitable but much more needed sectors. The Centre was thus left to fill the gaps, thus defeating the original purpose of the clampdown.¹⁵ Another example of the power of provincial governments is that exercised in the implementation of the new Investment Direction Adjustment Tax. The tax was promulgated in April 1991 to act as an economic lever to encourage investment actors to invest in sectors favoured by the Centre, and to penalize those who continued to invest in others. The responses of provincial and lower-level governments ranged from ambivalent support to outright opposition. As seen in a survey carried out by the State Planning

¹⁵This is a comment frequently made by respondents from the central government. (Author's interviews) An indirect evidence of the move is the growing "similarity" of industrial structure in the provinces in the 1980s, as a result of the inclination of all provincial governments to concentrate investment in more profitable processing industries. See State Planning Commission and State Statistical Bureau (eds.), *China Investment Report, 1992*, p.23.

Commission, a few respondents, in their responses to the survey questionnaire, explicitly expressed their "decision" not to implement the new tax because they had "rather significantly different views (vis-a-vis the Centre's view) on this tax".¹⁶ Other respondents gave a politically "safe" response, saying that "the tax could have *some* effects regarding its objectives", rather than giving their unambiguous approval.¹⁷ The successful implementation of any new tax would require the co-operation of the provinces, who, in this case, had precisely the opposite incentive. This new measure of central control was, therefore, doomed from the beginning.

Explaining the Phenomenon

Why has the Centre been unable to control investment in the provinces? To what extent is the failure of control a result of the decentralization reforms in the 1980s? And what does it tell us about central-provincial relations in China? These questions are discussed below.

The root of the problem can be explained in both socio-historical and institutional terms. Moreover, this issue is more than a mere question of the Centre exerting control over the provinces. On the one hand, resource misallocation and subsequent waste on a massive scale has sometimes been the result of investment initiatives by the Centre. The most spectacular example of such an instance is the Great Leap Forward of 1958-60, during which massive quantities of resources were misused and wasted in the blind pursuit of rapid heavy industrialization. On the other hand, waste and inefficiency at micro-level had always existed prior to investment administration being substantially decentralized in the 1980s.

The fact that investment control is not a problem regarding the provinces *only* has important implications as regards the relationship between the Centre and the provinces. It explains why the Centre was so ineffective in exerting control over the provinces in the 1980s. To anticipate the following discussion, the Centre itself is part of the problem of excessive and inefficient investment and is, therefore, problematic also in its capacity of being the object of control.

¹⁶Ibid., p.101.

¹⁷Ibid., p.100.

The Socio-Historical Background: Urge for National Strength and Glory

The Chinese socialist revolution is, to a large extent, the action of a country, after decades of foreign invasion and humiliation, as a means to regaining its past glory. The desire for rapid modernization and ascendancy from humiliation underlines the waves of radicalism during the Maoist period.

The impact of such radicalism was that little consideration was paid to objective constraints posed by resource availability when investment decisions were made. The limitations of resources were considered secondary. The belief was that all difficulties could be overcome by human effort. The general ideology of the time was that it is good to plan more investment than is physically allowed in terms of available resources. To plan well within what is already known to be available would be simply too conservative. It would, on the other hand, be "revolutionary" to overfulfill plans. Conversely, it was considered "revisionist" and conservative merely to satisfy the plans. Taking the latter course would achieve less, and the road to national prosperity and modernization would, therefore, be unnecessarily lengthened. A casual glimpse of press reports during the 1960s and early 1970s reveals amazingly numerous instances in which substantial amounts of materials and equipment were saved by the initiatives of the people. Indeed, it has been argued that plans with "gaps" and "the call for progressive balance" have been the employed tactics of central leaders within an economic system devoid of effective incentives---in order to extract more productivity out of a "slack" workforce.¹⁸

While radicalism has gradually receded in the political arena since the 1978 Third Plenum, the urge to develop the economy and strengthen the country rapidly has remained the goal of the post-1978 leaderships. Investment, therefore, has remained a priority item in the national agenda. A very important feature of this nationalistic urge is that the central leaders, as the representative of the nation, are often inclined to stress the importance of investment. As national political leaders, central officials are naturally more identified with the modernization task than are the provincial leaders. This makes the Centre traditionally the major locomotive in successive investment waves. The Centre demands more investment because it feels the most pressure to strengthen the national economy and guarantee prosperity for the population. In its dealings with the international community, on both political and economic issues, the central leadership is well aware of the

¹⁸See Wu Ruyin, *Economics of Inefficiency*, p.163.

importance of a strong economy as regards its international status and bargaining leverage. As the People's Republic entered its fourth decade during the 1980s, the central leaders knew that, as regards domestic affairs, they did not have too much time in which to prove to the population that socialism could produce a better livelihood. Economic growth and prosperity was and still is central to the political legitimacy of the regime. This urgency was particularly felt when communist regimes in the Soviet Union, in Mongolia, and in Eastern Europe collapsed during the years 1989-91. Deng Xiaoping's comments in 1990 aptly reflect why the central leadership is always so concerned about investment:

"We have to pay special attention to the slide in the economic growth rate. I am worried about it... Some countries have encountered problems, in the final analysis, because their economy is failing... Why do the people support us now? Simply because there have been developments in the economy over the last decade, and obvious developments... This question (about economic development) is, therefore, not only an economic issue. It is in fact political... If only we successfully attain the objective (of improving the livelihood of the population), we would be safe regardless regardless of what changes take place internationally..."¹⁹

At the time Deng was, therefore, concerned about whether or not central leaders had set out at the right rate of growth. Was it too low? Could new initiatives in any way be made to sustain the momentum of economic growth of the 1980s? Deng was obviously unconvinced that the 6% annual growth as planned by Premier Li Peng for the 1990s was fast enough. He encouraged central leaders to explore new development opportunities, and in particular, the development of Shanghai:

"What is proper growth? The criterion is, what can guarantee a doubling of our economy in the next decade, at constant prices, discounting inflation, and taking population growth into account. Then, at what rate does the economy have to grow per annum in order to achieve our objective? Is our present calculation correct and reliable? Can an annual 6% growth rate really bring us the second doubling (of economic wealth) in the coming second decade of reform? We really need to apply our mind to this... People are very sensitive about their well being, and we cannot cheat on this..."
"We have to grasp opportunities and make timely decisions. We have to identify places having more potential for development... for instance Shanghai. This would be a big move... Developing Shanghai could be a quick route to achieving our objective."²⁰

In the end, after some delay and considerable intra-elite debate,²¹ in 1992 the

¹⁹Deng Xiaoping, "The International Situation and Economic Issues", March 3, 1990, in Deng Xiaoping, *Selected Works of Deng Xiaoping*, Volume 3, (Beijing: Renmin chubanshe, 1993), pp.353-56, pp.354-55. This is part of a conversation between Deng and several "third-tier" central leaders.

²⁰Ibid.

²¹Despite the reservations of Deng early in March 1990, as noted above, the rate of growth for the 1990s was still planned at 6% per annum in the Ten-year Plan and the Eighth Five-Year Plan

planned growth rate was raised from the original 6% per annum throughout 1990s to 9-10%, following Deng's southern tour early that year.²²

However, nationalism is not the motive for investment of the central leaders only. Provincial leaders also may share this urge for modernization. This could be the result of political socialization, in which nationalism and patriotism play an important part. The importance of modernization is moreover reflected in performance appraisal "yardsticks" for provincial leaders, whereby the Centre seeks to ensure that provincial leaders work towards the same goal as the Centre. Although the yardsticks have not been institutionalised, it is clear that since 1978 particularly, the levels of provincial economic development and social stability have constituted two major yardsticks in the assessment criteria of the performance of provincial leaders. Economic development is very often measured in terms of the growth rate of societal production,²³ and social stability often hinges on job opportunities. Both can be achieved through expanding investment and building more factories. Provincial leaders are thus effectively motivated to launch investment projects which increase the level of production, and provide more jobs for the local population.²⁴

submitted by Li Peng the Premier in March 1991 to the National People's Congress. See Li Peng, "A Report on the 'Ten Year Plan for National Economic and Social Development' and the Eighth Five-Year Plan Outline", March 25, 1991, speech to the Fourth Session of the Seventh National People's Congress, printed in Zhonggong Zhongyang Wenxian Yanjiushi (ed.), *Shisanda Yilai Zhongyao Wenxian Xuanbian* (Since the Thirteenth Party Congress: A Compendium of Important Documents) (3 volumes), Volume 3, (Beijing: Renmin chubanshe, 1993), p.1486. The 6% rate of growth was insisted upon even in the immediate aftermath of Deng's southern tour. When Li Peng made the government report to the National People's Congress in March 1992, he reiterated that the planned growth rate for the coming year, that is 1992, would be 6%. See Li Peng, "The Government Report", March 20, 1992, printed in *Since the Thirteenth Party Congress*, Volume 3, p.1993.

²²See Jiang Zemin, "Deeply Understand and Fully Implement the Spirits of Deng's Talks, to Develop the Economy and Carry on Reform and Opening in a Better, and Faster Way", June 9, 1990, printed in *Since the Thirteenth Party Congress*, Volume 3, p.2063.

²³For instance in both the Twelfth and Thirteenth Party Congresses, the target of the economic work of the country was expressed in terms of the total value of agricultural and industrial production. In the Twelfth Party Congress in September 1982, the target was to quadruple this value from 710 billion yuan in 1980 to 28900 billion yuan in 2000. See You Lin, et al (eds.), *Zhonghua Renmin Gongheguo Guoshi Tongjian, 1979-1992* (A History of the People's Republic of China, 1979-1992) (Beijing: Hongqi chubanshe, 1993), pp.114-15. Moreover, back in 1958 the Centre had issued a document to provincial officials explicitly requiring them to increase their industrial production capacity so that the value of industrial production output could exceed that of agriculture. See Fang Weizhong (ed.), *Zhonghua Renmin Gongheguo Jingji Dashiji, 1949-1980* (The Major Economic Events in the People's Republic of China) (Beijing: Zhongguo Shehui Kexue chubanshe, 1984), p.210.

²⁴This paragraph is deduced from the author's various interviews. The yardstick of production level is a feature both before and after 1978, but social stability was less a concern for the pre-1978 decades, when the ideological mobilization of the population meant that stability was not an issue. In fact the more social *instability* there was in the *engineered* direction of the Central leadership, the more "revolutionary" and the better the work of the local leadership was thought to be.

Institutional Base and Facilitation

In addressing the institutional base of the investment phenomenon, there are two levels of analysis which reinforce and sustain the nationalistic motives for investment. The first is the more fundamental level whereby the effects of the public ownership system, and of the "soft constraints" and "iron bowl" characteristics deriving from the public ownership system may be analysed.²⁵ The public ownership system is the *definitive* institution in Marxist economics. Investment expansion is, in the final analysis, rooted in the nature of this fundamental institution of the socialist economy.

The second level of analysis refers to the *specific* forms of economic management system within the public ownership system. It analyses how public ownership is actually effected in practice, and how this affects investment behaviour. This second level serves to explicate the ways in which the public ownership system, *through* its specific forms and via specific policies, has brought about investment expansion. The central-provincial interface enters the picture at this second level.

Public Ownership System and Soft Constraints

There has been a growing body of literature which addresses the linkage of the public ownership system in socialist countries with the various problems within the economy, including the phenomenon of investment expansion.²⁶ Economists differ in their views regarding what actually constitutes the crux of economic problems in traditionally socialist countries. Some attribute the problems to the excessive demand for consumer and investment goods, for instance, while others argue for the incapability of the system to supply enough goods of appropriate quality. Investment expansion *per se*, therefore, may or may not constitute the root to economic difficulties according to different interpretations. These arguments between economists, however, are not the subject of concern here. Rather, the

²⁵The phenomenon of "soft budget constraints" was first discussed in the classic work by Janos Kornai, *Economics of Shortage* (Amsterdam: North Holland Publishing Co., 1980), p.210, in which Kornai identifies the soft budget constraints of a socialist firm as sufficient cause for the constant phenomenon of insatiable investment and investment tension in socialist economies.

²⁶In this section, I draw mainly from the following literature on China: Fan Gang et al. *A Sketch of the Macro-economic Theories Under a Public Ownership System*, Wu Ruyin *Economics of Inefficiency*, Liu Guoguang, *Zhongguo Jingji Tizhi Gaige Moshi Yanjiu* (Analysing the Models of China's Economic System Reform) (Beijing: Zhongguo Shehui Kexue chubanshe, 1988) and Wu Xiaoqiu, *On the Tight Operation*. I also consulted Janos Kornai, *Economics of Shortage*, Paul R. Gregory and R. C. Stuart, *Soviet Economic Structure and Performance* fourth edition, (Harpen Collins Publications, 1990), which are on the Soviet and Eastern European experience.

interest of this study is in the circumstances wherein investment expansion as a phenomenon occurs and, in particular, in the ways through which provincial governments achieve such expansion regardless of central efforts of control. In this respect, it should be noted that, notwithstanding their disagreements regarding the *significance* of investment expansion, there is nevertheless wide agreement amongst economists regarding what *causes* investment expansion in socialist economies.

This explanation focuses on one point: the public ownership system is unable to define clear boundaries of property ownership or to specify responsibility for investment decisions. Ownership signifies rights as well as responsibilities. An owner of a property enjoys the right to use and dispose of the property, as well as shouldering all liabilities in this connection. The clear assignment of responsibility inevitably imposes restraint on the owner. It necessitates careful consideration as regards investment plans, and provisions whereby any failures may be cushioned. In a society dominated by public ownership, such a natural restraint mechanism is conspicuous in its absence.

Ownership by all people, as public ownership is described in China, denotes that all the means of production in the society are collectively owned by all the people in that society. As regards any single individual, he or she owns all means of production in the society, but *only as a member of the entire community*. In practice, public ownership has led to a paradox of ownership relations: an individual is both an owner and a "non-owner". The public ownership system should in theory render the very concept of "ownership" redundant and useless to the practical needs of individuals, who are required to "contribute according to capability, and take according to needs". In practice, rights and responsibilities must be defined. Since the state has taken up the role of guardian of public ownership, it is therefore the representative of "all-people" in exercising its rights and bearing all responsibility in its capacity as the owner of the means of production. The individual, though still the ultimate owner in name, only takes up, in practice, the roles of worker and consumer.²⁷

Consequently, individuals, albeit being ultimate owner, do not have to

²⁷See Fan Gang et al., *An Sketch of the Macro-economic Theories Under a Public Ownership System*, pp.24-28, for an exposition of this paradox of ownership status in societies with public ownership as the dominant system. Some colloquial catchphrases on such a paradoxical situation are: "One has everything; and at the same time has nothing"; "Everybody is the owner; nobody is the owner". Reflecting the indivisiveness of ownership rights and the confusion arising there is the saying: "Mine is yours; and yours is mine".

shoulder responsibility for the use, reproduction or accumulation of the means of production. That is the work of the state. However, the state is not itself a monolithic whole. Different tasks must be done by different departments and enterprises at different levels. This gives rise to a paradoxical situation. On the one hand, each unit of the state is entrusted with responsibility over a certain segment of the means of production on the behalf of the public. In this sense units are expected to act *like* the owners of the segment of public property under their jurisdiction. On the other hand, each of these units is but an administrative arm of the state. As ownership by all the people is a "collective ownership" and is not to be distributed amongst individuals, so ownership, when entrusted to the state as a whole, is, in theory, not amenable to division between the various state organs. The implication is that any state unit, be it a government department or a state enterprise, does not have a clear-cut boundary of ownership and responsibility for the property under its control. It is entrusted with a duty for its own segment of public property. However, as part of the state *and in a sense being the state itself*, it can claim the right to deploy resources entrusted to *other* units, on the argument that this will be beneficial to the common interests of all. Conversely, therefore, the unit is also vulnerable to "intrusion" by other units.²⁸ The implications of such flexible boundaries of "ownership" are that should one unit suffer loss in an investment, the unit is able to diffuse the losses through other units. The responsibility for any actor under the public ownership system is thus "softly" delineated and subject to all kinds of manipulation.²⁹

This softness of constraints is rooted in the indivisiveness of public ownership. It cannot therefore be eliminated by changes to the economic management system governing the relationship between the various actors of the state. In the end, whether the actor involved in a particular investment decision is a government department or a state enterprise, the role performed and the nature of the organizations concerned is the same. They all form that part of the division of

²⁸The situation whereby the administrative units of the state exercise a degree of but incomplete ownership rights over the "public properties" under their administrative jurisdiction is described as the "proliferation of the public ownership system" in Quan Zhiping and Jiang Zuozhong, *Lun Difang Jingji Liyi* (An Analysis of the Local Economic Interests) (Guangzhou: Guangdong Renmin chubanshe, 1992), Chapter one, particularly pp.23-27. Each level of the state hierarchy and each administrative unit of the party-state has become the *defacto* owner of the slice of public properties under their administrative custody, although the exercise of their power is subject to control and manipulation of the superior levels and ultimately of the Centre.

²⁹Janos Kornai identified several conditions, any one of which in his view would be sufficient to make the constraints "soft": (1) firms as price-makers instead of price-takers; (2) "soft" tax system, meaning that the formulation of tax rules is influenced by the firms; firms may be granted exemption or postponement of payment as an individual favour; and the slack collection of taxes; (3) free state grants, in form of ad hoc or recurrent state subsidies, and injection of investment capital; (4) soft credit system: credit is granted even if there is no full guarantee of repayment. See Kornai, *Economics of Shortage*, Volume B, pp.306-7.

labour concerned with fulfilling the state role of ownership agent. In this sense, both the state enterprises and government departments are similarly "administrative" organs by nature.

It is thereby obvious that, although discussions since the 1980s on the "departmentalization" and "regionalization" of public ownership suggest a fragmentation of public ownership within the state,³⁰ such a compartmentalization phenomenon does not actually entail *full and clear-cut* ownership relations between the various actors.³¹ Compartmentalization became a major phenomenon primarily as a result of the decentralization reforms of the 1980s. The decentralization reforms tended to harden the hold of state units---provinces, government departments and state enterprises---on resources and therefore *encourage* investment expansion behaviour. However insofar as the reforms strengthen the *de facto* ownership rights of provincial governments over local resources, the reforms do not in themselves lead to insatiable appetite for investment. It is the *interaction* between quasi-ownership rights and flexible boundaries of responsibilities on the one hand, and the latent modernization drive previously discussed on the other, that leads to the investment expansion phenomenon. The fluidity of any demarcation of responsibility means that provincial governments are not required to bear squarely the risks of their investment decisions. All internal checks on investment expansion is, therefore, rendered ineffective.

The above discussion indicates that the difficulty in controlling investment and in ensuring an efficient allocation of scarce resources predates the decentralization reforms of the 1980s. In the final analysis it is a problem grounded in the roots of the socialist system: the public ownership system. The issue is, therefore, *by its nature*, not a political problem of compliance with central policies by lower-level units. As, since the 1980s, this problem has become a political issue of noncompliance, the fundamental background of the problem, being one grounded in the "soft constraints" of the socialist economic system, explains to a large extent why the Centre has been so ineffective in achieving its will. In other words, the fact that China's investment problem is not solely an issue concerning

³⁰See for instance, David Granick, *Chinese State Enterprises* (Chicago: Chicago University Press, 1990); and Susan Shirk, *The Political Logic of Economic Reforms in China* (Berkeley: University of California Press, 1993).

³¹David Granick, in *Ibid.*, failed to note the incompleteness of the property-rights of regional governments in his analysis of regional property rights. The failure stems from his neglect of the indivisiveness of ownership rights under public ownership, and from the fact that the focus of his research was solely on the phenomenal symptoms, which show provinces and enterprises acting very much like the owner of property under their jurisdiction.

central-provincial relations accounts in some way for its central-provincial conflicts in the investment arena.

Economic Management System: Decentralization in the 1980s

The decentralization reforms of the 1980s changed the economic management system from one which was basically top-heavy to one which placed more power and responsibility at provincial level. Provincial governments were, subsequent to these reforms, given more powers and incentives with which to make, and benefit from, investment. Consequently, the problem of investment control, previously a basically Centre-led issue, has, since the 1980s reform, become increasingly one in which the provincial level had played an important part. Since the 1980s investment control has therefore become a largely central-provincial issue .

The Fiscal Reform

The fiscal reform instilled in 1980 is central in this process. The fixing of revenue shares for five years and the autonomy to arrange local spending intensified the local economy orientation of provincial governments and reinforced the provincial officials' sense of proprietorship over provincial enterprises.³² As this fiscal reform allowed provincial governments to retain all local revenues, after remittance of a prearranged sum/percentage to the Centre, and with the added security of a five-year arrangement, they consequently became more motivated towards developing the local economy, thereby increasing local revenue.

In 1980 the State Council announced that all provincial-levels, with the exception of three provincial-level municipalities, should practice a contractual fiscal system in which the level of remittance or subsidy would be fixed for five years.³³ Two crucial features of the 1980 reform set it apart from the previous numerous changes made to the fiscal system, and account for the significance of the changes in 1980. First, the level of provincial remittance or central subsidy was

³²Susan Shirk, *The Political Logic of Economic Reform*, Chapter Nine presents an account of the development of the 1980 fiscal reform and its positive and negative effects. A major negative effect was the increase in administrative interference in enterprise management as the new fiscal system reinforced the "local ownership system".

³³See "State Council Document on Implementing the 'Dividing Revenues and Expenditures, Contracting at Various Levels' Fiscal Management System", February 1, 1980, printed in State Planning Commission (ed.), *Zhongyao Jingji Fagui Ziliu Xuanbian: 1977-1986* (A Selected Collection of the Major Economic Regulations) (Beijing: Zhongguo Tongji chubanshe, 1987), pp.629-31.

to be fixed for a period of five years. This was a feature which appeared briefly in the 1958 fiscal reform, but which did not persist long due to the chaos of the Great Leap Forward. Second, the sectoral expenditure control figures imposed by the central government ministries on provincial governments were abolished, allowing the latter unprecedented leeway in allocating resources within the provincial budgets. Again, this had been a feature of the aborted 1958 system.

It is true to say that the decentralization of fiscal power and resources from the central to the provincial and lower levels did not begin in 1980 but actually dates back to the Cultural Revolution. Michel Oksenberg and James Tong rightly point out that in this respect the Cultural Revolution was the turning point in the history of the People's Republic since 1949, when the highly centralized system established in the 1950s gave way to a highly decentralized and even fragmented system.³⁴ Due to the virtual paralysis of the state apparatus between 1966-68 and the emphasis on local radicalism thereafter, central control on the collection and spending of local revenue in the provinces simply collapsed. There was no annual economic plan for 1967 and 1968, and nine central government agencies in economic planning and management were merged into one in 1970, when only 11.6% of their combined total establishment remained in operation.³⁵

The decentralization of fiscal resources during the 1966-76 decade was nevertheless a *de facto* result of radicalism against bureaucratic control and management which caused the paralysis of the Centre at that time.³⁶ The design of the fiscal system was reduced to a bare minimum whereby the continual running of the state, however shattered, was ensured and the despatch of necessary expenditures was carried out. The following quote from an official from the Ministry of Finance states the nature of the decentralization of the period unambiguously:

"The fiscal management system during the Cultural Revolution decade could hardly be described as forming any sort of model. The system kept changing all the time, almost annually. There was hardly any mechanism as such; *the purpose was simply to muddle through, and to survive the chaos.*"³⁷ (emphasis added)

³⁴See Michel Oksenberg and James Tong, "The Evolution of Central-Provincial Fiscal Relations in China, 1971-1984: the Formal System", *China Quarterly*, No.125 (March 1990), pp.1-32.

³⁵Ibid., p. 8, Footnotes 12, 13, quoting Gao Shanquan et. al., *Dangdai Zhongguo de Jingji Tizhi Gaige* (Current Reforms in the Economic Structure in China) (Beijing: Zhongguo Shehui Kexue chubanshe, 1984).

³⁶This fact is also briefly noted in Michel Oksenberg and James Tong, Ibid., p.5, where they wrote that "the long-term trend since 1949 has been toward an expansion of the fiscal powers of provincial governments. To a considerable extent this trend is the result of default rather than design."

³⁷See Song Xinzhong (ed.), *Zhongguo Caizheng Tizhi Gaige Yanjiu* (A Study on the Fiscal

Decentralization in the late 1960s and early 1970s was, therefore, a convenient expedient and *de facto* consequence of the chaos of the Cultural Revolution. Provincial governments enjoyed substantial autonomy, not because the system explicitly allowed them the authority to do so, but because the system of control had fallen apart. Provincial governments, as the level of the state apparatus responsible for policy implementation and the collection and spending of most state revenues, simply filled the vacuum of power.

The decentralization of fiscal authority in the 1980s is both a break and a continuation of the "decentralization" of the 1970s. Unlike the *de facto* dispersion of fiscal resources during the Cultural Revolution decade, the 1980 fiscal decentralization reform signalled a deliberate decentralization of fiscal responsibility, as well as resources, to the provincial level and below. Whilst the autonomy of provincial level governments was, in the earlier period, largely the result of control failure at a divided Centre, the enlarged provincial fiscal authority in the 1980s was part of a larger program of economic reform of a relatively unified Centre. Notwithstanding the incremental manner whereby reform programs were tested and experimented in the 1980s, the sense of direction was unambiguous when contrasted to the "muddling through" mentality of the early 1970s. However, on the other hand, there was also obvious continuity of the 1980 decentralization decision with developments in the previous decade. As noted in Chapter One, the decision of the 1980 fiscal reform, from the Centre's point of view, was basically a reaction to the financial difficulties resulted from the extensive diffusion of fiscal resources to provinces during the previous decade.³⁸ The status quo as of 1979 was perceived by central leaders as leaving them little choice but to further decentralize fiscal authority in order to arrest the decline in central fiscal revenue.

As is noted in Chapter Three, the significance of the 1980 fiscal reform for provincial investment behaviour is *not* solely manifest in the fact that provincial governments could obtain a larger share of national fiscal revenue, and therefore more budgetary revenues to spend on investment. In fact, the share of provincial government revenue in the total national revenue was *lower* in the 1980s than in the previous decade. In 1972, the share stood at a high level of 86.2%, but by 1982 it had dropped to less than 80%, and by 1985 to less than 70%.³⁹ Retained local

System Reform in China) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1992), p.48.

³⁸See Susan Shirk, *The Political Logic of Economic Reform* (Berkeley: University of California Press, 1993), p.163.

³⁹See Okensberg and Tong, "The Evolution of Central-Provincial Relations in China, 1971-1984", p.31. It should however be noted that the share refers to the amount of fiscal revenue *collected*

fiscal revenues, however, generally increased, as provincial governments had in the previous decade generally succeeded in ensuring that changes in the system worked in their favour.⁴⁰ The significance of the contractual system instituted since 1980 is the fact that fiscal arrangements between the provinces and the Centre became more like a "contract". The long time span of the contract and the unprecedented autonomy of the provincial government in allocating local resources were revolutionary innovations in themselves. What makes such features more significant still is that fiscal reform was merely a part and fore-runner of reforms regarding the economic relations between the central and provincial governments, and between the state and society as a whole. Fiscal reform was launched with the deliberate intention of acting as the breakthrough point of change. This larger context of fiscal reform has sustained and legitimized the vested interests of the provincial governments since the system has been in operation.

The new contractual fiscal system has had repercussions regarding the investment control problem in two aspects. First, the security of a five-year contract, in which all above-quota revenue could be retained for local discretionary use, reinforced the *incentive* of provincial governments to increase investment and thereby increase revenue. Under the soft constraints of the public ownership system, as noted in the previous section, the provincial government could easily transfer the risks of investment to other entities whilst retaining all the benefits, such as the new tax and profit revenue arising from new enterprises, the additional job opportunities and the glamour brought about by big investment projects. In other words, the contractual fiscal system brought more benefits to provincial governments as regards additional investments, but did nothing to change the lack of financial accountability and responsibility associated with the public ownership system. Consequently, the symptoms of "investment hunger" became intensified, and the enthusiasm of provincial governments for new investment became higher than ever before.

The other repercussion concerns the supply of a relatively independent source of finance. The new fiscal system leads indirectly to the explosion of the extrabudgetary part of public finance, which ensures the provincial governments a secure and "private" source of revenue for their investment plans. The

locally and not the retained local revenue which was usually a fraction of the former for the remitting provinces.

⁴⁰This is why those provinces who had originally adopted the "Sichuan model" quickly changed over in 1980 to the "Jiangsu model" within three years of the initial adoption. Many provinces found that their actual retained revenue decreased rather than increased under the original "Sichuan model". See Song Xinzhong (ed.), *A Study on the Fiscal System Reform in China*, p.52.

extrabudgetary finance (*yusuanwai*) used to be a marginal and supplementary feature of public finance intended to supplement the rigidity of a highly centralized system. It originated in as early as 1951, when the State Council issued an administrative notice authorizing the imposition of 15% local surcharges over and above state taxes by county level governments in order to finance discretionary local expenses. City governments were also authorized to levy public utilities surcharges in order to raise funds for the construction and maintenance of urban infrastructure.⁴¹ During the 1970s extrabudgetary finance grew to a substantial portion of total public finance, reflecting the dispersion of resources and loosening of central control during the Cultural Revolution decade. Yet the most spectacular growth was in the 1980s. From 1966 to 1976, total extrabudgetary finance, as a proportion of budgetary finance, increased from 15.1% to 35.5%. In 1980 this figure stood at 53.5%, rising to 83.3% in 1985 and 94.5% in 1991.⁴²

Behind the spectacular growth of the extrabudgetary finance from that of only a minor supplement of budgetary finance are the deliberate tactics employed by provincial governments in order to maximize retained local resources under the fiscal contractual system. The incentive to maximize local revenue was regarded as better served by diverting revenues and resources from the budgetary sector to the extrabudgetary. In practice, this diversion slows down the growth of local budgetary revenue, and therefore reduces the exposure of provincial coffers to the encroachment of the Centre via the adjustment of contracted remittance. The means by which provincial governments achieved their purpose is discussed in detail in Chapters Five and Six. At this point the relationship between fiscal reform, the growth of the extrabudgetary finance, and the phenomenon of weakening central control over investment is merely noted. Insofar as fiscal reform has enabled provincial governments to get hold of more resources with which to finance projects independently, extra revenue has come only indirectly from extrabudgetary finance. As noted in Chapters Three and Four, most local investment in the 1980s was financed by resources from outside the state budget. The availability of a huge pool of extrabudgetary funds has enabled provincial governments to disregard the bulk of central directives.

Investment Administration

The other major reform is decentralization in the administration and planning of fixed asset investment. The main implications of fiscal reform for

⁴¹Ibid., p.42.

⁴²See Ministry of Finance (ed.), *China Finance Statistics, 1950-1991*, pp.186-87.

investment expansion, as noted in the previous section, are the strengthening of the provinces' *incentive* to invest and the provision of, indirectly through the extrabudgetary finance, the *resources* with which to invest. On the other hand, the decentralization of investment administration authority *facilitates* investment expansion by enabling the reinforced investment incentive and enhanced financial strength of the provinces to materialize into investment activity.

The major changes in the investment administration system have taken place in two areas. First came the abolition of sectoral control figures previously assigned by the central ministries. This enabled the provincial governments to arrange their own investment priorities with unprecedented flexibility. The other was the decentralization of project approval authority and the simplification of approval procedures, to the effect that provincial governments have since had much more control over whether or not individual local investment projects might proceed.

Sectoral control

Sectoral control figures refer to the detailed mandatory prescriptions of investment for each "administrative system" (*xitong*) which are determined at central government level, between the central government ministries and the State Planning Commission, and then passed down to the provinces for implementation. They symbolize the tight control of the central government over investment and were a major feature of the investment administration system prior to the 1980s.

The central government attempted to do away with mandatory fiscal targets during the reforms of 1958 and in the 1970s. However, this was not achieved until the 1980s. Earlier efforts failed, either because the economic situation changed too rapidly, as in the case of the 1958 reform, or because any possible effects were swamped by the inertia of central dominance in a politically-charged climate.⁴³

The centralized system was in place early in 1952, when the procedure of investment planning was formalized and the rules promulgated. The central government, through the various ministries, was responsible for the prescription of investment control figures for the lower levels of government. Unlike the central

⁴³Zhao Xiaomin (ed.), *Caimao Jingji Tizhi Gaige Yanjiu* (A Study of Financial and Trade System Reform) (Beijing: Zhongguo Zhanyun chubanshe, 1985), p.40. It is stated that previous fiscal reforms have failed to break through the dominance of central government ministries in issuing mandatory fiscal targets. Only in the 1980 reform is this achieved. Provinces since then can and do become relatively autonomous and independent in setting their own priorities in fiscal expenditure.

control figures of the 1980s, which were only lump-sum figures for the total investment scale in a province, control figures from the 1950s to the 1970s were disaggregated to specific industrial sectors and administration systems. The lower-level governments were required to propose specific investment projects within the control figures for onward screening and approval, as well as for inclusion in the state investment plan. Provinces themselves had very little discretion in the allocation of resources across sectors.⁴⁴ The central government exercised tight control over the size of total yearly investment, as well as over which specific investment projects were launched or dropped from the plan. Provinces were merely delegated the tasks of detailed planning and implementation.

In 1958 the control figures were nearly axed under the decentralization of the Great Leap Forward. According to the reform design, the entire planning system was to be shifted to one which would be province-based. Instead of central ministries playing the dominant part and assigning specific mandatory targets for the provinces, the plans were to be based on suggestions from the provinces. Provinces were also allowed much more discretionary power as regards the allocation of resources *across* sectors, provided that the overall spending limit was not exceeded.⁴⁵

The 1958 reform failed, and with recentralization setting in, the old control figures were resurrected. Then in 1965, when the economy was back to normal, a limited degree of decentralization was again launched. The sectoral investment control figures for 18 non-industrial sectors were replaced by one single lump-sum control figure. The purpose was obvious. It was beyond doubt that the existing system was too centralized. The 1958 experience, however, reminded the central leadership that steps needed to be cautious. The 18 sectors chosen were the smaller and more localized economic sectors which, in any case, could not be efficiently planned from so far away as Beijing. Another sector was added in 1966.⁴⁶

In the 1970s, as still more emphasis was placed on strengthening local autonomy, the discretion of provincial governments in investment planning was enlarged. The dual system existing after 1965 was replaced by a system whereby

⁴⁴See Dangdai Zhongguo Congshu Bianji Bu (ed.), *Dangdai Zhongguo de Guding Zichan Touzi Guanli* (The Administration of Fixed Asset Investment in Contemporary China) (Beijing: zhongguo Shehui Kexue chubanshe, 1989), p.19.

⁴⁵*Ibid.*, p.26.

⁴⁶Dangdai Zhongguo Congshu Bianji Bu (ed.), *Dangdai Zhongguo de Jiben Jianshe*. (Capital Construction in Contemporary China) (2 volumes) Vol.2, (Beijing: Zhongguo Shehui Kexue chubanshe, 1989), p.472.

each level of government would be awarded discretionary control for projects within their subordination jurisdiction. In other words, instead of central ministries issuing investment control figures to all sectors, or to all except the 19 designated sectors after 1966, central ministries would issue mandatory control figures for central investment projects only. However because of instabilities in the economic and political situation, the changes had not fully materialized, and on the eve of reform in 1980, central ministries were still issuing mandatory investment figures to the provinces.⁴⁷ In 1980, the sectoral control figures were abolished as the fiscal system was changed to that of a contractual system.⁴⁸ Thereafter provincial governments were allowed, in principle, to *plan* and allocate resources to local investment projects in different sectors according to their own priorities. What this meant was that provincial governments had become free to allocate their own retained local resources, under the fiscal system, to industries of their own choice, instead of as previously merely providing the resources with which to implement the choices and priorities of the central government ministries. Provincial governments thus became more or less independent actors regarding investment decisions. They had both the power to plan investment projects and a relatively secure and independent access to resources with which to finance their plans.

Decentralization of project approval

The other aspect of decentralization is that of project approval authority. In China every investment project has to be screened and approved by the government. This applies to all investment projects, irrespective of ownership types and finance channels, and includes both projects within and outside of the state investment plan. Historically the power to approve projects was highly centralized. However, since the 1980s this authority has been decentralized on a substantial scale resulting in the bulk of projects having been approved within the provincial boundaries.

Fiscal reform and the change in the investment planning system since 1980 (of which the abolition of the sectoral control figures is a central part) has given provinces the freedom to plan, to propose, and to spend. However, in between the planning and actual spending, there is still an intermediate step: that of having the plans and the specific projects approved. Two issues are involved here. First is the approval of yearly investment plans, a power firmly vested in the Centre. The

⁴⁷Ibid., p.473. See also Zhao Xiaomin, *A Study of Financial and Trade System Reform*, p.40.

⁴⁸See "State Council Document on Implementing the 'Dividing Revenues and Expenditures, Contracting at Various Levels' Fiscal Management System", February 1, 1980.

other is the approval of individual investment projects on a case-by-case basis. The two are interconnected because, as a rule, the yearly plans only list the projects requiring the approval of the central government. For projects which can be approved within the province, the lump-sum total of investments only are listed.⁴⁹ Therefore, if provinces are allowed to approve more projects, they can then invest more without reference to the Centre.

This detailed mechanism works in the following manner. Historically, the control instruments used by the Centre have always been targeted at *yearly* investment. The annual investment plan submitted to the Centre for approval lists the planned value of investments *in the coming year*. The total investment control figure assigned to each province by the central government refers to total investment *for the year*, as do the control figures for bank finance issued to the banks. There is basically *no* measure to ensure that the central government controls the total scale of *committed* investment, as expressed in the total accumulated planned investments of all the approved projects.

At times when the central government discovered that yearly investment was running out of control, the provinces would be told to examine critically the total scale of approved projects, and some projects would have to be dropped in order to cut down the commitment. However the recurrent cycle of clamp-down and excess investment over the decades has proved such control to be ineffective.

At this point, the decentralization of approval authority enters the process. As provinces were authorized to approve more projects, they could easily expand the total commitment of investment and use this as a bargaining chip when negotiating the yearly control figures with the Centre. By approving more projects and allowing construction to commence, the province increased the committed cost of the central government as a measure against any possible future retrenchment. The province was thus likely to be able to retain more investment projects, despite retrenchment, and to expand the yearly investments by starting at a larger base. In the event of huge public resources having been used up by projects already in construction, the central government would be less likely to abandon these, as opposed to projects existing on paper only. After all, under the public ownership system most of the resources are "state" resources, and provincial governments can always justify investment projects in terms of public interests. This is why "outside plan" (*jihuawai*) investments have been a consistent feature in China. No matter

⁴⁹Respondent No.5, Guangdong interview, September 1993.

how often and how strongly the central government issues orders to stamp out these "illegitimate" investment projects, provinces nevertheless know that "outside plan" projects are their best guarantee for winning a bigger share in the total investment scale nationwide. Therefore, as long as the central government cannot control the total scale of investment commitment *on a regular basis*, its battle on the yearly investments front is without doubt doomed to failure.⁵⁰ When the main rule of the system is to protect the vested interests, the secret of success is in getting one's own feet under the table by whatever means possible, and as early as possible. The decentralization of project approval power is thus the ladder which has enabled and facilitated provinces to get a strong foothold in the investment arena.

Due to its importance, project approval authority has historically been centralized. Investment projects were, since the early 1950s, classified into various categories in accordance with their design production capacity or investment value. Provinces were, generally speaking, allowed to approve only small sized projects. For instance, in the early 1950s, provinces could only approve projects with an investment of under 0.2 million yuan. Investment projects were then classified into two main categories: "above the ceiling" and "below the ceiling", each of which were further subdivided into two sub-categories. The largest projects, Category A "above the ceiling" projects, which were projects of over 10 million yuan, were to be screened and approved by the State Council. Category B "above the ceiling" projects, with an investment under 10 million yuan, would have their project design documents screened by the relevant central government ministry for onward approval by the State Council. Projects of a value between the 10 million yuan ceiling and 200,000 yuan were in "Category C", screened and approved by the relevant central government ministries or the regional governments.⁵¹ Category D projects of under 200,000 yuan were approved by provincial governments.⁵² Later the categories were simplified. Categories A and B became the near-equivalents of large and medium sized projects, and Categories C and D became the small sized

⁵⁰Hence some officials of the State Commission on System Reform have suggested mandatory controls on the total *committed* investment scale for projects approved both at the central and provincial levels. See Xie Minggan and Lou Yuanming (eds.), *Forty Years of Economic Development*, p.194.

⁵¹In-between the central government and the provinces, there were six regional-level governments in China in the early years of the People's Republic. In November 1952, the status of the six regional governments was converted from that of government level to that of the representative or agent of the central government at the sub-national level, and were renamed regional commissions. The regions were eventually abolished in 1954. See Zhonghua Renmin Gongheguo Minzhengbu (ed.), *Zhonghua Renmin Gongheguo Xingzheng Quhua Shouce* (A Handbook of the Administrative Districts in the PRC) (Beijing: Guangming chubanshe, 1986), p.105.

⁵²See Dangdai Zhongguo Congshu Bianji Bu (ed.), *The Administration of Fixed Asset Investment in Contemporary China*, pp.14-15.

projects.

The power conferred on the provinces at that time was, therefore, very limited. Category D projects amounted to only 13.5% of total investment within the First-Five-Year-Plan period of 1953-58. The central government, through the State Council and the various ministries, controlled the planning as well as the detailed scrutiny of the vast majority (86.5%) of investment projects.

Decentralization then occurred during the 1958 reforms. Provinces' power to approve projects was extended to cover *all* Category C projects and, under two circumstances, to Categories A and B as well. First, provinces were made responsible for screening the design and budgetary documents prior to the Category A and B projects being submitted to the Centre for approval. Second, if the Category A and B projects did not require co-ordination from the Centre either during construction or after production, the provinces themselves would be allowed to approve them, reporting to the Centre for their records thereafter.⁵³

The 1958 reform was extensive but it failed to take root as a result of the chaos in investment and production between 1958-60. Powers which had been decentralized were again recentralized after 1960. In 1962, the approval authority for *all* medium-large sized investment projects was placed with the State Planning Commission. Provinces and central government ministries were left to approve small sized projects, in accordance with the subordination relations of the projects. In 1963, a regulation was issued stating clearly that ministries and provinces should be responsible for approving investment projects of less than 0.5 million yuan only.⁵⁴

Approval authority of provinces saw several up-and-down adjustments during the 1970s. The provinces' power was enlarged in 1972, when it was announced that provinces could approve those medium-large sized projects which had been included in the state's long-term investment plan.⁵⁵ In 1978, the situation again reverted to centralized control. In 1978 a regulation jointly issued by the State Planning Commission, the Ministry of Finance, the State Planning Commission and the Construction Commission reaffirmed the rule that all medium-large sized projects, irrespective of subordination relations, should be

⁵³Ibid., p.26.

⁵⁴See State Planning Commission (ed.), *Jingben Jianshe Fagui Dadian* (A Comprehensive Collection of Rules and Regulations on Capital Construction) (2 volumes), Vol.2, (Beijing: Hongqii chubanshe, 1987), pp.61-63.

⁵⁵Regulation issued by the State Council in May 31, 1972. See Ibid., p.63.

approved by the State Planning Commission.⁵⁶ However, centralized control did not apparently last long because evidence available indicates that, on the eve of the 1984 decentralization, provincial governments had already the authority to approve projects below 10 million yuan.

In 1984, the investment ceiling for projects nationwide requiring the State Planning Commission's approval was raised by 300% from 10 million yuan to 30 million yuan. The value of projects requiring the approval of the State Council was also raised from 100 million yuan to 200 million yuan.⁵⁷ Moreover, the screening and approval procedures for medium-large sized projects were simplified. The time required by the central government in which to approve projects, proposed and screened by the provinces was shortened. After the projects were approved, the provinces would also be entrusted with the formulation of their implementation plans.⁵⁸

In a move to encourage local investment in "bottleneck" sectors, the central government authorized provincial-level governments, via a notice in March 1987, to approve investment projects in the energy, transportation and raw materials sectors having a total value of up to 50 million yuan. The jurisdiction for other investments remained unchanged at the 30 million yuan limit.⁵⁹

In August 1979 at a time when the central government sought to encourage more export and foreign investment, authority to approve foreign-related investments was first delegated to provincial-level governments nationwide. As long as provinces could find their own supplies of raw materials and balance their foreign exchange exclusive of assistance from the Centre, they could approve export-oriented projects and other forms of foreign investment up to US\$1

⁵⁶According to "Regulation on Procedures of Capital Construction" issued by the State Planning Commission, State Construction Commission and Ministry of Finance on April 22, 1978, printed in State Planning Commission (ed.), *A Collection of Documents on the Capital Construction System Reform*, pp.121-28, all medium-large sized projects would be approved by the State Planning Commission, and small sized projects would be approved in accordance with their subordination relations.

⁵⁷State Council Notice No.138 (1984), October 4, 1984, "Temporary Regulations on Improving the Planning System", printed in *Ibid.*, pp.1-12.

⁵⁸State Planning Commission, "Notice on Simplifying the Approval Procedures of Capital Construction Projects", August 18, 1984, printed in *Ibid.*, pp.21-25.

⁵⁹State Council Notice No. 23, 1987 (March 30, 1987), "On the extension of project approval authority of fixed assets investment and the simplification of approval procedures", printed in State Statistical Bureau (ed.), *Guding Zichan Touzi he Jianzhuye Wenjian Huibian* (A Compendium of Documents on Fixed Assets Investment and the Construction Industry) (Beijing: Zhongguo Tongji chubanshe, 1992), pp.111-17.

million.⁶⁰ In 1982 this ceiling was again raised to US\$3 million for provincial-level governments, other than the three provincial-level municipalities, Shanghai, Beijing and Tianjin, and apart from Guangdong and Fujian, who enjoyed still greater power under the "Special Policy". These five provinces could approve foreign investment of up to US\$5 million.⁶¹ In 1984, the jurisdiction of Guangzhou, together with that of Dalian, was increased by 100% to US\$10 million.⁶² Guangdong's power was further raised to US\$30 million in 1987.⁶³

More details are incorporated in the discussions on Guangdong and Shanghai in Chapters Three and Four. Suffice it here to note that one important effect of the decentralization of power to approve projects is that provincial governments have been able to control the bulk of investment activities within the boundaries of their provinces. This development explains to a large extent how the provincial governments have been able to withstand pressure from the Centre as regards their investment enthusiasm. This new-found provincial discretionary behaviour is one of the main findings of this dissertation.

Economic Liberalization Reforms

The decentralization of fiscal authority and investment administration authority as outlined above relates to the category of *administrative* decentralization, whereby power and resources shifted downwards from the upper level of the state apparatus to the lower levels. Reform accentuated the desire for self-sufficiency and the more inward-looking orientations of provinces which had, to a lesser extent, existed under the central planning system.⁶⁴ Decentralization has

⁶⁰See State Council Notice No. 202 (1979), August 13, 1979, "On approving the Regulations on Promoting Foreign Trade and Increasing Foreign Exchange Revenue", in State Commission for Economic System Reform (ed.), *Jingji Tizhi Gaige Wenjian Huibian* (A Collection of the Documents on Economic System Reform) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1983), pp. 481-87.

⁶¹See Central Committee Notice No.6 (1982) January 15, 1982, "On Approving the Notes of Meeting on the Foreign Trade-Related Work in the Nine Coastal Provinces and Municipalities" in *Ibid.*, p.577.

⁶²State Council Notice No.138 (1984), October 4, 1984, "On Approving State Planning Commission's Temporary Regulations on Improving the Planning System". See also Guangdong Jungji Xuehui (ed.), *Guangdong Jingji Tiji Gaige Yanjiu* (A Study of the Economic System Reform in Guangdong) (Guangdong: Zhongshan University Press, 1986), p.121. Shanghai was ahead of Guangzhou in the power to approve foreign investment, and was allowed the jurisdiction up to US\$30 million. See also Chapter Four.

⁶³This was the decision of the Central Finance and Economy Leading Group on October 27, 1987. See Guangdong Provincial Party Committee (ed.), *Zhongyang Dui Guangdong Gongzuo Zhishi Huibian* (A Collection of Central Government's Instructions to the Work of the Guangdong Provincial Government) (Hereinafter as *Centre's Instructions to Guangdong*) (Four volumes), 1986-1987 (Part 2), (Neibu: 1988), p.388.

⁶⁴See Thomas Lyons, *Economic Integration and Planning in Maoist China* (New York: Columbia University Press, 1987). A central theme of Lyons' is that the failure of the central planning system

had a marked effect on the relationship between the Centre and the provinces because provincial governments have since had more resources and power with which to exert their own agenda in defiance of central government directives.

In the 1980s there was another type of reform which had an important effect on the central-provincial relationship. These reforms were targeted at the state-society interface. They included changes in the relationships between the state enterprises and their superordinate government departments, changes of policy regarding the non-state sector and a gradual "retuning" of the role and functions of the state in general. They fall into the general category of economic decentralization and may be described generally as economic liberalization reforms. A discussion of the contents of these reforms would be beyond the scope of this study. Nevertheless, these reforms have so far had the effect of weakening the strength of the Centre and of enhancing the power and influence of provincial governments. Specifically, they have enhanced the provinces' capability of outmanoeuvring the Centre's control measures.

The relevance of economic decentralization reforms to central-provincial relations is apparent in the difficulty, and, as yet, the failure to turn state enterprises into autonomous productive entities.⁶⁵ This failure has enabled provincial governments to make use of the enterprises as a "second battlefield" on which to achieve their investment plans, irrespective of the supervision of the Centre. Budgetary revenue can, for instance, be diverted, through tax alleviation, to extrabudgetary funds in the form of funds retained in state enterprises. Investment is then made by enterprises using their own retained funds, with the provincial government acting as the approving authority. Provincial governments can thus

forced each of the constituent units, enterprises, localities, departments, etc., to work for the highest possible degree of self-sufficiency for survival and organizational interests. The result was therefore a fragmentation of the supposedly tightly knitted social fabric.

⁶⁵ The State Enterprise Law promulgated in 1988 and the "Regulation to Change the Operation Mechanism of State Enterprises" promulgated in 1992 are two major attempts to this end. The 1988 Enterprise Law was a landmark move in that it was the first time that the state enterprises were, via a formal and authoritative legal document, accorded independent status as economic entities exercising a prescribed level of autonomy at a distance from their superordinate government departments. The 1992 Regulation sought to substantiate and improve the general provisions of the 1988 Law, and include six long articles prescribing in further detail the relations between state enterprises and the government. The intention was to continue the unfinished task of the 1988 Law of delineating the respective duties and powers, as well as responsibilities of the enterprises and the government departments. State enterprises were to enjoy powers in fourteen different areas, ranging from the power to manage its production, the power to invest, the power to dispose of and handle the enterprise properties, to personnel power and the power to refuse unlawful fees. See "An explanatory note by the State Commission for Economic System Reform on the 'Regulations'", printed in Xie Zhijiang, and Jia Huajiang, eds., *Regulation to Change the Operation Mechanism of State Enterprises: 100 Questions and Answers* (Beijing: Zhongguo Dabaike Quanshu chubanshe, 1992), pp.227-39.

divest themselves of direct responsibility for excess investment, whilst, in reality, continuing to pull the strings behind the scenes through their influence on the enterprises.

Moreover, the scope of influence of provincial governments often goes beyond state enterprises to include the local branches of state banks and enterprises in the non-state sector. Provincial leverage over local banks ensures that an ample supply of bank finance is available for their investment plans, whilst collective and private enterprises allow provincial governments to fulfill their plans in an arena which is still more remote from the oversight of the central bureaucracy.

How can provincial governments continue to exercise such leverage over enterprises, despite the attempts of the Centre to make the latter independent? The answer is that provincial governments have been instrumental in the survival of enterprises. The latter rely on the active assistance and co-operation of provincial governments in solving problems of production as well as in the welfare needs of their workforce. This assistance is often crucial to the enterprises, given the difficulty in obtaining such necessities from an underdeveloped market. This is especially the case for state enterprises, which have operated under the planned economy system for so long that they often find it difficult, both objectively and subjectively, to look beyond their government superior. A market is, without doubt, in the process of development since the commencement of economic reform. However, as of the 1980s and the early 1990s, it has still been a very immature market and as such is not the fair, transparent and easily accessible forum whereby one yuan is exchanged for one yuan. In fact the reliance of enterprises on the government may even have increased since the reform. For instance, enterprises could previously rely on annual planning exercises as a means to obtaining raw materials and capital. Since the 1980s, however, that simply promised in the state plans may not necessarily materialize at all. Enterprises are then obliged to begin yet another round of bargaining with provincial, and lower-level, governments, depending on their subordination relations, in order to achieve their ends. Since commencement of the reform period, enterprises have also been under greater financial pressure. Managers of state enterprises find that completing their plan assignments and co-operating with their government superiors is no longer all that is entailed in being seen to be doing a good job. They are rather expected to produce profits, even though they do not have full command over the factors which have a direct bearing on the financial status of the enterprises. The enactment of the Bankruptcy Law (For Trial Implementation), for instance, which took effect in 1988, has forced enterprises in a poor financial situation to depend

upon the assistance of their government superiors for subsidies and loan support. In other words, although enterprises have often cried out for more autonomy and frequently condemned interference from the state, practical difficulties in the transition towards a market economy have, ironically, depended upon the participation of provincial governments in order that they may be resolved.⁶⁶ Provincial governments have thus continued to enjoy considerable power over enterprises.

One important resource over which provincial governments have had great leverage is that of bank finance. The ability to influence the supply and allocation of bank loans has also enabled provincial governments to influence investment which relies on bank loans for finance. Since the management of enterprises' "own funds" is expedited through the bank system, the bank, therefore, controls the bulk majority of resources used in investment in the 1980s.⁶⁷ This means that provincial governments, as well as lower-level governments, are able to exercise considerable influence over the bulk majority of investment decisions within provincial boundaries through their manipulation of bank officials. The power of provincial governments over investment decisions has not, therefore, been affected by the proliferation of investment actors and the growth of the non-state sector.

Why, then, are the provincial governments able to exercise such substantial influence, if not control, over the banks? The bank system in China is, in theory, a vertical system, whereby the provincial branches of the specialized state banks owe their first allegiance to their headquarters in Beijing. In practice the influence of the provincial government is unsurmountable. The provincial branches rely on the provincial government to provide the social infrastructural support for their staff. Moreover, whilst provincial governments count on the banks to provide capital for their investment projects, the banks depend on the provincial governments and their subordinate enterprises in order to meet their quotas of business turnover. Again, this interdependence is largely a product of the reforms of the 1980s, when banks were required increasingly to act like commercial entities and to produce profits.⁶⁸ However, as one type of state enterprise operating under "soft

⁶⁶A nationwide survey covering over 2600 managers of state enterprises conducted in 1994 found that nearly 80% of the respondents was so dissatisfied with their situation that they would like to be transferred to the non-state sector. The number one problem was the failure to materialize the autonomy promised in the 1992 Regulation, and nearly 70% of the managers had to spend over 30% of their management time on "handling interferences from outside". See *Ming Pao* (Hong Kong) June 25, 1994, p.A13.

⁶⁷The percentage share of total investment using bank loans and "own funds and other funds", the latter often having to be used through the banks, during 1986-90 stood at 84.6%, while the share of budgetary investment was only 9.7%. See *Statistics on F&I (1990-1991)*, p.19.

⁶⁸See Zhong Chengxu (ed.), *Difang Zhengfu Touzi Xingwei Yanjiu* (A Study of the Investment

constraints", the banks themselves would not be penalized for bad debts loaned to inefficient projects.⁶⁹ Consequently, the banks would be inclined to co-operate with provincial governments in expanding credits to finance local projects, especially at times when the "political atmosphere" was relatively relaxed and pressure from the Centre to control the finance quotas was relatively mild.⁷⁰ Summarily reflecting the close relationship between the provincial government, the enterprises and the local banks, a city mayor told a director of a local bank:

"For progressive and advanced enterprises, you have to support (their development and growth); for the average enterprises, you have to lend a hand (to improve their performance); for backward enterprises running in the red, you have to help them to maintain (survival needs)."⁷¹

Provincial governments have, therefore, been able to retain, if not increase, their influence over investment activities through their leverage over the supply of bank finance, and through their authority as government units to "make life easier" for enterprises. By giving more resources to the enterprises but not quite enough to enable them to stand on their own feet, the program of economic decentralization has worked largely in the interests of the provincial and lower-level governments, as opposed to those of the Centre. Moreover, the continued participation of the provincial government in investment decisions in enterprises, as well as its extension into areas outside the traditional domain of the government, not only extends the influence of the local state, but also accounts for the provinces' success in withstanding central control over their investment agenda (the details of which are discussed in Chapters Five and Six). By acting as the "visible hand" behind the decisions of enterprises, and by assuming the role of mentor, sponsor and co-ordinator, the provincial government has come to exercise a degree of power far exceeding that suggested by the proportion of investment financed by the

Behaviour of Local Governments) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1993), p.170.

⁶⁹For an analysis of the problem of efficiency of the state banks in the reform period, see Wang Haibo (ed.), *A Study of the Economic Efficiency*, p.400.

⁷⁰Since the late 1980s the Centre has repeatedly warned against improper interference by provincial governments in the local bank branches. In the comprehensive reform package by the State Commission for Economic System Reform in 1988, it was explicitly stated that "leaders of various levels and various government departments have to support the banks in the exercise of their autonomy, and should stop any credits above those of the state set quotas." See "The 1988 Comprehensive package on deepening the economic system reform, State Commission for Economic System Reform", approved by the State Council on February 27, 1988, printed in *Since the Thirteenth Party Congress*, p.87. Again, during the macro-adjustment of 1993, Vice-premier Zhu Rongji in a national finance conference explicitly warned that banks should follow the rules of the Centre. He pledged that if in the future any bank officials in local branches were dismissed by the local governments as a result of their refusal to co-operate in unreasonable loan requests, they should complain to him directly and that he would back them up. See *Ming Pao* (Hong Kong) July 7, 1993. Zhu's statement reveals the substantial power and leverage of provincial and lower-level governments over the local branches of the banks, and the severity of the problem.

⁷¹See Zhong Chengxun (ed.), *A Study of the Investment Behaviour of Local Governments*, p.14.

provincial budget. Through this indirect route, provinces have, since the 1980s, become the predominant actor in investment vis-a-vis the Centre, thereby altering the central/provincial balance of power in this arena.

Implications of the Investment Problem: A Central *and* Local Issue

The above discussion suggests that the problem of investment control in China is both a central and a local problem. It is a central problem because the quest for more investment is ultimately grounded in a nationalistic desire to regain national glory and to raise the international status of the nation. Given the historical context of the formation of the People's Republic, the success or failure of the modernization program could affect the entire political legitimacy of the regime. Investment and economic development have, therefore, always been a major concern of leaders at the Centre.⁷² Moreover, the institutional context which has *facilitated* excess investment over and above prescribed quotas over the years is also part and parcel of the socialist system of public ownership. Consequently, the issue of investment control is endemic to the socialist system, and, given the bias for centralization within such a system, the local factor of implementation bias was, until the 1980s, only secondary.

The decentralization reforms of the 1980s gave enough power and resources to provincial and lower levels to change the scene. The fiscal reform in 1980 in particular resulted in a situation whereby the provincial government had a built-in incentive to increase investment. In the political language of the central leadership, fiscal reform successfully built up a second source of "enthusiasm" in the state apparatus at provincial level, as "back up" to the source of enthusiasm at the Centre.⁷³ The changes outlined in the above section demonstrate that the provincial

⁷²This is despite the fact that leaders of different periods have had widely different assessments of the economic situation of the country, as well as ideas regarding appropriate strategies with which to further the might and the strength of the country. Chairman Mao Zedong opted for a mobilization approach, whereby the enthusiasm of the masses was used to provide extra inputs of resources at a time when the international exclusion of China disabled it from obtaining additional resources from outside of its borders. This strategy *required* a more optimistic assessment of China's strength, so that the enthusiasm of the masses could be protected and reinforced. This deliberate radicalism was obvious when Mao faced criticisms from the more "conservative" central leaders during the Great Leap Forward. In a meeting held in January 1958, Mao reportedly criticised his conservative colleagues for committing a political mistake, because "if you were to oppose radicalism, the enthusiasm of the masses would be immediately affected." See Fang Weizhong (ed.), *The Major Economic Events in the People's Republic of China, 1949-1980*, p.205. The excesses of optimistic radicalism forced the revamped post-Mao leadership under Deng Xiaoping to adopt a more conservative and realistic assessment of the situation. The warming up of Chinese-U.S. relations since 1972 also provided a favourable international environment for the change.

⁷³The reference to provinces and localities as being the second source of enthusiasm, the Centre being the first and primary source, is made by Mao Zedong in his famous speech, "Lun Shida Guanxi" (On the Ten Great Relationships), April 15, 1956, printed in Mao Zedong, *Selected Works*

government has increasingly become an *independent* actor in investment decisions, and the problems of investment since the 1980s have increasingly merged into the one main issue of central control over investment decisions made at provincial and subprovincial levels.

What is most important, however, is that since the 1980s the investment problem has been, still, *both* a central and local issue. The reforms of the 1980s have added a local implementation dimension to the issue. Yet the original nature of the problem remains the same. It is bound up in the nationalistic drive for rapid modernization and in the failure of the public ownership system to impose an effective self-monitoring efficiency mechanism. The dual nature of the investment problem since the 1980s explains its complexity. In particular, it explains the recurrent phenomenon whereby after each drive of central control and investment contraction, there is a new round of investment expansion, often sanctioned by the central leadership itself.

For instance, Zhao Ziyang, former premier and General Secretary of the Chinese Communist Party, was reportedly very slack in the enforcement of control instruments and policies, and ignored the excessive expansion of bank credits which first started in the south and which became serious in the mid-1980s.⁷⁴ Eager to expand the economy, Zhao apparently believed that expansion of credits and some degree of inflation was not a serious issue, and did not bother, therefore, to revise the original quotas so as to make them approach the actual level of credits.⁷⁵ The system simply fell into disuse. This problem finally led to the retrenchment which started in late 1988 and lasted until 1991. The southern tour of Deng Xiaoping in 1992 however signalled a change of "political wind" from the Centre and provincial governments acted immediately in readjusting their plans and strategies. As a Guangdong official commented in 1993, "By this year (1993), the control over the investment scale, stringent once more since 1989, is no longer working. There is, however, no explicit change of policy or rules. The climate is simply different, and any attempts at control in this situation would have been futile."⁷⁶

of Mao Zedong (5 volumes), Vol. 5, (Beijing: Renmin chubanshe, 1977), p.275.

⁷⁴Respondent No.39, Beijing interview, June 1994. Respondent No.1 revealed that during 1987 and 1988, the banks themselves relaxed the control over money and credit supply, and many bank officials at that time had to knock the doors of local government departments and enterprises asking for loan applications. (Guangzhou interview, May 1993).

⁷⁵Respondent No.39, Beijing interview, June 1994.

⁷⁶Respondent No.4, Guangzhou interview, May 1993.

The recurrent cycles of expansion and contraction suggest that central control, or effective central control, is at best an intermittent phenomenon. Although there are regulations, rules and policies prescribing the proper investment scale and the proper procedures for project approval, provincial government officials know that they are safe to ignore, or pay only lip service to, the rules "when the climate is right". The fact that central leaders themselves are eager to increase *viable* investment and to launch good investment projects has enabled provincial leaders to argue for exceptions in the various central control measures by appealing directly to the desires and inclinations of the central leaders.⁷⁷ In fact, because of such inclination on the part of the central leadership, a "more relaxed" environment, meaning that rules and regulations may be ignored or bypassed with relative safety, has become the "normal" state from the perspective of the provincial government. The "stringent" climate whereby the Centre demands strict enforcement of existing rules is regarded either as "extraordinary" or as being a "crisis" situation.

The fact that central leaders are equally as eager to expand investment and develop the economy as provincial leaders, if not more, explains why the control of the Centre has been so ineffective. It is ineffective because since the very beginning this has not been a control versus being controlled situation. Provincial government officials have always argued, and justifiably so, that their investment plans are of help to the Centre in its task of developing the national economy. Here it is worth recalling that the investment scale *per se* has not actually been the issue, as noted in the first section of this Chapter. Investment scale has become the issue only when the direction and efficiency of the projects involved has been considered problematic. But the propriety of investment direction and efficiency is no simple, hard-and-fast issue. As a result, as will be discussed further in Chapter Five, a motivated provincial government official can frequently convince an equally motivated central government official that certain local investment projects are good and well worth the resources, even though the original centrally prescribed investment quotas are necessarily exceeded as a result.

⁷⁷One tactic used by the Guangdong provincial government to bargain for a higher investment quotas from the Centre, and to legitimize excess performance, is to convince the central leadership of the desirability of particularly individual investment projects. Respondent No. 9, Guangzhou interview, December 1993. See discussion in Chapter Five.

Chapter Three

Institutional Context of Investment Administration in Guangdong

The objective of this chapter is to provide the context for answering the question: what does fixed asset investment in Guangdong tell us about provincial-central relations in Guangdong? Two sets of questions are involved here. First, what characterizes Guangdong's investment after 1980? What are the major changes in investment so far as central-provincial relations are concerned? Is there an "implementation gap" in fixed asset investment policy in the Centre-Guangdong interface, and what are its characteristics? Second, how do the changes in Guangdong's investment come about? What institutional changes have taken place behind the phenomenal changes in the investment scene, and in particular, the phenomenon of an investment "implementation gap"? A full understanding of the institutional context is prerequisite to understanding the politics of the process, which is explicitly discussed in Chapters Five and Seven. This chapter will focus on an examination of the institutional context which is pertinent to the behaviour of the provincial government in fixed asset investment.

Investment in Guangdong

The fixed asset investment scene in Guangdong after 1980 is characterized by two phenomena. One is the proliferation of investment funding channels and investment actors. The other is the rapid growth of the total size of investment from a relatively low base. The two are clearly related. On the one hand, the rapid growth in total investment is the result of the proliferation of investment funding channels and investment actors. On the other hand, such a plurality of actors and funding sources has evolved due to a strong *demand* for more investment. The dynamics and processes through which Guangdong's investment has developed into a "great leap forward" are the subject of the next section, where the institutional changes of the 1980s will be discussed. This section begins with an analysis of the investment expansion phenomenon.

Rapid Growth from a Low Base

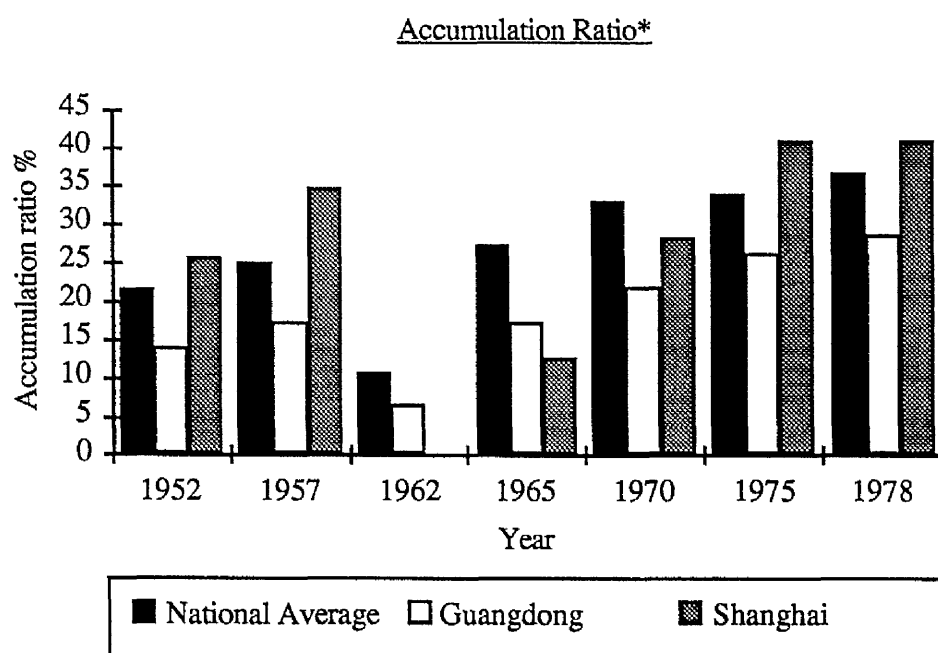
Low Base

Historically Guangdong has not been a preferred recipient of state investment. The proportion of national income utilized in the province for

accumulation purposes prior to 1979 was low compared to the national average and that of industrial centres such as Shanghai. At that time there were few large and medium sized investment projects in the province, most of the investment undertaken having been in the light and processing industries. The tables below show the low level of investment in Guangdong before the reform decade commenced in 1979.

Table 3.1

<u>Accumulation Ratio (%)</u> *			
<u>Year</u>	<u>National Average</u>	<u>Guangdong</u>	<u>Shanghai</u>
1952	21.4	13.9	25.6
1957	24.9	17.2	34.6
1962	10.4	6.6	n/a
1965	27.1	17.1	12.4
1970	32.9	21.9	28.3
1975	33.9	26.1	41.0
1978	36.5	28.4	41.0

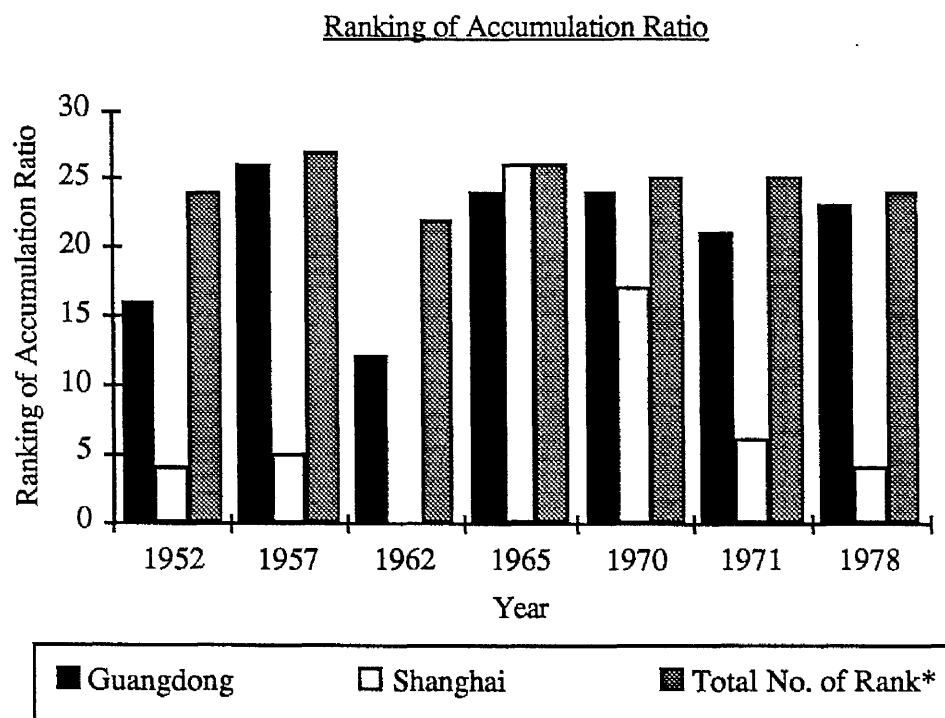


*Notes: Accumulation ratio is the ratio of utilized national income used for working capital, stock, and fixed assets investment.

Source: *Guangdong National Economic and Social Development Statistics and Information 1949-88. Part on Fixed Assets Investment.* (hereinafter *Guangdong 1949-88. FAI*) (Neibu, 1989), pp.197-99.

Table 3.2

Year	Ranking of Accumulation Ratio		
	Guangdong	Shanghai	Total No. of Rank*
1952	16	4	24
1957	26	5	27
1962	12	n/a	22
1965	24	26	26
1970	24	17	25
1971	21	6	25
1978	23	4	24



*Notes: The total number fluctuates each year and is not necessarily equal to the total number of provinces as some provinces may have identical accumulation ratios.

Source: Computed from *Guangdong National Economic and Social Development Statistics and Information 1949-88. Part on General Statistics*. (hereinafter *Guangdong 1949-88 (General)*) (Neibu, 1989), pp.197-98.

Tables 3.1 and 3.2 show that Guangdong's accumulation ratios prior to 1979 were, for most of the years shown, at least 7% lower than the national average. Compared with the 28 other provincial-level administrations, its ranking was always at the bottom end of the scale.¹ Its ranking was particularly poor when compared to Shanghai, which was, with the exception of 1965 and 1970, amongst the upper ranks.

¹Prior to 1988 there were only 29 provinces (including provincial-level municipalities and autonomous regions) in China. In 1988 Hainan was separated from Guangdong and made a province on its own.

This low accumulation was probably due to the small number of medium-large sized investment projects carried out in Guangdong before 1980. The coastal and peripheral geographical location of Guangdong made the province vulnerable to foreign attack. At a time when strategic and warfare considerations loomed large within the central leadership, Guangdong was not a preferred base for investment and economic development in the eyes of the central government. As medium-large sized investments were at that time mostly approved and financed by the central government, the number of sizable investment in Guangdong during the pre-1980 period remained small and the rate of accumulation was, therefore, low.

Table 3.3

Completed Medium-large sized
capital construction projects (Number)

<u>Year</u>	<u>National</u>	<u>Guangdong</u>	<u>(%)</u>
1953-57	595	17	(2.85)
1958-62	581	25	(4.30)
1963-65	355	26	(7.32)
1966-70	743	15	(2.02)
1971-75	742	8	(3.10)
1976-80	515	26	(5.05)
Total	3531	117	(3.31)

Sources: Xie Minggan, and Lou Yuanming (eds.), *Zhongguo Jingji Fazhan Sishi Nian* (Beijing: Remin chubanshe, 1990), p.174; *Guangdong 1949-88. FAI*, p.206.

As a result of its below average accumulation ratio, Guangdong's yearly investment correspondingly fell below the national average. From 1950 to 1978, Guangdong's fixed asset investment in the state sector amounted to a total of 21.3 billion yuan. The average investment per annum figure of 734 million yuan was one-third short of the national average yearly investment, assuming investment has been distributed evenly across the 29 provinces/municipalities.

Table 3.41950-78 State Sector Investment (Yuan billion)

	<u>National(N)</u>	<u>Guangdong(G)</u>	<u>G % of N</u>	<u>Average*</u>
Total	768.8	21.3	(2.8)	-
Annual Average	26.5	0.7	-	0.9

*Notes: "Average" refers to the hypothetical share of investment for each province if total investment is evenly distributed amongst all provinces.

Sources: *Guangdong 1949-88. FAI*, pp.158-61; State Statistical Bureau (ed.), *Statistics on Investment in Fixed Assets of China (1950-1985)* (hereinafter *Statistics on FAI*) (Beijing: Zhongguo Tongji chubanshe, 1986), p.9.

Rapid Growth

The small share of Guangdong's investment in the national total before 1979 indicates how much has changed since then. In 1992 Guangdong's total societal investment amounted to 11.8% of the national total.² In both 1991 and 1992, Guangdong ranked first among the 30 provincial-level administrations in terms of the value of total societal investment, with Shanghai ranking sixth and seventh.³ Guangdong's yearly average investment during the 1979-92 period amounted to 25.4 billion yuan, more than 32 times the average during the 1950-78 period, as shown in Table 3. 5 below.

Table 3.5Guangdong's Total Societal Investment
(Yuan billion)

<u>Period</u>	<u>Total</u>	<u>Annual Average</u>
1950-78	22.6	0.8
1979-92	355.6	25.4
1950-92	378.3	11.5

Source: *Guangdong Statistical Yearbook 1993*, p.236.

This high rate of growth has made possible the "great leap forward" in Guangdong's investment ranking. The annual investment growth rates of Guangdong as compared with growth rates nationwide are shown in Table 3.6 below.

²See *Guangdong Statistical Yearbook 1993*, p.94.

³See State Statistical Bureau (ed.), *Quanguo Zhuyao Shehui Jingji Zhibiao Paixu Nianjian-1992*. (The 1992 Yearbook of the Ranking of Provinces in Major Social and Economic Indicators) (Beijing: Zhongguo Tongji chubanshe, 1992), p.19.

Table 3.6

Growth Rate of Total Societal Investment (%)

<u>Year</u>	<u>Guangdong</u>	<u>National Average</u>
1979	3.9	n/a
1980	35.4	n/a
1981	57.7	n/a
1982	40.3	28.0
1983	4.7	16.2
1984	47.0	28.2
1985	41.6	38.7
1986	17.3	18.7
1987	16.0	20.6
1988	40.9	23.5
1989	-1.8	-8.0
1990	7.3	7.5
1991	28.3	23.8
1992	92.8	n/a
1979-1992	30.8	*19.7

*Note: The cumulative average for the national figure is for the period 1982 to 1991 only.

Sources: *Guangdong Statistical Yearbook 1992, 1993*, respectively, p.145, p.236; *Guangdong 1949-88. FAI*, p.176; *Statistics on FAI (1950-1985), (1988-1989)*, respectively, p.8, p.13.

Table 3.6 shows that for most of the years since 1979, total societal investment has more often than not grown more rapidly in Guangdong than nationwide. The average yearly growth rate for the 1979-92 period was 30.8%, whilst nationally during the 1982-91 period the growth rate stood at 19.7%. This continuous growth throughout the 14-year period was interrupted in 1989, when investment throughout the country was hampered by severe retrenchment measures and the national growth figure dived to -8%. However, investment in Guangdong's collective sector nevertheless rose by 1.7% in 1989, indicating that the 1989 austerity programme failed to suppress entirely the investment drive in Guangdong.

The high growth rate of Guangdong's investment is reflected in its higher than average accumulative ratio. Table 3.7 below shows Guangdong's accumulation ratios during the 1980s as being, in general, slightly higher than the national average. These ratios were also on average over ten percentage points higher than those prior to 1980 as shown in Table 3.1. Consequently Guangdong's ranking at the bottom end of the provinces in 1980 elevated significantly towards a more central position by 1985.

Table 3.7

Accumulation Ratio: Guangdong(G)

<u>Year</u>	<u>National Average</u>	<u>G (%)</u>	<u>G Ranking</u>	<u>Total No.of ranks</u>
1980	31.5	22.4	27	28
1985	35.0	35.4	12	26
1986	34.7	34.3	14	29
1987	34.2	34.6	13	28
1988	34.1	35.8	14	29
1989	34.4	35.6	12	29

Source: *Guangdong 1949-88 (General Statistics)*, pp.197-99.

Guangdong's investments during the 1980s were on a much larger scale than those prior to 1980 when it was assigned only a small number of medium-large sized investment projects. In 1990 and 1991, Guangdong completed the largest number of medium-large sized projects nationally. A total of 19 and 22 projects were completed respectively, as compared with nine and four projects in Shanghai.⁴ Table 3.8 demonstrates the substantial increase which has occurred in Guangdong's share in medium-large sized investments since the mid-1980s.

Table 3.8

Share of Guangdong's medium-large sized
investments in national total

<u>Year</u>	<u>Share (%)</u>
1953-57	2.3
1958-62	3.5
1963-65	2.1
1966-70	2.9
1971-75	2.5
1976-80	3.1
1981-85	3.9
1985	4.8
1986	8.9
1987	5.6
1988	6.4
1989	6.5
1990	10.3
1991	10.5

Sources: *Guangdong 1949-88. FAI*, p.197; *Guangdong Statistical Yearbook 1991, 1992*, respectively, p.151, p.153; *Statistics on FAI (1950-1985), (1988-1989)*, respectively, p.70, p.60.

As a result of its high rates of growth, Guangdong's total societal investment has

⁴Ibid., p.27.

consistently surpassed the control figures agreed with the Centre, and by very large margins. Table 3.9 supplies the details.

Table 3.9

Differentials between Plans and Performance
(Yuan Billion)

<u>Year</u>	<u>Control Figures*</u>	<u>Actual Societal Investment</u>	<u>Excess Investment (%)**</u>
1980	5.1	3.8	-25.5
1985	5.5	18.5	236.4
1988	12.8	35.4	176.6
1989	14.0	34.7	147.9
1990	20.7	37.3	80.2
1991	23.6	47.8	102.5
1992	34.5	92.2	167.2

Notes: * Figures for 1980, 1985, and 1988 are control figures calculated at the beginning of the year. Adjusted figures calculated at the years' end, which are usually larger, are not available. Figures for the other years are year-end adjusted figures.

** Because of the discrepancy in the coverage of the planning control figures and statistics on actual investment, the two are not entirely comparable.

Source: Information obtained from Guangdong Planning Commission, Investment Bureau.

The above table shows that during the 1980s control figures passed down by the central government were consistently and substantially surpassed. The retrenchment years of 1989, 1990 and 1991 were no exception. The planned investment level for 1989 in the provincial plans made according to central directives prescribed a *decrease* of 20.5% from the planned level in 1988.⁵ But as seen in Table 3.9, the actual societal investment for the year 1989 surpassed the control limit by 150%.

It should be noted that the control figures and investment statistics are not, strictly speaking, entirely comparable. The statistics purportedly measure all investments undertaken in the province *which have been reported to the authorities concerned*.⁶ Such statistics include investment in the state and the non-state sectors

⁵See extracts from The Report of Guangdong's 1989 Economic and Social Development Plan by the director of Guangdong's Provincial Planning Commission, published in *Jihua Yu Fazhan* No.1 (1989), pp.6-12, p.7.

⁶Some investments, usually at local levels, were *not* reported to superiors and therefore were not included in the statistics. A former State Planning Commission official told the author that in his visits to the localities, he had discovered some "unreported" investment projects which had never

and of all funding channels, including those of both central and local investment projects. The control figures, on the other hand, have a narrower scope due to multiple exclusion categories as detailed below. Coverage has also varied over the years. For instance, in 1980 control figures cover capital construction investment in the state sector only, but as from 1988 capital construction in the non-state sector was also included. Since 1990, investment in commodity housing projects has always been included due to its increasing share in the total investment. However, central investment projects in either sector have always been excluded, as have foreign direct investments. And in 1992, the central government assigned specific control figures to Shenzhen and Guangzhou, whose investments have since also been excluded from the Guangdong provincial control figures.⁷

If investment in central projects is deducted from the total investment figure thereby eliminating a major source of coverage incompatibility, the excess investment ratios fell but are nevertheless significantly high.

gone through the formal planning and approval procedures and were supposedly "nonexistent" in the state investment plans and in the investment statistics. See Chapter Four on Shanghai for more on the coverage of statistical data and underreporting of investment activities in statistics.

⁷Respondent No.9, telephone interview, September 1993. In a sense the different coverage is due to differences in the *nature* of the two. Investment statistics are meant to be a factual reflection of the total amount of investment activity taking place in the province, irrespective of whether the investments are authorized or "illegal", or whether the investments have a subordination relationship within or without the province, or whether the funding comes from inside or outside the state coffers, or from inside or outside of China. On the other hand, the planning control figures are a *tool* of the central government to control investments undertaken by Guangdong. As a result, investments undertaken in Guangdong but not by the enterprises and authorities of Guangdong, for instance, those by the central ministries and other provinces, are excluded from the planning figures. See "Supplementary Regulations on Domestic Joint Investments" by the State Planning Commission, the State Economic Commission, and Finance Ministry, et al. 19 December 1984, printed in State Statistical Bureau (ed.), *Guding Zichan Touzi he Jianzhuye Wenjian Huibian* (A Compendium of Documents on Fixed Asset Investment and the Construction Industry) (Beijing: Zhongguo Tongji chubanshe, 1992), p.326. Certain categories of investment may also be excluded from the planning figure as a result of central policy. Foreign direct investments, for example, are excluded so as to encourage the Guangdong province to attract more foreign investments. In 1982 and 1985, respectively eleven and five categories of investment such as the repair of existing equipment, the building of roads, schools, hospitals and museums, and staff hostels using extrabudgetary or "own funds" were excluded so as to avoid these socially desirable projects from being crowded out by more profit-oriented projects. See Dangdai Zhongguo Congshu Bianji Bu. (ed.), *Dangdai Zhongguo de Jingji Guanli* (The Economic Management of Contemporary China) (Beijing: Zhongguo Shehui Kexue chubanshe, 1985), p.237.

Table 3.10

Differentials between Plans and Performance (Adjusted)
(Yuan Billion)

<u>Year</u>	<u>Control Figures</u>	<u>Societal Investment*</u>	<u>Excess Investment %</u>
1980	5.1	3.0	-42.0
1985	5.5	15.6	184.4
1988	12.8	35.4	139.8
1989	14.0	30.0	113.7
1990	20.7	31.5	52.0
1991	23.6	41.3	75.4
1992	34.5	82.5	139.2

*Note: The adjusted figures are arrived at by deducting central projects (state sector) investments from the total societal investment figures. (For sources see Table 3.11 below). Because investments in the non-state sector are normally of local subordination relations, the difference should be locally-subordinated investments.

Their different coverages notwithstanding, the substantial differentials between the control figures and actual investment give some idea as to the extent of investment activity taking place beyond the scope of planning control. This is indicative of the waning control of central government over the province via the traditional planning system, and of the increasing irrelevance of the state plan as an indication of the actual investment activities at provincial and lower levels.

In 1993, Guangdong Provincial Planning Commission in a quite defiant move ceased its practice of assigning investment control figures to the subprovincial levels of government after it was assigned a lump sum control figure by the central government. The quota instruction was simply filed away. In the words of a provincial official, the task had become little more than a ritual surviving from the old system of central planning, and which as such had no place in the current drive towards a market economy.⁸

Proliferation of Actors

The proliferation of actors in the field of fixed asset investment occurs on two fronts. First, there has been a diversification of investment funding channels, which has had the effect of bringing in more actors as lenders and investors in the undertaking of investment activities than ever before. Therefore the state, and in particular the central government, can no longer dominate the investment scene by

⁸Respondent No.9, Guangzhou interview, September 1993.

controlling the supply of funds. Second, investment has become more diffused within society and is no longer the sole privilege of the state sector. The non-state sector, comprising the collectives and the private sector, has also been growing at a much faster rate than the traditionally mighty state sector. Within the state sector itself decentralization of investment authority has made subprovincial governments at city, county and township level active investors in themselves. Consequently the authority of the central government has become appreciably marginalized.

Declining Central Investment

The most significant phenomenon resulting from the proliferation of funding channels in Guangdong has been the marginalization of central investment in Guangdong's fixed asset investment.

As shown in Table 3.11 below, during the early 1950s fixed asset investment by the central government accounted for over 70% of the total. This share declined drastically during the 1960s and 1970s when a large number of central enterprises became decentralized to provincial and lower levels at that time. The share of central investment again rose to 66% in 1978 when many large enterprises resumed their former subordination relationship. But after decentralization once more during the 1980s the share of central investment fell and was under 20% by 1992.

