



Government-Industry Relations in China: A Review of the Art of the State

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For those who have studied the political economy of China since the onset of urban-industrial reform in the 1980s, the state looks considerably less powerful today than it once was.

Market mechanisms and state regulation have been brought in to replace direct control and planning, whilst the importance of state ownership has diminished through the effective privatisation of many State Owned Enterprises (SOEs) and the emergence of new private economic sectors and actors. Nevertheless, this does not mean that the state has withdrawn from economic activity. On the contrary, the state is alive and well and exercising considerable control over the nature of economic activity, albeit in different less direct ways than before.

This is partly because state ownership remains dominant in key economic sectors – the “commanding heights” of the Chinese economy remain largely under state control. But it’s also because while the non-state sector in China might really be a “private” one, it is not always wholly “independent” from the state. To be sure this is not just a one way relationship - in divesting itself of ownership, the party-state helped create new economic actors and generate new interest that now influence the nature of Chinese industrial policy, macroeconomic control, and economic strategy in general. So what we have is a symbiotic relationship between private economic actors and the state (which often spawned the private actors in the first place).

¹ This paper was first presented at a workshop on East Asian Capitalism organised by Andrew Walter and Xiaoke Zhang at the LSE in June 2010. A revised version will be published as part of the proceedings of the workshop in an edited book

So this paper aims to show that China has moved from a state planned and state owned economy towards state regulation of a hybrid economic system with the existence of a private economic sphere that remains very close to the state system that created it, with the state sector dominating key economic sectors. The form of capitalism that has materialized in China is one where state actors, often at the local level, remain central to the functioning of an economic system through control over key enterprises, indirect control over allocation of finance, and residual control over access to (local) markets.

It proceeds by first taking a very quick historical tour of the four key phases in the transition to socialism in China tracing the way in which the state retreated from direct control of most enterprises. Having then outlined the way in which the state at national and local levels exerts influence over key enterprises today, it concludes by using the example of the response to the global financial crisis as a means of showing how the state exerts control over economic activity using non direct forms, and the problems that this creates for the paradigm shift to a new model of economic activity that some in China's leadership think is long overdue.

A Brief History of Chinese Privatisation

Without wishing to go into any great details about the transformation of the Chinese economy since the onset of reform, it is perhaps worth very briefly outlining the main phases of change in the transition from socialism using a very blunt and at times arbitrary division of the post-Mao era into four periods.² The first phase was one of agricultural reform – an attempt to tinker with the existing agricultural system to make it work better. Initially at least, this was backwards looking rather than a forward move, in that the leadership looked backwards to Chen Yun's initial proposals for the second Five Year Plan in 1956 which were subsequently

² To be more correct, it should be the post-Hua era. But Hua Guofeng's period of leadership from September 1976-December 1978 (formally until June 1981 but he effectively lost power in 78) is not usually considered to be part of the post-Mao epoch. So oddly, the post Mao era is typically dated as starting a full two years after Mao actually died.

swept aside by Mao's push for a more rapid pace of agricultural collectivisation that ended up as the Great Leap Forward. But once the status quo anti had been re-established, reforms gained their own momentum with farmers pushing for greater freedoms and leading the drive to decollectivise.³ Local experiments with different forms of rural responsibility systems (most notably in Anhui and Sichuan)⁴ led to "responsibility" systems being rolled out nationally that allowed peasants to produce what they wanted guided by the market once they had fulfilled their commitments to the state. Crucially, though, the state (through the collective) retained ownership of the land.

With farmers selling their new surplus in the cities at newly established free markets, the state's monopoly on the pricing and distribution of agricultural produce was broken for the first time in decades.⁵ Nevertheless, this first phase was overwhelmingly a rural phenomenon, and the second phase can be roughly dated from the decision to move the focus to urban industrial sectors and the "Decision on the Reform of the Economic Structure" in 1984. Here, the Chinese economy was characterised as a planned 'socialist commodity economy' *shehuizhuyi shangpin jingji* 社会主义商品经济 – an economy where the state still played the key leading role in guiding the drive towards industrialisation and economic modernisation, but where individual enterprises should take responsibility for profits and losses, and for meeting the economic demands of the people. In order to do this, the state began to cut the number of goods that were produced under mandatory plans and state set

³ Including resisting the imposition of the one child policy. The most extreme version of farmer power is provided by Kate Xiao Zhou (1996) *How the Farmers Changed China: Power of the People* (Boulder: Westview).

⁴ Experimentation and incrementalism have been almost a defining characteristic of China's retreat from socialism. See Sebastian Heilmann (2009) "Maximum Tinkering under Uncertainty: Unorthodox Lessons from China", *Modern China*, 35 (4): 450. See also Sebastian Heilmann (2008) "Policy Experimentation in China's Economic Rise", *Studies of Comparative and International Development*, 43 (1): 1-26.

⁵ David Zweig (1997) *Freeing China's Farmers: Rural Restructuring in the Reform Era* (Armonk: Sharpe).

prices, allowing the “law of value” to take a greater role in the pricing and allocation of goods.⁶

At this stage, the promotion of private ownership and the formal acceptance of capitalist methods remained politically difficult, but in practice, the emergence of non-state controlled but not really private enterprises had already played a significant role in generating economic growth. This took two forms. First, the drive to encourage foreign investment led to a change in policy towards forms of foreign ownership. In order to encourage more inward investment, the Wholly Foreign Owned Enterprise (WFOE) Law of April 1986 freed foreign investors from the need to set up joint ventures with domestic Chinese companies. To be sure what they could was still heavily controlled by the state and although at this stage they were still relatively small in number, WFOEs were accepted as legitimate privately owned organizations and ‘no interference shall be allowed in the operation and management activities of a wholly foreign-owned enterprise’ (Article 11).

Second, as workers left the land but were restricted through registration laws from migrating to the cities, around 100 million rural workers were absorbed by the creation of Township and Village Enterprises (TVEs) between 1984 and 1997 (when the TVE sector began to retract).⁷ By the end of the decade, they were producing a quarter of industrial production, and brought in around a third of China’s foreign exchange earnings.⁸ Strictly speaking, these TVEs were not state owned under Chinese definitions (“owned by all the people” – quanmin suoyou 全民所有). But strictly speaking, neither were they private; partly because the concept of private ownership was slow in emerging and being legalised, and

⁶ Joseph Yu-shek Cheng (1985) ‘Reform of the Economic Structure and ‘One Country, Two Systems’, *The Australian Journal of Chinese Affairs*, (13); 109-20. Referring back to the division into phases as “blunt”, Cheng points out that much of this was already happening in experimental fashion in a number of places, and what the 1984 “Decision” did was formalise existing ad hoc changes.

⁷ D. Gale Johnson (1999) ‘China's Reforms - Some Unfinished Business’ University of Chicago Office of Agricultural Economics Research Working Paper No. 99-08.

⁸ David Zweig (1997) *Freeing China's Farmers: Rural Restructuring in the Reform Era* (Armonk: Sharpe): 254.

partly because they were owned by local township and village governments. While comparing them to what had dominated before and SOEs in China might lead to an emphasis on the market oriented nature of these TVEs, they would still probably be considered to be part of the “public” sector in most parts of the world.⁹ The extent to which their relationship with the state marked them out as different from purely private and independent enterprises is an issue we will return to later in the paper.

Although small “individual” forms of ownership (getihu 个体户) had been legitimate since 1981,¹⁰ truly private ownership was only formally accepted in 1988 through revisions to the state constitution and the ‘Tentative Stipulations on Private Enterprises’. Although, the formal legal situation followed *de facto* developments,¹¹ there was no rush to join the ranks of the private sector – it was, after all, only just over a decade since the demise of the Gang of Four. And the attacks on the private sector and market economics in general after the suppression of the Tiananmen demonstrators in 1989 showed just how precarious the emerging non-state sector really was. But in 1992 the balance tipped back towards liberalisation with Deng Xiaoping’s support for quasi-capitalist forms during his “southern tour” (the nanxun 南巡).

With the increasing importance of the non-state sector and concomitant decline in the significance of state planning, the concept of a planned socialist economy was increasingly out of step with reality. Thus, in October 1993, the Chinese economy was once again re-defined – this time as a ‘socialist market economy’ (shehuizhuyi shichang jingji 社会主义市场经济). Any apparent contradiction between being both socialist whilst having a market economy had already been dismissed by Deng – both the plan and the market were

⁹ See Guo Sujian (1998) ‘Enigma of All Enigmas: Capitalist Takeover? Assessment of the Post-Mao Economic Transformation’, *Journal of Chinese Political Science*, 4 (1): 33-72 and Guo Sujian (2003) ‘The Ownership Reform in China: What Direction and How Far?’, *Journal of Contemporary China*, 12 (36): 553-573.

¹⁰ These could originally employ no more than five people (raised to seven in 1988) and were supposed at first to be family members. They were often small service providers like hairdressers etc.

¹¹ Particularly the growth of the private sector in Wenzhou.

simply economic means that could be used in both capitalist and socialist states to attain different goals. And in any case, while the law of value and non-state forms of ownership would play an ever greater role, SOES would remain “the leading force” in a national economy (Article 7).

In essence, this second phase entailed the facilitation and legitimating of the new without the eradication of the old. New types of activity emerged, and the commercialisation of existing SOEs was encouraged, but they were largely protected from competition that would put them out of business, and supported by the banks if they struggled.¹² Where I failed in my attempt to get the idea of an “embedded socialist compromise” into the discourse, Lau, Qian and Roland did much better with their idea of ‘reform without losers’.¹³ The next third phase from around 1994 to 2004 entailed the attempt to build a new system of macroeconomic control based on law and regulation (rather than through state planning control under a guided market system) and a retreat from state ownership.

The Retreat of the State?

Between 1978 and 1993, SOEs share of share of industrial output dropped from 78 per cent to 43 per cent, but their share of employment only fell from 75 per cent to around 60 per cent.¹⁴ Nearly three quarters of the SOEs owned by local governments were making a loss,¹⁵ with most of them only surviving by taking loans that everybody knew would never be paid back. For example, the ratio of debts to the equity of SOEs grew from 23 per cent at the start

¹² Largely, but not wholly. A bankruptcy law was introduced in 1986 (though very seldom used) and mergers were encouraged at times.

¹³ Lawrence Lau, Qian Yingyi and Gerard Roland, (2000) ‘Reform Without Losers: An Interpretation of China’s Dual Track Approach to Transition’, *Journal of Political Economy*, 108 (1): 120-63.

¹⁴ Cao Yuanzheng, Qian Yingyi, and Weingast, B. (1999) ‘From Federalism, Chinese Style, to Privatization, Chinese Style’, *Economics of Transition*, 7 (1): 103-131.

¹⁵ As opposed to more than three quarters of larger centrally owned enterprises making a profit. Ross Garnaut, Ligang Song, L. and Yao Yang. (2006). Impact and significance of state-owned enterprise restructuring. *The China Journal*, 55: 38.

of the reform process to 440 per cent by 1998.¹⁶ With this situation deemed unsustainable, Yao Yang argues that China changed from *gaige* 改革– reform of the system to make it work better – to *gaizhi* 改制; fundamentally changing the system.¹⁷

The basic idea was captured by the slogan *zhuada fangxiao* 抓大放小 – “grasp the big, let go of the small”.¹⁸ Large SOEs would be consolidated to create even larger internationally competitive enterprise groups (*qiye jituan* 企业集团) as the bedrock of the economy. These large conglomerates would be the major recipients of state capital, and would occupy key strategic sectors and those related to state security. Smaller and less efficient SOEs were also encouraged to merge, shed excess workers to become efficient and competitive, and to free themselves (or more correctly, be cut loose from) state ownership and support.¹⁹ Although this in effect saw them moving out of state ownership, the process was officially known as ‘shareholding transformation’ (*gufenhua* 股份化) rather than the more politically and loaded term, “privatisation” (*siyouhua* 私有化”).²⁰ Indeed, even today when the vast majority of Chinese enterprises are privately owned, the concept of privatization is still highly sensitive –

¹⁶ Bonin, J. and Huang Yiping (2001) ‘Dealing with the Bad Loans of the Chinese Banks’, Columbia University APEC Studies Center Discussion Paper No. 13: 8-9.

¹⁷ Yang Yao (2004) ‘Government Commitment and the Outcome of Privatization’, in Takatoshi Ito and Anne O. Krueger (eds) *Governance, Regulation, and Privatization in the Asia-Pacific Region* (Chicago: University of Chicago Press): 251-278.

¹⁸ This is often associated with the 15th party congress in 1997, but was in fact first announced as party policy by the central committee in September 1995.

¹⁹ The original regulatory changes to allow for this transition came as early as July 1992 with the “Regulations Regarding the Transformation of the Management Mechanism of State-Owned Industrial Enterprises”. But fundamental reform only became possible after the passing of the Company Law in 1993, which came into operation in July 1994 – hence the designation here of 1994 as the start of a new phase. But in reality, it wasn’t until 1996 that shareholder transformation began in great numbers. For details of the different regulations, see Geng Xiao (1998) “Reforming the governance structure of China’s state-owned enterprises”, *Public Administration and Development*, 18 (3): 273-80.

²⁰ For a detailed discussion on how ideological hangovers and concerns about worker reactions influenced policy changes, see Jean C. Oi (2005) “Patterns of Corporate Restructuring in China: Political Constraints on Privatization”, *The China Journal*, (53): 115-36.

particularly when it comes to potential privatisation of land (given all the problems that beset China the last time land was in private ownership).²¹

Originally, the dominant form of such a transformation was through processes of worker buyouts, which took the burden of responsibility away from the state, whilst still being politically acceptable in a supposedly socialist society.²² Indeed, Philion argues that this was a deliberate means of divesting loss making enterprises without the state taking the blame for either privatisation or liquidation; if things went wrong and the newly democratically managed SOEs were not viable, then it wasn't the state's responsibility to keep them going – it was the workers' responsibility (and fault) instead.²³ Whether through Machiavellian intent or simply as a result of failure, worker buyouts were soon eclipsed by more “elite” forms of ownership transfer with managers and relatives of government officials playing leading roles in what was effectively privatisation, irrespective of the official terminology.²⁴

As with most things relating to China, consensus on statistics is difficult to find. But while the numbers may differ depending on what sources you read, the overall story of the retreat of the state from direct ownership and control of most of China's enterprises is clear. One report suggesting that 80 per cent of firms at the county level and lower had been privatised in less than two years by as early as at the end of 1998.²⁵ According to China Labour Bulletin, “by the end of 2001, 86 percent of all SOEs had been restructured and about 70 percent had been partially or fully privatized. The number of SOEs fell from 64,737 in

²¹ See Lin Chun (2008) “Against Privatization in China: A Historical and Empirical Argument” *Journal of Chinese Political Science*, 13(1) 1-27.