Table 3.11

Central and Local Investments
in Guangdong's State Sector (%)

<u>Year</u>	<u>Central Investment</u>	<u>Local Investment</u>
1952	72.0	27.9
1957	64.0	36.0
1962	31.6	68.4
1965	37.6	62.4
1970	12.2	87.8
1975	17.4	82.6
1978	66.4	33.6
1980	32.6	67.4
1981	27.8	74.2
1984	25.8	74.2
1987	29.7	71.3
1988	16.4	83.6
1989	23.9	76.1
1990	23.4	76.6
1991	21.3	76.7
1992	19.5	80.5

Sources: For 1952-78: *Guangdong Statistical Yearbook 1984*, p.217. For 1979-83: *Guangdong 1949-88 FAI*, p.172. For 1984-92: *Guangdong's Fixed Assets Investment Statistical Information*. (hereinafter *Guangdong FAI Statistics*) Yearly volumes 1984-1992. (Guangdong Statistical Bureau, Not openly published)

It should be noted that the percentage shares in Table 3.11 are calculated according to the subordination relations of each investment project. The entire value of a centrally subordinated investment project is calculated as a central investment. The same applies conversely to locally subordinated projects. However it appears from data made available during the 1980s that there have been substantial cross-overs of funds from a government level to a project subordinated to another government level.⁹ It is thus possible to know more precisely the share of central/local investment in terms of actual monetary contribution. The movement of funds also indicates the underlying central-provincial dynamics. Details are shown in the following two tables.

⁹It should be noted that before 1980 it was customary to have substantial inflows of central funds to locally subordinated investment projects. This was because under the traditional fiscal and planning system, revenues were highly centralized and the central government was responsible for the planning, approval as well as the funding of the larger investment projects. However this has changed since 1980, especially in Guangdong which, with the new *dabaogan* system, has become responsible, in principle, for the planning and funding of most investment activities within the provincial borders. This must be taken into account when looking at statistics on central and local investment calculated according to subordination relations before and after 1980. (See Chapter Four for more discussion on this point.) In accordance with the new principle of division of responsibilities between Centre and provinces, the amount of local investment by subordination is purportedly the same as the amount by source funding. This sets the scene for the following discussion on the cross-over of funds.

Table 3.12

Local Investment Share (%)

<u>Year</u>	<u>By Subordination Relations</u>	<u>By Funding Source</u>
1984	74.2	68.2
1985	79.1	77.6
1986	80.7	80.7
1987	71.4	74.2
1988	83.6	n/a
1989	76.2	75.5
1990	76.6	76.3
1991	78.7	78.4
1992	80.5	81.1
1984) 1992)	78.2	78.1

Source: *Guangdong FAI Statistics.*

Table 3.13

Fund Cross-Overs (Yuan Mn)

<u>Year</u>	<u>Central Funds to Local Projects</u>	<u>Local Funds to Central Projects</u>	<u>Crossover % of Total</u>
1984	379.9	26.4	(5.1)
1985	81.9	54.7	(1.1)
1986	0.0	n/a	n/a
1987	47.7	113.5	(0.9)
1988	n/a	n.a	n/a
1989	151.5	169.3	(1.6)
1990	185.0	117.2	(1.2)
1991	333.6	260.5	(2.0)
1992	150.2	554.4	(1.4)
1984) 1992)	1329.8	1296.0	(2.2)

Source: *Guangdong FAI Statistics.*

Table 3.13 shows that in Guangdong between 1984 and 1992 the total crossover of funds amounted to some 2.2% of the total value of investments. Table 3.12 shows that, after accounting for the cross-over of funds as detailed in Table 3.13, the share of local investment during the 1984-92 period dropped slightly, but still remained at more or less the same level as the subordination figure. It is interesting to note that in Table 3.13, the crossover of local funds to central projects is not much less than vice versa. And in 1987 and 1992, Guangdong's injection into central projects was between two and three times the value of the inflow of funds from the Centre.

The information shown in Table 3.13 represents only part of the scale of fund movement which actually took place. To disaggregate entirely the source of funding, a detailed breakdown of every channel of funds is necessary. In other words, the general category of "budgetary funds" needs to be broken down into central budgetary funds and local budgetary funds. The "own funds" should be differentiated in accordance with the source, namely, *whose* own funds. As a portion of bank loans are financed directly from the central coffers, this part should be differentiated from the balance of loans which are financed by bank deposits. Thus each category of detailed funding source and its allocation of funds to central/local investment projects is clearly identified.¹⁰

Due to data limitation, Table 3.13 is primarily based on the cross-over of "own funds". A breakdown of budgetary funds is available for the technical renovation investment of 1984 only. This piece of information, however, indicates that the budgetary channel is a major channel of inflow of central funds to local projects.¹¹ Hence the extent of the central inflow of funds over the years may well be substantially under-reported due to the lack of available data in this area. However, the outflow of local funds to centrally subordinated projects in Guangdong should not be interpreted as skill on the part of the Centre in extracting local resources from Guangdong. The phenomenon is more likely the result of Guangdong's successful "fishing" of central investment in the province. By agreeing to contribute capital to central projects *located in the province*, the Guangdong government can increase the total value of investment projects in the province, particularly when central investment projects are not taken into account in the centrally prescribed quotas of total local investment. As a planning official put it, "since these projects are all located in Guangdong, they contribute towards the multiplier effect of the economic development in the province regardless of their subordination relations and to where the *direct* taxes and profit of the project go."¹²

¹⁰The necessity of such disaggregation was confirmed by Respondent No.4, Guangzhou interview, September 1993. Respondent No. 36 clarified that foreign loans which are centrally co-ordinated are *not* the means to a central injection of funds. Whether the foreign loans are centrally or locally co-ordinated depends on the method of arranging the loans. Centrally co-ordinated loans may have a lower interest rate because of the type of loans normally dealt with by the Centre and its superior bargaining power with the lending parties. Nevertheless the loans are still repaid by the user-units, albeit via the Centre, to the lending parties. (Beijing interview, May 1994)

¹¹This pattern of capital inflow from the Centre was also confirmed by Respondent No.4, Guangzhou interview, September 1993.

¹²Respondent No.9, Guangzhou interview, December 1993. It should be noted that before the 1994 tax reform, indirect taxes, for instance turnover taxes, of all enterprises, central and local, went to the local coffers where the enterprises were situated. After the reform 75% of the turnover taxes of *all* enterprises went to the central coffers, and 25% to the local coffers. See State Council Notice No.85, 1993, "State Council's Decision on Implementing the Tax-sharing Fiscal Management System", printed in *Caizheng*, No.2 (1994), pp.18-20.

It must be remembered that Tables 3.11 to 3.13 refer to investment in the state sector only. As most investment in the collective sector, and virtually all in the private sector, is local investment, the share of local investment in total societal investment is larger than the percentage shares indicated in these tables. This is especially so for the 1980s when the non-state sector investment grew to a substantial share.

The decline of central investment's share in Guangdong is due to two independent developments. First is the reform in the budgetary fiscal system with the subsequent decentralization of budgetary resources. Second is the proliferation of funding channels of investment. As a result of fiscal reform Guangdong can deploy more budgetary funds for local investment. However, this does not necessarily mean that Guangdong's growth of investment is fueled by the increased inflow of budgetary funds. In fact, more of the additional budgetary revenues Guangdong retains as a result of fiscal reform is assigned to social expenditure such as education and health than to fixed asset investment, both in percentage and absolute terms.¹³ Therefore the influence of fiscal reform on investment growth is far more subtle than the straight forward supply of funds.

The decline of central investment in Guangdong is therefore more directly due to the second development, that of proliferation of funding channels other than the state budget. As these "extrabudgetary" sources are less subject to central government control, Guangdong has been able to circumvent a substantial part of central scrutiny by resorting to these financing resources for its investments.

Decline in Budgetary Investment

The shrinking share of central investment in Guangdong was underlined by greater shrinkage still of the share of investments using budgetary revenues. The state budget, whether at the central or provincial level, used to be the major source of funding for fixed asset investment. Before 1978 over 80% of state sector investment in Guangdong was funded by the state budget. This share declined to only 13% between 1979 and 1988.¹⁴ This rapid and continuous decline of the state-

¹³Guangdong's fiscal expenditure on education and health from 1987 to 1991 was 2.29 (billion yuan, same as follows), 2.60, 3.32, 3.53, and 3.98 respectively; while fiscal expenditure on investment for the same period was 2.05, 2.62, 2.64, 2.96, and 3.62 billion yuan. See *China Finance Statistics, 1950-1991* (Beijing, Science Press, 1992), p.157. For figures in percentage terms, see Table 3.23 in text.

¹⁴See *Guangdong 1949-88. FAI*, pp.11-12.

budget-financed share of investment is detailed in Table 3.14 below.

Table 3.14

Share of Investment Financed by the State Budget in Guangdong (%)

<u>Year</u>	<u>Total Societal Investment</u>	<u>State Investment</u>
1978	46.3	62.9
1979	49.0	69.0
1980	30.0	44.6
1981	15.1	26.4
1985	7.2	10.2
1988	3.1	4.3
1989	n/a	4.4
1990	3.2	4.4
1991	2.5	3.7
1992	1.3	1.9

Source: *Guangdong 1949-88. FAI*, pp.88-89; *Guangdong Statistical Yearbook 1992, 1993*, respectively, pp.231, 233; p.237.

From 1979 to 1992, the share of budgetary investment declined from nearly 70% for the state sector and just under 50% for total societal investment to a negligible 1.9% and 1.3% respectively. The gap has been filled by investments financed by bank loans, by "own funds" of enterprises and departments, by foreign investment and, since the early 1990s, by societal capital gathered through the issue of shares via the developing securities market.

Table 3.15

Funding Channels of State Sector Investment
1979-1988 (%)

<u>State Budget</u>	<u>Bank Loans</u>	<u>Foreign Capital</u>	<u>Own Funds</u>	<u>Others</u>
13.3	25.2	13.7	34.2	13.6

Source: *Guangdong 1949-88. FAI*, p.12.

Table 3.15 shows that during the 1979-88 decade, the state budget became the *least* important channel of investment funding for state sector investment in Guangdong. More investment in the state sector was financed by money from abroad than by money from the state. In fact it was not only the relative share of investment financed by the state budget which dropped drastically, the *absolute* value also decreased. Table 3.16 shows that while total investment in the state sector increased by 66,045 million yuan, or 3292%, from 1979 to 1992, the absolute value of budgetary investment dropped by 110 million, or 8%.

Table 3.16

1979-92 Differentials: State Sector Investment
(Yuan Million)

<u>Year</u>	<u>Total</u>	<u>Budgetary Investment</u>
1979	2006	1385
1992	68051	1275
1979-92 Difference (%)	3292%	-7.9%

Sources: *Guangdong Statistical Yearbook 1993*, p.237; *Guangdong 1949-88. FAI*, p.89.

Before proceeding further it may be useful to consider the significance of this budgetary investment statistic and its relevance to this study. In order to do so it is necessary to know precisely what this statistic comprises. *Prima facie*, it is a measure of the total value of fixed asset investment financed by the state budget, central or local, in a given year. (This is the definition given in the explanatory notes of official statistical publications and other reference materials on investment statistics.) However, when looking at the breakdowns of local fiscal expenditures and comparing the figures covering expenditure on fixed asset investment with those calculated within the state plan covering "budgetary investment", it is plain that the two have very different coverages. Table 3.17 below gives the details:

Table 3.17

Budgetary Investment and Local Fiscal Investment Expenditures*
(Yuan Billion)

<u>Year</u>	<u>Budgetary Investment</u>	<u>Fiscal Exp.</u>	<u>Discrepancy</u>	<u>%</u>
1987	1.26	2.05	0.85	70.2
1988	1.09	2.62	1.53	141.1
1989	1.10	2.64	1.54	140.2
1990	1.20	2.96	1.76	146.8
1991	1.26	3.62	2.36	186.8
Total	5.91	13.89	8.04	137.3

*Note: Discrepancy refers to the amount of local fiscal, that is, budgetary investment expenditures over the value of budgetary investments as appeared in the statistics of investment by types of funding. The % refers to the absolute discrepancy value as a percentage of the budgetary investments. The figures of budgetary investment covers the state sector only.

Source: Ministry of Finance (ed.), *China Finance Statistics 1950-1991* (Beijing: Science Press, 1992), p.157; *Guangdong Statistical Yearbook 1988-1992*.

The table above shows a cumulative discrepancy between the two statistics whereby fiscal expenditure exceeds the budgetary investment figure for the five years between 1987 and 1992 by nearly 140%. According to interviews in Guangdong, this was more than a mere discrepancy in statistics. The value of budgetary investments within investment statistics covers the amount of investment *included in the state plans*, having been approved by the Centre and which, in accordance with the plan, is to be financed from the state budget. However, the figures for fiscal expenditure on investment, as they appear within government finance statistics, refer to the actual amount of local budgetary funds spent on fixed asset investment. In theory any outlay from local coffers should be strictly in accordance with state investment plans, and as such local fiscal expenditure would be expected to be smaller or at most equivalent to the value of investment financed by the state budget. This is because budgetary investment may be financed by state budget resources from the *central* budget as well as from the provincial budget. The existence of such a disproportionate discrepancy in favour of local fiscal expenditure suggests, therefore, that "outside plan" investments are conducted by the provincial government financed from provincial fiscal resources. How close the discrepancy is actually equivalent to that portion of outside plan investment depends on the amount of budgetary investments that has the origin of funding coming from the central rather than provincial budget.¹⁵

The budgetary investment statistic is *not*, therefore, a measure of the total value of investments financed with budgetary funds, as it was originally intended and is formally defined in official publications. From the way the statistic is compiled, it can be seen to be rather a measure of the portion of total investment which is *included in the centrally endorsed investment plans and financed with budgetary funds*.¹⁶ Those "outside plan" investments financed with local budgetary funds are excluded from the budgetary investment statistic. They are largely included in the "own funds" category.¹⁷

¹⁵Respondents Nos. 4 and 6, Guangdong interviews, September 1993. Guangdong officials did not seem too worried about the fact that the discrepancy of the two statistics revealed that the provincial government had been launching and financing "outside plan" investments with money from the state coffers. Moreover, as the amount of inflow of central budgetary funds to Guangdong was very small, the discrepancy could be regarded as a fairly accurate indication of the portion of outside plan investment directly conducted by the provincial government with budgetary money.

¹⁶The statistic is calculated from data provided by the Provincial Planning Commission. The data basically covers the yearly investment plans endorsed by the Centre. Hence it does not include "budgetary investment" in projects which are not listed in the plans. Respondent No.4, Guangzhou interview, September 1993.

¹⁷Respondent No. 4 confirmed that the discrepancy of investments was being included in the category "investments with own funds" in the compilation of investment statistics. This classification makes sense, since fiscal revenues have been used and regarded as the "own funds" of the provincial government from the planning perspective of the provincial government, given the

The implications of this disclosure of the vagaries of the budgetary investment statistic is threefold. First, there is now not only hard evidence of the existence, but also a partial indication of the extent, of "outside plan" (jihuwai) investments in the provinces other than records of the Centre's complaints on the issue. Second, it demonstrates that the Guangdong provincial government has been very actively involved in such supposedly "illegal" activities. Findings detailed above show that more than half the provincial fiscal outlay for investments of Guangdong during 1987-91 has been assigned to projects not endorsed by the Centre. One can only imagine the Guangdong government's attitude towards similar "illegal" activities by enterprises using their own funds. Third, the relevance of the budgetary investment statistic to the present study is now clear. Since the statistic is actually a reflection of the state investment plan, its utility in a study of central-provincial relations is greater than that of a comprehensive statistic of investments financed with budgetary funds.

In other words, the significance of the discrepancy between the two statistical measures is that it exposes the discretionary behaviour of provincial governments regarding financing "outside plan" investment with fiscal resources. If the central government has traditionally used both the plan and the supply of money as a means of keeping its grip on provinces and society in general, then the budgetary investment statistic is exactly a measure of how much hard core control the Centre actually retains. Therefore, as more funding channels develop and state ethos becomes less omnipotent, so the significance of the receding dependence on budgetary funds becomes more profound. Table 3.18 illustrates the position in the early 1990s.

dabaogan fiscal system in practice in Guangdong. A research report conducted by the State Planning Commission in Beijing also stated that the "own funds" in the source of investment funds mainly included two types of funding: (a) fiscal investment expenditure coming from the budgets of the local governments, and (b) funds raised from the society by various means. See Li Fan and Zheng Xiao-he, *Zhongguo Touzi Zhuti Ji Qi Touzi Xingwei Yanjiu* (A Study of the Investment Actors and Their Investment Behaviour in China) (State Planning Commission, not openly published, 1991), p.83.

Table 3.18

Funding Channels of Total Investment (%)

<u>Year</u>	<u>Budget</u>	<u>Bank Loans</u>	<u>Foreign Capital</u>	<u>Own Funds</u>	<u>Others</u>
1990	3.2	18.1	14.9	32.1	32.2
1991	2.5	21.1	13.0	32.0	31.0
1992	1.3	20.4	12.0	31.7	34.3

Sources: *Guangdong Statistical Yearbooks 1991, 1992, 1993*, respectively, p.193; p.231; p.237.

Note: The percentages do not add up to 100 as one minor channel of funding, the "coal for oil fund", is not listed here.

If bank loans and "own funds" are to an extent transferred resources from the state,¹⁸ foreign capital, on the other hand, represents a source of funding which is external to the state and is therefore only indirectly under the influence of government policies. It is thus worth noting that between 1979 and 1991 the share of foreign capital in Guangdong's total investment funding rose to a substantial 25% share.¹⁹ Moreover, as noted in Table 3.18 above, by 1992 the "others" category has become the largest single category of funding channel. The fact that an ostensibly miscellaneous category has acquired such prominence demonstrates the extent of funding proliferation. The fact that the content of "others" had not been disaggregated and the categories not broken down and renamed reflects the diversity of content.²⁰

The institutional changes leading to this drastic decline in the importance of budgetary investment and the proliferation of funding channels is discussed later. First is an examination of the proliferation of investment actors from another perspective: that of ownership relations.

¹⁸This statement is made on the basis that state banks were closely associated with state finance and were not therefore independent of the state. "Own funds" of enterprises were boosted in the first place because the state cut taxes, the amount being arbitrarily decided by the government. Also, as noted above, some of the "own funds" actually were budgetary funds of provincial and lower-level governments.

¹⁹The vice-director of Guangdong Foreign Trade Commission, in Zhang Hanqing (ed.), *Gaige Kaifeng Zai Guangdong* (Reform and Opening in Guangdong: Implementation and Thoughts on the One Step Ahead Policy) (Guangzhou: Guangdong Higher Education Press, 1992), p.120.

²⁰Respondent No.4, Guangzhou interview, May 1993, revealed that there remained many irregularities and "diversities" in the collection of data for the "others" category. This aggregated category is often used as a dumping ground for "illegal" and unorthodox funding so as to evade supervision and queries from superior levels. The sudden increase in societal capital used in investment via the securities market was included in the "others" category in some places, and in the "own funds" in others.

Rise of the Non-State Sector

Prior to 1980s investment in Guangdong and in China overall was largely confined to investment in the state sector. Investment in Guangdong's non-state sector, that is, in urban collective enterprises, rural communes and communal workshops, small private businesses, and in the building of houses in the countryside, amounted to only 6% of the total societal investment for the 29 years from 1950 to 1978. Between 1979 and 1992 the share rose to a significant 30%. Table 3.19 below details the escalation:

Table 3.19

Guangdong's Non-State Sector Investment (Yuan Million)

<u>Year</u>	<u>Collective</u> <u>(C)</u>	<u>Private</u> <u>(P)</u>	<u>% Share of Total Investment</u>		<u>C + P</u>
			<u>C</u>	<u>P</u>	
1950-52	-	-			
1953-57	-	-			
1958-62	348	4	8.2	0.1	8.3
1963-65	254	-	1.3	-	1.3
1966-70	-	-			
1971-75	-	-			
1976-80	346	2452	2.7	19.1	21.8
1981-85	7219	12255	13.2	22.3	35.5
1986-90	21838	20902	14.2	13.6	27.8
1991	7121	6398	14.9	13.4	28.3
1992	20932	10914	22.7	18.1	40.8
Total:					
1950-78	686	639	3.0	2.8	5.8
1979-92	57373	52285	16.1	14.7	30.8
1950-92	58059	52925	24.6	14.0	38.6

Sources: *Guangdong 1949-88 FAI*, pp.158-61 (for 1950-85 figures); *Guangdong Statistical Yearbook 1993*, p.236 (for 1986-92 figures).

Table 3.19 shows that by 1992, just over 40% of total investment in Guangdong had taken place in the non-state sector. This leap in the relative share within little more than a decade is indicative of the high rate of growth. Tables 3.19 and 3.20 below illustrate that, for most of the years since 1979, investment in the non-state sector has grown at a far more rapid cumulative rate than in the state sector.

Table 3.20Guangdong's Investments (Yuan Million)

<u>Year</u>	<u>State Sector</u>	<u>Non-state Sector</u>	<u>Total</u>
1979	2006	823	2829
1992	60329	31846	92175
% Increase	2907%	3770%	3158%

Source: *Guangdong Statistical Yearbook 1993*, p.236.

Table 3.21Yearly Growth Rate (%)

<u>Year</u>	<u>Total</u>	<u>State Sector</u>	<u>Non-State Sector</u>	<u>(C)</u>	<u>(P)</u>
1979	3.9	0.1	14.5	13.1	14.9
1980	35.4	28.2	52.7	76.8	49.6
1981	57.7	34.6	105.2	281.6	78.0
1982	40.3	49.6	27.8	79.4	10.7
1983	4.7	8.0	-0.005	3.6	-2.7
1984	47.0	44.2	51.7	52.8	51.0
1985	41.6	62.6	7.6	32.9	-7.0
1986	17.3	21.0	8.3	7.0	9.4
1987	15.9	12.9	24.4	31.4	18.8
1988	40.9	42.1	37.9	52.9	25.6
1989	-1.8	-1.8	-1.7	1.7	-5.5
1990	7.3	9.0	2.8	1.9	3.9
1991	28.3	26.0	34.6	32.3	37.3
1992	92.8	75.9	135.6	194.0	53.3
average					
1979-92	30.9	29.5	35.8	61.5	24.1

Source: Computed from *Guangdong Statistical Yearbook 1993*, p.236.

From Table 3.21, it can be seen that during the fourteen years from 1979 to 1992 the growth rates of investment in the non-state sector exceeded those of the state sector during eight years. The other six years during which growth rates in the non-state sector slowed down were those when the Centre demanded retrenchment action from the provinces. This suggests that the non-state sector is not altogether impervious to interference from the state, a point upon which I shall elaborate in a later chapter. Nonetheless, investment in the non-state sector quickly rebounded once political pressure had died down. And at 35.8% the average growth rates of investments in the non-state sector was well above that of the state sector at 29.5%. These illustrate beyond doubt that the non-state sector is, on balance, more prone to investment growth than the state sector.

The increasing importance of investment in the non-state sector marks an important development in China since commencement of the economic reform programme in 1979. This ostensibly socialist country is obviously no longer solely dominated solely by "socialistic" modes of production. For instance, in 1980 the state sector in Guangdong produced over 60% of the total production output value of the industrial sector. But in 1992 the percentage dropped by almost half to 33%,²¹ whilst the collective and private sectors together accounted for over 50% of total industrial product output. Moreover, that which previously constituted the collective sector has also changed considerably. What was a "para-state" sector has gradually taken on some characteristics of an autonomous private sector. In fact a substantial number of private enterprises became registered as collective enterprises in order to qualify for lower tax rates and easier access to bank finance. Nevertheless, the relationship between the non-state sector and the state remains "close", with the state, especially at local levels, exercising a pervasive influence, a point to be discussed in greater detail in later chapters.

This growth in the non-state sector is material to comprehending the decline of central/budgetary investment in Guangdong. The previous dominance of the state budget and therefore of the central government in fixed asset investment existed in a social context in which the state sector was supreme and central planning was the main mode of economic management. Even though there has always been a collective sector in the cities, and state ownership was never the major mode of production in the countryside, the ideological orthodoxy at that time nevertheless specified that the collectives were no more than second brothers to the state sector. Methods of management and administration in the collective sector were based on those operational within the state sector. As and when a collective enterprise had notable results, the enterprise would subsequently be "upgraded" and become state-owned. Investment in the collective sector was therefore definitively on a small scale. This concentration of budgetary investment in the state sector has, in fact, continued into the 1990s, as shown in Table 3.22 below.

²¹See *Guangdong Statistical Yearbook 1993*, p.183.

Table 3.22

Distribution of Budgetary Investments
Across Sectors (Yuan Mn)

<u>Year</u>	<u>Total</u>	<u>State Sector</u>		<u>Non-State Sector</u>	
			<u>(%)</u>		<u>(%)</u>
1990	1292	1256	97.7	36	2.3
1991	1282	1245	97.1	37	2.9
1992	1298	1275	98.2	23	1.8

Source: *Guangdong Statistical Yearbook 1991, 1992, 1993*, respectively, p.193; p.231; p.237.

The design of the budget and the entire system of investment administration was therefore based on an economy dominated by the state sector, within which the central government was predominant. The economic reforms in the 1980s loosened central control on the lower levels of government, thus giving rise to more "unorthodox" and "liberalizing" behaviour among the provinces, as well as enabling the growth of a *relatively* autonomous non-state sector *outside* the scope of control of the traditional system of administration. The consequence of this is a relative decline in terms of central investment due to the altered roles of central and provincial governments within the investment scene.

Institutional Backdrops

Fiscal Reforms

Fiscal reforms between central government and Guangdong represent the most important single change in central-Guangdong relations for their effect of enhanced provincial control over investment in Guangdong, and the subsequent rapid pace of economic development in the province generally. Fiscal reform also represents the point at which developments which would affect future investment activity began. The fiscal reforms' effect of provincial financial autonomy further consolidated the local economy orientation of the Guangdong Government.

Reform Content and Developments

The *dabaogan* fiscal system approved by the State Council in 1979 allowed Guangdong to retain all fiscal revenues collected from provincial revenue sources after remitting a sum of 1.2 billion yuan annually fixed for 5 years.²² However, this

²²State Commission for Economic System Reform (ed.), *Jingji Tiji Gaige Wenjian Huaibien, 1978-1983* (A Collection of the Documents on Economic System Reforms, 1978-1983) (Beijing:

sum was cut to 1 billion in 1980 and the system remained in force beyond the five year expiry date. Moreover, since a number of Guangdong enterprises hitherto under the jurisdiction of the provincial government were converted to centrally "owned" enterprises, thereby shrinking the revenue base of the provincial coffers, the remittance sum was adjusted to 778 million yuan annually from the period 1985 to 1987.²³

In 1988, the system was again adjusted in order that the central government might extract still more revenue from Guangdong. Instead of fixing a lump sum payment for a number of years, the central government fixed a base figure with a percentage increase each subsequent year. The base figure was fixed at 1.413 billion for 1988, and the percentage increase for 1989 and 1990 set at 9%.²⁴

A direct effect of fiscal reform is the increase in the pool of fiscal revenue retained by the provincial government for its discretionary use. From 1980 to 1987, the total net remittance from Guangdong to the Centre, amounting to 12.2 billion, accounted for 26.5% of Guangdong's total fiscal revenue. This amount includes the amount of fiscal remittance as defined by the fiscal system as well as the part of fiscal revenue extracted by the Centre in addition to the agreed sum, for instance, in the form of intergovernmental "loans", Treasury bonds and new taxes. When comparing this figure with Guangdong's net fiscal remittance for the entire 1950-87 period, which amounted to a full 37% of Guangdong's total fiscal revenue,²⁵ it is obvious that Guangdong has successively lowered the revenue extraction rate by the Centre since implementation of the new fiscal system.

This has not been a stable contract, however. During the retrenchment years of 1989, 1990 and 1991, Guangdong was obliged to raise substantially its remittance in order to supplement the national coffers. In 1991, for instance, when the fiscal scheme was renewed by another three years, the base figure was reportedly increased by 360 million yuan, though the annual increment percentage remained unchanged at 9%.²⁶ According to recent articles authored by senior Guangdong leaders, the net remittance in the retrenchment years of 1990 and 1991

Zhongguo Caizheng Jingji chubanshe, 1983), p.471.

²³Dangdai Zhongguo Congshu Bianji Bu (ed.), *Dangdai Zhongguo de Guangdong* (Guangdong in Contemporary China) (two volumes) Vol.1, (Beijing: Dangdai Zhongguo chubanshe, 1991), p.687.

²⁴Ibid.

²⁵Ibid., p. 673. Total Guangdong fiscal revenue means the total amount of fiscal revenue collected from Guangdong. This includes revenue collected by the provincial as well as those collected directly by the central government, e.g. from central enterprises in Guangdong and revenue from tariffs and customs.

²⁶Figures reported in *Wen Wei Po* (Hong Kong) March 9, 1991.

was respectively 5.2 billion and 6.985 billion yuan, amounting to about 40% of the annual provincial budgetary revenue. Total fiscal remittance to the Centre from 1980 to 1991 amounted to 31.5 billion yuan.²⁷ From 1979 to 1991, the amount of net provincial remittance has increased by 7.5 times and from 850 million yuan to 7 billion yuan, representing an annual average growth rate of nearly 17.6%.²⁸ It can thus be seen that the central government exacted heavy "fees" from Guangdong in return for its new financial freedom.

Nonetheless, in 1992, Guangdong succeeded in its negotiations with the Centre to retain its system until the year 2000. The terms of the deal was that, from 1994 to 1997, the yearly remittance would be based on the existing base figure plus an annual increment figure, which would remain at 9%, whilst the increment percentage from 1998 to 2000 would be subject to change.²⁹ This agreement was, however, curtailed when towards the end of 1993 the Centre announced its decision to replace nationwide the fiscal contractual system with a tax-sharing system starting as from 1994. However, officials I met in Guangdong expressed in no uncertain terms their wish to retain the *dabaogan* system.³⁰ Failing that, their objective was to tailor the new system in such a way that Guangdong's existing financial autonomy would not be jeopardized.

The strategies by which Guangdong's officials undertook to "protect" their preferred fiscal system will be described in detail in Chapter Five. The foregoing information confirms that although Guangdong has repeatedly been obliged to remit more than the agreed sum, the remittance in 1991 for example accounting for a substantial 40% of its budgetary revenue, the province was nevertheless very keen to retain the *dabaogan* system for Guangdong. The significance of the lump-sum payment arrangement, therefore, goes beyond the increased amount of fiscal revenue retained in the province.

"Eating in Separate Kitchens" and Investment Drive

The main theme of the fiscal system instituted in the majority of provinces since 1980 until its replacement by the new "tax-sharing system" in 1994 was

²⁷Zhang Hanqing (ed.), *Reform and Opening in Guangdong*, p.7; Guangdong Provincial Party Committee Secretariat (ed.), *Guangdong Gaige Kaifang Qishi Lu* (A Record of Insights of Opening and Reforms in Guangdong) (Beijing: Renmin chubanshe, 1993), pp.43, 59.

²⁸Ibid., p.59.

²⁹Speech given by the Director of Guangdong's Finance Bureau on 16 January 1993 during a provincial financial conference, reported in *Guangdong Caizheng*, No.1 (1993), p. 7.

³⁰Respondent No.6, Guangzhou interview, September 1993.

defined in the expression, "eating in separate kitchens". Under this system, the common central/provincial bowl from which to draw revenue was broken for the first time. Circumstances varied in different provinces, as there were a variety of contractual arrangements in operation. Guangdong's *dabaogan* system, however, was always the most aggressive type, in the sense that Guangdong's system had until 1988 fixed the *absolute* sum of annual remittance, while other remitting provinces had fixed only the *percentage* share of remittance.³¹ For Guangdong, the certainty that fixed lump-sum remittances would not change for five years, or three years after 1985, not only gave the province an unprecedented sense of security and independence. The fixed absolute sum also enabled the province to keep an increasingly large share of its total fiscal revenue, as the total revenue increased each year but the amount of remittance remaining unchanged. Although a similar five-year fixed arrangement was instituted in 1958, it failed to survive the second year and the lump-sum transfers in 1971-73 were single-year arrangements only, meaning that provinces had to renegotiate the lump-sum payments or subsidies every year. Provinces whose financial situations improved one year, therefore, would often be obliged to increase their remittances the following year. There was prior to 1980, therefore, little financial security for the provinces, and consequently little incentive to generate more revenue or to cut expenses.³² Since 1980, irregularities still existed and the central government frequently demanded additional financial contributions over and above the prearranged fiscal remissions.³³ The change in the formal fiscal system nevertheless provided increased protection for the provinces. There was at least a contract on which provinces could base their position in negotiations with the Centre.³⁴

³¹See Michel Oksenberg and James Tong, "The Evolution of Central-Provincial Fiscal Relations in China, 1971-1984: The Formal System", *China Quarterly*, No.125 (March 1991), pp.1-32.

³²For more discussion about the inadequacies and characteristics of fiscal regimes in the Maoist period, see James Tong, "Fiscal Reform, Elite Turnover and Central-Provincial Relations in Post-Mao China", *Australian Journal of Chinese Affairs* No.22 (July 1989), pp.5-6; Michel Oksenberg and James Tong, "The Evolution of Fiscal relations in China, 1971-1984"; Michel Oksenberg and James Tong, "The Evolution of Central-Provincial Fiscal Relations in China, 1950-1983: The Formal System", unpublished paper, 1987.

³³For instance the Centre borrowed 1.6 billion yuan from Guangdong in 1981 and again a considerable sum in 1982, immediately after the "contract" of fiscal remittance was implemented. The "loans" were never returned and written off formally in 1983. See James Tong, "Fiscal Reform, Elites Turnover and Central-Provincial Relations", p.19. For a discussion of the situation nationwide, see Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993), p.173.

³⁴*Ibid.*, p.170, for a similar observation of the utility of the existence of a "contract" for the bargaining position of provinces vis-a-vis the Centre. The fact that Guangdong officials were worried about the loss of financial security and the need to depend upon the Centre for remittances of revenue under the 1994 tax-sharing system reform exemplifies this point about the security of a contract. See *Guangdong Caizheng*, No.1 (1994) for a collection of very informative essays on Guangdong's responses and attitudes to the ending of the *dabaogan* system and the new system being formed.

The sense of security derived from the *dabaogan* fiscal system is directly connected to the investment phenomenon in Guangdong. In fact, the institution of the contractual fiscal system in 1980 marked the onset of a chain of developments which led to accelerated investment. This acceleration was not spurred on due to Guangdong being authorized to retain a greater amount of budgetary revenue, but by the relative financial stability which the new system provided, thereby affording the confidence for further investment. Whilst taking into account the fact that the investment-hunger syndrome has much deeper roots in the public ownership system, as we have seen in Chapter Two, and the drive for investment had existed before the reforms were launched in the 1980s, the post-1980 fiscal system has nevertheless *accentuated* the "hunger" for more investment and at a much higher level.

In other words, while soft constraints under the public ownership system relieved the efficiency checks on investments, the post-1980 fiscal system made additional investments further more attractive in the eyes of the provinces. Since the *dabaogan* system allowed Guangdong to retain all provincial revenue over and above its lump-sum remittance, Guangdong could obtain conspicuous benefit from an expansion of the provincial revenue base. Positive inducements have therefore increased for further investment, whilst negative sanctions remain minimal and ineffective. Investment expansion has been, therefore, a logical course of action in the province's rational pursuit for more revenue.

The Extrabudgetary Finance

It has previously been mentioned that the additional fiscal revenue retained in Guangdong under the *dabaogan* system has not necessarily been spent on fixed asset investment. In fact, a much smaller portion of budgetary expenditure went to investment in the 1980s than previously. During the 1970s, 30% of Guangdong's total budgetary expenditure was spent on investment. During 1980-91 this figure fell to only 18%.³⁵ Table 3.23 gives a detailed breakdown of budgetary expenditure for the period 1987-91.

³⁵See *Dangdai Zhongguo de Guangdong*, Vol.1, p. 673.

Table 3.23

Share of Major Expenditure Categories in
Guangdong's Budgetary Expenditure (%)

<u>Expenditure</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
Investment	21.3	22.7	18.7	19.7	19.8
Education & Health	23.7	22.6	23.5	23.4	21.8
Price Subsidy	14.0	12.3	12.4	11.8	6.6
Agriculture	7.8	7.5	7.8	7.3	7.1
Law & Order	n/a	3.2	3.9	4.1	3.9

Source: *China Finance Statistics 1950-91*, p.157.

As a result of the decreasing inflow of budgetary fiscal funds for investment purposes, and the increasing prominence of other non-fiscal channels of investment funding as outlined earlier in this chapter, the share of budgetary investment dropped to a negligible level by the late 1980s. However, this did not mean that the state, and in particular the state at provincial and lower levels, no longer had a role to play in investment financing. The role had merely been shifted outside of the budgetary avenue. The existence of a parallel fiscal system external to the budget at all levels of government provides a second coffer from which to finance investments other than those specified within the state budget.

Table 3.24 below compares the total value and the yearly growth rates of Guangdong's budgetary/extrabudgetary fiscal revenue in the 1980s.

Table 3.24

Guangdong's Fiscal Revenue

<u>Year</u>	<u>Budgetary</u>		<u>Extrabudgetary</u>	
	<u>Yuan Bn</u>	<u>Growth %</u>	<u>Yuan Bn</u>	<u>Growth %</u>
1982	4.2	-	2.9	-
1983	4.4	5.0	3.2	9.2
1984	4.9	11.4	3.7	16.7
1985	6.5	32.7	4.6	8.6
1986	8.2	26.2	5.2	14.2
1987	9.6	17.2	6.7	29.2
1988	10.8	12.2	8.4	25.2
1989	13.7	27.2	9.1	7.9
1990	13.1	-4.3	9.8	8.4

Source: *China Finance Statistics 1950-85*, p.144; *1950-91*, pp.78, 204. *Guangdong Statistical Yearbook 1984, 1986, 1987*, respectively, p. 295; p.291; p.367.

Table 3.24 shows that in 1990, Guangdong's extrabudgetary fiscal revenue amounted to just under 10 billion yuan, ten times that of the original budgetary

remittance value agreed with the central government in 1980, and equivalent to over 75% of the budgetary revenue for the same year. In 1990, 47% of total extrabudgetary expenditure was spent on investment. In absolute value this is nearly 20% more than the amount drawn from the budget. As shown in Table 3.25 below, the cumulative value of investment funded from extrabudgetary fiscal revenue for the period 1986-90 was almost one quarter more than that financed from the official budget.

Table 3.25

Investment: Budgetary & Extrabudgetary Fiscal Funds
(Yuan million)

<u>Year</u>	<u>Budgetary (B)</u>	<u>Extrabudgetary (E)</u>	<u>E over B %</u>
1986	2053	2536	23.5
1987	2616	3097	18.4
1988	2644	3573	35.1
1989	2964	3774	27.3
1990	3617	4293	18.7
Total	13894	17273	24.3

Note: The budgetary investment figures amalgamate the following categories as listed in the original source: (1) capital construction; (2) enterprise funds for technical renovation; (3) 3 funds for scientific development. The extrabudgetary figures amalgamate (1) fixed assets investment; (2) Repair Fund; (3) miscellaneous construction; (4) Road Maintenance Fee Fund expenditures; (5) 3 funds of scientific development.

Source: *China Finance Statistics 1950-91*, pp.157, 232.

So what are these extrabudgetary fiscal funds and their sources? How does the "extrabudget" relate to the "budget proper" within the fiscal system? What role does this second coffer of the provincial government have in Guangdong's investment behaviour? These questions will be discussed in Chapter Five, which will focus on investment and fiscal behaviour and strategies of the Guangdong government. Suffice it here to emphasize that extrabudgetary finance is a legal and long-existing fiscal device. As a supplementary fiscal channel its existence dates back to 1951, as noted in Chapter Two.³⁶ However the *growth* to such prominence of this portion of fiscal revenue represents a major development during the reform decade. With such growth in extrabudgetary finance, provincial and lower-level governments in Guangdong and elsewhere have been able to finance their investment projects with a source of revenue which is less noticeable and therefore less subject to scrutiny and control from the Centre.

³⁶See discussion in Chapter Two: Fiscal Reform.

Decentralization in Investment Administration

Along with the 1980 fiscal reform came the decentralization of planning authority in various areas, including investment administration, to the Guangdong provincial government. However it is worth emphasizing that the decentralization of investment administration, and in particular the abolition of sectoral investment figures, was more than simply a corollary of fiscal reform. Fiscal and planning reforms went hand in hand. The *dabaogan* system requires Guangdong to be responsible, in theory, for *all* provincial expenditures, including investment expenditure, by means of retained fiscal revenue. Guangdong therefore acquires the authority to prioritize its various expenditure items, for instance to decide whether more should be spent on education or on fixed asset investment, as well as the subsequent internal allocation of resources within each category of expenditure, for instance, whether to invest more in processing industries or more in infrastructure. Therefore from 1980, with the institution of the new fiscal system, the entire planning system between Guangdong and the Centre has become a "province-based" system. The central government ceased issuing detailed and mandatory orders instructing Guangdong to invest how much at what time and in what area. However, overall control figures prescribing the upper limit of total investment in any one year are still in force, and Guangdong's investment plans must still be submitted to the Centre for approval. One new rule of the game is, however, that the Centre is *expected* to accept the investment plans proposed from below. In other words, the province has become the major player and the formal power of the central government has receded to that of almost nominal status.

The abolition of detailed investment control figures was, therefore, the basis of the 1980 reform programme. From the central government's point of view, the slackening of sectoral control represented an adjustment in the relative power of the ministries (*tiao-tiao*) and the provinces (*kuai-kuai*). Fiscal reform has undoubtedly enhanced the financial strength and autonomy of the *kuai-kuai*, while weakening the power of the *tiao-tiao*. However, the central government does not intend to abandon overall control and the State Planning Commission continues to prescribe overall quotas of yearly investments within provinces. In addition, the central government also controls the total amount of bank finance via mandatory control figures issued every year.

However, as we have seen earlier in this and previous chapters, the central government did not succeed in controlling the overall size of investment. Table 3.9

shows that since 1980 the overall investment control figures issued by the Centre have been consistently and substantially surpassed. The mandatory control figures were therefore tigers without teeth. In Guangdong, as will be discussed in Chapter Five, these figures were rarely seen outside the four walls of a small number of government planning bureaux.³⁷ However, the problems with the "controlling tools" aside, another major development in the investment administration system in the 1980s was the substantial decentralization of project approval authority.

As noted in Chapter Two, it was this aspect of decentralization that enabled the provincial governments to circumvent central control on total investment scale. As provincial governments was authorized to approve more and ever larger-scale investment projects, the Centre was confronted with ever more *fait accompli* situations whereby it was forced to recognize the legitimacy of projects which were approved by provincial and lower-level governments but which fell outside the state plan and central quotas on the investment scale. The scale of decentralization was indeed massive. In the early 1950s provincial governments could only approve projects of under 0.2 million yuan, and in 1963, the authority granted was still for projects requiring less than 0.5 million yuan. However, by the early 1980s, the upper ceiling of investment value for a single project which provincial governments were authorized to approve stood at 10 million yuan. And in 1984, the ceiling further increased to 30 million yuan.³⁸ Thus the Centre approved less than 40% of all investment projects in the early 1980s, and less than one-third in the late 1980s.³⁹

Prior to the nationwide decentralization of approval authority in 1984, Guangdong's authority had already been enlarged under the auspices of the central government's preferential policy to Guangdong. In 1981, to complement the enhanced authority conferred on Guangdong and Fujian under the 1979 Special Policy,⁴⁰ the two provincial governments were authorized to approve medium-large sized projects, which had previously required the approval of the State Planning Commission (as was still the case in other provinces), other than projects which

³⁷The officials in Guangdong have come to regard the central quotas on the investment scale as increasingly irrelevant to their work. Consequently only lip service was given to the control figures and very often they were simply passed on to the various planning departments without further allocation to the various departments and enterprises. In 1993 the provincial government did not even allocate the figure from the Centre to the subprovincial levels. Respondent No.9, Guangzhou interview, September 1993. See also Chapter Five: Bargaining for more favourable central policies: investment administration.

³⁸See discussion in Chapter Two: Investment administration.

³⁹See Table 2.3 in Chapter Two.

⁴⁰The Special Policy is discussed in more detail in Chapter Five: Bargaining for more favourable central policies.

requiring State Council's approval. The only precondition of this authority was that the two provinces be solely responsible for all aspects of the investment, from funding to construction materials, exclusive of assistance from the Centre.⁴¹ In November 1982, Guangdong and Fujian were further authorized to approve investment projects of under 30 million yuan. This was a full two years ahead of the nationwide decentralization move in 1984.⁴²

As already noted in Chapter Two, in October 1984, the jurisdiction of other provincial-level governments was raised from 10 million yuan to 30 million yuan. Shortly after Guangdong, and Fujian, again received preferential treatment when in March 1985, at which point the Centre was apparently quite satisfied with the development in Guangdong and Fujian, the Special Policy for the two provinces was extended for another five years. The power of Guangdong and Fujian provincial government to approve investment projects was then raised from 30 million yuan to 200 million.⁴³ This means that the entire jurisdiction of the State Planning Commission was delegated to the two provincial governments, a privilege which was only conferred on Shanghai in 1992 for projects in Pudong, and which no other provincial-level governments had ever been granted.⁴⁴ Apart from investments in "bottleneck" sectors, namely, the energy, transportation and raw materials sectors, for which the authority of all provincial governments was raised to 50 million yuan in March 1987,⁴⁵ the jurisdiction for other types of investments in provincial governments other than Guangdong and Fujian has remained unchanged

⁴¹Central Committee Document No.27 (1981), July 19, 1981, "Approving the Notes of Work Conference of Guangdong, Fujian and the Special Economic Zones", printed in *A Collection of the Documents on Economic System Reforms, 1978-1983*, pp.558-566. See also Dangdai Zhongguo Congshu Bianji Bu (ed.), *Dangdai Zhongguo de Jiben Jianshe* (two volumes), Vol.2, (Beijing: Zhongguo Shehui Kexue chubanshe, 1989), p.481.

⁴²Central Committee Report, "On the Implementation of the 'Special Policy' in Guangdong and Fujian, and the Operation of Special Economic Zones", November 15, 1982, in Guangdong Provincial Party Committee Secretariat (ed.), *Zhongyang Dui Guangdong Gongzuo Zhishi Huibian* (A Collection of Central Government's Instructions to the work of the Guangdong Provincial Government), (hereinafter Centre's Instructions to Guangdong), (four volumes: 1979-1982; 1983-1985; 1986-1987, Part I and II), 1979-1982, (Guangdong, Neibu, 1986), p.406.

⁴³State Council Notice No.46 (1985), March 28, 1985, "On Approving the Notes of Meeting on Extending the Special Policy of Guangdong and Fujian", printed in *Centre's Instructions to Guangdong, 1983-1985*, pp.377-385.

⁴⁴The question here is whether or not the central government has ever conferred *formal authorization*. The "contraction" of delegated powers during the retrenchment years is not the issue. It was revealed during field interviews that most provincial-level governments, if not all, had exercised *de facto* approving power of up to 200 million yuan since the second half of 1992, without formal endorsement and authorization from the Centre. Also see Footnote 42 in Chapter Four.

⁴⁵State Council Notice No. 23, 1987 (March 30, 1987), "On the Extension of Project Approval Authority of Fixed Asset Investment and the Simplification of Approval Procedures", printed in State Statistical Bureau (ed.), *A Compendium of Documents on Fixed Assets and the Construction Industry*, pp.111-17. See also discussion in Chapter Two.

at the 30 million yuan limit.⁴⁶

The extent of the delegation of project approval authority is figuratively reflected in the volume of planning documents submitted annually by Guangdong to the central government. As an informed source described the situation, previously whole cartons of materials were sent to Beijing for scrutiny and approval each year. These were gradually reduced to only a few volumes by the late 1980s.⁴⁷ This suggests that as the planning and approval of more projects in Guangdong was completed and the work expedited *within* the province, there was consequently far less to report back to the Centre.⁴⁸

It should be noted that notwithstanding the decentralization of project approval authority, the classification criteria of projects into small, medium and large sizes has not changed since 1979.⁴⁹ As a result, an increasing proportion of medium-large sized projects undertaken in Guangdong have in fact been local investment projects planned and approved locally. In the absence of more comprehensive data reflecting the actual share of medium-large sized projects approved by the province as compared to those approved by the central government, the following table gives a rough indication via the value of investment formed.

Table 3.26

Medium-Large Sized Projects Started Since 1984
Cumulative Investments as at 1989 (Yuan Mn)

<u>Projects Above 30Mn (C)</u>	<u>Projects Below 30 Mn (P)</u>	<u>C+P</u>
7839.6 (49.2%)	8092.3 (50.8%)	15931.9 (100%)

Source: Computed from *Guangdong 1949-88 FAI*, pp. 215-33.

Table 3.26 compares the total investment formed for post-1984 projects whose cumulative investment value exceeded 30 million yuan with those whose value was under 30 million yuan, and shows that the latter accounted for over half

⁴⁶This has been the case until 1994, but Shanghai was excluded here, as Shanghai's authority was formally raised to 200 million yuan in 1992. See discussion in Chapter Four.

⁴⁷Respondent No.1, Guangzhou interview, May 1993.

⁴⁸The detailed mechanics involved is discussed in Chapter Two.

⁴⁹The first classification rule was passed in 1952. It was subsequently amended in 1962, 1978 and 1979. The 1979 amendment was partial and affected only a number of specific sectors. Therefore the 1978 classification rule is still largely in force as at 1993. (Respondent No.4, Guangzhou interview, September 1993). For documents, see State Planning Commission (ed.), *Jiben Jianshe Fagui Dadin* (A Comprehensive Collection of Rules and Regulations on Capital Construction), (two volumes), Vol.1, (Beijing: Hongqi chubanshe, 1985), pp.581-611.

the total medium-large sized investments. This table is not however a conclusive indication as it relates to investment formed for ongoing projects only and project approval authority is assigned with reference to the total planned investment value of a project. It is quite feasible that projects in the (P) column include those which have a planned investment value of over 30 million yuan. Nonetheless, an informed source disclosed that most projects in the medium-large sized category were approved within the province.⁵⁰ And as Table 2.3 in Chapter 2 has indicated, a report from the Centre estimated that only 35% of medium-large sized projects nationwide between 1980-1984 were approved by the central government, the rest approved by provinces. The figure fell to 25% during 1985 and 1990.⁵¹ Therefore the 1978/79 classification rule, whilst still in force in 1993, is nevertheless obsolete and no longer reflects the locus of project approval authority. The actual share of total investment which was approved within Guangdong was therefore likely to be much higher than the just over 50% indicated by Table 3.26, which only shows statistics of investments already formed. Nationally, as noted earlier above, the Centre is estimated to approve around 40% of total investment in the early 1980s, falling to less than one-third since the mid-1980s.⁵²

Decentralization of the power to approve projects, therefore, has enabled Guangdong to control the bulk of its own investment activities. This fact, coupled with the extensive subdelegation of such authority to the subprovincial levels, has allowed the Guangdong government to sidestep interference from the Centre regarding its investment plans.

⁵⁰Respondent No.4, Guangzhou interview, September 1993. The respondent told the author that because the ceiling for medium-large sized projects as prescribed by the 1979/79 classification regulation was so low, (amounting to only several million yuan for many industries) the provincial statistical bureau would sometimes exercise its discretion to *exclude* some projects when calculating the statistic. Those excluded would be projects whose original estimates had been below the ceiling, but due to subsequent amendments had exceeded it, and projects which the provincial government regarded as "desirable", but whose "elevation" to the medium-large size category might raise the attention of the central government and affect the chance of the projects proceeding.

⁵¹The estimate comes from a report by the State Planning Commission. See table and details in Chapter 2.

⁵²See Table 2.3. It should be noted that the percentage of "centrally decided" investment is constructed to contrast with "provincially decided" investment. "Centrally decided" investment therefore include those approved by the State Council, the State Planning Commission, as well as those approved by central ministries which have a largely similar jurisdiction of project approval authority.

Extensive Sub-delegation of Authority

An important feature of Guangdong's fiscal reforms in the 1980s and in the administration of investment, and indeed in most of other policy areas, has been the extent of delegation to the sub-provincial levels. Extensive sub-delegation to lower levels has the effect of magnifying the impact of the original decentralization at the central-provincial nexus. Although delegating authority to cities and counties might appear to be a measure which would deplete the power of the provincial government, in the final analysis it cannot but work to strengthen further the position of the provincial government vis-a-vis the central government. The dynamics of subdelegation strongly suggests that power between governments at different levels is not of a zero-sum nature.

Fiscal System

As Guangdong entered into a "contract" with the Centre, so the provincial government contracted with its own cities and counties. By the late 1980s, the majority of governments at grassroots administrative level, in townships and *xiangs*, had entered into some kind of fiscal contractual arrangement with their county superiors, who, in turn, had similar arrangements with the cities.⁵³

Such extensive sub-delegation of fiscal autonomy is not, however, the product of some preconceived grand plan of the provincial government. After 1980, the fiscal system at subprovincial levels was still operating along traditional lines whereby the provincial government would negotiate a certain percentage share of the fiscal revenue collected at the lower levels. Although more discretionary money was granted to counties and cities, the fiscal system between the provincial government and the cities, and between the cities and the counties, was still that of the "common bowl". There was no financial security at sub-provincial levels, and therefore no incentive to increase the revenue. Between 1980 to 1984 total provincial fiscal revenue grew at only half the rate of national income. The provincial government subsequently delegated autonomy and in 1985 five new fiscal arrangements were introduced at subprovincial levels, tailored-made to suit different situations in different cities and counties. The counties and cities were, in turn, authorized and

⁵³Over 70% of rural townships in Guangdong entered into some kind of fiscal contractual arrangements with the counties in 1988, indicating the thoroughness of the extension of the *dabaogan* fiscal system throughout the province. See Wu Yixin, *Guangdong Shinian Jingji Tizhi Gaige Yanjiu* (Analysing the Ten Years of Economic System Reform in Guangdong) (Guangzhou: Zhongshan Daxue chubanshe, 1990), p.127.

encouraged to subdelegate authority to the townships.⁵⁴

As a result of the sub-delegation, local governments' remittances to the provincial coffers dropped from a 33% share of the total provincial fiscal revenue in 1980 to only 20% in 1988.⁵⁵ In other words, while Guangdong's *dabaogan* contract with the central government effectively retained more fiscal revenue at provincial level, a large portion of that retained fiscal revenue was in fact retained at city, county, township and *xiang* level. The extension of the fiscal contractual scheme to the subprovincial levels has thus accentuated the diffusion of financial resources. As fiscal reform at the central-provincial level has strengthened the autonomy of the provincial government, the replication of such reform at subprovincial levels means that, as regards Centre-Guangdong relations, the central government must deal not only with the provincial government, but also with a multitude of local actors, each claiming their own interests and jealously guarding their autonomy and jurisdiction.

Investment Administration

In March 1992, the Guangdong government decided to delegate the *entire* authority of the provincial level government to approve foreign investment projects to city governments and departments directly subordinated to it. The counties would, in turn, be delegated the authority originally assigned at city level. This latest wave of subprovincial decentralization has enabled the cities and provincial bureaux to approve foreign investment projects of up to US\$30 million, and county governments to approve foreign investment projects of up to US\$15 million.⁵⁶ The fact that the provincial government did not reserve any exclusive jurisdiction for itself demonstrated Guangdong's enthusiasm for subprovincial delegation of power.

⁵⁴Wang Yaming, "Guanyu Wanshan Caizheng Baoganzhi de Ruogan Kanfa", (Some Views on How to Improve the Fiscal *Dabaogan* System), *Jihua Yu Fazhan* 1989: 14. See also Wu Yixin, *Analysing the Ten Years of Economic System Reform in Guangdong*, p.127, for a description of the five types of fiscal regimes which the provincial government entered into five groups of cities/districts in 1985. These five types are: (1) for Shenzhen, Zhuhai and Swatow Special Economic Zones: retaining all fiscal revenue for local use; (2) for Guangzhou, the provincial capital: the city sharing 60% of the surplus revenue after remitting a fixed lump-sum; (3) for Foshan and four other cities with a surplus local revenue: a base figure and a percentage increase for subsequent years, ranging from 4% to 7%, for remittance as negotiated; (4) for the "deficit" areas: fixed lump-sum as subsidy; (5) minority areas: fixed lump-sum as subsidy, to be increased by 10% per annum.

⁵⁵Wang Yaming, "Some Views on How to Improve the Fiscal *Dabaogan* System", p.15.

⁵⁶*Nanfang Ribao* May 5, 1992, p.1. The extract of the formal government notice, Guangdong Provincial Government Secretariat Notice No.36, is published in *Guangdong Zhengbao*, No.5 (1992), p.11.

Decentralization of investment approval authority to cities and counties dates back to 1980. In 1980 Guangdong Provincial Government announced that as long as local governments complied with foreign investment policy, and as long as the various production and marketing requirements of the projects did not affect the provincial overall balance, then cities, districts, and counties would be authorized to approve foreign investment and outward processing projects. The allocation of jurisdiction was: Guangzhou, US\$5 million or below; Hainan, US\$3 million; all other districts, cities and bureaux-level units, US\$1.5 million; counties, US\$0.5 million.⁵⁷

Power to approve domestic investment was also delegated. Before 1979, all investment projects of over 0.3 million yuan had to be approved by the provincial government.⁵⁸ After 1979, when the provincial government was authorised to approve medium-large sized projects as long as the province arranged the investment funds and materials for construction and subsequent production, the power of the subprovincials was also enhanced: Guangzhou could approve projects of 10 million yuan or below; Foshan, Jiangmen, Shantou, Zhuhai and Zhanjiang could approve projects of up to 5 million yuan; while other district-level cities, the figure stood at 3 million yuan; for county-level cities, it was 1.5 million yuan; and for counties, 1 million yuan.⁵⁹

By September 1992, the extent of delegation had reached the uppermost limit. The entire jurisdiction of the provincial government had been delegated to city-level. City-level governments were thus authorized to approve projects of up to 30 million yuan, so long as no direct capital injection was required from the superior government.⁶⁰

As a result, a large portion of investment activity was taking place *further away* from the scope of scrutiny of the central government. Successive delegation of approval authority for investment projects meant that most of the investment projects could be (and have been) designed and approved at city, county and even

⁵⁷Guangdong Jingji Xuehui (ed.), *Guangdong Jingji Tizhi Gaige Yanjiu* (A Study of the Economic System Reform in Guangdong) (Guangdong: Zhongshan University Press, 1986), p.121.

⁵⁸Economic Institute, Guangdong Planning Commission, "Guangdong Touzi Lingyu de Jihua yu Shichang" (Plan and Market in the investment arena of Guangdong), in State Planning Commission Research Centre (ed.), *Zhongguo: Jingji Tiaojie de Lilun he Shijian* (The Theory and Practice of Economic Adjustment in China) (Beijing: People's University of China Press, 1992), p.69.

⁵⁹See Guangdong Jingji Xuehui (ed.), *A Study of the Economic System Reform in Guangdong*, p.122.

⁶⁰See Guangdong Provincial Government Notice No.131(1992), in *Guangdong Zhengbao*, No.9 (1992), p.46.

township level. Table 3.27 below shows that for the period 1985-92, the share of subprovincial investment in Guangdong's state sector investment amounted to 62%. Moreover this share exclusive of central investment amounts to a staggering 80%.

Table 3.27

<u>Year</u>	<u>Share of Subprovincial Investment¹</u> <u>in Guangdong's State Sector Investment (%)²</u>	
	<u>Of Local Investment³</u>	<u>Of Total Investment⁴</u>
1985	86.00	66.87
1986 ⁵	64.85	48.01
1987	75.52	55.75
1988	81.60	65.36
1989	77.00	58.65
1990	77.61	59.42
1991	79.87	62.84
1992	82.16	66.10
1985) 1992)	82.16	61.94

Notes:

1.This calculation is in accordance with the subordination relationship of the investment project, and does not take into account injection of provincial/central funds or the outflow of subprovincial funds to central/provincial projects.

2.These figures cover capital construction investment and technical renovation, and do not include other miscellaneous investments such as single-item purchases.

3.Local investment refers to provincial and sub-provincial investment.

4.Total investment refers local investment plus central investment.

5.1986 figures include capital construction investment only.

Source: *Guangdong FAI Statistics*. Yearly volumes on 1985-1992.

It should be noted that such extensive subdelegation of approval authority is not in line with directives from the Centre, i.e. with explicit regulations issued by the central government from time to time. In a regulation issued by the State Planning Commission in 1978, it was announced that subsequent to the delineation of project approval authority between central and provincial governments, such authority should not be subdelegated to lower levels.⁶¹ This was tersely reiterated in 1981 and 1983. The 1981 directive specified that approval authority was to be rested at central government and provincial level only. Sub-provincials did not therefore in

⁶¹"Notice by the State Planning Commission, State Construction Commission and Ministry of Finance on Regulations (Trial) on the Procedures of Capital Construction", April 22, 1978, printed in State Planning Commission (ed.), *Jiben Jianshe Guanli Tizhi Gaige Wenjian Huibian* (A Colection of Documents on the Capital Construction System Reform) (Beijing: Hongqi chubanshe, 1985), pp.121-29.

theory have the power to approve investment plans and projects.⁶² The 1983 statement expressed the cause of the official disapproval explicitly: subdelegation was contributory to runaway investment. As and when approval powers are delegated to levels below the province, and where the extent of delegation is the more extensive, it is much more difficult to control the level and direction of investment.⁶³ This, of course, is exactly why subdelegation of authority was so keenly expedited, and consequently why subdelegation is so relevant to this study of central-provincial relations in investment administration.

Given the imposition of control figures by the Centre and the administration of investment via a stratified system, it is surprising the Centre is to estimate how much investment is in fact being planned by the various strata of administration, or how much is actually under way. In theory, the planning authority of capital investment resides at only two levels: first, the central government, i.e. the level of the State Planning Commission and State Council, and second, the provincial-level government, and the central ministries.⁶⁴ In practice, each level of administration adds its own projects to the plan already approved at the higher levels. The widespread existence of "outside plan" projects makes the plan, and the original control figures, increasingly irrelevant. Not only are the control figures issued by the Centre substantially exceeded, as Table 3.9 in this chapter shows, but investment plans drawn up by the provincial government is actively utilized as the base upon which the subprovincial levels plan their own additional projects, rather than being an authoritative plan of the type of investment and its amount to be made within the entire province.⁶⁵

⁶²"State Council, Regulations on Strengthening the System of Capital Construction Administration and Controlling the Level of Investment", March 3, 1981, printed in State Planning Commission (ed.), *Zhongyao Jingji Fagui Ziliao Xuanbian* (A Selected Collection of the Major Economic Regulations) (Beijing: Zhongguo Tongji chubanshe, 1987), pp. 556-58.

⁶³State Planning Commission, "Report on Controlling the Investment Level and Reducing the Number of Investment Projects Under Construction", October 22, 1983, pp.584-86.

⁶⁴The provincial-level and the sectoral central ministries are of the same administrative ranking and their jurisdiction in investment project approval is therefore the same in most cases.

⁶⁵See "State Planning Commission, Report on Controlling the Investment Level and Reducing the Number of Investment Projects Under Construction", October 22, 1983. It was stated in the report that the 1983 capital investment plans of central ministries and of provincial governments exceeded the Centre's control figures by 1 billion yuan and 3.3 billion yuan respectively. For the latter part, the special economic zones of Guangdong and Fujian accounted for 1 billion yuan. However, due to the fact that subprovincial levels all had investment projects in addition to the official provincial plans, the total amount of investment exceeding the Centre's control figures was well in excess of 4.3 billion yuan. A respondent closely associated with some of Guangdong's subprovincial governments told the author that the provincial governments themselves did not know how much investment was in reality taking place within the provinces. For instance 100 million yuan of investment was included for Shunde city in Guangdong's 1992 provincial investment plan. The total amount of investment in Shunde that year was actually more than 1 billion yuan, ten times of the provincial planned value. (Respondent No.2, Guangzhou Interviews, May 1993).

According to the rules, "outside plan" investments are undoubtedly "illegal", and their existence, albeit extensive, is the result of a slackening of administrative rules and passive tolerance of the Centre. The sub-delegation of investment approval authority, however, represents explicit recognition of the authority of subprovincial levels as regards project approval. Although such delegation is, strictly speaking, also "illegal", given the existence of formal regulations which forbid delegation of project approval powers to cities and counties, the formal and open way in which subdelegation occurs provides a strong protection for investments made by subdelegated powers. The Guangdong Government would find it easy to ward off central pressure to cut investments by claiming that a substantial portion of provincial investment is in fact approved by the cities and counties.⁶⁶ Whilst "outside plan" investments represent a "tool" with which to bargain for a higher control figure, subdelegation of approval authority is a means to a defence for excess investment, as well as providing a venue for investment.⁶⁷

⁶⁶In one report on Guangdong's industrial structure, the writer grouped the planned investments by the Centre and those of the provincial government together as one category, as opposed to the "local investments" by the subprovincial governments. In this way the provincial government put itself in the same camp of the Centre thus being able to put the blame for problematic local investment on the lower level governments. See The Project Group, "The Adjustment of Guangdong's Industrial Structure and Deepening of Economic System Reform", in Xiao Ruchuan (ed.), *A Study of Guangdong's Industrial Structure* (Guangzhou: Guangdong Renmin chubanshe, 1991), p.267.

⁶⁷Guangdong and some other provinces argued for a higher control figure at a time when the central government pushed for austerity. The argument put forward was that "outside plan" investments which had been completed earlier in the year had already used up a substantial portion of the central control figures to the provinces. Such being *fait accompli*, it would lead to great hardship if projects within the state plan and considered essential were to be discontinued. Therefore it was necessary to adjust the central control figures upwards. State Planning Commission, "Report on Controlling the Investment Level and Reducing the Number of Investment Projects Under Construction", October 22, 1983.

Chapter Four

Institutional Context of Investment Administration in Shanghai

As one Shanghai official put it, historically both Shanghai and Guangdong have had a commercialized regional culture. In his view, the strong tradition of Shanghai's commercialized culture enabled it to change, if not revolutionize, itself rapidly once the central government changed its policy towards the city in the early 1990s, a full decade after the reform process took off in Guangdong.¹

Shanghai is one of the three largest metropolitan areas in China, the other two being Beijing, the capital, and Tianjin, both of which are also granted provincial-level administrative status.² Shanghai has also been the largest economic centre of China this century, when the city flourished under the peculiar conditions of the treaty powers.³ Until the 1990s Shanghai was the highest contributor of national revenue amongst the provincial-level administration. From 1953 to 1980, Shanghai generated over 280 billion yuan, or 14% of the total national fiscal revenue, while Guangdong generated only 43 billion yuan, 2.7% of the national total and less than one-sixth that of Shanghai.⁴

The industrialization and commercialization of the Shanghai economy earlier in the century as opposed to the rest of the country where the economy had remained predominantly agrarian has led to descriptions of Shanghai as being the "other China".⁵ At the time when the city flourished under the protection of the foreign treaty powers, the resultant wealth of the city caused hostility and suspicion within both the bureaucratic and revolutionary forces of China, whose agrarian and inward-looking orientation always carried on in an uneasy coexistence with the modern and cosmopolitan orientation of the city.⁶ However, after the city was severed from its foreign connections in 1949, and its economic strength, albeit affected, nevertheless remained the most formidable within the country, the "one-

¹Respondent No. 22, Shanghai interview, January 1994.

²With the resumption of sovereignty of China over Hong Kong and Macau in 1997 and 1999, there will be two other such areas, although they will be under a special administrative category called the "Special Administrative Region".

³For a study of Shanghai between 1919 to 1949, see Marie-Claire Bergere, "'The Other China': Shanghai from 1919 to 1949", in Christopher Howe (ed.), *Shanghai: Revolution and Development in an Asian Metropolis* (Cambridge: Cambridge University Press, 1981), pp.1-34.

⁴Calculated from Shanghai Statistical Bureau (ed.), *Xin Shanghai Sishi Nian* (Forty Years of New Shanghai) (Beijing: Zhongguo Tongji chubanshe, 1989), p.78; *Shanghai Statistical Yearbook 1993*, p.14; *Guangdong 1949-88 (General)*, p.74, and *Statistical Yearbook of China 1993*, p.229.

⁵See Marie-Claire Bergere, "'The Other China': Shanghai from 1919 to 1949".

⁶*Ibid.*

step ahead" economic development of the city gave Shanghai a peculiarly important place in the socialist economy and in the maintenance of the regime. Ironically Shanghai has since 1949, or, more accurately, since 1956 when the "socialist transformation process" of private enterprises was announced complete, become the most important base of the socialist economy and of the socialist planning system.⁷ This previously most developed hub of capitalism and the centre of private enterprises suddenly became the centre of gravity of the central planning system, as a result of the nationalization of Shanghai's industry between 1955-1956.⁸

Since then Shanghai has played a critical role in the history of the People's Republic. The city has generated one-sixth of the total national fiscal revenue. The total profit and tax submitted by its enterprises during the first 40 years of the Republic was, cumulatively, six times that of the total value of their fixed assets at their original prices. Its export trade also accounted for one-quarter of the national total during the same period.⁹ Politically, its leaders have always been part of the national politics. Shanghai's leaders in the early years, for instance Chen Yi and Ke Qingshi,¹⁰ were all central government figures posted in Shanghai. Later Zhang Chunqiao, Yao Wenyun and Wang Hongwen became central leaders during the Cultural Revolution. And in the 1990s Shanghai's leaders, Jiang Zemin, Zhu Rongji, Wu Bangguo and Huang Ju all capitulated to national power. It has been argued that, given Shanghai's importance in the national economy, its leaders were

⁷Respondent No. 14, Shanghai interview, January 1994. Other respondents have expressed similar comments on the changing "face" of the city before and after 1949. Lucian Pye noted that the Chinese Communist Party realized after gaining power that the economic strength of Shanghai, which they previously tended to blacken as a model of foreign and capitalistic exploitation, could be usefully "exploited" for the development of the rest of China. As a result Shanghai became more important strategically. See Pye, "Foreword", in Howe (ed.), *Shanghai: Revolution and Development*, p.xii.

⁸The Politburo discussed the "Draft Resolution of Transforming Capitalist Industries and Commerce" on December 16, 1955. Within one month Beijing announced the completion of the transformation of all capitalist industries and commerce in the city. By the end of March 1956, it was announced that all capitalist industrial and commercial enterprises in the country had been "transformed" into public-private jointly operated enterprises. See Fang Weizhong (ed.), *Zhonghua Renmin Gongheguo Jingji Dashiji, 1949-1980* (The Major Economic Events in the People's Republic of China, 1949-1980) (Beijing: Zhongguo Shehui Kexue chubanshe, 1984), pp.158, 163.

⁹See Shanghai Statistical Bureau (ed.), *Forty Years of New Shanghai*, p.77.

¹⁰Chen Yi was the second First Party Secretary (1950-1954) and Ke Qingshi the third (1954-1965) of Shanghai. Both were prominent figures of the Party and joined the revolution in its early years. Chen was regarded one of the ten greatest generals of the Army and Ke had served as the general secretary of the Party before the outbreak of the Sino-Japanese War, and became member of the Party Politburo in 1956. See Ma Qibing et al., *Zhongguo Gongchandang Zhizheng Sishi Nian* (The Chinese Communist Party: Forty Years in Power) (Beijing: Zhonggong Dangshi Ziliu chubanshe, 1989), p.574; and Xiao Chaoran et al. ed. *A Concise Dictionary of the Chinese Communist Party's History* (Beijing: The People's Liberation Army Press, 1987), p. 819.

more subject to the pull of central politics than leaders of other provinces were.¹¹ Does the historical importance of Shanghai affect its relations with the Centre in this new era of decentralization and reform since 1979? How does the new environment of the post-Mao reform era affect Shanghai's relationship with the Centre? How does Shanghai compare with Guangdong as regards central-provincial relations? These are the general questions which I intend to address in the case study of Shanghai, while contrasting Shanghai's fixed asset investment implementation with Guangdong.

As in the case of Guangdong, this chapter discusses contextual information regarding the administration of fixed asset investment in Shanghai in the post-Mao period. It describes the changes to fixed asset investment in Shanghai after 1979, and outlines the institutional backdrop to these changes. The purpose is to map out the institutional context of central-Shanghai political processes to pave the way for a discussion of Shanghai's discretionary behaviour in Chapter Six.

Investment in Shanghai

On the eve of reform in the late 1970s Shanghai's investment was at a higher base than that of Guangdong, but thereafter grew at a sluggish rate. Funding for investment had become more diversified, in line with the nationwide trend, but throughout the 1980s Shanghai was remarkably more reliant on central investments than was Guangdong, and the share of investment financed by the state budget in Shanghai was also significantly larger.

Trailing Performance

At the beginning of the 1980s, Shanghai's investment was at a much higher base than Guangdong, having invested 30% more during the previous 30 years than had Guangdong. Tables 3.1 and 3.2 have already shown that Shanghai's accumulation ratios before 1980 were much higher than those of Guangdong. As a result, the total cumulative investment was conspicuously larger in Shanghai, as the table below shows:

¹¹This is the argument of David S. G. Goodman's and in a more complicated way that of Lynn T. White III's. See David S. G. Goodman, "The Shanghai Connection: Shanghai's Role in National Politics During the 1970s", in Howe (ed.), *Shanghai: Revolution and Development*, pp.125-52; Lynn T. White III, "Local Autonomy in China During the Cultural Revolution: The Theoretical Uses of an Atypical Case", *American Political Science Review*, Vol.70 (1976), pp.479-91. For an alternative view, see Parris H. Chang, "Shanghai and Chinese Politics: Before and After the Cultural Revolution", in Howe (ed.), *Shanghai: Revolution and Development*, pp.66-90.

Table 4.1

Total Societal Investment: 1950-1980
(Billion Yuan)

<u>Year</u>	<u>Shanghai</u>	<u>Guangdong</u>
1950-52	0.29	0.16
1953-57	1.93	1.28
1958-62	5.56	4.26
1963-65	2.03	1.99
1966-70	3.48	2.60
1971-75	9.58	6.12
1976-80	15.14	12.87
Total: 1950-80	38.01	29.28

Source: *Shanghai Statistical Yearbook 1980*, p.271; *Guangdong 1949-88. FAI*, pp.158-61.

Table 4.1 shows that between 1950 and 1980 Shanghai had a consistent edge over Guangdong and that by 1980 the cumulative difference in investments made amounted to 30% of Guangdong's total investment. Despite the central government's preference for the interior regarding new investments, given the perceived threat of foreign attack in the 1960s and 1970s, and despite the relocation of many factories inland during the 1950s,¹² Shanghai nevertheless benefited from being the largest economic centre in pre-1949 China. In order to better tap its industrial infrastructure and highly educated workforce, relatively substantial investment was pumped into Shanghai's industrial sector.¹³

¹²See Christopher Howe, *Employment and Economic Growth in Urban China 1949-1957* (London: Cambridge University Press, 1971), p.37; and Fang Weizhong (ed.), *The Major Economic Events in the People's Republic of China, 1949-1980*, p.144. The latter source states that resiting was part of the exercise to remedy the problem of surplus within the industrial infrastructure, such as the oversupply of workers and equipment in the old and established industrial centres, the inadequate supply of raw materials and new demand for finished products, a problem which was acute in 1955.

¹³The policy of the central government towards the developed areas in the coastal region in the 1950s and the 1960s can be described as one of "exploitation and utilization to the full". In accordance with the central policy, the Party Committee of Shanghai formulated an investment policy which "fully utilizes the existing capacities while reasonably develops new facilities". See *Shanghai Jingji Nianjian 1982 (Internal Version)*, p.844. As a result of this policy, although Shanghai had more investment than other coastal provinces, almost all investments were aimed at a quick and direct return of revenue whilst industrial infrastructure and social needs such as roads and domestic housing were seriously neglected. Moreover, as we shall see later in this chapter, Shanghai has had the highest extraction rate in the country, in terms of the share of local fiscal remittances to the Centre, and the amount of resources ploughed back to the municipality in the form of central and state investments was only a tiny fraction of the fiscal transfers.

However, at the start of the 1980s when the central government's experimental reforms gathered momentum in the southern provinces, the edge which Shanghai had previously enjoyed gradually dulled.

Table 4.2

Growth Rates of Shanghai's Total Societal Investment
(%)

<u>Year</u>	<u>Shanghai</u>	<u>National</u>
1980	28.8	n/a
1981	20.2	n/a
1983	30.7	28.0
1984	6.6	16.2
1985	28.5	38.7
1986	23.9	18.7
1987	26.8	20.6
1988	31.7	23.5
1989	(12.4)	(8.0)
1990	5.7	7.5
1991	13.7	23.8
1992	38.4	42.6
Average	8.0	19.7

Source: *Shanghai Statistical Yearbook 1989, 1990, 1991, 1992, 1993*, respectively, p.271, p.238, p.260, p.280, p.244.

Table 4.2 shows that in six out of the ten years between 1983 and 1992, Shanghai's total investment grew at a substantially slower rate than nationally. Investment in Shanghai grew at an annual average rate of 8%, as compared to 20% nationwide. More notably, despite having in 1988 obtained a more favourable fiscal arrangement with the Centre, and, bearing in mind that after 1990, when the Centre announced the Pudong policies and investment accelerated, the rate of growth in Shanghai was still far short of the national average. When comparing Table 4.2 with Table 3.6 on Guangdong, the relatively lacklustre growth of Shanghai's investment during the 1980s is obvious. The average annual growth rate in Guangdong for the same period stood at 30.8%, nearly four times that of Shanghai, at 8%. Also, the rate of growth in Guangdong in 1991 and 1992 was substantially higher than that of Shanghai, and this occurred at a time when the announcement of the Pudong preferential policies should have made Shanghai the new magnet of investment. Guangdong's investment performance in 1992, the year of Deng Xiaoping's southern tour, was particularly spectacular. That year total societal investment almost doubled at 93%, more than double the rate in Shanghai and nationally. Moreover, investment in Shanghai had contracted on a larger scale during the 1989 national retrenchment drive than was the case nationally and when

compared with Guangdong's modest dive, at -1.8%. This suggests that Shanghai's investment during the 1980s was, contrary to what happened in Guangdong, more prone to contract than expand, even when the stimuli for both growth and contraction came from the same origin: the Centre.

As a result of much slower growth rates, Shanghai's cumulative investment during the period 1981-92 was less than 60% that of Guangdong's. Table 4.3 below shows that in 1992, Guangdong's total annual investment amounted to 2.5 times that of Shanghai.

Table 4.3

Total Societal Investment 1981-1992
(Billion Yuan)

<u>Year</u>	<u>Shanghai</u>	<u>Guangdong</u>
1981-85	41.28	54.88
1986-90	102.04	154.10
1991	25.83	47.82
1992	35.74	92.18
Total	204.89	348.98

Source: *Guangdong Statistical Yearbook 1993*, p. 236; *Shanghai Statistical Yearbook 1989, 1990, 1992, 1993*, respectively, p.271, p.260, p.281, p.244.

From 1980 to 1992, Shanghai's total investment grew by 687%, whilst during the same period that of Guangdong grew by 2307%. Table 4.4 below shows that the edge Shanghai had enjoyed over Guangdong prior to 1980 was thereafter reversed to meagre significance in the overall context.

Table 4.4

Relative Edge between Shanghai and Guangdong:
Total Investments (Billion Yuan)

<u>Year</u>	<u>Shanghai (S)</u>	<u>Guangdong (G)</u>	<u>Edge</u>
1950-80	38.0	29.28	S over G 8.73
1981-92	204.89	348.98	G over S 144.09
1950-92	242.90	378.26	G over S 135.36

Guangdong has topped the list of provincial-level jurisdictions as regards the value of its total investment since 1988, whilst Shanghai has trailed far behind between fourth and seventh positions. From 1988, Shanghai moved down in the ranking

one position annually, having been overtaken by Shandong, Zhejiang and Sichuan.¹⁴

Lingering State Dominance amidst Proliferation of Actors

The proliferation of actors in the field of investment was a nationwide phenomenon. Nonetheless Shanghai's investment was characterized in three ways. First, the state sector continued its predominance with the non-state sector growing more slowly than in Guangdong and nationally. Second, the central government played a far more active part in Shanghai's investment than in Guangdong. Thirdly, whilst funding for investment had diversified substantially, money from the state budget still accounted for a higher proportion of total funding than was the case in Guangdong, and the eventual drop was not until much later. All these factors point to the premise that the grip of the central state via the traditional planning mechanism on investment and other economic activities has been much stronger and more persistent in Shanghai vis-a-vis Guangdong.

Lingering Central Dominance

If the marginalization of central investment best characterizes the proliferation of investment funding and actors in Guangdong since the 1980s, the lingering dominance of central investment in post-1980 Shanghai as regards its investment behaviour constitutes its opposite extreme. Table 4.5 below depicts the different proportion shares between central and local investment in the state sector since 1950.

¹⁴See State Statistical Bureau (ed.), *Quangguo Zhuyao Shehui Jingji Zhibiao Paixu Nianjian, 1992* (The 1992 Yearbook of the Ranking of Provinces in Major Social and Economic Indicators) (Beijing: Zhongguo Tongji chubanshe, 1992), p.19; *Statistics on FAI, 1988-89*, p.24.

Table 4.5

Central and Local Investment In Shanghai*
(% Share)

<u>Year</u>	<u>Central Investment</u>	<u>Local Investment</u>
1950-52	52.1	47.9
1953-57	70.0	30.0
1958-62	15.8	84.2
1963-65	29.2	70.8
1966-70	27.1	72.9
1971-75	24.0	76.0
1976-80	30.4	69.6
1981-85	49.8	50.2
1986-90	29.3	70.7
1991	36.1	63.9
1992	27.3	72.7
Total:		
1950-80	31.3	68.7
1981-92	40.2	59.8

*Note: Statistics for 1950-1977 include capital construction only, as capital construction accounted for the bulk of state sector investments (from more than 80% in the 1950s to more than 60% in the 1970s) and no data of this kind is available for technical renovation.

Source: *Shanghai Statistics Yearbook 1993*, pp. 248, 259.

Table 4.5 shows that from 1981 to 1985 the share of central investment surged nearly 20 percentage points to account for half of the state sector investment before subsiding in later years. During the 1981-92 period central investment accounted for 40% of total investment in the state sector, as compared with the 31% share during 1950-80. It is interesting that central investment should have become *more* important to Shanghai during the 1980s when the national trend elsewhere was towards decentralization of power and resources to the provinces. When looking more closely at the capital construction portion of investment, it becomes clear that the part being played by the central government had increased, and that the upward trend of central participation in Shanghai's capital construction investment lingered and persisted through to the end of 1980s.

Table 4.6

Central Investment in Capital Construction
(% Share)

<u>Year</u>	<u>% Share</u>
1981-85	66.0
1986-90	58.6
1986	49.6
1987	55.3
1988	62.8
1989	60.5
1990	61.0
1991	50.5
1992	34.7

Source: *Shanghai Statistics Yearbook 1993, 1991*, respectively, p.248, p.264.

When I raised the issue of the heavy share of central investment during interviews with Shanghai officials, they invariably cautioned against too simplified an interpretation of the statistics. First, they stressed that the calculation of proportion shares according to the subordination relations of the projects might be misleading as regards the extent of central influence over Shanghai's investment activities. This is because other factors, such as the planning system and the funding arrangement of investment, would have a significant effect on the pendulum of power between the Centre and the municipality, given that there is a certain division of subordination relations. Second, it was suggested by officials that a substantial part of local investment had not been included in the official statistics and that the share of central investments was artificially inflated.¹⁵

As regards the first point, it is well known that the shares of central and local investment calculated according to the subordination relations of projects undertaken are a rough indication only of the balance of central/provincial influence over investment in a province. Subordination relations assign the detailed administration of projects to different levels of the government. The extent of power the government department-in-charge actually has over projects is dependent on a host of factors. As discussed in Chapter Three, it would be naive to interpret the heavy share of local investment in Guangdong after 1958 in the same way as one would the similar situation in the 1980s and 1990s. The centralized

¹⁵Respondents Nos. 15, 22, and 17, Shanghai interviews, January 1994. The interviews were separately conducted. Although the precise wordings of the different respondents may differ, they all pointed to the same message concerning what should be read from the statistics on central investment.

planning and fiscal systems before 1980 ensured that though projects and enterprises were delegated to local administration, the Centre still retained a high degree of control over planning and approval of investment, as well as over the allocation of resources which made investment possible in the first place.

Similar caution is therefore necessary when interpreting the heavy share of central investment according to subordination relations in the 1980s in Shanghai. As one respondent explained to the author, due to changes in funding channels, the extent of central control over central investment projects had changed considerably since early/mid-1980s. The proliferation of funding channels towards the end of the 1980s decade reduced the Centre's grip even when the project concerned is a central project, as the local economy and the Shanghai government played a more active role in "supporting" central investment projects.¹⁶

Caution and prudence notwithstanding, it is important not to underestimate the significance of these statistics. First, given the national policy of decentralization in the 1980s and the nationwide trend of proliferation of investment actors, it is noteworthy that such a high percentage of Shanghai's investment has been under the administration jurisdiction of the central government. The high percentage of central funds in Shanghai's investment is an *indication* of the high degree of central involvement in Shanghai's investment affairs. Second, evidence exists that most central investment projects in the 1981-85 period were directly financed by the central government budget, whether in the form of central budgetary funds or planned loans under the quotas of the central ministries. This means that for the first half of 1980s at least, the high percentage shares of central investment are a fairly accurate reflection of the extent of central control over investment in Shanghai. I shall discuss this point in more detail in the next section on funding channels.

Underreporting is probably a common practice nationwide and its extent is, therefore, difficult to gauge. Underreporting actually encompasses three types of situation. First, and perhaps the most interesting type for our purposes is the conscious decision of the provincial government deliberately to conceal information from the Centre. In such cases data for projects is actually available in the provincial government files, but they are not included in yearly investment plans and reports submitted to the Centre, or in official statistics. The second type is a corresponding development of the first type at subprovincial levels vis-a-vis

¹⁶Respondent No.15, Shanghai interview, January 1994.

the provincial-level. Similarly subprovincial governments do to the provincial governments as they do to the Centre so as not to appear to be disobeying orders and flouting planning limits assigned from above. Such practice may well exist at every level of the hierarchy right from the very grassroots level of enterprise. The third type of underreporting is due to the methods of collection of statistics and data on investment activities. In other words, owing to a lack of personnel or inadequacy in management, some investment activities, usually those small in scale or occurring in remote places where management standards are the weakest, never enter the statistical books or files at any level of government.¹⁷

It is obvious that the largest area of underreporting within provincial statistics is that of local investments. One respondent explicitly stated that official statistics were compiled *in accordance with* the planning control figure of total investment handed down from the Centre every year. The total value of investment as shown in the statistics would be made to appear roughly equivalent to the value endorsed by the Centre, allowing a reasonable, though not too wide, margin to account for the narrower coverage of the planning control figures.¹⁸

The extent to which underreporting has underestimated the share of local investment is difficult to ascertain, since no such data will be made available whilst the provinces and lower-levels still feel the need to engage in such practice. Nonetheless, by looking at the absolute amount of central investment and comparing Shanghai and Guangdong, it is beyond doubt that Shanghai has had far more central investment in absolute terms, as the table below well shows:

¹⁷Ibid. That local governments have indeed been manipulating statistical data was confirmed by the Centre's move to ban such behaviour openly in May 1994, when in a national telephone conference with provincial governments Vice-Premier Zhou Jiahua announced that a comprehensive inspection exercise was to be carried out regarding the accuracy of statistical information reported to the Centre. See *People's Daily* May 27, 1994, p.3. The problematic behaviour Zhou pointed out in the conference includes delays in reporting data, refusing to report, and hiding data and inflating data.

¹⁸Respondent No.15, Shanghai interview, January 1994. It was revealed in a study on local (provincial) government investment behaviour conducted by Mainland Chinese scholars that in some provinces the provincial government has been keeping two separate sets of investment statistics. One set is the raw data recording the total amount of investment undertaken and known to the provincial government. The other set is a "processed" version of the first for forwarding to the central government. According to the study, this is why there are often huge discrepancies between investment data released by the banks and the final official investment statistics released by the provincial government. (The latter is often much less.) See Zhong Chengxun (ed.), *Difang Zhengfu Touzi Xingwei Yanjiu* (A Study of the Investment Behaviour of Local Governments) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1993), p.448. From the interviews conducted in Shanghai, it is clear that Shanghai is one of those provinces. See also Footnote 20 below. On the different coverages of the planning control figures passed down from the Centre and the statistics on investment, see Footnote 7 of Chapter Three.

Table 4.7

Central Investment in State Sector:
Shanghai and Guangdong
(Billion Yuan)

<u>Year</u>	<u>Shanghai</u>	<u>Guangdong</u>
1981)	0.94
1982)	1.33
1983) 16.10	1.42
1984)	1.99
1985)	8.32
1986	4.22	3.25
1987	6.06	4.02
1988	8.29	4.40
1989	7.79	4.78
1990	7.54	5.84
1991	7.37	6.49
1992	7.01	9.86
Total	64.38	46.96

Source: *Guangdong 1949-1988 FAI*, p.172; *Guangdong FAI Statistics, Yearly Volumes (1989-92)*; *Shanghai Statistical Yearbooks 1991, 1993*, respectively, p.264; pp.248, 259.

Bearing in mind that underreporting is a nationwide phenomenon, and the fact that Shanghai is more reliant than other provinces/municipalities on central investment, it is obviously in the interests of the Shanghai government to desist from reporting an investment total which far exceeds the central control figure. In the event that the central government judges the total investment as excessive, central investments *could* in theory be more easily controlled and projects curtailed than could local investment.¹⁹ The Shanghai government is therefore more wary of arousing unwelcome attention of the Centre. The effect is that in Shanghai, the *appearance* of complying with central planning control is of greater importance in the minds of local officials than is the case in Guangdong.²⁰

¹⁹Respondent No.15, Shanghai interview, January 1994. It should be noted that, in reality, central investment is not necessarily more subject to retrenchment moves than is local investment. Since "strategic" projects are not usually the targets of retrenchment, more often receiving additional resources released from other projects, and since central projects were more likely to be regarded as "strategic", central investment projects would thus be less affected than local investment during retrenchment. In fact this has been the case in Shanghai, where central investment in 1989 shrunk by less than 6% from the level of 1988, as against a 12.4% decrease for local investments. (See *Shanghai Statistical Yearbooks 1991, 1993*). However since central investment is directly under the control of the central government, the *feeling* in the locality is that this is a slice of investment subject to the mercy of the Centre.

²⁰It is noted that during discussions with Guangdong and Shanghai officials on the underreporting of local investments in official statistics, (Guangzhou interviews, May and September 1993; Shanghai interviews, January 1994) Guangdong officials confirmed that the third type of underreporting is most common, and to a less extent the second type, i.e. subprovincial underreporting. On the other hand, Shanghai officials laid the emphasis on the first. In the judgement of the author, it would not be right to attribute this difference to idiosyncratic and other

Funding Channels

Funding of investment in Shanghai is characterized by a relatively high proportion share of budgetary funds, foreign capital and bank loans and, in contrast to Guangdong, a lower share for "own funds" and other miscellaneous headings. Table 4.8 below shows the cumulative position from 1983 to 1992:

Table 4.8

Funding Channels of State Sector Investment 1983-1992

<u>Channels</u>	<u>Billion Yuan</u>		<u>% Share</u>	
	<u>Shanghai</u>	<u>Guangdong</u>	<u>Shanghai</u>	<u>Guangdong</u>
Budget	14.74	12.72	8.50	5.48
Bank Loans	58.56	57.46	27.29	24.76
Foreign Capital	30.54	35.15	19.02	15.15
Own Funds & Others	71.50	126.72	44.52	54.61
Total	175.34	232.05	100.00	100.00

Source: *Shanghai Statistical Yearbooks 1983-1993* ; *Guangdong 1949-1988 FAI*, p. 89; *Guangdong Statistical Yearbook 1991, 1992, 1993*, respectively, p.195, p.231, p.237.

Table 4.8 shows that although the cumulative value of Shanghai's state sector investment was only three-fourths those of Guangdong, the absolute value of investment using budgetary funds and domestic bank loans was 3 billion yuan more than that of Guangdong. The proportional share of foreign capital is also almost four percentage points higher, despite the fact that Guangdong has taken the lead in the Open Door Policy and has been successful in attracting direct foreign investments. A more detailed look at the figures suggests that the higher share of investment using budgetary funds, foreign capital, and bank loans, is related to the high proportion of central investment.

random factors, such as the possibly different levels of candidness of the respondents. Responses were consistently along the same lines for different respondents in either Guangdong or Shanghai when this question was raised.

Table 4.9

Budgetary Investments in State Sector
% Share

<u>Year</u>	<u>National</u>	<u>Shanghai</u>	<u>Guangdong</u>
1983	34.9	13.6	22.6
1984	34.2	15.2	17.0
1985	23.9	12.9	10.6
1986	22.1	15.0	11.7
1987	20.5	17.8	7.6
1988	14.8	13.0	4.8
1989	13.3	5.5	5.5
1990	13.1	5.6	4.4
1991	10.1	4.5	3.3
1992	6.2	4.0	1.9

Source: *Guangdong 1949-1988 FAI*, p. 89; *Guangdong Statistical Yearbooks 1991-1993*; *Shanghai Statistical Yearbooks 1983-1993*; *Statistical Yearbook of China 1993*, pp.146, 149; *Statistics on FAI (1950-1985)*; (1986-87); (1988-89); (1990-91).

Table 4.9 shows that Guangdong started off with the higher share of budgetary investment in 1983, but that this share rapidly and consistently declined over the years. Five years later in 1987, the share of budgetary investment in Guangdong was only about one third that of 1983. On the other hand, budgetary investment in Shanghai was resilient. Between 1983 and 1987, the share of budgetary investments was generally on an upward trend, climbing from 13.6% in 1983 to 17.8% in 1987---more than ten percentage points higher than of Guangdong's 7.6% share the same year. It was only in 1989 that the budgetary investment share declined, abruptly, falling 7.5 percentage points to equal Guangdong at 5.5%.

Table 4.5 and Table 4.9 together show that the period during which Shanghai's budgetary investments increased was precisely the time when central investment surged in Shanghai. One element of data which strongly suggests the extent of the contribution from the central government to Shanghai's budgetary investments is the discrepancy between the amount of budgetary investments made and the amount of local budgetary funds spent on investment, as Table 4.10 below shows:

Table 4.10

Discrepancy of Budgetary Investment and Local Fiscal Investment Expenditures*
(Yuan Million)

<u>Year</u>	<u>Budgetary Investment</u>	<u>Fiscal Exp.</u>	<u>Discrepancy</u>	<u>%</u>
1952	141	91	(50)	(35.5)
1957	330	132	(198)	(60.0)
1962	169	145	(24)	(14.2)
1965	283	336	53	18.7
1970	521	731	210	40.3
1978	1139	1601	462	40.6
1980	1222	890	(332)	(27.2)
1981	1008	887	(121)	(12.0)
1982	733	914	181	24.7
1983	821	1030	209	25.5
1984	1063	1620	557	52.4
1985	1194	2364	1170	98.0
1986	1777	2773	996	56.0
1987	2930	1747	(1183)	(40.3)
1988	2712	2397	(315)	(11.6)
1989	945	2291	1346	142.4
1990	1106	2123	1017	92.0
1991	1044	2107	1063	101.8
1992	1147	2247	1100	50.0
Total:				
1981-92	16480	22500	6020	36.5
1987-91	8787	10665	1928	21.9

*Note: Discrepancy refers to the amount of local fiscal, that is, budgetary investment expenditures over the value of budgetary investments as shown in the statistics of investment by types of funding. The % refers to the absolute discrepancy value as a percentage of the budgetary investment. Figures for budgetary investments cover the state sector only, and prior to 1983, cover capital construction only.

Source: Fiscal expenditures: *Shanghai Statistical Yearbook 1993*, p. 56; budgetary investments: (before 1983) *Shanghai Statistical Yearbook 1986*, p.243; (in and after 1983) *Shanghai Statistical Yearbook 1983, 1984, 1986, 1987, 1988, 1989, 1990, 1991, 1992, 1993*, respectively, p.219, p.133, p.242, p.232, p.244, p.274, p.239, p. 261, p.281 and p. 245.

It is interesting to compare the table above with Table 3.17 in Chapter Three. A comparison of the two makes it clear that the overall discrepancy ratio in Guangdong during 1987-91, at 137%, is much higher than the 22% in Shanghai. Table 4.10 thus conveys two important indications. First, it shows that, in Shanghai as in Guangdong, the amount of budgetary funds spent on investment from the provincial state coffers is, both on average and cumulatively, larger than the value of investment recorded in the official investment statistics as having been financed with budgetary funds, although the difference in Shanghai's figures is much more modest than that of Guangdong. As discussed in the previous

chapter on Guangdong, this indicates that the government of Shanghai has also been actively involved in "outside plan" investment.

Second, the relative modesty of the difference in Shanghai's figures is largely a result of two years' negative discrepancy in 1987 and 1988, which served to cancel out a substantial portion of the positive discrepancy in other years. When looking at the years 1990 and 1991, the discrepancy percentage in Shanghai was not much less than that of Guangdong, and in 1989 it even marginally surpassed Guangdong.

In Chapter Three it has been noted that, in theory, a negative discrepancy is the norm. This is because if local fiscal resources are spent strictly in accordance with the state investment plan, and there is normally at least some inflow of central budgetary funds, the amount of local fiscal spending on investment would be only a portion of the investment financed with budgetary funds, the balance of the portion depending on the amount of central inflow. However, in practice the opposite has been the case. Table 4.10 shows that for the entire decade of 1980s, negative discrepancy occurred in only three years. Data available in the 1960s and 1970s also recorded the frequent occurrence of positive discrepancies of some magnitude. This demonstrates that the Shanghai government has for a long period of time actively engaged in outside plan investments, the extent of which increased still further in the 1980s.

Given this historical trend, that a negative discrepancy recurred in 1987 and 1988 indicates a very substantial inflow of central budgetary funds. Taking into account the underlying trend of a positive discrepancy, and the fact that local fiscal expenditure on investment in these two years was sustained at a more or less stable level, it is likely that the actual amount of central budgetary inflow was in excess of the discrepancy value.²¹

A dominant "central factor" is also indicated in data available on the composition and allocation of foreign capital. Such data reveals that there are three major ways in which foreign loans are raised and arranged, in terms of the different degree of involvement of the central government. First, the central government *arranges* both the raising and repayment of the loan. Second, the Centre arranges for the raising of the capital, and the user repays the loan directly.

²¹This interpretation of the negative discrepancies as signalling large inflows of central fiscal funds was confirmed with informed sources in the Shanghai municipal government. (Respondents Nos. 20 and 21, Shanghai interviews, January 1994)

Thirdly, the user both raises and repays the loan directly exclusive of direct involvement with the central government. The Centre has the highest level of involvement in the first type of foreign loan, which would be described as centrally-coordinated foreign capital in the following discussion. It should be noted that in all three cases the users are responsible for repaying loans. In the case of centrally co-ordinated loans, repayment would be *via* the central government ministry concerned. Therefore, from the viewpoint of maximizing local autonomy and flexibility, the second type was probably the most beneficial of the three, since it makes use of the superior bargaining power of the central government when securing loans for the use of localities.²² There is however no statistical breakdown available for the second and third type of arrangement. The two are thus lumped together in the following discussion as symbolizing a high extent of provincial involvement.

Table 4.11

Centrally Co-ordinated Foreign Loans in Foreign Capital
Shanghai's State Sector Investment
(Billion Yuan)

<u>Year</u>	<u>Foreign Capital</u>	<u>Centrally Co-ordinated</u>	<u>% Share</u>
1987	3.60	2.20	61.11
1988	4.62	2.04	44.16
1989	3.74	1.60	42.78
1990	3.54	1.01	28.53
1991	3.74	0.99	26.47
1992	3.01	0.001	0.03
Total	22.25	7.84	35.24

Source: *Shanghai Statistical Yearbook 1988-1993.*

Table 4.11 shows that over one-third of foreign capital used in state sector investment between 1987 and 1992 was centrally coordinated. It can be seen that the percentage shares stood at a very high level, at over 60% in 1987 and over 40% in 1989, before dropping substantially in the 1990s. Although data for earlier years is not available, the trend of the available data strongly suggests a high percentage for the pre-1987 years.

A contrast with Guangdong better illustrates the picture, as Table 4.12 below shows:

²²This is the opinion of Respondent No.36, Beijing interview, April 1994. Provincial governments could then retain the autonomy in managing the details of the loans while securing more favourable terms or larger scale of loan finance through the central government.

Table 4.12

Centrally Co-ordinated Foreign Loans in Foreign Capital
Guangdong's State Sector Investment
 (Billion Yuan)

<u>Year</u>	<u>Foreign Capital</u>	<u>Centrally Coordinated</u>	<u>% Share</u>
1984	0.90	0.06	6.67
1985	1.74	0.18	10.34
1986	2.46	0.32	13.01
1987	2.69	0.26	9.67
1988	n/a	n/a	n/a
1989	3.90	0.24	6.15
1990	4.89	0.18	3.68
1991	n/a	n/a	n/a
1992	7.66	0.14	1.83
Total			
1984-92	24.24	1.37	5.65
1987-92	19.14	0.82	4.28

Source: *Guangdong FAI Statistics*, Yearly volumes 1984-92.

A comparison of Tables 4.11 and 4.12 shows that the amount of centrally coordinated foreign loans in Shanghai between 1987 and 1992 was nearly ten times that in Guangdong. Shanghai was consequently more dependent on the central government for the supply of foreign investment funding, whilst in Guangdong the portion in this area was less than 5%. This indicates that Guangdong, due to its success in attracting direct foreign investment, has been more capable than Shanghai of raising foreign capital independently. More importantly, Shanghai has been much less successful in gaining control over resources provided by the Centre. As the table below reveals, Guangdong was able to deploy the bulk of its 5% of centrally coordinated loans to *local* investment projects, whilst the majority of such loans to Shanghai was used for central projects in Shanghai.

Table 4.13

Distribution of Centrally Coordinated Foreign Loans
in Local and Central Investment Projects
(Million Yuan)

Guangdong

<u>Year</u>	<u>Total</u>	<u>Central Projects</u>		<u>Local Projects</u>	
		<u>Mn Yuan</u>	<u>(%)</u>	<u>Mn Yuan</u>	<u>(%)</u>
1984	59.7	59.7	(100.0)	0.0	(0.0)
1985	175.2	87.5	(49.9)	87.7	(50.1)
1986	315.4	164.5	(52.2)	150.9	(47.8)
1987		n/a		n/a	
1988		n/a		n/a	
1989	236.6	158.6	(67.0)	78.0	(33.0)
1990	179.9	36.3	(20.2)	143.5	(79.8)
1991		n/a		n/a	
1992	142.5	3.5	(2.5)	139.0	(97.5)
Total:					
1984-92	1069.1	510.2	(31.5)	1109.3	(68.5)
1989-92	559.0	198.4	(18.6)	870.7	(81.4)

Source: *Guangdong FAI Statistics*, Yearly volumes.

Shanghai

<u>Year</u>	<u>Total</u>	<u>Central Projects</u>		<u>Local Projects</u>	
		<u>Mn Yuan</u>	<u>(%)</u>	<u>Mn Yuan</u>	<u>(%)</u>
1989	1603	1540	(96.1)	63	(3.9)
1990	1013	958	(94.6)	55	(5.4)
1991	992	978	(98.6)	14	(1.4)
1992	1	0	(0.0)	1	(100.0)
Total	2006	1936	(96.5)	70	(3.5)

Source: *Shanghai Statistical Yearbooks, 1990-1993.*

Table 4.13 shows that between 1984 and 1992, nearly 70% of centrally coordinated loans in Guangdong was used for local investment projects. This share rose to over 80% between 1989 and 1992, as compared to less than 4% in Shanghai. It is, therefore, clear that although Shanghai has had more than three times the amount of Guangdong's centrally coordinated loans, the amount that was used for local projects was only 15% of the amount spent on local projects in Guangdong in absolute terms. The message is loud and clear: whilst the Shanghai

government succeeded in the "pulling in" of resources to the municipality,²³ such resources came with strings attached. The Centre retained control over the resources by assigning them largely to centrally subordinated projects. When considering Guangdong's success in allocating centrally coordinated loans to local projects, it appears that Shanghai may have paid a disproportionate price in terms of leverage vis-a-vis the Centre for its reliance on central-originated funding.

Slow Growing Non-State Sector

Concomitant with the lingering dominance of central investment and the resilience of budgetary funds as a source of funding is the predominance of the state sector in investment and the economy of Shanghai generally. As detailed in Table 4.14 below, as late as 1992, investment in the non-state sector accounted for just over 20% of the total, with the state sector accounting for 80%. For the entire 1981-92 period, the share of non-state sector investment cumulatively was only about 18%, less than eight percentage points higher than the share during the 1950-80 period.

Table 4.14

Shanghai's Non-State Sector Investment (Million Yuan)

<u>Year</u>	<u>Collective (C)</u>	<u>Private (P)</u>	<u>% Share of Total Investment</u>		
			<u>(C)</u>	<u>(P)</u>	<u>(C)+(P)</u>
1950-52	2	48	0.7	16.4	17.1
1953-57	15	315	0.8	16.3	17.1
1958-62	167	133	3.0	2.4	5.4
1963-65	149	97	7.3	4.8	12.1
1966-70	262	213	7.5	6.1	13.7
1971-75	615	305	6.4	3.2	9.6
1976-80	1297	485	8.6	3.2	11.8
1981-85	3616	3323	8.8	8.1	16.8
1986-90	10096	7296	9.9	7.2	17.0
1991	2782	1487	10.8	5.8	16.5
1992	6416	1755	18.0	4.9	22.9
Total:					
1950-80	2507	1596	6.6	4.2	10.8
1981-92	22910	13861	11.8	6.8	18.0
1950-92	25417	15457	10.5	6.4	16.8

Source: *Shanghai Statistical Yearbook 1993*, p.244.

²³Centrally coordinated loans could amount to some kind of central support as the provinces may not be able to solicit and organize foreign loans independently, and the interest rate or repayment terms negotiated by the Centre may be more favourable than otherwise.

When comparing Table 4.14 with Table 3.19 of Chapter Three, the sluggish growth of investment in Shanghai's non state sector relative to Guangdong's is clear. In line with its high base of total investment before 1980, and in particular due to the concentration of the country's private capital there in the early 1950s, both the absolute value and percentage share of non-state sector investment was larger in Shanghai than in Guangdong in the 1950-1980 period. The absolute cumulative value was nearly three times more, and the percentage share was almost double. During the 1981-92 period, however, investment in Shanghai's non-state sector was only 40% that of Guangdong's, and the proportion share of the total lower by, again, 40%. The non-state sector became a relatively light weight in Shanghai's economy, as compared in Guangdong and nationally, as shown in the table below:

Table 4.15

<u>Proportion Share of Non-State Sector Investment</u> <u>in Total Investment (%)</u> <u>(1992)</u>			
<u>Sector</u>	<u>National</u>	<u>Guangdong</u>	<u>Shanghai</u>
State	67.1	59.2	77.1
Non-state	32.9	40.8	22.9
of which:			
Collective	17.3	22.7	18.0
Private	15.6	18.1	4.9

Source: Table 4.14, Table 3.19, *Statistical Yearbook of China 1993*, p.145.

Table 4.16

Yearly Growth Rate of Investment (%)

<u>Year</u>	<u>Total</u>	<u>State Sector</u>	<u>Non-State Sector</u>		
			<u>C</u>	<u>P</u>	<u>C+P</u>
1981	20.2	11.8	51.9	163.1	86.1
1982	30.7	36.9	(5.9)	10.4	11.7
1983	6.5	5.5	21.3	2.8	12.5
1984	21.5	16.6	44.8	58.6	50.9
1985	28.5	26.6	16.2	62.2	37.2
1986	23.9	27.7	34.0	(14.1)	8.1
1987	26.8	26.1	33.4	25.9	30.6
1988	31.7	28.6	55.6	33.1	45.8
1989	(12.4)	(10.0)	(27.7)	(14.8)	(22.8)
1990	5.7	7.5	(12.9)	10.7	(3.1)
1991	13.7	8.2	52.1	(10.2)	22.5
1992	38.4	26.4	130.6	18.0	91.4
Average	19.6	17.7	32.8	30.0	30.9

Source: *Shanghai Statistical Yearbook 1989, 1990, 1991, 1992, 1993*, respectively, p.271, p. 238, p. 260, p.280 and p.244.

Table 4.16 above details the annual growth rates of investment in the state and non-state sectors in Shanghai. When looking at Table 4.16 in tandem with Table 3.21 of Chapter 3 on Guangdong, the following observations may be made:

First, in both Guangdong and Shanghai investment in the non-state sector grew at a faster rate than it did in the state sector. The average annual growth rate of the non-state sector is higher, and when looking at the trend year by year, the non-state sector grew faster in *more years* in Shanghai than in Guangdong. In Shanghai, for instance, investments in the non-state sector accelerated during eight out of the twelve years between 1981 and 1992. In Guangdong it was the case during only six out of the same twelve years. This suggests that while the non-state sector in both areas was more prone to growth and increased investment, this trend was *more consistent* in Shanghai, even though the state sector has been a more dominant player there. It could be that precisely because the non-state sector was a lesser player in investment in Shanghai, it became in a sense less vulnerable to the changes in economic and political "climate" which had a larger impact on investment in the non-state sector in Guangdong.

Second, in both places it was the collectives within the non-state sector that took the lead, and, despite the stronger presence of the state and the plan in Shanghai, the greater gap of growth between the collective and the private/individual was in Guangdong. Here, the gap was more a result of the high

growth rates of the collective than of a low base in private investment. Table 4.17 below gives a clear illustration of the loci of growth in Guangdong and Shanghai:

Table 4.17
Average Annual Growth Rates of Investment: A Comparison
1981-1992 (%)

<u>Sectors</u>	<u>Shanghai</u>	<u>Guangdong</u>	<u>Gap*</u>
Total Societal	19.6	31.5	11.9
State Sector	17.7	32.0	14.3
Non-State	30.9	36.2	5.3
of which:			
Collective	32.8	64.3	31.5
Private/Individual	30.0	22.7	(7.3)

*Note: "Gap" here refers to the difference between Guangdong's growth rates over Shanghai's. The "gap" mentioned in the text above refers to the differences in growth rates between the collective and private investments in a locality.

Between 1981 and 1992, Guangdong's investment in the collective sector grew at an average annual rate of 64%, as against a rate of only 23% in private investment. In Shanghai the respective rates were 33% vis-a-vis 30%, a much smaller difference. In fact the average growth rate of Guangdong's private investment was lower than that of Shanghai, as indicated by the negative gap in Table 4.17 above. The largest gap in growth rates between Shanghai and Guangdong is in the collective sector, amounting to 32 percentage points.

This recalls the early stage of development of the non-state sector in China, and the heavy involvement of the government in the economy and in investment decisions in particular. The non-state sector in China has never been simply the opposite of the state sector. During the 1980s to present day to the foreseeable future, the non-state sector has not been and will not be an autonomous actor in society as it has in the West. Within the non-state sector the collective has always been favoured as a magnet for economic activities. Here is a large grey area outside the strict control of the state system yet still endowed with the label of public ownership making it much more attractive and convenient politically than the capitalistic private sector. The collective has therefore become the hub of investment in places with a rapidly expanding economy.

The role of the state in investment decisions and the close relationship between the government and the collective sector explains the otherwise peculiar phenomenon noted in Table 4.17 above. The private/individual sector was *not* the

fastest growth point in the 1980s, not even in Guangdong where decentralization reforms first took off in the country and where private investment has accumulated to a noticeable proportion of the total (18% in 1992). Therefore it is no surprise that the average annual growth rates of private sector investments in Shanghai should outstrip those of Guangdong. The crucial gap in performance lies in the collective sector. Given the active role of provincial governments in many investments in the collective sector, and the fact that the collective sector was never the central government's baby, the more a provincial government operates under the control of the Centre, the less opportunity it has to invest in the collective sector. Under the traditionally tight scrutiny of the Centre and the strong presence of the state plan in its economy, the Shanghai Government has therefore used to focus its attention on the state sector up until the 1990s. In other words, the relatively slow growth of the non-state sector, and of the collective in particular, in Shanghai in the 1980s was the result of the traditionally strong hold of central government over the municipal government. The development of the non-state sector in China, in the 1980s and probably for the near future, is more a matter of an adjustment of power between the central and lower levels of the state, than between state and society. Consequently, the non-state sector has an integral part to play in the discussion on central-provincial relations.

Institutional Backdrop

Why had the central government retained such a level of dominance in Shanghai's investment, when the national slogan for the 1980s was "decentralization" and "reform"? The answer requires a closer examination of the institutional environment in Shanghai in more detail. What are the rules of the game which Shanghai has played, and probably does still, with the Centre since 1979?

Fiscal System: Tight Jacket

The most important and decisive institutional constraint of Shanghai's development and investment behaviour is arguably its tight financial situation resulting from a centralized fiscal system which operated almost through the 1980s. Burdened with a high extraction rate and left with little money to spare,²⁴ the

²⁴Shanghai has the highest extraction rate of all provincial-level jurisdictions in post-1949 China. In 1980, the extraction rate of local fiscal revenue to the central fiscal coffers is 91.4%, followed by Shandong's 90%, and Zhejiang's 87%. See Tian Yinong, Zhu Fulin, and Xiang Huaicheng, *Lun Zhongguo Caizheng Guanli Tizhi de Gaige* (On China's Fiscal System Reform) (Beijing: Economics and Sciences Press, 1986), pp.88-89.

Shanghai government was particularly keen to fight for central investment as well as for all kinds of other central support. In the eyes of Shanghai officials, and probably of the city residents as well, the inflow of central resources has been but a partial refund of the huge contributions which Shanghai has made to the central coffers and to the nation generally over the decades.

Developments

From 1980 to the eve of 1994 when the new tax-sharing fiscal system was adopted nationwide, the fiscal system in Shanghai has come through three stages. Whilst in 1980 nearly all provinces adopted some kind of contractual fiscal system which conferred more autonomy and resources to provincial governments, it was not until 1988 that Shanghai won its own kind of fiscal reform. Moreover, this belated reform only came after two rounds of unusual "slides" in Shanghai's fiscal revenue between 1981-83 and 1986-87, which convinced the Centre that changes could be delayed no longer.

1980-1984

The most striking and, from the viewpoint of Shanghai, unfortunate development in the 1980s was the central government's announcement of the adoption of a new contractual fiscal system nationwide in February 1980, from which Shanghai, along with the other two provincial-level municipalities, Beijing and Tianjin, was to be excluded.²⁵ Consequently, as Guangdong entered what has subsequently proved to be an unprecedented period of local autonomy and development via the *dabaogan* system, Shanghai was stuck with the old-style centralized system which had been in operation since 1976.

The essence of the 1976 system was to enable central government to take the bulk of local fiscal revenue, after leaving behind an agreed sum to cover local budgetary expenditures and another small fixed amount for the flexible deployment of the Shanghai government. Under this system the central government prescribed a revenue target for Shanghai, which in 1976 was set as 13.84 billion yuan. The Centre also set the fiscal expenditure target of funds to be provided from the retained local revenue, as well as detailed prescriptions on expenditure for each

²⁵State Council Notice, February 1, 1980, on approving the "Temporary Regulation on Implementing the 'Dividing Revenues and Expenditures, Contracting at Each Levels' Fiscal System", printed in State Planning Commission (ed.), *Zhongyao Jingji Fagui Ziliu Xuanbian, 1977-1986* (A Selected Collection of the Major Economic Regulations) (Beijing: Zhongguo Tongji chubanshe, 1987), pp. 629-31.

policy sector which had been passed down from the relevant central ministries. In 1976 this expenditure target was set at 1.6 billion yuan. There was also a fixed sum of 0.15 billion yuan assigned to Shanghai as additional "retention funds" over and above the planned expenditure which could be spent at the discretion of the Shanghai Government. The balance of local fiscal revenue went to the central coffers. If at the end of the year total budgetary revenue exceeded the prescribed revenue target, Shanghai would have additional retention funds amounting to 30% of the surplus revenue. If however the prescribed revenue target was not met, planned expenditure would be reduced proportionately.²⁶

At face value the system was not entirely unjust to the municipal government. Shanghai could in theory retain more with more fiscal revenue collected: a full 30% of the portion of revenue exceeding the prescribed target would go to the coffers of Shanghai. In practice the target was so high that it was very difficult to overachieve. The fact that the revenue target was set every year also eliminated the possibility of a substantial surplus. Meanwhile if the target was not met, as it has not in 1976, the Centre would accordingly reduce the amount allotted for local spending, and thus ensuring that remittances to the Centre would not be too much affected. This system put a pressure on the municipal government to achieve the target as, in the event of a shortfall, municipal expenditure would be cut. The value of central remittance was thus guaranteed. In contrast with the contractual system in place in other provinces, which had the effect of fattening the local coffers at the expense of the Centre, the system in place in Shanghai until 1984 was one that ensured that the Centre got the best end of deal.

As a result of this arrangement, only 12% of the total local budgetary revenue was retained in Shanghai to cover municipal expenditure during the 1980-1984 period. The retention rate in Guangdong was 82%, as the table below shows:

²⁶See *Shanghai Jingji Nianjian 1949-1982 (Internal Version)*, p.892. Shanghai failed to meet the revenue target in 1976 by 5.3%, and planned expenditure was decreased by 85 million yuan. The fixed retention remained constant at 0.15 billion throughout 1976-1981, and Shanghai got a cumulative additional retention of 0.93 billion yuan during 1977-1981 by overachieving the revenue targets.

Table 4.18

Remittance Rates of Fiscal Revenues
1980-1984

	<u>Shanghai</u>	<u>Guangdong</u>
Fiscal Revenue	82.3	21.3
Fiscal Expenditure (Billion Yuan)	9.9	17.5
Remission (%)	88.0	17.8

Source: *Shanghai Statistical Yearbook 1993*, p.55; *Guangdong 1949-1988 (General)*, p.74; *China Finance Statistics 1950-1985*, pp.54, 92.

Table 4.18 shows that although the absolute value of Shanghai's fiscal revenue was more than four times that of Guangdong, given the much higher central extraction rate in Shanghai, the value of revenue spent in the municipality was only just over half of that of Guangdong.

1985-1987

From 1981 to 1983, Shanghai's municipal fiscal revenue experienced the first ever "slide" since 1949. Municipal budgetary revenue decreased from 17.21 billion yuan in 1980 to 17.15 billion in 1981, then to 16.51 billion in 1982, and still lower to 15.37 billion yuan in 1983, a consecutive slide of -0.3%, -3.76% and -6.9% respectively.²⁷ When the slide finally halted in 1984, the value of revenue at 16.1 billion yuan was still much lower than the level achieved in 1980. The causes of the slide are many: rises in industrial production costs not keeping up with rises in product prices, the reduction of taxes on enterprises, and also mismanagement in both industry and the government which resulted in losses of opportunity and increase of wastes and costs.²⁸ Whatever the causes are, the unprecedented slide in revenue in a place long renowned for its economic efficiency and ability to turn over revenue constituted a clear signal to the Centre: that some kind of change was necessary. As Shanghai had been complaining about the insufficiency of discretionary funds provided in the 1976 fiscal system, the central government

²⁷See *Shanghai Statistical Yearbook 1993*, p. 55.

²⁸See Tu Jimo, "An analysis of the fiscal 'slides' in Shanghai" in *Shanghai Jihua Jingji Tansuo*, No.1 (1988), pp.47-52 and *Shanghai Gongye Nianjian 1989*, p.38 for discussion of the two slides in 1981-1983 and 1986-87 and the causes. A multitude of causes notwithstanding, the ultimate one was actually the failure of Shanghai's system, still entrenched in the traditional planning system, to adjust to the changed national circumstances. Thus state enterprises were still required to produce at a rate which was in accordance with mandatory production plans under set, and usually low, prices while raw materials increasingly had to be sourced from the market at much higher prices. The sustained utilization of the 1976 system until 1984 was a reflection of how Shanghai was stuck with the old system while for others the rules of the game had already changed.

finally agreed to increase Shanghai's local financial resources by means of a new system implemented in 1985.²⁹

The 1985 system abolished the previous practice of dividing local retained fiscal revenue into various portions for "planned expenditure", "fixed retentions", and "additional retentions". Instead Shanghai would get a fixed percentage of the total local fiscal revenue which would be used to cover all local expenditure. The percentage was fixed at 23.2% in 1985 and would supposedly remain unchanged for six years. Shanghai could, therefore, retain a greater amount for local use and avoid the lack of security of the previous system, whereby the sum retained locally was subject to annual adjustment. Moreover, in order to improve Shanghai's financial situation, some 1.5 billion yuan was added to the actual expenditure of 2.2 billion of 1983, bringing the retention ratio up to 23.2%. As a result the amount of fiscal revenue spent in Shanghai increased from 3 billion yuan in 1984 to 4.6 billion in 1985, a leap of over 50%.³⁰

More importantly, with the new system the central prescriptions on spending in each policy sector ceased. Thereafter the Shanghai government could control the deployment of the entire amount of local fiscal revenue retained locally, rather than only a tiny portion of "flexible money" as before.³¹ This amounted to a substantial enhancement of the autonomy of the municipal government, although this autonomy had already been in place in Guangdong and other provinces since 1980.³²

Therefore by 1985, half a decade after the contractual fiscal system was adopted nationally, Shanghai was finally awarded a new fiscal system encompassing two important features which promised an enhanced local financial autonomy. The first was the sense of security gained from the fixation of the remittance percentage for six years. This provided the Shanghai government the means whereby it could plan forward something which had not previously been possible due to uncertainty regarding available resources the following year. The second feature was the enhanced responsibility and autonomy of the municipal government as regards decisions on municipal expenditure. With the sectoral

²⁹For a discussion on the process please see Chapter Six: Bargaining for more favourable central policies.

³⁰See Jiang Zemin (ed.), *The Ten Years of Economic Reforms in Shanghai* (Shanghai: Shanghai Renmin chubanshe, 1989), p.114.

³¹*Shanghai Economy Yearbook 1983-1985*, p.830.

³²Mandatory sectoral control figures on fiscal expenditures were abolished formally in the State Council's Notice on the 1980 fiscal system, February 1, 1980. See Footnote 25 above.

control targets gone, the Shanghai government was free to act more like a municipal *government*, and take responsibility for crucial decisions on municipal policies and expenses, rather than behaving as the messenger and agent of the central government ministries. Moreover the immediate effect of the 1985 fiscal regime was the lowering of the remittance rate to 76.8%, down eleven percentage points from the 1980-84 figure of 88%.

However, it was later found that the challenge to Shanghai's economy required more than a mere adjustment in the fiscal system. In 1986 and 1987 came the second "slide" in local budgetary revenue. In 1986 Shanghai's budgetary revenue decreased by 3% in absolute value from the level in 1985, and in 1987 further dropped by another 6.2%.³³ State enterprises which had long since been adapted to operate under the traditional planning system, whereby low-priced raw materials supplied through the allocation system and products were eventually purchased by the state, performed badly as state supplies of raw materials dried up and new markets for products had to be found. As the absolute amount of revenue fell, the original fixed retention percentage arrangement which had been intended to allow Shanghai to retain more revenue each year, went seriously awry. According to the agreed sharing percentage, local retention in 1986 and 1987 would be respectively 4.09 billion yuan and 3.51 billion yuan, which was respectively 0.52 billion and 1.1 billion *less* than the amount retained and used locally in 1985. Eventually the sharing percentage was not strictly applied in order to enable Shanghai to meet necessary local expenditures. But this "funding fiasco", however, clearly demonstrated the need for further and more radical change in the system.

1988-1993

If the 1985 system was designed to enhance the sense of security within the Shanghai government regarding its local retention as well as to raise, albeit modestly, the retention share for Shanghai, the basic tenet of the design was nevertheless to ensure that remittances to central coffers would increase in line with local revenue increases. Since the percentage share was heavily in favour of the Centre, it ensured that only a minor portion of new increments of revenue raised would go to the municipal government. There would be, in other words, security for Shanghai, but the fortune, in the best situation of a rising total revenue, would be modest.

³³See *Shanghai Statistical Yearbook 1993*, p.55.

The 1988 fiscal system negotiated between the Shanghai government and the Centre in the midst of the fiscal slide of 1987 effectively reversed the Centre's method of exacting fiscal remittance.³⁴ Instead of fixing the portion to be left for local use, be it the absolute amount or a percentage share, the 1988 contractual system fixed for five years the absolute amount that Shanghai would have to remit to the Centre. In other words, as similar to the *dabaogan* system of Guangdong, Shanghai would be able to retain all its revenues upon fulfillment of its obligation to the central government.

Under this system Shanghai would remit to the Centre 10.5 billion yuan of its local budgetary revenue and retain the rest. The 10.5 billion figure was based on the actual performance in 1987, when local budgetary revenue amounted to 16.5 billion yuan. This sum was taken as the base figure. As actual budgetary expenditure in 1987 had been 5.3 billion yuan, so six billion yuan of local expenditure was allowed for, thus giving the 10.5 billion remittance figure. The system also provided that from 1988 to 1990, Shanghai was to retain all revenue surplus to the 10.5 billion remittance. However, as from 1991 Shanghai was to share the portion of revenue in excess of 16.5 billion yuan with the Centre on a 50:50 basis.

The 1988 system was obviously designed as a means to conferring more financial resources on Shanghai. From the point of view of Shanghai's officials, the new system would make Shanghai's budgetary coffers better off by 1.4 billion yuan in 1988 alone.³⁵ 10.5 billion was also substantially less than the amount of remittance in the early 1980s.³⁶ Its benefits however were on a far smaller scale than those of Guangdong's *dabaogan* system. First, Shanghai's required remittance was by far the higher of the two. As seen in Chapter Three, the total cumulative remittance from 1980 to 1987 in Guangdong's case amounted to 12.2 billion, an amount Shanghai was obliged to remit annually. Although Guangdong was required to remit more in later years, for instance with the introduction of a new incremental increase factor in 1989 as well as all kinds of irregular arrangements such as "loans" to the Centre, its remittance in 1991 at 7 billion yuan was

³⁴For a discussion on the process and considerations at that time, see Chapter Six: Bargaining for more favourable central policies.

³⁵*Shanghai Economy Yearbook 1989*, p.73.

³⁶Taking the average remittance rate of 88% as shown in Table 4.18, the average annual remittance between 1980 to 1984 would amount to 14.5 billion yuan. In the eyes of central government officials, the 1988 system had, therefore, already brought about a fairly significant improvement for Shanghai. (Respondent No.29, Beijing interview, April 1994).

nevertheless only 70% that of Shanghai's. Second, the 50:50 sharing ratio for revenue over and above 16.5 billion yuan effective from 1991 was much less favourable than the 9% incremental growth of remittance in operation in Guangdong. Table 4.19 below shows the remittance rates in Shanghai since 1980:

Table 4.19

Remittance Rates of Local Budgetary Revenues

<u>Year</u>	<u>Local Revenue</u> (Billion Yuan)	<u>Local Expenditure</u> (Billion Yuan)	<u>Remittance Rate</u> (%)
1980-84	82.3	9.9	88.0
1985-87	52.2	14.8	71.6
1988-92	83.6	37.3	55.4
1980-92	218.1	62.0	71.6

Source: *Shanghai Statistical Yearbook 1993*, p.55.

Consequences

The above section notes that Shanghai, as the most developed economic city prior to 1980, was a relatively late comer to the fiscal decentralization reforms of the 1980s. What specific implications did this fact have for Shanghai's investment, and in particular, for the behaviour of the Shanghai government regarding investment decisions and Shanghai's relationship with the central government?

Given the circumstances surrounding the birth of the 1985 and 1988 fiscal systems, it might be surmised that Shanghai's late entry into the fiscal reforms and the consequently depleted state of its local coffers, would limit the amount the Shanghai government could afford to spend on investments. However the breakdowns in Table 4.20 below of fiscal expenditures between 1987-1991 shows that this is not strictly the case.

Table 4.20

Local Fiscal Investment Expenditures: Share of Total Local Fiscal Expenditure

<u>Year</u>	<u>Shanghai</u>		<u>Guangdong</u>	
	<u>Yuan Mn</u>	<u>% Share</u>	<u>Yuan Mn</u>	<u>% Share</u>
1987	1617	32.2	2053	21.3
1988	2247	34.8	2616	22.7
1989	2291	31.3	2644	18.7
1990	2123	28.1	2964	19.7
1991	2107	20.8	3617	19.8
Total	10385	35.0	13894	20.3

(Total fiscal expenditures: 1987-91: Shanghai, 29.7 billion yuan, Guangdong, 68.6 billion yuan)

Source: *China Finance Statistics, 1950-1991*, pp.138, 147, 157.

Table 4.20 shows that Shanghai has spent almost as much budgetary resources on investment as has Guangdong, despite the fact that Guangdong's total local budgetary revenue for the period was more than double that of Shanghai. Whilst Shanghai may have experienced financial difficulties, such difficulties did not apparently inhibit the municipal government from launching investment projects financed from budgetary resources.

It has been noted in Chapter Three that the major significance of the *dabaogan* fiscal system as regards investment in Guangdong does not lie in the increased amount of fiscal revenue Guangdong is permitted to retain under the new system. The opening up of the domestic economy to the international community and ever expanding liberalization policies have made it impossible for the state budget, central or local, to foot all the bills of investment. In fact, as Guangdong's local revenue grew, the proportion that on investment fell, rather than rose.

It would be helpful here to reiterate the Guangdong case, and to note that the impact of the fiscal system on local investment behaviour, as seen in the case of Guangdong, is diffused. Bringing about an enhanced sense of security as well as autonomy to the provincial government, the fiscal system forms the core of the new environment in which the Guangdong government has operated successfully. The key features of the new environment are: (1) the provincial government has had a clear and focused target and agenda, namely economic development and pioneering in reforms; (2) repeated and high-level assurances from the Centre during the 1980s has reinforced the sense of security and direction first conferred by formal

arrangements and policies; and (3) there has been a rapid and directed (especially during the earlier period) diffusion of such clarity of direction and purpose from the provincial government to subprovincial levels and to the community, and that a growing self-generating momentum of change and development has developed in the society at large. This societal force, in turn, has served to provide the pressure and impetus needed for further initiatives within the provincial government. Therefore, the *dabaogan* fiscal system was not *the* direct cause for the investment phenomenon in Guangdong; it was instead the core of the new environment in which such growth and changes were possible. That the system allowed the province to retain more revenue undoubtedly had effects on investment, but the effect was neither direct nor linear. More investment was made possible not because the Guangdong government was allowed to retain more fiscal revenue locally, thus having more funds to finance investment projects. Investments grew immensely in Guangdong because the provincial government felt reasonably secure, due to the *dabaogan* system and other central policy concerns, that most of the additional revenue generated from the new projects would remain in the province.

The implication of the sluggishness of fiscal reforms in Shanghai is likewise not directly related to fear of a tight financial situation resulting from the high remittance rate and the resultant tight financial situation. Table 4.20 above shows that it would even be *wrong* to deduce that potential financial difficulty was the inhibiting factor in local government investment activity.

The reason is rather that Shanghai leaders have focused more on the day-to-day balancing of the local budget than on forward-looking long-term plans for the economy. As the extraction rate was high and Shanghai's previous supplies of low-priced raw materials and consumer goods from the planning channels dried up, the municipal government was caught up in the double-edged trap of heading to reduce the burden of tax on enterprises to enable them to survive on the one hand, and having to hand out increasingly large sums of subsidy on the other. The two fiscal "slides" of 1981-83 and 1986-88 indicate fully how difficult the financial situation really was. The local financial situation was often described as "catering finance", meaning that it was so tight that the budget could normally provide for the most basic needs only. The most important task for senior officials became therefore the routine balancing of the budget books. Attention focused on lobbying the central government to increase the local retention rate every year, and on closely confining expenses to those of most immediate need. When survival was regarded as the

paramount issue, there could be no place for long term planning and development strategies.³⁷

Therefore the most important consequence of the fiscal system on Shanghai's investment was that the fiscal system created an environment which, rightly, in practice led the municipal government to care more about the petty administration of the account books than about planning the expansion of the economy. The horizon of concern was largely restricted to the traditional boundaries of the state sector, and the working methods accordingly followed the traditional style. Investment remained a high priority of the municipal government. Indeed, as Table 4.20 above has shown, the percentage of local fiscal expenditure spent on investment was substantially higher in Shanghai than in Guangdong. However the municipal budget was too small to satisfy investment requirements. Shanghai consequently took the traditional route and turned its attention towards the Centre as a means to further investment resources. This explains why the percentage share of central investment in Shanghai in the 1980s was so high and, given the difficulty in the local finance at that time, Shanghai's reliance on central investment was higher in 1980s than during the previous full decade.

Investment Administration

In its capacity as being the largest port of China and until 1986 its top exporter,³⁸ Shanghai has been able to obtain more autonomy in the area of investment administration relative to the situation in the area of fiscal finance. The

³⁷Shanghai officials during interviews often stressed the heavy burden of Shanghai and the lack of favourable central policy in explaining the lacklustre economic development in the 1980s. When asked to mention some examples to illustrate what the municipal government leaders had previously done to advance the welfare and interests of Shanghai, the lowering of central extraction resulting from several adjustments in the fiscal system was amongst the popular answers. Moreover it is revealed that because Shanghai traditionally has been the top contributor to the central coffers, the city has been the Centre's top choice to turn to for "additional contributions" in case of difficulties within central coffers. Such borrowing became almost a yearly routine in the later years of 1980s. An academic summarized the situation in this way: "The most important job of the senior local officials has been to try to increase the amount of local retention. Their work would thus comprise the following aspects. First, to negotiate the best possible deal at the beginning of a financial year. This includes, for the pre-1988 years, trying to raise the expenditure control targets as high as possible, whilst keeping the revenue target as low as possible. The former would enable Shanghai to have more money retained for local use, and the latter would make it easier to achieve or overachieve the target. Then during the year and especially towards the end of the year, the job mainly involved warding off central "borrowing", or failing that, trying to confine it. Finally, local officials would try their best to fight for central resources which would serve to compensate for the drain on local resources. Therefore if in a year the officials succeed in reducing Shanghai's burden by a few hundred million yuan, or managed to attract central investment projects, they were regarded having done service to the best interests of Shanghai." (Respondent No.16, Shanghai interview, January 1994).

³⁸See *Jiefang Ribao* February 22, 1994, p. 9.

central government has in fact adopted a more even-handed approach to the decentralization of investment administration than it has to the reform in fiscal system. In the 1984 decentralization move, *all* provincial-level governments were awarded the power to approve investment projects up to a value of 30 million yuan.

Shanghai was later than Guangdong in having the central ministries' mandatory sectoral control figures abolished. It was not until 1983, three years after central sectoral control figures of all kinds were abolished in Guangdong, that Shanghai was awarded the autonomy to decide on its own fiscal investment expenditure.³⁹

As regards project approval authority in November 1985, Shanghai was awarded the power to approve domestic investments forming part of a foreign investment project of under 30 million yuan. This came later than similar privileges came to Guangdong whose power had been enhanced in 1981 and again in 1982.⁴⁰ There was then the lift in 1984 when the central government raised the ceiling for provincial-level jurisdiction of all domestic investments across the board and in March 1987, as noted in Chapter Three, the Centre raised the provincial-level jurisdiction nationwide on approving projects in the "bottleneck" sectors to 50 million yuan. However, Shanghai's authority had apparently been raised to 50 million yuan ahead of the national move.⁴¹ In 1992, Shanghai was authorized to approve Pudong projects under 200 million yuan as a boost to the Pudong area. Thereby Shanghai became the third provincial-level government after Guangdong and Fujian, to whom such authority had been granted in 1985, to wield such power.⁴²

³⁹The Shanghai government specifically asked for such autonomy in a report submitted to the central government in March 1983. The State Council approved the report a month later. Shanghai could thereafter decide the allocation of local fiscal investment expenditure, subject to the approval of specific projects by the relevant levels in accordance with the approval jurisdiction system. Shanghai's autonomy in some other areas such as the use of foreign investment and foreign trade was also enhanced via that report. See State Council Notice No.55, 1983, "On Approving the 'Proposals on Developing Shanghai's Foreign Economic and Trade' by the Shanghai Government" (April 4, 1983), printed in State Commission for Economic System Reform (ed.), *Jingji Tizhi Gaige Wenjian Huibian, 1978-1983* (A Collection of the Documents on Economic System Reform, 1978-1983) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1983), pp.605-10.

⁴⁰See Chapter Three, Footnotes 41 and 42.

⁴¹In a report from the Shanghai Planning Commission released in early 1983, it was stated that the municipal Planning Commission would handle the investment application of between 30 million to 50 million yuan. There was no mention of the designation of industrial sectors; therefore the 50 million yuan jurisdiction was probably applicable to all projects in all sectors. See *Shanghai Jihua Jingji Tansuo*, No.2 (1987), p.28.

⁴²See *People's Daily* March 11, 1992, p.1. During interviews in Beijing, January/February 1994, Respondent No.31 told the author that *all* provincial-level governments have in fact been approving investment projects under the 200 million yuan ceiling since the second half of 1992 as a result of the heightened "atmosphere" for quicker economic development since the southern tour of Deng Xiaoping in January-February 1992. Such approval has, however, been without formal

As the largest economic centre and the historical hub of foreign commercial activity, Shanghai has been more successful still in obtaining power for foreign investment. In 1983 Shanghai was authorized to approve foreign investment projects of up to US\$10 million, which was twice the ceiling in Guangzhou.⁴³ In October 1984, the Centre enlarged the power of the fourteen open coastal cities as regards foreign investment, and Shanghai's power, together with Tianjin's, was raised to US\$30 million, three times more than the jurisdiction of Guangzhou.⁴⁴ If there was still some lag in investment administration between Shanghai and Guangdong, therefore, it was nevertheless minor as compared with the greater disparities of the fiscal system.

Having an enlarged power to approve investment projects may be necessary but it is not solely sufficient for a take-off in investment activities. For instance, the decentralization of investment administration from the Centre is fairly uniform nationally, but the performance of different provinces in investment and economic development is conspicuously uneven. In the words of an authoritative source in

endorsement from the Centre. Some provincial-levels, including the Beijing Municipality, had delegated the authority to approve projects under the 200 million yuan ceiling to the county/district level. *United Daily* (Hong Kong) March 9, 1993, reported the similar delegation of such authority by the Xiamen city government, Fujian, to some of its counties and districts. The respondent revealed that the State Planning Commission had drafted a document with a view to recognizing the *de facto* enlarged power of the provinces in early 1993, but the document was held up in the Secretariat of the State Council, and has not since been approved. This indicates that the Centre chose an ambivalent and flexible approach towards provinces' self initiative, whilst maintained the power to call stop to their activities should situations change. So in the end in this period it was only Shanghai that got the formal power to approve projects under the 200 million yuan ceiling, although all provincial-level governments had in fact been doing likewise. (Guangdong and Fujian were awarded the power when the Centre extended the "special policy" for the two provinces in 1985. See also Chapter Three, Footnote 43.) This suggests two possibilities: first, the central government has been uncertain about the proper approval jurisdiction of the provinces, and insecure about its ability to recentralize power formally awarded to the provinces. Second is the relatively favourite position of Shanghai as opposed to other provinces in 1992 in the considerations of the Centre. The fact that formal endorsement was given only to Shanghai reflects the priority development status of Shanghai in the strategy of Centre in the 1990s. For documentary evidence of the original proposal by the State Planning Commission, see *Shanghai Guanli Kexue*, No.2(1993), p.10. It was reported that during the national economic conference of early 1993, proposals were made to extend further the project approval authorities of the provinces. It was proposed that the investment ceiling of projects requiring the approval of the State Council be raised from 200 million yuan to 1 billion yuan, and provinces' authority to approve foreign investments raised to the ceiling of US\$50 million.

⁴³This was the result of a "petition" from Shanghai. See State Council Notice (Circular) No.55 (1983) April 4, 1983, "On Approving Shanghai's Petition on Developing Shanghai's External Business and Trade", printed in State Commission for Economic System Reform (ed.), *A Collection of the Documents on Economic System Reform, 1978-1983*, pp.605-10.

⁴⁴See State Council Notice (Circular) No. 138 (1984), October 4, 1984, "Temporary Regulations on Improving the Planning System", in State Planning Commission (ed.), *Jiben Jianshe Guanli Tizhi Gaige Wenjian Huibian* (A Collection of the Documents on the Capital Construction System Reform) (Beijing: Hongqi chubanshe, 1985), pp.1-12. It is stated that Guangzhou and Dalian could approve foreign investment projects of under US\$10 million, while the remaining ten open coastal cities could approve up to US\$5 million.

Beijing, "the decentralization of investment authority to the provinces has had different effects in different provinces. The inland provinces complain that in any event they have little money to spend on investment and development, so enlarged powers for investment mean little to them. They were simply too constrained by survival matters to utilize fully the powers."⁴⁵ It is necessary, therefore, to look at the substratum on which new policy initiatives were made in order to have a clear idea of their effects.

As regards Shanghai, the earlier discussion of the wider environment in which the Shanghai government has been operating is relevant. It all originates from Shanghai's conferred role as the "eldest son" of the Centre. Officials in Shanghai have repeatedly stated that since the economy of Shanghai is much more developed than in other parts of the country, its better performance had brought about more responsibilities.⁴⁶ This has resulted in the high extraction rate of local revenue by the central government, which, as seen in the previous section, has consequently obliged the Shanghai government to focus its attention on survival needs rather than on long-term economic development.

In addition to the detrimental effect of the fiscal situation, local scholars and officials have condemned the system of administration in Shanghai, and its process of approval of investment projects as bureaucratic and inefficient.⁴⁷ Although Shanghai had been awarded increased powers in 1984, along with other open coastal cities, the system within the municipality remained highly centralized for some years after. For instance it was only in 1987 that the power to approve projects was decentralized horizontally to other municipal departments from the municipal Planning Commission. Vertical decentralization to bureaux and counties had also been slow, finally gathering momentum as late as in 1988.⁴⁸

⁴⁵Respondent No. 31, Beijing interview, February 1994.

⁴⁶This was mentioned by many respondents in the Shanghai government the author interviewed in Shanghai in 1994.

⁴⁷See for instance Wang Zhang, "The 'Shanghai Phenomenon' in China's Economic Growth" (Part 2), *Shanghai Gaige*, No.5 (1991), pp.14-15, 41. Wang was then a professor at Shanghai's Fudan University and later appointed the director of the Shanghai Economic Research Centre---a think tank of the municipal government. Despite complaints and some subsequent improvement, there was indication that as late as 1994, foreign investors were still dissatisfied with the low efficiency and uncoordinated policies among different departments of the Shanghai government regarding foreign investment. See *Jiefang Daily* February 21, 1994, p.1.

⁴⁸See Jiang Zemin (ed.), *The Ten Years of Economic Reform in Shanghai*, p.94; *Shanghai Economic Yearbook 1989*, p.85. Previously there had been modest measures towards decentralization, and bureau-level units were awarded the power to approve projects under 3 million yuan in 1984. See the Shanghai Government Notice No. 99, 1984, "Notice on Approving the Proposals of the Municipal Planning Commission on Improving the Planning System in Shanghai", printed in *Shanghaishi Jingji Tizhi Gaige Lingdao Xiaozhu* (Shanghai Economic System Reform Leading Group) (ed.), *Shanghaishi Jingji Tizhi Gaige Wenjian Huibian, Part 2* (A Compendium of

Consequently Shanghai has been excluded from the 1980s "multiplier effects" conferred by the extensive subdelegation of powers to subprovincials in Guangdong. The cumulative effect of always having been under close scrutiny of the Centre, and the thus internalized expectation of having to set an example for the "younger brothers" to follow, has resulted in relatively rule-abiding behaviour amongst officials in Shanghai. When comparing the behaviour of officials of other provinces, and Guangdong in particular, with that of the latter, Shanghai officials are more conservative and cautious. Shanghai officials follow more closely the rules and regulations laid down by the Centre and are less inclined than counterparts in other provinces to venture into the unspoken grey areas, a practice for which Guangdong is famous.⁴⁹ Consequently, although Shanghai and Guangdong have been granted a similar range of power regarding investment administration, Shanghai has nevertheless continued to seek the detailed approval, screening and, in particular, financing directives of central regulations. It has also been disinclined to decentralize the power of the Municipal Planning Commission--simply because there has never been a central document specifically sanctioning the authority of provincial-levels to delegate downwards!⁵⁰

The Shanghai leadership has learned its lesson, albeit slowly. As from 1988 bureaux, districts and counties were authorized to approve domestic investments of a "productive" nature of up to 10 million yuan, and up to 5 million yuan for non-productive projects such as hotels and real estate.⁵¹ As from 1992 they could also approve foreign investments of up to US\$5 million,⁵² and in 1993 this was extended to US\$10 million.⁵³ Since 1992 district governments have also

Economic System Reform Documents of Shanghai. Part 2) (Shanghai: Qiye Guanli Xuehui, 1985), pp.91-99.

⁴⁹For more discussion of these characteristics, see Chapter Seven.

⁵⁰It should be noted that the central government has never issued positive statements concerning the subdelegation of authority by the provincial-level to the subprovincials. Normally there would be a brief statement at the end of policy documents or regulations when the authority of the provincial-level was adjusted vis-a-vis the Centre, saying that the system at subprovincial levels was to be designed and decided by the provincial-level governments *accordingly*. Occasionally when the Centre felt that subdelegation had become too extensive it would issue directives voicing its disapproval. These were, however, vague and unspecific. At other times the Centre would simply say nothing and acquiesce in whatever the provinces were doing. This reflects the "stratified administration" approach of the Chinese government, whereby the central government sets its eye mainly at the provincial level, which consequently has quite a free hand in management at subprovincial level. As long as things do not go wrong, and, as regards investment matters, as long as the local economy is running smoothly and does not create problems for other provinces, the Centre does not impose itself at subprovincial level. Under such a system the power of the subprovincial levels of government varies substantially according to the choices and initiatives taken by the provincial leadership in different provinces.

⁵¹*Shanghai Economy Yearbook 1989*, p.85.

⁵²*Wen Wei Po* (Hong Kong) October 2, 1992, p.1.

⁵³*Wen Wei Po* (Hong Kong) March 3, 1993, p.1.

also been authorized to raise loans, foreign and domestic, for urban renewal projects, as well as the authority to lease out public land sites to investors.

The rapid growth in investment activity since 1992 made obvious the need for extensive delegation to subprovincials, particularly during the early period of economic take-off. This was obviously acknowledged by the Shanghai government in 1993 when it further enhanced the powers of the districts.⁵⁴ However, the deep-seated and pervasive influence of central monitoring is strong on officials' behaviour and attitudes. As an official in Shanghai described the "rule abiding" behaviour of Shanghai officials:

" Unlike their counterparts in Guangdong, the bank and auditing personnel in Shanghai were, and are, very "conscientious" about their job. That is, they are much stricter in applying the rules. Officers in the banks are more concerned with the "propriety" of the projects applying for loans, for instance: whether the projects are included in the state plans of investment and bank finance, and whether the projects' finance are strictly in order. Audit officials are most assiduous in their task of locating misdeeds in financial management within the units in question. The background of such behaviour traces back to the tight financial situation in Shanghai, and to the heavy extraction of revenue by the Centre, so that traditionally the banks were more vigilant in their lending procedures for fear of missing the central remittance target, and auditing personnel were under pressure from the municipal leadership to ensure that every cent was duly collected to the local fiscal coffers. The resultant situation is in direct contrast to the "hands-off" approach in the auditing and banking sectors of Guangdong. However, such behaviour and attitude cannot be changed within a short time."⁵⁵

If China can be said to be administered by the cross-secting systems of "tiao-tiao" and "kuai-kuai", then Shanghai may be characterized as a place wherein the "tiao-tiao" has had historically the upper hand within the administration. This does not mean, however, that local interests are not important in Shanghai, but that the influence of the "tiao-tiao" became so strong that following central regulations was regarded as the best and safest policy when safeguarding local interests given Shanghai's circumstances. Since, in any event, there could be little room for manoeuvre under the high extraction rate and close scrutiny of the Centre, it seemed better for Shanghai to exceed the expectations of the Centre and earn the reputation of being a "good boy". In local official and nonofficial publications, therefore, the high percentage of remittance was traditionally hailed not as a

⁵⁴The Shanghai Government included in their 1993 Government work report a section on the subprovincial level. Because of the increased economic activities in the counties and districts in 1992 subsequent to the decentralization in 1992, it was proposed that more powers should be delegated downwards to keep up the momentum. See *Shanghai Economy Yearbook 1993*, pp.34, 41.

⁵⁵Respondent No.14, Shanghai interview, January 1994.

burden, but as a positive contribution and thereby fulfilling Shanghai's obligation to the country as the "elder brother" ⁵⁶ Shanghai thus strove for overachievement of remittances to the Centre, and was, ostensibly, happier with a higher, rather than lower, extraction rate. Rather than attempting to manoeuvre within the tight control of the Centre, it had adopted a pragmatic attitude. Following the central rules appeared to be the safest course to take, because in the event of any failure to accomplish targets assigned from the Centre, the municipal government could point out the fact that every prescription and directive had been followed and thus enabling it to disclaim responsibility.

Such behavioural pattern has given rise to the conservative manner in which the Shanghai government has utilized the new powers conferred by the Centre during the 1980s. It took the Shanghai leadership almost a decade to recognise the fact that the circumstances within which they had been operating had, in fact, changed radically, and, consequently, that their strategy of survival within the system also had to change. The state plan was no longer operating as before. Shanghai's obedience and responsiveness could, therefore, no longer be rewarded by supplies through the administrative system. As the Centre did not have its previous leverage over other provinces, Shanghai could no longer rely on the sway of the Centre in its dealings with other provinces. In fact being the "good boy" of the Centre has made Shanghai a mockery amongst the other provinces, since the Centre could no longer "deliver the goodies" as effectively as in the past, yet Shanghai was still nevertheless stuck with its own obligations to the Centre. Since 1988 Shanghai has sought to reduce these obligations, but the city started from a high base, and the change of people's behaviour and attitudes is often slow and gradual. The effect of past central control, therefore, is an historic legacy for Shanghai, which will continue to influence its leadership and personnel, for some time to come.

⁵⁶A standard entry in statistical publications, as well as in articles and books on the economic situation of Shanghai, is a list of contributions made by Shanghai to the Centre and nationally. Examples are: Shanghai's GNP as a portion of the national GNP, the high remittance of local revenue to the national coffers, the percentage of Shanghai's internal and external trade in the national total, etc.

Chapter Five

Provincial Discretionary Behaviour: Guangdong

In this and the next chapter, the discretionary behaviour of the Guangdong and Shanghai governments in the investment arena will be discussed. The purpose of this discussion is to show, by explicating the details of provincial discretions, how provincial governments interact with the Centre and what strategies they undertake to advance their interests to gain more investment and faster economic development within the context of central policies.

Defining Provincial Discretionary Behaviour

Before proceeding further it is necessary to define and clarify what is meant by "provincial discretionary behaviour". This concept refers to actions and inactions taken by the provincial government without the formal endorsement of the Centre. The term "formal endorsement" defines written affirmation by the Centre of any particular course of action taken by the provincial government through the issue of formal Central or State Council documents. But as the concluding chapter notes, such "endorsements" are often not clearly defined. Very often the behaviour of the Centre has been first to acquiesce, only to criticize or give explicit endorsements to the contrary at a later stage. It is arguable that acquiescence itself constitutes some kind of *de facto* endorsement, especially when seen from the provincial perspective. However as such "approval" is of an unstable and transient nature, it is not in this discussion considered as formal endorsement.

One further clarification is that of the concept of "behaviour" which, as used here, refers to behavioural phenomenon only. The institutional causes of excessive investment have been discussed in Chapter Two. However, the level of motivation and consciousness of provincial leaders in terms of their actions and inactions may vary. And since it is difficult if not impossible to study motivation scientifically, the approach taken here is to focus on the behaviour itself rather than the motives behind it.¹ "Discretionary behaviour", therefore, covers behaviour which is purposefully taken, as well as that is of a more spontaneous and customary nature.

¹On the complications of motivations, see Peter Ferdinand, "Interest Groups and Chinese Politics", in David S. G. Goodman (ed.), *Groups and Politics in the People's Republic of China* (Armonk, New York: M. E. Sharpe, 1984), pp.18-9. For a brief discussion on this point, see Chapter One, footnote 41.

Studies of Chinese politics in the reform period have noted the prevalence of bargaining behaviour amongst the various government actors and, in particular, between the central government units and the subnational units of government.² Guangdong, in particular, has been famous for its flexible implementation of central policies. The so-called "red-light theory" defines the ways in which Guangdong has made the best possible use of the ambiguities of many central policies as well as the existence of a policy "vacuum" in terms of the implementation of policies.³ Bargaining and implementation deviations are, therefore, two forms of discretionary behaviour employed by the provincial leadership at the appropriate stages of policy formulation.

Bargaining occurs normally during the deliberation stage of a yet-to-be formulated policy. Provincial governments aim at gaining an advantage through early participation in the formulation of any particular policy. There are two types of bargaining in terms of the aspirations of the provincial governments. One type may be described as "macro", as its aim is to influence major central policies which, in the eyes of the provincial leadership, may affect provincial interests. A typical example of "macro" bargaining is that of the bargaining and articulation of interests which occurred in April 1979 at the Central Work Conference. The bargaining between the central and the Guangdong/Fujian leaders there led eventually to the Centre's agreement that Guangdong and Fujian should receive preferential treatment, thus significantly enhancing their fiscal and economic planning autonomy. Macro bargaining is particularly important for the provinces as, if they win, an altogether more favourable policy environment results wherein there is more room for manoeuvre. In other words, if it is the Centre who takes the lead in being the one to "set the scene," it is the province which, through its

²See for instance David M. Lampton, "Chinese Politics: The Bargaining Treadmill", *Issues and Studies*, Vol.23, No.3 (1987), pp.11-41; Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structure and Processes* (New Jersey, Princeton: Princeton University Press, 1988). Bargaining is also intense within the central government, especially between the commissions endowed with more comprehensive and macro-management functions, such as the State Planning Commission and Finance Ministry on the one hand, and various departmental ministries on the other. But because the focus of the dissertation is on the interface of the Centre as a whole and the provinces, and because such conflicts are on the rise as more power has been taken from the ministries and given to the provinces, emphasis is placed on the bargaining between these two groups of actors rather than amongst members of each group.

³The "red-light theory" is the summary abstraction of Guangdong's flexible implementation of central policies during the reform period. The exact source of such a saying has become obscure but it is probably the product of study trips by other provincial governments to Guangdong. The theory includes three statements which describe Guangdong's strategy in different circumstances: "When you see the green light, go ahead at a running pace; when you see the red light, go around it; when there is no light at all, find your own way." See *Zhongguo Jinbao*, January 13, 1989, p. 2.

successful bargaining activities, "collaborate" in this scene-setting in such a way as to ensure that it is set to their advantage.

The other type of bargaining, whilst on the surface more mundane, is no less important than the first. Provinces normally spend a great deal of effort in this type of day-to-day bargaining with the central ministries. This is because, first, central policies are generally laid down in vague and flexible terms, so that central ministries have a great deal of power of interpretation. Second, central ministries control a substantial amount of resources on which provinces depend. Accordingly, the bargaining revolves around these two aspects. First, provinces seek to bargain for the best deal as regards the routine planning and allocation of resources by the various central ministries. Bargaining for a higher control figure of investment and for more central investment projects can be classified in this category. Second, provinces bargain for a greater say in the design of detailed implementation prescriptions of existing central policies. Be it "mundane" or "macro", the purpose of bargaining is to get a better deal on existing practices and to obtain more concessions from the central government, whether in terms of more resources or greater autonomy.

The term "implementation deviations" refers to discretionary behaviour during the implementation phase of policies. In other words, after bargaining with the Centre for a better policy, and whether or not the bargaining has succeeded, the provincial government may still seek to affect the ultimate outcome of the central policy through its behaviour during implementation.

Provincial governments may adopt different strategies of implementation deviations for different situations. Yang Xiaofei in his study of the Guangdong Government describes five types of implementation deviations.⁴ First is *passive implementation*---a form of feigned compliance. The orders and policies of the Centre are superficially followed on the surface. However, through slack follow-ups and a laxity of supervision in their implementation, an unequivocal message is communicated to the grass-roots enforcers that such policies are not to be taken too seriously. Second is *locally invented policies*, or so-called "native" policies. Where there is a policy vacuum in new areas of activity, or where the existing central policies have become so outdated and obsolete due to changes in circumstances,

⁴Yang Xiaofei, *Shengji Zhengfu de Zizhu Xingwei: Kaifang Gaige Shiqi de Guangdong Zhengfu* (Discretionary Behaviour of Provincial-level Governments---the Guangdong Provincial Government in the Reform Period) M.Phil Thesis, Chinese University of Hong Kong, 1990, pp.61-65.

provincial governments will implement policies of their own making. Third is the *evasion of central policies*. Where provincial governments find certain central policies "inconvenient", they may take measures which *circumvent* such policies without explicitly flouting them. This is also expressed in the saying, "going round the red light" as part of the "red-light theory". Fourth, provinces may take *action without asking for prior central approval*. Some central government directives have included the general, and hence vague, requirement that the Guangdong provincial government obtain central approval prior to taking any major initiative beyond the parameters of existing central policies. However, the Guangdong government has, on many occasions, opted to go ahead without such approval, thus avoiding the eventuality of a negative response. Finally, the fifth type of implementation deviations is *explicit contravention of specific central directives*. For instance, the Guangdong provincial government has sometimes carried on certain investment projects despite specific central orders to stop.

The foregoing definitions of "bargaining" and "implementation deviations" clarify the variety of provincial discretionary behaviour. They highlight the fact that the provinces have certain means through which to influence both the formulation and implementation of central policies. Nevertheless, it should be reminded that policy formulation and implementation are different and distinct stages in the analytical sense only. In practice, formulation and implementation are part of a continuous process through which policies are initially formulated, implemented and tried out, before being adjusted and reformulated. Bargaining and implementation deviations, being types of discretionary behaviour employed at stages of this process, are not, therefore, clear-cut, separate activities on the part of the provincial governments. Rather bargaining and implementation deviations interact. The provincial government first bargains with the Centre as it "sets the scene", within which it makes its own decisions on exactly which directives to implement and in what manner. The conditions resulting from such implementation deviations subsequently constitute an altered environment in which the provincial leadership may again bargain with the Centre on new policies as they arise, or on revisions of existing policies. There is therefore no hard-and-fast line between policy bargaining and implementation deviations in practice. Consequently, it is necessary to bear in mind the dynamic and continuous nature of the whole process in the subsequent discussion.

A more viable criterion of classification of provincial discretionary behaviour is with regard to their differential degree of dependence from the Centre. Provincial discretionary behaviour as discussed in this and the next chapters is

consequently grouped into the following five general categories. The first is *bargaining with the Centre for more favourable policies* in order that the provincial government may obtain more authority and a larger room for manoeuvre regarding investment. The second is *bargaining with the Centre for more direct central support*, in the form of injection of central resources, such as budgetary or extrabudgetary fiscal resources, bank finance, and larger investment scale quotas. The third is *flexible implementation of central policies*---provinces using feigned compliance as the "cover" whilst engaging in various "creative" interpretations of central policies in order to attain provincial objectives. The fourth is *developing the "new horizon" of investment expansion*---provincial governments moving beyond the state budget and the conventional state sector towards the burgeoning market (the non-state sector as well as the "extrabudgetary state enterprises") in their pursuit of investment expansion. Finally, the fifth type of discretionary behaviour may be described as *internationalization*---in terms of the provincial effort in attracting external resources from beyond the national borders, and in terms of its being a new pretext used by the provincial government to demand greater autonomy from the Centre.

Of these five categories of discretionary behaviour, there is a general progression away from dependence on the Centre from the first to the fifth types. The rationale of such a classification is apparent. Some discretionary behaviour is conducted with the Centre as the focus of attention, and provincial discretions in this respect reflect as much reliance of the provincial government on the Centre as its ability to manoeuvre. On the other hand, some other discretionary behaviour by the provinces has a more obvious "independence" orientation. An increasing occurrence of this latter type of discretionary behaviour indicates that a provincial government is getting more "independent" and less dependent on the Centre as regards its investment activity.

Figure 5.1 below places these categories of provincial discretions along two dimensions. The first is the degree of provincial "independence", or autarchy, vis-a-vis dependence on the Centre, as two ideal-type situations along the top axis of the figure. Provincial autarchy indicates that discretionary behaviour is done with little reference and interactions with the Centre. On the other hand, central dependency suggests a situation whereby provincial discretions are largely directed towards the lobbying of, and bargaining with central leaders for more favourable policies and more central resources. The second dimension is the degree of involvement of the local plans and the "market" in the discretionary behaviour, as vis-a-vis central

plans and policies. Some provincial discretions are directed towards central policies and plans, while others are concerned with local plans and the market situation.

Figure 5.1

Provincial Discretions: A Typology

	<u>Provincial Autarchy</u>	<u>Central Dependency</u>
<u>Central Plans/ Policies</u>	-Flexible implementation of central policies (A)	-Bargaining for more favourable central policies -Bargaining for direct central support (e.g., budgetary resources, investment scale) (B)
<u>Provincial Plans/ Markets</u>	-Develop "new horizon" beyond the budget: expansion into the "market" -Internationalization (C)	-Bargaining for direct central support (e.g., extrabudgetary resources of central ministries) (D)

As Figure 5.1 depicts, the types of discretionary behaviour which have the highest degree of provincial "independence" as vis-a-vis dependence on the Centre are those in quadrant (C), namely, the behaviour of "developing the new horizon" and "internationalization". In quadrant (C) the two dimensions interset to denote discretions which are neither engaged with the central government nor concerned with central policies and central plans. Both the expansionary behaviour into the "market" and the effort towards internationalization are activities largely done by provincial governments independently. Moreover, their targets of activity are, respectively, the enterprises in the market and the international community. The Centre, and its policies, are not the primary focus of these behaviour. Situated at the opposite end is discretionary behaviour in quadrant (B), namely, bargaining with the Centre for more favourable policies and for more central resources. The dependence on the Centre is obvious here. The success of these provincial discretionary behaviour relies upon decisions by the Centre regarding, for instance, the approval of a favourable policy or the delegation of more generous resources to

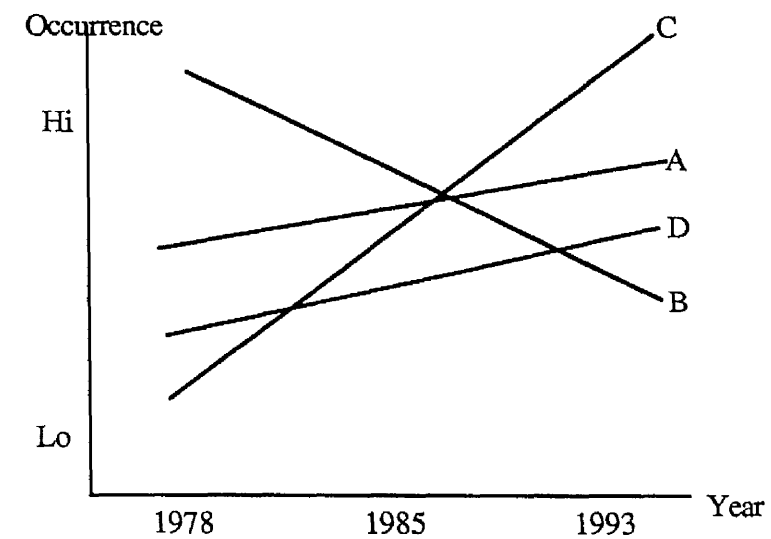
the province. In between these extremes is behaviour at quadrants (A) and (D). Flexible implementation of central policies denotes a kind of provincial discretionary behaviour which, albeit concerned with central policies, reflects a high degree of provincial independence orientation in terms of feigned compliance and "creative" local interpretation of central policies. As an activity it is largely an "autarchic" behaviour conducted by provincial governments on their own. Meanwhile, in quadrant (D) there are discretions which have the Centre as their major focus of concern, but are nevertheless occurring beyond the traditional realm of central plans. An example is the attraction of extrabudgetary central investment by a provincial government. While such investment constitutes a kind of direct central support, these central resources did not come from the central plan. For these central resources, the injection of resources took more of the nature of commercial investment projects, and central ministries were commensurate with "investors" looking for viable investment projects within the country in order to obtain profits. To a large extent, provincial governments in these cases acted as if they were attracting foreign investors.

Guangdong's Discretionary Behaviour

The Guangdong government since 1978 has engaged in both "centrally dependent" and "independence-oriented" discretionary behaviour when seeking to increase investment within the province. However, as compared to Shanghai, the Guangdong government have undertaken more independence-oriented discretions. A comparative discussion of the discretionary behaviour of the Guangdong and Shanghai governments is undertaken in Chapter Seven. Figure 5.2 below summarizes the development of Guangdong's discretionary behaviour since 1978, each of the lines representing one of the four quadrants of discretionary behaviour in Figure 5.1, and denoting a different level of central dependence.

Figure 5.2

Trends of Guangdong's Discretionary Behaviour, 1978-1993



The hierarchy of central dependency of the four quadrants of discretionary behaviour in Figure 5.1 is, as noted above, from the highest to the lowest, B, D, A, C. Figure 5.2 shows that in the reform period 1978-93, Guangdong's discretionary behaviour shows an obvious trend of increasing provincial independence and decreasing central dependence. This is most markedly indicated by the crossing lines of B and C, each representing the more extreme cases of central dependence and provincial independence respectively. Meanwhile, the intermediate cases of A and D started at a fairly high level in 1978, and show a gradual increase over the reform period. The rest of this chapter discusses each category of Guangdong's discretionary behaviour in these respective quadrants in detail.

Bargaining For More Favourable Central Policies

The first category of Guangdong's discretionary behaviour is that whose aim is to obtain the most favourable policies from the Centre. Although the focus of this type of discretionary behaviour reflects the heavy reliance of provincial governments on the goodwill of the Centre, it also confirms that provincial governments do, in fact, have a substantial amount of influence on central policy-making. As the focus of this behaviour is on the formulation of central policies, its method consists largely of bargaining behaviour.

This section outlines Guangdong's efforts in three major areas, namely, the Centre's "Special Policy" on Guangdong, the fiscal system, and the investment

administration system. Bargaining for the most favourable central policies that circumstances allow has always been the major focus of the Guangdong government. It has been a very important, if not the most important, type of discretionary behaviour, particularly in terms of the earlier years of the reform decade. The basic policy framework regarding the economic development of the whole southern province and, in particular, the development of investment, was formulated in direct relation to these three areas of central policies. The success of such bargaining has produced a progressively more favourable environment in which to deploy other categories of discretionary behaviour.

Special Policy

The opening up and implementation of reform in Guangdong took off with the announcement of the "Special Policy" for Guangdong and Fujian in April 1979. The policy, embodied in a State Council Document No.50 in July 1979,⁵ gave Guangdong and Fujian "pioneer" status within the opening up and reform process, as well as enlarged provincial autonomy in planning and fiscal aspects, and more power to attract foreign investment. The Guangdong and Fujian officials lobbied intensively for a preferential policy. At a time following the Third Plenum of 1978 when the Centre was eager and receptive to new ideas on how to develop the economy, they succeeded. The Special Policy is important to Guangdong because it formally endorses, as a matter of principle, the legitimacy of future deviations on the part of the province from national practice. The only two preconditions are for Guangdong, firstly, to justify the merits of such actions in terms of performance in economic development and, secondly, to guarantee that the interests of the rest of the nation would not be too adversely affected. The wide umbrella of the Special Policy also facilitated Guangdong's fight for specific central support and more favourable treatment in more specific items.

The Centre was "receptive" to Guangdong's bargaining as the opening and development of both Guangdong and Fujian would fulfill an important political goal, as well as certain strategic concerns and tactical requirements.⁶ Guangdong and Fujian are, respectively, the neighbouring territories of Hong Kong/Macau, and

⁵The document is printed in full in Guangdong Provincial Party Committee, the Secretariat (ed.), *Zhongyang Dui Guangdong Gongzuo Zhishi Huibian, 1979-1982* (A Collection of Central Government's Instructions to the Work of the Guangdong Provincial Government) (Neibu) (Four Volumes, 1979-82, 1983-85, 1986-87, Parts I and II) (hereinafter as *Centre's Instructions to Guangdong*), (1986), pp.18-40.

⁶Ezra F. Vogel briefly discussed these political and strategic concerns in Vogel, *One Step Ahead in China: Guangdong Under Reform* (Cambridge, Mass.: Harvard University Press, 1989), pp.82-83.

Taiwan. The successful development of the economy of these two provinces could have a "demonstration effect" on the residents of these neighbouring areas and this encourages national unification in the long run. The many kinship ties between the residents of Guangdong and Fujian with residents of Hong Kong/Macau and Taiwan could also be integral in the endeavour of these two southern provinces to attract the capital and management support of their richer neighbours, as well as to utilize their overseas market connection bringing products to the international market. This tactical consideration was particularly relevant in 1979 when the financial situation of the country was put under strain by negligent production during the Cultural Revolution decade 1966-76 and by the "Western-style Leap Forward" in 1977-79. Moreover, in revenue terms, Guangdong and Fujian are situated near the southern border of the country and had in past times been relatively insignificant contributors to total national revenue. Fujian had always been a deficit province requiring net inflow of central fiscal subsidy, and Guangdong's remittance to the Centre in 1978 was 1.2 billion yuan, amounting to only 2.3% of the total central fiscal expenditure of the year.⁷ As seen in Chapter Three, historically the central government had not invested much in Guangdong. The low revenue baseline and marginal contribution of the border provinces to the national economy meant that economically little could be lost in the event of any failure in this experiment with reform and opening up.

It would appear to be the early awareness and initiative of Guangdong provincial officials that has enabled Guangdong to seize the opportunity presented by the change in policy at central level in the late 1970s and secure favourable treatment. The various strategic considerations of the Centre notwithstanding, it was officials from the Guangdong provincial government, not the Centre, who first raised the idea of a preferential policy as a means which could enable the province to open up to the international market at a faster rate.⁸ As neighbours of Hong Kong and Macau, Guangdong officials were able to move more quickly than their counterparts in other provinces in redirecting attention towards economic

⁷The contracted remittance sum of Guangdong originally agreed in Central Document No.50 (1979) at 1.2 billion yuan was based on the actual performance of 1978. Fujian had the Centre agree to give it annual subsidy of 100 million yuan by the same document.

⁸Respondent No.9, Guangzhou Interview, December 1993. This is also supported by documentary evidence. The idea of setting up special economic zones first appeared in a Guangdong Party Committee meeting in January 1979. See Liu Zhongxiu, *Thoughts on Shenzhen by 100 Scholars*, (Shenzhen: Haitian chubanshe, 1991), p.162. Ezra F. Vogel stated that Guangdong's leaders and those in the central government concerned with Guangdong had been given forewarning of the new policy of economic opening and development prior to the Third Plenum of the Eleventh Party Congress in late 1978 and as a result Guangdong's leaders had had more time to contemplate how the new turn in the Centre's attitude might be applied. In the end they came up with the idea of the Special Policy for Guangdong. See Vogel, *One Step Ahead in China*, p.84.

development after the downfall of the Gang of Four. The Third Plenum of the Eleventh Congress of the Party Central Committee gave Guangdong officials a clear go-ahead. Serious consideration was promptly given within the provincial government to identify specific measures through which an economic take-off could take place. A report on Ye Jianying's meeting with Guangdong officials confirms the initiatives taken by the two provinces. In a meeting in June 1979, Ye told officials in Guangdong that "during the central work conference held in April, there were strong calls for decentralization and reforms of the economic management system from the two provinces. As a result the Centre has decided to let Guangdong and Fujian spearhead reforms."⁹

After the April conference, in May Guangdong officials worked together with the central working team headed by State Councillor Gu Mu and by early June 1979 had formulated a proposal on how to begin the reforms and speed up the opening of Guangdong. In the report the Guangdong provincial government made specific requests for a *dabaogan* fiscal system and for autonomy as regards the planning of local investment projects.¹⁰ The report was approved just over one month later.

Apart from a few specific decisions such as those covering the new fiscal system and the retention of foreign exchange reserves, the Special Policy approved in 1979 included only general statements as regards the decentralization of authority to Guangdong. There was, therefore, a need for certain refinements in order that the latitude provided by such nebulosity might be better utilized.