²² Ross Garnaut, Ligang Song, and Yao Yang. (2006) “Impact and Significance of State-Owned Enterprise Restructuring”, *The China Journal*, 55: 35-65.

²³ Stephen Philion (2007) 'Workers' Democracy vs. Privatization in China', *Socialism and Democracy*, 21 (2): 37-55.

²⁴ Chen An (2003) ‘Rising Class Politics and its Impact on China's Path to Democracy’ *Democratization*, 10 (2) : 141–162.

²⁵ Zhao Xiao (1999) ‘Jingzheng, Gonggong Xuanze yu Zhidu Bianqiang (Competition, Public Choice and System Change)’, Beijing University China Centre for Economic Research Working Paper No. C1999025; 26.

1998 to 27,477 in 2005”.²⁶ By the end of the following year “county level SOEs had virtually disappeared. Collective township and village enterprises, too, were nearly gone, with private takeovers spreading to place after place around the turn of the millennium”.²⁷ And from the announcement of *zhuada fangxiao* in 1995 to China’s WTO entry at the end of 2001, there was a 40 per cent reduction in the number of workers in the state sector (46 million workers losing their jobs), and a 60 per cent reduction in workers in collectively owned urban enterprises (18.6 million), with a further 34 million state sector workers registered as laid off.²⁸ Conversely, by the end of the millennium, the broadly defined non-state sector accounted for 63 per cent of GDP, 80 per cent of GDP growth, and ‘more than 100 per cent’ of new jobs.²⁹

Nor was it just a matter of the state retreating from ownership. In terms of pricing, in the summer of 2005, the Minister of the National Development and Reform Commission, Ma Kai, announced that the task of replacing state planning with a ‘socialist market economy’ was now completed. Market forces determined the price of 96 per cent of retail commodities, 97 per cent of agro-and sideline products and 87 per cent of capital goods.³⁰ Moreover, the formal relationship between party, state and economy has been altered through structural changes to the organisational principles and structures of the Chinese state, and ideational change reflected in reforms to the party and state constitution.

In terms of structures, government restructuring after 1998 were designed to make a final move from government control over the economy to macroeconomic supervision and

²⁶ “Reform of State-owned enterprises in China” China Labour Bulletin, 19 December 2007 at <http://www.clb.org.hk/en/node/100153>

²⁷ Lin Chun (2008) “Against Privatization in China: A Historical and Empirical Argument” *Journal of Chinese Political Science*, 13(1): 4.

²⁸ John Giles, Albert Park, Fang Cai (2003) ‘How has Economic Restructuring Affected China’s Urban Workers?’; 1. Available at www.msu.edu/~gilesj/gilesparkcai.pdf

²⁹ Fan Gang (2000), ‘Lun Ti Zhi Zhuan Gui de Dong Tai Guo Cheng (On Dynamic Process of Institutional Transition- The Growth of Non-State Sector and the Reform of the State Sector)’, *Jingji Yanjiu (Economic Review)*, (January): 11-21.

³⁰ *People’s Daily* (2005b) ‘China has Socialist Market Economy in Place’, *People’s Daily* (online edition), 13th July. Available at http://english.peopledaily.com.cn/200507/13/eng20050713_195876.html

regulation. The key pillars in this supervision and regulation were initially the Ministry of Finance, the People's Bank of China and the State Planning Commission (renamed the State Development Planning Commission in 2000). In 2003, the China Banking Regulatory Committee took control of banking regulation and supervision from the PBC. In name at least, 'planning' disappeared altogether, as the Planning Commission was merged with the Structural Reform Office of the State Council and the administrative and regulatory functions of the State Economic and Trade Commission to form the National Development and Reform Commission;³¹ indeed, when the 11th Five Year Plan was announced in 2005, the term *jihua* 计划 or 'plan' was replaced by *guihua gangyao* 规划纲要 or 'outline programme'.

In addition from April 2003 a new organisation, the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) took over control of SOESs – an organisation and an issue we will return to shortly. SASAC took over responsibility for the state's interests in SOEs as shareholder rather than as direct manager/owner/planner. The idea was to give enterprises the freedom to behave as commercial agents free from bureaucratic control, but without losing overall state ownership of key enterprises. Thus, for example, they are allowed to recruit the brightest and best to their ranks (even though, as Naughton points out, the CCP retains overall control of appointments).³² This means that successful SOES were left in a position where they could behave as market actors but also retain the benefits that accrue from being part of the state sector. The need to put in place a new regulatory framework resulting from China's WTO commitments resulted in the distinction and bureaucratic separation of the regulation of internal and external trade coming to an end with

³¹ The Chinese term for this organisation is 国家发展和改革委员会. 国家 here can be translated as state or national, but although previous planning organisations were always known in English as "state", the NDRC is instead known as national.

³² Barry Naughton "Top-Down Control: SASAC and the Persistence of State Ownership in China" Paper presented at the conference on "China and the World Economy" Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham June 23, 2006: 4

the creation of a new Ministry of Commerce.³³ In combination, these reforms established a governmental structure designed to regulate the economy rather than control it through the plan - albeit relatively strong regulatory control.

In ideational terms, the key turning point came in a speech by the then Party leader, Jiang Zemin on the 80th anniversary of the creation of the CCP in 2001 and his proposal to allow private entrepreneurs to join the party. Jiang's theory of the 'Three Represents' (sange daibiao三个代表) was subsequently added to Marxism-Leninism-Mao Zedong Thought-Deng Xiaoping Theory as the Party's guiding principle at the 16th Party Congress in November 2002. The following year, the PRC constitution was also amended to not only include the 'three represents' but also to commit the state to guarantee the right to have and inherit private property

2003-2004 Onwards – Re-defining the State's Economic Role

The choice of 2003-4 as the start of the latest and current phase of SOE reform is a somewhat arbitrary one. Although the number of central SASAC controlled enterprises continued to diminish after 2004 through a process of mergers, it more or less marks the end of the years of the state's retreat from ownership, and a turn towards profitability for the residual central state sector.³⁴ It also sort of marks the beginning of a new era of leadership. This might sound odd given that Hu Jintao succeeded Jiang Zemin as party leader and state President in 2002 and Wen Jiabao became Premier the following March (succeeding Zhu Rongji). But despite the formal transfer of power, the shadow of the previous leadership remained until the

³³ The former had previously been in the hands of the State Economic and Trade Commission and the latter the Ministry of Foreign Trade and Economic Cooperation.

³⁴ Barry Naughton (2009) "China: Economic Transformation Before and After 1989", paper prepared for the conference —1989: Twenty Years After, University of California, Irvine. November 6-7, 2009, available at <http://www.democ.uci.edu/research/conferences/documents/naughton.pdf>

summer of 2004, with the official report on the fourth plenum of the 16th party congress³⁵ pointing to new directions in policy going forward.³⁶

But while dividing points are debatable, what is beyond question is that in the previous era, the state withdrew from its traditional historical position as enterprise owner, central economic planner and the pricer and distributor of most goods and commodities. But this does not mean that the state has withdrawn from the economy *per se*. Indeed, the unashamedly pro-neoliberal Heritage Foundation ranks the Chinese economy as less free today than in the run up to WTO entry in 1999 and 2000 (and pretty much as it was when the rankings first started in 1995).

So we seem to have a bit of a conundrum – on one level, a story of privatisation and the retreat of the state from economic activity; but on another level, an economy which still appears to be dominated by the state. For example, whilst noting the dramatic increase in private enterprises, the main conclusion of Kroeber and Yao's brief overview of privatisation in China is that "economic power remains firmly concentrated in the hands of the state".³⁷ Why this is not a contradiction can perhaps be best explained in three ways; by considering the unit of comparison, by looking at what the state still owns, and by an analysis of what the state can control through mechanisms other than formal ownership.

Units of Comparison

First, we have to think in terms of what we are comparing today's China with. The element of direct state ownership and control today might be much less than in previous eras. But when compared to an advanced industrial liberal economy, then the residual degree of state control in

³⁵ Central Committee, 中共中央关于加强党的执政能力建设的决定 *Zhonggong Zhongyang Guanyu Jiaqiang Dangde Zhizheng Nengli Jianshe de Jueding* (The Party Central Committee Decision on Strengthening Governing Capacity Construction), available at <http://www.china.com.cn/chinese/2004/Sep/668376.htm> (in Chinese)

³⁶ Though in many ways exaggerating the difference between the new and old guards. See Shaun Breslin "Do Leaders Matter? Chinese Politics, Leadership Transition and the 17th Party Congress", *Contemporary Politics* 14 (2) 2008: 215-231.

³⁷ Arthur Kroeber and Rosealea Yao (2008) "Large and in Charge", *Financial Times*, 14 July.

China remains considerable. And as the benchmark for comparison is indeed other advanced industrial liberal economies – for example, when it comes to anti-dumping considerations – then what might seem an unfair unit of comparison from an academic viewpoint is a pertinent one in policy circles.

This points us towards an area that is probably beyond the scope of this paper; the extent to which state control creates an unfair playing field and China's position in the global economy. For most part, this debate has focussed on the support given to Chinese exporters and the protection afforded to domestic producers to prevent competition with foreign producers. Whilst WTO entry in 2001 supposedly reduced the state's ability to protect and support and really did open up previously protected/restricted sectors, liberalisation has been far from complete. In particular, foreign companies operating in China suggest that things have actually got worse as the Chinese government seeks to maintain (domestic sources of) growth in wake of the global financial crisis.³⁸

More recently, the focus has also turned to the role of Chinese companies overseas. The main concern has related to the activities of large Chinese resource (particularly energy) companies that have been seeking to obtain supplies across the world. For example, when the state owned China National Offshore Oil Corporation bid for the US based Unocal in 2005, there was concern in the US that CNOOC was an agent of Chinese state power and policy, utilising cheap loans to pursue China's energy security strategy at the expense of the USA's own national security.³⁹ Similar concerns have been raised in Australia about the wisdom of allowing so much of the country's resources to be bought up by Chinese companies; concerns highlighted by the Rio Tinto Stern Hu trial (but as yet without restrictions on the highly lucrative trade). There is also concern that Chinese resource activities in Africa, Latin

³⁸ According to reports by both the EU and US Chambers of Commerce in China. See, Joerg Wuttke (2010) "China is beginning to frustrate foreign business", *The Financial Times*, 7th April. See also Keith Bradsher (2010) "Foreign Companies Chafe at China's Restrictions", *New York Times*, 16th May.

³⁹ Kim, Joongi (2007) "Fears of Foreign Ownership: The Old Face of Economic Nationalism" SAIS Review, Volume 27, Number 2, Summer-Fall 2007, pp. 167-177

America and the Middle East will have an indirect impact on the core “Western” states; partly through changes to the price and distribution of key resources, but also through providing “no strings attached” economic relations with states that:

“Could set scores of developing nations away from the path of liberal democracy, creating a community of countries that reject Western views of human rights and accepted standards of national governance”⁴⁰

But there is more to this than just the activities of large resource conglomerates. With both financial and manufacturing sectors in many countries facing severe difficulties, the activities and intentions of Chinese state-related entities generate conflicting emotions. On the one hand, Chinese companies and the holders of Chinese sovereign wealth⁴¹ are the only hope for some companies to keep going. But on the other hand, there remains concern that the hand of the Chinese state (often combined with suspicions of Chinese intent) lies behind these commercial activities, and that selling to China is in some ways playing into the hands of a potentially destabilising rising world power.

In short, the argument here is that China’s growing significance, its sheer size and global impact, and fears about China’s (malign) intent mean that the nature of state control in China faces perhaps closer scrutiny than is the case with many other countries. Recognizing that this might be interesting, but ultimately perhaps peripheral to this paper (at best) it is time to move to more important issues.

The Nature of Residual State Ownership

Size really is important

⁴⁰ Naazneen Barma and Ely Ratner, ‘China’s Illiberal Challenge’, *Democracy: A Journal of Ideas* 2, 2006, p. 57. Cited in Chan Lai-Ha, Pak Lee and Gerald Chan, ‘Rethinking Global Governance: a China Model in the Making?’ *Contemporary Politics* 14: 1, 2008, 3-19.

⁴¹ Much of the attention focuses on the China Investment Corporation – the “official” sovereign wealth fund. But this is not the only holder and disburser of foreign currency in China. Alongside CIC the policy banks (China Development Bank and the import/export Bank of China) and SAFE are also key actors.

So the State Sector may not be as large as it once was, but it is still large by most international comparisons. It also remains strategically central to the functioning of the Chinese economy. Perhaps surprisingly, getting reliable and agreed figures for the number of enterprises by ownership type in China is not particularly easy (or maybe not surprising when you think of the size of the country). To be sure, you can look at the SASAC webpage and see that the central government level SASAC owns 150 (check number at time of publication) entities, but many of them are large industrial groups and conglomerates which in turn are parents of numerous other smaller companies:

“most Chinese SOEs operate through opaque holding entities and it is generally impossible to determine the exact ownership structure of Chinese business corporations. This includes those that claim to be privately owned”.⁴²

Moreover, when state firms go “public”, this provides extra capital for the companies, but through the state’s ownership of the majority of the shares, does not wholly take the enterprise out of the state sector.⁴³ Add this all together and Naughton calculates that firms under the ownership of central SASAC own about a third of the value of all shares on the Shenzhen and Shanghai markets, and just under a fifth of the value of the Hong Kong market.⁴⁴

“today’s companies preside over a staggering 16,870 subsidiaries of all kinds. These are sprawling corporate empires with interests in wide-ranging areas.... The state

⁴² Jeff Rae (2008) “Foreign Investment & Australia – Counting the Cost of Regulation”, AOIF Paper 2, available at http://www.ipa.org.au/library/publication/1229298979_document_rae.pdf:13. This paper draws most of its information on China from Naughton, and it’s impossible to write on SASAC and the state sector without referring to Naughton’s numerous publications on the topic.

⁴³ Ross Garnaut, Ligang Song, and Yao Yang. (2006) “Impact and significance of state-owned enterprise restructuring”, *The China Journal*, 55: 41-2.