During 1980 and 1981 in various meetings with central government leaders, the Guangdong officials complained about the "uncooperative attitude of many central government ministries and the difficulty experienced in putting the Special Policy into practice. For instance, during a meeting in March 1980, Guangdong's leaders told State Councillor Gu Mu that there was a lack of support and understanding among some central government ministries regarding the Special

⁹See "Ye Jianying's Speech in Meeting with Guangdong's Party Secretaries at the District, City, and County-Levels, June 1979", *Centre's Instructions to Guangdong, 1986-1987*, Part II, p.446. Ye, one of the first generation leaders of the Chinese Communist Party and a Guangdong native (of Mui County), served as the first First Party Secretary and governor of Guangdong after 1949. His son, Ye Xuanping, subsequently became governor of Guangdong from 1985 to 1991.

¹⁰See "Report by the Guangdong Provincial Party Committee on Utilizing Guangdong's Favourable Conditions, Expanding External Trade, and Speeding up Economic Development", June 6, 1979. This was approved by the Centre via State Council Notice No. 50 (1979), July 15, 1979. See *Ibid.*, (1979-1982), pp.18-40.

Policy.¹¹ The complaint was lodged again in September when provincial officials in the Central Committee Secretariat reported on Guangdong's work before top central leaders, including Hu Yaobang, Wan Li and Gu Mu.¹² In another meeting held in Guangdong in December 1980, when State Councillor Gu Mu urged Guangdong to take the initiative and to propose bills for approval rather than relying on the central ministries to take action, the then Provincial Party Secretary Ren Zhongyi remarked that "the ministries do make some regulations, but they are all negative in content and prohibit necessary action."¹³

In a meeting on the work of Guangdong, Fujian and the Special Economic Zones held in Beijing in May 1981, Guangdong, collaborating with Fujian, requested specifically that the central government lay down a few major binding principles, such as avoiding the "capitalistic road", and strictly following the four basic principles, and to leave the rest to them.¹⁴ This request was granted. In the minutes of the meeting, as approved by the State Council in July, it was written unambiguously that,

"Subject to the following major principles, the meeting agreed that the two provinces should be allowed the autonomy to go their own way: (1) abiding by the four basic principles; (2) following the major policy direction of the Party and national unity; (3) obeying the guidance of the state plan; (4) completing the tasks handed down from above; and (5) maintaining a united front in external matters."¹⁵

It would appear that the central government effectively granted residual power to the two provinces. In addition, the content of the central government's Special Policy for the two provinces were laid down in still more specific terms:

"(1) the two provinces should be more open to the outside world than other provinces, including the use of foreign investment and foreign technology and management, and the expansion of foreign trade; (2) the two provinces should practice more "liberalized" domestic policies, such as the development of other modes of ownership and the expanded use of various economic levers; and (3) the two provinces should have enlarged authority,

¹¹This is inferred from Gu Mu's speech on the meeting and from the minutes of meeting. Guangdong's officials at the meeting included the First Party Secretary Xi Zhongxun, Vice-governors Lau Tianfu and Wu Nansang. See *Ibid.*, pp. 57, 60-71.

¹²See *Ibid.*, pp.94-108.

¹³*Ibid.*, p.122.

¹⁴*Ibid.*, p.153.

¹⁵See Central Committee Document No. 27(1981), July 19, 1981, "On Approving the Notes of Meeting on the Work of Guangdong, Fujian and the Special Economic Zones", printed in State Commission for Economic System Reform (ed.), *Jingji Tizhi Gaige Wenjian Huibian, 1978-1983* (A Collection of Documents on Economic System Reforms, 1978-1983) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1983), pp. 558-66.

including the power to legislate on provincial matters, and more autonomy as regards economic, personnel, and enterprise management."¹⁶

This was therefore a successful bid on the part of the Guangdong government to enrich and refine the vaguely worded Special Policy first announced in 1979. For the first time the two provinces were heralded explicitly as constituting the experimental base of economic reform. The coverage and policy dimensions theoretically applicable to the Special Policy were also explicitly laid down. The provincial government obtained as well the central government's pledge of "non-intervention" within the five major principles, which indicated the granting of a kind of residual power within a federal system of government.

However, Guangdong officials had experienced considerable "struggle" with officials from central ministries in their efforts to secure the "non-intervention" pledge. Success had not come easily. Although the attitude of some central leaders, and in this case, Gu Mu in particular, was one of support for Guangdong's request for more autonomy, central ministerial officials at working level who had direct working relations with Guangdong were often less than supportive. Such disparities in attitude were a contributing factor to the minutes of the meeting needing to be drafted four times before being eventually approved. Guangdong officials also had to join the drafting work in the final round to ensure that the pledges they requested and that Gu Mu had endorsed were formally laid down.¹⁷

It is true that the concept of residual power was one somewhat alien to China's political culture, and announcements in an administrative document did not necessarily protect Guangdong from future "encroachments" on its delegated autonomy. The five major principles are undoubtedly coined in general terms still and open therefore to interpretation. This is possibly the reason why the central government saw no harm in approving them. However, despite such remaining limitations, the significance of the overall success of this attempt should not be underestimated. The Guangdong government has made the Centre specify the dimensions and coverage of the policy, and make explicit the "taboo" areas. This in itself was a significant improvement on the previously nebulous concept of the

¹⁶Ibid.

¹⁷See Gu Mu speaking in the work conference of Guangdong, Fujian and the special economic zones, May 27, and June 12, 1981, in *Centre's Instructions to Guangdong, 1979-1982*, pp.158-60. The officials responsible for the drafting of the notes were from the central Foreign Trade Commission. The earlier three drafts included lots of references of concrete examples of Guangdong's "problematic" economic profiteering activities.

"Special Policy". On this new footing the Guangdong government improved its position for future bargaining with the central government on a specific level, as well as in enlarging its room for manoeuvre within and beyond existing central policies.

Fiscal System

The *dabaogan* fiscal system, whereby the Guangdong government was required to remit 1 billion yuan per year from 1980 for a fixed period of five years, was instrumental to the economic development and investment growth in Guangdong, as noted in Chapter Three. This was one of the few specific policies requested by Guangdong and obtained from the central government in July 1979, and which remained thereafter a focus for "protection and enhancement" by the Guangdong provincial government.¹⁸

The Reduction of Fiscal Remittance

The amount of fiscal remittance was first set at 1.2 billion yuan in July 1979, and was supposed to be fixed for the two years, 1980 and 1981. This was less time than that requested by the provincial government. In the June 1979 report Guangdong did not specify the amount of fiscal remittance but rather requested that the amount be fixed for a period of five years.¹⁹ Therefore, only three months after the passage of the report at a meeting with Gu Mu in September 1979, the Guangdong officials had begun to "rattle their case". They pointed out the need for additional local expenditure as a result of the price adjustment of agricultural products and salary rises, and accordingly asked that the remittance amount be lowered. The attitude of the Centre was very supportive, as can be seen from the following quote:

"It does not really matter how much you remit to the Centre next year, whether it is 1.2 billion or 1 billion yuan. ... The calculation of the remittance amount should not be a serious issue. The figure of 1.2 billion yuan is a little arbitrary. If it is not correct, simply do the calculation again."²⁰

¹⁸The other specific preferential policy Guangdong obtained was regarding more favourable foreign exchange retention. Other preferential policies such as the delegation of planning authority and the enhancement of investment approval authority had been coined in loose and general phrases in the 1979 report. See Guangdong Party Committee's Report, June 6, 1979, approved via Central Committee Document No. 50 (1979), in *Centre's Instructions to Guangdong, 1979-1982*, p.18-40.

¹⁹Ibid.

²⁰Gu Mu was talking to Guangdong provincial officials in September 22, 1979. See Ibid., pp.42, 48.

As a result in May 1980 the amount of fiscal remittance was slashed by one-sixth to 1 billion yuan,²¹ and after a further meeting with central leaders in September, the amount was fixed for a period of five years, just as Guangdong had originally requested.²² At that time the Centre was obviously more concerned with getting reforms off the ground in Guangdong than in extracting revenue. After all, the difference in remittance of 0.2 billion yuan represented only 0.18% of the national total fiscal revenue in 1980. However, this was nevertheless of significant advantage to Guangdong, and it is noteworthy that in this case Guangdong succeeded in making the Centre revise an earlier decision *before* it had even come into effect.

Defending the Coverage of the Contract

One area of frequent bargaining within revenue matters over the years between the Centre and Guangdong has been the effect of the ongoing reform measures on the revenue and expenditure of the province. Reforms have brought about new sources of revenue as well as expenses. How should such revenue and expenditure be allocated? Should they go to the central or the provincial budgets? If they are assigned to the provincial budget, should the remittance amount be adjusted accordingly?

Guangdong provincial officials were in the habit of emphasizing the fact that Guangdong had shouldered the "burden" of reform during the 1980s. Provincial officials from the Provincial Party Committee Secretariat calculated that, from 1980 to 1992, reform measures engineered by the Centre had cost the provincial government over 13 billion yuan through increase in its expenditure and decrease in its revenue.²³ From the provincial standpoint the cost of these measures should have been shouldered by the central government budget. According to their account, the Centre increased *de facto* the annual remittance from Guangdong by

²¹See Central Committee Notice No. 41 (1980), May 16, 1980, "On Approving the Notes of the Meeting on Guangdong and Fujian", in State Commission for Economic System Reform (ed.), *A Collection of Documents on Economic System Reforms, 1978-1983*, pp.500-4. The meeting was held in March 30.

²²See "Notes of Dialogue of Central Committee Members when Hearing Briefing by Guangdong Officials" September 24, 25, 1980, and "Notes of Meeting of the Central Committee Meeting", September 28, 1980, in *Centre's Instructions to Guangdong, 1979-82*, pp.94-112.

²³See Guangdong Provincial Party Committee, the Secretariat (ed.), *Guangdong Gaige Kaifang Qishi Lu* (A Record of Insights of Opening and Reform in Guangdong) (Beijing: Renmin chubanshe, 1993), p.59.

an annual average of 1 billion yuan over the 13 year period since 1980, effectively doubling the remittance rate of the earlier years of that period.

Moreover, Guangdong has been made to make additional contributions to the Centre exclusive of the arrangements of the "contract". For instance, when the central government ran into the red during the late 1980s, as was often the case, the "extra-contract" remittances of Guangdong became increasingly hefty, being often several times that of the "normal" remittances under the contract. The following table sets out the details:

Table 5.1
Guangdong's Fiscal Remittances: "Contract" and "Extra-Contract"
(Billion Yuan)

<u>Year</u>	<u>Total Remittances</u>	<u>Contract</u>	<u>Extra-Contract</u>	<u>(% of Total)</u>
1980-1987	12.197	7.334	4.863	39.87
1987	2.319	0.778	1.541	66.45
1988-1991	19.308	7.044	12.264	63.52
1991	6.985	1.995	4.990	71.44

Source: Calculated from Dangdai Zhongguo Congshu Bianji Bu (ed.), *Dangdai Zhongguo de Guangdong* (Guangdong in Contemporary China) Vol. 1, (Beijing: Dangdai Zhongguo chubanshe, 1991), pp.686-87; and Guangdong Provincial Party Committee (ed.), *A Record of Insights of Opening and Reform in Guangdong*, p.59.

Available evidence shows that Guangdong has resisted this imposed "obligation", and has, at times, won concessions from the Centre. During a meeting in the Central Committee Secretariat in 1982, Guangdong officials together with Fujian officials complained of the burden imposed by central borrowing and the reduction in local revenue levels.²⁴ They made remarks such as "the Centre gets the increases in revenue, the province shoulders all increases in expenditure; we can hardly continue under this type of contractual system". Some even said, "Now we know how good the traditional system is of 'eating from the same pot'". As a result, central leaders agreed at the meeting that from then on the provinces could retain all extra sources of revenue arising from reform whilst, at

²⁴See "Report for the Central Committee Meeting: The Implementation of Special Policy in Guangdong and Fujian and the Trial Operation of the Special Economic Zones" November 15, 1982, in *Centre's Instructions to Guangdong, 1979-1982*, pp.405-6. In 1980, in Central Committee Notice No.41 (1980), it was stated that the remittance amount was to be adjusted according to changes in the local revenue base and at times when the revenue and expenditure situation of the provinces was affected substantially by major economic measures taken by the Centre. The grievance of provinces was that while extra revenue went to the Centre, the provinces were often left to shoulder additional expenditure alone. The pledge that the two provinces could retain extra revenues generated from new revenue sources was therefore an improvement.

the same time, they would shoulder all extra expenditures. The meeting also pledged that the Centre would not borrow from the two provinces again, and that revenue from the local sale of state bonds would go to the provincial coffers on the understanding that the provinces would also be responsible for their repayment. Revenue collected from the provinces in the form of "Energy and Transportation Fund" would subsequently be used to support investment projects in the provinces.²⁵

It is noteworthy that the last item mentioned, the Energy and Transportation Construction Fund, had not yet been formally announced at the time of the meeting. Since the tax base figure of the Fund is equal to the amount of the extra-budgetary funds of local units, and most of the collected revenue was destined for the central coffers, this fund was regarded as a typical example of new measures cutting into the retained local revenue which so aggrieved the provinces. By obtaining a pledge that funds would be allocated back to the provinces, Guangdong officials sought to minimize the effect of the measure and to prepare the ground for future bargaining with regard to direct central support in the form of central investment projects.

The province again succeeded in reducing remittance in 1985, when the *dabaogan* system was renewed for another five years. Guangdong succeeded in lowering its remittance amount from 1 billion yuan to 0.778 billion by arguing that a number of local enterprises had been made central enterprises and the revenue base of the provincial government was thus adversely affected. This arrangement lasted for three years from 1985 to 1987, and was terminated in 1988 when the fixed sum contract system was changed to an incremental adjustment contract.²⁶

²⁵The Energy and Transportation Construction Fund was a new tax announced in December 1982. The fund is imposed on the extrabudgetary funds of all units and local governments with a tax rate of 10%. All revenue collected *within the prescribed quota* was to go to the central coffers. The provincial and lower-level governments could keep all revenues collected above the quotas for local use, and as from 1985, 70%. See "The Collection Rules of the State Energy and Transportation Construction Fund", announced by the State Council on December 15, 1982, printed in State Planning Commission (ed.), *Zhongyao Jingji Fagui Ziliu Xuanbian, 1977-1986* (A Selected Collection of the Major Economic Regulations) (Beijing: Zhongguo Tongji chubanshe, 1987), pp.664-66. The pledge of no more borrowings was, of course, not followed through, as demonstrated by the increased amount of "extra-contract" remittance as shown in Table 5.1.

²⁶See Dangdai Zhongguo Congshu Bianji Bu (ed.), *Guangdong in Contemporary China*, Vol.1, p.687.

Saving the Contract

The most important discretionary behaviour in relation to the fiscal system following the establishment of the *dabaogan* system was that employed in the effort to save this system in 1987-88, and again in 1993, when there were growing signs that the central government intended replacing it with a "tax-sharing" system. In 1988 Guangdong succeeded in its "rescue" attempt. By proposing an annual incremental increase of 9% to the original fixed lump-sum remittance, the Guangdong government alleviated the Centre's concern that Guangdong might have retained too much for itself. When, in 1993, retaining the system was found to be impossible, the focus changed to that of safeguarding the local interests associated with the system.

The Incremental *Dabaogan*: 1987-88

Guangdong's lump-sum *dabaogan* system, first established in 1980, was extended for another five years in 1985. In anticipation of its expiry in 1989, the Guangdong Provincial Government again started its lobbying early in 1987. In recent years there had been increasing pressure from the central government to raise Guangdong's remittances to the Centre over and above the contracted remittance amount. Table 5.1 above shows that in 1987, Guangdong remitted a total of 2.3 billion yuan, more than triple that of the contracted remittance. Difficulties within the central budget and growing disparities in wealth between Guangdong and the inland provinces made Guangdong's position increasingly vulnerable, given the still very dominant belief in equalization of wealth. The idea of a tax-sharing system, whereby different levels of government had as their source of revenue different taxes and the discussion of which had first occurred in 1984-85, was picked up once again in 1987-88. Guangdong did, therefore, have good grounds for concern over the fate of the *dabaogan* system.

In October 1987, around the time of the convening of the Thirteenth Party Congress, the Guangdong provincial leadership submitted a report to the Party Centre and the State Council lobbying for more autonomy.²⁷ The tone of the report was forward-looking and progressive, rather than defensive and inward-looking. It detailed the strong development in foreign investment which had occurred earlier that year. The report described the international background to such a warming in

²⁷Guangdong Provincial Party Committee and Provincial Government, "Proposals on Fully Utilizing the Current Opportunities to Speed up Economic Development" October 12, 1987, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, pp.370-75.

investment, arguing that it signalled the beginning of a new era of development and represented a golden opportunity for Guangdong and China. Consequently, the Centre should delegate further autonomy to Guangdong so that the province might better grasp this opportunity, and hence advance further the nation's quest for development and modernization. It was only at the end of the report that the demand for an extension of the fiscal contractual system was made. The message seemed to be: as more autonomy is needed to enable us better to serve our designated role for the nation, how can there be any question of doing away with existing autonomy (on the fiscal system)?

The lobbying worked. Fourteen days after the report had been submitted, Zhao Ziyang, Li Peng and other central leaders received Guangdong's provincial leaders, who were at that time attending the Thirteenth Party Congress in Beijing. Zhao talked about making Guangdong an experimental site for comprehensive reforms, allowing, in principle, the provincial government to launch reform experiments on all fronts.²⁸ As regards the fiscal system, Zhao guaranteed that the tax-sharing system would not be implemented in Guangdong.²⁹ This was of significant meaning to Guangdong as otherwise its favourable *dabaogan* system would end and more revenue would inevitably go to the central budget. Instead, Zhao indicated that the "sharing-the-total" system could be considered for application to Guangdong.

At this point Guangdong's purpose had been only half-way achieved. It had obtained Zhao's promise regarding the tax-sharing system, but the "sharing-the-total" system was not the best alternative, given the experience of the three provincial-level municipalities, namely, Beijing, Tianjin and Shanghai, which operated under such a system until 1988. However, the Guangdong leadership finally got its way when the formal response of the central government to its report requested that Guangdong and the Finance Ministry work together to produce a specific proposal on the fiscal system.³⁰

²⁸"Zhao Ziyang Discusses Guangdong Becoming the Experimental Zone for Comprehensive Reform" October 26, 1987, in *Ibid.*, pp. 384-86.

²⁹At that time the Centre had not yet arrived at a mature view of the tax-sharing system. But when the system was finally implemented in 1994, the *target* of the Centre was to centralize 60% of the total national fiscal revenue to the central budget, before some portion of the revenue was redirected to the provincial-level as transfer payments. See State Council Notice No.85 (1993) December 15, 1993, "State Council's Decision on Implementing the Tax-sharing Fiscal Management System", printed in *Caizheng*, No.2 (1994), pp.18-20.

³⁰"Central Finance and Economy Leading Group on Guangdong's October 12 Report", October 27, 1987, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, pp.387-91.

A report was promptly submitted by the Guangdong government in January 1988. As regards the fiscal system, instead of proposing something along the lines of the "sharing-the-total" system, the Guangdong government proposed a modification of the original contractual system. It, moreover, proposed that the expiry date of the original lump-sum system be moved forward for two years from the end of 1989 to the end of 1987. From 1988 onwards the annual remittance amount would no longer be a fixed lump sum, but rather increase by a fixed percentage over the the remittance amount of the previous year. The incremental rate for 1988-91 was to be fixed at 9%. The report also proposed to set the base line figure for the calculation of the 1988 remittance figure at 1.414 billion yuan, which was the total fiscal remittance (including "extra-contract borrowing") for 1987.³¹ The incremental rate after 1991 could be subject to change.³²

The strategy was to surrender part of the revenue voluntarily in order to retain more. The Guangdong government undertook a three-pronged initiative to impress the Centre that Guangdong had no intention of jealously hoarding local revenue at the expense of central revenue, thus preempting central moves which may prove more disadvantageous to Guangdong. The three proposals are: (1) to cut short the existing lump-sum arrangement for two years; (2) to voluntarily increase its future annual remittance amount by a fixed incremental rate; and (3) to raise the level of base-line figure for the first year of the new system to include "extra-contract" remittance, effectively increasing the level of its annual contractual remittance amount in future. The strategy worked, and in February 1988, Guangdong's report was approved by the State Council. As will be noted later in this chapter, many of the other areas of enhanced powers granted at this time were later recentralized in practice during the 1989-91 retrenchment. The agreement on the *dabaogan* fiscal system however remained intact.³³

³¹The contracted remittance in 1987 was 778 million yuan, and the Centre "borrowed" an extra amount of 635 million yuan that year. The two sums together became the 1.414 billion new base-line figure for the calculation of the new contracted remittance for 1988, which was 1.54 billion yuan. See Huang Haichao et al., *The Realization of Dreams. Guangdong Advancing to Market Economy*. (Guangzhou: South China University of Technology Press, 1993), p.31.

³²Guangdong Provincial Government, "Proposals on Deepening Guangdong's Reforms, Expanding the Opening to the World, and Speeding up Economic Development" January 7, 1988, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, pp.427-41. According to Respondent No.6, Guangzhou Interview, September 1993, eventually the 9% rate was retained for 1992 and 1993 in later negotiations. See also Chapter Three.

³³See Ibid., p.426, for the State Council Notice, February 2, 1988, approving Guangdong's January 1988 Report in principle. See Yang Xiaofei, "Discretionary Behaviour of the Provincial-Level Government", pp. 43-45, for a discussion of the Guangdong January report and the subsequent lapse of many of the approved powers, in investment, bank finance, pricing, etc.

Guangdong succeeded in saving and retaining the *dabaogan* system, albeit with some concession, due to developments in the national scene. At that time, the tax-sharing system had been little more than a talking point amongst academics and researchers rather than a concrete policy with proposals ready for implementation. In view of the spectacular developments in Guangdong, it was in the interests of most provinces to adopt rather than to scrap the *dabaogan* system. Even between academics and central think tanks, the formulation of the tax-sharing system was at that time still at a rudimentary stage. Consequently, in order to encourage the provinces to develop the economy, in early 1988 the central government was prepared to continue, and in fact, to expand, the application of the *dabaogan* system. In 1987 Shanghai obtained the approval to start the new *dabaogan* system as from 1988. In July 1988, a notice was issued to extend this contractual system nationwide, allowing variations in different provinces.³⁴ In an environment such as this, it is thus no surprise that the Guangdong government succeeded in its lobbying effort.

1993: Guarding and Maximizing Vested Interest

By the second half of 1993, when the Centre's intention to implement the tax-sharing system was clear and imminent,³⁵ the preference for the *dabaogan* system amongst Guangdong officials was nevertheless unambiguous. Planning and finance officials interviewed in summer and autumn 1993 freely admitted to the author that they would like to keep the system which had born such abundant fruit for the past fourteen years.³⁶ Even after the formal announcement of adoption of the new tax-sharing system in December 1993, many had not lost the hope that the

³⁴The document on the new regime is found in 1988 *Nian Caizheng Zhidu Xuanbian*. 1989, pp.104-8. From 1988 the whole nation was therefore practising some kind of *dabaogan* system. There were six major variations of contract. For details see Xu Yi and Xiang Jingquan (eds.), 1986-1990: *Diqige Wunian Jihua Shiqi de Guojia Caizheng* (State Finance during the Seventh Five-Year Plan Period) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1993), pp.74-77.

³⁵According to an internal report from the Finance Ministry, it was at the conclusion of the Fourteenth Party Congress in late 1992 that the tax-sharing system progressed from being only a concept and a discussion topic amongst the academics and government think tanks to a formidable policy proposal on the government agenda. The Finance Ministry started to work out the specifics of a tax-sharing system in May 1993. In July, the new system was presented for discussion at the National Finance Work Conference for the first time. After further revisions in August, the reform plan was presented to and approved by the State Council and the Politburo of the Party at end August/early September. A further meeting with the provincial finance department officials was held in late October/early November to solicit further opinions and to check the budgetary figures of the provinces for the preliminary calculation of the central transfers in 1994. See "Guanyu Fenshuizhi Caizheng Tizhi Ruogan Wenti de Shuoming", by the assistant of the Finance Minister compiled from working papers of the national finance work conferences, printed in State Audit Commission, Finance Audit Bureau (ed.), *Caishui Tizhi Gaige Xueshi Ziliao* (Study Materials on Taxation and Fiscal Reforms) (Neibu, 1994), pp.99-109.

³⁶Respondents Nos. 6 and 9, Guangzhou interviews, May and September 1993.

old system might be retained in some form. A number of authoritative provincial government advisers suggested in local conferences and openly published articles that Guangdong should continue the *dabaogan* system at subprovincial level.³⁷

As it was obvious that the Centre was determined to go ahead, the focus of the provincial leadership became that of safeguarding Guangdong's vested interests under the new system. A provincial official revealed that the Centre had originally intended to use the 1992 figure as the base line, but as a result of intense lobbying by Guangdong officials in September 1993, at the time of Vice-Premier Zhu Rongji's visit to Guangdong, the Centre agreed to use 1993 as the base line year. When formally announcing the new fiscal system in December 1993, the central government could therefore assure the provinces that since their accumulated vested interests under the old system would be calculated as of 1993, their provincial coffers would not therefore be adversely affected under the new system.³⁸ Since the economy had grown rapidly during 1993, with government revenue swelling accordingly, the change of the base-line year from 1992 to 1993 would enable the provinces to retain more revenue under the new fiscal system.³⁹

Fixing the base year at 1993 also allowed the provinces to make full use of the remaining three months of 1993 in which to boost the base figures. After Zhu's visit in September, fiscal revenue collected in Guangdong during the fourth quarter of 1993 increased spectacularly, accounting for 37% of the total revenue of that year. Table 5.2 shows the rise:

³⁷Opinions of this sort appeared in several articles on the tax-sharing system in the *Guangdong Finance*, No.1 (1994), which is a publication of the Guangdong Finance Bureau. The articles include, Zeng Zhiwen, "A collection of views on the tax-sharing system", pp.8-9, which is a summary of views emanating from a seminar in Guangdong; Wang Guanjiu, "An alternative view on the tax-sharing system", pp.10-13, which is an explicit defense of the advantages of the *dabaogan* system; and Zeng Xiaohong, "Thinking and worrying about the tax-sharing system", pp.18-19. For suggestions regarding continuing the practice of the old system at subprovincial levels, see p.9.

³⁸See State Council Notice No. 85 (1993) December 15, 1993, "State Council's Decision on Implementing the Tax-sharing Fiscal Management System", printed in *Caizheng* 1994, No. 2:18-20. This means that even though, in accordance with the allocation of fiscal revenue under the new system, the Centre would get about 60% of total fiscal revenue, a substantial part of that revenue would be transferred back to the provincial coffers in a lump-sum. The purpose was to ensure that the amount of fiscal revenue that the provinces would retain and use at their discretion in 1994 would be at least equal to the amount they had retained in 1993 under the contractual fiscal system.

³⁹Respondent No.9, Guangzhou interview, December 1993. The lobbying took place during Zhu Rongji's tour to the coastal provinces in September 1993. The purpose of Zhu's tour, which included Guangdong, Shanghai, Zhejiang, Jiangsu and Hainan, was to discuss the Centre's plan to implement the new system with the provincial leadership and get their support. According to the respondent, Guangdong provincial officials told Zhu that given Guangdong's rapid economic development in 1993, the enthusiasm of the grassroots officials to develop the economy would be seriously

Table 5.2Guangdong's Fiscal Revenue 1993 (100 million yuan)

<u>Month</u>	<u>Revenue</u>	<u>% Increase over Same Month 1992</u>
Jan.	18.7	14.2
Feb.	21.7	39.2
Mar.	24.0	36.8
Apr.	25.4	27.3
May	23.9	34.6
June	24.8	26.6
July	26.2	38.3
Aug.	24.9	46.1
Sep.	27.3	63.3
Oct.	35.6	70.6
Nov.	35.5	105.1
Dec.	58.2	145.7

Source: Information from the State Planning Commission.

Table 5.2 shows a spectacular surge in fiscal revenue collected after September 1993. The chase for more revenue in order to boost the base line was, in fact, a nationwide phenomenon, but Guangdong was obviously among the more "aggressive" provinces. Despite issue of a notice by the central government in November 15th criticising and banning such behaviour on the part of provincial governments,⁴⁰ Guangdong's revenue continued nevertheless to surge and by an even larger percentage by December.⁴¹

Guangdong officials could obviously see that this was their last chance to enhance, at a relatively low risk, Guangdong's interests and to reduce its potential loss under the impending change of fiscal system. In other words, Guangdong would have much to gain and little to lose by engaging in such behaviour. One of the motivations for the Centre's determination to implement the new system was that of centralizing more fiscal revenues at central level, and of narrowing the

dampened if the lower figure of 1992 was used as the base line to calculate Guangdong's retained revenue in 1994.

⁴⁰In mid-November the State Council issued a severely worded notice warning against provincial government moves to boost the revenue base line via irregular means. Three types of irregular moves were identified: (1) collecting "prepayments": revenues not yet realized being taxed in advance; advancing the payment dates of taxes accrued, etc; (2) collecting bad debt taxes by requiring the enterprises concerned to take out bank loans or borrow fiscal funds from the finance department in order to pay the taxes; (The provincial governments allegedly volunteered to lend the money and also instructed the local banks to do so) (3) delaying the normal refund of taxes to exporting enterprises, or reducing the amount refunded, thereby increasing the total fiscal revenue for the year. See "State Council's Notice on Issues relating to the Implementation of the Tax-sharing System" November 15, 1993, printed in State Audit Commission (ed.), *Study Materials on Taxation and Fiscal Reform*, pp.20-22.

⁴¹Respondent No.11, Guangzhou interview, December 1993, confirmed that there had been revenue-scrambling behaviour in Guangdong in the fourth quarter of 1993.

widening gap in fiscal strength between different provincial jurisdictions.⁴² As Guangdong had been the largest benefactor under the *dabaogan* system it therefore stood to lose the most. Enlarging the base line was thus its last chance to cash in on benefits accrued from the old system and to reduce its loss under the new. This is the reason why during Zhu Rongji's tour of September 1993 the Guangdong provincial officials focused their lobbying on the determination of base year.

On the other hand, the risk of being penalized by the Centre was low. First, although Guangdong would benefit most from manoeuvring the base line, the other provinces would also benefit from such behaviour. The design of the new system is to protect the vested interests of all provinces. Consequently poor provinces also stood to gain from an inflated base line. Guangdong was not, therefore, alone in this rush for a higher base line, and as long as everyone was in the game, the risk of central repercussions on any particular individual became much lower.

The risk was also low due to the unclear boundaries between "irregular" revenue collection and "effective" collection. It is somewhat ironic that provincial governments were criticized for collecting too much revenue in the fourth quarter of 1993, when in the past they had been blamed for collecting too little. Since it was not easy for the central government categorically to establish their "hypothesis" (i.e., that the surge in fiscal revenue in the fourth quarter was due to provincial governments' discretionary behaviour as a means to boost the base year revenue), provincial governments could justify the surge by putting it down to faster economic growth and more effective and efficient tax collection.⁴³

⁴²In an article explicating the tax-sharing system the Deputy Minister of Finance Ministry made it clear that increasing the proportion of fiscal revenue in the central government was one of the four major reasons for the new system. The other three purposes were: (1) to stabilize the revenue sources of the central and provincial governments, minimize the "haemorrhage" of fiscal revenue; (2) to reduce the arbitrariness of the distribution of fiscal revenue amongst different levels of the government, and enhance the role of the fiscal system in the allocation of resources across the country; (3) to facilitate the conversion of government functions and powers, to contribute to a unified national market and to optimize on resource allocation. See Xiang Huaizheng, "Tax-sharing System Is a Major Item of the Tax and Fiscal Reform", *Qiushi*, No.2 (1994), pp.32-36.

⁴³Guangdong officials confirmed that as long as the provincial government acted discreetly, it was difficult for the Centre to prove that they had done wrong. Revenue collection was after all the duty of the government. (Respondent No.11, Guangzhou interview, December 1993). In the official report on Guangdong's 1993 budget implementation and the 1994 budget, of February 19, 1994, the Director of Guangdong's Finance Bureau cited both objective and subjective reasons in accounting for the overachievement of fiscal revenue. They included: robust economic performance, policy factors (the rise of business tax for retail transactions by two percentage points, inflationary effects, etc.), improved implementation of central orders to stop new tax exemption and reduction in the second half of the year, and the adherence to central regulations on plugging the "holes" in tax collection, etc. For the Report see *Guangdong Caizheng*, No.4 (1994), pp.4-10.

In the end, the central government had no option but to call for "self-restraint" on the part of provincial governments. In January 1994 another urgent notice was issued by the State Council in conjunction with the Finance Ministry, the State Taxation Bureau and the People's Bank reiterating earlier warnings and restating the severity of the issue. Although some provinces were criticized for not abiding by the earlier November notice, the notice asked only that provincial governments be conscientious in the propriety of their local budget implementation figures, that they refund taxes which had been collected ahead of time, and that they deduct any "irregular" revenue from the provisional revenue statistics.⁴⁴ Given the substantial interest which Guangdong had in boosting the base line, and the ambiguity of the line of irregularity,⁴⁵ such a weak call for self-restraint could not hope to be effective in forestalling the scramble for more revenue.⁴⁶

This is a classic example of the interactive use of bargaining and implementation deviation over a period of time in order to further provincial interests. By first bargaining for a base line which was more susceptible to manoeuvre, and then making best use of such manoeuvrability, Guangdong was not only able to *realize* a higher base line of retained local revenue, it has also improved its bargaining position for *future* bargaining of provincial and central interests at the next stage of the new tax-sharing system.⁴⁷

⁴⁴State Council, Finance Ministry, the State Taxation Bureau, People's Bank of China, "Urgent notice on clearing and verifying the expenditure and revenue figures of the 1993 budget", January 20, 1994, printed in State Audit Commission (ed.), *Study Materials on Taxation and Fiscal Reforms*, pp.34-37.

⁴⁵The ambiguity of the propriety of the actions was illustrated in the report of the Finance Minister on the implementation of the 1993 State Budget, March 1994. In the report to the National People's Congress, Minister Liu Zhongli analysed the three causes for the substantial over-achievement of fiscal revenue as compared to the original estimates. (Total fiscal revenue including foreign and domestic debts in 1993 reached 511.48 billion yuan, 113.1% of the original estimates.) Apart from fast economic growth and the effect of the macro-economic adjustment in the second half of 1993, the third reason was the increased enthusiasm of provincial governments in tightening up revenue collection and preventing a haemorrhage of revenue which had resulted from the Centre's adoption of the 1993 revenue figure as the base line year for the calculation of central transfers to the provinces under the tax-sharing system. The revenue in the fourth quarter consequently saw a large increase. *The Economic Daily* (Beijing) March 12, 1994, p. 2. It should be noted that although the Minister referred to what the Centre's knowledge of the real reason behind the surge in enthusiasm, the action itself was described in fairly neutral terms. It would have been difficult for the Centre to punish the provinces for stemming the outflow of revenue when the Centre had for a long time urged them so to do.

⁴⁶In fact there was a considerable corner of opinion among central government officials that the fixing of the base line year at 1993, instead of at 1992, represented yet another concession on the part of the central government in face of provincial pressure. They claimed that this had seriously undermined the original intention behind implementing the tax-sharing system as a means of increasing the share of national revenue in the central coffers. Beijing interview with Respondent No. 31, April 1994.

⁴⁷The arrangement in 1994, in which the vested interests of the provinces under the preexisting *dabaogan* system would be protected, and the sharing of revenue between the central and provincial governments would still be largely in accordance with the preexisting arrangement, was intended only as a measure through which to "buy over" the support of provincial governments for the new

Investment Administration

The substantial power of investment administration enjoyed by Guangdong came as a result of bargaining for better policies from the Centre as well as from the frequent manipulation of implementation discretion. In this section the focus is on the former behaviour: that of obtaining a more favourable central policy whereby the province could achieve a greater autonomy within investment administration.

The Guangdong government focused primarily on two areas in its bargaining with the Centre for more investment power, the first being provincial project approval authority. In this respect, the quest for a higher ceiling of provincial authority was ongoing and relentless. The second area was the desire for a larger investment scale, and the ultimate abolition of annual control figures as set by the Centre and thus giving Guangdong the autonomy to plan its own investment scale. The following sections discuss these two areas of bargaining within the domestic and foreign investment scenes respectively.

Domestic Investment

As noted in Chapter Three, the decentralization of investment administration powers was a material factor in the rapid growth of investment activity in Guangdong. As more and larger investment projects were approved and funded within the ambit of the provincial government, the central government had less and less influence on the total scale, the allocation direction and content of investments.

The development of Guangdong's investment administration authority, and the fact that Guangdong had succeeded throughout each wave of national decentralization in gaining greater autonomy than other provinces nationwide have been described in Chapter Three. This section describes *how* the Guangdong leadership managed to achieve such an edge, and *how* they proceeded, step by step,

system. The announced intention of the Centre was that the system would gradually be changed to a more uniform system whereby a larger share of the national revenue would go to the central coffers. Further rounds of bargaining were, therefore, inevitable. The intention was explicit in the State Council Notice No. 85 (1993) "State Council's Decision on Implementing the Tax-sharing Fiscal Management System", which announces the implementation of the tax-sharing system. See the Notice as printed in *Caizheng*, No.2 (1994), pp.18-20.

in their attempt to circumvent central control on the investment scale in Guangdong.

Guangdong obtained the authority to approve projects of under 30 million yuan, and for investment in heavy industries under 50 million yuan, in 1982. As regards its approval authority of the former figure, this was at least two years ahead of other provinces nationwide, and the 50 million yuan authority was five years in advance. This resulted from persistent lobbying for more investment support from the Centre by the provincial leadership.

In the report of June 1979, and thereafter, Guangdong's officials frequently impressed on the Centre the urgent need for more investment in the province if it was to fulfill its national role as the forerunner in reforms and economic development. The last part of the report contained a checklist of projects, mainly raw materials, energy and transport projects, for which central investment was deemed necessary.⁴⁸ Strained as it was by the huge financial commitments demanded by "foreign leap" projects the Centre was not too forthcoming in providing direct investment. However, this cry for central support brought to Guangdong a higher level of autonomy in investment administration which the central government awarded to Guangdong as compensation for the low level of investment funding.

When Gu Mu inspected the work of Guangdong in December 1980, he made clear that it would be more pragmatic to expect the Centre to give leeway on policy rather than on the financial side. "We (the Centre) will give neither money nor materials to Guangdong, but we will formulate specific policies (to let you develop on your own)".⁴⁹ This attitude was formally adopted in the December 24, 1980 meeting with central leaders chaired by the Party Secretary General Hu Yaobang, and attended by Zhao Ziyang, Yao Yilin, Gu Mu, Yang Shangkun as well as senior Guangdong and Fujian officials. The minutes of the meeting recorded that in view of the central government being pressed for funds in the current economic adjustment period (which lasted from 1980 to 1983), it would be unable to give much monetary support to Guangdong and Fujian. The two provinces were, in fact, required to contribute still more to the central coffers in order to ease financial pressure at the Centre. The meeting agreed that in order to enable Guangdong and Fujian to continue to develop without central financial

⁴⁸See *Centre's Instructions to Guangdong, 1979-1982*, p.29.

⁴⁹See "Gu Mu Speaking When Inspecting Work in Zhuhai", December 10, 1980, in *Ibid.*, p.114.

support, the approval procedures of investment should be simplified and more approval authority decentralized to the provincial level.⁵⁰

Following this, and as mentioned in Chapter Three in July 1981, Guangdong and Fujian were allowed to approve medium-large sized projects, whereas other provinces would still require approval at State Planning Commission level.

In August 18, 1981, when reporting the work of the provincial government to Zhao Ziyang, Guangdong's senior officials again played on Zhao's concern regarding energy and transport sectors as a means to raising the ceiling on provincial investment authority. Since energy and transport were traditionally the responsibility of the central government, Guangdong sought to bargain for more investment authority in exchange for agreeing to fund a number of energy and transport projects. Therefore when Zhao asked Guangdong to place priority on transport and energy when planning local investment projects, Vice-governor Liu Tianfu immediately requested that the Centre raise the limit on the investment scale. Zhao agreed to this request.⁵¹

This is the process leading to the one-step-ahead decentralization in 1982. The Guangdong leadership succeeded in exploiting central government's concern over "bottlenecks" in the energy and transport sectors. Conversely, the central government saw no harm in delegating authority thereby facilitating the province to invest in areas wherein the Centre found difficulty in sustaining the financial commitment singlehandedly. It is interesting to note that enhanced authority was not necessarily restricted to the bottleneck sectors, but that a disparity (50 million yuan versus 30 million yuan) was built in which reflected the Centre's preference for investment in the energy and transport sectors. This happened, of course, as a result of bargaining and compromise between Guangdong and the Centre.

In March 1985 Guangdong's authority was further raised to 200 million yuan, a sum equivalent to the authority of the State Planning Commission, as described in Chapter Three. This was ostensibly shortlived, as retrenchment set in later the same year. However, in October 1987 Guangdong attempted to reclaim this "lost authority", and asked for a jurisdiction of 100 million yuan in a petition to

⁵⁰See "Central Party Secretariat Approving the Notes of Meeting of the Guangdong and Fujian Seminar", January 21, 1981, in *Ibid.*, pp.128-31.

⁵¹See "Zhao Ziyang Speaking When Receiving the Briefing of the Guangdong Party Committee" August 18, 1981, in *Ibid.*, pp. 213-14.

the Centre.⁵² When the initial response from the central leadership (and most particularly, from Zhao Ziyang) sounded positive, the Guangdong leadership raised its demand further. In a later report drafted in accordance with instructions from Zhao, the Guangdong leadership reverted its demand back to the 200 million yuan it had so briefly enjoyed in 1985.⁵³

More importantly, and probably encouraged by the Centre's favourable response to its initial "testing of the waters", Guangdong's 1988 report asked for the autonomy to determine independently the total investment scale for the province, whilst taking into account national guidelines, the financial strength of the province and the requirements of the economy. The entire report was approved quickly, in principle, by the Centre. However, many of the provisions of the report which had been approved failed to materialize, as the national economic situation quickly deteriorated during the second half of 1988 and the Centre was keen to reestablish its hold on the run-away economy. The 200 million yuan project approval authority finally materialized towards 1992 when the national economic atmosphere improved, as noted earlier. However, the power independently to set the provincial investment scale was never again formally endorsed or practised.

This request to manage the total local investment scale demonstrates the extent of Guangdong's push for ever more autonomy in its domestic investment administration. Towards the late 1980s the ceiling of project approval authority became so high that the provincial government could plan and approve most, if not all, projects as it saw fit. At times when the value of an investment project exceeded the provincial jurisdiction and in theory should have required the approval of the State Council, the structure of the project could be manipulated whereby a large project would be broken down into several related but separate projects the separate funding of which fell well within the jurisdiction of the provincial government.⁵⁴ From the point of view of the Centre, the retention of control over the total investment scale was the remaining major control instrument at its disposal. If materialised in accordance with the February 1988 Report, the

⁵²See "Zhao Ziyang Approving Guangdong's Two Petition Reports", October 6, 1987, in *Ibid.*, (1986-1987), Part II, p.374.

⁵³See "State Council Approving Guangdong's Petition on Further Opening and Speeding up Economic Development", February 10, 1988, in *Ibid.*, p.438.

⁵⁴In the situation where a provincial government could approve projects of under 30 million yuan, an industrial project of a total investment scale of, for instance, of 40 million yuan could be broken down into two projects each of 20 million yuan, so that the provincial government could approve the project(s) independently without submitting the project to the State Planning Commission for approval. This has been the most extensively used, and successful, method of provincial governments to expand their *de facto* authority on investments *vis-a-vis* their superiors. Respondents Nos. 31, and 35, Beijing interviews, November 1993 and August 1994 respectively.

replacement of central control figures by provincial-devised control would effectively eliminate this last major tool of central control over local investment in Guangdong.

This control instrument had, however, for some time been less than effective. As noted in Chapter Three the norm throughout the 1980s was for the central control figures to be substantially exceeded. As a control instrument therefore it was no more than a "tiger without teeth" and depended heavily on the voluntary compliance by provincial governments for its effectiveness. During times of "crisis", such as during the 1989-91 retrenchment, when the Centre sought to tighten control, provinces were more likely to abide by control figures than during "normal" years when economic development was the major theme, and the central government itself was not overly concerned with the implementation of control figures.⁵⁵ In general, therefore, the relevance of control figures in terms of amounts actually invested had receded significantly. In early 1993, for instance, the control figures handed down from the State Planning Commission to Guangdong were *not* passed down to the subprovincial levels for implementation as they should have been according to central government regulations. The control figures were simply filed away at the provincial level.⁵⁶

Therefore, although since 1988 Guangdong had not again sought to materialize the approved autonomy through which to set the local investment scale, this should not be interpreted as a sign of weakness on the part of the province. The lack of attention to pursue this authority reflects the recognition by the provincial leadership of the obsolescence of the investment scale control as a control instrument.⁵⁷ In fact many planning officials at the central government

⁵⁵The fact that the problem of investment control is a part central and part provincial issue is discussed at length in Chapter Two.

⁵⁶Respondent No.9, Guangzhou Interview, September 1993. Early in 1988 it became clear that Guangdong's implementation of the central control figures had been half-hearted. In an article on Guangdong's investment in 1989, it was revealed that although the Centre had, since 1988, included investments by individuals within the non-state sector in the coverage of the investment scale control figure, that part of the plan had not been implemented by authorities in Guangdong. The control figures of this part of investment simply stayed in the files of Guangdong's planning departments. See Sun Jian, "A Report on Guangdong's Efforts to Contain Its Investment Scale", *China Investment and Construction*, No.8 (1989), pp.17-18. Therefore that which had occurred in 1993 merely followed on from the practice which had come to light in 1988.

⁵⁷A senior research official at the Guangdong Provincial Planning Commission wrote in an article published in 1992 that it was futile to attempt to contain the total volume (scale) of investment activities by administratively setting an overall control figure. He argued that the root of the two waves of investment expansion in Guangdong in 1984/1985 and 1988 was the oversupply of bank loans at the national level. Since money supply was the jurisdiction of the central government, he implied that ultimately the central government was to blame for "overheated" investment activities. See Guangdong Provincial Planning Commission Research Institute, "The Plan and the Market in the Investment Scene of Guangdong", in State Planning Commission (ed.), *Zhongguo Jingji Tiaojie*

would appear also to have recognized this. When the central government reviewed the administration system of fixed asset investment in the early 1990s, the continued utility of the control figures was cast into serious doubt. In the reform proposals of 1994, it was envisaged that the use of the central control figures on investment scale would have to be gradually phased out.⁵⁸

Foreign Investment

Similar developments occurred regarding foreign investment, when the Guangdong government demanded progressively more authority to approve foreign investments and, eventually, the autonomy to determine the total scale of foreign investment, including loans. Moreover, the Guangdong leadership had, at a very early stage, started to push for a wider usage of foreign investment, being cognizant of the potential use of such an important source of investment funding. The scope of use of foreign capital is discussed in a later section of this chapter.

As seen in Chapter Three, Guangzhou's, (and therefore Guangdong's) jurisdiction was raised to US\$10 million in October 1984. The authority was expanded to US\$30 million in October 1987. The rise to US\$10 million in 1984 was the result of lobbying by Guangzhou officials with Gu Mu during a briefing session in June 1984. Guangzhou's jurisdiction had originally been set at US\$5 million at the time when the city was made one of the fourteen open coastal cities in April 1984. However, as Guangzhou, and the Guangdong provincial government, had been operating at that level of authority since 1982, Guangdong's officials protested at this lack of improvement to Gu Mu, and obtained his support.⁵⁹

de Lilun he Shijian (The Theory and the Practice of Economic Adjustment in China) (Beijing: People's University of China Press, 1992), p.72.

⁵⁸For a description of the proposed reform measures, see an article by the vice-director of the State Planning Commission, Yao Zhenyan, "Build Up an Investment Finance System Commensurate with the Socialist Market Economy", *China Investment and Construction*, No.1 (1994), pp.5-10. In an interview with an informed source of the Commission, it was revealed that some central officials still favoured the retention, if only for a transitional period, of the old system. One type of lingering was more psychological: due to the inertia of past practices. The other type saw the continued usefulness of administrative controls during the transitional period. Since enterprises were still less than independent investors, and the local governments could still lay their hands on investment decisions, the existence of administrative controls such as the investment scale control figures could still exert some kind of control. Therefore control figures would only be gradually phased out. Respondent No.31, Beijing interview, February 1994.

⁵⁹A senior official of the Guangzhou city government, Li Jianan, made the point that prior to Guangzhou being made one of the open coastal cities its authority on foreign investment already stood at US\$5 million. The open coastal city status appeared, therefore, to mean little to Guangzhou in regard to a higher investment authority. Gu Mu commented that they had reason on their side. See "Gu Mu's Response on Hearing the Briefing by Guangzhou and Zhangjiang City Officials", June 9, 1984, in *Centre's Instructions to Guangdong, 1983-1985*, p.168.

Guangdong had just cause to protest. According to the original decision on the fourteen open coastal cities, Shanghai and Tianjian would have the authority to approve foreign investment under the US\$30 million ceiling, and Dalian for those of under US\$10 million. Guangzhou had since 1982 had the authority to approve foreign projects under US\$5 million as had Shanghai and Tianjian, whilst other provincial governments could approve projects of under US\$3 million only. Guangzhou was, however, grouped together with the other eleven cities with an authority of US\$ 5 million.⁶⁰ In other words, all thirteen open coastal cities other than Guangzhou had improved their situation and obtained an expanded authority. From the point of view of Guangdong officials, if the intention behind the establishment of open coastal cities was to encourage faster economic expansion by delegating more foreign investment and related authority, then Guangzhou should not be restricted in this way. This was probably this logic which prevailed upon Gu Mu to respond positively to Guangzhou's petition.

In October 1987, when the central government was preparing to launch another wave of reform with the convening of the thirteenth Party Congress, Guangdong submitted a petition for further power and autonomy over, amongst other things, foreign investment. Although in the end not all the requests of Guangdong were approved, the approval authority of the province was nevertheless raised to US\$30 million whilst for projects in the energy and transport sectors, which did not require assistance from the state for materials or foreign exchange, Guangdong had total authority regardless of the value of investment.

It is revealing to look in some detail at the back and forth process through which Guangdong's leadership bargained for the best possible deal. There were four rounds of events in this process, which lasted from October 12, 1987 to February 10, 1988.

First, on October 12, 1987, the Guangdong leadership submitted a petition report to the Party Centre and State Council. As already noted in the previous discussion on the fiscal policy earlier in this chapter, the report was primarily a high-sounding policy statement asking for wider powers and more favourable policies for Guangdong. As regards foreign investment, the report asked, rather

⁶⁰See "Central Committee and State Council's Notice on Approving the Notes of Meeting of the Panel Discussion of Some Coastal Cities, April 30, 1984", May 4, 1984, printed in State Economic Commission (ed.), *Zhongguo Jingji Guanli Zhengce Faling Xuanbian, July 1983 - June 1984* (A Collection of Policies and Regulations on China's Economic Management, July 1983-June 1984) (Beijing: Jingji Kexue chubanshe, 1985), p.61.

aggressively, for the scrapping of the Centre's control over the absolute amount of foreign loans which the province could borrow in any one year, and the autonomy to devise its scale of foreign loans independently. The report also requested that Guangdong be allowed to approve foreign investment projects regardless of their investment value as long as 70% of their output were for export.⁶¹

The Guangdong government was actually asking for nearly complete autonomy to decide on how much foreign investment, including loans, it should use, and which specific projects it should approve. The demand for the abolition of central control on the total scale of foreign capital was in line with similar requests regarding domestic fixed asset investment, as discussed in the previous section. This was, however, deemed too radical by the central leadership. Consequently, although the response from the Centre on the report was generally positive, the extra powers granted regarding foreign investment were very limited compared to Guangdong's original demands.

The second event was the central government's response to Guangdong's demands. On October 23, 1987, the Central Finance and Economy Leading Group rejected Guangdong's request for the abolition of central control over the total scale of foreign capital used every year. The province would instead continue the practice of submitting annual foreign loan plans to the State Planning Commission for approval. But Guangdong did not go empty-handed. The ceiling for 1988, 1989, and 1990 was raised from the original level of around US\$300million per year, to US\$500 million, US\$700 million and US\$900 million respectively. In other words Guangdong more than doubled its quotas of foreign loans for the next three years.

Guangdong's request to approve independently export-oriented foreign projects regardless of investment value was also turned down. Instead, Guangdong's approval authority on foreign investment *across the board* was raised three-fold from the pre-existing US\$10 million ceiling to US\$30 million.⁶² The rationale of the central government's decision on Guangdong's request was revealed in Zhao Ziyang's meeting with Guangdong's senior leaders on October 26, 1987. Zhao commented that as the use of foreign capital in Guangdong would affect the national balance of foreign exchange reserves, for which the Centre would be

⁶¹See Guangdong Provincial Party Committee and Provincial Government, "Proposals on Fully Utilizing the Current Opportunities to Speed up Economic Development" October 12, 1987, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, p.374.

⁶²See "Central Finance and Economy Leading Group on Guangdong's October 12 Report" October 27, 1987, in *Ibid.*, p.388.

ultimately responsible, it could not, therefore, relinquish control. However, with regard to central control on a total scale, the jurisdiction of Guangdong on specific projects could be enhanced.⁶³

However, in comparison with that which Guangdong had originally requested, what the central government, via the Central Finance and Economy Leading Group, actually agreed to was much less impressive. The meeting with Zhao and other central leaders on October 26 therefore gave the Guangdong officials a chance to get back some of their "lost lands", the third event in this series of development. Consequently, when the decision of the Central Finance and Economy Leading Group, arrived on October 23th, was printed out on October 27th, it included a post-meeting note recording a new directive from the State Council in the aftermath of the October 26 meeting between Zhao and Guangdong's leaders.⁶⁴ The addition was that a further policy document would have to be drafted on the development strategy and mission of Guangdong and on the necessary measures required. This formed the background for another round of lobbying for more favourable policies *beyond* that which had been decided by the Central Finance and Economy Leading Group.⁶⁵

According to the central directive arising from Zhao's meeting with Guangdong's leaders, the drafting of the policy document on Guangdong's developmental strategy and mission was supposedly "to be co-ordinated by the Special Economic Zone Office, State Council, and the State Commission for Economic System Reform, with other relevant departments".⁶⁶ However, it was eventually drafted by the Guangdong provincial government alone. The report subsequently submitted to the State Council on January 7, 1988 included requests for more favourable policies and enlarged jurisdiction in ten policy areas. The report was, therefore, an expanded and elaborate version of the October 12 petition. More importantly, while taking heed of the Centre's clear objections, for instance concerning the abolition of control figures on foreign capital, many other specific policy demands transgressed the boundaries already laid down by the Central Finance and Economy Leading Group.

⁶³See "Zhao Ziyang talking about Guangdong becoming the experimental zone for comprehensive reform" October 26, 1987, in *Ibid.*, p.385.

⁶⁴*Ibid.*, p.389.

⁶⁵The Central Finance and Economy Leading Group meeting was chaired by Zhang Jingfu, State Councillor, under the *general* instruction of Zhao. Zhao himself was not directly involved in the detailed decisions of the Group. There was therefore still room for manoeuvre for the Guangdong leadership.

⁶⁶As footnote 64.

The attitude of the central government towards overall scale control was clear and adamant. Zhao himself had made clear to Guangdong officials at the October 26 meeting that the Centre would continue to keep control over the total scale of foreign loans. However the Centre was more flexible on the issue of Guangdong's approval authority of individual foreign investment projects. It was, in fact, Zhao that stated in the same meeting that whilst the Centre controlled the total scale, Guangdong could be allowed to decide on the specifics.

As a result in the 1988 report the Guangdong leadership included again a request for unlimited approval jurisdiction for export-oriented projects. To make the request *look* different from the earlier one which had been rejected by the Central Finance and Economy Leading Group, the energy and transport sectors, as well as import substitution projects, were added to the list of eligible projects for unlimited jurisdiction. In effect, this expanded the coverage of the original request. As regards other projects, Guangdong requested a jurisdiction of under US\$30 million--- in line with what the Central Leading Group had prescribed.⁶⁷

The report was approved in February. Thus by testing the waters and quickly identifying both "die-hard" and "flexible" areas, the Guangdong leadership was able to obtain the best possible policies and to expand its latitude to the outermost boundary despite the constraints and "taboos" of the Centre.

Fight For Central Direct Support

The second category of discretionary behaviour with similar proximity to and reliance on the Centre is the struggle for central direct support in Guangdong's investment. This category differs from that of bargaining for more favourable central policies in that it is concerned with getting a *direct* central injection of capital and resources, often under the auspices of the traditional system of investment activity, whilst preferential policies can be described as *indirect* central support. Fighting for direct central support has been the traditional behaviour under the central planning system, when most resources for investment have come directly from the central government and the Centre has been responsible for the planning and approval of most investment projects. Although its significance has receded greatly in the 1980s relative to earlier decades, this type of behaviour has often recurred, and has, as will be shown, played an important part in interaction

⁶⁷See Guangdong Provincial Government, "Proposals on Deepening Guangdong's Reforms, Expanding the Opening to the World, and Speeding up Economic Development" January 7, 1988, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, pp.431-32.

with other categories of discretionary behaviour to produce the greatest benefit for the province.

Asking for direct central support has been a frequent occurrence in the interactions between Guangdong officials and central leaders, particularly in the earlier years of opening and reform. As from the very first petition for more favourable policies as included in the June 1979 Report, and in practically all subsequent encounters with central leaders, the Guangdong leadership has persistently reminded the Centre that its past neglect has resulted in Guangdong being seriously short of infrastructure and other investment badly needed for the success of the reform experiment. The last part of the June 1979 Report, for instance, consisted of a checklist of investment projects requiring central support; for instance, electricity stations at Shaojiao and Maoming and the double-tracking of railroad between Hengyang in Hunan and Guangzhou, etc.⁶⁸ From 1979 to 1980 alone Guangdong succeeded in obtaining central endorsement to provide direct support, either in the form of direct investment or through the provision of materials or favourable financing policies, on the following projects: power stations at Shaojiao and Maoming, the double-tracking of Hengyang-Guangzhou railroad, power station equipment from Romania, a nuclear power station and the construction of power stations in southwest China for transmission of electricity to Guangdong.⁶⁹

The desire for direct central support in investment amongst Guangdong's leadership is reflected in the comments of central leaders who were the targets of intensive lobbying activities. In the Central Committee meeting on Guangdong's work in September 1980, Zhao Ziyang urged Guangdong's senior officials to take a longer term view and to devise a long term plan for economic development. "On this point Guangdong has to change its attitude too. Do not come to Beijing on every minor issue. The Centre has only a limited amount to offer and cannot help much. It is more worthwhile to rely on one's own efforts."⁷⁰ Gu Mu at the same

⁶⁸See "Report by the Guangdong Provincial Party on Utilizing Guangdong's Favourable Conditions, Expanding External Trade, and Speeding up Economic Development" June 6, 1979, in *Ibid.* (1979-1982), p.29.

⁶⁹The Shaojiao and Maoming power stations were endorsed after the June 1979 Report. The double-tracking of railroad was proposed in the June 1979 Report, and endorsed after a further meeting in March 1980, approved via the Central Committee Notice No.41 (1980), May 16, 1980. The Romanian equipment was apparently planned well in advance, and the Guangdong officials asked for prompt implementation in a meeting with Central Committee members in September 1980, when they were assured by Gu Mu that Guangdong would not have to pay a cent for the equipment. The nuclear power station (completed in Daya Bay in 1994) would be financed by Guangdong itself, but only after the Centre had already negotiated favourable terms from the French equipment supplier. See *Centre's Instructions to Guangdong, 1979-1982*, pp. 60-72, 96, 100, 126.

⁷⁰*Ibid.*, p.99.

forum commented that in his previous two meetings with Guangzhou officials, "They were always talking about the need for more funds from the Centre, or complaining about their contradictions with their superiors at the provincial government; they scarcely talked at all about how to make use of their own favourable conditions."⁷¹

It should be noted that due to its tight financial situation the central government did not materialize all the projects for which Guangdong had won central support.⁷² However, having a pledge entitled Guangdong to bargain for other "goodies" as some sort of "compensation" and many favourable policies were subsequently obtained in this manner. For instance, the central endorsement for using foreign capital on infrastructural development, collecting tolls to finance the construction of highways and bridges, and the rise in rail freight fare to finance railway developments, all of which had far-reaching significance for investment growth in Guangdong, were among the examples.⁷³ Another example was the expansion of Guangdong's project approval authority, which allowed Guangdong to invest more freely in energy and transport projects, which had traditionally been planned and financed by the Centre, as discussed earlier in this chapter. A popular statement often used by central leaders in the early 1980s regarding their response to provincial lobbying for support was: "ask for money, no, sorry; ask for policies, take a few."⁷⁴ This vividly reflects the situation whereby favourable policies were granted as compensation for aborted promises of direct support. The importance of this provincial discretionary behaviour of getting more direct central support, therefore, has to be understood as extending far beyond its direct effect on the amount of direct resources it actually achieved.

Direct central support can take various forms. The most obvious form is central investment projects and central participation in central-provincial "joint venture" projects. The amount of central fund injection is difficult to ascertain,

⁷¹Ibid., p.105.

⁷²The "softness", or unreliability, of central pledges of support was revealed in this comment of Zhao Ziyang made in August 1981, the mid-point of the 1980-82 economic adjustment, "... the several power stations already mentioned (in the July 1979 Central Committee Document approving Guangdong's June 1979 Report on the Special Policy) could be undertaken by the Centre, but there is always a precondition to this undertaking. Given the current national economic situation, we can only talk about to what extent the Centre will be responsible for these projects." See *Centre's Instructions to Guangdong, 1979-1982*, p.214.

⁷³Ibid., pp. 47, 51, 64, 214.

⁷⁴Gu Mu uttered this phrase frequently in his conversations and meetings with Guangdong officials. See for instance Ibid., p.114 (December 1980), p.385 (September 1982).

given the lack of statistical information of central investment by province.⁷⁵ In an article by officials from the Guangdong Provincial Party Committee Secretariat, the cumulative central investment in Guangdong's electricity, roads and bridges, and telecommunications sectors amounted to 0.58 billion yuan, only 2.2% of the total investment actually carried out in these sectors in Guangdong.⁷⁶ However, this refers only to central investment within the state plan. Alongside this there was another group of central investment activity by the various central ministries in Guangdong which was not within the investment plan of the State Planning Commission, the so-called "outside plan" projects. And as the economy of Guangdong developed the province became a still stronger magnet of investment.⁷⁷ A gross estimation by a Guangdong source put the share of central investment by source of capital in the total societal investment from 1980 to 1991 at 15%.⁷⁸ How this percentage was arrived at, however, was nowhere elaborated and so remained unclear.⁷⁹

Table 3.11 of Chapter Three gives the percentage of central and local investment by administration subordination in Guangdong. This could serve as a rough estimate of the amount of direct central support Guangdong has succeeded in attracting. The percentage of central investment by subordination from 1984 to 1992 was about 18%, and Table 3.13 of Chapter Three shows that Guangdong has invested a not insignificant amount in central projects, probably as a result of bargaining with the central government to "fish" for central investment.

"Mutual fishing" was the strategy taken by both the central and provincial governments as a means of attracting the capital of the other party to projects in one's own interests. For the provinces seeking to attract large-scale central

⁷⁵There is no readily available information on this aspect as central investment projects or central-local joint ventures, normally large-scale projects listed under the State Planning Commission annual investment plan, are listed by projects. As these are usually infrastructure projects, more than one province is usually covered, either geographically or as benefactors. It would not be easy to disaggregate the total central investment by area. Respondent No.36, Beijing interview, April 1994. It should be noted that "central investment" here refers to the amount of capital the Centre invested in investment projects in Guangdong.

⁷⁶See Guangdong Provincial Party Committee (ed.), *A Record of Insights of Opening and Reforms in Guangdong*, p.57.

⁷⁷Both officials in Guangdong and in Beijing commented that Guangdong had been a strong magnet attracting investment from central ministries and other provinces, including poor provinces short of capital. This "magnetic power" became stronger each year. Interviews with Guangdong Provincial Planning Commission official, December 1993, and with officials from the Finance Ministry and State Planning Commission, April 1994.

⁷⁸See *People's Daily* August 8, 1992, p.1. Another percentage, 16%, appeared in an article by the Guangdong Provincial Planning Commission, "The Plan and the Market in the Investment Scene of Guangdong", p.70.

⁷⁹The coverage of the 15% was unclear even to an informed source in Guangdong. Respondent No.9, telephone interview, April 1994.

investment projects, the willingness to shoulder part of the cost enhanced the possibility of success, given the tight financial situation of the central government. On the other hand, the central government liked to encourage provincial governments to invest more in infrastructure facilities, thereby easing the "bottleneck" situation, by itself providing part of the funds or other necessary resources for the projects. As the financial strength of the provincial governments grew stronger and that of the Centre relatively weaker, there was an increasing occurrence of "central-provincial joint ventures", some of which might involve several provinces.

The expansion of the Shantou airport was one incidence of central-provincial "mutual fishing" in Guangdong. The following quote from Zhao Ziyang speaking to Shantou's officials in 1986 reveals the dynamics of this practice:

*"I think the (Aviation Bureau) might be unable to allocate that much money for the project in a year, because they have made promises to many similar projects nationwide. If the costs of all these projects are added together, they simply do not have enough funds. Perhaps you should pay the bills first, or you can pay on behalf of the Bureau. ... You promised to shoulder 20 million yuan, and now you say you also have difficulty in raising that amount all at once. How can you then expect the Bureau to raise the promised 40 million yuan all at once? You had better pay your part of the bill first, then I shall telephone Beijing to ask the Bureau to consider whether they can squeeze out any more ..."*⁸⁰

Another example of Centre-Guangdong joint venture investment is the project to build several hydroelectric power stations in southwest China to supply electricity to Guangdong. The project involved the cooperation of four provinces, namely, Guangdong, Guangxi, Yunnan, Guizhou, with the central government. First formally mentioned in Central Committee Document No.41 (1980) as a central-provincial joint-investment project, formal agreement was reached in June 1988, with construction planned to commence as from April 1991. Total investment up to the year 2000 was projected to exceed 20 billion yuan. In some major parts of the project Guangdong's contribution in terms of investment capital reached a level of 50%-70%, an exceptionally high percentage to be shouldered by a province in a central-provincial joint project.⁸¹

Another form of direct central support was the injection of fiscal transfer funds to pay for specific social and economic needs, such as anti-poverty funds for

⁸⁰"Zhao Ziyang Speaking When Hearing the Briefing on Shantou's Work" February 2-5, 1986, in *Centre's Instructions to Guangdong, 1986-1987*, Part I, p.28.

⁸¹ This was the first ever joint investment by more than one province for the development of electricity in China. See *Nanfang Ribao*, December 29, 1993, p.2.

poor counties and villages, subsidies for natural disasters and various price subsidies. Some of the anti-poverty funds would end up being used for the financing of investment projects in the poor areas. While natural disaster funds and price subsidies did not have direct bearing on investment, the injection of central subsidy made available the equivalent amount of local resources which could then be channelled into investment projects. The amount of this kind of central fund injection in Guangdong has been reportedly small. When interviewed, Guangdong officials frequently stated that the province had shouldered most of the costs of reform which should, according to the traditional division of responsibility, have been met by the central government, which was still the practice in the case of less well-off provinces.⁸² According to an account quoting source from the Provincial Finance Bureau, central fiscal fund injections of this sort amounted to a total of 2 billion yuan for the period 1980-88, which is equivalent to about 3% of the total provincial fiscal revenue for the period.⁸³

Despite the lack of clear and unambiguous data on the exact amount of direct central support in terms of capital finance to Guangdong, the general impression in Beijing amongst planning and finance officials was that, contrary to the picture openly portrayed by Guangdong's officials, Guangdong had in fact fared quite well in attracting investment from the central government ministries. The remarks of a central planning official are revealing:

"In some cases it is the richer localities who can do better in attracting funds and investments than the poorer guys, because those who have money to lend and invest expect a higher and quicker return."⁸⁴

The rapid progression of reform and a strengthened economic force inevitably changed the rules of the game in the scramble for direct central support. Under the traditional system, when the concern of the central government ministries was focused less on economic benefits and more on social stability and resource equalization, a commonly used tactic for attracting central funding was "crying wolf", thus exaggerating crises. Poorer areas may then have had an edge over those more well-off. However, whilst the traditional tactics of exaggerating

⁸²Officials from the Guangdong Provincial Party Committee Secretariat wrote that the reform measures such as reductions in revenue and increases in expenditure engineered by the Centre since 1980 had cost the provincial coffers about 13 billion, an average of 1.3 billion per year. According to the traditional fiscal system these should have been borne by the Centre. See Guangdong Provincial Party Committee (ed.) *A Record of Insights of Opening and Reforms in Guangdong*, p.59.

⁸³See Leung Kwaichuen et al., *The Track of Rising Economy: A Sample Analysis of Guangdong's Economic Development* (Guangzhou: Guangdong Renmin chubanshe, 1992), p.42.

⁸⁴Respondent No.35, Beijing interview, 1994.

one's difficulties continued to be used, the central government started to shift its emphasis from even development and equalization of wealth to speeding up the pace of development, and central ministries became more like profit/cost centres seeking to maximise returns on investment. Exaggerating one's difficulties, therefore, had to be combined with the prospect of high potential return in order to be effective in attracting investment. Consequently, as the economy of Guangdong blossomed, the province became a strong magnet for investment capital as units nationwide were anxious to come to the province to make money.

The mechanics of attracting central investment also altered as the economy changed its tack, albeit gradually, from the traditional central planning system to the market economy. Under the traditional system resources were distributed via administrative channels, and this gave the central government, which by definition was at a superior level in the administrative hierarchy, a commanding position in the allocation of investment funding. The provinces seeking to attract central investment resources were thus situated at a subordinate footing, reduced to asking for favours from the relevant central ministries. However, under the emerging market economy, economic calculation entered the equation in the allocation of investment resources. Fast-growing provinces like Guangdong, therefore, had a much more improved position as now the previous "central boss" had become more like a co-partner in economic development.

The Guangdong government in the 1980s was in fact very keen to attract investment from the central ministries and other provinces.⁸⁵ Its motive was two-fold, being political as well as economic. From the economic point of view, attracting external investment helped Guangdong to enlarge its investment capital and thus expand the size of the economy. This was the economic motive. However, since capital supply had improved substantially since the early 1980s, this motive became less of a survival significance and was, therefore, much less imminent in the minds of Guangdong officials. The political motive, however, had gradually born fruit. Investment from central ministries and other provinces was welcome as part of the effort to cultivate nationwide support for Guangdong. In attracting central ministries and other provinces to Guangdong to invest in a share of its economic growth, the Guangdong government sought to defuse misgivings and cultivate support. By sharing the *prospect of economic growth* with its potential "enemies", Guangdong thus sought to turn them into partners and supporters.

⁸⁵Information in this paragraph is the view of Respondent No.9, Guangzhou Interview, December 1993.

Guangdong was, of course, in an advantageous position as regards attracting investment from the central ministries. On the one hand, there was the economic "pull" effect as discussed above. Central ministries came to invest because they felt that a good profit could be made in Guangdong. Funding channels for these central investment projects would, therefore, include budgetary allocation, bank loans (using quotas of the investing ministries), the "own funds" of the ministries, usually in form of various specialized funds, and capital from the six specialized investment companies set up in 1988.⁸⁶ Since Guangdong had also become much richer over the 1980s than many other provinces, it therefore had more resources at its disposal with which to "fish" central investment.

Another edge which Guangdong had was the "liberal" attitude of its officials towards the "fishing" of central investment. In the words of a Guangdong official, "some provinces, especially the inland provinces, are still endowed with the mentality of the central planning system, and regard central investment purely as the administrative appropriation of funds. They are therefore not prepared to accept that if they want central investment nowadays, they themselves need to offer something in return, either in the form of potential profits from the projects, or by the provinces sharing the investment capital and the cost of the project, or both. Guangdong has long recognized this as working in a similar way to a joint-venture business. Both parties (Guangdong and the central ministry) have to bear some of the costs, with both sharing the benefits."⁸⁷ Guangdong's more liberal attitude to "fishing" is, however, obviously linked to its relatively superior economic strength. The interactive and mutually reinforcing relationship between economic situation and subjective attitudes of Guangdong officials has together resulted in Guangdong's relative success in gaining central investment.

A further form of direct central support of resources was the provision of bank finance. There are no complete statistics on exactly how much financial support the Centre has given to Guangdong's investment via the banking system. An account by officials from the Guangdong Planning Commission, Industry Division, put support in the form of central bank loans to cover the shortfall of deposit-loan balance between 1980-1988 at some 26.6 billion yuan.⁸⁸ After deducting the transfer to the Centre of various bank funds, including deposit

⁸⁶Ibid.

⁸⁷Ibid.

⁸⁸See Yao Dinghai and Zeng Shunming, "An Analysis of the Scale and Structure of Guangdong's Bank Loans", *Jihua Yu Fazhan*, No.6 (1989), pp.52-54.

liquidity provision, and the "compulsory" purchase of central bonds of about 13.4 billion yuan, the net injection of central money into the banking system from 1980 to 1988 amounted to 13.2 billion yuan. Since the interest rate of the central bank loans was very low, and much of the bank loans lent out from Guangdong's banks were used for investment purposes, this amounted to a fairly substantial central subsidy of Guangdong's investment capital.⁸⁹

Guangdong officials were therefore keen to obtain central loans via the financial system. For instance, when Zhao Ziyang, Hu Qili and Tian Jiyun visited Shantou in February 1986, officials from Shantou lobbied the Centre to increase the flow of central bank loans to Shantou's banks and to waive the 10% remittance from Shantou's total bank deposits to the central bank. In response, Zhao revealed that the total value of cash circulation in Guangdong already amounted to one-third of the national total, and that money had been diverted by Guangdong from inland provinces such as Xinjiang, Inner Mongolia and Gansu.⁹⁰ In other words, Guangdong had been using part of the deposit resources of the inland provinces, via the central bank, to make up the shortfall of its own deposits to satisfy the demand for bank finance emanating from investment activities. Despite the fact that Guangdong's deposit-loan balance had been "in the black" since 1991, the Guangdong government nevertheless continued to bargain with the Centre and to succeed in obtaining central bank loans amounting to some 1 billion yuan per year. The major reason for this as put forward by Guangdong officials is that so long as the Centre requires Guangdong's banks to lend out "policy loans" as prescribed in the annual bank finance plan, the Centre should provide some form of compensatory subsidy via cheap central loans.⁹¹

Sometimes the aim of winning central funds was attained the other way round: by remitting less to the Centre. For instance, apart from the annual fiscal contractual remittance, part of the profits of those provincial departments which had traditionally been managed by the central ministries had to be remitted to the central ministries. In 1983, however, Guangdong officials persuaded visiting

⁸⁹This interpretation was confirmed with the respondent from the Guangdong Planning Commission, Guangzhou Interview, December 1993. He commented that it was difficult to ascertain the full extent of central support in this manner as it was supplied in a somewhat obscure fashion.

⁹⁰See "Zhao Ziyang, Hu Qili and Tian Jiyun Speaking When Receiving Officials of Shantou", February 5, 1986, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, p.44. The Centre finally agreed to their requests and exempted banks in Shantou, Zhuhai and Xiamen from remitting the 10% deposit contingency allowance to the Centre. This part of resources was instead retained by the local branch of the People's Bank of China for local use. See "Notes of Meeting of the 1987 Work Conference of the Special Economic Zones", February 10, 1987, in *Ibid.*, p.297.

⁹¹Respondent No.8, Guangzhou interview, December 1993.

central leader Gu Mu to do away the annual remittance of 2 million yuan to the Telecommunication Ministry so that the province and the special economic zones could have more funds for economic construction. They won Gu Mu's support.⁹²

Flexible Implementation of Central Policies

A category of discretionary behaviour which exhibited both central dependency and provincial independence, and for which the Guangdong government has become famous for during the 1980s, is flexible implementation of central policies. The targeted group of policies might be those central policies for which the province had bargained hard, or those of the "traditional" policies which the province had still to tolerate. Whether it be the former or the latter, flexible manoeuvres were necessary in order to mould the policies laid down to suit the changing needs of investment in the province.

Shaping a New Reform Policy

One example of the need to modify via implementation discretion central policies, the formulation of which the province had played a part, is the establishment of Special Economic Zones. The idea of establishing Special Economic Zones to speed up foreign investment and economic development was first suggested by the Guangdong provincial leadership to the Centre in the Central Work Conference of April 1979.⁹³ The establishment of "special export zones" initially in Shenzhen and Zhuhai, extended later to Shantou and Xiamen, was endorsed by the Centre in July 1979. In the next Central Document (*zhongfa*) on the work of Guangdong and Fujian in May 1980, it was clearly stated that the primary and major purpose of the Special Economic Zones, as so renamed, was to attract foreign investment. The influx of investment from inland provinces and the central ministries was to be strictly controlled. Prior approval also had to be obtained for domestic units from outside Shenzhen seeking to set up companies, including joint ventures with foreign investors.⁹⁴

⁹²See "Gu Mu speaking when inspecting the Shenzhen Special Economic Zone" April 7-18, 1983, in *Centre's Instructions to Guangdong, 1986-1987.*, Part II, p.540.

⁹³See Liu Zhongxiu (ed.), *Thoughts on Shenzhen by 100 Scholars*, p.162.

⁹⁴See Central Committee Document No. 41 (1980), May 16, 1980, "Approving the Notes of Meeting on Guangdong and Fujian, March 30, 1980". In a Central Committee Document (No.17) issued in March 1, 1983, it was ordered that *all* unauthorized temporary or permanent offices/companies set up by central ministries and other provinces in Guangdong and Fujian, including those in the special economic zones, had to be moved out. See *Centre's Instructions to Guangdong, 1979-1982*, p.310. The context of the order was ostensibly to curb the smuggling and speculative trading activities in Guangdong, but it actually reflected the lack of concern of the central leaders of the possible role of domestic investment in the Special Economic Zones.

As soon as the construction of the zones took off, the tight restriction on the influx of domestic companies and capital became a clearly unrealistic and detrimental measure. Not only did the construction of the city's infrastructure desperately require investment from nationwide units, given the tight supply of finance from the state budget, but the attraction of foreign investment would also require the presence of a considerable number of domestic investors to act as partners in the joint ventures. In any event the initial five years saw domestic capital from all over the country playing a dominant part in the largest special economic zone, Shenzhen. By 1985, the use of foreign capital had accounted for under 20% of the cumulative total fixed asset investment in Shenzhen. On the other hand, domestic bank loans, "own funds" of enterprises and their superordinate units accounted for over 40%.⁹⁵

When Gu Mu commented on the declining share of foreign capital in the investment activities in Shenzhen in January 1986, he was neither pleased nor undisturbed.⁹⁶ However, the utilization of extra-budgetary capital from all over the country and the participation of a multitude of domestic units nationwide was eventually acknowledged as a major success factor in Shenzhen's development. Domestic investment and participation, in the absence of strong support from the state budget, enabled Shenzhen to develop and to overcome problems such as shortage of expertise and personnel in developing what had originally been a piece of rural land.⁹⁷

By 1989, 46 central ministries and 29 provinces had earmarked their "piece" in Shenzhen, and 6000 contracts were signed. 3900 enterprises were established with these central and provincial units, and this did not include the foreign joint ventures of which these units were partners. Realized capital injection amounted to 3 billion yuan. This "domestic" sector compared not unfavourably with the foreign sector, which in 1989 consisted of just under 2600 foreign-invested enterprises, with a total realized capital injection of US\$ 2.7 billion.⁹⁸

⁹⁵See Pei Guanzhong, *Finance and Banking* (Beijing: Haiyang chubanshe, 1990), p.3, quoting source from the *Shenzhen Special Economic Zone Daily*, December 1985.

⁹⁶Gu Mu's comments came in the context of a nationwide economic retrenchment which started in 1985, whilst investment in Shenzhen continued to grow by 141% in 1985. The share of foreign capital in total investment in the zone decreased from 42% in 1980, to only 13% in 1985. (1981: 50%, 1982: 32%; 1983: 25%; 1984: 16%), while the share of bank loans increased year by year to 44% in 1985. See "Gu Mu's speech in the Special Economic Zones Meeting", January 5, 1986, in *Centre's Instructions to Guangdong, 1986-1987*, Part I, p.16.

⁹⁷See for instance Liu Zhongxiu (ed.), *Thoughts on Shenzhen by 100 Scholars*, p.139.

⁹⁸See Huang Haichao et al., *The Realization of Dreams*, p.127.

What had taken place was a reversal of the original policy of restricting domestic investment and participation to one of enthusiastic attraction. This was possible because from the very beginning the original policy had been tentatively set and both the central and Guangdong governments had no clear idea of how to develop the special economic zones effectively. This is substantiated by Gu Mu's comments on the March 1980 meeting with Guangdong and Fujian officials, as quoted below:

"As far as the method of developing the special economic zones, and what the zones should look like in due course is concerned, we did not specify either in detail in (the July 1979 Central Committee Notice No. 50). Comrades from Guangdong did write a few outlines, about one to two pages long, but we felt they were too abstract. We actually did not know how and what to specify. Therefore we just left it unsaid." ⁹⁹

Neither the central government nor the Guangdong leadership had a firm or clear idea of how to practically progress from the general concept of establishing several special zones. Bearing this in mind, it is understandable that the ostensibly clearly worded policy on restricting domestic investment in the special economic zones should be so easily discarded in practice. As the provincial leadership, together with the leadership of the zones, were in the frontline of policy implementation, they were able to realize at an earlier stage the folly of the earlier design to restrict the role of participation and investment of units nationwide, whilst central leaders were apparently stuck with the earlier preconception for a much longer period.¹⁰⁰ Like all reform measures of the 1980s, the experimental nature of the policy allowed for, and necessitated, a substantial amount of flexibility at the implementation level.¹⁰¹

⁹⁹See "Gu Mu Speaking in the Meeting on the Work of Guangdong and Fujian", March 24, 1980, in *Centre's Instructions to Guangdong, 1979-1982*, p.57.

¹⁰⁰In a report to the Centre in October 1982 the Guangdong leadership pointed out that experience had proved the importance of soliciting the participation of the whole province and the entire country in the construction and development of the special economic zones. Although the overall direction of development should be externally oriented, with the attraction of foreign investment being the primary immediate objective of the zones, the participation of domestic units nationwide was necessary to solve practical difficulties such as the lack of capital, personnel and equipment in the zones, as well as to strengthen the ability of the zones in the attraction of foreign investment. See "Guangdong Party Committee, and Guangdong People's Government on the Preliminary Appraisal of the Experiment of the Special Economic Zones", October 22, 1982, in *Ibid.*, pp.380, 382.

¹⁰¹Implementation discretion and the interactive relations between policy formulation and implementation is of course a generic phenomenon of the policy process. The extensiveness and magnitude of the occurrence of implementation discretion in China is related to two factors. One is the experimental approach of China's reforms, which made many policies necessarily general, vague and tentative, allowing a lot of room for manoeuvre within the wordings of the policies. The other is the slackness of law/policy enforcement in China. The effect on implementation discretion was that provincial governments could often openly violate the confines of a stated policy, without

Discretion in the Traditional System

China's economic reforms took place within the context of the traditional central planning system. This meant that at any one time, two systemic "streams" were operating simultaneously. The first are the new reform systems which were set up on a tentative, and experimental basis. The other are the pre-existing systems operating under the central planning system of government and economic administration. As has been discussed in the section above, the tentative and experimental nature of the reform policies necessitated and, therefore, allowed ample room for implementation discretions. Meanwhile, the extensive occurrence of discretions and deviations emanating from the traditional policies was immanent in the uneasy co-existence between the old system and the requirements of those which were new and emerging.

The old system, as compared to that of the emerging reform policies, was relatively specific and had a clear purpose and rationale. There was, in other words, a more established and formidable existence of vested interests in the old policy and system. It was thus less easy simply to "muddle through", and change the content of the policy through actual practice than was the case in the new reform measures. Therefore, discretionary behaviour could either be applied within the confines of the policies, or failing that, more efforts would be required to justify the violation of the existing policies. In this section I shall illustrate these two varieties of discretionary behaviour through the discussion of the implementation of three specific policies.

Expanding the Central Control Figure on the Total Investment Scale

As previously discussed, the central control figure on the total investment scale was one of the few major control instruments through which the Centre sought to keep control on investment activities in the provinces.¹⁰² Guangdong's discretionary behaviour towards this central control instrument may be differentiated into three types: (1) seeking its abolition; (2) ignoring it; or (3) seeking to raise the ceiling. An example of the first case occurred in February 1988, as discussed earlier in this chapter. This was the boldest and most

feeling compelled first to amend the policy, no matter how general and vague the amended policy may still be.

¹⁰²The other instruments include control over the total bank finance and over the project approval authority of the provinces.

aggressive type of action as it required a projected calculation of possible central response. It worked in 1988, if only temporarily, and was overturned by subsequent changes in the macro-economic situation and, thus, in central policies.

The other two types had been commonly used as a matter of routine. At times when the policy emphasis of the Centre was on economic growth and was therefore more tolerant towards excesses over the control figures, they would be more or less ignored in the investment administration and planning of the provincial government. On the other hand, at times of economic retrenchment the Centre became more serious about the investment scale of provinces, the provincial government had to act with more prudence. It would have to make more effort towards enlarging the quotas of total investment scale, instead of simply ignoring them.

Table 3.9 of Chapter Three shows clearly that the control figures were, as a rule, substantially exceeded in actual practice, normally by at least 100%. In 1985 actual societal investment reached 18.5 billion yuan, while the central control figure supposedly prescribing the total scale of societal investment for the year stood at only 5.5 billion yuan, less than one-third of the actual amount of investment in practice. This exemplifies the fact that the control figures were, for most of the time, not taken seriously.

During retrenchment years the Centre was more stringent in its attempts to control the total investment scale, as economic retrenchment was itself the normal response of the central leaders to the perceived threat of the economy becoming "over-heated" as a result of over-active investment activity during the previous period. In these years the provinces were under pressure from the Centre in two ways. First, the total scale of investment allowed by the Centre, as expressed in the control figure, would often be considerably reduced. Second, the Centre would be displeased if the control figure was greatly exceeded than it would be in more "normal" years.

The usual response of the provinces during such "crisis" periods was to bargain for a higher control figure from the outset, and when actual investment still exceeded the approved scale, to come up with various excuses through which to escape responsibility. Guangdong, with its active investment scene, was particularly sensitive to any tightening of central control as regards its investment activity.