⁴⁴ Barry Naughton “Top-Down Control: SASAC and the Persistence of State Ownership in China” Paper presented at the conference on “China and the World Economy” Leverhulme Centre for Research on Globalisation and Economic Policy (GEP), University of Nottingham June 23, 2006: 7-9

empire in fact consists of large web of patronage and business opportunity which is only imperfectly tracked at the top”⁴⁵

This includes state owned companies and their subsidiaries having special relationships with companies that are outside of the state sector, but which nevertheless largely owe their existence to their relationship to state firms (and the state in general) – an issue we shall return to later.

Moreover, the vast majority of State Owned enterprises are owned by provincial and municipal level SASACs, not by the centre. Some of these locally owned companies are very large entities indeed; the Shanghai Automotive Industry Corporation and Hai'er, China's leading manufacturer of white goods (owned by Qingdao city) are two examples of locally owned companies that now have a global reach and profile. Just like the centrally owned SOEs, large and smaller local state enterprises are also major shareholders in themselves – typically of companies that were spun off from the state enterprise during the period of privatisation and restructuring. In combination, “these SOEs constitute the largest group of controlling shareholders of listed companies in China”.⁴⁶

So with this in mind, we can interpret the official figures with an interrogative eye. One of the most authoritative sources on the size of the state sector was the Second National Economic Census which concluded in December 2008 (the first was in 2004) – though note that this only covers the secondary and tertiary sectors.⁴⁷ One of the key findings of this census was the increase in the number of registered and licensed self-employed workers (up 30 per cent from 2004 to nearly 29 million people). Over the same period, the number of SOEs had decreased by 20% leaving the distribution as follows:

⁴⁵ Barry Naughton (2009) “China: Economic Transformation Before and After 1989” available at <http://www.democ.uci.edu/research/conferences/documents/naughton.pdf> :14.

⁴⁶ Gongmeng Chen, Michael Firth and Liping Xu (2009) “Does the type of Ownership Control Matter? Evidence from China's listed Companies”, *Journal of Banking and Finance*, 33 (1): 173.

⁴⁷ ie: it excludes agriculture, forestry, animal husbandry and fishery.

Total	4,959,000	100.0
Domestic-Funded Corporations	4,774,000	96.3
State-owned	143,000	2.9
Collective-owned	192,000	3.9
Share-holding Cooperatives	64,000	1.3
Limited Liability Corporations	551,000	11.1
Of which Solely state funded	11,000	
Other funded	540,000	
Share-holding Corporations Ltd.	97,000	2.0
Private	3,966,000	72.5
Other Domestic Corporations	119,000	2.4

Source: National Bureau of Statistics in China (2009) “Communiqué on Major Data of the Second National Economic Census”, 25th December 2009, available on-line at http://www.stats.gov.cn/english/newsandcomingevents/t20091225_402610168.htm

But is quality more important than size?

But having said that the size of the residual state sector is still important (and bigger than might appear at first sight), it is important to note that there is a difference between how much the state owns, and the importance of what it owns. Smaller enterprises, those that were loss making in competitive sectors and even those making a profit but with very low margins and therefore vulnerable to increased competition have been let go. But via SASAC, the central government retains ownership (if not direct day to day control) of large enterprises that dominate key sectors and produce significant profits.⁴⁸ If we add the large locally owned enterprises together with central SOEs, in 2007 almost 70 per cent of China’s top 500 enterprises were state owned. Of these 500, state owned enterprises created 88 per cent of their profit, had 94 per cent of asset value and provided 92.7 per cent of their taxes.⁴⁹

⁴⁸ Gabriel Wildau (2008), “Enterprise Reform: Albatross turns Phoenix”, *China Economic Quarterly*, 12 (2): 27-33.

⁴⁹ Xiao Geng, Xiuke Yang and Anna Janus (2009) “State-owned enterprises in China: Reform dynamics and impacts” in Ross Garnaut, Ligang Song and Wing Thye Woo (eds) *China’s New Place In A World In Crisis*:

State sector reform has left the central state as owners of key enterprises in “strategically important sectors” 战略重要部分, defined by SASAC Chairman Li Rongrong as “the vital arteries of the national economy and essential to national security”. These were armaments, electrical power and distribution, oil and chemicals, telecommunications, coal, aviation, and shipping, which accounted for around a quarter of central SASAC SOEs at the time, three quarters of their assets and 79 per cent of their profits.⁵⁰ The state also retains a controlling share in “pillar” sectors of the economy⁵¹. Theoretically, these sectors should have become open to private investment following the 2005 “36 guidelines”, but at the time of writing, little concrete seems to have been done to remove state monopolies (more on this later).

As a result by “controlling tightly a small fraction of all SOEs, the state can maintain disproportionate control over profits, investments and the national economy”.⁵² Notably, research and development institutions remain under central SASAC control – for example, the Academy of Machinery Science and Technology, the Chinese Academy of Agricultural Mechanization Sciences, the China Textile Academy, the China Academy of Telecommunications Technology and the China Academy of Building Research are all technically central SOEs. When added to the government funded research undertaken at Universities, and in the Chinese Academy of Science (which has ministerial standing), then

Economic, Geopolitical and Environmental Dimensions (Canberra: ANU Epress): 159
http://epress.anu.edu.au/china_new_place/pdf/whole_book.pdf

⁵⁰ China Daily (2006) “China defines key national economic sectors” China Daily, 18th December

⁵¹ Mattlin identifies pillar sectors where the state retains a controlling stake are machinery, auto, IT, construction, steel, base metals, chemicals, land surveying, and R&D. There are around 40 other key enterprises in trading, investment, medicine, construction materials, agriculture, and geological exploration where the state is to retain controlling stake where necessary, and reduce its control where not. Mikael Mattlin (2009) “Chinese Strategic state-owned enterprises and ownership control” Brussels Institute of Contemporary China Studies Asia Paper, 4 (6): 13 available at [http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20Paper%204\(6\).pdf](http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20Paper%204(6).pdf)

⁵² Mikael Mattlin (2009) “Chinese Strategic state-owned enterprises and ownership control” Brussels Institute of Contemporary China Studies Asia Paper, 4 (6): 14 available at [http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20Paper%204\(6\).pdf](http://www.vub.ac.be/biccs/site/assets/files/apapers/Asia%20Paper%204(6).pdf)

the state remains responsible for R&D and training in a way that Gabriele argues goes way beyond the “normal” public sector research activities of other states and societies.⁵³

At the local level, many SOEs are smaller companies that do not necessarily have a global or even national presence, but which are nevertheless the lynchpin of local economies – companies that have access to markets (including market information) and capital and which receive preferential treatment from local governments that are not afforded to “outsiders” – including here outsiders from other local authorities within China itself. In combination, these enterprises are key determinants of daily economic activity in much of China, if not as powerful and significant on their own as the major centrally owned conglomerates.

State Control Beyond Direct Ownership

As already noted, it is not easy to get a full understanding of the extent of state ownership due to the way in which smaller companies have parents (including more than one parent) in the state sector. We have also seen how in terms of research and development, the state remains a key producer of knowledge and innovation that is used throughout the rest of the economy. And this brings us to the extent to which the state can influence and at times even control the economy through indirect measures – responding to the global crisis in 2008 being a good case in point and as such will form a separate section at the end of this paper.

At the national level, like in Japan previously, China’s leaders are keen to promote and support “national champions” in the global economy. Most of these putative champions are large companies that remain under degrees of state ownership and benefit from “normal” levels of state support (most notably policy inspired financial support for global activities through the China Development Bank). But strong state support is also open to nominally

⁵³ Alberto Gabriele (2009) “The Role of the State in China's Industrial Development: a Reassessment” MPRA Paper No. 1455: 17 http://mpra.ub.uni-muenchen.de/14551/1/MPRA_paper_14551.pdf

private national champions such as Huawei as China's leaders seek to push China's global economic profile through the promotion of Chinese TNCs.⁵⁴

At the sectoral level, the state protects domestic producers in key sectors by limiting the level of external participation through "The Catalogue Guiding Foreign Investment in Industry", which sets out those economic sectors where foreign investment is encouraged, prohibited and restricted. Prohibited sectors include those deemed to be essential services (compulsory education, postal service), investment in industries considered to be essential for national defence, those that produce harmful and "persistent pollutant products", and industries that are illegal under domestic Chinese law (for example, pornography). The catalogue "protects" also protects China's cultural heritage by prohibiting investment in traditional medicines, the cultivation of rare plant and animals, speciality teas, decorative carvings and so on; and prohibits investment in those areas that the leadership perceives could damage its monopoly on political power in China (dissemination of news and information, publishing and entertainment industries, and also in what is called "social investigation"). Investment is prohibited in key economic sectors such as fishing, the production and supply of power and water, and futures companies.

In the wake of China's WTO entry, the catalogue has been revised three times to open previously closed sectors, restrictions on investment remain in those sectors where injections of foreign capital are welcomed, but only if the foreign interests remain subordinate to national interests and if national development objectives are not distorted by external actors. They cover those economic sectors that are deemed central to national economic development, and this need to remain out of foreign ownership or control – for example, the production and processing of certain foods (most notably grain), medical and pharmaceutical

⁵⁴ Cartledge S. 2008, China's first multinational? ,China Economic Quarterly, September check ref cause cant find where this came from

products, raw material exploration, power plants, chemical goods and processing, wool cotton and silk production, and so on.

Moreover, even in supposedly encouraged sectors, the catalogue is full of conditions and clauses, and the full and detailed restrictions for each industry can only be found by referring to the specific laws and regulations for that industry. And it is in the interpretation of this regulatory confusion that many foreign actors think that the Chinese authorities are avoiding some of the commitments that they made to openness and liberalisation in joining the WTO. Notably, these regulations seem to be deployed selectively when overall economic trends dictate a move back from openness – as appears to be the case as China responded to the global economic crisis in 2008. In this respect, it is not that state support is always there on a daily basis, but that it provides some form of safety net for producers if and when the going gets tough.

And of course, we cannot ignore the state support provided to help Chinese exporters prosper. Exchange rate policy is a particular case in point here, and something that has been the source of considerable political debate and also political tension (between the US and China in particular) in recent times. In addition, many exporters negotiate tax deals to increase their profitability and to allow them to produce at margins that might not otherwise be commercially viable. When many of these breaks were removed in the summer of 2007, China's leaders faced a barrage of complaints from exporters in China's coastal provinces, and collectively spent their summers visiting those areas. As a result of the problems that these overwhelmingly private sector enterprises were facing, there was a retreat from the original policy in the summer of 2008 (before the impact of the global crisis began to hit China) and a reinstatement of support. Again, such state support is hardly unique to China, but the extent of state support for exporters over a long period does perhaps mark the Chinese case out as being different from the "norm".

Private but not independent?

Finally in this section, we return to the difficulty in identifying the exact relationship between individual enterprises and the state sector. It is not just a matter of the opacity of who owns what through overlapping and confusing share holdings and so on outlined above. Rather, the focus here is on the levels of dependence many private enterprises have, which makes them in some respects privately owned participants in the state sector.

In an early study of different ownership forms in China, Wank found that the official legal status of an enterprise was irrelevant – having a good relationship with local party state officials was much more important for doing business than the formal ownership classification of that enterprise.⁵⁵ Enterprises that were formally classified as “private” were often effectively dependent on local governments for financial help, and on local SOEs for supplies (at preferential rates) and often key personnel. This hand in glove relationship often emerged as enterprises were privatised, or as new private enterprises sprung up alongside existing state enterprises, benefiting from an advantageous relationship with the SOE as either supplier, or market, or both. This close relationship was helped by the way in which relatives of political officials were often the owners of new private entities,⁵⁶ with the long term success of these new enterprises contingent on new owners’ relationship with the local government.⁵⁷ In the process, it’s fair to say that a number of officials used the opportunity to move state assets into private hands.⁵⁸

⁵⁵ David Wank (1998) *Commodifying Chinese Communism: Business, Trust, and Politics in a South Coast City* (Cambridge: Cambridge University Press).

⁵⁶ Bruce Dickson, B. (2003) *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change* (Cambridge: Cambridge University Press).

⁵⁷ See Andrew Walder (2002) ‘Privatization and Elite Mobility: Rural China, 1979–1996’ Stanford Institute for International Studies A/PARC Working Paper; Li Hongbin and Scott Rozelle (2003) ‘Privatizing Rural China: Insider Privatization, Innovative Contracts and the Performance of Township Enterprises’, *The China Quarterly*, (176): 981-1005 and Cai Yongshun (2002) ‘Relaxing the Constraints from Above: Politics of Privatizing Public Enterprises in China’, *Asian Journal of Political Science*, 10 (2): 94-121.

⁵⁸ See Ding Xueliang (2000a) ‘Informal Privatization Through Internationalization: The Rise of Nomenklatura Capitalism in China’s Offshore Business’, *British Journal of Political Science*, 30 (1): 121-46; Ding Xueliang

Times have moved on, and the legal status of private enterprises has been established. So to has their theoretical right to access to finance and markets. Nevertheless, and notwithstanding liberalisation of most economic sectors and the dominance of “market” based levers of macroeconomic control, the state can (and indeed does) utilise a lack of transparency in market conditions and regulatory requirements, a flexible interpretation of fiscal responsibilities, and its authority over the financial system to support and protect favoured actors. Indeed, Chou goes as far as to suggest that the regulatory structure gives local authorities in particular the ability to control who is allowed to operate and who doesn’t – and also allows the local governments to revoke these licences for not just economic reasons.⁵⁹

Access to finance is also an area where truly private companies fair less well than their state owned or state related counterparts. Quite simply, political connections matter; be that gaining access to domestic finance, the terms and conditions on which credit might be given, or being able to raise money through IPOs at home and abroad.⁶⁰ Moreover, “in an environment in which skepticism, mistrust, and discrimination toward private enterprises abound, affiliation with the ruling party confers congruence and trustworthiness.”⁶¹ In short,

(2000b) ‘The Illicit Asset Stripping of China’s State Firms’, *China Journal*, (43): 1-2; and Dali Yang (2004) *Remaking the Chinese Leviathan: Market Transition and the Politics of Governance in China* (Stanford: Stanford University Press).

⁵⁹ KP Chou (2006) ‘Downsizing Administrative Licensing System and Private Sector Development in China: A Preliminary Assessment’, Asian Development Bank Institute (Tokyo) Discussion Paper No. 52.

⁶⁰ For examples, see Hongbin Li, Lingsheng Meng, Qian Wang and Li-An Zhou (2008). “Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms.” *Journal of Development Economics*, 87(2): 283-299; Mingyi Hung, T.J. Wong, and Tianyu Zhang (2008) “Political Relations and Overseas Stock Exchange Listing: Evidence from Chinese State Owned Enterprises.” Working paper, available at <https://www.bschoool.nus.edu.sg/Departments/FinanceNAccounting/seminars/Papers/mingyi%20hung.pdf>; and Bill B. Francis, Iftekhar Hasan and Xian Sun (2009) “Political connections and the process of going public: Evidence from China” *Journal of International Money and Finance* 28 (4): 696–719.