As briefly noted near the end of Chapter Three, the Guangdong government in 1983 used the *fait accompli* argument in resisting pressure from the Centre to cut its investment, despite the fact that much of the *fait accompli* actually consisted of "outside plan" projects which, in theory, should not have existed in the first place. From late 1980 to 1983 the central government launched an economic adjustment campaign to contain the investment drive set off by the "Western-styled Great Leap", and to restructure investments in preparation for further economic reforms. From the Centre's point of view, "outside-plan" investment in Guangdong and Fujian was excessive and some containment was necessary. This attitude is clearly revealed by Yao Yilin's comments in the course of a meeting on Guangdong and Fujian in February 1982:

"Many economic activities in the two provinces took place outside the state plans....The economic policy of the two provinces need review... There were many "outside plan" investment projects there... The value of "outside plan" investment in the two provinces was 44% of the total "outside plan" investments nationally."¹⁰³

The Guangdong government, however, argued that the Centre had failed to give adequate consideration to the special circumstances of Guangdong, given its assigned role in the economic opening and reform in the country. The total scale of local capital construction investment approved by the Centre for Guangdong for the Sixth Five-Year Plan period (1981-85), which was announced only in February 1983, was less than 2.8 billion yuan. In the end a total of 12.5 billion yuan of local investment was accomplished in the five years, 4.5 times of the scale allowed for by the Centre. The Guangdong government argued that this control figure was totally unrealistic. First, the controlled scale announced in February 1983 did not even allow for the investment already made in 1981 and 1982, at 3.9 billion yuan. Second, a larger investment scale was necessitated by Guangdong's task of pioneering economic reforms. As a result the control figure was adjusted upwards in the subsequent annual planning conferences when the control figure for the coming year was to be decided. Cumulatively the revised central control figure for Guangdong's local investment in the 1981-85 period was 6.3 billion yuan. Guangdong was thus able to enlarge the approved scale by more than double via annual bargaining at the operational level.¹⁰⁴

¹⁰³ See "Yao Yilin's Speech in a Meeting on Guangdong and Fujian", February 13, 1982, in *Centre's Instructions to Guangdong, 1979-1982*, p.287.

¹⁰⁴ See Wang Zhongliang, "The Capital Investment and Macro Management of Guangdong in the Sixth and Seventh Five-Year Plan Periods", in Wang Kunwei (ed.), *Gaige, Kaifang, Fazhan*. (Reform, Opening, Development: A Collection of Essays in the Various Annual Meetings of the Guangdong Planning Society) (Beijing: Zhongguo Jingji chubanshe, 1989), p.82. It should be noted that the above figures, on the control scale as well as actual investment, covered local capital

Apart from bargaining in the annual planning conferences, the Guangdong government persistently lobbied central leaders for their support. For instance, when Gu Mu came to Guangdong to inspect work in December 1983, the Guangdong leadership presented Gu Mu with a development plan for the Pearl River Delta Region. After winning his admiration and endorsement for their achievements and initiatives, they then asked Gu Mu to help to solve a few "specific problems". All these "specific problems" were concerned with obtaining more favourable treatment and less stringent policies towards Guangdong's investment for the coming year, and most necessarily regarding the Centre's control quotas for Guangdong's investment.¹⁰⁵

It may be noted that the value of local capital construction investment finally accomplished for the five years 1981-85 still exceeded the adjusted approved control scale by nearly 100%. By voicing protest at the outset, therefore, Guangdong had psychologically prepared central leaders for the later proven insufficiency of the approved scale. Bargaining activities for a larger investment scale, therefore, served a dual purpose. First, the frontier of central control was pushed back, thus enlarging the room for legitimate local manoeuvre. Second, the bargaining activity prepared the ground for central tolerance of the "illegitimate" provincial implementation that might still have to take place.

The second half of 1989 was the most severe retrenchment year in China in terms of contraction in investment since the commencement of economic reform. Table 3.6 of Chapter Three shows that during that year, the value of total societal investment nationwide dropped by 8% as compared to 1988. In Guangdong, where investments had been growing at a double-digit rate with a high 40% growth in 1988, there was a negative growth of -1.8% in 1989. Control on bank finance was tightened, and the investment control figure for 1989 was drastically cut back from the level of the previous year. In a report in early 1989 by the Director of Guangdong Planning Commission on the provincial economic and social development plan of 1989, it was revealed that the total investment scale approved

construction investment projects only, and were thus considerably smaller than the investment statistics in the statistical yearbooks, which included both central and local investments.

¹⁰⁵See Gu Mu, "On the Planning of the Pearl River Delta Region and the Work of the Special Economic Zones", December 12, 1983, in *Centre's Instructions to Guangdong, 1983-1985*, pp.87-90. The list of specific problems seeking the support of the State Council and the State Planning Commission includes the Centre's quotas of Guangdong's investment not requiring state financial support, the construction of the Shaojiao power station, getting a separate quotas for investments in Hainan, foreign investment, and the construction of a sugar factory. Gu Mu, his attitude sounding supportive, promised to discuss these with Zhao Ziyang and the State Council.

by the Centre for 1989 was 20.5% and 57.8% less than the control figure and provisional estimates of completed investments for 1988, the extent of reduction thus greatly exceeding the original expectation of the provincial government.¹⁰⁶

However, data obtained from the Guangdong Planning Commission, as detailed in Table 3.9 of Chapter Three, shows that the central control figure for 1989 was eventually adjusted upwards to 14 billion yuan, a 42.4% increase from the original level. An informed source in Guangdong confirmed that the Guangdong government had sought to ease the pressure of the tight restrictions by bringing the Centre's attention to the practical difficulties these had caused.¹⁰⁷ *The tactic was to focus on specific projects*, arguing that the severe reduction in the investment scale would cause valuable projects to bog down and good opportunities therefore lost. *Rather than arguing with the Centre on matters of principle, the Guangdong leadership brought up more "mundane" concerns, putting forward specific calculations of costs and benefits.* They thus managed to loosen slightly the tight reins imposed by the Centre, even at a time of "crisis".¹⁰⁸ A quote from an article from the Provincial Planning Commission clearly explicates the line adopted by the Guangdong government:

"In finalising Guangdong's total investment scale for the year earlier this year, the provincial government stated unambiguously the position of the government: The provincial government should plan in accordance with the scale assigned from the State Planning Commission. *Difficulties should be brought to the attention of the Centre for its consideration*, but no

¹⁰⁶See Wong Guiying, "Report on the Preparation of the 1989 National Economic and Social Development Plans of Guangdong Province" (Summary), *Jihua Yu Fazhan*, No.1 (1989), pp.6-12. In the report it was revealed that the Centre had made the central control figure on investment scale a mandatory order. Lending more than the planned total of bank loans was strictly prohibited.

¹⁰⁷Respondent No.9, Guangzhou interview, December 1993. *Zhongguo Jinbao*, October 7, 1989, p.1, contains a report which shows precisely the practical and empirical approach through which the Guangdong government managed to enlarge the approved investment scale. The report was about a glass factory the construction of which was prohibited in February 1989 as a result of the investment stamping exercise. It was argued that stopping the construction would do more harm than good because a total of US\$2 million of imported equipment would stand idle, and compensation would have to be made for previously signed sale contracts. As nearly 5 million yuan in bank loans had already been used, interest therefore had still to be paid even though the project had been halted with no prospect of realized income.

¹⁰⁸The Guangdong leadership openly adopted an understanding and supportive attitude towards the retrenchment, but at the same time kept on raising "practical difficulties" with the Centre. In a speech in the provincial planning meeting in early 1989 Vice-governor Yu Fei stated that "the adjustment and retrenchment policy of the Centre not only suits the needs of our country, the policy is also good for the situation in Guangdong, ... We should take the initiative to adjust our economy, based on Guangdong's local conditions, and should not regard retrenchment as a matter of obeying orders (from the Centre). Moreover, we have to start early and be progressive in our specific actions." See Yu Fei's speech in the provincial planning and economic meeting, 1989, "Restructuring During the Retrenchment; Developing Amidst the Restructuring" (Summary), *Jihua Yu Fazhan*, No.1 (1989), p.2.

(provincial and subprovincial) level should enlarge its investment scale without first obtaining the Centre's approval."¹⁰⁹ (*Italics added*)

The Guangdong leadership was therefore careful not to oppose the central policy of economic retrenchment and adjustment. Its strategy was to emphasize those parts of central policy which better served its purposes. For instance, in a Provincial Party Work Conference in January 1989, the participating officials pointed out two separate requirements of the Centre concerning the policy of economic retrenchment and adjustment. The first was the determination to stamp out runaway investment and to adjust the economy; the second was the determination to continue the externally-oriented economic development strategy of the coastal region.¹¹⁰ In other words, the main purpose of the retrenchment was to clamp down on "unnecessary" and ill-conceived investment projects, saving the resources for "worthwhile" and "necessary" projects. In view of this, one argument the Guangdong government used to counter the Centre's pressure to cut investment was that some investment projects such as those concerned with energy and transport did have good returns and were badly needed by the economy. Such projects should therefore be protected and advanced rather than restricted. In order to promote this argument, Zhao Ziyang's statement that improving the overall economic environment started from adjusting the structure of the economy was quoted conspicuously in the provincial press.¹¹¹ In this way Guangdong could move towards continuing some of its projects by claiming that they contributed to the restructuring of the economy.

Guangdong's leadership was also adamant in asking for "exceptional" and preferential treatment during the 1989 retrenchment. They put forward the fact that, since the tightening policies of late 1988, there had been a decline in foreign trade and investment. Good economic prospects in the province was thus destroyed by overrestrictive policies. The argument was that more flexible policies should be

¹⁰⁹See "Guangdong Province: Implementing the Licensing Management System for Construction Projects" in *Zhongguo Touzi Yu Jianshe*, No.10 (1989), p.7. The author was from the Investment Division of Guangdong's Planning Commission.

¹¹⁰See *Zhongguo Jinbao*, January 27, 1989, p. 2, for the report on the conference. This newspaper was a Guangdong provincial weekly paper first published in late 1988, having been approved by the Centre in late 1987 and early 1988, and was one of the byproducts of Guangdong becoming the experimental region for comprehensive reforms. The mission and purpose of the newspaper was therefore to promote and advance the frontiers of reform. Guangdong's Party Secretary from 1980-1985, Ren Zhongyi, stated in the opening publication of the paper in January 1989 that the paper should *for the time being* (that is, during the period of retrenchment) focus on publicising the "making an exception" policy for the coastal region, and especially Guangdong. See *Zhongguo Jinbao*, January 6, 1989, p.1.

¹¹¹See *Zhongguo Jinbao*, January 20, 1989, p.1.

applied to Guangdong in order to forestall the slide and continue the good progress made in the province during the previous year.¹¹²

The above discussion shows that Guangdong has been able to enlarge its room for manoeuvre, even under more difficult circumstances, by "playing around" with the confines of the central policies and asking for "minor" and "operational" adjustments based on considerations of the "practical" circumstances of the province. Although central control figures on total investment scale as a control instrument was in practice ineffective for most of the time, it was nevertheless a major tool of control upon which the Centre depended during the transitional stage of economic reform. Consequently, with the exception of the 1988 attempt, Guangdong had avoided openly challenging the central policy of investment scale control, choosing instead to bargain for special consideration on a more mundane level.¹¹³ However, as regards other central policies towards which central determination was more ambiguous, Guangdong's discretionary behaviour was more confrontational in nature.

Justifying the Breaking of "Traditional" Rules on Bank Finance Management

In this section I discuss Guangdong's discretionary implementation of two central policies concerning the management of bank finance. In both cases Guangdong has sought to justify and legitimize its extensive violation of the policies by distinguishing the original, that is, "outdated", aims of the policies from the present requirements of reform and the externally oriented economic development of Guangdong. The two serve as convenient examples for the sake of illustration, and are not intended to be exclusive.

First, as from 1979, there was central policy regarding the management of bank loans requiring state banks to establish different categories for loans directed to the working capital of enterprises and to fixed asset investment. By distinguishing loans for working capital from loans for fixed asset investment, and the corresponding assignment of separate quotas for each, the central government

¹¹²A senior official in Guangdong's foreign trade and investment work brought attention to the negative effect of the change in policies since the onset of retrenchment on foreign trade and the inflow of foreign capital into Guangdong. Foreign trade for the first quarter of 1989 dropped by 20%, as against the national slide of 8%, and many foreign joint ventures could not proceed because the capital supply of Chinese partners was affected by the tightening of bank finance. He asked for more flexible policies based on the special circumstances of Guangdong. See *Zhongguo Jinbao*, April 21, 1989, p. 8.

¹¹³The only time Guangdong's leadership did try to do away with the application of investment scale control policy for Guangdong was in early 1988, as discussed earlier this chapter.

sought to maintain control over the scale of investment. However a substantial portion of the bank loans which had been assigned for working capital was actually being used to finance investment projects.¹¹⁴ And this was one major area of scrutiny in the annual inspection exercise on taxes and finance every year.

It was, however, difficult to gauge the precise extent of the diffusion of funds across the quotas. It was only in the past few years that the State Audit Commission started auditing the work of banks. In the case of Guangdong, because of the limitation of manpower and other resources, only one bank system could be inspected each year.¹¹⁵ In an audit inspection of the Construction Bank conducted in 1993, it was discovered that in some Guangdong branches up to 3% of the loans ostensibly used for financing working capital was actually directed to fixed asset investment. On average the ratio was about 1 to 2% in 1992 in Guangdong. The value of bank loans directed towards working capital was 141.36 billion yuan, and the value of fixed asset investment loans was 23.58 billion.¹¹⁶ As 2% of the value of working capital amounts to 2.83 billion yuan, it may be calculated that investment loans were, in effect, increased by more than 10% by way of circumventing the quotas control.

What is significant in this discussion of Guangdong's discretionary behaviour is not the sheer scale of covert violation of central rules but the near-overt advocacy of the abolition of the rules. In an openly published article, an official of the Shenzhen Branch of the Construction Bank championed the "flexible" approach of the branch in its utilization of the two separate quotas as one of the major successful "reform measures" that had helped solve the capital problems of Shenzhen.¹¹⁷ This view was echoed by a respondent in the provincial government. The following quote was his response to the question on why there had been such an extensive occurrence of quota-diffusion behaviour:

¹¹⁴For instance during the retrenchment of 1985, State Councillor Chen Muhua as the then head of the People's Bank of China criticized when paying a visit to Zhuhai the use of so much bank finance originally intended for working capital as on *de facto* investment projects. See "Chen Muhua Speaking When Visiting Zhuhai Special Economic Zone", December 12, 1985, in *Centre's Instructions to Guangdong, 1983-1985*, p.428.

¹¹⁵Respondent No.10, Guangzhou Interview, December 1993. The percentage tallied with the percentage quoted in an article from the Shaoxing city Audit Bureau in *Guangdong Audit*, No.2 (1991), pp.14-15. In the article, it was stated that inspection on the use of the two streams of bank finance in banks of the city in 1988 found that 2.2% of working capital loans was actually used for fixed asset investment.

¹¹⁶See *Guangdong Statistics Yearbook 1993*, p.385.

¹¹⁷See Li Chaoyung, "The Capital Problem in the Development of Externally-Oriented Economy of the Special Economic Zones", *Theory and Practice of the Special Economic Zone*, No.4 (1990), p.59.

"There have been both positive and negative reasons for this. The negative reason has been corruption. It has often been the case that certain members of bank staff have been able to obtain "benefits" from enterprises in return for lending them funds for investment purpose. This works in such a way that when quotas for fixed asset investment had been used up, or projects did not meet the criteria for such loans, bank staff might then lend out the money in the form of working capital loans... As regards the positive reasons, the system of separate quotas for working capital and investment loans was in fact a product of the central planning system. When the system was first set up, there was the concern that loans for fixed asset investment would, in practice, be little more than grants by another name (traditionally most investment projects had been financed by state fiscal grants). Control on the scale of loans was therefore necessary. However, nowadays as the market economy gradually develops in Guangdong, the capacity for self-restraint by enterprises in terms of cost and investment control has been increasing substantially, or at least, this is the goal of provincial government and banks. Under such circumstances the banks in Guangdong feel that they should be able to use the capital available to them more flexibly."¹¹⁸

Among officials in Guangdong a feeling was that the system of separate quotas for working capital loans and investment loans had become outdated in terms of the swing towards a market economy. What is noteworthy here is that, as reflected in the above quote, provincial auditing officials appear to take a similar view towards the "legitimacy" of what is, strictly speaking, illegitimate behaviour from an auditing perspective.

The other policy to be discussed is the central policy precluding the provision of bank finance for foreign investors of foreign-funded enterprises, as well as the provision of a guarantee to enterprises by government departments of bank loans. From the point of view of Guangdong, this policy was not conducive to the attraction of foreign investment. The Shenzhen Construction Bank official again championed the breaking of these rules as being one of the success factors of Shenzhen. He wrote in 1990:

"(One success factor of Shenzhen in attracting foreign investment is) the abandonment of the preconception that banks should not lend out investment loans to foreign-funded enterprises. *In the past* there was a rule that foreign investors in foreign-funded enterprises had to inject their own investment capital from abroad in full. We were not allowed to provide loans to cover that part of investment. At the time this was a necessary provision. However, due to some occasional unanticipated factors, a shortfall in the amount of investment capital injected from abroad would occur. If the shortfall was not made up, production would not be able to commence. In order to solve practical difficulties of this sort, the Shenzhen Construction Bank made loans to these enterprises. Since the enterprises had not yet commenced production and thus could not borrow in their own

¹¹⁸Respondent No.10, Guangzhou interview, December 1993.

name, we would take the shares of the enterprise as mortgage, or *let the department-in-charge of the Chinese partners guarantee the loans...*"¹¹⁹

It should be noted that it was only in local practice that the rule had been changed. From the point of view of the Centre, such provision of finance and guarantee was banned. In February 1993, a notice was issued by the State Council reiterating its prohibition of government departments acting as guarantors for bank loans, a position which had already been clearly stated in 1984, and again, in 1988.¹²⁰

In a sense the "flexibility" with which the Guangdong government implemented central policies and the discretionary behaviour of the Guangdong leadership were quite apparent within the country and to China watchers abroad. It has raised eyebrows most because, unlike the first two types of discretionary behaviour which are basically concerned with lobbying for more favours from the Centre, implementation discretion requires more calculation and strategic analysis on the part of provincial officials. For instance, provincial officials must first assess the suitability of central policies for local application, and subsequently undertake the course of action which would bring the most benefit and incur the least cost. Whether in theory or in practice, implementation discretion represents a far higher degree of provincial independence than does the scramble for preferential policies and direct central support. Relative to the two other categories of discretionary behaviour, i.e., the development of the non-state sector and the embrace of internationalization, which will be discussed later in this Chapter, implementation discretion is also more directly targeted at central policies. The degree of provincial independence as indicated by this type of discretionary behaviour makes the controversies which have consequently resulted come as no surprise.

During the 1989 retrenchment Guangdong came under great pressure to conform to central requirements and, therefore, to cut investments and to control prices, amongst other retrenchment measures. The flexibility with which the province had implemented central policies in the past came under severe attack. It is, therefore, indicative of the degree of independence which had developed within the provincial leadership that despite the harsh approach adopted by the Centre

¹¹⁹Li Chaoyung, "The Capital Problem", p.60.

¹²⁰See "The Notice by the State Council Secretariat on the Strict Prohibition of Administrative Departments to Guarantee for Economic Activities", February 23, 1993, in *Zhonghua Renmin Gongheguo Xin Fagui Huibian, 1993*, Volume 1, 1994, pp.189-90; "Notice by the Finance Ministry on the Prohibition of Finance Departments to Act as Guarantee for Economic Activities", November 20, 1988, in *Caizheng Guizhan Zhidu Xuanbian, 1988*, Volume 1, pp.115-16.

towards the Guangdong Government at that time, it nevertheless still published in a provincial paper an up-front counter-attack of the criticisms which had been levelled against it. This article defended Guangdong's flexible implementation of central policies, and argued that, rather than blindly following the vagaries of central policies, "unsuitable policies" should be either ignored or, at least, revised. The following self-explanatory quotes fully explicate the discussion in this section:

On the inevitability of flexible implementation, in the generic sense:
"the directives and policies of the Party are formulated in accordance with the objective and practical situations of a certain time; they themselves are not constant and are subject to change.... Some policies and directives no longer suit the changed objective situation. We should take the initiative to discard these, rather than try to retain the unretainable..."

In the particularistic sense:
"the directives and policies of the Party were formulated to reflect the long-term interests of the community as a whole. But there are huge differences between various sectors and regions. ... When these policies do not suit the particular circumstances of the local situation, there is no need to apply them strictly and without adaptation."

For an example in this case:
"the commodity economy has become quite well developed in the coastal region. The price of many commodities in this region has already been deregulated. There is thus no need and no sense in going back to the old way of administrative control of price and the use of rationing in the effort to contain inflation."

And for the case of Guangdong:
"The Party Centre and the State Council previously instructed Guangdong and Fujian to go one step ahead of the rest of the country...and allowed the two provinces to act according to the Special Policy, and 'flexible measures'. This means that the Centre does not require the two provinces to follow in strict accordance the policy documents which are meant for the use of the rest of the country, but rather to follow the Special Policy documents tailored specifically for these regions."

On the need to implement flexibly reform policies:
"as reform is a totally new task and there is no precedent in this area, mistakes are inevitable. It is therefore inevitable that some policies made on reform are later found to be unsuitable when applied to the actual situation. With this understanding,... we should then move quickly to adjust and revise policies which are found to be inappropriate to the practical situations."

And, on the ultimate criterion of whether or not one has followed the (Centre's) policy:
"The four modernizations are the major tasks of the entire party, and productivity is the criterion by which to judge whether our work is good or not..."

Finally, the counter attack on the critics:
"Now that the Centre has flashed a "special green light" to the two provinces, and we (in going in the direction of this special green light) are merely going around the "ordinary" red light (meant for the rest of the

country), what is there to be criticized? On the contrary, if somebody does not implement or try to put their own limitations on the Special Policy formulated by the Centre, then this should amount to the flouting of (party) discipline....*Isn't this going against economic opening and reform*, the highest-order policy directive of the Party ?"¹²¹ (emphasis added)

Developing the New Horizon: Beyond the Budget

The three categories of discretionary behaviour of the Guangdong government which have been discussed so far all have a common characteristic: the central government is the primary focus of their attention. In a sense these were the responses calculated by the provincial leadership to achieve the most benefit and to obtain the best deal possible under a centrally dominated environment. It is the relative absence of this characteristic which distinguishes the fourth type of discretionary behaviour from the other three.

In this category of discretionary behaviour, the provincial government moves beyond the traditional domain of governmental action: the state and, within this, the budgetary sector. Such a diversion from the state and budgetary sectors includes a vertical as well as a horizontal dimension. Vertically, the provincial government no longer fixes its eyes solely on the debits and credits of the fiscal budget. Enterprises are no longer simply tax-payers (revenue remitters) and spending units of state grants, but also major players in the development of the economy and, as such, important investors. Horizontally, the state sector and, within this, the budgetary sector, are no longer the primary focus of governmental attention. The collective, the individual and the private sector, as well as the "extrabudgetary" enterprises within the state sector assume an increasingly important role as they can far better perform as vibrant economic actors and investors than can the traditional state enterprises.

Discretionary actions taken can be summarized in three major parts. First, more funds were allowed to be retained at the enterprise level in order to facilitate investments by enterprises. As long as Guangdong had more than enough fiscal revenue to pay the contracted remittance amount to the Centre under the *dabaogan* system, there was no point in raising too much revenue as this would result in too large a surplus of provincial budget, which would, in turn, invite "borrowing"

¹²¹See Wang Hao, "Three 'Sayings'; Three Defences", *Zhongguo Jinbao*, January 13, 1989, p.2. The author was alerted to the article by Yang Xiaofei, "Discretionary Behaviour of the Provincial-Level Government". According to Yang, Wang was the propaganda chief of the Guangdong Provincial Party Committee.

requests from the Centre, or worse still, an upward adjustment of the contracted amount.

Second, the government encouraged the development of the collective and individual/private sector. Traditionally, these enterprises either fell outside, or were at the periphery of, the ambit of the central planning system. The various control instruments of the central government did not usually touch these sectors, and when they did, they were ineffective. The central control figure on the investment scale, for instance, covered until 1988 investment in the state sector only, and even after 1988 control on investment scale of the non-state sector was more symbolic than real. Some new state enterprises set up in the 1980s were placed outside of the state budget, and their taxes and profit remittance was not included in the budget.

Both measures---retaining more funds in the enterprises and developing non-state and extra-budgetary enterprises---had the effect of keeping the flow of resources to the state budget to a minimum. Accordingly the province could better ward off the tapping of its resources by the Centre.

The next step was that of recentralizing funds which had been diffused to enterprises back to the provincial government. In the 1980s social and economic development in Guangdong, and to a greater extent in China as a whole, was still at a stage whereby the government had a major and direct role both as investor and financier. Therefore while the provincial government was reducing the taxes of enterprises in order not to swell its fiscal coffers and thereby attract the unwelcome attention of the Centre, the province had to recollect at least part of that revenue by the imposition of various fees with which to finance its investment and other economic activities. Unlike fiscal revenue, which was collected primarily by the finance department which then allocated the funds to various user departments as fiscal expenditure, this income was usually collected separately by different user departments for their own use. All of such revenue was placed outside of the budget as part of the extrabudgetary revenue of the collecting departments.

As a result of these manoeuvres, the size of extrabudgetary revenue grew rapidly during the 1980s. The table below shows the spectacular growth:

Table 5.3

<u>Budgetary and Extrabudgetary Revenues of Guangdong</u> (Yuan Billion)				
<u>Year</u>	<u>Budgetary</u>	<u>Growth (%)</u>	<u>Extrabudgetary</u>	<u>Growth (%)</u>
1982	3.83	-	2.90	-
1983	3.63	-5.2	3.17	9.3
1984	4.96	36.6	3.70	16.7
1985	6.97	40.5	4.56	23.2
1986	n/a	n/a	5.20	14.0
1987	9.59	n/a	6.72	29.2
1988	10.76	12.2	8.41	25.2
1989	13.69	27.2	9.08	8.0
1990	13.10	-4.3	9.84	8.4

Source: *China Finance Statistics 1950-1985*, pp.54, 144; *1950-1991*, pp.59, 204.

Cutting Back the Budgetary Sector

The provincial governments could achieve its aim of retaining more funds outside the budget in three major ways. These were (1) extensively and generously applying the policy of tax exemption and reduction; (2) on the operational level of tax collection, by reducing the actual amount of taxes collected by manoeuvring the method and base of calculation, etc., and by tolerating the tax-evasion behaviour of the enterprises; and (3) by finance departments at various levels of provincial government diverting part of their fiscal revenue to the extrabudgetary sector through, for instance, setting up "private accounts".

Exempting and Reducing Tax Payments

Reducing the tax burden of enterprises via various tax exemption and reduction policies was a major governmental tactic in the 1980s. It was in fact an approach adopted and endorsed by the central government in order to develop the economy and attract foreign investment. In 1977, the State Council approved a notice drafted by the Finance Ministry on the tax administration system. This notice recognized the necessity sometimes to reduce and exempt taxes to help enterprises faced with difficulty in paying them. Different jurisdictions were also assigned to approve or initiate such actions at different levels of the government.¹²²

¹²²Information from an informed source, Respondent No.34, Beijing interview, March 1994. For the 1977 notice, "The Regulation by the Ministry of Finance on the Tax Management System", November 13, 1977, see State Planning Commission, *A Selected Collection of the Major Economic Regulations*, pp.877-78. In sum, the notice reserves the formal power of promulgating new taxes and the changes of official tax rates to the State Council, but assigns a wide range of discretions to provincial governments in implementing the tax policies to the effect that the effective tax rates were in fact set by the provincial governments.

This principle of tax alleviation was followed by subsequently promulgated tax regulations. Therefore, offering favourable tax treatment with preferential tax rates and generous reductions and exemptions was from the beginning the Centre's approach in order to attract foreign investment. The trend of offering ever more favourable tax policies to foreign investors by provincial governments nationwide was, therefore, only an extended version of the original central policy.

The 1977 State Council Notice prescribes the jurisdiction of tax management at various government levels which includes the imposition of new taxes, the designation of tax rates, the specific taxable categories as well as the exemption and reduction of taxes.¹²³ It states that for decisions covering the country as a whole, the State Council would be the authority, and for decisions affecting a province or a particular sector, the Finance Ministry and State Taxation Bureau would be the authority. Decisions on individual enterprises within a province would be the authority of the provincial government. The notice states that the provincial jurisdiction regarding discretionary implementation of tax policies should, *in general cases*, not be subdelegated further to subprovincial levels. *Presumably*, therefore, the subprovincial levels do not have authority as regards tax exemption and reduction.¹²⁴

However, in practice extensive authority was, in fact, delegated and exercised by the subprovincial levels of government in Guangdong. Moreover, since the regulations and central government notices on tax administration often included only a very general provision regarding tax exemption and reduction, the provinces had ample latitude regarding the specifics. The subdelegation of authority to subprovincials was a widespread and accepted practice throughout the provincial-level areas. In a book on tax exemption/reduction policies and management authored by officials from the Finance Ministry, the State Taxation Bureau and the State Audit Commission in 1993, the division of jurisdiction amongst the provincial, district and county levels, in accordance with the amount of tax exemption and reduction involved, was described as part of the country's tax exemption/reduction policy.¹²⁵ The tax department at the county level, it was written, would in general have the jurisdiction to exempt or reduce taxes of under 30,000 yuan in a single application. The district level had a jurisdiction of under 100,000 yuan, above which the provincial tax bureau would be responsible. All of

¹²³Ibid.

¹²⁴This was the interpretation of Respondent No.34, Beijing interview, March 1994.

¹²⁵See Han Shaochu, *Shuishou Jianmian Zhengce Yu Guanli* (The Policy and Administration of Tax Reduction and Exemption) (Beijing: Zhongguo Wuzi chubanshe, 1993), p.293.

this in fact amounted to provincial discretionary behaviour, or "native" policies beyond the general provision of central regulations.¹²⁶ However, the fact that such discretionary behaviour was described in a suitably neutral manner as the "policy" on tax exemption and reduction by officials from the central departments of finance, tax and audit, albeit sixteen years after the issue of the 1977 State Council Notice, reflects the ambiguity of "unlawfulness" from this aspect.

In fact the above description of subdelegation is still very much an understatement of the actual practice in Guangdong. In a notice by the Guangdong Provincial Government in 1992, a county level city, Shunde, was given the authority to approve the application of tax exemption and reduction of amounts under 600,000 yuan, in a move to extend Shunde's authority to the district-level.¹²⁷ This amount was six times that of the 100,000 yuan jurisdiction of the district level governments in the country in general, and indicates the success of the Guangdong government in keeping one step ahead of other provinces in tax exemption and reduction.

In an account from the research institute of the Guangdong Provincial Planning Commission, it was estimated that the total value of tax exemption and reduction from 1979 to 1987 amounted to 3.54 billion yuan, which is equivalent to over 8% of the total revenue from industrial and commercial taxes, the most major source of fiscal income for Guangdong and for the whole country. If the revenue foregone via the arrangement of tax for loan payments is included, the haemorrhage of tax revenue during the period approaches 12% of total industrial and commercial tax revenue.¹²⁸ Due to the sensitivity of the issue and the consequent difficulty in calculating the total amount of tax revenue foregone as a result of tax exemption and reduction, the above estimates are nevertheless likely to be a gross understatement of the total picture.¹²⁹

¹²⁶According to Respondent No.34, such local policies were tolerated by the central government before 1990. However, in 1990 the State Council issued a notice which explicitly prohibited the delegation of tax exemption and reduction authority to the subprovincial levels. (Beijing Interview, March 1994).

¹²⁷The notice, reference no. 337, 1992, was published in *Guangdong Zhengbao*, No.9 (1992), p.50.

¹²⁸See Yang Ming, "An Analysis of the Haemorrhage of Tax Revenue in Guangdong", *Jihua Yu Fazhan*, No.2 (1989), p.29. Revenue from the industrial and commercial taxes can be nearly equivalent to, and has sometimes been larger than, the total fiscal revenue, because revenue from state enterprises (in the terms of profit/profit tax) is either very small or negative due to huge losses on the part of many enterprises.

¹²⁹Respondent No.12, Guangzhou interview, December 1993, admitted that the issue of tax exemption and reduction was a sensitive one in the context of central-provincial relations, and declined to provide specific details of how the system worked in Guangdong in terms of the value of tax exempted and reduced. In the course of this and other interviews the author sensed that secrecy was directed more from the domestic audience, in particular the central authorities, than from the outside world. In a press report by an official from the People's Bank of China, the total revenue

The sensitivity surrounding this issue substantiates the argument that even though tax alleviation started as a centrally directed and endorsed policy, it eventually developed into a practice by the provincial governments with which to shield local resources from the Centre. Guangdong's officials were obviously very conscious of the strategic role of tax exemption and reduction as regards a more autonomous economic development of the province.¹³⁰

The "Unenthusiastic Collectors"

Apart from generously reducing the tax burden of enterprises, the provincial and lower-level governments could *a priori* reduce revenue inflow into the state budget by manipulating the calculations of the exact amount of taxes to be levied at an operational level, and by being lax in the supervision of tax assessment and payments. This tactic was more commonly used in the case of those new taxes which were imposed by the central government during the 1980s as part of its effort to control the scale and direction of investment in the provinces.

The Energy and Transport Strategic Construction Fund, first imposed by the Centre in December 1982 as a means to tap the growing extra-budgetary funds in the provinces, required as 10%, and rising to 15% from August 1983, of the extrabudgetary funds in various units to be collected to the state budget. A large proportion of this fund goes to the central coffers in order to finance badly needed energy and transport investment. In theory, payments into the Fund would increase in line with the extrabudgetary funds of a unit. As regards the public roads department in Guangdong, however, this was not the case. In order to retain more funds within the department with which to finance the province's road construction programme, the Guangdong Government froze the payments of the department into

lost nationally as a result of abusive tax exemption and reduction was estimated to reach 50 billion yuan a year. See *Economic Information Daily* (Beijing) March 9, 1993, p.4.

¹³⁰This is the impression given to the author by Respondent No.12, Guangzhou interview, December 1993. When comparing the relative importance of the expanding investment administration authority, in particular project approval authority, with the effect of tax alleviation for the growth of investment in Guangdong, the respondent stated unambiguously that the former was more important than the latter. Therefore, even though Guangdong's power to reduce and exempt taxes would be greatly restricted by the tax reforms in 1994, in his opinion the effect on Guangdong's investment would not be too severe. This respondent's judgement is not the issue here. What is important is that his articulations reflect how strategically minded he is as a member of the Guangdong government and his consequent consciousness of the role of tax alleviation in Guangdong's central-provincial relations.

the Fund at the base line level of 1984. As a result the department was able to retain several hundred thousand yuan in the 1980s.¹³¹

There was similar resistance to paying taxes on the part of the electricity department in Guangdong. Guangdong's electricity department was unwilling to pay into the Energy and Transport Strategic Construction Fund and the Budgetary Adjustment Fund, as altogether this would amount to 25% of the total electricity fund of the department.¹³² The two funds were central measures through which to recentralize extrabudgetary funds in the provinces; and as the electricity fund belonged to the extrabudgetary category, paying the taxes should therefore have been a matter of course. However, the Guangdong department argued that since the electricity fund was set up with the approval of the Centre to facilitate local financing of Guangdong's energy projects, the diminution of the fund as a result of paying the two central taxes would amount to a violation of the original intention of the Centre in establishing the electricity fund. As a result of this bargaining, Guangdong's electricity department was in the end required to pay only a fraction of the original liable tax.¹³³

Construction Tax was another measure imposed by the Centre from 1983 to 1989 to control investments. 10% of the value of investment using funds outside of the state budget, and including local budgetary funds used in "outside plan" projects, was required to be paid in this tax. However the implementation of the tax was far from effective. Investments in Guangdong continued to grow spectacularly, but the amount of Construction Tax collected remained more or less static, and at an extraordinarily low level. Total investment in 1985, 1986 and 1987 was 18.46 billion yuan, 21.65 billion yuan, and 25.1 billion yuan respectively,¹³⁴ whereas Construction Tax collected in these three years amounted to only 90 million yuan, 107 million yuan, and 115 million yuan, accounting for 0.5%, 0.49% and 0.48% of total societal investment.¹³⁵ In some periods the tax revenue *dropped*

¹³¹ See Lou Jingfen and Guo Shuqing, *Jichu Chanye Jianshe Zijin Chouji*. (Capital Mobilization for Infrastructural Construction) (Beijing: Jingji Guanli chubanshe, 1993), p.234. This is a book organized and written by officials from the State Planning Commission.

¹³² This was mentioned by Respondent No.34, Beijing interview, March 1994.

¹³³ Ibid. An informed source in Guangdong provincial government (Respondent No.7, Guangzhou interview, December 1993) also revealed that because the two funds, the Energy and Transport Strategic Construction Fund, and the Extrabudgetary Adjustment Fund, were measures arising from administrative notices, rather than formal taxes promulgated by law, they were of lower status and authority, and had long been the targets of severe lobbying and even blanket violation by various unwilling tax-payers.

¹³⁴ See *Guangdong Statistical Yearbook 1993*, p.236.

¹³⁵ See Yang Ming, "An Analysis of the Haemorrhage of Tax Revenue in Guangdong", *Jihua Yu Fazhan*, No.2 (1989), p. 29. Total societal investment is used here as the comparison base. Because

in relation to a rising investment total. According to the Guangdong Provincial Tax Bureau estimate, a maximum of 40% to 50% of the tax was actually collected in 1987 and 1988.¹³⁶

A major and systematic method through which to retain more revenue outside the state budget is that of manoeuvring the base-line of the tax-profit remittance contracts with enterprises. It should be noted that the contracting system was formally endorsed and its application extended to nearly all state enterprises by the Centre in 1987. Fixing the amount of remittance from the enterprises to their superordinate departments was intended to cultivate a greater potential for development among the traditionally weak state enterprises. As the calculation of the base line was normally based on the average tax level of enterprises over the previous few years, this method of tax assessment resulted in more revenue being retained by the enterprises, an advantage similar to that gained by the provincial government vis-a-vis its fiscal contracts with the Centre. Moreover, in the event of straitened times and of profits falling below average, enterprises would still be able to apply for temporary tax reduction or exemption.¹³⁷

The contracting system relied on the superordinate departments and the provincial governments negotiating an adequate "contract" through which to find a balance between both the competing needs to encourage the incentives of enterprises and to ensure an adequate level of fiscal income. However, since a larger fiscal revenue on the part of the provincial government would be likely to affect central-provincial negotiations over the province's fiscal remittance, the provincial government was careful not to let the local coffers swell too much, and as a result opted for retaining more within the enterprises. Pushing down the base-line of contracts with enterprises was therefore commonplace amongst local finance departments in Guangdong.¹³⁸ Moreover, when first conceived the

the proportion of investment using budgetary funds was getting increasingly smaller in the 1980s, as shown in Chapter Three, this does not greatly affect the accuracy of the whole picture.

¹³⁶Ibid. During the first nine months of 1988, the value of investment in the state sector increased by 37.4% over same period last year. Meanwhile the amount of construction tax revenue for the period dropped by 13.3%.

¹³⁷For discussion of the practice of collecting tax via "tax contracts", and criticisms of the practice by some local tax officials in Guangdong, see Zhu Jiangchou, "The Ten Drawbacks of the Tax Contracting Practice", *Guangdong Taxation*, No.9 (1992), pp. 8-9.

¹³⁸In an article from the Audit Bureau, Jiangmen city, Guangdong, it was stated that some local finance departments, with the purpose of retaining more discretionary revenue in the locality in mind, would undertake various tactics through which to reduce the recorded fiscal revenue for the year, whilst exaggerating the level of fiscal expenses. These tactics included transferring part of the revenue for the current year to the following year, and of the following year to the next, and on to the following; and treating the unspent cash in hand as spent expenditure. See Ngan Shaoping, "A

contracting system was supposed to cover the remittance of profit and profit tax only. However, in the course of implementation the provincial and lower-level governments often also included industrial and commercial taxes. Since these were the major fiscal revenue items, the central government was adamant that the industrial and commercial taxes should be levied strictly in accordance with the tax regulations, but obviously with little success.¹³⁹

It is difficult to know exactly how much revenue has been kept from the state budget in this way. Annual financial and taxation inspection exercises have, however, recovered increasingly large sums of lost revenue. For instance, in 1988 it was 0.4 billion yuan and in 1993 over 0.7 billion yuan was recovered.¹⁴⁰ Although these were not huge sums when compared to Guangdong's total fiscal revenue of over 22 billion yuan in 1992, the coverage of haemorrhage behaviour was nevertheless extensive. The 1989 inspection found that nearly 60% of the inspected enterprises in the state and collective sectors, and 80% of the inspected central enterprises in Guangdong, had experienced such problems.¹⁴¹

However, whatever was unearthed during inspections, it was almost certainly only the tip of the iceberg. There is immense difficulty in digging out such figures, given the current state of auditing work within the Chinese government and the protectionist attitude of provincial governments towards this issue. Moreover, it is not easy to define clearly or identify the boundaries of revenue haemorrhage. For instance, the lowering of the remittance contracts of enterprises is not, as long as the rules of accounting have been duly observed, easily disclosed by ordinary audit scrutiny, and there are also many more grey areas than outsiders would expect to find, even in the seemingly straight-forward matter of the observance of auditing and financial rules. As an informed source described it, practical situations in the country had changed so much and so rapidly that many accounting and financial rules had become inapplicable and obsolete. When inspecting the accounts of the various units, the audit personnel, therefore, could not follow the straight-forward approach and focus on just the books and rules, but needed to look at the actual situations in order to arrive at a sensible judgement of whether or not a certain act was "against the rule". There is,

preliminary discussion of the auditing work of local fiscal budgets under the *dabaogan* fiscal system", *Guangdong Audit*, No.4 (1990), p.16.

¹³⁹The Director of the State Taxation Bureau, Jin Xin, stressed that the industrial and commercial taxes should not be "contracted" and stated four reasons for it. See *Guangdong Taxation* No.10 (1992), p.24.

¹⁴⁰See *Zhongguo Jinbao* June 16, 1989, p.1; *Nanfang Ribao* January 8, 1994, p.1.

¹⁴¹See *Zhongguo Jinbao* June 16, 1989, p.1.

therefore, an inevitable element of subjectivity, thus adding to the difficulty in ascertaining the extent of revenue haemorrhage in an objective sense.¹⁴²

Diverting Budgetary Revenue to the Extrabudgetary and "Private Accounts"

After initially reducing the flow of local resources into the state budget through the exemption and reduction of taxes, then manipulating the calculation of tax payments and tolerating underpayment on the operational level, local departments, including the finance department, could ultimately reduce the size of fiscal revenue by "illegally" appropriating part of the collected fiscal revenue to the extrabudgetary funds of the departments. Alternatively, they may divert part of the collected budgetary revenue to "hidden" or "private" accounts beyond the coverage of both the budgetary and extrabudgetary fiscal finance.

Budgetary revenue of an *ad hoc* nature was more susceptible to such diversion efforts. Income arising from various administrative penalty fees, for instance, was a major target. In an inspection report in 1986, it was discovered that less than 30% of the penalty income entered the budget, as compared to 70% prescribed by central finance regulations.¹⁴³ The report found that at least 13% of the total revenue arising from such fees and retained outside of the state budget had been used for capital construction. Moreover, many such investment projects had not obtained the necessary approvals and were thus "hidden" projects.

Diverting funds to "private accounts" is a much more serious type of discretionary behaviour and edges more towards illegality than does the shifting of funds from the budget to the extrabudgetary. Unlike problems with the extrabudgetary funds which were basically a matter of abusing and stretching the preexisting system of extrabudgetary management of fiscal resources, private accounts were blatantly "illegal" and should not have been in existence. There could still be some kind of control over extrabudgetary funds, (*in theory* the central

¹⁴²Respondent No.10, Guangzhou Interview, December 1993. The respondent regarded the inevitability of a subjective element in auditing work as one of the peculiar difficulties of audit work in China. Because of the experimental nature of China's reforms in the 1980s and the fact that laws and regulations had lagged substantially behind the actual situation, audit officials in their work often had to "cross the river by touching the stones". Having been placed in a role whereby they were required to judge what was wrong or right while some of the laws themselves had become seriously obsolete, the audit staff usually had to rely on the highest principle of promoting productivity as well as abstract principles such as fairness in their day-to-day judgements.

¹⁴³See "The Guangdong People's Government Notice No. 125 (1986) approving the Provincial Audit Bureau's report on the auditing of the penalty income of Guangdong" July 26, 1986, in *Jingji Tizhi Gaige Wenjian Huibian*, 1986-1988, 1988, pp. 450-51. The remaining 30% could be retained by the units to cover the administration and related expenses.

government knew exactly how much funds in the extrabudgetary sector amounted to, as reflected in the statistics of extrabudgetary funds), making them potentially susceptible to central control.¹⁴⁴ The "private accounts", on the other hand, were supposedly non-existent and there was, therefore, no control mechanism in force over them at all. As a result provincial and lower-level governments were able to have an even larger degree of autonomy over this part of revenue.

This absence of control has made private accounts a widespread phenomenon, existing as they do in state enterprises, local and central administrative units, and also government departments at various levels. Even the finance bureaux at provincial and subprovincial levels, which should act as managers, guardians of the local budget, have had their own private accounts. For instance, in an account from the Guangdong Provincial Audit Bureau, it was revealed that the finance departments in some Guangdong cities had opened separate bank accounts in which to keep the "private money". Revenues diverted to these private accounts included taxes paid by the extrabudgetary state enterprises and income from anti-smuggling activities.¹⁴⁵

In order to wipe out the private accounts, a severely worded notice was issued by the State Council in 1989.¹⁴⁶ In about a month 1 billion yuan of funds was recovered from the "private accounts". However because of the huge interests involved, many units implemented the State Council notice only half-heartedly.¹⁴⁷ Given the vested interests of the units, the commonality of the practice nationwide, and the inevitable reliance of the inspection exercise on the self-discipline of the units themselves, it is doubtful whether the private accounts could be successfully banned merely by administrative orders.¹⁴⁸

¹⁴⁴The Energy and Transport Strategic Construction Fund started in 1983, and the Budgetary Adjustment Fund started in 1989 were two such examples. Both had the extra-budgetary funds as the tax base. The two together could take away 25% of total extrabudgetary funds to the budget.

¹⁴⁵See Lin Zhengbo, "A Preliminary analysis of the rule-abating behaviour of local finance departments and some possible solutions", *Guangdong Audit*, No.5 (1990), pp.9-10.

¹⁴⁶State Council Notice No. 77 (1989), State Council, "Notice on the inspection and wiping out of 'private treasuries'", November 14, 1989, in *State Council Gazette*, No.24 (1989), pp.867-68.

¹⁴⁷In another notice issued in February 1990, the Centre complained about the unenthusiastic attitude of many enterprises, departments and units in the inspection and wiping out of private accounts and urged that more cooperation and effort to be applied to the task. See State Council Notice No. 6 (1990), the State Council Secretariat, "Notice on the further inspection and wiping out of the 'private treasuries'", February 22, 1990, in *State Council Gazette*, No.3 (1990), pp.91-92.

¹⁴⁸One difficulty in wiping out the practice is the vagueness in boundaries between legitimate own funds and illegitimate private accounts or treasuries. The State Council Notice No. 77 (1989) made a distinction, stating that party fees, union fees, mutual aid funds of staff, and retention funds from literary writing revenue did not belong to the category of "private treasuries". This meant that there would then be a fourth segment of revenue, apart from budgetary, extrabudgetary and the illegitimate private accounts. Although this fourth segment of funds was legitimate, it was seemingly not included in the statistics and accounts of budgetary and extrabudgetary funds.

Developing the Extra-Budgetary and Non-State Sector

The state sector was traditionally the focus of concern within the central planning system. As state enterprises obtained more support through the planning system, they were consequently under tighter scrutiny than the non-state sector. With the gradual liberalization of the economy, state enterprises had obtained fewer and fewer benefits from the state, but the traditional management system, albeit also under change and increasingly ineffective, was still comparatively harder on state enterprises than on the collective and individual sector. As Guangdong progressed still further in its economic development, so the constraints on the state sector of the economy emanating from the traditional system were increasingly felt. Therefore, moving beyond the traditional model of state enterprises became increasingly the consensus of the Guangdong leadership as regards the direction of Guangdong's economic development.

An article published in 1992 written by Lin Ruo, Guangdong's Party Secretary from 1986 to 1990, and subsequently the chairman of the Provincial People's Congress Standing Committee, includes an explicit reference to this strategy and approach by the Guangdong leadership:

*"As state enterprises would not be able to get rid of the centralized control of the state for some time to come, Guangdong has taken the approach of going round this obstacle by focusing on the development of collective enterprises of various types. We have not placed these enterprises under the control of the budget. This has worked well and these enterprises have succeeded. That is why the proportion of our state enterprises within the budget has been ever on the decline whilst the proportion of collective enterprises of various types is ever increasing."*¹⁴⁹

In encouraging the development of the collective and private sectors, the Guangdong government not only granted generous tax reduction policies and reduced the taboo areas of private sector activities, it also provided the organizational cover for the new and emerging private sector.

In 1989 there were an estimated 800,000 to 900,000 private enterprises in Guangdong. However, the number of private enterprises in the formal register of

Respondent No.34, Beijing interview, March 1994, confirmed the existence of such fourth segment funds in every unit. This fourth segment of funds was, according to the respondent, normally quite small in amount and was usually some kind of petty cash for staff welfare. The problem was that the line of demarcation between legitimacy and illegitimacy was far from clear.

¹⁴⁹See Lin Ruo, "Looking Back and Rethink: The Track of Reform and Opening of Guangdong", in Zhang Hanqing (ed.), *Reform and Opening in Guangdong*, p.18.

the Industry and Commerce Bureau was under 6000, the registration rate standing at only 6%. The vast majority of these private enterprises had been registered as collectives under the auspices of "shell collective enterprises".¹⁵⁰

This apparently ridiculous phenomenon was the result of progressive discretions carried out by the Guangdong government in order to facilitate the development of the private sector within a still restrictive macro-environment. Having been all too aware of "exploitation" within private enterprises, the central government was slow to recognize the legitimacy of private enterprises. It was only in 1987 that the Centre first endorsed the existence of private enterprises, and only in 1988 that the constitution was amended to give legitimacy to the private sector. The rights of private enterprises started to get some form of legal protection with the passage of the first administrative regulation on the private sector in 1988.¹⁵¹

Prior to 1988, therefore, private enterprises were deprived of a legal existence. Many had existed as individual businesses, although the number of employees had far exceeded the permitted ceiling of eight persons. Many more had operated as collectives due to the convenience resulting from the legitimacy accorded to collective enterprises in an economic management system which was still seriously biased towards the public sector. One major advantage of collective enterprises was their ability to obtain bank finance. Under the constraints of central rules, banks in Guangdong could offer very limited services to private enterprises. In Foshan, loan policies in the late 1980s prescribed that private individuals and enterprises could normally borrow only 3000 to 5000 yuan at one time, and could under no circumstances borrow more than 10,000 yuan. There was, however, no ceiling for collectives. The interest rate for private enterprise loans was also substantially higher than that of loans for collectives.¹⁵²

Local governments, usually at the township levels, obtained benefits in the form of management fees and licence fees from these enterprises. In a sense it was the vested interest of the "shell enterprises" which had encouraged and sustained such a practice. However given its extensiveness, the connivance of the upper

¹⁵⁰See an article by Guangdong's Industry and Commerce Bureau, "The present status and future development strategies of private enterprises in Guangdong" in Lok Chaopei and Zheng Yanchao (ed.) *A Study of Guangdong's Private Sector Economy*, pp.257-58.

¹⁵¹Ibid.

¹⁵²See Fong Jishun (from the Industry and Commerce Bureau of Foshan) "A Study Into the "Pseudo" Collectives in Foshan", in Lok Chaopei and Zheng Yanchao (ed.) *A Study of Guangdong's Private Sector Economy*, pp.164-69.

levels of government within the province was nevertheless still required. In this respect the Guangdong provincial leadership would not have been so tolerant or supportive if not for their strategy to promote the development of the previously peripheral non-state sectors.

Apart from the collective and private enterprises, there was another category of enterprise which was promoted by the Guangdong government in a move to circumvent the traditional state sector. In terms of modes of ownership these were still owned by the state, and were similar to state enterprises. The main difference between these and the traditional sector was, however, that they were not placed within the state budget, and could thus be described as "extrabudgetary state enterprises".

The existence of extrabudgetary state enterprises was not new, but as a major phenomenon it occurred only in the 1980s with the proliferation of investment actors and funding channels. Traditionally state enterprises were established by budgetary grants of the state but at the same time there were still a small number of enterprises which had been set up by various departments using their own extrabudgetary funds. These enterprises were usually small in scale and performed a subsidiary role in the economy and as their source of capital was extrabudgetary funds via the state, they were still, in theory, state enterprises. They were consequently placed outside of the budget and, after paying indirect taxes (the industrial and commercial taxes, for instance) to the state, the distribution of profits was entirely a matter between the enterprises and their "mother units".¹⁵³ In other words the relationship between the state budget and such enterprises is similar to that of state-enterprise relations in a private-ownership system. The state collects taxes, and the sharing of profits (and losses) is entirely a matter between the shareholders of the enterprise and the enterprise itself. The only difference is that in a private ownership system, the taxes paid by enterprises to the state treasury include a direct tax on their profits, which is not paid by extrabudgetary enterprises in China.

In a sense the concept of extrabudgetary enterprises has always been marginal and transient. As an economic phenomenon, enterprises such as these before the 1980s had been relatively few in number, small in scale, and therefore

¹⁵³For a succinct discussion of the state of extrabudgetary state enterprises, their distinguishing characteristics, state of development and existing problems, see Wang Weijian, "Thoughts on Some Issues Concerning the Extrabudgetary Enterprises", *Jihua Jingji Yanjiu*, No.7 (1990), pp.59-62. Wang was from the General Planning Department of the Finance Ministry.

largely neglected by the central government. Some regarded the concept as a contradiction in terms, since state enterprises should, by definition, be governed by the state budget.¹⁵⁴ As their numbers grew phenomenally during the 1980s, it has been argued that the concept, which had from the beginning been a product of the central planning economy, would become increasingly irrelevant in the age of market economy.¹⁵⁵ Nevertheless the concept is material as regards a better understanding of the economic and investment behaviour of provincial and lower-level governments at a time when the transition from a planned economy to a market system is as yet incomplete. Due to the fact that after-tax profit could be retained entirely between the enterprises and their "mother units", and that taxes could easily be reduced by the local government under various pretexts, the growing number of extrabudgetary enterprises had, therefore, become a major avenue for the haemorrhage of state revenue. Some "mother units" would use budgetary resources to support the enterprises during their inception, whilst retaining all revenues outside the budget.

There are no formal and official statistics on the total number of extrabudgetary enterprises. An account from the State Planning Commission in 1990 estimated the total number nationwide as of the end of the 1980s decade as over 10,000, and the production value of these enterprises as tens of billion yuan.¹⁵⁶ Neither estimates or statistics were available for Guangdong, but officials in Guangdong admitted to an increased number of extrabudgetary enterprises in the province since 1980. The number of extrabudgetary enterprises in a single city, for instance, nearly tripled from 51 to 138 enterprises between 1985 and 1991, so that by the end of 1991 the turnover revenue of extrabudgetary enterprises amounted to 60% of the total of the budgetary sector.¹⁵⁷ It is therefore unsurprising that many new state enterprises established in the 1980s were said to have been placed outside the budget.¹⁵⁸

Three reasons were cited for placing enterprises in the extrabudgetary sector in Guangdong.¹⁵⁹ The first was as a means to helping enterprises to repay

¹⁵⁴Ibid., p.59. Experience of the author during the field trip in Beijing pointed to the same impression that the concept of extrabudgetary enterprises was not commonly known. Several respondents from the economic and planning stream appeared never to have heard of the concept.

¹⁵⁵See Lou Shangxi et al., "An Appraisal of the History of Creativity of Fiscal Theories", *Caizheng Yanjiu*, NO.7 (1993), p.13.

¹⁵⁶Wang Weijian, "Thoughts on Some Issues Concerning the Extrabudgetary Enterprises", p.59.

¹⁵⁷See Zeng Xiangyou, "A Study of the Financial Management of Extrabudgetary Enterprises in Maoming", *Guangdong Caizheng*, No.1 (1993), p.46.

¹⁵⁸Respondent No.7, Guangzhou interview, December 1993.

¹⁵⁹Ibid. For an explicit advocacy of the establishment of extrabudgetary enterprises by the local financial department, see Zhong Qijun, "A Preliminary Study of the Approach Whereby the

bank loans with which most extrabudgetary enterprises were established. Placing enterprises outside of the budgetary system made tax-reduction and exemption easier. The enterprises could then have more retained resources with which to repay the loans. Second, enterprises in the extrabudgetary sector helped to contain the budgetary revenue base line of the province, thus reducing the exposure of the province to extraction pressure from the Centre. Thirdly, the province was very often left to shoulder new expenditure items or additional expenditure as a result of the progress of reform or new central initiatives. Under the *dabaogan* system, however, it was not easy for the province to bargain for a reduced value of contracted remittance due to its increased expenditure obligation. Under such circumstances, the availability of a second source of fiscal revenue to make up the losses could help the provincial coffers to stay afloat.

Moreover, all revenues derived from extrabudgetary enterprises in Guangdong were also placed outside the budget. A provincial government notice in 1985 openly prescribed that profit tax revenues from extrabudgetary enterprises be managed outside the budget even though central policy was that extrabudgetary enterprises should pay both profit and indirect taxes to the state coffers.¹⁶⁰ This open violation of central policy was only rectified in 1992, after pressure from the central government following an audit inspection from Beijing, when another provincial government notice proclaimed the cease of effect of the 1985 rule, and that taxes paid by the extrabudgetary enterprises would thereafter be included in the budget.¹⁶¹

The Guangdong Development Bank, established in 1988, is an example of one such extrabudgetary enterprise. Its shareholders included Guangdong's Finance Department, various specialised state banks, several major provincial enterprises and the China Bank Group based in Hong Kong. It was stated that the establishment of the bank did not involve state grants, being wholly supported by the "own funds" of the shareholders.¹⁶² The Finance Department, as one of the

Finance Department Invests Directly in Extrabudgetary Enterprises", *Guangdong Caizheng*, No.1 (1993), pp.55-56. The author is an official from the local finance department of Maoming city, Guangdong.

¹⁶⁰This is revealed in Guangdong Provincial Government Notice No.3, 1992, "On the Inclusion in Budgetary Management of Profit Taxes and Adjustment Taxes Paid by Extrabudgetary Enterprises" printed in *Guangdong Zhengbao*, No.1 (1992), p.34, which states that the 1985 notice would hereafter be superseded.

¹⁶¹That the change was a result of central pressure after audit inspection was revealed by Respondent No.7, Guangzhou interview, December 1993. For the 1992 Notice, see Footnote 160 above.

¹⁶²Respondent No.7, Guangzhou interview, December 1993, admitted that the bank was within the extrabudgetary enterprise category. See also a report in *Nanfang Ribao*, February 6, 1990.

shareholders, did however provide at least several hundred million yuan from the provincial budget as the initial capital of the bank.¹⁶³ First established in 1988, the bank was still exempted from profit taxes in 1993.¹⁶⁴

Through developing the non-state sector and placing new state enterprises beyond the budget, the Guangdong leadership sought to speed up economic development by ignoring the relatively stagnant traditional state sector and focusing on the new and more flexible non-state and extrabudgetary sectors. Not only was the mode of operation of these enterprises often more flexible, and with less red tape, they were also more susceptible to manoeuvring by the provincial and lower-level governments. As local enterprises they were under the sole management of the Guangdong government. This enabled easier manoeuvring of the tax payments of the enterprises, and, as and when the need arose, easier extraction also.

Recentralization of Societal Resources

Additional resources retained at enterprises and grass-roots units through tax reduction and exemption could be recentralized by the imposition of various fees. These revenues were usually placed outside of the budget in order to reserve the revenue exclusively for local use. Through first reducing taxes and then levying local charges, the provincial and lower-level governments were able to retain more resources within Guangdong and to minimize the possibility of extraction by the Centre, whilst still being able to gain access to local resources for their own disposal and allocation.

The Electricity Fund established in 1987 in Guangdong is an example of one of those larger extrabudgetary funds whose major revenue source derived from that which had previously been budgetary revenue. In March 1987, the Guangdong provincial government approved a proposal from the provincial electricity bureau that taxes formerly paid by the bureau be exempted. Meanwhile an equivalent amount of funds would be paid into a newly formed electricity fund. This fund would be placed outside the budget for the autonomous use of the bureau. In return the bureau would take up the responsibility, including the provision of capital, for the construction of an agreed list of electricity supply projects. In addition, the electricity bureau was allowed to charge an electricity construction fee to the users,

¹⁶³Respondent No.6, Guangzhou interview, September 1993.

¹⁶⁴Respondent No.7, Guangzhou interview, December 1993.

with the revenue ostensibly paid into the Fund.¹⁶⁵ A total of more than 8 billion yuan was raised by this extrabudgetary fund by the end of 1990.¹⁶⁶

A substantial proportion of investment in the "bottleneck" sectors, of energy, transport and telecommunications, in Guangdong was also financed from extrabudgetary resources. The flexibility and higher degree of autonomy associated with this type of financing and investment management enabled Guangdong to overcome, to an extent, traditional bias against investment allocation to these sectors. For this reason the experience of Guangdong was made the subject of intensive examination and was evaluated fairly positively by the central government in a high-level study in the early 1990s.¹⁶⁷

Apart from the electricity fund as described above, it was found that Guangdong had also collected more than 20 billion yuan in the extrabudgetary sector via road tolls, additional or adjusted charges on freight transport, installation fees for new telephones since 1980. These funds had been used to finance the construction of roads, bridges and ports, and the development of the telecommunication service within the province.¹⁶⁸ Part of this sum came from new charges, for example adjusted freight prices and telephone installation fees. Part was also derived from what had originally been the revenue of the budget. For instance, the port authorities were exempted from paying into the Energy and Transport Strategic Construction Fund and the Budget Adjustment Fund by the provincial government in order that the resources could be used to develop the port facilities locally.¹⁶⁹ This, in effect, amounted to a transfer of budgetary resources to the extrabudgetary.

¹⁶⁵See Guangdong Provincial Government Notice No. 20 (1987), "Guangdong People's Government's Notice of Approving the Proposal by the Provincial Electricity Bureau on Contracting the Electricity Development Targets of the Seventh Five-Year Plan Period", March 20, 1987, in Guangdong People's Government, and Provincial Commission for the Restructuring and Reform of Economic Systems (ed.), *Jingji Tizhi Gaige Wenjian Huibian, 1986-1988* (A Compendium of Economic System Reform Documents, 1986-1988) (Guangdong: Neibu), pp.225-29.

¹⁶⁶See Guangdong Planning Commission Research Institute, "The Plan and the Market in the Investment Scene of Guangdong", in State Planning Commission (ed.), *Zhongguo Jingji Tiaojie de Lilun he Shijian* (The Theory and Practice of Economic Adjustment in China) (Beijing: People's University of China Press, 1992), p.72.

¹⁶⁷The experience of Guangdong figured conspicuously and were evaluated in a positive light in a study by the State Planning Commission, the State Council, the Construction Bank and the Ministry of Finance in 1991/1992. The findings of the study were published in Luo Jingfen and Guo Shuqing (ed.), *Jichu Chanye Jianshe Zijin Chouji* (Capital Mobilization for Infrastructural Construction) (Beijing: Jingji Guanli chubanshe, 1993). For more discussion on this point, see Chapter Seven.

¹⁶⁸See Footnote 166, p.73.

¹⁶⁹See Luo Jingfen and Guo Shuqing (ed.), *Jichu Chanye Jianshe Zijin Chouji*, p.235.

In a report on the use of extrabudgetary funds in fixed asset investment nationally, it was stated that in some provinces there were more than 100 different channels whereby extrabudgetary funds were obtained and used by various units for investment purpose.¹⁷⁰ In general 80% of funds was kept in state enterprises and their superordinate departments-in-charge. Government departments and various administrative ("shiye") units kept about 18%, with the remaining 2% being kept in the local finance departments. In Guangdong, the share was 64%, 32% and 4% respectively for the period 1986 to 1990.¹⁷¹ The share kept in the government departments, "shiye" units and local finance departments was considerably larger in Guangdong as compared with the national average. As there was a larger number of state enterprises than government and administrative units, this suggests a higher degree than average of centralization of extrabudgetary funds in Guangdong, probably due to a more aggressive involvement of governmental units in investment, through, for instance, the establishment of the various utility funds as outlined above.

There were two major ways in which the provincial government could recentralize societal resources. One was through various types of capitalization exercise, including the sale of local public bonds, the near-administrative assignment of capitalization quotas, and through high-interest loans. In one report, for instance, it was stated that Dongguan city, a hub of export-processing activity in the Pearl River Delta Region, planned to raise 0.6 billion yuan of capital between 1989 and 1991 with which to finance infrastructure investments, despite the fact that the national economy was at that time in the throes of an austerity programme.¹⁷² The other was via the more traditional method of levying various administrative or service fees and charges, or by adjusting the prices of commodities.

There are no comprehensive statistics on the total number of extrabudgetary fees and charges levied by various government and administrative units, either nationwide or in Guangdong. An insight into the possible scale of such a practice has been made possible via information made available through campaigns to stamp out the excessive proliferation of such levies in the early 1990s. In late 1991 it was reported that, in total, 70378 categories of fees and charges involving a total sum of 3.3 billion yuan were being inspected and screened during the 1990-91

¹⁷⁰See Gui Shiyong (ed.), *Xianshi Yu Jueze: Lai Zi Guojia Jiwei Jingji Yanjiu Zhongxin de Baogao* (The Reality and the Choice: A Report from the State Planning Commission) (Shanghai: Shanghai Renmin chubanshe, 1991), p.79.

¹⁷¹Calculated from Ministry of Finance (ed.), *China Finance Statistics 1950-1991*, p.294.

¹⁷²See *Nanfang Ribao*, February 27, 1989, p.1.

inspection campaign regarding excessive fees in Guangdong. In the end about 7200 categories were either abolished or revised, thus lowering the level of fees by about 0.8 billion yuan.¹⁷³

The central government, concerned with the haemorrhage effect of such extrabudgetary charges, launched campaigns to stamp out their proliferation from time to time. An administrative regulation issued by the State Council in 1988, for instance, unambiguously banned the levying of fees and charges beyond the provision of laws and administrative regulations.¹⁷⁴ In October 1993, in the midst of the effort to rein in the runaway financial activities which had occurred earlier in the year, the central government announced that all administrative charges and fees, including penalty levies which had been previously placed outside the budget, should thereafter be gradually subsumed into the budget, and remitted to the state treasury.¹⁷⁵ In November and December 1993, a total of 143 administrative charges by various departments were abolished in two batches.¹⁷⁶ Nevertheless, given the relatively good performance of Guangdong's extrabudgetary funds, in terms of the effect on the investment in bottleneck sectors, and the fact that Guangdong had sought the approval of the State Council for at least some of its major initiatives, the brunt of the ban fell mostly on the other provinces, having relatively little effect on the extrabudgetary finance of Guangdong.¹⁷⁷

¹⁷³See *Nanfang Ribao*, December 11, 1991, p.1.

¹⁷⁴"The Temporary Regulation on the Banning of *Tan-pei* Charges to Enterprises" promulgated by the State Council in April 28, 1988. This regulation provided that all charges to enterprises not provided under laws and formal administrative regulations of a legal effect, and all "compulsory" sale of bonds and other securities beyond the provision of laws and regulations would be banned. Enterprises had the right to refuse any such illegal charges imposed by any government units. The Regulation was printed in *State Council Gazette*, No.12 (1988), pp.387-90.

¹⁷⁵"Central Committee Secretariat and State Council Secretariat Approving Ministry of Finance's 'Regulation on Implementing the Budgetary Management on Administrative Fees and Penalty Revenues'", released in *Beijing Daily*, October 24, 1993, and reprinted in State Audit Commission (ed.), *Study Materials on Taxation and Fiscal Reforms*, pp.75-79.

¹⁷⁶Two lists of charges banned with immediate effect were released in national newspapers on November 9, and December 31, 1993. The lists were reprinted in *Ibid.*, pp.84-94.

¹⁷⁷The two lists of banned charges included exemptions of those already approved by the Centre. For instance, it was explicitly stated in the announcement that surcharges levied on freight transport, an item banned in the second list, would not include those surcharges already approved by previous State Council documents. Since Guangdong had already obtained approval for freight transport surcharges in the mid-1980s, its interest would not be affected. Respondent No.9 from Guangdong confirmed that Guangdong had obtained the approval of the Centre to raise charges for freight transport as early as 1984 or 1985. (Telephone interview, November 1993) A report by officials of the State Planning Commission on the financing of infrastructure investment in Guangdong also stated that it was the preferential policy of the Centre to allow Guangdong to levy higher charges for newly built railroads financed with locally raised funds. See Luo Jingfen and Guo Shuqing, *Capital Mobilization for Infrastructural Construction*, p.235.

Internationalization

The term "internationalization" refers to the increasing use of foreign capital in the economy of Guangdong. It is included as one type of discretionary behaviour because although the use of foreign capital was the stated policy of the Centre, the method in which the Guangdong government has implemented this general policy has had a significant effect on its relations with the Centre regarding investment.

The use of foreign capital, in Guangdong and nationally, started with the initial aim of supplementing the shortage of domestic investment capital and bringing in foreign technology and management techniques to order to speed up the modernization drive of the country. At that time it was largely a demand driven exercise, particularly as the onset of economic adjustment between 1980-83 tightened the supply of domestic capital when additional input was badly needed, both for the take-off of the economic experiments in Guangdong and the construction of the freshly established special economic zones.

However, the use of foreign capital brought with it certain "benefits" other than additional resources from abroad, and the Guangdong government soon became conscious of the advantage the foreign factor provided vis-a-vis its relations with the Centre. As the vice-director of Guangdong's Foreign Economic and Trade Commission commented, "the work of the provincial government in attracting foreign investment has gone through a developmental process, from one of passivity to active, conscious and strategic action."¹⁷⁸ He was actually referring to the allocation and direction of foreign investment, but this statement could also be used to describe the process by which the Guangdong leadership recognized the possible use of internationalization, both for Guangdong's development and for its relations with the Centre.

Demand-driven: Expanding Scope of Utilization

From 1979 to 1991, a total of nearly US\$15 billion of realized foreign capital was used in Guangdong, of which 18%, or US\$2.76 billion, was invested in infrastructure projects such as roads, ports, electricity stations, and

¹⁷⁸See Zhang Hanqing (ed.), *Gaige Kaifang Zai Guangdong* (Reform and Opening in Guangdong: Implementation and Thoughts on the One Step Ahead Policy) (Guangdong: Guangdong Higher Education Press, 1992), p.125.

telecommunication equipment.¹⁷⁹ The heavy use of foreign capital in infrastructure projects, an area traditionally the domain of central planning and administration, was initially a practical response on the part of Guangdong's leadership to the shortage of central investment input. As central leaders in the early 1980s repeatedly had emphasized the impracticability of Guangdong in expecting substantial central capital injection, provincial leaders had no choice but to turn to external sources.

In September 1979 Guangdong leaders suggested to central leaders the idea of using foreign capital in infrastructure investments for the first time, and received a favourable response.¹⁸⁰ Gu Mu even elaborated on the idea, suggesting that foreign capital be paid back via other industrial projects yielding a higher profit, should infrastructure projects fail to provide by themselves the profit return required to attract foreign investors.¹⁸¹ Central approval was formally given in Central Committee Notice No.41 in May 1980. This notice was issued after a meeting on the work of Guangdong and Fujian and included a statement explicitly authorizing the two provinces to utilize foreign capital in infrastructure projects including the electrification of railroads and the construction of ports and roads, in view of the shortage of state funds.¹⁸² In 1981, it was further announced that infrastructure projects using foreign capital could be exempted from taxes and profit remittance for a period in order to facilitate capital/loan repayment.¹⁸³ Therefore within first two years of the commencement of the Special Policy, the door to extensive use of foreign capital in nearly all corners of the economy was opened for Guangdong.¹⁸⁴

¹⁷⁹Ibid., pp.120-21. Realized foreign capital used in 1992 reached another peak of US\$4.9 billion. This was the largest amount of foreign capital used in any single previous year. See *Nanfang Ribao*, February 2, 1993, p.2.

¹⁸⁰Guangdong's vice-governor, Wu Nansang, raised the idea of using foreign capital in electricity and highway projects whilst Gu Mu was visiting Guangdong in September 1979. See *Centre's Instructions to Guangdong, 1979-1982*, p.47. Gu Mu immediately agreed to the suggestion, and added that since both the central government and the Guangdong government were short of funds, foreign capital should also be used to finance roads and power stations.

¹⁸¹Ibid.

¹⁸²Central Committee Notice No. 41 (1980), May 16, 1980, "On Approving the Notes of Meeting on Guangdong and Fujian".

¹⁸³See Central Committee Notice No.27 (1981), July 19, 1981, "On Approving the Notes of Meeting on the Work of Guangdong, Fujian and the Special Economic Zones".

¹⁸⁴This is not to say that all obstacles to the use of foreign capital in investment were removed in these two central documents. The approval given in 1980 and 1981 focused on roads, ports and railroad projects. In 1983, Guangdong approached the centre for using foreign capital on telecommunication investments. The response from the relevant ministry initially was not positive. But later Guangdong's idea was supported by Hu Yaobang. See "Hu Yaobang speaking when inspecting Guangdong", February 6-14, 1983, in *Centre's Instructions to Guangdong, 1983-1985*, p.23. The importance of the developments in 1980/1981 is in that they laid the ground for later specific bargaining with the Centre.

Circumventing Central Control

The extensive use of foreign capital in investment projects in Guangdong not only brought in a massive amount of external resources from abroad, with the total value of foreign capital used from 1979 to 1991 accounting for more than 25% of total societal investment in the province,¹⁸⁵ it also enabled the Guangdong government to circumvent some of the control measures imposed by the Centre on the investment of the province. Foreign investment has been a material factor in enabling Guangdong to raise the ceiling of central control figures during times of economic retrenchments, for instance, in 1986 and 1989, so that more domestic capital could be made available to Guangdong with which to finance joint-venture projects. The Guangdong leadership has, therefore, become more strategically minded and conscientious in making full use of the "foreign element" in the economy as a means to obtaining more favourable treatment from the Centre.

Foreign investment was excluded from the coverage of central control figures on the total investment scale as these quotas were designed as a control instrument on the use of *domestic* investment resources only. However, since most foreign investment projects were in fact joint venture projects, the use of a certain amount of foreign capital would, in turn, involve the use of a more or less equivalent amount of domestic capital, which being domestically derived, falls under the coverage of the central control figure on the total investment scale.

Because of this linkage of foreign and domestic capital, the contraction of the investment scale during retrenchment could seriously affect both the progress of foreign investment projects and the use of foreign capital in Guangdong. On the grounds that this province absorbs the largest amount of foreign capital in the country, the Guangdong government has succeeded in exacting concessions from the Centre on the pretext of protecting the country's interest through attracting and retaining foreign capital.

In 1986, for instance, in the middle of a retrenchment exercise, a State Council notice stated that,

"for those foreign investment projects which were already registered or under construction, provincial governments and various ministries should ensure the provision of the capital required by the Chinese partners in foreign investment projects within the central control figure. *If that was*

¹⁸⁵See Zhang Hanqing (ed.), *Reform and Opening in Guangdong*, p.120.

really impossible, this year's control ceiling of investment scale and total bank finance could be raised..."

"From 1987 onwards, the investment and bank finance required by the Chinese partners in foreign investment projects will be covered in *separate quotas* in the central and provincial plans."¹⁸⁶ (*Italics added*)

It is likely that provincial governments had deliberately held back capital for foreign enterprises in order to press for a higher ceiling of total investment scale. Many foreign investors complained of the effect of tightening finance on their projects, and the Centre, anxious to maintain foreign confidence, finally yielded to pressure. In this way, both the investment control and the supply of domestic capital was eased.

Having the largest number of foreign enterprises, Guangdong was obviously the major player in this game. In October 1986, Guangdong's leaders took up the case with Zhao Ziyang during Zhao's visit to Zhuhai and complained about the shortfall of bank finance. From Zhao's reply it could reasonably be deduced that the context of their discussion was related to foreign investment.

In response to a comment by Guangdong's leaders that there was a mismatch between investment plans and the supply of capital, and that there was often no capital provided for projects within the plan, Zhao replied:

"Nationwide there are now about 6000 foreign joint ventures... with a total investment scale of US\$20 billion, and requiring "partner capital" from our side of over 10 billion yuan... We do not have the capacity to provide that much... There is probably not enough money."¹⁸⁷

In October 1987, after Guangdong had submitted a report to the Centre presenting the good prospects of foreign investment inflow and requesting more relaxed policies and greater local autonomy with which to tap this golden opportunity, it finally succeeded in obtaining an additional domestic capital supply to go with the new foreign investment contracts it had won. The Centre agreed to assign an additional 100 million yuan of special circulating loans from the central bank to Guangdong to solve the shortage of domestic "partner capital" arising from

¹⁸⁶State Council Notice No.6 (1986), "On Further Improving the Production and Operation Conditions of Foreign-Funded Enterprises", July 11, 1986, in *Centre's Instructions to Guangdong, 1986-1987*, Part I, pp.136-41, pp. 137-38.

¹⁸⁷See "Zhao Ziyang Speaking When Inspecting the Zhuhai Special Economic Zone", October 18, 1986, in *Centre's Instructions to Guangdong, 1986-1987*, Part I, p.195.

the rise in foreign capital investment since 1986.¹⁸⁸ In a sense Guangdong had succeeded in "fishing" the Centre's provision of domestic capital through its success in attracting foreign investment.

The foreign factor was put to use again in 1989, when the Centre ordered a severe cut in the investment scale nationwide. The ceiling for Guangdong was substantially less than the provincial government had contemplated, as mentioned earlier in this chapter. The strategy of the provincial leadership was, therefore, to shift emphasis to the foreign investment sector. More efforts were made to attract foreign investment and to link existing domestic enterprises to the foreign sector. As a result, more, not less, foreign capital was used in Guangdong in the three years of nationwide retrenchment between 1989 and 1991. The total value of realized foreign capital from 1989 to 1991 was US\$6.8 billion, 13% more than the total value realized in the four years preceding 1988.¹⁸⁹

Placing the emphasis on the foreign sector served two purposes for the Guangdong government. First, the foreign sector enabled the provincial government to bargain for preferential treatment for Guangdong, exempting the province from some of the harsh control measures imposed by the Centre as a result of the retrenchment drive. This included a higher ceiling on the investment control figure¹⁹⁰, relaxation of control in the supply of bank finance, and the possible removal of custom duties imposed on imported raw materials and semi-finished parts for export processing, etc.¹⁹¹ In other words, the foreign sector was being held "hostage" by the Guangdong leadership in its bargaining with the Centre for preferential treatment. Secondly, the increased use of foreign capital enabled Guangdong's economy to continue to develop whilst most other provinces were badly affected by the straitened financial situation caused by retrenchment. Since the use of foreign capital effectively brought in additional resources to the domestic economy, it could not, in theory, worsen, but rather improve, the supply and demand situation within the economy. In the event that the use of foreign

¹⁸⁸See "The Central Leading Group on Guangdong's Report", October 27, 1987, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, p.389.

¹⁸⁹See *People's Daily*, January 23, 1992, p.2.

¹⁹⁰See Sun Jian, "A Report on Guangdong's Efforts to Contain Its Investment Scale", p.18. It should be noted that Sun Jian was a central government official participating in the inspection work on Guangdong's retrenchment efforts. In his article on Guangdong's investment scale, however, he suggested that consideration be given to the special needs of the foreign-funded enterprises in Guangdong. He had apparently been "co-opted" and successfully persuaded by Guangdong's presentation of its special circumstances. Respondent No.9 also admitted to the author that Guangdong had played the "foreign investment card" in fighting for a more relaxed environment in the retrenchment years. (Guangzhou interview, December 1993).

¹⁹¹See *Zhongguo Jinbao*, April 21, 1989, p.8, and March 10, 1989, p.1.

capital had an adverse effect in terms of continuing to "heat up" the economy, it would nonetheless be difficult for the Centre to dampen Guangdong's enthusiasm for attracting foreign investment, due to the possible negative repercussions this might cause within the international community and on Guangdong's future prospects of attracting foreign investment.

In fact the Guangdong government had early in 1989 moved beyond the more traditional approach of attracting *new* foreign investment projects. More emphasis was placed on linking the domestic sector to a foreign element, thereby expanding the benefits of the "exemptional policies" awarded to the foreign sector. Yu Fei, Guangdong's vice-governor, made this intention explicit in his speech to a provincial planning and economic meeting:

*"We must make every good use of the favourable conditions given by the 'exemptional policy'. Those capital construction projects which have a linkage with foreign-invested enterprises should be supported by all means. We should try to convert some domestic investment projects and find for them a foreign linkage so that they can enjoy the 'exemptional policies'."*¹⁹²

As it turned out, the number of co-operative joint ventures formed between existing state enterprises and a foreign partner rose conspicuously in 1989. For Guangzhou alone, the number of such contracts from January to April 1989 was 2.5 times greater than those of the same period the previous year, with the value of realized foreign capital leaping by more than 20 times.¹⁹³

This tactic was repeated in the second half of 1993 when the Centre once more tightened its supply of funds and clamped down on investment projects. In July 1993, at the onset of the Centre's tightening of bank credit, the mayor of Guangzhou, Lai Ziliu, said that his government would implement a more favourable policy with which to expand the use of foreign capital in the city, thereby enabling local enterprises to withstand the capital shortage problems resulting from the Centre's move.¹⁹⁴ In a move to attract foreign capital the city would offer to foreign investors the prospect of a larger share in the domestic market, more profits, and shares in the existing state enterprises.

¹⁹²See *Jihua Yu Fazhan*, No.1 (1989), pp.4-5.

¹⁹³See *Zhongguo Jinbao*, July 21, 1989, p.1.

¹⁹⁴See *Ming Pao* (Hong Kong) Daily, July 8, 1993.

International Centre: Justifying a Higher Level of Investment and Provincial Autonomy

With more foreign capital being absorbed into the economy, and the economy becoming increasingly externally oriented,¹⁹⁵ there arose the call to build Guangzhou and Shenzhen, the two major economic centres of Guangdong, into international cities. The purposes of such a call were two-fold. First, it justified Guangdong's plans for further and higher quality investment projects in order to make the infrastructure and industrial structure of the two cities commensurate with the standards of international cities. Second, it strengthened Guangdong's position in bargaining for a higher degree of autonomy from the central government, as a high degree of autonomy would be necessitated by such building of as well as its being the symbol of all such international cities.

The idea of building international centres was first raised in 1987 by Deng Xiaoping. When receiving a foreign delegation in May/June 1987, Deng stated that a few more "Hong Kong"s would be built in Mainland China, and the idea was raised again during Deng's southern tour in February 1992.¹⁹⁶ As Hong Kong is an international city, the call for the building of several more international cities is thus regarded as obvious.¹⁹⁷ With the end of the retrenchment policy and the change towards a more relaxed and optimistic economic "atmosphere" after the southern tour, the call for building international cities was taken quite literally in the more developed coastal regions, and particularly in Guangdong and Shanghai.

For the Guangdong leadership, the opening of Pudong in Shanghai posed new challenges to the status and prospects of Guangdong, and to its special economic zones in particular. There was increasing concern that other open areas and cities were enjoying preferential policies similar to, if not more favourable than, those once exclusively found in its special economic zones, and that the special economic zones were no longer that "special". There was therefore a need to move beyond the preoccupation with central preferential policies and to find

¹⁹⁵Shenzhen took over Shanghai's long-held position as the No.1 city in export trade in 1993. The total export value of Shenzhen in 1993 reached US\$8.33 billion, 15% of the national total, surpassing Shanghai's US\$7 billion. Foreign-funded enterprises, together with enterprises engaging in export processing, accounted for 87% of the total export trade of Shenzhen. See *Shenzhen Special Economic Zone Daily*, March 8, 1994, p.1. It should be noted that Shanghai is a provincial-level municipality. If compared on a provincial level, Guangdong has, since 1986, surpassed Shanghai as the No.1 exporter of the country.

¹⁹⁶See Lin Zhuji (ed.), *Shenzhen Guojixing Chengshi Lunwenji* (A Collection of Essays on Shenzhen Becoming an International City) (Beijing: Zhongguo Jingji chubanshe, 1993), p.4.

¹⁹⁷*Ibid.*, p.2.

new goals and targets in order to keep up the momentum of development, and to sustain the image of the province as the pioneer of economic reform. For Guangdong as a whole, the new aim was to reach and surpass the economic and social development of the "four little dragons" in two decades.¹⁹⁸ For Guangzhou and Shenzhen, their sights were set on becoming the first two international cities in Mainland China.¹⁹⁹

International cities require good infrastructure as well as a correspondingly high standard of economic development. Thus the quest for investment polarized into a legitimate, clear-cut and high-sounding focus. The prospect of being an international city provided an objective yardstick against which the investment and development plans of Guangdong, and Guangzhou and Shenzhen in particular, could be evaluated. Since it was obvious that the standards of the two cities still lagged substantially behind most international cities, the city governments would have a strong "alibi" through which to justify their ambitious investment plans and, in the event of pressure from the Centre to cut investments, a legitimate position from which to defend their investment activity and to bargain for exemptional and preferential treatment.

To make way for the realization of this goal, the Guangzhou city government plans to build a new airport with the capacity to handle 63 million passengers per year---three times the capacity of Hong Kong's Kai Tak Airport. Ten billion yuan is to be spent on building a mass transit rail system in the city area, and a long list of road and railway projects are also in the pipeline.²⁰⁰ In Shenzhen, investment projects for the decade of 1990s would require more than

¹⁹⁸This was stated as the goal of Guangdong in Deng's talks during his southern tour in February 1992. In a speech at a provincial government meeting in July 1992, Guangdong's governor, Zhu Senlin, stated that Guangdong had set its aim at reaching the standards of the "four little dragons" in 20 years. The provincial government had already completed a preliminary plan for the attainment of the goal. See *Nanfang Ribao*, July 25, 1992, p.1. The description, "four little dragons", refers to four newly industrialized countries/territories in East Asia whose rapid economic development since the 1960s has startled the international community. The four are: South Korea, Singapore, Taiwan and Hong Kong.