⁶¹ For examples, see Hongbin Li, Lingsheng Meng, Qian Wang and Li-An Zhou (2008). “Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms.” *Journal of Development Economics*, 87(2): 284.

“when the institutional environment is relatively underdeveloped and when law enforcement is capricious and weak” as it is in China, then both ownership and connections matter.⁶²

In the literature debating whether TVEs were part of the state sector or not, three key features kept re-emerging to distinguish them from truly private enterprise;; they had special and preferred access to credit, benefited from trading relations with SOEs, and received support and protection from local governments not afforded to individual or private enterprises.⁶³ If we take this basic idea and bring it forward to the contemporary era, we can argue that this remains the case for a number of enterprises that are nominally in the private sector. They might not be formally part of the state sector, but again, they are not wholly independent from the state, and benefit from the protection and support of the state – and this relationship with the state is “qualitatively different and deeper than that of their counterparts in capitalist countries.”⁶⁴

The State, the local state and economic control

While this all suggests in combination that the state is still central to the functioning of the Chinese economy, it does not necessarily mean that the central state is central. Two issues are worth mentioning here in as much brevity as possible. First, there is considerable regional disparity in the dominant types of economic activity and dominant forms of ownership. For example, Huang Yasheng notes that “the Zhejiang model is characterized by a heavy reliance on private initiatives, a noninterventionist government style in the management of firms, and a supportive credit policy stance toward private companies” compared to the much more

⁶² Gongmeng Chen, Michael Firth and Liping Xu (2008) “Does the Type of Ownership Control Matter? Evidence from China’s Listed Companies”, *Journal of Banking and Finance*, 33 (1):172.

⁶³ For an overview of this literature, see Che Jiahua and Qian Yingyi (1998) ‘Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises’, *Journal of Law, Economics, and Organization*, 14 (1): 1-23..

⁶⁴ Alberto Gabriele (2009) “The Role of the State in China's Industrial Development: a Reassessment” MPRA Paper No. 1455: 17 http://mpa.ub.uni-muenchen.de/14551/1/MPRA_paper_14551.pdf

“statist” economies of neighbouring Jiangsu and Shanghai.⁶⁵ As such, trying to generalise the situation in China as a whole can at best only result in broad indications of the nature of state-industry relations that will not match reality in large parts of the country.

Second, we should not think of state-industry relations in China as a national project organised in Beijing and implemented across the country. On the contrary, a considerable amount of the central government’s time and effort is taken up by trying to coordinate the national economy and prevent local governments from developing their own sometimes competing and overlapping strategies. Fiscal reforms in the 1990s and the abolition of the myriad ad hoc fees that local governments used to levy on just about anything they wanted to went a long way to reducing the financial autonomy of local governments by the turn of the millennium.

Nevertheless, the local state remains a key determinant of the functioning of the Chinese economy. Indeed, in some respects fiscal reform has actually reinforced local governments’ relations with local enterprises:

“As local governments cannot raise bonds to finance their social and hard infrastructure, they are far more reliant on their local producers than are local governments in OECD countries. Their reliance on value-added tax (VAT) and business tax means they tend to encourage investments that maximize their fiscal incomes regardless of the overall market situation”⁶⁶

This tendency to lever financial institutions to loan money to favoured enterprises whether they need to produce more or not gains significance when the central government loosens credit controls - as it did in response to the global crisis in 2008.

⁶⁵ Huang Yasheng (2008) “Zhejiang Province: A Free-Market Success Story” in *Business Week*, 20th October, available at http://www.businessweek.com/globalbiz/content/oct2008/gb20081020_124170.htm

⁶⁶ European Union Chamber of Commerce in China (2010) *Overcapacity in China* (Beijing: Roland Berger Strategy Consultants for the European Union Chamber of Commerce in China :11.

Responding to the Global Crisis and State-Industry Relations

It is not possible here to give a full overview of how China responded to the impact of the global financial crisis in 2008; nor is it entirely clear what the long term consequences of this response will be. But before moving to the conclusion, it is worth spending a few words on the response to the crisis as it reveals the extent to which the state can mobilise the economy when it needs to; and also the problems that the central state has in controlling the authority of local state actors.

With the global crisis resulting in a collapse in demand for Chinese exports, the government responded in two ways. First, on 9th November, it announced a RMBB4 trillion stimulus package. On closer inspection, it turned out that some of the fund had previously been pledged as part of the Sichuan earthquake recovery strategy, and that the central government was only committed to funding around a quarter of the total, with the remainder expected to be provided by local governments.⁶⁷ In the process, the central government not only took the shackles off local government spending, but at the same time loosened credit controls and urged banks to expand liquidity.

Effectively, local governments were being told to take their share in boosting the economy without being given the resources to do so. In response, local governments utilised (or established) various types of investment companies which are essentially underwritten by the value of land and property owned by the local governments and “confidence” in future local government income. By the end of 2009, new bank loans in China had reached more than double the stimulus package at RMB9.6 trillion with about half funding infrastructure projects via such local investment platforms.⁶⁸ The total debt of these local companies ranging anywhere from official statements of around RMB6 trillion to Victor Shih’s

⁶⁷ Geoff Dyer (2008) “Beijing offers just quarter of stimulus funds” in *Financial Times*, 14 November.

⁶⁸ Wang Xinyuan (2010) “Local Government Debt Balloons”, *Global Times*, 7th April, available online at <http://business.globaltimes.cn/china-economy/2010-04/519528.html>

guesstimate of RMB11 trillion.⁶⁹ When the highest calculation is added to other debts, then on a national level at worst debt is about a third of GDP. However, this debt is not equally spread across the country, with ten cities and provinces reporting that their local investment companies' debts were over 100 per cent of local GDP, with some reporting a figure as high as 400 per cent.⁷⁰

At the time of writing, the central government was still trying to find an effective way of dealing with this local debt without crashing local economies, and the partly related issue of how to deflate (rather than simply pop) land and property bubbles in parts of China. As many local governments depend on selling land for much of their income, then a slump in land prices would also undermine their ability to cover the loans of their investment companies and deliver on the bonds they have issued, thus increasing the extent of nonperforming loans. Whether this is possible, and what this means for future economic prospects, will have to remain off limits for the time being. Instead, I will simply focus on what the main implications seem to be for the understanding of the role of the state and state-enterprise relations.

First and second, as already noted, on one hand it shows the state's ability to mobilise the key levers of the financial system in support of political objectives; but on the other hand, it also shows the key role that local governments play, and the significance of local level government-enterprise relations (via local investment companies). Indeed, local protectionism seems to have increased with "buy local" projects instituted in a number of provinces and municipalities to try to make up for some of the decline in export markets, and

⁶⁹ Andrew Batson (2010) "China's Localities Feel Pinch of Tighter Credit", *Wall Street Journal*, 24th January.