¹⁹⁹The vice-mayor of Guangzhou, Dai Zhiguo, stated unambiguously that the target of Guangzhou was to develop into an international city. He revealed in a press interview that Guangzhou had applied for membership of the Association of International Cities in May 1993, and was accepted in September, the first city in China to become a member of the worldwide association. See *Economic Daily* (Hong Kong), February 15, 1994, p.2. This demonstrates the determination of the Guangzhou government to elevate the status of Guangzhou internationally, and to acquire the recognition of international associations ahead of other competitors such as Shenzhen and Shanghai. Shenzhen's ambition was also explicit and open. The Shenzhen Government spearheaded a seminar in February 1993 on the strategies to realise the goal. In a paper by the organizer, it was stated that out of all other cities Shenzhen was the best qualified to be turned into an international city. The essays of the seminar were published in the book, Lin Zhuji (ed.), *A Collection of Essays on Shenzhen Becoming an International City*. For the above comment, see p.4.

²⁰⁰See *Economic Daily* (Hong Kong), February 15, 1994, p.2.

100 billion yuan of capital.²⁰¹ To finance development plans on such an immense scale, however, more foreign capital would need to be used. Increasing internationalization of the economy of the two cities is, therefore, an inevitable consequence of the building of an international city. More importantly, making internationalization as the *goal* of the two cities enables the city governments to obtain the necessary clearance from the central government for their ambitious investment plans.

Another interesting implication of the call for internationalization is the legitimization of provincial calls for less central control and more provincial autonomy generally. Ever since the conception of the special policy for Guangdong and Fujian in 1979, the prospect of more authority and autonomy for Guangdong has been discussed, both on the part of the Centre and of the provincial leadership, as the necessary *expedient* whereby the province may act as a spearhead in economic development and reform. The goal of economic development would therefore be achieved through the means of local autonomy for Guangdong. In a sense the delegation of additional authority to Guangdong in the 1980s was necessitated by the difficulty in bringing changes to the country as a whole at one time. With the progress of reform and the subsequent changes in many provinces in the country, Guangdong was becoming less exceptional and during recent retrenchment drives its economy was more often placed within the same jurisdiction of central macro-economic control as other provinces. There is concern among the Guangdong leadership that the Special Policy no longer exists in practice, and that the autonomy of the Guangdong government to manage its own economy will gradually be reduced.²⁰²

By setting itself the new goal of building international cities the Guangdong government has enabled itself to transcend the crisis arising from the end of the pioneering role of Guangdong during the initial stage of China's reforms. Not only does the idea of international cities represent a new and higher-order goal in the development of China's reforms, and thus extend Guangdong's frontier position among other provinces, this new goal also poses an inherent requirement to the level of autonomy of the provincial government. The Guangdong government

²⁰¹ See Lin Shuji (ed.), *A Collection on Essays on Shenzhen Becoming an International City*, p.6.

²⁰² This is, of course, more in a relative sense than in an absolute sense. As a result of the economic reforms and the liberalization of the economy, the degree of planning and administration from the Centre has already been substantially reduced. In other words the Centre has been issuing fewer number of orders and detailed prescriptions to the provincial government. However as decentralization of authority was extending nationwide, and Guangdong was increasingly placed under the national macro control instruments, the Guangdong government had a feeling that its autonomy vis-a vis the Centre *relative to other provinces* was less than before.

could refer to the achievements of other international cities when arguing for a higher degree of local autonomy for Guangzhou and Shenzhen, and by extension, for the provincial government itself. Power and autonomy are no longer merely the expedient; they constitute an integral part of the goal: international cities.

The following quotes serve to conclude this section:

"To materialize the strategy, Shenzhen must solve a number of things... *how to obtain the necessary degree of local autonomy and "self rule" required by any international city.*"²⁰³

(As written by a scholar from Shanghai wrote in a paper in a seminar on Shenzhen's strategies to develop into an international city)

"We need to limit the scope and weaken the force of control by the central ministries on the special economic zones, and let the zones practice self-rule in economic affairs.... Practising self-rule is necessitated by the complexity of the national economy and the imbalances in the commodity economy... This kind of economic self-rule does not ask for the rendering of all authority to the localities. It is not a pretext for regional separatism or independence. *The purpose is to adapt better to the requirements of an internationalized market situation.*"²⁰⁴

(As written by a researcher in Shenzhen wrote in an article entitled, "Self-rule is the direction of future development for the special economic zones" published in 1991.)

²⁰³See Lin Zhuji (ed.), *A Collection of Essays on Shenzhen Becoming an International City*, p.183.

²⁰⁴See Zhu Tijin, "Self-Rule Is the Direction of Future Development of Special Economic Zones", in Liu Zhongxiu (ed.), *Thoughts on Shenzhen by 100 Scholars*, pp.99-103.

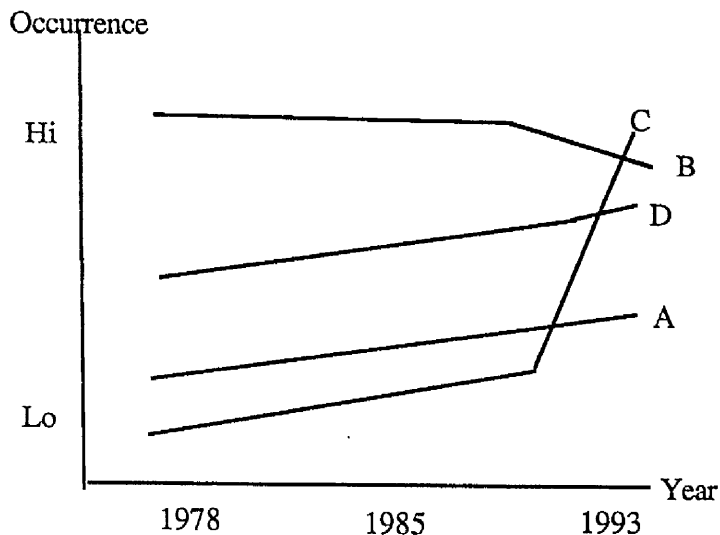
Chapter Six

Provincial Discretionary Behaviour: Shanghai

As the largest economic centre and the number one contributor to total national revenue until 1991¹, Shanghai was in a policy and economic environment very different from that of Guangdong. As officials in Shanghai were very conscious of, and, at least initially, quite proud of, their special role within the national economy, they themselves also formed part of the context of Shanghai government's discretionary behaviour. Notwithstanding the fact that the same five categories of discretionary behaviour were apparent in both Guangdong and Shanghai, such behaviour had entirely different emphases. The details of such a part-external/part-internal context are discussed comparatively in terms of Guangdong in the next chapter. Figure 6.1 below depicts the pattern visually. When compared with Figure 5.1 of Chapter Five, it is clear that discretionary behaviour of Shanghai in the 1980s was far more Centre-oriented than that of Guangdong.

Figure 6.1

Trends of Shanghai's Discretionary Behaviour, 1978-93



¹ Shanghai's number one position in terms of total fiscal revenue was assumed by Guangdong in 1991, when Shanghai's fiscal revenue was 19.19 billion yuan, and Guangdong's 19.21 billion yuan. It should be noted that the concept of fiscal revenue being compared here was the total value of fiscal revenue collected by the local collectors, and *not* the retained local fiscal revenue after remittance to the Centre. For the figures see Ministry of Finance (ed.), *China Finance Statistics, 1950-1991* (Beijing: Science Press, 1992), p.59.

The four lines in the above figure represent each of the quadrants of discretionary behaviour as discussed in Figure 5.1, with the order of provincial "independence" increasing from B, D, A, C. Figure 6.2 recaps the discussion as follows:

Figure 6.2

Provincial Discretionary Behaviour: Degree of Provincial "Independence"

	<u>Provincial Autarchy</u>	<u>Central Dependence</u>
<u>Central Plans/Policies</u>	(A): High	(B): Lowest
<u>Local Plans/Markets</u>	(C): Highest	(D): Low

Throughout the entire decade of 1980s the most important single objective of the Shanghai government was to bargain for more favourable central policies in order to improve the macro economic environment. Since it had taken Shanghai so long to attain this end, and in the interim the municipal government's room for manoeuvre has been severely constrained, the Shanghai government was keen and persistent to garner further central resources from within the bounds of the prevailing system. Bargaining for more central investment and reducing annual local fiscal remittance thus accounted for a very large part of the day-to-day dealing between the Shanghai government and the Centre during the 1980s. Therefore, as indicated in Figure 6.1 above, the lines (B) and (D) have always been of a high level of occurrence throughout the reform period. The room for discretions in implementation was limited, thus the relatively low level of the line (A) in Figure 6.1. Nonetheless the tight constraints of Shanghai's system did not entirely preclude the occurrence of policy deviations, such pressure merely shaping their form and content. As will be discussed in this and the next chapters, as the economic situation became more stringent for Shanghai during the 1980s, the Shanghai government was forced to be more "flexible" in their implementation of central rules and policies in order to make their ends meet. When the economic situation of Shanghai finally improved towards the beginning of the 1990s, the Shanghai government increasingly adopted discretionary behaviour of a kind which was less focused on the Centre and more "independence-oriented". This is represented in Figure 6.1 by the sharp rise of the line (C) from a fairly low basis

during the 1980s. The sights of Shanghai are now set beyond the state and budgetary sectors and, having adopted an increasingly outward orientation, it is now aiming at the international community beyond the Yangzi estuary.

Bargaining for More Favourable Central Policies

The position of the central government is, in some aspects, particularly strong vis-a-vis the lower levels. Consequently, improving the position of the latter requires fundamental changes to the system. One of the ways this may be achieved is through lower-level governments bargaining for more favourable sets of rules. In this respect, Shanghai's capacity to participate in this kind of behaviour has been seriously jeopardized due to its special position amongst other provincial-level units. This "stumbling block" has been Shanghai's conferred role as the "eldest son" of the Centre and the "elder brother" of other provinces. As such, Shanghai is expected to shoulder more responsibilities for the "father", and act as rear-guard whilst the younger brothers are left to make their way through the reform experiment. This special responsibility was considered by Shanghai's officials, in *post facto* analysis, as the major factor inhibiting rapid economic development in Shanghai in the 1980s.

As a result of this greater responsibility, it took the Shanghai government relatively longer to achieve a favourable macro-policy environment comparable to that of Guangdong. Whilst Guangdong was awarded the "Special Policy" early in 1979, and its subsequent bargaining efforts aimed at the implementation and refinement of that Special Policy, Shanghai spent the entire 1980s in pursuit of a more favourable policy environment.

Early Manoeuvres: 1979-1983

Upon Guangdong and Fujian being granted a preferential investment and revenue policy in July 1979, Shanghai and the other two provincial-level municipalities also pressed for preferential treatment. A meeting between the three municipalities and the Centre was held between July and September 1979, in which Beijing, Shanghai and Tianjin asked for half of the new powers of Guangdong and Fujian.² Due to the pressure from the municipalities and other coastal provinces, in

²This is revealed by Gu Mu when he was visiting Guangdong in September 22, 1979. He urged Guangdong officials to move faster in implementing the special policy because other provinces were very envious of their position. He said, "Since the release of the central documents on these two provinces, the three municipalities, Beijing, Tianjin and Shanghai, have become very envious of you. They demand to enjoy one-half of your new powers. A meeting was later convened between

November 1981 a work conference was convened with the municipalities and coastal provinces other than Guangdong and Fujian. The meeting agreed on the general principle of trickle-down economics, that is, that the coastal provinces should lead the inland provinces in the modernization of the economy. In order to fulfill this role the coastal provinces were urged to strengthen their work regarding foreign trade and the economy in general, and, in particular, to utilize more foreign capital in the improvement of the technology.³

The concessions these coastal provinces and municipalities eventually obtained, however, bore a pale resemblance to those perquisites given to Guangdong and Fujian two years previously. The theme of the 1979 meeting was restricted to external economics, focusing largely on the issues of allocation of foreign exchange income from foreign trade and the attraction of foreign investment. The fiscal system, the planning system, price controls---issues of major importance to the autonomy of provincial governments---and generous powers over which had been delegated to Guangdong, were, simply, not touched on. On approving the minutes of the meeting the central government, on the contrary, made clear that reform in the foreign trade system and delegation of autonomy in this area should be implemented in a cautious and case-by-case manner.

The cautious attitude of the central government is expressed in the following statements in the Notice:

"Situations vary between the coastal provinces and municipalities. We should therefore start from the actual situation of each area, and develop our external economic work in a gradual but progressive manner. You should not blindly emulate one another... In order to adjust to the needs for the development of foreign trade, it is necessary to expand the authority and autonomy of coastal provinces and municipalities as regards the conduct of foreign trade... But we would consider this issue on a case by case basis, and approve each case as and when the situation is ripe for change..."⁴

The Centre was obviously anxious to contain the aspirations of coastal provinces and to preempt any further demands for policies as favourable as those

the three. However, once the problem with the three municipalities had been solved, several other coastal provinces, Jiangsu, Zhejiang, Shandong and Liaoning, all expressed their desire to participate in the opening drive..." See *Centre Instructions to Guangdong, 1979-1982*, p.41.

³See "The Central Committee, State Council Notice No.6 (1982), January 15, 1982, on approving the Notes of Meeting of the External Economic and Trade Work Conference of the Nine Coastal Provinces and Municipalities (November 29, 1981)" in State Commission for Economic System Reform (ed.), *Jingji Tizhi Gaige Wenjian Huibian, 1978-1993* (A Collection of the Documents on Economic System Reform, 1983), pp.574-81.

⁴*Ibid.*, p.574.

granted to Guangdong and Fujian. Therefore, whilst recognizing the leading role of the better endowed coastal provinces relative to the inland region in economic development, the central government emphasized that there were also significant differences *between* the coastal provinces, which necessitated their being dealt with on an individual basis. Consequently, Shanghai did not gain much from this meeting in terms of fewer restraints. Apart from the general recognition of the need to use more foreign capital, the only specific authority of significance won by Shanghai from the 1981 meeting was that of having its project approval authority on foreign investment raised to US\$5 million.⁵

In response, perhaps, to the central government's case-by-case approach, the Shanghai government independently submitted a report to the Centre in March 1983 putting forward its case. The report, entitled "A Petition on Several Issues Concerning External Economic and Trade Work of Shanghai", of March 30, 1983, urged the central government to delegate more power to Shanghai in respect of foreign investment approval authority, and to confer on them the power to borrow foreign loans independently. It also called for more favourable tax policies towards enterprises using foreign capital for technical renovation, the abolition of central sectoral figures on the allocation of budgetary investment funding, and more direct central support in the form of investment funding and foreign exchange supply.⁶

As a result of this petition, the ceiling of Shanghai's approval authority for foreign investment projects was raised 100% from US\$5 million to US\$10 million. Also, and as noted in Chapter Four, central sectoral control over the allocation of budgetary investment was cancelled, thereby enabling the Shanghai government to distribute budgetary investment funds amongst different sectors and industries as it saw fit. Shanghai also gained more autonomy in the management of bank investment finance. It was discovered that the Centre would thereafter allocate a lump-sum quota of bank loans on fixed asset investment to Shanghai's People's Bank, in a similar way as it did in Guangdong, for its onward distribution to the various specialized banks. This replaced the previous system whereby the headquarters of specialised banks assigned individual quotas to their local branches.

⁵Ibid., p.577. The authority of Shanghai, Beijing and Tianjin to approve foreign investment projects was raised to under US\$5 million, while the other coastal provinces got the US\$3 million ceiling.

⁶See State Council Notice No. 55 (1983), April 4, 1983, "State Council Approving Shanghai's 'A Petition on Several Issues of the External Economic and Trade Work of Shanghai'" in State Commission for Economic System Reform (ed.), *A Collection of the Documents on Economic System Reform*, pp.605-10.

Therefore, Shanghai finally obtained its slice of favourable policies, albeit four years after the announcement of the Special Policy for Guangdong and Fujian. It was, however, a very small slice. The central government was explicit in its policy towards Shanghai, as expressed by State Councillor Zhang Jingfu during his visit to Guangdong shortly after Shanghai's petition had been approved. At this point Zhang specified to Guangdong officials the exact nature of Shanghai's favourable policies and recently enhanced local autonomy:

"The Centre has asked me to handle the issues arising from Shanghai's petition...But this autonomy (of Shanghai) has a special meaning. The Centre has appointed Shanghai the task of developing a group of industrial projects to an internationally advanced level by the year 1990 and 2000. Under this precondition, the Centre has allowed Shanghai 300 new industrial projects, at a total value of US\$300 million. This is thus the "cage" (scope of manoeuvre) the Centre has allowed Shanghai. *Within this "cage", we might loosen the "strings". However this "cage" has its defined limits. We are not loosening the "strings" in an abstract (general) way, but with and under specific preconditions....As special economic zones you have definitely more power than Shanghai...*"⁷

The concessions Shanghai achieved in 1983 were, therefore, limited and highly circumscribed. The enlarged autonomy on foreign investment approval was not accompanied by any loosening in other areas of central planning. There was no general endorsement of the enhanced autonomy of Shanghai to decide on municipal affairs, as was the case in Guangdong. The fiscal situation, in particular, was left totally untouched. Shanghai was still practising the "sharing-the-total" system in place since 1976, as were Beijing and Tianjin, whilst other provinces had obtained more local fiscal resources since 1980. In fact, as seen in Chapter Four, instead of increasing local revenue as was the case in most other provinces, the local fiscal revenue of Shanghai *decreased in absolute terms* from 1981 to 1983. The macro fiscal policy environment in Shanghai had not, therefore, seen any improvement since the start of the reform decade, and could even be described as having deteriorated from the pre-1980 conditions.

1984: Grand Development Plans

The quest for a better policy environment therefore continued. A year later, in August 1984, the Shanghai leadership met Zhao Ziyang and other central leaders of the State Council and the (Party) Central Finance and Economy Leading Group. During the meeting the Shanghai leaders made suggestions and sounded out their

⁷ See "Zhang Jingfu Speaking When Hearing the Briefing of the Shenzhen City Party Committee", May 26, 1983, in *Centre's Instructions to Guangdong, 1986-1987*, Part II, p.559.

views on a more aggressive development plan in Shanghai. Subsequent to this meeting, the State Council sent a research team to Shanghai for further investigation. After rounds of discussions and deliberations, a report on the future development strategies of the Shanghai economy was produced on December 1, 1984.⁸

The report, approved by the State Council in February 1985, confirmed the pioneer status of Shanghai in the modernization and development of the national economy, and accordingly called for more delegation of power and resources from the Centre to facilitate the realization of this role. The most important change was in the adjustment of the fiscal system. As noted in Chapter Four, the fiscal system of 1985 fixed the local retention ratio at 23.5% for six years. An additional 1.5 billion yuan was allowed for local expenditure in the calculation of the retention ratio, and in fixing this for six years the intention was to give a degree of certainty to the Shanghai government so that it might better plan its expenditure.

Despite the positive tone of the report, not many policy concessions were granted, and the macro policy environment of Shanghai remained largely unchanged. In the absence of substantial concessions in the form of preferential policies, this ostensible affirmation of Shanghai's position as the largest economic centre in the country and pioneer of modernization sounded hollow. The changes in the fiscal system, which were often hailed as a major achievement in securing more resources for local use, were, in fact, only a meagre improvement. They were, in any event, too insignificant to offset the negative impact of rising costs of production to prevent a second slide of fiscal revenue from 1986 to 1988.

The 1985 fiscal arrangement was probably the result of a compromise made by the Shanghai government in its negotiations with the Centre. This hypothesis is based on two observations. First, the preference of Shanghai's officials as early as 1984 had been for some form of tax-sharing system through which the municipal and central governments would retain their respective taxes as sources of revenue. Secondly, as soon as the deal with the Centre had been struck, there were indications from Shanghai officials that the 1985 system was considered inadequate for the needs of Shanghai. Some of the more explicit statements

⁸See the opening paragraphs of the "Report on the Development Strategy of the Shanghai Economy", printed in *Shanghai Economy 1983-1985*, p.25.

maintained that the 1985 system was suitable only as a transient arrangement pending the anticipated full establishment of the tax-sharing system.⁹

Another shortcoming of the 1984 Report concerns its underlying assumptions. The general direction and goal of development proposed by the Shanghai government in the report was strongly imbued with Shanghai's traditional thoughts about its own role. As the "eldest son" of the Centre, it was unthinkable to Shanghai's leaders that Shanghai should have no major role to play in the new drive for reform and development. Despite the central government's well known strategy of having the southern "border" provinces test the waters, it was almost the reflex response of the Shanghai leadership that Shanghai should in *some* respect play a major role. However, given its greater responsibility to the national economy, it was accepted that its development strategy and emphasis was bound to differ from that of the southern provinces. The following quotes from the Shanghai government's 1984 Report substantiate this irony vividly:

"... Shanghai should become the pioneer of the four modernizations of the country. *This is preconditioned by the status and position of Shanghai in the country and in the whole world. ...*"

"...*As the largest industrial and economic centre in the country, Shanghai should make the largest contribution to the national goal of "quadrupling the production output" by the end of this century... As for the production plan of Shanghai during the seventh Five-year Plan period (1986-1990), we should be pragmatic. We should strive to maximize our production under the precondition of fulfilling our development strategy (i.e. restructuring Shanghai's industrial structure), and should not blindly pursue projects with the sole aim of doubling the production output by 1990...*"¹⁰

In other words, whilst the Shanghai leadership were eager to jump on the economic development bandwagon and sustain the leading position of Shanghai,

⁹See Xu Riqing et. al., "Wanshan Difangshui Tixi, Shixing Fenji Caizheng Tizhi" (Perfecting the Local Tax System, Practising a Stratified System of Government Finance," *Shanghai Caizheng Yanjiu*, No.1 (1985), pp.2-5; Xu Riqing et. al. "Wanshan Shanghaishi Difang Caizheng de Yanjiu" (A Study on How to Perfect the Local Fiscal System in Shanghai), in Chen Minzhi (ed.), *Shanghai Jingji Fazhan Zhanlue Yanjiu* (A Study of Shanghai's Economic Development Strategy, 1985), pp.247-48; Tu Jimo, "A Preliminary Deliberation to Improve the Allocation of Shanghai's Fiscal Resources in the Seventh Five-Year-Plan Period", *Shanghai Caizheng Yanjiu*, No.2 (1985), p.11. It should be noted that during 1984/1985, the central government had designed a new fiscal system, based on the principle of the provinces and the Centre separately obtaining revenue from different taxes. This was intended to replace the contractual/sharing system in place nationwide since 1980. At that time Shanghai officials therefore expected some form of tax-sharing system to be imminent and that the 1985 arrangement, though considered inadequate, would be only temporary. Respondents No.23 and 27 from the Shanghai municipal government also confirmed that the ultimate goal of the Shanghai government since the 1980s regarding the fiscal system had been the tax sharing system which was considered fairer to Shanghai. (Shanghai interviews, May 1994).

¹⁰See "Report on the Development Strategy of the Shanghai Economy", printed in *Shanghai Economy 1983-1985*, pp.26-27.

their views had been so conditioned and constrained by Shanghai's traditional "role model" of the leading municipality in China that they effectively temporized their own demands. The situation was similar to one of one party on the negotiating table willingly agreeing to all the major arguments of its negotiating counterpart. In such case Shanghai's defeat in the negotiations was, in a sense, self-inflicted.

1987: Saving the "Dragon Head" Position

The limitations of the 1984 attempt were unambiguously reflected in the second, and more serious, slide in fiscal revenue which occurred in the years 1986 and 1987.¹¹ The leading position of Shanghai in the national economy was thus under increasing threat. Shanghai's local fiscal revenue in 1987, at 16.5 billion yuan, was 7.3% of the national total, a substantial fall from the 16% share in 1981.¹² The average annual economic growth rates had also fallen well behind the national average. For instance, the national annual average for national income growth from 1981 to 1987 was 9.73%, as compared to 7.85% in Shanghai. The national annual average growth rate of total societal production output was 11.44%, as compared to Shanghai's 10.16%.¹³ In sharp contrast to the lacklustre performance of Shanghai's economy, that of Guangdong's was booming, with the annual average growth rates for the two indices at 11.7% and 15.3%.¹⁴ There was an increasing sense of crisis amongst Shanghai officials and Shanghai watchers of the "Shanghai phenomenon", as there appeared to be imminent danger that Shanghai's leading status in China's economy might be taken over by the southern provinces.¹⁵

The repeated and continuous slides in fiscal revenues soon raised the concern of the Centre. In late 1987 central leaders Zhao Ziyang and Yao Yilin went to Shanghai to investigate into the difficulties faced by Shanghai. The Shanghai

¹¹The average annual rate of decrease was 3.8% for 1981-1983, and 4.2% for 1986-1987.

¹²Calculated from *China Finance Statistics 1950-1991*, pp. 59, 102; *Statistical Yearbook of China 1993*, p.229, *Shanghai Statistical Yearbook 1993*, p.55.

¹³Calculated from *Statistical Yearbook of China 1993*, pp.35, 52; *Shanghai Statistical Yearbook 1993*, pp.40, 44.

¹⁴Calculated from *Guangdong National Economic and Social Development Statistics and Information 1949-1988. Part on General Statistics*, p.69.

¹⁵A number of foreign experts from the United States and Europe reportedly made the observation when visiting China in 1987 that the economic centre of China was moving southwards to Guangzhou, and Shanghai was in the course of becoming the "British Empire" of China, meaning that Shanghai, once an omnipotent city, was on the slope of inevitable decline. Such comments raised alarm amongst the Shanghai leadership, and reminded them that the threat and danger of having moved too slowly in the economic reforms was materializing. See Yu Xiangnian, "The Objectives and Strategies of Shanghai's Externally-Oriented Economic Development", *Shanghai Jihua Jingji Tanshuo*, No.2 (1988), p.10. Yu was the vice-director of the Shanghai Economic Research Centre, a high-profile think tank of the Shanghai leadership.

government took this opportunity to submit a petition report asking for more powers and policies favourable to facilitating the revitalization of the economy. The report was approved by the State Council in February 1988.¹⁶

In this petition the Shanghai government demanded a version of the *dabaogan* responsibility system whereby the level of local fiscal remittance would be fixed at 10.5 billion yuan for a period of 5 years. From the fourth year, that is 1991, onwards, if the total local fiscal revenue exceeded 16.5 billion yuan, half of the excess would be forwarded to the central coffers on top of the 10.5 billion remittance. In addition, the Shanghai government asked for more autonomy in the conduct of export trade, and in the management of prices. It demanded for the power to determine independently the level of wages and incomes of the Shanghai citizens. Moreover, it requested the acceleration of the development of financial institutions, with a view to reestablishing Shanghai's pre-1949 financial centre status. In order to enable Shanghai to make up for its relatively slack development in the early 1980s, the Shanghai government specifically asked the Centre to increase the central control figures on its total investment scale, thus allowing local state enterprises to issue more bonds to raise capital. The Centre was also asked to provide more direct support in the form of funds and capital.¹⁷

The demands spanned the most important policy areas and, if fully realized, signalled the beginning of a substantial change in the macro policy environment. The implementation of the report was not smooth, however, and most of the powers and additional resources requested by Shanghai, and initially granted, in principle, by the Centre, did not materialize in practice. With the onset of nationwide retrenchment as from the fourth quarter of 1988, most of the new powers were either rapidly recentralized, or simply not implemented. For instance,

¹⁶The report was serialised Shanghai Government Notice No.123 (1987), entitled, "A Report on Deepening the Reform, Expanding the Opening, and Speeding Up the Development of Externally-Oriented Economy in Shanghai". See *Shanghai Industry Yearbook 1988*, pp.10-11, for an extract of the report.

¹⁷More details of the 1987 Report may be found in a report reviewing the implementation of the Report conducted by Shanghai planning officials one year later. See Cai Laixing et al. "123 Hao Wen Guanche Qingkuang Pouxu" (An Anatomy of the Implementation Status of the Report No.123), *Shanghai Jihua Jingji Tansuo*, No.2 (1989), pp.2-63. The Shanghai government requested the Centre to enlarge the quotas on total investment scale and total bank finance by 100 million yuan annually, and from 1988 to 1990, to provide additional bank finance capital via the People's Bank of China with which to finance Shanghai's infrastructural investments and its development of food industries. The report also urged the Centre to provide sufficient funds and additional finance quotas for centrally planned investment projects in Shanghai, so that Shanghai could use the entirety of local bank funds and local quotas in local investment projects. This suggests that central projects in Shanghai had previously used up part of the local capital and finance quotas originally meant for the exclusive use of local projects, and this had caused some grumbling amongst the Shanghai officials.

the power to manage the prices of 76 more categories of industrial goods was undermined by the Centre's determination to stamp out inflationary pressures, and the price management authority of eight products was formally recentralized. Shanghai's efforts to obtain larger quotas of investment scale and bank finance simply failed to bear fruit. The 100 million yuan additional quotas for investment and bank finance, and the additional bank capital for infrastructural investments, were either cancelled or substantially reduced.¹⁸

The *dabaogan* system was relatively secure, but the Shanghai government was still somewhat dissatisfied. First, the change in economic macro-environment caused by the Centre's retrenchment policies resulted in increases in local expenditures which had not been taken account at the time when the 10.5 billion yuan contract sum was calculated. This meant that the municipal government had to shoulder additional burdens, estimated in 1989 at about 1.6 billion yuan, which would have been shared with, if not entirely borne by, the Centre under the preexisting "sharing the total" fiscal system.

Second, there was the feeling that the Centre had not given Shanghai a fair deal. Due to Shanghai's historical legacy of being the base of capitalistic activities before 1949, the bulk of Shanghai's fixed assets, formed before 1949, had been substantially underestimated at the time when the private enterprises were converted into private-public joint enterprises, in order that less interests would be paid to the former owners. The implication was that the cost of renovating this part of the city's fixed assets could be one to two times that of the official estimates as stated in the account books.¹⁹ Under the contractual *dabaogan* system the municipal government would be responsible for footing the bill. Since the account books had substantially undervalued the costs and thus inflated the profits of many old local enterprises inherited from the pre-1949 industrial infrastructure, the 10.5 billion yuan figure, calculated on the basis of previously existing accounts, was similarly inflated. In other words, while the contractual system was intended clearly to delineate and assign responsibilities and resources between the Centre and the provinces, Shanghai had, within the perspective of municipal officials,

¹⁸See Cai Laixing et al., "An Anatomy of the Implementation Status of the Report No. 123", p.8.

¹⁹The Shanghai government in fact expressed concern over the historical undervaluation of the fixed assets in Shanghai in 1984, with the implication that not enough depreciation provision was allowed for technical renovation of the state enterprises. See Lin Qiushi, "Dui Guding Zichan Buchang Gengxin de Yixie Kanfa" (Some Opinions on the Replacement and Renovation of Fixed Asset Investment), *Shanghai Caizheng Yanjiu*, No.1 (1984), pp.10-12.

agreed to a deal which had given it heavy responsibilities but a less than fair share of resources.²⁰

Shanghai was not alone in having its reforms cut short. Guangdong's attempt to further expand the limits of its autonomy in early 1988 was likewise curtailed by the change of the macro economic environment and the onset of more control-oriented central policies. The main difference between the two was that Guangdong fell back onto a much higher base. The 1987 Report, on the other hand, was the first occasion on which the Shanghai government had succeeded in obtaining central approval of favourable measures on a more substantial scale. With many of the new powers cancelled or severely watered down, and more expenditure burdens placed on local fiscal shoulders, it was no surprise that Shanghai officials should feel that the 10.5 billion yuan deal and the *dabaogan* system had not in practice been a preferential policy to Shanghai. This was apparent in the fact that the macro-environment of Shanghai's economy had not seen any significant improvement.²¹

1990: Favourable Policies on Pudong

In April 1990, Premier Li Peng announced in Shanghai the Centre's decision to "open" the Pudong area in east Shanghai and its approval of ten favourable policies. These would be largely along the lines of those in the existing five (including Hainan) special economic zones. The announcement in April 1990 ended the situation whereby the policy environment and power of the Shanghai government was substantially less favourable than that of the southern provinces. This had been a change long sought by the Shanghai leadership.²²

²⁰See Cai Laixing et al., "An Anatomy of the Implementation Status of the Report No.123", pp.6-7. The politics of asset valuation has subsequently entered a new phase with new and shifting issues in the 1990s, as the new trend of liquidization of state assets in the burgeoning state assets market triggered new conflicts of interests between the local and central governments as to how the proceeds of sales should be shared. Respondent No.19, Hong Kong interview, November 1993, remarked that as a result of the low depreciation provisions since 1949, the net value of state assets in state enterprises in Shanghai as of the 1990s was grossly *overvalued*. Given that an estimated 80% of investment in Shanghai state enterprises was formed in and before the 1970s, thus coming from the central investment, the "ownership shares" of the Centre in the assets were correspondingly inflated. Respondent No.27, Shanghai interview, May 1994, admitted that the question of how the Centre and Shanghai government obtained their proper share of state assets sale in Shanghai was a complicated one, a contentious issue which was at the present in the court of the Centre.

²¹That the *dabaogan* system was not quite a preferential policy from the Centre was the general feeling of Shanghai officials. Respondents No.23 and 27 stressed that 10.5 billion yuan was a large sum, and Shanghai had to give half of the local revenue in excess of 16.5 billion to the Centre since 1991. They agreed that the tax-sharing system should be a fairer system, as the allocation of resources between the Centre and provinces would be based on responsibilities and actual needs rather than historical precedents which themselves were less than fair. Shanghai Interviews, May 1994.

²²See *Shanghai Economy 1990*, pp.20-21, for the ten favourable policies announced in April 1990.

The Shanghai leaders had, in fact, earlier in the year actively lobbied the central leaders. When President Yang Shangkun visited Shanghai, Shanghai's leaders complained to him about the plight of their city, asking Yang whether it was the Centre's policy to see the decline of Shanghai. Yang reassured the Shanghai leadership that the Centre was determined to assist Shanghai.²³ Deng Xiaoping, who was also visiting Shanghai at that time, also indicated that the Centre would give Shanghai additional support.²⁴ Having sounded out the views of the Centre,²⁵ the Shanghai government submitted to the Centre a petition report outlining detailed policy proposals for the development of Pudong in February 1990 for approval.²⁶ The petition included requests for 18 favourable policies. In the end eight of these, including more radical proposals such as allowing foreign joint ventures in the communications and publication industry, were deleted from the approved list.²⁷

Although some specific proposals were not approved, Shanghai nevertheless achieved a set of favourable policies comparable to those which had been enjoyed by Guangdong for the previous decade. The April 1990 announcement was, therefore, a major milestone for Shanghai. Shanghai thereby acquired a more equal footing in terms of developing its economy, thus ending the decade of "policy discrimination" which, in the eyes of Shanghai's officials, had been the major cause of the decline in Shanghai's economic status in the 1980s.²⁸

²³Information by Respondent No.23, Shanghai interview, May 1994.

²⁴ See *Wen Wei Po* (Hong Kong), April 23, 1990. See also Yu Xiguang et al., *Dachao Chuqi* (The Rise of the Big Wave: The Preludes and Aftermaths of the Southern Tour of Deng Xiaoping) (Beijing: Zhongguo Guangbo chubanshe, 1992), p.177.

²⁵Another major elderly leader, Chen Yun, did not make his views on Pudong public until May 1992, when he visited Shanghai on the eve of the May Day and expressed unambiguous support. That he had not made clear his views in public is evident from his conversation with Shanghai's Mayor Huang Ju. Chen Yun reportedly said to Huang Ju, "Aren't there some journalists asking you about my views on the opening of Pudong? Your answer to them is appropriate. I very much support the opening and development of Pudong... and you have done a great job here." See *People's Daily*, May 2, 1992, also printed in You Lin et. al (eds.), *Zhonghua Renmin Gongheguo Guoshi Tongjian, 1976-1992* (A History of the People's Republic of China, 1976-1992) (Beijing: Hongqiao chubanshe, 1993), p.1002.

²⁶See "The Two Reports by Wang Ju on the Opening and Development of Pudong", *Shanghai Economy* 1991, p.22. The petition report submitted to the Centre was entitled "A Petition on Opening and Developing the Pudong Area".

²⁷Information from Respondent No.25, Shanghai interview, May 1994. According to the respondent, the inclusion of more policy proposals was a conscious bargaining tactic of the Shanghai government.

²⁸One of the usual comments of Shanghai's government/party officials and enterprise officials after "study tours" to Guangdong in the 1980s was: if we were to have been given the same policies (by the Centre) as those of Guangdong, we could certainly have done better than they did." Jiang Zemin had also made similar comments while he was the party secretary of Shanghai. Respondents No.23 and 25, Shanghai interviews, May 1994.

How did this turnaround come about? The Shanghai economy had been facing grave difficulties for quite a considerable period, and the Shanghai leadership had time and again lobbied for changes throughout the 1980s. Why did the Shanghai leadership finally succeed *at that particular point in time*? It is possible that the critical factor at work was one of national political consideration, and that the specific circumstances of Shanghai may not have been relevant. In the aftermath of June 4, 1989, it was the international environment which was most central in the minds of the decision makers at the Centre.

One possible explanation for that particular decision in 1990 sees, therefore, the main concern being one of a strategic and political nature, and Shanghai being a convenient pawn. Less than a year before, in the aftermath of the June 4th incident, many foreign investors had fled the country. China's international image was seriously damaged and some of its major trading partners and exporting countries had announced economic sanctions against China. This was an undesirable situation both in terms of China's international relations and of its unfinished task of modernization. It was necessary to divert the attention of international investors and foreign governments from the events of 1989 back to the economic development programme of the country. Guangdong and its special economic zones had made an impression on the international community, but developments there were no longer a "fresh" phenomenon. Shanghai, with its historical fame within the international community, its central position in the national economy, and its strong association with the planned economy, was the ideal candidate. It was envisaged that the opening of Pudong at Shanghai would send a strong and clear message to the international community that the Chinese government was, despite the "setback" of 1989 and continued economic retrenchment, consistent and serious in its economic reform and development.²⁹

This may be one of the main motives behind the Centre's decision to confer more favourable policies on Shanghai. Another major reason could be that the Centre considered the time to be ripe for a shift in the focus of economic reform and development from the border provinces in the south to more centrally situated and, traditionally, more important economic centres such as Shanghai.³⁰ In any event this extension of the reform based on experience first gained in the south was a logical development in the progress of China's reform. As the largest city and

²⁹This was described to the author, by Respondents No. 23 and 25, Shanghai interviews, May 1994.

³⁰This is the reason cited by a number of Shanghai officials on the change of central policy regarding Shanghai in the 1990s and the fast economic development in Shanghai since. (Respondents Nos 14 and 22, Shanghai interviews, January 1994)

traditionally the most important economic centre of the country, Shanghai's historical status made it the ideal medium through which to consolidate the reform experience of the southern provinces and to extend them inland.

However, the national environment of 1990 lends credibility to the suggestion that political motives had played a part in the April 1990 announcement. It must be remembered that in 1990 China was in the middle of economic retrenchment which had begun in late 1988. When the Special Policy for Guangdong and the establishment of special economic zones were announced in 1979 and 1980, the national economic situation was relatively normal. Moreover, the decision on Guangdong was, it may be noted, well in advance of the announcement for economic adjustment in 1980. In Shanghai's case, retrenchment had already been in operation for a year and a half with no sign of ending at the time the Pudong policies were announced in April 1990.³¹ Consequently, economic development in Shanghai and Pudong in the immediate aftermath of the 1990 announcements remained lacklustre. Under severely straitened circumstances it was also difficult for the Centre to live up to its promised extra funding support, amounting to 1.3 billion yuan per year for a total of five years.³² Foreign investments, especially larger projects, were slow to regain their former momentum after the impact of the 1989 episode. Whilst investment in the local state sector increased by 20% in 1991, on the whole, the performance of the economy was constrained by the inertia of Shanghai's established systems. According to one report on Shanghai, "the development of Pudong has yet to overcome many hurdles to achieve substantive progress".³³ There was talk as late as December 1991 that the time was not yet ripe for the opening of Pudong.³⁴

³¹That the decision on Guangdong was made prior to the 1980 adjustment decision was clearly demonstrated in Gu Mu's talks with the Guangdong leadership in December 1980. Gu Mu reassured Guangdong's leaders in a provincial party committee meeting that the decision on special economic zones had been made more than a year before the announcement of the economic adjustment measures. Therefore Guangdong could not retreat what had just be started." See *Centre's Instructions to Guangdong, 1979-1982*, p.125.

³²In April 1990 the Centre promised a total of 6.5 billion yuan of additional capital within a period of five years in the form of loans and grants. See *Shanghai Economy 1991* : 27. For details of the breakdown of the 6.5 billion yuan, see a report by the Shenzhen City Study Group, "Pudong de Kaifa Jidui Shenzhen de Qishi" (Pudong's Opening and Development and Its Message to Shenzhen), *Theory and Practice of the Special Economic Zone*, No.5 (1990), p.11. See also discussion later in this chapter.

³³See Yan Jialin et. al, "Tuanzhe Yu Jiyu" (Swings and Opportunities: A Report on the 1991 Economic Development of Shanghai), *Shanghai Jihua Jingji Tansuo*, No.7 (December 1991), p.7.

³⁴Some scholars and experts, in a seminar on the Pudong development and investment in the Yangzi River Delta, commented that the immediate prospects for Pudong were dim. Major reasons included the unfavourable international environment, the burden of the Shanghai municipality in the traditional planned economy, and the lack of competitiveness of Pudong's favourable policies compared to other and earlier established special economic zones. See *Ming Pao* (Hong Kong), December 5, 1991. The occurrence of such negative comments reflected that the developments in

The development of Pudong and Shanghai only entered into the "fast lane" after Deng Xiaoping's southern tour in January-February 1992. Deng's talks with local officials during his tour of Guangdong, Shanghai, and Wuhan effectively announced the end of the 1989-91 economic retrenchment, and called for bolder attitudes towards developing the economy. In March 1992 Huang Ju, Shanghai's mayor, announced that the Centre had approved additional powers and extra capital support for Shanghai. This relaxation of the economic situation nationwide allowed the favourable policies announced back in 1990 gradually to have some impact. Consequently, in the year 1992 Shanghai's economic environment saw its first substantial improvement.³⁵ This indicates that whilst the Centre had announced the opening of the Pudong Development Zone in April 1990, the priority of the Centre at that time was nonetheless the implementation of economic retrenchment. Pudong and Shanghai had thus to wait until the end of the retrenchment policy before their development could gather momentum. This fact supports the suggestion that the announcement made in April 1990 was more of a symbolic than material nature, political considerations having been amongst the major motivations behind the decision of the central leaders on Pudong at that particular juncture in 1990.³⁶

1993: Protecting the Pudong Policies

The Pudong policies of 1990 and 1992 represented the results of prolonged bargaining with the Centre and marked the change in central policy towards Shanghai. Subsequent to these announcements, the next important task of the Shanghai government was that concerning publicity. It was necessary to eliminate the doubts and hesitation abounding in 1990/91 regarding the viability and prospects of the Pudong development.³⁷ The collective perception, both within and without the nation, of Shanghai as one of the most important bases of central planning also needed to change to see Shanghai as a pioneer in economic

Pudong and Shanghai since the April 1990 central government announcement had been less than impressive.

³⁵The marked improvement in the macro environment of Shanghai's economy was clearly noted by the Shanghai government towards the end of 1992. See *Shanghai Caishui*, No.11 (1992), p.4.

³⁶According to Respondent No.25, the Shanghai government had submitted a development proposal, outlining the development plans of Pudong in detail along with some relatively crude policy requests, to the Centre in 1987. Zhao Ziyang was in favour of approving. Some other central leaders were, however, more critical of local demands for favourable policies and their implications as regards the central coffers. As a result the report was not approved. However in 1990 this same group of leaders was very enthusiastic as regards the opening of Pudong area. Their political motive was self-apparent. (Shanghai interview, May 1994).

³⁷See footnote 34 above.

development and in market-oriented reforms. The favourable policies enjoyed by foreign and domestic investors in special economic zones in the south as compared to those in Pudong became hot topics of discussion in official and semi-official publications. The most important single message and purpose of these comparisons was to convince potential investors that Pudong's policies were the most favourable in the country, and that Shanghai, with its new initiatives in Pudong, was about to become the most important growth area in China.³⁸

This was, in a sense, the reflex response of a late-comer. It indicates the underlying worry amongst Shanghai officials of being left once more in the rear of the fast train of economic development. Shanghai's officials were, therefore, particularly weary of any hint of erosion of their hard-won favourable policies.

When Zhu Rongji came to Shanghai in October 1993 to solicit Shanghai's support for the imminent tax and fiscal reforms on the eve of the Third Plenum of the Fourteenth National People's Congress, therefore, the objective of the Shanghai leadership was to protect Pudong's favourable policies from any possible threat. Shanghai officials were concerned that the central policy to control tax exemption, announced in July 1993, as part of the macro economic adjustment measures, and likely also to form part of the pending tax and fiscal reforms, would, in effect mean the withdrawal of the Pudong policies. The preferential policies were, after all, largely built around favourable tax rates and generous tax exemptions. This also explains why the Shanghai leadership was so immediately contented and expressive of its support to the reforms, upon Zhu Rongji's agreement to Pudong's policies remaining unchanged under the 1994 tax and fiscal reforms. As a gesture of support, and as "trade-in" for the Centre's pledge, the Shanghai leadership therefore agreed to remit an additional sum of 600 million yuan in 1993 over and above the originally agreed sum of 11.5 billion yuan.³⁹ In the end Shanghai's

³⁸See for instance two articles from the Pudong Administration office, Huang Qifan, "Shanghai Pudong Xinqu Touzi Kaifa de Zhengce Tedian" (The Specialities of Pudong's Investment Policies), *Pudong Development*, No.4 (1992), pp.15-17; Gu Xingguan, "Pudong Xinqu Caizheng Zhengce de Xinyi Ji Tezheng" (The Characteristics and New Aspects of Pudong's Fiscal and Tax Policies), *Pudong Development*, No.3 (1992), pp.12-13.

³⁹Information from Respondents No.19, 20 and 21, Shanghai interviews, January 1994. Shanghai's contracted remittance sum was originally only 10.5 billion, but since 1992 400 million yuan of "additional contribution" had been added. 500 million yuan was added in 1993 as Shanghai's additional remittance for local fiscal revenue in excess of 16.5 billion yuan under the contractual scheme. This constituted substantially less than the half of the excess as prescribed by the original agreement, which would amount to some 3.7 billion yuan given Shanghai's local fiscal revenue of 1993 reaching 24 billion yuan. This represented the success of bargaining of the Shanghai leadership with the Centre. On the other hand, the Shanghai leadership agreed to remit an additional 600 million yuan as Shanghai's contribution to the pending tax reforms and in return for the Centre's assurance that Shanghai's favourable policies would continue to be implemented.

support proved critical to Zhu in pushing through the fiscal and taxation reforms at the Third Plenum in November 1993.

The priority and emphasis of the Shanghai leadership has, therefore, been very different from that of Guangdong. As discussed in Chapter Five, the Guangdong leadership's area of concern was more the effect of the tax-sharing reform on its retained fiscal revenue. Guangdong consequently focused its lobbying on the determination of the base line year during Zhu's visit. Such a difference in lobbying emphasis was, however, partly the logical result of the success of Guangdong's lobbying on the base line year. Zhu had agreed to postpone the base line year to 1993 in Guangdong prior to his visit to Shanghai, and since this policy would be universally applied, the Shanghai leadership stood to gain by relying on Guangdong's success. Consequently, Shanghai could seek to expand its benefits by focusing its own bargaining on preserving its hard-won favourable policies.

The emphasis of the Shanghai leadership nevertheless revealed some of its deep-seated concerns regarding Shanghai's development strategy. It should be remembered that from the beginning the contractual fiscal system was regarded as neither favourable nor fair to Shanghai. Shanghai's goal, since 1984, had been for some kind of tax-sharing system, whereby the revenue sources and expenditure responsibilities of the Centre and Shanghai were clearly delineated. Within this system the Shanghai government would have ample autonomy to manage local affairs, including the legislative power on local taxes.⁴⁰ Consequently, the Shanghai government was not overly concerned about the abolition of the *dabaogan* fiscal system and its replacement by a new tax-sharing system in 1994. It was more interested in keeping its centrally approved preferential Pudong policies intact. This was particularly the case in view of rumours that the Centre intended to withdraw or tighten similar policies originally granted to the south during the 1980s.

⁴⁰This is reflected in a report by Shanghai officials during the discussion over Shanghai's development strategy in 1984, in which it was written that "the current (1985) changes to Shanghai's fiscal system is...largely of a transitional nature, and cannot solve many fundamental problems. To improve fundamentally the local fiscal system, the obvious situation has to be a system whereby the Centre and the local governments obtain their share of total revenue according to the types of taxes... This should be the basic direction of future fiscal system reform." See Xu Riqing et al, "A Study on How to Perfect the Local Fiscal System of Shanghai", p.247. For even more specific advocacy of a tax-sharing system in later years, see for instance, Xu Yunren, "Jiasu Tuixing Yi Fenshuizhi Wei Zhongxin de Shenceng Gaige" (Speed up the Implementation of More Fundamental Reforms Around the Tax-Sharing System), *Shanghai Jinghua Jingji Tansuo*, No.3 (1990), pp.17-20, (Xu was then the vice-director of the Institute of Fiscal Science, Shanghai Fiscal and Tax Bureau); and Yan Bin, "Zhengque Chuli Zhongyang Yu Difang Caizheng Guanxi de Guanjian: Zhubu Shixing Fenshuizhi" (Correctly Handle the Crux of the Fiscal Relationship Between the Centre and the Local Governments: Implement the Tax-Sharing System Step-By-Step), *Caijing Yanjiu* (Shanghai), No.4 (1991), pp.3-10.

In the eyes of Shanghai officials the new tax and fiscal reforms of 1994 represented, amongst other things, the beginning of a new era of central development strategy. Equalization was the key word of this new era. The numerous discriminatory practices of the 1980s were either to be cancelled or gradually phased out. A major area for such equalization was that of the policy environments of different provinces. Faced with such a change in the Centre's development strategy the Shanghai government had mixed feelings. On the one hand, Shanghai had been the loser in the area-based discriminatory development approach of the 1980s and would welcome the shift to more area-neutral policies. On the other hand, the Pudong policies were themselves an area-based discriminatory policy, and Shanghai was also eager to reap the benefits of such policies, as Guangdong had done since the 1980s. Therefore the approach was to protect the Pudong policies for as long a period as possible, giving them up only after other special economic zones had also done so.⁴¹

Although the Shanghai leadership had obtained oral assurances from Zhu Rongji about the Pudong policies in October 1993, the special circumstances of Pudong (and other special economic zones) were not taken into account when the precise measures and policy announcements were subsequently made. There was, in other words, a gap between the oral assurances of top leaders and the implementation at the working level in central ministries.⁴² The Shanghai government was left to negotiate with the relevant central ministries, notably the Ministry of Finance and the State Taxation Bureau, about the status of each of the tax reduction policies in Pudong. The uncertainty surrounding the new tax systems was of an extent that caused hesitation among foreign investors in early 1994.⁴³

⁴¹Respondent No.27 stated that under the *existing* provisions of the new tax systems, most of the existing favourable policies in Pudong and the southern special economic zones would eventually disappear. (Shanghai interview, May 1994.) Respondent No.36 confirmed that the power of local governments in tax reduction and exemption was placed under control under the new tax and fiscal system. As a matter of principle the power to approve new tax reductions and exemptions was centralized at the State Council. Pudong and Shenzhen and other special economic zones would therefore have to make their cases on an individual basis. In future, under a more rational delineation of authority required by the tax-sharing system, the power would be divided between the local government and central government. Local governments would then have the power to reduce and exempt local taxes. But since the Shanghai government under the Pudong policies had previously been allowed to exempt and reduce industrial and commercial taxes (which became a "shared" tax under the new tax system) of foreign enterprises, the new system would still amount to a diminution of the power of the Shanghai government under the favourable policies. (Beijing interview, May 1994). For the provision see State Council Notice No.85 (1993), December 15, 1993, "State Council's Decision on Implementing the Tax-sharing Fiscal Management System", printed in *Caizheng*, No.2 (1994), pp.18-20, particularly point No.6 in p.20.

⁴²Respondent No.25, Shanghai interview, May 1994.

⁴³The thorny issue involved was whether the Shanghai government could continue to approve *new* tax reduction and exemptions for qualified foreign and domestic investors in accordance with the Pudong policies. According to Respondent No.24, the Shanghai government had successfully

The objective of the Shanghai leadership was to make the central government issue a policy document unambiguously confirming the "exceptional" status of Pudong. Meanwhile the Shanghai government would continue to implement the Pudong policies regardless of the new control provisions.⁴⁴

Fight for Direct Central Support

Due to the slow pace of change in the macro policy environment, and because Shanghai was traditionally a major base of central planning, more central support in the form of direct investment projects, capital finance and expansion of the total investment control scale represented one important and frequently employed means by which the Shanghai government sought to increase investment and boost the local economy.

Central Investment Projects

In Chapter Four it was noted that the share of central investment in Shanghai's total state sector investment during the 1980s was *larger* than that of the pre-1980 years. From 1950 to 1980, the share was at around 30%, surging to 40% during the 1981-92 period. Counting only capital construction projects, central investment projects reached their zenith at 66% during 1981-85, declining only slightly to 59% between 1986-90.⁴⁵

This high proportion reflects the substantial amount of central investment in Shanghai. Amongst the more notable and larger projects was the expansion of the Shanghai Petrochemical Plant, the first phase of which was completed in 1978, the construction of Shanghai Baoshan Iron and Steel Corporation, the Hongqiao Airport, and an electricity power plant in Pudong. Discussion in Chapter Four has shown that, despite the proliferation of funding channels in the 1980s, there are solid indications of quite a substantial inflow of central *fiscal* investment funds to Shanghai in particular years of the 1980s.⁴⁶

cleared the case with the Centre regarding the approval of new exemptions and reductions of profit taxes. But exemptions of business tax and value-added tax were still unresolved. (Shanghai interview, May 1994)

⁴⁴Respondent No.28, Shanghai interview, May 1994. Shanghai's vice-mayor cum director of the Pudong Management Committee, Zhao Qizheng, confirmed publicly in a press briefing on June 9, 1994 that the Shanghai government would continue to implement all the preferential policies, including tax reduction and exemption policies, which had been in force since 1990, quoting recent central leadership's assurances that the Centre's policy regarding Pudong remained unchanged. See *Jiefang Ribao*, June 10, 1994, p.1.

⁴⁵See discussion in Chapter Four: Tables 4.5 and 4.6.

⁴⁶See discussion in Chapter Four: Table 4.10.

Partly as a bargaining tactic and partly as a matter of subjective evaluation, there was a marked tendency among Shanghai's officials and commentators to play down the contribution of central investment projects to the local economy and to the local fiscal coffers.⁴⁷ There were frequent complaints about the extra burdens posed by central enterprises on Shanghai's capital supply, food subsidies, and other demands on the city infrastructure and community facilities. The fact that central investment could induce a multiplier effect on the local economy and was itself a major source of local fiscal revenue via the turnover taxes was ignored. For instance, it was commonplace to point out that the profit tax revenue of central enterprises entered the central government coffers directly, and that other taxes, including the turnover taxes, paid to local coffers were relatively minor and insignificant. The fact is, to the contrary, that turnover taxes were the largest revenue item in the state budget, and that central enterprises in Shanghai were the major source of these taxes. For instance, total local revenue from turnover taxes in the first nine months of 1993 was 800 million yuan more than that for the same period the previous year, of which 500 million yuan, or 63% of the increase, came solely from the Baoshan Iron and Steel Corporation alone.⁴⁸

Another major area of complaint has been the supply of working capital to central enterprises. State enterprises traditionally relied on the state for their working capital supply. Previously working capital was supplied in the form of state grants. Since the early 1980s, however, this has been carried out via bank loans. Since the supply of total bank finance in any one area was controlled by centrally prescribed quotas, the Shanghai government was very wary of central enterprises utilizing that part of the quotas which had been allotted to the city, especially when central enterprises were normally of very large scale and their demand for capital thus very substantial. In one estimate, three central enterprises alone could account for 1.05 billion yuan of Shanghai's working capital bank loans in 1989, or nearly 2% of the total working capital bank loans for the year. This

⁴⁷Respondent No.19 admitted that it was a bargaining tactic of Shanghai in its dealing with the Centre. By "crying wolf" and playing down the positive side, Shanghai sought to raise the attention of the Centre and succeed in winning more resources. (Shanghai interview, January 1994) The December 1987 Report by the Shanghai government also included such a complaint: that centrally planned projects had used up a substantial portion of Shanghai's finance capital, and requesting that the Centre provide sufficient additional capital to finance its projects in Shanghai. This of course did not mean that the complaints were entirely unfounded, but that part of the reality was somehow exaggerated and other parts played down, to give the most favourable picture conducive to Shanghai's articulation of interests to the Centre.

⁴⁸Information from Respondent No.21, Shanghai interviews, January 1994. It should be noted that prior to the tax reforms in 1994, all revenue from the turnover taxes went into the local fiscal coffers.

feeling amongst Shanghai officials was amplified by the fact that the Shanghai government had originally obtained the consent of central leaders, around 1983/84, to guarantee additional capital supply for the central enterprises, but that had not been implemented by the relevant central ministries.⁴⁹ The Shanghai government eventually lodged a formal but coded complaint in their December 1987 Report, which stated that central projects had used up a substantial portion of Shanghai's finance capital and that thereafter the Centre should provide sufficient additional capital with which to finance its projects in Shanghai.

Another area of discontent was food subsidies. The Shanghai government had to shoulder increasingly large food subsidies in the 1980s as a result of the widening gap between the purchase price of agricultural products and the actual retail price level. Any rise in retail prices was constrained by the political necessity to keep prices at a socially acceptable level.⁵⁰ Available data shows that subsidies of various kinds had eaten increasingly into the total local fiscal expenditure, rising from under 700 million yuan in 1985, or 16% of total fiscal expenditure, to 3.8 billion yuan in 1990, or 53% of the total. Of these, a substantial amount was spent on food subsidies.⁵¹ From the point of view of the Shanghai government, Shanghai was subsidizing portion of the costs of the central enterprises. By paying the cost of food subsidies, the local government coffers had been bearing a part of the cost of living of their staff, which, in theory, should be covered by the wages earned in central enterprises.⁵²

Therefore, although the Shanghai government was eager to obtain more direct central support in investment (and statistical information does suggest a

⁴⁹See Cui Laifu, "Shanghai's Zijin de Xianzhuang, Wenti Yu Duice" (Shanghai's Capital Supply: Present Situation, Issues, and Solutions), *Shanghai Economic Review*, No.4 (July 1989), p.49.

⁵⁰Historically Shanghai's retail price level has been lower and has risen more slowly than the national average. From 1951 to 1978, the annual average increase in retail prices in Shanghai was 0.7%, against the national average of 1.1%. From 1979 to 1984 it was 1.88% against 2.75%. As a result the residents in Shanghai were relatively unused to high price rises, and this seriously constrained the ability of the Shanghai government to reduce the fiscal subsidies by raising retail prices. See Jiang Zemin (ed.), *The Ten Years of Economic System Reform in Shanghai*. (The Ten Years of Economic Reform in Shanghai) (Shanghai: Shanghai Renmin chubanshe, 1989), p.132.

⁵¹Respondents No. 20 and 21, Shanghai interviews, January 1994. Input price subsidies and food subsidies are the two major items of expenditure. See also Bao Youde, "Dangqian Caizheng de Kunnan Yu Chulu" (The Current Fiscal Situation: Difficulties and the Way Out), *Shanghai Jihua Jingji Tansuo*, No.7 (December 1989), pp.1-2. Pao was the then Director of Shanghai's Finance Bureau. The subsidy on state enterprises running in the red was not included in the fiscal subsidy expenditures in accordance with China's accounting method. Until 1993 that sum of subsidy had been simply deducted from the incomes of state enterprises, which actually constituted revenue from profit taxes and remittance of profits after tax. The poor profit conditions of many state enterprises had resulted in negative figures in this revenue item throughout the 1980s. This accounting method also made turnover taxes the most important single revenue item in the state budget.

⁵²This was pointed out by Respondent No.19, Hong Kong interview, November 1993.

strong presence of the central government in investment activities during the 1980s), the general *perception* amongst Shanghai officials was that Shanghai had not benefited much from central investments in Shanghai, and that the amount of investment made during the decade had not been that substantial.⁵³ All in all, central investment did bring some benefits in terms of increased indirect tax revenue and job opportunities for the local population. On balance, however, these benefits were regarded as neither substantial nor material in terms of the benefits Shanghai should, in theory, have obtained. Part of the benefits were cancelled out by the additional financial burdens Shanghai had to bear from accommodating these central enterprises. More importantly, Shanghai officials generally *expected* a higher level of central support in return for their historically high contribution to the national coffers. The feeling was that: Shanghai deserved more.

In a sense this perception and feeling of discontent amongst Shanghai officials regarding central investment was the result of a gap between the changes in the macro environment and the rules of the game as regards the attraction of central investment on the one hand, and the capability of the Shanghai government to adapt to these conditions on the other. As discussed in Chapter Five, the progress of economic reforms in the 1980s had significantly altered the rules of the game in what had once been largely an administrative exercise in the allocation of investment resources. In order successfully to attract investment one would have to offer convincing incentives, in the form of good prospects for profit-making. One must also, at a time of tight capital supply and keen competition for capital, be prepared to contribute part of the investment and to share part of the risk. This capability to attract external investment capital by offering has been described by Chinese economists as "fishing power". The complaints of Shanghai regarding the extra burdens imposed by central projects thus reflected the fact that the Shanghai government, and its officials, had yet to adapt to the requirements of the new operating environment.

Capital Supply

Another way to increase investment in Shanghai, apart from central direct investment projects, was to increase the supply of capital from the Centre, either in

⁵³This view was clearly elaborated by Respondent No.27, Shanghai interview, May 1994. The respondent remarked that while central investment projects to inland provinces involved "real" injection of capital, central investment projects in Shanghai usually involved substantial capital contribution by the local government, whether in form of infrastructure investments such as roads and other community facilities or working capital finance. Some existing central enterprises were even originally local investment projects and were made central enterprises upon their completion.

the form of grants or bank finance. This was in a sense an even better method than that of receiving central direct investments as the municipal government could then have more autonomy in the use of capital, and the profits generated from new local projects would enter local fiscal coffers instead of central coffers as was the case for central direct investments.

There are various types of capital supply. There are, first, grants and loans requiring specified investment purposes. For instance, from 1984 to 1991 Shanghai obtained 2.9 billion yuan of additional capital from the Centre for renovating the city's infrastructure⁵⁴, and a total of some US\$1.3 billion of bank loans was also acquired from the Centre to finance the technical renovation of Shanghai's aged state enterprises.⁵⁵ In 1987, the Shanghai government, together with Beijing and Tianjin, solicited the support of the State Council in providing extra support to the development of export-oriented industries in the three municipalities. Additional funds were put aside for the competitive bidding of enterprises from the three cities.⁵⁶ Although such capital usually came with specified purposes, it was not difficult for the municipal government to circumvent control and divert the funds to other uses. The 2.9 billion yuan targeted for city infrastructure renovation was, for instance, appropriated to other uses.⁵⁷

The largest inflow of extra investment capital came as a corollary of the Pudong favourable policies, announced in 1990 and reinforced in 1992. Extra capital, to be provided in the five years between 1991-95, totalling 6.5 billion yuan, was promised to the Shanghai government at the time the central government announced the opening of Pudong in April 1990. The 6.5 billion yuan was in four parts: (1) US\$ 100 million per annum of foreign capital with favourable interest rates equivalent to 2 billion yuan in five years; (2) central fiscal grants of 200 million yuan per year, totalling 1 billion yuan in five years; (3) additional bank loans amounting to 1.5 billion yuan in five years to assist old enterprises in the city district to resite in Pudong and upgrade their technology; and (4) loans from the

⁵⁴See Jin Wen, "Yao Qieshi Jiajiang Shiji Jianshe Zijin de Hongguan Guanli" (To Substantially Strengthen the Macro-Management of Shanghai's Investment Capital), *Shanghai Jihua Jingji Tansuo*, No.1 (February 1992), p.6.

⁵⁵See *Guangming Daily*, February 24, 1993, p.1. The sum was reportedly used as from 1987. See also *Shanghai Statistics*, No.8 (1993), p.3 for a reference of additional loans by the Centre to renovate Shanghai's industrial infrastructure, the quotas of 1992 being 1.3 billion yuan, which had however not yet been realized.

⁵⁶See Lou Rucheng, "Tantan Ruohu Jiakuai Shanghai '116 Jijian Xiangmu' Jianshe Bufa" (On How to Speed Up the Pace of Shanghai's No.116 Capital Construction Projects), *Shanghai Investment*, No.5 (May 1987), pp.16-17.

⁵⁷See Jin Wen, "To Substantially Strengthen the Macro-Management of Shanghai's Investment Capital", p.6.

central Ministry of Finance with negative interest rates of 3% to 4.32% totalling 2 billion yuan in five years.⁵⁸

In March 1992, additional capital of up to 4 billion yuan more each year, or 16 billion yuan in total from 1992 to 1995, was pledged by the Centre. This included (1) allowing the Shanghai government to issue 500 million yuan of bonds each year to finance specific developments in Pudong; (2) twice as many foreign loans as those of 1990 would be arranged with favourable interest rates, making a total of US\$300 million per annum; (3) an additional 100 million yuan in annual quotas of enterprise share issue; (4) the power to issue B shares amounting to US\$100 million per annum; and (5) an extra 100 million yuan annual central fiscal grant.⁵⁹

From the above data it should be noted that of the total 22.5 billion yuan promised by the Centre, only a fraction was central money injected via the traditional channels. Money from the central government, namely, outright fiscal grants and the negative rate fiscal loans, totalled 2.4 billion yuan. This sort of capital incurred the least cost from the viewpoint of the municipal government, and was traditionally the most welcome. Next came the 1.5 billion yuan of domestic bank loans and the US\$1.3 billion foreign loans. The loans would be arranged by the central government, and although the municipal government had to pay them back in due course, the favourable interest rates amounted to some kind of subsidy. Most of the new capital promised in 1992 belonged to the third type, whereby that which the Shanghai government obtained from the Centre was not the actual supply of capital, whether as grants or loans, but the power to raise capital from the market. This included the power to issue 2 billion yuan in bonds, 400 million yuan in enterprise shares and US\$4 million in B shares. In such cases whether or not the capital could be realized would depend on the management ability of the Shanghai government, and on the condition and responses of the market.⁶⁰

Central government fiscal grants for purposes other than investment could be a support to local investment, because under the *dabaogan* system the municipal government would be able to deploy more resources to investment if more expenditures were borne by the central government. Central fiscal grants in 1992

⁵⁸See Shenzhen City Study Group, "Pudong's Opening and Development and Its Message to Shenzhen", p.11.

⁵⁹See *People's Daily*, March 11, 1992, p.1.

⁶⁰Respondent No.28 confirmed that the pledges of additional capital were, basically, realized in full. The buoyancy in the securities market ensured full utilization of the quotas of share issue allowed by the Centre. (Telephone interview, May 1994)

amounted to about 1.4 billion yuan⁶¹, accounting for some 16% of the disposable local revenue of Shanghai.⁶²

Another form of central capital supply was through the bank finance system. Loans from the central bank at favourable rates amounted to "cheap" money. From 1986 to 1990 the cumulative deposit-loan deficit reached 17.5 billion yuan⁶³, which was largely covered by loans from the central bank.⁶⁴ However information on the transfer of various bank funds to the Centre, at a level of 13.4 billion yuan in the case of Guangdong from 1980-88, is not available in the case of Shanghai. Nevertheless, information on Guangdong indicates the proportion of the net central fund injection into the local bank system.⁶⁵

The Shanghai government was adamant about its need for more in this respect. It was stated that the direct supply of bank funds from the central bank had declined substantially, from 4.8 billion yuan in 1986 to 1.6 billion yuan in 1987. This was considered totally inadequate for Shanghai's economy, and was not commensurate with the contribution and role of Shanghai in the national economy.⁶⁶

Expanding the "Cages"

The central control figures on the scale of total bank finance and total investment have been described by Chinese officials as "cages". This term conveys the message that provincial governments are, in theory, to confine their discretionary investment decisions and planning within the limits of investment total and bank finance as prescribed by the Centre. Although the control figures were actually an index of control purpose, itself not denoting any inflow of central resources to the provinces, expanding the size of the "cages" has been synonymous with attracting more investment capital from the Centre. This was particularly the case as regards bank finance quotas. As the Centre expanded the quotas of bank finance, Shanghai would be able to obtain more central bank loans to make up for

⁶¹See Zhou Youdao, "A Report on the Final Accounts of Shanghai's 1992 Budget", *Shanghai Caishui*, No.7 (1993), p.4.

⁶²Disposable local fiscal revenue refers to total local fiscal revenue (including the central grants) minus the remittance to the Centre. For the figures see *Ibid*.

⁶³See *Almanac of China's Finance and Banking 1992*, p.229.

⁶⁴This was generally the normal way of operation as understood from Respondent No.8, Guangzhou interview, December 1993.

⁶⁵As stated in Chapter Five, net injection of central money into Guangdong's banking system from 1980-1988 amounted to 13.2 billion yuan, which was about 50% of the value of central bank loans to Guangdong in the same period.

⁶⁶See Cui Laifu, "Shanghai's Capital Supply: Present Situation, Issues and Solutions", p.48.

its shortfall of deposit. As a result the call for more injection of central bank funds in the 1980s, as noted in the section above, was actually a covert call for the expansion of the bank finance scale.⁶⁷

The Shanghai government was most concerned about the constraints imposed by the central control figures, as, on the whole, it took the quotas more seriously than did Guangdong. This was especially so for the quotas on investment scale, which, in Guangdong, were not very seriously observed, as discussed in Chapters Three and Five. In Shanghai, data available suggest that the quotas were more or less followed, as shown in the table below:

Table 6.1
Shanghai's Total Investment Scale Control and Actual Performance
(Billion Yuan)

<u>Year</u>	<u>Scale</u>	<u>Performance⁴</u>	<u>Excess Investment %</u>
1988	13.01	25.4	95.4
1991	14.22	19.2	35.0
1992	22.03	29.8	44.5

Note: Performance means total *local* investment made in the year.

Source: (1) *China Capital Construction*, No.5 (1989), p.4.

(2) calculated from *Shanghai Statistics*, No.5 (1992), pp.2-5.

(3) *Shanghai Jihua Jingji Tansuo*, No.1 (1992), p.2.

(4) *Shanghai Statistical Yearbooks*, 1989, 1992, 1993.

The extent of excess investment was modest compared to that of Guangdong, as shown in Chapter Three. Taking into account that some categories of investment were, as a matter of central policy, excluded from the coverage, such modest excess investment means, in effect, that the centrally imposed quota was largely followed.⁶⁸

Consequently, very substantial effort was spent every year with a view to securing as large a "cage" as possible, and especially at the beginning of a five-year-plan cycle. In an account by Shanghai's vice-mayor and head of the Planning Commission about the work of the Planning Commission in 1991, the securing of a higher investment control scale and the associated supply of investment capital from the Centre for the 1991-95 period figured prominently as a major

⁶⁷This is the interpretation of Respondent No.28. (Telephone interview, May 1994)

⁶⁸ Some categories of investment were excluded from the coverage of the scale control so as to encourage investment in specified sectors. Otherwise they were considered too trivial to merit control. For more discussion refer to Chapter Four.

accomplishment.⁶⁹ Expanding the quotas was a major objective behind Shanghai's bargaining with the Centre for more favourable policies. For instance, in the December 1987 petition, the Shanghai government explicitly asked for the expansion of the quotas on bank finance and investment scale.

The high degree of concern for the scale quotas was fully revealed with the opening of Pudong. When the opening of Pudong became central policy in 1990 and more investments were destined to be allocated to the area, the Shanghai government was keen to have a separate quota of total investment scale for the Pudong area. The purpose of this was to prevent the displacement effect of Pudong on the old city area, and to increase the total scale of investment in Shanghai as a whole.⁷⁰ This was eventually achieved in 1992.⁷¹ In 1993, the quota for total investment scale in the old city area was 30 billion yuan, and the quota for Pudong 10.4 billion. Having a separate quota for Pudong, therefore, amounted to an increase of the total investment scale of Shanghai by one-third.⁷²

The meaning of the central control figures to the Shanghai Government was considered by some Shanghai officials as analogous to the significance of rice coupons to Chinese city residents. To be able to buy rice one must first have rice coupons, regardless of whether or not there was, in fact, sufficient rice in supply in the government reserves.⁷³ In practice the central quotas had more potential than rice coupons for coupon-holders. The supply of rice was ultimately determined by the actual quantity of the rice harvest, a factor which was not susceptible to manipulation, or certainly not on a substantial scale, at any particular point in time. On the other hand, the supply of capital in China, at least until the early 1990s, was very much a matter of the will of the central government, and developments suggested that it was possible to "push" the central government, via the central bank, to increase the supply of money by expanding the total scale of investment

⁶⁹See Xu Hangdi, "To Further Change the Functions of the Planning Commission, to Contribute Towards the Opening of Pudong and the Revitalization of Shanghai", *Shanghai Jihua Jingji Tansuo*, No.1 (1992), p.1.

⁷⁰How to formulate and implement the favourable policies in such a way that no extra burdens would be imposed on the old city area of Shanghai was a major consideration of the Shanghai government in the immediate aftermath of the announcement of Pudong policies. See for instance Cai Laixing, "Kaifang Pudong, Kaifa Pudong, Zhenxing Shanghai" (Open Pudong, Develop Pudong, Revitalize Pudong), *Shanghai Jihua Jingji Tansuo*, No.3 (June 1990), pp.1-6. Cai was then the head of Economic Research Institute, Shanghai Planning Commission.

⁷¹The negotiation for a separate investment scale quota for Pudong reached breakthrough in 1991. See Jin Wen, "To Substantially Strengthen the Macro-Management of Shanghai's Investment Capital", p.4.

⁷²For the figures on the quotas, see Shanghai Audit Bureau, "Grasp the Opportunity, and Strengthen the Audit Supervision on Capital Construction", *Shanghai Audit*, No.4 (August 1993), pp.16-17.

⁷³This is an analogy suggested by Respondent No.28.

beyond the existing means. In other words, as far as investment was concerned, the primary concern of provincial governments was that of expanding their investment scale and bank finance quotas. Having achieved a larger scale, they would then be in a position to ask for the "associated" supply of capital with which to finance the investment. How the capital was ultimately made available was not their concern.

This illustrates why control figures were deemed necessary as some form of control over the investment drives of provincial governments. However in practice the central government did not have an effective means through which to prevent non-observance of the quotas or to penalize the offenders.⁷⁴ Some provincial governments simply ignored the quotas and implemented their own investment plans. In this way their behaviour may be compared to offenders in the case of rice control who simply break into the official emergency storage godowns to take the rice. Bargaining with the authorities for more rice coupons is no longer their major means of access to an increased rice intake. This has been largely the case in Guangdong, where there has been substantial excess investment over and above the central quotas which have increasingly been ignored. In the case of Shanghai, the modest "excess" of investment shows that, on the whole, obtaining more rice coupons was still considered to be the major and most appropriate route to a full stomach.

Implementation Manoeuvres

Having established the fact that the Shanghai government was more rule-abiding than was Guangdong, this does not imply that there was no occurrence at all of deviant behaviour. A municipal finance official admitted that the Shanghai government would adapt the generally-worded central policies and laws in order that they were more "tailored" to fit the local circumstances.⁷⁵ At this point it is necessary to differentiate two types of local discretion during implementation. One type is that necessitated and allowed by central documents. Provincial governments in China are, in fact, generally expected to take the initiative in adapting national laws and central government policies to fit the local situation. Very often the national documents include general principles and crude provisions only, and it is the job of provincial government to formulate provincial regulations so as to provide detailed prescriptions. The other type is deviation from the originally intended course of action, often motivated by the quest for localised

⁷⁴This is especially true for the control figure on investment scale. The control on total bank finance was strengthened since 1989.

⁷⁵Respondent No.20, Shanghai interview, January 1994.

interest. In practice the two types of discretion are not easily distinguishable, therefore the legitimacy of the first type to adapt to local conditions provides a convenient camouflage for the second, and usually more common, type of local deviation.

The common deviations in implementation notwithstanding, the cautious mentality of the Shanghai officials has been apparent in its scale and content of the deviations, as the following instances show.

Manipulating the Central Quotas on Investment Scale

As discussed in Chapter Three, some categories of investment were excluded from the central control figures on total investment scale as part of the central policy to encourage socially desirable, non-profit-making, investment projects such as the building of schools and staff hostels.⁷⁶ One way of beating the Centre's scale control was, therefore, through manipulating these legitimate exemption categories. The Shanghai government was an active exponent of this practice.

Data available shows that 36% of Shanghai's local capital construction investment in 1987 belonged to these exempted categories. Total local investment in 1987 surpassed the original plan by just under 40%. However, if the exempted categories are excluded, the total investment is more or less equal to the value prescribed by the Centre.⁷⁷

The exempted categories became, therefore, a convenient vehicle through which the Shanghai government might legitimately increase investment beyond the control scale. Legitimacy is the key word. The Shanghai government was eager to expand investment *and* to remain righteous. This explains the "coincidence" whereby the percentage of excess investment should be nearly the equivalent of the percentage of exempted categories within the total investment.⁷⁸ However there was a limit to which one could be both rule-abiding and self-cultivating. The concern to *appear* to be abiding by the rules has imposed a strong self-restraint on

⁷⁶See Footnote 7 in Chapter Three.

⁷⁷See *Shanghai Economy* 1988, pp.558-59.

⁷⁸Respondent No.15 admitted that some investments were being *placed* in the exempted categories so that more investments could be made without breaking the Centre's quota control on investment scale. But there was a limit as to how much investment one placed beyond the coverage of the quotas without inviting queries and disapproval from the Centre. (Shanghai interview, January 1994)

the investment behaviour of the Shanghai government, and explains its relative modesty in terms of excess investment over the centrally prescribed quotas, as shown in Table 6.1 above.

Another method through which to achieve a bigger "cage" was that of excluding projects regarded as important by the Centre from the scale covered by the central quota. This tactic was particularly used during periods of retrenchment when the Centre was more stringent on the issue of excess investment. For instance during the retrenchment in 1989 when the investment scale quota of Shanghai was cut by 40%, the strategy employed by the Shanghai government was that of excluding a number of profitable industrial projects from the plan, and using this basis for bargaining when negotiating a larger quota from the Centre. During a session of the National People's Congress in Spring 1989 the Director of the Shanghai Planning Commission made the following comment on this approach:

"The uniform approach of the current retrenchment drive has brought three major difficulties to Shanghai's economic development. First is the cut in the investment scale quota, from over 13 billion yuan last year to only 8 billion yuan this year, a cut of nearly 40%. The US\$3.2 billion "9-4" special items which were previously allowed outside the coverage of the scale quota were included within the coverage of the quota this year. But this left the "cage" (i.e., the quota) too small. The only solution was to cut out this portion of investment projects. But this also brought about a problem. Of the US\$3.2 billion, US\$1.4 billion was for infrastructural projects such as airports, bridges, etc... To repay these loans we had to rely on the more profitable projects in which the balance of US\$1.8 billion was invested. *However, now the infrastructural projects were already in progress, we could only cut all that the industrial projects. But in this way we would also have curtailed the means through which to repay the loans for infrastructural projects. ...*"⁷⁹

A difficult situation was thus deliberately created by giving desirable projects a low priority within the scale of investment allowed by the Centre. The Centre was then confronted with a "problem" which could only be solved by enlarging the quota.

⁷⁹See Chan Xianglin, "Adjustment must be Based on the Actual Circumstances", *China Capital Construction*, No.5 (1989), pp.4-5. The "9-4" special items were a category of projects approved by the Centre via a central document issued on September 4, 1986, which allowed the Shanghai government additional powers to borrow and use foreign capital of US\$3.2 billion to finance badly needed infrastructural and industrial renovation projects. In order to ensure Shanghai's ability to repay the foreign loans, and to guarantee the certainty of profits through which to lure potential foreign investors, a series of more profitable industrial projects were launched as part of the "9-4" projects and the profits from these projects were used to finance the loan-repayment of the infrastructural projects. Altogether US\$1.3 billion had been used (or assigned to be used) for infrastructural projects, including the construction of the Yangpo and Nanpo bridges across the Huangpo River, and an amount of US\$1.9 billion had been used on industrial projects. Respondent No.14, Shanghai interview, January 1994.

Increasing the Revenue Base of 1993

Another instance of deviation in implementation by the Shanghai government is that of the effort to increase the revenue base on the eve of the implementation of the tax-sharing system in late 1993. Table 6.2 below shows the month-by-month local fiscal revenue in 1993.

Table 6.2

Shanghai's Local Fiscal Revenue: 1993 (100 Million Yuan)

<u>Month</u>	<u>Revenue</u>	<u>% Increase Over Same Month 1992</u>
January	11.8	23.1
February	10.6	(2.3)
March	15.9	26.9
April	24.6	25.0
May	21.1	36.2
June	13.7	2.0
July	19.6	20.4
August	18.8	32.5
September	25.2	105.6
October	31.6	65.1
November	20.4	32.4
December	29.0	8.5

Source: Information from the State Planning Commission.

Table 6.2 shows that from September to November, the local fiscal revenue of Shanghai increased at a substantially higher rate in comparison with the same months of the previous year. This suggests that there was deliberate action to collect more revenue before the end of the year.⁸⁰ The pattern of development from September to December was, however, interesting. Contrary to the "upward development", with the rate of increase accelerating towards the end of the year as was the case of Guangdong, and, as shown in Table 5.2 in Chapter Five, the trend in Shanghai was quite the opposite of that in Guangdong. The rate of increase was at its highest in September, and it fell substantially each subsequent month.

It should be noted that, as mentioned in Chapter Five, the central government, noting the sudden rise in fiscal revenue in September and October, had issued a notice in November 1993 warning against the premature and improper collection of revenue by provincial governments in an attempt to boost the revenue

⁸⁰An informed source told the author that the director of Shanghai's Finance Bureau issued in early October 1993 an internal directive to finance departments at the district and county levels to order them to collect "all revenues which should have been collected." Respondent No.21, Shanghai interview, January 1994.

base line.⁸¹ In a national finance meeting early in December, the Finance Minister Liu Zhongli reiterated this warning,⁸² and this had its desired effect on the Shanghai government. Consequently, in early December many enterprises in Shanghai received "refunds" of a substantial part of the tax payments they had earlier made.⁸³ Many enterprises were reportedly caught off guard when they received these tax refunds, no special reason or pretext having been given for them. This indicates the abruptness with which the decision on refunding the taxes had been made.

The motive behind this swift turnabout concurs with that behind the original revenue grasping behaviour, in both cases of which the local coffers benefited. Since the central government had made clear its position on the issue, to continue such behaviour was likely to invite penalties. More importantly, there was strong concern that collecting too much revenue might be detrimental to the city in the long run, since it would raise the expectations of the Centre as regards the financial strength of Shanghai, and thus invite more "requests" for additional "contributions".⁸⁴

Reaching out for the New Horizon

Until the late 1980s and even into the early 1990s the attention of the Shanghai leadership had been on the heavy burden imposed by the high base of fiscal remittances and on the rising prices of raw materials and consumer products. The senior leadership spent much time bargaining for a lower fiscal remittance level and securing more central support, in the form of fiscal grants, bank finance or direct investments. At the level of policy implementation and day-to-day practice, various tactics were employed to ensure that more could be achieved under a veil of compliance. In these circumstances, manoeuvres were largely built around the established area of the central plan system and squarely within the bounds of the traditional state sector.

⁸¹See Footnote 41 of Chapter Five.

⁸²See a report on the meeting in *Shanghai Caishui* 1993, No.12, p.5.

⁸³Respondent No.21, Shanghai interview, January 1994.

⁸⁴Shanghai's local fiscal revenue in 1993 amounted to 24.2 billion yuan, an increase of 30% over 1992. This was a huge jump when compared to the sluggish performance and slides of the 1980s. The increase would have been more if not for the substantial refunds in December 1993. As the provincial government did not have legislative power over taxes and other fiscal revenue, there was concern that, under the tax-sharing system, more of the local fiscal revenue would be transferred to the central coffers through the shared taxes. The desire to retain more resources in the locality, by collecting less taxes, was therefore still quite urgent as had been the case under the *dabaogan* system. (Respondents No 19 and 21, Shanghai interviews, January 1994)

This is, however, an oversimplification of the discretionary behaviour of the Shanghai government. It is, in fact, incorrect for observers to conclude that the Shanghai government did not use, or failed to notice the importance of, tactics which developed the room for manoeuvre of the municipal government *beyond* the traditional boundaries of state control. Such tactics had been widely used in other provinces, particularly in Guangdong, but in Shanghai the issue was more often a matter of capability than of willingness. When the Shanghai government finally secured a more relaxed macro environment towards the end of the 1980s, such tactics increasingly characterized its discretionary behaviour. By focusing on the non-state and extrabudgetary sectors, as opposed to the state and budgetary sectors, these recent forms of discretion became the major factors underlining the surge of local investment activity since the late 1980s.

For instance there was evidence that, from at least as early as 1984, some officials in the Finance Bureau had explicitly advocated the use of tax alleviation to promote local economic development.⁸⁵ It was in fact an established practice. From 1980 to 1983, whilst Shanghai was still operating the "sharing the total" fiscal system of 1976 and remitting roughly 80% of its local fiscal revenue to the Centre, the total value of tax revenue foregone as a result of exemption and reduction amounted to nearly 600 million yuan. This was about 1% of the total local fiscal revenue of the period.⁸⁶ An article by a finance official aptly describes the early thinking of some Shanghai officials on this issue:

"(The finance work), in Shanghai's case, is to expedite the purpose of our economic development strategy (approved by the Centre in early 1985). We have to drop the old way. That is, we have to change the attitude from one of being satisfied simply with increasing the amount of revenue collected, containing expenditure, and with balancing revenue and expenditure bills. The emphasis of our work should instead be placed on the promotion of production... *We have to learn a new approach in the management of our finance. In order to take more, we have first to give; to give a small piece in return for a larger piece.*"⁸⁷

It cannot, of course, be denied that as of the mid-1980s, many officials in Shanghai were not too receptive to the idea of tax alleviation being incorporated as

⁸⁵See Tao Changyuan and Lin Weiting, "Cong Jianmian Shui Kan Shuishou de Jingji Ganggan Zuoyong" (Tax Alleviation: the Leverage Function of Taxes in the Economy), *Shanghai Caishui Yanjiu*, No.5 (May 1984), pp.28-30.

⁸⁶Ibid. Of the total 600 million yuan, about 58% was directed to support production of state enterprises which were operating either in the red or on the verge of losses; 12% to support export-oriented production; 25% to collective enterprises and 4.5% to support the production of new products.

⁸⁷See Xiong Ruixiang, "Wanshan Caishui Gaige, Wei Shixian Shanghai Jingji Fazhan Zhanlue Fuwu" (To Further Improve the Fiscal Reform in the Service of Shanghai's Economic Development Strategy), *Shanghai Caishui Yanjiu*, No.8 (August 1985), p.4.

a major part of Shanghai's economic development strategy. In fact the above quote points out precisely the dominant approach towards finance work amongst Shanghai officials in the mid-1980s. It was obviously still very much focused on the due collection of revenue. Nonetheless, if it had not been for the stringent fiscal state of local coffers during the 1980s, i.e., the existence of formidable objective obstacles, such subjective obstacles might have been overcome in a much shorter period of time.

A report completed in 1991 by the Shanghai Commission for System Reform on the development strategies of Shanghai's reform in the 1990s includes a critical and frank reference to the implications of the objective circumstances regarding the municipal government's room for manoeuvre:

"The contradiction arising from the excessively heavy fiscal remittance, itself a left-over from the old centralized system, has yet to be solved. This has posed a limit on the capacity of the local finance (bureau) to adjust and regulate the economy. Some fiscal measures which would have made a substantial impact on the development of economy could not, as a result, be implemented. For instance the municipal government has been unable, whether in terms of its authorised powers or in terms of the limits posed by the actual circumstances, to implement measures on depreciation, which would have a major directing effect on our industrial and investment structure, or to devise favourable policies on profit taxes..."⁸⁸

The background to this report was the two slides of local fiscal revenue of 1981-83, and 1986-88, as described in Chapter Four. At this time the size of Shanghai's local fiscal revenue fell to *less* than that of the previous decade.⁸⁹ The pressure constituted by the high base of fiscal remittance meant there was little room for the government to manoeuvre in order to relieve itself of the burden of state enterprises, the tax on which Shanghai paid at a rate generally higher than that of the national average.⁹⁰ The weight of such pressure may have been reflected in the fact that, even at the point when the macro environment finally improved in

⁸⁸See Shanghai Institute for Economic System Reform, *Jiushi Niandai Shanghai Gaige de Zhanlue Gouxiang* (Thoughts on the Strategies of Shanghai's Reforms in the 1990s) (Shanghai: not openly published), p.238.

⁸⁹Shanghai's local fiscal revenue for 1988 was 15.75 billion yuan, which was 94.4% of the revenue level of 1978, at current prices. See *Shanghai Statistical Yearbook 1993*, p.55. Please note that fiscal revenue here refers to budgetary revenue of the local government. The total figures according to the statistical table of the yearbook include both the budgetary and extrabudgetary revenues of the local finance bureau.

⁹⁰The practical tax burden of Shanghai's state enterprises was about 40.8%, which was substantially higher than the national average. See Lou Jiwei, "Shanghai Jingji Fazhan Zhanlue Xuanze he Gaige Celui" (Reform Strategies and Choices Available for Shanghai's Economic Development Strategy), *Comparative Economic and Social Systems*, No.1 (1992), p.11. Lou was then a senior official of Shanghai's Commission for Structural System Reform.

Shanghai's favour, the reaction and responses of the Shanghai government were stubbornly anachronistic.

The initial response of the Shanghai government to the announcement of the Pudong policies illustrates the prolonged effect of the austerity during the 1980s upon the behaviour of the Shanghai leadership into the early 1990s. In the aftermath of the excitement after the 1990 announcement, there was a widespread and strongly felt anxiety within the Shanghai government that the Centre's high-profile plan for Pudong would have a negative impact on the development of the old Shanghai city area. It has been noted earlier in this chapter that the Shanghai government bargained for a separate investment scale quota for Pudong. The following quote from the 1991 report of the Shanghai Commission for System Reform shows clearly that the worry over displacement was the major concern behind the fight for a separate quota.

"To build a modernized new area in Pudong, it is necessary to inject a huge amount of capital... Under the existing investment administration system, the central government has a tight scale control on investment activities. *This would engender competition between Pudong and Puxi (the old Shanghai city) for the supply of capital and the planned scale quota.* The consequences thereof could be of three types of situation: (a) investments flow to Pudong on a substantial scale, and Puxi as a result declines rapidly; (b) investments flow to Puxi instead; Puxi is revitalized but the development of Pudong is delayed and slowed down as a result; (c) investments flow to both Pudong and Puxi without any emphasis; but since the supply of capital is limited, investments in both areas are insufficient to achieve breakthrough in either area. *Based on the present situation, the third situation is the most probable.*"⁹¹

Anxiety about the negative effect of the development of Pudong on the old Shanghai area was diffused into all the major areas of the favourable policies on Pudong. Instead of considering how to make use of the new policies so as to benefit Shanghai as a whole, the Shanghai government was preoccupied with the restrictions and limitations of the preexisting system. It was concerned that the effect of giving preferential treatment to Pudong would make the fulfilment of such preexisting duties and tasks more difficult still. For instance, in the 1991 report by the Shanghai Institute of Economic System Reform on the reform strategies of Shanghai, nearly one-third of the chapter on Pudong development was devoted to a section captioned "the system frictions between Pudong and Puxi".⁹² The subsequent long list of "system frictions" spanned the enterprise, investment,

⁹¹See Shanghai Institute for Economic System Reform (ed.), *Thoughts on the Strategies of Shanghai's Reforms in the 1990s*, p.283.

⁹²Ibid. The chapter on Pudong spans 22 pages (pp.276-98), of which seven pages was on the system frictions between Pudong and Puxi.

material supply, finance and banking, fiscal, foreign trade, price, employment, social security, and management systems. The following quote from the discussion of fiscal system frictions best illustrates the burden of the preexisting system:

"... the 10.5 billion yuan remittance task has (since 1988) become an increasingly heavy burden... This fixed remittance target will inevitably come into sharp conflict with the tax alleviation policies in Pudong. The conflict could be in the form of three types of situation. (1) Existing enterprises in Pudong currently have a fiscal contracted remittance task of 2 billion yuan. If we allow these enterprises to enjoy the policies similarly favourable to those existing in the special economic zones, fiscal revenues from these enterprises will see a significant shortfall from the original contracted sum. (2) If we allow those Puxi enterprises resiting to Pudong to enjoy the same favourable policies, there will be another shortfall. (3) Enterprises in Puxi will not obtain additional resources but have to bear an increasing (fiscal) burden (in face of the shortfall in Pudong, which Puxi enterprises will have to make up for if the fixed remittance total to the Centre is to be met). Another effect could be that of the remittance sum to the Centre not being achieved at all. Either one of the three types of situations will directly cause a decrease in local fiscal revenue. *The effect is that in a relatively long period of time, there would be a dilemma between the needs of the Pudong area and the (requirements of the) local fiscal finance (to increase local fiscal revenue and to fulfill central remittance targets).*"⁹³

The stringent fiscal and other operating conditions of the 1980s had a decisive effect on the behaviour of the Shanghai government. Not only did manoeuvres of a more substantive scale outside the traditional state and planning sector come much later, the configuration of the manoeuvres bore witness to a preoccupation with the old concerns, as the following discussion reveals.

Cutting Back the Budgetary Sector

As noted above, the positive role of tax alleviation for economic development and promotion of production was recognized by at least one group of Shanghai finance officials in the early 1980s. The haemorrhage of tax revenue, as a result of the failure to collect tax or of deliberate evasion by unscrupulous tax payers, was a common phenomenon in any tax-paying community. However, due to the constraints of the tight fiscal situation throughout the 1980s, the conscious use of tax alleviation and the deliberate slackening of tax collection, on the part of the tax collecting authority itself as a means to promote economic growth, was limited until the early 1990s.

⁹³Ibid., pp. 285-86. The 10.5 billion target of contracted remittance negotiated in 1988 was later felt amongst Shanghai officials to be too heavy a burden and an unfair deal for Shanghai generally. See discussion earlier this chapter, Footnotes 19 and 20.

Tax Alleviation

Tax alleviation in Shanghai, according to an official account, has undergone three major developments since the 1980s.⁹⁴ The first, in 1985, was the alleviation of the profit adjustment tax of state enterprises, first imposed in 1984. This incurred reductions in local fiscal revenue of several thousand million yuan. The second was in 1988, when the Shanghai government basically transferred the additional resources retained from the new fiscal *dabaogan* system to the state enterprises. A total of 1.2 billion yuan of taxes was exempted or reduced at this time.⁹⁵ The third major tax alleviation occurred in 1991, when the central government announced a series of measures to alleviate the burden of the medium-large sized state enterprises which had accumulated amid the recession of the 1989-91 retrenchment. Tax alleviation in Shanghai resulting from the measures was estimated to reach 1.3 billion yuan.

It should be noted that apart from these three major instances of tax alleviation, there was also the "regular" tax alleviation granted to enterprises either upon application, or as a result of, a case-by-case bargaining between the enterprises through their departments-in-charge. The objective of such tax alleviation was generally to help with the development of the enterprises. The growth of this category of tax alleviation was restrained by the tight financial situation of the 1980s, but towards the late 1980s, its scale had grown to a substantial level.⁹⁶

No comprehensive statistics are available for the total volume of fiscal revenue foregone as a result of the tax alleviations. Earlier in this section it was noted that the total value of tax alleviation between 1980 to 1983 amounted to about 1% of the total local fiscal revenue for the four-year-period. In the inspection of 1989, a total 153 million yuan of improper tax reductions/exemptions was detected in Shanghai, which was also just under 1% of the total local fiscal revenue

⁹⁴See Zhou Youdao, "92 Caishui Gongzuo Tansuo" (Probing the Way of the Fiscal Work of 1992), *Shanghai Caishui*, No.1 (1992), p.7. Zhou was the director of Shanghai Finance Bureau.

⁹⁵The Shanghai government retained an additional 1.4 billion of local fiscal revenue in 1988 relative to the 1987 level as a result of the *dabaogan* system. See Chapter Four for more discussion.

⁹⁶The director of the Shanghai Finance Bureau, Zhou Youdao, stated in a speech during a tax and fiscal reform seminar in November 1992 that regular tax reductions and exemptions during the past several years accounted for a substantial portion of Shanghai's local fiscal revenue. See Zhou Youdao, "Shanghai Jiang Shixing 'Yiti Liangyi' Caizheng Xintizhi" (Shanghai Will Implement the 'One-System: Two Wings' New Fiscal System", *Shanghai Caizhui*, No.11 (November 1992), p.4.

for the year.⁹⁷ The amount detected from inspections is inevitably a small part of the whole picture, which therefore suggests that the value of tax alleviations has grown substantially from its level in the early 1980s.

The changes in the macro-environment after 1988 served to activate Shanghai's long-suppressed urge to relieve itself of the burden of enterprises. In 1991, there were proposals to relax the requirements for regular tax alleviation from the existing ceiling of 250 yuan profit per worker to a higher level, although they have not apparently been adopted.⁹⁸ In 1992, the generous use of tax alleviation was finally adopted as a major tactic, if not the official "policy", of the Shanghai government to promote the development of the local economy,⁹⁹ after lagging behind Guangdong's example for almost a decade.

The effect of the stringent financial situation of the 1980s continued, however, to linger. The cautious attitude towards fiscal revenue, inevitable after decades of tight central control and the pressure to fulfill a high remittance task, could not be done away with in a couple of years. An illustrative example is the implementation of the Centre's measures to revitalize state enterprises announced in 1991. The Shanghai government was well aware of the difficulties of its state enterprises, and it had increasingly recognized and adopted tax alleviation as an approach to develop the economy. However, there was evidence to suggest that some measures approved by the Centre had not been adopted, at least not as swiftly as would have been expected, by Shanghai's local-level authorities.¹⁰⁰ An investigation report by Shanghai Audit Bureau discovered that local authorities were slow and unenthusiastic in the promotion and implementation of the centrally approved policies. A major and identifiable factor was the concern over the possible loss of local fiscal revenue as a result of the policies. Locally devised

⁹⁷ See Wu Jinglian (ed.) *Zhongguo Jingji de Dongtai Fenxi he Duice Yanjiu* (An Analysis of the Dynamics of the Chinese Economy and Some Solutions) (Beijing: People's University of China Press), p. 53.

⁹⁸ A major type of regular tax alleviation was granted to state enterprises operating at, or on the verge of, losses, in the hopes that the enterprises could thereby improve their financial position and continue production. The proposal was made by the Research Office of the Shanghai Party Committee. See "Proposals to end the difficulties faced by Shanghai's industries", *Shanghai Reform*, No.3 (1991), pp.20-22. Respondent No.21, Shanghai interview, May 1994, confirmed that the ceiling remained 250 yuan as of 1994.

⁹⁹ See a speech by a Shanghai vice-mayor in the city finance meeting in early 1993, printed in *Shanghai Caishui*, No.1 (1993), p.6, in which the vice-mayor, Xu Hongdi, stated that the Shanghai government in 1992 had focused on "letting in water to feed the fishes", a description long used to describe the use of tax alleviation to vitalize the enterprises in Guangdong.

¹⁰⁰ See *Shanghai Caishui*, No.1 (1992), p.12, and No.4 (1992), p.1, for inferences that the Shanghai government should make more effort and create suitable conditions under which to implement central government measures. This suggests that such central measures had still not been implemented in Shanghai.

application and detailed implementation rules were bureaucratic and cumbersome, it was found, and were often not in line with the actual circumstances. The enterprises themselves were also sceptical, suspicious that any benefits gained from the new policies might be recollectd on an even larger scale in later inspections, as had previously occurred.¹⁰¹

On the other hand, there was a very strong motive for making full use of the favourable policies, such as tax reduction and exemption, formally authorized by the Centre for Pudong. Earlier in this chapter it has been noted that, on the eve of the implementation of the new tax and fiscal system in 1994, the Shanghai leadership was adamant in seeking to retain Pudong's favourable policies. At the implementation level, there was a "last-minute rush" of tax alleviation applications by Pudong enterprises for the year 1993, when the prospect of the continuation of the policies was crowded with uncertainties.¹⁰² The message is clear: while the Shanghai government might still be constrained, to an extent, by the hangovers of past financial difficulties in carrying through the tax alleviation policies at enterprise level, it was unwilling to be stripped of the *power* to do so as a result of changes in the central policies. This was especially so when other provinces, and in particular Guangdong, had been able to tap the benefits of the policies a decade earlier.

Ineffective Revenue Collection

The Shanghai government was not quite the same "unenthusiastic tax collector" in comparison with its counterpart in Guangdong. This difference was due to, on the part of Shanghai, pressure to collect enough revenue to cover both the central remittance and necessary fiscal expenditures. Revenue manipulation was, however, far from nonexistent. The surge and sudden decline in fiscal revenue in late 1993, as discussed above, was a typical case of revenue manipulation at the collection stage engineered from the municipal level. There is evidence that such refunds of tax revenue aiming at lowering the level of local

¹⁰¹See the Audit Bureau, Shanghai, Changling district, "An Audit Investigation on the Implementation of State Enterprise Policies", *Shanghai Audit*, No.6 (December 1992), pp.15-18. Similar problems existed in collective enterprises. See Zeng Niansi, and Sui Liang, "Guanyu Shanghai Shiqu Chengzhen Jiti Jingji Zhuangkuang de Tiaocha" (A Survey of the Economic Situation of the Urban Collective Sector in Shanghai), *Shanghai Caizhui*, No.12 (December 1992), p.8.

¹⁰²Between January-November 1993, more than 800 applications for the alleviation of circulation taxes from Pudong enterprises were approved. This rush was in order to take advantage of the favourable policy of reducing/exempting circulation taxes during the first year of operation of any Pudong enterprise. The tax revenue forgone on this last minute rush amounted to more than 70 million yuan. (Respondent No. 21, Shanghai interview, January 1994)

fiscal revenue also occurred in 1992. A tax department at the district level was found to have returned, in November-December 1992, without due approval of the district government, over 10 million yuan of taxes. It had also contracted profit payments to 24 enterprises under the pretext of over-payments.¹⁰³ From the viewpoint of this discussion it is not material whether or not due approval from the district government was given for the tax refunds. The 1993 manoeuvres, albeit under the instructions of the leadership of the municipal bureau, amounted to local deviant behaviour by any standard. In other words, notwithstanding the preoccupation of the Shanghai government with revenue collection, it has a simultaneous tendency to conceal a part of its revenue and local resources from the Centre. This tendency could be materialized as and when circumstances required.

Consequently, Shanghai has also been seen in the upper ranks of the "black list" of unenthusiastic revenue collectors. In the early 1990s, Shanghai ranked second, after Guangdong, in the list of provincial-levels having the highest number of "improper" accounts.¹⁰⁴ From 1985 to 1991, about 3.7 billion yuan of lost fiscal revenue was discovered during annual inspection exercises.¹⁰⁵ Lost revenue in 1990 and 1991 amounted to 0.6 billion yuan and 0.34 billion yuan respectively.

Moreover, as in Guangdong, new revenue items were often the major source of revenue haemorrhage. From data available for 1991, the Energy and Transport Strategic Development Fund and the Budget Adjustment Fund accounted for a substantial 13.5% share of the rediscovered fiscal revenue for the year. This suggests a strangely similar difficulty in collecting new revenue items as was experienced in Guangdong. Deliberate account manoeuvres by state enterprises to exaggerate expenditures and conceal revenues accounted for 35%, while the rest was primarily due to evasion of various industrial and commercial taxes.¹⁰⁶

It is difficult to know precisely the background to the statistical data on revenue haemorrhage, and to what extent the haemorrhage was the deliberate tolerance, even active facilitation, of the municipal government. Nevertheless the data points out the fact that notwithstanding the image of the Shanghai government

¹⁰³ See Zheng Rujuan, "Jianghua Caizheng Shenji de Jidian Tansuo" (Several Suggestions to Strengthen Fiscal Audit), *Shanghai Audit*, No.2 (April 1993), p.17.

¹⁰⁴ Respondent No.10, Guangzhou interview, December 1993. According to the respondent, the "improper" accounts discovered in annual inspection exercises during the recent years in Guangdong amounted to over 2 billion yuan. Shanghai was second to Guangdong, though there was a considerable gap between the two.

¹⁰⁵ Calculated from *Shanghai Jingji*, No.5 (1989), p.23; *Shanghai Caishui*, No.2 (1991), p.14; *Shanghai Caishui*, No.3 (1992), p.31.

¹⁰⁶ See Qin Li, Qian Zhiping, "A Report of the 1991 Fiscal and Tax Inspection Exercise", *Shanghai Caishui*, No.3 (1992), pp.6-7.

as a diligent and sometimes over-diligent revenue collector, the city still had the second largest sum of "improper" accounts, and also that a substantial amount of revenues had simply not been collected.

Diverting Budgetary Revenue to Extrabudgetary Investment

Given the usual image of the Shanghai government, it would be expected that the extrabudgetary part of Shanghai's revenue would be relatively small. Evidence available suggests the contrary, as shown in Table 6.2 below:

Table 6.3

Budgetary and Extrabudgetary Revenues of Shanghai (Yuan Billion)

<u>Year</u>	<u>Budgetary</u>	<u>Growth %</u>	<u>Extrabudgetary</u>	<u>Growth %</u>
1982	16.51	-	4.10	-
1983	15.37	(6.9)	4.52	10.2
1984	16.11	4.8	5.30	17.3
1985	18.16	12.7	6.75	27.4
1986	17.61	(3.0)	8.43	25.0
1987	16.51	(6.2)	9.68	14.8
1988	14.68	(11.1)	10.94	13.2
1989	15.27	4.0	10.52	(3.8)
1990	15.77	3.3	10.34	(1.7)
Total	145.99		70.58	
Average)				
Growth) %		(0.3)		12.8

Note: The budgetary revenue figures shown for the period 1988 to 1990 were less than those in *Shanghai Statistical Yearbook 1993*, p.55. For consistency purpose the figure in the Statistical Book was ignored. The 1986 figure was taken from the *Statistical Yearbook 1993*, p.55.

Source: *China Finance Statistics 1950-1991*, pp.68, 199; 1950-1985, pp.54, 144.

Table 6.3 shows that the average growth rate of extrabudgetary revenue was conspicuously higher than that of budgetary revenue, which had an average annual negative growth rate of -0.3% throughout the 1980s. In fact, the total value of extrabudgetary revenue was nearly one-third more than that of Guangdong, as shown in Table 5.3 of Chapter Five. It should be noted that although Shanghai's total budgetary revenue, at 128.38 billion yuan (discounting the year 1986 for the sake of comparison with Guangdong, for which the 1986 figure was not available), was much larger than Guangdong's at 66.53 billion yuan, this was mainly because Shanghai had started from a high base in the first place. Moreover, and more importantly, a large portion of Shanghai's budgetary revenue, over two-thirds for

1990, had been remitted to the central coffers, whilst a much smaller proportion of Guangdong's revenue was sent to the Centre.¹⁰⁷ Therefore although Shanghai had, at face value, a higher level of revenue both within and without the budget vis-a-vis Guangdong, it was only the latter that could be material in terms of Shanghai achieving a higher level of retained revenue for local discretionary use than Guangdong.

Since extrabudgetary revenue was completely under local control and deployment, this provided a strong motive for provincial governments to increase this kind of revenue. On not infrequent occasions, budgetary revenue was diverted to the extrabudgetary stream of the local coffers. The heavy remittance task of Shanghai, however, limited the extent of such diversionary behaviour. Nevertheless, if enough budgetary revenue had been collected and the remittance target had been met, it was always in the local interests to expand the extrabudgetary part of revenue. In this way more resources could be deployed and allocated locally with the minimal oversight from the Centre. More importantly, it could preempt possible "requests" from the Centre for additional contributions, and sustain Shanghai's image of being in need of the support of the Centre.

The apparently contradictory interest of the Shanghai government in collecting a sufficiently high level of fiscal revenue, whilst retaining the surplus in the extrabudgetary part so as to forestall central encroachment upon its resources, resulted in the composition of Shanghai's extrabudgetary revenue being quite different from that of the national average, and, particularly, of Guangdong. Table 6.4 below shows the difference:

¹⁰⁷For the later years from 1988 to 1990, a total of 12.32 billion yuan was remitted to the centre, accounting for 32.8% of the total fiscal revenue of the three-year-period. See Table 5.1 of Chapter Five.

Table 6.4

Growth Rates of Shanghai's Extrabudgetary Revenue: By Make-up Portions
National Average and Guangdong
1990 over 1986 (%)

<u>1990/1986 Increase %</u>	<u>National</u>	<u>Shanghai</u>	<u>Guangdong</u>
Local finance bureau (L)	40.3	34.2	26.4
Administrative/ <i>Shiye</i> units (A)	96.1	106.4	103.4
State enterprises & Departments-in-charge (S)	48.4	10.9	89.1
Total	55.9	23.2	89.2

Source: *China Finance Statistics 1950-1991*, pp.189, 199, 204.

Table 6.4 above shows that the extrabudgetary revenue kept by state enterprises and their departments-in-charge, primarily in the form of profit retentions and technical renovation funds, had grown at a much lower rate in Shanghai. However, on the other hand, revenue kept by the local finance bureau grew at a substantially faster rate than it did in Guangdong. The funds kept by various administrative and non-profit making institutions (the *shiye* units) grew at the fastest rate, exemplifying the fast growth of various investment funds which had been kept in the units since the late 1980s. Table 6.5 below shows the trend of the composition percentages over the years, and giving a broader understanding of the full picture.

Table 6.5

Composition of Extrabudgetary Revenues (%)

	<u>Shanghai</u>	<u>Guangdong</u>	<u>National</u>
1986			
L	4.4	6.5	2.5
A	11.8	29.1	16.3
S	83.9	64.4	80.6
1987			
L	4.6	5.0	2.2
A	13.3	28.4	17.7
S	82.1	66.6	80.1
1988			
L	4.4	4.4	2.1
A	13.8	30.2	18.6
S	81.7	65.4	79.3
1989			
L	4.7	3.5	2.0
A	17.1	28.9	18.8
S	78.3	67.6	79.1
1990			
L	4.8	4.3	2.2
A	19.7	31.3	21.3
S	75.5	64.4	76.5
1991			
L	5.3	n/a	2.1
A	19.8	n/a	21.5
S	74.9	n/a	76.4
1992			
L	9.9	n/a	n/a
A	37.2	n/a	n/a
S	52.9	n/a	n/a

Source: For 1986-1991, *China Finance Statistics 1950-1991*, pp.191, 199, 204. For Shanghai data of 1991, 1992, information from the Shanghai Finance Bureau (Neibu).

The information in Table 6.5 shows that Shanghai's extrabudgetary revenue in state enterprises and their departments-in-charge declined steadily from a very high share in 1986. The high share was probably attributable to the large number of relatively old state enterprises in Shanghai. Technical renovation funds, the major form of investment of these enterprises, were a form of extrabudgetary revenue. This part of extrabudgetary funds had been growing very slowly, however, as shown in Table 6.4 above. By 1992, it accounted for just over half of total extrabudgetary funds in Shanghai.

The main growth points were those handled by the local finance departments and by the administrative units, the latter being discussed in more detail later in this chapter. As regards the portion held by local finance departments,

this share increased steadily, becoming towards the end of the 1980 decade higher than that of Guangdong. It was also much higher than the national average, despite a higher growth in absolute value in the latter as shown in Table 6.4.

The picture emerging from the above case data is one of the Shanghai government balancing the need to contain the amount of revenue exposed to possible manipulation by the central government, whilst centralizing more of the resources under its direct control for its own flexible deployment. The slow growth of extrabudgetary funds as handled by enterprises demonstrates the reluctance and consequently slow pace of the Shanghai government in dispersing its resources amongst enterprises in its society, as discussed in the section on tax alleviation. This is particularly clear when contrasted with the rapid and strong surge of extrabudgetary funds in state enterprises in Guangdong.

On the other hand, more and more extrabudgetary funds were being held by the local finance departments. The proportional share was consistently about double that of the national average, and the share in 1991 was more than double the share of 1986. Provisional figures for 1993 projected a doubling of this part of revenue in terms of absolute value.¹⁰⁸ Table 6.4 shows that while extrabudgetary funds held by local finance departments generally grew at a slower rate than the total sum, both nationally and in Guangdong, the reverse was true in Shanghai. The implication is clear. **The pressure of a high remittance target, and the heavy burden of fiscal subsidies, resulted in a strong inclination within the Shanghai government to seek some form of financial security. Funds dispersed amongst state enterprises, even though these would be local resources and would benefit the development of the enterprises and thus the local economy, would still be beyond the *direct* control of the municipal government and would thus not ease the concern over security. Extrabudgetary funds of the local financial departments, on the other hand, fulfilled the dual requirements of keeping the resources at a distance from the central government, and allowing close and direct control by the municipal government.**

It is therefore not surprising that instances of "account manoeuvres" by Shanghai's finance departments can be detected. Common tactics include keeping

¹⁰⁸See "An Analysis of the Local Fiscal Revenue and Expenditure of Shanghai in 1993 and a Forecast of 1994", in Shanghai Institute of Economic Development (ed.), *Shanghai Jingji Fazhan, 1993* (Shanghai Economic Development, 1993) (Shanghai: China Business Weekly Press), p.75. This article was reportedly written by informed sources in the municipal finance bureau. The value of extrabudgetary local fiscal revenue in 1993 was estimated to reach 2 billion yuan, which was over 8% of the total fiscal revenue of the year.

budgetary revenues outside of the budget, exaggerating the value of budgetary expenditures, and even keeping "private accounts" beyond both the budgetary and properly documented extrabudgetary revenues.¹⁰⁹ This rationale is similar to the occurrence of tax evasion and haemorrhage phenomenon amongst the enterprises. It is not therefore contradictory that the Shanghai tax and fiscal departments are strict in the collection of taxes and revenue, and simultaneously evade and hoard revenue against possible encroachment by the Centre. Under such strong pressure from above, the need to retain some "private" resources as a means to enhance one's independence and room for manoeuvre is natural, whether this be from the point of view of state enterprises as tax payers or of local finance departments as remitters of fiscal revenue.

Developing the Extrabudgetary and Non-State Sectors

In the late 1980s, the Shanghai government started to reorient emphasis from that solely of the traditional state sector and to pay more attention to the extrabudgetary and non-state sectors.¹¹⁰ However, as a result of its preoccupation with security, the Shanghai government was more interested in developing the extrabudgetary part of the state sector than it was the more societal-oriented, independence-prone non-state enterprises. Consequently, the development of the non-state sector was relatively slow in Shanghai in the 1980s. When more attention was finally paid to this sector in the 1990s, the development of the non-budgetary state sector grew at a similarly fast, if not faster, pace.

Until 1992 over 60% of industrial output value and over 80% of total investment in Shanghai had been accounted for by the state sector.¹¹¹ The Shanghai government had held a traditionally cautious attitude as regards the development of the non-state sector. This was despite the fact that most collective enterprises were in fact quasi-state enterprises set up by government departments and by state enterprises for a wide range of purposes. The general approach of the Shanghai

¹⁰⁹ See Zheng Rujuan, "Several Suggestions to Strengthen Fiscal Audit", pp.17-19.

¹¹⁰ This is reflected in an article from the Municipal Planning Commission in 1987 calling for a broadening of the scope of planning work beyond the budgetary sector and the plans. See Shanghai Planning Commission, "Zonghe Yunyong Jingji Gangan de Shijian Yu Tansuo" (The Use of Economic Leverage: Probes and Practice), *Shanghai Jihua Jingji Tansuo*, No.2 (April 1987), p.36.

¹¹¹ See *Shanghai Statistical Yearbook 1993*, pp.99, 244. See also discussion in Chapter Four: Table 4.14. The more rapid development of the non-state sector since the late 1980s was partly a result of the decentralization of fiscal and investment authority to the subprovincial levels. The motivation of district and county level governments to develop the collective sector and to promote economic development in general could be traced back to the establishment of the contractual fiscal system in 1988. More authority was delegated in 1992. See Zeng Niansi, and Xue Liang, "A Survey of the Economic Situation of the Urban Collective Sector in Shanghai", p.7.

government until the early 1990s was one of control rather than of facilitation and support. The emphasis was squarely on "proper management" in accordance with the rules of the state, instead of being on creating a favourable environment for the proper growth and development of the enterprises.

In this regard the Shanghai government issued a notice in 1985 prohibiting the diversion of state revenue by state enterprises to their subordinate collective enterprises. In order to qualify for the lower tax rates applicable to collective enterprises, it was stipulated that collective enterprises must have accounts independent of and separate from their affiliated state enterprises. Any property belonging to the latter but previously diverted for use of the enterprise should be paid for.¹¹² Given that collective enterprises had traditionally been treated as a lesser form of state ownership, and that the establishment of many collective enterprises in Shanghai in the early 1980s had been based on administrative and political decisions,¹¹³ these rules verged on hostility to the collective sector.

Another instance of hostility relates to the provision of bank finance. Obtaining capital has been one of the most difficult obstacles for the development of the private sector, the existence of which was only legalized in a constitutional amendment in 1988.¹¹⁴ The difficulty was, however, more serious in Shanghai than elsewhere in China as a result of much stricter observance and more cautious implementation of central rules by the Shanghai government.¹¹⁵ For instance, when the Shanghai government announced a notice in 1985 regulating the growing financing activities of enterprises, it did not take account of the changing economic situation since the commencement of economic reform and simply reiterated the old rule of a total ban on bank loans to the private sector.¹¹⁶ This effectively

¹¹²See Shanghai Government Notice No. 43 (1985), July 15, 1985, "The Finance Bureau's Notice on the Fiscal and Tax Issues Regarding Collective Enterprises Organized by State Enterprises", printed in Shanghai Economic System Reform Leading Group (ed.), *A Compendium of Economic System Reform Documents of Shanghai*. (Shanghai: Qiye Guanli Xuehui, 1986)

¹¹³From 1977 to 1982, a total of 365 collective enterprises was set up by municipal bureaux to provide jobs for just under 100,000 youths coming back to Shanghai from villages with the end of the 10-year Cultural Revolution. See Jiang Zemin (ed.), *The Ten Years of Economic System Reform in Shanghai*, p.77.

¹¹⁴An amendment was made to Article 11 of the State Constitution at the First Session of the Seventh National People's Congress on April 12, 1988 to explicitly allow the operation and development of private enterprises within the country. See Zhonggong Zhongyang Wenxian Yanjiushi (ed.), *Shisanda Yilai Zhongyao Wenxian Xuanbian* (Since the Thirteenth Party Congress: A Compendium of Important Documents) (Parts 1-3) (Beijing: Renmin chubanshe), Part 1, p.216.

¹¹⁵Even though national laws allowed joint ventures between foreigners and private enterprises, and nationwide more than 50 private enterprises had formed joint ventures with foreign partners, there was reportedly not even a single case in Shanghai as at 1991. See *Ming Pao* (Hong Kong), December 18, 1991.

¹¹⁶See Shanghai Government Notice No. 112 (1985), December 13, 1985, "Some regulations of The People's Bank of China (Shanghai Branch) on the financing and capital brokerage of

blocked the route for private enterprises to obtain bank finance. This contrast in behaviour with that of Guangdong is spectacular. In order to promote development in the local economy, the Guangdong government tolerated, and even facilitated, the phenomenon of "pseudo-collectives", whereby private enterprises and individuals could obtain the favourable treatment and convenience as that afforded to collective enterprises by acquiring a collective enterprise registration. The Shanghai government was much more restrictive. In as late as 1989, a campaign was launched in Shanghai specifically condemning "pseudo collectives", and many had their registration reverted to "private individuals" and were made to pay higher taxes.¹¹⁷

In contrast to the lukewarm attitude regarding the non-state sector, there was enthusiasm for the extrabudgetary state sector, and particularly for the development of fiscal credits, a new form of fiscal management of the budgetary fiscal funds. The development of extrabudgetary finance, described as the "second finance", was increasingly cherished in the promotion of industrial production.¹¹⁸ The quote below shows the high esteem of official authorities for "second finance":

"Strengthening the credit function of the local finance department is necessary for the development of the local economy. The support of local finance is a vital part of the development of the local economy...It is the duty of the local finance department to utilize fully local fiscal funds (through fiscal credits) to support the local economy..."¹¹⁹

Fiscal credits refers to the management by the local finance and tax bureaux of funds originally derived from budgetary fiscal funds for circulatory use. In a sense it is the local finance bureaux acting as banks providing loans to enterprises for investment or production,¹²⁰ or sometimes as ultimate investors via their investment companies. This use of fiscal funds was a relatively recent phenomenon, although an embryonic form had existed since the 1960s. In 1988, the Shanghai government specifically set up an investment company, under the auspices of the municipal finance bureau, to engage in lending and investment activities, using capital from the municipal budget.¹²¹

enterprises", printed in Shanghai Economic System Reform Leading Group, *A Compendium of Economic System Reform in Shanghai*, Part 4, pp.109-13.

¹¹⁷See *Shanghai Economy* 1990, p.460.

¹¹⁸See *Shanghai Economy* 1989, p.482.

¹¹⁹See Yang Sheng, "Caizheng Xinyong Zhineng Burong Xueruo" (The Credits Function of the Finance Department Should Not Be Weakened), *Shanghai Caishui*, No.3 (March 1993), p.29. Yang was an official of the Shanghai Finance Bureau.

¹²⁰One major business of fiscal credit was to serve as the agent of loan finance between two groups of enterprises. (Respondent No.27, Shanghai interview, May 1994)

¹²¹*Shanghai Economy* 1989, p.482.

The funds originally diverted from the municipal budget and subsequently placed beyond the budget should, in theory, form part of the total extrabudgetary funds, and in particular, part of the extrabudgetary fiscal revenue held by the local finance departments. However, as this practice had begun only recently nationwide, and as it was in the vested interests of the provincial governments to conceal the size of local resources from central scrutiny, this part of funds was *not*, in fact, included in the compilation of the statistics as shown in the tables earlier this chapter.¹²² The value of these funds is estimated to have increased by 1 to 2 billion yuan per annum in the early 1990s,¹²³ which is nearly a double that of the "official" extrabudgetary fiscal revenue of 1992, and up to nearly a quarter of the total "official" extrabudgetary funds for 1992. These funds thus constitute a very substantial "private account" for the Shanghai government, well beyond the coverage of extrabudgetary funds. In other words, whilst the budget is the "first finance", and the "official" extrabudgetary funds form the "second finance", this new commercialized use of budgetary funds becomes the "third finance" of the Shanghai government.

Its large scale, and the likelihood it might shake off central control has made the status of this "third finance" controversial. The central bank has always had reservations regarding the development of bank-like business by the finance department. The Ministry of Finance, on the other hand, seeing its functions under the old central planning system on the decline, was happy at the prospect of an enlarged scope of activity, and thus influence, in the economy. The provincial governments therefore had a powerful ally in this respect.¹²⁴ Finally a notice was

¹²²Respondents No.22 (Shanghai interview, January 1994), No.27 (Shanghai interview, May 1994), and No.34 (Beijing interview, March 1994) confirmed that the official statistics on extrabudgetary funds *nationwide*, and in Shanghai in particular, did not encompass the funds diverted, generated and kept outside of the budget as a result of the "second finance" activities of the local finance departments and their affiliated investment companies. Respondent No.38 (Beijing interview, May 1994) remarked that it was very difficult to require the local governments and units to provide information at all, the accuracy of the information also being questionable, on those locally retained resources beyond the traditional coverage dating back to the pre-reform period. A classic and recent example was the data regarding the part of extrabudgetary funds held by state enterprises and their departments-in-charge. This entire section of information was simply not available when the statistics on extrabudgetary funds were compiled for the year of 1993, since the accounting books of state enterprises saw a complete revamp with the implementation of international accounting rules with effect from July 1993. According to Respondent No. 38, there was a real possibility that data on this part of extrabudgetary funds, notwithstanding the inevitable adjustment in the figures with the change in accounting rules, would not be reported in future. It simply happened that a convenient pretext was found through which to serve the needs of the local interest.

¹²³This was the estimate of Respondent No.34, who had had official access to the records of the local fiscal finance in Shanghai. (Beijing interview, March 1994)

¹²⁴Respondent No.34, Beijing interview, March 1994. According to the respondent, Vice-premier Zhu Rongji, concurrently head of the People's Bank of China since the dismissal of the former head

issued by the Ministry of Finance in late 1993 regulating the management of funds in the "third finance", implying that the Ministry of Finance, together with the provinces, had finally won the battle for the legitimate status of fiscal credits.¹²⁵

Recentralization of Societal Resources

It should be noted that it was after 1988 that there was first such a major source of "extra-extrabudgetary funds" under the auspices of the local finance departments. For most of the 1980s decade, and especially during the early 1980s, most extrabudgetary resources were in the hands of state enterprises and their departments-in-charge. At that time, in order that the available resources could be utilized more efficiently and effectively, specialised funds were set up, under the auspices of the departments-in-charge, to centralize extrabudgetary funds dispersed amongst state enterprises.¹²⁶

By 1988, it was estimated that not less than 22 specialized funds had been set up in Shanghai, of which at least seven were geared towards investment and economic development, the focus of the current discussion. The rest were of a more "social and welfare" nature.¹²⁷ As of 1989, investment-oriented funds had accumulated a total value of 1 to 2 billion yuan.¹²⁸ As in the case of fiscal credits,

Li Guixian in July 1993, was inclined to support the position of the banks. That the Ministry of Finance supported the development of fiscal credits could also be shown in a study report from the ministry, which stated that the development of fiscal credits was "an inevitable requirement of the marketization process." See Ministry of Finance, Research Institute for Fiscal Science, "Woguo Zhongchangqi Caizheng Zhengce Quxiang de Yanjiu" (A Study of the Policy Orientations of Medium-Long Term Fiscal Policy), *Caizheng Yanjiu*, No.3 (March 1993), p.22. The article by Yang Sheng, "The Credits Function of the Finance Department Should not be Weakened", was presumably part of the Shanghai government's effort in lobbying for support of the practice of fiscal credits. A major argument for fiscal credits put forward in Yang's article, apart from its function in supporting the local economy, was that it allowed the finance departments a role in the production side of the economy, which was regarded as necessary if the finance department was to continue to perform any kind of regulatory role on the economy.

¹²⁵ See Ministry of Finance Notice No. 189 (1993), November 19, 1993, "A Notice on Promulgating the 'Management Rules of Fiscal Credits (Provisional)'" , printed in State Audit Commission (ed.), *Caishui Tizhi Gaige Xueshi Ziliao* (Study Materials on Taxation and Fiscal Reforms) (Beijing: Neibu, 1994), pp.71-74.

¹²⁶ See for instance Yu Daxiang, "Pay More Attention to the Efficiency and Effectiveness in the Utilization of Extrabudgetary funds", *Shanghai Caizheng Yanjiu*, No.5 (1984), pp.5-7. It was suggested that funds should be set up to centralize extrabudgetary funds dispersed among individual state enterprises to ensure better utilization and minimize wastage.

¹²⁷ See Bao Youde, "Shenhua Caizheng Gaige, Zhenxing Shanghai Jingji" (Deepen the Fiscal and Tax Reform, Vitalize the Economy of Shanghai), *Shanghai Caishui*, No.2 (1988), p.7. Bao was the then director of Shanghai Finance Bureau. See also Tu Jimo, "Shanghai Difang Touzi Fangshi de Bianhua Yu Duice" (Approaches of Shanghai's Local Investment: Changes and Solutions), *Shanghai Jihua Jingji Tansuo*, No.1 (1990), p.27.

¹²⁸ Ibid., p.28.

these specialized funds had not been included in the official statistics of extrabudgetary funds.¹²⁹

The sources of capital of these funds were primarily of three types: (1) diversion from budgetary revenue; (2) the imposition of various administrative fees and the adjustment of prices of products; and (3) capitalization exercises targeted at enterprises and private individuals. For instance, more than 1 billion yuan per annum of fiscal budgetary funds had reportedly been allocated to the investment arm of the municipal government, the Shanghai Jiu Shi Corporation. In another case, in 1987 on the establishment of the new electricity development company, some 200 million yuan of budgetary funds was granted in order centrally to manage the Electricity Fund.¹³⁰ Part of the capital of the Electricity Fund was derived from an increase in the price of electricity, and some administrative fees were even collected and imposed directly by the fund managers, instead of by government departments.¹³¹ Where the purpose of a fund was to solicit capital to finance the construction of particular projects, the source of capital could be primarily from societal capitalization exercises.¹³²

Specialized funds, therefore, became a major source of investment capital in Shanghai towards the late 1980s and especially into the 1990s. The upper estimate of their value as of 1989, at 2 billion yuan, is equivalent to 18% of the total value of investments in Shanghai's local state sector for the same year, or more than 7 times that of local budgetary investment.¹³³ Given the diffused nature of the management of the funds, it was difficult for the Centre to control this part of local

¹²⁹This was confirmed by Respondent No.27, Shanghai interview, May 1994. The respondent remarked that since the specialised funds all have their allocation specified and the local finance departments could not deploy their resources, there was no need to include the funds in the statistics of extrabudgetary funds.

¹³⁰Respondent No.26, Shanghai interview, May 1994. Shanghai Jiu Shi Corporation was set up in 1987 initially to manage and coordinate the use of the newly approved US\$3.2 billion foreign capital. It subsequently developed as a major investment arm of the local government with an expanded scope of business spanning real estate development and foreign trade.

¹³¹See Tu Jimo, "Approaches of Shanghai's Local Investment", p.29.

¹³²This was the case of the Fund specifically set up to finance the construction of the television tower at Pudong, completed in 1994. Capital came primarily from sponsorships of enterprises and "investments" from individuals. (Respondent No.27, Shanghai interview, May 1994) According to the respondent, the municipal government would normally pay closer attention to and impose stricter rules on, funds soliciting "share capital" from individuals. The main concern was to protect individual investors and to contain unscrupulous capitalization practices, since some funds might have no prospect of profit return.

¹³³Total investments in Shanghai's local state sector in 1989 were 11 billion yuan, of which 277 million yuan was money from the state budget. See *Shanghai Statistical Yearbook 1990*, p. 240.

investment capital. The provincial leaderships themselves have even shown signs of losing control over the specialized funds supposedly under their management.¹³⁴

A major reason for the loss of central control is that the establishment of specialised investment funds was largely a local matter. Although some individual funds were established on the *basis* of centrally approved policies,¹³⁵ most specialized investment funds were primarily the result of local initiatives. There were no central regulations or policies requiring the funds to obtain the approval of the central government. Consequently, basically all specialized investment funds were approved independently by the Shanghai municipal government.¹³⁶

In facing this new initiative of the provinces, the Centre has yet to give a definitive response. No explicit approval and affirmation of authority on these funds is conferred on the provincial governments. However, neither is there any explicit condemnation of such practice. From the viewpoint of the Centre, the funds are one of those "new phenomena" of the reforms, and its attitude has been one of "wait and see", and toleration. In fact in 1991 the Centre contemplated either centralizing the approval authority to the central Ministry of Finance or explicitly delegating the authority to the provincial-level government.¹³⁷ In the end no changes were undertaken and the provincial governments continued their adventure in "no man's land" under the passive tolerance and acquiescence of the Centre.¹³⁸

¹³⁴It was stated that there had been inadequate oversight and management of the funds at the government level, with the management left largely to the fund managers. See Tu Jimo, "Approaches of Shanghai's Local Investment", pp.28-29. This is also the view of Respondent No.34, Beijing interview, March 1994.

¹³⁵An example was the set up of the Shanghai Jiu Shi Corporation in 1987. The background of the corporation was the approval of the central government in 1986 allowing Shanghai to borrow foreign capital amounting to US\$3.2 billion independently to finance necessary infrastructural projects. Some of the capital could be used for more profitable industrial products to provide the necessary returns to pay back the loans. The Corporation was set up by Shanghai to take charge of the raising of foreign capital and management of the investment projects. See Ni Wen, "New Attempts in the Changes in the Functions of the Government", *Shanghai Jihua Jingji Tansuo*, No.2 (1987), pp.48-51. Strictly speaking the set up of the corporation itself was the discretionary action of the Shanghai government in the implementation of the centrally approved policy.

¹³⁶Respondent No.27, Shanghai interview, May 1994.

¹³⁷In 1991 there was a big surge in various kinds of specialized funds in many provinces and particularly at the subprovincial levels. There was therefore a heightened worry in the Centre that the situation might develop further out of control. Several documents had even been drafted to tighten control of the funds. If authority should be formally delegated to the provinces, the motive is still that of control: with formal power the provincial governments may then be held responsible for the better management of the funds.(Respondents Nos.34 and 38, Beijing interviews, May 1994.)

¹³⁸The Centre's attitude was one of "passive tolerance" because, in accordance with Respondent No.38, the reason why the drafted documents were not adopted was the concern that the establishment of a formal approval and control system by the Centre would amount to giving a legitimate and formal status to the funds, at a time when the Centre had yet to arrive a firm view to the future of the funds. This might create difficulties to future plans to replace these funds with more proper means to finance local investments. (Beijing interview, May 1994)

Internationalization

As a major investment strategy in the economic development of Shanghai, internationalization is an even more recent development. Notwithstanding the fact that Shanghai has a history of being the largest port and hub of foreign economic activities in China prior to 1949, internationalization came slowly into the agenda of the Shanghai government. This recency of internationalism is more ironic in face of the fact that, as noted earlier in this chapter, the Shanghai government has been so successful in winning over preferential policies regarding foreign trade and foreign investment. Unlike other policy areas, where the Shanghai government can attribute their failure in development to a stringent central policy, the "opening up" of Shanghai since the early 1980s has been a development encouraged by central leaders.

The authority of the Shanghai government regarding foreign investment, for instance, was, in the early 1980s, even larger than its Guangdong counterpart. The tight financial situation of the Shanghai government would have made turning overseas for investment capital a natural recourse. However, having a total cumulative value of direct foreign investment contracts of US\$3.33 billion, of which US\$1.5 billion had been realized,¹³⁹ the foreign investment in Shanghai as of 1992 was only a tiny fraction of that in Guangdong, where the cumulative realized foreign investment from 1979-91 amounted to US\$15 billion.¹⁴⁰ Comparative studies done by researchers in Shanghai also found that, as a result of the much smaller size of total foreign investment in Shanghai, the economy of Shanghai was, at the end of the 1980s, still largely inward-oriented.¹⁴¹

To account for the relatively slow pace of foreign investment is a complicated and difficult task. It is very likely only one facet of the general performance of economic development and reform of Shanghai in the 1980s, and a product of the interactive effect of central development strategy on reform and the Centre's policies on Shanghai. The geographical position of Shanghai, and of course the attitude and management style of the Shanghai government are also

¹³⁹ Calculated from *Shanghai Statistical Yearbook 1993*, p.306.

¹⁴⁰ See Zhang Hanqing (ed.), *Gaige Kaifang Zai Guangdong* (Reform and Opening in Guangdong: Implementation and Thoughts on the One Step Ahead Policy) (Guangzhou: Guangdong Higher Education Press, 1992), p.125. See also discussion in Chapter Five on "Internationalization".

¹⁴¹ See Rui Mingjie and Yu Wenyi, "Wuyue Liangdi Waishang Touzi de Bijiao Fenxi" (A Comparative Analysis of Foreign Investments in Shanghai and Guangdong), *Shanghai Investment*, No.7 (July 1992), pp12-13. It was reported that the share of export value in total GNP in Shanghai in 1989 was only 7%, while Guangdong's was 13%---nearly double. Part of the reason was the much lower level of foreign investment in Shanghai, since most of the output in foreign enterprises was exported.

likely to have had their bearing on the matter. These issues will be the subject of discussion in the following chapter.

Nevertheless the change finally came. The announcement of the opening of Pudong in 1990 was a prelude; and this was affirmed and elevated to an ever higher profile in 1992. In the Fourteenth Party Congress convened in October 1992, Shanghai was hailed as the "dragon head" of the development of the entire Yangzi River region. The Centre also unambiguously stated, for the first time, that Shanghai should be developed into an international economic, financial and commercial centre. Direct foreign investment contracted in 1992 alone, at the value US\$3.36 billion, was consequently US\$ 30 million more than the total cumulative value of the previous 12 years.¹⁴² In 1993, another peak was reached with the contracted value of projects reaching US\$7 billion, a more than double of the level achieved in 1992. The value of realized foreign investment, at US\$2.3 billion, was about the equivalent of the total realized between 1980 and 1992.¹⁴³ Momentum had finally been gained.

Internationalization is, however, not simply about foreign investment. Attracting more foreign investment is only a necessary component and a *means* to becoming international. The objective is to make Shanghai an international city, an international economic, financial and commercial centre, and a modern one. Foreign investment is the means by which the Shanghai leadership seeks to improve the standards of Shanghai's economic and management makeup to an internationally advanced level. Wu Bangguo, Shanghai's Party Secretary, made this point clearly in his report to the Shanghai Sixth Party Congress in December 1992:

"To open and develop Pudong would inevitably break the ground to the all-rounded opening of Shanghai. We have to fully utilize the high degree of openness of Pudong, ... to push forward the bridging of Shanghai with the international economy in the areas of finance, commerce, industry, and management. We have to expand the areas in which foreign capital may be used... To establish multi-national corporations of our own, so as to enhance the capability of Shanghai in international economic participation."¹⁴⁴

As a strategy of development, the very goal of becoming an international economic centre is material in enabling the Shanghai government to obtain more resources and autonomy. That the goal was endorsed by the Centre itself and

¹⁴²See *Shanghai Statistical Yearbook 1993*, p.306.

¹⁴³Respondent No.24, Shanghai interview, May 1994. See also *Shanghai Statistical Yearbook 1993*, p.306.

¹⁴⁴See *Shanghai Economy 1993*, p.11.

included in documents of the Fourteenth Party Congress makes this goal still more achievable. The Shanghai government might then argue legitimately, in terms of the requirements of progressing towards its international position, for more central concessions.¹⁴⁵

This is, in fact, a logical and foreseeable development. The decentralization of authority in the 1980s was conceived with the purpose of facilitating a more active role by provincial-level governments in the experimentation of reforms and the development of the economy. Reform experiments and economic developments in the 1980s were, however, necessarily starting from a low base. The decentralization of authority to provincial-level governments was correspondingly so, and was primarily a series of piece-meal adjustments of the preexisting management systems. In other words the reforms in the 1980s were, by their nature, largely incremental. The general direction was to improve the livelihood and develop the economy. However, in the absence of specific and clearly envisaged objectives the formulation of detailed reform measures was largely a result of the push effect of the inadequacies of the preexisting system. It has, therefore, tended to be piecemeal and relatively limited. With the goal of Shanghai specifically that of reaching the advanced international standard, the inadequacy of the previous approach became all too obvious.¹⁴⁶ Whether in terms of the amount of resources available to attain the goal, or in terms of the power of the Shanghai government to gather and manage the resources, either way there was a substantial gap between the status quo and the projected requirements for building an international economic, commercial and financial centre on a par with those of advanced industrialized countries. This gap thereby became the fertile ground on which the Shanghai leadership could bargain with the Centre.

¹⁴⁵For instance the Shanghai government contemplated asking for more favourable policies for Pudong as the original favourable policies, such as the bonded area policy, were subsequently also practised in other centrally approved development areas. The new policies included allowing foreign-funded trading companies, and enlarging the use of foreign capital in the tertiary sector. See Huang Qifan, "Pudong development: the hope of building Shanghai into an international metropolis", *Economic Forecasting*, No.4 (December 1993), p.35. Huang is the vice director of Pudong Management Committee.

¹⁴⁶An official of the State Council Development Research Centre admitted that although the central government had in the past delegated quite substantial authority to the Shanghai government, the Shanghai government would still ask for more in view of the requirements of the objective of building an international economic, financial and commercial centre. See Zhu Ronglin, "Shanghai Dabu Manxiang Xinshiji" (Shanghai Marching Toward the New Century), *Economic Forecasting*, No.4 (December 1993), p.44.

Chapter 7

Central-Provincial Relations: Interactive Processes

The discussion of provincial discretionary behaviour in the past two chapters shows that the provinces are very proactive in central-provincial investment politics. This chapter refines this image of proactive provinces by emphasizing the interactive relationship and mutual influence between the Centre and the provinces. Proactive as they are, provincial leaders nevertheless work under the constraints and influence of the Centre. Mutual influence means that central-provincial relations do not constitute a zero-sum game. Instead of arguing for the Centre, or the province, being more powerful regarding investment policy, this study sees both the Centre and the province as forming institutional constraints on each other. Understanding central-provincial relations, therefore, requires an examination of this interactive relationship and of the process whereby the central and provincial actors seek to outmanoeuvre one another.

The purpose of this chapter is to discuss this interactive relationship. The broad institutional context, as set by central policies, regarding provincial investment implementation has been outlined in Chapters Three and Four. Chapters Five and Six described in detail the methods whereby the Guangdong and Shanghai governments manoeuvre within the institutional context in order to attain their objective of investment expansion. This chapter focuses on the *linkage* between the institutional context posed by the Centre and the resultant discretionary behaviour of the two provincial governments. Specifically, this chapter seeks to examine the mediating process whereby central policies influence and constrain the choices and behaviour of the two provincial governments, as well as the process whereby provincial discretionary behaviour influences central policies. As such, this discussion weaves the previous four chapters together.

Guangdong's and Shanghai's Discretionary Behaviour: A Comparison

Before exploring the linkage between central policies and provincial behaviour it is pertinent first to compare generally the discretionary behaviour of the Guangdong and Shanghai governments. There are obvious differences, as well as similarities, in the behaviour as noted in the previous two chapters, and both have equal significance. On the one hand, the substantial differences in their respective institutional contexts provide grounds whereby differences in the discretionary behaviour of the Guangdong and Shanghai leaderships might be

expected. These differences suggest the impact of differential central policies towards the provinces. On the other hand, similarities in discretionary behaviour between Guangdong and Shanghai serve to qualify the above impact of central policies on provincial behaviour. The similarities suggest that notwithstanding the impact of differential central policies, provinces are nonetheless capable of very substantive manoeuvres. It would, thus, appear that there is a limit to central power over the provinces.

A comparison of Figures 5.2 and 6.1 in Chapters Five and Six respectively summarizes the differences and the similarities in a visual manner. On the one hand, both the Guangdong and Shanghai governments have engaged in similar categories of discretionary behaviour. The discretionary behaviour of the two provincial-level governments can be summarized into the same five categories: (1) bargaining for more favourable central policies, (2) fighting for more direct central support, (3) the flexible implementation of central policies, (4) developing the "new horizon" beyond the budget for investment expansion and (5) internationalization. These common categories indicate a considerable level of similarities between the discretionary behaviour of the two governments. However, the two figures, 5.2 and 6.1, also clearly show that the relative extent of the different categories of behaviour of the two governments in the 1978-93 period has been quite dissimilar. The Shanghai government has been more dependent on the Centre as its source of additional resources and as the focus of its discretionary behaviour. On the other hand, the Guangdong government has expended relatively more effort on "independent" categories of discretionary behaviour, such as flexible implementation of policies, developing innovative local policies beyond the scope of existing central policies, and internationalization.

It may be helpful to have another look at these two figures, combined into Figure 7.1, here again:

Figure 7.1

A Comparison of Provincial Discretionary Behaviour: Guangdong and Shanghai

Order of Provincial "Independence", from the highest order to the lowest order:

C, A, D, B

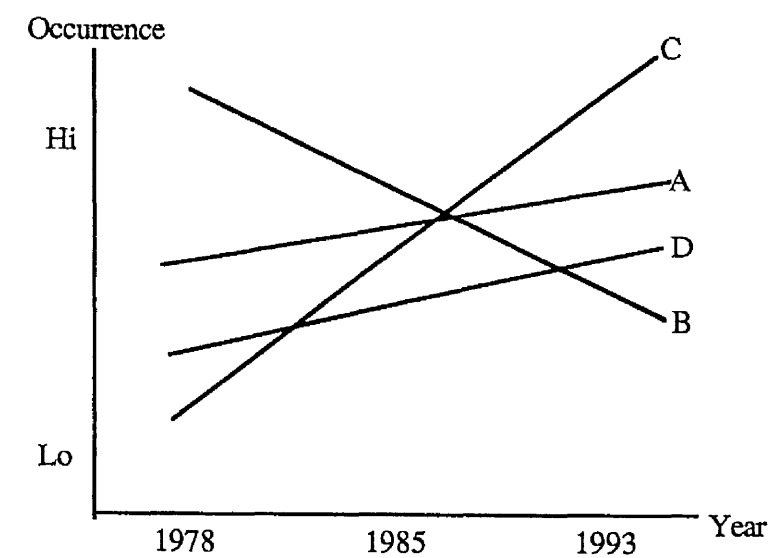
C: High on Provincial Autarchy and High on Local Plans/Market---Developing the "New Horizon" beyond the budget and internationalization

A: High on Provincial Autarchy and High on Central Plans/Policies---Flexible Implementation of Central Policies

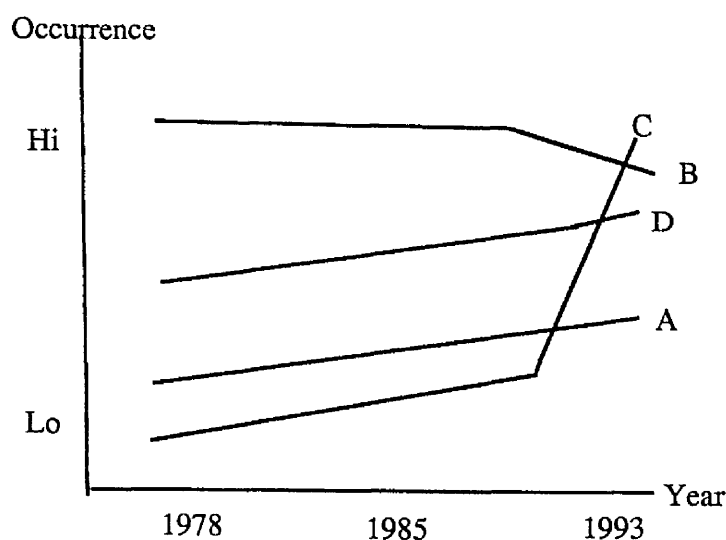
D: High on Central Dependence and High on Local Plans/Market---Bargaining for more direct central support (in the form of extrabudgetary resources)

B: High on Central Dependence and High on Central Plans/Policies---Bargaining for more favourable central policies and more direct central support (in the form of planned resources)

(a) Trends of Guangdong's Discretionary Behaviour, 1978-93



(b) Trends of Shanghai's Discretionary Behaviour, 1978-93



The above figures give a clear contrast regarding the discretionary behaviour of Guangdong and Shanghai. Both Guangdong and Shanghai started off in 1978 with a high level of occurrence of discretionary behaviour which was highly dependent on the Centre, as reflected by the line (B). However, into the 1980s, the line (B) declines substantially in the case of Guangdong, while other lines which denote a higher order of provincial independence, (C) and (A), increased steadily over the decade. On the other hand, the line (B) in Shanghai remains at a high level throughout the decade, and lines (C) and (A) continue to lie at a relatively low level until the 1990s, when there is a sharp rise in the line (C). In other words, until the early 1990s, discretionary behaviour of the Shanghai government exhibited a heavy reliance on the Centre, while that of Guangdong has seen a steady progression towards a higher level of independence orientation during the 1980s.

A revealing example of the differences is seen in the different approaches through which the Guangdong and Shanghai leaderships have manoeuvred regarding their total investment scale. As discussed in Chapters Three and Five, the central control figures in Guangdong prescribing, in theory, the upper-most limit of the total local investment scale in the province has not been obeyed. Its assigned role in pioneering economic reform provides the Guangdong leadership with a strong pretext to "implement flexibly" this central instrument of investment control. It has been during times of economic retrenchment only, when central leaders have been more concerned about excess investment that the Guangdong leaders have paid more attention to the control figures and sought more seriously

for a larger quota. On the other hand, the control figures have posed more formidable pressure on the Shanghai leadership, who more closely adhered to central rules. As a result, instead of simply ignoring the quotas for most of the years as has Guangdong, the Shanghai government has generally bargained for a larger quota. Consequently, as regards the issue of investment scale control, the discretionary behaviour of the Guangdong government is manifest within the category of implementation discretions, whilst that of Shanghai falls within that of bargaining for direct central support. The heavier reliance on the Centre by Shanghai is obvious.

The Guangdong leaders were thus bolder than their Shanghai colleagues in the flexible implementation of central policy. Shanghai leaders' concern over keeping up the appearance of abiding by rules prompts them to "paper over" the discrepancy between central rules and the outcome of their implementation. Thus they have simultaneously sought to "bend the rules" by bargaining for a larger quota as well as manipulating investment statistics. The result is that, superficially, Guangdong's investment behaviour appears unscrupulous, as its substantial excess investment over and above the central quotas provides clear testimony to its deviant behaviour. Shanghai's excess investment is, in comparison, modest and insignificant, reinforcing the image of the Shanghai government as the loyal lieutenant of the Centre.

Important and obvious as these differences may be, their significance should not be overstated. Such differences are, after all, relative. Whilst the Guangdong leadership has been less preoccupied with bargaining for preferential policies than the Shanghai leadership, they have nevertheless been highly vigilant in ensuring the *continuation* of their established preferential policies. This explains why the Guangdong leadership was so concerned about the abolition of the *dabaogan* fiscal system in 1993. In order to retain more of its vested interests under the new system, the Guangdong leadership took the initiative in bargaining for a more favourable base-line, notwithstanding the Centre's promise to respect the existing vested interests of provinces in the new fiscal reform.

Moreover, bargaining for more central investment and bank finance has also been an important activity of the Guangdong government. As noted previously, Guangdong has been quite successful in attracting central investment from various central ministries because its vibrant economic growth was able to give potential "investors" a better prospect of earning profits. Moreover, crying for direct forms of assistance is often a useful tactic for achieving other objectives,

such as lobbying for more favourable policies.¹ In other words, while during the 1980s the Guangdong government frequently engaged in "independence-oriented" discretionary behaviour, the provincial leadership was nevertheless well aware that its ability to do so was due to the favourable macro environment deriving from preferential central policies. It has therefore taken great care to keep and enhance those policies. Guangdong's ability to use the new resources awarded to it *subsequent to* the preferential central policies in order to bargain for better policies and cultivate a favourable macro-environment has become well known nationally. This has, in fact, been the major characteristic of Guangdong's discretionary behaviour.

Similarly, the Shanghai government has not been concerned solely with obtaining better policies from the Centre. Officials in its finance bureau recognized early on the fact that Shanghai's economy could also benefit from a Guangdong-style tax alleviation policy.² Consequently, towards the end of the 1980s, the discretionary behaviour of the Shanghai government became increasingly similar to that of Guangdong in being more "independence-oriented", their manoeuvres becoming less directed towards the Centre. As noted in Chapter Six, into the 1990s, the number of local and extrabudgetary specialized funds in the new "third finance" multiplied and the value of investment resources managed outside the purview of the budget snowballed. Amidst the call to speed up Shanghai's development towards making it an international financial centre, the reliance of the Shanghai government on the Centre has also conspicuously declined.

To understand the implications of such differences and similarities in the behaviour of Guangdong and Shanghai as regards their relationship with the Centre, it is necessary to look more closely at the linkage between the institutional context posed by the Centre and the behaviour of the provinces. If the differences suggest the impact of central constraints on provincial behaviour, how is this impact effected? Conversely, if the similarities indicate the activism of the provincial leaderships given their constraints as posed by the Centre, what is the extent of this activism and its implication for the central-provincial relationship?

Impact of Central Policies: the Mediating Process

The policies of the central government form the most prominent factors in the context of the investment discretionary behaviour of the Guangdong and

¹ See discussion in Chapter Five: Fight for more direct central support.

² See Chapter Six: Develop the new horizon.

Shanghai governments. As noted in Chapters Five and Six, the central government's differential policies for the two areas were originally based on national strategic and tactical considerations. As a result, during the 1980s the Guangdong leadership found itself operating in a more relaxed policy environment with much more room for manoeuvre, much to the envy of most provincial leaderships, in particular, Shanghai.

The following table summarizes the relative positions of the two provinces in the national economy in 1978, on the eve of the onset of economic reform. It explains why the Centre has treated them in such a differential manner.

Table 7.1

Guangdong and Shanghai: 1978

<u>Economic Indicators</u>	<u>Guangdong</u>			<u>Shanghai</u>		
	<u>Total</u> (bn yuan)	<u>%/National</u>	<u>Rank</u> ¹	<u>Total</u> (bn yuan)	<u>%/National</u>	<u>Rank</u>
GNP	18.5	5.1	6	27.3	7.6	1
Societal Output	35.0	5.1	7	59.2	8.7	1
Export ²	1.4	14.2	n/a	2.9	29.7	n/a
Total local fiscal revenue	3.9	3.5	n/a	16.7	14.9	1

Notes: (1) Rank refers to the ranking position among all provincial-level administrations. (2) Export value is in terms of US\$ billion.

Sources: *Guangdong's Statistics, 1949-1988. (General)*, pp.74, 162, 175; *Shanghai Statistical Yearbook 1993*, pp.54, 300; *Guangdong Statistical Yearbook 1993*, p.350; *Statistical Yearbook of China 1993*, pp.215, 633.

Table 7.1 reveals the substantial gap between Guangdong and Shanghai in terms of their importance to the national economy. The differential in fiscal revenue is particularly significant, as Shanghai's local fiscal revenue accounts for 15% of the national total in 1978 and Guangdong's for only 3.5%. When using an analogy of kinship relations to characterize the situation, the position of Shanghai resembles that of the eldest child, and Guangdong of the younger child, of a family, with the central government as head of family. As the eldest child, Shanghai has had the advantage of advanced developments way in advance ahead of its younger brothers. It has correspondingly been required to share the responsibility of the Centre earlier than the others in the maintenance of the family and the care for the weaker children, namely, the poorer inland regions.

Meanwhile Guangdong, as the younger child, received attention of the Centre much later and did not therefore have any major responsibility placed on its shoulders. The Centre therefore found it easier and more feasible to offer concessions to the younger child, who, accepting them as its fair share of the family resources, did not hesitate to utilize them to the utmost.

Consequently, two different sets of policies were conferred on the two. Guangdong was awarded the "Special Policy" early in 1979 which enabled the province to retain more resources for local economic development, as well as a larger scope of authority in the administration of investment policies. Shanghai, on the other hand, was expected to provide the resources necessary for the experiment. As a result, central policies in Shanghai were necessarily cautious and prudent. Having a more developed economy, its having been developed at a much earlier stage, Shanghai was required to support and assist in the development of other provinces. As noted later in this section, this took the form of the direct provision of technical and financial assistance to enterprises in other provinces, as well as indirect fiscal transfers via the Centre. In 1979, Guangdong was weak and relatively unimportant to the Centre. The Centre could, therefore, afford to allow it to be "special"---meaning preferentially treated. On the other hand, in 1979 Shanghai was relatively well-off. It was thus asked to "integrate horizontally" with the poorer inland provinces---meaning to play the fraternal role of "elder brother" and share its wealth with its weaker brothers.

The discretionary behaviour of provincial governments is, by definition, a product of the decisions of provincial officials effected under the auspices of the existing administrative structure. Given that provincial discretions are constrained and influenced by central policies, such influence is effected through the intermediary of the attitudes and survival strategies of the provincial officials themselves. An explicit discussion of these attitudes and strategies, therefore, may illuminate the linkage between static institutional policies and the resultant provincial behaviour.

Guangdong

In Guangdong the Special Policy confers on the provincial leadership a clear role in achieving the targets of economic development and reform. Guangdong is to act as the pioneer of reforms for the rest of country. Such pioneer status has allowed the Guangdong government a greater latitude of manoeuvre than other provinces, and exceptions were made in its case to central policies and rules

in order to facilitate its experiments. The entrusted task of the province as the pioneer of and experimenter in economic reform in the country required in fact a new outlook and attitude amongst provincial officials. Guangdong's leaders were therefore encouraged by the Centre to be bolder, less conventional and more aggressive.

However, changes in habitual attitudes and working style do not come overnight. The emergence of a more progressive attitude towards change and, in particular, flexible discretions amongst Guangdong officials occurred through a series of developments over a period of time. The early endowment of a favourable set of policies in 1979 provided the contextual change necessary for changes in attitudes. However, for some time thereafter the conventionally cautious mentality was still predominant, even amongst the senior leadership of the Guangdong government.³ This is understandable, given that Guangdong, along with Fujian, was the first area in the country to undertake reforms, at a time when the inertia of the central planning system and the old way of thinking, whereby provincial governments were expected to implement central plans and policies only, was still very strong nationwide.

The active "coaching" by central leaders during the earlier years had a catalytic effect in this respect. In order to alleviate the initial hesitation and feeling of insecurity amongst Guangdong's provincial and local officials, central leaders had in fact frequently encouraged Guangdong's officials to be bold. The quotes below show that sometimes the remarks of central leaders were quite exaggerated in this respect:

"Comrade Xi Zhongxun once said, if Guangdong was an independent country, its development would certainly be fast. Guangdong has now become basically semi-independent."⁴

³This is reflected in a comment by Gu Mu during a meeting in the Central Party Secretariat in September 1980, when Gu Mu was reported to have said that "the major question (regarding the implementation of the Special Policy and promoting economic development in Guangdong) is still the question of leadership...First, Guangdong's leaders in charge of economic work have still not yet been working as a team. Second, there are problems with their style of mentality." At that time Xi Zhongxun and Yang Shangkun were respectively the first and second Party Secretaries. See *Centre's Instructions to Guangdong, 1979-1982*, p.97.

⁴Gu Mu was talking to Guangdong officials, September 1979, in the first meeting with Guangdong's leaders after the approval of the Special Policy for Guangdong and Fujian in July. See *Centre's Instructions to Guangdong, 1979-1982*, p.53. Xi Zhongxun was the First Party Secretary of Guangdong from November 1978 to November 1980.

"All central ministries should consider Guangdong's case independently, based on Guangdong's Special Policy. ... (Guangdong) should have a larger degree of independence."⁵

"Since (Guangdong) is in fact an 'independent kingdom', or an 'semi-independent kingdom', you (Ren Zhongyi) are the King."⁶

Anxious as they were to cultivate a bolder-minded force of cadres with which to undertake economic reforms and speed up the pace of economic development in Guangdong, central leaders reshuffled the provincial leadership in late 1980.⁷ The new first party secretary, Ren Zhongyi, who had been the first party secretary and Governor of Liaoning Province during 1978-1980, subsequently became famous for his role in revolutionizing the dominant norms of the local officialdom and creating an environment suitable for the Special Policy to be put into practice. Under the guiding hand of the new Party Secretary, the provincial leadership in December 1980 interpreted the vague contents of the Special Policy as meaning "Guangdong should open further to the outside world, further relax internal policies, and delegate more power to the lower levels".⁸ The change brought about by this new leadership was noted by Gu Mu in his meeting with the new Provincial Party Committee in December 1980, when he expressed the overall observation that "all cadres, from the leadership to the working level, are now fairly confident of their ability to do well in the implementation of the Special Policy and in the development of the special economic zones. There is a sense of direction."⁹ In addition to laying down the specific contents of an otherwise vague policy, Ren was ready to protect his subordinates from the central government, especially when changes in the political wind at the Centre made local officials feel vulnerable.¹⁰ Clear backing from the central leadership for a bolder Guangdong has given the Guangdong leadership greater freedom to flexibly implement central policies. They have, in fact, been required to do so.

⁵Yao Yilin was speaking in a meeting of the Central Party Committee Secretariat, September 1980, referring to the special status of Guangdong under the Centre's austerity program. Ibid., p.101.

⁶Gu Mu was speaking in a meeting of the Guangdong Provincial Party Committee, December 1980, assuring the new First Party Secretary of his autonomy. Ibid., p.127.

⁷Hu Yaobang had become the Secretary General of CCP in February 1980, and Zhao Ziyang had become premier in September 1980, both replacing Hua Gufeng. This reshuffle in central leadership is likely to be connected to the changes in provincial leadership later in Guangdong.

⁸See Lu Di et al. "Looking Back the 13 Years of Opening and Reforms in Guangdong", in Guangdong Provincial Party Committee (ed.), *Guangdong Gaige Kaifang Qishi Lu* (A Record of Insights of Opening and Reforms in Guangdong) (Beijing: Renmin chubanshe, 1993), p.60. The authors were officials from the Guangdong Provincial Party Committee Secretariat. The three dimensions were endorsed by the Centre via Central Document No.27 (1981) as the major contents of the special policy, as discussed previously in Chapter Five.

⁹See *Centre's Instructions to Guangdong, 1979-1982*, p.121.

¹⁰See Lu di et al., "Looking Back the 13 Years of Opening and Reforms in Guangdong", pp.60-61, for a brief description of Ren's role in Guangdong in these respects. See also Ezra F. Vogel, *One Step Ahead of China: Guangdong Under Reform*, pp.88, 314-17 for Ren's role and a brief profile.

The combined effect of favourable central policies, active coaching and encouragement by central leaders, as well as the leadership of a centrally picked leader, was the gradual emergence and maturation of a new culture of officialdom in Guangdong. This is not to say, however, that there has not been a substantial lingering of the old preference for caution and conservatism in some quarters of the government ranks. Moreover, discretions and flexible implementation of central policies are by no means a phenomenon of the post-Mao reform years only. Nor are provincial discretions a feature present only in Guangdong. Notwithstanding the possible continuities of the past and similarities with other provinces, there were undeniable behavioural and attitudinal changes in Guangdong in the 1980s. The normal criterion of performance appraisal has changed from the traditional favour for conservatism and caution to one which rewards initiative and experiment. Moreover, this is the first time in China since 1949 that discretions at a subnational level have acquired such a high degree of legitimate status for an extended period.¹¹

The legitimacy, at least from the perspective of Guangdong officials, of engaging in flexible implementation of central policies was reflected in many locally written articles. The publication of an article by the provincial propaganda chief, entitled "Three 'Sayings', Three Defences" during the retrenchment period of 1989 is particularly indicative of the degree of legitimacy and righteousness the Guangdong leadership felt towards its flexible implementation.¹² After a decade of reform, the Guangdong leadership had apparently fully adopted the bold and unconventional attitudes which were coached by central leaders earlier in the decade. Therefore, when the Centre tightened its economic policies in late 1988, the Guangdong leadership felt secure enough to protest against the Centre's centralizing measures. The implication of this article for central-provincial relationship is discussed in more detail later in this chapter. Here it is noteworthy that the sense of pride of the Guangdong officials for their flexibility in policy implementation is explicit in the following quote by a group of local scholars:

"The once popular saying of 'going round the red light' is a typical description (of the flexibility of the Guangdong government in fully utilizing central policies). For instance, according to the formal procedures,

¹¹There are periods in the history of the Republic and pre-1949 China when local governments were allowed, or endeavoured to defy the Centre without endorsement. Examples of the former type are the wide powers and autonomy given to the Regional Governments in the early years of the Republic, and the massive decentralization to provincial governments in 1958. These incidences were, however, either of a relatively short endurance or blatantly illegitimate.

¹²This article was published in three parts in *Zhongguo Jinbao*, January 13, 1989, p.2. See Chapter Five: Flexible implementation, for more discussion and quotes from the article.

in order to import production equipment into export production bases, we would have to apply for approval from the Ministry of Foreign Economic Relations and Trade and other relevant ministries and commissions. That would take a very long time... A flexible way to achieve the purpose is to treat the imports as those of a foreign-funded project. Then it would require the approval of the Provincial Commission of Foreign Economic Relations and Trade only, as Guangdong has a larger approval jurisdiction regarding foreign investment. *We are very proud of the pragmatism and flexibility of our government, which has won the admiration of other provinces and municipalities.*"¹³

As this chapter will later elaborate, the Guangdong government has now come to a stage where it competes with the central government in the definition of the content of the central policies. However, this process was started by the Centre itself. By allowing Guangdong to be exempted from many nationwide central policies via the Special Policy, the Centre prepared the ground for the erosion of its own authority. Guangdong's leaders were taught to be flexible and imaginative in implementing central policies. They were repeatedly told that if they found specific central policies and rules which obstructed the course of reform, they could ignore them and make their own. They were also assured of the safety of such boldness. They would not be blamed for being overzealous in the advancement of their autonomy and for inadvertently ignoring central policies. Reform requires learning, and mistakes are inevitable, as provincial officials were often told. Such is the role of a pioneer, and the economic reform of the nation required a pioneer who could innovate and try out its options.

Shanghai

In contrast to the clear role of the "pioneer of economic reform" as assigned to Guangdong, the role of Shanghai at the start of the reform decade was confused and ambivalent. On the one hand, Shanghai was required to perform a "rearguard" role in providing the Centre with the resources which were then diverted to the experiments in the southern provinces.¹⁴ On the other hand, the Shanghai leadership expected to perform a role in the process of reform other than that of providing the cash for other provinces. Similarly, the central leaders were eager to

¹³See Huang Haichao et al (ed.), *The Realization of Dreams---Guangdong Advancing to Market Economy* (Guangzhou: South China University of Technology Press, 1993), p.116.

¹⁴Most of such diversion came in an indirect and diffuse way, rather than direct injection of central resources through the plans. One way has been through the slack enforcement during the 1980s of the bank finance quotas in Guangdong, which effectively enabled Guangdong the resources to finance its expanding investment program through bank credits which exceeded the total level of bank deposit within the province. The balance of bank finance thus indicated a net inflow of central resources which were either diverted from other provinces where bank credits were of a smaller sum than the total amount of deposits, or downright "fresh" new money arising from printing of new notes. See discussion in Chapter Five.

tap the other resources of Shanghai, as well as its fiscal remittance, such as its higher level of technology and educated workforce. Consequently, the role of Shanghai as perceived by the Shanghai leaders, as well as by central leaders, was less than clear-cut. The Guangdong leaders, on the other hand, having been designated a specific target of achievement, were able to progress through the decade deepening their understanding and fulfillment of their defined role within the reform. For Shanghai, however, the 1980s was a decade of confusion. From the beginning the message from the Centre was that Shanghai could best serve reform by sustaining its traditional roles. Disruptions in the macro-operating environment caused by the reform, however, placed the Shanghai government, acting in a traditional manner, in a difficult position. As noted as Chapters Four and Six, the Shanghai leaders gradually discovered that things were not working in the same way as before. However, central policies towards them were slow to change, as were their own attitudes and accustomed behaviour. Both influenced the reactions of the Shanghai leadership to their new-found difficulties during the first decade of reform.

The ambivalence of the roles of Shanghai in the process of reform as perceived by the Centre and by the Shanghai leadership is embodied in the central policy of "horizontal integration". This policy set out the active role which Shanghai was expected to play in reform, in addition to its passive role of providing funding through fiscal transfers. As an advanced industrial centre with a highly educated workforce, the city was to engage in co-operative ventures with the less developed provinces and assist their economic development at factory-floor level. In other words, Shanghai was not only collectively to share its wealth with other provinces in the form of high remittance to the Centre, but the individual Shanghai managers, technicians and engineers were also to participate in the nation's reform by helping their counterparts in other provinces.

The central government policy of "horizontal integration" refers to economic co-operation across administrative boundaries. It was initiated in the early 1980s to counter the trend of compartmentalized economic development in the provinces. The basic idea was to encourage the better-off coastal areas to help the poorer inland regions in their economic development.¹⁵ In 1980 the first

¹⁵Breaking the compartmentalized structure of the economy was made an explicit aim of the policy in the 1980 Temporary Regulation, and repeated in a later 1986 regulation. See Footnote 16 below. The aim of encouraging the better-off areas to help the poorer regions was, however, less explicit. A municipal government notice on economic co-operation, however, described co-operation with the national minority areas and border areas as "assistance", stressing that more benefits should be given to the other parties. See Shanghai Municipal Government Document No.85 (1984), November 11, 1984, "The Municipal People's Government approving the Regulation on certain

regulation on the subject was issued by the State Council.¹⁶ Shanghai was obviously the major candidate targeted to offer help. In December 1982, the Shanghai Economic Zone was established to include the regional economy of the Shanghai Municipality, Suzhou, Wuxi, Changzhou in Jiangsu, and Hangzhou, Jiaqing, Huzhou and Ningbo in Zhejiang.¹⁷ The Zone thereby defines the scope of Shanghai's provision of assistance, starting from its encircling hinterlands. Since then the spatial coverage of the policy has extended and the pace of establishing economic linkage increased. As of 1990, a total of 4000 economic organizations was set up. And a total of 1.8 billion yuan of capital from units in Shanghai was invested in resource exploration projects in the resource-rich inland provinces.¹⁸

However, "horizontal integration" was from the beginning plagued by immense obstacles.¹⁹ Under the existing compartmentalized economic system, provincial governments were responsible for the administration and collection of taxes/revenues from their subordinate enterprises. Under this system it was difficult to reconcile the conflicting economic interests of different areas and to achieve inter-provincial economic co-operation. The contractual fiscal system, in place since 1980, further reinforced such compartmentalization by raising the rewards to provincial governments for making local investment, thus increasing the opportunity cost of investing elsewhere. Therefore, by promoting interprovincial co-operation through a policy of horizontal integration, the Centre sought to ameliorate the negative effects of its fiscal reform policy. In practice this was easier said than done.²⁰

issues governing economic and technical co-operation between Shanghai enterprises and enterprises in "brother-areas" by the Co-operation Office, and other departments", printed in *Shanghaishi Jingji Tizhi Gaige Lingdao Xiaozhu* (ed.), *Shanghai Shi Jingji Tizhi Gaige Wenjian Huibian*, (A Compendium of Economic System Reform in Shanghai), Part 2, (Shanghai: Qiye Guanli Xuehui, 1985), pp.12-20, especially p.14.

¹⁶"Temporary Regulation of the State Council on Promoting Economic Integration", passed by State Council Executive Committee, July 1, 1980, printed in State Planning Commission (ed.), *Zhongyao Jingji Fagui Ziliu Xuanbian, 1977-1986* (A Selected Collection of the Major Economic Regulations) (Beijing: Zhongguo Tongji chubanshe, 1987), p.62.

¹⁷State Council Document No.152 (1982), December 22, 1982, "A Notice of the State Council on the Establishment of the Shanghai Economic Zone and Shanxi Energy Base Planning Office", printed in State Commission for Economic System Reform (ed.), *Jingji Tizhi Gaige Wenjian Huibian, 1978-1983* (A Collection of the Documents on Economic System Reform) (Beijing: Zhongguo Caizheng Jingji chubanshe, 1983), p.672.

¹⁸See *The Yearbook of Chinese Horizontal Economy 1991*, p.281.

¹⁹A Shanghai scholar remarked in a 1984 article on horizontal integration that sometimes it was even more difficult to do business with other units in the country than with foreign bodies. See Wu Qi, "Zhinan Ertui, Nuli Kaichuang Jingji Lianhe Xiezuo de Xinjiumian" (Marching Against Difficulties; Earnestly Working for a New Phase of Economic Integration and Co-Operation), *Shanghai Jingji Kexue*, No.5 (1984), p.8.

²⁰Zhao Ziyang when meeting the provincial leaders of the Shanghai Economic Zone on June 30, 1983, talked at length about the need to balance the interests of the parties concerned, and the principle of mutual benefits in economic co-operation. He said explicitly, for instance, "Economic co-operation must be mutually beneficial. Shanghai would not lose, nor would Zhejiang and

By the end of the 1980s, there was a common consensus among officials in Shanghai that horizontal integration had failed to bring the expected benefits to Shanghai.²¹ It was regarded as a failure because assistance had not been reciprocal, at least as the Shanghai officials saw it. In return for technical and financial assistance, Shanghai had expected to obtain raw materials for production in its local enterprises, the previous supply of which since the commencement of reforms had become unreliable and had dwindled through the state plan system. These expectations had, however, not materialized. As investors in projects located in other provinces, the interests of Shanghai's enterprises were often not given proper protection and the terms of contracts consequently not honoured. For instance, a Shanghai enterprise had, in 1986, invested 6.7 million yuan in an aluminium factory in Qinghai. According to the contract, the Shanghai investor would get 7.8% of the annual production in return for its investment. The actual return in 1988 was however only 4.8% of the total production, and the Shanghai enterprise was forced to pay for the product at a much higher price than the originally agreed level.²² Thus while many inventions were transferred to other provinces and cities as part of Shanghai's assistance to other areas, Shanghai gained little in return. From its own perspective, the policy of "horizontal integration" with other provinces had served only to accentuate the outflow of resources and expertise from Shanghai.²³

This is only half the story. The central policy in the 1980s was to encourage coastal regions, including Shanghai and Guangdong, to export more of their products in order to earn more foreign exchange with which to finance their increasing import bill. This would also leave more room in the domestic market for industries of the less well-off areas. The policy was described as one of "opening

Jiangsu." See "Zhao Ziyang Tongzhi Tan Shanghai Jingji de Renwu ji Gongzuo Fangfa Deng Wenti" (Comrade Zhao Ziyang on the Tasks and Working Approach of the Shanghai Economic Zone), *Shanghai Jingji Kexue*, No.1 (1984), p.3.