⁷⁰ Wang Xinyuan (2010) "Local Government Debt Balloons", *Global Times*, 7th April, available online at <http://business.globaltimes.cn/china-economy/2010-04/519528.html>

to ensure that investment spurred production did not all simply result in a build up of inventories.⁷¹

Finally, the response to the crisis seems to have been largely (and disproportionately) based on the state sector. This is partly because of the expansion of infrastructure spending, where state owned enterprises are pretty much the only game in town. But it also seems that non-state SMEs found it difficult to get access to money to tide them through the decline in export markets even during this period of expansive bank lending. Indeed, in the second half of 2009, the idea of *guojin mintui* 国进民退 or “the expansion of the state, and the retreat of the private” began to gain increased attention in China. This was partly because of the above mentioned disparity in access to bank loans, which strengthened the state sector whilst leaving some private SMEs with nowhere to go other than bankruptcy.⁷² But it was also because of an increase in acquisitions of private companies by state enterprises – including the acquisition of some of those that were finding it difficult to get other forms of funding to survive.

The official position is that this is nothing to do with ownership, but simply a result of the strong taking over the weak, combined with changes to rules that allow, for example, greater state ownership in mining sectors (where private mines also have terrible safety records).⁷³ Moreover, the government has been keen to emphasise that the private sector has a legitimate role to play. In March 2010, Premier Wen Jiabao presided over a State Council meeting to find new ways of bringing private investment into the state sector, including making it easier for private enterprises to gain access to finance and opening previously

⁷¹ European Union Chamber of Commerce in China (2010) *Overcapacity in China* (Beijing: Roland Berger Strategy Consultants for the European Union Chamber of Commerce in China :11.

⁷² Bao Yujun (2010) “Fitting in The Private Sector” *Caixin*, 20th April, available at <http://english.caing.com/2010-04-20/100137074.html>

⁷³ Xie Weiqun (2010) "并购是强进弱退而非国进民退 Binggou shi jiangjin ruotui erfei guojin mintui Mergers and Acquisitions are the strong expanding and the weak retreating, not the state expanding and the private retreating" *People's Daily*, 5th March. When I was checking this source, I came across an excellent three part blog on debates over *guojin mintui* in China at <http://chinabizgov.blogspot.com/2010/03/is-china-really-re-nationalizing.html>

closed sectors.⁷⁴ However sceptics point out that this was supposed to have already happened with the 36 guidelines in 2005, and the fact that a new set of regulations was being promoted five years later shows just how ineffective the government's promotion of private sector activity could be.⁷⁵

Conclusions

Of course, China is far from unique in trying to deal with the global financial crisis by turn back to the state to get through the turmoil and it will take a lot of time in China and elsewhere for the full implications of the crisis (and the responses to the crises) to become clear. On one hand the evidence to date suggests a strengthening of state power in China and a retreat from the private sector. On the other, there have been commitments to increasing the scope of the private sector from the very top of the political system, as more and more loans become non-performing, then the need to engage the private sector to keep the economy going. But then again, if we had a third hand, we could discuss the way in which the appeal of liberal economics has been somewhat undermined by the crisis.

Perhaps the response to the crisis in China tells us three things. First, the state still has the ability to mobilise the economy behind its objectives when it needs to. In this respect, state power is more latent than an everyday phenomenon. Second, the financial system is in some ways more important than ownership. And third, when we speak of the state in China, we need to disaggregate our perspectives and consider different levels of state authority – and in doing so, also consider the way that the interest and actions of the local state can actually run counter to the goals and ambitions of central state leaders.

⁷⁴ "国务院常务会议部署鼓励引导民间投资发展政策措施 Guowuyuan Changwuhuiyi bushu guili yindao minjian touzi fazhan zhengce cuoshi State Council executive meeting policies to encourage and promote and encourage private sector development measures" 25th March 2010, available online at http://fdi.gov.cn/pub/FDI/tzdt/dt/t20100325_119658.htm?fclose=1

⁷⁵ "我们需要多少'36条' Women xiyao duoshao '36 tiao' How many '36 Regulations' Do we require?" 经济观察网 3rd April 2010 available online at http://www.eeo.com.cn/observer/pop_commentary/2010/04/03/166766.shtml

Before finishing, and in the knowledge that this will probably be revised out of the final version, two final points are worth raising that haven't really been addressed in the paper. The first is the extent to which economic debates and policy changes in China take place under the umbrella of the wider "national project". Deng Xiaoping argued that

The fundamental difference between socialism and capitalism does not lie in the question of whether the planning mechanism or the market mechanism plays a larger role. [The] planned economy does not equal socialism, because planning also exists in capitalism; neither does [the] market economy equal capitalism, because the market also exists in socialism. Both planning and market are just economic means.⁷⁶

But means to what end? The answer is China's glory – the return of China to its rightful place of global power (and maybe even supremacy). Underpinning all that follows is the importance of the "national" element of China's national capitalism. This is much more than just the idea that there is a distinctive and distinctly Chinese type of capitalism that is built on a unique set of Chinese conditions (as opposed to the universal application of a single capitalist form). From the onset, the need for reform of the Chinese economy has been justified in nationalist terms.⁷⁷ Indeed Gallaher argues that this appeal to nationalism explains why the breaking of the old socialist social contract was accepted by China's workers (compared to what happened when the same social contract was torn up in Eastern Europe).⁷⁸

This argument perhaps understates the extent to which many Chinese workers were far from happy to sacrifice their own fortunes for the national cause, and the extent of mass demonstrations against the closure of state enterprises, the non-payment of benefits and so on. Nevertheless, that policy changes and indeed radical systemic transformations are

⁷⁶ Cited in Wing Thye Woo (1999) 'The Economics And Politics Of Transition To An Open Market Economy: China', OECD Development Centre Technical Paper No. 153:46.

⁷⁷ Christopher Hughes (2006) *Chinese Nationalism in the Global Era* (London: Routledge).

⁷⁸ Mary Gallagher (2002) "Reform and Openness: Why China's Reforms have Delayed Democracy" *World Politics*, 54 (3): 338-372.

justified in terms of the national interest is a significant element of the Chinese political economy – and in many respects industrial policy is both a cause of and consequence of such a nationalist basis to the contemporary Chinese body politic.

Second, not least because of China’s “success” in surviving the crisis in Western capitalism, there has been growing interest in China over the idea of a “China model” that might provide lessons for other developing states to learn from.⁷⁹ Now clearly, there is something unique about China’s experience – all countries’ experiences are unique. My question is whether China’s experience is so different from what has gone before that it makes it a distinct and different model? And my answer is no.

Rather, what has happened in China seems to conform with traditions of strong state-led development that can be traced back to earlier developmental states in East Asia, to Japanese development in the early twentieth century, to Bismarkian development in Germany in the late nineteenth century, and even initial development and industrialisation in the USA in the 1820s-30s under Hamilton, Adams and Clay.

This might simply sound like an exercise in semantics. And in some ways if people think that there is a Chinese model, then there is one irrespective of what I or others might think. But the question of whether China is unique or not really does have importance. If we think of China as “abnormal” then it is an outlier that doesn’t fit with the “normal” and/or dominant and/or mainstream. But this seems to me to be ahistorical. If we instead think of China as at the latest example in a relatively long line of developmental states, then strong state led development seems normal, and the promotion of neoliberal capitalism as the best way of spurring development becomes the departure from the norm. So in this respect, rather than thinking in terms of a unique Chinese model, China instead appears to be a “neo-listian developmental state with Chinese characteristics”.

⁷⁹ I’ve gathered together a collection of them on <http://tinyurl.com/chinamodel>