²¹This is the view of Respondent No.23. Respondent No.28 also admitted the adverse effect of the policy on Shanghai. (Shanghai interviews, May 1994)

²²See Tu Jimo, "Shanghai Difang Touzi Fangshi de Bianhua Yu Duice" (Approaches of Shanghai's Local Investment: Changes and Solutions), *Shanghai Jihua Jingji Tansuo*, No.1 (1990), p.29.

²³A Shanghai official wrote that although tens of thousands of inventions were made in Shanghai every year, in average only several hundred patent applications were submitted and processed every year. The ranking of Shanghai in terms of cumulative number of patent applications of the recent decade was only the ninth; in 1985 it was the second, falling to the twelfth place in 1993. See Shanghai Institute of Economic Development (ed.), *Shanghai Jingji Fazhan, 1993* (Shanghai Economic Development, 1993) (Shanghai: China Business Weekly Press, 1994), p.44. From 1979 to 1983, for instance, a total of 3600 technical and technological items were transferred from Shanghai's units to brother areas. See He Gaosheng et al, "Shanghai Jingji Tizhi de Lishi Yangce" (Shanghai's Economic System Reforms: a Historical Chronology), (Parts 1-3), Part 3, *Shanghai Jingji Kexue*, No.7 (1984), p.30.

up to the world, and co-operating with other regions", and was included in the "Shanghai Jingji Fazhan Zhanlue de Huibao Tigong" (Outline of a report of Economic Development Strategy of Shanghai). It was approved by the State Council in 1985, as a major development strategy.²⁴ The policy looked fairly reasonable, *prima facie*, since the coastal regions were in a better position to develop export-oriented industries, with their better access to foreign investment and generally higher level of industrial and economic development than that of the interior.

In a sense this policy was the Centre's response to two-pronged pressure. On the one hand, the inland provinces were eager to develop their own industries and narrow down the disparity of wealth between themselves and the coastal regions. On the other hand, there was a practical need for more export in order to balance the terms of trade. This was why, from the perspective of Shanghai, the policy of encouraging exports could *in hindsight* be alternatively understood as a policy of restricting the sale of Shanghai's industrial products to its traditional domestic market.²⁵ The idea was for Shanghai to sell more of its products overseas so that the industries of less well-off provinces could have access to more of the domestic market. In practice this strategy proved easier said than done. Unlike Guangdong, which started from a small base, Shanghai's older, and therefore larger, industrial base had heavily depended on the national market since 1949. It was thus more difficult for Shanghai rapidly to reorient its products in terms of international competition, despite the fact that they were of the best quality in the country. Trade statistics confirm that this transition has been difficult. The total value of exports by Shanghai's enterprises in 1987, at US\$4.16 billion, was even 2.5% less than the value achieved in 1980 at current prices with an almost consecutive decline throughout the 1980-87 period.²⁶ Since this value is in terms of the current prices for the year, the decline is, in fact, more serious in real terms. Meanwhile, sales to the domestic market faced increasing obstacles with the breakdown of the traditional sales system and the rising protectionism of other

²⁴For an extracted version of the Outline, see *Shanghai Economy, 1983-1985*, pp.25-34. The reference to the policy was in p.28.

²⁵This is the opinion of Respondent No.23, Shanghai interview, May 1994.

²⁶See *Shanghai Statistical Yearbook 1993*, p.300. The exceptions are 1983 and 1986 which saw a very slight rise over the previous year. These statistics include all exports made through local Shanghai enterprises (foreign trade companies and industrial enterprises with export authority, foreign invested companies) central enterprises and foreign trade companies. A portion of the exports made through these enterprises were not Shanghai products but brought in from other localities. This portion used to be fairly substantial, accounting for up to 40% of the total value conducted through the Shanghai enterprises in 1978 and 18% in 1984. Since then the share has drastically shrunk to only 6% in the 1990s. See also *Shanghai Statistical Yearbook 1993*, p.300. The coverage of statistics was confirmed with Respondent No.28(a), telephone interview, June 1994.

provincial governments against "non-indigenous" products.²⁷ Table 7.2 below illustrates the slackened "growth" of Shanghai's "exports" to other provinces since the 1980s.

Table 7.2

Shanghai's "Export" Trade with other Provinces
(Billion Yuan and Growth % over Last Calendar Year)

<u>Year</u>	<u>Total</u>	<u>Industrial Products</u>	<u>Agricultural Products</u>
1952	1.92	1.84	0.08
	(n/a)	(n/a)	(n/a)
1960	6.43	6.33	0.10
	(-1.2)	(0.3)	(-49.0)
1965	5.23	4.73	0.49
	(11.0)	(9.5)	(27.6)
1970	8.08	7.85	0.24
	(6.7)	(3.6)	(11700.0)
1975	8.36	8.09	0.27
	(8.8)	(8.7)	(11.2)
1980	11.23	10.68	0.54
	(5.7)	(5.8)	(3.8)
1985	16.34	15.90	0.44
	(18.6)	(18.2)	(31.8)
1986	15.22	14.78	0.44
	(-6.8)	(-7.0)	(0.9)
1987	15.39	14.73	0.69
	(1.1)	(-0.4)	(48.5)
1988	16.25	15.43	0.83
	(5.6)	(4.8)	(20.6)
1989	16.93	15.90	1.04
	(4.2)	(3.0)	(25.3)
1990	15.25	14.28	0.97
	(-10.0)	(-9.5)	(-6.3)
1991	15.3	15.06	0.24
	(0.5)	(5.7)	(-75.0)
1992	15.09	12.38	2.71
	(-1.6)	(-18.0)	(1053.0)

Notes and Sources: For the purpose of comparison across the years, these figures cover trade conducted by the state sector enterprises only, and are at the current prices of the year. Total societal figures are available for the years since 1987, but do not alter the general trend of the state sector trade. See *Shanghai Statistical Yearbook 1983, 1987, 1989, 1990, 1991, 1992, 1993*, respectively, p.246; p.274; p.324; p.282; p.312; p.334; p.286.

Table 7.2 shows that Shanghai's outgoing trade to the other provinces in the 1980s can best be described as stagnating. 1985 was the peak of Shanghai's domestic "export". After 1985, and up to 1992, three out of the seven years saw negative growth, the most serious year being 1990 when the amount of goods sold

²⁷This was brought to the author's attention by Respondent No.23, Shanghai interview, May 1994.

to other provinces dived 10% from that of the previous year. When inflation is taken into account, the slow growth originating from the percentage points gained in the growth years can be written off, and negative growths appeared steeper still. In any event the absolute value of goods sold by Shanghai's state enterprises to other provinces in 1992, before discounting inflation, was nearly 8% *less* than the value sold in 1985. This loss of the domestic market at a time when Shanghai's products were not yet ready to face the severe competition in the international market thus caused the Shanghai economy in the 1980s grave difficulties. This is reflected in the two slides in local fiscal revenue during 1981-83 and 1986-88 as discussed in Chapter Four.

Towards the late 1980s the central leadership was forced to review its policy on Shanghai as its economy continued to ail further, in sharp contrast to the robust growth of its previously poor neighbours, and Guangdong in particular. Finally, in the spring of 1992, the Centre formally renounced its previous "rearguard" policy on Shanghai. The municipality was then asked to play a central role in the deepening and broadening of reform in the 1990s.²⁸ The description of its new role---the "dragon-head"---, included in a formal resolution in the Fourteenth Party Congress of October 1992, reflected the change of Shanghai's position from that of back-seat to one of centre stage.

However, it is oversimplistic to assign the difficulties faced by Shanghai during the 1980s solely to central policies. They were also a result of both central and Shanghai leaders gaining through a process of change regarding the perceived role and task of this major city in economic reform. The attitudes and accustomed behaviour of the Shanghai officials, though partly a product of the circumscribing effect of previous central policies, have themselves constituted a major part of the context in which their own discretionary behaviour was constrained.

The Eldest Son

The key element affecting the attitudes of Shanghai officials regarding their role in reform and thus their discretionary behaviour was, and still is, their perception of being the "eldest son" of the Centre. Originating as it did from

²⁸Deng Xiaoping had expressed regret for not having made Shanghai a special economic zone in the 1980s during his visit to Shanghai in January-February 1991, after the opening of Pudong was formally announced by the Centre in April 1990. However, it was during his southern tour in January-February 1992 that he explicitly regarded this as a major mistake of his in the 1980s. See Deng Xiaoping, *Deng Xiaoping Wenxuan* (Selected Works of Deng Xiaoping), Volume 3, (Beijing: Renmin chubanshe, 1994), pp.366, 376.

Shanghai's important position in the national economy since the early twentieth century, this perceived status as the "eldest son" has had important implications for the choices of behaviour by the Shanghai leadership. First, as the "eldest son", the Shanghai government has had to be the right-hand man of the "father Centre". This has required the Shanghai government to offer its advice and comments on policy options, as well as on the implementation of existing policies. Second, the eldest son has to share the burden of responsibility of the father for the younger brothers. This has required the Shanghai government to follow in the footsteps of the Centre and become the model for emulation by other provinces. Shanghai's leaders, therefore, must act in accordance with the rules, or, at least, appear to have acted within the rules. As the "eldest son", Shanghai has occasionally acted as "surrogate father", in helping the Centre to rein in other provinces.²⁹

On face value these would appear to be contradictory behavioural patterns. The Shanghai government is to take the lead in following strictly the rules and policies as prescribed by the Centre, as well as promoting the rationale of policies which have not been well received by other provinces. On the other hand, as the "right-hand man", the Shanghai government must also act as the critical adviser of the Centre, pointing out the inadequacies of existing and fermenting central policies, as well as offering constructive suggestions. In reality the contradiction is superficial. The Shanghai government has to assist the Centre in maintaining the authority of its policies among the provinces, since the central policies are, to an extent, a product of its own advice and therefore work towards its own interests. Critical advice and interest articulations to the Centre are largely an "internal" matter between the Centre and its major assistant, and should be kept as far as possible from public sight.³⁰ The remarks of Shanghai's Party Secretary, Wu Bangguo, during the Second Session of the Eighth Party Congress in March 1994, reflect the relationship between Shanghai and the Centre:

"Regarding the distribution of interests between the Centre and the provinces, our position is: *once the Centre has made its decision, Shanghai unambiguously follows and loyally implements them.* Shanghai does not seek exceptions as all issues must be uniformly handled."³¹

²⁹The idea of the role of "surrogate father", which was often exhibited in the behaviour of the Shanghai government, if not required by the Centre, was brought to the author's attention by Respondent No.23, (Shanghai interview, May 1994).

³⁰This explains why that which is publicly available in documentary evidence regarding Shanghai's articulation of interest and criticisms directed at central policies is generally very mild and lightly worded.

³¹See *Jiefang Daily*, March 11, 1994, p.5.

The relationship between public statements of support and loyalty, and private communications of criticisms and opinions, is interestingly analogous to the relationship between senior civil servants and their political masters in Western countries within a Weberian-type bureaucracy. The main contrast with Western countries is, perhaps, the circumstance under which articulations of interest and internal communications are revealed to the public. In the West, such revelation is a matter of procedural prescription. In China, it is a measure of the relative strength of the different power forces in the system. As and when conflicts of interests between the Centre and its main lieutenant become serious and intense, and when their differential power narrows to the extent that neither could be coerced into silence, differences may then emerge.

Understanding the attitude of Shanghai officials regarding Shanghai's role in the nation helps to explain the self-restraint in their discretionary behaviour. Despite their discontent with the way economic reforms in the 1980s worked to their disadvantage, Shanghai's officials have nevertheless resigned themselves to the inevitability of their misfortune. Moreover, the turnaround of central policies in the 1990s has vindicated the importance of Shanghai to the progress of the reform process. The coded self-criticism of Deng Xiaoping during his 1992 "southern tour" regarding the neglect of Shanghai has been of some consolation to Shanghai officials. Nevertheless, the general feeling amongst Shanghai officials was that what had occurred had been, by and large, inevitable. Shanghai's importance to the national economy meant that the Centre had no alternative but to be prudent with changes there at the early stage of reform. In the words of a municipal planning official, "it would have been too risky for the Centre to "open" Shanghai and try out experiments in the early 1980s."³² Shanghai was not comparable to the remote village of Shenzhen and the humble towns of Zhuhai and Shantou, whose different treatment and roles at the early stage of reform had been its opposite. The pride of Shanghai officials with Shanghai's "eldest son" status and national role had, therefore, resulted in a strangely mixed feeling of righteous deprivation and stoic acceptance.

Similarly, the central policy of "horizontal integration" had the enthusiastic support of the Shanghai government when it was first announced. However, the policy was subsequently blamed by the Shanghai leadership for Shanghai's lacklustre economic performance in the 1980s. The municipal government was said to have been led to focus on setting up factories in the inland provinces at a

³²Respondent No. 27, Shanghai interview, May 1994. Similar comments were made by respondent No.23, Shanghai interview, May 1994.

time when they should have paid more attention to the attraction of foreign capital and technology.³³ Nevertheless, this policy was not simply imposed by the Centre on Shanghai. A policy asking for mutual help and co-operation is unable to take off unless the dominant donor is willing. The fact is that this policy suited perfectly the "big brotherly" orientation of Shanghai officials. Seeing themselves as the stronger partner in interprovincial co-operation, the Shanghai government was explicit in encouraging its enterprises to care *less* about their own interests and give *more* benefits to their partners.³⁴ It was only later, when the adverse effect of the policy became obvious that Shanghai officials started complaining. To a large extent, therefore, it was their own self-image that was at the root of their difficulties in the 1980s.

Rule-Abiding Bureaucrats

Shanghai's officials have often been described as the best modern technocrats in China because of their respect for rules and regulations.³⁵ Some Shanghai officials regard the attention they give to rules as the best observance of the rule of law in the country, and they are inclined to attribute this characteristic to the relatively higher level of education of Shanghai's workforce.³⁶ This characteristic of the Shanghai administration has also been regarded as the important edge which enabled Shanghai to develop its commodity and futures markets much faster in the early 1990s than other cities.³⁷

This tendency to observe rules, as noted in Chapter Six, permeates Shanghai's discretionary behaviour regarding its attempts to expand investment and

³³Shanghai has since 1949 been an inward-oriented economy, despite the fact that it was China's number one exporter until 1986. In one account it was stated that exports of Shanghai in 1989 accounted for only 7% of total GNP, whilst the share in Guangdong was 13%. See Rui Mingjie and Yu Wenyi, "A Comparative Analysis of Foreign Investments in Shanghai and Guangdong", *Shanghai Investment*, No.7 (1992), p.13.

³⁴This was reflected in the Municipal Government Document No.85 (1984) on economic and technological co-operation with other localities. See Footnote 14 above. It should be noted that giving more benefit to others was *not* explicitly stated in the Centre's 1980 and 1986 documents on horizontal integration.

³⁵Respondent No. 39, Beijing interview, May 1994.

³⁶Respondent No. 14, Shanghai interview, January 1994. Respondent No.39, Beijing interview, May 1994, described the officials in Shanghai as the best bureaucrats in China with the most loyal adherence to rules in policy implementation in the sense of a legal-rational western-styled bureaucracy.

³⁷*Ibid.* Also Respondent No.15, Shanghai interview, January 1994. The rapid development of the commodity and futures market, as well as the stock exchange, in Shanghai in the 1990s was also largely due to the change of central policy towards Shanghai. But the technocratic expertise of Shanghai administrators as well as a more educated workforce and a historical tighter observance of rules and regulations in Shanghai were, according to the respondents, important factors in allowing the markets to run relatively smoothly within a short period and time. The rules of the game were also more transparent and evenly levied---the key to the successful development of markets.

develop its economy. Where observance of rules to the letter is not possible, due to the rules being either obsolete, inapplicable or impractical, the tendency is to *appear* to be abiding by the rules. Feigned compliance has therefore been a major characteristic of Shanghai's discretionary behaviour. Shanghai officials, as compared to their counterparts in Guangdong, have been more concerned with their investment statistics for fear that the statistics might reveal their deviation from the centrally prescribed quotas of investment. This concern with rules is partly a product of the constraints posed by a tight economic environment, given its heavy fiscal burden and the difficulties experienced by Shanghai in the 1980s. It is also partly a result of the perceived role of Shanghai by the Shanghai leadership as the "eldest son" of the Centre. However, in either case, concern over rules forms a part of the strategy employed by Shanghai leaders to improve Shanghai's lot. It is the choice of the provincial actor in the context of its institutional constraints.

Regarding the constraints of the preexisting economic management rules and policies in Shanghai, it has been argued that rule-observance could be considered as the accustomed response of municipal officials as a means to surviving under existing circumstances.³⁸ The strong element of central planning in the Shanghai economy since 1956 has resulted in a macro environment where room for local manoeuvre has been small.³⁹ The heavy burden of fiscal remittance and inability freely to adjust prices to compensate for the rising costs of production left little leeway for local policies with which to encourage investment in the economy.⁴⁰ The municipal government was *conditioned* to being meticulous in revenue collection as this was the means by which it could meet the fiscal remittance targets. The cumulative effect of years of fiscal strain resulted in government departments, especially the finance and audit departments, being accustomed to focusing their work on the *due* collection of revenue and prevention of haemorrhage.⁴¹ Flexibly implementing the rules so as to collect less in order to encourage production was alien to this culture. Where discretions and flexibilities occurred, they were invariably marginal and of peripheral effect.

However, it is important to emphasize that such rigour is *not* entirely due to surveillance by the Centre. The central policies and centrally prescribed systems

³⁸Respondent No. 15, Shanghai interview, January 1994.

³⁹See discussion in Chapter Six, footnotes 88-90. See also Tu Jimo, "Shanghai Caizheng 'Huabo' Pouxu" (An Analysis of the Fiscal 'Slides' in Shanghai) *Shanghai Jihua Jingji Tansuo*, No.1 (1988), p.53.

⁴⁰For descriptions on the effect of the tight fiscal jacket on the behaviour of Shanghai's officials regarding investment, see the discussion in Chapters Four and Six.

⁴¹For some documentary evidence of the meticulous attention to the due collection of revenue, see for instance *Shanghai Audit*, No.5 (October 1992), pp.5-6; No.6 (December 1992), pp.15-18.

would never be able to eliminate local discretions. Rather, the Shanghai government has itself, *over time*, developed its own system, and culture, of internal control in the process of enhancing its ability to fulfill its assigned tasks under the system.⁴² This kind of culture, once established, has taken some time to change despite the removal of objective constraints. Although the Centre finally abandoned its "rear guard" policy towards Shanghai in 1990, this was a full twelve years after the adoption of the Open Door Policy and eleven years after the approval of the Special Policy for Guangdong and Fujian. Accustomed strategies of survival established during this time could not, therefore, be changed overnight. This was the basis on which in 1991, Wu Bangguo, Shanghai's Party Secretary, felt compelled to warn municipal finance officials against too pedantic and narrow an orientation as regards revenue collection. Instead, he called for a new and more progressive attitude towards economic development. The Party Secretary said during a visit to the municipal finance bureau:

"(We) have to handle correctly the relations between finance and tax work in our work on the economy. *At present, many departments have not yet fully regarded the promotion of production and economic development as the core of their work.* In other words, serving the economy is not yet considered as the job of many departments. What is the primary preoccupation of these departments...? *Many are working for the functionary needs of the departments, working to their administrative superiors, and to the rules of the departments....* We should not simply apply our minds to a particular rule or document, but also set our eyes on economic development as a whole..."⁴³ (emphasis added)

It has previously been noted that provincial leaders are quick to adjust their survival strategies in accordance with changing situations.⁴⁴ However, before strategies can be adjusted, the new situation must first be defined. Where radical changes in the environment demand basic attitudinal changes, rather than mere tactical shifts, adjustments come more slowly. To an extent this is also the case in Guangdong. In the previous section it has been noted that attitudinal changes there,

⁴²The banks and audit departments were two typical examples of the culture of strict internal control in the Shanghai administration. According to Respondent No.15, the banks in Shanghai would normally stick to the rule book and require the inclusion of a project in both plans, namely the credit finance plan, and the investment plan, before approving loans to a particular investment project. The breaking of central rules by the municipal government, a frequent phenomenon elsewhere, was relatively infrequent in Shanghai. The strictness of the local audit bureau could not be compared to the relaxed attitude and flexible implementation of accounting rules as occurred in Guangdong. (Shanghai interview, January 1994) Respondent No.23 agreed that much of the control that existed in the Shanghai administration was self-imposed local control. This informal culture was such that the behaviour of each official was under the surveillance of their surrounding colleagues, and this formed a mutually reinforcing environment in which changes happened slowly and where they did occur needed to be pushed forcefully from outside and above. (Shanghai interview, May 1994)

⁴³See *Shanghai Caishui*, No.6 (1991), pp.6-7.

⁴⁴See discussion of the literature on China's central-provincial relations in Chapter one.

too, were not achieved overnight. However, the Guangdong leadership has an advantage over its Shanghai counterpart in having been assigned a clear and focused role early on in reform---a development which has worked successfully, by and large, in terms of both national and provincial interests. On the other hand, the Shanghai leadership has been struggling for a redefinition of its role at a time of deepening economic reform and at the outset of the break-down of the central planning system. As a result, the process of strategy adjustment has seen more twists and turns in Shanghai than in Guangdong.

The above discussion on the mediating process between differential central policies and the discretionary behaviour of the Guangdong and Shanghai governments gives rise to two observations. First, the process whereby central policies have had an impact on provincial behaviour has not been straight-forward. Provincial leaders are not merely responding and reacting to the policies of the Centre. Rather, central policies define the limits within which provincial governments may then design their strategies in a manner best to enhance their own interests. In other words, the Centre prescribes the context and parameters within which provincial actors exercise their choice. Provinces are constrained, but they also have substantial room for manoeuvre.

Second, the key mediating factors underlining the choices of provincial leaders within central constraints are the strategies and attitudes of the provincial leaders. These may include their accustomed behaviour and conscious "interest-advancement" strategies arisen as a result of the macro-environment in which provincial leaders operate, as well as their ideas regarding their role in the nation. At times of radical change, there is often a time lag between contextual changes and changes in strategies and attitudes. As a result, strategies and attitudes are often coloured by yesterday's policies or an objective situation which has subsequently changed. This characteristic of attitudinal changes complicates the mediating process between central policies and provincial behaviour.

This slackness of attitudinal change is found both in the Guangdong and Shanghai leaderships, and has important implications as regards their discretionary behaviour. For instance, Guangdong's perception of its role in the nation is, in the early 1990s, largely unchanged despite its emergence as a major economic power. In 1993, Guangdong became the top exporter of the nation for the eighth-

consecutive year.⁴⁵ Its gross national product surpassed that of Shanghai in 1981,⁴⁶ and has since 1989 topped the national ranking.⁴⁷ Economically, therefore, the province has become a formidable national force. However, the perceived role of the province by the Guangdong leadership and by the Centre has apparently remained that of the favoured younger child pioneering in reform. As pioneer, the Guangdong leadership had, since 1979, been aggressive in asking for central concessions for its assigned task. The Centre had, in fact, encouraged such "aggressiveness" on the part of the Guangdong leaders. During one decade of reform, Guangdong's wealth snowballed. This pioneer is consequently no longer the weak and unimportant peripheral province whose possible failure in the reform experiment would not cause the nation too dear. Yet more reforms are still on the way, and more pioneering work is yet required. As the discussion in Chapter Five has shown, since the early 1990s the Guangdong government has displayed little hesitation in pushing for concessions from the Centre at times when it felt that its interests were under threat. One revealing example is Guangdong's response to the Centre's plan to replace the *dabaogan* fiscal system, in place since 1980, with a tax-sharing system as from 1994. Another instance is its bargaining with the Centre in 1991 to obtain cheap central bank loans amounting to some 1 billion yuan annually, even though local bank deposits at that time exceeded the local demand for loans. The aggressiveness and openness of its lobbying for concessions and support, and its success in getting them, demonstrate that old attitudes still hold amongst both the central and Guangdong leaders regarding the role, and thus responsibility, of Guangdong in the nation.

When taking into account the ready response of the Shanghai leadership to central instructions on the eve of the implementation of the new fiscal system of 1994, the contrast in Guangdong's behaviour becomes still clearer. As discussed in Chapter Six, the Shanghai government, in a manner similar to other provinces, had sought to expand the revenue base of 1993 in order to increase its retained local revenue under the new fiscal system. However, after the Centre detected such manoeuvring behaviour by the provinces and issued a stern warning against it, the Shanghai government immediately obliged. Some collected revenue was even refunded to enterprises. As a result, Shanghai's local fiscal revenue increased by

⁴⁵See *Jiefang Daily*, February 22, 1994, p.9.

⁴⁶Calculated from *Guangdong Social and Economic Statistics, 1949-1988. Part on General Statistics*, p.69; *Guangdong Statistical Yearbook 1993*, p.27; *Shanghai Statistical Yearbook 1993*, p.35.

⁴⁷See *Guangdong Social and Economic Statistics: 1949-1988, Part on General Statistics*, p.176, and State Statistical Bureau (ed.), *Quanguo Zhuyao Shehui Jingji Zhiliao Paixu Nianjian, 1992* (The 1992 Yearbook of the Ranking of Provinces in Major Social and Economic Indicators) (Beijing: Zhongguo Tongji chubanshe, 1992), p.8.

only 8.5% in December 1993 over same month in 1992, in contrast to a 150% increase in Guangdong.⁴⁸ The Shanghai leadership may have felt obliged to follow the Centre's instructions as a result of its traditional role of "setting a good example" to other provinces. They may also have acted out of calculated interest, believing that this approach would best serve Shanghai's interest in the long run.⁴⁹ In any event, the Shanghai leadership may have considered such a temporary retreat as a necessary means of maintaining its status in the country,⁵⁰ thus enabling it to sustain its influence on the Centre and obtain more favourable policies over the long run.⁵¹ Thus, while Guangdong has become economically strong, it still clings to the role of a younger child. Shanghai has also chosen to continue to perform its "eldest son" role. The Shanghai leadership has apparently come to the conclusion that its interests may be better served through strengthening its position as "right-hand man" of the Centre, and that added responsibility is the inevitable price to be paid. This is notwithstanding the fact that, as previously noted, Shanghai has already been surpassed by Guangdong and other provinces in terms of important economic indicators since the late 1980s. In fact, the more vulnerable the Shanghai leadership has felt in the face of the threat to its traditionally dominant position, the more anxious it has been to maintain its status by acting even more like a "good son" than it would otherwise.

Figure 7.2 below visualizes the mediating process between the imposition of central policies as the institutional context and the discretionary behaviour of provincial leaderships:

⁴⁸See discussion in Chapters Five and Six.

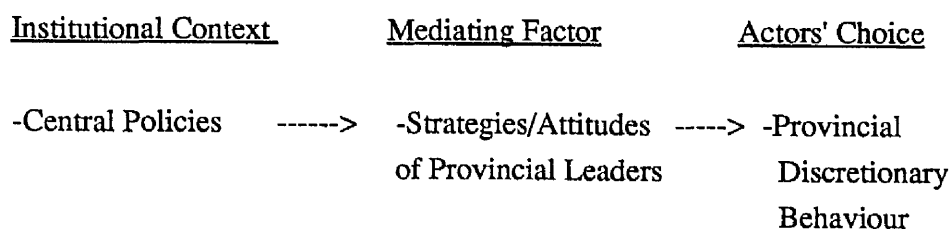
⁴⁹According to Respondent No.21, (Shanghai interview, January 1994), underlying the refunds of taxes in December 1993, in the aftermath of warnings from the Centre against base-line scrambling behaviour, was the worry that the rapid surge of fiscal revenue in Shanghai might raise the future expectations of the Centre regarding the financial strength of Shanghai, and therefore invite further extraction from the Centre.

⁵⁰Respondent No.23 (Shanghai interview, May 1994) remarked that given the difference in historical and strategical roles of Guangdong and Shanghai, the Centre was generally more tolerant of deviations in Guangdong, than was of those in Shanghai. While the Centre generally required an expression of loyalty from all provincial leaderships, localist tendencies in some provinces were more tolerable, if not acceptable, than in others. According to the respondent, the expectation of the Centre for Shanghai was especially high, and it was "totally unacceptable for the senior leaders of Shanghai not to see things from the national viewpoint."

⁵¹That Shanghai's Party Secretary, Wu Bangguo, was promoted to the Party Central Committee Secretariat, and mayor, Wang Ju, concurrently to the Politburo in the Fourth Plenum of Fourteenth Party Congress in September 1994 may indicate that this strategy of Shanghai paid off in enhancing its influence on the Centre. See *Wen Wei Po* (Hong Kong), October 1, 1994.

Figure 7.2

Linkage of Institutional Context and Actors' Choice



What needs re-emphasis in the above figure is that the strategies and attitudes of provincial leaders are often slower to change than is the institutional context itself. This is especially the case when changes in the context are radical, as in the case of economic reform. Consequently, central policies, as well as other objective conditions of an earlier period, may still be part of the scene in the form of attitudes of the actors involved.

The Power of the Province

The foregoing section elaborates the complexities involved when considering the extent in which the Centre influences and constrains the provinces. It seeks to demonstrate that the impact of the Centre on provinces is not as simple and straight-forward as it may seem. It concludes by pointing out that provinces themselves influence the way in which the Centre exercises power over them. Central policies work through the attitudes of provincial leaders, who choose their specific actions from within the parameters prescribed by central policies. The considerable scope to choose within central constraints, which provincial leaders have, constitutes their power. The overall operating context is, however, still prescribed by the Centre, and the attitudes and survival strategies of provincial leaders are also, to a considerable extent, a product of central policies, if only those of an earlier period. The overall framework of the above discussion is, therefore, still one based on the flow of influence from the Centre to the provinces.

The purpose of this section is to highlight the reverse: the flow of provincial power to the Centre. Instead of asking how provincial discretionary behaviour is influenced by central policies, therefore, this section asks how the provinces seek to influence central policies through their discretionary behaviour.⁵² What

⁵²As noted in Chapter One, the influence of the provinces on central policies has been one major theme of Susan Shirk's works. See Susan Shirk, *The Political Logics of Economic Reform*

pressures have the provinces placed on the Centre in order to effect changes? As this discussion shows, the role of provinces is not confined to one of responding to central policies. *It is also one of competing with the Centre in defining the contents of the central policies.* Provinces thus formulate policies as well as creatively implementing them.

Guangdong

When flexibly implementing central policies, the Guangdong government has frequently challenged the legitimacy and appropriateness of existing central policies and rules. Such competition with the Centre for the right to define the contents of central policy becomes a more frequent and manifest phenomenon towards the end of the 1980s. As its pioneering skill is increasingly proven through the sustained affluence of the province, the Guangdong government has also gained confidence as regards its local policies. Meanwhile, as the progress of reforms has brought about more difficulties and displacements within the nation, conflicts between the Centre and Guangdong have become more intense. A more confident Guangdong government has, in these circumstances, felt it necessary to "persuade" the Centre to adopt its manner of dealing. The result has been a proliferation of local publications since the late 1980s summarizing and publicizing the "Guangdong experience".⁵³

The most explicit instance of such competition for orthodoxy is the "Three 'Sayings', Three Defences" article published by the Guangdong leadership in January 1989. As discussed in Chapter Five and earlier in this chapter, these articles amount to an open protest by the Guangdong government against the effect of the centrally imposed austerity programme, started in late 1988, upon its reform efforts. Discouraged by the twists and turns of central policies and the withdrawal of many of its special powers since late 1988, the Guangdong government launched the most explicit and outright attack ever made by a provincial government on a central directive. The thrust of this articulation, through a series

(Berkeley: University of California Press, 1993), especially Chapter Nine; "Playing to the Provinces: Deng Xiaoping's Political Strategy of Economic Reform", *Studies in Comparative Communism*, Vol.23, No.3 (Autumn/Winter 1990), pp.227-58. The difference of this section with Shirk's work is a matter of emphasis and perspective. Shirk's focus of analysis remains, by and large, the Centre, and her discussion elaborates how central officials felt being constrained by provinces. The activism and influence of the provinces on central policies was thus deduced from the articulations by central officials about their difficulties in imposing their will. On the other hand, this thesis has taken a more direct approach in this respect. The power of provinces is discussed by explicit description about the behaviour of provincial leaders and how they sought to influence central policies. For more discussion of the provincialist approach of this thesis, see Chapter One.

⁵³This is a point raised by Respondent No.9, Guangzhou interview, December 1993.

of three articles by the provincial party propaganda chief on a provincial party paper, went far beyond the usual lobbying for exceptional treatment based on local conditions. The particularistic arguments rather formed a part of a general and fundamental challenge to the orthodoxy of central policies. This challenge is directed at that constituting the fundamentals of central policy.

The argument went as follows: the fundamental central policy since the 1978 Third Plenum had been that of economic reform, "opening up" and modernization, or simply, economic development. Thus, productivity was the one and only criterion against which the work of the province should be judged. Moreover, Guangdong had been assigned the task of going one step ahead of the rest of the nation in pioneering the means to such a goal. Consequently, it should not be governed by any of the preexisting central rules and regulations formed before the new central policy of economic reform and development came into being. Nor, it was argued, should the province be bound by national rules formulated thereafter for nationwide application. Its role as a pioneer should preclude such a "blanket" treatment. Whatever the justification of these national regulations for the rest of the nation, they should be subordinated to the fundamental policy of economic reform and development as regards Guangdong. Constraining the ability of the pioneer of reform, it was further argued, was commensurate to sabotaging central policy of the highest order through pedantic regulations. Therefore, unless the Centre changed its fundamental policy and abandoned reform and modernization, or unless Guangdong's methods of fulfilling this goal failed to bear fruit, those national rules and policies which obstructed Guangdong's experiments should give way.

It is helpful to repeat here again the remarks of the Guangdong leadership in the "Three 'Sayings', Three Defences" articles, previously quoted in Chapter Five:

"The four modernizations are the major tasks of the entire Party, and productivity is the criterion by which to judge whether our work is good or not..."

"The Party Centre and the State Council instructed Guangdong and Fujian to go one step ahead of the rest of the country...and allowed the two provinces to act according to the Special Policy, and 'flexible measures'. This means that the Centre does not require the two provinces to follow in strict accordance the policy documents which are meant for the use of the rest of the country, but rather to follow the Special Policy documents tailored for these regions."

"Now that the Centre has flashed a special green light to the two provinces, and we (in going in the direction of this special green light) are merely going around the "ordinary" red lights (meant for the rest of the country),

what is there to be criticized? On the contrary, if somebody does not implement or try to put their own limitations on the Special Policy formulated by the Centre, then this should amount to the flouting of (party) discipline. ... *Isn't this going against economic opening and reform, the highest-order policy directive of the Party ?*"⁵⁴ (emphasis added)

Chapter Five also describes some other more specific examples of Guangdong officials seeking to redefine central policies. For instance, the Guangdong officials have called for the abolition of central rules regarding the management of bank loans. They argued openly that the rules had become outdated, grounded in rationales of an earlier period. Such rules were therefore obstructing the needs of economic development and reform. It was pointed out, for instance, that the segregation of bank loans into fixed asset investment loans and working capital loans arose from a concern to contain the former, which the central government had not expected to have them repaid. But as market reforms progressed, enterprises were, at least in theory, required to repay both kinds of loans. While some enterprises might be unable to repay their loans in practice, it was argued, this was not the reason to arbitrarily impose administrative quotas. The quotas had had the effect of displacing the independent professional judgement of local banks, and thus inhibiting the spirit of the bank reform. By ignoring the central rules, the Guangdong officials argued, they were in fact helping to advance economic reform, a role they were assigned to perform. After all, the amount of loans lent by a local bank should be restricted by the total amount of deposits, and banks should not be disallowed to lend out its available resources to viable projects.

There are indications that Guangdong's argument has had some impact on national policies. A report by the State Planning Commission, published in 1993, acknowledged the wisdom of Guangdong's flexible implementation of these bank rules as well as its flexible attitude to rules regarding the central quotas of total investment scale. The report noted that by "flexibly handling" these rules, Guangdong's authorities had successfully developed the infrastructural facilities of the province. Since the Centre and other provinces had generally found it difficult to divert enough investment to the low-profit infrastructural sectors, Guangdong's success by *not* strictly following central prescriptions could not but give the Centre a disturbing and yet illuminating message. The report of the State Planning

⁵⁴See Wang Hao, "Sanshui, Sanbian" (Three 'Sayings', Three Defences), *Zhongguo Jinbao*, January 13, 1989, p.2. The author was alerted to the article by Yang Xiaofei, *Shengji Zhengfu de Zishu Xingwei: Kaifang Gaige Shiqi de Guangdong Zhengfu* (Discretionary Behaviour of the Provincial-Level Government: The Guangdong Provincial Government in the Reform Period) (M. Phil Dissertation, Chinese University of Hong Kong, 1990). According to Yang, Wang was the propaganda chief of the Guangdong Provincial Party Committee.

Commission was generally supportive of Guangdong's argument, noting that "taking into account Guangdong's success, the Centre should perhaps change the rules to accommodate, rather than merely tolerating such so called "illegal manoeuvres" of the existing system."⁵⁵ The report notes that Guangdong's extensive use of extrabudgetary funds in investment had played a material role in enabling the province to finance an ambitious infrastructural and energy investment plan.⁵⁶ Revenue was raised directly from the immediate users of the facilities as a means to raising capital for the projects, while in other provinces investment in infrastructure had always depended heavily on the state budget. Their scale of investment had thus been limited, given the declining share of budgetary revenue in national income generally and the existence of other spending priorities. Guangdong's success in overcoming these difficulties had impact on the Centre's considerations as to the most appropriate way of financing investment. It paved the way for officially endorsed large scale development of the capital market and the issuing of stocks and shares in the 1990s.

Shanghai

If the power of the Guangdong government to influence central policies derives in part from its pioneering role and experience in reform, the power of Shanghai is rooted in its established status as the "eldest son" of the Centre. As the "eldest son", the Shanghai leaderships have historically had a close relationship with the Centre. As discussed above, the Shanghai leadership has maintained a veil of feigned compliance, even to those central policies with which they do not agree, in order that their status as the "right-hand man" of the Centre be maintained. Observing central rules is, in this way, seen as the best strategy through which to sustain Shanghai's influence in the making of rules.

One fairly obvious indicator of Shanghai's influence at the Centre is the career mobility of its leaders. Since 1949 a good number of Shanghai leaders have led both provincial and central government careers. To name the more recent developments, both the current Secretary General of the Party and a prominent vice-premier, Jiang Zemin and Zhu Rongji, had served in Shanghai immediately before their promotion to the central leadership. In September 1994, as previously noted, the then Shanghai Party boss, Wu Bangguo, after made a Politburo member

⁵⁵Lou Jinfen and Guo Shuqing (ed.), *Jichu ChanYe Jianshe Ziji Chouju* (Capital Mobilization for Infrastructural Construction) (Beijing: Zhongguo Fazhan chubanshe, 1993), p.239.

⁵⁶*Ibid.*, p.232-41.

in 1992, was elevated to an important position at the Central Party Secretariat, while its mayor, Huang Ju, was made a Politburo member.

A clear statement of provincial power, nevertheless, requires us to explore the *processes* whereby Shanghai's leaderships have exerted their influence. This examination has, however, proved to be plagued by immense difficulties. Not only is there the problem of ascertaining articulations of interests from within such a closed political system, but this relationship between the Centre and its "lieutenant" is also, by its nature, an "internal" matter. As noted previously in this chapter, opinions and advice are, as a rule, deliberated and delivered in private. Wherever possible, the Centre and its lieutenant maintain a "united front" in public. As in the relationship between the political master and the senior civil servant in the West, this veil of homogeneity and harmony is necessary for the public image of effective governance. The veil only drops to reveal the underlying dissension on rare occasions where fundamental and material disagreements are involved.⁵⁷

Notwithstanding such difficulty in detection, some fragments of the arguments which have been put forward by the Shanghai government to influence central policies in the 1980s have come to light. One major case is the fiscal system. In Chapter Six it is mentioned that Shanghai's finance officials have, since the early 1980s, advocated a tax-sharing fiscal system.⁵⁸ At a time, during the early to mid 1980s, when the recently installed contractual fiscal system had brought in sustained benefits to the Centre as its share of national fiscal revenue rose,⁵⁹ Shanghai's officials were nevertheless adamant that this was not the proper fiscal system. They argued for a system whereby fiscal authority and responsibility between the Centre and the provinces should be clearly delineated through separate taxes.⁶⁰ In other words, revenue would no longer be divided according to the

⁵⁷One recent case in which dissensions between political masters and civil servants in the West were brought into the open was the provision of overseas development aid by the British Government in the early 1990s to the Pergau Dam Project of the Malaysian Government. The senior civil servant involved held opposing views to those of the ministers and provided evidence to parliamentary hearings and judicial review proceedings on the propriety of the aid decision. Eventually the court, relying heavily on the evidence by the civil servant, ruled that the Government had acted illegally. See *The Guardian*, (London) November 11, 1994. A similar and more dramatic case, again in Britain, occurred over the Falklands War when a senior civil servant was sued by the Government as a result of his making his dissensions public, see Clive Ponting, *The Right to Know: The Inside Story of the Belgrano Affair* (London: Sphere Books, 1985).

⁵⁸See footnote 40 of Chapter Six.

⁵⁹The share of centrally collected fiscal revenue had been rising since the institution of the contractual system in 1980, only beginning to drop in 1987. See Ministry of Finance (ed.), *China Finance Statistics, 1950-1991*, p.102.

⁶⁰See Xu Riqing et al, "Wanshan Shanghaishi Difang Caizheng de Yanjiu" (A study on How to Perfect the Local Fiscal System of Shanghai), in Chen Menzhi (ed.), *Shanghai Jingji Fazhan Zhanlue Yanjiu* (A Study of Shanghai's Economic Development Strategy) (Shanghai: Renmin chubanshe, 1985), pp.243-58; "Wanshan Difangshui Tixi, Shixing Fenji Caizheng Tizhi"

subordination relations of enterprises as it was under the existing system. Instead, some taxes would form the revenue of the Centre, and others that of the province. These principles have in fact formed the backbone of the new tax-sharing fiscal system of 1994, although many of the more radical changes to the preexisting system have been subsequently watered down.

It must be emphasized that in arguing for a fiscal system based on the principle of dividing and sharing taxes in the 1980s, Shanghai officials have been acting in the municipality's best interests. The interests of the municipal government, namely of having a healthy and stable fiscal system, could, in their opinion, be best fulfilled by a tax-sharing system. Powers and responsibilities between the Centre and Shanghai would then be clearly defined. The contractual system was seen as being of transient utility, not merely because Shanghai had not obtained much benefit under such a system, but also because provinces generally had remained dependent on the Centre for a good contract. Without a clear-cut division of taxes between the Centre and the provinces, the provinces would not be able to exercise their independent authority.

This is not to say, however, that Shanghai officials have sought deliberately to influence adversely the interests of the Centre. There is no simple dichotomy of municipal interests versus central government's interests. As Peter Ferdinand has pointed out, it is often immaterial to try to discern motives behind behaviour in terms of private or altruistic interests.⁶¹ Very often motives have both private and altruistic facets. In the search for a central-provincial fiscal system, it is in the interests of the Shanghai government to have a system which guarantees a higher and more stable fiscal revenue over which the municipal government may exercise autonomous control. The national interest lies in having a system which proportionately assigns jurisdictional authority and responsibility to each level of government, whilst maintaining the national authority of the central government. These two motives do not necessarily contradict one another. From the point of view of Shanghai officials, tax-sharing is the best design for a central-provincial fiscal system because it more specifically delineates the power and responsibilities of *both* the Centre and the provinces. Both the Centre and Shanghai thereby benefit from a stable and secure fiscal relationship: the more the Centre benefits, the more

(Perfecting the Local Tax system, Practising a Stratified System of Fiscal Finance), *Shanghai Caizheng Yanjiu*, No.1 (1985), pp.2-5.

⁶¹Peter Ferdinand, "Interest Groups and Chinese Politics", in David S. G. Goodman (ed.), *Groups and Politics in the People's Republic of China* (Armonk, New York: M. E. Sharpe, 1984), pp.18-19.

Shanghai also benefits. In the view of Shanghai officials, in the long run a system that enables both sides to benefit and feel secure is the only kind likely to survive.

There is a strong affinity between these early opinions in Shanghai and the rationale behind the institution of the new tax-sharing system in 1994. This similarity indicates the extent of Shanghai's influence on the central decision to implement the tax-sharing system in 1994. In fact, there are indications that Shanghai officials and scholars have participated extensively with central government officials in the search for a long-term fiscal system between the central and lower-level governments. One example is the research on fiscal system reform during the latter half of the Seventh Five-year Plan (1986-1990) organized and coordinated by the Research Institute for Fiscal Science of the Ministry of Finance.⁶² Amongst the participants was a number of scholars from the Shanghai Academy of Social Sciences. The major thrust of the findings of the project was a critique of the continued operation of the contractual fiscal system of the 1980s. This research also suggests that the vehicle for fiscal system reform should be along the lines of a tax-sharing system. The continuity with Shanghai's earlier position is thus obvious.

Shanghai's participation in the formulation of the new tax-sharing policy continued as the system entered its early phase of implementation in 1994. The early months of 1994 saw numerous detailed expositions from Shanghai on how the new system should and could operate.⁶³ As new policies in China were often only half-implemented initially due partly to a lack of detailed implementation rules and partly to the ponderousness of the preexisting system, Shanghai's proactive suggestions constituted a de facto drafter of new central regulations.

Therefore, both the Guangdong and Shanghai governments have, in their own characteristic ways, played a considerable role in the formulation of central policies. Guangdong's approach, on the one hand, is led by implementation. It was only after the successful implementation of its own "native" policies that the Guangdong government ever challenged the legitimacy of central policies whilst simultaneously pushing for amendments to such policies. In the case of Shanghai,

⁶²See Song Xinzong (ed.), *Zhongguo Caizheng Tizhi Gaige Yanjiu* (A Study on the Fiscal System Reform in China) (Zhongguo Caizheng chubanshe, 1992).

⁶³See for instance Ke Tizuo, "Fenshuizhi de Tansuo Yu Xuanze" (Probes and Choices on the Tax-Sharing System), *Shanghai Caishui*, No.2 (1994), pp.8-14; Gu Xingquan, "Qiantan Caishui Tizhi Gaige" (A Preliminary Discussion on the Fiscal and Tax Reforms), *Shanghai Caishui*, No.3 (1994), pp.10-11, 31; and Wu Jianguo, "Dui Shishi Caizheng 'Tuanyi Zhifuzhi' de Xianshi Sikao" (Pragmatic Thoughts on Implementing the Fiscal Transfer Payment System), *Shanghai Caishui*, No.3 (1994), pp.12-14.

participation in central policy formulation has followed a more conventional sequence. First, there would be advocacy of policy options, followed by participation with central officials in their deliberations. Upon the Centre adopting a new policy, the municipal government would continue its participation through recommendations for smooth implementation. Figure 7.3 below summarizes the approaches of Guangdong and Shanghai in exercising their influence on central policies.

Figure 7.3

Processes of Provincial Participation in the Formulation of Central Policy

Guangdong

Flexible Provincial Implementation of Central Policies -----> De facto Amendments to Central Policies (at Provincial Level) -----> Official Amendments to Central Policies

Shanghai

Advocacy at Municipal Level -----> Participation in Policy Deliberations with Central officials -----> (Central Policy Adopted) -----> Recommending Details for Smooth Implementation of the Policy

Conclusion: An Interactive Central-Provincial Relationship

Discussions in this chapter have sought to demonstrate one point: that political influence has many manifestations. The Centre obviously has leverage over the behaviour of provincial governments. Its policies define the scope of provincial manoeuvre. Through their circumscribing effect on the attitudes and role perceptions of the provincial leaders, specific central policies often have an impact on provincial behaviour outlasting their very existence. However, the existence of central influence does not necessarily mean that provincial leaders have been merely the agents of the Centre, or that they respond and react to stimuli from the Centre in accordance with a preconceived formula determined at the Centre. On the contrary, provincial leaders have ample choice within the contextual constraints of central policies. Thus the resultant provincial behaviour is the product of *both*

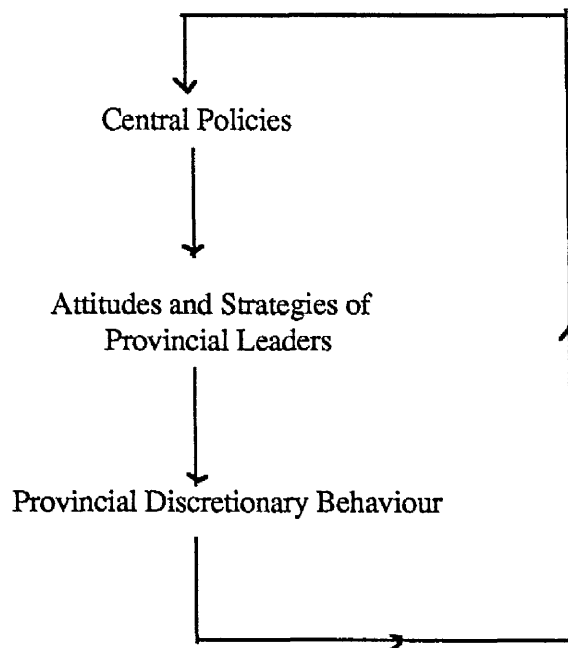
central policies and provincial choices. The institutional context posed by central policies and the actors' choice of the provincial leaderships interact with each other to produce the manifest behaviour and strategies described in detail in Chapters Five and Six.

The interactive relationship between central policies and provincial discretionary behaviour thus works both ways. The choices of the provinces also have their effect on the Centre. For instance, the success of Guangdong's flexible implementation of central policies in delivering positive results has enabled the Guangdong leadership to vie with the Centre in defining the content of its policies. Shanghai's historical importance in the nation has enabled its sustained participation in the formulation of central policies from the initial stage. For both provincial governments, their leverage on the Centre is dependent on their success in achieving their roles: Guangdong as the pioneer of reform and Shanghai as the "right-hand man" of the Centre. The concern for maintaining and enhancing this leverage has consequently affected the choice of discretionary behaviour by provincial officials. On the one hand, the Guangdong leadership has taken care to sustain its momentum of economic growth and, therefore, its image as the successful pioneer of reforms. On the other, the Shanghai leadership is concerned about maintaining its image of trustworthiness in its capacity as "eldest son" whilst also sustaining its economic strength in the nation.

Combining Figures 7.2 and 7.3, Figure 7.4 below visualizes the interactive relationship between central policies and provincial discretions:

Figure 7.4

Central-Provincial Relations: An Interactive Process



The concept of central-provincial relations as interactive is significant in both theoretical and empirical respects. First, on the theoretical level, an interactive relationship rejects the centrist, top-down perspective of political processes. Rather it sees both the Centre and the provinces as actors capable of active choices within their respective constraints. Central-provincial relations are, therefore, understood in the context whereby the actions of the Centre, via central policies, and those of the provincial governments, via their discretionary behaviour, inevitably affect each other's choices of subsequent actions. Second, in terms of empirical findings, the interactive perspective enables analysts to explain the discretionary behaviour of provinces during the reform period of the 1980s and early 1990s. The Centre is behind the scenes of provincial government discretions, whose actions and orientations are partly a product of past and current central policies. In this respect the Centre is itself partly to blame for its frustrations when dealing with the increasingly assertive provinces. On the other hand, provinces have been successful in exerting influence over the Centre. Provinces are not only the flexible implementors and half-hearted agents of the Centre, and orthodoxy is not the monopoly of the central government. Previously "orthodox" central policies could be displaced and amended by flexible implementation from below, as in the case of

Guangdong. Alternatively, as in the case of Shanghai, central policies could be literally written by provincial officials *in conjunction with* central officials. This concurs with the theoretical discussion in Chapter One, wherein it is suggested that the provinces, as well as the central government, may be a locus of the "central zone" within the political system from which ideas flow and experiences disseminated to the "periphery" of the system. This and previous chapters provide sound evidence of the possibility of this "central" role of the provinces.

Chapter Eight

Shifting Central-Provincial Relations: Emerging Trends

The previous chapter has elaborated an interactive central-provincial relationship. An interactive relationship emphasizes the interdependence and mutual influences between the Centre and the provinces. This concluding chapter highlights the *dynamic* aspects of this interactive relationship. It demonstrates that the central and provincial actors, by influencing each other, themselves constitute the forces of change to their relationship. This chapter also identifies the emerging trends of change in central-provincial relations in the post-Mao reform period. It explains their emergence and draws preliminary conclusions as to the significance of these trends as regards political processes in the Chinese system generally.

Before proceeding further it may be helpful to go back to a question first raised in Chapter One: why did the Centre simply not crush the unwelcome discretions of the provinces by utilizing its superior organizational position and command of coercive forces? The Centre possesses at least two forms of coercive resources which may be used against the provinces. The first is the use of sheer physical force through the Centre's superior command of the military. The second is the dismissal of provincial leaders through the Centre's nomenklatura control of personnel. The answer for the unreliability of these coercive resources is two-fold. First, coercive power is a blunt instrument of control and, given its limited supply, can only be used intermittently and sparingly. Second, provincial governments are an indispensable ally of the Centre in its task of governance. The utility of the provinces as an intermediate level of government imposes a structural constraint on the extent to which their power can be crushed. Consequently, although the Centre has sometimes used its superior power to stamp out excessive provincial discretions, such use of coercion has been temporized by the indispensability of provincial discretions, at least to some degree, to any kind of effective governance. Due to this fundamental mutual interdependence between the Centre and the provinces, it has simply not been feasible that the Centre "crush" its provincial opponent as a means to resolving central-provincial conflicts. This is, therefore, not because that the Centre is loath to do so, as some analysts have argued, but that it is patently unable to.¹

¹Barry Naughton argues that the Centre is acting with one hand tied behind its back as a result of its reform intentions which require decentralization to the provinces and enterprises. As a result the Centre has been unwilling to recentralize investment resources and authority. Barry Naughton, "Decline of Central Control over Investment in Post-Mao China", in David M. Lampton (ed.),

The fact of co-existence obliges the Centre and the provinces to find a means through which to resolve their conflicts. One important observation that arises from this study is that the search for such a means is a dynamic process involving interactions and compromises between the central and provincial actors. Moreover, as reform policies accentuate old conflicts and create new ones, both the Centre and the provinces have been obliged to find a better means through which to ameliorate their conflicts and thereby protect and enhance their respective interests. New trends of central-provincial relations have emerged from the intense conflicts, manoeuvres and counter-manoevres, which have taken place over the years. Such emerging trends embody the attempts by both the Centre and the provinces to adjust their relationship to the new circumstances of the reform period so as better to advance their respective interests within their respective constraints.

Traditionally, the Centre and provinces have sought to live in harmony, whilst advancing their respective interests, through "papering over" any conflicts which may have arisen. The context is a political system wherein the low level of institutionalization fails to provide a regularized means through which to reconcile conflicts of interests and clear division of jurisdictional authority. The rhetoric is that both the interests of the Centre as representative of the nation as a whole, and the particularistic interests of the provinces are fundamentally reconcilable. Consequently, any manifest sign of central-provincial conflict is, therefore, of minor significance. In practice, such conflicts have been reconciled through the arbitration of the Centre itself. The resultant situation sees a high-ranking central unit or central official presiding as the nonpartial judge over the arbitration of conflicts between a province and a central government ministry. This tactic allows the Centre to contain the conflicts and encourage its assistants both at central level and intermediate level to cooperate. This also enables the provinces to benefit, as more often than not the Centre makes concessions to the provinces as a result of the foregoing bargaining and arbitration process.²

The ability of central leaders to arbitrate and resolve conflicts between provincial and central agencies depends on the resources at their command. The traditional means by which to resolve conflicts may be described as a "carrot-and-stick" approach. Resources were often awarded to the provinces as a means of

Policy Implementation in Post-Mao China (Berkeley: University of California Press, 1987), p.78. See Chapter One for more discussion on the problem of such an interpretation.

²This ability of the lower-levels to extract concessions from superiors has been noted by Lucian Pye in his discussion on "the comfort of dependency". See Lucian Pye, *The Dynamics of Chinese Politics* (Cambridge: Massachusetts, 1981), p.20.

resolving conflicts. However, at times when provinces were considered to have gone too far in their discretions they would be warned and penalized in no uncertain terms. There is an interactive relationship between the use of "carrots" and "sticks" for control purpose. As noted in Chapter One, although coercion is an effective means through which to extract compliance in specific instances, it is so blunt an instrument it cannot too frequently be used. Consequently, in order that compliance can be exacted from provinces without the use of direct coercive power, the Centre needs to possess other resources through which to solve conflicts in an equable manner. Conflicts could be more easily "papered over" at the time when the political system was more centralized, and the Centre commanded more vital resources with which to "buy off" provinces and "resolve" conflicts. The success of the socialist revolution brought immense political capital to the central leadership and this had kept the level of central-provincial conflict at a relatively low level. However, as more and more resources were siphoned off to the provinces, partly as a result of this "buying off" process, the provinces became more and more assertive. Since possessing fewer resources since the 1980s, the Centre has found it increasingly difficult to arbitrate conflicts amongst its own assistants and intermediaries. Coercion has had to be employed more frequently in these circumstances in the form of retrenchment campaigns and reshuffles of provincial leaderships. Ironically, however, more coercion has had the effect of diminishing returns, as provinces have become increasingly adept at dodging the consequences of any "crisis", "sitting it out" until the return to "normality". With fewer "carrots" to hand out and "sticks" becoming increasingly costly to administer, the traditional means of conflict resolution have now become ineffective.

Emerging Trends of Central-Provincial Interactions: Institutionalization

The major trend emerging from the intense conflicts and interactions between the Centre and the provinces in the reform period is that of a gradual move towards institutionalization. This move is characterized by shifts in two aspects. First, the Centre and the provinces find that in order to protect their respective interests they will need clearer specification and closer observance of rules. Clarity must replace ambiguity in the definition of their relationship and in the conduct of their interactions. Second, resources are still the ultimate concern in central-provincial relations, but a clearer definition of jurisdiction is gradually coming to be regarded as the best means through which to obtain more resources, as well as retaining those which have already been delegated.

From Resources to Jurisdiction

One important change regarding China's central-provincial relations after one decade of reform is that the scramble between the Centre and the provinces is no longer simply a struggle over *resources*. Conflicts have rather become more about *well-defined authority and responsibility*. The focus of contention has shifted from the possession of resources to the question of *how* and *what* one may do with one's resources. Ironically, this shift in the objectives of central-provincial interactions and bargaining, as economic reform enters its second decade, is the end result of intense conflicts and manoeuvres over *resources* during the 1980s. As described in Chapters Five and Six, bargaining between the Guangdong and Shanghai governments with the Centre in the 1980s frequently revolved around securing resources for the provinces. These resources may have been in the form of central investments, or in a lower level of local fiscal remittance to the Centre, or of central financial subsidies. It may even have been that of the enlargement of investment quotas. Although provinces also bargained for better central policies, their main concern was for policies which could increase the amount of resources under their control. This focus on resources has resulted in provincial governments appearing "Machiavellian" and incredibly "flexible" over policy matters. Policies and rules *per se* have not been the question. What has been most at stake as regards bargaining and implementation of policies and rules are resources which such policies and rules could bring to the province. Should circumstances change, hitherto cherished policies and rules would be abandoned immediately. Responsibility and authority could work both ways; hence there was little emphasis on having a clear definition of one's responsibility and authority. Authority was welcome only when it could bring more resources.

Conversely, from the perspective of the Centre, the allocation to the provinces of *resources* and the authority freely to deploy *resources* was always the focus of its adjustment of policies regarding the provinces. Depending on the requirements of different circumstances at different periods, resources and authority have on previous occasions been decentralized and recentralized from the provinces. Policies have always been subject to change, as has the authority of the provinces.

Against this background, it is interesting to note that towards the late 1980s and into the 1990s, bargaining between the Centre and the provinces became

increasingly concerned about a better demarcation of jurisdiction *on both sides*.³ Not only should the specific assignment of authority and responsibility be fair and consistent, but, more importantly, the demarcation of jurisdiction should be laid down in law, and even included in the Constitution, to ensure their relative *stability* and security from encroachment on both sides.⁴ These calls for a clearer demarcation of jurisdiction between the central and provincial governments have gone beyond mere requests for an adjustment to the existing distribution of power and resources. Both the Centre and the provinces have obviously had grievances over the status quo and therefore want changes. Nevertheless, these calls are unprecedented in calling for the institution of a regularized avenue through which to resolve disagreements in the future. There is, in other words, a recognition of the need for a higher level of institutionalization within central-provincial relations.

The question is: what is it that has caused the Centre and the provinces to abandon their previous focus on resources, requiring instead a clearer institutionalization of their respective authority? Does this shift of focus from resources to jurisdiction, as the objective of central-provincial interactions and bargaining, signify the failure of previous manoeuvres on both sides to deliver on their respective interests? What are their grievances as regards the status quo, and why do they believe that institutionalization of their relationship will be the solution?

Both the Centre and the provinces have their grievances. On the one hand, the Centre has wearied increasingly in its sustained failure to contain the "deviant

³This is reflected in the open articulations of central and provincial officials. For articulations by central government officials, see for instance Gu Guoxin, "My View on the Demarcation of Economic Management Jurisdiction of the Central and Local Governments", *China Administration*, No.8 (1989), pp.4-7. Gu is an official from the State Planning Commission. For articulations by officials from the Shanghai government, see for instance Mou Shide and Wu Guoqing, "The Demarcation of Government Jurisdiction of the Centre and the Local government: A Perspective from Shanghai's Practice", *China Administration*, No.8 (1989), pp.11-13; Dong Dingrong and Zhou Xiaoyun, "Several thoughts on reforming the tax management jurisdiction of the central and local governments", *Shanghai Caishui*, No.11 (1992), pp.14-17; on articulations by Guangdong officials, see for instance Li Chunhong and Wu Yixin, "Thoughts on Establishing a Multi-Layered Macro-Management System", *Social Sciences in Guangdong*, No.3 (1991), pp.101-7; The Project Group, "The Adjustment of Industrial Structure and Deepening Economic System Reforms in Guangdong", in Xiao Ruchuan (ed.), *A Study of Guangdong's Industrial Structure* (Guangzhou: Guangdong Renmin chubanshe, 1991), pp.243-77. For articulations by officials from other provinces, see Xu Fengchao and Zhang Tianping (Hebei), "Thoughts on How to Reasonably Demarcate the Jurisdiction of the Central and Local Governments", *China Administration*, No.8 (1989), pp.8-10.

⁴See for instance Mou Shide and Wu Guoqing, "The Demarcation of Government Jurisdiction of the Central and Local Governments", p.13; The Project Group, "The Adjustment of Industrial Structure", p.259. Both articles, from Shanghai and Guangdong respectively, stressed the need for legal protection on the demarcation of jurisdiction of the central and local governments. In a work adopting a centralist theme, there is a similar call that the demarcation arrangements should be written into the Constitution. See Wang Xiaoguang and Wu Angang, *A Report on the State Capacity of China*, p.168.

behaviour" of provincial governments. Given the inertia of delegated powers, the decentralization reforms of the 1980s have further accentuated the dispersion of resources and authority from the Centre to the provincial and lower level governments since 1958 and especially since the Cultural Revolution. In the process, the power of provincial governments has been enhanced, and the power of the Centre to control the provinces further strained. The Centre feels itself to be losing control in view of the ever more numerous subnational actors and of provincial governments failing to fulfill their proper share of national responsibilities. This perception has been reinforced by the fact that, despite the frequent extra-contractual "borrowing" and other central extractions from the provincial coffers, the share of central fiscal revenue in the total national fiscal revenue, as opposed to provincial fiscal revenue, has declined conspicuously and successively since the commencement of economic reform. The Centre, therefore, wants a clearer demarcation of jurisdiction as a means to containing the unwelcome discretions of the provinces, as well as to enhance its power.

On the other hand, provinces also have serious complaints. Provincial governments have complained about the insecurity of their decentralized powers and the arbitrariness of central intervention. They are, for instance, tired of the annual central "borrowing" and the pressure of having to provide additional "contributions" to the central fiscal revenue. They also resent the arbitrary withdrawal of policies by the Centre. The threat of arbitrary encroachment by the Centre is a built-in feature of any authoritarian political system. The low level of institutionalization in the system gives provincial governments little protection once the Centre changes its mind and opts, once more, for recentralization. Provinces may abort and water down the impact of the Centre's moves, but they cannot stop the Centre from embarking on a clamp-down. Provincial governments, once having tasted the benefits of enhanced power, are all the more resentful of such *threats* to their authority, and thus their dissatisfaction with the status quo. Consequently, provinces also want more specifically defined jurisdiction through which to protect their hard won resources and authority.

A revealing example of this common interest in increased institutionalization is that of the process of institution of the tax-sharing system in 1994, replacing the fiscal contractual system, in place since 1980. The significance of the tax-sharing system reform, as opposed to previous reforms to the fiscal system, lies in the emphasis given to the *uniformity and legality* of the distribution of fiscal authority between the Centre and the different provinces. The system would be uniform and standardized, by and large, for all provinces. Moreover, and

most importantly, the delineation of authority and responsibility between the Centre and the provinces under this system would have to be legally coded, by which code both the Centre and the provinces would have to abide. Given the magnitude of vested interests involved in the pre-existing fiscal contractual system, such a change would have been inconceivable unless *both* the Centre and the provinces did not stand to gain from the move.

From Ambivalence to Clarity

At the same time, there is the move from ambiguity to clarity in central-provincial interactions. A major feature of central-provincial relations in China has been a high degree of ambiguity and ambivalence regarding the demarcation of "proper" implementation of central policies on the one hand, and provincial deviations on the other. It is in fact this very ambivalence that made possible the rapid regional growth of the 1980s. The famous "red light theory", based on Guangdong's experience, is a summary of the strategies a provincial government can deploy to manipulate the ambiguity of central policies and rules. Conversely, the lacklustre performance of the Shanghai economy in the 1980s was attributed to the "loyal" and excessively rigid implementation by Shanghai's officials of central rules and policies.

Under the pre-reform political system when the power of the Centre was much stronger, provincial governments had often sought to blur the clarity of central policies. Vague policies increased the latitude for provincial discretions during implementation. This preference for ambiguity had not changed with the commencement of economic reform. At a time when the situation was changing rapidly and uncertainties abounded, clarity and precision in policies and rules could only restrict provincial discretions when they were most necessary. There has been, therefore, a consistent tendency on the part of the provincial leaderships to blur the instructions of central documents, no matter how precise they may originally have been. The new ambivalence of central policies and the inconsistencies within different central policies has allowed provincial governments to play off one central prescription against another, as well as to escape responsibilities for their discretions. If ambiguity was insufficient, therefore, provincial governments would actively create them.

The benefit of this ambiguity cuts both ways, however, extending beyond that of the provinces alone. The Centre, also, requires a degree of ambiguity and ambivalence in its policies and rules in order to be able to conduct experiments and

to minimize the political risk of failures associated with individual initiatives. The Centre will tolerate the discretionary behaviour of provincial governments when either the overall impact of the behaviour tallies with its objective, or when it has yet to decide on an alternative. Normally the ambiguity is ended when the positive impact of the move proves undeniable, at which time local experiments become national policy. Alternatively, it is ended when the negative impact of ambiguity becomes too much to tolerate. Ambiguity and ambivalence have, therefore, been engineered and reinforced by both the provinces and the Centre. The provinces seek ambivalence because of the latitude it gives them. By watering down central documents and creating a *fait accompli*, provinces can circumscribe the range of actions which the Centre may take in future, and thereby restrict the power of the Centre. Meanwhile ambivalence enables the Centre to turn a blind eye to supposedly illegal activities without being branded as politically impotent. In the event of things going badly, the superior organizational power of the Centre enables it to intervene at will, if at a cost.

A typical example of the politics of ambivalence is found in the "automatic" enhancement of investment project approval authority by provincial governments nationwide subsequent to Deng Xiaoping's southern tour in early 1992, and in the subsequent reaction of the Centre regarding this obvious violation of central rules. As noted in Chapter Four,⁵ the call from Deng Xiaoping for faster economic development and reforms were interpreted by the provinces as signalling a further round of decentralization. As a result, provincial governments coincidentally seized the initiative to "simplify approval procedures and speed up economic development" by approving, independently, domestic investment projects of under 200 million yuan. By so doing the provinces were acting against formal central rules regarding their approval jurisdiction of investment projects. According to the rules, provinces are allowed to approve projects of under 30 million yuan only, and in case of "bottleneck" projects, i.e., those infrastructural and energy projects specified by the Centre, up to 50 million yuan. Projects above these ceilings up to 200 million yuan require the approval of the State Planning Commission and projects of over 200 million yuan have to go to the State Council. Interestingly, even though the provinces, in this instance, clearly acted beyond the prescription of central rules, at that time the Centre did not utter a word, thereby tacitly acquiescing to this "illegal" behaviour. Even more interestingly, when the Centre became concerned about excess investment and the prospect of "overheating" in

⁵See Chapter Four: Footnote 42.

the economy in 1993,⁶ the Centre's disapproval of provincial deviations was, still, starkly ambivalent. A State Council Notice in January 1994 banned further subdelegation of project approval authority at subprovincial levels and the dispersion of approval authority horizontally amongst government departments. The Notice was, however, conspicuously vague and surprisingly silent about the open violation of the preexisting jurisdiction by provincial governments since 1992, and which was ongoing. A central government official's comments on the Notice is revealing in this respect:

"We have also been studying the meaning and implications of the Notice on provincial governments' investment approval authority...Regarding the reference to subdelegation of authority, our judgement is that the Notice definitely means that local governments at various levels should not *further* delegate their existing authorities to lower levels, but nothing is said about the propriety of the status quo, that is, the discretionary, or deviationary, expansion of provincial government authority to under 200 million yuan, and the subsequent subdelegation to city and lower levels. *Therefore the status quo can probably continue.* In other words, provincial level governments can probably continue to approve projects under 200 million yuan. What as regards the legitimacy of the approval decisions made by the local governments beyond their formal limit of jurisdiction before the Notice? This is absolutely not an issue here. They are of course valid."⁷

It has been noted in Chapter Four that the Centre had initially moved in 1992 to amend the formal rules with a view to recognizing the legality of the provincial practice regarding approval authority, but subsequently chose to do nothing.⁸ In 1994 the economic situation changed and the Centre, whilst determined to have a fast economic growth rate, was increasingly worried about the "overheating" of the economy as a result of the investment drive of provincial and lower-level governments. In acting to stamp out the investment drive through restricting the excessive delegation of investment authority, the Centre failed, however, to specify exactly what kind of behaviour that was really problematic and needed correction. The above remarks by a central official illustrate the ambivalence even of a sternly worded order. It is thus difficult to distinguish what is the righteous and legitimate from the unlawful and illegitimate. The implication of this ambivalence for central-provincial power relations is a high degree of

⁶The State Council on January 29, 1994 issued a notice ordering the strengthening of macro-adjustment of fixed asset investment in the country. The notice denounced the excessive growth of investment in 1993, and the poor efficiency and bias within investment allocation, and called for a stop to discretionary subdelegation of project approval authority beyond that which had been approved by the Centre. See *Guangming Daily*, January 30, 1994, p. 1.

⁷Respondent No.31, Beijing interview, February 1994.

⁸See Chapter Four: Footnote 42.

indeterminacy as regards their respective rights and privileges and in their responsibilities towards each other.

This explains why a new trend is emerging, that of ambiguity giving way to clarity. As long as the objective of central-provincial politics is one focused on resources, ambivalence could serve both the provinces and the Centre well. The indeterminacy of one's rights and privileges does not matter as long as one gets the desired resources. However, when the objective of both the Centre and provinces gradually shifts away from resources to the delineation of jurisdiction, this change of objective calls for a different tactic in the political game. *There will still be bargaining, but the context and content of bargaining will change substantially.* Success and failure in the power game will no longer depend upon one's ability to manipulate ambivalence. It will rather depend on one's ability to define and clarify the meaning of jurisdiction to one's advantage, and make it binding to all relevant parties. The change of objective towards institutionalization of the central-provincial relationship leads, therefore, to a corresponding change in central-provincial interactions whereby they are to be increasingly characterized by clarity rather than ambivalence. Into the 1990s, trends indicate that both the provincial governments and the Centre have *begun* to demonstrate acknowledgement of the rule of law.⁹ They need the law in order to protect the hard-won results of their bargaining efforts from the encroachment of the other party.

Toward A Politics of Compromise

The move towards institutionalization in central-provincial relations in the 1990s is a result of intense conflicts between the Centre and the provinces since the 1980s. The intense conflicts which occurred as the objective environment experienced radical changes left both the Centre and the provinces dissatisfied with their respective situations. The Centre sees itself as losing out to the provinces as a result of its earlier decentralization program, and is desperate to regain control. The provinces regard themselves as having been unfairly treated by the Centre, which

⁹See for instance Zhu Xiaoming, "Tupo Chuantong Tizhi Moshi, Gaige Zhengfu Guanli Jigou" (Breakthrough the Traditional System Model, and Reform the Management Structure of the Government: An Appraisal of the Ten Years' Organizational Reform of the Shenzhen Government), *Theory and Practice of the Special Economic Zone*, No.4 (1990), pp.30-33; Zhang Linghan, "Chengli Shenzhen Renda Jigou de Zhanwang" (The Prospect of Establishing the People's Congress in Shenzhen), *Theory and Practice of the Special Economic Zone*, No.2 (1989), pp.16-18; Xuan Zhuxi, "Jianzheng Fangquan Wenti Zuotanhui Fayan Zheyao" (Summary of Discussion of the 'Streamlining Administration and Delegating Powers' Seminar), *Theory and Practice of the Special Economic Zone*, No.5 (1992), pp.57-59; Mou Shide and Wu Guoqing, "The Demarcation of Government Jurisdiction of the Central and Local Governments".

had penalized them for doing that which had previously been encouraged and, indeed, assigned. **The forces behind the trend towards institutionalization are therefore the Centre and the provincial governments themselves. Both being dissatisfied with the status quo, they each want a change in order to improve their situations.**

There has been, therefore, no single loser or winner in the conflicts between the Centre and the provinces. It is not a case of the Centre losing out to the provinces, or of the provinces losing out to the Centre. On the one hand, there is a clear trend of diffusion of resources from the central level to the provincial and lower levels of the governments. Attempts by the Centre to rein in excessive provincial discretions have brought diminishing returns. In this respect it would appear that the Centre has lost and the provinces have gained. However, the provinces have been operating under the constant threat of interference by the Centre in their delegated jurisdictions. From their perspective, their new tasks under the changed environment of reform have not been reciprocated by appropriate changes to their authority and resources. Therefore, both the Centre and the provinces have seen themselves as "loser" in the relationship. The Centre complains of its weakening capacity to preside over the increasingly assertive and, from its point of view, irresponsible, provinces. The provinces wonder how they are to fulfill this task of economic reform and development with so little authority and support from the Centre.

A situation of "negative-sum" game is necessary to produce the impetus for change. A zero-sum situation means that one party gains to the extent that the other party loses. Insofar as the gaining party is thus satisfied with its situation, it will not force change, other than in the direction that its gains may be increased. The loser, however, being dissatisfied with its situation, constitutes a potential force of change. However as the loser it has had diminishing power within the system, so that it is less likely to be able to change the course of events and become an actual force of change. Changes in a zero-sum power situation can thus run unilinearly only, as cumulative additions to the gains of the winning party. More radical or "qualitative" changes rely on *ad hoc* factors beyond the zero-sum framework, for instance, a change of heart by the winner.

Using an implicit zero-sum framework, some analysts have discussed the possibility of the trend towards national disintegration in China.¹⁰ While their

¹⁰See, for instance, Gerald Segal, *China Changes Shape: Regionalism and Foreign Policy*. Adelphi Paper 287 (London: International Institute for Strategic Studies, 1994); Maria Hsia Chang, "China's

conclusions have varied as regards prospects of disintegration, such differences are more a matter of judgement regarding *to what extent* the forces of fragmentation in the provinces have overwhelmed the integrating forces of the Centre. Central-provincial relations in China are, therefore, seen as being trapped in a paradox of highly centralized control vis-a-vis fragmentation and disintegration. Either the system will continue on its path towards increasing fragmentation, to the point of dissolving the Chinese nation, or the Centre will choose to use its superior coercive power to crush the centrifugal forces once and for all. The system may then relapse into some former situation involving a high degree of centralized control. Changes beyond these two static poles are inconceivable in a zero-sum framework of central-provincial relations.

In reality, the power relationship between the Centre and the provinces is not a zero-sum game. It is not zero-sum because, contrary to the assumption of a zero-sum framework, power does not flow a single direction. As this study has shown, both the Centre and provinces are actors exerting influence over each other, and their relationship is interactive rather than simply top-down or bottom-up. This mutual influence has provided the necessary context for compromise. Despite the concern of the dissatisfied Centre for enhancing its control it must nevertheless use its superior organizational power with restraint. It has to be highly selective of the situations where it flexes its muscles over the provinces, since excessive use of coercion will bring a diminishing return of desirable results. Moreover, it may also be counterproductive in terms of its effects on the fulfillment of the task of governance. Any such overt show of force may thus adversely affect the political legitimacy of the regime in the long run. Similarly, there is a broad gap between dissatisfaction amongst the provinces over authority and resources and any move towards secessionist disintegration.

What has occurred in China since the early 1990s, therefore, indicates the emergence of a politics of compromise between the Centre and the provinces. As a result of the intense conflicts they have experienced, which have led some analysts to contemplate the possibility of China disintegrating, the Centre and the provinces have been forced, albeit gradually, to acknowledge that the best way to advance their respective interests is through institutionalization of their new relationship. Institutionalization provides a regularized avenue through which to arbitrate conflicts, and works in the interests of both parties. Institutionalization requires a

future: regionalism, federation, or disintegration", *Studies in Comparative Communism*, Vol.25, No.3 (September, 1992), pp. 211-27; Ellis Joffe, "Regionalism in China", *Pacific Review*, No.1, 1994; and David Goodman, "The PLA and regionalism in Guangdong", *Pacific Review*, No.1, 1994.

clearer delineation of jurisdiction and better observance of rules and regulations. This rezoning of authority assuages the Centre by preventing unruly provinces from chasing resources whilst shirking responsibilities. Specifically, the burden of the senior central leadership, which has become overloaded with the necessity of presiding over increasingly intense conflicts between provincial and central units, may thereby be ameliorated. For the provinces, institutionalization of their authority helps to ward off unwelcome, arbitrary, central intervention, as well as enabling them to keep safely the resources and authority they have already obtained. By reaching a compromise, the Centre and the provinces both stand to gain in a "positive-sum" relationship.

Wider Ramifications: Tentative Thoughts

It is likely, therefore, that the central-provincial interface will become the breakthrough point for a qualitative change in the political processes within the Chinese system. The core characteristic of the Chinese political system is its low level of institutionalization of power. The socialist revolution of 1949 substantially expanded the scope and the depth of state power, which Tang Tsou describes as "totalism",¹¹ but the problem of low institutionalization has remained. To an extent this problem has been accentuated by the radicalism of the revolution, which sees institutionalization as an enemy to its continuing progress. The expansion of state activity has also made the low level of institutionalization more important in terms of its repercussions. During imperial times, the negative effects of low level of institutionalization within the state was temporized by the ethos of the mandarin state for a limited government, which ordained that the monarch should simply reign, but not rule, for the best governance of his people. This ethos has been completely reversed since 1949, if not before, as the government has had to lead the entire nation down to the grassroots level towards a new way of life. The confusion over power and responsibilities amongst the constituent parts of the state---a noted feature of low level institutionalization---has resulted in numerous conflicts between the different state actors upon embarkment of their new duties. Whilst the

¹¹Tang Tsou uses the concept of "totalism" to describe the high degree of state penetration into the society in a political system. Unlike the concept of "totalitarianism", which assumes that a government which penetrates deeply into society is also "undemocratic", thus the usual term of "totalitarian dictatorship", Tsou's concept of "totalism" refers to the state-society relationship only. In other words, it is theoretically possible to have a totalist and yet democratic government, as well as totalist and dictatorial government. Similarly, "liberalism", the opposite end of "totalism" can theoretically come with a democratic as well as a dictatorial political institution. For the most recent and comprehensive exposition of this concept of totalism and its use in the analysis of political systems, see Tang Tsou, *Twentieth Century Chinese Politics: From the Perspectives of Macro-History and Micro-Mechanism Analysis* (in Chinese) (Hong Kong: Oxford University Press, 1994), pp.204-49.

level of conflict was previously low during the imperial period, due to the low level of state activity, conflicts subsequently snowballed as the socialist state took over all the major activities within the society.

A number of analysts have elaborated the linkage between the low level of institutionalization of the political system and the difficulties of governance by the socialist government.¹² They have rightly pointed out that in order for such difficulties in policy implementation and interest reconciliation to be resolved, a change towards a higher level of institutionalization is required. To move towards institutionalization requires all actors in the political system simultaneously to abandon the perception of political conflicts as necessarily constituting a "total victory, total failure" situation, and to adopt a new politics of compromise.¹³ The unanswered question is one of *how* this change, this "historical compromise" between the "warring" parties, may be effected.

This study has shown that such a change is likely to occur first of all at the central-provincial interface. This is possible because, fundamentally, the Centre and the provinces, though engaging in perpetual conflicts, are interdependent. The intensity of central-provincial conflicts forces both the central and provincial actors to search for new ways to handle their relationship, and thus to enhance further their respective interests. Their mutual indispensability and long-term co-existence require each to recognize the interests of the other and to seek compromise. Changes do not come, therefore, because some central leaders are simply wise enough to design a new relationship with the provinces. Rules and regulations, as the Centre and the provinces have gradually come to recognize, can protect one party whilst constraining the other, as long as both parties observe the rules. One's power first is to be delineated, and thus limited, in order that it can be protected from encroachment. As bargaining is rife only amongst near equals, institutionalization will be adopted only when the actors on both sides are seriously constrained by each other and are thus dissatisfied with the existing rules of the game. As a result of their experience in the 1980s, both sides see themselves as the

¹²See Zhao Suisheng, "The Feeble Political Capacity of a Strong One-Party Regime---An Institutional Approach Toward the Formulation and Implementation of Economic Policy in Post-Mao Mainland China", *Issues and Studies*, Parts I & II, Vol.26, Nos.1-2 (1990), pp.47-80, 35-74; Michel Oksenberg, "The American Study of Modern China: Toward the Twenty-first Century", in David Shambaugh (ed.), *American Studies of Contemporary China*. (Armonk, New York: M. E. Sharpe, 1993), pp. 315-43; Jia Hao and Lin Zhimin (eds.), *Changing Central-Local Relations in China* (Colorado: Westview Press, 1994); Joseph Fewsmith, *Dilemmas of Reforms in China* (Armonk, New York: M.E. Sharpe, 1994).

¹³Tang Tsou, "The Tiananmen Tragedy: The State-Society Relationship, Choices, and Mechanisms in Historical Perspective", in Brantly Womack (ed.), *Contemporary Chinese Politics in Political Perspective* (Cambridge: Cambridge University Press, 1991), p.319.

loser and therefore vulnerable to the encroachment of the other. The Centre and the provinces are therefore best placed in the political system to see the dialectical utility of restricting one's power in order to restrict the power of the other, thus enhancing one's power as a result.

Appendix

List of Interview Respondents

<u>Respondent No.</u>	<u>Institution/Stream</u>	<u>Date and Place</u>
<u>Guangdong</u>		
1	Planning/Information	(1) June 1991, Hong Kong (2) May 1993, Guangzhou
2	Academic/Policy Research	(1) June 1991, Hong Kong (2) May 1993, Guangzhou
3	ditto	June 1991, Hong Kong
4	Statistics	(1) May 1993, Guangzhou (2) August 1993, telephone (3) Sep. 1993, Guangzhou
5	Bank	Sep. 1993, Guangzhou
6	Finance	(1) August 1993, telephone (2) Sep. 1993, Guangzhou (3) Feb. 1994, telephone
7	Finance	December 1993, Guangzhou
8	Bank	December 1993, Guangzhou
9	Planning	(1) Sep. 1993, Guangzhou (2) Sep. 1993, telephone (3) Nov. 1993, telephone (4) Dec. 1993, Guangzhou (5) Feb. 1994, telephone (6) April 1994, telephone
10	Audit	December 1993, Guangzhou
11	Tax	ditto
12	Tax	ditto
13	Land	ditto
<u>Shanghai</u>		
14	Planning	January 1994, Shanghai
15	Bank	ditto
16	Academic	ditto
17	Statistics	ditto
18	Pudong Management Committee	ditto

19	Academic	(1) Nov. 1993, Hong Kong (2) January 1994, Shanghai
20	Finance	January 1994
21	Finance	(1) January 1994, Shanghai (2) May 1994, Shanghai
22	Planning	January 1994, Shanghai
23	Planning	May 1994, Shanghai
24	Policy Research	ditto
25	Former research official	ditto
26	Bank	ditto
27	Planning	ditto
28	Policy Research	ditto
28a	Statistics	June 1994, telephone
28b	ditto	ditto

Beijing (Centre)

29	former finance official	April 1994, Beijing
30	Planning	(1) April 1993, Beijing (2) January 1994, Beijing
31	Planning (Investment)	(1) November 1993, Beijing (2) January 1994, Beijing (3) February 1994, Beijing
32	ditto	February 1994, Beijing
33	Finance	ditto
34	Audit	(1) March 1994, Beijing (2) May 1994, Beijing
35	Planning	April 1994, Beijing
36	Finance	(1) April 1994, Beijing (2) May 1994, Beijing
37	Policy research	April 1994, Beijing
38	Planning	May 1994, Beijing
39	Academic	(1) May 1994, Beijing (2) June 1994, Beijing
40	Research	May 1994, Beijing

41	ditto	ditto
42	Ministry of Justice/NPC	(1) May 1994, Beijing (2) August 1994, Beijing
43	Finance	August 1994, Beijing

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